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Debt Restructuring and Rescue Packages Helped Offset Private Capital Flow Reversals During the Crisis

THIS CHAPTER DRAWS SOME TENTATIVE conclusions concerning the role of debt restructuring and rescue packages in helping some of the countries affected by the financial crisis compensate for severe shortfalls in private external finance:

- The East Asian crisis countries continued to service their sovereign debt, except for Indonesia, which rescheduled debt owed to Paris Club creditors. The situation in Russia remains difficult, however. Debt service is large relative to fiscal resources, and the authorities face considerable hurdles in formulating an effective adjustment program. Crisis countries made considerable progress in refinancing the external debt of domestic banking systems, in part because the limited number of debtors and creditors facilitated negotiations. There has been much less progress in restructuring the external debt of the corporate sectors.
- Official support to countries in crisis has alleviated systemic risk and reduced the cost of adjustment. From August 1997 to December 1998 the international community committed almost \$190 billion to Thailand, Korea, Indonesia, Russia, and Brazil, with \$63 billion disbursed. Disbursements under the rescue packages have depended critically on implementation of reforms.
- Performance of rescue packages and progress on debt restructuring have been closely related. In Korea and Thailand the restructuring of the banking system debt and disbursements under the reform program proceeded rapidly. And although the recessions have been deeper than anyone anticipated, signs of recovery are

evident. However, burden sharing by private creditors of the countries' banking systems was less than by other creditors and holders of equity, raising concerns that the packages increased moral hazard in specific segments of borrowers and lenders. In Indonesia difficulties in policy implementation slowed disbursements under the rescue package. In Russia disbursements were halted. Progress in debt restructuring was limited in both countries, and they remain in a severe recession.

Debt Restructuring

The resolution of financial crises often, but not invariably, requires some form of debt restructuring (IMF 1998a). Experience in Latin America (Eichengreen and Fishlow 1996; Aggarwal 1990), as well as in more recent crises (Aggarwal 1998), shows that many countries experience difficulties in fully servicing existing debt when new financing disappears. Of the 56 balance of payments crises since 1970 (as identified in Kaminsky and Reinhart 1997), 35 were accompanied by either debt restructuring or an increase in arrears. It may be in the interest of both debtors and creditors to ensure a cooperative and orderly debt restructuring, not the least to avoid default that entails losses to creditors and curtailment of financing to the debtor. Given the substantial exposure of international banks to developing countries and the implications for the political stability of developing country governments, creditor governments have often played an important role in facilitating debt negotiations.

One critical aspect of the financial crisis of 1997–98, which distinguishes it from most earlier

developing country crises, has been the important role played by the external debt of the private sector (table 5.1). The private sector accounted for 60 percent of total debt in Indonesia, 69 percent in Thailand, and 90 percent in Korea. The restructuring of cross-border debt owed by the private sector can be difficult, owing in part to the absence of a universally recognized bankruptcy framework (World Bank 1999). There are no established mechanisms for dealing with private sector debt in arrears comparable to those for sovereign debt (such as the Paris Club for official-source debt and the more informal London Club-type consortia of commercial banks that deal with rescheduling sovereign debt).

Sovereign debt

Public sector debt played only a limited role in the problems confronting the countries most affected by the financial crisis (with the important exception of Russia).¹ Korea and Thailand had relatively small amounts of public sector debt and sound fiscal positions (World Bank 1998), so that even a severe interruption of external finance did not threaten the government's ability to meet debt service payments. But sovereign debt management remains a critical issue for ensuring the sustainability of capital flows, and several developing countries are taking steps to strengthen their debt management practices (box 5.1).

Indonesia. Among the East Asian crisis countries, public debt was most significant in the case of Indonesia (39 percent of total debt), and the government was forced to reschedule debt service payments. The established mechanisms for handling sovereign debt functioned well, and Indonesia's sovereign debt negotiations with public creditors were remarkably speedy. On September 23, 1998, Indonesia and its official bilateral creditors agreed to reschedule or refinance \$4.1 billion in principal payments over 11 years, including three years' grace. The government plans to meet with commercial bank creditors soon to discuss rescheduling of \$263 million in payments on its bank debt.

Russia. By contrast, the negotiation of the Russian government's debt has been protracted and difficult, owing to the huge discounts necessary to resolve the problem and the difficulties that Russian authorities have faced in formulating an effective adjustment program. The government's external debt service due is approximately equal to the level

Table 5.1 External debt of East Asian crisis countries, end-1997

(billions of U.S. dollars)

	Indonesia	Rep. of Korea	Thailand
Total	137.0	154.4	102.0
Long term	116.8	86.0	72.9
Short term	20.2	68.4	29.1
Public sector	54.0	15.0	31.5
Private financial sector	13.0	95.7	49.0
Private nonfinancial sector	70.0	43.7	21.5
Share of bonds in private debt (percent)	15	10	25

Sources: International Monetary Fund and Aggarwal 1998.

of government revenues projected in the budget. Given the unsustainable debt situation, in August 1998 the government announced a 90-day moratorium on about \$40 billion of its ruble-denominated debt to private creditors, of which foreigners held about \$17 billion at the exchange rate prevailing before the moratorium.² In November 1998, the government announced that Russia and foreign banks had reached an agreement in principle on restructuring more than \$10 billion of frozen treasury debt. Under the agreement, the foreign banks would get a 10 percent cash payment in rubles, 20 percent in securities that are tradable for tax debts or stakes in Russian banks, and the remaining 70 percent in interest-bearing, ruble-dominated securities. It has not been decided when the ruble payments could be repatriated. In addition, Russia has experienced considerable difficulties in servicing the already-restructured debt to the commercial banks and the Paris Club inherited from the former Soviet Union. As the year ended, discussions with both groups of creditors were ongoing.

Russia is not the first country to declare a moratorium on servicing debt; moratoriums on cross-border exposure have occurred regularly over the past two centuries. The imposition of a mutually agreed-upon moratorium may be considered an effective emergency mechanism: for private debt, it allows time for orderly bankruptcy proceedings to take place within the home country, and for public debt it gives the authorities time to organize debt restructuring efforts. The historical record suggests that some countries that defaulted were excluded from the market for a long time. For example, a few countries that defaulted

Box 5.1 The advantages of good debt management

Over the past decade recurrent debt crises have heightened awareness in developing countries of the need to maintain sustainable levels of debt. This required achieving a balance between reducing risk and reducing cost, and deepening domestic markets so as to reduce excessive reliance on foreign financing. Diversifying the foreign investor base and sources of funding is also important. However, too often with increased access to international capital markets, the choice of currency and the maturity structure of external borrowing by developing countries has been driven by short-term cost savings rather than long-term strategies.

