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## **Preface**

My interest for international political economy arised as I took a master's course in International Political Economy, lectured by Helge Hveem, Bent Sofus Tranøy and Dag Harald Claes. This course gave me inspiration as we discussed what established and governed the mechanisms in the international trade system. David Ricardo and Adam Smith, representing respectively comparative advantage and absolute advantage, were eagerly discussed. I made the decision to write about the Asian financial crisis because it is a topic that I find very interesting. The journey began and along with it appeared several questions. What were the driving forces behind the IMF's policy making? Was it possible that the Treasury, Wall Street and the Institutional investors had a say in the IMF's policy making? Was it possible to discover a change in the IMF's policy making as the crisis developed and what was the reason for this? Was it possible to speak about technocratic learning? Before the process of writing started, everything seemed really difficult. My loving and caring girlfriend, Stine, has supported me all the way through the writing of this thesis, first of all with correcting my English. But she was always there for me when the process of writing this thesis did not flow. She knows what I am like in periods like these, and then it takes a lot of courage, energy and patience to live with me. Thank you, I owe you and I love you. I remember that Tranøy told me to go and buy two books; "Globalisation and its Discontents" by Stiglitz and "The Chastening" by Bluestein. These two books have been the foundation of my thesis. My mentor; Bent Sofus Tranøy, has been a great inspiration to me. Your knowledge and personal care for my progress with the thesis (autumn 2004 – spring 2006) have been very much appreciated.

Oslo, Spring 2006, Thomas Bråtner

# 1 INTRO

## 1.1 *"The Committee to Save the World"*

On July 2<sup>nd</sup> 1997, when it was announced that the Thai central bank no longer could maintain its fixed exchange rate, the dream and the promise of what was once called the "East-Asian Miracle" vanished in a second and cast a shadow not only over East Asia but over several countries. According to Stiglitz, "no one knew that this was the beginning of the greatest economic crisis since the Great Depression - one that would spread from Asia to Russia and Latin America and threaten the entire world" (Stiglitz 2003: 89). Globalisation had made it possible to transfer financial assets across borders within a few seconds. Greater financial turbulence and "contagion"<sup>1</sup> now made it clear that one was facing a new type of financial crisis referred to as "crises within crises" (Eichengreen 2003: 251) or as "twenty-first century crises" (Bluestein 2001: 25). Bluestein and Fratzscher demonstrate how the "Electronic Herd" of portfolio investors woke up during the crisis and spread the crisis to other countries, resulting in accelerated turbulence in the already affected financial markets. (Fratzscher 2000: 3, Bluestein 2001: 124).

"The Committee to Save the World" was the headline of an article published in Time Magazine in 1999 (Bluestein 2001:11). The magazine showed a photo of Alan Greenspan; chairman of the Federal Reserve Board, Robert Rubin; Secretary of Treasury and his deputy; Lawrence Summers (ibid). These men, together with central IMF officials, were referred to as the "High Command", since it was assumed that they exerted extraordinary influence over the process of the crisis. Even though the situation was serious, there was a positive belief among central International Monetary Fund (The IMF) officials that this crisis would be solvable. The problems in Latin America had been handled successfully, so why should it not be the same this time? (Blustein 2001:11). The IMF's crisis solving approach was based on the principles entrenched in what has become known as the Washington Consensus (WC). These

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<sup>1</sup> Contagion is to be understood as "the transmission of a crisis to a particular country due to its real and financial interdependence with countries that are already experiencing a crisis" (Fratzscher 2000: 2).

principles referred to central policy strategies of the IMF concentrated around points like fiscal austerity, privatisation, exchange rates and market liberalisation. This list was labelled “the universal convergence” and “the recipe was generally applicable and universally agreed upon in Washington, i.e. by senior members of the US administration and Congress, the Federal reserve, the World Bank and central IMF officials” (Florio: 2002:375-377).

Despite the positivism and optimism of the possibility to solve the crisis, many have argued that the reforms that were to alleviate the crisis only made things worse. It seemed like the universal recipe from the Washington Consensus of how to deal with financial crises did not work everywhere. According to Bluestein, “it is no secret that the Fund made serious mistakes in its efforts to rescue countries from crises. Some of these involved the Fund’s well-known penchant for over prescribing austerity, an example being the excessive fiscal stringency it demanded of Thailand” (Blustein 2001:17). The confident IMF officials thought they were easily going to solve the financial crisis by applying the recipe from the Washington Consensus. As it proved that the advice from the Washington Consensus made things worse instead of better, it is fruitful to investigate the Washington Consensus more in depth. First of all: Are the IMF’s policies today still in harmony with the Washington Consensus? To the degree that they are, is this because they reflect the powerful interests of institutional investors as carried forward by the Treasury and US policymakers in general? And thirdly, to the degree that we find change is this change substantial or mainly “window dressing” (Brunsson 1989), can we, whichever way change is conceptualised, explain this with reference to theories of institutional learning?

## ***1.2 The purpose of the thesis***

The purpose of this study is to highlight what is lying behind and influencing the IMF’s policy making process. To what degree has the IMF stayed loyal to the Washington Consensus and to what extent has it moved beyond and how can we account for this outcome? In order to embark upon this, I have chosen to take a closer look at the Asian Crisis.

More specifically I wish to study two countries that were deeply affected by the Asian financial crisis. Accordingly, I have chosen to take a closer look at Thailand and South

Korea, because I find it interesting to compare these two countries in a comparative analysis. I am well aware of the fact that there were other countries affected by the financial crisis in Asia. One of them was Indonesia. It would have been interesting to investigate this country as well. However, the limited number of pages of the master's thesis do not allow me to explore the IMF's policy towards this country. This leaves me with Thailand and Korea where I wish to investigate the IMF's policy making towards these countries. In order to do so, I have developed two perspectives: The first one is a continuity perspective, i.e. a perspective that can account for the possible finding that the Washington Consensus is largely upheld. Here I will aim at demonstrating the influence of Wall Street on US policy making. This is done through showing that Wall Street exerts a lot of power on the decision making process of the US. Extending this; I demonstrate that there is a strong link between the Washington Consensus and the preferences of the institutional investors. Regarding the societal level, I wish to go deeper into, and explore, the possibility that the US maintains a certain hegemonic position in the World. Factors like the spread of liberal financial regimes and the IMF's weighted voting can justify this assumption. Therefore my continuity perspective is built up from three blocks; one about the hegemonic position of the US, and another of the Wall Street's dominance in the US policy making process. My third block makes reference to the institutional investors' preferences expected to be reflected in the Washington Consensus.

The other perspective aims at gauging the degree to which there has been a change in the IMF's policy making away from the Washington Consensus. If we can justify that the institutional investors have an interest in a continuity of the Washington Consensus in the IMF's policy making process, and we despite this discover significant movement away from the Washington Consensus and institutional investors' preferences, what can explain that? My competing perspective entails change with two assumptions about learning. The first hypothesis is called technocratic "learning with effect" and pertains to the notion that the change process happens endogenously where the technocrats alter their ideas and preferences about what policy is the most apposite to deal with macroeconomic problems. The other hypothesis studies "learning without

effect”, where the IMF gives the impression that it has learned from the consequences of its policy advice, without incorporating this into real policy making.

The theories can, put together, help me build an explanation of the findings. I expect to find some continuity in the IMF’s policies and some change on the other hand. The purpose is not to test in first place if the theories chosen fit the empirical observations I carry out. Therefore my theories will more elucidate and justify why I chose the two perspectives and further support me in formulating the null hypothesis about the institutional investors’ preferences and the alternative hypothesis about technocratic “learning with substantial effect” and the supplementary hypothesis, “learning without substantial effect”.

### **1.3 Theory**

#### **1.3.1 Continuity perspective**

The selected aspect upon which I will steer my focus encompasses the institutional investors and their ability to influence and govern the currency crises and thus the policies of the IMF. I will make use of Moravcsik’s (1997) two step model of international relations in order to conceptualise how investors’ interests come to be reflected in the Washington Consensus, regarding the IMF’s policy making liberal theory of international relations. I choose to this to make obvious how the investors act to agitate their interests from a bottom up perspective prior to the IMF’s policy making. By applying Moravcsik’s liberal theory, I aim at demonstrating that the “transmission belt” (Tranøy 1998: 22) can be considered a two stage process. Therefore we can contend that this model has two processes of influence and three levels of aggregation. The first level is the individual level where the institutional investors through Wall Street and Treasury lobby through their preferences towards the US policy makers. Extending this theory I argue that these US policy makers further exert the necessary influence on international institutions like the IMF. This thought is further justified in the second chapter of my thesis. Therefore, if I detect that the investors’ preferences are being reflected in the Washington Consensus, it strengthens my continuity hypothesis, where the interests are being continued at a higher level, namely on the policy making level of the IMF.



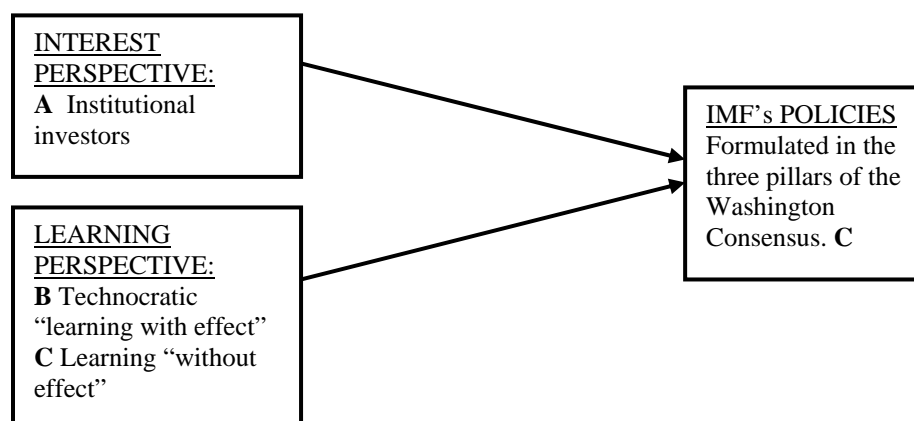
### 1.3.2 Change perspective

The second perspective I would like to study, is the “change perspective” which will predict changes in the policies of the IMF due to a learning process. The whole learning process starts from the notion that one can consider the IMF to be a technocratic organisation<sup>2</sup>. Kaufmann and Kaufmann emphasise that “Organisations are areas for learning and learning is crucial because organisations and their employees are in constant change and development” (My translation: Kaufmann and Kaufmann: 1998: 188). Extending this, it is suitable to make use of Tranøy’s definition of learning “as the ability to interpret the character (and sometimes the effects) of policy at time – 0 so that it has implications for how one handles the creation of policy at time – 1 (Tranøy 1998: 21). In order to investigate the possible technocratic learning in the IMF, I want to apply historical institutionalism in order to highlight the learning process that takes place in the institutions, where learning from an event A develops into B, where B becomes the new analytical tool in order to solve new problems at hand (Tranøy 1998). The historical institutionalism will be applied to explain what I will call technocratic learning with substantial effect. The other type of institutionalism applied in this thesis is a variant of the new institutionalism; the sociological institutionalism. This type of institutionalism emphasises the “logic of appropriateness” seeming from “social norms” (Checkel 1998), which entails “[...] reasoning by analogy and metaphor, not about ends and means” (ibid). The exogenous element is stressed in the sociological institutionalism as the change process has to be seen in context with its environment. To study the changing environment, I aim at elucidating how external ideas are being adopted in the institution inspired by the new institutionalism. The sociological institutionalism is applied to formulate the supplementary hypothesis aiming at explaining technocratic learning without substantial effect.

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<sup>2</sup> The technocracy in the IMF pertains to the notion that “[...] the IMF staff is filled with highly trained, highly professional economists who follow the rules and guidelines of the institution” (Vreeland 2004: 5).

## 1.4 Analytical Framework



As can be seen from the model above, I wish to investigate the “continuity perspective” and the “change perspective”. I will focus on institutional investors under the interest perspective, and apply Washington Consensus as a proxy for the preferences of the institutional investors. I will return to why this is permissible in chapter two. As can be comprehended from the model, the chronological approach will start by looking into the investors’ preferences and examine if they can be discovered in the IMF’s policies. The structure of my interest hypothesis departs from the assumption that Wall Street is a dominant financial centre in the World today and further that this centre represents the preferences of the institutional investors. Much of the staff recruited to Treasury comes from Wall Street. Since the weighted voting procedure in the IMF favours the US, it is justifiable to expect a certain influence from the institutional investors on the policies of the IMF. This is point A in the model above.

From then on I will, as pointed out in the introductory chapter, look at the institution and see if there has been a change in the IMF’s policy advice. I assume that the change mainly occurs endogenously, where the technocrats commence questioning their choice of policy. I expect to possibly find such a change, and therefore my analysis will open up for a “change perspective”. The technocratic learning with substantial effect hypothesis is point B in the model above. The supplementary hypothesis is being constructed by making use of the sociological intuitionism as described in 1.3.2. Is there a change in the IMF’s policy making, and what might have caused this change? What is the origin of this change? These above mentioned points are elaborated further in the theory chapter (chapter two).

### **1.5 The further structure of the thesis**

**Chapter three** will treat the IMF's policies before and after the crisis. Moreover, I will look for empirical evidence for my operationalisation of the Washington Consensus in Williamson's ten points in order to discover either continuity or change in the IMF's policies. If I, working with the empirical material, make observations that the Washington Consensus has not been subject to much change, this will reinforce my hypothesis about Wall Street. However, if the observations go towards a significant change in the IMF's policies, this will strengthen my hypothesis about technocratic learning.

**Chapter four** provides a causal analysis of my material where I aim at going deeper into the continuity and the change perspective to see how the explanatory power of my independent variables actually are. Can the continuity perspective best explain the IMF's policies or are the IMF's policies best understood by making use of the change perspective?

**Chapter five** intends to give a wrap up of my entire thesis. This chapter will present a summary of my findings. Questions that will be addressed are among others: Where will the IMF go in the future? Will it still have a role to play in the financial markets?

## **2 THEORY AND QUESTIONS TO BE INVESTIGATED**

### **2.1 Continuity perspective**

Inspired by Moravcsik's two step theory about international relations (1997), I aim at constructing a two stage model where the preferences of the institutional investors on the individual or group level can be viewed as a bottom up process exerting influence on the societal level. Moravcsik states in the first assumption about liberal IR theory: "The fundamental actors in international politics are individuals and private groups, who are on the average rational and risk-averse and who organize exchange and collective action to promote differentiated interests under constraints imposed by material scarcity, conflicting values, and variations in societal influence" (Moravcsik 1997: 516). Power asymmetries predict that actors with more power will generate more "voice" upon the political institutions (Moravcsik 1997). Some of the groups with interests towards Treasury are Wall Street, Main Street, members of key

Congressional committees, and development NGO's (White 2004:15). Consequently, I will build up Tranøy's presumption about the "transmission belt" (Tranøy 1998: 22). This is done through displaying how the institutional investors' preferences are being conveyed from the finance centre Wall Street, through Treasury, ending up with the supposition that the US as a hegemonic power wields certain pressure on the IMF's policy making.

### **2.1.1 Wall Street's dominance of US policy making**

It is incontestable that Wall Street has great influence on US policy making. Wall Street often acts in favour of the institutional investors. It advises deals, sets up funds etc. so that the preferences of Wall Street and institutional investors tend to merge. However, it is also possible to assert that diverging interests between investors might exist. One example would be that Wall Street would prefer full information about how the markets function in order to maintain efficient markets. The hedge funds on the other side conceal their investment strategies<sup>3</sup> to other competitors (Connor and Woo 2003: 5), resulting in a less efficient market.

My point is that there will be no contrary expectations from the institutional investors' side regarding third countries' policies as we can assume that full information about these countries would be preferable for all investors. I do not wish to go further on this, but leave it as it is for reflection as I assume that the preferences of the institutional investors are compatible with those from Wall Street with regards to third countries' economic policies.

### **2.1.2 The Wall Street –Treasury IMF complex**

The Wall Street Treasury – IMF complex was first developed by Jagdish Bhagwati to demonstrate the tight link between Wall Street, Treasury and the IMF. His main argument is that the interests of Wall Street are being reflected in Treasury and further in the IMF's policy decision making process: "Wall Street has become a very powerful influence in terms of seeking markets everywhere. Morgan Stanley and all these

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<sup>3</sup> In fact a hedge fund applies a variety of strategies, such as taking "long or short" positions in the market. "Relative value" strategies try to capitalise on the wrong valuation of related financial instruments. "Event driven" strategies entail hedge funds taking positions in stocks due to anticipated mergers/acquisitions and bankruptcies and the effect thereof. "Global macro" strategies invest in interest rates, exchange rates inflation etc (Connor and Woo 2003: 9-11).

gigantic firms want to be able to get into other markets and essentially see capital account convertibility as what will enable them to operate everywhere. Just like in the old days there was this ‘military-industrial complex’, nowadays there is a ‘Wall St.-Treasury complex’ [...]” (Wade and Veneroso 1998:14). “Even when Wall Street does not prescribe Treasury what to do, Treasury personnel have been trained in the financial services industry and move in that kind of social circle” (White 2004:21). To justify this view, the emphasis is put on the notion that much of the recruitment of the economists to Treasury and to the IMF is carried out by picking people from Wall Street. Robert Rubin was for example recruited this way (Wade and Veneroso 1998:14).

### **2.1.3 Institutional investors’ preferences towards the Washington Consensus**

Following Moravscik’s argumentation, individuals and groups have strong preferences for contending existing investments and they are not willing to take further risks in search for new profit unless the potential gain is significantly higher than the potential loss (1997: 516). This is of course a simplification of the investors’ preferences. In general one might argue that they are weighing the risks with the potential rewards, but there is more to it. According to King, the preferences of the institutional investors are not that simple to identify (2000)<sup>4</sup>. There would be as many preferences as there are types of investors that match the term “institutional investor”. My ambition however, leaving this accurate graduation of the investors preferences under the term institutional investors, is to map out some preferences towards macroeconomic policies that would be valid for the general institutional investor. Of particular interest for me to study, is whether it is plausible to identify and predict certain investor preferences for macroeconomic policy or to be more specific: What kind of preferences do the institutional investors have towards the policies that are inherent in the Washington Consensus?

