# MULTILATERAL AGENCIES AND THE ASIAN CRISIS (1997-2000): A BORROWER COUNTRY VIEW (COLOMBIA)

(Abstract)

This paper analyzes, from a borrower country point of view, the performance of the multilateral agencies (IMF and World Bank) with respect to their institutional challenges as a result of the Asian crisis (1997-2000). We highlight the relative magnitude of the different financial packages that were arranged by these institutions, first for Mexico (1994-95) and, more recently, for some Asian countries, Russia, Brazil, and Colombia, to help overcome the financial turbulence. Such packages are also scaled with respect to the magnitude of their local financial crisis. It was found that Indonesia and Mexico were offered the more generous packages (12-22% of their GDPs), while those of Russia, Brazil and Colombia represented about 5% of their GDPs. The efforts of the IMF-WB for creating a "new financial architecture" are also placed in historical perspective (including the CCL and the CDF initiatives further enhanced in the Prague Meetings).

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# MULTILATERAL AGENCIES AND THE ASIAN CRISIS (1997-2000): A BORROWER COUNTRY VIEW (COLOMBIA)

## I. Introduction

The outburst of the Asian crisis in July of 1997 prompted an interesting debate around causes, duration, and contagion effects. It was initially thought that, given the lack of notorious structural problems in the region, in early 1998 the worst would be over. In fact, the fiscal accounts and the external sector did not reveal major problems, although in some cases the volatility of the capital accounts represented a real threat (IMF, 1997; World Bank, 1997).

There were, however, two unfavorable signals. On the one hand, some countries revealed a lack of exchange rate flexibility, notably Korea and Indonesia, and their export models were showing fatigue since the early 1990s, particularly Japan's (Krugman, 1997). On the other hand, most financial systems in Asia had endured a long period of "repression" and *dirigiseme,* while those economies that were moving towards a more liberalized system showed weak regulatory frameworks and bad supervision practices (clearly the case of Japan). See Krugman (1998a) and Clavijo (1998a).

As it has been extensively documented, the crisis not only got worse in the region during the first term of 1998, but ended-up generating a contagion effect over Russia and Brazil during the second term of that year. This international crisis had serious implications. During 1998, the ASEAN-5 countries (Indonesia, Korea, Malaysia, Philippines, and Thailand) most affected by the crisis saw their real-GDP contracting at –7.7%, while Latin America only grew 2%. As the crisis rebounded on Latin America during 1999, it generated a contraction of –0.5% and a slow recovery for the ASEAN-5 countries at only 0.3%. The crisis showed-up in net capital inflows of only US$30 billion for the ASEAN-5 during 1999, compared to the US$52 billion received in 1997, while in Latin America the net inflow was about US$67 billion, down from the US$107 billion of 1997 (World Bank, 1999a).

Contested hypotheses regarding causes and channels of diffusion of the crises have included the exhaustion of the “Asian Miracle”, the “moral hazards” built-in the solution of some cases (including that of Mexico 1994-95), and the occurrence of “herd effects” in a financial environment lacking adequate regulation and supervision. The International Monetary Fund (IMF) and the World Bank (WB) reacted in different ways, trying to accommodate unforeseen phases of the crises (local expansion/contagion) and a changing mood of the international markets (inflows/dry-outs). From the clamor of the G-7 governments for fresh resources to recapitalize the IMF-WB during 1998, the debate took the form of threats to the private markets to induce a bailing-in during 1999 that could improve distribution of the institutional burden sharing. Negotiations around discounts/honoring of the Brady bonds were particularly troublesome in the case of Ecuador.

Debt spreads, privatization plans, and the growth perspectives of emerging markets were seriously affected, forcing the world financial community to provide for new institutional arrangements that could help in the recovery of market confidence. During late 1997 and early 1998, private rating agencies moved swiftly to downgrade all ASEAN-5 countries (and also Japan), in some cases by as much as six grades, and by late 1998 most of the Latin-American economies had also been downgraded (with the notable exception of Chile).

In July 1999, Colombia announced formal discussions with the IMF oriented to the adoption of a medium term structural program. It was a “last resort” scheme that Colombia had used back in 1974 (under the modality of a “stand-by”), although in 1985-86 it operated under an “enhanced surveillance” (with no possible “drawings” from IMF resources). The support provided by the private rating agencies during the second term of 1998, which lead to ratifying the “investment grade” obtained back in 1995, was not enough to overcome several difficulties. In fact, during the first half of 1999 Colombia experienced: aggravation of the internal security situation, political turmoil regarding the peace process, a placement on a “watch situation for possible downgrade” by the rating agencies, and difficulties regarding the privatization program. On December 27th, 1999, an

Extended Fund Facility was signed for the amount of US$2.7 billion for the period 1999-2002 (equivalent to about 85% of the IMF-country quota). See Ministerio de Hacienda – Banco de la República (1999).

The purpose of this paper is to analyze, from the perspective of a country user of multilateral resources, the process of requirements to and responses from the multilateral institutions during the international crises of 1997-2000. The support received relative to some Asian countries, Russia, Brazil, and Colombia is placed in historical perspective. It was found that Indonesia and Mexico were offered the more generous packages (12-22% of their GDPs), while those of Russia, Brazil and Colombia represented about 5% of their GDPs. When such packages are scaled with respect to the magnitude of their local financial crisis, it was found that Mexico and Colombia received support representing about two thirds of the net cost of the (expected) financial crisis. Most of these countries faced, however, serious social challenges, as exemplified by the on-going events in Chiapas (Mexico), Jakarta (Indonesia), and Caguan (Colombia). The fungibility of the financial resources involved in such packages has helped in alleviating these social pressures.

The most relevant efforts of the IMF-WB as a result of the crises have to do with their contribution in creating the basis of a "new financial architecture." At the internal level of the multilaterals, such efforts were directed towards creating a "Contingency Credit Line" (CCL) in the IMF and building a "Comprehensive Development Framework" (CDF) in the WB. These initiatives are here placed in historical perspective, including the assessments discussed in Prague (IMF, 2000b,c; World Bank, 2000b). We conclude that, in spite of their well conceived theoretical basis, their implementation has not been encouraging enough for developing countries and that most likely the medium term positive effects will come from consolidating a "new financial architecture" that could provide better prudential regulations and financial supervision.

For the sake of brevity, we do not elaborate on the crucial role played by the regional banks and corporations in helping these countries, especially that of the Asian Development Bank (ADB), the Interamerican Development Bank (IADB), and the Andean Financial

Corporation (CAF). However, it is worth highlighting the expedite manner in which these regional banks provided additional resources that were quickly disbursed, alleviating the external financial stress brought about by the crises.