Developing countries are particularly exposed to the volatility of global markets because of their large stock of foreign currency liabilities. Outstanding external public and publicly guaranteed liabilities of developing countries are currently more than two and a half times their international reserves. Sixty percent of these liabilities are at floating interest rates (mostly indexed to LIBOR) and 20 percent of overall liabilities (including those of the private sector in developing countries) are short-term, with a maturity of less than one year. Yet a recent survey by the World Bank revealed that 70 percent of sovereign borrowers in developing countries do not hedge their interest or their exchange rate exposures.

The arguments in favor of active liability management are compelling: diversifying the portfolio, improving credit ratings, and making timely debt service payments all lead to lower borrowing costs. The median level of the spread on emerging market eurobonds for the 17 major borrowers now exceeds 500 basis points. Halving this spread would over time save \$42 billion a year, equivalent to more than 3 percent of these countries' exports and 1 percent of their GDP.

Several developing countries, including Argentina, Brazil, Colombia, Czech Republic, and Hungary are among those taking a strategic approach to debt management. While each borrower is unique and driven by a different set of risk preferences, there are several common principles that govern their debt management strategy. The primary goals are improving credit ratings, limiting the impact of volatility in global markets, maintaining access to international capital markets, and minimizing borrowing costs.

In the first instance, countries have followed the lead of the debt managers in industrialized countries and established a linked fiscal policy with the budget-making

process and its financing—debt management policy—and established a *hard borrowing constraint*, under which public entities are given strict limits on the amount of their borrowing. This helps insulate the authority for sovereign borrowing from various pressures (for example, from special interest groups) that can lead to incurring excessive and undesirable liabilities. Equally important, the policy objectives of the debt management strategy are communicated and measured through a set of clearly articulated and quantifiable limits, such as borrowing-ceilings or performance benchmarks.

Second, countries that pursue effective debt management strategies are acutely aware that the perception of creditworthiness by foreign investors plays an important role in determining the availability, cost, and sustainability of capital. They understand the importance of communication with the markets and the need to regularly make information internationally available, not only about the general economic situation of a country but also its current financial situation and its policies, to attract foreign investors.

Third, to cushion the impact of market shocks and avoid the need to issue debt when the markets are unfavorable, liquid reserves are maintained at a level equivalent to one-quarter to one-third of annual external financing requirements. In 1998, total reserves (all of which may not be liquid) in most of the principal developing-country borrowers exceeded this level, and in several cases reserves were greater than even a generous estimate of financing requirements (calculated as the current account deficit, plus amortization on long-term debt plus short-term debt).

Fourth, the vulnerability to large stocks of short-term debt, which was a distinctive feature of the Russian crisis, is addressed. Experience shows that limiting the size of short-term debt in the overall portfolio can greatly reduce the rollover risk. Argentina has been particularly successful in this, as short-term debt accounts for just 3 percent of total debt, or less than 1 percent of GDP.

Fifth, the sources of financing are diversified, so as to increase the number of both domestic and foreign investors that hold the external debt and thereby improve the opportunity for access to all markets. This includes development of a domestic Treasury bill market.

Sixth, the use of guarantee schemes is restricted so that the level of external contingent liabilities is contained, and the likelihood of the government having to absorb significant volumes of "private" debt is much reduced.

in the nineteenth century were cut off from external finance for extended periods and ultimately forced to repay at unfavorable terms (box 5.2). Countries that defaulted during the 1930s also had to wait several decades before regaining access to the capital markets. However, even countries that serviced their debt during this period could not borrow in the international markets for an extended period (Eichengreen 1991), in part reflecting a general disillusionment with lending to developing countries in the wake of the defaults. The experience of Latin American countries in the first few decades after World War II also suggests that there was no systematic difference in market access by governments or private borrowers who defaulted or maintained debt service (Cardoso and Dornbusch 1989; Jorgensen and Sachs 1988). Fishlow (1989) suggests that international creditors may be willing to resume lending to defaulters because the market views improvements in macroeconomic policies as sufficient to erase the bad reputation resulting from default.

Debt owed by banking systems

The restructuring of debt owed by domestic banking systems has in practice proved less intractable than other forms of private sector debt. Creditors at the onset of the crisis withdrew a significant portion of the short-term debt. For the remainder, the limited number of debtors and creditors made negotiations between creditors and debtors feasible, and made it easier to negotiate burden sharing among creditors. And both creditor and debtor governments have important incentives to facilitate a resolution to the debt problem. Creditor governments have an interest in ensuring the financial soundness of the major international banks, and have encouraged them to reach agreement on the restructuring of debt owed by the crisis countries' banking systems. Debtor governments have been concerned over the systemic implications of widespread defaults by domestic banks, and have offered sovereign guarantees on their external liabilities.

Korea. The Korean authorities took an active role in helping domestic banks restructure their foreign debt through providing sovereign guarantees on the debt and participating in negotiations with creditors. The deal was facilitated by the relatively small number of foreign creditors and the support of creditor governments, particularly the United States, and of multilateral institutions. The agree-

ment, reached on January 5, 1998,³ provided for the rollover of all of Korea's maturing obligations until March 3. About \$24 billion of Korea's short-term bank debt was exchanged for loans with maturities of one to three years with an interest rate of 2.25–2.75 percent over six-month LIBOR, respectively. The Korean government pledged to guarantee \$20 billion of the \$24 billion restructured. The terms were more favorable to the government than lenders had initially proposed, a resolution that creditor governments may have helped to achieve. Of course, it is difficult to evaluate the impact of creditor governments on the decisions of commercial banks during debt negotiations. Banks may have been influenced by the position of their governments, or they may have felt that in any event the final deal was the most that could be gained.

The Korean rescheduling deal has important parallels with the post-1982 debt rescheduling efforts in Mexico and other Latin American countries (box 5.3). As in Korea, Mexico was close to default and foreign lenders were reluctant to make concessions, whether in terms of debt rescheduling or debt reduction. In both Korea and Mexico, creditor governments, particularly the United States, took a highly active role to encourage bank agreement. Major banks with large exposure—for which default was a significant threat to their solvency—agreed and helped convince the smaller banks to participate. So far the Korean approach has been successful: in April 1998, Korea launched its first-ever sovereign bonds worth \$4 billion; \$3 billion of 10-year paper were placed at 355 basis points over comparable U.S. Treasuries, and \$1 billion of five-year notes were placed with a spread of 345 basis points (although access was again curtailed in the wake of the Russian debt moratorium).⁴ Korea's experience appears likely to differ from that of Argentina, Brazil, and Mexico, which found themselves in repeated negotiations with bankers during the 1980s. It was only after the 1989 Brady Plan and the recognition that debt reduction was necessary that a successful approach to debt restructuring was adopted.