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<sup>4</sup> King applies a two by two table to flesh out his point. The table includes combinations of expansive and contractive monetary and fiscal policy. He further includes under each of these four points different types of institutional investors and identifies whether they benefit or not from each of the combinations. Pertaining to the combination of restrictive monetary and fiscal policy which is closest to the IMF’s macroeconomic crisis advice that favours the institutional investors, King states that the winners are “long term equity” and “short term bonds” whereas the loser are “short term equity” and “long term bonds” (2000: 25). The limits of the master’s thesis do however not allow me to explore these arguments further.

### **2.1.4 Strict macroeconomic governance**

Before moving on to my discussion of the degree to which the policy advice contained in the Washington Consensus is in harmony with what we can deduce as investor interests, a quick glance at Williamson's original formulation is in order. The original list of ten points was written with regards to what Williamson thought would be good policy measures for Washington to adapt towards the Latin American countries. The ten points included in the list were: "fiscal discipline", "public expenditure priorities", "tax reform", "interest rate liberalization", "competitive exchange rate", "trade liberalization", "liberalization of inflows of foreign direct investment", "privatization", "deregulation" and finally "secure property rights" (Williamson 2000: 252-253). In my analysis of the IMF's policy towards Thailand and South Korea, it is however not appropriate to follow this list. Instead I choose five analytical distinct points to deduce what are the interests of the institutional investors. The first four points can be said to encompass the IMF's crisis advice that would favour the preferences of the institutional investors. The last point, concerning risk distribution, even though never mentioned in the Washington Consensus, is included because a bail out strategy would favour the institutional investors.

#### **2.1.4.1 Fiscal austerity**

Focus on fiscal austerity is important to investors in several ways: If there is a surplus in the budget of the country in which the investments are placed, it gives the impression of a healthy and profitable economy beneficial to the investors. Furthermore, as the government's expenditure priorities move away from focusing on defence to activities that pace up the economic growth in the country, like education, construction of a better infrastructure and better health services, the profit forecasts on the institutional investors investments augment (Florio 2002: 377).

#### **2.1.4.2 Monetary policy**

Regarding monetary policy, I argue that strict monetary policy is favourable for the investors. Strict or contractive monetary policy will entail that the central bank sets interest rates relatively high. So when foreign investors are looking for profitable places for their investments, they search for places where the interest rates are relatively high. Regarding higher foreign interest rates than home interest rates, it is

important to consider whether the investors can capitalise on the interest rate differentials<sup>5</sup>. To this it must be added that high interest rates are a relative term. I would claim that whether one looks at an interest rate as high or not, is relative to three things: The state of the economy, the interest rate differential and finally historical interest rates. I will discuss these points more in detail in the operationalisation of monetary policy in paragraph 2.3.3.2.

#### **2.1.4.3 Fixed or stable exchange rates**

Already having argued that high interest rates ensure more profit for the investors, fixed or stable exchange rates would entail lower risks. For example if foreign investors invest in Thailand and the Thai currency is pegged to the dollar, the investors go clear the otherwise inherent currency risk that such an investment normally would imply. Therefore, having exchange rate arrangements that eliminate the potential damaging volatility in fluctuating currencies would be of significant importance for the investors. This is so because then the investors would only have to worry about the risks in the projects they were investing in without having to take into account currency instability.

#### **2.1.4.4 Capital market liberalisation**

It can easily be seen that through opening the markets one facilitates the investments abroad. It opens up for investors to freely move towards the most profitable investment opportunities since these will not be restricted by capital controls.

#### **2.1.4.5 Risk distribution**

This point, which I want to investigate further, was never mentioned in the Washington Consensus. I will provide an elaboration on this in paragraph 2.3.1. However this does not imply that the bail out strategy was not favourable for the investors. By bailing out the investors, the IMF ensured that the investors were saved

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<sup>5</sup> It is possible to allege that the institutional investors could capitalise on the interest differentials between their home countries and foreign interest rates (implying the interest rates in the Asian countries affected by the crisis). The International Fischer Effect explains that if the spot rate of one currency with reference to another currency does not change in accordance with the differential of the interest rates between the two respective countries, it is possible to capitalise on this interest rate differential (Madura 2003:247-258). Madura explains that since the Southeast Asian countries maintained their exchange rates in “narrow bands”, the International Fischer Effect could not hold and consequently “there was motivation for foreign investors to attempt to capitalize on the high interest rates in Southeast Asia” (Madura 2003: 255).

by the bell because there was no symmetry between the upside gain potential and the downside loss possibility.

## **2.1.6 The US hegemony**

### **2.1.6.1 Hegemonic perspectives on financial integration**

I agree with Brilmayer's extension of the definition of a hegemon to encompass "political, military, economic, and psychological dimensions" (1994:14). However, I will restrict myself to a deeper elaboration of the hegemon's interest in creating liberal regimes.

Hegemonic power approaches argue that "financial globalisation is a product of dominant political forces. These may be in the shape of a hegemonic country that promotes financial liberalisation abroad (the US), and/or in the shape of a set of hegemonic ideas ('market neo liberalism') that shape the assumptions and choices of policymakers" (Walter 2002:8). According to the theory of hegemonic stability, the liberal World economy needs a strong political leader to maintain stability and order in the system. Gilpin emphasises that a hegemon will apply its power to promote trade liberalisation and a stable international monetary system in order to secure its own economic interests. Even though my analysis of the Asian crisis falls under the Clinton period, I do not believe that this has changed after Bush became president since it is possible to assert that both presidents were protecting the interests of Wall Street by promoting trade liberalisation throughout the World. With regards to the US, Mastanduno stresses that it plays "economic hardball" and "security softball"<sup>6</sup> with other powerful nations to avoid "friction" in the system (1997:52)<sup>7</sup>.

### **2.1.6.2 Hegemonic creation of Liberal regimes**

The creation of the regimes in the liberal World economy took place in the post-war period with the establishment of the Bretton Woods system in 1944. The goal of the Bretton Woods conference was among other things to formulate guidelines that could be embedded in the institutions set to encompass the Bretton Woods system, namely

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<sup>6</sup> This quotation was more relevant during the Clinton period than during the Bush period. Bush is more of a "security hardball" player I would allege. Examples from the Iraq war show what I aim at.

<sup>7</sup> The Clinton period was from 1992-2001, whereas the Bush period started in 2001 and is still going on.

[http://www.gabbianelli.net/USApresidency/USA\\_Presidency.htm](http://www.gabbianelli.net/USApresidency/USA_Presidency.htm)



the IMF, GATT and the World Bank. With my focus on finance and how important financial integration has become nowadays, it is possible to detect certain evolutionary stages through which a hegemon passes. The Bretton Woods era after the Second World War was clearly dominated by the goal of liberalising trade. The focus now has shifted towards the focus on abolishing capital regulations as to facilitate the free flow of foreign direct investments<sup>8</sup> to the most rentable areas in the World. My view is supported by Walter: “At the extreme, the hegemonic project becomes less that of the hegemonic (US) government and more that of ‘haute finance’ itself (Walter 2002: 11). Central to the “Wall Street-Treasury Complex” is that the hegemonic state interests have been replaced by dominant classes able to speak up and lobby for their interests. (Walter 2002:11-12).

### **2.1.6.3 Weighted voting – Treasury’s policy towards the IMF**

The purpose of this paragraph is not to investigate what the US and the UK actually has voted in the IMF. My goal is rather to show how the system of weighted voting in the IMF can be used to understand why some member countries exert larger influence on the IMF than other member countries. Taking a closer look at the voting system in the IMF, we find that it is a voting system that heavily favours rich countries in general and the US in particular. As opposed to the United Nations where the “one country one vote” procedure is being practiced, the IMF maintains weighted voting for their members. However, the IMF tried to unify these two principles in 1944, when each country was awarded 250 votes. By doing this it was possible to retain an equality principle and adding one vote for every 100 000 dollars of the quota which maintained weighted voting. (Willets 2001:9). The US have over 17% of the votes, giving them a veto power since the most important decisions require support from 85% of all the votes in the IMF (Leech 2002:375). The US have more votes than the following next three largest countries, Japan, Germany and the UK all together. The Group of ten has more than 53% of the total votes, implying that they hold more votes

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<sup>8</sup> There are two main distinctions to be made in foreign direct investments. The first is called horizontal foreign direct investment where the main motivation is to avoid transportation costs by accessing a foreign market that can only be served locally (Protsenko 2003: 16). The other form is called vertical foreign direct investment. Here, the differences in input prices are the main motivation to split the production by conducting for example labour intensive production in countries with low labour costs (Protsenko 2003: 19).

than the other 172 nations and further retaining a group veto in all important decisions (Willetts 2001: 9).

#### **2.1.6.4 The US and UK compatible capitalisms**

The powerful countries exert influence on the IMF. To this it must be mentioned that the more alike the countries' economic systems are, the more likely it is that they will wield more powerful pressure on the IMF to force forward their preferences. I chose the continuity perspective to investigate the institutional investors' preferences towards the IMF. Hall and Soskice expect that the agents' institutional preferences in the same type of economies are hard to change (2001). Regarding my thesis, it will be the UK and the US economies' similarities that confirm the growing relevance of the continuity perspective in explaining the institutional investors' preferences on the IMF's policy making towards Thailand and Korea. Hall and Soskice (2001) make reference to this point in "Varieties of Capitalism". They assert that "the varieties of capitalism framework can be used to explain the structure of states' multilateral preferences" (Hall and Soskice 2001: 215). Further it is maintained that in liberalised market economies like the UK and the US economy, "market institutions provide a highly effective means for coordinating the endeavours of economic actors" (Hall and Soskice 2001: 8). From these assumptions follows logically that Germany, classified as a coordinated market economy, will have diverse preferences from the actors in the liberal market economy countries like the UK and the US. Consequently, it is more comprehensible that complementary economies tend to mutually confirm each others similarities and preferences. This in turn reinforces their influence towards the existing market institutions.

#### **2.1.7 The H0 hypothesis 1: Wall Street**

*Institutional investors have preferences towards the macroeconomic policies entrenched in the Washington Consensus and this is expected to be mirrored in the IMF's policy making towards Thailand and South Korea.*

## **2.2 The change perspective**

### **2.2.1 Technocratic learning**

As mentioned, I wish to investigate whether there has been a change in the IMF's policies operationalised in the Washington Consensus. To do this, I have chosen to focus on the IMF as a technocratic institution. Before continuing on this, it is apposite to define the term technocracy. A definition is provided by Fisher, where technocracy "refers to a system of governance in which technically trained experts rule by virtue of their specialized knowledge and position in dominant political and economic institutions" (Fisher 1990: 17). Much of the debate which I will return to under the following paragraph alleges that the technocrats have become an elite group filled with trained experts in their fields who, in power of their technical knowledge, are shaping the political agenda of the society (Beckman 1990: 270). My point is to elaborate how technocratic learning can be included in a historical institutionalist framework as is argued for by Tranøy (1998:4).

### **2.2.2 The technocrats' power over policy**

There are two substantial points that I want to elaborate on regarding the technocrats' power over policy. The first point wants to contend that the technocracy is awarded legitimisation because it understands how central values are to be optimised. Tranøy (1998: 9) argues that it is how tasks concerning maximisation of desired values concerning inflation, employment, growth and export performance are carried out that legitimises the work of professional economists, thereby awarding them institutional power. This view is shared by Fisher (1990: 18) who claims that "In a pure technocracy, technical knowledge would serve as the base of power [...]". If a macro model has succeeded in dealing with one financial crisis, it enhances the likelihood that the same model will be applied to tackle other crises.

The other point which I want to stress is the power awarded the technocrats due to technical complexity. This technical complexity makes it difficult for the rest of the society to interfere and influence the direction of this type of technical complex policies. White maintains that "International financial policy is very much an elite concern. It is very difficult to get the broader electorate excited about it" (White 2004:15). Fisher (1990: 27) elaborates on this and calls this phenomenon "techno

corporatism”. This phenomenon refers to a system where the governance is moving towards greater centralisation by depoliticising the mass public at the same time. This system relies on experts where the three levels encompass “a top echelon of political and economic elites, a technocratic stratum of experts and specialised administrators [.....], and a largely depoliticised mass public” (Fisher 1990: 27). The “hidden hierarchies” in which the distance between the experts and the public is well defined awards the experts disproportionate powers not only to define the political agenda, but also to estimate the feasibility and appropriateness of the decisions being made (Fisher 1990: 19).

### **2.2.3 Technocratic values**

“Technocratic consciousness” rests on a belief that there are specific ways to deal with problems and that there are tools to change the World (Fisher 1990: 41). Consequently the technocrats believe there are technical good solutions to the problems they are facing and that these problems are best solved by technical expertise. Having mentioned this, it becomes a must to study how this “technocratic consciousness” is manifested in concrete values in the organisations.

Tranøy draws a sharp contrast between a “narrow or cynical view” and a “naïve view” (1998:14-15) on how technocratic values are manifested in an organisation. The first point has its links to a “Niskanen tradition”; where the personal incentives of the technocrats are defined to be narrow (Tranøy 1998: 14, Niskanen 1971). This is so because “it assumes that individual bureaucrats seek programme and unit expansion in order to maximise their career opportunities, salaries and prestige” (ibid). To Smith, budget maximisation is a condition for survival of the organisation because it ensures that there are possibilities for promotion and other benefits to the employees steaming from an enlarged budget (Smith 1988: 163). Tranøy extends the tradition of Niskanen to include a “cynical view”, where the “professions primarily aim for monopoly and closure because they are driven by a desire to enhance the power and income of its members” (Tranøy 1998:14).

The contrast to the “cynical view” is the “naïve view”, where the professionals are governed by “enlightenment ideals” striving for “rational progress based on scientific knowledge” (Tranøy 1998: 14). According to the “naïve view”, the institutions consist

of “altruistic members [...] which are filled with a desire to work for the common good” (Tranøy 1998: 14, Brante 1988: 122,). This stands as a sharp pole against the “cynical view”. Tranøy’s point here is that the two views become extreme points in trying to map out the driving interests of the technocrats.

It can easily be claimed that it would prove difficult if not impossible to totally strive for a cynical view to reach one’s own career goals without having to follow the overall ideals of the institution (Tranøy 1998:14-15). Therefore, one would also expect to discover that the institution will exert certain influence on the identity formation of the institution’s members where the behaviour of the members is shaped in coherence with the ideals of the institution (Tranøy 1998: 14, March and Olsen 1989). March and Olsen (2004: 5) argue that the institutions “guide behaviour and stabilize expectations” by prescribing what is appropriate behaviour in different situations. Tranøy (1998:14) further contends that “job satisfaction in central bankers is linked to their ability to managing the monetary economy in accordance with their institutionally inherited ideals”. Tranøy’s (1998: 14-15) point regarding technocratic values and institutional ideals is that in stable periods these two dimensions tend to approach each other and end up more or less converged. To Tranøy (1998: 15), the “narrow or cynical view” and the “naïve view” become two extremes when discussing what values drive the technocrats and he makes his point clear: “If it is naïve to assume that government economists are motivated by a genuine desire to do a good job (as defined by professional and institutional standards), it is close to paranoid to assume that all that drives them is considerations for their personal purse” (ibid).

#### **2.2.4 Technocratic reflections**

I have earlier argued that the evolution of the policy decision making process to a large extent can be seen in the light of technocratic learning. Hence, technocratic learning must encompass reflections about how apposite the technical models prove to solve complex problems. If we accept the premise that the technocrats strive towards meeting the ideals of the institution and aspire for promotion to increase their career possibilities, they must also have an interest in delivering their best. It is in the technocrats’ interest to do a good job. I do not argue that this interest to do a good job is subject to much change, however I believe that the interests towards selecting the

most appropriate problem solving tool, depends on how good this tool is to solve the problem as well as what kind of problem one is faced with. Tranøy (1998) argues that there exists a better environment for new ideas when the reality is being questioned due to a “performance crisis”. Crises can be seen as “moments of ‘Knightian uncertainty’<sup>9</sup> in which actors’ perceptions of their own self interest become problematised” (Hay, 2004:5, Blyth 2001). Consequently, “new economic doctrines have a better chance of succeeding in situations that are defined as an economic crisis [...]” (Tranøy 1998:18). An interesting point regarding this is that the Washington Consensus silently waned when one started to question its relevance in dealing with economic crises. Hence, the outcome of a performance crisis will lead to a “restoration of a more ‘normal’ condition of ‘Knightian certainty’ – in which actors’ interests are once again made clear and transparent to them” (Hay, 2004:5-6, Blyth 2001).

### **2.2.5 Technocratic learning – developing competing hypothesis in the change perspective**

Learning must include a chronological dimension. Learning therefore consists of a historical element following Tranøy’s definition of learning as “[...] the ability to interpret events at time – 0 so that it has implications for how one handles a situation at time - 1” (Tranøy 1998:19).

Historical institutionalism, as highlighted earlier in the thesis, “take history seriously” (Pierson and Skocpol 2002: 5). This means an analytical framework where processes change over time by theorising about a universe of variables causally linked to each other in a relationship where A comes before B in time (Pierson and Skocpol 2002: 6). Consequently, learning must imply that one looks back in time and discovers the consequence of a policy response to a specific crisis. If the policy response was said to work well, this would naturally be the chosen policy response for a new economic crisis. In the literature, this is called “path dependence” which “refers to the dynamics of self-reinforcing or positive feedback processes in a political system – what economists call “increasing returns” processes” (Pierson and Skocpol 2002 :6). But if this response does not prove to be the best way to solve an economic crisis, questions

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<sup>9</sup> In general “Knightian Uncertainty” refers to cases or situations in which the actors involved do not fully know the probabilities of specific outcomes even if all information is accessible (Stout 1997: 16), see also Knight, Frank H. 1921 “Risk, Uncertainty and profit”).

about the capacity of this policy response to solve economic crises arise. Therefore we have to open up for that the crisis solving tools available at the Washington Consensus' way of interpreting the crisis can change. This is justified by applying the definition of Tranøy (1998:19) since learning is part of the process when going from a Washington Consensus to a constructed post Washington Consensus. However, we also have to be open to the possibility that learning can have a character of that one says something but does something else<sup>10</sup>. This makes it apposite to distinguish between learning with substantial effect and learning without substantial effect. The last possibility is discussed in the supplementary hypothesis paragraphs below.

