



## **Asia and the IMF**

Stanley Fischer  
First Deputy Managing Director  
International Monetary Fund<sup>1</sup>

Institute for Policy Studies, Singapore  
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### **1. Introduction**

It is a great pleasure to be back in Singapore, a country from which I have learned so much during my time at the IMF, and I would like to thank the Institute for Policy Studies and the Monetary Authority of Singapore for making possible this opportunity to discuss Asia and the IMF. The title suggests looking back, to the Asian economic crisis. But that has been done, repeatedly, including by the IMF<sup>2</sup>, and while yet another discussion of the crisis and its lessons would surely be interesting – particularly with this distinguished audience – I would rather focus on IMF reforms and on future relations between the Fund and its Asian member countries.

I will start by discussing the reforms that have been undertaken in the IMF since the mid-1990s, and particularly since the start of the Asian economic crisis. I will then ask what would have been done differently if these reforms had been in place in 1997 and 1998 – thus after all giving us an opportunity to look back. I will conclude by discussing the potential future roles of the IMF in Asia, and of Asian countries in the IMF, particularly in light of the emerging regional financial arrangements.

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<sup>1</sup> As prepared for delivery. Views expressed are those of the author, not necessarily of the International Monetary Fund. I am indebted to Robert Chote, Anoop Singh, Russell Kincaid and Ratna Sahay for their assistance.

<sup>2</sup> See Jack Boorman *et al*, "Managing Financial Crises: The Experience in East Asia", IMF Working Paper WP/00/107 (Washington: International Monetary Fund, 2000)

## II. IMF Reforms

Following the Mexican crisis, and more intensively after the Asian and Russian crises, the IMF entered a period of far-reaching reform, which is still continuing.<sup>3</sup> The reforms aim to help us prevent crises where we can, and to mitigate their effects where we cannot. Given the economic and social consequences of crises – and the public attention they receive – it seems natural to focus on crisis prevention and management. But we should be just as concerned about how well the international financial system functions in non-crisis times, because of the contribution it can make then to economic stability, growth and welfare.

Michel Camdessus characterized the Mexican crisis as the first economic crisis of the twenty first century. By that he meant that the dynamics of the crisis were driven primarily by the capital account of the balance of payments. From Thailand in 1997 to Brazil in 1999, we had at least six more such twenty-first century crises during the last decade of the twentieth century, each of them made more difficult by the speed and extent of capital flow reversals and the associated contagion. By now, we should know that the capital account will be a primary factor in economic developments in any emerging market country. Nonetheless, the good old-fashioned elements on which we used to focus - including the current account, fiscal policy, monetary policy, and the exchange rate system - remain critical in determining both the underlying real developments in the economy and the behavior of the capital account.

### Crisis prevention

I will focus on three ways in which the IMF, in its crisis prevention efforts, has responded to the enhanced role of the capital account:<sup>4</sup>

- by strengthening surveillance of national policies, financial sector soundness, and international capital flows;
- by reconsidering the role of the exchange rate and capital account regimes;
- and by introducing the Contingent Credit Line lending facility, designed to enable the Fund for the first time to use its lending capacity to help prevent crises, rather than to respond to them after they break out.

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<sup>3</sup> I shall not today discuss the important changes that have taken place in the Fund's concessional lending facility, the Poverty Reduction and Growth Facility (PRGF), which replaced the Enhanced Structural Adjustment Facility (ESAF), except to note (i) the intensified focus on poverty reduction; (ii) the key innovation of the Poverty Reduction Strategy Paper (PRSP) as the central mechanism for involving civil society and donors in the economic policy process; (iii) the intensified collaboration between the Bank and the Fund; and (iv) the role of the PRGF in delivering the Fund's contribution to debt relief in countries eligible for help under the enhanced HIPC initiative.

