Productive Incoherence in an Uncertain World: Financial Governance, Policy Space and Development after the Global Crisis

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PRODUCTIVE INCOHERENCE IN AN UNCERTAIN WORLD:

FINANCIAL GOVERNANCE, POLICY SPACE AND DEVELOPMENT

AFTER THE GLOBAL CRISIS

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ABSTRACT

The current global financial crisis raises important questions for scholars of international political economy. Among the most important of these is how it is influencing various dimensions of financial governance vis-à-vis developing and transitional economies. The heart of this paper examines three related questions. How is the crisis affecting the governance and policies of the IMF; the prospects of regional alternatives to the Fund; and the policy space available to developing and transitional countries?

Two principal findings are articulated in this paper. The first is that the crisis does not appear to be inducing epochal, universal changes in financial governance. That said, the second principal finding concerns the tentative emergence of what I call "productive incoherence" in place of the neo-liberal coherence that has characterized financial governance over the past several decades. Evidence gleaned from a review of institutional and policy responses to the crisis to date suggest that the neo-liberal prescription that predominated in response to the East Asian and other recent financial crises is no longer the default or only option for national governments or even for the international financial institutions that have been forced, at least in some country contexts, to allow substantial departures from their traditional policy prescriptions. Instead, we find a proliferation of responses to the crisis by national governments and multilateral institutions that to date have not congealed into any sort of coherent strategy or regime.

I refer to the inconsistency and even contradictions in crisis response as productive incoherence. For those (like this author) who have elsewhere worried about neo-liberalism as a straightjacket that has severely constrained policy space in developing countries, the new incoherence may signal a new openness to policy and institutional innovation or, at the very least, a temporary aperture born of uncertainty about the lessons of the current crisis. In that sense, what I see as an incoherent response to the current crisis may ultimately prove to be productive of development and supportive of policy and institutional diversity in vital ways. We must be cautious in reaching such judgments, however, because advocates of neo-liberalism have, in the recent past, proven remarkably adept at "paradigm maintenance." It is at least conceivable that this worldview may re-establish itself in the post-crisis environment.

1. INTRODUCTION

The current global financial crisis raises important questions for scholars of international political economy. Among the most important of these is how it is influencing various dimensions of financial governance vis-à-vis developing and transitional economies. The heart of this paper examines three related questions. How is the crisis affecting the governance and policies of the IMF; the prospects of regional alternatives to the Fund; and the policy space available to developing and transitional countries?

In the paper I scan the current landscape for evidence of changes in these dimensions of financial governance. I also speculate about future developments in financial governance in the post-crisis environment. In each case, I look for evidence about what has survived, what has been solidified, and what has been overturned, challenged or erased by the crisis. I am particularly interested in highlighting those instances where we find some evidence of increasing policy space or alternative institutional arrangements as a consequence of failing institutions, changes in ideas, undermined confidence, or ambiguity concerning the steps necessary to staunch the crisis. It is far too early to say with confidence just how financial governance vis-à-vis developing and transitional countries will in fact evolve from the crisis. It is an appropriate moment, however, to examine what might be thought of as pressing research questions that are of paramount importance for scholars and policymakers.

Two principal findings are articulated in this paper. The first is that the crisis does not appear to be inducing epochal, universal changes in financial governance. That said, the second principal finding concerns the tentative emergence of what I call "productive incoherence" in place of the neo-liberal coherence that has characterized financial governance over the past several decades. Evidence gleaned from a review of institutional and policy responses to the crisis to date suggest that the neo-liberal prescription that predominated in response to the East Asian and other recent financial crises is no longer the default or only option for national governments or even for the international financial institutions that have been forced, at least in some country contexts, to allow substantial departures from their traditional policy prescriptions. Instead, we find a proliferation of responses to the crisis by national governments and multilateral institutions that to date have not congealed into any sort of coherent strategy or regime.

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[1] To borrow a phrase from Wade [1996].

2. THE EFFECTS OF THE CURRENT CRISIS ON DEVELOPING AND TRANSITIONAL ECONOMIES

Before exploring in detail the institutional and policy responses to the current crisis, we should survey its effects on developing and transitional countries. This mapping is necessarily preliminary, since the crisis continues to unfold. We know that the severity, types of transmission channels, and effects of the crisis differ across countries and regions insofar as they depend on unique initial conditions. Among the most important of these conditioning factors are the following: the level of financial fragility in the country (which in turn depends on the depth of the domestic financial system and the degree of domestic financial liberalization and global financial integration); the degree of dependence on export performance and the particular composition of a country's exports; the mix of official development assistance (ODA) and of different types of international private capital flows (namely, FDI, PI, foreign bank loan and remittances) and their respective influence on domestic investment, working capital, employment, wages and consumption; and the conditions of the public sector as concerns its fiscal position, official reserves, capacity, and the types and intensity of pre-crisis pressures that it faced, such as the legacy of civil war, food or fuel price pressures, or public health emergencies.

In what follows I offer a sketch of the diverse effects and transmission channels of the crisis in developing and transitional countries. These effects are proving to be numerous and severe across a wide range of countries. Indeed, the World Bank and the IMF have correctly identified a "development emergency" [WB-IMF, 2009] since the effects of the financial crisis compound the problems that so many countries already faced owing to the food and fuel crises that began at the end of 2007. Moreover, many of the effects of the crisis are likely to have long-term consequences that affect future generations.

Economic growth

The IMF's April 2009 *World Economic Outlook* forecasts a "long and severe contraction" for developing and transitional countries [IMF, 2009b]. According to the IMF's October 2009 forecast, average output growth in developing and transitional economies is expected to be as low as 1.7% in 2009, down from growth of 8.3% in 2007 and 6% in 2008. Average growth rates for developing and transitional countries are significantly affected by conditions in China and India. The Fund projects that output in China will grow by 8.5% in 2009 (down from 13% growth in 2007 and 9% in 2008), and that India will grow by 5.4% (down from 9.4% in 2007 and 7.3% in 2008). Output in several regions of the developing and transitional world is projected to contract in 2009. Specifically, Central and Eastern Europe is projected to contract by 6.7%, the Commonwealth of Independent States (CIS) by 6.7% (excluding Russia, the area is expected to contract by 4.7%), the ASEAN-5 countries (namely, Indonesia, Malaysia, Philippines, Thailand and Vietnam) by .7%, and the Western Hemisphere by 2.5% (with Brazil expected to contract by .7%, Mexico by 7.3%).

Financial flows and markets

For the countries and regions that had been successful in attracting high levels of FDI, PI, and foreign bank loans during 2003-07, the dramatic reversal of these flows that began in 2008 has had severe consequences for the price and availability of working capital, investment, firm and domestic bank performance, output, employment and financial and exchange rate stability. Between 2007 and 2008, net portfolio equity flows to developing and transitional countries fell by almost 90 percent (from $139 billion in 2007 to $16 billion in 2008).[2] Similarly, private debt flows declined substantially (from $499 billion in 2007 to $108 billion in 2008), largely driven by a reversal in short-term debt flows, which fell from $202 billion in 2007 to -$16.3 billion in 2008, and by the decline in available bond financing, which fell from $85 billion in 2007 to $11 billion in 2008.[3] During the same period, the rate of increase in FDI slowed significantly. UNCTAD [2009a] forecasts that FDI inflows to developing and transitional countries—the largest component of international capital flows to non-wealthy countries--will decline in 2009 by 25% in developing countries and by as much as 40% in transition countries.

The downturn in international private capital flows in 2008 affected all developing regions, but to various degrees. The only exception is the Middle East and North Africa, where inflows increased slightly. The transitional countries of Europe and countries in Central Asia experienced the most significant reduction in international private capital inflows. Short-term debt accounted for a major share of the decline in private capital inflows in East Asia and the Pacific (where short-term debt inflows fell by 67 percent), South Asia (by 56 percent), and Europe and Central Asia (by 45 percent). In Sub-Saharan Africa, two-thirds of the $15 billion decline in private capital inflows was accounted for by the collapse in portfolio equity inflows, with the rest in bond financing.

Countries that had relatively deep and internationally integrated stock markets prior to the crisis (such as Brazil, China, India, Russia, South Africa, Chile, and Mexico) experienced in 2008 the worst yearly decline in market value in recent history. This decline was much more severe than the collapse in wealthy country stock markets. Investors herded out of frontier markets more quickly and aggressively than they did out of the US market. The Russian market experienced a 72.5% decline in value (local currency valuation), Brazil's 40%, India's 52%, China's 66%, and the markets of Chile, Mexico and South Africa each fell by more than 20% in 2008. The MSCI Emerging Market Index fell by 55 percent during 2008, eliminating some $17 trillion in market valuation. According to Merrill Lynch's Africa Lions Index (which tracks 15 African countries), Africa's markets declined by almost 70% during March-December 2008 [IMF, 2009a]. The fall in share prices in developing and transitional countries resulted in margin calls, forced liquidation of holdings and severe trading and wealth losses, a phenomenon that had important effects on domestic banks and households.

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[2] Data in this sub-section (except where noted) are from World Bank [2009a].

[3] The magnitude of the decline in lending is particularly worrisome from the perspective of financial stability since much of the $1.2 trillion in external debt raised by banks and firms in developing and transitional countries between 2003 and 2007 is now maturing. This puts pressure on borrowers' finances at a time when the average cost of external borrowing has increased to 11.7 percent, compared to 6.4 percent in the pre-crisis years when the debt was contracted [World Bank, 2009a].

In many developing and transitional countries, foreign banks play a large role in the domestic market both as direct lenders to households and firms and also as lenders to domestic banks. The financial crisis has caused many foreign banks to curtail their operations in local markets by a faster rate than they are contracting lending in their home markets [IMF, 2009c). This contraction in foreign bank operations had concomitant negative effects on the availability, price and spreads on credit. Many Central and East European (especially the Baltic states) and the CIS countries were very successful from 2002 to 2007 in attracting foreign bank loans from EU countries, especially from Sweden, but also from Austria and Italy. These loans, like those made to East Asia a decade ago by US and Japanese banks, fueled a consumption and real estate bubble and were characterized by high levels of maturity- and especially locational mismatch. By 2008, thirteen countries that were once part of the Soviet Union had accumulated a collective debt to foreign banks or in foreign currencies of more than $1 trillion. Countries like Bulgaria and Latvia borrowed annually the equivalent of more than 20% of their GDP from abroad, leading some analysts to refer to the transitional countries as Europe's version of the sub-prime market [Ahamed, 3/8/09].

The reversal of diverse types of international capital flows has also caused the currencies of almost all developing countries to depreciate against the US dollar, in many countries by 20% or more. Exceptions to this trend include the Chinese currency and those of several oil exporters that peg to the US dollar. [4] Currency depreciations have increased the cost of servicing US dollar-denominated debt and of purchasing essential imported wage goods and medicines. Depreciations have not had the usual beneficial effect on exports because of the contraction of global demand. In many countries, official reserves are being depleted in efforts to stabilize floating exchange rates or to maintain exchange rate pegs with the dollar or the euro. Indeed, at the end of 2008, reserves in the developing and transitional world were up only by $447 billion, about half of the almost $1 trillion increase in 2007.

It might seem that the picture is brighter for those countries that did not have access to FDI, PI and foreign loans prior to the crisis. But this is simply not the case. These countries (many of them low-income) have been hard hit by the contraction in domestic financial intermediation, ODA and remittance inflows. Even those domestic banks that were not integrated internationally prior to the crisis have increased spreads and curtailed lending in their home markets in the context of rising risk aversion, debt distress by households and firms, and the reduction in global liquidity. Moreover, the substantial reduction in ODA has hit the poorest countries in the world especially hard.