In section II we provide a summary of the contesting hypothesis regarding the origin and propagation of the Asian Crisis, in order to better understand the framework in which the multilaterals had to quickly operate. Section III is devoted to the financial packages put together for some Asian countries, Russia, Brazil, and Colombia over the period 1997-2000. Section IV tackles the issue of the "in-house" response of the IMF-WB to the crises under the form of the CCL and the CDF (above mentioned).

Finally, Section V deals with several issues regarding the financial crises, namely: prudential policies being discussed under the New Basle Agreement, the role of the Asset Management Companies (AMCs), and the importance of creating flexible bankruptcy legislation. The Asian Crisis has demonstrated that unless workouts are simultaneously tackled in the financial sector and at the firm level, it will be difficult to overcome the long lasting liquidity trap/"credit crunch" situation.

## II. Origin and Propagation of the Asian Crisis: Contesting Hypothesis

### A. The Legacy of the Mexican Crisis 1994-95

Different analysts have found common factors between the Mexican crisis of 1994-95 and the Asian crisis 1997-98. It is then useful to briefly state the contesting hypothesis about what "really" happened in Mexico in the mid-1990s.

The IMF (1995 p.90ss) offered three main hypothesis of the events that triggered the crisis of December 1994 – January 1995:

1. The first hypothesis had to do with "adverse internal shocks." There were certainly many of them: The January 1994 social up-surge in Chiapas, the March assassination of the PRI-Official Presidential candidate, the August announcement of the PRI victory,

and the launch of a Social Pact, challenged by a second social up-surge in December in Chiapas. This internal situation was aggravated by worldwide portfolio recompositions. By April 1994 net international reserves had decline from US$28 to US$11 billion, the exchange rate remained consistently on the most depreciated side of the band, and the interest rate on the domestic debt (CETES) had doubled, experiencing a rapid flight to short-term dollar denominated debt (TESOBONOS). In spite of the US$6 billion support by NAFTA members and the exchange rate band depreciation of an additional 15%, by December 1994 the foreign reserves had collapsed to just US$10 billion. Mexico had no other alternative but floating the peso against the dollar, which immediately took a dive of 40%.

2. The second hypothesis dealt with the "unsustainability of the current account of the balance of payments." One of the "trademarks" of the mid-1990s crises in Mexico is related to the role played by private investment projects in increasing the external imbalances, which averaged 7% of the GDP over the period 1992-94. By arguing that in the absence of significant fiscal imbalances external financing could sustain such current account deficits, the issue of volatility of the external resources was underplayed. Today it is clear that the external debt dynamics and the Foreign Direct Investment (FDI) volatility can easily turn the pegged exchange rate systems unsustainable, as happened in Mexico in 1994.
3. The hypothesis of "policy mistakes." One of them points to the issue of having pursued the convergence of the TESOBONOS interest rates towards the US.-treasuries, resulting in a lower-than-required interest rate level for Mexico. It is not clear, however, what policy instruments could have been used, considering that the fiscal accounts were already in a primary surplus close to 4% of the GDP. Most likely, the required policy implied a faster depreciation of the peso, which was finally the policy adopted.

It is interesting to point out that these hypotheses reappeared later during the Asian crisis, with some variations. Perhaps the most agitated debate had to do with the exchange rate systems. During the years 1998-99 became clear that only "polar" arrangements (either floating or fixed systems) can maintain the required credibility (Summers, 1999a), while

the "crawling bands" had to be abandoned in Brazil, Chile, Colombia, and Ecuador. Another interesting variation with respect to the Mexican crisis has to do with *the fragility of the financial* system as a propagation device of the crisis. This topic did not receive much attention during the early 1990s. Nevertheless, the issues of prudential policies and debt works outs for the firms are at the core of the required solutions to properly overcome the (five-year-old) financial fragility in Mexico, in most Asian countries, and the Andean Pact Countries (Colombia, Ecuador, and Venezuela).

## B. Origin and Propagation of the Asian Crisis

During the first term of 1998 it became evident that the Asian crisis was spreading out of the region. The first channel of diffusion was through trade, as a logical result of globalization. For instance, Chile was exposed to Asia in about one third of its exports, so the slowdown in the economic activity resulted in a sharp increase of its current account deficit up to 6% of the GDP, while economic growth declined from 7% to 2%.

The second channel of diffusion of the crisis was the financial fragility, particularly in the cases of Japan, Korea, and Indonesia. The culture of the economic conglomerates (*Chaebols* type) had prevailed over the microeconomic criteria. Governments interfered with credit allocations and corruption rings were later discovered, resulting in widespread bankruptcies. As a result of these serious limitations concerning the "Asian Miracle," the multilateral agencies were forced to think of a "new financial architecture."

Following the studies of Krugman (1997, 1998a,b, 1999), Sachs (1998), Radelet and Sachs (1998, 1999) and Fischer (1998, 1999a,b), it is possible to group under four categories the hypothesis surrounding the Asian Crisis explosion of July 1997, namely:

1. "Exhaustion of the Asian Miracle," which has two angles. The first one is related to the productivity decline, observed in Japan and the "Asian Tigers" since the mid-1980s (Ito, 1996; Clavijo, 1998a). The second aspect refers to the lack of proper prudential policies for the financial system, which became clear after the "speculative bubble" burst in Thailand. Both structural problems had existed for more than a decade, so it is

not easy to explain why the system broke down and why the economies have rapidly "rebound" without really fixing their financial systems in a significant manner (especially in the cases of Thailand and Japan).