<sup>4</sup> For a fuller account, see the Report of the Managing Director to the International Monetary and Financial Committee on *The IMF and the Process of Change*, April 25, 2001 (<http://www.imf.org/external/np/omd/2001/report.htm>)

### *Surveillance and the Financial Sector*

First, surveillance. In response to the crises, the Fund has sharpened its scrutiny of national policies and international markets, focusing in particular on developments that can leave countries vulnerable to crisis. One manifestation of this change is apparent to anyone who visits the area departments at IMF headquarters, which are responsible for relations with member countries. At the time of the Mexican crisis, the staff in these departments had no access to breaking news in the countries and markets that they were following, while the staff of private sector institutions had their Reuters or Bloomberg screens. Not only do all Fund staff now have access to these news services, but they also receive up to eight or nine specially compiled news summaries a day through our intranet. This information is augmented by daily reports from our resident representatives and regional offices. It would have been said in 1994 that all this focus on the daily news encourages short-termism and detracts from more serious examination of the fundamentals – but that would be flatly wrong, for the first question the staff has to ask about the daily developments is whether they are consistent with the more fundamental developments taking place in the economy.

Put simply, the Fund has joined the information age.

That applies also to the information we make available to the outside world. In their reporting to the Executive Board, including through the regular Article IV reports, the Fund staff presents their analysis of the underlying developments taking place in the economies of our members. The great majority of countries now publish the summary of the Board's discussion of their Article IV report, and a growing number also release the staff report on which the Board discussion is based. All these are available on our website. We also sometimes use the website to solicit comments on Fund policy papers.

Of all the changes that have taken place in the Fund in recent years, this increase in two-way transparency between the Fund and the outside world is the most significant. Transparency not only helps ensure better-informed citizens and investors, but also encourages policymakers to strengthen their policies and institutions. By ensuring public and professional scrutiny of what the staff and management of the Fund have to say on an issue, transparency also provides incentives for us to perform better. Would this increased transparency have happened without the crises? Probably – but not as fast, nor as thoroughly.

The structure of external debt and financial sector weaknesses played key roles in exacerbating capital account crises. This is evident not only from what happened in countries with excessive short term debts and weak financial sectors, but also from the fact that in Brazil, where the financial sector is relatively strong, the 1999 devaluation was much less costly than the devaluations in the other crisis countries. Accordingly, we have significantly stepped up our surveillance of external vulnerabilities, including by

scrutiny of the national balance sheet, particularly external debt and reserves, and the strength of financial systems, most notably through the Financial Sector Assessment Program (FSAP).

The FSAP, undertaken jointly with the World Bank, provides a comprehensive health-check of a country's financial sector, by a joint team drawn typically from the Fund, the World Bank, and national central banks and supervisory authorities. Developed and developing countries alike are finding the FSAPs useful. Important weaknesses have been identified in some countries, and the supervisory authorities are using these diagnoses to strengthen their systems. By the end of this year, around 36 countries should have gone through the FSAP process. Many countries in which policymakers are aware of financial sector problems have asked to take part in the process. We are trying to ensure that systemically important countries participate, although not all of them are eager to participate. Important issues of confidentiality arise when a particular institution is found to be weak, as some have been. In these cases the information is very tightly held, even within the Fund, as it has to be if countries are to agree to undertake these reviews.

Surveillance is also being given greater focus and structure by the development of international standards and codes of conduct, monitored by the Fund or other relevant bodies. The development and monitoring of these codes and standards provides a potentially important mechanism through which countries can calibrate and develop their financial and economic infrastructure to international standards. The codes now cover a wide variety of policy areas, including statistical dissemination, monetary and fiscal policy transparency, banking supervision, accounting, and corporate governance. Information about the implementation of these codes and standards is being published in ROSCs (Reports on the Observance of Standards and Codes) for individual countries.

The Managing Director's decision to set up a new International Capital Markets (ICM) Department, is further evidence of the increased attention the Fund is paying to both surveillance and international capital flows. The new Department has two prime tasks: first, to monitor international capital flows and help ensure that the area departments of the Fund take full account of the implications for our member countries; and second, to help member countries reap the gains from participation in international capital markets, while helping strengthen their economies to deal with the potential risks. Press reports have tended to focus on the ICM's role in further developing the Fund's early warning systems; it will do that, together with other departments, but that is only a small part of its mandate. We hope to announce the selection of the first Director shortly, and hope the new department can begin working in the first part of the summer.