In those countries and regions in which remittances have long been essential sources of purchasing power and social insurance, the contraction in remittance inflows has had serious negative effects on living standards, consumer spending, the operation of small businesses, and housing markets. Remittances grew rapidly from $285 billion in 2007 to $328 billion in 2008, but have slowed down considerably in many areas since the last quarter of 2008 and the slowdown continued into the first half of 2009.[5] Remittance inflows are expected to decline by 7-10% in 2009 because of the deterioration in the economic and employment situation in many

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[4] The collapse in commodity prices also played a role in exchange-rate depreciations.
[5] Data on remittances are drawn from World Bank [2009c].

migrant-destination countries (particularly, the USA, Western Europe, the UK and Japan). Europe and Central Asia are expected to experience the largest decline in remittance inflows among all regions in 2009 (by 15%); remittance inflows to Latin America and the Caribbean are expected to decline by 7%, those to the Middle East and North Africa by 6%, to Sub-Saharan Africa by 8%, and to South Asia by 4%. Even a modest decline in remittances hits smaller countries especially hard since remittances are often the largest source of external finance to these countries (e.g., remittances in 2008 exceeded 25% of 2007 GDP in Tajikistan, Tonga, Moldova, Lesotho and Guyana). Remittances have traditionally played an important social insurance role in poor countries, have long been countercyclical during downturns in recipient economies, and have traditionally been less volatile compared to other types of international private capital flows. The global nature of the current crisis, however, undermines their traditional stabilizing characteristics.

The reversal of so many types of international capital flows means that there will be large financing gaps across developing and transitional countries. According to the World Bank (2009b], external financing needs in 2009 are expected to exceed private sources of financing in 98 of 102 developing and transitional economies. According to these same estimates by the Bank, total external official financing shortfalls in these 98 countries range from $270 to $700 billion (whereas institutions like UNCTAD project a far larger external financing gap of as much as $2 to $3 trillion, see Akyüz, 2009). The World Bank estimates that only ¼ of developing countries are in a position to expand their fiscal deficit to undertake serious countercyclical spending; moreover, 1/3 of these countries are dependent on ODA and will require additional external support to finance increased spending owing to the crisis. The Bank also estimates that financing shortfalls to cover at-risk core spending on health, education, safety nets, and infrastructure amounts to about $11.6 billion for the poorest countries [World Bank 2009b].

International trade

There are several ways that the crisis has undermined the international trade environment for developing and transitional countries. The evaporation of global and national liquidity has meant that essential trade finance has become less available. In low-income countries, the volume of trade financing dropped by 18% in the last quarter of 2008 [IMF, 2009a]. The demand (and terms of trade) for exports of consumer goods, manufactured and capital goods, and commodities has fallen with the overall global decline in consumer spending and real investment. The IMF projects a 6.5% decline in exports from developing and transitional countries in 2009 (compared to an increase in exports of 9.5% and 4.1% in 2007 and 2008, respectively) [IMF, 2009b]. For some countries, this drop off in export performance has been especially significant: e.g., in December 2008, Brazil reported its first trade deficit in almost eight years, as exports fell by 29% [World Bank, 2009b].

East Asian economies have been affected very seriously by the decline in demand for manufactured goods; China has been affected by the same trend, especially given the decline in demand for consumer goods; African economies have been hard hit by the decline in commodity exports; and in Latin American economies, which are so highly integrated with the USA, the impact of the crisis is felt through many trade and financial channels, such as the increased cost of food imports from the USA, the decline in demand for exports, and the reduction in

remittances. The World Bank [2009d] estimates that in US dollar terms, merchandise exports from low-income countries are anticipated to drop by 14.4% in 2009, compared to a 22.8% increase in 2008.

Employment, wages and industrial production

The deterioration of financial and trade conditions and of consumer and business confidence has obvious negative implications for industrial production, employment, wages, and living standards. Industrial production in developing countries fell by 15% in the fourth quarter of 2008 [World Bank, 2009b]. The International Labor Organization estimates that unemployment in 2009 could exceed 50 million if conditions continue to deteriorate (this compares to 30 million unemployed in 2007) [UN, 2009a].

The wage picture is further undermined by the return of migrant workers at a time when under- and unemployment is already high and rising. The dismal employment environment in many destination countries and the rise in anti-immigration sentiment (especially in Western Europe, the USA, UK and Russia) have induced migrants to return home. This deterioration in the environment for migrants has also led to an increase in forcible deportation in some countries (such as the USA) and to the introduction of programs that provide migrants with financial incentives to return to their country of origin (such as in Spain and Japan). For example, under an emergency program introduced in April 2009, Japan's Brazilian and other Latin American guest workers (who worked in the country in large numbers beginning in 1990 on Nikkei visas) have been offered lump sum payments to leave the country [Tabuchi, 4/23/09]. Spain has adopted a similar program, though unlike the Japanese program, immigrants are allowed to reclaim their residency and work visas after three years [Tabuchi, 4/23/09]. In the Czech Republic in February 2009 foreign guest workers were offered free airline tickets and a 500 euro allowance to go home [Bilefsky, 2/24/09].

Poverty and vulnerable groups

The number of working poor in the developing world, and the number of people living in poverty (incomes below $2 per day) and extreme poverty (incomes below $1.25 per day) is increasing in the context of the crisis. The World Bank estimates that by the end of 2010, 89 million more people will be living in extreme poverty than would have been the case without the crisis [WB 2009d]. Rising poverty rates have particularly severe consequences for women, infants and children, the elderly, migrants, and the likelihood that families will be able to invest in health, nutrition and education, especially for girls. Research by the World Bank [2009d] estimates that the crisis could result in 30 to 50 thousand additional infant deaths in Sub-Saharan Africa in 2009.

These shortfalls in financial support are aggravated by the contraction in ODA inflows. The effect of the crisis on vulnerable groups is likely to have long-lived intergenerational macroeconomic, microeconomic, and equity impacts that trap households in a vicious cycle of low assets and human capital investments that frustrate their movement out of poverty [UNICEF, 2009].

Effects on states

Rising social dislocation is increasing political instability and social unrest in many countries. The Icelandic government was the first to fall because of social unrest directly related to the crisis. The current government is also in a vulnerable position as it seeks to navigate the dislocation caused by the restrictive macroeconomic policies associated with its stand-by arrangements (SBAs) with the IMF-EU and other institutions and with its attempt to pay off foreign depositors.[6] The situation of several transitional countries (e.g., Latvia, Bulgaria, Ukraine, Hungary, Romania) is uncertain as well since these governments are dealing with the painful social costs of reforms necessitated by their own SBAs.

States in the developing world are under immense pressure owing to the tight fiscal constraints that they face. Tax collections and ODA are down, official reserves are being depleted, international capital flows are being reversed, energy and food costs are rising, and returning migrants are placing pressure on social safety nets that were already strained prior to the crisis. Finally, higher levels of risk aversion globally make it harder and more costly for the public and private sectors to borrow on international capital markets, especially as new sovereign issues by wealthy governments are seen by global investors to be a safer investment. All of this has meant that many developing countries (especially the poorest of them) have been unable to respond to the crisis through the types of dramatic countercyclical monetary and/or fiscal policies that have been pursued in many wealthy countries, but also in China, in about half of the economies in Latin America and the Caribbean and in a number of countries in Asia (see below). Indeed, few low-income countries have the fiscal space to undertake counter-cyclical policy [World Bank, 2009d]. Infrastructure spending by governments has disappeared in many poorer countries, and this obviously has long-term implications for economic growth prospects.

3. THE CRISIS AND GOVERNANCE

Gauging and evaluating the institutional and policy response to the current crisis can benefit from a brief comparison with the outcomes of two previous crises that share important features with the present: the East Asian crisis of 1997-98 and the Great Depression. For our purposes, what is most important about the earlier crises is the imprint that each had on global financial and economic governance.

A look back at the effects of previous financial crises on governance

Several features of the East Asian crisis are relevant to our examination of the current crisis.[7] The East Asian crisis emerged in the "Asian miracle" economies (per the title of the well-known 1993 report by the World Bank), economies that were models for much of the developing world right up until their collapse. The collapse of these economies took foreign and domestic investors by surprise. Investors had been riding a wave of euphoria about East Asian economies for roughly fifteen years. This euphoria was manifest in the foreign bank loans, PI and FDI that

[6] SBAs are the IMF's basic short-term loan agreement.
[7] Discussion of the East Asian crisis and it effects on governance draws on Grabel [1999, 2003a, 2004b, 2007].

poured into these booming economies. The contagion effects of the East Asian crisis were rapid and severe, initially affecting neighboring economies, but eventually spreading to other developing and transitional countries, such as Russia, Brazil and Argentina. Spared from the worst of the contagion effects of the crisis were those developing countries that managed global financial integration and domestic financial flows in a variety of ways (such as China, India, Chile, Colombia, Singapore, and Malaysia) and those that could draw on high levels of official foreign exchange reserves (such as China, Hong Kong, and Singapore).

After the crisis, a cottage industry of forensic studies emerged, the majority and most influential of which uncovered in the crisis economies deeply rooted and pervasive, yet somehow previously undetected patterns of corruption, cronyism, non-transparent business-government relations, and unsustainable financial fragilities (such as excessive leverage of the private sector and non-viable exchange rate pegs). The East Asian miracle economies were accordingly recast as financially fragile economies in which rapid output and export growth were conditioned on unsustainable patterns of borrowing and investment. This characterization had elements of truth insofar as countries that eventually fell victim to the East Asian contagion did have high levels of external debt (with locational and maturity mismatches), low levels of foreign exchange reserves relative to external obligations, and fiscal imbalances.

In the immediate aftermath of the crisis the SBAs with the IMF provided assistance conditioned on stringent macroeconomic policy contraction, market flexibility, privatization, economic openness that provided foreign investors with access to formerly protected areas such as banking, and a strengthened commitment to export-led growth. The intensification of the export-led growth regime in the post-Asian crisis environment was made possible by the appetite for consumption in wealthy countries at a time of high global growth. Given the diagnostics of the Asian crisis offered by influential analysts, it is not surprising that the IMF and the G-7 leaders in the post-crisis environment promoted reforms in economic and financial governance through a variety of fora that focused on greater dissemination of information, increased monitoring and surveillance, the adoption of universal standards and codes, arms-length corporate governance, regulatory and institutional harmonization around Anglo-American norms, and an associated enhanced role for market discipline, market-adjustment mechanisms and private actors (such as credit rating agencies) in financial governance.

The East Asian crisis therefore amplified the pressures toward neo-liberal conformance in a great many countries (even if a few countries, most notably China, bucked these trends). In fact, reform in the post-Asian crisis environment in both wealthy and developing countries cohered in the direction of enhancing neo-liberal, market-led, private financial governance.[8]

The IMF emerged from the Asian crisis a greatly weakened institution in regards to its credibility around the world, the adequacy of its own financial resources, the size of its staff, and the geographic reach of its programs. Critics on both the left and the right railed against the institutions' mission creep, heavy handedness, domination by the USA, and its myriad failures in East Asia prior to and following the crisis. Policymakers in a number of Asian countries and in

[8] The Enron, Long-Term Capital Management and other financial scandals of the 1990s were also resolved on the side of those favoring more information, transparency and market discipline.

other successful developing countries (particularly in Latin America) sought to insulate themselves from the hardships and humiliations suffered by Asian policymakers at the hands of the IMF by self-insuring against future crises through the over-accumulation of official reserves. After the loans associated with the Asian crisis were repaid, the scope of the Fund's loan portfolio contracted dramatically since those countries that could afford to do so deliberately turned away from the institution. Consequently, the Fund's loan portfolio after the Asian crisis came to focus on low-income countries and other countries that were not able to self-insure.

Like the East Asian crisis the current crisis emerged in a model economy, in this case the USA, which during the 1990s and much of the 2000s was set out as the model for the world (for its flexibility, transparency, regulatory architecture, dynamism and technological innovation, and most importantly, for the vitality and soundness of its financial system). The pre-crisis standing of the US economy of course transcended that of East Asia's insofar as the USA was a model not just for developing, but for all countries, even the aging economies of Western and Southern Europe and Japan. The current crisis also had several secondary epicenters, most notably Iceland and the Baltic states. In their own right these countries, too, were designated model economies right up until they imploded. (As Paul Krugman ironically notes, "there is an almost eerie correlation between conservative praise two or three years ago and economic disaster today" [Krugman, 3/2/09). It is clear that the contagion effects of the current crisis are more severe, likely to be more enduring, and have already cut a far wider geographic swathe than did the East Asian crisis. The current crisis is global in nature--indeed, no country has been left untouched. What is worse, the economic effects of the crisis in developing and transitional countries are far more severe and will endure longer there than in the countries whose implosion caused the crisis.

