Hans Visser* and Jan ter Wengel**

The Asian Crisis, the IMF and Dr Mahathir

While in the literature concerning the Asian crisis extensive coverage has been given to the course of events in the countries implementing IMF-supported programmes, scant attention has been paid to other countries that also suffered from the crisis. Potential alternatives to the IMF way of handling the crisis are thus in danger of being neglected.

Much has been written on the causes of the Asian crisis and whole rivers of ink have also been spilled on its aftermath. Lively discussions have been taking place on the pros and cons of the IMF packages imposed on, in particular, Korea, Indonesia and Thailand. To its credit, the IMF does not shy away from such discussions and it freely admits that it did not foresee the severity of the crisis.[1] It has responded to the substantial decline in GDP in these countries by allowing more expansionary monetary and fiscal policies and it cannot be accused of dog-matism. It even more or less openly admitted not only that it had been taken by surprise but also that it had been a little baffled by the nature of the crisis, differing as it did from most other crises where the help of the IMF was invoked.[2] Whilst the course of events in the countries implementing IMF-supported programmes is extensively analysed, however, scant attention is given to other countries that also suffered from the Asian crisis. Potential alternatives to the IMF way of handling the crisis are thus in danger of being neglected. We feel that, in particular, the imposition of capital controls as a crisis measure should not be dismissed out of hand. There is, therefore, every reason to compare the experience of Korea and Thailand with that of Malaysia (no attention will be paid to Indonesia because of the political situation, which gave the economic crisis a particular, and nasty, twist).

We do not go into the causes of the crisis, but we recognise that poor regulation and supervision of the banking system has played a major role in deepening the crisis and that tying one's currency to the dollar at a time when the dollar is rising vis-à-vis the yen (from a low of 80 yen to the dollar in 1995 to 147 in June 1998[3]) does little to prevent the the balance of payments on current account deteriorating and making investors nervous. Still, the current account deficit was already declining in Malaysia before the crisis broke out and at least in the case of Malaysia can hardly be seen as a cause of the trouble (see Table 1).

Our analysis starts with the exposition of a standard dependent economy model that, though simple, can accommodate the salient features of the Asian crisis insofar as they are related to the exchange rate. On the basis of this model, we discuss the various ways of handling the crisis. Finally, we go into more detail and compare Malaysia's response to the crisis with the IMF approach implemented by Thailand and Korea.

A Dependent Economy Framework for Analysing the Asian Crisis

Theoretical models can, of course, not be seen as truthful depictions of reality. They are, rather, constructs that enable us to get a mental grip on the world around us. As McCloskey wrote, 'We humans must deal in fictions of our own making. Whether or not they correspond to God's Own Universe is something we cannot know'.[4] We do not maintain, therefore, that the neoclassical dependent economy model is necessarily the best model for analysing the Asian crisis, but we feel that some important aspects of that crisis can usefully be studied within that framework. This modest claim implies that the model should not be applied mechanically. We are fully aware, for instance, that continuous full employment,

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[1] See, e.g., 'The IMF's Response to the Asian Crisis' – Factsheet, January 17, 1999; http://www.imf.org/External/np/exr/facts/asia.htm.

[2] 'Summing Up by the Chairman: Fund-Supported Programs in the Asian Crisis; Executive Board Meeting December 21, 1998', in T. Lane et al.: IMF-Supported Programs in Indonesia, Korea, and Thailand: A Preliminary Assessment, http://www.imf.org/external/pubs/ft/op/opasia/index.htm, January 1999, pp. 141 ff.

[3] R. Wade: From 'miracle' to 'cronyism', in: Cambridge Journal of Economics, Vol. 22, No. 6, 1998, p. 698.

[4] D. N. McCloskey: Knowledge and persuasion in economics, Cambridge University Press, Cambridge 1994, p. 195.

an assumption in our model, cannot be taken for granted.