2. "Lack of Democracy." Korea and Indonesia have shown not only lack of democracy but widespread rings of corruption. Given the absence of proper "check and balances" in those societies, some analysts conclude that in such countries there exists a peculiar "Asian capitalism." Again, this explanation seems to be more closely related to elements that operate as conduits of the crisis than to a trigger role.
3. "Moral Hazard." It has been said that in the process of helping some of these economies there appeared inconsistencies about who would receive support and who would be left to go bankrupt. For instance, Mexico was offered support for about US$48 billion during 1995, without the imposition of stringent conditionalities (Radelet and Sachs, 1999 p.10-14), in part because of the structural reforms adopted over the years 1982-86 (Loser and Kalter, 1992). A similar analogy could be made regarding the (contagion) financial crisis experienced by Argentina in 1995. The "moral hazard" problem experienced by the multilateral agencies in solving the Asian crisis could then have had some of its origins back in the mid-1990s. The possibility of "bailing-out" the private sector reappeared with the Russian crisis in August 1998, but on this occasion the result was a default on the short-term GKO-debt (World Bank, 1999 p.92). The immediate result of this "moral hazard problem" is that in the near future the multilaterals, specially the IMF, will be limiting resources to "last resort uses" (Fischer, 1999a; Summers, 1999b; IFIAC, 2000). The idea is then to "bail-in" the private sector in the crisis resolutions, as was attempted recently with regard to the Brady bonds of Ecuador, although without much success.
4. "Panics and Herd Effects." These are basic elements in any financial crisis (Kindelberger, 1978; Mishkin, 1982), but recent events have permitted to elaborate on sequencing. There are three new elements. The first one is related to the role of the exchange rate systems. As previously explained, pegged systems have recently suffered from lack of credibility (Summers, 1999b), so the switch to float/fixed systems in a fragile financial system generated additional macroeconomic instability on most countries affected by the crisis. Secondly, the issue of liquidity became crucial and was

first assessed using the ratio of Net International Reserves (NIR)/Broad Money, and more recently the NIR/Short Term External Debt. The speed of capital outflows and its potential negative effects were simplistically summarized in these indicators, giving the market another element to be hesitant about. Finally, it has been emphasized that contagion occurs in weak financial systems. Hence, emerging economies were asked to make an additional effort to strengthen their financial systems in a difficult moment. Lacking fresh resources, most governments had to issue long term domestic public bonds to cope with the new requirement of solvency ratios. The cases of FOBAPROA-IPAB in Mexico and FOGAFIN in Colombia illustrate the need to quickly look for mechanisms to inject fresh money into the financial systems of emerging market economies.

It is clear that the above mentioned issues played a role in generating the Asian crisis (especially points 1-3), while the last element of "herd effects," in an environment of poor prudential regulations, helps to explain the rapid propagation of the crisis to different regions. As it will be later analyzed, the IMF-WB structures were questioned in their ability to promptly respond to volatility of external flows and the fragility of the banking sector in countries affected by the crisis.

## III. Size and Composition of the Financial Packages: The Case of Colombia 1999-2000

### A. The Role of the Rating Agencies

"Herd effects" also affected the (private) rating agencies immediately after the outburst of the Asian Crisis. During the second term of 1997 sovereign debts and local bank ratings were quickly demerit, especially in Japan and Korea (Ferri et. al., 1999). However, when the crisis expanded to Latin America in September 1998, the rating agencies made efforts for properly discriminate those countries affected by contagion (like Chile) from those that faced structural problems (like Brazil). The latter underwent downgrading almost immediately (two notches) and practically all the region was placed on short-term negative outlook (Moody´s, 1999).

The downgrade of Colombia from "investment grade," which had been achieved through the years 1993-95, to "speculative grade" (beginning in August 1999) was particularly troublesome. The Pastrana Administration was admonished in early July 1998 that maintaining the "investment grade" (along with Chile and Uruguay) would require prompt actions to correct the external imbalances (nearly 5% of GDP) and the fiscal imbalances (almost 4% of GDP). Taking into account the fiscal actions and the declaration of a State of Economic Emergency in November 1998, Moody´s temporarily ratified the "investment grade" for Colombia in December 1998, although the outlook remained negative. See details in Clavijo (1999). Standard & Poors was also monitoring Colombia and signaling a possible downgrade.

In January 1999 Brazil traumatically abandoned the crawling band system and Chile followed right after, leaving Colombia with the market speculating against the crawling band system that had already depreciated in additional 9% in June 1998. The exchange rate instability, the shortfall in tax collections due to the deep economic recession, the damage caused by the January earthquake that hit a densely populated coffee area, and the risks of contagion resulted in the final downgrade of Colombia in August 1999. Moody´s downgraded Colombia by two notches, placing it in the upper-scale of "speculative grade," while S & P downgraded one notch, maintaining the "investment grade," but under a split call. More recently, S&P and Duff&Phelps downgraded Colombia leaving her in all cases at the level of "speculative grade."

The treatment given to Colombia was rather benevolent when compared to that of some Asian countries. In fact, Indonesia and Korea were downgraded by six notches, Thailand descended by five grades and Malaysia fell four scales, although maintaining the "investment grade" (see Ferri et. al., 1999 p.337). After loosing credibility in the private markets, Colombia had no other alternative but to adopt a program of structural adjustments under the surveillance of the IMF (see details of the EFF-program in web-sites imf.org or banrep.gov.co). In the following section we will analyze the size and sources of the financial support offered to some countries.

## B. The Asian Crisis and the Financial Support

The upsurge of *private* capital flows during the 1990s created support for the emerging markets and the *private* rating agencies partially substituted the IMF-WB in its traditional role of surveillance. However, the Mexican crisis of 1994-95 and the outburst of the Asian crisis in mid-1997 made evident the negative impact that capital volatility can exert on medium term growth.

The IMF-WB, without having adequate information to distinguish liquidity from solvency problems, had to quickly react as the crisis spread (IMF, 1999d Cap. III). Both multilateral institutions underwent the highest historical financial leverage in order to gather the resources required by many countries facing structural and contagion problems. Accordingly, G-7 countries asked their parliaments for the additional resources. In many cases their Congresses pledged the required resources, but disbursements were conditional to overall reviews of the tasks being performed by the IMF-WB. The most illustrative story is that of the United States, were a recent Report to Congress is calling for drastic changes in objectives and operational principles of the multilateral agencies (IFIAC, 2000).

Table 1 shows the different components of the financial packages offered to Mexico, the Asian countries, Russia, Brazil, and Colombia over the period 1995-2000. The main features can be summarized as follows:

- Total resources offered to Mexico (1995) amounted to US$48 billion (about 12.3% of GDP), where US$20 billion came from the Exchange Stabilization Fund of the US-Treasury (facility later closed by the US-Congress);
- Indonesia (1997-98) was offered US$47 billion (about 22.7% of GDP), where the bilateral support represented close to 50% of the total.
- In both cases there was serious political unrest (the Chiapas revolts and the Jakarta turmoil, respectively) and there were elements of financial contagion, which contributed to understanding the generosity of these financial packages for Mexico and Indonesia.