The etiology of the current crisis is familiar to students of the East Asian experience of more than a decade ago. Again, we see corruption, cronyism, financial fragilities, and a variety of pyramid schemes, all on a scale far larger than in the Asian cases. The US case is also characterized by a regulatory architecture that was simply unable and unwilling to keep pace with outsized financial innovations and fraud.

There are also important parallels between the Great Depression and the current crisis. The epicenter of that crisis, like the current one, was the USA. The two crises share some structural roots, and both became global in scope—though, reflecting today's high level of global and economic integration, the current crisis spread geographically far more quickly.

Unlike the Asian crisis, the Great Depression ultimately represented a turning point in financial governance. It resulted in far-reaching reform of national financial institutions and policies, the creation of a new global financial architecture with the US economy and currency enshrined at its center, with the newly-created IMF as the institution charged with responding to balance-of-payments and liquidity crises, and an international financial system in which control over international private capital flows was an essential tool of macroeconomic management. Finally, the Depression ushered in an era of Keynesian-inspired economic theory and policies around the globe, and the demise of liberal, market-oriented economics.

It is necessarily too early to say with any confidence if and how the lessons of the current crisis will be imprinted on national and global financial reform. But it is certainly likely that the

current crisis will have a number of important, lasting effects on financial governance. I would suggest that the most likely outcomes of the current crisis are less hubris on the part of the American economics profession and policymakers, more institutional and policy divergence across developing countries (with the exception being those that have committed themselves to currency substitution or currency board arrangements), a greater role for regional governance arrangements, and a greater role for the state in mediating some types of financial flows in some countries. In addition, the IMF seems to have emerged from the current crisis as a clear winner in a couple of senses. The IMF's financial resources have been buttressed, the global reach of its loan portfolio has been restored, and it has been rescued from possible irrelevance. What is less certain about the current crisis in connection with the IMF is whether this event will result in fundamental, consistent changes in the institution's relationship with developing countries and in the character of its policy recommendations to these countries.

So far, the current crisis has called forth diverse and collectively incoherent responses across the globe--national Keynesianism in many countries (e.g., the USA, France, China, Brazil, India), a "schizophrenic Keynesianism" in many countries that have SBAs with the IMF (such that there is no discernable pattern to their monetary and fiscal policy responses), Hooverism in a smaller group of countries (e.g., Iceland and the Baltic States), and a greater degree of political pluralism that is exemplified by the displacement of the G-7 by the G-20 and by the commitments made by some developing countries to enhance the resources of the IMF. It is unlikely (though still uncertain) that the current crisis will ultimately have lasting, radical and universalizing effects on financial governance that followed the Great Depression.

Even if we are not on the brink of an epochal shift in governance, the current crisis holds the promise of changes in facets of governance that can create more space for development, policy and institutional experimentation and heterogeneity, and a greater degree of pluralism in the governance of the world economy. The incoherent responses to the current crisis that we are witnessing might ultimately be productive of development.

We now turn to the effects of the current crisis on three dimensions of financial governance vis-à-vis developing and transitional countries. I also offer some speculations on future developments.

The IMF: Global role and governance

The IMF has had a dominant and controversial role in financial governance from the debt crisis of the 1980s through the immediate aftermath of the East Asian crisis. As mentioned previously, an important consequence of the East Asian crisis and subsequent changes in the global economy was the loss of purpose, standing and relevance by the IMF. Indeed, prior to the current crisis, demand for the institution's resources was at an historic low. Major borrowers (including Argentina, Brazil, and Ukraine) had repaid their outstanding debt to the institution and the Fund had contracted its staff [Kapur and Webb, 2006].[9] In fiscal year 2005, just six countries had SBAs with the Fund, the lowest number since 1975 [Kapur and Webb, 2006]. From 2003 to

[9] In the years following the East Asian crisis, the Fund eliminated as much as 15% of its staff [Thomas, 4/5/09].

2007, the Fund's loan portfolio shrunk dramatically: from $105 billion to less than $10 billion, while just two countries, Turkey and Pakistan, owed most of the $10 billion [Weisbrot, Cordero and Sandoval, 2009]. The IMF's list of customers came to include primarily only extremely poor countries that had no choice but to borrow from the Fund [Chorev and Babb, 2009]. Some developing countries had opted out of Fund programs by relying on a combination of their own foreign exchange reserves, international private capital inflows and newer sources of international private and public capital, such as securitized remittances, swap arrangements among central banks, and the trade finance, private investment and ODA provided by fast-growing developing countries, especially China [Kapur and Webb, 2006; Ketkar and Ratha, 2008].

The current crisis has been good to the IMF [Chorev and Babb, 2009; Cammack, 2009]. It has rescued the institution from its growing irrelevance by re-establishing its central place as first responder to financial distress. This re-empowerment has come about for a number of reasons. Even with reduced staffing the Fund still holds a monopoly position when it comes to experience in responding to financial distress in poorer countries. Moreover, the IMF has no immediate competitors for this essential role. The regional arrangements and institutions that have evolved in the developing world in response to the East Asian crisis are not yet in a position to substitute for the Fund (see discussion below). Leading nations within each region might have taken a key role in responding to the effects of the crisis in neighboring countries had they not been struggling to respond to the crisis themselves.

The April 2009 meeting of the G-20 played an important role in re-empowering the IMF. At that meeting, G-20 representatives gave the IMF pride of place in global efforts to respond to the crisis. The message was not lost on the Fund's Managing Director, Dominique Strauss-Kahn who, at the meeting's end said: "Today is the proof that the IMF is back" [Landler and Sanger, 4/2/09] (It bears noting that the global crisis has reinvigorated not only the IMF, but also other multilateral financial institutions, such as the Inter-American Development Bank and the European Bank for Reconstruction and Development, EBRD.[10]) The meeting not only restored the IMF's mandate but also yielded massive new funding commitments to the institution to support its efforts to respond to the crisis (even if upon close examination these commitments are less than advertised[11]). Representatives committed $1.1 trillion in funds to combat the financial crisis, with the bulk of it, namely, $750 billion to be delivered through the IMF.[12]

At the same G-20 meeting several developing countries committed to purchase the IMF's first ever issuance of its own bonds: China committed to purchase $50 billion, and Brazil, Russia,

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[10] For an interesting anecdote along these lines, see McElhiny [2009] for a description of how the Inter-American Development Bank's holiday party in 2008 celebrated the increased demand for infrastructure stimulus packages through a musical number performed by some Bank staff (see Youtube clip, as noted in this report). See Kulish [10/8/09] on the EBRD.

[11] Some commitments had already been made prior to the G-20 meeting, some announced commitments involve double counting, and some involve funding commitments that may or may not ever materialize [see Akyüz, 2009:8, fn7; Chowla, 2009].

[12] Of this $750 billion, $500 billion was for new lending, while $250 billion was to be provided by an issuance of special drawing rights, SDRs.

South Korea and India each committed to purchase $10 billion. Thus, $90 billion of the proposed $500 billion in new resources for IMF lending will come from countries that have traditionally not played an important role at the Fund. China has now signed the formal agreement with the Fund to make purchase of these bonds a reality. The support for the Fund coming from developing countries is surely a landmark event in the institution's life. For our purposes, what is most important about these new commitments is that they provide the Fund's new lenders with a means to press the case for reform of IMF governance (concerning the voice and voting rights of developing countries).

IMF governance has long been a point of contention among developing countries and civil society organizations.[13] To date, progress on even modest governance reform at the Fund has been glacial. After nearly 12 years of pressure, the "Singapore reforms" of 2006 have resulted in inconsequential changes in the voice and vote of developing countries at the Fund. As a consequence of these reforms, the voting shares held by the US fell from 17% to 16.7%, by high-income countries from 52.7% to 52.3%, the voting shares of the BRIC countries plus Mexico increased from 10.1% to 11.1%, those held by China increased from 2.9% to 3.6%, and the voting shares held by the "rest of the world" (that is, 163 of 185 countries) dropped 0.5 percentage points from 37.1% to 36.6% [Weisbrot and Johnson, 2009].

The April 2009 G-20 funding commitments by developing countries were not conditioned on specific governance reforms at the Fund, though the matter was raised quite clearly by the institution's new funders. Indeed, senior Chinese officials said at the time that Beijing would be willing to contribute more money if China's quota were adjusted to reflect its economic weight, namely, by basing its quota on economic output per person [Landler, 3/30/09].[14] The Fund's new contributors also required that their contributions to the Fund not be channeled through existing bilateral mechanisms, both because of fiscal and budgetary rules at home and because they wanted to maintain pressure on the Fund for further governance reform [Bretton Woods Update, July/Aug. 2009].

The BRIC countries and the G-24 in fall 2009 proposed a 7% increase in quotas in favor of developing countries [Reuters.com, 9/15/09]. China proposed a far more ambitious goal for governance reform. In a briefing to lay out China's positions ahead of the September 2009 G-20 summit in Pittsburgh, the assistant governor of China's central bank, Guo Qingping said the meeting should "set further specific goals and a timeline for transferring voting rights from developed countries to developing countries" in the IMF and World Bank so that developing and

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[13] A variety of far-reaching reforms in IMF governance are presented in Eichengreen [2009a: section H], Akyüz [2009], UN [2009b], Buria [2003], Lombardi [2009], Evans and Finnemore [2001].

[14] The Russian government appears a bit ambivalent on this matter. On many different occasions it has aligned itself with critics of IMF governance and it has certainly been among the most outspoken critics of the US' "exhorbitant priviledge" [on the latter, see Johnson, 2008]. But officials have occasionally stepped away from positions taken by fellow BRIC countries. E.g., during the fall 2009 meeting of the IMF-World Bank in Istanbul, a Russian central bank official stated that the country's purchase of IMF bonds would not be conditioned on IMF governance reforms [Reuters.com, 10/5/09].

developed countries ultimately each hold 50% of the voting rights. The September G-20 meeting resulted, not surprisingly, in something far more modest: namely, the representatives agreed to increase the quota share held by under-represented emerging and developing countries by at least 5% at the IMF and by at least 3% at the World Bank. Details about how this is to be operationalized are to be announced by January 2011.

Critics of the IMF have already predicted that negotiations over quota shares are not likely to increase the voice of developing countries [e.g., BWP, 10/3/09]. This is the case for three reasons. First, the G-20 charged the institutions with using the current quota formula as the starting point for reform. Second, the European countries, especially the smaller ones, stand to lose the most in regards to voting shares from more dramatic changes in governance. It is expected that they will continue to put up roadblocks to serious reform in view of statements on the subject at the IMF-World Bank's Spring 2009 meetings [Prasad, 2009]. It is far too early to tell whether these fears will be realized. But in my view, even a very modest adjustment of voting shares may reinforce other changes in the governance of the Bretton Woods institutions. Third, as Nelson [2009, private correspondence] alleges, governance at institutions as complex as the IMF and World Bank depends largely on informal practices, power and know-how (such as expertise in using back-channels to exert influence). This realm of informal governance is not likely to change overnight simply on account of changes in voting shares. This suggests that the effects of reform in voting shares will be long-term rather than immediate, and successful only to the degree that it is associated with other changes (in personnel, ideologies, and informal practices).

Together, the sale of IMF bonds and the upcoming change in quota shares suggest that one of the most important effects of the global financial crisis might ultimately be the way in which it has increased the leverage of developing countries in regards to their voice and vote at the IMF.[15] This could have significant implications in future discussions at the Fund over its policies and the appointment of a new Managing Director. Indeed, developing countries have long chafed at the "gentlemen's agreement" that has meant that the Fund's director is a European and the World Bank's director an American. The G-20 finance ministers reportedly agreed to end this practice at their mid-March 2009 meeting in Sussex, England [Eichengreen, 2009a]. Since institutional

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[15] In a related vein, see Helleiner and Pagliari [2009] who argue that the first G-20 Leaders Summit in Washington DC on November 15, 2008 might ultimately be remembered for giving G-20, rather than G-7, leaders "a seat at the table." The authors are careful to note that this legacy will only matter if the seats turn out to be real rather than symbolic. Helleiner and Porter [2009] describe the increased representation of developing countries on many bodies that constitute the global financial regulatory architecture (namely, the Financial Stability Board, the IASB, the Technical Committee of the IOSCO and the BCBS) that came about as a consequence of the November 2008 G-20 Leaders' Summit. The paper is careful to point out that reforms that expand the membership of these key bodies is important, but they do not fully address the representation problem in the global financial system. This is because membership in these bodies has generally been expanded to include only the largest or systematically significant countries. The September 2009 G-20 summit was significant and problematic in the same respects---it enshrined the G-20 as the premier forum for discussions of international economic cooperation, but in doing so privileged larger over smaller developing countries.

change happens slowly and often informally, it may be that the new loans by developing countries and the shift in quota shares at the Fund are part of a gradual process that ultimately results in significant changes in Fund practice.

