7

Global Financial Crisis

During most of the two fiscal years over which the D'Amato amendment was in effect, the international financial system was reasonably stable. Although many analysts were on the lookout for the ''next Mexico,'' none came until the middle of 1997. Then Thailand was seized with a sharp reversal of capital inflows and allowed the baht to depreciate, sparking the beginning of far larger regional, then global, financial instability. [For a discussion of the origins of the Asian financial crisis, see Goldstein (1998), Noland, Liu, Robinson, and Wang (1998), and Lane et al. (1999), among other works.]

Thailand, Indonesia, and South Korea

The Clinton administration could have tapped the ESF for Thailand. But lending any amount above $1 billion for more than 6 months would have required a presidential waiver and exposed the program to the uncertainty of a congressional resolution of disapproval. Concerned as well about the commitment of the Thai government to financial reform, the Treasury gave no commitment at an August meeting of potential donors in Tokyo regarding what, if any, amount it might contribute from the ESF for the Thai rescue package. On 15 August, though, Secretary Rubin indicated to Chairman Greenspan that the United States was prepared to provide guarantee financing for a Bank for International Settlements (BIS) facility to assist Thailand. The US portion of the total guarantee was set at ''up to $200 million'' (US Treasury Department, press release, 20 August 1997;

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US Treasury Department, *ESF Annual Report* 1997, note 8). The BIS negotiations with Thailand ended inconclusively, however. The Treasury's response thus contrasted sharply with its response to the Mexican crisis of 2½ years earlier, a contrast that many Thai and other Asian officials interpreted—mistakenly—as reflecting American indifference.

The reluctance of the US government to commit financial resources in the case of Thailand had an immediate impact on the balance of influence among countries and institutions. The Japanese government was quick to attempt to fill the vacuum, inviting the Thai finance minister to Tokyo for discussions and contributing to the rescue package. More ambitiously, the Japanese Ministry of Finance proposed an ''Asian monetary fund.'' The US Treasury reacted swiftly to staunch any such movement, concerned that an Asian fund would undercut the position of the IMF as well as that of the United States in such rescues. At the annual meetings of the IMF and the World Bank held in Hong Kong, senior Treasury officials lobbied against and, at least for the moment, defeated the proposal, which in any case lacked the necessary support within the region. In the event, the IMF led and set the terms of Thailand's rescue package. Nonetheless, the withholding of US funds appears to have encouraged independent financial diplomacy on the part of the Japanese. Moreover, with the benefit of hindsight, one might reasonably ask whether larger-scale US financial assistance, blocked by the D'Amato amendment, could have nipped the Asian financial crisis in the bud or moderated the global instability that characterized at least the following 18 months.

In the face of the emerging crisis in Asia, in early autumn 1997 Congress did not renew the D'Amato amendment for FY1998. Several factors appear to have been at work. First, given the experience with the Japanese, the Treasury could credibly argue that constraints on the ESF limited its ability to assert US interests in Asia and to shape the terms of financial rescues. Second, members of Congress did not want to be blamed for exacerbating financial instability. Third, Senator D'Amato himself was up for reelection in 1998, and financial instability was an important concern of his Wall Street constituency (he was not reelected).

Within one month after the expiration of the D'Amato amendment, the Treasury announced that it was willing to provide contingent financing of up to $3 billion from the ESF as part of the ''second line of defense'' for the Indonesian program (US Treasury, press release, 31 October 1997). Before Indonesia had been affected, the crisis had spread from Thailand to Malaysia, the Philippines, and Hong Kong, triggering a record daily plunge in the US stock market. The Treasury therefore had both the flexibility and the political cover for advancing ESF resources, which were conditioned on Indonesian satisfaction of IMF conditionality. In the event, the Treasury and Indonesian officials never began negotiations on the necessary legal agreement that would have permitted a drawing from the ESF.

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The strategy whereby the IMF would provide the ''first line of defense'' and governments would supplement IMF resources on a bilateral basis, if needed, was formalized at a meeting of deputy finance ministers and central bank governors from 14 countries of the Asia Pacific region in Manila in mid-November (G-14 communiqué, 18-19 November 1997; US Treasury Department, press release, 19 November 1997). Consistent with this newly articulated strategy, the Treasury in early December announced that it was ''prepared to provide contingent additional financial support'' of up to $5 billion as part of the second line of defense for South Korea (US Treasury Department, press release, 3 December 1997). Again, this financing was to be made available temporarily and conditioned on policy reforms. Secretary Rubin stated that any disbursements from the ESF, ''to the extent they occur—will be in the form of short-term loans whose payment is guaranteed by the borrowing government'' (address at Georgetown University, 21 January 1998). Although US and South Korean authorities worked on a draft framework agreement, it has not been concluded, and no disbursements have been made as of this writing.