Our interactions with the capital markets have also been enhanced through the creation of the Capital Markets Consultative Group, which consists of private sector market participants and members of Fund management and staff, who meet regularly to discuss matters of mutual interest. The second meeting of the CMCG took place in Hong Kong yesterday. In the CMCG, as in all Fund contacts with the private sector, it is essential that no privileged information be provided to particular private sector participants.

Surveillance also has an important regional dimension, which in Asia is well-advanced. Meetings of the ASEAN and ASEAN+3 countries, and also the Manila Framework Group, play a useful role and should help identify and rectify problems in individual countries that have potential spillover effects. The Fund has been cooperating closely with these fora, as well as with similar fora in other regions.

### *Exchange Rate and Capital Account Regimes*

Every major financial crisis since Mexico's in 1994 has in some way involved a fixed or pegged exchange rate regime. Countries without pegged rates – among them South Africa, Israel in 1998, Mexico in 1998, and Turkey in 1998 – have certainly suffered from international capital market disturbances, but to nothing like the same degree as those with soft pegs. No wonder then that many, including myself, have been arguing that the intermediate regimes that lie between hard pegs (currency boards, dollarization, or membership of a currency union) and floating rates are not generally sustainable in countries open to international capital flows.<sup>5</sup> The fundamental reason for this is the famous “impossible trinity” of Robert Mundell – that among a fixed exchange rate, capital mobility, and a monetary policy dedicated to domestic goals, a country can only have two out of three over a sustained period.

Let me note two caveats: first, while a floating exchange rate regime reduces the risk of external crises, it is not sufficient to prevent them, for a crisis can also be caused by adverse external debt dynamics or a loss of domestic fiscal control; second, in advocating a floating rate regime, I do not imply that policymakers can or should be indifferent to the exchange rate, nor that they should totally refrain from intervention in the foreign exchange markets. Changes in the nominal exchange rate affect inflation, and changes in the real exchange rate may have a powerful effect on the allocation of resources. So we would expect monetary policy in countries with floating exchange rate systems to respond to movements in the exchange rate – and in most countries it does. Beyond the use of interest rates, some countries – including some in Asia – intervene directly from time to time in the foreign exchange markets to try to stabilize the exchange rate. So long as they are not perceived as trying to defend a particular rate, this can be useful.

Once a country begins to float, it has to decide on the monetary policy it will follow. Many recent converts have opted for inflation targeting. That system seems to be working well, and has much to commend it. Under inflation targeting, exchange rate movements are automatically taken into account to the extent that they are expected to affect future inflation. This will generally produce a pattern of monetary tightening when the exchange rate depreciates, a response similar, but not necessarily of the same magnitude, to that which would be undertaken if the exchange rate were being targeted directly.

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<sup>5</sup> See for instance my paper, “Exchange Rate Regimes: Is the Bipolar View Correct?”, forthcoming in the *Journal of Economic Perspectives*.

One obvious solution to the impossible trinity is to impose capital controls. Rather than enter the debate over capital controls in depth, let me make a few comments. First, experience suggests that countries will in the course of their development ultimately want to liberalize the capital account and integrate into global capital markets. It is surely no coincidence that the most advanced economies *all* have open capital accounts – which implies that as countries develop, they will want to get rid of capital controls, albeit at their own rates.

Second, when discussing capital controls, it is important to distinguish between outflows and inflows. For controls on outflows to succeed, they need to be quite extensive. As a country develops, these are likely to become more distorting and less effective. And controls cannot prevent a devaluation if domestic policies are fundamentally inconsistent with maintaining the peg.

Once controls are in place it is never easy to remove them. They should be removed gradually, at a time when the exchange rate is not under pressure, and when the necessary infrastructure is in place: strong financial institutions; a market-based monetary policy; an effective foreign exchange market; and the information base necessary for the markets to operate efficiently.

Turning to controls on capital inflows, the IMF has cautiously supported the use of market-based controls like those pioneered by Chile. These can in principle help a country both reduce the volume of short-term capital inflows and thus the risk of capital flow reversals, and provide some room for an independent monetary policy. Such controls have for instance been used when a country is trying to reduce inflation using an exchange rate anchor, and in order to get inflation down needs interest rates higher than those implied by the sum of the foreign interest rate and the rate at which the currency is expected to depreciate. In Chile the controls seem to have been successful for a time in allowing some monetary policy independence, and also in shifting the composition of capital inflows away from short-term debt. But empirical evidence suggests that they lost their effectiveness after 1998. And in any event, in time the Chilean authorities decided to remove them.

