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This is the second special issue of Focus on Trade in the lead-up to this year's 2000 IMF and World Bank Annual Meetings in Prague. Three year's after the financial crisis Jacques-chai Chomthongdi assesses the IMF's legacy in Thailand, South Korea and Indonesia, Shalmali Guttal reviews the Southeast Asian experience of the World Bank-IMF Poverty Reduction Strategy Papers (PRSPs) and Chris Adams delves into the inner circle of the World Bank and the IMF.

The IMF's Asian legacy

by Jacques-chai Chomthongdi*

INTRODUCTION

“The IMF’s Asian Legacy” is a continuation of earlier work by Focus on the Global South on the causes and consequences of the Asian crisis and the role played by the multilateral institutions. “Taming the Tigers” released in March 1998, explored the motives and actions of one of the key players in the crisis – the International Monetary Fund. This paper assesses the consequences of IMF intervention over a two to three year period in three crisis-affected countries in the region.

The paper describes what actually happened in Thailand, Indonesia and South Korea under IMF tutelage. In each case, the report assesses the consequences of IMF-prescribed macroeconomic policy reform using leading economic indicators as a guide. It pays particular attention to the impact of the crisis and the policies subsequently adopted by national governments on the domestic economy and the role and capacity of the state. It analyses both progress to date and the consequences of IMF-led structural reforms in the financial, corporate and public sectors. Finally, it examines the enduring human impact both of the crisis and of IMF-led interventions.

The paper finds that even though the IMF prescribed similar therapy for the three countries, the outcomes have been very different in each case. There is in fact little evidence to support the IMF’s claim that the limited and in many ways fragile recovery underway in each of the three countries was in fact due to IMF intervention. To the contrary, there is a clear link between IMF intervention and the crisis in the social sector in each country, particularly increasing unemployment and impoverishment. IMF-prescribed financial sector bailouts have saddled all three countries with very high levels of public debt. Servicing this debt will severely limit the state’s capacity to mitigate the negative social impacts of the crisis for the foreseeable future, let alone advance on the modest gains made in human development in the pre-crisis period. More perniciously, debt servicing precludes any serious consideration of policy alternatives to the prevailing economic orthodoxy of privatization, liberalization and deregulation.

As Joseph Stiglitz, the former World Bank Chief Economist, clearly put it “IMF boosters suggest that the recession’s end is a testament to the effectiveness of the agency’s policies. Nonsense. Every recession eventually ends. All the IMF did was to make East Asia’s recessions deeper, longer and harder”.⁽¹⁾

In short, this paper demonstrates that despite nearly three years of IMF intervention, little has been done to address many of the problems which precipitated the crisis in the first place. Exchange rate volatility, capital flight, declining export competitiveness and weak financial sector governance continue to plague some if not all of the crisis affected countries. The critical changes that have occurred – at least from the perspective of the poor - are routinely ignored or downplayed by the IMF. These include increased unemployment, declining wages and conditions, increased public debt, cuts in health and education expenditure, increased foreign ownership and reduced national sovereignty in policy making as the IMF has expanded its role and influence in the region.

The paper finds that many of the negative outcomes could have been avoided if the recommendations proposed in Taming the Tigers more than two years ago had been adopted.

In particular, governments should urgently:

- ☞ Adopt mechanisms for the effective regulation of international capital flows, particularly short-term speculative capital
- ☞ Negotiate a “debt stand still” and facilitate orderly private sector debt workouts
- ☞ Halt the transfer of private sector debt to the public sector
- ☞ before further damage is done.

Thailand

After nearly three years of enthusiastic commitment by Thai governments to International Monetary Fund (IMF) prescribed economic reforms, the current government has repeatedly claimed that Thailand is well on the road to recovery. In June 2000, the Chuan Leekpai administration attempted to confirm these claims by pointing to economic indicators such as increasing GDP growth, rapid export growth, increasing government reserves, declining private debt, a reduction in non-performing loans (NPLs) and increasing private domestic consumption. This view was echoed by the Executive Board of the IMF, which in its final review of the status

of the rescue package for Thailand, hailed the country's recovery from the financial crisis as "impressive".

In the words of Stanley Fischer, the IMF's First Deputy Managing Director: "indeed, the recovery has turned out to be impressive: output growth this year is set once again to exceed four per cent, exports are growing rapidly, the balance of payments position remains strong and inflation is well under control."⁽²⁾

These claims imply that the IMF-led reform program is the right medicine for the Thai economy and that nothing more is necessary than for the Thai people to swallow the rest of it. Nonetheless, there are a lot of people, not only academics and activists, but also a fast growing number of ordinary Thais, who challenge these claims.

As the former Chief Economist at the World Bank from 1996 until November 1999 put it "austerity, the Fund's leader said, would restore confidence in the Thai economy...even as evidence of policy failure mounted, the IMF barely blinked, delivering the same medicine to each ailing nation that showed up on its door step."⁽³⁾

A narrow focus on a limited number of economic indicators such as those cited by both the IMF and the Thai government invariably conceals more than they reveal. The impact of the crisis on different social groups, the extent of the recovery and the consequences of IMF intervention need to be examined from a much more critical perspective, one informed particularly by the experience of the poor. How for example, have funds been found to recapitalise the banking system? What have been the consequences of privatisation and further deregulation of the financial sector? What has happened to domestic businesses, particularly small to medium sized enterprises? What has happened to public debt in the crisis affected countries? What has happened to government investment in health, education and environmental management? What has happened to school retention rates and the health status of the poor as a result? What has happened to employment rates, wages and conditions? What has happened to inequality?

The IMF stabilisation and structural adjustment program in Thailand started in August 1997 when the IMF Executive Board approved a US\$ 4 billion loan for Thailand as part of an overall US\$ 17.2 billion bailout package. In return, the Thai Government agreed to implement stabilisation measures and undertake structural reform of the financial sector. The main components of the stabilisation package were tight monetary policy to stabilise exchange rates, strict limits to government spending and further economic liberalisation to improve the balance of payments. Financial sector reform included the closure of non-viable financial institutions, government intervention in the weakest banks and recapitalisation of the banking system. ⁽⁴⁾

Under the IMF program, the high cost of financial sector restructuring was to be met through the imposition of harsh fiscal measures including a reduction in public spending and an increase in the VAT tax rate from 7 per cent to 10 per cent. In addition, the IMF insisted on the privatisation of public enterprises in most sectors. These changes were designed to deliver a public sector surplus of 1 per cent of GDP in the 1997/1998 fiscal year. In the long run, these structural adjustments were designed to "deepen the role of the private sector in the Thai economy, and reinforce its outward orientation". ⁽⁵⁾

Once the IMF was in charge, interest rates were increased dramatically to help stabilise the exchange rate and to restore confidence in domestic financial assets. The principal aim of interest rate policy was to attract foreign capital. However, net capital movement went from a surplus of US\$ 19.5 billion in 1996 to a deficit of US\$ 9.1 billion in 1997 and an even larger deficit of US\$ 9.5 billion in 1998. Not only did this policy fail to attract or retain foreign capital, it also had a very negative impact on the domestic economy by dramatically increasing costs for domestic business. This had a particularly severe impact on small to medium sized enterprises (SMEs). As a result, up to 1,000 businesses closed per month in 1998, leading to a sharp increase in unemployment and a decline in private consumption. ⁽⁶⁾ The 1998 Private Consumption Index fell to minus 3.7 per cent. The reduction in public expenditure and the rise in the VAT rate further suppressed domestic private demand.

The IMF already knew that "domestically, there [was] pronounced weakness in private consumption and investment demand, and continued liquidity shortage"⁽⁷⁾ (LOI, 26.05.98) but did nothing to change its deflationary policy stance. The IMF only relented when large revenue shortfalls, particularly from corporate income tax and from state enterprises, coupled with the higher than anticipated cost of financial sector restructuring, forced it to allow the public sector deficit to increase to 2.5 per cent and later to 5 per cent. Nonetheless, tight monetary policy was maintained for a full eighteen months after the crisis. The IMF had turned a crisis in the financial sector into a full-blown economic recession.

Financial sector reform was seen as the cornerstone of the IMF economic program. Under IMF guidance, the government nationalised 6 banks and 12 finance companies and closed 56 non-viable finance companies. The remaining financial institutions that were unable to raise capital in the market place were offered up to B 300 million in state funds for recapitalisation. To date, the cost of financial restructuring has been borne by the Financial Institution Development Fund (FIDF).

In both the fourth and fifth Letters of Intent (LOI) with the IMF, the government has confirmed that it will take full financial responsibility for the losses of the FIDF by converting FIDF debt into government debt. This process has already begun with the government issuing bonds to the value of B 500 billion in the 1998/99 fiscal year. Interest on these bonds will be paid from the fiscal budget while repayments of principal will be met from the anticipated proceeds of state enterprise privatisation. ⁽⁸⁾ In effect, private sector debts, often due to impudent lending, have been transferred to the public sector and hence to the taxpayer.