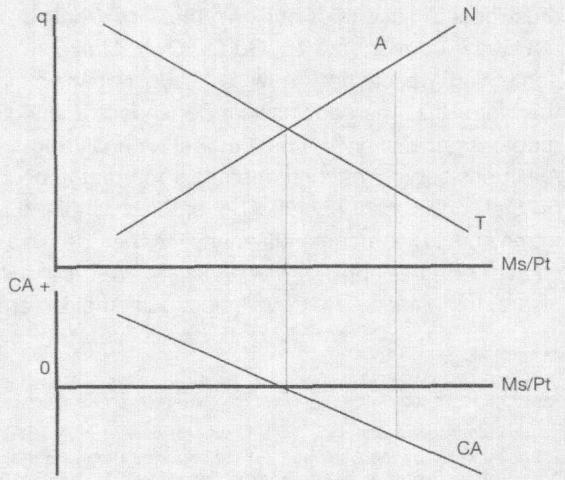
The dependent economy model is neoclassical in the sense that the price mechanism ensures that full employment is maintained or, after a shock, quickly restored. In the basic version of the model there are two goods, tradeables and nontradeables.[*] The price mechanism ensures constant full employment equilibrium in the nontradeables sector. In the tradeables sector there may be excess supply or excess demand, i.e. a surplus or a deficit on the current account (we equate the current account with the trade account). Capital flows plus changes in foreign exchange reserves can accommodate such imbalances. Only in a free-floating system without capital flows (and, by definition, without interventions by the central bank) is the current account permanently in equilibrium and the excess supply or demand in the market for tradeables consequently always zero. Demand and supply for tradeables on the world market are fully price-elastic and the demand and supply of loanable funds are fully interest-elastic. In other words, the country faces given world prices of tradeables and a given international interest rate, which explains the dependent economy moniker.

Table 1
Current Account Deficits in Korea, Malaysia and Thailand
(as a percentage of GDP)

	Korea	Malaysia	Thailand
Average 1990-95	–1.2	–6.2	–6.6
1996	–4.7	–4.9	–7.9
1997	–1.8	–4.2	–2.0
1998 (expected)	13.3	11.0	11.4
1999 (forecast)	8.7	9.2	8.4

Source: 'Economic and Financial Situation in Asia: Latest Developments'. Background paper prepared for presentation by Michel Camdessus, Managing Director of the International Monetary Fund; Asia-Europe Finance Ministers Meeting, Frankfurt, Germany, January 16, 1999; http://www.imf.org/external/np/speeches/1999/011699.htm.

Figure 1
The Dependent Economy Model with Fixed Exchange Rates



N = line or curve depicting equilibrium conditions on the market for nontradeables;
T = line or curve depicting equilibrium conditions on the market for tradeables;
CA = balance on the balance of payments on current account;
Ms = nominal money supply; Pt = price of tradeables; q = ratio of price of nontradeables to price of tradeables.

Figure 1 depicts the equilibrium conditions for the market for tradeables and the market for nontradeables. The market for nontradeables is always in equilibrium and the economy is therefore permanently at a point on the N curve. The distribution of production between tradeables and nontradeables is a function, and only a function, of the relative price q of the nontradeables. An increase in q makes it attractive for producers to shift factors of production from the tradeables industry to the nontradeables industry. In order to maintain equilibrium, demand for nontradeables has to increase correspondingly. In the model, demand is dependent on q again and on (financial) wealth, represented by real cash balances (found by deflating the nominal money supply by the price of tradeables rather than the general price level, which is more convenient for studying the effects of current account imbalances and exchange rate changes). N consequently has a positive slope in the Ms/Pt, q plane. For the T line or curve a similar reasoning applies. An in-crease in the relative price of tradeables, i.e. a fall in q, makes producers shift resources from non-tradeables to tradeables. Equilibrium requires, again, an increase in wealth. The T line or curve thus slopes downward. Given that the economy is always at a point on N, it follows that the the balance of payments on current account is in equilibrium at the point of intersection of N and T. To the right of that point the value q is above the value that would bring equilibrium in the trade-ables market; i.e. the relative price of tradeables is below its equilibrium value.

[*] The exposition draws heavily on J. A. Frenkel, M. L. Mussa: Asset markets, exchange rates and the balance of payments, Ch. 14, in: R. W. Jones, P. B. Kenen (eds): Handbook of International Economics, Vol. II, North Holland, Elsevier 1985, and on exercises on the basis of their model in: H. Visser: A Guide to International Monetary Economics, Edward Elgar, Aldershot 1995, Ch. 3.

There will be excess demand for tradeables, i.e. a deficit on the current account. At any point on N to the left of the point of intersection there is a surplus on the current account.

Unemployment and sticky prices could be included. At any point to the left of N wealth, and consequently aggregate spending, is too low for equilibrium in the tradeables market. A shock that reduces domestic spending thus may not make the system slide downward along the N curve but, at least initially, shift to the left of the N curve.