In sum, for a variety of reasons the global crisis has re-installed the IMF at the heart of the global financial system. This is a significant development since the IMF has played such a central role in shaping the policy space available to developing and transitional countries over the last twenty-five years. Whether the IMF will use its renewed influence and financial resources in old ways (that is, in ways that constrain policy space in poorer countries) or in new ways (that expand the space for policy heterogeneity) will depend on many factors, not least of which is how and to what extent developing countries are able to use the financial crisis to enhance their formal voting rights and informal influence at the Fund. As of this writing it appears that China is positioning itself to exploit the voice made possible by its new contributions to Fund resources.

Bilateral and regional alternatives to the IMF

The experience of East Asian countries with the IMF during the Asian financial crisis was the catalyst for two developments. First, as discussed above, it led many countries (in Asia, but also elsewhere) to self-insure against future involvement with the Fund via the accumulation of foreign exchange reserves. Second, it stimulated a great deal of interest in the creation of regional alternatives to the Fund that could provide support during financial distress absent the painful and politically-difficult conditionality imposed upon East Asian borrowers. Asia has made the most progress towards the creation of facilities that might eventually reduce or even obviate the role of the IMF in economic and financial governance in the region. Realizing this goal depends crucially on the design and implementation of regional surveillance mechanisms that substitute for the IMF.

From the Asian Monetary Fund to Chiang Mai

Interest in an Asian alternative to the IMF began in the summer of 1997, as the Asian crisis was beginning to unfold.[16] In that context, Japan's Ministry of Finance proposed the creation of an Asian Monetary Fund, a new institution that would provide emergency financial support—*sans* the IMF's conditions--to countries in the region that were caught up in the crisis. Though the proposal was never fully articulated, it was to be capitalized with an initial $50 billion contribution by Japan and another $50 billion in contributions from other Asian nations. The Asian Monetary Fund proposal grew out of frustration in Japan and in the region with IMF conditionality in the crisis countries, and more broadly with the limited voice of Asian countries at the Fund. The proposal was eventually tabled in the wake of tensions between Japan and China, tensions that were adroitly exploited by the IMF and the US government.

The vision and frustrations that inspired the Asian Monetary Fund proposal formed the basis for the Chiang Mai Initiative (CMI), an agreement that was signed at a meeting of the finance ministers of the ASEAN nations plus three other countries (namely, China, Japan and South

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[16] Details in much of this paragraph are drawn from Kirshner [2006].

Korea, hereafter ASEAN+3) in a Thai city of the same name in May 2000.[17] The CMI initially involved a set of bilateral swap agreements among member nations' central banks, agreements that in the span of four to five years grew in number and size. The CMI also came to involve bond market initiatives, such as the creation of a regional bond fund.

Despite the circumstances that led to its creation and expansion, the CMI did not challenge the role of the IMF. In fact, the main operational goal of the CMI (namely, the availability of bilateral swap agreements to countries in distress) reinforced the existence of the IMF conditionality that many Asian borrowers found so problematic. This is because the creditor countries within the CMI insisted that 80% of the amounts available to borrowing countries as medium-term balance of payments loans (made possible via the swap facilities) would only be disbursed to a borrower if they also agreed to an IMF program. A medium-term loan of 20% of the amount available did not require that the borrower be under an IMF program.[18] CMI swaps still seem somewhat notional today since none of them have ever been activated. For example, during the current crisis South Korea drew on an existing swap arrangement with the US Federal Reserve rather than avail itself of the resources available under the CMI.

Since 2005, ASEAN+3 finance ministers have been discussing modifications to the CMI that would move it closer to functioning as a common regional fund in the spirit of the Asian Monetary Fund proposal. The current financial crisis has been a powerful impetus propelling these discussions. They culminated in a decision in May 2009 to "multilaterize" the CMI (hence, it is now known as the Chiang Mai Initiative Multilateralisation, CMIM). The CMIM is a $120 billion regional currency reserve pool from which member countries can borrow in times of crisis. China, Japan and Korea provide 80% of the CMIM's resources (with China and Japan each contributing 32% to the pool or $38.4 billion). Decisions regarding disbursals from the fund will be made by simple majority, and voting shares will be roughly in proportion to a country's contributions. Importantly, this means that unlike the IMF's Executive Board (which makes decisions by consensus), no single country can block action. The transformation of the CMI to the CMIM is significant because it increases the scope of central bank currency swaps and reserve pooling arrangements in the region. This introduces the possibility that countries that are members of the CMIM will not need to turn to the IMF when they face some liquidity crises. It may also (at least partly) eliminate the perceived need by individual member nations to over-accumulate official reserves for purposes of self insurance.

At the behest of creditor countries, however, disbursals from the CMIM in excess of 20% of the credits available to a country retain the same IMF link that was a key feature of the CMI.[19] There is a plan to eliminate the 20% IMF link, but the specifics of that plan have been left for an unspecified future date when member countries can devise and staff a regional surveillance unit that would substitute for the IMF's surveillance. If the regional surveillance mechanism in the CMIM is ultimately realized, then it is reasonable to expect that the initiative can go a long way

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[17] Details in this and the next paragraph are drawn from Henning [2009].

[18] Initially, the "IMF link" was activated when the amount disbursable was equal to 10% of the amount available to a borrower.

[19] Details in this paragraph from Eichengreen [2009c].

toward realizing the prior goals of the Asian Monetary Fund—that is, towards replacing IMF with a regional governance mechanism.

These measures are promising, to be sure. But as the recent experience of the EU indicates, devising and implementing regional surveillance is no simple matter since it involves criticizing the policies of neighbors and demanding changes. At present, the EU has largely outsourced the design and monitoring of conditionality to the IMF in the cases of those of its neighbors that have been hard hit by the global financial crisis (see details below). Indeed, in a telling statement, an EU official when asked about the Union's support of the stringent conditionality associated with a possible assistance package to Belarus said: "The conditionality is, so to say, the IMF's conditions" [Reuters.com 7/27/09]. It appears that political sensitivities (and rivalries) among Asian neighbors run even higher than in the EU, making the design of a regional surveillance mechanism the likely site of protracted negotiations (especially among China, Japan and South Korea), thereby limiting the extent to which the CMIM will fully displace IMF governance in the region in the near future.

Other initiatives

Outside the ASEAN+3, we see more modest and ad hoc signs that the current crisis has stimulated interest in bilateral and regional mechanisms that provide financial support to countries in distress outside the framework of the IMF. For example, Henning [2009] notes that at the outset of the current crisis, Iceland and Pakistan unsuccessfully appealed to reserve-rich countries for support in an effort to avoid resorting to the IMF, Russia provided modest support to some regional neighbors, and since December 2008 the US Federal Reserve opened temporary swap agreements with fourteen central banks (building on long-standing swap agreements with the Bank of Canada and the Bank of Mexico), including several in East Asia and Latin America. For example, Mexico now has a $30 billion currency swap arrangement with the Federal Reserve [Banco de México, 2009]. The EU contributed significant funds to the SBAs of many neighboring economies (e.g., Iceland, Hungary, Latvia), but it did so very much as a junior partner of the Fund.

Turning to China, one must be cautious about reading too much into its recent bilateral initiatives vis-à-vis developing countries during the current crisis. None of these activities seem driven by the same goal of supplanting the IMF as we see in the CMI/CMIM. For example, during spring 2009, China negotiated a doubling of a development fund in Venezuela to $12 billion while agreeing to lend Ecuador at least $1 billion to build a hydroelectric plant and to lend Brazil's national oil company $10 billion.[20] These deals seem largely aimed at locking in strategic natural resources for China in the years to come. Other deals that China has struck have involved currency swap arrangements that allow some of its trading partners to maintain reliable access to the Chinese currency so that they can continue to pay for imports from the country. For example, China has made arrangements to ensure that Argentina has access to $10 billion of renminbi, and it has made the same kinds of arrangements with South Korea, Indonesia, Belarus, Hong Kong

[20] Details on these Chinese investments and currency swaps are drawn from Romero and Barrionuevo [4/16/09].

and Malaysia.[21] The Chinese central bank will make its currency available to pay for imports from China if these countries are short of foreign exchange.[22] These bilateral swap arrangements do not challenge the role of the IMF (or the dollar for that matter) since the central banks of these countries cannot use the renminbi to intervene in foreign exchange markets, import merchandise from third countries,[23] or pay foreign banks or foreign bondholders because the currency remains inconvertible [Eichengreen, 2009b].

In Latin America we find modest regional gestures toward creating mechanisms that might in the future play a role in providing financial support to countries in the region during crises. At present these mechanisms are too ill formed and/or under-funded to play a role of any significance. One such initiative is the Bank of the South (Banco del Sur), an institution developed by Venezuelan President Hugo Chavez and headquartered in the country. The Bank has received a great deal of attention because it has been situated rhetorically as a rival to the IMF. At this point, the rivalry remains aspirational rather than practical. The Bank was founded in December 2007; in May 2009, the 4 member countries of MERCOSUR (namely, Argentina, Brazil, Paraguay, and Uruguay) and the Union of South American Nations (Bolivia, Ecuador, and Venezuela), agreed on the details necessary to get the Bank off the ground.[24] According to the agreement, Argentina, Brazil and Venezuela will capitalize the Bank with contributions of $2 billion each, Uruguay and Ecuador with $400 million each, and Bolivia and Paraguay with $200 million each. The Bank will grant all of its member countries the same level of voting power, though loans of more than $70 million will require approval of countries that represent at least 2/3 of the bank's total capital.

Another Latin American initiative, the Latin American Reserve Fund which was founded in 1978 (as the Andean Reserve Fund) seeks *inter alia* to support balance of payments and provide emergency liquidity assistance to central banks. Based in Colombia, its members include Bolivia, Colombia, Costa Rica, Ecuador, Perú, Uruguay and Venezuela. It has a very modest capitalization of just over $2.3 billion, and has offered to make available liquidity credit lines totaling US $1.8 billion to member countries confronting the effects of the current financial crisis [McElhiny, 2009]. Thus far it has made modest loans to members during the crisis. For instance, it extended a $482 million US dollar loan to Ecuador in April 2009.

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[21] In July 2009, China also started to allow selected firms in five Chinese cities to use renminbi to settle transactions with businesses in Hong Kong, Macau and ASEAN countries. Foreign banks will be allowed to buy or borrow Chinese currency from mainland lenders to finance such trade.

[22] Brazil and Argentina, too, have moved to settle their trade transactions with one another in their own currencies (rather than using the US dollar as an intermediary). In October 2008 they agreed to allow exporters and importers from both countries to settle their transactions in Brazilian real and Argentine pesos. This settlement mechanism is embodied in the "Payment System on Local Currency" [Gnos and Ponsot, 2009].

[23] The only exception is that the renminbi can be used in cross-border trade with China's immediate neighbors or the special administrative regions of Hong Kong or Macao.

[24] Details on membership, funding and voting rights at the Bank of the South from Phillips [2009] and the International Center for Trade and Sustainable Development [2009].

In sum, among regional or bilateral initiatives that have emerged or been expanded during the current crisis, ASEAN's CMIM is the only immediate candidate for displacing the IMF in a significant part of the developing world. The articulation of a viable regional surveillance mechanism is an important and challenging prerequisite to the achievement of this goal. Were it to be realized, the CMIM might well serve as a model for other regions of the developing world that have thus far expressed interest in regional alternatives to the Fund, but have not made much progress toward that aim.

