

THE ASIAN FINANCIAL CRISIS IN RETROSPECT – OBSERVATIONS ON LEGAL AND INSTITUTIONAL
LESSONS LEARNED AFTER A DOZEN YEARS

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In this contribution to the Review symposium on the Asian Financial Crisis, Professor Head examines how, in retrospect, we should view that tumultuous set of developments and the lessons they offered. After tracing the causes and triggers that set the crisis in motion in 1997, and identifying what paths toward recovery the three countries hardest-hit – Thailand, Indonesia, and South Korea – took over the years that followed, Head focuses on certain international legal and institutional aspects of the crisis. He gives particular attention to the International Monetary Fund (“IMF”), first by summarizing the “cacophony of criticisms” directed at the IMF over its involvement in the Asian Financial Crisis and then by examining numerous ways in which the IMF has responded (or failed to respond) to those criticisms. Head closes with some observations about what lessons were “offered” and which lessons were “learned” as a result of the Asian Financial Crisis – and also with a cautionary note about the difficulties inherent in any international regime designed to respond to the unexpected.

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I. INTRODUCTION: WHY A RETROSPECTIVE ASSESSMENT NOW?

In this article I offer my views on the Asian Financial Crisis in retrospect, as my contribution to the November 2009 Symposium sponsored by the *East Asia Law Review*. I am quite pleased to have been invited to participate in the symposium and to have my views published in the *Review*’s symposium issue. In keeping with common practice for such “symposium issues”, and reflecting the main purpose of such a symposium—to facilitate the easy exchange of ideas among experts rather than providing extensive background explanations that non-experts would need—I have, with the kind permission of the *Review*’s editorial staff, structured this article more in the form of an essay, with somewhat less comprehensive citations to authority than might otherwise be provided.¹

¹ In particular, I have assumed that other symposium participants, and most readers, will already be generally familiar with the history, organization, and operations of the International Monetary Fund; hence I have provided relatively few explanatory or research-oriented citations regarding that institution—relying instead on some general citations to works that I and others have written on it. In this and several other respects I have tried to keep a relatively clean “story line” without the distraction of extensive background explanations or citations. I greatly appreciate the cooperation and flexibility of the *Review* staff in this respect and for the assistance and patience they have shown in the preparation and publishing process. While I am thanking people, I also wish to

In the remainder of this section, I wish to address three introductory questions: (a) what, in its broad contours, was the “Asian Financial Crisis” that our symposium aims to consider in retrospect, (b) why do we wish to do so—that is, what is to be gained by reviewing that crisis from a dozen years ago—and (c) in particular, why might it be fruitful to take a legal and institutional perspective in reviewing the crisis? In section II, I shall offer a brief review of how experts now understand the Asian Financial Crisis to have unfolded and to have gradually gotten resolved in the three countries that it affected most severely—Thailand, Indonesia, and Korea. In section III, I turn my attention to the International Monetary Fund (“IMF”), with an eye to discerning and assessing how the IMF responded to the Asian Financial Crisis, both immediately and over the years that have followed. In section IV, I conclude with some observations about the cluster of lessons that I believe the Asian Financial Crisis, viewed in retrospect, offers to us in terms of legal and institutional mechanisms that are available to address such global financial traumas.

A. *What Was the Asian Financial Crisis?*

This is not the first time I have written about the Asian Financial Crisis. Just about twelve years ago, at the end of 1997 and very beginning of 1998, I wrote a brief explanation and early assessment of the crisis, in the “heat of the moment” when its long-term implications were of course completely unknown. Here is how I described the crisis at that time:

The second half of 1997 proved disastrous for Asia—particularly Thailand, Indonesia, and Korea. The 1997 financial crisis that hit those countries was

thank Ms. Heba Hazzaa (research associate at the Cairo University School of Law), Ms. Maria Neal, and Ms. Dana Watts—all of whom contributed importantly to my work in compiling this article—and to express my appreciation also to Lucia Orth and to my colleagues and fellow participants in the symposium for offering helpful comments and suggestions. As usual, research assistance from the University of Kansas General Research Fund is also gratefully acknowledged.

massive in scale. Here are some representative figures showing the magnitude of the damage:

- The Thai baht, having traded at around 25 to the dollar for thirteen years, lost over half of its value between July 1997 and January 1998, when it was trading at about 55 to the dollar. Thailand's stock market value declined over 60 percent in that same period.
- The Indonesian rupiah lost about 75 percent of its value against the dollar between mid-1997 and early 1998. The Indonesian stock market dropped in value even more than Thailand's had—by over 75 percent in the second half of 1997.
- Korea was in some ways the hardest hit of all—and this is especially significant because of its economic importance in Asia. The won fell in value 70 percent between mid-October and mid-December 1997, and Korea's stock market lost two-thirds of its value from August to December. Korea's foreign exchange reserves fell by more than 50 percent in the space of two months. Bonds issued by one of Korea's biggest banks were trading at 60 percent of face value in December 1997, down from 100 percent of face value in October 1997.²

A year later, in early 1999, I wrote another article on the Asian Financial Crisis and explained some of the damage it had done as of that point:

It has been a crisis for millions of people in Asia in terms of their household economies, businesses, savings, education, health, and futures. President Clinton, in his state of the union address in January [1999], called it “the most serious financial crisis in a half a century.” A leading economist has referred to it as “something that has no parallel in human history.” For millions of people, it has increased unemployment, prices, and poverty, while cutting opportunities for education, health, and other social programs.³

In a nutshell, the economic trauma that hit Asia a dozen years ago caused widespread distress—particularly in Thailand, Indonesia, and Korea. It left both the populations and the governments of those countries severely wounded.

² John W. Head, *Lessons from the Asian Financial Crisis: The Role of the IMF and the United States*, 7 KAN. J.L. & PUB. POL'Y 70, 70 (1998) [hereinafter Head, *Lessons*] (citations omitted).

³ John W. Head, *Global Implications of the Asian Financial Crisis: Banking, Economic Integration, and Crisis Management in the New Century*, 25 WM. MITCHELL L. REV. 939, 940 (1999) [hereinafter Head, *Global Implications*] (citations omitted).

B. *Why Does It Matter Now?*

From many perspectives, a period of twelve years is a long time. Most of the students taking my courses at the University of Kansas (or at the University of Trento, where I taught a course on the IMF earlier this year) have no clear recollection of the Asian Financial Crisis or of any other international economic events occurring that long ago. Indeed, I would venture to say that most people around the world, at least outside Thailand, Indonesia, and Korea, know or remember very little about the Asian Financial Crisis, in part because so many other events—tsunamis in Asia, airplanes hitting buildings in New York and Washington, wars in the Middle East, stock-market crashes nearly everywhere—have grabbed our attention over the past dozen years. Given this gradually fading memory and consciousness of the Asian Financial Crisis, why should we spend time and energy looking back on it now?

Two reasons come to mind for me. First, there should be some accounting for where responsibility lies for a crisis that brought deep distress to so many people, and such an accounting might be more possible with the clarity of hindsight, beyond the heat of the moment. Second, there should be some effort on our part to help avoid such crises in the future, or to lessen their impact if they do occur, and such efforts are unlikely to be productive without an assessment of how the Asian Financial Crisis was caused, handled, and resolved. Such an assessment becomes even more important when we realize that the Asian Financial Crisis is merely one of a rather long list of international financial crises that have added distress to an already distressing eight or ten decades since World War I. As I explain more thoroughly in a

companion article to this one,⁴ the period from the 1920s to the present has been marked by a succession of crises—most notably the worldwide Great Depression in the 1920s and 1930s, the breakdown of the par value system in the 1970s, the 1982 debt crisis, financial meltdowns in Mexico and Russia and elsewhere in the early 1990s, the Asian Financial Crisis emerging in 1997, and most recently the global financial crisis of 2008-2009. If there is any hope of arresting this troubling trend—and frankly, I am not sure there is any such hope—it will require a reflective assessment of the Asian Financial Crisis.

C. *Why Take a Legal and Institutional Point of View?*

Before concluding these introductory remarks, I should explain why I believe we should give special emphasis to legal and institutional matters in our retrospective assessment of the Asian Financial Crisis. The explanation centers around the notion of financial regulation, and around how such regulation operates on two distinct levels.

I assume most people would agree that much of the responsibility for avoiding (or at least mitigating) financial crises of the sort that erupted in Asia in the late 1990s lies with regulatory agencies, acting under national laws and procedures. In many countries, this sort of regulation lies within the authority of central banks or Ministries of Finance or other similar government authorities. The outbreak of a major crisis suggests that the regulatory action taken by such authorities has been inadequate—and therefore, probably, that the national laws under which those authorities operate are likewise inadequate. The examination of such inadequacies at the

⁴ See John W. Head, *The Global Financial Crisis of 2008-2009 in Context – Reflections on Legal and Institutional Failings, “Fixes”, and Fundamentals*, 23 PAC. MCGEORGE GLOBAL BUS. & DEV. L.J. (forthcoming 2010).

national level, and the measures taken to overcome those inadequacies, are therefore worthy of attention.

What I am more interested in examining, however, is the “regulation of the regulators” — that is, the actions taken not at the level of the national regulators but instead at the international level. After all, it is at that international level where we should expect to see some effective efforts to ensure that national laws and regulations—created and implemented by national governments—are adequate to prevent financial chaos from erupting and causing harm not only to the people to whom those governments are directly accountable but also to other countries and the global financial system as a whole.

Much of the institutional responsibility for such “regulation of the regulators” in the sphere of financial stability rests with the IMF, which in a variety of ways exerts influence over national economic and financial policies. In addition, since the time of the 1982 debt crisis, the IMF has generally been expected to play a key role in responding to financial crises when they do break out. Accordingly, this article will give special attention to the IMF’s handling of the Asian Financial Crisis. To do this, I shall turn first to an accounting of how we should appropriately see—twelve years after the fact—the underlying causes, the immediate triggers, and the various responses to the crisis.

II. THE UNFOLDING OF THE CRISIS

A. *The Underlying Causes*

Once regarded as having created an “Asian Miracle,” the East Asian economies were praised through most of the 1990s for their low inflation rates, their high national savings rates,

and their steady steps towards market liberalization.⁵ However, this praise ended—along with the positive forecasts for the East Asian economies—when a painful crisis of confidence confronted Thailand in July 1997 and soon moved to Indonesia and Korea.

Although the underlying causes and specific triggers of the crisis are country-specific, some similarities are evident. The following paragraphs attempt a synopsis of the causes and triggering events, giving special attention to the similarities.⁶ As we shall see, one of these is the interplay of politics and economics: the *chaebol*'s political clout in Korea⁷ resembled both the patronage system in Thailand⁸ and the Suharato “family and friends” network in Indonesia.⁹ A term often used to describe such similar systems of intertwining political and economic influences is “crony capitalism.”¹⁰ “Hot money”—that is, investment funds that were allowed to come and go quickly upon news or even speculation of unattractive developments—is another common factor often blamed for triggering the crisis in Korea, Thailand, and Indonesia—as well as in Malaysia (described with a touch of a conspiracy theory by some observers of that country¹¹). Among the other most common explanations of the crisis are high percentages of short term foreign denominated debt,¹² speculative activities (as opposed to productive or industrial activities), weak central bank supervision, “moral hazard” (expectations of bailouts,

⁵ TULL TRAISORAT, THAILAND: FINANCIAL SECTOR REFORM AND THE EAST ASIAN CRISES 113 (2000).

⁶ In presenting this synopsis, I have relied both on (i) my own understanding, developed over a dozen years, regarding the causes of the crisis and on (ii) several fairly recent books and articles offering economic analyses of the crises. Naturally, I have provided footnote citations only to the latter of these. I am deeply indebted to Heba Hazzaa of the Cairo University School of Law for helping me research and prepare the following account.

⁷ See *infra* note 38, citing pertinent portions from BEN THIRKELL-WHITE, THE IMF AND THE POLITICS OF FINANCIAL GLOBALIZATION: FROM THE ASIAN CRISIS TO A NEW INTERNATIONAL FINANCIAL ARCHITECTURE? (2005).

⁸ TRAISORAT, *supra* note 5, at 115.

⁹ THIRKELL-WHITE, *supra* note 7, at 130–33.

¹⁰ Jomo Kwame Sundaram, *What did we really learn from the 1997-1998 Asian Debacle?*, in TEN YEARS AFTER: REVISITING THE ASIAN FINANCIAL CRISIS, 21, 21–23 (Bhumika Muchahala ed., 2007).

¹¹ Meredith Jung-En Woo, *A Century After the Unparalleled Invasion: East Asia After The Crisis*, in TEN YEARS AFTER: REVISITING THE ASIAN FINANCIAL CRISIS 53, 53 (Bhumika Muchahala ed., 2007) (referring to Dr. Mahateer Mohamad's comments about the role of George Soros in the freefall of the Asian economies).

¹² Most of this was held by private firms and corporations. TRAISORAT, *supra* note 5, at 120.

leading to risky lending)¹³ and deficiencies in corporate governance. Exacerbating the crisis, according to some commentators, were contractionary policies followed by some East Asian governments (applying, it is said, the IMF's recipe for crisis management¹⁴) and the herd behavior and collective panic by foreign institutional investors.¹⁵

Let us see how these and other themes played out in the unfolding of the crisis in Thailand, Indonesia, and South Korea.

i. Thailand

In the 1990s Thailand was marketed as the regional financial hub¹⁶: the Thai economy presented strong macroeconomic performance, and Thailand was eagerly liberalizing its economy. With no capital controls and little industrial or productive investment, the abundance of capital inflows was directed to speculative activities,¹⁷ including speculative real estate lending.

Unrealistic excitement about the Thai economy, the Thai baht, and the Thai real estate market created a bubble that soon burst.¹⁸

But the problem had deeper roots. One of these was weakness in Thailand's banking sector, which is said to have been characterized by unsafe lending practices (evident in connected lending and lax lending criteria¹⁹), inadequate banking regulation (Thai commercial

¹³ A. Maria Toyoda, *East Asian Capital Flows: Political Network, Liberalization, and Crisis*, in FROM CRISIS TO OPPORTUNITY: FINANCIAL GLOBALIZATION AND EAST ASIAN CAPITALISM 123 (Jongryn Mo & Daniel I. Okimoto eds., 2006).

¹⁴ JOSEPH E. STIGLITZ, *GLOBALIZATION AND ITS DISCONTENTS* 210 (2nd ed. 2003) [hereinafter STIGLITZ, *GLOBALIZATION*].

¹⁵ Sundaram, *supra* note 10, at 23.

¹⁶ TRAIORAT, *supra* note 5, at 121.

¹⁷ STIGLITZ, *GLOBALIZATION*, *supra* note 14, at 198; TRAIORAT, *supra* note 5, at 121.

¹⁸ STIGLITZ, *GLOBALIZATION*, *supra* note 14, at 198.

¹⁹ HIRKELL-WHITE, *supra* note 7, at 126.

banks were permitted to become significantly undercapitalized and over-exposed to the ailing property market²⁰), and lax enforcement (incidents of insider fraud and mismanagement were prevalent²¹). The political environment helped submerge these weaknesses. Specifically, the military was extremely influential in providing the economically powerful elite with the necessary protection from effective bank supervision.²²

These problems in Thailand's financial sector were accompanied by problems in monetary policy, particularly Thailand's pegged exchange system: the Thai baht was pegged to the U.S. dollar.²³ So long as Thai exports were growing and their access to the U.S. market was guaranteed, this pegged exchange arrangement was not a problem. However, starting in 1995, Thai exports faced fierce competition from China and former Soviet republics, especially in goods produced by the labor-intensive industries. Thai exports were negatively affected also by the implementation in the early 1990s of the North American Free Trade Agreement ("NAFTA"), which increased access of Latin American exporters to the U.S. market.²⁴ For these and other reasons, Thai exports significantly slowed down.²⁵ The Thai government fought strenuously to maintain the baht's fixed exchange rate (that is, its "peg" to the U.S. dollar),

²⁰ *Id.* at 127.

²¹ *Id.* at 126.

²² *Id.* at 127. Several of the weaknesses summarized in this paragraph were evident well before 1997, at least to some observers:

From 1993 onward, Thailand's economic progress of the previous decade started to unravel, with external debt reaching 50% of GDP—and 40% of that debt was short-term. Most ominous, in my view, were the weaknesses that started appearing in the financial system, especially banks and finance companies. These institutions borrowed heavily in dollars and used those resources to pump money into the economy. Governmental attempts at banking supervision were fruitless because of the political power of the banks and finance companies.

Head, *Lessons*, *supra* note 2, at 71.

²³ Under this "pegging" exchange arrangement, the Thai government assured that as the US dollar appreciated the Thai baht also would appreciate (and likewise for depreciations). The Thai baht was thus tied to the US dollar and therefore to the performance of the US economy rather than to the performance of the Thai economy.

²⁴ THIRKELL-WHITE, *supra* note 7, at 130.

²⁵ Kanit Sangsubhan, *Managing Capital Flows: The Case of Thailand*, in ADB INSTITUTE, DISCUSSION PAPER NO. 95, at 5 (March 2008), available at <http://www.adbi.org/discussionpaper/2008/03/10/2502.managing.capital.flows.thailand/>.

despite the apparent economic slowdown, by using the country's U.S.-dollar foreign reserves to purchase baht. Indeed, it is estimated that the Thai government lost U.S. \$30 billion in its attempts to maintain the fixed exchange rate.²⁶ Those attempts were ultimately ineffective. Speculators and foreign exchange traders realized that the value of the baht was falling, and that the Thai economy was deteriorating more generally, and they started to attack the baht, further exacerbating the matter.²⁷

In addition to these problems in the financial system and in the currency arrangements was the problem of a growing short-term foreign debt. Here the focus was on private firms, which used short-term foreign debt to finance long term investments, typically with no arrangements to hedge against, or insure against, exchange rate risk.²⁸ With the baht under attack and eventually devalued, businesses were forced to dump the baht and buy dollars and other hard currencies to service their short term foreign debt, thus putting even more pressure on the baht.

According to some commentators, a common feature in pre-crisis East Asian economies was what is known as "herd behavior" among foreign investors.²⁹ Foreign investors seemed to follow an unwritten script: they entered the East Asian markets with optimism, which later proved to be irrational, and then they rushed out in an equally irrational way.³⁰ In the face of this

²⁶ THIRKELL-WHITE, *supra* note 7, at 130.