Ways of Handling the Asian Crisis

The economies hit by the Asian crisis were characterised by a sudden drying up of net capital inflows after a protracted period of net capital imports and current account deficits. Exchange rates were perhaps not fully pegged to the dollar but yet kept more or less stable. Such a situa-tion corresponds to point A in Figure 1. If net capital imports now suddenly dry up, the economy has to move to the intersection of N and T in order to prevent unemployment. In the case of net capital outflows it would even have to move further to the left. In any case, a downward movement along the N curve is implied. Under a fixed peg, this would require a fall in nominal prices on the N market. To some extent that could happen without too much disruption to the economy: current account deficits are typical for a situation where domestic spending exceeds domestic income. There is increas-ed aggregate demand (with respect to the situation of current account equilibrium), which leads to net imports in the tradeables sector and to higher prices in the nontradeables sector. With net capital imports and consequently aggregate spending falling, nominal prices in at least some parts of the nontradeable sec-tor can be expected to give way rea-sonably quickly, in particular real estate prices. But a fall in prices of other nontradeables, pri-marily services, would be conditional on a fall in nominal wages, which is harder to realise. Given that prices and wages are not as flexible as in the ideal neoclassical world which under-lies the model, a protracted period of relatively high unemployment can only be prevented if the required relative price adjustment is brought about by a devaluation of the domestic currency. Even then, a shift of resources from the production of nontradeab-les to the production of tradeables can be a painful process with serious transitional unemployment.

A shift to the left along N goes hand in hand with a fall in real balances as capital inflows stop and the balance of payments on current account is still in deficit. Monetary and fiscal policies will have to be restrictive in order not to stimulate spending and in that way contribute to a further depletion of foreign exchange reserves. But that is not the whole story. At any given combination of q and real wealth the pro-pensity to spend is likely to fall. For one thing, busi-ness firms get caught between falling sales and rising interest rates and if the domestic currency devalues while they have large uncovered foreign currency denominated debts it may even be difficult to avoid bankruptcy. This would destroy capital and reduce real wealth. The financial sector is also likely to be severely hit, both because of such foreign debts on the credit side of their balance sheet and because of a sudden rise in bad debts on the debit side. Bank credit will be harder to get. All this will contribute to a fall in domestic spending. But that means that the various curves in Figure 1 are likely to shift. A fall in the propensity to spend implies that at any value of q a higher value of real balances is required to make demand match supply. Both N and T (and con-se-quently CA) will shift to the right. This means that monetary policy, and fiscal policy for that matter (which is one determinant of the economy-wide propensity to spend), should be less restrictive than might be deemed necessary at first sight.

The existence of foreign currency denominated debt is a complicating factor that compounds the disruptive effects of a devaluation. Instead of sitting back and letting things run their course, the authorities could therefore try to stem the downward slide of their currency. One way to do this, essentially the course advocated by the IMF, would be to try to lure back investors, among other things by keeping interest rates high, and another potential way would be to stop or reduce capital outflows by introducing capital restrictions. There thus seem to be (at least) three ways open to the authorities to deal with an Asian crisis type of situation:

- laissez-faire, with possibly a precipitous fall in the external value of the domestic currency, widespread business failures and serious devaluation-induced inflation;
- the IMF way, with the immediate priority on restor-ing shattered investor confidence;[6]
- imposing (temporary) capital controls, as Malay-sia's Prime Minister, Dr Mahathir, did in October, 1998.

In all fairness it must be said that the IMF does not stop at demanding restrictive monetary and fiscal

policies. A prominent feature of the IMF packages for the Asian countries was structural reform in the financial and corporate sectors, aimed at restoring market confidence and at improving growth prospects, in addition to financial support.[7] Of course, temporary capital controls can go hand in hand with such measures. Indeed, Malaysia has taken steps to restructure the financial sector, forced by circumstances.[8]

