Stanley Fischer was first deputy managing director of the IMF from 1994 to 2001 and special advisor to the managing director until January 2002. Prior to his tenure at the IMF, Fischer had a successful academic career and also served as vice president of development economics and chief economist at the World Bank.

In this interview, Fischer discusses the role of the IMF and global financial institutions in the changing global economy, and also the difference between economics in theory and economics in practice.

The Purpose of the IMF

INTERVIEWER: We filmed in Bretton Woods [where the International Monetary Fund (IMF) was established]. Tell us what the original purpose of the IMF was.

STANLEY FISCHER: During the interwar period [between World Wars I and II], the international economy collapsed: Trade collapsed; countries didn't know how to import and export; there were restrictions on using your money to buy goods from elsewhere. [At the end of World War II] they determined that wasn't going to happen again, and that we had to have a system whereby countries could trade and could make payments to each other. And they designed a system in which international trade in goods would take place, and citizens would be able to pay for imports. And that was the basic idea. They set up a system in which exchange rates would be fixed, and that system lasted 25 years, and the growth of trade in the postwar period was one of the most important factors that produced so much prosperity after World War II.

INTERVIEWER: So would you say that the IMF achieved its purpose?

STANLEY FISCHER: It was the IMF and the World Bank, and what was at that time the General Agreement on Tariffs and Trade [GATT]. It was a whole system that was consciously designed in 1944 and '45 to avoid the mistakes of the interwar period, and to enable all the countries in this system to benefit if they would take part in this global system. And the countries that have taken part have benefited.

INTERVIEWER: The person, of course, who wrote *The Economic Consequences of the Peace* was John Maynard Keynes. What was his role in shaping the system?

STANLEY FISCHER: In terms of the IMF, Keynes's role in setting up the system was quite fundamental. But he had a much more expansionary idea of how the global economy should work. Then... [his] American counterpart, who was known as... [as] great [an] economist as Keynes, is Harry Dexter White—and it was the American views, which were a bit more constraining, that succeeded. But Keynes was a moving force there. He was a great orator. Between the two of them, they produced a system. Of course, it took the governments to make it work, but it was their ideas.

INTERVIEWER: You spoke in one of your speeches about the vision of the founders. What was the vision?

STANLEY FISCHER: The vision was an old one in many ways. It was the vision that the global economy should work as it had before World War I, when global trade expanded and countries were on the gold standard. Exchange rates were stable; people could buy and sell anything from anywhere, and the system seemed to work. And then between the wars, it broke down completely. They wanted to resort to it, but they didn't want to restore it on the basis of gold. And they tried to restore it on the basis of paper money, with a gold backing. They made it work for 25 years, and then the system broke down. And it was rebuilt in a different way between 1973 and 1978. We now have a different system in which [foreign currency] exchange rates fluctuate. They used to be fixed, and changed only occasionally. The new system works pretty well, as well, although there are some... [who are] hankering after much greater stability of exchange rates.

INTERVIEWER: So the system we have today really is a different system than the original IMF system?

STANLEY FISCHER: The system, the so-called Bretton Woods system, has changed. The purposes of the IMF, and the World Bank, and what is now the World Trade Organization [WTO] have not changed. The institutional framework in which they operate is different.

The Issue of Protectionism

INTERVIEWER: Since you wrote your first edition of your textbook, you've been at the World Bank, you've been at the IMF—we've seen this global shift towards greater confidence in markets, away from heavy reliance on government. Why have we seen this shift towards markets around the world in the last 20 years?

STANLEY FISCHER: The shift towards markets took place quite late in the postwar period, and right through the '60s and '70s, the heavy reliance on government intervention seemed to be working. And many of the countries—say, like Brazil, which had very extensive intervention—were growing quite fast. It was a period in the '70s, after the energy crisis, [and] the early '80s [with] the debt crisis, when it became clearer and clearer that this model of trying to shut off the world economy—rely on protectionism, control everything—was not working. And gradually—and it was very gradual—countries moved into a new model. It was not ideologically driven. It was driven by the failures of the old model. And the change hasn't happened all the way yet. The hankering after more government intervention is still there in many countries. And, of course, nobody proposes getting rid of government intervention.

INTERVIEWER: Do I take it from your remarks that you do think that this general shift makes sense, that this is the direction in which to have moved?

STANLEY FISCHER: I don't doubt—although I did at various stages in my career—that the shift towards markets, the shift towards freeing up trade, has been enormously beneficial to the countries that have done it. And you learn things in strange ways. I began to think about this more than anything looking at cars in Argentina and India. They protected their car industries, and when you went to Argentina in the 1980s you saw tens of thousands, hundreds of thousands of 1962 Fords. And if you went to India in the 1980s, you saw hundreds of thousands of 1958 British cars. And you realize if you protect, you don't have technical progress; your consumers are hurt and firms get lazy, and you need that competition from abroad. You need new technology to come in for firm industries to [get] better, and for citizens to get the benefit of what is available out there in the world.

INTERVIEWER: So seeing the car situation really... changed your thinking?

STANLEY FISCHER: Well, I knew all the theories and I'd studied them. And I knew that free trade had many benefits. It also had certain disadvantages. It's one thing to see it in the textbook; it's another to look at it and say, "Well, I guess that's what the textbooks mean."

INTERVIEWER: You are a student of [Paul] Samuelson; you worked with Milton Friedman. Can you tell us how your own thinking of those big issues have evolved?

STANLEY FISCHER: I was a student of the London School of Economics in the 1960s, and then moved to the United States. One of the hardest things to understand is that relying on markets can work. And the notion of protectionism, of giving your producers a chance of producing employment in your country, is intuitively plausible. Any protectionism is the obvious way for people who haven't been trained to think. So as I started, I found all that very persuasive. It was also true that during that period there was more success. The Soviet Union looked like it was working. Then gradually, over the course of time, watching what happened, thinking about the economics of it—the economics points, I believe, in the direction of markets. Your views begin to change. I was not fully convinced of the virtues of [a] more market-[driven] approach when I was in the World Bank in the late '80s. [But] the more I saw of what countries were doing to themselves and to their citizens, the more I moved in the direction of markets.

INTERVIEWER: Can you elaborate on that, because one of the questions we do want to ask you is what the impact of these seven years you've had at the IMF? Your time with the World Bank, this practical experience—how has it affected your thinking on these big economic themes?

