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Joseph P. Joyce
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THE IMF AND GLOBAL FINANCIAL CRISES

The International Monetary Fund's response to the global crisis of 2008–9 marked a significant change from its past policies. The IMF provided relatively large amounts of credit quickly with limited conditions and accepted the use of capital controls. This book traces the evolution of the IMF's actions to promote international financial stability from the Bretton Woods era through the most recent crisis. The analysis includes an examination of the IMF's crisis management activities during the debt crisis of the 1980s, the upheavals in emerging markets in the 1990s and early 2000s, and the ongoing European crisis. The dominant influence of the United States and other advanced economies in the governance of the IMF is also described, as well as the replacement of the G7 nations by the members of the more inclusive G20, which have promised to give the IMF a role in their mutual assessment of policies while undertaking reforms of the IMF's governance.

Joseph P. Joyce is a professor of economics at Wellesley College and serves as the faculty director of the Madeleine Korbel Institute for Global Affairs. Professor Joyce's research deals with issues in financial globalization. He has published articles in many journals, including the *Journal of International Money and Finance*, *Open Economies Review*, *Review of International Economics*, *Journal of Development Economics*, and *Economics & Politics*, and he is a member of the Editorial Board of the *Review of International Organizations*. He received his Ph.D. in economics from Boston University.

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Phoenix Rising?

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The phoenix hope can wing her flight
Thro' the vast deserts of the skies,
And still defying fortune's spite,
Revive, and from her ashes rise.

Miguel De Cervantes,
Don Quixote (Motteux, trans.)

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Preface

The year 1973 was a transitional one for the global economy. Attempts to revive the Bretton Woods system of fixed exchange rates were abandoned; increases in oil prices led to the occurrence of higher prices and falling output, which was labeled "stagflation"; and it was the last year that the U.S. government maintained restrictions on capital flows. There was one other event of somewhat lesser significance: my graduation from Georgetown University's School of Foreign Service, where I developed an interest in international economics. After two years of work in New York, I entered Boston University's graduate program in economics. I subsequently was fortunate to receive an appointment to the faculty at Wellesley College, where I have remained ever since.

I began my professional academic life, therefore, during the post–Bretton Woods era of currency regime and financial liberalization. The removal of capital controls by the United States was followed by financial deregulation in other developed economies in the 1970s, and by many Asian and Latin American countries during the following decades. Capital flows rapidly expanded, and by the end of the century it was possible to refer to the integration of financial markets across borders as the latest manifestation of globalization (Mishkin 2006). But it was also a period of economic volatility and upheaval, which included the debt crisis of the 1980s, the financial crises in the emerging markets of the 1990s, and, most recently, the global crisis of 2008–9.

At the center of all these events was the International Monetary Fund. I was drawn to the study of the IMF because it provided a focus on the twists and turns in the international economy. The IMF was often the subject of criticism: sometimes misinformed and unfair, sometimes well deserved. In my research I sought to substantiate the record of the IMF's activities and their impact. In one of my first postdissertation research papers, I investigated the economic characteristics of countries that sought the IMF's assistance. Subsequent works dealt with the repeated occurrence of IMF programs, the implementation of the policy conditions attached to them, the impact of Fund programs on poverty, the IMF's status as a provider of public goods, and the IMF's stance on capital account deregulation. In all of these studies I learned something about the IMF and about the economic conditions of its member countries.

Like others, I was caught off guard by the outbreak of the financial crisis in 2008 but greatly interested by the response of the IMF. The Fund, which had laid off staff members earlier in the decade because of a lack of lending programs, answered its members' requests for assistance by providing large amounts of credit with relatively limited and focused conditionality. The IMF was labeled a "phoenix" and seen as "back in the game," and its rapid and energetic reaction allowed its reputation to recover from the criticisms it had received for its previous crisis management activities, particularly those undertaken during the East Asian crisis of 1997–8. But the IMF was soon involved in the European debt crisis, while the emerging market nations pressed the IMF to investigate the role of capital controls in containing the impact of financial flows.

This book examines the IMF's attempts to promote the international public goods of economic and financial stability from the end of the Bretton Woods system in 1973 through the 2008–9 crisis and the subsequent events in Europe. This account demonstrates how the IMF changed its policy prescriptions in response to the financial turbulence of this era. The IMF learned to respond more quickly when necessary and to distinguish between crisis conditions that require major adjustments in domestic policies and those that are due to external shocks that should be financed. This shift matched a growing awareness of the instability that can arise in financial sectors and an evolution in the IMF's position on the advantages and disadvantages of unregulated capital accounts.