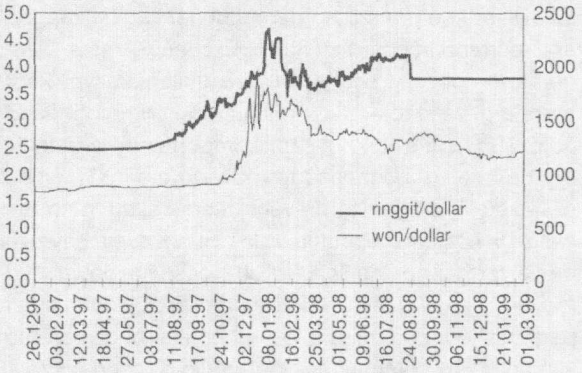
The question then arises as to which approach works better, the IMF approach or Malaysia's. Put differently: do (temporary) capital controls work and do the side effects not outweigh any benefits from capital controls? We shall look at the experience of Thailand and Korea on the one hand and Malaysia's on the other. It should be said at the outset that no firm conclusions can be drawn from such a comparison, mainly because capital controls were not introduced in Malaysia until October, 1998, long after the currency, the ringgit, had come under attack.

Thailand and Korea vs. Malaysia

The strategy chosen by the IMF in designing the policy packages for Thailand and Korea was to try and break what they saw as a self-reinforcing cycle of capital outflows, exchange rate depreciation, and financial sector weaknesses.[9] This included, among other things, monetary tightening and a reduction of fiscal deficits or even the creation of a fiscal surplus. The fiscal measures aimed on the one hand at facilitating external adjustment, i.e. at improving the current account of the balance of payments, and on the other hand at accumulating funds to be used for financing a cleaning-up of the financial sector. The IMF's immediate priority has been explicitly stated as the restoration of shattered investor confidence.[10]

It is our conviction that the priority given by the Fund to monetary and fiscal tightness was mistaken. In terms of Figure 1, this policy drives the economy further to the left than is warranted, aggravating the downturn (and unemployment, which is not in the diagram). The costs are high, the benefits in terms of creating confidence in a country's currency, which should translate into stabilisation, are negligible. In the case of Thailand, a stand-by arrangement was approved by the Fund's Executive Board on August 20, 1997, but that did not prevent the baht slipping from 32.3 to the dollar to 56.1 to the dollar on January 12th, 1998 (see also Figure 3 and Figure 4). On December 4, 1997, a stand-by arrangement for Korea was approved to the amount of US$ 21 billion. The World Bank, the Asian Development Bank and individual countries between them promised another

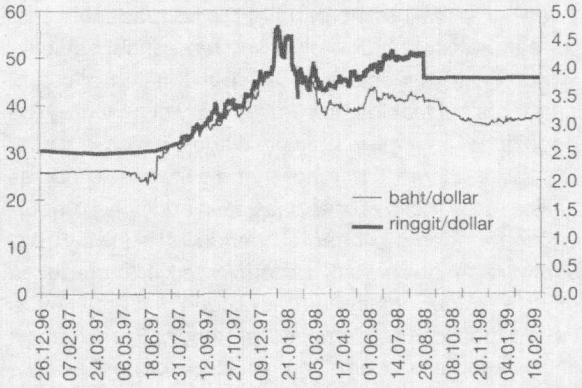
Figure 2
Malaysian and Korean Exchange Rates



Note: The ringgit/dollar rate is measured on the left-hand vertical axis, the won/dollar rate on the right-hand one.

Sources: Datastream; Malaysian rates before August 11, 1997 are from IMF: International Financial Statistics.

Figure 3
Malaysian and Thai Exchange Rates



Note: The ringgit/dollar rate is measured on the right-hand vertical axis, the baht/dollar rate on the left-hand one.

Sources: Datastream; Malaysian rates before August 11, 1997 are from IMF: International Financial Statistics.

[7] As explicitly stated by the Fund, see e.g. 'Economic and Financial Situation in Asia: Latest Developments'. Background paper prepared for presentation by Michel Camdessus, Managing Director of the International Monetary Fund, Asia-Europe Finance Ministers Meeting, Frankfurt, Germany, January 16, 1999; http://www.imf.org/external/np/speeches/1999/011699.htm.

[8] Ibid.

[9] 'IMF Concludes Article IV Consultation with Malaysia', Press Information Notice (PIN) No. 98/31, April 27, 1998. Available on the IMF website, http://www.imf.org.