Policy incoherence and policy space for development

Both the Great Depression and the East Asian crisis induced genuinely coherent institutional and policy responses. The Great Depression ushered in a broad complex of complimentary institutions and policies that secured substantial state management of vital aspects of economic affairs—both domestically and internationally. In contrast, the response to the Asian crisis was organized around the goal of deepening neo-liberalism, increasing informational adequacy, and enhancing market discipline. This agenda dominated the reform efforts of not only those countries that were affected directly by the crisis, but also the vast majority of other developing countries. The post-Asian crisis environment was thus one in which developing countries faced a contraction in the policy space available to them. It is not our goal here to rehearse the mechanisms by which multiple factors collectively instantiated neo-liberalism over the last three decades in the developing world (and more recently, in the transitional countries). Suffice to say that the contraction in the policy space owed to the combined pressures that stemmed from the IMF, World Bank and WTO, bi- and multi-lateral trade and investment agreements, a variety of domestic policy and institutional reforms (such as independent central banks, inflation targeting, fiscal balance rules, currency boards, currency substitution, and capital account openness), the power exercised by the global financial community and powerful states (particularly the US and UK), and the ascendance of neo-liberal economic ideas.

In the context of the current crisis, we are seeing a fraying of the fabric of neo-liberalism. But at this point there is no evidence of the emergence of a coherent alternative policy regime to replace it. Instead, we appear to be confronting the beginning of a new period of economic regulation that might best be characterized by what I will call "productive incoherence." By incoherence I hope to signal the absence of a unified, consistent, universally applicable response to the crisis. The responses that are emerging across the globe span the range from those that reflect substantial continuity with neo-liberalism to those that reveal greater discontinuity. Many responses lie in between these poles, of course—their relation to neo-liberalism remains ambiguous, at least for now. At present, we are seeing evidence of policies that fall all along this spectrum, even within the IMF itself—which suggests the utility of the concept of incoherence to capture current developments.

I call this incoherence productive because for several decades development policy has been imprisoned in an overarching regime that afforded little space for economic experimentation. If crisis signals a turning point—an inability of existing practices and institutions to continue on as they had previously—the prominent feature of the current crisis is not what will replace existing practices and institutions, since there is as of yet no fleshed out rival for neo-liberalism on the horizon. The prominent feature is multifaceted aperture that comprises both a profound loss of

confidence in the economic theories that have sustained neo-liberalism, and the emergence of pragmatic policy interventions that seek to respond to the crisis. This aperture might create opportunities for enduring institutional innovation in development that we have not witnessed over the past quarter century.

In what follows, I will review evidence of the incoherence of crisis responses, and some factors that might ultimately contribute to a greater degree of policy space for developing and transitional countries in the post-crisis environment. In this context I will consider how these developments bear on economic governance in the developing world.

The IMF: Policy incoherence in the face of crisis

We turn first to the IMF since it continues to influence economic and financial governance in developing and transitional countries, and since it has been such a powerful vehicle for the transmission of neo-liberal thought and practice across the developing world. If we find that even within this institution there are signs of a new incoherence in its crisis response, then we have strong grounds for the incoherence thesis. In what follows, then, we probe the IMF response to the crisis—teasing out signs of tension within its conduct during the crisis period. We will see that the IMF has at once demonstrated more flexibility in the past in managing countries in crisis, while also holding fast to neo-liberal strategies in many cases. On balance one must conclude that the IMF's behavior has been ambiguous during the crisis. This nevertheless represents a substantial shift from its unified and coherent response to the Asian crisis. I will highlight several related issues in connection with the IMF's incoherence: the IMF's Flexible Credit Line (FCL), which demonstrates unambiguous continuity with neo-liberalism; IMF conditionality and the numerous SBAs (and other assistance packages) it has signed in the context of the current crisis, which largely reaffirm neo-liberalism, but with some increased flexibility on the ground when it comes to fiscal policy; and capital controls, where the case of Iceland contradicts the IMF's longstanding position and the case of Brazil reflects the tenuous situation the institution finds itself in as it seeks to manage when, how and by whom this instrument is employed.

The IMF's FCL

The IMF has been very active in providing support to developing and transitional countries through SBAs and several other programs. It has modified several existing programs, and has created new ones as well. Among the most important of these initiatives is the introduction of the FCL in March 2009, the elimination in May 2009 of structural performance criteria on all programs, the doubling of normal access limits, and the allocation of $250 billion to all members in proportion to their existing membership borrowing quotas (per the G-20 commitment in April 2009). We turn now to the FCL.

The FCL is essentially a precautionary line of credit designed for countries that meet the IMF's pre-established qualification criteria. This demanding set of pre-conditions requires that a country possess the following: international capital market access; strong fundamentals; and a record of sound policies, the institutional framework necessary to support them, and credible

commitment to continue these policies in the future.[25] Funds are available through the FCL as a single up-front disbursement or may be treated as a precautionary line of pre-approved credit. Disbursements under this program are not conditioned on the traditional ex-post policy conditions (known as structural performance criteria, which include cuts in government spending, increasing taxes, raising interest rates, etc.).

The IMF has heralded the FCL as a key example of its new "modernized conditionality." Given the demanding nature of the *ex-ante* conditions attached to the FCLs, it is unsurprising that few countries have applied for support under this vehicle. As of this writing, only three countries have applied for and received funding in April 2009 through the FCL program—Mexico ($47 billion, the largest arrangement in the Fund's history), followed shortly thereafter by Poland ($20.5 billion) and Colombia ($10.4 billion). Despite the Fund's rhetoric to the contrary, the FCL is hardly a major advance in regards to conditionality. The FCL transforms traditional structural (*ex-post*) conditionality into a demanding *ex-ante* conditionality that elevates precisely the same neo-liberal policy and institutional agenda that the Fund has been promoting over the last three decades. The FCL parses developing countries into a good-bad policy binary. Thus, the FCL program demonstrates a strong continuity with the neo-liberal agenda and the associated contraction of policy space in the post-Asian crisis environment.

At least two decisions regarding FCLs appear politicized in a way that demonstrates continuity with the Fund's past practice vis-à-vis support decisions (e.g., on Fund politicization vis-à-vis Egypt, see Momani, 2004]. In a largely anecdotal and somewhat polemical study (that is nevertheless compelling), Cammack [2009] makes the point that Mexico's FCL is a reward for the compliant behavior of the country's policymakers in relation to the US, the IMF, and global capital. It has been suggested that the decision to grant Colombia an FCL was motivated not by the country's having met the demanding pre-qualification criteria, but rather by the US and the IMF's commitment to support the government of President Uribe in response to its "war on drugs" and its role in hosting new US military forces in the country, and by the need to shore up forces in the region that are opposed to Venezuelan President Chavez.[26]

Conditionality and recent SBAs

The matter of modernized fund conditionality deserves further discussion since this pertains not only to FCL countries, but also to recent SBAs insofar as the IMF pledged to eliminate structural performance criteria on all programs in May 2009. Fund officials have sought to carve out a new

[25] The criteria for policy soundness under the FCL are so demanding as to render most developing countries ineligible for support. A country must have a sustainable external position, a capital account position dominated by private flows, a track record of steady sovereign access to international capital markets at favorable rates, a reserve position that is relatively comfortable, sound public finances, low and stable inflation in the context of a sound monetary and exchange rate policy framework, the absence of bank solvency problems that pose an immediate threat of a systemic banking crisis, and effective financial sector supervision, data transparency and integrity.

[26] Per conversations with staff at the UN.

identity for themselves in the current crisis by (a) heralding the "end of conditionality,"[27] (b) emphasizing country ownership and national policymaker involvement in the design of the reforms mandated by SBAs and (c) mandating the protection of vulnerable groups that may be affected by an IMF program (in what some Fund officials have called the new social conditionality) [e.g., IMF, 2008; IMF, 2009g].

Many recent studies of the SBAs (and other assistance programs, such as the Exogenous Shock Facilities and the Poverty Reduction and Growth Facilities) negotiated during the current crisis have concluded that the IMF has promoted pro-cyclical macroeconomic policy adjustments or targets [e.g., Muchhala, 2009; Eurodad, 2009; Solidar, 2009; Cordero, 2009a, 2009b; Weisbrot, Ray, Johnston, Cordero, and Montecino, 2009].[28] This makes the IMF's response to the current crisis not too dissimilar to its response to the Asian crisis. In this sense, there is a strong continuity between the Fund's responses to both crises.

There are, nevertheless, some important discontinuities emerging in some of the SBAs. It must be said, however, that some of these distinctions may have academic rather than any immediate practical significance in the affected countries. Nearly all studies on the subject acknowledge three differences between the current IMF assistance programs and the Asian SBAs.

First, in the current crisis the IMF has narrowed the scope of some of its conditionality. For instance, certain reforms that have long been at the heart of IMF activity, such as privatization and liberalization, tend not to be features of the current SBAs.[29]

Second, the IMF has demonstrated a greater degree of flexibility when countries fail to meet their fiscal targets. The IMF began to allow some countries to relax the fiscal targets in their SBAs (in some cases through 2010) as domestic and world economic growth decelerated and as serious political and social tensions emerged in various countries. But this flexibility, which for some countries has provided a rather large degree of relaxation, has been offset by the IMF's

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[27] The current crisis is certainly an important factor in the IMF's rethinking of conditionality, but note that the process of rethinking conditionality began after the Asian crisis. A review of conditionality began in 2000. In September 2002, the IMF adopted new guidelines on conditionality. However, despite these new guidelines a 2007 study of conditionality by the IMF's Independent Evaluation Office found that the number of structural conditions on Fund programs had not declined and that some conditions were not necessary to achieve the goals of Fund-supported programs [see IMF, 2009i].

[28] We rely heavily on empirical details provided in the studies listed above. In connection with the pro-cyclicality of the majority of recent IMF programs, it bears mention that a few programs have counter-cyclical elements. Programs in Georgia, Mozambique, Niger, and São Tomé and Principé involve expansionary fiscal policy, and that of Tanzania involves both expansionary fiscal and monetary policy [Eurodad, 2009; Weisbrot et al., 2009]. Note that the discussion above also relies on program descriptions in IMF [2009g, 2009h]. These two IMF studies do not identify pro-cyclicality as a feature of the current programs.

[29] In conversation over this paper Steve Nelson noted ironically that this may simply be a function of the fact that earlier, expansive IMF programs have left many developing countries with nothing to liberalize or privatize.

continued insistence on stringent monetary policy in many program countries (Cordero 2009b]. The result of these conflicting interventions is Stackleberg warfare that renders some of the IMF's programs incoherent.[30] In surveying the original design of 41 SBAs and other recent programs, Weisbrot et al. [2009] identify five cases where the initial agreements with the Fund involved a conflict between fiscal and monetary policy (namely, in Armenia, Costa Rica, Haiti, the Kyrgz Republic and Serbia).[31] I would emphasize here that the instances of what I term policy incoherence grew far more numerous as the crisis unfolded and the Fund allowed for more expansive fiscal targets, while maintaining its commitment to restrictive monetary policy.

Stackleberg warfare in some countries is also being aggravated by the decisions of national policy makers prior to the financial crisis. In the pre-crisis years, some countries made monetary and exchange rate policy decisions that have severely constrained their monetary policy autonomy owing to commitments to hard currency pegs, currency boards, currency substitution or plans to adopt the euro. In addition, the commitments of some national policymakers to adopt the euro in the coming years has also constrained fiscal space insofar as such countries must keep their fiscal deficits under 3%. And, as noted in a study by the NGO Solidar [2009], the political economy of the pro-cyclical macroeconomic policies in some countries is more complicated than some critics of the IMF would suggest. In some national contexts, policymakers themselves are proponents of fiscal restraint, even during the crisis.

Third, the current SBAs can be distinguished from those of the Asian crisis years by the IMF's emphasis on the importance of social protection for the poor and vulnerable. This is something that the IMF emphasizes in two recent (and congratulatory) reports, one that surveys fifteen SBAs between July 2008 and September 2009 [IMF 2009g] and another that surveys diverse assistance packages in nineteen low-income countries during the same period [IMF, 2009h, see especially Annex 3]. However, it is difficult to square this emphasis on protection of socially vulnerable groups with the fiscal policy constraints that are a key feature of so many of the SBAs negotiated in the context of the current crisis. The decline in tax revenues and ODA has further complicated the matter of financing programs of social protection during the crisis.

