MAKE IMF AID PAY OFF

A Commentary

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Martin Feldstein ("In My View," July 10) contends that, by emphasizing structural and institutional reforms in Asian countries, the International Monetary Fund (IMF) is unwisely going beyond its essential task of correcting the balance of payments and intruding into the countries' political processes.

He is also troubled by the problem of "moral hazard"--that IMF financial support could tempt policymakers to delay adjustments or allow some creditors to escape losses, thereby encouraging excessive risk-taking in the future.

Mr. Feldstein proposes three questions the IMF should consider in deciding whether a particular measure ought to be included in a programme: whether it is needed to restore access to international capital markets, whether it is a technical measure that does not interfere unnecessarily with national sovereignty, and whether the IMF would ask for similar measures in major industrial countries. The IMF programmes for the three countries embroiled in the Asian crisis pass all three tests, plus a more important one that Mr. Feldstein does not ask.

The primary question must be: Does the programme address the underlying causes of the crisis? Financial sector and other structural reforms are vital to the reform programmes of Thailand, Indonesia, and Korea because the problems of weak financial institutions, inadequate bank regulation and supervision, and the complicated and non-transparent relations among governments, banks, and corporations, were central to the economic crisis.

IMF lending to these countries would serve no purpose if these problems were not addressed. Nor would it be in the countries' interest to leave the structural and governance issues aside: markets are skeptical of halfhearted reform efforts. Governments of all three countries are exercising their sovereign judgment wisely by not succumbing to the siren song of "quick fix" injections of liquidity but persevering instead with deeper reform programmes that will bring longer lasting economic gains. As for asking for structural reform in industrial countries, the IMF's candid recommendation to European countries on reducing labour market rigidities is a salient case on point.

The moral hazard concern, while essential to deal with, is easily exaggerated. To think that policymakers pursue risky courses of action because they believe that the IMF safety net will catch them if things go badly is far-fetched. Policymakers whose countries end up in trouble generally do not survive politically.

The conditions attached to IMF assistance gives policymakers incentives to do the right thing, not only when they come to the IMF but to take pre-emptive reforms before conditions deteriorate so much that they must come to the IMF. The political, economic and social costs of delayed reform in Thailand, Korea and Indonesia should give policymakers everywhere a renewed "moral imperative" to act sooner to avoid similar crises.

The thornier issues arise on the side of investors. Most investors in the Asian crisis countries have taken heavy losses, including equity investors and many who lent to corporations and banks. By the end of 1997, foreign equity investors had lost nearly three-quarters of the value of their equity holdings in some Asian markets. Many Asian firms and financial institutions will, unfortunately, go bankrupt, and their foreign and domestic lenders will share the losses.

Earnings reports indicate that, overall, the crisis has been costly for foreign commercial banks, although some short-term creditors, notably those involved in the interbank market, were protected for a while. This was unavoidable at the time because the IMF sought to avert a formal debt moratorium for fear of contagion. A debt payment standstill in one country, when markets were highly sensitive, would very likely have spread to other countries and possibly other continents. In any case, most creditor banks have now been bailed in, through negotiated extensions of the maturities of their loans in Korea and Indonesia.

Moral hazard is, therefore, a significant problem but one limited in scope to certain types of investors under special circumstances. Better ways of dealing with it must be found, and the IMF is considering alternatives for doing so.

An important task for the IMF in the future will be crisis prevention, as Mr. Feldstein suggests: "The IMF should work with countries that have not yet reached a currency crisis in order to prevent the large current account deficits or the excess short-term debts that could later precipitate a crisis." The experience in Asia confirms that prevention cannot be simply a matter of getting the macroeconomic fundamentals right. Because structural rigidities and institutional weaknesses can precipitate or worsen financial crises, the IMF must continue to broaden its economic surveillance of all member countries, and to make its analysis and policy advice to members timely, candid and transparent.

Still, we can be sure that, despite our best efforts, some financial crises will occur in future. To ensure global financial stability, therefore, the IMF must be prepared to act quickly in crisis situations and have access to adequate financial resources to help countries weather the crisis and recover--provided their governments are prepared to carry out the economic reforms manifestly in their countries' and the world's best interests.

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