STANLEY FISCHER: When you're a professor or a student, you tend to get very tied up in the special cases and all the nice theoretical possibilities that are out there. And there is no question that there are many ways, in principle, of improving on markets by being clever, by regulating this, that, and the other. When you actually work with governments and watch the consequences of these attempts at very detailed intervention—trying to help out there, and deal with an imperfection here, and an externality there—you begin to get much more skeptical about the ability of social scientists to predict what's going to happen, and then their inability to understand some of the political economy of what happens. And I think it is those factors—watching governments try to make what sounds like good policies work, and realiz[ing] that you can get into huge messes—that tends to move you... to understand [that] the theories [are a] good guide to what is analytically possible, but that you have to look at what has actually happened when different governments have tried to implement these measures. To understand what you should recommend, as opposed to what is analytically a possibility.

INTERVIEWER: As with the cars, is there a specific experience you went through that really underlined that and crystallized that for you?

STANLEY FISCHER: More than anything else, I changed my views based on watching Latin America and watching countries which I thought had got interventions well organized, particularly Brazil. [I] watched what happened to them as they kept pushing further and further in the interventionist route, and saw their macroeconomies first destabilized, and then the microeconomies didn't work—and realiz[ed], watching them, that they had to rely more and more on markets. It's as much a theory about how difficult it is for the state to do these things as about what is analytically possible.

The Impact of Keynes, Hayek, and Friedman

INTERVIEWER: Has your thinking about Keynes and your thinking about Hayek changed? And maybe you never thought about Hayek in the beginning.

STANLEY FISCHER: I was at the London School of Economics, so I'd certainly heard of Keynes, heard of Hayek. My thinking about Keynes has changed, I think, much less than the profession's thinking has changed. I still believe there's an enormous amount in Keynes... [that's helpful in] understanding business cycles. The Keynesian apparatus is really enormously important, and I'd still, if students could read only one thing—fortunately they don't have to read only one thing—I would still teach them Keynesianism. But there's more to life than that, and there's inflation to worry about. My thinking about Hayek has changed...—about the problem that the market solves, [about] the information aggregation concept that's in Hayek. As a theorist, there's a lot being done to make clear what that [concept] actually means since then, and that insight is basically right, just as it took a very long time to figure out what it meant—that there's an invisible hand and the Adam Smith insight. But... seeing that, combined with realizing... that markets do tend to do better—never perfectly, always with the needed government regulation, always with the need for government to set the framework in which they operate—that shift has taken me more in the direction of Hayek. And I don't see the two of them as totally different. Keynes is much more on macroeconomics.

INTERVIEWER: You were at Chicago in the '50s. What do you think is the historical impact of Milton Friedman?

STANLEY FISCHER: I'm a macroeconomist, and Milton Friedman's macroeconomics, I think, has not stood the test of time as well as his microeconomic insights.... I think the specifics of Milton Friedman's macroeconomics monetarism, etc., have not stood up. We do monetary policy now much more like Keynesians thought of it than [how] Milton Friedman thought we should be doing it. The analysis of the role of government possibly is more sophisticated than the simple Keynesian approach. But the notion that raising taxes in the middle of a recession is a bad idea, that's a Keynesian idea. I think that's pretty valid still.

The Link Between Weaknesses in Financial Systems and Financial Crises

INTERVIEWER: One of the things that has become one of the themes of the series.... [is] that there's a particular need to keep [financial institutions] solid. Of course, you've lived through some of the experiences about that. Tell us what you think about why it's so urgent to keep the financial system going—to not just let it collapse, if you believe that.

STANLEY FISCHER: I believe it more and more—and I believe more and more after the Asian crisis that the strength of the financial system is... essential to the health of the economy. That is the mechanism connecting all decisions about the future, from the side of household savings where they put their resources, [to] the investment decisions of banks, and that savings investment decisions are the critical driving force for the future in any economy. And that's what the financial system does. During the '60s and '70s, the systems were extensively controlled, and you could get by without worrying about this strength, because they weren't doing very much. As they became deregulated, it became clearer and clearer that you could have catastrophes if these things didn't work well. And we've had catastrophes in Asia, [with] costs to the economy of fixing the financial system, of 50 percent of GDP. Six months' production goes into making a banking system healthy again. Just the financial cost, and then, of course, you've lost a whole lot of output because nobody can rely on the banking system; you have a recession in the middle of it. So the centrality of the financial system has become clearer and clearer. At the same time, it has to be said you can have a very strong financial system, but if you subject it to massive pressures in a financial crisis of some sort, even the best of banking systems is not going to look great if, for some other reason, output is going to decline by 15 percent. So you have to worry about the rest of the macroeconomy as well. But a sound banking system, a sound financial system, is essential, and we've learned that through very painful experiences.

INTERVIEWER: We noticed that you and Newt Gingrich both describe the Mexican bank crisis of '94-95 as the first financial crisis of the 21st century. When you said that, what was the significance of it? And what did you have in mind when you said that?

STANLEY FISCHER: It was Michel Camdessus, the managing director of the IMF at the time, who I think described the Mexican crisis as the first financial crisis of the 21st century. He meant that it was the first time in modern history that we've seen a developing country get into a financial crisis that was driven essentially by capital-account developments—by asset flows rather than by anything that was seen to be happening on the current account or in the budget, and that a sudden turnaround in confidence was able to take an economy which was growing (not fast—about 3 percent into recession of 7 percent of GDP), [and] cause a decline in output of 10 percent of GDP as a result of a loss of confidence. That was what he meant.... It was the first of a series of virulent capital-account driven, asset flow-driven crises, and so we've had a lot of them recently. And that is because of weaknesses in the financial system as much as anything else.

Examining the Causes of the Asian Financial Crisis

INTERVIEWER: Look back and tell us what caused the Asian financial crisis. Where did the crisis come from?