## **2.2.6 Supplementary hypothesis**

### **2.2.6.1 Demand and supply**

The technocrats must be aware of the environment and the feedback it gives concerning the IMF's performance in dealing with economic crises. Under technocratic reflections, I discussed what happened in terms of a performance crisis. A performance crisis generally puts into question the legitimacy of the institution. My ambition constructing this supplementary hypothesis is to build on Tranøy's distinction between the "demand and supply side of learning" (1999: 92). Therefore, we might argue that when the technocrats do not find the apposite solutions to their problems by looking for solutions within the organisation, they start looking for new ideas in the environment. Consequently, there is room for alleging that the IMF as an institution will "[...] incorporate elements that are legitimated externally [...]" (Meyer and Rowan 1991: 49, DiMaggio and Powell). Central in the new intuitionism is the term "isomorphism". DiMaggio and Powell (1991: 66) stress that "organizations compete not just for resources and customers, but for political power and institutional legitimacy [...]". Further it is argued that "the concept institutional isomorphism is a useful tool for understanding the politics and ceremony that pervade much modern organizational life" (DiMaggio and Powell 1991: 66).

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<sup>10</sup> Hall (1993) draws an interesting distinction between first, second and third order learning. First order learning involves changing the setting of instruments, second order learning involves changing of instruments and third order learning refers to goals of the policy are changed. I will not apply these distinctions, but just make aware of this more fine grained way of viewing learning (Hall 1993, Tranøy 198: 20-21).

### **2.2.6.2 Fashion, myths and decoupling**

I will not emphasise the different organisational forms so much when constructing the supplementary hypothesis but rather embrace the notion of learning. Therefore, I will keep the idea that learning comes from the outside and that some of this learning will tend to be “fashion oriented”. A definition of the “fashion perspective” could be that “everybody” thinks the same at the same time about what is legitimate or not. However, it is important to stress that what is looked upon as legitimate may vary with time (Folmo 2005: 24, Røvik 1996: 153, Czarniawska and Sevón). This is so because “fashion” is regarded as “dynamic” and “explains how forms of human expression can achieve popularity, become widespread, and then later become unfashionable” (ibid). Røvik applies the fashion perspective in order to elucidate the development of “institutionalised standards”<sup>11</sup>. He argues that the fashion perspective in this sense provides assistance to developing such a theory (ibid). The fashion perspective leaves us with the awareness that what will be adopted as an institutionalised standard is dependent on what is popular at the given point of adoption.

Myths are “meta structural elements existing on the surface of organizations as “window dressing””(Christensen and Lægreid 2004, Brunsson 1989). Accordingly, the organisation will increase its level of legitimacy and chances for survival when adapting new popular myths instead of old ones (ibid). This is by Brunsson et al. (1993) labelled “modernity” and he stresses that reforms that are perceived as “modern” will have a bigger chance for “success”. Further, the organisations apply “decoupling” in order to maintain the internal structure so that the regular activities continue as normal whereas the external “window dressing” structure adapts symbolic standards that are accepted in the environment (Christensen and Lægreid 2004, Brunsson 1989, Meyer and Rowan 1991: 5, DiMaggio and Powell). Consequently I will look for evidence for the IMF having “decoupled” the internal from the external activities in order to maintain external legitimacy. This leads me on to the formulation of the supplementary hypothesis in point 2.2.8.

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<sup>11</sup> “Institutionalized standards are widespread up-to-date prescriptions for how to organize successfully, prescriptions that nowadays “travel” quickly and with little resistance among people, organizations, countries and global regions” (Røvik 1996: 139 in Czarniawska and Sevón).



### **2.2.7 The Halt hypothesis 1: Technocratic learning with effect**

*There has been a change in the Washington Consensus policy principles, towards Thailand and South Korea due to technocratic learning with substantial effect.*

### **2.2.8 The Halt hypothesis 2: Technocratic learning without effect**

*There has been a superficial change in the Washington Consensus policy principles towards Thailand and South Korea due to technocratic learning without substantial effect.*

## **2.3. Operationalisation of the IMF's policies**

In this section I aim at operationalising the IMF's policies (Williamson 2004)<sup>12</sup>. This process has three steps. First I select those points in the Washington Consensus policy list which are most relevant for countries in crisis. The Washington Consensus will be developed in two parts where the first part is a concretisation of Williamson's points; the next part is a precision of how these points ought to be operationalised in terms of crisis advice. The third point aims at describing what can be an alternative crisis policy. In the empirical analysis, the purpose is to keep IMF's concrete advice towards Thailand and Korea up against the crisis advice typologies. By doing this we can provide a basis for a conclusion of whether the IMF has moved away from the Washington Consensus or if the IMF's crisis advice best can be explained by my continuity perspective.

### **2.3.1 Washington Consensus, neo-liberalism and Keynesianism**

My methodological approach in order to gauge change is to present two typologies of policy advice. The first typology is about what policy advice is derived from the Washington Consensus. But since this thesis is about the crisis advice, I cannot directly make use of the Washington Consensus. Therefore I must deduce what is appropriate crisis advice in an economy crisis. In addition to this, I will need a counterpoint. In which direction is it possible to expect that the advice will go if the

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<sup>12</sup> In order to operationalise my the continuity and change perspective I make use of the Washington Consensus and Williamson's list of ten policy points for structural adjustment in Latin America. The Washington Consensus entails three points: fiscal stringency, market liberalisation and finally privatisation (Stiglitz 2003: 53). Williamson's list of ten points is a concretisation of the Washington Consensus, encompassed comments on the following points: "budget deficits", "public expenditure", "tax reform", "financial liberalization", "exchange rate", "trade restrictions", "foreign direct investment", "privatisation", "abolition of regulations" and finally "property rights" (Williamson 2004: 3-11).

IMF revises its policy? To answer this question, we do not dispose over a limited set of doctrines. Whereas the Washington Consensus in many ways is consistent with the neo-liberal tradition, a logical contrast point to this would be a more Keynesian understanding of the economy. The basic divide between these two traditions said to be: frequency and the degree of market failure and the willingness to do something about it. Where the neo-liberals are optimistic with regards to market failure where we expect to find a small degree of market failure, the Keynesian tradition is more optimistic with regards to the active role the state can play in order to correct market failure (Keynes 1936). We are basically talking about two different doctrines that deviate from one another on two fundamental points: state and market.

At first sight, one might argue that the Washington Consensus perfectly reflects neo-liberal ideals. This however, appears to be a simplification. The thesis is not supposed to be designed to deal with the contradiction between neo-liberalism and Keynesianism. My point is rather to demonstrate that there is a strong link between the IMF's policy advice and its crisis advice as it can be reflected in the Washington Consensus and in the interests of the institutional investors. This is something we see clearly when we are to ascribe values to the different variables. The Washington Consensus with the three first policy dimensions can be argued to be representing the neo-liberal economy paradigm with free market forces as the crux, "a resuscitation of the laissez-faire policies that were popular in some circles in the nineteenth century" (Stiglitz 2003: 74). To assert that the Washington Consensus was fully compatible with neo-liberalism is as mentioned a simplification. This simplification becomes especially clear for the points about risk distribution and exchange rate management. Therefore, without opening up for a discussion of how Keynesian the bail out strategy and choice of stable or fixed exchange rate are, I would claim that these two points deviate substantially from neo-liberal ideals. In a neo-liberal ideal, there would further be symmetry between upsides and downsides in order to maintain efficient markets. The bail out strategy however, represents a significant move away from this ideal towards something that appears more Keynesian in its substance since the investors are being saved by the bell even if they involve themselves in risky investments. As is the case for the bail out strategy, I argue that the fixed exchange rate, or managed floating

exchange rate, does not fit into the neo-liberal paradigm in the Washington Consensus, even if it is defensible that these types of exchange rates shall be included under Washington Consensus. The reason for this is that the government in case of a run on the currency would be allowed to intervene in the currency market to correct for market failure. Therefore, it can be contended that the fixed exchange rate or the managed floating exchange rate have the same characteristics as has the bail out strategy, to ensure that the investors do not pay the full price of their hazardous investments. Regarding the three remaining points, fiscal policy, monetary policy and capital market liberalisation, the divide between the Washington Consensus crisis advice and the Post Washington Consensus crisis advice is well matched with the neo-liberal ideals on one side, and the Keynesian ideals on the other. The table below illustrates the logical steps that I aim at investigating.

<b>IMF's policy</b>	<b>1.Washington Consensus</b>	<b>2.Washington Consensus based orthodox crisis advice</b>	<b>3.Post- orthodox Washington Consensus crisis advice</b>
1.Fiscal policy	balanced budgets – restrictive	contractive	opening for expansive
2.Monetary policy	high interest rates – restrictive	contractive – high interest rates	expansive – lower interest rates
3. Exchange rate	fixed/stable exchange rate regime	stable exchange rate/ managed float	free floating exchange rate
4. Cap market lib.	“Big Bang” Fast and uncompromising	“Big Bang” Fast and uncompromising	more cautious, sequencing
5. Risk distribution	not included in the WC	bail out	bail in

Since the Washington Consensus was dubious about the capabilities of the governments to correct market failures, the governments were left to play a circumscribed role (Stiglitz 2004: 3). Therefore, the logical counter pole to which I gauge my continuity perspective must leave some space for another view on the governments' capabilities and their potential to correct market failure. The logical

counter point with my imagined Washington Consensus post-orthodox crisis advice consequently entails inspirations that are more compatible with Keynes (Keynes 1936). Keynes' point was that the government in times of recession should intervene actively in the economic cycle by increasing aggregate demand through increased governmental expenditure and for reduced taxes (Keynes 1936). The market forces had to be corrected by the government's assistance and the answer was expansionary fiscal and monetary policy. Consequently, the neo-liberal tradition is reductionist in its view of the markets because all markets are the same and the message then is to open up all markets in order to ensure the most optimal resource allocation possible. In the neo-liberal tradition, markets are viewed as fundamentally stable without governmental intervention. As a result, the credit market also functions best without regulations. However, the Keynesian tradition (Keynes 1936) extracts the credit markets from other markets and maintains that this particular market is fundamentally different from other markets and that it maintains a more important and privileged place in the overall economy than other markets. The view which legitimises governmental intervention in the Keynesian tradition is that the markets are looked upon as fundamentally unstable. This instability is especially evident when discussing the credit market. An unstable credit market would according to the Keynesian tradition not be able to correct itself with a consequence of triggering a bank run which may force the whole economy to go under. So in the Keynesian tradition, there is a valid argument for governmental intervention or bail out of the credit market because the efficiency loss provided by a bail out in the short run very much would supersede the negative consequences of non intervention in the credit market when so is needed. Arguing for the credit market being a more important market than other markets is justifiable through an example: It is assumed that the domino effect of a bank run exacerbates the overall economy to a much larger degree than would be the case if a company goes bankrupt. This is so because the bank at anytime has obligations that are much larger than its disposable cash. So if a bank defaults all the companies and private persons and other banks having relations to this bank run the risk of going bankrupt too. In the following paragraphs, the five chosen main IMF policy points will be discussed and taken through the three dimensions; the Washington Consensus, the

Washington Consensus orthodox crisis advice and its imagined counter pole, the Post Washington Consensus. The two last operationalise the continuity and the change perspective. This will be further elaborated as I take the four policy dimensions through the Washington Consensus orthodox crisis advice and the Post Washington Consensus crisis advice.

## **2.3.2. Fiscal policy**

### **2.3.2.1 Washington Consensus**

“Fiscal policy is the result of what products the government wants to buy and what kind of taxes it charges. These choices can include spending money on defence, reducing the corporate profit tax, sales taxes or focusing on social security issues” (Dornbusch et al. 1998: 253-254). Regarding fiscal policy, the general IMF objective would be to go from a “budget deficit to a budget surplus by applying contractive fiscal policy” (Florio 2002: 377). The consensus in Washington was that large long term budget deficits were undermining macroeconomic stability (Williamson 2002: 3-4). I will contend that the goal of the IMF’s policies in this context will be to reach balanced budgets for the crisis countries.

### **2.3.2.2 Washington Consensus based orthodox crisis advice**

The orthodox crisis advice regarding fiscal policy would be to advocate a contractive fiscal policy where the immediate result will be a decrease in investments due to lowered governmental expenditure. The rationale was a belief that this causes less pressure on the economy and the result is a decrease in output in the short run. In the medium run, the output will return to the natural level of output and the investments will slowly start to thrive. The effects of contractive fiscal policy in the long run will be increased output (Blanchard 2003:149-152). With regards to contractive fiscal policy, it is a relative aspect here that is not to be forgotten. A fiscal policy aiming at a budget deficit of 5 percent of the governmental budget is less contractive than a policy aiming at a budgetary deficit of 4 percent. How contractive a fiscal policy actually is, is dependent of the position of the economy in the economic cycle in the respective country. If the position of the economy in the economic cycle is negative or low, a contractive fiscal policy may be perceived to be “more” contractive than if the position

of the economy in the economic cycle in the country is high. How contractive a fiscal policy is, must also be seen in relation to other countries. A fiscal policy may in itself be contractive, but if we compare it to another country, we may find that the fiscal policy in the respective country is less contractive. Finally, how contractive a fiscal policy is, must be gauged in a historical context. I will look for evidence of the IMF having advised the governments in Thailand and Korea to follow contractive fiscal policies which support the move from budget deficits towards balanced budgets. If I discover evidence for this, it will strengthen my institutional investor hypothesis in my continuity perspective, where the interests of the institutional investors are canalised through Wall Street and manifested in the policy making of the IMF towards the financial crisis in Asia.

### **2.3.2.3 Post-orthodox Washington Consensus crisis advice**

The Post-orthodox Washington Consensus crisis advice that I construct in the form of a typology is in this context fully compatible with the Keynesian economic view. John Maynard Keynes, the founding father of modern macroeconomics, published in 1936 the famous book “General Theory of Employment, Interest and Money” (Keynes: 1936, Ytterhus 2001:168). He argued that it is not possible for a country’s economy to correct itself to reach a level of full employment. Therefore, the government has to intervene actively by stimulating aggregate demand through increased spending. Keynes’ point was that in times of recession governmental expenditures should increase more than in normal periods through tax relief and stimulation of private expenditure and investments (ibid). This is expansive fiscal policy where the demand for goods and services will increase in the public as well as in the private sector, resulting in full exploitation of the possible production capacity (My translation: Ytterhus 2001:168-169). My investigation will be to look for evidence of the IMF having changed its fiscal policy crisis advice towards Thailand and Korea from contractive to expansive in order to tackle the crisis. If the IMF advocates and encourages the authorities in Thailand and Korea to implement expansionary fiscal policies instead of contractive, it will encompass a change in the IMF’s policies through a move away from the continuity perspective towards a strengthening of the technocratic learning hypothesis in my change perspective.

### **2.3.3 Monetary policy**

#### **2.3.3.1 Washington Consensus**

The view in Washington has been to favour relatively high interest rates<sup>13</sup>. The logic behind this, as it was argued by the IMF's officials, was that high interest rates would trigger large capital inflows due to more attractive investment opportunities for foreign investors (Stiglitz 2003: 110). Restoration of market confidence for crisis affected countries is an important reason why Washington favoured high interest rates. High interest rates imply that the economy in the respective country is growing, and this upward trend can be perceived as a healthy sign for the investors considering placing their money in the country. Higher interest rates are good for the foreign investors because their investments get higher yields. This is the reasoning behind why Washington contended that higher interest rates increase the inflow of capital to a crisis affected country. What Washington did not consider however, was that high interest rates, especially when considering highly indebted businesses, which was the case for Thailand and Korea, tended to increase the possibility of these ending up in bankruptcy. I will return to this reflection as I operationalise the change perspective under the Post-orthodox Washington Consensus crisis advice.

#### **2.3.3.2 Washington Consensus based orthodox crisis advice**

The Washington Consensus based orthodox crisis advice does not deviate much from the general view in the Washington Consensus on interest rates. If the goal of applying monetary policy is to ensure exchange rate stability through inflow of capital, and thereby restoring market confidence, the IMF's crisis advice in order to reach this goal, would be to encourage Thailand and Korea to undertake a restrictive monetary policy. This means that the orthodox IMF crisis advice would be to advocate high interest rates<sup>14</sup>. Under point 2.1.4.2 about institutional investors' preferences for

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<sup>13</sup> I will concentrate on the IMF's advice to the central banks in Thailand and Korea to decrease vs. increase the interest rate (or discount rate). There are two other main monetary policy tools to increase or decrease the money supply growth, being open market operations and adjustment of reserve requirements. In the first, the central bank purchases government securities in the secondary market to increase the money supply growth and then sells off securities in the secondary market to decrease the money supply growth. For the last, the central bank could lower the reserve requirement ratio in order to make the money multiply at a higher rate which results in an increase in the money supply growth or it can raise the reserve requirement ratio to make the money multiply at a lower rate which decreases the money supply growth (Madura 1995: 124).

<sup>14</sup> Actually when the IMF encourages the governments in Thailand and Korea to increase the interest rates, the central banks will buy domestic currency and sell off foreign currency. The point is that the central bank at any

monetary policy I claimed there that whether one looks at a interest rate as high or not, is relative to three things: First the state of the economy: If the state of the economy is in a phase with negative growth, even low interest rates may be perceived as high. Secondly, a high or low interest rate is relative to the interest rate differential between two countries. If country A has an interest rate of 15 percent and country B has an interest rate of 25 percent, it is possible to contend even if both interest rates are high, that A has a relatively lower interest rate than country B taking the interest rate differential into account. Thirdly, when assessing whether a country has high or low interest rates one needs to look at historical interest rates. Consequently, I seek to find evidence for the IMF having advised the central banks in Thailand and Korea to undertake restrictive monetary measures by increasing the interest rate to a relatively high level. If this is confirmed done, it will provide support for my continuity perspective and strengthen my hypothesis about the institutional investors.