Capital controls may at times appear attractive, especially during a crisis. The jury is still out on some aspects of such controls, including measures that seek to close down offshore markets. But it is telling that even among the countries worst affected by the crises, almost all have resisted the temptation to close themselves off. When push comes to shove, policymakers have abandoned fixed exchange rates before capital mobility, and they have been wise to do so.

#### *Foreign Reserves and the Contingent Credit Line facility*

The growth of international capital flows has prompted a rethink of the way we assess the adequacy of a country's reserves. Traditionally, it has been assumed that countries need reserves sufficient to pay for three or four months of imports. But in an era when crises are as likely to arise from a sudden capital outflow, it makes more sense to argue – as a

first approximation – that countries need reserves sufficient to cover their short-term debt. It was obvious in the Asian crisis that countries with very large reserves generally did better in avoiding the worst of the crisis than those with smaller reserves. Indeed, the ratio of short-term external debt to reserves is the single best crisis indicator, and the IMF now uses that ratio as a basic indicator of reserve adequacy.

Accordingly, many emerging market economies need more reserves than they once thought. One approach is simply to accumulate them in the traditional manner, and several countries in Asia have accumulated very large reserves indeed. Another approach is to ensure that a country has access to reserves from elsewhere in the event that it needs them.

The central bank swap arrangements being drawn up by the ASEAN+3 countries under the Chiang Mai initiative can make a useful contribution here. And it was welcome to hear at the recent Asian Development Bank meeting that Japan has concluded a series of bilateral swap agreements with Korea, Thailand and Malaysia to that end. Except in the case of a pure liquidity crisis – and such cases are relatively rare in the historical record – it is important that financial support be used to mitigate the costs of policy adjustments needed to restore equilibrium in the balance of payments. That is why it is important that financing provided under these initiatives be complementary with financial support from the Fund and the associated conditionality, to help ensure that the policy adjustments needed to deal with the crisis are undertaken.

A second source of supplementary reserves is the Fund's recently enhanced Contingent Credit Line facility, which offers precautionary credit lines to countries with demonstrably sound policies that nonetheless feel threatened by contagion elsewhere. When first introduced, the CCL had several unattractive features from the viewpoint of potential users. After amendments introduced last year, the CCL is now in effect a flexible way for countries to augment their reserves at very low cost, as well as offering a seal of approval for their policies that should be helpful in times when financial markets are jittery. We have discussed access to the facility with a number of countries, and I am confident both that the CCL will begin to be used in the next few months, and that once a few countries join, the CCL will increasingly be used as a supplementary source of reserves by other countries with good policies.

### **Crisis response**

In discussing the Fund's response to crises, I will examine three recent changes:

- the development of the Supplementary Reserve Facility (SRF), which was introduced in December 1997 and used in the Korean crisis and subsequently;
- the narrowing of the scope of conditionality, an ongoing change initiated by Managing Director Köhler; and
- private sector involvement in the resolution of crises.

### *The SRF*

The SRF was introduced at the end of 1997 to enable the Fund to tailor its lending better to capital account driven crises. Access to Fund resources under conventional standby loans is normally limited to no more than 100 percent of quota per annum, with a cumulative limit of 300 percent of quota. There is, however, an exceptional circumstances clause – which was invoked in the case of Mexico – that makes it possible to exceed these limits. This approach to determining access to Fund resources was developed at a time when IMF loans typically dealt with current account problems.

Capital account driven crises, usually reflecting sudden changes in investor and creditor confidence, are likely to require more financing relative to quota. Further, such crises, if properly dealt with, should reverse more rapidly than a current account driven crisis as confidence is restored. The design of the SRF takes account of these features. Reflecting the potentially large need for financing, there are no formal limits on access to SRF resources. Reflecting lender of last resort doctrine, SRF loans carry a significantly higher charge than normal standbys (with the interest charged rising the longer the loan is outstanding). And reflecting the likelihood that confidence can be restored relatively quickly, SRF loans have a shorter repayment period than the normal standby.