The auction of assets seized from the 56 failed finance companies by the Financial Restructuring Authority (FRA) has been a failure. At the first auction, assets worth B 31.757 billion were sold to four bidders for a total of only B 11.66 billion, just 37 per cent of their book value. The large size of the bid lots discouraged local participation and favoured powerful foreign bidders that were able to purchase Thai assets at fire-sale prices.

By the end of 1998, it was obvious that the IMF program was pulling the Thai economy deeper into the recession. The IMF's stringent restructuring measures, which even if they had helped restore the stability of the exchange rate, had wrought havoc on the domestic economy. Private investment was down by 45.8 percent from 1997. Export growth in US\$ terms had fallen to minus 6.4 percent. The current account stayed in surplus but only because of a sharp decrease in domestic demand and a 35.5 per cent contraction in the value of imports in US\$ terms. Non-performing loans in the banking sector had jumped as corporate borrowers were squeezed by higher debt-servicing costs. Although both commercial banks and finance firms were under significant pressure to raise new capital to help cope with declining asset quality and higher provisioning requirements, the process has been very slow.

During the period of the seventh LOI, more than 21 months after the crisis started, the government finally began to implement measures to stimulate the economy. These included tax reductions and the injection of B 53 billion from the "Miyazawa Initiative" into the economy. ⁽⁹⁾ The exchange rate had stabilised at around 37 to 39 baht to the US dollar so domestic interest rates were brought down to around pre-crisis levels. In a continuing attempt to attract foreign investment, the government converted the Alien Business Law into a more liberal Foreign Investment Law and amended related legislation to liberalise ownership of land and buildings.

In response, GDP grew by 0.2 percent in the second quarter of 1999 and by 4.2 percent for the whole year. Exports rose by 7.4 percent and inflation dropped to 0.4 percent. These positive trends have continued into 2000. GDP grew by 5.2 per cent in the first quarter of 2000 and GDP growth is expected to average not less than 4 percent for the whole year. Exports grew by 30.4 percent in US\$ terms in the first quarter year-on-year. Private sector debt had fallen to US\$ 35.4 billion by the end of March 2000, down from US\$ 54.6 billion at the end of 1998. Private consumption expanded by 3.5 percent in 1999 and continued to expand by 2.7 percent in the first quarter of 2000. International reserves increased from US\$ 29.5 billion at the end of 1998 to US\$ 32.2 billion at the end of March 2000.

The crucial factor driving growth in 1999 was domestic demand, reflecting an expansion in both private and public expenditure. Despite the improvement in export performance, net exports recorded a smaller surplus than in the previous year because of a surge in imports. The growth in exports was due to a competitive exchange rate, low real wages that had fallen below pre-crisis levels, the recovery of the regional economy and the continued rapid growth of the US economy which is one of Thailand's biggest export markets. Any slowdown in the US will therefore pose a major risk to the Thai economy because the promised productivity improvements have not eventuated and nor has the Thai economy adopted a more diversified and sustainable export structure.

The main objective of the IMF-led program was to bring back foreign capital. In this regard, it has been a total failure. The 1999 capital account registered a deficit of more than US\$ 6.0 billion. Whilst smaller than the deficit in 1998, this was only due to a US\$ 6.8 billion surplus on the public sector capital account which resulted from the disbursement of loans under the Miyazawa Plan and the IMF package.

In the banking sector, non-performing loans decreased from 47.03 percent to 36.47 percent between March 1999 and March 2000. However, commercial bank credit declined by 2.8 per cent overall in 1999.

Whilst international reserves have increased and private debt has declined, public debt has increased dramatically. On the eve of the crisis, public debt was B 720 billion or 15.7 percent of GDP; by the end of April 2000, it had jumped to B 2613 billion or 51.9 percent of GDP. If the losses of the FIDF and debt of the Bank of Thailand (BoT) are included, then this figure increases to around B 3500 billion. The proportion of foreign debt has increased dramatically in the past three years due to government borrowings to fund reform and stimulus programs. While the total cost of financial restructuring has yet to be determined, it is obvious that debt servicing will take an increasingly higher share of the budget in years to come. If financial sector losses total B 1.2 trillion, as claimed by BoT, then total debt service costs will reach 19.2 percent of the fiscal budget by 2005. ⁽¹⁰⁾ Since more than 70 percent of the budget is for routine expenditures such as the maintenance of buildings and payment of salaries, the increasing cost of debt servicing will have a severe impact on both the country's economic and social development in the long term.

Domestic demand grew in both 1999 and the first half of 2000, this in marked contrast to a contraction of 23.9 percent in 1998. Demand grew much more strongly in the private sector than in the public sector. This was largely due to an increase in consumption by well-off groups who had reduced or withheld spending earlier in the crisis. Government measures to reduce interest rates, income taxes and the VAT rate prompted this increased consumption. However, people on lower salaries could not take advantage of these changes and continued to rely on accumulated savings. Any sustained improvement in private sector demand will require an increase in incomes. In any case, these measures do not bring any benefit to the poor who do not pay income tax and do not have accumulated savings.

As noted previously, financial sector restructuring is in part dependent on the rapid privatisation of state-owned enterprises (SOEs). The Third LOI with the IMF went as far as to identify and set a time frame for the privatisation of specific SOEs. For example, Thai National Airways and the Telephone Organisation of Thailand, two of the most profitable SOEs, were to have been privatised by 1998 and 1999 respectively. However, none of the SOEs had been privatised by September 2000. This was not only because of opposition from elite groups such as politicians and high ranking bureaucrats who benefit from government ownership of enterprises. There has also been growing opposition in Thai society to the sale of public assets, as can be seen in the case of Bangchak Petroleum and the Electricity Generating Authority of Thailand (EGAT). The stalled privatisation process shows how little the IMF understands the political economy of Thailand.

Progress with financial sector reform has also stalled. Few, if any steps have been taken to improve governance and efficiency. In effect, the IMF and the government have rescued rather than reformed the sector, at huge cost to the Thai taxpayer.

According to the IMF, Thailand "has impressively recovered" from the financial crisis. This recovery has occurred despite the failure of financial sector reform and the dearth of new foreign investment, two of the "essential pre-conditions" of an IMF-led recovery. Given this, it is fair to ask, "does Thailand need the IMF program at all?"

Social impact in Thailand

The IMF-led program in Thailand increased the negative impact of the economic crisis on the poor. Tight monetary policies led to a deep recession in the real economy and resulted in large increases in unemployment. The cuts in public expenditure required by the IMF further diminished the government's already limited ability to mitigate the social impacts of the crisis.

In response, the government borrowed US\$ 300 million from the World Bank for a "social investment project"; US\$ 500 million from the Asian Development Bank (ADB) for a "social sector program loan" and US\$ 1,450 million from the Miyazawa Plan for three programs: i) employment schemes; ii) restructuring of the agricultural sector; and iii) industrial credit. There were some immediate benefits from these programs. For example, jobs created through the Miyazawa Plan helped to reduce the number of unemployed. However, funding for these positions will end in September 2000. In addition, many of the public resources did not reach those who needed them the most.

Unemployment rose from 1.5 per cent in 1997 to 4.4 per cent in 1999 before falling slightly to 4.3 percent in 2000 (February round). As noted above, the 1999 and 2000 figures were influenced by the Miyazawa funded job creation scheme which is due to end in September 2000. As a result, the unemployment rate is likely to rise further in the latter part of 2000. Despite a surge in the GDP growth rate from minus 10.2 percent in 1998 to 4.2 percent in 1999, the unemployment rate has increased and will remain high in 2000.

For those still in employment, the nominal wage rate for private employees increased by only 6 percent per annum during the period 1995-1998, almost half the 11.7 percent per annum increases received during the 1992-1995 period. ⁽¹¹⁾ Minimum wage rates for low-income groups have been frozen since January 1998 in all areas. According to official figures, more than 50,000 workers were laid off in 1998. This figure only includes the unemployed who requested job placements from state authorities. Many of the laid-off workers did not receive proper compensation from their employers. In 1998 alone, laid-off workers lodged complaints with the government claiming about B 24 billion in severance payments from their employers, an increase of 22 percent from 1997. ⁽¹²⁾ Some of those laid off were re-employed in the formal sector but most became self-employed, home-based workers taking orders from factories or shops on a piece work basis. The increasing numbers of workers in the informal sector are not protected by law, do not receive welfare benefits and usually have a much lower income.

Since the crisis began, the number of people living under the poverty line has increased by at least 1.1 million and the percentage of Thailand's population living under the poverty line has increased from 11.4% in 1996 to 12.9% in 1998. The 1998 figure clearly understates the current extent of poverty because many people were able to avoid impoverishment by drawing on their savings or other traditional safety net measures during 1998 and 1999. Prices of agricultural outputs were also relatively high in 1998 but prices dropped sharply in 1999 and 2000, concomitant with a sharp increase in the cost of agricultural inputs. As a result, the number and proportion of poor people is expected to have increased significantly in 1999 and 2000.