Indonesia. Indonesia reached an initial agreement on the restructuring of its external debt to international banks in June 1998 (the Frankfurt agreement).⁵ It included a plan to restructure corporate debt (described below) and a plan to restructure the \$13.6 billion banking sector debt, of which about \$4 billion was in trade credits and

Box 5.2 Selected cases of debt moratoriums

Defaults were common in the nineteenth century. In the early decades of the 1800s, most of the Latin American countries defaulted on their foreign debt, which was largely in the form of bonds. In the event of a liquidity crisis, avoiding default was difficult, because the infusion of new finance would require the almost impossible coordination of thousands of bondholders. The 1930s depression saw a wave of defaults, but these became less frequent after World War II because shocks to the system were less severe, countries relied more on bank lending (which is easier to reschedule), and creditor governments played a more active role in resolving crises. The following are some selected examples.

Mexico, 1820s to 1880s. In 1824 and 1825 the Mexican government contracted two bond loans of \$16 million each through London financial houses, pledging one-third of its custom duties as security. Approaching bankruptcy, it suspended interest payments in October 1827. Negotiating readjustments of this “London debt” would plague Mexico for the next 60 years. Settlement on the defaulted debt was reached only in 1886. Bondholders fared very well in the new agreement: they recovered all of their principal in 1888, with interest averaging 2.3 percent a year on the 1824 bond issues, and 1.1 percent on the 1825 bond issues.

Mexico, 1920s to 1940s. By contrast with the nineteenth century debt experience, Mexico secured much more favorable terms during the 1920s–1940s period. Mexico had been in default since 1913, and various efforts to come to an agreement with bondholders failed throughout the 1920s and 1930s. After proposals and counterproposals, a new agreement was reached on Mexico’s direct foreign debt in November 1942. Overall, the Mexican government would pay 23.7 cents on every dollar of secured debt bonds, and only 14.2 cents on every dollar of unsecured debt bonds.

Peru, 1930s to 1940s. In 1931 the Peruvian government suspended payment of interest on its external debt. In 1932 it passed a law indefinitely extending the moratorium on the entire external debt service. Throughout the 1930s and 1940s, negotiations dragged on between the bondholders and Peru without sign of resolution. Credit from multilateral institutions was curtailed. An onerous agreement was reached only in 1947, with Peru having to repay full interest on the bonds and the principal.

Brazil, 1980s to 1990s. On February 1987, Brazil suspended payments on \$67 billion of its commercial debt and froze payments on approximately \$15 billion of trade credits and money market deposits, bringing the total moratorium value to \$83 billion. The authorities first attempted to divide the “creditors cartel” by approaching the banks in separate groups, and then to enlist creditor government cooperation—strategies that failed. An agreement was reached only in June 1988. The package stipulated that the banks would provide \$5.8 billion in new funds. In addition to the new money provided by commercial banks and co-financing with the World Bank, the restructuring package included lower interest rates, continuation of the debt-equity swaps program, and a spreading of principal repayment over a 10-year period. The 10-year period began in 1995, with a provision that allowed banks to purchase up to \$15 billion in 25-year tradable exit bonds (at 6 percent). After Brazil and the banks signed the agreement, in August 1988 the IMF approved \$1.4 billion in standby credits. By early November, after making large payments to the banks, Brazil was no longer in arrears on its interest—but that did not last long. It was only in 1993 that Brazil negotiated a final rescheduling accord under Brady Plan guidelines and restructured \$52 billion in debt, including funds held by foreign branches of Brazilian banks.

swap transactions and \$9 billion in interbank credit. For trade credit, creditors were asked to maintain their lines at the level that existed in April 1998. For interbank credit, existing liabilities of Indonesian banks to foreign banks maturing by March 31, 1999, were to be exchanged for new loans with maturities of one to four years, and interest rates over LIBOR ranging from 2.75 to 3.5 percent. The new loans would benefit from a full dollar guarantee from the Bank of Indonesia.

Thailand. The government encouraged international creditors and domestic banks to negotiate their own voluntary agreements.⁶ The fact that about 50 percent of the banking debt originated

from Japanese banks facilitated the reaching of the agreement. Voluntary deals, consisting mostly of rollover of short-term credit and maturity lengthening, have reportedly been very successful. Moreover, the process of unwinding swaps with offshore counterparties (totaling about \$20 billion since mid-1997) was completed in November 1998.

Corporate debt

Debt owed by corporates has been more difficult to restructure, owing to the multiplicity of debtors and creditors involved, and the smaller implications for systemic risk (as compared to banking system debt), so that governments have played a

Box 5.3 Banking debt rescheduling with foreign creditors

Name of plan and effective dates	Debtor's options and procedure	Lender's option and procedure	Governments and international organizations' roles	Outcome
<ul style="list-style-type: none"> • KOREAN RESCHEDULING January 1998 • \$24 billion of total of \$112.2 billion short-term debt and \$1,236.3 billion long-term debt (including debt of financial institutions) 	<ul style="list-style-type: none"> • Negotiations on rollover of debt due by end of March 31, 1998. • Negotiations on longer-term rescheduling of short-term bank debt. 	<ul style="list-style-type: none"> • Choice of loans of one, two, or three years maturity with interest rate of 2.25, 2.5, and 2.75 over the six month LIBOR totaling \$24 billion. 	<ul style="list-style-type: none"> • Korean government guarantees bank debt. • U.S. government urges own banks to rollover debt. 	<ul style="list-style-type: none"> • Agreement on \$24 billion debt at end of January 1998.
<ul style="list-style-type: none"> • MEXICAN ROLLOVER during 1982–83 following August 13, 1982 crisis 	<ul style="list-style-type: none"> • Mexico seeks loans from the United States, BIS, and IMF. • Mexican government pressures banks to lend. 	<ul style="list-style-type: none"> • 1,400 commercial banks, of which 550 were main creditors. • Banks strongly encouraged to lend by creditor governments, and IMF. • Banks contributed about 7% of outstanding loans as part of jumbo loan. 	<ul style="list-style-type: none"> • IMF makes \$3.92 billion credit contingent on \$5 billion jumbo loan from banks. • Bridge loan through BIS. 	<ul style="list-style-type: none"> • U.S. loan of \$2 billion, BIS loan of \$1.85 billion, \$3.92 billion from IMF. • \$5 billion from banks with six-year maturity, three years grace, at 2.25% over LIBOR with a 1.25% fee. \$20 billion owed from August 1982 to December 31, 1984, rescheduled over eight years with four years grace at 1.875% over LIBOR and fee of 1%.
<ul style="list-style-type: none"> • MEXICAN BRADY PLAN AGREEMENT, February 1990 	<ul style="list-style-type: none"> • Mexico backs principal on bonds with U.S. Treasury zero-coupon bonds and interest for 18 months with loans from IMF, World Bank, Japan, and Mexico itself. • Agrees to resumption of debt-equity swaps. • Mexico to pay 3% higher interest on fixed interest bonds if oil price above \$14 after July 1996. 	<ul style="list-style-type: none"> • Choice of three options: <ol style="list-style-type: none"> 1. Reduce principal by 35% by exchanging loans for bonds at 65% of face value. Bonds would pay interest at 13/16% over LIBOR. 2. Exchange loans for bonds with the same face value as old loans but at a fixed interest rate of 6.25%. 3. New loans worth 25% of outstanding exposure (after debt reduction) with 15-year payback period after 7-year grace at 7/8% over LIBOR. 	<ul style="list-style-type: none"> • U.S. Secretary of Treasury develops Brady Plan. • Pressure by Brady on leading New York banks. • IMF and World Bank cooperate with new approach. • Japan contributes to plan. 	<ul style="list-style-type: none"> • \$48.5 billion in medium- and long-term debt covered by agreement with 41% choosing principal reduction and 49% choosing interest reduction.