²⁷ STIGLITZ, *GLOBALIZATION*, *supra* note 14, at 198.

²⁸ Sangsubhan, *supra* note 25, at 2.

²⁹ Sherry M. Shore, *SEC Regulatory Implications on Asian Emerging Markets: Bottom Line or Bust*, 13 CARDOZO J. INT'L & COMP. L. 563, 581 (2005). There is perhaps a certain naiveté in such a "herd behavior" observation. After all, the foreign investors operating in Asia were by and large institutional investors (whether portfolio investors or banks) who are presumably sophisticated and knowledgeable players. Nonetheless, it seems to be widely accepted that the deterioration of the baht in July 1997 was the tip of the iceberg and that more profound weaknesses of the Thai and neighboring economies were rather suddenly revealed as Thailand's currency problems unfolded.

³⁰ JOSEPH E. STIGLITZ, *MAKING GLOBALIZATION WORK*, 217 (2007) [hereinafter STIGLITZ, *MAKING*].

collective action and in the absence of capital controls, the East Asian economies were perhaps doomed to fail.

ii. Indonesia

Economics alone fail to explain the situation in Indonesia. Indonesia is a country with an ethnically, linguistically, and religiously diverse population. Indonesia obtained its independence in the latter part of the 1940s and moved to sustain its unity through centralized economic policies and authoritarian rule.³¹ During the 1970s and 1980s economic policies were apparently designed to favor the *pribumi* (indigenous Indonesian)—as distinct from other ethnic groups in the country—but in fact such favoritism was used to secure the authoritarian rule of President Suharto.³²

Until the fall of oil prices in 1982, oil revenues provided Indonesia with a fairly stable national income. The steady oil income reduced the need for foreign direct investment.³³ With the deregulation of the financial industry in the early 1990s, credit market opened to foreign lenders. However, because of a weak and deficient system of banking regulation, the Indonesian central bank had little to work with in the way of effective tools to conduct adequate surveillance³⁴ of the risky lending practices—a shortcoming which later proved to be fatal.

The politico-business families that dominated the pre-liberalization scene were best suited to take advantage of the deregulated market.³⁵ Incidents of insider trading, fraud, and

³¹ THIRKELL-WHITE, *supra* note 7, at 130.

³² *Id.* at 132.

³³ *Id.*

³⁴ Sundaram, *supra* note 10, at 22.

³⁵ THIRKELL-WHITE, *supra* note 7, at 133.

incomplete disclosure plagued the Indonesian capital market. And as in the banking sector, capital markets were not efficiently monitored and existing regulations were not enforced.³⁶

Another underlying cause cited by some observers also warrants mention here: Indonesia had already found its economy—and especially its currency, the rupiah—in a weakened position because of two incidents that occurred earlier in the 1990s. In the first of those two incidents, the Indonesian central bank (Bank Indonesia) reportedly lost U.S. \$600 million defending the rupiah following the Mexican Peso crisis in January 1995. In the second, Bank Indonesia had reportedly lost another U.S. \$700 million in a second currency shock that was prompted by the internal political fight between President Suharto and an opposition movement led by Megawati Sukarnoputri.³⁷ These incidents, some say, left the Indonesian economy unprepared to fight the Thai baht contagion when it came in 1997.

iii. South Korea

Two key factors are widely cited as underlying causes for the economic crisis in Korea: (i) the *chaebol* structure and (ii) the rise in short-term foreign debt. Let us examine these in turn.

Much has been said about the *chaebol* and its role in South Korea's financial crisis in 1997. The term *chaebol* is used to describe a tight net of political and business relations that ties the Korean government, banks, and businesses. The *chaebol* was an essential component of Korea's economic and political independence following World War II. The close relations between the government and businesses guaranteed that they would work together to protect

³⁶ *Id.*

³⁷ J. Soedradjad Djiwandono, *Ten Years After the Asian Crisis: An Indonesian Insider's View*, in TEN YEARS AFTER: REVISITING THE ASIAN FINANCIAL CRISIS 39, 42–43 (2007).

Korea both from re-subordination to Japan and from the communist threat from the north.³⁸ The *chaebol* were also crucial to the stability of the Korean incumbent government, since the *chaebol* system tended to provide good-paying jobs and constituted a huge source for tax revenues.³⁹ These close ties with the government, combined with the *chaebol*'s economic power, resulted in policy loans through state owned banks and explicit guarantees to foreign creditors of Korean businesses.⁴⁰

Even before the liberalization wave of the 1990s, the *chaebol* were highly leveraged. Much of the *chaebol* capital came from the banking system (through loans) as opposed to equity markets where shareholders provide the capital. There was no efficient equity market and the government had little incentive to develop such a market. The government used credit allocation to reward “good” *chaebol*—thus gaining an enormous power over any business.⁴¹ The *chaebol* did not have to “sell themselves” in a highly competitive equity market. The lack of transparency that characterized the *chaebol*'s accounting and corporate governance practices thus continued.⁴²

The financial liberalization in the early 1990s brought some changes to the role of government in the *chaebol*. The lifting of entry restrictions on non-banking financial institutions (“NBFIs”) encouraged the *chaebol* to secure their funding through their wholly owned NBFIs such as *chaebol*-owned merchant banks, insurance companies, and investment trusts.⁴³ The *chaebol* were also encouraged to borrow directly from capital markets through corporate

³⁸ THIRKELL-WHITE, *supra* note 7, at 100–01.

³⁹ *Id.*

⁴⁰ Wonhyuk Lim & Joon-Ho Hahm, *Turning a Crisis into an Opportunity: The Political Economy of Korea's Financial Sector Reform*, in FROM CRISIS TO OPPORTUNITY: FINANCIAL GLOBALIZATION AND EAST ASIAN CAPITALISM 85, 85–88 (Jongryn Mo & Daniel I. Okimoto eds., 2000).

⁴¹ Lim & Hahm, *supra* note 40, at 86.

⁴² Stiglitz offers a different analysis. He sees the problem not in the lack of transparency of borrowing firms but rather in a lack of scrutiny by lending institutions. See STIGLITZ, *GLOBALIZATION*, *supra* note 14, at 211.

⁴³ Lim & Hahm *supra* note 40, at 86.

bonds.⁴⁴ Although the *chaebol* thus gained freedom to finance their activities in ways other than through government policy loans and explicit guarantees, there was still a shared expectation that the Korean government would protect the *chaebol* from bankruptcy.⁴⁵ This peculiar combination of deregulation and protectionism undermined the efficiency of the financial sector. Banks had little incentive to assess the high risk of default⁴⁶ or the absence of corporate governance in the businesses to which they were lending. NBFIs owned or controlled by the *chaebol* were offering investors returns higher than those offered in the market and were thus able to attract a considerable amount of capital.⁴⁷ Foreign banks were content to lend to Korean banks which in turn engaged in “care free” lending to the *chaebol*.⁴⁸

The other key factor often cited as a reason for Korea’s economic crisis is the sharp rise in short-term foreign debt. The lure of short-term foreign debt seems to have been irresistible to Korean businesses. In the four-year period running up to September 1997, foreign debt rose from U.S. \$44 billion to U.S. \$120 billion, with 67.9 percent of it short-term in nature.⁴⁹ The precipitous depreciation of the South Korean won in late 1997⁵⁰ increased the cost of foreign debt services in a very short period and put severe pressure on local currency as borrowers were feverishly trying to sell the won and buy dollars and “hard” currencies to service their short term debt.⁵¹

⁴⁴ *Id.*

⁴⁵ *Id.* at 87.

⁴⁶ *Id.*

⁴⁷ *Id.*

⁴⁸ *Id.*

⁴⁹ Mark Weisbrot, *Ten Years After: The Lasting Impact of the Asian Financial Crisis*, in TEN YEARS AFTER: REVISITING THE ASIAN FINANCIAL CRISIS 105, 105–107 (Bhumika Muchahala ed., 2007).

⁵⁰ As noted above, the won fell in value 70 percent between mid-October and mid-December 1997. See *supra* text accompanying note 2.

⁵¹ Weisbrot, *supra* note 49, at 108.

B. *Specific Triggers*

The foregoing summary has identified underlying conditions that set the stage for the Asian Financial Crisis. In the following paragraphs I focus on the specific events that triggered the crisis in each of the East Asian countries.

i. Thailand

On July 2, 1997, the Thai government took a decision to free-float its currency, the baht. As noted above, this decision came only after months of trying to maintain the baht's peg to the dollar against attacks from currency speculators who saw the weaknesses of the Thai economy and bet on its collapse.⁵² Speculators saw a growing deficit in Thailand's current accounts;⁵³ Thais were over-spending on luxury and imported brands while Thai exports were facing a rough time. Thai businesses had not hedged their foreign exchange risk and continued to borrow extensively. Unofficial accounts indicate that the IMF had warned Thailand in early 1997 that it should cut down on imports and change its currency exchange regime to reflect the real status of the economy,⁵⁴ but the Thai government preferred to defend the unrealistic exchange rate and

⁵² See *supra* text accompanying notes 23–26. The speculative attacks on the baht took the form of a massive wave of selling in spot and forward markets to put pressure on the baht price. Speculators anticipated a devaluation of the baht (and put bets on this) and used the massive selling to induce such an effect. One observer offers this explanation:

A massive attack on the baht took place in mid-May 1997. Baht selling took place in the spot market and also in the forward markets in the form of swap arrangements. Speculators hoped to cause devaluation by selling short the baht. When this strategy was countered by intervention the spot rate held, [and] speculators went to sell the baht forward through swap arrangements. The swap arrangements that the speculators engaged in were essentially contracting to sell the baht forward at the same time they were buying the baht in the spot market (probably squaring the position of earlier short selling in the spot market).

Takatoshi Ito, *Capital Flows in East and Southeast Asia*, in INTERNATIONAL CAPITAL FLOWS 111, at 128, (Martin S. Feldstein ed., 1999).

⁵³ Chris Giles, *Wrong Lessons from Asia's Crisis*, FIN. TIMES, July 2, 2007, at 11. On the effects of trade deficits in this regard, see STIGLITZ, GLOBALIZATION, *supra* note 14, at 200.

⁵⁴ Paul Blustein, *Thais' Reluctance to Act Added to Currency Crisis*, WASH. POST, Aug. 1, 1997, at F01.

lost a significant part of its foreign reserves in the process. The Thai government increased interest rates in an attempt to make the baht a desired currency but this decision had negative effects on lending cost and credit availability.

As a result of the decision to free float the baht, the baht's value fell by 20 percent. The depreciation of the baht had significant effects on different fronts. Domestically, the foreign debt service soared; many borrowers unable to service their debts or get more credit defaulted and eventually declared bankruptcy. Regionally, the fall in the value of the baht had a ripple effect on the currencies and economies of neighboring countries. The cheap baht meant that Thai exports became cheaper, which in turn prompted the governments of Indonesia and South Korea to free-float their currencies to undercut any competitive advantage⁵⁵ that the cheaper baht would bring to Thailand.⁵⁶

As remarked earlier, the Thai property market was the main attraction for capital inflows in pre-crisis years.⁵⁷ This money was channeled to fund "speculative lending" for real estate development.⁵⁸ Abundant inflows induced an increase in the supply of real estate, and subsequently the real estate market overvalued the property, creating a bubble. That bubble eventually burst when the Thai government, as part of its heated defense of the Thai baht, increased interest rates and the cost of lending thus soared. Faced with defaults, the banking sector realized that it was overexposed to an overvalued property market and began to reduce

⁵⁵ Head, *Lessons*, *supra* note 2, at 71.

⁵⁶ The competitive advantage was eventually realized as Thailand was able to increase the volume of its exports following the crisis and thus reversed the negative current account. *See* Sangsubhan, *supra* note 25, at 5. Moreover, since the weaknesses of the Thai economy—including, as noted above, heavy reliance on short-term foreign debt, highly leveraged business and risky lending practices, a lack of effective surveillance or regulation, and speculative over-lending and over-spending—were not unique to Thailand, the devaluation of the won and the rupiah had similar effects on Korean and Indonesian businesses, respectively.

⁵⁷ STIGLITZ, *GLOBALIZATION*, *supra* note 14, at 198.

⁵⁸ TRAISORAT, *supra* note 5, at 120.

credit extensions.⁵⁹ The stock market had also been pumped up by speculative money. As the Thai baht fell and the confidence crisis began, the Thai stock market crashed.

ii. Indonesia

The decision to free-float the Thai baht had drastic effects on the Indonesian economy. As the weaknesses of the Thai economy were highlighted by the currency attacks, speculators and investors were prompted to scrutinize the Indonesian economy for similar weaknesses.⁶⁰ The distrust in the Indonesian economy was reflected in the steep depreciation of the rupiah following the moves to “float” the currency on August 14, 1997. In the period from June 1997 to March 1998, the rupiah lost more than 75 percent of its value and the Indonesian gross domestic product (GDP) scored a negative of 13.7 percent.⁶¹ Moreover, as noted above, the Indonesian stock market dropped in value by over 75 percent in the second half of 1997.⁶²

iii. South Korea

The highly leveraged *chaebol* were running into trouble even before the devaluation of the won. Several Korean conglomerates were declaring bankruptcy, the most famous of which were the giant steel company Hanbo⁶³ and Kia (which was later bailed out in October 1997⁶⁴).

⁵⁹ *Id.* at 121.

⁶⁰ Djiwandono, *supra* note 37, at 43.

⁶¹ *Id.* at 47, tbl.2 (“Impacts of the Crisis”).

⁶² *See supra* text accompanying note 2.

⁶³ Hanbo declared bankruptcy in January 1997. *See* Andrew Pollack, *Steel Bankruptcy: New Jolt to South Koreans*, N.Y. TIMES, Jan. 31, 1997, at D1. The reason why the Korean government allowed Hanbo to go bankrupt might be that Hanbo was over-exposed in the steel industry, which was facing some difficulties at the time, and that bailing out Hanbo in the midst of the generally worsening conditions would have distressed the Korean economy even earlier than its neighbors. Hanbo alone had \$ 6 billion in debt. *See* Tim Ito, *Broken Economies: The Turmoil in Asia*, WASH. POST, Jan. 1999, available at <http://www.washingtonpost.com/wp-srv/business/longterm/asiaecon/overview.htm>.

⁶⁴ THIRKELL-WHITE, *supra* note 7, at 108. Kia had been in serious trouble since April 1997 and was placed under bankruptcy protection in July 1997. *See* Andrew Pollack, *Koreans Place Kia Motors Under Bankruptcy*

The short-term foreign debt that was due in 1997 (estimated at \$100 billion⁶⁵) toppled Korea's foreign currency reserves (the ratio was 250 percent⁶⁶). As the failure of large *chaebol* loomed over the Korean economy and signs of default on short-term foreign debt were unmistakable, creditors refused to roll over debts and called in loans from other *chaebol*.⁶⁷ In addition, large foreign banks that had funds on deposit in foreign branches of Korean banks started withdrawing those deposits. In short, a run by creditors on Korean banks was the main trigger of the crisis in Korea.⁶⁸

C. *Immediate Responses*
i. National Responses

The responses that Thailand, Indonesia, and Korea mounted in the face of the growing crises varied. Thailand employed various measures to restrict capital outflows and close non-viable banks and financial institutions. To control capital outflows, the Thai government banned securities lending, required banks to report to Bank of Thailand all currency transactions by non-residents, and prescribed that proceeds from exports had to be deposited in domestic banks within fifteen days and repatriated within one hundred and twenty days.⁶⁹ By August 1997, the Thai government had entered into a borrowing arrangement with the IMF.⁷⁰

Indonesia responded to the crisis there with a variety of measures to reduce spending, stabilize the economy, and prevent capital flight. Between August 14 (when the rupiah was

Shield, N.Y. TIMES, July 16, 1999, at D6.

⁶⁵ Letter of Intent from Kyung-shik Lee, Governor, Bank of Korea, and Chang-Yuel Lim, Deputy Prime Minister and Minister of Finance and Economy, to Michel Camdessus, Managing Director, International Monetary Fund (Dec. 3, 1997) available at <http://www.imf.org/external/np/loi/120397.htm#1>.

⁶⁶ Kim Kyoungwha & Saeromi Shin, *Korean Won Falls Most Since 1997, Stocks Drop on S&P Warning*, BLOOMBERG NEWS, Oct. 16, 2008.

⁶⁷ THIRKELL-WHITE, *supra* note 7, at 108.

⁶⁸ Lim & Hahm, *supra* note 40, at 91.

⁶⁹ Sangsubhan, *supra* note 25, at 37–39.

⁷⁰ Head, *Lessons*, *supra* note 2, at 71.

allowed to free-float) and the announcement of the first IMF assistance package to Indonesia on October 31,⁷¹ the Indonesian government announced a package of measures including canceling government projects, raising overnight interest rates to 81 percent, removing import tariffs on one hundred and fifty items, and abolishing the requirement that 49 percent of equity in foreign investments be held by Indonesians. These immediate measures had a positive effect on the market.⁷² However, after the announcement of the first IMF assistance program, the Indonesian government forced the closure of sixteen banks—but it failed to close two troubled banks that were owned and run by the Suharto family. As the run on Indonesian banks continued, Bank Indonesia pumped emergency funds into local banks. The funds were used, ironically, to purchase foreign exchange that further weakened the rupiah.⁷³

South Korea's government started its policy reaction to economic troubles earlier than the governments of Thailand and Indonesia did. As noted above, the year 1997 started with the failure of Hanbo. Then in March and April, Sammi Steel and Jinro failed.⁷⁴ By mid-1997 the financial crisis in Thailand, and particularly the concerns it had begun raising in the minds of financial markets, was beginning to spill over to Korea. The Korean government tried to send positive signals to credit markets by consolidating bank mergers and allowing foreign access to the Korean bond market.⁷⁵ Such actions were apparently not enough. The Korean government began talks with the IMF on November 20, 1997. Political change was seen by many as a direct

⁷¹ See Letter of Intent from Mar'ie Muhammad, Minister of Finance, and J. Soedradjad Djiwandono, Governor, Bank of Indonesia, to Michel Camdessus, Managing Director, International Monetary Fund (Oct. 31, 1997), available at <http://www.imf.org/external/np/loi/103197.htm>.