Inequality has also jumped in Thailand as a result of the crisis, with the Gini index increasing from 0.477 in 1996 to 0.481 in 1998. An ADB regional technical assistance study has shown that the crisis has had the greatest negative impact on low-income and middle income groups. Women-headed households have been particularly badly affected because female incomes are, on average, 26 percent lower than for men and 54 percent of the unemployed are women. This clearly shows that the increase in private sector demand, which had fuelled growth in 1999 and 2000, is due largely to increased consumption by upper income groups i.e. those who have suffered least from the recession. It is these groups, not the poor, which have been the principal beneficiaries of the IMF rescue programs to date.

Increasing inequality in incomes has been compounded by cuts in government services. Under the IMF program, the Ministry of Public Health (MOPH) budget was severely cut from B 68.93 billion in 1997 to B 61.69 billion in 1999, a reduction of 17.3 percent. The 2000 budget is lower than it was in 1996. Cuts in public health funding will have an inequitable impact on the health status of low-income groups who rely almost exclusively on publicly funded services compared to the well off who are able to access private sector health care. The crisis and the cuts to health care funding have had a particularly negative impact on children's' health. The prevalence of underweight schoolchildren increased from 7.9 percent in 1996 to 11.8 and 12.3 percent in 1998 and 1999 respectively. The prevalence of low birth weight new-borns also rose from 8.1 percent in 1995 to 8.5 and 8.9 percent in 1998 and 1999 respectively. ⁽¹³⁾

Education budgets have also been cut as a result of the IMF austerity program. The education budget fell to around B 202 billion in 1997, down from B 214 billion in 1996, a drop of around 5.7 percent. The 1998 education budget increased slightly to B 207 billion but this was still lower than pre-crisis levels. School retention rates have fallen significantly since the onset of the crisis. The total number of children who dropped out of school from all levels during school year 1998/1999 was estimated at 676,221, an increase of 129,330 from the previous year (SY 1997/98) which in turn was more than 40,000 more than SY 1996/97. ⁽¹⁴⁾

Spending on environmental protection had been increasing each year in the 1990s up until the onset of the crisis in mid 1997. The environmental protection budget for fiscal year 1997/1998 was originally set at B 13.6 billion but it was subsequently reduced to B 11.5 billion because of the austerity program. It was cut again to B 9.2 billion and B 6.9 billion in 1998 and 1999 respectively. After the crisis broke, the emphasis on sustainable development gave way to an emphasis on growth that will inevitably lead to environmental devastation. For example, prior to the economic crisis, the government spent one baht on marine conservation for every three baht it spent on aquaculture promotion. This ratio has been reduced to one baht for every five. Moreover, only B 1.2 billion has been allocated to the promotion of agricultural self-sufficiency whilst B 13.1 billion has been set aside for export-orientated agriculture. ⁽¹⁵⁾ These policies will magnify the negative impact of the economic crisis on the environment. Already there are reports of soil degradation due to agricultural intensification in agro-industrial zones on the central plains.

INDONESIA

Both the implementation and the outcomes of IMF-prescribed macroeconomic policy in Indonesia have been

hailed as success story, both by the IMF itself and other supporters of neo-liberalism. The IMF announced in early 1999 that “Policy implementation has continued to be satisfactory since the last review was completed in December 1998, and the major macroeconomic targets under the program for 1998/1999 have been met”.⁽¹⁶⁾ The World Bank joined in the chorus, arguing that the stability shown by key economic indicators was the result of the government’s sustained commitment to conservative monetary policies.⁽¹⁷⁾ Then, at the IMF’s first review of Indonesia’s performance under the three-year, US\$ 5 billion Extended Fund Facility, Stanley Fischer stated “Executive Directors welcomed Indonesia’s recent progress in implementing fiscal and structural reform measures. The key macroeconomic objectives for 2000 set out in the original program remain within reach. Prices are stable...[and] real GDP growth has become significantly positive”.⁽¹⁸⁾

Official positions on the Indonesian recovery vary however. For example, the Asian Development Bank (ADB) went further than both the WB and the IMF in its own review of the Indonesian recovery, stating that “macroeconomic stability not only supported the economic recovery and reduced poverty, but also improved market sentiment towards Indonesia”.⁽¹⁹⁾ In contrast, the IMF believes that market sentiment has deteriorated.⁽²⁰⁾ It blames this on the government for inconsistent implementation of the structural reform program. Despite continuing pressure from the IMF and its sister organisations, only limited progress has in fact been made with structural reform to date. These competing interpretations, made at the same time and using the same information, reflect the different perspectives and political objectives of the two institutions.

As with Thailand, the claim that Indonesia is well on the way to an IMF-led recovery requires critical re-examination, particularly in relation to the social consequences of IMF policies, progress with structural reforms and the impact of the overall reform program on the Indonesian economy.

The IMF prescribed its now familiar tight macro-economic formula when it came to Indonesia: i.e. strict monetary policy to stabilise the exchange rate and a tight fiscal stance to facilitate external adjustment and provide at least some of the resources necessary for financial sector reform.

Interest rates were quickly increased in order to stabilise the rupiah. However, due to the negative impact of high interest rates on domestic businesses, the government lowered interest rates again and tried to adopt a more interventionist approach. The IMF, however, forced the government to abandon all such measures and return to a policy of high interest rates. As a result, the Bank Indonesia (BI) Certificate annual interest rate soared from around 10 percent in June 1997 to a peak of 70 percent in August 1998. The impact of high interest rates on the exchange rate was less than clear cut however.

Despite high interest rates, the rupiah depreciated dramatically from 2,599 to the U.S. dollar in July 1997 to 11,075 to the dollar in August 1998. Some observers argued that political risks, rather than purely economic factors, were influencing the exchange rate. This is probably partially correct because the rupiah plummeted to its lowest level at nearly the same time as wide spread social unrest in Indonesia led to the resignation of President Suharto on May 21, 1998. However, the IMF-prescribed macroeconomic policy was ineffective in retaining existing or attracting new foreign capital. Net private capital outflows in 1998 reached US\$13.8 billion compared to US\$0.4 billion in 1997.

Not only did the high interest rates fail to influence the exchange rate to any significant degree, tight monetary policy painfully squeezed the domestic economy. The real economy contracted continuously during this period. Each week brought additional reports of firms cutting back or ceasing operation, as inputs became unavailable and demand slumped. Construction sites stood idle and factories empty. The official unemployment rate increased to 5.5 percent in August 1998 from 4.7 in August 1997.

Moreover, despite the Indonesian economy being in deep recession, the IMF and the Indonesian government maintained a deflationary fiscal stance. The fiscal deficit for 1998/1999 (April-March) was much lower than planned. Rather than the budgeted 8.5 percent of GDP, the actual deficit was only 2.2 percent of GDP. As a result, far from providing a fiscal stimulus to resuscitate domestic demand, the budget had a deflationary effect. Even the smaller than planned fiscal deficit was the result of drastic reduction in government revenue rather than an increase in spending linked to stimulus measures.

Given the decline in domestic demand, strong export performance was seen as being essential to Indonesia’s recovery. The depreciation of the rupiah should have raised export competitiveness. Indeed, many businesses re-orientated their production to export markets in early 1998. However, exporting firms experienced difficulty getting trade credits which created shortages in key imported inputs. This, together with the slowdown in traditional Asian markets, resulted in a 10.5% fall in the US\$ value of total exports in 1998. The only reason that the current account registered a US\$ 4.1 billion surplus in 1998 was the drastic 30.9 percent drop in the value of imports in US\$ terms.

Interest rates began to decline from the third quarter of 1998, reaching pre-crisis levels in late 1999 and have remained relatively stable in 2000. The exchange rate followed a similar pattern, with the rupiah appreciating against the dollar from the third quarter of 1998, albeit with a continuing high degree of volatility. For example, despite this general upward trend, the rupiah depreciated by 18 percent between July and September 1999 in the lead up to the presidential election. Following the election, it appreciated again to below 7000 per U.S. dollar. The standard deviation of the exchange rate averaged 5 percent per week in 1999, and even by May 2000 it was still fluctuating by as much as 5 percent per day. This pattern of exchange rate vibration is normally associated with currency speculation. The unstable exchange rate still poses a lot of difficulties in business management. The IMF argues that macroeconomic stability has been maintained, despite the hiccups in the exchange rate, largely because of positive trends in both inflation and GDP. The inflation rate, which started to decline in the third quarter of 1998, has been relatively low since September 1999. GDP, following a fall of 13 percent in 1998, rose by 0.2 percent in 1999 and is expected to increase to around 3 percent in 2000.

Export growth also appears to have resumed in the first quarter of 2000 with the total value of exports reaching almost 100 percent of pre-crisis levels. However, this is largely due to higher world oil prices. There is no evidence to suggest that exporters have taken advantage of the depreciation of the rupiah to improve productivity. Instead, Bank Indonesia continues to support the gradual weakening of the rupiah in order to maintain export competitiveness.

Imports are also increasing although those of capital goods, particularly machinery and other equipment vital for manufacturing, are still at only 30 percent of their 1997 level. Whilst this was to be expected during the deep recession when much of Indonesia's manufacturing capacity was under-utilised, it now suggests that modernisation plans are still being postponed, despite the increase in the growth rate and the much trumpeted recovery.

Private capital inflows in 1999 still registered minus 7.4 percent, although this was a substantial improvement on 1998 figures. FDI has continued to fall, declining from US\$ 34 billion in 1997 to less than US\$ 14 billion in 1998 and US\$ 10.89 billion in 1999.