Table 1

COMPOSITION OF RECENT RESCUE PACKAGES *

( Resources Offered, Billion of US$)

| Periods | IMF | Multilateral Banks | Bilateral Support | | TOTAL In US$ | TOTAL % of GDP ** | |
|---|---|---|---|---|---|---|---|
| **1995** | | | | | | | |
| Mexico | 17.7 | 11.1 | 20.0 | | 48.8 | 12.5 | |
| **1997 - 98** | | | | | | | |
| Indonesia | 11.2 | 10.0 | 26.1 | | 47.3 | 22.7 | |
| Korea | 20.9 | 14.0 | 23.3 | | 58.2 | 13.3 | |
| Thailand | 4.0 | 2.7 | 10.5 | | 17.2 | 11.5 | |
| Russia | 11.2 | 1.5 | 9.9 | | 22.6 | 4.7 | |
| Brazil | 18.1 | 9.0 | 14.5 | | 41.6 | 5.2 | |
| **1999-2000** | | | | | | | |
| Colombia (Base Scen. | 1.8 | 1.4 | 0.5 | a / | 3.7 | 4.0 | a / |
| (With Plan Colombia) | 1.8 | 1.4 | 1.5 | b / | 4.6 | 5.1 | b / |

* Excludes Tradicional sources, as "Pipeline".
** Refers to 1997 GDP value, World Bank (1999a) p.103.
a/ Excludes resources from "Plan Colombia"
b/ Includes (expected) first tranche of "Plan Colombia" for US$950 million.

Sources: IMF (1999), World Bank (1999a) and own calculations.

- In the more recent cases of Russia and Brazil, the quick response and the low conditionality imposed by the IMF-WB helped explain the smaller magnitude of the packages (about 5% of GDP in each case). The burden sharing of the bilateral agencies was also maintained close to 50% of the package.
- Finally, Colombia signed a three-year EFF agreement with the IMF for US$2,7 billion (1,900 million SDRs), equivalent to US$1,8 billion over 1999-2000. In turn, the WB approved US$500 million (additional to the "pipeline"), while the IADB approved quick disbursements for another US$850 million. In January 2000, the United States government offered an additional US$1,3 billion as part of the so-called "Plan Colombia." If the United States Congress approves this support (US$950 over 1999-2000), the total package for Colombia would represent about 5% of GDP, similar to the packages offered to Russia or Brazil, but significantly less than the 12-23% of GDP offered to Mexico or Indonesia.

Taking into account that international resources are, in general, "fungible" (Bosworth y Collins, 1999 p.163), in Table 2 we scale these financial packages with respect to the sizes of the financial crisis in order to measure the "relative support" provided by them. In the case of Mexico the financial support of 12.5% of GDP represents about two-thirds of the (expected) cost of the financial crisis (currently estimated at 19% of GDP). The financial packages offered to Indonesia, Korea and Thailand represent 57-110% of the (expected) cost of their financial crisis. By contrast, in the case of Brazil the support represents about a third of such cost, due to the fact that non-performing loans and the financial crisis were of a lower magnitude. For Colombia the relative support of the package in terms of the cost of the financial crisis could be as high as 84% (under the scenario of the "Plan Colombia" approval).

The figures provided above give support to the idea that multilateral and bilateral resources played a crucial role in quickly solving the financial difficulties resulting from the volatility of capital flows since the mid-1990s. Mexico, troubled Asian countries, Russia, Brazil, and Colombia received support ranging from 5-22% of their GDP, which in many cases represented (short-term) "full coverage" for the cost of their financial crisis (under the

Table 2

FINANCIAL CRISIS COST AND INTERNACIONAL SUPPORT

( Billion of US$ and Percentages)

| Period / Country | NPLs * / Loans | Cost of the Crisis: US$ | Cost of the Crisis: % of GDP ** ( 1) | Internat. Support: US$ | Internat. Support: % of GDP ** ( 2) | | Ratio Support/ Cost ( 2) / (1) % | |
|---|---|---|---|---|---|---|---|---|
| **1995** | | | | | | | | |
| Mexico | 12.0 | 72.2 | 18.5 | 48.8 | 12.5 | | 67.6 | |
| **1997 - 98** | | | | | | | | |
| Indonesia | 75.0 | 81.4 | 39.0 | 47.3 | 22.7 | | 58.1 | |
| Korea | 50.0 | 101.9 | 23.3 | 58.2 | 13.3 | | 57.1 | |
| Thailand | 55.0 | 15.7 | 10.5 | 17.2 | 11.5 | | 109.8 | |
| Russia | nd. | nd. | nd. | 22.6 | 4.7 | | nd. | |
| Brazil | 10.0 | 116.3 | 14.5 | 41.6 | 5.2 | | 35.8 | |
| **1999-2000** | | | | | | | | |
| Colombia (Base Scen.) | 18.0 | 5.5 | 6.0 | 3.7 | 4.0 | a / | 66.9 | a / |
| (With Plan Colombia) | 18.0 | 5.5 | 6.0 | 4.6 | 5.1 | b / | 84.3 | b / |

* NPLs:"non-performing loans".
** Refers to 1997 GDP value, World Bank (1999a) p.103.
a/ Excludes resources from "Plan Colombia"
b/ Includes (expected) first tranche of "Plan Colombia" for US$950 million.

Sources: IMF (1999), World Bank (1999a) and own calculations.

assumption of complete fungibility of resources). Very likely, the quick growth recovery that most of these countries are currently experiencing is rooted in this financial support and the structural reforms that have been implement since the crises broke out.

**C. Towards "Investment Grade"**

Mexico is a good example of quick recovery, but also of vulnerability. After the crisis of 1982-84 and 1994-95, there have been periods of rapid growth in 1987-92 and 1996-2000. This time the difference comes from a full commitment towards globalization, supported by NAFTA, and the deep rooted structural reforms (fiscal and political).

In light of rapid growth, above 4% per year since 1996, the rating agencies are upgrading Mexico. Moody´s granted it "investment grade" in March of this year and Standard & Poors followed right after. It is then relevant to make a parallel of Mexico and Colombia in order to gauge the required adjustment that the latter must undergo in order to recover the "investment grade" lost in August 1999.

Table 3 shows that the export ratio of Colombia is relatively low with respect to Mexico (18% vs. 33% of GDP). In terms of growth, Colombia is under-performing (0.7% per-year over the 1996-2000). However, the estimated cost of the financial crisis (6% of GDP) in Colombia is about a third of the estimate for Mexico, where FOBAPROA/IPAB are managing about US$90 billion of non-productive assets.

External liquidity indicators have been quite favorable in the case of Colombia. In fact, graphs 1 and 2 illustrate how the ratio NIR/Short term debt is currently above 170% and that of NIR/M2 is as low as 30%. This explains why Colombia continues to treat the IMF facility as a *de- facto* "precautionary" line, while accessing the private capital markets (US$500 million in December 1999 and US$750 million in February 2000), although at a significantly higher costs when compared to Mexico.