STANLEY FISCHER: The Asian crisis came from a combination of domestic weakness and external capital flows. You had countries which had run in a particular way for a long time—great confidence in investment, huge rates of investment—countries [where] 40 percent of GNP was being invested, buildings all over Bangkok. You went to Bangkok in 1997, it was full of cranes everywhere. And it looked like the boom would never end. But there were very weak banks who were lending against the security of those buildings which were never going to be filled. And there was over-investment there. They had attracted a lot of foreign money in a very short term into their country, and it was all there earning high interest.... And the sudden realization dawned [that] the markets they were selling into, the electronics they were exporting at the end of '96, that those markets weren't going to grow at the same rates forever.... And suddenly, confidence began to turn; the money began to move out. And the investments started declining, and suddenly you'd have this boom that was built on building: building of factories, building of machines, [anticipated] huge exports. And people suddenly said, "Well, this isn't going to happen." And foreigners took their money out, and there wasn't money to continue investing, and firms began to go broke; banks began to go broke. And so it was a combination of overconfidence domestically, weak banking systems, and foreign money that had come in very short term and it went out very short term.

INTERVIEWER: A point you made in some of your speeches is that as the amount of assets flow [increases], it increases the scale of the risk. Is that a characteristic of it?

STANLEY FISCHER: As international capital flows have increased, the dangers that arise from the reversal become larger and larger. And countries that rely very heavily on international capital flows to finance themselves are at greater risk. Sentiment can change; developments somewhere else can move money out of a country and have very devastating effects.

INTERVIEWER: Tell us when you first heard about the crisis, or first realized there was a crisis. Tell us the story.

STANLEY FISCHER: The Asian crisis countries got into [the] crisis in different ways. And the one that was most foreseen was the crisis in Thailand. Thailand had fixed the value of its currency in terms of dollars. It had a fixed exchange rate. And people began to wonder, "Well, do they actually have enough dollars to always be able to give me dollars in exchange for the baht, the Thai currency I have?" And when they begin to wonder about that, they start asking for the dollars, and then they "attack the currency," as it is said. We saw attacks on Thai currency in late '96 and then '97. I went to Bangkok in May 1997 because the situation was looking very, very serious, and discussed it with them. And they wouldn't give us full data at the time. That's when we began to get really worried. People said they don't have as much foreign exchanges [as] they claim. And they weren't making it clear to everyone how much foreign exchange they had; that led you to believe they didn't have that much. When eventually they ran out of foreign exchange, it turned out they didn't have that much, and then the crisis just took off. So it really degenerated in July, August 1997. The Thai crisis did not look very different than other crises in past history. It was when it spread to Indonesia, and then—to the amazement of all except those who had been following very carefully—Korea, that people said, "Well, something is happening here." And what would happen in Korea was that banks [that] had lent to Korean banks were pulling out their money, because they realized that Korean firms were beginning to go broke. And we didn't pay as much attention as we should. But big Korean companies started going bankrupt in the early part of '97. And they had over-invested, too.

INTERVIEWER: What created the contagion? Why did this happen?

STANLEY FISCHER: Some of the contagion was caused because these economies had certain similarities; some of it was caused because in the minds of investors, there were certain similarities; some of it was caused because there are mutual funds that invest in "emerging markets," so they treat emerging markets as a group; and some of it was caused because the things that happened to these economies, the real things, were reasonably similar. They were almost all hit by a decline in electronics exports at the end of 1996. They all had a weakness there, they all had stock markets which got overvalued and began to decline, so it was a mixture of valid reasons and some which relate to the structure of international capital flows that you wish you could change.

A State of Panic: Korea in Crisis

INTERVIEWER: Tell us about the day that you realized that this was not another garden-variety crisis.

STANLEY FISCHER: We were getting more and more worried. The IMF was getting more and more worried as the Indonesian crisis worsened. But as money poured out of Korea in November 1997, and you realized that a country which everybody had thought was extremely strong—the 11th biggest economy in the world—was heading for disaster, that was the point at which I began to worry. And I visited Korea a couple of days before they turned to the IMF for help, and it was a circus atmosphere. I got imprisoned in my hotel room—couldn't move out because [if] I opened the door, there were 10,000 photographers, and I had to stay in the room. And it was a state of panic, and it was at that point that I went to the Central Bank and was shown how much money was left in the Korean Central Bank. It was essentially all gone, down to $6 billion. Now they've got $95 billion; they'd just been paying it out and not doing anything about it, and you realized at that point that this country is near the verge of disaster, and is psychologically unprepared to deal with it. I met with the finance minister to discuss what was going to happen the next year, and I said, "I don't think you'll have any growth next year." Turns out I was wrong—they had negative growth of about 8 percent. He said, "No, no, we can't do with less than 6 percent growth." That was the mindset at the time. And yet they had to do a whole lot of things to get this situation straightened out, and they weren't ready. And so you could see this conflagration spreading from Thailand to Indonesia; it was hitting Malaysia, and now it was in one of the world's really big economies and it seemed there was nothing going to stop it.

INTERVIEWER: What would have happened if it hadn't stopped? Would we have had a world depression?

STANLEY FISCHER: The situations in those countries would have been much, much worse if it hadn't been possible at that stage to stabilize Korea, which was done in January 1998. The money stopped pouring out and began coming back in. After the IMF program, after certain other things had been done, that was the huge stabilizing force, but if that hadn't happened, it would have been a continuing retreat from all the emerging market countries. Latin America, which actually, by and large, survived that period reasonably well, would have been hit very hard. [There] was Eastern Europe, reliant on this sort of money. There were other countries in Asia—one never knew! One feared what was going to happen to China; it has controls on these flows but no control is impervious. And there was Russia, of course, which we knew was vulnerable, and which did succumb, eventually. So we had a possibility of a virus going round the world, from Asia to Latin America to Russia and back to Asia, getting worse and worse. And what is the disaster, in the minds of everybody, is [that] the [response] to these problems if there's no international help is [that] everybody closes up. That's what they did in the 1930s, but the world doesn't work that well when everybody closes up. It may be rational for one country, but it's totally irrational for the system, and that was a fear—that was why we had to try and help those countries... help them stabilize, keep this system operating.

INTERVIEWER: What did you say to the Korean finance minister after this discussion?

STANLEY FISCHER: I said it isn't going to work that way. And I said we don't control growth. We're talking about what's going to happen, and wanting growth—which we all want—isn't going to resolve the problem. You've got to deal with it, and it was clear at that stage that the Korean problem is an interlocking problem, with the banks being a mess and the corporations being a mess and banks are a mess because the corporations are going broke, and because they had borrowed a lot of money from abroad and foreigners were taking that money out as fast as they possibly could.

INTERVIEWER: And of course they just had a new government, too.