Let's review a number of the IMF's recent SBAs. For example, Pakistan's SBA provides for significant spending cuts (as well as rising interest rates). Because of the worsening situation in the country, the Fund has recently allowed an increase in Pakistan's fiscal deficit from 3.4% to 4.6% of GDP, but it has not increased the flexibility of the monetary policy targets. El Salvador signed an agreement with the Fund in January 2009 that prevented it from using expansionary fiscal policy to counter a downturn. The agreement obligated policymakers to maintain a fiscal deficit of no more than 2.8% of GDP. Since the country is officially dollarized, monetary policy is effectively precluded. The original agreement with the Fund thus left the government with no means to stimulate the economy. The IMF has since allowed the fiscal deficit to rise to around 5%, though the government has committed to reduce it to 3.3% by 2011.

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[30] As should be clear, I am not arguing that incoherence is a desirable feature of development policy. Inconsistent policy can be quite harmful. What is productive about the present incoherence is the opportunity it creates for the expansion of policy space.

[31] Only Serbia's initial program featured fiscal contraction and monetary policy expansion; the other four incoherent agreements were initially characterized by the reverse combination.

During the crisis there has been a proliferation of SBAs with transitional countries. Most of these are jointly funded by the IMF, World Bank, EBRD and the EU and, in some cases, also with the Nordic countries. As noted above, the IMF is very much a dominant player in this lending consortium.

The SBA signed with Ukraine on October 2008 set a zero fiscal deficit target for 2009 as a binding condition. This target has since been relaxed twice, such that it now allows for a deficit of 6% of GDP. The initial agreement with the Fund stated that "there is no scope now for countercyclical fiscal loosening." In February 2009 the IMF refused to release the second tranche of the loan because the government would not adhere to an agreement to pare its budget. Implementation of the terms of the agreement have been complicated by conflicts between the country's President, Victor Yushchenko and Prime Minister Yulia Tymoshenko. The President supports the pursuit of a balanced budget, while the Prime Minister insists on the need to maintain present levels of greater social spending.

The SBA with Hungary signed in November 2008 required that the fiscal deficit be decreased from 3.4% in 2008 to 2.5% of GDP in 2009, and that the government cut public sector wages, pensions, social benefits and other government spending. A Fiscal Responsibility Law was passed by parliament on November 17, 2008. The law includes the obligation to achieve a decline in public debt in real terms, a requirement to comply with medium-term expenditure ceilings, and the requirement that prevents the government budget deficit from rising above 3% of GDP. The Prime Minister resigned in March 2009 under the weight of the social pressures associated with the crisis and the economic adjustments thereto. These fiscal targets have proven difficult to meet as the country's economy has deteriorated more than originally expected. By standards of recent history, the IMF has demonstrated an unusual degree of flexibility in softening Hungary's budget deficit targets twice in 2009 so that it has ultimately been set at 4.6%. Even with this expansion of fiscal space, the government is still obligated to reduce its deficit via a nominal wage freeze for public employees, the elimination of what is called the 13th month bonus for pensioners, and the postponement or elimination of the indexation of selected social benefits.

The SBA with Latvia signed in December 2008 requires that the fiscal deficit be reduced. Nevertheless, the deficit to GDP target has been raised several times in the context of the economic and political crisis in the country, and a series of protracted conflicts between the government, the EU and the IMF. One of these conflicts led to a suspension of disbursements to the country in April 2009. All told, during the lifetime of the SBA the deficit target more than doubled—from 4.9% of GDP to 13% in 2009 (with a target of 8.5% in 2010, 6% in 2011, and 3% in 2012). The Latvian government was the second to collapse in the face of the crisis (the first being Iceland) in February 2009. The decisive event was the social unrest and riots caused by the crisis and the reforms necessitated by the SBA (especially the spending cuts, the reduced wages of public employees, and the reductions in pensions). The situation in Latvia has been greatly complicated by the government's refusal to devalue its currency or to break the peg of the lat with the euro. Latvian officials see the peg as "the last pillar of trust" (in the words of a European Community official), as central to the adoption of the euro by 2012, and the key to a

permanent place in Europe [Financial Times, 6/17/09].[32] Since Latvia has a hard peg to the euro, there is no room for monetary policy expansion since the country has no access now to foreign funding and is committed to contract government spending in the presence of a large current account deficit [Cordero 2009b].

Romania signed an SBA in May 2009. The package mandates cuts in public spending by about 1% of GDP per year in 2009, and by an additional 1.5% per year in 2010. This comes on top of a fiscal consolidation of 3% of GDP that the country had already put in place prior to the IMF program. Under this agreement, the budget deficit cannot exceed 5.1% of GDP in 2009 and must be below 3% of GDP by 2011. In August 2009, however, the IMF allowed Romania to raise its budget deficit target for 2009 and 2010, such that it can run a deficit of 7.3% of GDP in 2009, though it has to bring it down to less than 6% in 2010. Despite this constraint, the letter of intent with the IMF commits the government to safeguarding the real incomes of the lowest paid public sector workers and investing 60 million euros in social protection. To put this amount in context, we should note that the government is expected to make $1.4 billion in public sector spending cuts under the terms of the agreement.

Monetary policy, too, has been highly contractionary; what is notable for present purposes is that the IMF has been far less flexible with this policy instrument than it has been with fiscal policy. Contractionary monetary policies are a key feature of the SBAs in a great many countries. For example, in Latvia, the SBA involved increasing interest rates by 600 basis points; in Iceland, the SBA involved increasing the interest rate by 600 basis points to 18% (from 15%) in order to stabilize the krona and restore confidence; in Pakistan, the SBA involved an increase in the rate by 200 basis points to 15% with the provision that any additional increases that may be necessary will also be implemented. The SBA with Georgia (which has an inflation targeting regime) calls for a reduction in inflation to 10% in 2008 and to 7.6% in 2009. The agreement states that "we are strongly committed to low inflation and, in the current environment, believe that maintaining single-digit inflation and reducing it gradually in the medium term is essential" [in Muchhala, 2009]. Under Ukraine's SBA, monetary policy is to reduce inflation from 25.5% in 2008, to 17% in 2009, and to 5-7% in 2010. In Hungary, the SBA seeks to bring down inflation to a target of 3% by early 2010 from its current level of 5¾%. Interest rates in the country are being kept to a high level—indeed, the policy interest rate stood at 9.5% in early 2009 and at 10% at the end of 2008, both of which are much higher than the 7.5% in January 2008, and dramatically higher than the average euro area rate of 3%. Despite the fiscal stimulus that is made possible by the Costa Rican SBA, the agreement provides for highly contractionary monetary policy to stave off inflationary pressures and reduce the external deficit [Cordero, 2009a]. In none of these cases has the IMF modified the stringent monetary policies that it has imposed on these countries as

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[32] Note that there are other reasons why devaluation would be a very serious problem for the country. Some 60% of export value is imported content, meaning that devaluation could encourage inflation, and some 85-90% of all loans are in euros, meaning that devaluation would bankrupt many firms and households. Latvia's economic woes have been a matter of great concern in Sweden due to the exposure of the country's banks to Latvian loans. Indeed, shares of Sweden's Swedbank dropped precipitously with each new conflict between the IMF and the Latvian government. Devaluation in Latvia could also cause investors to question the credibility of the pegs in other transitional countries, namely, Bulgaria, Estonia and Lithuania.

the crisis has deepened. We find, then, an ongoing tension between some degree of fiscal flexibility that allows for a degree of countercyclical policy on the one hand, and severe, procyclical monetary policy on the other.[33]

Low-income country SBAs

A study of SBAs signed by ten low-income countries between December 2008 and May 2009 shows much the same kind of incoherence at the Fund [Eurodad, 2009].[34] The Fund has advised these countries to pursue contractionary fiscal and monetary policies involving reductions in the fiscal deficit, a cap on the ability to contract new debts and the need to earmark funds to service existing foreign debts, increases in the level of official reserves, and the reduction in inflation via increased interest rates. The report does acknowledge that limited flexibility on fiscal targets is being granted on a very short term and temporary basis, and that a number of the programs maintain and some increase pro-poor spending. Of the ten low-income countries studied, five programs push for wage bill freezes or cuts; five have to reduce their deficit, and all have to make spending cuts; five out of ten programs still prompt governments to pass on food and fuel price rises to citizens, and none have flexibility to defer debt payments (indeed, for Senegal, the Fund requires as a binding condition that "any proceeds from asset sales be used for settlement of payment delays…"); and almost all programs make clear that the overall objective is the "forceful implementation of the planned fiscal and monetary tightening," including in Ethiopia, Malawi, and Mongolia. In over half the countries assessed, the IMF program intends to reduce the deficit below 5% of GDP. The programs establish budget deficit targets below 3% of GDP in Cote d'Ivoire, Ethiopia, Senegal, and Tajikistan; below 5% of GDP in São Tomé, and below 6% of GDP in Mongolia. In Cote d'Ivoire, Ethiopia, and Tajikistan targets are even more stringent, as the 2009 deficit is set below 2% of GDP. Ethiopia's general government deficit is projected to be reduced from 2.9% of GDP in 2007-8 to 1.5% in 2008-9. Seven of the ten programs reviewed aim at lowering inflation, and four intend to keep it below 5% in 2009.

The IMF and capital controls: What can we learn from Iceland and Brazil?

The case of Iceland is particularly interesting for the discontinuity that it demonstrates in connection with the IMF's view of capital controls.[35] The country was the first to sign a SBA during the current crisis, and it was the first financial rescue in Western Europe since Britain's in 1976. The country originally went to its Nordic neighbors for assistance, and then to Russia in early October 2008. When negotiations failed other European countries refused to lend unless Iceland negotiated an arrangement with the IMF, which it ultimately did in the fall of 2008. Iceland's package of reforms was very much conditioned on the kinds of highly restrictive monetary and fiscal policy conditions (per the description above) that we saw during the East Asian and other developing country financial crises.[36] In fact, monetary and fiscal policy constraints go further and are more internally consistent than other SBAs signed during the current crisis. These highly pro-cyclical macroeconomic polices induced intense, prolonged social unrest in the country. Tension between the IMF and Iceland intensified during the late

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[33] Again, recall that monetary policy rigidities in some countries are self-imposed.
[34] The IMF [2009h] takes a different view of some of these same agreements.
[35] See the discussion of Iceland in Wade [2009].
[36] E.g., Iceland has to turn a fiscal deficit that is equal to 13% of GDP to a balanced budget by 2013.

spring and summer of 2009 concerning cuts in public spending, an increase in the VAT to 18% and an increase in income taxes, and the central bank's decision to reduce the interest rate four times, from its initial high of 18% down to 12%. These tensions contributed importantly to the fall of the government, and led to a protracted game of chicken between the new Center-Left government and the IMF. Unrest became especially intense around the decision in August 2009 on the Icesave bill, which provides compensation to British and Dutch depositors for losses on savings accounts of the collapsed Landsbanki bank in Iceland. As of this writing, the status of the Icesave bill is uncertain insofar as the President of the country blocked the compensation package in January 2009 and is now planning to submit the matter to a popular referendum.

What is most interesting about the Icelandic SBA is that it includes provisions regarding the need for stringent capital controls, something that we don't find in earlier SBAs that the IMF signed in connection with East Asian countries and in other recent cases. The capital controls were initially imposed prior to the signing of the SBA in October 2008, though the agreement made a very strong case for their necessity. The central bank formalized the de facto regime on November 28, 2008, and then modified it via the issuance of new rules on December 15, 2008. The December rules prohibited foreign exchange related to capital transactions and required domestic parties to submit all foreign currency that they acquired either from the sale of goods and services or in another manner to a domestic financial institution. These capital controls were designed to protect the Icelandic krona from collapsing due to capital outflows from the country. (As soon as the crisis emerged, the krona depreciated by 70% and the stock market lost more than 80% of its value. Since most of Iceland's debt is denominated in foreign currency, the large currency depreciation had severe spillover effects on debt-service abilities.) However, even with strict capital controls, the krona depreciated against the euro by about 9% between March and August, 2009. Not surprisingly, given the IMF's long-held allergy to capital controls, IMF staff were questioned repeatedly on what seemed to be an about face on controls. Fund staff repeatedly said the capital controls were crucial to prevent a free fall of the currency, that they were explicitly temporary, and that it was a priority of the Fund to end all restrictions as soon as possible. Accordingly, the country's central bank began a sequenced removal of its capital controls in November 2009.