Table 4 illustrates the importance of Mexico (about 18%) in the case of the Lehman Brothers portfolio during 1999, similar to that of Brazil and Argentina. Mexico is likely to surpass its recent good performance, thanks to the promotion to "investment grade" in early 2000 and the gains from the oil-price boom, now extending onto year 2001.

Table 3. Mexico and Colombia: Main Indicators (Year 1999)

| | Mexico | Colombia |
|---|---|---|
| Grading (Moody's) | Ba1 (A notch below "investment") | Ba2 (Two notches below "invest.") |
| Exports / GDP | 33% | 18% |
| GDP annual growth (1996-00) | 4.5% | 0.7% |
| Financial Crisis Cost / GDP | 18% | 6% |
| NIR / Imports (Gs&Ss) | 2.8 Months | 5.8 Months |
| NIR / Short Term Debt | 116% | 180% |

Source: Lehman Brothers (2000a) and our computations.

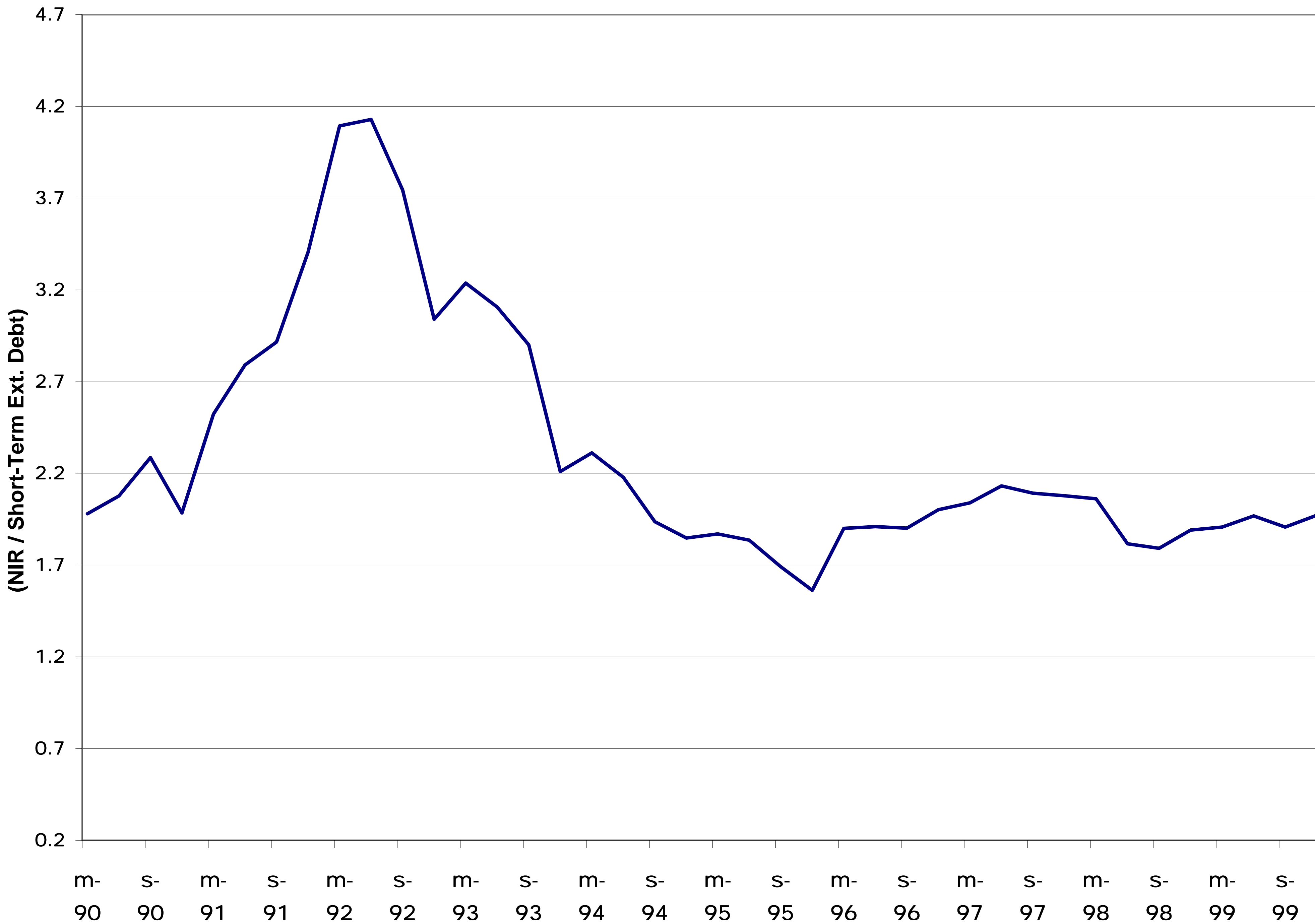
In the near future, Colombia could replicate the successful path followed by Mexico towards "investment grade" by persevering with its fiscal adjustment. If the Colombian Congress approves the Constitutional Reform aimed at "capping the territorial transfers" and the income tax reform is successful in reducing the marginal rate, while amplifying the tax base, then Colombia would be back on her long-term growth track. The recent idea of Colombia initiating talks towards joining NAFTA or extending ATPA-CBI concessions would then have a solid ground.

## IV. The Multilaterals and the Financial Reform

### A. Institutional Reforms

As a response to the difficulties faced by the emerging markets during the second half of the 1990s, the Boards of Directors of the multilaterals have been working on implementing a set of reforms. The idea is to reduce the risks of contagion (now that the world operates in trading blocks) and to better supervise the financial systems (see IMF, 1999e, cap. III and Fischer, 1999b).