⁷² THIRKELL-WHITE, *supra* note 7, at 138.

⁷³ *Id.*

⁷⁴ *Id.* at 109.

⁷⁵ *Id.*

response to the crisis; Korea's opposition leader Kim Dae Jung was elected president in December 1997.⁷⁶

ii. International Responses

Each of the brief accounts given above, summarizing the response by the national authorities in Thailand, Indonesia, and Korea, refers to IMF involvement. Let us turn now to an account of bilateral and multilateral responses to the crises in those countries.

In the early days of the crisis, Thailand sought to negotiate a bilateral assistance package with Japan.⁷⁷ In the midst of IMF talks with the affected countries, Japan led the ASEAN members in their efforts to establish an "Asian Monetary Fund", but the efforts did not materialize.⁷⁸

The IMF utilized its emergency finance procedures to extend funds to Thailand, Indonesia, and Korea. These measures provided Thailand, Indonesia, and Korea with a total of U.S. \$35 billion of IMF financial support.⁷⁹ The IMF advised the crisis countries to undertake a "temporary tighten[ing] [of their] . . . monetary policy to stem exchange rate depreciation."⁸⁰ The IMF loans were conditional upon the adoption and implementation of reform programs in each of the three countries. The main features of the reform programs were: closing or merging

⁷⁶ *Asia's Financial Crisis 1997-1999*, WASH. POST, available at <http://www.washingtonpost.com/wp-srv/business/longterm/asiaecon/timeline.htm>.

⁷⁷ TRAISORAT, *supra* note 5, at 137.

⁷⁸ Wang Yunjong, *The Asian Financial Crisis and Its Aftermath: Do We Need a Regional Financial Arrangement?*, ASEAN ECON. BULL., Aug. 1, 2000, <http://www.allbusiness.com/finance/667869-1.html>. Instead, the ASEAN and the ASEAN +3 agreed in May 2000 to the "Chaing Mai Initiative" or CMI according to which the ASEAN+3 members agreed to swap their currencies, their foreign reserves, and their debts through bilateral swap arrangements (BSAs). These arrangements were intended to operate as a safety cushion against future currency crisis in the region. See ASS'N OF SOUTH EAST ASIAN NATIONS (ASEAN), ASEAN RESPONSE TO THE FINANCIAL CRISIS, www.aseansec.org/7660.htm (last visited Mar. 15, 2010).

⁷⁹ International Monetary Fund, *The IMF's Response to the Asian Crisis Factsheet* (1999), <http://www.imf.org/External/np/exr/facts/asia.htm> [hereinafter IMF Factsheet].

⁸⁰ *Id.*

non-viable financial institutions, restructuring the financial system, increasing capitalization, enforcing corporate governance requirements, removing trade barriers, and allowing foreign acquisition of domestic businesses.⁸¹ The IMF also spearheaded the mobilization of some U.S. \$77 billion of additional financing (additional, that is, to IMF financing) from multilateral and bilateral sources in support of these reform programs.⁸²

Due largely to domestic opposition to any U.S. involvement in aiding Thailand, the U.S.A. did not participate in the IMF-led assistance package to Thailand.⁸³ The involvement of American officials from the U.S. Treasury Department and the Federal Reserve Board was heightened, however, when the crisis reached Korea. For reasons relating to U.S. economic and national security, it was seen that the Korean meltdown had to be stopped—partly because South Korea was a strong trade partner to the U.S.A.⁸⁴ and partly because of the threat that a weak South Korea could empower the unpredictable North Korean regime, which had to be contained.⁸⁵

The U.S. involvement in Korea's rescue efforts was not confined to the U.S. commitment to supply Korea with funds. The U.S. Treasury Department and the Federal Reserve Board reached an agreement with private external lenders (something the IMF was unable to do), under

⁸¹ *Id.*

⁸² For details on country-specific figures, see IMF Factsheet, *supra* note 79, at box 2, 3 & 4.

⁸³ Head, *Lessons*, *supra* note 2, at 71. The reasons for opposition within the USA may be traced to the Mexican credit crisis: “[C]ongressional restrictions on U.S. bilateral support for stabilization, enacted during the Mexican crisis, largely determined the initial U.S. decision not to aid Thailand in 1997. Moreover, subsequent U.S. commitments to provide bilateral assistance elsewhere were due more to the lifting of these restrictions and a growing recognition of the systemic nature of the crisis than to competition with a flawed Japanese proposal, as Blustein suggests. In addition, U.S. priorities on some of the financial programs were crafted with a view to the ongoing congressional debate over increased funding for the IMF.” See Lael Brainard, *Capitalism Unhinged: The IMF and the Lessons of the Last Financial Crisis*, FOREIGN AFF., Jan.-Feb. 2002, at 192 (reviewing PAUL BLUSTEIN, *THE CHASTENING: INSIDE THE CRISIS THAT ROCKED THE GLOBAL FINANCIAL SYSTEM AND HUMBLING THE IMF* (2001)), available at http://www.brookings.edu/opinions/2002/01globaleconomics_brainard.aspx.

⁸⁴ Brainard, *supra* note 83.

⁸⁵ Inst. for the Study of Diplomacy, *The Asian Financial Crisis of 1997–1998: Adapting U.S. Intelligence and Policy-Making to the Challenges of Global Economics* 8 (Edmund A. Walsh Sch. of Foreign Serv., Georgetown Univ., Working Group Report No. V, 2006).

which the short-term debt held by those investors would be rolled over, thereby stopping the run on Korean banks.⁸⁶

D. *Paths to Recovery*

What have the governments of Thailand, Indonesia, and Korea done since the time of the Asian Financial Crisis in order to claw their way back to viability, and how successful have those efforts been? For example, have these countries experienced a “V”-shaped, a “U”-shaped, or a “W”-shaped recovery? As explained in a recent *Economist* article (focusing on the current global economic crisis), “[a] V-shaped recovery would be vigorous, as pent-up demand is unleashed. A U-shaped one would be feebler and flatter. And in a W-shape, growth would return for a few quarters, only to peter out once more.”⁸⁷

Most observers describe the Asian recovery as a V-shaped recovery, since the most seriously affected economies have more or less rebounded from the crisis.⁸⁸ Thailand, Indonesia, and Korea have all posted impressive economic performance figures,⁸⁹ although still below those recorded in the pre-crisis years.⁹⁰ The following paragraphs summarize some aspects of their economic recovery and then focus especially on the legislative and regulatory changes, both economic and structural, that Thailand, Indonesia, and Korea took in their struggle toward recovery.

⁸⁶ *Id.*

⁸⁷ *U, V or W for Recovery*, *ECONOMIST*, Aug. 22-28, 2009, at 10 (discussing typical graph recovery shapes for recovering markets).

⁸⁸ Yung Chul Park & Jong-Wha Lee, *Recovery and Sustainability in East Asia*, in *KOREAN CRISIS AND RECOVERY* 353 (David T. Coe & Se-Jik Kim eds., 2002) (discussing the recoveries of five major East Asian countries).

⁸⁹ SHALENDRA D. SHARMA, *THE ASIAN FINANCIAL CRISIS: CRISIS, REFORM AND RECOVERY* 340 (2003).

⁹⁰ Giles, *supra* note 53. As another observer points out, the crisis countries engaged in a frenzied race to accumulate foreign reserves and maintained positive current accounts. Djiwandono, *supra* note ³⁷, at 51.

i. Thailand

Thailand's reforms can be summarized as follows:

- *Legislative and regulatory changes.* The IMF assistance package was conditional upon reforms being made in the Thai financial and banking sectors. The Thai government amended several laws to conform to the IMF's prescriptions. Among the laws that have been changed as a result of the crisis are the Commercial Banking Act, The Bankruptcy Act, The Act Regulating Finance and Securities and Credit Foncier Businesses, the Civil Code, and the Commercial Code.⁹¹
- *Recapitalization and foreign ownership.* The first pillar of structural reforms centered on rehabilitation and recapitalization of distressed banks and credit companies to face the growing problem of nonperforming loans.⁹² In order to facilitate such recapitalization, the Thai authorities allowed foreign ownership of financial institutions equity shares.⁹³
- *Bankruptcy court and laws.* The second pillar of reforms concerned bankruptcy laws. In 1999 the Thai government enacted a law establishing a specialized bankruptcy court which, in light of concurrent amendments to the Civil Procedures Act and the Bankruptcy Act,⁹⁴ functions in a more expedited and simplified way.
- *Debt restructuring agency.* The Thai government established the Financial Sector Restructuring Authority ("FRA") in October 1997⁹⁵ to oversee the debt restructuring processes and liquidation of 58 non-viable finance and credit companies⁹⁶ that were officially suspended in August 1997. The FRA offered each such suspended company one of four options: to recapitalize (by raising capital from its own sources or by engaging new outside partners), to merge with another viable domestic institution whose operations

⁹¹ TRAISORAT, *supra* note 5, at 140, 141. A "credit foncier" company is a business entity that is licensed for the purpose of carrying out improvements, by means of loans and advances upon real securities. See <http://www.thefreedictionary.com/Credit+foncier>.

⁹² TRAISORAT, *supra* note 5, at 8. The Emergency Decree No. 2 for the year 1997 amended the Commercial Banking Act of 1962 requiring banks to increase their capital (against non performing loans) by 15 percent and credit foncier companies by 20 percent. *Id.* at nn.168 & 170.

⁹³ *Id.* at 8. The remaining restrictions on foreign ownership of Thai shares were relaxed (allowing foreigners to own more than 25 percent) and the prohibition on cross directorship was also relaxed. *Id.*

⁹⁴ Ministry of Finance, Thailand's Economic Reform (II) Table No. 6 (2000) http://www.mof.go.th/ther_2/index_ther.html#6 (detailing various reform bills, their purpose and current status in Thailand).

⁹⁵ *Id.* at § 2.1.

⁹⁶ TRAISORAT, *supra* note 5, at 8.

were not suspended, to merge with a commercial bank, or to merge with another suspended company. Only two out of the 58 finance companies were successful in their rehabilitation efforts. The rest were liquidated.⁹⁷

- *Expanding the Bank of Thailand's authority.* The Bank of Thailand was given the authority to order financial institutions under its supervision to undertake capital write-downs (thus forcing shareholders to shoulder some losses), to undergo recapitalizations, and to make changes in management.⁹⁸
- *Imposition of higher capital requirements.* The Basel committee standards on capital adequacy were adopted by Thailand as part of its reform efforts. Thai banks were required by law to maintain capital reserves sufficient to meet Capital Adequacy Ratio ("CAR") requirements of 8.5 percent, and finance companies were required to reach the minimum legal CAR requirement of 8 percent.⁹⁹

Although it would be impossible to draw a definite causal connection between the various reforms noted above and Thailand's economic improvements over the past dozen years, there is no question that such improvements have occurred. Thailand was able to fully repay the IMF in 2003,¹⁰⁰ and growth rates have rebounded to nearly pre-crisis levels. In 1996 the real GDP growth rate was estimated at 5.5 percent, whereas in 1998 it fell to a shocking minus 7 percent to minus 8 percent.¹⁰¹ In 2008 Thailand scored a 5 percent growth rate of its GDP.¹⁰²

⁹⁷ *Id.* at 147.

⁹⁸ *Id.* at 148.

⁹⁹ MAMIKO YOKOI-ARAI, FINANCIAL STABILITY ISSUES 155 (2002).

¹⁰⁰ Wayne Arnold, *Thailand Sets Path to a Better Economy*, N.Y. TIMES, Oct. 24, 2003, at W1.

¹⁰¹ *Recovery from the Asian Crisis and the Role of the IMF* (June 2000), available at <http://www.imf.org/external/np/exr/ib/2000/062300.htm> (detailing Thailand's growth after the economic crisis, and its transaction with the IMF).

¹⁰² ASIAN DEVELOPMENT BANK, ASIAN DEVELOPMENT OUTLOOK 2007, tbl.A1 (2007), available at <http://www.adb.org/documents/books/ADO/2007/ADO-growth-rate.pdf> [hereinafter ADB OUTLOOK] (detailing the GDP growth rates of several Asian countries).

ii. Indonesia

Indonesia's government also introduced a variety of reforms, some of them similar to Thailand's, but various factors—perhaps most prominently the political turmoil of the country—seem to have prevented Indonesia from sustaining its initiatives satisfactorily. The application of financial reforms illustrates this point.

For one thing, applying the CAR requirements to the Indonesian financial sector proved problematic. In the heart of the crisis, several Indonesian banks were “negatively capitalized”.¹⁰³ This situation led to the introduction of a gradual CAR requirement,¹⁰⁴ whereby banks and financial institutions were required to reach the 8 percent CAR requirement by end of 2001.¹⁰⁵

The most important reform in this regard, however, was the increased autonomy given to the central bank, bank Indonesia (“BI”). The Banking Act was amended in 1998 to give BI the sole authority to grant, suspend, and revoke bank licenses and impose administrative sanctions on violators.¹⁰⁶ In 1999 the Central Bank Act of 1968 was replaced with the new Central Bank Act (Act No. 23 for the Year 1999). The new legislation emphasized that BI is “an independent national institution, which is free from intervention of the Government.”¹⁰⁷ The 1999 legislation

¹⁰³ YOKOI-ARAI, *supra* note 99, at 156.

¹⁰⁴ There had in fact been an earlier attempt at applying CAR requirements, in 1991. In February of that year, “the introduction of prudential regulations . . . included: (1) a requirement that all banks meet a capital adequacy ratio (CAR) of 8 percent by the end of 1993; (2) the introduction of new ratio-based standards of soundness and a point-rating system for all banks; and (3) the granting to the central bank of the authority to issue cease-and-desist orders to any bank defying its guidance.” Yuri Sato, Bank Restructuring and Financial Institution Reform in Indonesia, 43 DEVELOPING ECON. 91, 100 (March 2005), *available at* http://www.ide.go.jp/English/Publish/Periodicals/De/pdf/05_01_05.pdf. One of the fundamental reasons behind the lack of effectiveness of [these] pre-crisis prudential regulations was the limited authority of the central bank in bank supervision. In a narrow sense, this involved the division of powers between the Minister of Finance and the central bank. In a broader context, it involved the central bank's independence from the government and the president. Under pressure from the IMF's requests and the deconcentration of power after the fall of President Soeharto, moves were carried out to create a legal framework for ensuring the independence of the central bank.” *Id.* at 108.

¹⁰⁵ YOKOI-ARAI, *supra* note 99, at 156.

¹⁰⁶ Sato, *supra* note 104, at 108.

¹⁰⁷ *Id.* at 109.

also gave BI unfettered powers to control the fiscal, currency, and monetary policies, all of which were matters of great concern to the IMF.¹⁰⁸ Moreover, the procedure for appointment of the central bank governor and the board of directors was modified. Under the 1999 legislation, the President nominates the candidates, who are later examined and then appointed subject to parliamentary consent.¹⁰⁹

More recently, however, those initiatives have been placed in jeopardy. The Central Bank Act was further modified in 2004 to establish a new legal entity called the “Supervisory Board”, tasked with the supervision of the central bank.¹¹⁰ The 2004 legislation calls for members of the Supervisory Board to be appointed by the House of Representatives and the President.¹¹¹ The 2004 amendment also obligates the central bank to report to the House of Representatives and the President. A third feature is an astounding setback: the Act empowers the President to remove the central bank governor from his position if he “committed” a “prohibited act” and refused to resign.¹¹²

Indonesia’s banking law was also modified in 1998. The amendments strengthened criminal penalties against bankers and shareholders.¹¹³

What is the situation in Indonesia today, twelve years after the Asian Financial Crisis struck? Indonesia’s recovery has been the slowest among the crisis countries.¹¹⁴ Observers note

¹⁰⁸ The IMF wanted to separate monetary policy from bank supervision: “For Indonesia, the IMF proposed the establishment of the Financial Service Authority (Otorita Jasa Keuangan, OJK), with the task of supervising and regulating four sectors: banks, security markets, insurance firms, and pension funds. However, the establishment of the authority was not realized by 2002 as initially stipulated, and was eventually postponed until 2010.” Sato, *supra* note 104, at 111.

¹⁰⁹ *Id.* Reforms of this sort were among those that I urged in my earlier writings about the Asian Financial Crisis. See, e.g., Head, *Global Implications*, *supra* note 3, at 951–52.

¹¹⁰ Sato, *supra* note 104, at 111. Sato explains that the reason for establishing this entity was to create a “relationship of checks and balances between the Central Bank and the legislative and the executive branches” and to counter-balance the overheated concern for central bank independence that characterized the 1999 amendments of the Act. *Id.*

¹¹¹ *Id.*

¹¹² *Id.*

¹¹³ *Id.*

that political turmoil in Indonesia slowed down recovery.¹¹⁵ Indonesian GDP growth rates fell from an impressive 8.3 percent in 1996¹¹⁶ to a painful -14.2 percent in 1998. In 2008, Indonesia's GDP growth rate was estimated at 6.3 percent.¹¹⁷

iii. Korea

In the three years following the crisis, the Korean government pursued reform on various levels, as illustrated below:

- *Financial supervision—institutional aspects.* The Korean government established the Financial Supervisory Committee (“FSC”) in April 1998. Furthermore, in January 1999, all existing supervisory bodies were merged into one entity called the Financial Supervisory Service (“FSS”) under the FSC’s umbrella.¹¹⁸ The Financial Industry Restructuring Act was amended to give the FSS and the FSC statutory authority to order write-offs, to merge, to suspend, or to close non-viable financial institutions.¹¹⁹ As part of their operations, FSC and FSS conduct onsite and off site inspections.¹²⁰ This left the Bank of Korea (Korea’s central bank) responsible for fiscal and monetary policy, whereas the FSC and FSS were in charge of financial sector supervision.¹²¹
- *Restructuring of non-viable financial institutions.* For the first time in Korea’s history, non-viable banks were closing their doors.¹²² Cleaning up non-performing loans (“NPLs”)—which by March 1998 had reached 118 trillion won, equivalent to 28 percent of Korea’s 1997 GDP¹²³—was a top priority for the Korean Government.¹²⁴ The government established a special fund within the Korea Asset Management Corporation (“KAMCO”) to deal with the NPLs problem. KAMCO issued bonds to the public to raise the funds required to clean up NPLs from banks and financial institutions.¹²⁵ By 2001 the Korean financial sector was showing

¹¹⁴ Djiwandono, *supra* note 37, at 44.