The international financial institutions argue that the continued fall in FDI is mainly due to corruption, collusion and nepotism amongst government officers and business players. No doubt such practices do worsen the economic situation. However, it is illogical to attribute the continuing fall in FDI to practices which were much more prevalent in the decades preceding the crisis when the Indonesian economy was buoyed by high and sustained inflows of foreign capital.

A more likely reason for the fall is continued political instability. As recently as mid-2000, the U.S. government was still warning that: "American citizens travelling to Indonesia should exercise caution. Political activity, demonstrations, and localised hooliganism in Jakarta have increase recently and are expected to continue" and in some provinces "Violence has targeted American companies with growing frequency".⁽²¹⁾ This information has probably increased nervousness among foreign investors.

Despite its economic and political difficulties, Indonesia has maintained a relatively open foreign investment regime and has even taken some concrete steps to further streamline its investment application and permit process in order to attract new foreign investors. Investment approval values are showing modest signs of recovery in 2000. According to recent statistics covering the period January 1 2000 through June 15 2000, FDI approvals are up 16.7 percent on the same period in 1999, rising from US\$ 1.8 billion to US\$ 2.1 billion.

The main foci of the structural reform program have been public sector reform, corporate sector restructuring and financial sector restructuring. Since the start of the program in 1997, the IMF has pushed the Indonesian government to further open its economy through the elimination of monopolies and cartels, reform of the wood sector, privatisation of state-owned enterprises (SOEs), and a dramatic downsizing of the National Logistics Agency (BULOG). Whilst monopolies and cartels have been eliminated, including those for cloves, paper, and plywood, the privatisation process has moved at a much slower pace. Whilst the IMF may have achieved its unstated political objectives, it is not clear whether there is a real economic benefit to the country, or the environmental cost of unregulated natural resources exploitation has increased.

Little progress has been made to date with corporate debt restructuring in Indonesia. In late 1998, corporate indebtedness was estimated at US\$ 118 billion. In November 1998, the government launched the Jakarta Initiative Task Force (JITF) which aims to provide a framework for and facilitate voluntary out-of-court debt negotiations. Since then, at least 330 corporations holding more than US\$ 23 billion in debt, have registered with

the JITF. The results, however, have been very disappointing. Less than US\$ 1 billion in debt held by only 6 companies has been restructured to date. A commercial court focussing on bankruptcy cases has also been established but as of June 2000, little has been done to address Indonesia's US\$ 67 billion offshore corporate debt.

Despite a decade of ostensibly successful WB/IMF promoted financial liberalisation, the deepening crisis drew the Indonesian government into a protracted and costly rescue of the financial sector. At least 70 percent of bank loans were estimated to be non-performing in the wake of the financial crisis which hit Indonesia in 1997 and the banking system's total credit fell by almost 50 percent during 1999. At first, Bank Indonesia provided substantial liquidity credits to affected banks (more than Rp 140 trillion as of June 1998). However, as the extent of the problems in the banking sector became apparent, the government was forced to take more drastic steps and, under the supervision of the IMF and the World Bank, established the Indonesian Bank Restructuring Agency (IBRA). To date, IBRA has overseen the closure of more than 60 private banks, the government take-over of 11 others, and the recapitalisation of a further 7 (with government providing up to 80 percent of the required capital). The total number of banks has declined from 238 pre-crisis to 162 today. As of April 2000, IBRA held almost US\$52 billion in assets, including a large number of NPLs. The Indonesian government has also issued around US\$ 65 billion in bonds to support deposit guarantees and the recapitalisation of the surviving banks. The total cost of the recapitalisation program is likely to be in the vicinity of US\$ 90 billion. ⁽²²⁾ Much of this will be met through increasing public debt.

The economic crisis and more specifically the IMF-prescribed financial restructuring program have left Indonesia deeply in debt. Total public debt has risen sharply in the past three years. At end-June 1997, public debt totaled US\$ 51 billion, a manageable 23 percent of GDP. However, debt levels jumped to 60 percent of GDP by the end of 1998 and to 93 percent by April 2000 when total public debt reached US\$152 billion. This dramatic increase was due primarily to the issuance of bank restructuring bonds (US\$ 85 billion, equivalent to about 52 percent of GDP). Debt servicing now accounts for 27 percent of FY2000 expenditures, eclipsing all development expenditure which takes up 21 percent of the budget. The costs of debt servicing will increase in the future, requiring further constraints on expenditure and increased revenue mobilisation. This debt service burden will cripple the capacity of the Indonesia government to mitigate the impact of the crisis on vulnerable groups for the foreseeable future.

Most of the costs arising from the failure of IMF/WB-supported liberalisation of Indonesia's financial market and the malfunction of the banking system have been transferred from private financial institutions – whether domestic or foreign - to the Indonesian public. This apportioning of costs between the public and private sector is highly inequitable and is now impeding long-term development. Cutting back public spending and increasing taxes in order to meet debt service obligations reduces household purchasing power which is a crucial factor in sustainable economic development. This is acknowledged in a recent World Bank report which stated that the recent increase in GDP “has primarily been driven by increased household consumption”. ⁽²³⁾

Social impact in Indonesia

As the Indonesia economy fell deep into recession, the number of unemployed and underemployed people surged. The total labour force is made up of about 95 million people, 40% of whom are women. Before the crisis began in 1997, the Indonesian government estimated “open” unemployment to be roughly 5 percent. In August 1999, the Labour Force Survey concluded that 6.03 million or 6.4 percent of the labour force were unemployed. However, “open” unemployment is narrowly defined as a person who is working less than one hour a week. If the high level of underemployment is taken into account, then 36 million persons or 38 percent of the labour force were unemployed or underemployed in March 2000. For this and other reasons, unions and non-governmental observers have criticised the official survey for understating real unemployment; these sources estimate that more than half of the labour force is in fact underemployed.

There has been a major shift in employment from the formal to the informal sector (the percentage of workers employed in the latter rose from 62.8 percent to 65.4 percent between 1997 and 1998); and from the modern to the agricultural sector (workers employed in the agriculture rose from 40.8 percent in 1997 to 45 percent of the labour force in August 1998). ⁽²⁴⁾ The associated decline in real wages has had a significant impact on family welfare.

Faced with a sharp increase in the number of people who had fallen below the poverty line, the Indonesia government has sought to support the poor via three main measures: 1) temporary income transfers, through rice distribution to the poor at subsidised prices; 2) income support, through employment creation and by support for SMEs and co-operatives; and 3) preserving access to critical social services, particularly education

and health. Nevertheless, most of the government efforts to mitigate the impact on the poor have been limited by severe budget constraints.

Before the crisis hit in 1997, the World Bank estimated that around 10.1 percent of the population lived below the poverty line. A government survey indicated that this had jumped to 20.3 percent by 1999 i.e. an additional 21 million people had fallen below the poverty line in just two years. This still understated the extent of absolute poverty in Indonesia because the Indonesian government uses an extremely low poverty line of 55 U.S. cents a day for urban areas, and 40 U.S. cents a day for rural areas, compared to the WB standard poverty line of US\$ 1 per day. Many millions of people living just above the government-defined poverty line are in fact poor and highly vulnerable to external shocks.

Although urban areas have been hardest hit by the crisis, rural areas have also suffered. Rural inequality has increased and there has been a significant increase in the vulnerability of rural households, with some groups such as agricultural labourers who are net consumers suffering a very large drop in incomes. Agricultural wages have fallen by around 40 percent in real terms between 1997 and 1998.

Indonesia has been unable to maintain public spending on social services, particularly education and health, at constant real levels. The 1998/99 education budget was cut by 27.65 percent relative to 97/98. Whilst official figures on enrolments for 1999/00 indicate that primary enrolment rates are at pre-crisis levels, the lower secondary enrolment rate has dropped by around 2 percentage points. A study on the correlation between per capita expenditure and enrolment rates indicates that while overall enrolment levels have not declined, poorer families have had more difficulty in keeping their children in school.

Total public health spending fell by 8 percent in 1997/1998 and a further 12 percent in 1998/1999. The health sector has also been severely affected by a sharp rise in the prices of imported drugs, vaccines, contraceptives, and other medical supplies due to the depreciation of the rupiah. An official survey showed that health care utilisation declined quite dramatically in 1998: whilst 53 percent of those reporting an illness sought modern medical care in 1997, only 41 percent did so in 1998. Amongst those who did seek health care, fewer people went to public health facilities (the decline trend was also observed in private facilities). More people turned to self-treatment or traditional healers.

In relation to the environment, a generalised slowdown in production may have resulted in a reduction in pollution but this has probably been counteracted by reduced utilisation of costly pollution controls and less stringent enforcement of regulations. The exploitation of natural resources by both large businesses and by individuals has increased with the latter struggling to maintain household incomes at pre-crisis levels. For example, the rate of forest clearance for farm use has increased. It is widely accepted that illegal logging has increased significantly as a result of the crisis. A UK report shows that the illegal supply of logs from native forests is now about equal to the legal supply.⁽²⁵⁾ Furthermore, a case study in Lampung province has found that the rate of illegal logging had increased to the point where local supplies of timber have been exhausted.⁽²⁶⁾

SOUTH KOREA

The South Korean government and the IMF agreed on a rescue package worth US\$ 57 billion on December 3, 1997. As with Indonesia and Thailand, South Korea implemented IMF-prescribed tight macroeconomic policy and undertook far reaching structural reforms.