STANLEY FISCHER: The new government in Korea was what saved the situation. It was the old government in Korea that had messed up. When Kim Dae-jung was elected, before he was elected, we read Kim Dae-jung's election manifesto. It was exactly what the IMF supported, and so... this president, who was thought to be very left wing, anti-everything, hated the Korean system as it had developed up to that point—I believe that if Kim Dae-jung hadn't won the election, the Korean ability to turn that situation around would have been much, much less. It's a fact that Korea turned around after the election. Thailand began to turn around after an election, but not before. Indonesia continued to decline... until Suharto was replaced. The connection between politics and economics is very, very strong in these cases.

INTERVIEWER: After that discussion, you went back to your hotel and tried to sleep that night. Tell us what happened to your sleep patterns and what you thought about at 4:00 in the morning.

STANLEY FISCHER: I called the managing director and I reportedly said they're talking about 6 percent growth and I said it'll be zero. He said, "I bet you were thinking it was less than that." I said, "Yes, I was thinking it was less than that," and I explained to him about the reserves which we'd had other indications about. He said, "Well, they'll need a program." I said, "Yes, but they don't think that they need a program; they think they're going to manage without." So we just agreed to keep talking; you can't force a country to ask you for help. It has to ask. But when it's out of money, it hasn't got many places to turn.

The IMF and the Asian Crisis

INTERVIEWER: Tell us what the IMF was doing during those crisis months in the second half of 1997, for which, obviously, there's always been criticism. Set the record straight.

STANLEY FISCHER: The IMF was dealing with what looked like a new type of crisis in Thailand, to some extent, but to a great extent in Indonesia, Malaysia—which we worked with for a long time, although that's not generally known—and Korea. These were crises which didn't focus on excess, were not caused primarily by excess government spending. Problems were more in the banking sector and the corporate sector. We hadn't been used to dealing with those issues, and we made some mistakes in the beginning. In Thailand—I think, correctly—we thought government spending had been a factor. We thought it was in Korea and Indonesia, and it probably wasn't. Within a few months, we'd reversed that, and we'd stopped asking for a decline [in government spending], for tighter budgets. We were trying to understand what it is you do to fix a financial system quickly, how do you keep it operating while dealing with the very weak parts. How—and this is the hardest part—do you get bankrupt firms, those that should close, to close, and those that shouldn't close, to stay open? How do you make the financial system work at a time of huge stress like this? And those were the difficult issues, and we were sitting here debating what to do. Do you guarantee all bank deposits, even if the banks are in terrible shape? That's a huge cost for the government. The answer we arrived at was yes, even though it's very expensive. Do you try to close down the bad banks? Yes, very quickly. Try to move the bad assets out and build up the healthy banking system. But these things are societally wrenching, and there are huge vested interests. And you wouldn't get into these crises if the vested interests weren't that important. That, I think, is one of the reasons why it takes political change to deal with a crisis as big as this, because otherwise, the people who were there—who sort of drove the banking system into weakness, who were getting resources from the government to invest in inefficient places—are still politically powerful and influential and have these tremendous battles about what to do. But these were long-term problems that took years to really make progress on them.

INTERVIEWER: What was the atmosphere like here during those months, here in IMF headquarters in Washington?

STANLEY FISCHER: Well, you're in the office where many of the important meetings took place. The meetings were frenzied, and they were harried, and the reason they were harried is the 12-hour time difference. So you would have people in Korea negotiating all day—and it was not only negotiating, you had to get facts. So, for instance, we actually had people go in to the Central Bank and sit there and try to get numbers out and send them back to us. And we were meeting here and the number would come in, and we'd look at them and say, "Oh no, how do you deal with this one? How do you stop this money flying out of the country? What can you do?"

It was a bit like a seminar; they were very freewheeling discussions because we were[n't] certain what to do—but you knew that whatever you said here was going to have an impact in the next couple of days. We also have representatives—all our member governments are in this building, the executive board—so we were talking to them all the time and getting their advice and their encouragement and their discouragement for certain things. We were incredibly busy, and the phones were ringing all the time, and the minister of finance would say he can't do this, and the Central Bank governor would say can you help me on the other, and then our teams talked to each other. And when they send something into the IMF, it gets checked by quite a few units here, so we were turning papers around at speeds which we'd never done, which were probably too fast.

We negotiated the entire program for Korea from start to finish in one week. This was a program to restructure the economy fundamentally. It had to be done at that speed because we couldn't lend them money until we knew how they were going to use it. That meant we had to decide what they were going to do to the banks, how they were going to try to make the corporations whole again, what they were going to do to protect workers who were going to be laid off inevitably in this environment. How they were going to react to foreign capital—were they going to try and keep it out, which was their practice for long-term investment? And our board of directors said, "You mean the international community's going to give them official money, while they're at the same time telling private money you can't come in?" So there was a discussion about opening up to foreign investment at the same time. All that was going on simultaneously, and put together in a week; it was frenzied. I think it was extraordinarily well done under the circumstances. It was not perfect, but Korea began to turn around within a month and a half of signing the IMF program. It is an extraordinarily impressive country in many ways, because once they had decided to go down a particular path, with a new president, they went down it.

INTERVIEWER: Robert Rubin said that—he told us about calling the banks, saying, "You know, you can't call up your loans." Was that all happening at the same time?

STANLEY FISCHER: The Korean program had two phases. We started in early December, and it didn't work; money just kept flying out, and we had lent them a lot of money and eventually... our shareholders decided we had to get to the banks and just say, "This isn't going to work unless you keep your money there, so stop pulling it out." And this is one of these famous collective-action problems; it's like the problem of if everybody stands up in the football game, then they're all standing, but they might as well all sit down because they can all see the game equally well. It's the same thing: If everybody pulls out money, then other people should pull out money; if 90 percent of the people would leave their money in, the situation would stabilize and everybody should leave it in. So you had to persuade them to stop pulling it out and to leave it in, and that would stabilize the situation and then they'd be justified in having left it in. But you have to get them together and say, "Do it this way." It was tough, and there are leaders in the private sector to whom the world owes a great deal of credit. The IMF played a role, the U.S. government played a huge role, the European governments played a huge role, the Japanese government played a role—but it also took leadership among the banks, who understood that they could all either collapse together or succeed together, and they managed to succeed together with our help.