¹¹⁵ THIRKELL-WHITE, *supra* note 7, at 149.

¹¹⁶ *Recovery from the Asian Crisis*, *supra* note 101 (providing Indonesian authorities and IMF staff estimates for Indonesia).

¹¹⁷ ADB OUTLOOK, *supra* note 102.

¹¹⁸ Lim & Hahm, *supra* note 40, at 114.

¹¹⁹ *Id.* at 101.

¹²⁰ Byung-Tae Kim, *Korea’s Banking Law Reform: Post Asian Crisis*, 16 INT’L ECON. DEV. L. 6 (2003).

¹²¹ *Id.* at 41.

¹²² *Id.* at 28.

¹²³ See Lim & Hahm, *supra* note 40, at 103.

¹²⁴ *Id.* at 114.

¹²⁵ *Id.* at 108.

healthy signs; KAMCO's purchases of NPLs decreased significantly, and banks and financial institutions were able to deal with NPLs on their own.¹²⁶

- *Moral hazard and deposit insurance.* One of the main weaknesses of pre-crisis Korea was the cozy structure of government-business relationships, which gave the general public as well as the business community the confidence that the government would bail out failing businesses. This “moral hazard” dilemma was addressed on different fronts. For one thing, the government established the Korean Deposit Insurance Corporation (“KDIC”) in April 1998¹²⁷ to offer partial deposit insurance. Since the time of KDIC’s establishment, the government has had to deal with massive corporate failures—for example, Daewoo, one of the big five *chaebol*, showered the market with junk bonds and then started to crumble in August 1999¹²⁸—and to adjust the KDIC insurance limit accordingly. (In Daewoo’s case, the government allowed small individual investors to recoup 95 percent of Daewoo’s bonds, whereas investors’ assumption had been a 100 percent government bailout on grounds that Daewoo was “too big to fail.”¹²⁹) The insurance limit was finally capped in January 2001 at the equivalent of U.S. \$47,700 per person per financial institution.¹³⁰
- *Prudential regulation—CAR requirements.* Even before the crisis, Korea imposed a capital adequacy ratio (“CAR”) requirement of 8 percent.¹³¹ Although this requirement has not changed, in practice the average CAR of Korean commercial banks has risen since the crisis,¹³² perhaps in part because the FSC, now in charge of bank supervision, is keeping a close eye on banks’ health using various indicators, including their CARs.¹³³ The FSC has the authority to issue a Prompt Corrective Action (“PCA”) citation if a bank shows a decline in its CAR.¹³⁴
- *Other prudential regulation.* To limit the risks inherent in concentrated lending, the Korean government imposed a cap—amounting to a maximum of 25 percent of bank equity capital—on lending to any one borrower and its affiliates.¹³⁵ Moreover, the FSC also monitors and limits lending transactions between the banking institution and its shareholders

¹²⁶ *Id.* at 105.

¹²⁷ *Id.* at 114.

¹²⁸ *Id.* at 105.

¹²⁹ *Id.*

¹³⁰ *Id.*

¹³¹ Kim, *supra* note 120, at 39 n.144.

¹³² *Id.* at 91.

¹³³ *Id.*

¹³⁴ *Id.* at 108.

¹³⁵ Lim & Hahm, *supra* note 40, at 114.

or subsidiaries.¹³⁶ In addition, in order to combat the lack of transparency that was a common feature of pre-crisis Korea, the “Real Name Financial Transactions and Guarantee of Secrecy Act” was enacted in December 1997 to require banks to record the real names of their clients.¹³⁷

- *Equity markets.* One of the major reasons that the *chaebol* in pre-crisis Korea were able to operate without substantial scrutiny over their corporate governance was the lack of an efficient equity market.¹³⁸ Stock market reform was therefore an integral part of Korea’s recovery plan. The reform plan included: removing restrictions on cross-border¹³⁹ mergers and acquisitions (“M&As”),¹⁴⁰ including hostile M&As,¹⁴¹ lifting restrictions on foreign investments in listed stocks;¹⁴² and introducing mutual funds.
- *Corporate law reform and the chaebol system.*¹⁴³ Several initiatives have been undertaken to address the perceived problems associated with the *chaebol* system. These include:
 - 1) Adoption of the Act concerning the External Audit of Corporations, to require *chaebol* conglomerates to use external auditors to audit the *chaebol*’s consolidated financial statements.¹⁴⁴
 - 2) A requirement that a corporate board must have at least one quarter of its membership composed of outside directors,¹⁴⁵ and conflict-of-interest rules prohibiting the election of outside directors who “share interests with major *chaebol* shareholders.”¹⁴⁶

¹³⁶ Kim, *supra* note 120, at 97.

¹³⁷ *Id.* at 100.

¹³⁸ See *supra* text accompanying note 41.

¹³⁹ Lim & Hahm, *supra* note 40, at 115.

¹⁴⁰ By 1999, M&As in Korea alone accounted for US\$13 billion. See SHARMA, *supra* note 89, at 347.

¹⁴¹ Kim, *supra* note 120, at 60.

¹⁴² Lim & Hahm, *supra* note 40, at 115.

¹⁴³ While some see the corporate reforms as a success story, some view it as a failure: “We argue that this disappointing performance of corporate reform was not simply because the reform was implemented too rapidly or there were technical failures in carrying out the reform, although these were indeed important factors. It was mainly because the reform was misdirected, in the sense that it has been trying to introduce a system of corporate governance and financing that was not appropriate for the Korean Economy.” See JANG-SUP SHIN & HA-JOON CHANG, RESTRUCTURING KOREA INC, FINANCIAL CRISIS, CORPORATE REFORM, AND INSTITUTIONAL TRANSITION 84 (2003).

¹⁴⁴ *Id.* at 96.

¹⁴⁵ *Id.* at 100.

¹⁴⁶ *Id.*

- 3) A requirement that *chaebol* owners register themselves as “representative directors” of their *chaebol*, thus making *chaebol* owners subject to legal liability for managerial misconduct.¹⁴⁷
 - 4) Abolition from the corporate structure of the chairman’s office, a key feature of inter-*chaebol* coordination (this initiative was taken voluntarily by the *chaebol* themselves in an attempt to introduce corporate transparency and increase popularity).¹⁴⁸
- *Other forms of corporate law reform.* Also among the corporate reforms was the introduction of “cumulative voting.” Small shareholders were able, at least theoretically, to use the cumulative voting mechanism to get their director(s) elected. The cumulative voting that was adopted was easily bypassed, however, through amendments to corporate charters.¹⁴⁹ Another initiative, also aimed at empowering minority shareholders, involved lowering the statutory minimum ownership of shares required to bring a lawsuit against directors, from 1 percent of shares to 0.01 percent of shares; similarly, the 3 percent of shares previously required to allow inspection of corporate books was lowered to 1 percent.¹⁵⁰

As this enumeration illustrates, a very wide array of reforms has been undertaken in Korea following the outbreak of the crisis there in late 1997. Whether the reforms have in fact contributed to a recovery in Korea’s economy—a matter of some debate¹⁵¹—the fact remains that such a recovery has indeed occurred. Korea’s GDP growth rate fell from 7.1 percent in 1996 to -6.8 percent in 1998.¹⁵² It rebounded quickly, however, rising to 10.7 percent in 1999; and since then Korea has maintained a stable, yet humble, GDP growth rate—amounting in 2008 to an estimated 4.8 percent.¹⁵³

¹⁴⁷ *Id.*

¹⁴⁸ *Id.*

¹⁴⁹ Cally Jordan, *Additional Article: the Conundrum of Corporate Governance*, 30 BROOK. J. INT’L L. 983, 1022–1023 (2005).

¹⁵⁰ SHIN & CHANG, *supra* note 143, at 100.

¹⁵¹ Sup Shin and Joon Chang argue that the reforms did not have a positive effect on Korea’s national economy. They argue that the reforms unnecessarily limit the *chaebol*’s economic power and at the same time are easily circumvented. *Id.* at 84.

¹⁵² *Recovery from the Asian Crisis*, *supra* note 101, at 100 (providing Korean authorities and IMF staff estimates).

¹⁵³ ADB OUTLOOK, *supra* note 102.

III. REFORM EFFORTS IN THE IMF IN RESPONSE TO THE ASIAN FINANCIAL CRISIS

Having offered some observations about how the crisis unfolded in Thailand, Indonesia, and Korea in 1997, and having recounted what key steps were taken toward reform and recovery, I turn now to the role of the IMF. In particular, I wish to explore some key criticisms that have been leveled at the IMF for its handling of the crisis, and then to examine some legal and institutional reforms that those criticisms have helped trigger in the IMF over the past dozen years.

A. *A Cacophony of Criticisms*

About a year ago, I completed a book focusing on criticisms that have been directed at the IMF, the multilateral development banks, and the World Trade Organization (“WTO”).¹⁵⁴ My research for that book revealed that although the criticisms leveled at the IMF reflect discontent of all sorts, drawing from many years of IMF operations, it is the Asian Financial Crisis that has served as the most prominent lightning-rod of all, attracting intense scrutiny and often condemnation.

In a nutshell, the criticisms that have been directed most strenuously at the IMF in respect of the Asian Financial Crisis may be stated generally as follows:

- *Bad medicine.* “The IMF prescribes economic and financial policies that fail to cure, and that indeed often make sicker, its borrowing member countries and the entire world economy.”

¹⁵⁴ John W. Head, *LOSING THE GLOBAL DEVELOPMENT WAR: A CONTEMPORARY CRITIQUE OF THE IMF, THE WORLD BANK, AND THE WTO* (2008) [hereinafter Head, *LOSING*]. That book drew in part from an earlier work that I had written for an academic and research audience. *Id.* at 54–55 n.5.

- *Distributional and social injustice.* “The economic and financial policies that the IMF insists on create distributional inequities and ignore the social aspects of a country’s well-being.”
- *IMF secrecy and opaqueness.* “The IMF is a closed, non-transparent organization that operates in secret, despite its insistence on transparency in the governments of its members.”
- *The IMF democracy deficit.* “Controlled by a handful of rich countries, the IMF is an unaccountable autocracy in which the people most affected by its operations have far too little chance to participate or exert influence.”¹⁵⁵

Perhaps the most frequently voiced criticisms relating to the IMF’s involvement in the Asian Financial Crisis fall into the “bad medicine” category. Observers have condemned the IMF for urging those countries that were hardest-hit by the crisis to adopt economic and financial policies that were in fact harmful to their economies, thereby lengthening and deepening the injury—or even (according to some critics) bringing on the crisis in the first place.¹⁵⁶

¹⁵⁵ *Id.* at 55–56. I also identified in that 2008 book three other criticisms directed at the IMF—the “trampling of national sovereignty” criticism, the “mission creep” criticism, and the “asymmetry in obligations” criticism. *Id.* at 56. Those criticisms do not, in my experience, appear as frequently in the literature regarding the IMF’s handling of the Asian Financial Crisis as do the four criticisms referred to above, so I do not discuss them in the following paragraphs. The “trampling of national sovereignty” criticism, as I have summarized it, claims that “[i]n imposing conditionality on its loans, the IMF tramples on national sovereignty—not just in economics but increasingly in other areas of state autonomy.” *Id.* The “mission creep” criticism, as I have summarized it, claims that “[a]s both a legal and a practical matter, the IMF has overstepped its authority and its competence in providing bailouts and adopting policies on a proliferation of topics”. *Id.* The “asymmetry in obligations” criticism, as I have summarized it, claims that “[t]he IMF permits its rich member countries to insist that the poor borrowing member countries follow certain policies without pressuring the rich countries to follow those policies themselves.” *Id.*

¹⁵⁶ See, e.g., STIGLITZ, *GLOBALIZATION*, *supra* note 14, at 15 (referring to a “general consensus that the IMF pursued excessively contractionary fiscal policies” in responding to the Asian crisis, “and that the manner in which it handled financial-sector restructuring, at least in Indonesia, was a dismal failure”); Ross P. Buckley, *A Tale of Two Crises: The Search for the Enduring Reforms of the International Financial System*, 6 *UCLA J. INT’L L. & FOREIGN AFF.* 1, 42–43 (2001) (referring to the IMF’s bailouts of Asian debtors as “highly counterproductive” because the bailouts “rewarded creditors for investing in the most destabilizing form of debt,” and concluding that “[t]he IMF made the wrong call” in providing the bailouts “because it was viewing the situation from the wrong perspective”); Istvan Dupai, *Criticism of the IMF and the World Bank* (Oct. 4, 2000), <http://www.dupai.com/allforstudents/docs/00000004.html> (endorsing the view that “the IMF increased panic [in the crisis-hit Asian countries] with its public announcements that everything was wrong” and that more generally “IMF programs often incite financial panics”); Martin Khor, *IMF Policies Make Patient Sicker, Say Critics*, 176 *THIRD WORLD ECON.*, n.p. (Jan. 1-15, 1998), at <http://www.twinside.org.sg/title/sick-cn.htm> (endorsing the view that “by imposing a tough economic squeeze in affected [Asian] countries, the IMF risks undermining, not restoring, investor confidence,” that “by insisting on faster liberalisation of capital inflows, the IMF may exacerbate financial

The second criticism summarized above—the “distributional and social injustice” criticism—could be regarded as an offshoot of the “bad medicine” criticism. Several observers have asserted that the economic and financial policies urged by the IMF during the Asian Financial Crisis were especially harmful to those persons who were most vulnerable to economic trauma.¹⁵⁷ This “distributional and social injustice” claim also has been made by innumerable critics of other aspects of IMF operations.¹⁵⁸

The “secrecy and opaqueness” criticism has also appeared in literature criticizing the IMF’s handling of the Asian Financial Crisis,¹⁵⁹ as has the “democracy deficit” criticism.¹⁶⁰

vulnerability,” and that the IMF-led “bailouts may encourage further folly, mainly by lenders”); Catherine H. Lee, Comment, *To Thine Ownself Be True: IMF Conditionality and Erosion of Economic Sovereignty in the Asian Financial Crisis*, 24 U. PA. J. INT’L ECON. L. 875 (2003) (criticizing the IMF’s alleged “one size fits all” approach); John V. Paddock, Comment, *IMF Policy and the Argentine Crisis*, 34 U. MIAMI INTER-AM. L. REV. 155, 158–59 (2002) (complaining that the IMF has applied a “one-size-fits-all program” to Argentina, Mexico, Russia, and Asian countries despite differences in the crises faced by all those countries); *Frontline, The Crash: Views and Comments on the IMF* (PBS television broadcast June 29, 1999), transcript at <http://www.pbs.org/wgbh/pages/frontline/shows/crash/imf/views.html> (quoting Jeffrey D. Sachs’ assertion that in emphasizing the seriousness of financial conditions in Asia, “the IMF helped to detonate the Indonesian crisis” and took “the same kinds of provocative steps” in Korea, and overall “made a bad mistake”). These and other illustrations of the “bad medicine” criticism appear in HEAD, LOSING, *supra* note 154, app. at 64–67.

¹⁵⁷ See, e.g., *Frontline*, *supra* note 136 (quoting Jeffrey D. Sachs’ assertion that the IMF’s action in the Asian financial crisis “shift[ed] the attention away from the real facts and from the real world that people live in” and that the IMF is “not understanding that . . . [its] actions are having such a disastrous effect on the real economy, on the jobs, the production, the exports, and the living standards of the people”); *id.* (quoting Jeffrey Garten’s assertion, in evaluating the IMF’s handling of the Asian financial crisis, that “the social cost, the cost in terms of unemployment and, you know, the sheer human misery that is created—it was too much”).

¹⁵⁸ See HEAD, LOSING, *supra* note 154, at 67–69 (citing and summarizing other critics making the “distributional and social injustice” claim).

¹⁵⁹ See, e.g., Khor, *supra* note 156 (criticizing the IMF for “work[ing] in secret, drawing up policies for the 80 countries under its control, largely without their participation and without the knowledge of the world,” and operating with an “almost total lack of ‘transparency’ in decisions and decision-making process”); Ian Vasquez, *The IMF: Bad Watchdog with a Bad Attitude*, CATO INSTITUTE Mar. 16, 1998, http://www.cato.org/pub_display.php?pub_id=5932 (complaining that “even as the IMF insists on full and accurate information [from Asian governments], it remains one of the world’s most secretive bureaucracies”).

¹⁶⁰ See, e.g., Lee, *supra* note 156, at 902 (calling for a reallocation of voting power in the IMF to allow developing countries to have a meaningful voice in the determination of policies); Ngairé Woods, *From Intervention to Cooperation: Reforming the IMF and World Bank*, PROGRESSIVE GOVERNANCE, Apr. 2008, <http://www.policy-network.net/publications/index.aspx?id=2218> (asserting that the IMF is an undemocratic institution in which poor and developing countries, those that are typically the subject of IMF policy prescriptions, are under-represented).

How have these four key criticisms of the IMF's approach to handling the Asian Financial Crisis appeared in evaluations by other observers? I examine this in the following paragraphs.

i. The Stiglitz Analysis

One of the most vocal critics of the IMF's operations at the time of the Asian Financial Crisis is Joseph Stiglitz, especially in his books *Globalization and Its Discontents* and *Making Globalization Work*.¹⁶¹ His key points in this respect fit generally within the "bad medicine" criticism summarized above, and I interpret his account as having five main logical points.

First, the IMF has, in Stiglitz' view, lost its intellectual and policy coherence:

The Fund, in its original conception, was intended to put international pressure on countries to have more expansionary policies than they would choose of their own accord. Today, the Fund has reversed course, putting pressure on countries, particularly developing ones, to implement more contractionary policies than these countries would choose of their own accord. ... [T]oday's IMF has, in my judgment, not articulated a coherent theory of market failure that would justify its own existence and provide a rationale for its particular interventions in the market.¹⁶²

Second, the reason for this alleged incoherence (as I interpret Stiglitz' reasoning) is that the IMF is pursuing the interests of the financial community rather than the interests of its member countries. In this respect, Stiglitz points out that the IMF staff and key personnel come

¹⁶¹ See *supra* notes 14 and 30, respectively.