After the eighth review of the South Korea program, Stanley Fischer, First Deputy Managing Director, stated: "Directors commended the Korean authorities on the impressive recovery ... the rebound has been made possible by a combination of factors: supportive macroeconomic policies and ... a wide range of structural reforms that addressed the weakness that contributed to the 1997 crisis."⁽²⁷⁾

Fischer's claim that the "impressive" recovery was due to IMF-led macro-economic policy and structural reforms was designed to deflect increasing international and domestic criticism of IMF programs in South Korea and the region. Serious weaknesses are hidden behind the facade of a strong recovery, including problems arising from the IMF's own conditions. These are now undermining the sustainability of the South Korean recovery.

By the third week of December 1997, the Bank of Korea (BoK) had sharply raised short-term interest rates from pre-crisis levels of around 12 percent to over 30 percent, in an attempt to secure foreign currency liquidity and stabilise the exchange rate. Fiscal policy was tightened at the same time to cover the cost of financial sector restructuring and to support stabilisation. Higher and more retrogressive taxes were also imposed on the IMF's recommendation.⁽²⁸⁾

It was assumed that these changes would retain existing and attract new foreign capital into the Korean market. After only one month, the program had already fallen well short of IMF expectations. Foreign investment in bonds - which was expected to surge due to high interest rates - barely increased at all. Foreign financial institutions accelerated their retrieval of short-term credits, nearly driving the country to sovereign bankruptcy. As a result of this continuous outflow of foreign capital, the exchange rate fell dramatically to 2,000 won per U.S. dollar by the end of December 1997. It was only after the South Korean government extended a guarantee to cover most of the private sector's short-term debt that 96.5 percent of Korean commercial bank's debt was converted to medium and long-term loans. This provided the breathing room for Korean commercial banks to improve their foreign currency position.

In only a matter of months, the IMF shock therapy had transformed a financial crisis into an economic crisis. In a chain reaction, the credit crunch led to a dramatic increase in bankruptcies - both corporate and individual - and massive dismissals. For example, by February 1998, the number of bankruptcies had soared to more than three times the pre-crisis level. From the end of 1997 to the middle of 1998, an average of two to three thousand companies went bankrupt each month.

Surviving firms responded by slashing investment, reducing inventories and cutting labour costs. Consequently, the overall investment growth rate dropped from 4.3 percent in 1997 to minus 23.3 percent in 1998. The unemployment rate soared from 2.1 percent in the third quarter of 1997 to 8.6 percent in February 1999. In February 1998, the number of jobless exceeded one million for the first time.

As corporate bankruptcies increased and the economic recession deepened, the IMF gave the South Korean government permission to lower interest rates in May 1998. Since then, the government has been pursuing a low interest rate policy. The IMF also agreed to a fiscal deficit of 5 percent of GDP but only after a protracted series of readjustments. Initially, the IMF only accepted a deficit of 0.8 percent of the GDP, then as the recession continued, this was relaxed to 1.7 percent, 4.0 percent, and 5.0 percent in April, July and October respectively.

The key components of the structural reform program included corporate restructuring, financial sector restructuring, public sector restructuring and market liberalisation.

To accelerate corporate sector restructuring, all forms of mergers and acquisitions (M&As), including hostile take-overs, were liberalised in May 1998. Moreover, the IMF demanded the liquidation of cross-debt guarantees within a short period of time. The IMF argued that this previously common practice between affiliates belonging to the same conglomerate was a major cause of the banking sectors' huge losses because financial problems in one company could lead to the bankruptcy of the entire conglomerate. Nonetheless, the liquidation of cross-debt guarantees raised debt levels and depressed company investment, deepening an already severe recession.

On December 1998, the government and the top five chaebol reached an agreement on the implementation of the "big deal" program. This was originally intended to alleviate over-investment and hence over-competition between big companies, principally through business swaps. However, rather than engage in business swaps, companies consolidated their position through take-overs or mergers. As a result, the number of affiliated companies belonging to the five largest chaebol was significantly reduced from 262 in April 1997 to 177 in December 1999.

The restructuring of the financial sector has been driven by the government under the guidance of the IMF. The key components of the strategy were the closure of weak institutions and increased government support for surviving institutions. By the end of 1999, the number of commercial banks had declined from 27 to 17, and the number of employees had fallen by one-third.⁽²⁹⁾ In order to support the surviving institutions, the government established a "public fund" using W 64 trillion of taxpayer's money - W 32.5 trillion for purchasing NPLs and W 31.5 trillion for recapitalising financial institutions and deposit repayments. Many people dispute the reported success of financial sector restructuring in Korea. They argue that not only did the IMF strategy create "moral hazard" through the use of taxpayer funds to solve problems arising from the malfunction of the banking system and inappropriate financial sector liberalisation, they also believe that large amounts of public funds could have been saved through changes in macro-economic policy. This is because the excessively high interest rates and the bank's efforts to observe the Bank of International Settlements (BIS) capital adequacy ratio within a short period of time, both required by the IMF, drove health as well as insolvent companies into bankruptcy in the first half of 1998. This raised the volume of NPLs and the cost of recapitalisation of the banking sector. As a result, the South Korean government actually spent more than the W 64 trillion outlined in the initial plan.⁽³⁰⁾

The key components of the IMF-led public sector restructuring program were the downsizing of government bodies and privatisation. According to the plan, more than 80,000 government personnel were to lose their jobs over a three-year period, starting in February 1998. ⁽³¹⁾ In July 1998, the South Korean government announced that of the 108 state-owned enterprises (SOEs), 38 would be immediately privatised, 34 gradually privatised, 9 would be merged into others or liquidated and 21 would go through restructuring. As of November 1999, the government had sold SOE assets worth W 7.3 trillion and cut 32,005 of the 41,267 jobs targeted for elimination by the end of 2000. ⁽³²⁾ A large part of the funds raised from the sale of SOEs was used to finance financial sector restructuring.

In relation to trade, the South Korean government agreed to the elimination of import diversification regulations and trade-related subsidies (which had been one of the main factors behind South Korean economic success for the past thirty years) in accordance with the World Trade Organisation (WTO) schedule.

In May 1998, foreign equity ownership ceilings were eliminated and M&As by foreigners were fully deregulated as part of process of liberalisation of the capital market. In addition, foreigners are now able to invest - without any restrictions - in local bond and short-term money market instruments. All limits and restrictions on the acquisition of non-business related property for the personnel of foreign companies have been eliminated and the ceiling on the lease of public properties has been raised from 20 years to 30 years. The tax system was also made favourable to FDI. The term for tax incentives has been extended from eight to ten years. Furthermore, 41 business sectors which were previously closed to FDI have now been liberalised. Restrictions on FDI now only apply in a few very specific areas such as national security.

As a result, foreign direct investment increased significantly in 1999. From January to October, there were 1,591 cases of inbound FDI worth a total of US\$ 10,249 million. This was an 85.3 percent increase in the total amount of FDI in comparison with the same period in the previous year. By the end of 1999, FDI inflows had set an all time record, surpassing US\$ 15 billion. However, the benefits from hosting FDI are not automatic. Policies and regulations covering areas such as local content, technological upgrading and balance-of-payments stability are essential if countries are to benefit from FDI. As a result of rapid and far-reaching liberalisation, South Korea may no longer have the ability to bargain effectively with foreign investors.

The performance of the South Korean stock market has also improved spectacularly. It has attracted large foreign capital flows which pushed the share of foreign investment in the South Korean stock market from 13 percent to 21 percent in a one-year period ending in October 1999. This has significantly increased the influence of foreign investors in the stock market.

The inflow of foreign capital and the reorientation of macro-economic policy towards stimulating the domestic economy have played an important role in the so-called "spectacular economic rebound" of South Korea. In 1999, GDP grew by 10.2 percent compared to a contraction of 5.8 percent in 1998. Trade also grew strongly in 1999 because of the global economic recovery, the appreciation of the yen and the earthquakes in Taiwan. Exports grew by 8.6 percent in 1999, up from minus 2.8 percent in 1998. Imports also increased at the same time due to growing domestic demand, rising from minus 35.5 percent in 1998 to 28.4 percent in 1999. Despite this surge in imports, the current account still registered a surplus of US\$ 25.0 billion in 1999.

By the end of 1999, South Korean foreign reserves had surged to more than US\$ 74 billion, compared to only US\$ 3.9 billion two years earlier. At the same time, South Korea's total external liabilities had reduced by US\$ 22.8 billion. Whilst the external debt of private sector financial institutions has decreased, that of the public sector has increased dramatically. The ratio of public debt to GDP had increased from 12.0 percent in 1997 to 22.2 percent in 1999 whilst the ratio of total external debt to GDP remained at 35.0 percent. Although the unemployment rate has been declining since the first quarter of 1999, unemployment at the end of 1999 was still double the pre-crisis level, with more than one million people unemployed.