"Blaming the Doctor": Criticisms of the IMF

INTERVIEWER: What do you say to that spectrum that goes from Jeffrey Sachs to the people on the streets of Quebec, the criticism and the abuse of the IMF. What's your reply to that, as to the role of the IMF in all of this?

STANLEY FISCHER: These situations would have been much, much worse without the IMF. They were extraordinarily difficult circumstances to deal with. The IMF analysis—which said that the heart of the problem in these countries is the combination of the weakness of the financial sector and the weakness of the corporate system—was the correct analysis, and that was at the heart of what we tried to do. I don't think anybody that thinks about it can disagree with that. There were criticisms about what we recommended on the budget; they had some validity but... those remedies were reversed very quickly, and we very soon went to expansionary government budgets which were possible in those countries. There was a lot of discussion about whether interest rates should have been kept low. You can't persuade people to leave their money in a country which is risky if you have low interest rates. They need to be compensated for it. All of history, all of what happened, says that you have to raise interest rates to persuade Koreans not to send their money out; to persuade Korean banks that it was not a good idea that they should borrow from abroad, because they could get more money from abroad more cheaply; to persuade foreigners to put their money in Korea or Indonesia or Thailand. So this interest-rate argument, [that] we should have cut interest rates because, after all, in a recession the U.S. cuts interest rates, that's fine—but the U.S. didn't have a balance-of-payments problem. Money wasn't flying out of the United States when we had a recession. Money was flying out of these countries, and you had to stop it. You had to get it to go in.

INTERVIEWER: We were talking before you came in about how most people hadn't heard of the IMF 45 years ago. Why has the IMF become such a target of criticism?

STANLEY FISCHER: The IMF was a huge target of criticism in the 1980s in Latin America, and everything that's being said now was said then, with equal vehemence. The IMF has become a target of criticism because it's been in the eye of the storm; it's been the organization which the international community relies when a crisis develops. You're the doctor going in to deal with a very sick patient. The public blames the doctor for the fact that the patient is sick, but the patient was sick to begin with, and if you don't get the medicine exactly right—and for a few months we didn't have it exactly right in some of the Asian countries—you're vulnerable to criticism. But these were huge events, and we were the actors through which the international community operated. And if you were going to attack someone—and believe me, economists have a multitude of views—you know that we were the guys who were going to be attacked.

It's because we were important that we were so viciously attacked. I believe that most of those attacks were wrong in substance. They were certainly unfair.... The IMF has 183 member governments; we don't do anything without their voting on it. All those programs, which everyone had their time to take a shot at, were agreed to by the member governments of this organization—not only the G7, [but] everybody. For most of the time, there was unanimity in the IMF executive board that represents those governments and what we were doing, so we had their backing. This was not some bunch of crackpot economists sitting around here figuring out what to do. This was a considered set of views—considered by all governments. There were disagreements, but it was well thought out and it was not random. And I think it was basically right, not perfect.

Lessons Learned from the Asian Crisis

INTERVIEWER: Could we see crises like this in the future, or is this a once-in-the-century storm?

STANLEY FISCHER: There were elements of this set of crises that will probably not be repeated. Almost all those crises were related to fixed exchange rates, and they took the form of [a] tax on fixed exchange rates. We have, among the major emerging-market countries, very few fixed exchange rates now. The exchange rate can move, so the first shock absorber of any change is a movement in the exchange rate that was not possible in these countries at the time. So I think we've got much less reason to have that sort of crisis; we've also done a great deal of work—the IMF has, the international community has—to strengthen financial systems.

And there was another source of weakness. That work goes on, but you can still have crises which come because countries have over-borrowed, and you can still have crises because companies and countries have over-borrowed. The markets can be very confident about Country X one day, and then there's a recession in the United States or a change of government in that country, and the markets change their mind. Money could pour out, and they could need help again. I don't think we'll see a collection of crises on that scale any time soon, and I think we'll see fewer and fewer because we're getting more flexible exchange rates, but we will not be rid of crises.

INTERVIEWER: What are the lessons that we should take away... from the Asian crisis?

STANLEY FISCHER: The first lesson of the Asian crisis is, prevention is better than cure. Much of the work that we're doing now, much of the work that countries ought to be doing, is about strengthening their systems of corporate govern[ance]—their financial system, their accounting standards, how their Central Banks operate—simple things which we in the industrialized world take for granted. And... they need to be dealt with, and those fundamentals need to be taken care of. That's the prevention element. You'll see all the Asian countries have built up their reserves, their foreign exchange reserves. Countries that have a lot of reserves were less badly hit by the crises. They've changed their exchange rate systems, as I've mentioned. The lessons I take away from the IMF is beyond [the maxim] prevention is better than cure. [The lesson I take away] is much closer surveillance, as we call it: much closer relationships with these countries; trying to stay on top of things; helping them; being very close to them, which we are in some countries, in order to try to anticipate things; being ready when the crisis comes to move very fast, if you have to; and recognizing always that you've missed something, and that the next crisis will be different than the previous one, and that something's going to happen that will catch you unawares. We're a much more limber institution than we used to be. To give you one example, in 1994, there were no news screens in this organization... there were no Bloomberg's in this organization. They're all over the place now; nothing happens now that we're not aware of the next moment. We didn't used to be like that seven years ago.

INTERVIEWER: How were you changed by the crisis?

STANLEY FISCHER: I think my hair is much grayer than it used to be. My appreciation for the people who work in the IMF is much greater. My appreciation of the difficulties that confront people who want to do the right thing in difficult political circumstances (and they're all over the place—finance ministers who'd like to fix their countries, Central Bank governors who are trying hard) is much greater than it used to be. Trying to find ways of helping them is greater than it used to be and my recognition of the linkages between the economics and the politics is far, far, greater than it used to be. And I think I'm more humble, but who knows?

INTERVIEWER: One of the other charges that we should just ask you to respond to is that this all happened because the U.S. pushed these countries to lift capital controls in the early '90s. Was that significant?