¹⁶² STIGLITZ, *GLOBALIZATION*, *supra* note 14, at 197. While the reputation and influence of Joseph Stiglitz—a Nobel prize-winner in economics—obviously warrants giving attention to his views on the IMF, I should point out that I agree with Professor Kevin Kennedy's opinion of Stiglitz' 2003 book. Professor Kennedy writes that it amounts to "nothing less than a diatribe", mainly against the IMF, in which the author "makes no pretense of being balanced or of writing a scholarly work" but instead delivers only "rather rambling, uneven rhetoric" that includes "mean-spiritedness and ad hominem attacks". Kevin Kennedy, *A Review of Globalization and Its Discontents*, 35 GEO. WASH. INT'L L. REV. 251, 252–53 (2003). Kennedy criticizes Stiglitz's "wild hypothesizing, unsubstantiated accusations, and overheated rhetoric" and, perhaps more importantly, the glaring errors or omissions in Stiglitz's analysis of the IMF's role in the Asian financial crisis and Russia's painful economic transformation. *Id.* at 255–57.

from the financial community and are by virtue of their training and education defenders of the interests of financial institutions.¹⁶³ Moreover, those who leave the IMF leave for well paying jobs in the financial institutions world.¹⁶⁴ This explains, argues Stiglitz, why the IMF's attention during the Asian Financial Crisis was focused on getting foreign creditors repaid rather than helping the Asian economies to recover by keeping domestic businesses open.¹⁶⁵

Third, the course the IMF *should* have taken, in Stiglitz' view, was to protect the Asian economies:

There was an alternative to [the IMF] massive interventions.... [T]he IMF could have facilitated the workout process; it could have tried to engineer a standstill (the temporary interruption of payments) that would have given the countries—and their firms—time to recoup.... [I]t could have tried to create an accelerated bankruptcy process. But bankruptcies and standstills were not welcome options, for they meant that the creditors would not be repaid. Many of the loans were uncollateralized so in the event of bankruptcy, little could be recovered.¹⁶⁶

Fourth, Stiglitz acknowledges that the IMF was not totally oblivious to the economic well-being of the Asian countries:

[T]he IMF never wanted to harm the poor and believed that the policies it advocated would eventually benefit them; it believed in trickle down economics and . . . did not want to look too closely at evidence that might suggest otherwise. It believed that the discipline of the capital markets would help poor countries to grow, and therefore it believed that keeping in good stead with capital markets was of first-order importance.¹⁶⁷

Fifth, Stiglitz takes issue in particular with the high interest-rate policy urged by the Fund during the Asian Financial Crisis:

¹⁶³ STIGLITZ, GLOBALIZATION, *supra* note 14, at 207.

¹⁶⁴ *Id.*

¹⁶⁵ *Id.* at 208.

¹⁶⁶ *Id.*

¹⁶⁷ *Id.*

[E]specially problematic was the high interest rate policies that the IMF pushed to stabilize exchange rates; while the high interest rates failed to do that, they quickly led to an explosion of the debt burden. Governments had to borrow more and more just to make the interest payments on what they owed.¹⁶⁸

These contractionary policies—by which the affected countries were urged to “tighten their belts”—simply exacerbated the crisis, Stiglitz asserts,¹⁶⁹ and reduced the governments’ ability to face the increasing needs of their people by putting further pressure on the already weak social safety nets (social security programs, unemployment benefits, and food and fuel subsidies for the poor).¹⁷⁰ In this respect, Stiglitz asserts that the bailout package arranged for Indonesia was used to repay Western creditors, but there was never enough money to provide the poor with subsidized food and fuel.¹⁷¹

In the end, Stiglitz argues that in fact it was mainly the policy advice urged by the IMF and the U.S. Treasury Department—and not such issues as Asian cronyism or a lack of transparency—that precipitated the crisis in East Asia by pushing the countries there to adopt a liberalized economy when they lacked the economic and logistic ability to manage such liberalization.¹⁷² Stiglitz also argues that the U.S.A. and Japan and other industrialized countries

¹⁶⁸ STIGLITZ, *MAKING*, *supra* note 30, at 235.

¹⁶⁹ STIGLITZ, *GLOBALIZATION*, *supra* note 14, at 199.

¹⁷⁰ *Id.* at 210.

¹⁷¹ STIGLITZ, *MAKING*, *supra* note 30, at 243.

¹⁷² STIGLITZ, *GLOBALIZATION*, *supra* note 14, at 211–12. This alleged pressure from the IMF to adopt liberal economic policies could be viewed as operating to the detriment of Asian countries in another rather perverse way as well: One would have to wonder whether the financial regulatory agencies in countries such as Thailand, Indonesia, and Korea would have felt at liberty, under IMF-designed policies, to conduct adequate surveillance of the banks under their jurisdiction. That is, even if those agencies had plenty of economic and logistical ability to conduct such surveillance (which they probably did not), they might have been discouraged anyway from doing so—and from imposing restrictions, for example, on the free flow of “hot money”—by the real or perceived preference of the IMF and its strongest members for capital account and capital market liberalization. I am indebted to Ms. Heba Hazzaa for this observation.

were at fault in another way as well: their weak banking regulations encouraged their financial institutions to participate in risky lending to East Asian borrowers.¹⁷³

This last point—that blame for the outbreak of the Asian Financial Crisis and then its alleged mishandling lies in important measure with the U.S.A. and other industrialized countries—appears in the writings of other critics as well. One observer has expressed the point in this way:

East Asian nations came out of the experience profoundly shaken and deeply resentful of the reaction of the developed world as embodied in the International Monetary Fund (IMF), and its alleged master, the United States. This was particularly true of ASEAN. As Alice Ba has written:

ASEAN found International Monetary Fund (IMF) conditions intrusive, inappropriate, and insensitive to specific economic and political conditions in affected countries; however, its greatest unhappiness lay with the U.S. which was not only associated with the problematic IMF conditions but also was viewed as benefiting from Southeast Asia's financial problems.¹⁷⁴

In sum, we can see in these criticisms by Stiglitz and others a strong condemnation of the IMF's approach to handling the Asian Financial Crisis. To use my phrase, "bad medicine" was (according to these critics) prescribed by the IMF to the ailing economies of Thailand, Indonesia, and Korea, and that medicine made the recovery of those countries much more difficult than it should have been.

ii. The IMF's Self-Analysis

¹⁷³ *Id.* at 212. In this regard, he makes the related claim that poor Asian countries' taxpayers were left to pay for rich countries' lending mistakes. STIGLITZ, MAKING, *supra* note 30, at 217.

¹⁷⁴ Claude Barfield, *The Dragon Stirs: China's Trade Policy for Asia – and for the World*, 24 ARIZ. J. INT'L & COMP. L. 93, 102–03 (2007) (quoting Alice D. Ba, *China and ASEAN: Renavigating Relations for a 21st Century Asia*, 43 ASIAN SURV. 622, 635 (2003)).

It is worth noting that the critical evaluations of the IMF's handling of the Asian Financial Crisis have come not only from external sources but also from within the IMF itself. For example, a 2003 study and report by the IMF's Independent Evaluation Office ("IEO") identified a number of shortcomings in the IMF's performance in the late 1990s in its work with Indonesia and Korea (the 2003 IEO's report did not focus on Thailand).¹⁷⁵

These shortcomings can be classified as falling generally within three categories. The first was that the IMF's pre-crisis surveillance of economic and financial developments within Indonesia and Korea was not robust enough to identify certain weaknesses in those countries.¹⁷⁶ This alleged shortcoming has been addressed extensively, as the IEO itself acknowledges, by certain policy changes in IMF operations, especially in terms of revised consultation procedures, modified guidelines on conditionality, and increased transparency¹⁷⁷—matters I summarize later in this article.

The IEO's second main observation was that certain aspects of the IMF's economic and financial policy prescriptions were faulty—featuring overly tight macroeconomic policy, for example, as well as overly tight fiscal policy for both Indonesia and Korea, and also an unclear strategy for banking sector restructuring in Indonesia.¹⁷⁸ This assessment by the IEO resembles the "bad medicine" criticism that I have described above.

The third key shortcoming identified by the IEO relates to the IMF's internal governance, but not in the aspects that I have highlighted above in describing the "democracy deficit" criticism; instead, the IEO report refers to inefficiencies and confusion occurring in the handling

¹⁷⁵ See generally Independent Evaluation Office of the IMF, *The IMF and Recent Capital Account Crises: Indonesia, Korea, and Brazil* (2003) [hereinafter *IEO 2003 Report*], <http://www.iesoimf.org/eval/complete/pdf/07282003/main.pdf>.

¹⁷⁶ *Id.* at 1–3.

¹⁷⁷ *Id.* at 51.

¹⁷⁸ *Id.* at 3, 5.

of the crises in Indonesia and Korea because of certain political pressures within the IMF and between the IMF and other international financial institutions, particularly the World Bank.¹⁷⁹

B. *My Own Abbreviated Reaction to the Criticisms*

As I explained at the outset of this section III, my aim here is two-fold: (i) to explore some key criticisms that have been leveled at the IMF for its handling of the Asian Financial Crisis, and then (ii) to examine some legal and institutional reforms that those criticisms have helped trigger in the IMF over the past dozen years. To achieve these aims it is perhaps not really essential for me to explain my own views on the criticisms themselves. What is more important for present purposes is to evaluate the IMF's responsiveness. After all, as suggested in the subtitle to this article, I wish to focus on "legal and institutional lessons learned" in the dozen years since the Asian Financial Crisis erupted in 1997.

Having said that, I do wish to offer a thumbnail sketch of how I assess the four key criticisms that I enumerated above, as they have been leveled at the IMF in the context of the Asian Financial Crisis. Doing so will, I hope, lay further groundwork for a discussion of certain responses that the IMF has made to those criticisms. For a more detailed explanation of my views on these and other criticisms directed at the IMF and some of its sister institutions, readers can refer to my other recent works.¹⁸⁰

i. The "Bad Medicine" Criticism

¹⁷⁹ *Id.* at 5–6.

¹⁸⁰ *See, e.g.*, HEAD, LOSING, *supra* note 154; JOHN W. HEAD, THE FUTURE OF THE GLOBAL ECONOMIC ORGANIZATIONS: AN EVALUATION OF CRITICISMS LEVELED AT THE IMF, THE MULTILATERAL DEVELOPMENT BANKS, AND THE WTO (2005) [hereinafter HEAD, FUTURE].

Let me begin with the “bad medicine” criticism.¹⁸¹ This criticism, in its broadest form, claims that the economic and financial policies prescribed by the IMF follow a “Washington Consensus”¹⁸² recipe that typically consists of reducing a country’s budget deficit, its balance of payments deficit, its inflation rate, its trade barriers, and its restrictions on capital flows in and out of the country, while raising official interest rates and selling off state assets to private companies. This cocktail of “Washington Consensus” policies, according to the critics, discourages economic growth and drags down new investment. Another related version of the criticism is that some policies insisted on by the IMF in particular are not designed to help the countries’ economies but instead are designed to pressure the countries into honoring debt obligations they have to private-sector lenders. Such policies, the critics say, reflect the willingness of the IMF to serve essentially as a collection agency for major financial institutions that are creditors either of the governments or of private-sector actors in the less-developed, debt-ridden countries

Many of the critics voicing these opinions have focused their attention on the Asian Financial Crisis, asserting that the IMF, often with the World Bank at its side, took action that was inadequate, ill-suited for the circumstances, and ultimately harmful.

¹⁸¹ This account is drawn largely from HEAD, LOSING, *supra* note 154, at 175–83.

¹⁸² The term “Washington Consensus” was used by John Williamson in 1989, in a background paper for a conference on dealing with economic policy in Latin America, as a label for ten types of reforms that Williamson said “almost everyone in Washington thought were needed in Latin America as of that date”: fiscal discipline, reordering public expenditure priorities, tax reform, liberalization of interest rates, a competitive exchange rate, trade liberalization, liberalization of inward foreign direct investment, privatization, deregulation, and property rights. John Williamson, *From Reform Agenda to Damaged Brand Name*, FIN. & DEV. 10, 10 (Sept. 2003). But like a lion that escaped from its trainer, the term “Washington Consensus” has gone out of control. Williamson himself now calls for a new generation of reforms that will focus on (among other things) institutional reforms and income redistribution. *Id.* at 12–13. He also urges that the term “Washington Consensus” should actually be dropped from the vocabulary, in part because “there is no longer any agreement on the main lines of economic policy between the current U.S. administration and the international financial institutions.” *Id.* at 11–12 (citing recent IMF criticisms of US fiscal policy and the Bush-Cheney administration’s disdain for the expressions of concern about income distribution).

A form of this criticism centers on the notion of “moral hazard”. Moral hazard has been explained this way:

Moral hazard is a term often used when analyzing the effects of insurance. It refers to the idea that the very provision of insurance raises the likelihood of the event being insured against taking place. This is because insurance reduces the incentives for the insured party to take preventive actions.... In the financial context, economists and policy makers debate whether the availability of financial support from institutions like the [IMF] leads to moral hazard. That is, does the IMF’s role as a lender to countries in financial crisis actually encourage borrowers and lenders to behave in ways that makes a crisis more likely.¹⁸³

According to many critics, the answer is yes. Specifically in the context of the Asian Financial Crisis, they claim that the IMF’s bailouts for Thailand, Indonesia, and Korea created moral hazard in two ways: (i) by signaling to the governments engaging in poor economic management that their bad performance will have no penalty (because the IMF will bail them out); and (ii) by signaling to financiers investing in those countries that they can invest without risk (because the IMF will bail them out as well).

While I understand these points, I do not find the “bad medicine” criticism persuasive in the context of the Asian Financial Crisis, for two reasons. First, I have doubts on the matter of causation. Can we confidently conclude from the fact that IMF policy prescriptions were imposed on Thailand, Indonesia, and Korea that those prescribed policies actually caused (or exacerbated) the nose-dive taken by the economies of those countries in 1997? As one scholar points out, such a conclusion is “particularly troublesome because of the problem of defining the counter-factual; in other words, determining what would have happened in the absence of [an

¹⁸³ Timothy Lane & Steven Phillips, *Hazard: Does IMF Financing Encourage Imprudence by Borrowers and Lenders?* 28 *ECON. ISSUES* 1 (2002), www.imf.org/external/pubs/ft/issues/issues28/index.htm.

IMF-prescribed] program”.¹⁸⁴ Beyond that, it is important to recognize that national economic fortunes and misfortunes have momentum. It would be illogical to blame IMF policies for economic problems that already existed in a country before the IMF intervention began. (Indonesia, in particular, comes to mind in this regard.)

A second reason I find the “bad medicine” criticism unpersuasive focuses on the specific issue of “moral hazard” that I described above. I question whether the financial assistance packages arranged by the IMF during the Asian Financial Crisis would be interpreted either by national governments or by foreign investors as an assurance that they need not be prudent in their policies or their investments. As for *governments*, I agree with the view expressed by the then-Deputy Managing Director of the IMF, Stanley Fischer:

To think that [government] policymakers pursue risky courses of action because they know the IMF safety net will catch them if things go badly is far-fetched. Countries try to avoid going to the [IMF]; policymakers whose countries end up in trouble generally do not survive politically.¹⁸⁵

Fischer’s view on moral hazard for *investors* is also persuasive: “foreign equity investors had lost nearly three-quarters of the value of their equity holdings in some Asian markets . . . [and] the crisis [was also quite] . . . costly for foreign commercial banks”; in short, “[i]nvestors have been hit hard, as they should have been, for lending unwisely.”¹⁸⁶ Given this, I think the moral hazard complaint is exaggerated, at best, and perhaps even groundless.

¹⁸⁴ Gopal Garuda, *Lender of Last Resort: Rethinking IMF Conditionality*, 20 HARV. INT’L L.J. 36, 38 (1998). See also Graham Bird, *Reforming the IMF: Should the Fund Abandon Conditionality?*, 7 NEW ECON. 214, 214 (2000) (noting that “[n]umerous academic studies examining [whether IMF programs] work suggest this is a very difficult question to answer . . . largely because while the outcome is known in countries that adopted Fund programmes, what might have happened if agreement had not been reached cannot be known—the so-called counter-factual problem”). The “counterfactual” difficulty was also recognized explicitly by the IMF’s Independent Evaluation Office in its assessment of the IMF’s handling of the Asian Financial Crisis. See *IEO 2003 Report*, *supra* note 175, at 1.

¹⁸⁵ Stanley Fischer, *In Defense of the IMF*, 77 FOREIGN AFF. 103, 106 (1998).

¹⁸⁶ *Id.* For an extensive discussion of the moral hazard question, see generally Lane & Phillips, *supra* note 183. These authors conclude that “moral hazard’s role may have been seriously overstated by some observers”. *Id.* at 13.

ii. The “Distributional and Social Injustice” Criticism

Having offered my views on the “bad medicine” criticism leveled at the IMF in the context of the Asian Financial Crisis, let me turn to the second of the four criticisms enumerated above—the “distributional and social injustice” criticism. This criticism, as an offshoot of the “bad medicine” criticism, claims more specifically that IMF operations hurt the poor and generally undermine social safety nets and even social values. The reasoning is that even if the austerity measures that the IMF pressures its borrowing member countries to adopt do in fact provide net overall economic and financial benefits to those countries—by helping them to restore economic stability or to avoid defaulting on foreign debts, for example—they win those overall benefits at the expense of the poor. According to the critics, IMF-mandated measures to balance a government’s budget by slashing expenditures and raising revenues allegedly force that government (so the criticism runs) to eliminate public funding for social programs and to increase the price of social services, making health care and education unaffordable for the poor.