Following its inauguration in Korea, the SRF has been used in all the subsequent capital account driven crises, and it has performed essentially as expected.

### *Narrowing the scope of conditionality*

The number and scope of the structural policy conditions attached to IMF loans increased significantly over the 1980s and 1990s. The expansion was driven by two factors: first, the criticism in the 1980s that the Fund in dealing with balance of payments crises did not sufficiently concern itself with returning the economy to growth, which led to increased attention to the need for structural reforms to promote growth; and second, the Fund's work in the transition economies, where comprehensive structural reforms were needed.

Conditionality was also particularly broad in some of the crisis cases, including Indonesia, where concerns over governance led to conditions being imposed in policy areas not normally covered by the Fund, for instance the dismantling of the clove and plywood monopolies. The scope of conditionality was also broad in the Russian program. In many cases, some of the structural conditionality in Fund programs was expected to be implemented under World Bank supported loans, for instance strengthening unemployment insurance in Korea.

Notwithstanding the importance of structural policies in the countries to which we lend, there is general agreement that our conditionality in this area has sometimes been too extensive and restrictive. This can be a problem both because broader programs are more difficult to monitor by the Fund and implement by the member country, and because excessive conditionality may undermine a country's ownership of the program.



Accordingly, we are seeking to focus our conditionality to the Fund's key areas of responsibility – monetary, fiscal, and exchange rate policies, and the financial sector, and to those structural measures that are critical to achieving the macroeconomic objectives of the program. The intent is not to weaken conditionality, but to make it more effective.

This new approach raises important questions that will need to be resolved as we gain experience. The first question is how to ensure that key measures that are not in the Fund's area of expertise – including those that are critical for growth - are implemented. This will require close collaboration with the World Bank and the regional development banks. The second question is how to deal with problems of governance, for instance whether legal reforms, or measures to ensure the transparency of government operations, should in special cases be covered by conditionality.

This approach was introduced last September, and experience with it will be examined towards the end of this year.

While discussing conditionality, I should also mention that as a result of the Asian crisis, the Fund is more cautious about recommending fiscal tightening to deal with a crisis in which there is no significant current account or budget deficit.

#### *Private sector involvement (PSI)*

Private sector involvement remains one of the thorniest and most controversial issues on the Fund's agenda. The goal is to ensure that the private sector contributes to the resolution of financial crises by providing financing, rather than exacerbating the crisis by seeking to withdraw funds at the same time as the public sector is injecting them. More graphically, the argument is that the public sector should not bail out the private sector.

There are three reasons to require PSI. First, unless the external private sector shares in the losses caused by crises, it will not properly take account of the risks attached to its investments, and capital will be misallocated – this is essentially the moral hazard argument. Most foreign investors in emerging markets have taken substantial losses in the crises. But not all have done so, particularly those who lend short-term. Second, the public sector may not have sufficient money to turn the situation around without PSI. And third, official international lending will not be politically viable – in the sense that shareholders will be willing to provide more financing for the official institutions – unless there is PSI, that is, unless investors who made bad decisions are seen to take losses.

Agreements to secure private sector involvement were reached with important private sector participants in the Thai, Korean, Indonesian, Brazilian, Turkish, and Argentine programs in recent years. The most formal approach was made in the Korean case, when the banks were called in December 1997, and an agreement to roll over interbank lines of credit, with a government guarantee, was reached early in 1998. In addition, debt-restructuring agreements were reached with debt holders in Pakistan in November 1999

and Ukraine in February 2000. In cases where a country's medium-term balance of payments is not viable without debt restructuring and possibly debt reduction, the IMF has a policy of being willing to lend into arrears to private creditors, provided the country is making a good-faith effort to reach agreement with them. The Fund lent into arrears to Ecuador in 1999, at a time when some private sector participants claimed the country was not making a good faith effort to reach a negotiated settlement.

Fund staff and management presented a framework for PSI at our Prague annual meeting last September.<sup>6</sup> In brief, the intent of the framework is to rely on the catalytic approach and voluntary PSI in cases of normal access to Fund resources, as well as in those cases of exceptional access where it is believed that the crisis will be quickly reversed because it is fundamentally one of liquidity. In cases where the balance of payments outlook over the medium term is not viable without comprehensive debt restructuring, a coordinated approach will have to be made to ensure PSI. In certain extreme cases, a temporary payments suspension or standstill may be unavoidable.