### **2.3.3.3 Post-orthodox Washington Consensus crisis advice**

Under this point, I have selected the logical counterpart to contractive monetary policy, namely expansive monetary policy. The Keynesian view in times of economic recession favours that the government borrow foreign funds in order to increase the money supply<sup>15</sup>. The result of this is lower interest rates, which in turn encourage emerging businesses to take up loans. More people are employed because of emerging businesses' investments. The effect of this activity is an increased overall demand in the economy (Madura 1995:137-140). I wish to investigate whether the IMF has moved away from arguing for a restrictive or austere monetary policy towards an expansive Keynesian driven policy where the interest rates are set lower in order to encourage investments. If I find evidence for this, it will strengthen my change perspective.

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time is constricted to set interest rate and money supply combinations that lie on the downward sloping curve of interest rates and real money stock. Therefore, increasing the money stock will result in a specific given interest rate. Decreasing the money stock will make government funds more expensive, thereby raising the interest rate (Dornbusch et al. 1998: 244-245, 377-378).

<sup>15</sup> For further information on this see Dornbusch et al. "Macroeconomics" 1998: Chapter 16.



## **2.3.4 Exchange rate**

### **2.3.4.1 Washington Consensus**

There are four main distinctions one can find between exchange rates, one can have a fixed, freely floating, managed floating or pegged exchange rate regime<sup>16</sup>. The general preference on exchange rates for Washington was that they should be “stable and actually *high* enough to protect international lenders: the implication was that real interest rates should be compatible with a target exchange rate agreed with the most influential lenders, particularly with the IMF” (Florio 2002: 378). The Washington Consensus view regarding the choice of exchange rate regime for emerging markets is further elaborated on in an IMF Working Paper, where findings imply that emerging market economies shall move towards adapting floating exchange rate regimes after having obtained a certain level of financial and institutional development. The Working paper argues however for fixed exchange rates in cases where the institutional and financial framework is not satisfactory developed: “For countries that have relatively limited financial market development and relatively closed capital markets, fixed exchange rate regimes appear to offer some measure of credibility without compromising growth objectives – with the important proviso that monetary policy must be consistent with avoiding a large and volatile parallel market premium” (Rogoff et al. 2003: 4).

### **2.3.4.2 Washington Consensus based orthodox crisis advice**

The Washington Consensus based orthodox crisis advice would be to have a stable exchange rate for the crisis countries. The exchange rate possibilities that cover this preference are the fixed exchange rate, pegged or the managed floating exchange rate.

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<sup>16</sup> In the fixed exchange rate regime, the government intervenes in the market in order to keep the exchange rate fixed by selling off or buying some of its domestic money supply thereby reducing or devaluing the value of its own currency. If the central bank on the other hand sells away foreign money supplies and buys its own currency, it revalues or increases the price of its own currency (Madura 2003: 170-171). A pegged exchange rate regime is when the one country's currency value is decided by the currency to which it is pegged. This was the case for the Thai baht and the Malaysian ringgit which had pegged their currencies to the dollar before the Asian crisis broke out (Madura 2003: 174). The floating exchange rate regime is the direct opposite of the fixed exchange rate regime because the exchange rate in this sense is determined by market forces. Central banks do not intervene in order to fix the exchange rate (Madura 2003: 172-173). Managed dirty floating is a variant of the floating exchange rate regime where the currency is allowed to float within certain limit bands. If the currency moves too far away from this band, the government can intervene to maintain its desired exchange rate (Madura 2003: 174).

Madura (2003:174) seeks to define managed float in a more precise manner<sup>17</sup>. He argues that the managed floating exchange rate resembles the floating exchange rate system since the currency in the managed floating system is allowed to fluctuate freely on a daily basis (ibid). It further has the traits of a fixed exchange rate system in that if the managed floating exchange rate system moves too far away from reference values, the government will intervene in order to stabilise the currency around the reference value (ibid). What I aim at investigating is to see to what degree the IMF focuses on having stability in the exchange rate. The logic behind managed floating exchange rate regimes is that at a certain point, the managed floating exchange rate regime becomes so unstable that it does not fit with the preferences of the institutional investors, favouring a stable exchange rate regime. For example if the band limits are being considerably widened, the investors risk losing a lot of money, simply because these new band limits allow the currency to fluctuate more. Therefore I argue that in this case, the managed floating exchange rate resembles more a floating exchange rate regime than a fixed exchange rate regime. This makes it more difficult to argue that the managed floating exchange rate regime is as investor friendly as the fixed or pegged exchange rate regime. As earlier argued in the thesis, fixed exchange rates provide the investors with a more predictable and secure yield on their investments. The Thai currency, which was pegged to the dollar before the Asian crisis, ensured that the possibly risky currency fluctuations the American institutional investors otherwise would have had to take into account, substantially were done away with since the Thai currency's value moved in tandem with the dollar. Implications from the discussion above will be that there are two main different types of exchange rate regimes, the fixed exchange rate (pegged) and the totally freely floating exchange rate system, as well as one exchange rate regime that is lying somewhat between these two, namely the managed floating exchange rate regime. The fixed exchange rate system provides the institutional investors with more protection than does the totally freely floating system. It can also be argued that a totally freely floating exchange rate

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<sup>17</sup> Madura draws a distinction between what he calls “managed dirty float” and “managed clean float”. The first implies that the government can intervene in order to stabilise the exchange rate whereas the last simply refers to no governmental intervention at all (Madura 2003:174). I will however make use of the term managed float when I discuss the difference between floating exchange rates and exchange rates where the government is allowed to intervene in order to stabilise the exchange rate.

system is at best imaginable. If the currency value moves too far away from other currencies, it will be necessary for the government to take measures to encounter this problem. A logical Washington Consensus orthodox based crisis advice in this sense would be that the IMF encourages the governments to intervene in the market to keep the exchange rate within the floating band zone or if the IMF intervenes and attempts to defend the exchange rate at the old level. In this manner the exchange rate is not decided by the demand and supply in the currency market as is the case for totally freely floating exchange rates. If I find evidence that the IMF has advised the governments in Thailand and Korea to maintain or stabilise the exchange rate, it can strengthen my assumption about the continuity perspective.

#### **2.3.4.3 Post-orthodox Washington Consensus crisis advice**

Floating exchange rate regimes have the inherent capacity to be “self correcting” because the market sets the exchange rates at any time. The floating exchange rate regimes further provide the countries with domestic autonomy to freely set the interest rate at any time. How these countries can pursue a monetary policy is described by Cohen (1993) as the “unholy trinity” (Melchior 2002: 6-7): A country cannot maintain full autonomy over its monetary policy as long as it pursues full capital account liberalisation and at the same time maintain a fixed exchange rate (ibid). These three factors cannot all be maintained (ibid). If capital is allowed to flow into the country and the country has a fixed exchange rate, the possibility to retain an independent monetary policy disappears (ibid). With floating exchange rate regimes, one can apply inflation targeting monetary policy (ibid). It is also possible to reach a compromise between fixed and floating exchange rate regimes, and thereby retain some autonomy over the monetary policy (ibid). As countries with fixed exchange rates often have been subjected to speculative attacks, a natural response has been for the governments to move towards flexible exchange rates (ibid).

With regards to the “self correcting capacity” of floating exchange rates, let us imagine that the demand for a currency is low, which in turn decreases the value of this currency. This will force the home country to pay more for imported goods, whereas the home industry is stimulated due to increased foreign demand for cheaper home

products. More jobs are created and the exchange rate corrects itself upwards<sup>18</sup>. This “self correcting capacity” of the floating exchange rates however, means uncertainty for trade and investments since the governments do not intervene in the currency market in order to correct fluctuations in the exchange rate. Therefore, the predictability awarded the investors in the fixed, pegged or managed floating exchange rate regimes disappear if the government chooses a floating exchange rate regime. The above mentioned model demonstrates that a devaluation<sup>19</sup> of a currency can be simulative and positive for the home country in order to create a more competitive climate for the home country’s exporting products. This does not however indicate that it is just as favourable for the investors who want guaranteed yield on their investments without having to face the risky downside. This is why I believe this constructed point represents the direct counterpart of the Washington Consensus orthodox based crisis advice. Having made reference to the differences in how to distinguish between the different types of exchange rates, it becomes even harder to operationalise a direct valid counterpart to the fixed exchange rate regime. This allegation is especially relevant for the difficulties in categorising the managed floating exchange rate regime, as I argued in the paragraph above, since it has the traits of both a fixed and a floating exchange rate system. Nevertheless, I will search for evidence of the IMF having advocated fully floating exchange rates towards Thailand and Korea in order to stimulate the home countries’ industries by making their products cheaper than their competitors’. If I find evidence for this, it would weaken the continuity perspective

### **2.3.5. Capital market liberalisation**

#### **2.3.5.1 Washington Consensus**

The third point is capital market liberalisation. Capital market liberalisation, or financial liberalisation, means that the regulations protecting against inflow of capital

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<sup>18</sup> “Floating and Fixed Exchange Rates”

<http://www.investopedia.com/articles/03/020603.asp>

<sup>19</sup> The terminology applied for exchange rates differs from floating to fixed exchange rates. When I speak about a devaluation of a fixed, pegged or managed floating exchange rate regime, this is not entirely correct. The terms devaluation/revaluation are used to describe a weakening or strengthening of a currency in a fixed exchange rate regime. The terms depreciation/appreciation are used to describe a weakening/strengthening of a currency in a floating exchange rate regime (Abel and Bernanke 1995: 485)

are torn away (Stiglitz 2003: 65). The general view in Washington was that by advocating total market liberalisation, the markets would perform more efficiently, which in turn ensured faster recovery and growth for the crisis countries (Stiglitz 2003: 67). The belief about market forces is based on the assumption that the “invisible hand” works perfectly so that if all market non-compatible regulations<sup>20</sup> are removed, it will be even easier for this hand to allocate market resources more efficiently. This conviction is grounded in the neo-liberal paradigm which the Washington Consensus is based upon (Stiglitz 2003: 73-74). This confidence in market forces that are able to provide everybody with the best, makes it unnecessary to be aware of correct sequencing of the liberalisation process (Stiglitz 2003: 73-74). Washington believed “that once private property rights were established, all else would follow naturally – including the institutions and the kinds of legal structures that make the market economies work” (Stiglitz 2003: 73).

### **2.3.5.2 Washington Consensus based orthodox crisis advice**

Under the heading of capital market liberalisation in the section on Washington Consensus based crisis advice, I have written that the capital market liberalisation should be like a “big bang”; fast and uncompromising. This is a result of a belief that maintains that if the market forces get free reign, they will be able to allocate resources more efficiently, which ensures that the markets remain efficient. The term efficient markets, requires an elaboration. It may refer to how well capital is adjusting and moving to the best investment places available. To enable fast capital moves, the markets must have been liberalised. The adjustment comes as a consequence of information available in the market about places with investment potential. The efficient market hypothesis concerning portfolio investments refers to the notion “that prices of securities fully reflect available information about securities” (Bodie et al. 2003: 262). The hypothesis<sup>21</sup> about efficient markets also implies that it is very

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<sup>20</sup> It will be too simple to assert that all regulations should be removed. Market regulations that are non-compatible could be tariffs and subsidies because they might provide an efficiency loss. Market compatible regulations open up for the government correcting market failure in order to restore stability and make sure the market remains efficient (Niemeyer 2001:12). For more on this, see Niemeyer 2001.

<sup>21</sup> Three forms of efficient market hypothesis are identified by Bodie et al.; the weak form of efficient market hypothesis entails that “stock prices already reflect all information contained in the history of past trading”, the semi strong form of efficient market hypothesis implies that “stock prices already reflect all publicly available

difficult to “get free lunches” in the capital market because a huge number of all market participants have access to the information necessary for future investments. But, information for the emerging markets is less available since they get less attention and are not fully analysed like the US markets (Bodie et al. 2003: 264). If these markets, after having been thoroughly analysed, prove to offer great investment opportunities, it will make the investors able to get a foothold in these markets before other market participants; a first mover advantage<sup>22</sup>. Quoting Stiglitz’ reflections about Wall Street’s attitude towards the Chinese markets: “Wall Street rightly believed that China represented a potential vast market for its financial services, and it was important that Wall Street get in, establishing a strong toehold, before others” (Stiglitz 2003: 64). In order to enable this, it is required a fast and uncompromising liberalisation process where all possible hampering regulations are removed. Of particular interest to investigate regarding this point, is to look for evidence that the IMF has advised total capital market liberalisation towards the two chosen countries, namely Thailand and Korea. Possible findings in this direction will provide support for my institutional investor hypothesis in the continuity perspective.

### **2.3.5.3 Post-orthodox Washington Consensus crisis advice**

In this point, I have selected “cautious” and “sequencing” to describe the opposite of the IMF’s policy advice towards Thailand and Korea. Sequencing needs to be elaborated. It involves two important elements. The first refers to pacing; how fast the reforms are implemented. The second makes reference to the order of the reforms, because the reforms have to be implemented in a specific and correct order to ensure successful results. This does not make it too ambitious to assert that sequencing is everything. Regarding a liberalisation process, Stiglitz argues that “social safety nets” and “adequate regulatory framework” should be ensured before capital market liberalisation was forced through; otherwise the result could be fatal (Stiglitz 2003: 73). His argument is logical because if the process is not conducted in a correct order,

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information and finally the strong form of efficient market hypothesis involves that “stock prices reflect all relevant information, including inside information” (Bodie et al. 2003: 265).

<sup>22</sup> The term “first mover advantage” is actually taken from international business. If there is no entry barriers, for example that the entry of other businesses in the industry affects the competition, a business will have a first mover advantage if it is able to enter this business before other competitors. This first mover advantage will entail elements like cost advantage, economies of scale through more market share etc. <http://www.quickmba.com/>

any kind of market liberalisation process would entail greater risk for the individual. Building on this we can imagine a scenario where the actors in the market are given free rope without having made sure that brokers, lawyers, police and bankruptcy laws, to mention some of them, are in place. For example the banks have to be subjected to prudential regulation so that they do not push the economy into imbalances by excess lending to the customers.

Another example of the importance of sequencing is taken from Tranøy<sup>23</sup>. Tranøy's motivation in his doctorate is to elucidate "why interest rate controls and tax breaks were not done away with simultaneously so that price policy in the credit market could have been co-ordinated with the policy on volume" (1999: 63). He stresses the importance of not loosening up the supply of the credit market and maintaining the price at an artificially low level. This distorts the whole purpose of market mechanism where supply and demand naturally create equilibrium. This equilibrium is, as argued by Tranøy, being distorted because restrictions on volume are being done away with but with price caps remaining in place. According to Tranøy (1999), this priority was wrong as the price should have been deregulated before liberalising the credit market.

Generally reflecting, there are two different perspectives of how to see the World. The economists would apply comparative static in order to compare equilibrium values between supply and demand. The argument is simple: If the demand increases, it will result in less supply, thereby forcing the price upwards, resulting in a new equilibrium value. However, the political scientists will pay more attention to all the institutional factors that meddle with the process from the first to the second equilibrium value. Again it is justifiable to allege that sequencing is everything. To view the World as comparative static where two equilibrium values are compared to each other will be a too narrow view when a lot of different actors come into play when equilibrium values are to change.

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<sup>23</sup> My ambition regarding sequencing in this thesis is not to investigate what causes the sequencing process to go wrong, but rather stress the importance of correct order and pacing in the sequencing process. However, it might be worth mentioning that Tranøy comes up with explanations to why sequencing might be hard. He wants to elucidate why "disparate policy paths" may end up in "coordination failure" (Tranøy 1999: 60-62). Further the "technocratic bias" may lead to "selective learning" which results in a lack of understanding of "functional interdependencies between issue areas" (Tranøy 1999: 75).

My task regarding the Post Washington based crisis advice will be to search for IMF advice regarding capital market liberalisation that flows in the direction of correct order and pacing of the capital market liberalisation reform process. Finding this, it will provide support for the technocratic learning hypothesis in my change perspective.

### **2.3.6 Risk distribution**

#### **2.3.6.1 Washington Consensus**

Having argued for my standpoint regarding the risk distribution perspective in this analysis, it is worth mentioning that Williamson never wrote about risk distribution and bail out - bail in strategies. Practice has however shown that the bail out strategies have been applied by the IMF regarding crisis countries. It occurs to me that despite this, there is a certain consensus about applying these strategies towards countries in crisis even if this was never explicitly formulated in the Washington Consensus.

It can be argued that the market mechanisms are disrupted because of the moral hazard (Lane and Phillips 2000: 4) phenomenon inherent in the IMF's bail out packages. Moral hazard "[...] increases the *probability* of the event being insured against, usually because it diminishes the incentives for the insured party to take preventive actions" (Lane and Phillips 2000: 4). If the investors know they will be bailed out by the IMF if the market crashes, it may encourage the investors to take on riskier investments that they otherwise would have avoided if they were not "insured" by the IMF's bail out packages. Therefore, one can assert that the bail out strategy is representing a contradiction of the neo-liberal ideals of free and efficient markets, which is the crux of the Washington Consensus.

There are several types of risks in the international financial environment. Regarding a country's different types of risks, Madura draws a distinction between the macro political and financial risks and the micro political and financial risks (Madura 2003: 485). The macro risks will be all the variables that can affect a country except for the firm specific or micro risks (Madura 2003: 483). Political risks in general will, according to Madura, include variables like corruption, war, changes in government, bureaucracy, attitudes of consumers in the host country etc, whereas the financial risks entail interest rates, exchange rates and inflation, unemployment, government budget

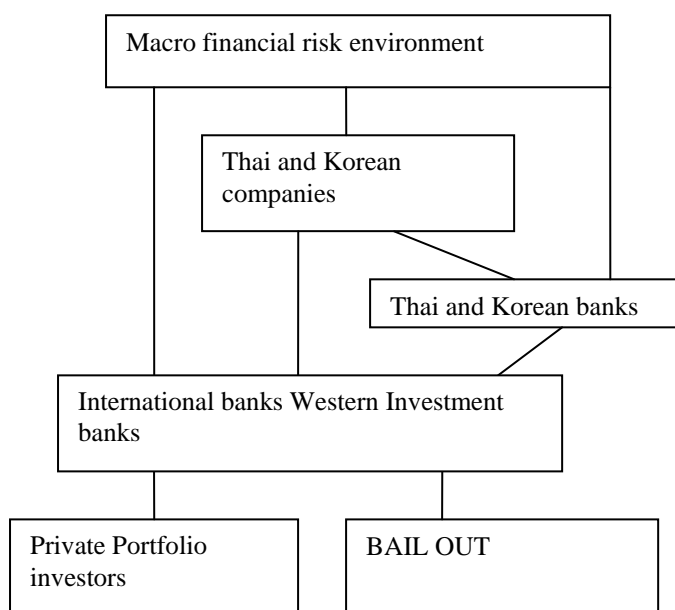


levels and balance of trade, to mention some of the points (Madura 2003: 478-483). Building on this, I argue that the risk distribution perspective applied in this thesis is one of country risk, more precisely country risk focused on the financial macro risks. To defend this assertion, I consider that the overall macro financial risks are of greater importance for the IMF when it considers whether a country is entitled to a bail out package or not. My conviction is that the firm specific risks of how sensitive a firm's business can be asserted to be towards fluctuations in interest rates, GDP growth, inflation trends and the like (Madura 2003: 485) are of minor importance for the IMF since it judges the country's overall economic situation when assessing whether a country is entitled to a rescue package or not.