**Graph 1: Colombia, (Net Int. Reserves / Short-Term External Debt)**
**1990 - 1999**



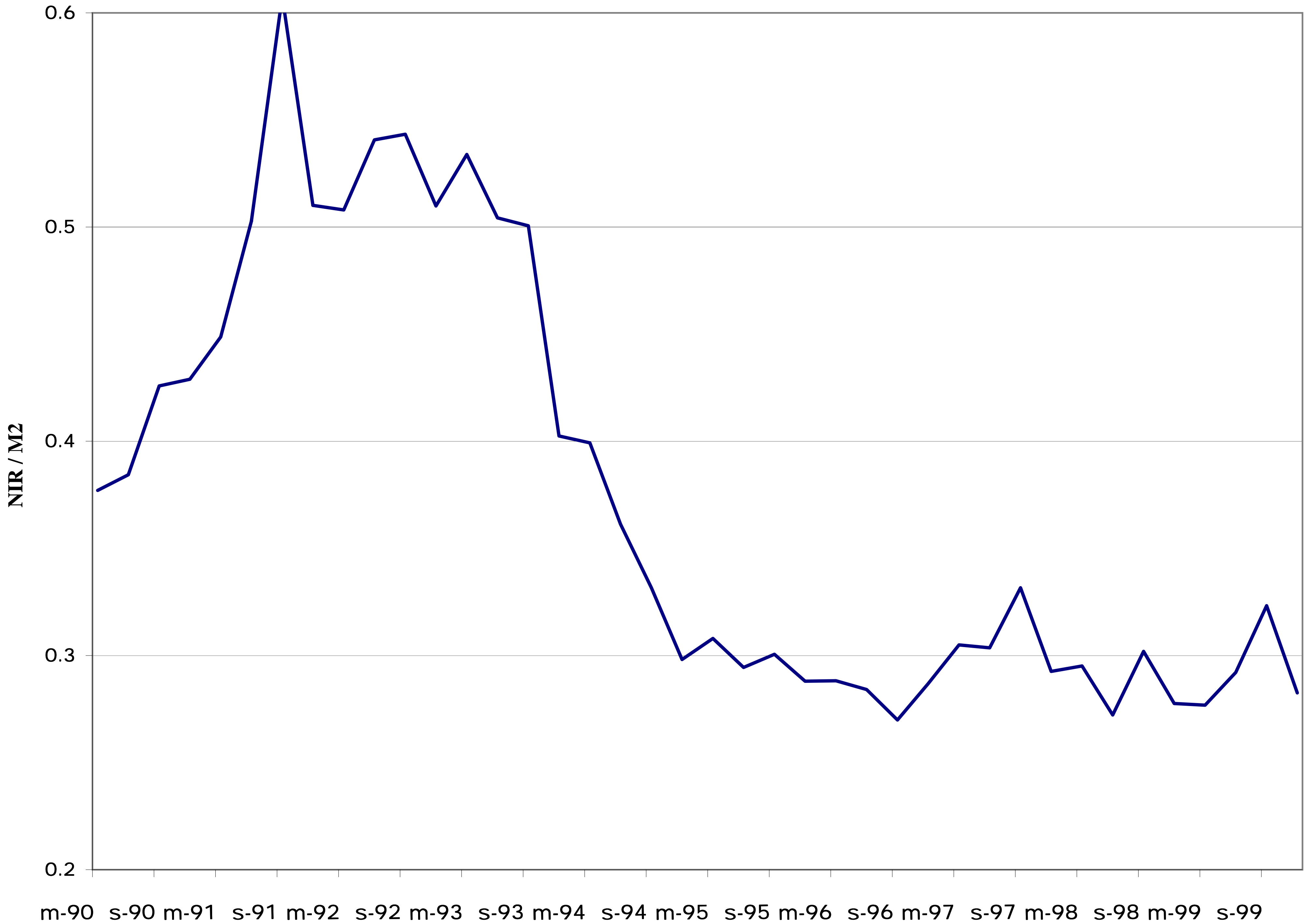

Graph 2: Colombia, (Net Int. Reserves / M2)
1990 - 1999
NIR / M2
0.6
0.5
0.4
0.3
0.2
m-90
s-90
m-91
s-91
m-92
s-92
m-93
s-93
m-94
s-94
m-95
s-95
m-96
s-96
m-97
s-97
m-98
s-98
m-99
s-99

Table 4

EMERGIN MARKETS PERFORMANCE
AND RELATIVE WEIGHTS, 1999
( Percentages )

| | Weights in the Portfolio Index | Yields | Moody´s Ratings |
|---|---|---|---|
| Latin America | 67.7 | 18.8 | ------ |
| Brazil | 18.0 | 37.3 | B2 |
| Mexico | 19.1 | 14.7 | Ba2 |
| Argentina | 19.2 | 12.1 | Ba3 |
| Venezuela | 5.2 | 22.2 | B2 |
| Colombia | 1.6 | 9.4 | Ba2 |
| Other | 4.6 | ------ | ------ |
| Asia | 17.7 | 17.8 | ------ |
| Europe | 8.4 | 86.0 | ------ |
| Middle East | 2.8 | 16.6 | ------ |
| Africa | 3.4 | 16.6 | ------ |
| TOTAL | 100.0 | 23.1 | ------ |

Source: Lehman Brothers (2000) and Moody's.

In light of the need to rethink the "Washington Consensus," different analysts have been suggesting three types of actions (Sachs, 1997):

1. To include in the decision-country groups some emerging market countries to better balance the political and economic costs. The recent creation of the G-22/3 could be seen as good progress in extending for that purpose the powerful G-7.
2. To focus and expedite actions of the multilaterals towards alleviating poverty in the third world. The overlapping of activities between IMF-WB continues to be one of the main problems at hand in the opinion of many well-known analysts (Gilbert, et. al. 1999; Collier y Gunning, 1999 p.638; IFIAC, 2000). The after-crisis has shown the advantages of "polar" exchange rate arrangements (Fischer, 1999a), so this division of labor should now be more clear: the IMF should focus on surveillance and the WB on development of the most troublesome areas, using its relatively low-cost financial leverage (Stiglitz, 1999 p.589).
3. Finally, there have been several proposals to help restructure the debt of the poor countries. During 1999, Canada, UK, and USA supported initiatives purporting the 100% debt forgiveness of the HIPC, but during the Prague Meetings of 2000 only Canada spoke vigorously about it. However, problems remain regarding other poor countries and the treatment that other regional banks would give them. Even the multilaterals are "learning by doing" in this process of debt restructuring (Fischer, 1999a p.574).

Most of these proposals made sense even before the Asian crisis; the crisis aftermath have revealed them as imminent. It should be stressed that the IMF-WB moved quickly to assess the possible effects of contagion over Latin America in September 1998 by calling special surveillance meetings (see IMF, 1999b). In this context, Malaysia adopted administrative controls over capital outflows (Krugman, 1998b), but Chile and Colombia further relaxed their taxes on capital inflows.

At that moment, the Under-Secretary of the US-Treasury called for the following (Summers, 1999 p.5):

1. To expedite the design and implementation of quick disbursement credit lines and to explore contingency lines,
2. To flexibilize fiscal adjustment programs in line with the “social stress” that was erupting as a result of the crisis (this element was key for Colombia’s program) and
3. To establish standards of “transparency” and “dissemination” of information, as a way to avoid problems such as those experienced during the Mexican crisis (IMF, 1999c).