Congressional Reaction

These ESF commitments once again caught the attention of particular members of Congress. In November 1997 Senator Lauch Faircloth (R-NC) introduced a bill that would have required congressional approval for any ESF loan greater than $250 million. In contrast to the D'Amato amendment attached to the Treasury appropriation, the Faircloth bill would have amended the ESF statute itself (Faircloth 1997). Unsuccessful in that effort, Senator Faircloth then attempted to attach a provision to an education bill that would have transferred $5 billion out of the ESF to support school infrastructure (Faircloth 1998).

In February 1998 the Joint Economic Committee held a hearing on the Asian crisis and IMF at which the chairman, Representative Jim Saxton (R-NJ), asked whether constraints should be placed on the Treasury's use of the ESF and whether the account should be abolished. Former Federal Reserve Board Governor Lawrence B. Lindsey advocated the liquidation of the ESF. Professor Allan H. Meltzer criticized the ESF for lack of transparency and the practice of warehousing as evading congressional controls on appropriations. C. Fred Bergsten, who managed the ESF as Assistant Secretary of the Treasury in the Carter administration, alone argued for maintaining the ESF (US Congress, Joint Economic Committee 1998).

In July Representative Sanders revived his amendment to the Treasury appropriations bill blocking any loan greater than $250 million from the ESF. He, Representative Bachus, and other proponents argued for their amendment mainly on the grounds that deciding on such loans should, under the Constitution, be the responsibility of the Congress and that

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moral hazard made such financial rescues undesirable. Opponents of the amendment argued, among other points, that Congress did not have the technical expertise to make these decisions, could not make them sufficiently quickly, and would be bound to tie them to a host of unrelated issues (*Congressional Record*, 20 July 1998, H5698-5709). Before debate on the amendment began, Secretary Rubin wrote to the chairman of the House Appropriations Committee, Robert Livingston (R-LA), to say that he was ''extremely concerned,'' that the amendment would constitute an ''unacceptable limitation,'' and that if it passed he would recommend that the President veto the bill (letter from Rubin to Livingston, 23 June 1998). In contrast to mid-1995, when the amendment was passed in the House by a vote of 245 to 183, the amendment failed on this occasion with an additional 43 votes in opposition by a vote of 195 to 226.

Through the first half of 1998 the Asian financial crisis deepened and broadened. Each of the major countries with stabilization programs, Thailand, Indonesia, and South Korea, was forced for one reason or another to renegotiate its arrangements with the IMF. The Japanese economy slowed, raising domestic and foreign criticism of the Liberal Democratic Party government's macroeconomic and financial policies. By late May the crisis had spread to Russia as well. Treasury officials negotiated with the Russian government and the IMF through June and early July, but the Treasury declined to commit ESF resources on this occasion. US authorities instead supported the new IMF agreement, announced in July, and lent money to the IMF through the GAB to replenish IMF liquidity and permit disbursement of IMF funds to Russia. In electing not to deploy the ESF, even after the intensification of the Russian crisis and the ruble devaluation in August, Treasury officials were sensitive, among other factors, to political sentiment on Capitol Hill, captured in part by the debate over the Sanders/Bachus amendment.

None of these efforts in Congress to restrict the use of the ESF after the D'Amato amendment were successful. This is not to say that they did not influence policy. Parsimonious use of the ESF during the global financial crisis suggests that the Treasury was in fact responsive to the political sentiment of which these efforts were symptomatic. Congressional support for Treasury flexibility in the use of the account can be described as fairly wide, at least wide enough to control a majority, but not entrenched or deep. The Treasury must be cognizant of a partially mobilized but pervasive opposition in Congress to ''bailouts'' in general as well as of congressional wariness of the absence of size and term limits on ESF loans. This political sentiment, as much as the D'Amato amendment itself and follow-on legislative proposals, made the Treasury reluctant to use the ESF for financial rescues.