Expressed in such blunt terms as these, this criticism strikes me as inaccurate because it both overstates and understates the IMF’s role. It overstates the IMF’s role by suggesting that the IMF-prescribed policies are so detailed as to dictate specific budgetary decisions by the governments of borrowing countries. But this is not the case (however convenient it might be for a borrowing government to suggest otherwise). Consider the letter of intent submitted by the government of Indonesia in late October 1997. That letter of intent (which would have emerged from discussions with IMF staff) did not dictate specific budget cuts. It did, however, specifically state that “it is imperative that the adjustment program does not result in a worsening of [the] economic and social conditions [of the poor] Measures necessary to achieve fiscal

targets will protect expenditures on health and education . . . [and] budgetary allocation for social spending will be increased.”¹⁸⁷

In addition to overstating the IMF’s role, the blanket criticism that the IMF insists on financial policies that create distributional inequities and ignore the social aspects of a country’s well-being is inaccurate in another way, at least in more recent years: the criticism understates the degree of attention that the IMF now gives to the social aspects of a country’s well-being. Since these recent developments will feature in subsection IIIC of this article, I need not discuss them here. (I shall also explain in subsection IIIC the additional initiatives that I believe the IMF should take regarding distributional and social issues.)

iii. The “Secrecy and Opaqueness” Criticism

What about the third of the four criticisms mentioned above—the “secrecy and opaqueness” criticism? In my view, this criticism is unpersuasive. Even when viewed as of 1997, the IMF’s policies on transparency seem adequate. Since that time, however, the IMF has undertaken further initiatives to address concerns about its alleged secretiveness—both what I have called “documentary secretiveness” and what I have called “operational secrecy”.¹⁸⁸ I shall

¹⁸⁷ See Letter of Intent, *supra* note 71. Similarly, the letter of intent submitted by the government of Indonesia in mid-January 1998, when the crisis had deepened, did not indicate particular budget cuts, and specifically called for the removal of subsidies to include *exemptions* “for prices of kerosene and diesel fuel, where increases will be kept to a minimum so as to protect the poor.” Memorandum from the Government of Indonesia to the International Monetary Fund (Jan. 15, 1998) available at <http://www.imf.org/external/np/loi/011598.htm>.

¹⁸⁸ See HEAD, LOSING, *supra* note 154, at 228. As explained there, the complaint that the IMF engages in “documentary secrecy” claims that the institution typically does not disclose documents that describe its governing policies, its decisions, and its plans—that is, how it does things, what it has done, and what it plans to do—and that those documents that the IMF does disclose are (according to this criticism) self-serving, biased, distracting, or deceptive. *Id.* The complaint that the IMF engages in “operational secrecy”, by contrast, claims that the IMF conducts business in closed meetings that exclude the public from observing the IMF in action, and that in fact many key decisions are made through informal “insider” meetings that are off-limits both to public scrutiny and to the formalities to which public meetings are usually subject in order to ensure procedural fairness.

refer to some of those recent initiatives also in subsection IIIC of this article, so I need not discuss them here.

iv. The “Democracy Deficit” Criticism

The fourth of the four criticisms mentioned above—the “democracy deficit” criticism—does strike me as valid. As summarized above, this criticism claims that the IMF, “[c]ontrolled by a handful of rich countries . . . is an unaccountable autocracy in which the people most affected by its operations have far too little chance to participate or exert influence.”¹⁸⁹ In the context of IMF involvement in the Asian Financial Crisis—just as in the context of other IMF operations both before and after 1997—this criticism has posed what I consider the most vexing institutional and legal problem for the Fund.

In the following paragraphs, I shall outline the main contours of the criticism, especially as it has been explored by two extraordinarily insightful observers—Professor Daniel Bradlow and Dr. Ngaire Woods.¹⁹⁰

Professor Bradlow draws an important distinction between two groups of IMF member states: “IMF supplier states” and “IMF consumer states”.¹⁹¹ The IMF supplier states are (Bradlow explains) “those countries which, because of their wealth, their access to alternative sources of funds, and for political reasons, have no intention of using the IMF’s services in the foreseeable future, and so do not need to pay particular attention to the views of the IMF”, whereas the IMF consumer states are those “that need or know they may need IMF financing in

¹⁸⁹ See *supra* text accompanying note 155.

¹⁹⁰ The following summary is drawn from HEAD, LOSING, *supra* note 154, at 234–35, 238–41.

¹⁹¹ Daniel D. Bradlow, *Rapidly Changing Functions and Slowly Evolving Structures: The Troubling Case of the IMF*, 94 AM. SOC’Y INT’L L. PROC. 152, 153 (2000) [hereinafter Bradlow, *Rapidly Changing*]. Professor Bradlow sounds many of the same themes in another article. See generally Daniel D. Bradlow, *Stuffing New Wine Into Old Bottles: The Troubling Case of the IMF*, 3 J. INT’L BANKING REG. 9 (2001).

the foreseeable future” and therefore “must pay careful attention to the views of the IMF because these views will influence the conditions the IMF will attach to the funds it disburses.”¹⁹²

The fact that this distinction exists between IMF supplier states and IMF consumer states, and that the latter need to listen to the IMF and the former do not, would not in itself make the IMF unaccountable or undemocratic but for another fact: the IMF supplier states dominate decision-making in the IMF, and their domination has in fact increased over the years. In explaining the source and growth of this domination, Professor Bradlow emphasizes these factors:

- the number of IMF Executive Directors has grown more slowly than the number of IMF member states, resulting in an increase in the number of “consumer states” that must be represented by shared Executive Directors, and thus diluting (in relative terms) the effective voice of those countries relative to the “supplier states”, several of which have their own unshared Executive Director;
- those shared Executive Directors who represent both consumer states and supplier states are always from supplier states, so that eleven of the IMF’s 24 Executive Directors are from industrialized countries; and
- the permanency of supplier state representation on the Executive Board gives those states negotiating and agenda-setting advantages.¹⁹³

Underlying these specific factors concerning how IMF supplier states dominate decision-making in the IMF is the IMF’s weighted voting system, which gives the G-7 countries control over nearly 45 percent of the voting power in the organization.¹⁹⁴ Professor Bradlow points out the pernicious result of this confluence of factors:

¹⁹² Bradlow, *Rapidly Changing*, *supra* note 191, at 153.

¹⁹³ *Id.* at 154.

¹⁹⁴ See HEAD, LOSING, *supra* note 154, at 114. As explained there, under the Fund’s “weighted voting” system a member country has two hundred fifty votes plus one additional vote for each part of its quota equivalent to one hundred thousand special drawing rights. Under this formula, the United States, Japan, Germany, France, and the United Kingdom control just under 40 percent of the total voting power in the IMF. If the other two countries in the Group of Seven (“G-7”) are included in the calculation, the aggregate voting power is nearly 45 percent of the total. Although the basic rule set forth in the IMF Charter is that all decisions are made by a majority of the votes

The result is that, de facto, the G-7 countries control the policy agenda in the IMF even though they do not have to live with the consequences of the policies they make for the IMF's operations. This means that they make policy that is only of limited interest to their own citizens. The policy is, of course, of immense interest to people in developing countries who have no ability to hold the G-7 countries accountable for their decisions or actions. This situation of decision makers having power with accountability to people who do not have to live with the consequences of their decisions but without accountability to those most affected by their decisions is a situation ripe with potential for abuse.¹⁹⁵

Dr. Ngaire Woods elaborates on this theme by asserting that the representation of member countries on the Executive Board of the IMF has become even more unequal over time because of changes in members' quotas: whereas the proportion of "basic votes" to total votes in the IMF in earlier years provided some equality among the members (that proportion was fourteen percent, for example, in 1955), now the "basic votes" amount to a tiny proportion (about three percent, according to Dr. Woods).¹⁹⁶ As I shall explain below in subsection IIIC, the IMF recently has taken steps toward addressing this situation.¹⁹⁷

Another aspect of the "democracy deficit" that Dr. Woods explains lies in the fact that the Managing Director of the IMF is "selected by a non-transparent process which excludes most member countries" because of a long-standing understanding by which the Managing Director "is appointed by convention according to the wishes of . . . western Europe."¹⁹⁸ As I shall

cast, special majorities are required for particular decisions, such as the amendment of the Charter (this requires an 85 percent approval), including of course the Charter provisions establishing the weighted voting system itself. *Id.*

¹⁹⁵ Bradlow, *Rapidly Changing*, *supra* note 191, at 154.

¹⁹⁶ Ngaire Woods, *Making the IMF and the World Bank More Accountable*, 77 INT'L AFF. 87 (2001). The IMF's former Secretary, Leo Van Houtven, has also pointed out the decline in the significance of "basic votes", which he says represent "barely 2 percent" of total votes. Leo Van Houtven, *Rethinking IMF Governance*, FIN. & DEV., 19 (2004).

¹⁹⁷ See *infra* text accompanying note 245.

¹⁹⁸ Woods, *supra* note 196, at 88.

explain below in subsection IIIC, the IMF recently has taken steps also toward addressing this situation.¹⁹⁹

Another form of unaccountability emerges from the IMF's legal authority to interpret its own Charter.²⁰⁰ One self-described "third-world scholar" has offered the following critical description of that authority:

[Under the pertinent provision,] an essentially legal question is decided by a non-legal body which appears to be under no obligation to decide the matter according to legal considerations. Furthermore, given that it is action by the Executive Directors that is most often in dispute, this system provides little remedy at all for the situation. In fact, the provision... represents a fundamental departure from the "rule of law"—a basic premise of which is that executive actions should be subject to review by an independent judicial process.²⁰¹

Related to this issue of interpretation is the issue of judicial review. As Professor Bradlow has expressed it, the IMF "has not established any mechanism through which the citizens of its consuming countries can hold the IMF or its management accountable for their actions as decision makers" in helping develop policies in those countries.²⁰² This issue has now been addressed to some extent by the establishment of the Independent Evaluation Office, discussed below in subsection IIIC.²⁰³

To summarize: Of the four main criticisms that have been leveled most strenuously at the IMF in the context of the Asian Financial Crisis, I find three of them unpersuasive. The first one—the "bad medicine" criticism—falls short because it is impossible (in my view) to prove

¹⁹⁹ See *infra* text accompanying notes 247.

²⁰⁰ Article XXIX of the IMF Charter provides that "[a]ny question of interpretation of the provisions of this Agreement . . . shall be submitted to the Executive Board for its decision" and may then, if a member country so requests, "be referred to the Board of Governors, whose decision shall be final". I.M.F. Charter art. 29.

²⁰¹ Antony Anghie, *Time Present and Time Past: Globalization, International Financial Institutions, and the Third World*, 32 N.Y.U. J. INT'L L. & POL'Y 243, 270–71 (2000). Although the specific provision to which Anghie refers is Article IX(a) of the charter of the International Bank for Reconstruction and Development (IBRD), that provision is virtually identical to Article XXIX of the IMF Charter, and Anghie makes it clear that he intends for his comments to apply both to the IBRD and to the IMF.

²⁰² Bradlow, *Rapidly Changing*, *supra* note 191, at 156.

²⁰³ See *infra* text accompanying note 221.

causation and moral hazard. The second one—the “distributional and social injustice” criticism—falls short because it overstates the IMF’s actual influence over the actual implementation of government policies. The third one—the “secrecy and opaqueness” criticism—falls short because the IMF was, in my view, adequately transparent in 1997. Moreover, as I shall discuss in the last portion of this section III, the IMF has in fact taken numerous steps since 1997 to improve its operations in several ways that relate to each of these first three criticisms. I find the fourth criticism—the “democracy deficit” criticism—persuasive. The IMF was in 1997, and remains today, plagued by a legal regime that lacks proper accountability and that therefore engenders mistrust and risks complete repudiation. It can, in my view, retain (or regain) legitimacy and effectiveness only by proceeding urgently with legal and institutional reform—a topic to which I now turn.

C. *Legal and Institutional Changes*

In subsection IIIC1 below, I look at a number of recent reforms that have been undertaken by the IMF in the dozen years since the Asian financial crisis erupted in 1997. Then in subsection IIIC2 I describe some new reforms now underway. As will become clear there, much of the impetus for these new reforms has come from the global financial crisis of 2008-2009, particularly following initiatives taken by the Group of Twenty (“G-20”).

i. Recent IMF Reforms — 1997–2008

The reforms that the IMF has undertaken in the years following the Asian Financial Crisis can be divided into (i) reforms in IMF operations and (ii) reforms in IMF accountability

and governance. In the following paragraphs I identify several major operational reforms before turning to reforms in accountability and governance.

One change in IMF operations—designed specifically to address the sort of “contagion” issues that arose so dangerously in the context of the Asian financial crisis—is the establishment in 1999 of a new source of financing called the Contingent Credit Line (“CCL”). The CCL was designed to provide a means by which the IMF could provide a member country that is pursuing strong economic policies an opportunity to obtain financing on a short-term basis when faced by a sudden and disruptive loss of market confidence because of contagion from difficulties in other countries.²⁰⁴ Although the CCL expired in 2003, a new instrument designed to serve similar purposes has been established recently. That facility, called the Flexible Credit Line (“FCL”) also aims to help countries with very strong fundamentals, policies, and track records of policy implementation—and, like the CCL, the FCL is particularly useful for crisis prevention purposes. Access to financing under the FCL is determined on a case-by-case basis, is not subject to the normal access limits, and is available in a single up-front disbursement rather than phased. In addition, disbursements under the FCL are not conditioned on implementation of specific policy understandings, as is the case under certain other types of IMF financing. Moreover, there is flexibility to draw on the credit line at the time it is approved, or the country may treat it as precautionary.²⁰⁵ In short, the IMF has put in place new forms of lending that can guard against some of the worst aspects of financial crises.

²⁰⁴ See Head, LOSING, *supra* note 154, at 108. See also HEAD, FUTURE, *supra* note 180, at 24–25.

²⁰⁵ See International Monetary Fund, *IMF Lending Factsheet*, <http://www.imf.org/external/np/exr/facts/howlend.htm> (last visited Mar. 15, 2010). Mexico entered into an FCL arrangement in April 2009, and announced at the time that it intended to treat the arrangement as precautionary and did not intend to draw on the line of credit. See Press Release, International Monetary Fund, IMF Executive Board Approves US\$47 Billion Arrangement for Mexico Under the Flexible Credit Line (Apr. 17, 2009).

Another change in IMF operations came in 2005 when the IMF introduced a new kind of instrument—Policy Support Instruments—designed for low-income countries that do not currently need or want IMF financing but do wish to have IMF endorsement of their economic and financial policies, and to provide advice and monitoring in connection with those policies. If a country agrees with the IMF on such a Policy Support Instrument, this will serve as a signal to potential donors and to the financial markets that the country’s policies have been discussed with the IMF; this can, in turn, help a country boost its international reputation for financial prudence, and hence its ability to obtain financing on attractive terms.²⁰⁶

Related to these initiatives aimed specifically at crisis prevention are two other recent operational changes undertaken by the IMF. Since 2006 the IMF has started engaging in multilateral consultations—the first one involved the Euro Area, Japan, Saudi Arabia, and the U.S.A.—focusing on how global imbalances can be addressed while robust global growth is maintained.²⁰⁷ More fundamentally still, changes were put in place in 2006 for more intensive economic surveillance at both the country level and the regional level. As components of the new “Medium-Term Strategy” introduced by former Managing Director Rodrigo de Rato, these changes are aimed at doing more to identify and promote effective responses to threats to economic stability. Moreover, a new model, the “Global Economy Model” was developed and launched by the IMF in 2004 to provide a better instrument for evaluating the effectiveness of various national economic and financial policies.²⁰⁸

²⁰⁶ See HEAD, LOSING, *supra* note 154, at 113. See also International Monetary Fund, *The Policy Support Instrument Factsheet* (Nov. 2008), available at <http://www.imf.org/external/np/exr/facts/psi.htm>.

²⁰⁷ See International Monetary Fund, *The Multilateral Consultation on Global Imbalances Factsheet*, <http://www.imf.org/external/np/exr/ib/2007/041807.htm> (last visited Mar. 15, 2010).

²⁰⁸ See HEAD, LOSING, *supra* note 154, at 180. See also International Monetary Fund, *GEM: A New International Macroeconomic Model* (January 2004), <http://www.imf.org/external/np/res/gem/2004/eng/012304.pdf>.

Another major change in IMF operations came in 2002 with the adoption of new guidelines on conditionality. The new guidelines on conditionality, replacing a set that had been in place since 1979, were designed to reflect four principles: (i) the need to enhance the borrowing country's "ownership" of the policy reforms, (ii) the need to reduce the number of conditions, (iii) the need to tailor the policy programs (and hence the content of the conditionalities) more closely to the borrowing country's circumstances, and (iv) the need to improve clarity in the specification of conditions.²⁰⁹

Another form of operational reform in the IMF—this one responding to the "distributional and social injustice" criticism summarized above²¹⁰—revolves around a set of steps the IMF has taken in recent years to give special attention to the social aspects of a country's well-being. In urging governments to provide such protections, the IMF has advanced the view (in one of its numerous "social dimensions" publications) that one of the elements in a strategy of high-quality growth for a country is "sound social policies, including social safety nets to protect the poor during the period of economic reform, cost-effective basic social expenditures, and employment-generating labor market policies."²¹¹ Likewise, in its 2003 annual report, the IMF offered this description of how social issues bear on its operations:

The IMF is committed to integrating poverty and social impact analysis in programs supported by lending under the [IMF's Poverty Reduction and Growth Facility]. The purpose of this analysis is to assess the implications of key policy measures on the well-being of different social groups, especially the vulnerable and the poor.

²⁰⁹ See IMF GUIDELINES ON CONDITIONALITY, Sept. 25, 2002, <http://www.imf.org/External/np/pdr/cond/2002/eng/guid/092302.htm>. The changes in the IMF conditionality guidelines were praised by Allan Meltzer, the chairman of the commission that in 2000 voiced strenuous criticisms at the IMF. See Allan H. Meltzer, *The IFIAC Report: Comments on the Critics*, in *THE IMF AND ITS CRITICS: REFORM OF GLOBAL FINANCIAL ARCHITECTURE* 106, 122 (David Vines & Christopher L. Gilbert eds., 2004).

²¹⁰ See *supra* text accompanying note 155.

²¹¹ INT'L MONETARY FUND, PAMPHLET NO. 47 SOCIAL DIMENSIONS OF THE IMF'S POLICY DIALOGUE 1 (1995).