The IMF focused on elaborating “complementary financial facilities,” while the WB further elaborated on its early 1990s idea of having a general framework for development planning.

### B. The Contingency Credit Line (CCL) of the IMF

During the AIDB March 1999 meeting, the contingency credit line idea generated many expectations for the Latin-American countries. It was stated there that the CCL had had good acceptance in previous IMF board meetings and that the mechanics of it was being worked out. The basic principle was that such a line would be available only for countries that had a sound track record and that were exposed to potential contagion.

There were initially three basic modalities under which the CCL would operate (IMF, 1999a):

1. “Fund Monitored Program,” in which the country adopted a program that the IMF could endorse and the Board stood ready to approve resources if the contagion appeared. This was a variation on the mid-1980s “enhanced surveillance” figure used by Colombia, among others.
2. “Augmented Option,” in which the amount of resources could be augmented, but there was no obligation from the Board to commit such additional resources.
3. “Commitment Option,” in which countries adopted a formal IMF program and the Board stood ready to approve disbursements if the program was on track.

Option No.3 has prevailed. This is not significantly different from the existing “Supplemental Reserve Facilities” (SRF), which operates as a higher tranche of a “stand-

by." The debate continues (Fischer, 1999 p.570), while not a single country has gained access to the CCL arguing "contagion." Several issues, including the thorny one of "burden sharing" among multilaterals, have further complicated operational progress. However, during the Prague Meetings of 2000 progress was made towards "making (the CCL) a more effective instrument for preserving crises and resisting contangion for countries pursuing sound policies" (IMF, 2000b p.4). However, in the meantime, this will also require that Stand-by Arrangements and Extended Facilities be adapted to encourage countries to avoid reliance on Fund resources for unduly long periods or in large amounts.

In synthesis, discussions around the implementation of a CCL did not surpass the level of revision of the existing mechanisms. The need for "bailing-in" the private sector and the new focus of the IMF as "a lender of last resort" (Fischer, 1999b) obstructed the implementation of a good idea that initially had captured the hopes of many emerging markets.

**C. The Comprehensive Development Framework (CDF) of the WB**

As a good response to social needs, the WB launched the idea of adopting a CDF to help guide the development programs of the poor countries (Wolfensohn, 1998; 1999). For this idea to be successful, it is required local governments to get involved in the design of the programs and to commit themselves to their implementation. Pilot programs were being worked out in Bolivia, several poor African countries, and in the region of West Bank and Gaza (World Bank, 2000b p.13). This idea can be characterized as a deepening of the relatively successful *policy-framework paper* (PFP) that helped frame the structural joint work of the IMF-WB throughout the 1980s by means of the SAF-ESAF programs. However, the implementation of the CDF requires that the so-called Strategic Compact succeeds in changing the Bank's internal culture, which "traditionally focused more on getting loans out the door than on achieving productive results" (Gopinath, 2000 p.38).

Besides its "holistic approach," one outstanding feature of the WB new operational framework has been a closer contact with the local needs of the borrowing countries. This

orientation entailed a redeployment of about 1,010 staff out of Washington D.C. onto the field. To further enhanced this "onto the field approach", the WB could improve the coordination with regional banks, particularly with the IADB and the Asian Development Bank (ADB), (see IFIAC, 2000 p.6-7).

Lack of appropriate coordination has been one of the mayor problems of WB operations. This is not easy to achieve, given the different approaches to sectoral development programs (Gilber et.al. 1999 p.626) and the multiplicity of objectives (about 80,000 were identified by the IFIAC). The IMF in turn is criticized for having a "too rigid approach" to macroeconomics stability, which is not easy to relax when operating in "emergency-room" environment.

In summary, the perception of several emerging markets is that the IMF-WB made some efforts to come up with "new products" to face crises, but their implementation has been slow. Making a long term difference will require deeper institutional changes in the line of avoiding overlapping and maintaining close contact with the local governments (Fischer, 1999b; IFIAC, 2000). It should be recognized that the multilateral agencies have made a fair effort in avoiding a mechanic application of their programs. For instance, this was achieved by changing the course in Asia during 1998-II/1999 with respect to the over-adjustment of the period 1997-II/1998-I, as analyzed by Radelet and Sachs (1998, p.55-61; 1999). There has also been an "up-lifting" of the social face of those institutions (IMF, 2000; World Bank, 2000a).

**D. The New Financial Architecture**

There is no doubt that the most enduring impact of the Asian crisis has to do with the reforms of the financial system, worldwide and at the country level. The main purpose is to better implement *in-situ* banking supervision, increase capital requirements, and to revisit the issue of risk weights allocated to short-term external debt (United Nations, 1999; IIF, 1999; IMF, 1999e; Mishkin, 1999).

However, overcoming the credit crunch situation of many emerging markets also calls for imaginative schemes of debt restructuring and proper provisioning, while avoiding "moral hazard" problems (Eichengreen, 1999 pgs.14-18). Many of these issues aroused during the IMF-WB "Collaboration Concordat of 1989" and their Coordination Committees have accelerated their work over 1997-99 (Fischer, 1999b; Stiglitz, 1999; IMF, 2000).

The best manner to tackle these complex issues is by briefly focusing on their microeconomic aspects. We will limit our comments to the most relevant ones.

The New Basle Rules

The Achilles' heel of the 1988 Basle Agreement has been how to properly weigh the risks involved in different banking activities. It has become evident that there is not an adequate treatment of the short-term external credit lines, which showed great volatility over the period of the crises.

The Committee in charge of Reforming the Basle Agreement will be providing final recommendations during the current year, after analyzing four different approaches to solving the main problems (United Nations, 1999 pgs.32-47; The Economist, 1999):

1. Using the private banking risk *models* to infer from them the criteria for allocating risk weights. The problem of this approach is the existing variety of models, which would make hard to come with a good worldwide standard.
2. Using the *ratings* produced by the private banks and standardizing them, as proposed by the European Union. However, implementation outside the EU would be complex.
3. Resorting to the private rating agencies, although their use outside the United States is rather limited (except for sovereign debt). In this case there would be a "moral hazard" problem in which these private institutions would be paid for assessing market risks for their clients. There would also be difficulties homogenizing treatment for institutions that have been on long-term watch by these agencies.
4. Issuing banking "subordinated debt" for the purpose of letting the market determine the institutional risks. Such debt would face yield limits and their comparison with low-

risk instruments would permit the creation of a benchmark for gauging market-determined solvency.