Before the autumn of 1998, the politics of the ESF were also complicated by the proposals pending before Congress to approve the New Arrange-

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ments to Borrow (NAB) and the IMF quota increase. With support for these measures soft and wavering, the administration feared that tapping the ESF would further jeopardize congressional approval. But a failure to approve the NAB or the regular quota increase, at the same time, would almost certainly have increased the likelihood that drawings on the ESF would have to be made. As the Russian crisis spread to Latin America and destabilized US financial markets in the autumn of 1998, congressional support for the IMF strengthened, and the appropriations bill providing for the NAB and the quota increase was passed in October.

Brazil

At the same time, Brazil's external financial situation became critical. The country's fiscal deficit was 7 percent of GDP, and many analysts believed Brazil's currency, the real, to be substantially overvalued. US policymakers nonetheless believed the Brazilian economy to be fundamentally sound, in contrast to that of Russia, and were very much concerned that the rest of Latin America was tied to Brazil's fate. Hence President Clinton and Secretary Rubin attempted to create a *cordon sanitaire* around the region. In September, shortly before the annual meetings of the Board of Governors of the World Bank and the IMF, President Clinton proposed the creation of a preemptive facility that could provide financing to countries *before* they were seized by crisis, when the amount of funds required might be less and the rigors of adjustment more manageable. The Brazilian package represented the first major program designed to preempt contagion.

In mid-November Secretary Rubin and IMF Managing Director Michel Camdessus separately announced the conclusion of extended negotiations with the government of Brazilian President Fernando Henrique Cardoso. This package provided loans in the amount of about $18.1 billion from the IMF, $4.5 billion from the World Bank, and $4.5 billion from the Inter-American Development Bank. In addition, the BIS contributed a credit facility of up to $13.3 billion, guaranteed by 19 governments, including the United States, and the Japanese government offered $1.25 billion in direct loans. The grand total amounted to some $41.5 billion, which closely approximated the value of Brazil's foreign exchange reserves. Brazil received its first disbursement under the package in mid-December—$4.8 billion from the IMF, $4.15 billion from the BIS, and $350 million from the Bank of Japan. Reviews for subsequent disbursements were scheduled periodically over the following year, with the proviso that Brazil could request accelerated payouts. When providing its portion of funds in December, the IMF activated the NAB for the first time in the amount of about $12.7 billion (IMF 1998a).

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The Brazilian package differed from the financial packages offered to the Asian countries in at least two important respects. First, Brazil could draw on these funds before it actually needed them to defend its currency or to repay foreign creditors. Second, the BIS funds, with ''bilateral'' guarantees, were disbursed simultaneously with the IMF funds, constituting a ''parallel'' rather than a second ''line of defense,'' a pattern closer to the Mexican operation of 1995 than the packages proposed for Indonesia in 1997 and South Korea in 1998.

The United States agreed to guarantee up to $5 billion of the $13.3 billion that could be made available by the BIS. This guarantee was a contingent liability of the ESF, which Deputy Secretary Summers pointed out could be granted by the Treasury Secretary without the approval of the Congress. Rubin and Summers nonetheless consulted with a number of members of Congress before the Brazilian package was announced (Rubin and Summers 1998). Brazil provided no collateral-like backing for the portion of the package that was guaranteed by national governments. When asked about this, Secretary Rubin stated that the loan was backed by the ''full faith and credit'' and ''sovereign obligation'' of Brazil (Rubin and Summers 1998). In addition, as part of the agreement, Brazil was required to maintain a level of foreign reserves greater than the amount of BIS loans subject to guarantees. Any failure on Brazil's part to observe certain conditions could also trigger government demands for early repayment. Although the private sector had no formal participation in the package, Brazil was effectively obligated under the agreement to ask private banks to roll over their loans, and most of those banks did so.

Despite the international support, in January 1999 a rebellion among some state governors over internal fiscal matters forced Brazil to float the real, which depreciated dramatically. President Cardoso dealt with the internal fiscal problem, at least temporarily, and renegotiated the agreement with the IMF in March. Secretary Rubin then reaffirmed US support for the program and for backing the BIS portion of the package. As of this writing the Brazilian crisis remains considerably short of full resolution. Nonetheless, with one or two exceptions, members of Congress have as yet offered little criticism of the Brazilian rescue plan—in sharp contrast to the opposition to the Mexican program of 1995.

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