### **2.3.6.2 Washington Consensus based orthodox crisis advice**

Even if the bail out strategy was never included in the policy prescription recipe of the Washington Consensus, I find it apposite to include under the "Washington Consensus based orthodox crisis advice". This is because earlier practice in the crises in Russia, Brazil, Argentina and last but not least the crisis in Asia (Stiglitz 2003: 131), has shown that the bail out strategy in all these examples has been used to try to ease the financial turmoil these countries were exposed to. The reason why I contended that the bail out strategy favours the investors, is that they have assurance that they will be saved by the IMF if something proves to go wrong. Therefore, the investors cannot easily lose their money when they are investing in countries where the IMF makes sure that the exchange rate is being stabilised at a certain level in order to ensure a certain profit on the hazardous investments. The bail out strategy does not provide symmetry between the upside and the downside of the investments' forecasts since there is a one way bet from the investors' side. The result is thus a distorted market and loss of market efficiency. Ideally it would be possible to imagine a complete bail out where the investors bear no losses. Take a bank for example; we as investors are guaranteed that even if the bank goes bankrupt, we are secured by an investor guarantee that gives us the money back. The investors affected by a bail out package from the IMF can be many, and the model below is included in order to highlight the complexity of discovering who the beneficiaries of a bail out package are. I have made some basic assumptions about where I believe there are relations between the identified actors in

my model. First I assume that the macro financial risks are influencing the whole model. Secondly I argue that there is a link between private investors investing in portfolios towards Thai and Korean companies, either directly or indirectly through an investment bank. This makes the investors vulnerable to abrupt changes in the macro financial environment. The other important relation is the one between the international banks that lent money to the Thai and Korean companies either directly or indirectly through Thai or Korean banks. This relation is also vulnerable to changes in the macro financial risk environment like changes in interest rates, changes in GDP etc. My goal for the bail out analysis is twofold. First, I wish to investigate whether the IMF has applied bail out strategies on Thailand and Korea. Secondly, I want to say something about the direction of the bail out package, if it is possible to allege that some of the actors clearly would profit more from a bail out package than others. Therefore, if I find empiric proof for the IMF having applied bail out strategies on Thailand and Korea, this will strengthen my assumption about the continuity hypothesis.



### 2.3.6.3 Post-orthodox Washington Consensus crisis advice

Questions have however risen against the bail out strategies since this strategy distorts the efficiency potential inherent in free market forces. Eichengreen and Rühl (2000) are clear in their judgement about the bail out strategies: “Not being subject to the costs of crises, investors disregard the risks of lending, and the consequent lack of

market discipline allows feckless governments to set themselves up for a painful fall” (Eichengreen and Rühl 2000: 1). They further argue that in order to strengthen the market discipline one has to look for new methods so that the investors do not go clear the losses they otherwise would have incurred. This is important because it will decrease the likelihood for future financial crises (Eichengreen and Rühl 2000: 1).

As mentioned in the former paragraph about bail out packages, it is possible to imagine a full bail out where the investors take no losses. Accordingly, there is another ideal side as well, namely the full bail in where the investors take all the losses from a crisis. This enables me to assert that there are two preferred points, between which two strategies oscillate, namely the full bail out, which can be awarded the value 100 and the full bail in which can be awarded the value 0. When moving away from the bail out strategy towards the bail in strategy, the investors receive less money from the bail out package implied by a decreasing value from 100 which further means that the part of the loss the investors have to take increases accordingly.

Following this argument, I will investigate and try to map out evidence for the IMF having moved away from bail out strategies to bail in strategies where the IMF has applied moral suasion against the investors to make them share the risk. I will focus on debt restructuring as an approach of a bail in strategy. Debt restructuring can be conducted in several ways like “reducing the outstanding principal”, “reducing the interest rate”, “extending repayment period or maturity extension”, “swapping debt for equity” or combining these strategies (Chanyarungrojn 1999: 5). I have chosen to focus on the third of these strategies; “extending repayment period or maturity extension”. The strategy of rolling over the debt is discussed by Bluestein (Bluestein 2001: 184-205). This entails that the investors who have lent money to other investors postpone the date at which the loan payment is due. By conducting such a practice, it is possible to avoid a default of the lenders and also involve more directly the investors having excessively lent money and force them to share the burden with the borrowers (Bluestein 2001: 184-205). If I find evidence for this move, it will strengthen the explanatory power of my change perspective.

## **2.3.7 Methodology**

### **2.3.7.1 Research design**

My thesis focuses on explaining the policies of the IMF in the East Asian Crisis towards Thailand and Korea centred in the Washington Consensus, applying a “continuity perspective” and a “change perspective”. Chapter three aims at finding a correlation between the IMF’s policy making and the continuity and/or the change perspective. Chapter four aims at elucidating the mechanisms or the process leading to a specific IMF policy advice towards Thailand and Korea. As I have limited access to information about the processes and mechanisms leading to the specific IMF policy outcome, I will be able to find support for my hypotheses if I find an IMF policy outcome that supports either the continuity or the change perspective. The chapter specifying the process and the mechanisms behind the process will be applied in order to further strengthen or weaken the findings made in chapter three.

The analytical case is the IMF’s policy making where I look at the causes (“interest/technocratic learning”) and its effects on the policy formulation of the IMF. There are diverse ways to define a case in the research tradition, but generally a case is known for being restricted to a definition of what is included in the case and what falls outside. Moreover, the researcher will focus on describing the defined case. This enables the researcher to identify specific traits and discover interesting findings connected to the case. By using a case research design, I gather a lot of information (data) about a restricted phenomenon (case). This said my research design is a case study where the case is the IMF’s policies towards the East Asian Crisis operationalised as an extension of the Washington Consensus, more specifically Williamson’s list of ten points for structural adjustment of the Latin American countries. Regarding the sub cases, I have selected two countries in East Asia; Thailand and Korea.

Given the notion that a research design like a case study is intensive, it turns out difficult if not impossible to generalize to other happenings and make statistical reliable data based on it. However, this is not the purpose of the case study and therefore I have restricted myself to the IMF, my two explanatory perspectives and its effects on East Asia. This does not however imply that interpretation of the accessible

statistical material about the case is in vain, i.e. method triangulation. Consequently, the strength of a case study is the detailed knowledge it provides me with. As a result “the loads of information accessible becomes loosely ripped apart fragments, but can be seen in the context in which they appear connected as parts of a broader picture” (My translation: Hellevik 2001: 98).

### **2.3.7.2 Sources**

The sources will primarily come from written sources. I will apply primary sources like IMF Working Papers and Letters of Intent and secondary sources like the Review of International Political Economy and a Journalistic book (Bluestein), newspapers, presentations etc. The contents of this material will be studied in depth. Content analysis can be both qualitative and quantitative. In qualitative content analysis one aims at interpreting quotations whereas in quantitative content analysis one registers and counts for example how many times a special word is being repeated (My translation: Ringdal 2001:115). I will apply qualitative content analysis in my research design. I aim at coming up with interesting findings as to what extent one may claim that the institutional investors are one of the driving forces behind the IMF’s policy making. Further I want to investigate whether there has been a change in the “continuity perspective” caused by technocratic learning as it is explained in my competing “change perspective”.

Method triangulation is a technique where qualitative data and quantitative data are combined to reach a broader picture of the case studied. This technique will be of value to me when I seek to find out more about the IMF’s policies. This requires interpreting statistical material as well as books and quotations, thereby allowing me to get a broader and more complete picture of the not easily approachable problem of the IMF’s policy making process (My translation: Ringdal 2001:115).

### **2.3.7.3 Validity and Reliability**

Validity simply means how valid your study is. Problems encompassing validity can arise due to the notion that I, as a researcher, am moving from a theoretical level where the problem is defined to a more concrete level where the problem is operationalised. The collection of the data material is being conducted on the empirical level, and

convergence between this level and the theoretical level is crucial in order to maintain the definition validity (My translation: Hellevik 2003: 54). My problem definition is as mentioned to find out what was lying behind and influenced the policies of the IMF towards the East Asian Crisis. The IMF's policies were concretised by the application of the Washington Consensus' three pillars; fiscal austerity, market liberalisation and privatisation. In order to operationalise this, I have chosen Williamson's list of ten points from restructuring the crisis affected countries in Latin America. Since I am not conducting a statistical analysis, but rather aim at investigating the IMF's policy making, I find it apposite to ask whether I find empirical evidence or not for the three pillars of the Washington Consensus by applying Williamsons' list of ten points. If I do not find empirical evidence for these points, it will strengthen my assumption that one has moved away from the Washington Consensus and that there has been a change in the IMF's policy making due to learning and not necessarily due to continuity. I argue that the definition validity is being taken care of since the theoretically defined problem of investigating what was lying behind and influencing the IMF's policy making in the Washington Consensus, already was operationalised by Williamson's list of ten points. However, I see that there were divergent interpretations between Washington and Williamson regarding the points about foreign direct investments and the exchange rate policy. This has been taken into consideration to make my thesis more accurate.

Regarding the data to be collected and analysed in order to investigate around my continuity and change perspective, it is an absolute prerequisite that the data be collected as accurately as possible (Hellevik 2003: 53). This will ensure that the reliability, as well as the validity, of the thesis is maintained. When I start analysing the content of the IMF's documents, looking for a change in the IMF's policies as well as a reason to why this change has occurred, this point becomes especially important. Therefore I must be conscious that there exists a tight link between my theoretically defined variable; the IMF's policies, the operationalised defined variable; Williamson's list of ten points and the data to be analysed (Hellevik 2003: 53).

### **3 THE IMF'S CRISIS ADVICE TO THAILAND AND KOREA**

The purpose of this chapter is to discover empiric evidence for my continuity and change perspective. In this chapter, I aim at discovering a sort of correlation between the IMF's policy making and the continuity and/or the change perspective. The two countries chosen, Thailand and Korea, and my five IMF policy points will be taken through two periods. Period one is by me set to be at the outbreak of the crisis in the beginning of July 1997, as the Thai government then had decided to abandon the fixed exchange rate regime and let the baht float freely with a consequence that the baht lost 19 percent of its value in the foreign exchange markets (Bluestein 2001: 51). The second period is selected on the basis that the crisis changed in character. This period is by me set to be from December 1997 to December 1998 because the worst economic downturn was alleviated by a following period of more financial stability. The construction of this chapter rests on a conviction that the learning process in the IMF actually started before the crisis was ended. Accordingly it should be unproblematic to identify a change from the first to the second period regarding the two first policy points, fiscal policy and monetary policy. For the exchange rate, the change actually appears to have come with the outbreak of the crisis which makes it harder to identify a change in the exchange rate policy from period one to period two. The same is the case for the capital market liberalisation where the chosen course in the first period did not alter in the second, but was rather fortified. The last point about risk distribution experienced a clear shift in the direction of the IMF's advice from the first to the second period.

After each of the two periods for Thailand and Korea I will provide a wrap up to conclude whether the five policy points can be claimed to represent either a continuity perspective or a change perspective.

#### ***3.1 Thailand Period 1***

Before I move on to the IMF's crisis advice for period 1 in Thailand, it is apposite to provide some background information of the overall macroeconomic situation. It is in this context we need to assess the IMF's crisis advice towards Thailand.

The tendency before the outbreak of the crisis was that the short term debt had increased faster than the total debt (Ghosh et al. 1999:11). Another problem was that

the growth in short term debt was faster than the growth in foreign reserves (ibid). This could cause serious liquidity problems, as much of the foreign reserves in Thailand were tied up in forward contracts (ibid). Since the nominal exchange rate was pegged to the dollar and the domestic interest rate was higher than foreign interest rates, a natural consequence was to borrow foreign money without hedging the positions (Ghosh et al. 1999:12). Thailand experienced a GDP growth from 1991 to 1995 of above 8 percent (ibid). Accompanying this, the unemployment rates decreased from above 3 percent in 1991 to below 2 percent in 1995 (ibid). This situation did however change during 1995 as the growth rate declined drastically and the unemployment rate started to rise (ibid). The dollar also strengthened and this deteriorated the competitiveness of the Thai exports, resulting in a fall in export revenues (Ghosh et al. 1999: 13).

With regards to the fiscal situation prior to the crisis, Thailand experienced surpluses every year from 1990 through 1996. However, due to declining exports, the value of the Thai portfolios decreased drastically (Ghosh et al. 1999: 9). The creditworthiness of the Thai financial institutions was put into question (ibid). The highly indebted financial system made it difficult if not impossible to raise interest rates to protect the exchange rate if a speculative attack should occur (ibid). Consequently, “Thailand was forced to float the baht July 2, 1997 in the face of serious difficulties in rolling over short-term debt and a depletion of net foreign exchange reserves” (Ghosh et al. 1999: 10). Despite the dramatic economic situation, Thailand did not want any assistance from the IMF (Bluestein 2001: 51). However, as Thailand’s Prime Minister received a refusal on a request to Japan and China to provide Thailand with bilateral loans of hard currency, he gave in and decided to ask the IMF for help (Bluestein 2001: 74).

### **3.1.1 Fiscal policy**

The IMF imposed measures on the Thai government in order to obtain a budget surplus. The first stringent fiscal policy measure included that the Thai government increase the value added tax (equivalent to a national sales tax) from 7 to 10 percent. In other words, the IMF required that the Thai government cut expenditures and rose taxes up to a level equivalent to 3 percent of total GDP in Thailand (Bluestein 2001: 74-75).



### **3.1.2 Monetary policy**

The IMF firmly backed a strict monetary policy direction where the Thai government imposed high interest rates. The IMF maintained that market confidence had to be restored to attract foreign capital into Thailand which would ensure economic prosperity. And more, that the exchange rate would collapse if high interest rates were not maintained (Stiglitz 2003: 110-112). As is described in the Letter of Intent of February 24<sup>th</sup> 1998, the IMF maintained “a tight monetary stance in support of exchange rate stability”<sup>24</sup>.

### **3.1.3 Exchange rate policy**

Before the crisis broke out in Thailand, the country maintained a fixed exchange rate. A series of depreciations of the baht against the dollar followed after the outbreak of the crisis (Ghosh et al. 1999: 36). The biggest depreciation came in July 1997, when the baht depreciated 24 percent to the dollar. The depreciation continued towards January 1998, with monthly depreciations ranging from approximately one percent to around 20 percent (ibid). Consequently, the IMF demanded that the Thai government leave the fixed exchange rate regime and move towards a more flexible market determined exchange rate regime (Bluestein 2001: 60). The reason for this advice, as it was argued for by top IMF officials like Camdessus, was that by lowering the baht, the Thai exports would be cheaper, thereby making the products from Thailand more competitive in the market. The IMF’s program design wanted to stabilise the baht in order to avoid further depreciation. This could be done in two ways; either by direct intervention (Madura 2003:186-188) by buying baht to support the currency, or by indirectly intervening (Madura 2003: 189-190) in the market by increasing the Thai interest rates. Between these strategies, the IMF strongly favoured the use of interest rates instead of direct intervention in the foreign exchange market (Ghosh et al. 1999:178). This is described in paragraph 3.1.2. The purpose with the new exchange rate regime was to “alter the incentive framework for short-term capital inflows and protect the future level of foreign exchange reserves”<sup>25</sup>. This indicates that the IMF favoured a managed floating exchange rate regime for Thailand in the first period.

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<sup>24</sup> <http://www.imf.org/external/np/loi/022498.HTM>

<sup>25</sup> <http://www.imf.org/external/np/sec/pr/1997/pr9737.htm>

### 3.1.4 Capital market liberalisation

The IMF strongly encouraged the Thai economy to open up its markets for foreign capital inflows. In addition to this, the IMF argued that open capital markets would provide a more efficient allocation of the resources. Even so, the IMF was not the only institution to advocate that Thailand liberalise the capital markets. The US Treasury also had a large say in dictating the policies of the IMF (Stiglitz 2003: 101-102).

### 3.1.5 Risk distribution

Regarding risk distribution, the IMF provided Thailand with a bail out package of 4 billion dollars (Bluestein 2001: 78-79). In order to highlight the complexity of who were the beneficiaries of the bail out package, I have made an attempt to construct a model below. My model aims at illustrating the relationship between the international banks, Western investment banks, Thai banks and companies and the private investors<sup>26</sup>.