What are we to make of the Fund's case for capital controls in Iceland? The Fund certainly did not encourage capital controls in other countries with which it signed SBAs during the present crisis. Indeed, there is no evidence available at this time that the matter was debated during any of the negotiations that led to the signing of the numerous SBAs that have emerged over the past year, even though many countries certainly faced significant capital outflows and pressures on their currencies to depreciate in the face of high levels of locational mismatch.[37]

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[37] The SBA with Latvia allowed for the maintenance of pre-existing restrictions arising from a partial deposit freeze at Parex, the largest domestic bank in the country [IMF, 2009g]. A recent report by the IMF [2009g] states that in Ukraine and Pakistan it "encouraged timely elimination of exchange restrictions on current payments." If this is code for something far stronger it would suggest the existence of a greater degree of continuity between the IMF's current view of capital controls and the view that it held during the Asian crisis. No further details are provided in Fund reports on the subject of Pakistan's capital controls. Weisbrot et al. [2009] mentions only in passing that there was a conflict between Pakistan and the IMF over capital controls. I will

Throughout the crisis the IMF has had little to say on capital controls. This makes it difficult to assess whether the crisis has caused the institution to rethink its views on capital controls. I should note, however, that the institution's views on capital controls had evolved from unequivocal opposition to them during the Asian crisis to a tepid, conditional endorsement of temporary market-based controls in some circumstances (e.g., see the widely cited study by Prasad et al., 2003). In the raft of reports that the IMF has issued in the context of the current crisis, the IMF and the Bank mention capital controls only very briefly and on few occasions. For example, an IMF report on low-income countries and the financial crisis states that the impact on banking systems in these countries has been modest insofar as "[t]he existence of capital controls in several countries and structural factors have helped moderate the direct and indirect effects of the financial crisis" (IMF 2009a:p.9, see also fn9). The protective role of capital controls is something that receives no further comment in this report.

Another report by the Fund warns that capital controls should be considered only a temporary and last resort. The costs of even temporary capital controls are enumerated with great care in this same report, e.g., a country "could as a last resort regulate capital transactions—though these carry significant risks and long term costs" and later goes on to say that "even temporary standstills will have long-lasting legal implications" (IMF, 2009d: pp. 8-9, fn5, fn8). A joint report by the Bank and Fund discusses capital controls in the same cautionary vein, though the brief discussion concludes that "nonetheless, capital controls might need to be imposed as a last resort to help mitigate a financial crisis or stabilize macroeconomic developments [WB-IMF, 2009:p.65]. These brief cautionary mentions of capital controls suggest that--despite the Icelandic case—that the IMF's view on capital controls has evolved only slowly since the Asian crisis. Iceland's capital controls then appear as something of an anomaly at the present time. The more they come to be viewed as having succeeded the more difficult it might be for the Fund to dismiss the policy tool in the face of future economic crises.

The new equivocation at the IMF regarding capital controls is evidenced in its response to the imposition of controls in Brazil. In late October 2009 Brazil imposed a self-described modest, temporary and market-friendly type of control that was designed to slow the appreciation of the currency in the face of signifcant international capital inflows to the country. Initially it imposed a 2% tax on money entering the country to invest in equities and fixed income investments, while leaving foreign direct investment untaxed. Once it became clear that foreign investors were using purchases of American Depository Receipts (ADRs) issued by Brazilian corporations to avoid the tax the country's Finance Ministry imposed a 1.5% tax on certain trades involving ADRs. The IMF's response was just mildly disapproving. A senior official said: "These kinds of taxes provide some room for manoeuvre, but it is not very much, so governments should not be

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investigate this matter in the future. Also, a joint World Bank-IMF report [2009:Table 1.4] on the current crisis notes that six countries (namely, China, Colombia, Ecuador, Indonesia, the Russian Federation, and Ukraine) imposed some type of capital control during the crisis. The report offers neither details on the nature of these controls nor commentary on their efficacy, which further suggests a lack of consistency of view at the IMF at present on capital controls. See Reuters.com [5/20/09] for a brief description of Ukraine's controls and also those imposed by Nigeria during the crisis. I will examine these initiatives in future research.

tempted to postpone other more fundamental adjustments. Second it is very complex to implement those kinds of taxes, because they have to be applied to every possible financial instrument," adding that such taxes have proven to be "porous" over time in a number of countries. No less than John Williamson (with Arvind Subramanian) indicted the IMF for its doctrinaire and wrong-headed response to the Brazilian capital controls, taking the institution to task for squandering the opportunity to think reasonably about the types of measures that governments can use to manage surges in international private capital inflows [Subramanian and Williamson, 10/25/09]. But Williamson's criticism misses the point that in fact the IMF reaction was quite muted (especially in comparison with its "doctrinaire" reaction to Malaysia's capital controls during the Asian crisis) and likely intended not to deter Brazil (a new lender to the IMF) from its strategy but to warn other developing countries against following Brazil's lead down a policy path that the IMF views as a last resort. The case demonstrates the tenuous situation in which the IMF now finds itself, as it begins to acknowledge the necessity of capital controls in cases of financial disruption while not wanting to lose control over just when, how and by whom this policy instrument is employed.[38]

Discontinuity in IMF discourse

It should be acknowledged here that the evidence for rupture in IMF practice during the current crisis is somewhat underwhelming. The fact is that the institution is trying hard to carry forward with its arsenal of well-established strategies, honed in earlier crises. But there is another indicator of discontinuity that, though less concrete, may be a better indicator of substantive future change. What I have in mind is the efforts that the IMF has gone to during the crisis to address the concerns of its critics—especially from the NGO development community. During the crisis the IMF has begun to present itself differently in ways that implicitly legitimate NGO concerns, and in so doing, would make it difficult for the IMF to revert to the kinds of interventions that it pursued so relentlessly during the Asian crisis.

Two notable reports of the IMF [2009g, 2009h], issued in October 2009, reveal the shift in discourse that I am speaking of here. In these reports, the IMF catalogues many complaints of the NGO community about its handling of economic crisis in the developing world. They include (for instance) the claim by NGOs that the IMF is continuing to impose too many egregious conditions on those countries in need of financial assistance. The IMF response is notable: rather than defend these conditions on the basis of Washington Consensus types of arguments, the IMF instead presents evidence that it has in fact substantially reduced the number of conditions in the new SBAs as compared with those that it negotiated in earlier periods. This discursive shift gives credence to NGO complaints about the ways in which IMF interventions have historically reduced developing country policy space. Hence, in defending itself, the IMF implicitly indicts its prior practice—and in so doing legitimates NGO demands for protecting and enhancing policy space.

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[38] Taiwan's government in December 2009 banned foreign investors from placing funds in time deposits to counter currency speculation. This capital control, has to this point, escaped comment by the IMF.

The same shift, with the same effects, is apparent in the IMF's defense against claims that its policies are harming the poor. In response, the IMF points to the fiscal flexibility it has provided many countries in the new SBAs, and to the requirements in the agreement that governments take steps to protect the poor during the crisis. We have considered already above the incoherent ways in which the SBAs are to do that, since these countries also are required to maintain tight fiscal discipline. But what is important here, again, is the fact that the IMF is establishing on the public record the legitimacy of the concerns about how its practice may affect the poor. Again here, too, we find an implicit criticism of the "old" IMF by a "new IMF" that understands and shares the concerns of its critics.

Discourse isn't everything, to be sure, as those who are now suffering from stringent IMF conditionality can attest. But it is something—and this particular discursive discontinuity may serve to push the IMF toward future policy adjustments that provide greater protections for vulnerable communities, a greater role for development NGOs, and greater policy space for developing country policymakers.

The crisis and economic ideas

It is too early to say whether the crisis will have a lasting effect on economic thought in the academy and beyond. Many commentators have seen in the crisis the end of neoclassical theory's simplistic account of financial market behavior and outcomes—provoked in part no doubt by Alan Greenspan's shocking mea culpa before Congress in the fall of 2008. Many also believe that the crisis signals the death knell for the old Washington Consensus, as British Prime Minister Gordon Brown proclaimed at the end of the April 2009 G20 summit [Thomas, 4/5/09]. Relatedly, others see the intellectual legacy of the crisis as the end of American exceptionalism [Gourevitch, 2009], whereas others see the biggest casualty of the crisis being unfettered capitalism in, for example, Eastern Europe [Bilefsky, 2/24/09]. This is very likely the case, meaning that it is conceivable that we will see a much greater degree of pluralism, heterogeneity and even incoherence in economic ideas in the coming years—especially but not only in the domain of financial governance. This could have the effect of increasing the policy space available for policy experimentation and diversity in developing countries, especially given that the IMF governance is beginning to change and the G-20 has displaced the G-7 as a forum for discussion of international economic issues.

Certainly, however, we should not be surprised if this period of incoherence ultimately gives way to a reassertion of the coherence that has been so damaging to policy space in the developing world. As Wade [2008] writes: "[t]here is a recurrent cycle of debate in the wake of financial crises, as an initial outpouring of radical proposals gives way to incremental muddling through, followed by the resumption of normal business" [p. 7]; furthermore "[n]eoliberal economics has powerful antibodies against evidence contrary to its way of seeing things" [p. 17]. Echoing this sentiment, interviews with economists suggest that the academic discipline of economics is not shifting nearly as much as some people think [Cohen, 3/5/09]. A recent report on the current crisis from the US (Federal) Government Accountability Office [2009] is illustrative of the long half-life of neo-liberal ideas in some quarters. This report is notable both for its puzzling and inaccurate reading of the economics literature on the macroeconomic costs of inflation and for its hagiographic interpretation of the IMF's response to the current crisis.

But even Wade acknowledges the possibilities that the current crisis presents. He concedes that "the current crisis may be severe enough to awaken economists from the 'deep slumber of a decided opinion'…" [2008:p. 17], and he argues that "[i]f the second leg of the 'double movement' turns out to be a period from which consensus is largely absent, it may provide space for a wider array of standards and institutions-economic and financial alternatives to the system-wide prescriptions for neo-liberalism [Wade, 2008:p. 21].[39] I should add that if the economics profession does not take stock of its historic failure, it may simply find itself relegated to the sidelines as economic governance decisions are taken by policymakers who come to take counsel from other kinds of experts.

The end of universal standards and codes

Following the Asian and other financial crises of the 1990s, the IMF, the G7 and private financial actors worked to develop and implement a set of universal standards and codes (based on Anglo-American practices) to govern global finance.[40] These standards and codes required not only changes in national policies vis-à-vis external actors (e.g. the reduction in barriers to investment abroad), but also changes in domestic policies (e.g., accounting practices of firms and banking sector regulation). Another distinguishing feature of these standards is the mix of public and private authority involved. In some cases, such as Basel II, private actors provided input to construct the rules and helped to implement them. The predominant influence of the major states and the private sector in the standard-setting process marginalized many of the ultimate subjects of the rules, particularly developing country governments and firms. The standards reflected a basic assumption that given accurate information in a timely fashion, private capital markets will operate efficiently.

The current crisis may well undermine the US-led effort to impose a universal set of standards and codes on developing countries. What appears to be emerging out of the current crisis is a reaction against universalism. To the extent that the standards and codes idea continues to have traction it is most likely that we will see development of more regional or even country specific standards and codes. Mosely [2009] argues that an end to universal standards and codes is one possible outcome of the current crisis, though she identifies other possible outcomes as well (including a renewed emphasis on standards and codes, but with new attention to regulatory issues in mature markets). Singer [2009] is less equivocal on the matter of universal regulatory standards. His view is that the prospects for new international regulatory standards are poor. This is because US regulators are unlikely to champion new international standards because of the US role in the financial crisis and because of the high degree of fragmentation of domestic financial regulation in the US. Without US leadership any modifications to the international standards and guidelines created by the Basel Committee, the IOSCO, etc. will likely be cosmetic rather than substantive. More broadly, Helleiner [2009] argues that the current crisis

[39] Johnson [2009) argues that the severity of the crisis means that the range of policy and regulatory options that are being considered is far wider than would have been possible a short while ago. Though he goes on to say that once the crisis ebbs, this policy window will begin closing.