Problems with the restructuring of the corporate sector also began to emerge in the second half of 1999. For instance, only one third of the W 70 trillion which the Daewoo Group owes to domestic and foreign creditors is considered ultimately recoverable. ⁽³³⁾

South Korea had resisted the opening up of its stock and bond markets when it joined the OECD. However, these markets were fully opened as part of the IMF-led process of capital transaction liberalisation. Although these measures facilitated the entry of foreign capital into the market, they also increased the vulnerability of the South Korean economy.

Moreover, the IMF program has inflicted deep damage on domestic businesses, seriously impairing their contribution to the national economy both now and in the future. This has left South Korea heavily dependent on external factors, especially foreign capital. The flight of now uncontrollable and foot-loose transnational financial capital from South Korea could trigger another crisis in the future.

Social impact in South Korea

Soon after the crisis started, a new labour law that facilitates lay-offs was introduced by the South Korean government on the advice of the IMF. As a result, unemployment rose sharply. By February 1999, a record 1.78 million people were unemployed. In response, the South Korean government allocated W 10.07 trillion for unemployment counter-measures and a further W 9.24 trillion for employment measures in the 1999 budget. This included support for job preservation, general job creation, vocational training, and social care.

The unemployment rate began to decline in the second quarter of 1999. Despite this, the structure of employment has changed for the worse since the crisis began. For example, the number of employees who work more than 36 hours a week has declined since November 1997 and the proportion of employees who work less than 36 hours a week has increased from 9.3 percent in December 1997 to 14.5 percent in December 1999.⁽³⁴⁾ In addition, the number of people in permanent employment has been in decline since the crisis started whilst the number of people employed on a daily basis has increased rapidly.

The definition of an unemployed person used by the government masks the extent of unemployment in South Korea. The government defines as unemployed “a person who worked under one hour in a week with the intention to earn income”. This excludes the “discouraged” unemployed from the official statistics. If the discouraged unemployed were taken in to account then unemployment would jump to closer to four million in 1999. In October 1999, a South Korean trade union was the first organisation ever to attempt to sue the IMF for damages in response to the mass lay-offs caused by IMF policies.

Labour-management conflicts increased sharply after the economic crisis. The number of disputes in 1998 was 2.5 times greater than in 1997 and the number of workdays lost in 1998 as a result of the disputes was around three times that in 1997. The processes of the Tripartite Commission that was established by the government to resolve worker-management disputes are characterised by long delays and constraints on participation. As a result, some independent organisations and trade unions see the Commission as a powerless and hence meaningless body. Many believe that the Commission was designed primarily to transfer the cost of the economic crisis to workers.

From 1975 to 1995, high growth rates permitted a reduction in the poverty rate among urban households from 20.4 percent to 7.4 percent. However, in the first 12 months after the crisis, the number of people living under the absolute poverty line increased rapidly. The South Korean government admitted that “since the foreign exchange crisis struck Korea, Korea’s mid- and low-income earners have suffered more than any other class” and “the income gap between the rich and the poor has grown wider”.⁽³⁵⁾ In the space of just one year, from 1997 to 1998, the number of homeless people increased ten fold and the number of students taking temporary absence increased by 70 percent. According to a Statistics Administration report issued in November 1998, families in the lowest 20 percent income bracket earned 24.4 percent less than the previous year while families in the highest 20 percent income bracket earned 8.0 percent less.⁽³⁶⁾

The economic crisis has hurt the poor both by reducing incomes and increasing prices. Due to the depreciation of the won, the price of medical care has increased. This has occurred at a time when Koreans, especially the poor and unemployed, are least able to afford the high cost of health care. In September 1998, the national federation of medical insurance reported that 34 percent less people bought 20 percent less medicine than in the previous year.⁽³⁷⁾

According to a health official in the Labour Ministry, “the sharp increase of occupational stress is seen to cause more occupational diseases since the days of the IMF, because workers are more worried of job loss, their labour intensity has increased, and new competition-inducing mechanisms have been introduced”.⁽³⁸⁾ The suicide rate in 1998 was 59.4 percent higher than in 1997.

The recession induced reduction in both production and consumption has had a positive effect on the environment because of a reduction in pollution. Pollution released as a result of production processes is estimated to have fallen by 10 to 20 percent.⁽³⁹⁾ The increased cost of imported materials coupled with a decline in purchasing power has also encouraged recycling in various sectors. On the other hand, a fall in profits may cause business corporations to ignore environmental regulations and the government may choose not to

enforce pollution controls. The ratio of the Ministry of Environment's budget to total finance fell from 1.51 percent in 1997 to 1.38 percent and 1.36 percent in 1998 and 1999, respectively. In order to attract foreign investment the South Korean government, on the advice of the IMF, has abolished or weakened various regulations. For example the government has removed the Green Belt Regulation, reorganised National Parks and weakened the regulations protecting sources of drinking water.

Thus, the question remains: is it worth sacrificing so much in order to achieve the questionable benefits of externally-led economic growth?

CONCLUSION

The IMF has given practically the same set of medicines to all three crisis-affected countries. Thailand, Indonesia and South Korea have, however, implemented the IMF-prescribed macroeconomic policy and structural reforms to differing degrees and with far from identical outcomes.

Yet, the IMF claims that each is a success. There is little evidence of any correlation between the IMF programs and the purported recovery in each country. In South Korea, very high capital inflows may in fact overheat the economy. In Thailand, increasing domestic demand has boosted GDP growth but the external sector is still characterized by a high degree of volatility. GDP growth is once again positive in Indonesia but foreign investors are staying away and there are still no signs of a stable recovery. There are some similarities in outcomes in each country which can, however, be attributed to the IMF i.e. severe social impact and huge public debt.

IMF shock therapy - currency devaluation and increased interest rates - squeezed the domestic economy and transformed the financial crisis in each country into an economic and social crisis. High levels of business bankruptcy led to a sharp increase in unemployment and underemployment. In South Korea in particular, unemployment jumped to unprecedented levels in a very short period of time. In Indonesia and Thailand, increases in unemployment were accompanied by a major shift in employment from the formal to the informal sector, the latter characterized by low wages, poor job security and inadequate or non-existent welfare benefits and legal protection. Those who were lucky enough to keep their jobs typically experienced a drop in real wages.

More than 20 million people in the three countries dropped below the poverty line in the space of less than two years both as a result of the financial crisis and, more significantly, as a consequence of macroeconomic reform and structural adjustment.

The IMF transformed a financial crisis into an economic and social crisis not only by demanding tight macroeconomic policy but also by ensuring that the cost of financial sector restructuring was transferred from predominantly private institutions to the public purse. Private debt has become public debt. As a result, public debt has surged in each country, by: 10.2 per cent of GDP in South Korea, 36.2 per cent of GDP in Thailand and 70.0 per cent of GDP in Indonesia. Each is now struggling with debt servicing which in the case of Indonesia consumes a quarter of the fiscal budget. Not only does debt servicing diminish the countries already limited capacity to mitigate unemployment and other social problems, it also severely constrains policy choices. Countries are forced to both maintain and expand exports in order to generate hard currency receipts and to adhere to the prevailing economic orthodoxy which prescribes further liberalization, privatization and deregulation.

Public debt as percentage of GDP

Country	1997(pre-crisis)	April 2000
Thailand	15.7	51.9
Indonesia	23.0	93.0
South Korea	12.0	22.2 (end-1999)

The IMF recognized that public debt would increase but assumed that it could be quickly repaid through the privatization of state-owned enterprises (SOEs). This proved hopelessly unrealistic, particularly in Thailand and Indonesia.

Despite continuing high levels of NPLs, limited if any financial sector reform in Indonesia and Thailand and continuing low levels of investor confidence, the IMF continues to hail the recovery in each of the three countries. Financial sector reform has in fact achieved little more than increased foreign ownership and the effective transfer of some private debts to the public sector. If inefficiencies and weak governance in the

financial sector were, as the IMF claimed, at the epi-centre of the crisis, how then has recovery occurred despite the evident failure of financial sector reform?

South Korea, the darling of the IMF, has – in IMF terms - experienced a “spectacular rebound”, made possible by the huge inflows of foreign capital. Economists now fear overheating. Whilst GDP growth has jumped remarkably in only one year, South Korea is now heavily dependent on foreign capital and vulnerable to capital flight.

As a result of the inequitable distribution and unnecessarily high costs of stabilization and adjustment, the IMF has met growing resistance from both governments and civil society in each country. Calls for modest changes to IMF programs have been routinely ignored or incorporated only after protracted delays. More radical changes are now necessary. Crisis prevention and reduced vulnerability to external shocks in the future will depend on the introduction of capital controls, a debt stand still and de-linking of private and public debt.

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The End of Imagination: The World Bank, the International Monetary Fund and Poverty Reduction

by *Shalmali Guttal**

The latest policy product of the World Bank and International Monetary Fund (IMF) - the Poverty Reduction Strategy Papers (PRSP) – is unlikely to make a dent on either poverty or on the institutions as they are proving to be little more than hurriedly worked-over versions of standard World Bank-IMF policy papers.