When analysis indicates that a particular measure (for example, currency devaluation) may harm the poor, the impact is addressed through the choice or timing of policies, the development of countervailing measures, or social safety nets.²¹²

That same report listed some of the safety nets built into IMF-supported programs: “subsidies or cash compensation for particularly vulnerable groups; improved distribution of essential commodities, such as medicines; temporary price controls on some essential commodities; severance pay and retraining for public sector employees who have lost their jobs; and employment through public works programs.”²¹³

The evidence offered above demonstrating the attention that the IMF now pays to social issues and distributional fairness is supplemented further, of course, by the IMF’s several lending mechanisms aimed directly at economically disadvantaged countries. Just after the Asian Financial Crisis, the IMF’s Poverty Reduction and Growth Facility (“PRGF”), designed to provide low-cost loans to poor countries, was created (from older programs created after the 1982 debt crisis); and it was later supplemented in 2005 with the Exogenous Shocks Facility (“ESF”)—also aimed expressly at low-income countries. These two facilities, both of which lend at 0.5 percent interest rate, can be summarized in this way²¹⁴:

²¹² INT’L MONETARY FUND, ANNUAL REPORT 2003 44 (2003) [hereinafter IMF Annual Report 2003]. The report goes on to list some of the safety nets built into IMF-supported programs: “subsidies or cash compensation for particularly vulnerable groups; improved distribution of essential commodities, such as medicines; temporary price controls on some essential commodities; severance pay and retraining for public sector employees who have lost their jobs; and employment through public works programs.” *Id.* For a couple of decades, numerous IMF-supported programs have been designed to provide specific protections for the poorest consumers and workers in borrowing member countries. Details on these are available in numerous IMF publications and website entries, as well as in HEAD, LOSING, *supra* note 154, at 82–83. For further information about IMF policies in this regard, see generally International Monetary Fund, *Poverty and Social Impact Analysis of Economic Policies Factsheet* (Apr. 2008), <http://www.imf.org/external/np/exr/facts/sia.htm>. For a discussion of issues relating to distributional justice, undertaken immediately after the outbreak of the Asian financial crisis, see generally IMF FISCAL AFFAIRS DEPARTMENT, SHOULD EQUITY BE A GOAL OF ECONOMIC POLICY?, 16 ECON. ISSUES (1998). It is perhaps worth noting that IMF attention to such issues dates back even a decade earlier. See generally Peter S. Heller, A. Lans Bovenberg, Thanos Catsambas, Ke-Young Chu, and Parthasarathi Shome, IMF Occasional Paper Series No. 58, *The Implications of Fund-Supported Adjustment Programs for Poverty* (1988).

²¹³ IMF Annual Report 2003, *supra* note 212, at 44.

²¹⁴ This summary is drawn from HEAD, LOSING, *supra* note 154, at 110. See also International Monetary Fund, *IMF Lending Factsheet* (Sept. 9, 2009), <http://www.imf.org/external/np/exr/facts/howlend.htm>.

- *Poverty Reduction and Growth Facility (1999)* – to provide longer-term assistance for deep-seated, structural balance of payments difficulties; aims at sustained, poverty-reducing growth.
- *Exogenous Shocks Facility (2005)* – to provide policy support and finance assistance to low-income countries facing exogenous shocks (commodity price changes, trade disruptions from neighboring country, etc.); available to countries eligible for the PRGF but without a PRGF-supported program in place.

In 2009 the IMF announced that these two facilities would be further enhanced in order to provide additional support for low-income member. I explain these very recent changes in subsection IIIC2 below, in my discussion of the “reactivation” of the IMF.

In yet another operational change designed to address the “distributional and social injustice” criticism—in addition, that is, to the establishment of these funding techniques designed to provide special favorable terms for low-income borrowing countries—the IMF has also helped create and implement the Multilateral Debt Relief Initiative aimed at canceling debt claims that the IMF holds on certain countries. As of 2006, the IMF had already canceled the debts owed to it by 19 poor countries.²¹⁵ Another special program for poor countries is the Heavily Indebted Poor Countries (“HIPC”) initiative, under which the international financial community reduces the overall external debt of the most heavily indebted poor countries.²¹⁶

In sum, in the dozen years since the Asian Financial Crisis erupted, the IMF has implemented some major reforms that increase its capacity to respond to crisis situations in a way that takes social and distributional justice issues into account. Although there is, as I have emphasized in another context, considerably more that could be done,²¹⁷ the IMF has already put in place an impressive array reforms in this respect.

²¹⁵ See HEAD, LOSING, *supra* note 154, at 116. The figure as of mid-2009 is 26 poor countries. See International Monetary Fund, *The Multilateral Debt Relief Initiative Factsheet* (June 2009), <http://www.imf.org/external/np/exr/facts/mdri.htm>.

²¹⁶ See International Monetary Fund, *Debt Relief Under the HPIC Initiative Factsheet* (Sept. 2009), <http://www.imf.org/external/np/exr/facts/mdri.htm>. The HIPC was created in 1996. *Id.*

²¹⁷ I have offered specific suggestions that would, if adopted by the IMF, give it a wider role in insisting

Another reform in IMF operations warrants some mention. This reform responds to the “secrecy and opaqueness” criticism mentioned above.²¹⁸ Especially in the last decade, the IMF has undertaken an impressive campaign to provide more information on its operations.²¹⁹ For one thing, the reports of nearly all Article IV consultations—that is, the consultations that the IMF holds annually (under the auspices of Article IV of the IMF Charter) with each of its member countries regarding economic and financial developments—are now made publicly available on the IMF’s website. Likewise, the letters of intent and associated documentation relating to stand-by arrangements and other IMF lending operations also are now made public. (Indeed, according to a recent entry on the IMF’s website, 95 percent of members now choose to release their letters to the IMF regarding their requests for use of IMF resources.) Similarly, three-quarters of all stand-alone reports on IMF-supported programs were published in the half-decade starting in 2001, with the pace of those releases increasing over time. The IMF now posts information on its website about each member’s financial position with the IMF, quarterly IMF financial statements, and other information about administrative and operational aspects of the IMF.

Having summarized several *operational* reforms undertaken by the IMF in recent years, let me turn now to some reforms in the IMF’s *accountability and governance* that had already been undertaken before the most recent global financial crisis of 2008-2009 erupted. These reforms reflect the IMF’s response to the “democracy deficit” criticism that I summarized

that its member countries recognize and protect human rights. See HEAD, LOSING, *supra* note 154, at 203, 297 (urging linkage of IMF operations with obligations of its members to implement certain treaties, including human rights treaties).

²¹⁸ See *supra* text accompanying note 155.

²¹⁹ Details in the remainder of this paragraph are drawn from HEAD, FUTURE, *supra* note 180, at 76–77 and HEAD, LOSING, *supra* note 154, at 229.

above,²²⁰ and by reviewing them here we might arrive at an assessment of whether the IMF has yet taken steps to address that criticism satisfactorily. As I indicated above, I think it has not—but I also believe the trajectory of change within the IMF offers some hope that it will do so in the future.

A first initiative regarding accountability and governance is the IMF's establishment in July 2001 of an Independent Evaluation Office ("IEO") in order "to conduct objective and independent assessments of issues of relevance to the mandate of the IMF."²²¹ The IEO has already undertaken several evaluation projects, including assessments of (i) the IMF's role in the economic crises in Brazil, Indonesia, and Korea, (ii) the IMF's role in Argentina, (iii) the effectiveness of the IMF's Poverty Reduction and Growth Facility (by which it makes low-cost loans to poor countries), (iv) IMF technical assistance, (v) the IMF's approach to capital account liberalization, and (vi) IMF initiatives in the area of corporate governance. One of its most recent evaluation efforts focuses on the governance of the IMF—a matter that I shall elaborate on below. In 2006, the IMF's Executive Board reviewed an external assessment of the IEO itself (a so-called "evaluation of the evaluators") and decided to continue the IEO in operation with no major changes.

²²⁰ See *supra* text accompanying note 155.

²²¹ IMF Annual Report 2003, *supra* note 212, at 60. For further information about the IEO's history, purpose, structure, and operations (including its official terms of reference), see materials available at <http://www.ieso-imf.org/about/> (last visited Mar. 15, 2010), including IEO annual reports. For some views on the IEO, see generally four short articles by (respectively) an academic, two former IMF Executive Directors, and a senior official of the NGO Friends of the Earth: Peter B. Kenen, *Appraising the IMF's Performance*, FIN. & DEV., 41 (Sept. 2004); Karin Lissakers, *Blunt Approach Does the Trick*, FIN. & DEV. 46 (Sept. 2004); Jean-Claude Milleron, *Enhancing the Learning Culture*, FIN. & DEV. 48 (Sept. 2004); Carol Welch, *Credible Start, Untested Impact*, FIN. & DEV. 50 (Sept. 2004). Some of the IEO's reports have criticized IMF operations. A March 2007 report, for example, found "ambiguity and confusion" about the IMF's policies and practices in its work in sub-Saharan Africa. A more recent report, also critical of IMF operations, found that the IMF needed to "play a larger and more considered role" in three areas: whether and how countries should liberalize trade in financial services, the systemic implications of the proliferation of preferential trade agreements, and the global effects of trade policies in systemically important countries. *Progress Report on the Activities of the Independent Evaluation Office (IEO)* (Oct. 2, 2009), available at <http://www.imf.org/external/np/pp/eng/2009/100209.pdf>.

Although it is too early to assess the long-term impact of the IEO's work, its very creation does signal a willingness on the part of the IMF to provide increased public accountability. In its current formulation, the IEO is largely an internal organ of the IMF, given the fact that the Director of the IEO is appointed by the IMF Executive Board, may be dismissed at any time by the Executive Board, hires other IEO officers on terms and conditions determined by the Board, depends on the Executive Board for budgetary funding, and reports to the Board.²²² Although the IEO's terms of reference call for it to "be independent of Fund management and staff"²²³—a requirement that is given some force by (i) requiring that a majority of IEO personnel come from outside the IMF and (ii) prohibiting the IEO Director from being appointed to a regular IMF staff position at the end of his or her term of office—the IEO nevertheless falls short of being an external organ broadly representative in character, empowered to exercise a fully objective review of IMF operations and to issue binding orders if it judges those operations to be improper or *ultra vires*. It is, however, a start toward a form of "judicial review" of IMF operations.

A second recent IMF initiative—or, more precisely, a cluster of related initiatives—to increase the institution's accountability to the citizens of IMF borrowing member countries centers on the notion of "voice".²²⁴ In order to increase the "voice" (notwithstanding the tiny voting strengths) of many member governments in IMF deliberations, steps were taken in 1999 to give broader authority to the IMF's International Monetary and Financial Committee, which is a group of 24 Governors that gathers twice a year to provide policy oversight to the Executive

²²² For specific citations to sources relied on in this paragraph, including pertinent provisions in the regulations governing the IEO, see HEAD, FUTURE, *supra* note 180, at 86–87.

²²³ *See id.* (citing a 2003 annual report of the IEO).

²²⁴ The account in this paragraph and the following paragraph is drawn from HEAD, LOSING, *supra* note 154, at 237–38.

Board. The aim of this was to provide “greater direct involvement of governments in the policy-making process within the Fund.”²²⁵

In a similar effort to strengthen the “voice” of developing countries, and of non-government entities and individuals within those countries, the IMF’s Executive Board has continued to develop the IMF’s Poverty Reduction Strategy Paper (“PRSP”) process, introduced in 1999, by which written plans for reducing poverty are prepared by low-income countries through a participatory process involving domestic stakeholders and external development partners. Moreover, as yet another effort to strengthen the “voice” of the most thinly-represented countries, the IMF’s Executive Board is undertaking efforts to address staffing and technological constraints of the two sub-Saharan African constituencies on the Executive Board.

In addition to these various initiatives to increase the “voice” of some of its smaller member countries, the IMF has also begun to make changes in the distribution of voting power. Although the weighted voting system itself is still in place, a first round of adjustments was made in 2006 to increase, on an *ad hoc* basis, the quotas (and therefore voting power) of four member countries: China, Korea, Mexico, and Turkey.²²⁶

²²⁵ François Gianviti, *The Reform of the International Monetary Fund (Conditionality and Surveillance)*, 34 INT’L L. 107, 115 (2000).

²²⁶ An IMF “Factsheet” issued in September 2009 (and available on the IMF website) reports as follows regarding the portion of the Medium-Term Strategy that relates to quotas and voting power:

On April 28, 2008, a large-scale quota and voice reform in the making for nearly two years was adopted by a large margin by the Board of Governors of the IMF. It aims to make quotas more responsive to economic realities by increasing the representation of fast-growing economies and at the same time giving low-income countries more say in the IMF’s decision making. The reform builds on an initial step agreed by the IMF’s membership in September 2006 to have ad hoc quota increases for four countries—China, Korea, Mexico, and Turkey.

See International Monetary Fund, *IMF Quotas Factsheet* (Oct. 31, 2009), <http://www.imf.org/external/np/exr/facts/quotas.htm>. For information on the Board of Governors resolution of April 2007 requesting work on a Charter amendment, see Press Release, International Monetary Fund, IMF Board of Governors Approves Quota and Related Governance Reforms, No. 06/205 (Sept. 18, 2006), available at <http://www.imf.org/external/np/sec/pr/2006/pr06205.htm>. For a summary of the IMF’s medium-term strategy, see International Monetary Fund, *Setting a New Course, in IMF IN FOCUS 7* (Sept. 2006), available at www.imf.org/external/pubs/FT/survey/2006/090106.pdf. For details about the charter amendment currently under consideration, see *infra* note 243 and accompanying text.

ii. The IMF “Reactivation” Starting in 2008

I have offered above some details about reforms that have been undertaken in the IMF in recent years—in terms of both the IMF’s operations and its accountability and governance. Many of those reforms have been in process for several years. More recently, a new set of reforms have been initiated, partly at the urging of the G-20 in its meetings in Washington, DC (November 2008), London (April 2009), and Pittsburgh (September 2009).²²⁷ Indeed, it is clear from various G-20 actions and communiqués that the IMF has been called on to take a leading role in addressing the current global financial crisis, nurturing a recovery from that crisis, and reducing the chances of a recurrence.²²⁸ I refer to this as the “reactivation” of the IMF.

It is worth noting that this “reactivation” has come on the heels of a period in which the IMF had in fact become substantially less active—so much so that it was scrambling as recently as the beginning of 2007 to find means of generating income to cover its operating expenses in the wake of a substantial drop in its lending volumes.²²⁹ Now the IMF’s lending volumes have shot skyward again: for example, the loans made available to members out of the IMF’s General Resources Account increased from about SDR1 billion in 2007 to over SDR13 billion in 2008, and already stood at nearly SDR17.7 billion for just the first three quarters of 2009.²³⁰ Large

²²⁷ For the declaration emerging from the G-20 meeting in Washington, see *Declaration: Summit on Financial Markets and the World Economy* (Nov. 15, 2008), available at http://www.g20.org/Documents/g20_summit_declaration.pdf. For the G-20 London Communiqué, see *The Global Plan for Recovery and Reform* (Apr. 2, 2009) [hereinafter G-20 London Communiqué], available at <http://www.g20.org/Documents/final-communicue.pdf>. For the declaration emerging from the G-20 meeting in Pittsburgh, see *Leader’s Statement: The Pittsburgh Summit* (Sept. 24-25, 2009), available at http://www.g20.org/Documents/pittsburgh_summit_leaders_statement_250909.pdf.

²²⁸ See *Global Economic Crisis: G-20 Reaffirms IMF’s Central Role in Combating Crisis*, in IMF SURVEY MAGAZINE: In the News (Apr. 3, 2009) available at <http://www.imf.org/external/pubs/ft/survey/so/2009/NEW040309A.htm>.

²²⁹ See HEAD, LOSING, *supra* note 154, at 116 (explaining that the drop in lending necessitated a call for proposals from a “Committee of Eminent Persons” as to how the IMF could meet its institutional funding needs).

²³⁰ See International Monetary Fund, *IMF Financial Activities – Update October 1, 2009*, available at <http://www.imf.org/external/np/tre/activity/2009/100109.htm#tab1>.

(sometimes massive) IMF loan commitments have been made since November 2008 to Iceland, Hungary, Mexico, Bosnia & Herzegovina, Serbia, Romania, Pakistan, Ukraine, Sri Lanka, Latvia, Belarus, and Colombia.²³¹

It seems that the IMF intends for this increased lending volume to continue: in April 2009, for example, the IMF doubled the “access limits”—that is, the amount of funds a country can borrow from the IMF—for its poorest member countries.²³² Indeed, an extensive reformulation and expansion of IMF lending to low-income countries, planned for implementation in late 2009, has been undertaken in response to the current global financial crisis. The changes involve the use of a trust—the Poverty Reduction and Growth Trust—which itself will have three facilities. The new regime for aiding low-income countries has been described this way:

To make its financial support more flexible and tailored to the diversity of low-income countries, the IMF has established a new Poverty Reduction and Growth Trust, which has three new lending windows. The new windows, which are expected to become effective later in 2009 when donor countries have given their final consent, are [1] The Extended Credit Facility (ECF), which replaces the Poverty Reduction and Growth Facility (PRGF). The ECF provides sustained engagement in case of medium-term balance of payments needs, should be based on a country’s own poverty reduction strategy, and offers more flexible timing requirements than the PRGF for countries to produce a formal poverty reduction strategy document. [2] The Standby Credit Facility (SCF), replacing the Exogenous Shocks Facility’s High Access Component, is similar to the Stand-By Arrangement for middle-income countries. The SCF provides flexible support to low-income countries with short-term financing and adjustment needs caused by domestic or external shocks, or policy slippages, targets countries that no longer face protracted balance of payments problems but may need help from time to time, and can also be used on a precautionary basis to provide insurance. [3] The Rapid Credit Facility (RCF), which provides limited financial support in a single, up-front payout for low-income countries facing urgent financing needs, substitutes for a regular IMF loan when use of the other two facilities, which

²³¹ For information on current IMF lending, see International Monetary Fund, *IMF Lending at a Glance*, available at <http://www.imf.org/external/np/exr/map/lending/index.htm> (last visited Mar. 15, 2010).

²³² See Press Release, International Monetary Fund, IMF Executive Board Approves Doubling of Borrowing Limits for Poorest Countries, No. 09/138 (Apr. 23, 2009), available at <http://www.imf.org/external/np/sec/pr/2009/pr09138.htm>.

involve one- to three-year policy programs, is either not necessary or not possible, and offers highly flexible financing that provides single-use loans that replace the Exogenous Shocks Facility's Rapid Access Component and the subsidized Emergency Natural Disaster Assistance; and offers successive drawings for countries in post-conflict or other fragile situations, replacing and expanding subsidized Emergency Post-Conflict Assistance.

For policy advice and signaling to donors, countries can request non-financial assistance under the existing Policy Support Instrument (PSI), which supports low-income countries that have secured macroeconomic stability and thus do not need IMF financial assistance, and can provide accelerated access to the new SCF in case of subsequent financial needs.