STANLEY FISCHER: Part of what happened is because... capital controls were removed incorrectly. Thailand opened up to short-term capital flows; you could invest for a week in Thailand, or three weeks in Thailand, but you couldn't invest in equity. That's the exact opposite of what to do. Korea—exactly the same. Koreans didn't want foreigners owning their companies, but they would borrow one-week money. That's exactly backwards, so there was an opening up incorrectly.... I wasn't here at the time, so I don't quite know how it happened. I don't think that was what the international community was pushing on them, opening up the short end, as we say. It had a role to play, and one of the important lessons is if you are going to open up the capital account, bring in the long-term money, first; let equity investment come in; let long-term borrowing come in; let foreign direct investment, buying companies, selling companies, come in. Only open up at the short end when your financial system is sound. That's a lesson we learned. I wouldn't blame the United States. I'm sure that it and others were pushing for a capital-account opening. I think the IMF has also been accused of that. Probably there was more pressure and less recognition of the need to differentiate what you were opening up than we would have now.

Bad Times in 1998: Russia, Brazil, and Fear of Contagion

INTERVIEWER: What was your worst moment of 1998, the autumn of '98?

STANLEY FISCHER: My worst moment in the autumn of '98 was in August 1998, the night I knew that Russia was going to announce a devaluation the next morning, and I knew that all hell was going to break loose all around the developing world. But I didn't know how much it was going to break loose. I thought that it was going to be a big event, and I thought there'd be repercussions not only in Russia—which, of course, was an extraordinarily important country—but in all the emerging markets. I did not appreciate at that point that the repercussions of the Russian crisis would result in liquidity crisis, in the [crisis at Long Term Capital Management, the hedge fund] in the United States, and the drying up of liquidity in the United States bond markets for a few days, and extraordinary events in this country. From a little market of $100 billion, the Russian Treasury bill market, we didn't understand that that was about to happen, but I was very, very worried on that night because of what it was going to do in Brazil, and was going to do in Latin America. And it happened.

INTERVIEWER: It's a very historic [moment]. How did you hear about the default? Did somebody call you?

STANLEY FISCHER: The IMF was working very closely with the Russians. We had lent to them in July 1998 to try to avert this crisis. We knew by the end of July 1998 that it wasn't working. We were in touch with them daily on the telephone—frequently, multiple [times a] day. We saw early in August that they were going to have to do something—devalue or restructure the debt, or default, those were all possibilities. The Russians said, "We tried restructuring, it didn't work. If we devalue, we're going to have to default. If we default, we're going to have to devalue. Let's try and do both neatly." In the event, the default was anything but neat. They should have tried to just tell people, "We'll work out how to pay you," but because of domestic politics and the interactions of the government and the Russian banks, they produced a scheme which basically screwed foreigners and helped the banks, and it was a disaster, We were in touch with them and we discussed with them how to do it, but it was their decision how to do it. In the end, the managing director of the IMF tried to persuade them on the last day before they did it not to go ahead in that way, but they went ahead. But we were talking; we had a team in Moscow; we knew exactly what was happening; cell phones were ringing inside meetings taking place with the Russians, so we knew the whole thing, unfortunately, and we knew... how difficult it was going to be....

When you have a group of policymakers who've had a very fixed way of thinking for a long time, [and] you tell them it's got to change—and however it changes, it's going to be terrible, but there are ways of making it less terrible or more terrible—it's very hard to get people to focus. It took until the middle of August before they really began to deal with the alternatives, and they were all on summer vacation, but they were in touch. Then they all came back to Moscow. [They had] started planning it just a couple of days before they came back to Moscow, and it wasn't done very well. Again, that was because of domestic political interests and involvement of bankers and other things. So this was decision-making under extreme pressure, people with a particular way of thinking, and that rarely works well. However hard you push, it's hard to find a way of getting them to get clear.

INTERVIEWER: Clarify one thing: When you say bankers, do you mean Russian bankers?

STANLEY FISCHER: I mean Russian bankers. They were very concerned. The Russian bankers were politically powerful, and they were very concerned about how this all was going to hit them.

INTERVIEWER: So what did you say when you got the phone call and heard that they'd actually defaulted? What was your reaction?

STANLEY FISCHER: It was a combination of fear and concern—concern for their having reached that position, and fear about what was going to happen in Russia and what was going to happen to the rest of the countries that rely on the international capital markets.

INTERVIEWER: Were the repercussions worse than you thought they would be?

STANLEY FISCHER: Yeah, they were much worse than I thought, because they reached into the industrial countries as well, and the impacts on Latin America were stronger than we expected.

INTERVIEWER: You were very active then in the autumn of 1998 as well. Do you remember a particularly dramatic involvement then?

STANLEY FISCHER: The aftermath of the Russian crisis was [the] Long Term Capital Management crisis, and then [the] seizing up, almost, of some United States capital markets, and a stopping of lending to the emerging-market countries. We were doing calculations in the IMF: How long can they go until they are forced to default (unless somebody lends to them, because countries have to roll over their debt all the time), and what can we do about it? How much money can we mobilize? We were out of money; at that time, we were down to our last $20 billion, and there was Brazil in deep trouble, there were other countries potentially in trouble, and we were trying to figure out how to deal with that. Fortunately, in October '98, the U.S. Congress passed the legislation that enabled us to get access to more funds and the problem then focused on Brazil, and we put a program in place with Brazil [that] was designed to defend their exchange rate. It ultimately failed to defend the exchange rate, but it stabilized the situation for a few months and it brought some respite to the international economy. The most important thing that happened at that time was that the Federal Reserve, seeing what was happening in the U.S. capital markets, cut interest rates three times and really acted preemptively to prevent a crisis, and what always happens when a crisis is prevented is everybody says ex post [facto]: "They overdid it. Look, nothing much happened! They shouldn't have cut rates." Well, they should have, because it they hadn't cut rates, we really would have had a severe global crisis.

INTERVIEWER: When did you finally allow yourself a sigh of relief?

STANLEY FISCHER: My two worst moments of this crisis were the night before Russia devalued and the night before Brazil devalued, and I was petrified about the consequences in each case. With Russia, I underestimated, and in Brazil, thank goodness, it worked out much better than I expected. Brazil devalued in January; we worked intensively with them in February. In March, it was clear that this situation was holding. Then one day, somewhere around March, first half of March, the clouds just lifted, and you suddenly thought, it's going to work, and that's how it was for a while....

INTERVIEWER: And why did Brazil work out better?