[40] This description of the standards and codes project draws heavily on Mosely [2009].

may be unleashing pressures that may lead toward more decentralized and fragmented forms of international financial governance over the medium term, including the growing possibility of divergent responses to financial regulation between G7 and East Asian countries (and even among the ASEAN+3 countries), and a strengthening of the opposition to universal standards and codes on the part of developing countries. He argues that this decentralization, coupled with re-regulation of international financial markets, suggests that the post-crisis world will be quite different from the one that emerged from the East Asian crisis a decade ago.

Rethinking financial and economic openness

Another way in which the current crisis may be creating more policy space for developing and transitional countries is by highlighting the benefits of national economic policies that depart rather significantly from the neo-liberal model with which so many developing countries conformed after the Asian crisis. Those developing countries that were able to resist pressures to replicate the extreme financial openness and the financial liberalization of the Anglo-American financial models were in a better position to weather the current global financial turbulence. For example, the Indian economy and financial system benefited from the country's stringent capital controls, prudent approach to financial regulation, and the counter-cyclical financial regulations that its central bank pursued under the leadership of Dr. V.Y. Reddy.[41] The title of a February 2009 report on India by Macquarie Capital captures the relevance of India's experience well—"India: Better off than most others" [Timmons, 3/2/09]. In commenting on India and the global crisis at the winter 2009 Davos World Economic Forum, Kenneth Rogoff said: "The most rational thing for many countries may be to insulate themselves from the globalized economy…"[c]ountries will feel required to put on more capital controls so they are not exposed to countries that are taking risks" [quoted in Norris, 2/6/09; see also Nocera,12/20/08]. Much the same can be said about China's experience during the current financial crisis. In addition, it bears noting that it has proven far easier for all levels of government to disburse counter-cyclical spending in more dirigiste financial and economic systems (as we have seen in China, India, let alone in France as compared to the USA).

The case of Brazil supplies further evidence of the wisdom of tight financial regulation. Prior to crisis Brazil had imposed restrictions on derivatives and naked short selling, and had imposed reserve requirements of 30% which far exceed the Basel II minimums. These initiatives are now

[41] Governor Reddy sharply curtailed securitization and derivatives as they were becoming more prominent globally. When there was a housing market bubble, he raised interest rates to 20% (to curb both the real estate bubble and inflationary pressures). He increased risk weightings on commercial buildings and shopping mall construction, and doubled the amount of capital banks were required to hold in reserve. In that way, he created liquidity in the period leading up to the crisis. This is not to say that India did not experience any fallout from the current crisis. Deterioration in export performance, FDI inflows and a shortage of liquidity certainly have had negative effects on the country's macroeconomic performance [see e.g., Bajaj and Sengupta, 5/5/09]. For instance, during the crisis Standard and Poors revised its outlook on India's sovereign debt to negative from stable, a decision that may well affect the cost of capital to the country. However, the performance of rating agencies in the years leading up to the crisis suggests that we might be cautious about the firm's judgments of the country's prospects.

widely recognized as a critical factor in the country's ability to with stand the volatility that has devastated so many developing countries [Wheatley, 6/17/09]. The general rule that has emerged from this crisis is that countries that have been less damaged by the crisis are those that managed financial flows and institutions more heavily. It is hard to imagine a scenario in which other developing countries do not take heed and search for ways to amend their financial and economic governance in anticipation of future regional or global crises.

Finally, it is conceivable that enthusiasm for externally-oriented models of development will be substantially diminished as a consequence of the current crisis. This external orientation has included among other things a reliance on manufactured and commodity exports, and the associated attraction of international private capital flows. Global trading centers such as Singapore, Hong Kong, and Taiwan have been particularly hard hit by the collapse of world export markets [Bradsher, 3/5/09]. Many low-income countries that relied on a single or a few commodities for export have been among the hardest hit. Moreover, the reduction in remittances has called into question the migration as development strategy for nations such as the Philippines and many small island economies. We may see a return to more domestic, demand-led rather than externally-oriented development strategies in the coming years as a component of a more diversified set of economic strategies.

The pursuit of countercyclical policies

The crisis has been marked by the pursuit of countercyclical policies by developing countries that have not been forced to negotiate SBAs. In the aftermath of the Asian crisis only Malaysia pursued countercyclical policies. During the current crisis, many developing countries have been able to use the policy space created by substantial reserves, initial current account positions and the degree of openness of their capital accounts to pursue the kinds of countercyclical fiscal and monetary expansions used by the USA, other wealthy countries and China as they have sought to respond to the crisis.

A recent study by ECLAC [2009] summarizes the diverse and largely Keynesian responses to the crisis across many Latin American and Caribbean countries. According to the report, about half the economies in Latin American and the Caribbean used some form of fiscal stimulus during 2008 and through the end of June 2009.[42] Notably, a study of the feasibility of countercyclical fiscal policies in Latin America by Fernández-Arias and Montiel [2009] concludes that most of the major countries in the region appear to possess the fiscal space (as measured by credible fiscal sustainability and debt headroom) to run (what they term) prudent countercyclical deficits.[43]

[42] Note the report does not score countries in terms of whether they deployed capital controls in response to the crisis, but it appears from some of the descriptions of the policy responses that some countries tightened and others loosened some types of capital controls. The details on these policies are sketchy and so I hesitate at this point to draw a firm conclusion whether these policies really should be classified as capital controls.

[43] They argue that those countries should undertake a constrained fiscal expansion focused on productive public spending financed by 'rainy day' funds, which are large stocks of foreign exchange reserves that they have accumulated over recent years. In those cases where the

A recent Asian Development Bank (ADB) report [2009] also documents the range of diverse countercyclical monetary and fiscal policies pursued in response to the crisis within its member countries. For example, the Cambodian government has allowed expenditures to rise and the overall budget deficit for 2009 is expected to climb to 3.9% of GDP from 2.7% in 2008, while monetary policy has also been relaxed; the Indian government has increased public expenditure; the government of Pakistan has increased public spending, relaxed monetary policy (though the continued ability to do so depends on the country's continued progress in reducing inflation), and has in place a major new social cash transfer program that has started to mitigate the impact of the crisis on poor; the Georgian government is maintaining a countercyclical fiscal stance and is providing for stronger social safety nets; and donor assistance is allowing some countercyclical measures in the Kyrgyz Republic. In addition, ASEAN nations have reduced interest rates to stimulate economic growth (this is the case in the Phillipines, Thailand, Viet Nam, India, Bangladesh, Sri Lanka), while also pursuing fiscal stimulus (e.g., China, Korea, Thailand, India, Bangladesh, Sri Lanka). China's fiscal stimulus is particularly notable, amounting to more than 13 percent of GDP [UNCTAD 2009b]. The ADB has also increased its lending by $3 billion including loans made under the new Countercyclical Support Facility, which constitute about 35% of the crisis-related loans made by the institution between September 1, 2008 and December 31, 2009. China, India and South Korea began to implement expansionary monetary policy in September 2008 [UNCTAD 2009b].

Few low-income countries (other than those that are commodity exporters) have the fiscal space to undertake countercyclical fiscal stimulus [World Bank, 2009d]. Commodity-exporting low-income countries have been able to expand their deficits significantly, by an average of over 8% of GDP between 2007 and 2009. By contrast, other low-income countries have been able to allow their fiscal deficits to expand on average only by about 2% of GDP during the same period.[44] Some low-income countries, including some in South Asia and many fragile states, have had almost no fiscal space to respond to the crisis.

It bears mentioning that the exchange rate arrangements in some countries have made it impossible for them to respond to the crisis with countercyclical monetary policy. Countries that have dollar- or euroized through formal currency substitution, hard pegs or currency boards have not backed away from these policies to this point. This policy continuity obviously restricts policymakers' ability to deploy monetary policy in response to the crisis. Indeed, in the transitional countries, the crisis seems to have intensified their commitment to euroization.[45] The Latvian case is especially interesting in this regard because the IMF has had to accommodate the commitment of domestic policymakers to tie their own hands through the currency peg, even though doing so has been quite costly economically and politically. The loosening of the fiscal constraint in the country's SBA has therefore been of little benefit. In

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foreign exchange reserves are not available, this constrained fiscal expansion should be financed with multilateral support. Their empirical research concludes that the Latin American countries with the most fiscal space are Chile, followed by Brazil, Colombia, Peru and Mexico.

[44] For example, Bangladesh has a fiscal stimulus package equivalent to 1.6% of GDP, Nigeria's amounts to .3% of GDP and Vietnam has one equal to about 12% of GDP.

[45] This commitment also limits the ability to deploy countercyclical fiscal policy.

officially dollarized El Salvador, monetary policy is also effectively precluded; this means that the loosening of the fiscal restraint in the original SBA has had little effect on the country.[46]

Space constraints preclude consideration of other factors that contribute to the incoherence that might well end up creating an increase in the policy space for developing countries. I will just mention here that the WTO (like the IMF prior to the global financial crisis) has been without a coherent vision or power since the collapse of trade talks at the Cancun meeting of the WTO in 2003. One other important factor is that the current US administration is rethinking the nature of its model bilateral investment treaties.[47] These treaties and the WTO have been powerful means of constraining policy space in developing countries over the last decade or so [Grabel, 2010].

4. CONCLUSIONS

Where does this review of the evidence leave us? The foregoing discussion sustains the following tentative conclusions. First, the IMF's response to the current crisis is somewhat different and far less coherent than was its response to the Asian crisis. Though the IMF certainly continues to apply pressure to secure compliance to stringent fiscal and monetary policy, it has chosen in the face of the unfolding crisis to exhibit a degree of flexibility that was absent during its response to the Asian financial crisis. In particular, it has relaxed fiscal constraints in countries facing crisis, and has at least paid lip service to the need to protect the dispossessed even in the face of what it takes to be the need to impose fiscal and monetary discipline. Moreover, in the case of Iceland it made a forceful case for the necessity of temporary capital controls, and it has begun to speak cautiously of the possibility of using capital controls in response to crisis conditions in developing countries; while in the case of Brazil its reaction reflects a growing pragmatism in the face of events it cannot control combined with an effort to warn others against imprudent use of a policy tool it does not yet fully trust. At the same time, however, it has not demonstrated a willingness to exhibit flexibility with respect to monetary targets. As a consequence, its restrictions on monetary loosening contradict its new fiscal flexibility—a fact that cannot be lost on IMF economists. Missing here is the confidence that comes from the consistent, universal implementation of an elegant, coherent model.

The upshot of all this is that at present there is no one unifying narrative at the IMF that coherently captures its approach to the crisis. This incoherence, coupled with a crisis of confidence among erstwhile neo-liberal economists and with initiatives taken independently by developing countries during the crisis, suggests that we have entered a period of "productive incoherence" as concerns economic governance in the developing world. There is a new

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[46] Space does not allow for discussion here of another issue of relevance---the question of the importance of the US dollar and the euro in developing and transitional economies. But this omission is not cause for concern since, at present, the crisis does not seem to be triggering a de-emphasis on these currencies. Indeed, the uncertain global economic environment seems to be leading vulnerable countries to cling more tightly to the credibility benefits that they associate with currency pegs and other links to hard currencies that pre-date the crisis. See a related discussion of policy credibility in Grabel [2003c].

[47] Per private correspondence with two appointed delegates to the committee that is working on a revision of the US' model bilateral investment treaty.

uncertainty among economists and a new ad hocery in evidence today that we have not seen for the past quarter century or so. While such confusion and ambiguity are generally seen by economists (and perhaps other social scientists) to be a problem in policy design and implementation, in the current context of the decay of the neo-liberal project it should instead be taken as productive insofar as it may be creating the opportunity for developing countries to engage in policy experimentation of their own design.[48] And on that score, the evidence seems to suggest that they are not waiting for the permission granted by the emergence of a new, coherent theoretical model. They are instead muddling through (Colander, 2003), and from the ad hoc, incoherent strategies now underway just might emerge a widely diverse platform of new interventions that are tailored to the diverse contexts that policymakers face across the developing world.

[48] This argument resonates with Best's [2005] treatment of the constructive role of ambiguity in global financial governance from the Bretton Woods era through the Asian financial crisis.

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