Low-income countries will receive exceptional forgiveness through end-2011 on all interest payments due to the IMF under its concessional lending instruments.

Increased IMF financial support for low-income countries has been joined by changes in the design and assembly of the agreed policy packages—called programs—that accompany IMF loans. These changes aim to strengthen the focus on supporting poverty alleviation and growth, for all these programs, protect public spending even as economic downswings cut revenues, prioritize national budgets in the direction of spending targeted at the poor, and focus loan conditions on critical areas, such as transparent management of public resources.²³³

These changes aimed at low-income countries supplement a major overhaul of the IMF's lending practices, announced in April 2009, that also includes the following other elements:²³⁴

Making further changes to IMF conditionality, to depart from the old practice, under which the IMF now says loans “often had too many conditions that were insufficiently focused on core objectives;”²³⁵

Introducing of the Flexible Credit Line described above, thereby giving qualified countries access to IMF funding with “[n]o hard cap on access to [IMF] resources”²³⁶ and with longer repayment periods than in the earlier Supplemental Reserve Facility;

²³³ International Monetary Fund, *IMF Support for Low-Income Countries Factsheet* (July 29, 2009), <http://www.imf.org/external/np/exr/facts/poor.htm>.

²³⁴ See International Monetary Fund, *IMF Implements Major Lending Policy Improvements* (Mar. 24, 2009) [hereinafter *IMF 2009 Lending Improvements*], available at <http://www.imf.org/external/np/pdr/fac/2009/032409.htm>. All quoted passages in the following bullet-points are drawn from that source.

²³⁵ *Id.*

²³⁶ *Id.*

Enhancing the flexibility of the IMF's regular stand-by arrangements, by permitting more front-end access to funds and reducing the frequency of reviews of a country's performance;

Continuing to allow countries to exceed the regular access limits—even after the doubling of the access limits noted above—under so-called Exceptional Access procedures; and

Eliminating the “time-based repurchase expectations policy”²³⁷ under which countries were requested to make repayment before actually being required to do so—with the ultimate effect of lengthening grace periods applicable to certain IMF loans.

In order to attain the increased lending volume that these various reforms envision, of course, the IMF has had to find new resources. As noted above, the G-20 called for a tripling of the IMF's borrowed resources.²³⁸ Moreover, in September 2009, the People's Republic of China agreed to purchase IMF notes in an amount of U.S. \$50 billion in order to expand the IMF's lending capacity.²³⁹ This came after an agreement that the IMF concluded with Japan in February 2009 under which Japan committed to lend the IMF up to U.S. \$100 billion as a measure to help overcome the global financial crisis.²⁴⁰ The European Union also has committed €75 billion for this purpose.²⁴¹

In addition, the IMF responded to the G-20's call to create another \$250 billion in SDRs.²⁴² The IMF allocated these in August 2009.²⁴³

The dramatic “reactivation” of the IMF described above involves not only operational elements—changing policies, increasing access limits, and so forth—but also elements relating

²³⁷ *Id.*

²³⁸ See G-20 London Communiqué, *supra* note 227.

²³⁹ See Press Release, International Monetary Fund, IMF Signs US \$50 Billion Note Purchase Agreement with China, No. 09/293 (Sept. 2, 2009), available at <http://www.imf.org/external/np/sec/pr/2009/pr09293.htm>.

²⁴⁰ See International Monetary Fund, *How to Increase the IMF's Lendable Resources Factsheet* (Apr. 2009), <http://www.imf.org/external/np/exr/facts/imfresources.htm>.

²⁴¹ See IMF Lending Improvements, *supra* note 234.

²⁴² See G-20 London Communiqué, *supra* note 227.

²⁴³ See C. Fred Bergsten, *The Dollar and the Deficits: How Washington Can Prevent the New Crisis*, 88 FOREIGN AFF. 20, 27 (Nov.-Dec. 2009). Bergsten states that “[t]his took SDRs' share of global reserves from a previous level of under one percent to about five percent.” *Id.*

to the institution's legitimacy. I have summarized above certain changes made in recent years in IMF accountability and governance, including the recent increase in voting power of China, Korea, Mexico, and Turkey. Even more significant change in the distribution of votes is currently in process. The following list shows the "top ten winners" and the "top ten losers" of voting power following a proposed second round of *ad hoc* adjustments:²⁴⁴

Increased:

- China: increase by 0.88 percentage points, to a 3.81 percent share of total voting power.
- Korea: increase by 0.61 percentage points, to a 1.36 percent share of total voting power.
- India: increase by 0.42 percentage points, to a 2.34 percent share of total voting power.
- Brazil: increase by 0.31 percentage points, to a 1.72 percent share of total voting power.
- Mexico: increase by 0.27 percentage points, to a 1.47 percent share of total voting power.
- Spain: increase by 0.22 percentage points, to a 1.63 percent share of total voting power.
- Singapore: increase by 0.18 percentage points, to a 0.59 percent share of total voting power.
- Turkey: increase by 0.15 percentage points, to a 0.61 percent share of total voting power.
- Ireland: increase by 0.13 percentage points, to a 0.53 percent share of total voting power.

²⁴⁴ See Press Release, International Monetary Fund, IMF Executive Board Recommends Reforms to Overhaul Quota and Voice, No. 08/64 (Mar. 28, 2008) [hereinafter Quota Recommendation] *available at* <http://www.imf.org/external/np/sec/pr/2008/pr0864.htm>. In describing this second round of adjustments, the IMF explained that its goal was "to enhance representation for dynamic economies, many of which are emerging market economies, whose weight and role in the global economy have increased." *Id.*

- Japan: increase by 0.12 percentage points, to a 6.23 percent share of total voting power.

Decreased:

- United Kingdom: decrease by 0.64 percentage points, to a 4.29 percent share of total voting power.
- France: decrease by 0.64 percentage points, to a 4.29 percent share of total voting power.
- Saudi Arabia: decrease by 0.41 percentage points, to a 2.80 percent share of total voting power.
- Canada: decrease by 0.37 percentage points, to a 2.56 percent share of total voting power.
- Russia: decrease by 0.35 percentage points, to a 2.39 percent share of total voting power.
- Netherlands: decrease by 0.30 percentage points, to a 2.08 percent share of total voting power.
- U.S.A.: decrease by 0.29 percentage points, to a 16.73 percent share of total voting power.
- Belgium: decrease by 0.26 percentage points, to a 1.86 percent share of total voting power.
- Switzerland: decrease by 0.19 percentage points, to a 1.40 percent share of total voting power.
- Australia: decrease by 0.18 percentage points, to a 1.31 percent share of total voting power.

Another proposed move is to increase the number of “basic votes” for all member countries, so as to increase the relative voting power of the IMF’s smaller members.²⁴⁵ This will require an amendment to the IMF Charter, a process that is currently underway.²⁴⁶ Indeed, as of

²⁴⁵ For an explanation of “basic votes”, and the effect of increasing them—a move that several observers have urged for years—see HEAD, FUTURE, *supra* note 154, at 89.

²⁴⁶ The text of the proposed amendment itself can be found in Appendix II to the pertinent report of the IMF Executive Board to the IMF Board of Governors. See International Monetary Fund, *Reform of Quota and*

late September 2009, 38 member countries—including all of the G-7 countries except Italy—had already voted in favor of this Charter amendment.²⁴⁷ The amendment would also authorize “an Executive Director elected by more than a specified number of members to appoint two Alternates.”²⁴⁸ The immediate (and intended) effect of this latter change would be to increase the “voice” of the two Executive Directors’ offices representing African constituencies.²⁴⁹

The same trajectory of change—designed to respond to the “democracy deficit” criticism—is evident in another important area as well: selection of the IMF Managing Director. In a 2008 report acknowledging that gradual reforms that have taken place in the governance of the IMF “have not kept pace with changes in the environment in which it operates,”²⁵⁰ the IEO recommended that “[t]he selection process for the Managing Director should be reformed... Candidates’ qualifications and likely effectiveness should be the main criteria used in the selection, and the competition should be open to candidates of all nationalities.”²⁵¹ Similarly, a 2009 report of a Committee on IMF Governance Reform—an external group of experts appointed by the IMF Managing Director—called for “[t]he introduction of an open, transparent and merit-based system for the appointment of the Managing Director and Deputy Managing Directors.”²⁵²

Voice in the International Monetary Fund 28 (Mar. 28, 2008), available at <http://www.imf.org/external/pp/longres.aspx?id=4235> [hereinafter Reform of Quota and Voice]. The modified Charter provision on basic votes is formulated in a way that will permit basic votes to be increased as overall quote increases occur in the future, by prescribing that the basic votes of each member country “shall be the number of votes that results from the equal distribution among all the members of 5.502 percent of the aggregate sum of the total voting power of all the members, provided that there shall be no fractional basic votes.” *Id.*

²⁴⁷ See International Monetary Fund, *Consents to the Proposed Amendments of the Articles of Agreement* (updated Sept. 29, 2009), available at <http://www.imf.org/external/np/sec/misc/consents.htm>.

²⁴⁸ See Reform of Quota and Voice, *supra* note 246, at 23.

²⁴⁹ See Quota Recommendation, *supra* note 226.

²⁵⁰ Independent Evaluation Office of the International Monetary Fund, *Governance of the IMF: An Evaluation* (2008) [hereinafter IEO Governance Report], available at http://www.ieo.imf.org/eval/complete/eval_05212008.html.

²⁵¹ *Id.* at para. 84.

²⁵² Committee on IMF Governance Reform, *Final Report* 4 (Mar. 24, 2009) [hereinafter Experts

It is worth noting that the 2008 and 2009 reports and recommendations go much further than recommending a change in the process for selection of the Managing Director. Both reports also urge sweeping changes in other aspects of IMF governance as well. These include (i) the activation of the Council of Ministers (as provided for in the IMF Charter but not used yet) “as the ultimate decision-making body for the IMF,” (ii) the reorientation of the Executive Board’s activities away from day-to-day operational activities toward a supervisory role, and (iii) the “lowering of the voting threshold on critical decisions from 85 percent to 70-75 percent, and consideration given to extending double majorities to a wider range of decisions” so as to ensure support of those decisions by most members.²⁵³

The precise outcome of these initiatives, which have been strongly urged but not yet set in stone, will reveal how serious the IMF—or more precisely, the handful of most powerful IMF members—really is about responding to the “democracy deficit” criticism and thereby gaining legitimacy to help the IMF meet the challenges that have been given to it in the context of the global financial crisis of 2008-2009. My own impression is that the changes *already made*, as described above in subsection IIIC1, are not adequate in that regard. Whether the changes *now under process*—as described in this subsection IIIC2—are adequate or not remains to be seen.

IV. SUMMING UP: THE ASIAN FINANCIAL CRISIS IN RETROSPECT

At the beginning of this article I offered two reasons for looking back now at the Asian Financial Crisis. First, I suggested that there should be some accounting for where responsibility lies for a crisis that brought deep distress to so many people. Second, I urged that there should

Governance Report], available at <http://www.imf.org/external/np/omd/2009/govref/032409.pdf>.

²⁵³ The first two of these recommendations appear in the IEO Governance Report, *supra* note 250, at Foreword. All three appear in the Experts Governance Report, *supra* note 252, at 3–4.

be some effort on our part to help avoid such crises in the future, or to lessen their impact if they do occur. In these closing paragraphs I wish to address these two points—that is, both accountability for the past and prescriptions for the future. I shall do so by enumerating, in brief, what lessons I believe the Asian Financial Crisis offers to us today—especially in the context of the current global financial crisis—and then by evaluating how well we seem to have learned those lessons. In doing so, I shall give special attention to the international legal and institutional regime (including particularly the IMF) that has some responsibility for the global economic system.

A. *Lessons Offered*

Drawing from the accounts given above of how the Asian Financial Crisis unfolded, I would suggest these key “lessons offered”:

i. Lesson #1 – National Financial Regulation

National agencies responsible for regulation of the financial system should do a dramatically better job in guarding against the following types of behavior in the financial institutions under their supervision—their failure to do so contributed to the Asian Financial Crisis.

- Connected lending
- Concentrated lending
- Political influence in banking decisions (as through an overly cozy *chaebol*-like relationship)
- Political influence in central banking operations (or in the operations of the government agency other than the central bank that engages in banking supervision)

- Capital inadequacy in individual financial institutions
- Concentration of banks into institutions that are “too big to fail”
- Slow or sloppy handling of troubled or insolvent banks²⁵⁴
- Systemic risk
- Cross-border contagion

ii. Lesson #2 – Other National Economic Policies

National government authorities should also be much more careful and competent in setting and implementing the following types of policies—their failure to do so contributed to the Asian Financial Crisis.

- Monetary policy—to stem currency depreciation
- Exchange rate policy—to avoid, for example, unrealistic currency pegs
- Foreign investment liberalization and trade liberalization—to guard against allowing liberalization of policies (and sophistication of transactions) that outpace the ability of a country's legal and regulatory infrastructure to exercise adequate controls over such investment and trade

iii. Lesson #3 – International Institutions in General

At the international level, there must be procedures and institutions adequate to do the following, which were insufficiently attended to at the time of the Asian Financial Crisis.

- Pressure countries into taking the actions noted above in Lesson #1 and Lesson #2
- Identify systemic risks (within countries and regions) and risks of contagion (from one country or region to another) and take action to head them off

²⁵⁴ In this regard, I would suggest the rules and procedures explained in ROBERT LEE RAMSEY & JOHN W. HEAD, *PREVENTING FINANCIAL CHAOS: AN INTERNATIONAL GUIDE TO LEGAL RULES AND OPERATIONAL PROCEDURES FOR HANDLING INSOLVENT BANKS* (2000).

- Avoid "bad medicine" if possible—for example, be especially careful not to prescribe contractionary policies if doing so in the short run would exacerbate, rather than ease, a crisis if it comes

iv. Lesson #4 – The IMF’s Legitimacy

In order to establish the “adequate procedures and institutions” referred to above in Lesson #3, the IMF (or some other institution) will need to be given a new legitimacy—which I believe it lacked at the time of the Asian Financial Crisis—through a dramatic transformation of its structure of governance and accountability. This transformation should, in my view, include:

- All the changes recently made in the IMF, as well as those recently proposed, regarding basic votes, quota adjustments, selection of the Managing Director and Deputy Managing Directors, and realignment of the Executive Board's operations
- Additional changes, including (i) expanding both the jurisdiction and the independence of the IEO—perhaps along the lines of the World Bank Inspection Panel—and (ii) introducing mechanisms to ensure “symmetry in obligations”²⁵⁵ so that “supplier” member states of the IMF will suffer some consequences (such as a reduction or suspension of voting power) for failing to implement economic and financial policies prescribed by the IMF

v. Lesson #5 – The IMF’s Abiding Agility and Long-Term Leadership

There are certain “known unknowns” that will inevitably interfere with the effectiveness of any international response to a regional or global economic problem. Among these are political developments and other exogenous factors whose precise nature is unpredictable but whose emergence can be anticipated. A goal of the IMF, and of other international institutions, is to have enough agility to respond as well as possible in the circumstances that arise.

²⁵⁵ For an explanation of the notion of “symmetry in obligations”—that is, a symmetry between the (i) obligations shouldered by IMF member states that do borrow from it and (ii) obligations shouldered by IMF member states that do *not* borrow from it—see HEAD, LOSING, *supra* note 154, at 56, 266–68.

In addition, however, there are also certain “unknown unknowns” that will require not only agility but a willingness to undertake fundamental reform—conceptually and institutionally—whenever it is needed. The membership of the IMF (under a new, legitimized system) must ensure that the IMF is prepared to serve as the premier international forum and “host” for such reform—not just called on in time of crisis (as was done especially in 1982, 1997, and 2009) but over the long haul.

B. *Lessons Learned*

Here my account turns rather dark, indeed perhaps depressing. How could one be upbeat—how could one conclude that *any* lessons from the Asian Financial Crisis had been learned—considering the eruption just over a decade later of the even bigger global financial crisis that we find ourselves in today? In a companion piece to this article,²⁵⁶ I provide an account of how several of the same deficiencies from which the Asian Financial Crisis emerged—lax financial supervision, real estate bubbles, deregulation, “hot money”, and others—also played a role in generating the even bigger crisis of 2008-2009.

It is worth reiterating that the three countries hit hardest by the Asian Financial Crisis—Thailand, Indonesia, and Korea—*did* in fact take numerous remedial actions. I have summarized these above in subsection IID, emphasizing the array of new laws, regulations, and supervisory agencies that emerged in these three countries. In that narrow country-specific respect, lessons were learned.

Likewise, I have noted above in subsection IIIC1 the substantial reforms that occurred in the IMF's operations and governance in the decade between 1998 and 2008, featuring changes in

²⁵⁶ See generally Head, *The Global Financial Crisis of 2008-2009 in Context*, *supra* note 4.

conditionality guidelines, in lending terms, in debt relief, in transparency, in multilateral consultations, and so forth. These are significant, and they might have established, or at least set the stage for, what I referred to earlier as a "revival" of the IMF.

Beyond that, however, the picture is hardly rosy. Apparently the lessons offered by the Asian Financial Crisis were *not* taken seriously either by private-sector players or by public-sector referees in the U.S.A.—the very country that should be most sophisticated and most prudent in economic and financial affairs, given its special status in international economic relations.

Will those lessons be learned now? I am not optimistic. As I view the history of international economic relations of the past half-century or so—and particularly the periodic recurrence of financial crises that bear tiresome resemblance to each other—I see little evidence that the international community is prepared to do any more than react with urgency and drama to each such crisis as it occurs and then simply to settle back into the comfortable patterns from which that crisis and others had emerged.

To close on a happier note, I will suggest that I see an opportunity right now for fundamental institutional change in the IMF. The proposed Charter amendments I referred to above relating to governance suggest a possible trajectory of reform that *might* bring needed legitimacy to that institution and its efforts to prevent and mitigate future financial crises. This is an opportunity that I believe has no precedent other than that of the early 1980s, when the debt crisis created a panic that reinvigorated the IMF. However, unless today's opportunity is in fact seized immediately, I fear it will be lost until another financial crisis—perhaps worse than either the Asian Financial Crisis or the current global financial crisis—erupts and brings greater distress to people around the world.