In telling this story, this book also surveys the IMF's relationship as an agent with its principals, the member governments. For many years the IMF's membership was divided among the advanced (or upper-income) economies, emerging market (or middle-income) nations, and developing (or lower-income) countries. This stratification was not rigid, and countries did rise and fall among the categories. But during the post–Bretton Woods era the advanced economies that dominated the IMF and other international agencies did not need to borrow from the Fund, while the emerging markets with much less clout were forced to turn to the IMF for credit whenever they experienced one of their recurrent financial crises.

The IMF's poorer members were cut off from private financial flows and depended upon the IMF and other multilateral agencies for assistance. Consequently there was friction between those nations that directed the IMF's governance and those that borrowed from it.

The financial shock that shook the world economy in 2008, however, originated in the United States, and the advanced economies were particularly hard hit by the ensuing crisis. Moreover, these nations could no longer claim any superiority in their regulatory systems once the activities of the "shadow" banking systems came to light. The emerging markets, on the other hand, suffered only mild slowdowns before their growth resumed its impressive pace. The change in the relative positions of the IMF's members was made clear when the G7 group of nations transferred its role as the chief forum for international economic policy making to the G20, which includes many emerging markets. This changeover was accompanied by promises to overhaul the governance of the IMF.

The IMF, which for thirty-five years sought to find its place in the era of financial globalization, must reinvent itself again. No one expects a return to a Bretton Woods–style system of universal exchange rate and capital account regimes. But the transition to a world where the advanced economies cope with mounting debt and the emerging markets and developing economies seek to continue their rapid growth without exposing themselves to financial volatility will require a reappraisal of the international monetary system by the IMF and its members as profound as that which occurred at the Bretton Woods conference in 1944. My hope is that this book contributes to that debate.

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The completion of this book owes much to the patience of my wife, Catherine Clark. She tolerated without reproach many hours of my absence while maintaining the household. My children, Caroline and Alison, also accepted as part of a normal childhood their father's many disappearances to work on the book. I am very fortunate in having a wonderful and supportive family.

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Abbreviations

ASEAN	Association of Southeast Asian Nations
BCBS	Basel Committee for Banking Supervision
BIS	Bank for International Settlement
CCL	Contingent Credit Line
CMI	Chiang Mai Initiative
CMIM	Chiang Mai Initiative Multilateralization
CPSS	Committee on Payments and Settlement Systems
EC	European Community
ECB	European Central Bank
EFF	Extended Fund Facility
EFSF	European Financial Stability Facility
EMS	European Monetary System
ERM	Exchange Rate Mechanism
ESAF	Enhanced Structural Adjustment Facility
ESF	Exogenous Shocks Facility
EU	European Union
FCL	Flexible Credit Line
FDI	Foreign Direct Investment
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board
FSF	Financial Stability Forum
FSSA	Financial System Stability Assessment
G5	Group of Five
G7/8	Group of Seven/Eight
G10	Group of Ten
G20	Group of Twenty
G24	Group of Twenty-Four
G77	Group of Seventy-Seven

GAB	General Arrangements to Borrow
GFSR	*Global Financial Stability Report*
GNI	Gross National Income
HAPA	High Access Precautionary Arrangement
IAIS	International Association of Insurance Supervisors
IEO	Independent Evaluation Office
IFI	International Financial Institution
IFIAC	International Financial Institution Advisory Commission
IGO	Intergovernmental Organization
IMF	International Monetary Fund
IMFC	International Monetary and Financial Committee
IOSCO	International Organization of Securities Commissions
IPG	International Public Good
LIBOR	London Interbank Offer Rate
NAB	New Arrangements to Borrow
OECD	Organisation for Economic Co-operation and Development
OPEC	Organization of Petroleum Exporting Countries
PRGF	Poverty Reduction and Growth Facility
SAF	Structural Adjustment Facility
SBA	Stand-By Arrangement
SDR	Special Drawing Rights
SDRM	Sovereign Debt Resolution Mechanism
SLF	Short-Term Liquidity Facility
SRF	Supplemental Reserve Facility
WEO	*World Economic Outlook*