STANLEY FISCHER: Brazil worked for two reasons. They shifted to a floating exchange rate, and they got a very skillful manager of the Central Bank, Arminio Fraga, in place. Enormous credit goes to the finance minister and the president of the country for saying we have to keep this situation together, for keeping the budget, tightening the budget in these circumstances, and just staying on a path, which most people thought they couldn't keep on. The president was extremely unpopular—I think confidence in him was down to single digits—and what he did was not the popular thing to do, but they held it together politically, and the other part of the miracle was... the fear [that] if Brazil devalues, hyperinflation will return. It was quiet. There was very little inflation, and that has a lot to do with the Central Bank. It has a lot to do with what Brazilian society learned about inflation after going through hyperinflation, and deciding they never wanted that again.

The Mexican Crisis

INTERVIEWER: When we talked about Mexico, what your role was during the Mexican crisis, what were you were doing?

STANLEY FISCHER: The Mexican crisis was complicated because when it started in December 1994, Mexico, having become an OECD [Organization for Economic Cooperation and Development] country, a member of the league of industrial countries, and having joined NAFTA [North American Free Trade Agreement], the thought was [that] this is a crisis that's going to be managed by the big boys; we're not going to get the IMF into this. So for a period of about two weeks, the United States and Mexico tried to resolve this issue. Then they figured out that there was a reason for an IMF, it is a way the international community can do things, and so we began negotiating with Mexico. I think the most dramatic moment in the Mexican crisis, from the viewpoint of the IMF, came when, at the end of January, I think, early February, the U.S. had said it would lend Mexico $40 billion—no mention of the IMF or a small loan from the IMF. One night, it became clear that the U.S. Congress was not going to lend Mexico $40 billion; it was going to lend it about $20 billion, and then somebody had to find a way of lending Mexico the rest, and we had a very difficult conversation late at night with the U.S. Treasury. And the next morning, Mr. Camdessus got us together and within two hours, he had put together the financing to make up for most of what the U.S. couldn't provide. It was dramatic. He went far beyond what he could normally do. He eventually told the board, "If you don't like what I'm doing, fire me." They didn't, and together we helped stabilize the situation, but those were very dramatic moments because Mexico was close to default. And people think it's not much to default, but we saw Russia default, and it's taken them years to dig out of that. And people say, "Look, Russia did very well in 2000." Well, they had oil to help them do very well in 2000, and they didn't do so well in 1998 or '99. And countries that had defaulted on their debt paid a high price for it for a long time, and the fact that we helped Mexico avoid a default, stay in the international capital markets, come back to rely on the private markets within months, seems to me one of the best things the U.S. administration and the IMF and the international community have done.

INTERVIEWER: When you say it was a difficult conversation with the Treasury, I'm not sure what you meant by "difficulty."

STANLEY FISCHER: Well, the issue was, you guys said you could produce $40 billion—what happened to it? And we don't have the capacity to produce $20 billion. How are we going to deal with this? Why did you promise 40 if you didn't have 40? So it was way beyond anything we thought conceivable that we could resolve that issue. It was just sort of thrown to us, and we knew we had to move quickly. And if the managing director hadn't had a lot of guts, he could have just walked away from it.

INTERVIEWER: Did you pull the money in from other countries?

STANLEY FISCHER: No, it was fundamentally our money, but he had to persuade the executive board of the IMF, which didn't like it, that this was what should be done, and it meant persuading a lot of countries that thought Mexico should be the United States's problem [that] it was actually the international community's problem.

INTERVIEWER: So... the bailout of Mexico didn't [set the stage for the Asian crisis by sending a signal that a bailout was likely to happen].

STANLEY FISCHER: I do not believe that the bailout of Mexico had anything to do with the Asian crisis, and I can give you a simple technical reason. If it was the bailout of Mexico that caused the Asian crisis, people would have looked at Mexico and said, "Wow, the guys invested in equity got hit, the guys who lent in bonds got hit; it was the short-term money guys that got saved. So that's where we should put our money: short-term government debt." That's not where the money went. In Asia, it went to the private sector, and I don't think there's any evidence looking at the detail level which supports that contention.

Has the Cloud Lifted?

INTERVIEWER: So we see with Turkey, Argentina... I know you can't comment specifically about them, but as you said, the cloud lifted for a time. But could these problems come back?

STANLEY FISCHER: These problems do come back. Turkey [has] a smaller economy than some of the East Asian economies or than Brazil, and it's in some sense a globalized problem. Of course, politically, Turkey is enormously important. That's another one of a combination of political crisis and economic crisis. It's one where you have a coalition government, heavily involved in the economy, lots of things happen that are economically very bad but politically part of the glue that holds the government together. The markets recognize that that's part of the problem and now they have to change that whole system and it's difficult. There's a few people who want to change it. The program presented by the Turkish government to us, which is a reform program, has massive public support; over 65 percent of the public supports it. It's tough. It says we're going to cut government spending; it says the economy's going to decline in 2001, but it also says we're going to get rid of the political influence of government in the banking system, in the nationalized industries, in agriculture, and we're going to clean up Turkish politics. And that's why the people were voting for it, [why] all the international communities [are] trying to make that happen.

The Washington Consensus

INTERVIEWER: Was there a Washington consensus, and is there now a post-Washington consensus, and if so, what is the post-Washington consensus?

STANLEY FISCHER: The way people relate to the Washington consensus tells you more about themselves than about the Washington consensus. There is a Washington consensus in favor of pretty standard policies: reasonable budgets, low inflation..., [the] private sector basically running the economy, private ownership, reliance on markets, don't get too much into debt—a whole host of very common sense things. That's, to me, the essence of the Washington consensus. Now, there are those who want to indicate that they don't like the IMF and the World Bank, or that they don't like free-market policies, so they'll position themselves to one side or the other. I never thought of the Washington consensus as something that is carved in stone. We all learn; the world changes; the way you think about the economy changes; information technology comes along; global capital markets develop. All those things happen, and how countries should behave changes as the environment changes. But the basic core of sensible market-related microeconomic policies, macroeconomic policies directed at stability and growth, some element of social concern essential to worry about those who get left behind—that, to me, is my view of the Washington consensus; I think it's what the Washington consensus is, and then people sort of position themselves relative to that. Some want to criticize it from the right, some from the left. That just tells you how they feel about themselves. I believe there is such a consensus. I believe it's valid; I don't believe it's... an eternal verity, but it has elements of eternal verities in it, like if you run a budget deficit, you [have] got to be able to finance it. If your debts get too big, you're in trouble.