less central role. At the same time, the restructuring of corporate debt is critical to resolving the financial crisis. It will be extremely difficult to establish sound banking systems in the crisis countries as long as a major share of the corporate sectors remain bankrupt. And recovery from the crisis ultimately will depend on restoring the financial soundness of viable companies while reallocating capital to more productive uses by dissolving non-viable corporations and selling their assets. Comprehensive legal, tax, and regulatory frameworks for facilitating the restructuring of corporate debt are being developed in the crisis countries.

Thailand. The government has established a Corporate Debt Restructuring Committee (CDRC)—chaired by the Governor of the Central Bank and including representatives from both domestic and international banks—to establish procedures for voluntary corporate restructuring. The government also has introduced a “Framework for Corporate Debt Restructuring,” a set of principles to guide voluntary corporate workouts.

Korea. As in Thailand, the government has not intervened in the rescheduling of corporate external debt, which represents less than 10 percent of the total corporate debt (estimated at \$500–600 billion).⁷ To facilitate the process of corporate restructuring, the regulations governing foreign investor participation in mergers and acquisitions are being liberalized.

Indonesia. By contrast with Korea and Thailand, the Indonesian government initially adopted a centralized framework for restructuring the foreign corporate debt. It created the Indonesian Debt Restructuring Agency (INDRA) to provide guarantees against exchange rate risk on re-negotiated foreign currency debt. Participating debtors would make payments in rupiah to INDRA, which would then repay the debts in foreign currencies. Debtors would be entitled to the best “real 20-day average market exchange rate” until June 30, 1999, when the program ends.⁸ Debtors and creditors are expected to negotiate their own terms (including debt-equity swaps and debt reductions), subject to the requirement that re-negotiated loans must have at least a three-year grace period on principal repayments starting December 1998, and an eight-year minimum maturity.

As of the end of 1998, no company had signed up to participate in INDRA. The main reason appears to be that debtors expect the appreciation of

the exchange rate since summer 1998 to be sustained, and are thus less interested in the exchange rate guarantee. Other features of INDRA may also be responsible for the lack of interest in debt cooperation. Companies may be unwilling or unable to resume interest payments, as required for participation in INDRA. Some foreign lenders, notably Japanese and Korean banks with weak balance sheets, have preferred to extend payments over a longer period rather than agree to any write-offs at this time. Moreover, a large percentage of corporations in Indonesia consists of family-held firms, which have traditionally been reluctant to disclose their balance sheets.

INDRA is similar to the successful program that Mexico created in 1982, FICORCA (box 5.4). It is worth recalling that about 90 percent of the firms signing onto the FICORCA program did so in the last few days, close to the deadline. A difference between the two schemes is that companies in Mexico could benefit from an exchange rate subsidy, because of the fixed peso-dollar exchange rate. Such a subsidy proved difficult to introduce in INDRA, particularly as a large proportion of consumer subsidies had been cut. Moreover, cooperation between bankers and private Mexican firms was more common than has been the case in Indonesia, which could delay resolution of Indonesia’s private sector debt.

In September 1998 the INDRA program was supplemented by the Jakarta Initiative, which establishes the principles that will guide out-of-court corporate restructuring; by revision of the bankruptcy law; and by the introduction of a special commercial court to deal exclusively with bankruptcy cases that emerge in the corporate restructuring process. Following the Initiative, some progress has been made in restructuring a number of companies.

Rescue Packages, Systemic Risk, and Moral Hazard

The international rescue packages helped compensate for declines in private financing and thus limit the size of the fall in aggregate demand in the crisis countries. The case for official lending from international financial institutions during crises is well established. Even countries with significant market access in normal times may require official support if balance of payments pressures

Box 5.4 Corporate debt rescheduling with foreign creditors

Name of plan and effective dates	Debtor's options and procedure	Lender's option	Government role	Outcome
<ul style="list-style-type: none"> • INDRA¹: Indonesian Debt Restructuring Agency, under the Bank of Indonesia's auspices. • Announced June 4, 1998. • Effective August 1, 1998. • Estimated that \$64 billion of private debt could fall under the program. 	<ul style="list-style-type: none"> • Debt to be restructured registered with INDRA by June 30, 1999. • Debtors and creditors must agree to inclusion of debt in INDRA; agreement must provide for a grace period for principal ending no earlier than December 31, 2001; final maturity no earlier than December 31, 2006. • Exchange rate guarantee based on announced market rate at beginning or monthly announcement until June 30, 1999 based on 20 day moving average (see notes). • There are about 2,000 firms that could potentially participate. 	<ul style="list-style-type: none"> • INDRA encourages creditors and debtors to come to terms. • Bankruptcy court is an option for nonpayment. 	<ul style="list-style-type: none"> • Exchange rate guarantee. • Government does not guarantee debt itself. • New bankruptcy rules as part of domestic debt settlement program (Jakarta Initiative of September 1998), rules on re-evaluation of fixed assets, tax rules on foreign debt, use of foreign currency in financial reports, relaxation of merger criteria, and share repurchase option. 	<ul style="list-style-type: none"> • By November 1998, no agreements had been reached.
<ul style="list-style-type: none"> • FICORCA.² • Fideicomiso para la Cobertura de Riesgos Cambiarios (The Trust Fund for the Coverage of Exchange Rate Risk). • Announced March 11, 1983. Operational May 1983. • \$11.6 billion of debt involved in the program. • Applied to foreign debt contracted before December 20, 1982. 	<ul style="list-style-type: none"> • Debt to be registered with Ministry of Finance at FICORCA by October 25, 1983. • Four systems regarding principal and interest (see below). • Exchange rate varied with repayment schedule: 84 pesos to the dollar for six-year loans, 81 pesos to the dollar for seven-year loans (both with three-year grace periods), and 75 pesos for eight-year loans (with four-year grace periods). • Participation by about 300 Mexican firms. 	<ul style="list-style-type: none"> • FICORCA informs creditors as to the loan maturity choice made by the company. • Participation by about 300 banks. 	<ul style="list-style-type: none"> • Exchange rate guarantee. • Government does not guarantee debt itself. 	<ul style="list-style-type: none"> • By 1989, program had paid out nearly all of the re-negotiated debt. • More than 40% of debt had maturities of eight years or more. • Some companies left FICORCA to negotiate directly with their creditors. • Some managed to secure lower interest rates, others debt writedowns.