Authority without Responsibility

In theory, the PRSPs are intended to be a set of papers prepared by country governments—although under the supervision of World Bank-IMF teams—that identify the causes of poverty, who the poor are, and strategies for overcoming poverty. In reality, most governments are likely to have little control over the prescriptions that emerge from these papers. Over 70 countries have been identified by the World Bank-IMF as qualifying for this new initiative, and all of them are required to develop PRSPs by 2001 in order to qualify for external assistance. Countries that urgently require World Bank-IMF credits or debt relief assistance can prepare an interim PRSP (IPRSP) for consideration at the World Bank-IMF meetings in September, 2000. All these papers feed into the PRGF (the old ESAF) and are a necessary precondition for any new loans and debt relief measures under the Enhanced HIPC (highly-indebted poor countries) Initiative.

The PRSPs have a leveraging role beyond debt relief and consequently, have grave implications for the economic sovereignty of low income, borrowing countries. Without an acceptable PRSP, a country can have little or no access to external assistance since the wider donor community will align their funding programmes and policies with the results of the PRSP. Also, it must be remembered that the majority of the major creditors and donors of the poorer countries are G7 members and practically own the Bretton Woods family. Without a PRSP that is accepted and approved by the Boards of the World Bank and IMF, a low-income borrowing country can be cut off from international aid, trade and finance.

Another side-effect of the PRGF framework is a further sidelining of UN agencies as key actors in national and international policy arenas. This sidelining was set in motion at least two decades ago, as the steady succession of World Bank and IMF structural adjustment programmes, structural adjustment lending, country assistance strategies and the ‘comprehensive development framework’ firmly paved the way towards globalisation, leaving the UN with little option or will to serve as anything other than a handmaiden of the G7 and its collection agencies. However, the positions taken by the UN at the recent Social Summit in Geneva show all too clearly that the UN cannot be relied upon to adequately represent the interests of less powerful or vulnerable nations, nor is it willing to serve as a counterweight to the Bretton Woods Institutions. ⁽¹⁾

Internal Contradictions

The World Bank-IMF PRGF and PRSP approach is seriously flawed in its assumptions of how to tackle poverty. It is also inherently contradictory.

In the PRGF framework, the “success” of a poverty reduction strategy is based on the borrowing government’s macroeconomic and structural reform policies. And while a PRSP might even yield some useful information about how poverty should be addressed, it is unclear how poverty elimination measures will be linked to the standard array of macroeconomic and structural adjustment conditionalities that continue to form the mainstay of the IMF-World Bank reform programmes—no matter what name they choose to give it.

Evidence from interim PRSPs (IPRSPs) already undertaken in Africa, Latin America and Southeast Asia show striking similarities between the conditionalities that accompanied earlier PFPs and current IPRSPs. Not only is there no significant transformation of earlier SAP objectives, but there appears to be no space to examine the impact of past SAPs on the creation of poverty in borrowing countries. The papers continue to promote production, distribution and financing approaches that are oriented towards greater trade and market “openness,” with scant attention to the historical causes of poverty. Social goals of equity and equality, although included in some strategies through education and health objectives, are largely relegated to the purview of social safety nets, which offer vulnerable populations too little support too late. Through the “globalisation for all” anthem of the World Bank, the IPRSPs continue to give the message that it’s okay to have losers in society—they will be picked up by the safety nets.

Both the World Bank and IMF have made strident claims that this time round, it will all be different, that the process and strategies will be “owned” by governments. However, these claims fall flat when one considers the fact that the 70 odd countries that are included in the PRSP initiative were identified by the Bank and Fund to begin with, and did not necessarily choose to participate in the initiative. Further, the process of formulating the poverty reduction strategies must follow the guidelines outlined by the Bank and Fund in a huge (1000 page!) source book, which then necessitates the involvement of Bank-Fund preparatory missions to kick-off the process in targeted countries.

In order to qualify for further credits and assistance, a PRSP must be approved by the World Bank and IMF Board of Directors on the basis of their own internal policy criteria, and not according to the requirements of the country in question. The Bank-Fund Boards can veto the strategy, the paper and the entire process if they stray from the narrowly prescribed path of Bank-Fund structural reform. The conditionalities attached to new loans must also be clearly reflected in the poverty reduction strategies and assistance from other external donors would be contingent on Bank-Fund approval of the process and strategies. Under such conditions, talk about “ownership” of the poverty reduction process by governments would be laughable if it were not quite so objectionable.

The Manipulation of Consent

The World Bank and IMF also claim that in the PRGF-PRSP framework, there will be greater importance than before on the participation of civil society in the development, implementation and monitoring of poverty reduction strategies.

However, experience from countries where the process has already started shows that participation to date has involved little more than consultations with a few prominent CSOs, rather than broad based, substantive public dialogue about the causes or incidence of poverty. Local civil society organisations such as labour unions, peasant organisations, social movements, women’s groups and indigenous peoples organisations have not been invited into the process, and the little public discussion that has taken place has been limited to well resourced national and international non-government organisations (NGOs). The insertion of foreign donors and creditors between civil society and capital deficit governments creates conditions whereby the influence of local civil society in setting national development agendas is weakened, and national governments become less accountable to their own citizens than to international creditors and donors. .

History Repeats Itself

Reports from countries where the PRSP process has begun show that little has changed in the IMF-World Bank’s approach to programming neither in content nor in process. Experiences from Bolivia, Nicaragua, Tanzania, Zambia and Mozambique indicate that PRSP processes continue to be based on existing structural adjustment frameworks and macroeconomic indicators, with little more than lip service to genuine public participation in poverty analyses and policy formulation.

In Cambodia, the Royal Cambodian Government (RCG) initially resisted the imposition of the PRGF and the PRSP process over its own five-year socio-economic development plan. However, due to a slow down in Foreign Direct Investment (FDI) and a decrease in government revenues, the RCG was eventually compelled to back down and accept the PRSP and PRGF frameworks. The experience thus far has remarkable similarities with experiences from Africa and South America in both content and process. Further, the macroeconomic framework for the IPRSP was determined ahead of poverty assessments or the formulation of poverty reduction strategies, and does not relate to international development targets. Local civil society was not involved in the design or development of the interim PRSP, and it appears unlikely that it will play more than a consultative role in future PRSP activities. ⁽²⁾

The Aide Memoire for the PRSP in the Lao PDR reveals the fundamental growth bias that underpins poverty reduction strategies: “...recognising that growth will be the best means of poverty reduction but also that certain structural and sectoral policies expedite the process.” The Aide Memoire also makes the importance of an acceptable (by Bank-Fund standards) three-year macroeconomic framework and policy matrix to future agreements abundantly clear. It unequivocally states that a country’s poverty reduction strategies will be jointly assessed by staff from the IMF and the World Bank before they are presented to the respective Boards. ⁽³⁾

In the Lao PDR, the IPRSP is being prepared by a consultant team recruited by the UNDP, and opportunities for local civil society and even broader government participation appear dim. Interviews with government officials in sectoral ministries at the national level and with provincial government staff revealed that they had little

knowledge of the PRSP formulation process. Their role was to provide sector and area specific information to the never ending stream of consultants and Bank-Fund mission teams. In Vietnam, while the government retains significant control over the process at the national level, foreign donors and international NGOs continue to play a significant role in carrying out poverty assessments and identifying development strategies.

In many of the countries targeted for the PRSP, documentation and information about macroeconomic policies, the ways loans and development finance are structured, and the conditionalities that accompany IMF-WB credits are not easily accessible. Despite the lofty ideals in Bank, Fund and UN speak, little information is available in local languages and there have been few attempts to educate the public about the PRSP.

Linking the availability of foreign aid and credits with the adoption of the financial and economic frameworks prescribed by the Bank and the Fund weakens the capacities of national governments to formulate their own, nationally relevant plans for socio-economic development and poverty alleviation. Many countries included in the HIPC initiative have attempted to formulate and implement their own long term national development strategies (for example, Ghana, Nigeria, Uganda, Gambia, Vietnam and Cambodia), but these strategies have been undermined by the IMF and World Bank through the leverage provided by the PRGF and PRSP framework.

A Time for New Imaginations

Experience over the last 40 years has proved that the IMF and World Bank are at best irrelevant, and at worst inimical to the goals of poverty reduction in the Third World.

The development of appropriate strategies to tackle the various forms of poverty in a society is the business of the citizens of that society and their representative governments. Governments and civil society need to evolve their own development approaches and plans that are locally and nationally relevant and sustainable, and which ensure that national policies serve human, social, and environmental goals rather the market and macroeconomic targets. While it is true that the international community can play a useful and beneficial role in strengthening national capacities for development and reducing poverty, governments and civil society need first to be accountable to each other, and second to external creditors and foreign donors.

It is within such frameworks that institutions such as the IMF and World Bank should operate, rather than dictating the grounds on which societies are built.