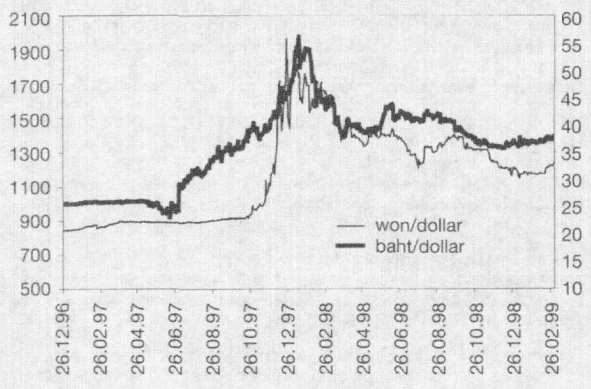
[10] T. Lane et al., op. cit., p. 6.

[11] T. Lane et al., op. cit., p. 6; 'The IMF's Response to the Asian Crisis', op. cit., p. 2. Economic and Financial Situation in Asia: Latest Developments, op. cit.

$ 37.4 billion. This did nothing to prevent the downward slide of the won accelerating into a precipitous fall, from 1172.5 to the dollar on December 4th to 1962.5 on De-cember 23th (see also Figure 2 and Figure 4). If economic agents expect a currency to depreciate in the short term, only draconic interest rate increases can stem a capital outflow (see sidebar). Nonetheless, the IMF asserts that, 'In Korea, Thailand, and more recently Indonesia, the tight-ening of monetary policies that occurred in the wake of the crises has achieved considerable success in reesta-blishing financial stability, and the strengthening of exchange rates has allowed interest rates to be lower-ed significantly'.[11] It is true that the exchange rates have recovered to some extent, but it is doubtful whether that can be ascribed to high interest rates. It could be suspected, rather, that investors need time to adjust their portfolios following a reassessment of a country's economic prospects and that this stock adjustment leads to exchange rate overshooting.[12] Indeed, the IMF itself notes that empirical studies do not find strong and unequivocal evidence that tight monetary policies stave off speculative attacks.[13]

Even if the Fund confidently proclaims that the temporary monetary tightness has been successful, it has been candid enough to admit that, 'A [...] difficult question is whether the Thai and Korean programs' successful stabilization caused monetary conditions to become too tight, contributing excessively to the contraction in economic activity'.[14] The same question could be asked for Malaysia, which under Finance Minister Anwar Ibrahim followed similar policies to Thailand and Korea, albeit without IMF support (other than moral support[15]).We would be inclined to answer

Figure 4
Thai and Korean Exchange Rates



Note: The bath/dollar rate is measured on the right-hand vertical axis, the won/dollar rate on the left-hand one.

Sources: Datastream.

Interest Rates and Speculation

If participants in foreign-exchange markets have a firm expectation of an imminent rise or fall in the exchange rate, short-term interest rates have to rise to extremely high levels indeed if they are to stem speculation. We start from uncovered interest rate parity:

$$(1 + i) = (1 + i^f).E_te_{t+1}/e_t$$

where

i = domestic interest rate, i^f = foreign interest rate, E = expectations operator, e = exchange rate (in terms of the number of domestic currency units per unit of foreign exchange); subscripts denote points in time.

Let market participants expect a rise in the price of foreign exchange of 10 per cent in a week's time. E_te_{t+1}/e_t then has the value 1.1. If the foreign short-term interest rate is, say, 8 per cent per annum, the UIP formula for a one-week horizon becomes

$$(1 + i)^{1/52} = (1.08)^{1/52}.(1.1)$$

Taking logs, we find

$$1/52\ \ln(1 + i) = 1/52\ \ln(1.08) + \ln(1.1)$$

which yields

$$1 + i = 153.406$$

so that

i = 152.406 = 15,240.6 per cent on an annual basis.

Assuming 260 workdays a year and composite interest, this works out at 1.95 per cent interest per day.

One case where it was decided to pull all stops to thwart speculation was Ireland in September 1992. Interest rates were upped to 25,000 percent, or 2.148 per cent per day, and this proved sufficient to stop speculation against the punt at that time.

[11] IMF: World Economic Outlook and International Capital Markets Interim Assessment. December 1998, p. 5.

[12] Cf H. Visser: A Guide to International Monetary Economics, Edward Elgar, Aldershot 1995, section 2.4.

[13] T. Lane et al., op. cit., pp. 74-5.

[14] T. Lane et al., op. cit., p. 16.