INDRA¹: Within 30 days after expiration of the entry period, debtors may elect to use an exchange rate that is 10% or 20% better than the rate announced. Interest rates payable under rupiah financing will then increase by 2.89% per year for a 10% reduction and by 6.36% per year for a 20% reduction. If the exchange rate from May 1 to July 30, 2000 is more favorable than base rates, payments will be adjusted downward after July 30, 2000. Rupiah financing will be indexed to inflation rate.

The FICORCA²: Program was applied only to long-term loans or debt restructured on a long-term basis. Long-term loans were defined as those whose principal is payable in equally successive quarterly installments in terms of at least six years with a minimum three-year grace period in systems 1 and 2, and for at least eight years with a minimum four-year grace period for systems 3 and 4. The program offered four systems. Systems 1 and 2 covered foreign exchange risks involved in payments of principal while systems 3 and 4 covered interest up to a certain limit as well as the principal. Firms were allowed to participate in whichever system they elected, including participation in two or more systems with respect to the same loan. Details on FICORCA program (based on Banco de Mexico Circular Number 1897/83), April 25, 1983.

arise because private investors ration credit (Mas-son and Mussa 1995), as occurred during the financial crisis. In addition, the international financial institutions provide a public good by gathering information and signaling which countries have appropriate policies, and support reform programs through policy conditionality (Guitian 1992, Rodrik 1995). One critical role during financial crises is to help limit contagion effects (see chapter 2) and avoid the potential systemic implications of default in emerging markets (Stiglitz 1998).

In performing these roles, a balance has to be struck between containing systemic risk and limiting moral hazard, which might encourage resumption of imprudent lending in the future. In Korea and Thailand, both the restructuring of the banking system debt and disbursements under the reform program proceeded rapidly, and the beginnings of recovery are apparent. However, the extent of burden sharing by private sector creditors has been unclear, raising the issue of whether the packages increased moral hazard. In Indonesia, by contrast, disbursements under the rescue package were delayed for a long time owing to lack of policy implementation, and little private debt restructuring took place. In Russia, both disbursements under the packages and debt restructuring have been limited, the country remains mired in a severe recession, and private sector creditors have taken enormous losses. Crisis management is never an easy task. Nevertheless, this mixed record suggests that encouraging greater burden sharing, while containing systemic risks, remains a major challenge for the international financial architecture.

The size of the rescue packages

The international rescues of the 1990s differed significantly from those in previous decades. Rescue packages have become much larger (Bordo 1998;

and Bordo and Schwartz 1998) as the opening of capital markets, the growing importance of private sector external debt, and the greater presence of foreign investors have increased the amount of funds required to stabilize markets. The 1990s packages also appeared to be more explicitly targeted at limiting the spread of contagion to other countries compared to the pre-1990s packages, which were aimed more at reducing the risk to the creditor countries' banks (table 5.2).

The Mexican peso crisis. The \$50 billion package given to Mexico on February 1995 was unprecedented for size and risk (Calvo, Goldstein, and Hochreiter 1996). It was feared that without significant official support and in the absence of a framework for bond restructuring, Mexico would default on its sovereign bonds, possibly leading to the collapse of other emerging markets. The IMF provided the largest standby loan in its history (\$17 billion), representing 700 percent of quota.⁹ The United States, concerned about the political and economic consequences of a Mexican default, provided \$20 billion through a conditional, collateralized loan funded from the U.S. Treasury's Exchange Stabilization Fund. The rescue package was successful in supporting recovery from the crisis, and private capital flows to Mexico resumed relatively quickly. But the resources provided enabled most private creditors to avoid losses, as Mexico was able to meet debt service payments and even reduce its short-term debt. This experience may have encouraged excessive optimism about the risks of lending to emerging markets, as evidenced by the sharp declines in spreads during 1996–97 (World Bank 1998).

The financial crisis of 1997–98. From August 1997 to December 1998 the international community pledged about \$190 billion to support Brazil, Indonesia, Korea, Russia, and Thailand. This

Table 5.2 Rescue packages in East Asia, Russia, and Brazil, July 1997–October 1998

(billions of U.S. dollars)

Country	Funds pledged					Funds disbursed		
	IMF	Multilateral ^a	World Bank	Bilateral	Total	IMF	World Bank	Others
Indonesia	11.2	10.0	5.5	26.1	42.3	6.8	1.3	1.4
Korea, Rep. of	20.9	14.0	10.0	23.3	58.2	18.2	5.0	4.0
Thailand	4.0	2.7	1.5	10.5	17.2	3.0	0.8	8.9
Russia Federation	11.2	1.5	1.5	9.9	22.6	4.5		
Brazil	18.0	9.0	4.5	14.5	41.0	9.0 ^b		

a. World Bank, Asian Development Bank, and Inter-American Development Bank.

b. Package was approved in December 1998. First IMF disbursement was in January 1999.

Sources: IMF and World Bank.

amount does not include \$30 billion pledged by the Japanese government (the Miyazawa Initiative) to help East Asian crisis countries undertake reforms essential to economic recovery.¹⁰ Generally the international financial institutions provided the rescue packages quickly, although the amount and timing of disbursements depended on the countries' performances under IMF-agreed reform programs. Between August 1997 and October 1998, Thailand received some 60 percent of the financing committed for that period by the IMF and the World Bank. Korea received almost 90 percent of financing committed in the very early stages of the crisis. By contrast, official lending to Indonesia was held up after an initial disbursement of \$3 billion in early November 1997, owing to the slow implementation of reforms. IMF disbursements resumed only in May 1998, and stepped up during the summer, after major political changes took place in the country.

Rodrik (1998) has argued that democratic institutions allowed a faster adjustment to the crisis in Korea and Thailand. Elections in both countries promoted a change in government that strengthened support for the program of structural reforms that accompanied the rescue packages. By contrast, Indonesia faced more difficulties in managing the crisis. (Note, however, that despite its democratic government, Russia has faced considerable difficulties in achieving the policy reforms essential to surmounting the crisis.)

