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International Economic Policy Under the Clinton Administration

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In 1990, it was possible to believe that the leadership of the international economic system was moving away from the United States, towards Japan and Europe. A decade later there was no question that the United States had for good or ill maintained its position.

I believe it was mainly for the good.

In describing the development and exercise of that leadership, I will focus on two closely related topics: the financial crises in Mexico, Asia and Russia; and the reform of the international monetary system.

The Financial Crises

Despite some early wrestling over the question of the value of the yen in its first two years, the Clinton administration first became deeply involved in issues of the international financial system during the Mexican crisis in 1994-95. The IMF, the U.S. Treasury, and the international community all learned important lessons from that experience.

At the Fund, having been surprised by the crisis, we learned that we had to operate on a real time basis in our surveillance of economies and markets. In 1994 there were no Reuters or Bloomberg screens in the Fund. Some argued that we should take the long-term perspective, and not focus too much on day-to-day market movements. Possibly that was true before the emerging market countries emerged into the international capital markets. But the Mexican experience - labeled by then Managing Director Michel Camdessus as the first international financial crisis of the twenty first century - drove home how essential it is to pay very close attention both to capital account developments and to market developments. The Fund now monitors market and market-related political developments continuously, through staff access to financial news services, and with seven to eight news summaries a day circulated by email. This summer our new International Capital Markets

department will start operating. It is dedicated to further improving surveillance of the international capital markets, to improving our understanding of those markets, and to helping our members take advantage of them (and deal with the risks they bring).

The U.S. learned lessons too. NAFTA had just been set up, and Mexico had recently joined the OECD. There was a view in the Treasury that such a country does not go to the IMF for assistance. In addition, the United States did not share whatever advanced information it had about the developing crisis in Mexico with the IMF, and for about two weeks after the December 20 devaluation, the Treasury tried to handle the problem on its own - though to be sure, the Mexican authorities did visit the Fund soon after the devaluation to explain the policies they would be following. Eventually, the Mexicans decided to ask for IMF support for the program. The lesson here is clear: when a country gets into trouble, trying to help it fix its problems bilaterally is much more difficult than trying to do so in the context of a multilateral organization, to which the country itself belongs, and in which it has certain membership rights.

Over the course of its existence, the Clinton administration progressively moved away from attempts to handle problems bilaterally, towards involving the IMF much more quickly. And as the IMF reformed itself, it was quickly involved in crises in any event. That was good for the system, and good for the administration. Of course, that doesn't mean the Treasury didn't try to micromanage crises - which was frequently a mistake.

A second lesson emerged when the $40 billion package of financial support for Mexico proposed by the administration fell apart at the end of January 1998. The administration turned to the IMF to provide about half the financial package. The lesson: the IMF was set up in part as an international mechanism to lend to countries in financial trouble, with international burden-sharing in the provision of loans (and they are of course loans, not grants) determined by the size of IMF quotas. It is an effective and fair way of dealing with financial crises, and should be used for that purpose.

The administration's support for the IMF was expressed in concrete form in 1998, when a quota increase became necessary. The congressional battle over the quota increase (like the battles over the funding of IDA, the World Bank's concessional window, and the funding of the United Nations) was difficult and intense, but the administration was able to deliver. Equally important to the IMF and particularly its staff was the unambiguous support for the institution expressed by Secretary Rubin during the times when the Fund was under most intense attack during the global crisis.

The international community learned lessons from the Mexican crisis too. The most important was the need for transparency, especially as regards economic data. The IMF and investors simply did not know what

was happening to Mexico's reserves in the lead-up to the crisis. There was a massive effort immediately after the crisis had stabilized to improve public data provision by member countries. This took the form of the so-called Special Data Dissemination Standard (SDDS), to which nearly 50 countries now subscribe. The reserves template in the SDDS requires detailed information on reserves to be made available monthly, with a maximum one-month lag. If the reserves template had been in operation before 1994, several of the later crises could not have happened in the way they did, for public availability of data on reserves would have forced changes in central bank policy much earlier.

The Asian crisis is too big a topic to take up comprehensively in these comments, but let me mention a few issues relevant to U.S. policy. The first is the Thai package. Thailand was the first Asian country to get into trouble. The IMF provided a loan to Thailand, and so did a group of bilateral creditors, with Japan as the single largest contributor. The United States decided to stay out of that arrangement, possibly because of the domestic heat it had taken over its loans to Mexico. The Thais still remember that the U.S. did not participate in the bilateral financing package. This was a diplomatic mistake, which the U.S. was wise not to repeat in Indonesia and Korea.