[15] 'Camdessus Welcomes Malayia's New Package of Economic Measures', News Brief No. 98/9, IMF, March 25, 1998 (available on the IMF website, http://www.imf.org).

the question in the affirmative. In Table 1 we see that the swing in the current account balance in the three countries between 1997 and 1998 was gigantic. This was at the cost, in all three cases, of a fall in real total domestic demand by more than 20 per cent.[16]

Given that high interest rates are detrimental to those business firms which, as seems predominantly to be the case in Asia, are highly dependent on short-term debt[17] and that steep declines in the external value of the currency are harmful to firms, including banks, that have borrowed abroad without foreign-exchange cover, the question naturally arises whether capital controls could help to cushion the shock. It is well known that capital controls cause rentseeking behaviour and will be circumvented both legally and illegally. Indeed, it was the growing difficulty of controlling capital flows that lay behind the decision to liberalise capital flows in Indonesia in 1970 and to fully liberalise capital movements in Europe in the 1980s.[18] Still, if there is a crisis, recourse should be taken to emergency measures and it should not be pretended that business is as usual. There is, in our view, a case for imposing capital controls for a short period, say up to six months, in order to prevent overshooting of the exchange rate and to keep interest rates low at the same time. As the panic ebbs away, the controls can be eased. People need time to devise ways of circumventing regulations and such regulations should be able to bite for a restricted number of months.

It may be asked whether the experience with the Malaysian controls, effective from October 1, 1998, offers any evidence as to the desirability of capital controls. In Figures 2, 3 and 4 we see that between August 1997 and February 1998 the ringgit and the baht followed a remarkably similar course, but since then the baht has been recovering more lost ground than the ringgit. The won tells a slightly different story. Its fall was more precipitous, but its recovery from its nadir is more or less along the same line as the baht's (see Figure 4). Whereas the baht and the won more or less halved their depreciation, the ringgit was slipping away again. Possibly investors became disheartened because of a combination of what they saw as lax monetary policies and Dr Mahathir's attack on speculators and the Western world in general in a speech delivered at the joint IMF/World Bank Annual Meeting in Hong Kong in September 1997,[19] which was followed by the fall from grace on 2 September 1998 of Malaysia's Finance Minister Anwar Ibrahim, who was highly respected in financial circles around the world. It was then that Malaysia decided to introduce capital controls, effective as of October 1. In explaining this decision, Malaysia's Second Finance Minister referred to the distress caused by the combination of high interest rates and tight fiscal policies.[20] To all evidence, the controls succeeded in bringing the depreciation to a halt. Still, the ringgit has lost more terrain relative to its level in mid-1997, when things started moving the wrong way in Asia, than the won and the baht (see Figures 2, 3 and 4). This may, however, not entirely be the result of scared investors staying away, but a consequence of the fact that in Thailand and Korea foreigners are welcome to take over ailing businesses, whereas Malaysia is interested in foreign direct investment but not in takeovers. Cross-border mergers and acquisitions in Korea increased from $ 1.4 billion in 1997 to $ 6.3 billion in 1998 and total foreign direct investment rose from $ 2.8 billion to $ 5.1 billion. Thailand saw a similar rise, from $ 3.7 billion to $ 7.0 billion, whereas net foreign direct investment in Malaysia fell from $ 5.1 billion to $ 3.6 billion.[21] The severe drought that hit Malaysia in 1998 may also have taken its toll. However, the ringgit has been stabilised and pressures seem to have abated and, as in Thailand and Korea, interest rates have fallen to pre-crisis levels.

Conclusions

Capital controls, to be imposed for a period of up to six months, should be considered as a serious alternative to the IMF kneejerk reaction of tight monetary and fiscal policies.[22] It could be an effective means of

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[16] Economic and Financial Situation in Asia: Latest Developments, op. cit., p. 12.

[17] Cf G. Caprio, Jr., A. Demirgüç-Kunt: The Role of Long-Term Finance: Theory and Evidence, in: World Bank Research Observer, Vol. 13, No. 2, 1998; J. E. Stiglitz: The Role of the State in Financial Markets, Proceedings of the World Bank Annual Conference on Development Economics 1993, 1994. In Korea short-term debt of a sample of firms was no less than about one half of total liabilities over 1980-90, other countries had lower percentages. cf J. Glen, B. Pinto: Debt or Equity? How Firms in Developing Countries Choose, Discussion Paper 22, International Finance Corporation, Washington 1994.