The rescue package for Russia was a calculated risk (Fischer 1998), and the results have been disappointing. Despite the progress made in reforming the tax system and in reducing inflation during 1996–97, by 1998 the situation was critical—the budget deficit had reached almost 7 percent of GDP, with revenues covering just half of expenditures. In addition, falling oil and commodity prices reduced foreign exchange earnings and the government was rolling over \$1 billion a week of short-term ruble denominated debt (GKOs). The package was made conditional on strict fiscal measures and adoption of a voluntary plan to transform GKOs to long-term dollar obligations. However, only the first tranche of the IMF loan (\$4.5 billion) could be disbursed. As the Parliament failed to pass important tax measures, capital outflows intensified. On August 17, 1998, the Russian authorities devalued the ruble, imposed a

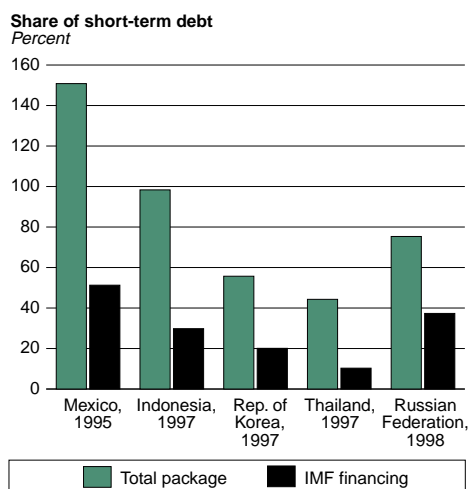
unilateral restructuring of the GKO debt and declared a 90-day moratorium on private debt repayments. Finance under the rescue package was cut off and has yet to resume.

The rescue package for Brazil, approved in December 1998, reflects an effort to provide a greater share of available financing up front, compared to the experience in East Asia. The first tranche, \$5 billion from the IMF and \$4 billion from bilaterals, was available on approval (it was drawn in January 1999). By contrast, in the East Asian packages, bilateral financing was only a second line of defense. Also, Brazil can draw the second tranche much earlier than under prior arrangements. The World Bank approved \$1 billion to Brazil in January 1999 to support reforms in the areas of social protection, social security, and administration.

The size of the packages. Determining the size of the rescue packages was a difficult exercise. Sufficient financing was necessary to meet anticipated foreign exchange needs, restore market confidence, and ensure the success of the program. However, the provision of a very large amount of finance risked increasing moral hazard.

The size of the packages varied greatly. The total amount pledged under the rescue packages represented almost about 150 percent of the stock of short-term debt in Mexico, 100 percent in Indonesia, and significantly less in Korea, Thailand, and Russia (figure 5.1). Multilateral financing is perhaps a better indicator of the size of the packages, as many of the funds made available by bilaterals are in fact only “second line resources,” available only if required due to a decline in reserves. The World Bank committed a total of \$18.5 billion to Indonesia, Korea, Thailand, and Russia, and \$4.5 billion to Brazil. IMF commitments under the rescue packages totaled \$65 billion. The IMF's contribution to the Asian packages was small in relation to GDP, external debt, and projected gross financing needs (table 5.3). It is interesting to note that Mexico received a larger share of IMF financing relative to all of these indicators than any of the East Asian countries. It is possible that after the Mexican experience investors viewed the smaller size of the East Asian packages as reducing the likelihood that they would succeed, which made it more difficult to restore market confidence in the countries' economic programs. Some observers believed that the Russian package was too small to be

Figure 5.1 Total packages and IMF financing have varied as a share of short-term debt



Source: World Bank.

effective (Hale 1998). However, in terms of covering short-term debt, the package in Russia was larger than that of Korea or Thailand.

The lender of last resort and moral hazard in an international context

The international financial institutions perform some of the functions of a lender of last resort. In a domestic context, the lender of last resort is charged with providing resources to stem financial panics. The lender of last resort would “lend freely to temporarily illiquid but nonetheless solvent banks, at a penalty rate and on good collateral” (Bagehot 1873; Goodhart 1988). Historically, effective application of these principles has required access to sufficient financial resources, discretion to decide the form of intervention, availability of adequate information (that is, through supervisory authority), and the power to impose penalties in order to limit moral hazard (Giannini 1998). The central bank typically takes on the responsibility of a lender of last resort, although other institutions, both public and private, have performed this function over the past century (Fischer 1999). This responsibility is not easily replicated outside national borders (Guttentag and Herring 1983).

Table 5.3 Approved IMF financing as share of GDP, external debt, and financing requirements (percent)

	GDP	External debt ^a	GFN ^b	GFN, plus stock of short-term debt
Mexico, 1995	6	13	39	16
Indonesia, 1997	5	7	22	13
Rep. of Korea, 1997	5	12	32	12
Thailand, 1997	3	5	10	5

a. Stock of external debt of all maturities, both public and private, prior to the approval of IMF arrangement (December 1994 for Mexico, June 1997 for Indonesia, September 1997 for Korea, and December 1996 for Thailand).

b. GFN is gross financing requirements. Excludes amortization of short-term debt. Figures refer to the entire period of the arrangement. During a program's first year, the IMF's share of GFN may be higher, particularly in multi-year arrangements with front-loaded access (for example, for Korea the first-year ratio was 51 percent; in Thailand it was 31 percent).

Sources: IMF *International Financial Statistics* and World Bank.

The lender of last resort function was particularly difficult to fulfill during the financial crisis, as the large amount of short-term debt and open capital accounts made it virtually impossible to provide financing sufficient to cover all potential foreign exchange obligations. The goal of the rescue packages was rather to help cover temporary shortfalls in external finance, to stem capital outflows by strengthening market confidence, to support the policy reforms ultimately required to resolve the crisis, and to contain systemic risk by providing finance when investor confidence in emerging markets was particularly vulnerable. For example, the Brazilian package, in conjunction with interest rate reductions by major industrial-country central banks and the provision of additional resources to the IMF, helped avoid a further retreat from emerging market investments in late 1998.

Some degree of moral hazard is inherent in any rescue package, as foreign creditors will be willing to take on more risks because of the implicit insurance that packages offer.¹¹ The critical issue is whether the moral hazard implicit in the expectation of official support induces excessively risky lending. This is a difficult judgment, given that it is not clear *ex ante* what level of lending is excessive, and it is impossible to tell what would have been the level of finance available from the markets without the packages. One approach is to infer evidence of moral hazard from market reac-

tion to the increased availability of international financial support. Neither the 45 percent IMF quota increase approved on September 1997, nor the introduction of the Supplemental Reserve Facility on December 1997, nor the approval of rescue packages in East Asia had a sizable influence on spreads on debt to emerging markets. However, expectations of these measures may have already been reflected in outstanding prices.