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Notes

1. See "The United Nations shows its True Colours," Nicola Bullard, Focus on Trade Number 52, August 2000; Focus on the Global South
2. Draft Report on the PRSP process in Cambodia, Chris Adams, Focus on the Global South, August, 2000
3. The World Bank, The Lao PDR Poverty Reduction Strategy Paper Information Mission, February 29-March 16, 2000, Aide Memoire

All in the family: musical chairs in the neo-liberal establishment

By Chris Adams*

Has the World Bank changed? In particular, do recent changes in senior management mark a significant break with the past? On the face of it, Wolfensohn has broken with tradition, appointing several “outsiders” to key positions which had previously been filled by staff who had risen through the ranks of the Bank itself. However, a closer examination of the careers of the President, Managing Directors and Chief Economists suggests that little has changed.

James Wolfensohn was first appointed President of the World Bank in 1995. Like all Bank Presidents, Wolfensohn is an American citizen. ⁽¹⁾ Like his predecessor Lewis Preston (1991-95) Wolfensohn has a MBA from Harvard. Also like Preston, who was President and CEO of the US-based global investment firm JP Morgan for 11 years prior to joining the Bank, Wolfensohn was President and CEO of the investment firm James D Wolfensohn Inc. which he established in 1981. JP Morgan, incidentally, figures prominently in the CVs of many current and former senior Bank staff. To name but two: the current head of the International Finance Corporation (IFC – one of the many tentacles of the World Bank Group) Peter Woicke, was previously the Chairman of JP Morgan Securities Asia and Gerard Caprio, the lead economist of the Bank’s Development Research Group, is the former vice-president and head of JP Morgan Global Economics.

James D Wolfensohn Inc. specialized in mergers and acquisitions on behalf of its many Fortune 200 corporate clients. While mergers and acquisitions may be good business, they are not good development. According to Susan George, “depending on the year, two thirds to three quarters of all that money labeled foreign direct investment is not devoted to new, job creating investment but to mergers and acquisitions which almost invariably result in job losses”. ⁽²⁾ Wolfensohn relinquished his interests in the company on joining the World Bank in 1995. He was replaced as CEO and Chairman by none other than Paul Volcker, former Professor of Economics at Princeton University and Chairman of the Board of Governors of the US Federal Reserve from 1979 to 1987. Following the 1996 merger of Wolfensohn Inc. with Bankers Trust to form BT Wolfensohn, Volcker retired as Chairman and CEO and became a Director of Bankers Trust. He was replaced by Jeffrey Goldstein as Co-Chair, the same Jeffrey Goldstein who in mid-1999 was appointed as one of the five managing directors in the World Bank, reporting directly to Wolfensohn. Goldstein was one of many BT Wolfensohn staff to leave the Bankers Trust group around the time of its acquisition by Deutsche Bank for \$10 billion in 1999. This incidentally attracted the attention of public interest groups in the US, which accused Bankers Trust of predatory, high interest mortgage lending, and foreclosures in low-income areas in the United States.

What then of the chief economists, the World Bank’s equivalent of Cardinal Ratzinger, prefect of the Vatican’s Congregation for the Doctrine of the Faith? Four of the last five chief economists – Nicholas Stern (current), Joseph Stiglitz (1997-2000), Lawrence Summers (1991-93) and Stanley Fischer (1988-1990) – are academics with PhDs in economics from either MIT, Harvard or Oxford who have taught at MIT, Harvard, Stanford, Yale, Princeton, the University of Chicago and the London School of Economics. Without exception, the chief economists of the World Bank are products of the most elite Anglo-American universities. ⁽³⁾

The World Bank’s regional chief economists share a similar pedigree. John Williamson (South Asia Region), John Page (Middle East and North Africa), Guillermo Perry (Latin America and the Caribbean) and Masahiro Kawai (East Asia and the Pacific) either have PhDs from or have taught at Princeton, LSE, Massachusetts Institute of Technology (MIT) and Stanford. According to the Bank, Masahiro Kawai’s appointment “symbolises our commitment to place more leading people from Japan and other East Asian countries in senior positions within the Bank”. ⁽⁴⁾ This commitment was slow in coming however. Despite protracted lobbying by the Japanese government, the number of Japanese personnel in the World Bank is still far from commensurate with its financial contribution. This in part reflects the triumph of Anglo-American economic orthodoxy in the Bank and the IMF over Japan’s preferred “Asian” development model. Not that Kawai is likely to pose a significant challenge to that orthodoxy. He remains, at least in academic terms, an “insider”, taking his MS and PhD in Economics from Stanford and teaching for more than 11 years at US universities.

What happens then to chief economists when they leave the Bank? Stanley Fischer joined the IMF as First Deputy Managing Director in 1994 and from that position provided much of the intellectual justification for the Washington Consensus and the IMF’s role in East Asia. Fischer was followed to the IMF in 1998 by World Bank Managing Director Jessica Einhorn who has a PhD from Princeton and worked with the US Treasury and US Department of State before joining the Bank and was a visiting fellow at the IMF in 1999. Einhorn was

followed in turn by Masood Ahmed who has a Masters in Economics from LSE and was Vice President for Poverty Reduction at the Bank before joining the IMF as Deputy Director of the Policy Development and Review Department in January 2000. Ahmed's appointment suggests that the IMF is unlikely to abandon its new found interest in poverty in favour of a return to its original narrow focus on managing exchange rates and balance of payments support. (See articles by Shalmali Guttal and Nicola Bullard in this collection.)

Larry Summers moved from the Bank to the US Treasury first as Undersecretary for International Affairs and, following Robert Rubin's departure in 1999, was appointed Secretary of Treasury. Summers, Rubin, Fischer and Greenspan (Volcker's successor at the US Federal Reserve) have been dubbed the "Four Horsemen of the Apocalypse" by Walden Bello for their role in turning a conjunctural crisis in East Asia into a deep recession. One of Rubin's predecessors, Nicholas Brady, established Darby Overseas Investment Ltd, an emerging market investment firm, on his departure from Treasury. Brady was joined in 1997 by Richard Frank, former World Bank Managing Director and Chair of the Bank's Private Sector Group.

This is not to say that US Treasury, the IMF and the Bank's Chief Economist will always see eye to eye as Joseph Stiglitz discovered to his cost. Stiglitz dared challenge the US Treasury-IMF response to the East Asian financial crisis and as a result was forced to resign, apparently under pressure from US Treasury. According to Doug Henwood writing in *The Nation*, "Summers informed Wolfensohn that if he wanted another term as World Bank president, Stiglitz had to go – so Stiglitz went".⁽⁵⁾ Other more mundane factors may have been at play as well – Bank insiders say that Wolfensohn's and Stiglitz's egos simply could not be accommodated in the Bank at the same time. Stiglitz went public with his criticism of the IMF and the US soon after his resignation, arguing that "All the IMF did was to make East Asia's recessions deeper, longer and harder". He described many IMF economists as "third rank students from first-rate universities".⁽⁶⁾ Stiglitz has now returned to teaching at Stanford.

Ravi Kanbur's fate is also illustrative of those who dare challenge the prevailing orthodoxy from within. Kanbur, a pre-eminent "insider" was recruited from Cornell University by the World Bank to lead the team drafting the World Development Report 2000/2001: *Attacking Poverty*. Kanbur oversaw a participatory process which resulted in a strong emphasis on inequality and empowerment in the draft report, too strong it seems for the US Treasury, academic supporters of neo-liberalism and key senior figures within the Bank itself who wanted hold the line on "growth-first". And who reportedly delivered this message to Kanbur? None other than Wolfensohn's old comrade-in-arms, now Managing Director, Jeffrey Goldstein. After a meeting between Kanbur, Goldstein and Treasury officials in late May, Kanbur left the Bank and did not return.

If you want a top job at the Bank these days, a CV which includes an MBA from Harvard or a PhD in economics from an Ivy League university and a stint with an investment bank or major US law firm will stand you in good stead, perhaps more so than long and faithful service at the Bank itself. Non-Americans are encouraged to apply provided of course you are ideologically trained in the US or can be left safely to your own devices in a "soft" sector like health or education.

What to do after you leave a senior position at the Bank? If you haven't been ostracised by your former comrades for daring to question the prevailing ideological consensus, you could consider a return to Ivy League academia, a tour of duty at the IMF or even a step up to the mother ship, US Treasury. For those from the South, perhaps a posting to the Central Bank of a client state and for those from northern Europe a stint at an ideologically aligned Ministry of Finance could be on the cards. And if you're feeling a little more entrepreneurial, you could always use your extensive contacts to establish an emerging market investment company....

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Notes

1. Wolfensohn was born in Australia but is now an American citizen.
2. Susan George in *Global Finance: New Thinking on Regulating Speculative Capital Markets*, Eds. Walden Bello, Nicola Bullard and Kamal Malhotra, Zed Books, 2000, p. 30.
3. A preliminary search of the World Bank website does provide any biographical data on the fifth Chief Economist, Michael Bruno (1994-96).
4. Jean-Michael Severino, World Bank Group Press Release No. 98/1658/EAP, 20/2/1998
5. Doug Henwood, "Stiglitz and the Limits of Reform", *The Nation*, 2 October 2000.
6. Joseph Stiglitz in *The New Republic* magazine, 17-24 April 2000