Lessons from the Asian contagion helped the IMF tackle global financial crisis

The International Monetary Fund learned a thing or two from the 1997 Asian financial crisis, which helped it respond better to the 2008 global financial crisis.

Thanks to IMF assistance, troubled countries were in a better position to weather the global crisis. The IMF provided financing to more than 30 countries that saw investors and capital flee financial markets.

On average, IMF financing after the global crisis was larger than after the Asian crisis by more than 3 percentage points of gross domestic product. The IMF lent to countries beyond normal limits and increased the size of assistance in several instances when the initial amount wasn't enough to curb capital outflow and stabilize exchange rates.

The bigger financing packages and other innovations it introduced from 2008 to 2011 showed the IMF had learned its lesson from the Asian financial crisis, when inadequate financing contributed to the failure of IMF programs to stop capital outflows and currency free-falls.

The IMF also collaborated with other multilateral institutions and bilateral donors in a number of cases during the global crisis—something it learned from the Asian crisis. Some argue that the transparency of IMF collaboration with official donors helped IMF-backed programs build investor confidence.

The early European programs did not have the credibility problem that plagued the Asian programs, whose insufficient financing led market participants to doubt that the official financial packages were credible or even available. Europe's official financing packages appeared to have more substance.

The IMF has a long history of co-financing with the World Bank and other multilateral regional banks, but the post-global crisis innovation was that the IMF collaborated with official partners to design the financing programs.

The onset of crises in the euro area from 2010 saw the IMF deepening collaboration with European institutions, albeit informally. The IMF also involved the private sector in bailout programs in several countries from the outset of the global crisis—another case of learning from previous emerging-market crises.

In Hungary, Latvia, and Ukraine, IMF-backed programs secured commitments from parent banks to maintain their exposure to local subsidiaries. During the Asian financial crisis, involving the private sector helped quickly resolve the crisis in the Republic of Korea. Following the global crisis, involving the private sector appears to have helped increase the credibility of financing packages.

The IMF also backed capital and exchange controls in some countries to curb capital outflows and ease the pressure on exchange rates. The most notable case was Iceland's move to introduce capital controls under the 2008 IMF-backed program. The IMF fully backed the decision, recognizing that the alternatives were few and unpalatable: in the absence of controls, the currency could depreciate beyond the 40% that it already had.

Following the global crisis, the IMF became more open to using capital controls to check the outflow of capital during times of volatility. But despite these innovations, countries that received IMF assistance saw a steeper fall in their GDP than did countries during the Asian crisis. They also experienced a significant exchange rate adjustment, although economies that did not receive IMF funding were worse off.

Does this mean that IMF intervention didn't quite cushion countries against the impact of the global crisis? To answer this question, we have to know what the outcome would have been had the IMF not intervened.

But to put it in context, the global and Asian crises occurred in different environments.

For starters, during the global crisis, affected countries faced the withdrawal of a large volume of portfolio assets from major financial centers, which translated to massive volatility in emerging markets.

From the end of 2007 to the end of 2008, for example, the balance of external portfolio assets fell by $967 billion in the United Kingdom and by $2.9 trillion in the United States; the balance declined by $4.9 trillion in five major financial centers combined.

This is not to suggest that some $5 trillion was withdrawn entirely from emerging-market economies, but it does show that global liquidity was tightening.

This did not happen during the Asian crisis. From the end of 1997 to the end of 1998, for example, the same five financial centers accumulated nearly $1 trillion in external assets.

Second, troubled countries during the global crisis had fiscal deficits, which required larger corrections. The Asian crisis countries did not have a fiscal imbalance to begin with—in fact, they all had fiscal surpluses before the crisis.

In contrast, all the countries affected by the global crisis had fiscal imbalances at the outset of IMF intervention. Given such challenges, the IMF innovations following the global crisis made a difference. Without IMF assistance and innovations during the global crisis, troubled countries would have been worse off than those during the Asian crisis.

The IMF's crisis-lending programs continue to evolve.

Attempts to forge formal regional financing arrangements to help countries face similar future crises have floundered, no thanks to competing mandates and different viewpoints on how to go about such tie-ups.

The IMF has been more successful in collaborating with some Asian economies to set up mechanisms to ensure financial stability in the region. But only time can tell how these and other efforts will ensure a global financial safety net is in place when a crisis hits anew.

Given how governments seem to favor regional alliances to stave off similar future crises, the IMF may end up being just a part of such initiatives instead of being in the driver's seat.

This episode is based on research done for the Asian Development Bank Institute by Carlos De Resende, senior economist at the Institute for Capacity Development of the International Monetary Fund, and Shinji Takagi, professor emeritus of economics at Osaka University and visiting research professor at the Asian Growth Research Institute, Fukuoka, Japan.

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