Another approach to gauging the potential impact of the packages on availability of future capital flows is to examine the extent and nature of the losses investors sustained in crisis countries. In general, holders of equities and bonds lost heavily. From June 1997 to December 1998, the dollar value of stock market indexes in the five East Asian crisis countries fell by between 45 and 83 percent (chapter 2). Foreign investors suffered potential losses from June 1997 to June 1998 of approximately \$100 billion (IIF 1999).¹² Bond losses were also significant. From June 1997 to the lowest point reached, the prices of the five countries' sovereign eurobonds fell by between 11 percent (in Malaysia) and 54 percent (in Indonesia), for a total decline in the market price of sovereign bonds of \$6 billion. However, by January 1999 the market price of sovereign bonds in the five countries had recovered to only about \$2 billion less than in June 1997. The total losses on private bonds was several times the losses on sovereign bonds, as the price decline in corporate sector bonds was much greater, and the dollar value of private sector international bonds in the five countries was \$60 billion compared with \$24 billion for sovereign bonds. Using a sample of the most actively traded corporate bonds in the five countries, the decline in market value from June 1997 to January 1999 was about \$23 billion. This figure underestimates the total loss, as it excludes bonds that ceased to trade during the period (that is, because the firm went bankrupt).

Losses by international banks to the East Asian crisis countries were limited on loans to banks, but significant on loans to corporates and off-balance-sheet items. Most loans to banking systems have been serviced or rolled over. In Korea and Thailand substantial short-term debts were either repaid directly after disbursement of the IMF loan package or converted to long-term maturities (in Korea, coupled with the provision of government guarantees). By contrast, banks lost substantial amounts on their

loans to the corporate sectors in the five East Asian economies, in which (according to recent estimates) 63 percent of firms are illiquid and 30 percent could be technically insolvent (Claessens, Djankov, and Ferri 1999). Corporate loans are largely not being serviced in Indonesia.

One indication of the potential losses on bank claims is the amount set aside for provisions. Based on press reports through August 1998, international banks set aside \$12.5 billion in reserves for provisions on their exposure to the five East Asian countries (IIF 1999). Supervisory authorities in several industrial countries have recommended increased provisions for exposure in the East Asian crisis countries. The increases vary considerably by East Asian country and by supervisory agency, with some supervisors recommending provisions ranging from 15 to 65 percent of exposure (compared with zero before the crisis).¹³ Income statements from the international banks indicate that banks suffered losses in off-balance-sheet exposure as well (IMF 1998b). In other words, banks did lose substantial sums in East Asia, although their loans to domestic banks were relatively protected. One concern for the future is whether this experience will skew the allocation of foreign loans toward short-term exposure to banks.

Finally, another indication of the impact of the packages on moral hazard was seen in the reaction of markets when funds are not forthcoming. As discussed in chapter 2, lending to Russia despite unsustainable policies was based in part on expectation of support from the international community. One explanation of the general retreat from emerging markets after the Russian debt moratorium is that the failure of the Russian package led to dramatic increases in market perception of the risk of lending to emerging markets.

The role of the international financial institutions

The IMF. The IMF has taken on a number of roles and adapted its policies to cope with the financial crisis. The IMF organized rescue packages with the help of the World Bank, the Asian Development Bank, the Inter-American Development Bank and several high-income countries.¹⁴ IMF programs in countries experiencing crisis have emphasized structural reforms, particularly in the financial sector, and measures to improve the efficiency of markets and improve governance (IMF 1998c).¹⁵ The

Box 5.5 IMF and World Bank financial instruments for managing crisis

IMF INSTRUMENTS

Supplemental Reserve Facility (SRF). The SRF, established in December 1997, is to be used when large capital outflows from a country create a risk of contagion and threaten the international monetary system. Financing under the SRF is committed for up to one year in two or more tranches, of which the first is available on approval. Countries are expected to repay within 18 months of the date of each disbursement (though the repayment may be extended by up to one year). During the first year from the date of approval, borrowers pay a surcharge of 300 basis points above the rate on IMF drawings. This rate increases by 50 basis points at the end of the first year, and every six months thereafter, until the surcharge reaches 500 basis points.

General Arrangements to Borrow and New Arrangements to Borrow. Under the General Arrangements to Borrow (GAB), 11 industrial countries have agreed to make available some \$23 billion as “first line” resources for emergency credit. The GAB has been renewed for a further five-year period from December 26, 1998. The New Arrangements to Borrow (NAB), adopted in January 1998, is a *supplemental* pool of resources available for responding to financial emergencies that threaten the stability of the international system. The resources that could be activated under both the GAB and the NAB cumulatively amount to roughly \$45 billion, through 25 participants. The NAB became effective on November 17, 1998. Brazil was the first country to activate the NAB.

Access policy and limits on use of IMF resources. In 1994 the IMF raised the annual access limit to its resources from 68 percent to 100 percent of quota under the credit tranches and the Extended Fund Facility (EFF), while keeping the cumulative access limit unchanged at 300 percent of quota. These limits, however, do not apply to the special facilities, including the SRF.

WORLD BANK INSTRUMENTS¹⁶

Special Structural Adjustment Loans (SSAL). Because of its special nature and the high risks involved, the SSAL carries higher pricing and a shorter maturity and grace period than a normal SAL. SSALs are intended to provide excep-

tional support for structural and social reforms to client countries approaching a possible crisis, or already in crisis, with exceptional financing needs. The main justification for exceptional World Bank support through an SSAL is the structural origin of a potential or actual crisis and its major social or poverty-related consequences. In instances in which such a crisis opens a window of opportunity for reforms that might otherwise have remained closed, SSALs help countries prevent the crisis or mitigate its adverse economic and social impact.

SSALs are exceptional and may be justified on a case-by-case basis if the country is an IBRD member country, and faces an actual or potential crisis with substantial structural and social dimensions; the structural, social, and macroeconomic policy reform package is satisfactory; the SSAL is part of an international support package, which would include the IMF and other multilateral and bilateral donors as well; and the financing plan is judged likely to be sustainable.

Financial instruments for preventing crises. Strengthening the macroeconomic, structural, and social foundations of sustainable development is a critical dimension of crisis prevention. With this objective in mind, and to regularize and strengthen World Bank support for policy reform over the medium term, the World Bank has developed Programmatic Structural Adjustment Loans (PSALs) for IBRD borrowers, and Programmatic Structural Adjustment Credits (PSACs) for IDA borrowers.

PSALs and PSACs are designed to help clients calibrate the amount and timing of World Bank financial support to their resource needs in support of medium-term programs of structural reform and institution building. As compared with standard World Bank adjustment loans, PSALs and PSACs are more flexible and can provide support to borrowers in a wide-range of circumstances. For example, they can support time-slices of government development programs funded from successive annual budgets; or a series of step-by-step reforms to strengthen budget and public sector institutions; or a program of economic governance and institutional reforms in one or more areas, such as natural monopoly regulation, privatization, or pensions.