Another important issue at the time was the proposal to create an Asian Monetary Fund (AMF). This was an attempt, led by Japan, to set up a regional monetary organization that would help countries in trouble in a kinder, gentler way than the IMF, the U.S. or the Europeans would do. The IMF and the U.S. opposed the creation of the AMF. I believe the AMF would have failed if it had been set up then, because the notion that there was some easy way of resolving these crises was false. All it would have meant is that a lot more money would have been lost before the problems confronting the affected economies were dealt with. However, active consideration is now being given to gradual regional monetary integration in Asia - and this is an issue that future administrations will have to consider how to deal with.

Eichengreen and DeLong do not discuss Russia much. But there is an important question here: whether the U.S. (more generally, the G-7) and the IMF continued assisting Russia for too long?

There is room to quibble about whether assistance to Russia should have stopped three months earlier or six months earlier than it did. But the aid effort to Russia - relying largely on IMF and other IFI funding, as well as bilateral contributions from Germany and others - was fundamentally successful. The main evidence for that view is there is now absolutely no disagreement in Russia on the right economic path to take. Everything that we in the IMF were trying to support in the way of macroeconomic stability and the direction of structural reforms is now conventional wisdom in Russia. No doubt the path of reform will not be smooth and there will still be setbacks along the way, but the goal and the route are clear to Russians.

The International Financial System

Now let me turn to the U.S. role in the reform of the international financial system. DeLong and Eichengreen describe this as a three-pronged approach. First, increasing transparency and disclosure of information to markets; second, strengthening the financial assistance available to countries in trouble; and third, a greater effort to make the private sector bear some of the costs of these crises. The last is the most difficult of these prongs to make stick, and more work remains to be done to ensure that private sector involvement operates effectively. But overall, this approach to improving the international financial architecture is proving successful.

I would add to the list the emphasis on the strengthening of financial systems. This is a particularly important area, in which there has been much progress - and the effort is continuing. There are also areas on the margin where more could have been done: for instance, in requiring greater provision of information by hedge funds.

U.S. leadership in the reform of the international financial system often took the form of institutional innovation. Within the IMF, the U.S. took the lead in promoting changes in our lending facilities. This included the Systemic Transformation Facility, introduced in 1993 to help start transition economies on the road to reform. In 1995 the Fund adopted a policy to offer support for currency stabilization funds within stand-by or extended arrangements, to help countries support fixed exchange rate pegs as a way of getting out of high inflations. The Supplemental Reserve Facility (SRF) was introduced in 1997, moving the Fund more in the direction of a classic lender of last resort, by increasing the amounts that could be lent without invoking the exceptional circumstances clause, and by raising fees and shortening repayment periods. The impetus for these changes came from the U.S. Treasury and they were very important.

The U.S. was also strongly behind the most recent innovation, the Contingent Credit Line (CCL) facility. CCLs are a way of providing precautionary lending, helping countries strengthen their policies by making a line of credit available to them to help withstand the effect of crises elsewhere. Pre-qualification for loans was favored by the Meltzer Commission, and it is an important direction for the Fund to move for some of its lending. We should soon have our first taker for that facility.

Having helped introduce these new lending facilities, the administration, together with their European allies, also pushed hard for a simplification of the Fund's array of lending vehicles. So we abolished a few outdated ones - including the CSF introduced in 1994 - and that made sense too.

Other innovations included setting up new groupings. The G20 brings 20 of the main industrial and developing countries into a group whose

precise purpose is not yet clear. Another newly created institution was the Financial Stability Forum, where the lead was taken by the Europeans. This proliferation of institutions has not been entirely helpful. There are too many meetings, too many overlapping groups, and too many working groups, which must surely take officials away from their regular work. Some rationalization of these groupings would be welcome. Such a rationalization could also involve making the meetings of the International Monetary and Finance Committee (IMFC) less formal and more useful to the participants, as well as possibly changing the composition of the IMFC.

The administration's views on capital mobility did not change much during its period in office. Throughout it supported countries keeping the capital account open, and for moving gradually, as the financial system and macroeconomic framework strengthened, to liberalize capital movements. Initially it supported amending the IMF's Articles of Agreement to make promotion of capital account liberalization a goal of the Fund, but in the face of Congressional opposition, it later withdrew its support. That was a pity, for giving the IMF the goal of promoting *orderly* capital account liberalization would make it more likely that future liberalizations will be well done. Some of the crises of the past were due to badly done liberalization.

My final comment is to note how the administration's views on exchange rate regimes evolved over time. Like the IMF, but much more so, its view shifted from support for pegs, at least as a tool for disinflation, to a strong preference for flexible exchange rates. At the same time, the administration recognized that once a country is in a pegged rate regime, forcing it out is very difficult.

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[1] These comments were delivered on June 27, 2001, in a session on "International Finance and Crises in Emerging Markets" at a conference on "American Economic Policy in the 1990s", held at the Kennedy School of Government, Harvard University. The background paper for the session, "Between Meltdown and Moral Hazard: The International Monetary and Financial Policies of the Clinton Administration" was prepared by Barry Eichengreen and Brad DeLong.

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