Fund staff and management are leery of using too heavy a hand in dealing with PSI, for fear that coercive measures to resolve a problem in one country will lead to contagion effects in other countries. However, some members of the IMF, unhappy about the extent of judgment and discretion involved in recent cases, and also believing that the private sector's contribution has been inadequate, are calling for more precise rules for dealing with PSI in Fund programs. This issue will have to be revisited soon. Nonetheless, it is accepted by all that efforts have to be made to obtain private sector involvement in Fund programs – and furthermore, there has been PSI in all recent Fund programs.

### **III. Revisiting the Asian Crisis**

Suppose, counter-factually, that all the changes I have described had been in place in 1996. What difference would that have made to the course of the Asian financial crisis? The real answer is that we cannot know. But let me speculate.

First, the exchange rate regime. If exchange rates had been flexible, Asian currencies would have appreciated less in late 1996 than they did as the dollar appreciated. The balance of payments difficulties faced in early 1997 by the countries that later went into crisis would therefore have been mitigated. Further, with more flexible exchange rates, short-term capital inflows – and the subsequent outflows – would probably have been smaller. And neither Thailand nor Korea would have used up essentially all their foreign exchange reserves to defend the exchange rate.

Second, if there had been more transparency, with reserves data meeting the standards of the SDDS, far more would have been known about the state of the foreign reserves in the

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<sup>6</sup> Communiqué of the International Monetary and Financial Committee of the Board of Governors of the IMF, September 24, 2000 (<http://www.imf.org/external/np/cm/2000/092400.htm>)

crisis countries. Again, this would have prevented countries using up all their reserves, and would have forced earlier action on the exchange rate. Further, more would have been known about the composition of external debts. That should have cut off capital inflows earlier, and therefore reduced the disruption caused by subsequent outflows.

Third, if more attention had been focused on the health of the financial system, action could have been taken earlier to begin strengthening weak institutions, avoiding or reducing the extent of liquidity support that was extended in all the crisis countries. For instance, it would have been possible in Indonesia to begin dealing with weak banks before the crisis began, and to have been better prepared with bank resolution mechanisms. It would also have been possible to spot the deterioration of corporate finances, and it might have been possible to begin dealing earlier with the disastrous interaction of corporate financial and banking sector weaknesses.

Fourth, if Fund surveillance had been more vigilant, and more attuned to market developments, it is possible that the financial attack on Korea would have rung the alarm bells a month or two earlier than November 1997, and perhaps the Korean government could have been persuaded to let the exchange rate float earlier. In Thailand, we would probably have struck a different balance in informing markets about our increasingly urgent dialogue with the authorities there in the run-up to the crisis.

Perhaps all these possibilities mean that it would have been possible to advance adjustment, thereby mitigating if not preventing the crisis, had the crisis prevention measures taken since the crisis been in place in 1995. I do believe that the crisis would have been far less virulent if exchange rates had been floating for some years before 1997. But exchange rate regimes aside, the other changes would only have made a difference if it had been possible to persuade governments to act in time. It is not clear that that would have been the case. After all, many of the warning signs were around before the crisis: some of them were brought to the attention of governments; and others must have been known to governments (including central banks) even though they were not made public.

Why did governments not act? That is hard to know. Some may have been lulled into a false sense of security by many years of success. They had surely heard many earlier warnings of disasters, which had failed to materialize. Some of the governments were politically weak. Some of them were caught up in the familiar syndrome in which an exchange rate peg takes on a political significance that transcends its economic importance. And some of them must have thought that any action they might take would only precipitate the crisis they were trying to avoid.

The interactions between politics and economics in any economic crisis are illustrated by the striking fact that in all three IMF-supported programs in Asia in 1997-98, the economy began to turn only when new governments came into power: first in Thailand, then in Korea, and last, and with the most disruption, in Indonesia in May 1998.