- ✚ Regarding point number one in my model, Stiglitz argues that the IMF's money package to Thailand was "a bail out to the international banks [...] the lenders did not have to face the full consequences of having made bad loans (Stiglitz 2003: 95).
- ✚ Corden firmly states that the equity investors in Thailand were not being bailed out (Corden 1998:19). This is confirmed by an IMF Working Paper, as the shareholders' stakes in various commercial banks and companies in Thailand through the period of June 29<sup>th</sup> 1997 to August 14<sup>th</sup> 1998 were eliminated (Enoch et al. 1999: 2-4). This is illustrated in point 2 in my model.
- ✚ Due to the Financial Sector Restructuring Authority (FRA), all of the 58 financial institutions in Thailand were closed down, except for two. The conditions further implied that the assets of these financial companies were to be sold to foreign investors<sup>27</sup>. To me this looks more like a bail in of the

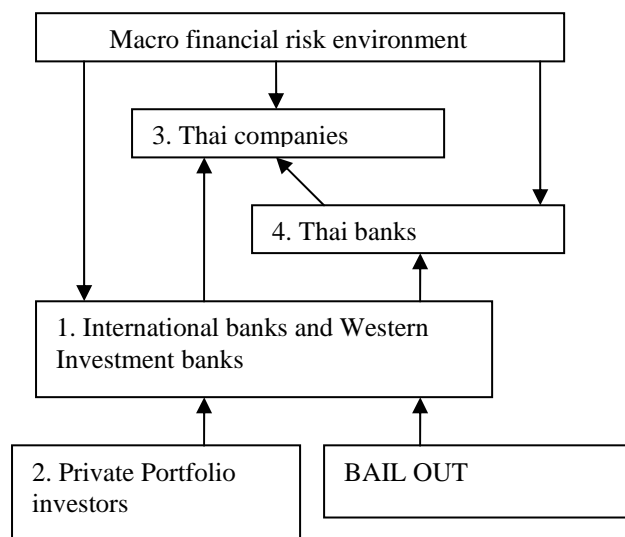
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<sup>26</sup> I have placed the macro financial risk environment on top of this model since factors like "GDP growth, inflation trends, government budget levels (and the government deficit), interest rates, unemployment, the country's reliance on export income, the balance of trade, and foreign exchange controls" (Madura 2003 :483) all influence the other factors included in the model.

<sup>27</sup> <http://www.imf.org/external/np/loi/022498.htm>

financial companies in Thailand, as these had to carry some of the losses. This is point three in my model.

✚ The restructuring of the banks in Thailand, point four in my model, had elements of bail out, as many of these banks were provided assistance through the Financial Institutions Development Fund. Nevertheless, I will contend that the bail in element for the Thai banks was stronger than the bail out element since one commercial bank was closed down and several others were subjected to strict restructuring measures. All banks in Thailand had to take on the losses from the financial crisis, and had to meet strict rules on loan classification (Enoch et al. 1999: 97). Another element was that none of the banks were allowed to pay dividends for the rest of 1997 and 1998 (ibid). The international and western banks were bailed out and had the opportunity to capitalise on the distressed securities in what was left of the Thai financial system. For example foreign investors did buy more than 50 percent of two private domestic banks in Thailand (Enoch et al. 1999: 100).



### 3.1.6 Main tendencies for period 1 in Thailand

Having investigated what type of crisis advice the IMF gave concerning Thailand in the first period of the East Asian Crisis, it seems unambiguous to claim that the first period is a reflection of the continuity perspective. However, the point about exchange rate policy, I will argue, indicated more continuity than change, but is still unclear. The main tendencies for period one in Thailand are wrapped up in the following table.

Thailand period 1	Type of IMF crisis advice	Type of perspective
Fiscal policy	Contractive	Continuity
Monetary policy	Contractive	Continuity
Exchange rate policy	Managed float	Unclear
Cap. Market liberalisation	Fast and uncompromising	Continuity
Risk distribution	Bail out	Continuity

### **3.2 Thailand Period 2**

In the beginning of chapter three, I argued that the first period of the crisis started in July 1997, when the Thai government had to let the baht float freely (Bluestein 2001: 51). Period two was set to be between December 1997 to December 1998, as the worst economic downturn had been alleviated and one witnessed more financial stability in this period than in the first. Accordingly, the following paragraphs describe how the IMF's crisis advice towards Thailand adjusted to this.

#### **3.2.1 Fiscal policy**

Of particular interest is the change observed in the IMF's fiscal policy advice as IMF officials experienced that the conditions they had imposed and urged the Thai government to meet, only exacerbated and accelerated the already dangerous financial crisis. Consequently, the stringent tight fiscal policy course dictated by the IMF on Thailand was later to be reversed and the IMF's officials encouraged the Thais to "run a budget deficit". The gradual change in the IMF's fiscal policy is apparent in Letters of Intent, where fiscal policy measures in the initial reform programme for Thailand were set to 3 percent of GDP in order to correct the deficit in the public sector towards a surplus of 1 percent of GDP in 1997/98<sup>28</sup>. In the Letter of Intent of December 1<sup>st</sup> 1998, the public sector deficit target was set to 5 percent of GDP<sup>29</sup>.

#### **3.2.2 Monetary policy**

Consequently, as the situation in the economy cooled down, the IMF promoted a lowering of the interest rates in order to encounter a possible deflation. The crux was to maintain a stable exchange rate and fight inflation by higher interest rates, making

<sup>28</sup> <http://www.imf.org/external/np/loi/120198.htm>

<sup>29</sup> <http://www.imf.org/external/np/loi/120198.htm>

the exchange rate appreciate, but at the same time avoid a possible deflation. In the mid of 1998 the interest rates were approaching pre-crisis levels down from approximately 25 percent in the end of 1997 to around 10 percent in the mid of 1998. The interest rates continued to decline, and in 1999 they crawled under 5 percent according to the Bank of Thailand's statistics<sup>30</sup>.

### **3.2.3 Exchange rate**

In a news brief on March 4<sup>th</sup> 1998, at that time managing director for the IMF said “there was sufficient financing to assure that key external objectives—exchange rate stability and the maintenance of adequate foreign exchange reserves—would be met” and further that “The IMF will continue to monitor the situation closely to ensure that the program remains properly funded at all times including, if necessary, by the provision of additional financing”<sup>31</sup>. This implies that the IMF's choice of a managed floating exchange rate regime did not change in the second period of the crisis.

### **3.2.4 Capital market liberalisation**

The IMF's position towards liberalisation of the capital market did not change in the second period in Thailand. What happens is that the consequences of the crisis advice the IMF gave Thailand in the first period, now become evident. In a letter sent to Managing Director, Michael Camdessus, the Thai authorities stated that “market sentiment has been boosted by the early February abolition of capital controls” and that the developments of the future capital account developments would be closely observed<sup>32</sup>.

### **3.2.5 Risk distribution**

Steps were taken in order to involve the Japanese private creditors more directly. Moral suasion was used against the Japanese banks in Thailand since these banks were the largest creditors to the Thai borrowers and several Thai corporations<sup>33</sup>. Actually two-thirds of all total short-term debt outstanding in Thailand, was owned mainly by Japanese banks (Ghosh et al. 1999: 22). Having the IMF coordinating the debt

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<sup>30</sup> <http://www.bot.or.th/bothomepage/databank/ArticlesAndPublications/Others/Annual-99.pdf>

<sup>31</sup> <http://www.imf.org/external/np/sec/nb/1998/nb9805.htm>

<sup>32</sup> <http://www.imf.org/external/np/loi/022498.htm#tab>

<sup>33</sup> <http://www.imf.org/external/pubs/ft/series/01/privsecp.pdf...> page 1

restructuring process in Thailand between the debtors and the Japanese creditors, it was possible for Thailand to reach an agreement with the Japanese creditors in August 1997<sup>34</sup>. The agreement assured that the Japanese creditors would roll over the debt by extending the loan maturing period for the debtors. Consequently, the rollover rates for short term obligations of the Japanese banks remained high through April 1998 (Ghosh et al. 1999: 22). This enabled the IMF to further stabilise the economic situation in Thailand<sup>35</sup>.

### **3.2.6 Main tendencies for Thailand in period 2**

The main tendency for Thailand in the second period of the crisis was the change perspective. The IMF's advice given for fiscal and monetary policy and risk distribution supported the change perspective. The IMF's advice for the exchange rate in the second period of the crisis did not change. The capital market liberalisation advice continued to support the continuity perspective. The findings are summed up in the table below.

<b>Thailand period 2</b>	<b>Type of IMF crisis advice</b>	<b>Type of perspective</b>
Fiscal policy	Expansive	Change
Monetary policy	Expansive	Change
Exchange rate policy	Managed float	Unclear
Cap. Market liberalisation	Fast and uncompromising	Continuity +
Risk distribution	Bail-in	Change

### **3.3 Korea Period 1**

Before I move on to the IMF's crisis advice towards Korea in the first period of the crisis, I feel that it is apposite to provide some background information about the overall macroeconomic situation in Korea. As emphasised in paragraph 3.1, about the macroeconomic situation in Thailand before the IMF intervened, it is in the light of the macroeconomic situation we need to see the IMF's crisis advice.

<sup>34</sup> <http://www.imf.org/External/np/exr/notions/asia.HTM>.

<sup>35</sup> <http://www.imf.org/external/pubs/ft/series/01/privsecp.pdf...> page 1

In Korea, from 1993 to 1996, the short term debt had risen faster than the total debt (Ghosh et al. 1999: 11). In addition to this, the growth of the international reserves was outperformed by a faster growth in short term debt (ibid). The reason was that Korea had lent many of its reserves to commercial banks (ibid). The GDP growth, first having increased from around 5 percent in 1992 to around 9 percent in 1995, started to decline sharply (Ghosh et al. 1999:12). However, the unemployment rates showed a decreasing tendency from around 2.5 percent in 1991 to around 2 percent in 1996 (ibid). Since the Korean won was linked to the dollar, the Korean export market started to soar as the dollar appreciated (Ghosh et al. 1999: 13). With regards to the fiscal situation, surpluses were reported in the budget before the crisis, with the exception of small deficits in 1991-1993 (Ghosh et al. 1999: 13-14, 15). The Article IV Report made after the IMF's mission to Korea stated among other things that: “[...] macroeconomic fundamentals remain strong [...]. External financing is certainly tight, but we have confidence in the authorities' ability to prudently manage the situation” (Bluestein 2001:118). Unfortunately, due to declining exports and increasing excess capacity, the asset prices fell by more than 20 percent (Ghosh et al. 1999: 14). The won declined and increased drastically the burden on Korean debtors who had to repay the short term dollar loans (Bluestein 2001:127). The Koreans did not want the IMF's assistance in the beginning; they turned to Japan and asked for a bilateral loan (Bluestein 2001: 128). As this proved in vain, Kang, Korea's Finance Minister and Lee, Head of the Central Bank in Korea reached an agreement with the IMF to accept a loan package (Bluestein 2001: 129).

### **3.3.1 Fiscal policy**

As was the case for Thailand, the IMF and Treasury advocated that the budget in Korea be balanced (Stiglitz 2003: 106). This was a result of a long and stressful negotiation process that started on November 28<sup>th</sup> 1997 at Seoul Hilton with IMF officials and representatives from Korea's Ministry of Finance and Economy. On Wednesday 3<sup>rd</sup> of December, the agreement between the two sides was made official by the, at that time Managing Director of the IMF, Michael Camdessus (Bluestein 2001: 7-8). The initial programme of economic reform in 1998 contained growth prospects of 2.5 percent and included strict fiscal austerity measures imposed by the

IMF on Korea, which included: “fiscal measures equivalent to about 2 percent of GDP to make room for the costs of financial sector restructuring in the budget, while maintaining a prudent fiscal stance. Fiscal measures include widening the bases for corporate, income, and VAT taxes”<sup>36</sup>.

### **3.3.2 Monetary policy**

Regarding the monetary policy, there was much disagreement between the Koreans and the IMF. But as we shall see, the Koreans had to give in to a more powerful IMF. Korea’s Finance Minister Lim Chang Yuel suggested that interest rates would only be raised a few percentage points (Bluestein 2001:141). According to Bluestein this was a large disappointment to the IMF’s officials who favoured high interest rates. David Lipton, at that time serving as Undersecretary at the Treasury, continued to negotiate with the Koreans. He wanted a tighter monetary policy, but several IMF staffers thought these proposals were more in line with serving the interests of the US so that there would be more opportunities and greater potential for US firms investing abroad (Bluestein 2001: 144-145). As a consequence of the tight macroeconomic policy prescribed by the IMF, the Bank of Korea had by the third week of December 1997 raised interest rates to over 30 percent (Chomthongdi 2000: 13). This measure was undertaken as it was seen as “the only viable option in order to secure foreign currency liquidity and to stabilize the exchange rate, in the face of the surge in capital outflows due to the loss of international confidence”<sup>37</sup>.

### **3.3.3 Exchange rate**

The development of the Korean exchange rate has changed gradually. The move has gone from a fixed/pegged exchange rate regime towards a managed floating exchange rate. First, the Korean won was pegged to the US dollar. This was to be changed as the Korean won’s pegging to the US dollar was abandoned and replaced by a controlled managed floating exchange rate regime. This was the case for the Korean won, which on November 1<sup>st</sup> 1994, was allowed to fluctuate within band limits of 1.5%. This band

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<sup>36</sup> <http://www.imf.org/external/np/exr/notions/asia.pdf>

<sup>37</sup> [http://www.bok.or.kr/content/old/attach/00000179/0308441998annual\\_report.pdf](http://www.bok.or.kr/content/old/attach/00000179/0308441998annual_report.pdf)



limit was on December 1<sup>st</sup> 1995 later widened, enabling it to move within limits of +/- 2.5%<sup>38</sup>.

The depreciation of the won was avoided until late 1997, when the won depreciated about 5 percent in October 1997, reaching its height in December 1997 with a depreciation of nearly 50 percent (Ghosh et al. 1999: 36). Therefore, the IMF wanted to make use of the interest rate changes instead of the direct intervention (Ghosh et al. 1999: 36) of buying won to prevent the exchange rate from depreciating further. The Managing Director of the IMF, Michael Camdessus gave a speech about the financial situation in Korea, where he argued that “there is no single “right” choice, but more flexible exchange rates can help provide early and visible signals of the need for policy adjustments and are less likely to invite reckless behaviour on the part of borrowers and lenders”<sup>39</sup>. In the IMF’s Stand by Agreement regarding the economic policy in Korea on December 5<sup>th</sup> 1997, the flexible exchange rate “with intervention limited to smoothing operations” was implemented<sup>40</sup>. This strengthens the allegation that the IMF favoured a managed floating exchange rate system for Korea in the first period of the crisis.

### **3.3.4 Capital market liberalisation**

Regarding the capital market liberalisation point towards Korea, Treasury had for a long time advocated that the Koreans open up their financial sector by tearing away restrictions on competition from foreign banks. In the initial programme for economic reform, capital account liberalisation measures were forwarded in order to open up the Korean bond, equity and money markets to foreign inflow of capital, facilitating foreign direct investment<sup>41</sup>. The liberalisation of the capital account and money markets as it is described in The Letter of Intent of December 24<sup>th</sup> 1997 was fast paced and included among other things “the lifting of all capital account restrictions on foreign investors’ access to the bond market by December 31<sup>st</sup> 1997”<sup>42</sup>.

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<sup>38</sup> [http://intl.econ.cuhk.edu.hk/exchange\\_rate\\_regime/index.php?cid=7](http://intl.econ.cuhk.edu.hk/exchange_rate_regime/index.php?cid=7)

<sup>39</sup> <http://www.imf.org/external/np/speeches/1997/120297a.htm>

<sup>40</sup> <http://www.imf.org/external/np/oth/korea.htm>

<sup>41</sup> <http://www.imf.org/external/np/exr/notions/asia.pdf>

<sup>42</sup> <http://www.imf.org/external/np/exr/notions/asia.pdf>

### 3.3.5 Risk distribution

The bail out package provided Korea by the IMF, the World Bank and the Asian Development Bank totalled 60 billion dollars (Bluestein 2001: 148). The structure of who actually was bailed out is more complicated than it seems at first sight. My model further down aims at illustrating exactly this complex relationship between the international banks, the Western investment banks, Korean banks, companies and the private investors<sup>43</sup>.

- ✚ Corden stresses that the huge bail out package that was provided for Korea actually bailed out the international banks that had lent to the Korean conglomerates or *chaebols* (Corden 1998: 19). This is point one in my model.
- ✚ The bail out package also had elements of bail in. The private investors had to take severe losses in the stock market as the stock market from August 11<sup>th</sup> 1997 to December 17<sup>th</sup> 1997 plummeted 63 percent<sup>44</sup>. This is illustrated by point two in my model.
- ✚ Point three includes the Korean companies, or the *chaebols*, which I claim were bailed in. In 1999 the Korean government decided to let two big *chaebols*, Daewoo and Sangyong, which were the third and the seventh biggest *chaebols*, go bankrupt. According to Mah (2003: 12), this “showed the government’s attitude toward *chaebols*”.
- ✚ The merchant banks and the commercial banks in Korea were restructured and/or closed down. This is included as point 4 in the model. During December 1997, the Korean government suspended 14 merchant banks where 10 of these were closed down totally during January 1998 (Enoch et al. 1999: 73). The commercial banks on the other hand, were assisted by foreign advisors so that they could be privatised. By December 1998, a US consortium had acquired a 51 percent ownership in Korea First Bank whereas Goldman Sachs by April

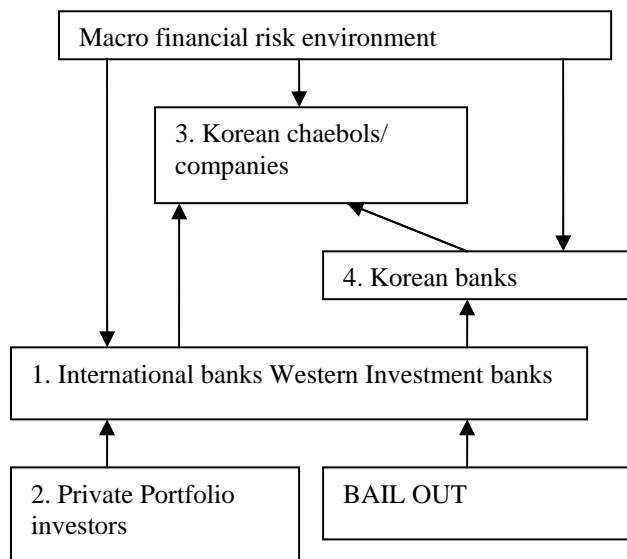
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<sup>43</sup> I have placed the macro financial risk environment on the top of this model since factors like “GDP growth, inflation trends, government budget levels (and the government deficit), interest rates, unemployment, the country’s reliance on export income, the balance of trade, and foreign exchange controls” (Madura 2003 :483) all influence the other factors included in the model.