[18] D. C. Cole, B. F. Slade: Indonesian Financial Development: A Different Sequencing?, in D. Vittas (ed.): Financial Regulation: Changing the Rules of the Game, World Bank, Washington, D.C. 1992; A. F. P. Bakker: The Liberalization of Capital Movements in Europe; The Monetary Committee and Financial Integration, 1958-1994, Kluwer Academic Publishers, Dordrecht 1996, pp. 188-9.

[19] Dato Seri Dr. Mahathir bin Mohamad: Asian Economies: Challenges and Opportunities, speech delivered at The Annual Seminar of the World Bank, Hong Kong, 20 September 1997; http://www.smpke.jpm.my/speech-pm/1997/970920.htm.

[20] Statement by Dato' Mustapa Mohamed, Second Finance Minister of Malaysia, Annual Meeting of the IMF/World Bank (Plenary Session), 7 October 1998, International Monetary Fund and World Bank Group, Press Release No. 45, October 6-8, 1998 (available on the IMF website, http://www.imf.org).

[21] IMF Survey March 22, 1999, p. 93.

preventing the overshooting to which exchange rates are apparently prone and might alleviate the need for a drastic reduction in domestic spending. It is a pity that Malaysia resorted to capital controls at such a late stage, when the harm had already been done. Had Dr Mahathir followed his natural inclinations immediately after the crisis broke out, and had he not frightened speculators away by his anti-Western rhetoric, we most likely would have had an ideal experiment enabling us to evaluate two competing approaches to facing a foreign-exchange crisis. So far, we can only say that the jury is still out. But even if capital controls should not prove superior to the IMF approach, it might at least turn out that there are more ways of handling a crisis than the one approved by Washington D.C.

All this does not alter the fact that it is better to prevent a crisis than to solve one. Excessive capital inflows, which stimulate spending and lead to import surpluses and relatively high prices of nontradeables (a situation represented by point A in Figure 1), should preferably be prevented. Imposing minimum capital ratios vis-à-vis foreign debts on firms and on financial institu-tions in the first place might help. Business firms would also become less vulnerable to hitches in the flow of short-term credit if they became less dependent on such credit. In South-East Asia, savings seem to flow primarily to the banks, and business firms are considerably dependent on the banks for their financing. Governments could contribute to improved financial stability by taking steps to develop their capital markets. One such step could be the introduction of funded pension systems and allowing pension funds to invest in private sector bonds and shares, following the example set by Chile.[23] That might make firms less dependent on short-term debt and thus less vulnerable to a liquidity squeeze. Another way is to grant borrowers the right to demand debt roll-overs from banks at the borrower's discretion, but at a penalty rate, as proposed by Buiter and Sibert[24] or some scheme to make banks share more of the risks of international lending. As it is now, the binary nature of capital flows, i.e. their on-or-off character, imposes unwarranted hardships on the countries hit by a sudden capital outflow.

[22] Again, the IMF fortunately is not dogmatic about this, see P. J. Quirk, O. Evans et al.: Capital Account Convertibility: Review of Experience and Implications for IMF Policies, Occasional Paper 131, IMF, Washington 1995, p. 4.

[23] G. A. Mackenzie: Reforming Latin America's Old-Age Pension Systems, in: Finance & Development, Vol. 32, No. 1, 1995; G. A. Mackenzie, P. Gerson, A. Cuevas: Pension Regimes and Saving, Occasional Paper 153, IMF, Washington 1997.

[24] W. H. Buiter, A. C. Sibert, UDROP or You Drop: A Small Contribution to the New International Financial Architecture, in: Onbeheersbare kapitaalstromen?, papers for a seminar at De Nederlandsche Bank, Amsterdam 5 March 1999.

Christa Randzio-Plath*

Do We Need a New Financial Architecture ?

The financial crises in Asia have shown the dangers resulting from globalised financial markets without an appropriate international legal and political framework. Effective regulations and supervisory mechanisms are called for.

The Janus face of globalisation has unveiled itself in the last few years. The global financial crisis has caused economic and social crises in the developing countries and slowed down growth in Europe. International movements of capital can increase world prosperity by a better allocation of capital, by lower costs for financial services and by improved risk management. The crisis made clear, however, that an inefficient, unstable and unfair global financial and monetary system can destroy the gain in prosperity within a very short time. The momentum financial markets develop by uncoupling from the real economy represents a danger. At the most 4% of world capital movements, about US dollars 1300 billion, are still linked to trade in goods and services.

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