INTERVIEWER: I think it's misleading to call it the "Washington consensus," because it suggests in a way that this is something that's made up just in Washington and not in any other countries.

STANLEY FISCHER: It strikes me as a global consensus, and it maybe [is] awkward for those who espouse these policies in Santiago, Chile, or in Mexico City or in Brasilia or in parts of Africa [or] even, dare one say it, gradually changing in India. It may be awkward for them to support something so identified, but maybe you can come up with a better name. We'd all be happier if we could call it the global consensus.

The Rules of the Game: In Whose Interest?

INTERVIEWER: You said earlier that the rules of the IMF, World Bank, WTO, [were originally] written to serve the interests of the U.S. in Europe. What are your thoughts on this?

STANLEY FISCHER: [T]he Asian countries that have grown fastest—Korea, Hong Kong, Singapore, China—have been the ones that have taken advantage of this system, have recognized that by integrating into the world economy, by exporting, by relying on import markets, and gradually opening up, that they can do better that way. Those are the rules Lee Kuan Yew's country [Singapore] followed; those are the rules that the others followed—not exactly, [because] they had more state intervention, but they've been gradually getting rid of it. I don't know what that is based in. If something is in the interests of the United States in Europe, it may well also be in the interests of the rest of the world. In this case, I think it is.

INTERVIEWER: We've talked about [the] Bretton Woods rules [established in 1944]. Do we need new rules for the global economy? Globalization, is that the issue of the day?

STANLEY FISCHER: It's the issue of the day because everyone says it is. It's obviously what gets people out into the streets. It's so obviously something that's happening just as we look at what we consume, how we travel, how we use the telephones. [It] is the basic issue of the day, but many of the phenomena that people are concerned about, that they ascribe to globalization, are related [more] to technical change—say the skill, the wage differentials that reward highly skilled people more than they used to be, relative to low-skilled. Those [differentials] have to do with the changing nature of technology more than the fact that we trade. Do we need different rules? I think we need, in the first instance, countries to strengthen the set of common rules—in terms of accounting standards, the way markets work—that they all have. But those are global rules applied to national economies, in terms of different sets of rules for, say, exchange rate systems. I think we're evolving in the direction of a new set of more flexible rules, more flexible exchange rates, to be followed, I think, by fewer currencies [based] on the European model of [trading] blocks developing a currency, with the recognition that you can do perfectly well with your trading partners with a common currency. So I expect that long after this program has been buried in a time capsule, there'll be much fewer currencies in the world.

INTERVIEWER: What is the moral hazard?

STANLEY FISCHER: A lot of people were very concerned that when the IMF lends to a country or when anyone lends to a country, the issue of moral hazard arises, [that] people are just lending to a country because they know the IMF is going to come to the rescue if there's a problem. You know, most of the people who invested in crisis countries—the equity investors, the foreign direct investors, those who lend to corporations in those countries—took tremendous beatings. I know, and I held some mutual funds—and all you involved in emerging-market mutual funds know that, if you had bonds, a few escaped. Those in the case of Mexico were healthy as a bonus, but the great bulk of people get hurt, and then if you look at the question or ask yourself the question—did people really invest in Asia because they thought that Asia was going to get into trouble and the IMF would be running along to give them the money?—I think it's absurd.

I think the reason they invested in Asia was that they thought that trees grow out of the sky, that 10 percent growth can continue forever, that there's not going to be a crisis here, and that's why they lent to Asia. There's one country where I think the moral hazard argument is right, and that is Russia. I think people thought that whatever trouble Russia gets into, somebody will make good on their debts because we can't afford to have a nuclear power fail economically. But it did fail, and those who believe in "moral hazard plays," as they're called,

[who] invest in important countries, should realize that the global system decided that a point is reached at which even Russia is allowed to fail, and that could happen to other countries, too. I don't think we need to go around creating crises and allowing countries to fail and default in order to prevent investors lending. I think investors lent too much before the IMF was invented; they would lend too much after the IMF [is] closed, if it is ever closed. This is just the way capital markets work—bursts of enthusiasm, high tech, whatever it is at the moment, [followed by] the realization that it's gone too far, and then it collapsed. [It] doesn't have much to do with the belief that somebody's going to rescue them if the crisis happens.

INTERVIEWER: How do you respond to the charge that... globalization, the [global] trading system, promotes inequality?

STANLEY FISCHER: [I think] the global trading system... and trade [are] the greatest force for reducing inequality in the world. The fact that huge parts of Asia, which used to be dirt poor, are now, some of them, at middle-income levels—some of them growing very fast, like the Chinese—is because of the global trading system; and so, at a global level, I believe this is a system for creating equality. Within a country, in the short run, there is no question that when you open up to trade, some of the people are going to get hurt—[and it's] likely to be the people who are affected by what is imported. That is a short-term consequence which must be dealt with, because it's very real what happens to people. It has to be dealt with through compensation payments (that is, unemployment benefits and other things), [but] primarily through training—retraining to help these people get the better jobs that will be created in their country, and this is a real problem. It cannot be laughed off. It must be dealt with. But if we allow concern over that problem—which is real—to stop international trade, we will create greater inequality economically.

Are the Crises Getting Worse?

INTERVIEWER: [Is the system] becoming increasingly unstable? [Are] the crises getting worse and coming more frequently?

STANLEY FISCHER: There were more crises, more big crises in emerging-market countries, in the 1990s than in the previous decades, and that had to do with the opening up to international capital flows. There is a set of improvements being put in place now, especially the move to flexible exchange rates, that I believe will reduce the frequency of crises. So I think that this period in this global economy is a bit like the period before the invention of the Federal Reserve in the United States economy. It was a succession of financial crises at the end of the 19th century. In the early 20th century, we developed the institutions—the Fed, and eventually deposit insurance during the Great Depression—[that] brought stability to the system—the SEC [Securities Exchange Commission], various other things, regulations. Those things are coming into the global system as well, but primarily the change in exchange rate systems. So I don't think this is a system that is subject to ever-growing instability, I think it's a system which demonstrated instability; it was diagnosed, and then measures are being taken to reduce it. I expect to continue to have crises, but I don't expect on the scale of the last few years.

INTERVIEWER: But we don't expect a world central bank, do we, a world Federal Reserve?

STANLEY FISCHER: Not in our lifetimes.