Coming to an agreement requires close work between the European Bank, the FED, and the BIS. The IMF would implement such standards worldwide and the WB and regional banks would facilitate loans and technical support for adopting the standards under the New Basle Agreement.

"Constructive Ambiguity" against "Moral Hazards"

Conditionalities imposed on Mexico in 1995 resulted weaker and asymmetric when compared to those adopted in Asia in 1997. Russia and Brazil received confusing signals during 1998. It has been said that "moral hazards" generated by these unequal treatments induced behavior that contributed to contagion (Radelet and Sachs, 1999).

One antidote concerning this problem is for the monetary authorities to adopt a position of "constructive ambiguity," so that institutions know that under liquidity problems they will receive financial support, but not when going through solvency problems. The gray area between liquidity and solvency could better be identified if the bank supervision tasks are carried out by an independent institution, like a Central Bank (Minsky, 1999 p.1530).

Deposit Insurance

In spite of the well known problem of the deposit insurance (which is likely to generate insecure practices by the banks and their customers), the recent literature supports the existence of such insurance with the purpose of creating a "financial safety net" (Eichengreen, 1999 p.3).

Recent financial fragility calls for the existence of such "safety net" (Demirguc-Kunt and Detragiache, 2000), but the problem remains of properly assessing the risks by institution. Individual monitoring is not only costly, but faces also the risk of "collective action." The

experiences of US, Mexico, and Colombia show that good regulations should carefully limit the amount insured and adopt mechanisms that implicitly differentiate by risks (for instance, by allocating drawbacks according to risks). See details in Clavijo (1998b).

Tobin Tax vs. *a la* Chile-Colombia

Chile and Colombia avoided volatility of short-term external debt by imposing a tax that took the form of incremental reserve requirements according to a time-span (up to 100% for very short-term debt). This practice showed some positive results over the years 1992-97, maintaining an average maturity of seven years and the one year-term below the 11% of the total. The Chilean-Colombian type tax, by focusing on capital inflows, has been highlighted as causing less distortions than the Tobin Tax adopted in a surprisingly manner by Malaysia, which focused on capital outflows (Fischer, 1999b p.564 and Eichengreen, 1999 p.88).

Another variation has been the domestic transaction tax adopted by Brazil and Colombia in recent years (at the rates of 0.38% and 0.20%, respectively). However, in the latter case the tax is also applied on interbank and foreign exchange transactions, negatively affecting the financial sector performance. The use of this transaction tax at the level of demand deposits and saving-accounts drawings, and as a "withholding tax," could be a good policy instrument to improve tax collections.

Debt Restructuring and Bankrupt Regulations

The need for debt restructuring in emerging markets has been usually the result of abrupt exchange rate depreciation. This was the case of Mexico in 1982-84, requiring the FICORCA scheme to differ in time the cost of serving private foreign debt. It was also the case of Colombia with the Resolution 33 of 1984 (Caballero, 1997; Palacios, 1997 p.254) and more recently the case of Indonesia with the INDRA scheme (Eichengreen, 1999; IIF, 1999 Appendix A).

During the current crises, schemes of local debt-equity-swaps have been explored as a financial devise to restore the capital of firms. Financial institutions are obliged to resale equity in 3-5 years in order to reinstate the principle of the "Chinese Wall" that has traditionally existed between the real and the financial sector.

Table 5 illustrates indicators related to emerging markets facing financial crisis. The size of the crisis, measured by the ratio of non-performing loans (NPL)/Total Loans, was higher in Indonesia and Thailand (52-55%) than in Korea, Mexico or Colombia (12-18%) by end of 1999. As related to their GDPs, the crisis was lower in Mexico and Colombia (6-18%) than in the Asian countries (22-53%).

Indonesia and Thailand have already adopted the required institutional changes to tackle the complex issue of debt restructuring and bankruptcy treatment in the best spirit of agile Chapter 7-11-type of resolutions (FMI, 1999e p.60). IPAB in Mexico is awaiting Congress approval of an appropriate law, while FOGAFIN in Colombia is in the process of solving legal problems with the Constitutional Court (Restrepo, 1999 p.322). In parallel, most countries are finding ways out of the credit crunch, where the recent Japanese experience with state guarantees looks promising (Kanaya and Woo, 2000 p.44).

Table 5: Financial Crises and Debt Restructuring
(End of 1999)

| (Percentages) | Indonesia | Korea | Thailand | Mexico | Colombia |
|---|---|---|---|---|---|
| NPLs * / Loans | 55 | 16 | 52 | 12 | 19 |
| Net Cost of the Crisis * / GDP | 22 | 23 | 53 | 19 | 6 |
| Provisions/ NPLs * | 22 | 13 | 25 | 95 | 31 |
| Asset Manag. Comp. / NPLs.* | 51 | 42 | Na. | Na. | Na. |
| Required Capital / GDP | 35 | 8 | 14 | 4 | 4 |
| Recapitalization / Required Capital | Na. | 31 | 51 | Na. | 50 |

* Includes all non-productive assets and loans, but excludes "own assets."
Sources: IIF (1999); FMI (1999e); Lehman Brothers (2000a); FOGAFIN, and own calculations.

Solving the financial crises will require, however, having access to fresh money in order to recapitalize banks and firms. Requirements are rather high in Indonesia (34% of GDP) and

Thailand (14% of GDP), and moderate in Mexico and Colombia (4% of GDP). Perhaps the only country that is recapitalizing its financial system at a good speed is Korea (31% of the requirements), while it has successfully mobilized around 42% of the non-productive assets.

## V. Conclusions

We have analyzed, from a borrower country point of view, the performance of the multilateral agencies (IMF and World Bank) with respect to the institutional challenges posed as a result of the Asian crisis (1997-2000). We highlighted the relative magnitude of the different financial packages that were arranged by these institutions, first for Mexico (1994-95) and, more recently, for some Asian countries, Russia, Brazil, and Colombia, to help overcome the financial turbulence.

It was found that Indonesia and Mexico were offered the most generous packages (12-22% of their GDPs), while those of Russia, Brazil and Colombia represented about 5% of their GDPs. The efforts of the IMF-WB for creating a "new financial architecture" were also placed in historical perspective (including the CCL and the CDF initiatives).

The perception of several emerging markets is that IMF-WB made some efforts to come up with "new products" to face the crises, but their implementation has been slow. Making a long-term difference will require deeper institutional changes in the line of avoiding overlapping and maintaining close contact with the local governments. It should be recognized that the multilateral agencies have made a fair effort in avoiding mechanic applications of their programs and that there has also been an "up-lifting" of their social face.

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