Next, ask what would have happened had the crises played out exactly as they did to the point where countries turned to the IMF for assistance, but the subsequent changes in methods of crisis response had then been in place. First, conditionality would have been more focused – on macroeconomics, on the exchange rate, and on financial sector restructuring. On the macroeconomic side, we would probably not have asked for as much fiscal tightening as we did initially – though that request was soon reversed in the Thai and other cases.

On the structural side, we would certainly still have urged rapid progress on financial sector restructuring. And we would have worked with greater urgency with the World Bank to try to ensure rapid progress on corporate restructuring. That is to say, that the core of structural conditionality in Fund-supported programs would not have been very different; but some other desirable, but not critical, policy changes would probably have been omitted from the programs.

Quite likely we would have sought to involve the private sector more rapidly in all cases – that would have saved a few weeks in Korea, and a few months and some distress in Indonesia and Thailand—and we would have had debt monitoring systems ready. Possibly, had the SRF then existed, we would have suggested making it available to Thailand. All this means that capital outflows might have been better contained than they were and exchange rates would likely have stabilized even more quickly than they did..

In brief, with today's methods of crisis response, the crisis would have been better handled. But there is again a but. The core structural measures in the Asian crisis countries involved financial and corporate sector restructuring. Those are still the main items on the policy agenda, and it is proving very difficult for the affected governments to implement those reforms thoroughly. Thus it is unlikely that conditionality would have been better implemented even had it been focussed on these key measures. Nor are the governments of the crisis countries unique in their reluctance to move speedily on financial sector reforms, for governments all over the world are slow to undertake such politically difficult structural changes, be they in Japan at present, or Russia over the last few years, or the United States during the savings and loan crisis of the 1980s.

#### **IV. Asia and the IMF: Looking Ahead**

In the wake of the crisis, Asian countries are moving to put in place new regional arrangements, including various swaps, and are considering alternative currency arrangements. The management of the IMF welcomes this enhanced regional cooperation, which should be complementary to more global arrangements, such as the Fund. We see potential advantages in regional currency cooperation, even though it will likely take many years – perhaps as many as it took in Europe – for such arrangements to come to fruition. The IMF stands ready to cooperate fully in helping make these regional arrangements more effective, for instance by assisting in the surveillance process, as we already do in several regional fora, and by cooperating in the financing arrangements envisaged under ASEAN + 3, where the activation of loans beyond 10 percent of the

agreed lines will take place in the context of IMF-supported programs. And to be sure, the lessons learned from recent crises will be applied when these programs are negotiated.

More also needs to be done to enhance the role of Asian countries in the working of the IMF. Much attention has been focused on the underrepresentation of Asia in the IMF's quotas. This is indeed a serious problem, which was recently somewhat mitigated by increasing China's quota to reflect the return of Hong Kong. But votes are rarely taken in the Executive Board of the IMF, and the effectiveness of Executive Directors is more related to their persuasiveness than to the size of their vote. Asia has five out of the 24 seats in the Board (Japan, China, and constituencies headed respectively by India, Indonesia, and Australia (with Korea as a member)). It is important, if Asia's voice is to be heard, that these positions are occupied consistently by the highest quality candidates, and that their countries take a lively interest in the matters discussed in the Board, and seek to develop independent policy positions on the key issues. Japan, our second largest member, always plays an important role in guiding the institution. Since the Executive Board of the IMF far prefers making decisions by consensus than by voting power, those directors who have coherent positions and the ability to advance them will usually see their views reflected in Fund positions on the issues.

It is also important that the Fund appoint more staff members from currently underrepresented Asian countries. This appears to be a matter more of supply than of demand, for the Fund is always on the lookout for qualified candidates to its staff. Many countries in other regions, and some in Asia, see an appointment to the staff of the Fund for some years as an important way to build up needed human capital inside their governments.

The Fund as a global institution is incomplete if Asia is not playing a full role. And I believe Asia needs the Fund if it is to continue to benefit as it has so spectacularly over the years from its integration into the global economy. For one thing, there is much unfinished business left over from the crisis, including how best to reduce the volatility of international capital flows – an issue on which we must make further progress. We must also ensure that countries in Asia and elsewhere that have not so far been able to enjoy the benefits of integration into the global economy can do so.

Thank you.