<sup>44</sup> <http://www.rrojasdatabank.org/imf2.htm>

<sup>44</sup> “IMF Bail Outs: Truth and Fiction”, <http://www.rrojasdatabank.org/imf2.htm>

1999 invested 500 million dollars in Kookmin Bank. (Enoch et al. 1999: 74). The International Finance Corporation invested 152 million dollars in Hana Bank and poured further 25 million dollars in KLTCB (ibid). Further, Germany's Commerzbank invested 249 million dollars in Korea Exchange Bank awarding the Commerzbank an ownership of 30 percent (ibid). It is possible to assert that the merchant and the commercial banks were helped by the international banks. However, I would assert that the greatest beneficiaries from this restructuring were the international and the western banks. I would therefore allege that the international and western banks were able to capitalise on the distressed securities in these financial companies in Korea. In this sense, the international and western banks were bailed out whereas the merchant and commercial banks in Korea were bailed in. This further implies that the bail in of the international and western banks that came in the second period of the crisis was of limited range since these banks already had capitalised on the distressed securities in the merchant and commercial banks in Korea.



### 3.3.6 Main tendencies for Korea in period 1

The tendency for period one in Korea is clear: I received support for my continuity perspective on all of the five policy points. The point about the exchange rate system indicated more continuity than change, however still unclear. The observations are summed up in the table on the following page.

<b>Korea period 1</b>	<b>Type of IMF crisis advice</b>	<b>Type of perspective</b>
Fiscal policy	Contractive	Continuity
Monetary policy	Contractive	Continuity
Exchange rate policy	Managed float	Unclear
Cap. Market liberalisation	Fast and uncompromising	Continuity
Risk distribution	Bail-out	Continuity

### **3.4.1 Fiscal policy**

The Letters of Intent from February 7<sup>th</sup>1998 to July 24<sup>th</sup> for Korea describe the fiscal measures taken by the Korean government strongly in accordance with the IMF's imposed conditions. Going through these Letters of Intent, one discovers that the fiscal policy targets were later to be revised and changed as described in the Letter of Intent of February 7<sup>th</sup> 1998<sup>45</sup>, where a budget deficit of 1 percent of GDP was allowed in order to offset the down turning cycle in domestic economic activity. In the Letter of Intent of May 2<sup>nd</sup> 1998<sup>46</sup>, the fiscal deficit was set to 2 percent of GDP and ended up in the Letter of Intent of July 24<sup>th</sup> 1998<sup>47</sup>, with a fiscal deficit target of 5 percent.

### **3.4.2 Monetary policy**

The Bank of Korea was well aware of the downside effects of high interest rates and argued that high interest rates “accelerated the slowdown in real economic activities through its contraction of consumption and investment, and it greatly increased the incidence of corporate failure and the accumulation of bad loans by financial institutions”<sup>48</sup>. As it became apparent that the interest rates were impeding economic growth in Korea, the IMF changed standpoint in May 1998 and gave the Korean government permission to lower the interest rates<sup>49</sup>. After May 1998, the interest rates were lowered further and stabilised around 5 percent throughout 1999 and 2000, according to the Bank of Korea's Annual Report for the year 2000<sup>50</sup>.

<sup>45</sup> <http://www.imf.org/external/np/loi/020798.HTM>

<sup>46</sup> <http://www.imf.org/external/np/loi/050298.HTM>

<sup>47</sup> <http://www.imf.org/external/np/loi/072498.htm>

<sup>48</sup> [http://www.bok.or.kr/content/old/attach/00000179/0308441998annual\\_report.pdf](http://www.bok.or.kr/content/old/attach/00000179/0308441998annual_report.pdf)

<sup>49</sup> <http://www.globalpolicy.org/soecon/bwi-wto/imf/2000/asiafc.htm>

<sup>50</sup> [http://www.bok.or.kr/content/old/attach/00000179/0308441998annual\\_report.pdf](http://www.bok.or.kr/content/old/attach/00000179/0308441998annual_report.pdf),

### **3.4.3 Exchange rate**

The policy about the managed floating exchange rate regime in Korea remained the same in the second period. In a memorandum of Economic Program in Korea 1998, sent to the Managing Director Michael Camdessus, the preferred exchange rate policy stance was the flexible exchange rate regime. However, the interventions by the Bank of Korea “will be limited to smoothing operations” in the foreign exchange rate market<sup>51</sup>. This indicates that the IMF also in the second period of the crisis preferred a managed floating exchange rate system.

### **3.4.4 Capital market liberalisation**

On February 16<sup>th</sup> 1998, in compliance with the IMF’s policy advice towards Korea for opening up the capital markets further, the Korean government expanded the possibilities for foreign investors by making available products for domestic portfolio investment like commercial papers, commercial bills and trade bills to the foreign investors<sup>52</sup>. The further liberalisation of the capital account continued without taking considerations of sequencing into account, as it is described in The Letter of Intent of May 2<sup>nd</sup> 1998 “including loosening restrictions on foreign exchange transactions, foreign ownership of certain assets and ceilings on foreign equity investment in nonlisted companies”<sup>53</sup>. With the Foreign Exchange Transaction Regulations on July 3<sup>rd</sup>, companies were given the permission to list on the Korean stock exchange, KOSDAQ. The restrictions on the foreigners’ share in the public companies like Pohang Iron and Steel Co were also removed<sup>54</sup>.

### **3.4.5 Risk distribution**

In the second period of the crisis, the IMF changed its policy towards Korea. Stiglitz argues that the new strategy of the IMF bailing in the investors came as a natural response of the failures the IMF had experienced with the bail out packages. “The IMF wanted the private sector institutions to be “in” on any bailouts” [...] there had to be extensive “participation” by the private sector lenders; they would have to take a “haircut”, forgiving a substantial part of the debt that was owned” (Stiglitz 2003: 203).

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<sup>51</sup> <http://www.imf.org/external/np/loi/020798.htm>

<sup>52</sup> [http://www.bok.or.kr/content/old/attach/00000179/0308441998annual\\_report.pdf](http://www.bok.or.kr/content/old/attach/00000179/0308441998annual_report.pdf)

<sup>53</sup> <http://www.imf.org/external/np/exr/notions/asia.pdf>

<sup>54</sup> [http://www.bok.or.kr/content/old/attach/00000179/0308441998annual\\_report.pdf](http://www.bok.or.kr/content/old/attach/00000179/0308441998annual_report.pdf)

Consequently in the beginning of December 1997, drafts for a “Plan B” were discussed, where the last out of three options considered, was a huge bail in where top government officials in Tokyo, London, Washington and other major capital cities would apply “moral suasion” in order to keep foreign Korean bank creditors from pulling their money out of the country (Bluestein 2001: 184-186). Finally, the strategy of bailing in of the Korean creditors was now being put into action as large US banks were encouraged to roll over their loans to Korea. The other G-7 partners were also persuaded to follow suit so that the excessive lending behaviour of foreign banks to Korea could finally be taken care of (Bluestein 2001: 199).

### **3.4.6 Main tendencies for Korea in period 2**

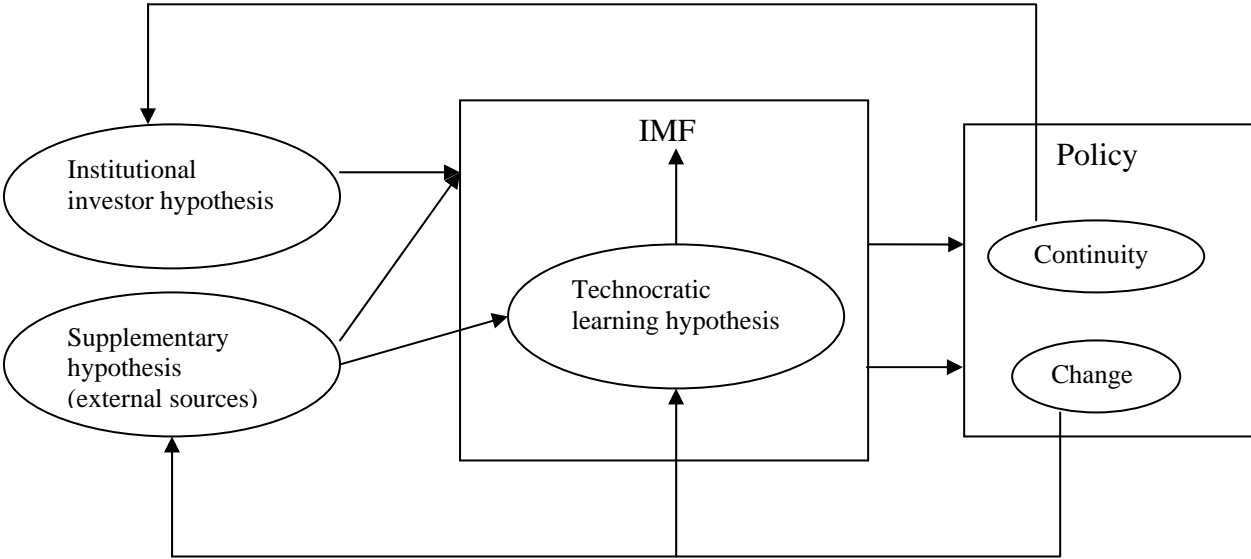
After having taken my five policy points through period two in Korea, I find that there is a shift in the tendency from continuity towards a support for my change perspective. I observed a change in the IMF’s policy advice for the points about fiscal and monetary policy and finally risk distribution. The point about exchange rate policy did not change from the first to the second period of the crisis.. Finally regarding capital market liberalisation I found no change in the IMF’s policy advice. The findings are wrapped up in the table below.

<b>Korea period 2</b>	<b>Type of IMF crisis advice</b>	<b>Type of perspective</b>
Fiscal policy	Expansive	Change
Monetary policy	Expansive	Change
Exchange rate policy	Managed float	Unclear
Cap. Market liberalisation	Fast and uncompromising	Continuity +
Risk distribution	Bail in	Change

## **4 CAUSES FOR THE IMF’S POLICY MAKING TOWARDS THAILAND AND KOREA**

Having discovered significant evidence for both the continuity and the technocratic learning hypothesis in the third chapter, I now wish to elucidate the process behind the IMF’s policy crisis advice and look for further evidence whether one is thinking in the

direction of the investors' preferences or whether there is technocratic learning to be observed. Regarding the structure of the chapter, I wish to converge the three first points about macroeconomic policy; fiscal policy, monetary policy and exchange rates, into one point. The last two points, capital market liberalisation and risk distribution will be treated separately. This is done so because it is much easier to identify investor preferences for these two points, regardless of what kind of investor you are. Every investor will prefer access to new undiscovered markets to no capital market liberalisation. With reference to the risk distribution point, every investor will prefer less risk by being bailed out instead of being bailed in, since this simply implies that the investors can take on more risk without having to pay the price if the markets plummet. I further wish to treat Thailand and Korea together since this it is more difficult to find evidence for the process behind the IMF's policy making than the IMF's policy outcome treated in chapter three. The model below describes my ambition with regards to this chapter. Of influential sources identified, we find two external sources and one internal. The first of the two external influences is formulated in the institutional investor hypothesis, whereas the other is sought explained by the supplementary hypothesis. I have put the technocratic learning hypothesis in the inner circle of the box. This influence is internal since the technocratic learning process takes place in the IMF.



## **4.1 Thailand and Korea period 1**

As described in the introduction of the correlation chapter (chapter three), period one was set by me to be at the outbreak of the crisis in the beginning of July 1997, because then the Thai government had decided to abandon the fixed exchange rate regime and let the baht float freely with a consequence that the baht lost 19 percent of its value in the foreign exchange markets (Bluestein 2001: 51).

### **4.1.1 Macroeconomic policy**

As mentioned in the paragraph above, I have converted the monetary, fiscal and exchange rate policy into one point since it can be claimed that these three points represent macroeconomic policy. For the two selected periods I will investigate whether the investors' preferences were driving the IMF's crisis advice towards continuity or change.

If we take a look at the process which resulted in the IMF's policy advice in the first period of the crisis, we find evidence for a further strengthening of the continuity hypothesis. There is a speech where Mr Camdessus, the Managing Director of the IMF, speaks about the so called "austerity measures to restore macroeconomic balance"<sup>55</sup>. The IMF's wish to "restore macroeconomic balance" obliged the IMF's officials to take the investors preferences primarily into consideration. With regards to Korea, Bluestein stresses that the presence of the Undersecretary from Treasury sent to Korea in order to negotiate the interest rate level [...] "added another element of theatre to the negotiations and provided a symbol to the Koreans of how the United States was influencing the IMF behind the scenes" (Bluestein 2001:144).

### **4.1.2 Capital market liberalisation**

Pertaining to capital market liberalisation, we find that the investors surely played a part in the process towards the IMF's policy advice for liberalising the capital markets in Thailand and Korea. This further strengthens the continuity hypothesis. Stiglitz alleges that the Asian countries were forced to open up their capital markets "[...] because of international pressure including some from the US Treasury Department" (Chakravarthi 2000: 2). The assumption that international financial institutions had a

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<sup>55</sup> <http://www.imf.org/external/np/speeches/1998/020698.htm> page 2



say in determining the course of the IMF's policy advice towards Thailand and Korea, is further strengthened as the investors from the G-7 countries looked at the countries in East Asia as having a high potential for profitable investments (Yew 1998: 1). This was because the fundamentals<sup>56</sup> in these countries seemed very promising. For this reason, the East Asian countries, "[...] were encouraged by multilateral institutions like WTO, IMF and WB and the finance ministers of the G-7 to open up their capital accounts and liberalise their financial systems in order to reap the full benefits from a globally efficient allocation of capital" (Yew 1998: 2).

An element behind the scenes of the IMF's policy making was that Treasury wanted Korean companies to borrow foreign bonds and that the Korean companies could sell more stocks for foreign investors. At the Council of Economic advisers at which Stiglitz was present, they looked back at what the members discussed and revealed that "we weren't convinced that South Korean liberalisation was an issue of US *national* interest, though obviously it would help the *special* interests of Wall Street" (ibid). The Fund strongly encouraged Korea to open up its capital markets for foreign investors, more especially Treasury's international staff played a key role in putting pressure on Seoul to open up its financial sector (Bluestein 2003: 143). According to Bluestein, the lobbying by American financial services firms was the main reason behind the force Treasury exerted on Seoul (ibid).

Building on this it is interesting to mention that Bhagwati wrote a book called "In Defence of Globalization" where he states that globalisation "alleviates many of the problems for which it has been blamed" (Bhagwati 2004)<sup>57</sup>. He further claims that the "human face" of globalisation helps fight poverty, child labour, democracy, and puts women's rights on the agenda (ibid). This is an interesting observation, because even if Bhagwati seems to support globalisation on several points, he seems less enthusiastic about the free flow of capital across borders. It was the "Wall Street-Treasury Complex" which aggressively advocated and pushed for liberalisation was to

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<sup>56</sup> The fundamentals included: high growth, low inflation, governmental budgets in balance or surplus and finally high savings rates (Yew 1998: 1).

<sup>57</sup> <http://www.foreignaffairs.org/20040101fareviewessay83114/richard-n-cooper/a-false-alarm-overcoming-globalization-s-discontents.html>

be blamed for the financial crisis we witnessed in the 1990's (Bhagwati 2004). Bhagwati has further stated that "Wall Street [...] exercises extraordinary influence over Washington for a simple reason. There is an influential like-minded elite that controls the key positions in the US Treasury, the US administration, the IMF and the World Bank" (Salah El 2002: 5). This supports the allegation that Thailand was subjected to a "US Treasury-Wall Street-IMF complex" (ibid) that pushed liberalisation of its capital market.

#### **4.1.3 Risk distribution**

Taking a closer look at the process leading to the IMF's policy advice regarding risk distribution towards Thailand and Korea in the first period of the crisis, we find that the investors played a central role here. This further strengthened the continuity perspective as we shall see below.

Craine alleges that "[...] investors have big stakes in the attempted "bail out" of Thailand" (Craine 1997:3). The role of Treasury in determining the course of the IMF's policy towards Thailand is not dismissed either: Treasury Secretary Robert Rubin made it clear with reference to the importance of bailing out Thailand and Korea "[...] America's national security is gravely jeopardized [...] and must take precedence" (Margolis 1997:3). "A total collapse of Indonesia, Thailand and South Korea who owe billions to Japanese banks, could bring down Japan's financial system, the world's second largest" (Margolis 1997:3). Pettifor (2000) makes reference to the G-7 leaders and their role as shareholders in the IMF and the World Bank. The powerful influences of these leaders were what kept the speculating environment for hedge funds upright. She concludes that "From the time of the discussions outlined above [...] the IMF was forced to bail out short term mainly private lenders by pouring \$18 bn into Thailand" (Pettifor 2000:1).

Taking a closer look at who were the influential sources behind the IMF's bail out policy in Korea, we make some interesting observations. For example, on December 24<sup>th</sup> 1997, there was a meeting between the officials from six of the leading US commercial banks including Chase, Bank of America, Citicorp and J.P. Morgan. They were all invited to the Federal Reserve Bank of New York to discuss the short term debt situation in Korea. The biggest merchant banks in the US; Goldman Sachs,

Lehman Brothers, Morgan Stanley and Salomon Smith Barney, were also invited to discuss the continuing exacerbation of Korea's short term debt status. In addition to this, some 80 European creditor banks were involved in discussions under the chairmanship of the Deutsche Bank in Frankfurt (Bluestein 2003).

#### **4.1.4 Main tendencies for Thailand and Korea in period one**

With regards to the macroeconomic policy in Thailand and Korea in the first period of the crisis, the information I found, indicated a further strengthening of the continuity perspective. Having studied the process behind the IMF's capital market liberalisation advice, I discovered that the continuity perspective was further strengthened. I also found further support for the continuity perspective with reference to the risk distribution point in the first period of the crisis. The findings are summed up in the table below.

<b>Thailand and Korea period 1</b>	<b>Type of process</b>	<b>Type of perspective</b>
Macroeconomic policy	Strict	Continuity
Capital market liberalisation	Fast and uncompromising	Continuity
Risk distribution	Bail out	Continuity

## **4.2 Thailand and Korea period 2**

As already claimed in the introduction of the correlation chapter (chapter three), the second period of the crisis was chosen to be from December 1997 to December 1998 because the worst economic downturn was alleviated by a following period of more financial stability.