IMF has introduced new financial instruments (see box 5.5) such as the Supplemental Reserve Facility (SRF). The SRF represents a departure from previous instruments: it is to be used by countries facing exceptional balance of payments outflows due to short-run speculative attacks; it is not necessarily

intended to finance a given outflow, but rather to improve market confidence and thus limit the capital outflow and help rebuild reserves; and it is to be used only when there is a significant risk of contagion that could threaten the international financial system. The IMF also has been actively in-

Box 5.6 The effect of special adjustment lending on the World Bank's financial position

During fiscal 1998 the World Bank experienced unprecedented growth in its loan commitments and disbursements, prompted primarily by the East Asian crisis. With the crisis extending to other parts of the world, this trend in lending growth has continued in fiscal 1999. World Bank lending had been on a declining trend from fiscal 1995 to fiscal 1997, but loans approved during fiscal 1998 were \$21 billion (including \$6 billion to Indonesia, Korea, and Thailand), up from \$14 billion in fiscal 1996 and fiscal 1997. With the World Bank's lending to other countries largely unaffected by the increase in lending to the countries most influenced by the recent global financial crisis, net loan disbursements increased from less than \$2 billion in fiscal 1997 to \$8 billion in fiscal 1998.

While the increase in demand for financing and deterioration in the credit quality of the loan portfolio has put some pressure on its financial ratios, the World Bank has taken offsetting measures. In July 1998, it introduced the

following changes in its loan price structure to improve its income-generating capacity to help ensure financial soundness over the medium to long term: (a) the introduction of a 100-basis point, front-end fee on new loans, payable on loan effectiveness; and (b) an increase in the interest spread on new loans from 50 to 75 basis points. In addition, to improve income capacity over the short term, the World Bank reduced the annually determined interest waiver on existing loans for all interest periods beginning in fiscal 1999 from 25 to 5 basis points. During fiscal 1999, the World Bank has also introduced the SSALs, which carry high lending spreads and shorter maturities in order to help manage the incremental risks represented by such extraordinary disbursements. While the World Bank is financially strong and has recently had its AAA rating confirmed by the rating agencies, management has commissioned a review of its capital adequacy by a panel of four international experts. The results of the study, which looks at the medium-term picture, will be considered later in FY1999.

involved in coordinating efforts between debtors and creditors to reschedule debt.

The IMF has for some time taken on some aspects of the lender of last resort function in the international context, by virtue of its mandate to conduct surveillance and promote international monetary cooperation and exchange stability (Obstfeld 1998). However, the IMF lacks some of the powers that a central bank enjoys in the domestic economy, particularly the ability to print any amount of currency that is required to support illiquid debtors. The IMF is essentially a credit union on which members can draw, at their request, and according to their participation.¹⁷ The IMF has shown considerable flexibility during the financial crisis to adapt its role and to perform, to the extent feasible, as a lender of last resort by organizing international rescue packages, making available its own resources, and designing stabilization measures to restore confidence in the affected countries and limit contagion.

The World Bank. The World Bank has responded to the financial crisis with assistance to strengthen policy regimes and financial support. While the World Bank is not intended to act as a lender of last resort and is not primarily designed

to fight crises, its participation has been required because of the important structural origins of the crisis and the enormous impact the crisis has had on poverty. The World Bank's policy support has included a number of areas, with particular focus on helping the Asian countries to address problems in the financial and corporate sectors, and to reduce the impact on the poor. In fiscal 1998 the World Bank pledged \$16 billion in Indonesia, Korea, and Thailand, to be approved over the next three to five years. Loans approved in the period July 1997 to December 1998 totaled almost \$8 billion. Like the IMF, the World Bank has modified its traditional lending instruments and introduced the SSAL (see box 5.5). So far, there is no indication that the World Bank's special adjustment lending has limited the resources available for other borrowers. The World Bank remains well within its statutory lending limit and other prudential ratios (see box 5.6).

Notes

1. Sovereign debt restructuring in other countries during 1998 is covered in appendix 3. One development that will have important implications for future debt reschedul-

ings is the agreement by Pakistan with Paris Club creditors in January 1999, which marks the first time that a debtor will be expected to seek restructuring of bond debt under the Paris Club's comparable treatment clause.

2. The huge losses suffered by foreign creditors are discussed in chapter 2.

3. It was signed in March 1998 with 134 creditor banks and 32 countries.

4. *USA Today*, April 8, 1998, p. 1B.

5. Joint statement of the Indonesian Bank Steering Committee and representatives from the Republic of Indonesia, June 4, 1998.

6. Before the IMF standby agreement of August 1997, the commercial banks gave assurances that they would maintain their credit lines.

7. See IMF 1998c.

8. "Debt-rescheduling deal." *The Jakarta Post*, June 6, 1998.

9. That is, the maximum cumulative access, 300 percent of quota, plus an additional \$10 billion under the "exceptional circumstances" provision.

10. The Miyazawa Initiative aims to help countries restructure corporate debt, reform financial systems, strengthen the social safety net, increase employment, and ease businesses' financial constraints. Initial allocations of \$2.3 billion to Korea, \$1.9 billion to Thailand, \$1.5 billion to Malaysia, and \$1.4 billion to the Philippines have been announced.

11. Here we are discussing the implications of moral hazard for private creditors. It is unlikely that the expectation of receiving a rescue package will lead developing-country governments to assume excessive risks, given the severe economic and political impact of crises.

12. The IIF calculates potential losses as the percent change in the equity market index in dollars multiplied by market capitalization multiplied by the share of foreign participation.

13. Based on discussions with regulatory authorities.

14. The Executive Meeting of East Asia and Pacific Central Banks, a regional forum comprising central bank governors of 11 Asian countries, managed to put together more than \$10 billion in August 1997 for financing the Thailand assistance package.

15. This reflects the view that inadequate structural policies were at the heart of the financial crisis. Critics (Kapur 1998) have argued that the emphasis on structural policies went beyond the IMF's mandate.

16. Other multilateral institutions have introduced similar instruments. For example, in November 1998 the Inter-American Development Bank adopted a \$10 billion emergency loan facility to help Latin American countries in crisis. The new facility, similar to the World Bank SSAL, will give access to quick funding; loans will be disbursed in a shorter period than the current IDB's fast-disbursing loans (18 months); and will carry a higher interest rate of 400 basis points over LIBOR.

17. At the same time, the Articles of Agreement give the IMF authority to borrow in order to provide temporary

supplements to its quota resources. Currently it borrows under the GAB and NAB facilities (see box 5.5).

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