### **4.2.1 Macroeconomic policy**

As we found that the continuity hypothesis in the first period of the crisis for Thailand and Korea was strengthened with regards to the IMF's macroeconomic policy advice, we find that there is evidence that further strengthens the technocratic learning hypothesis in the second period of the crisis. The reflections from Sachs, Stiglitz, Bluestein and Krugman represented a critical way of thinking about the IMF's policy

making. This critical thinking was later absorbed in the IMF as these critical persons contributed to an increased consciousness about the consequences of the IMF's policy making. According to Bluestein, the IMF realised that the strict crisis advice for fiscal policy in Thailand only made things worse (Bluestein 2001: 82). Jeffrey Sachs, who was a Harvard educated professor and a friend of Larry Summers; deputy secretary of Treasury, was clear in his opinion about the IMF's choice of strict macroeconomic policy. He stressed that the IMF's austere macroeconomic policy of encouraging budget cuts and tight monetary policy only exacerbated the economic situation: "Don't crunch fiscal policy. Don't send interest rates sky high. It doesn't restore confidence. It just makes the crisis worse" (Bluestein 2001: 155).

Even though the IMF admitted that the fiscal measures imposed on Thailand and Korea were too strict<sup>58</sup>, it was more reluctant to admit that the monetary policy on Thailand was too austere. To the question of whether the monetary policy the IMF pushed on Thailand was too strict, and thereby contributing to an acceleration of a further slowdown of the Thai economy, the answer was clear: the monetary policy imposed on Thailand was not too strict neither in duration or degree if compared to other financial crises elsewhere (Ghosh et al. 1999: 35). On behalf of the IMF, Boorman stated: "the budget targets established in the programs were predicated on a view of macroeconomic prospects that turned out in hindsight to be mistaken. They were too optimistic"<sup>59</sup>. By referring to the IMF as a "human institution"<sup>60</sup>, Neiss implicitly admitted that there was room for technocratic learning in the IMF as the macroeconomic models in the case of Thailand and Korea proved to be wrong.

In a study by Claessens et al. (1998), the currency and interest rate shocks' effects in the period of early 1997 and September 1998 are measured on the liquidity of Asian firms. The findings indicated that the exchange rate shock was the most important factor forcing Thai and Korean firms into insolvency<sup>61</sup> and illiquidity<sup>62</sup> (Steve and

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<sup>58</sup> <http://www.imf.org/external/np/tr/1999/tr990120.htm>

<sup>59</sup> <http://www.imf.org/external/np/tr/1999/tr990120.htm> p 6

<sup>60</sup> <http://www.imf.org/external/np/tr/1999/tr990122.htm> p 2

<sup>61</sup> Solvency actually means "The ability of a corporation to meet its long-term fixed expenses and to accomplish long-term expansion and growth" (<http://www.investopedia.com/terms/i/illiquid.asp>). An insolvent company implies that "it can no longer operate and is undergoing bankruptcy" (<http://www.investopedia.com/terms/i/illiquid.asp>).

Phillips 1999: 51). The effect on interest rate shocks driving Thai and Korean firms into financial distress was of minor importance compared to the effect from the exchange rate shock (ibid). Wanda Tseng who was co chief of the Seoul mission in November 1997 argued that “If you raise interest rates, the corporations will go further into the red [...]” (Bluestein 2001: 155).

#### **4.2.2 Capital market liberalisation**

As we saw in chapter three, there was never a change in the IMF’s policy regarding capital market liberalisation towards Thailand and Korea. Instead, the capital market liberalisation process was sped up. As we shall see in this paragraph, this observation supported the supplementary hypothesis where “window dressing” (Brunsson 1989) is a central word.

Regarding what was to be learnt from the case of Thailand and Korea, an IMF working paper argues that it would be preferable to have “well-planned and sequenced reforms” but that this can be done without necessarily implementing “a gradualist approach” (Johnston et al 1997:12). Johnston et al (1997) argue that “in some cases a faster liberalisation of the capital account than in other areas of the economic and financial sector reform program may be desirable”. And they carry on building on this argument: “It can help to develop markets by increasing competition and promoting a larger volume of capital flows” and speeding up the liberalisation of the capital account will also require faster progress in reforms entailing institutions in the domestic financial markets, and to adjust the macroeconomic policy thereafter (Johnston et al. 1997:12). Johnston further maintains that if countries are to open their capital account to capital inflows, there has to be “appropriate legal systems” like for example regulations on “foreign exchange transactions and transfers”. Johnston further argues with regards to the term “sequencing”, that the banking sector in general has to be developed before considering capital account liberalisation (ibid). However, the IMF pushed further liberalisation and restructured the banks at the same time whereas the latter should have occurred first.

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<sup>62</sup> Illiquidity describes a situation where in this case the firm is not able to get hold of cash quickly enough to pay its loans. An apposite definition of illiquid can be when “An asset or security that cannot be converted into cash very quickly (or near prevailing market prices) (<http://www.investopedia.com/terms/i/illiquid.asp>).

I believe that the working paper by Johnston et al confirms my assumptions that there is room for alleging that there has been some technocratic learning without effect in the case of capital market liberalisation towards Thailand and Korea in the second period of the crisis. The popular socially accepted word “sequencing” was incorporated into the IMF’s language. By doing this, I allege that the IMF was able to “decouple” (Meyer and Rowan 1991: 57-58, Powell and DiMaggio) what it asserted as being crucial to the IMF’s crisis strategy and what it actually did. This seems to have increased the legitimisation of the institution. However, the main goal did not change as they argued as we remember in the beginning of the paragraph that “in some cases a faster liberalisation of the capital account than in other areas of the economic and financial sector reform program may be desirable” (Johnson et al 1997:12).

#### **4.2.3 Risk distribution**

There is plenty of general evidence in the IMF’s working papers and various speeches that the Fund has learnt a lesson considering the importance of bailing in the private sector in general. However, I argue that if we study the process leading to the IMF’s policy advice in the second period, we discover “window dressing” (Brunsson 1989). This will be elaborated on in the end of the paragraph.

In a speech, Mr Camdessus speaks warmly about the new financial architecture in which the bailing in of the private sector plays a central part. He emphasises “more effective structures for orderly debt workouts, including better bankruptcy laws at the national level and, as recommended by last year’s study by the G-10, better ways at the international level of associating the private sector with official efforts to help resolve sovereign debt problems”<sup>63</sup>. In a video conference Mr Boorman, the Director of the Policy Development and Review Department of the IMF, stresses the point that there has been some sort of learning going on in the IMF: “Those directors saw a central lesson of the importance of on-going efforts to involve the private sector in forestalling and resolving financial crises”<sup>64</sup>. “We’re also examining, as you know,

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<sup>63</sup> <http://www.imf.org/external/np/speeches/1998/020698.htm> p 6-7

<sup>64</sup> <http://www.imf.org/external/np/tr/1999/tr990119.htm> p 8

ways of promoting greater private sector involvement in forestalling and, when they occur in resolving financial crises [...]”<sup>65</sup>.

With regards to Korea, Bluestein provides us with insight of how this process went forward. According to him, the IMF’s managing Director; Michael Camdessus and Stanley Fischer; First Deputy Managing Director, plus Bundesbank’s Tietmeyer and his colleagues from the German government favoured a bail in strategy (Bluestein 2001: 187). To the story also belongs the notion that even inside the Federal Reserve, there was disagreement between the New York’s Federal Reserve’s President; Wiliam McDonough and the chief himself; Alan Greenspan. The disagreement was about McDonough desperately wanting to apply moral suasion on the Korean creditors as he was strongly convinced that that would be in the interest of the creditors as well because such a strategy could prevent the borrowers from bankruptcy. Finally even Treasury and Alan Greenspan; Head of the Federal Reserve, changed their standpoints by welcoming a bail in strategy of the Korean creditors.

In Korea the investment banks bought stakes in the Korean financial companies in the first period of the crisis. However as the second period of the crisis in Korea unfolded, these investment banks were being bailed in. Even though these investment banks had to share some of the burden, I will still contend that the gains from buying stakes in the distressed Korean companies outperformed the losses that these investment banks had to bear from the bail out in the second period of the crisis. Regarding Thailand, foreign investors bought up Thai financial institutions. The second period in Thailand showed that the Japanese banks were being bailed in. I therefore allege that the foreign investors to a smaller degree had to share the burden I argued for concerning the “window dressing” (Brunsson 1989) in the beginning of the paragraph. I allege that the IMF was able to “decouple” (Meyer and Rowan 1991: 57-58, Powell and DiMaggio) their internal activities from what they pretended to do to the outside World, thereby preserving the necessary legitimacy of the institution (Meyer and Rowan 5, in DiMaggio and Powell 1991) from the crisis. The net gains earned to the foreign investors outweighed the possible losses that incurred from a bail in since only the

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<sup>65</sup> <http://www.imf.org/external/np/tr/1999/tr990119.htm> p 9

Japanese banks were bailed in. This observation supported the supplementary hypothesis.

#### **4.2.4 Main tendencies for Thailand and Korea in period 2**

After having studied the process leading to the IMF’s crisis advice for macroeconomic policy in the second period of the crisis, I found further support for the change perspective. Regarding the capital market liberalisation and risk distribution point, I argued for technocratic learning without substantial effect as I discovered “window dressing” in the process of both these points. The findings of chapters three and four enable me to present the conclusions for this thesis as will be done in the following chapter.

<b>Thailand and Korea period 2</b>	<b>Type of IMF crisis advice</b>	<b>Type of perspective</b>
Macroeconomic policy	Relaxed	Change
Cap. Market liberalisation	Fast and uncompromising	“Window dressing”
Risk distribution	Bail in	“Window dressing”

## **5 CONCLUSIONS AND WRAP UP**

This chapter aims at summing up the findings of my master’s thesis. Below follows a discussion of the five chosen policy points I wanted to investigate in this thesis; fiscal -, monetary -, exchange rate -, capital market liberalisation - and finally risk distribution policy. Further I wish to provide some final reflections of the prospects ahead for the IMF’s role as a financial institution in alleviating the financial turbulence in a World more and more characterised by rapid globalisation.

### **5.1 Fiscal policy**

The IMF advocated balanced budgets in the first period of the crisis for Thailand and Korea. This supported the continuity perspective with the institutional investors’ preferences. In the second period of the crisis, the IMF favoured opening up for budget deficits in Thailand and Korea in order to stimulate the economy. This observation supported the change perspective.



One factor important to consider is that whether the fiscal policy is strict or not has to be seen in the context of the history, other countries and the position of the economy in the economic cycle in the specific country. This relativity makes it harder to conclude that one specific policy advice over another is more favourable to the institutional investors. I further made reference to King (2000) as I wanted to highlight that different investors favour different types of fiscal policy. This indicates that there was learning to be observed for the fiscal policy from the first to the second period of the crisis for both Thailand and Korea.

## ***5.2 Monetary policy***

The IMF advocated high interest rates in Thailand and Korea in the first period of the crisis. This supported the continuity perspective as the institutional investors' preferences were taken into account. In the second period of the crisis, the monetary policy became less strict and interest rates were lowered. This in itself supported the change perspective; that there had been some sort of technocratic learning in the IMF. However, as I studied a research of what drove Thai and Korean firms into illiquidity, the exchange rate shock was the most important factor (Clasessens et al. 1998, Ghosh et al. 1999). The effect from interest rates shock were of minor importance (ibid).

Having said this, it is very crucial to see the monetary policy in relation to the position of the economy in the economic cycle in the country, the historical context and the interest rates in other countries in order to assess whether we speak of high interest rates. I also made reference to King (2000) in order to point out that different types of investors have different preferences for monetary policy. The IMF was more reluctant to admit that they learnt from their mistakes regarding the choice of monetary policy. Therefore, the IMF rather emphasised the change in monetary policy from the first to the second period as a natural consequence of easing economic turbulence. Nevertheless, I observed a change in the IMF's monetary policy from the first to the second period of the crisis for Thailand and Korea as the IMF had taken on some of the critics regarding how to solve the crisis.

### **5.3 Capital market liberalisation**

For the capital market liberalisation in Thailand and Korea in the first period of the crisis, I found that the IMF advised the countries to liberalise their capital markets. This observation supported the continuity perspective since liberalised capital markets can be claimed to be in the institutional investors' preferences. With reference to the second period, I observed that the IMF actually advised the two countries to speed up their capital liberalisation process. Therefore, I claimed in the wrap up of the second period of the crisis for both countries that this was continuity+. The institutional investors were even more taken care of by the IMF's crisis advice. However I also discovered that there was "window dressing" (Brunsson 1989) for Thailand and Korea in the second period of the crisis. The IMF was able to decouple what they pretended to do from what they actually did. In this sense, the word "sequencing" became the popular word which could enhance the legitimisation of the institution by exhibiting this "accepted" word to the public while they actually continued speeding up the capital liberalisation process in Thailand and Korea.

### **5.4 Exchange rate**

Regarding the exchange rate, I found that the IMF favoured a floating exchange rate system for both Thailand and Korea during the first and the second period of the crisis. I also found that the IMF preferred applying the interest rate (Ghosh et al. 1999: 38) in order to stabilise the baht and the won. The managed floating exchange rate regime was the system that the IMF advised both Thailand and Korea to apply in the first and second period of the crisis. I pointed to the subtleties (Madura 2003: 174) with regards to this exchange rate system in point 2.3.4.2.

The other element important to consider is that there are various preferences to different types of exchange rates among the different types of institutional investors (King 2000). As a consequence of the discussion above, findings from the IMF's advice regarding the exchange rate in Thailand and Korea at best proved unclear.

### **5.5 Risk distribution**

With regards to the risk distribution I observed a bail out of the International and Western investment banks in the first period of the crisis for Thailand and Korea. The

banks and financial institutions in Thailand and Korea incurred losses from the crisis and several were bought up and merged with foreign investment banks (Enoch et al. 1999). I argued in chapter four that the net gains earned to the investors both in Thailand and Korea outperformed the losses incurred on the investors that were bailed in during the second period of the crisis. I further argued that this supported the supplementary hypothesis and that there was “window dressing” (Brunsson 1989) to be identified. This is so since the IMF was able to “decouple” the actual effect a bail in strategy had on the investors from the fact that the bail in strategy seemed to incur more losses on the institutional investors than it actually did. This further made it easier for the outside World to support the IMF’s choice of crisis advice in the second period of the crisis.

### **5.6 Summary of the points**

Following the discussion above, I am left with two points which I argued in the beginning of chapter four to be the most important for all types of investors, namely capital market liberalisation and risk distribution policy, favouring a bail out strategy. As I observed “window dressing” on both of these points, it indicates that the most important points for the investors are being taken care of by the IMF. The concluding findings from my master’s thesis are summed up in a table below:

<b>Type of economic policy</b>	<b>Findings</b>
Fiscal policy	Change
Monetary policy	Change
Exchange rate policy	Unclear
Capital market liberalisation policy	“Window dressing”
Risk distribution policy	“Window dressing”

### **5.7 Prospects ahead**

I explained in this thesis that policies with regards to highly technical and complex problems are prone to be dominated by experts. Since many of the IMF’s officials are people recruited from Wall Street and other central financial institutions, it comes as no surprise that they contend specific interests, namely the interests of the investors. This said, I hope that I have been able to provide some reflections on the

disadvantages of a too narrow cultivation of profit seeking without taking the human aspects into consideration. As I discovered “window dressing” (Brunsson 1989) on the two most important points for the institutional investors, namely capital market liberalisation and risk distribution, I believe that the IMF still has a long way to go before it becomes a more human organisation which takes into account critics that arise from the outside, adapts to some of these and changes its policy thereafter. With regards to the points about macroeconomic policy, namely fiscal, monetary and exchange rate policy, as I argued earlier; strict macroeconomic policy may be good to some investors but not to all of them (King 2000). Therefore it can even be alleged that the investors would like the IMF to have learned from its mistakes regarding strict macro economic policy, whereas the status quo would be preferred for the investors regarding capital market liberalisation and risk distribution. I contend that it is not in the investors’ interests that the IMF learns from the points of capital market liberalisation and risk distribution. This is so since liberalised markets provide the investors with new investment opportunities and bail out strategies from the IMF makes it easier for the investors to take on more risk without having to pay the price if the markets drop. These are preferences that I without exaggerating will claim that all investors would favour. Therefore the investors defend a status quo with regards to the IMF’s policy on these two mentioned points. Accordingly, the ultimate test of the IMF having learned from their mistakes would have been if I discovered learning with substantial effect and not only learning without substantial effect on the points of capital market liberalisation and risk distribution. This is however very unlikely to occur since the IMF to a large extent is a mirror of the institutional investors’ preferences. Therefore this conclusion points to the notion that when it came to the real test of the IMF having moved away from the institutional investors’ preferences, we only discovered “window dressing” (Brunsson 1989). The economist has recently pointed to the need of reforming the IMF<sup>66</sup>. The IMF is almost entirely dominated by rich countries and these countries will not listen to what the IMF tells them to do unless it fits their needs (ibid). In practice the IMF only has power over nations that are dependent of IMF loan packages (ibid). Accordingly the challenge is that the

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<sup>66</sup> [http://www.economist.com/displaystory.cfm?story\\_id=6826176](http://www.economist.com/displaystory.cfm?story_id=6826176)

emerging market economies need to be heard; “[...] giving the emerging markets a bigger voice [...] would at least make the IMF more useful” (ibid). Much of the IMF’s revenues come from the emerging countries the IMF lends to. The lack of recent crises in emerging market economies will, according to *The Economist*, lead to a drop in revenues for the IMF of 30 percent which implies that the Fund needs to rethink its source of income in the future (ibid).

Having emphasised the need for the IMF to seriously rethink its future role, I am sure of one thing: There exists a consensus worldwide that there is a need for crisis prevention management as the financial crises we will encounter in the future will be of a much bigger and more threatening scale than was the case with the Asian crisis. To be able to handle this complexity, politics and economics will have to work together. In this context, the IMF will certainly play a part. But, I am afraid that “the policymaking wizards of Washington” [...] when the next financial crisis arise, will find “themselves overwhelmed and chastened by the forces unleashed in today’s World of globalized finance” (Bluestein 2001:13).

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