



Not Your Grandfather's IMF:  
Global Crisis, 'Productive Incoherence' and  
Developmental Policy Space

Ilene Grabel

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Gordon Hall  
418 North Pleasant Street  
Amherst, MA 01002

Phone: 413.545.6355  
Fax: 413.577.0261  
[peri@econs.umass.edu](mailto:peri@econs.umass.edu)  
[www.umass.edu/peri/](http://www.umass.edu/peri/)



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INCOHERENCE" AND DEVELOPMENTAL POLICY SPACE

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Ilene Grabel\*  
Professor of International Finance

Corresponding address:  
Josef Korbel School of International Studies  
University of Denver  
Denver, CO 80208, USA  
Office: 303/871-2546; FAX: 303/871-2456; Email: [igrabel@du.edu](mailto:igrabel@du.edu)

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*Abstract:* The response by the IMF (and developing country national governments) to the current global financial crisis represents a moment of what I term “productive incoherence” that has displaced the constraining “neoliberal coherence” of the past several decades. Productive incoherence refers to the proliferation of inconsistent and even contradictory strategies and statements by the IMF that to date have not congealed into any sort of new, organized regime. Those who see continuity at the IMF emphasize the reassertion of the IMF’s authority; the reiteration of pro-cyclical policy adjustment; and the maintenance of existing governance patterns within the institution. In contrast, evidence of discontinuity includes a world now populated by increasingly autonomous states in the South; the normalization of capital controls; and Fund conditionality programs that are inconsistent in key respects. In the face of this evidence, it is best to understand the current conjuncture as an “interregnum” that is pregnant with new development possibilities.

*Key words:* Global financial crisis; policy space for development; International Monetary Fund; capital controls; neo-liberal policies and development

*JEL classifications:* E65, F53, O23

## 1. INTRODUCTION

When things have been so bleak for so long, it is understandable that heterodox development economists fail to recognize change when it begins to unfold. This is certainly true of those of us who have railed against the extension of neo-liberalism across the developing world at the hands of the International Monetary Fund (IMF)/World Bank, Wall Street investment banks and hedge funds, credit rating agencies, the US and UK governments, neo-liberals in the developing world and the economics profession. Faced with a juggernaut of this sort, we can forgive ourselves for failing to recognize, let alone take any hope in, signs of change.

Forgiven, that is, if the stakes weren't so high. But they are very high, indeed—and so we can't be quite so self-forgiving if in fact our pessimism leads us to discount too readily evidence of new aperture that could be exploited by heterodox economists to bring about the kind of change in ideas and policies that the developing world so badly needs. Given the state of flux in economic thinking and policy, it is important at this juncture to guard against premature conclusions that nothing has, can or will change.

In this spirit, I argue that the mixed and even chaotic response to the current global financial crisis represents a historical moment of what I term “productive incoherence” that has displaced the constraining “neoliberal

coherence” of the past several decades. By productive incoherence I refer to the proliferation of responses to the crisis by national governments, multilateral institutions (particularly the IMF) and the economics profession that to date have not congealed into any sort of consistent strategy or regime. The term is intended to signal the absence of a unified, consistent, universally applicable response to the crisis—both at the levels of rhetoric and policymaking. This incoherence is radically different from the response to the East Asian financial crisis of 1997-98, the reaction to which was remarkably coherent. Indeed, the univocal response served to deepen the move to neo-liberal reform in the developing world through a variety of institutional and ideational mechanisms [on responses to the Asian crisis, see Grabel, 2003a, 2007; Singh, 1999; Wade, 2007].

The responses that are emerging across the globe and within the IMF to the current crisis range from those that reflect substantial continuity with neo-liberalism to those that represent pronounced discontinuity. For those like this author and others (e.g., Chang and Grabel, 2004; Gallagher, 2005; Shadlen, 2005; Wade, 2003) who have worried about neo-liberalism as a straightjacket over policy space in developing countries, the new incoherence may signal the tentative beginning of the end of a wrong-headed regime that granted excessive authority to the IMF, neo-liberal economists and the global financial community to set the parameters of acceptable, feasible policy

choices in the developing world. In this (albeit limited) sense, the present incoherence is productive, signaling as it does not the death of neo-liberalism, certainly, but erosion of the stifling consensus that has secured and deepened neo-liberalism across the developing world over the past several decades. It follows that we would make a grave error were we to prejudge the historical moment as one of simple inertia rather than potential rupture.

Advocates of continuity can certainly marshal compelling evidence. On the one hand, one of the most interesting and important institutional aspects of the current conjuncture is the degree to which the crisis has restored the IMF's authority (see below), just when long-standing critics of the Fund might have hoped for new institutional arrangements to manage crises. Moreover, in some very important respects, IMF assistance to countries in distress has followed its well-rehearsed script inasmuch as many conditionality programs continue to stress pro-cyclical policy adjustments, privatization and liberalization. Moreover, as of this writing the widely anticipated reform in IMF governance that would enhance the voice and influence of developing countries has borne no significant fruit whatsoever. These facts are noteworthy, to be sure, but they do not represent the whole story.

On the other side of the ledger are promising signs that the neoliberal prescriptions of important economists and departments at the Fund are being

challenged by the current crisis in ways that most of us did not anticipate. In response, at least some IMF economists are learning to live with serious departures from the old script. Most importantly in this regard, the crisis is having the effect of normalizing the use of capital controls in developing countries. I would suggest that this may represent the beginning of what may very well turn out to be the most significant expansion of policy space in the developing world of the past several decades. It is also the case that, in some important respects, Fund staff have developed conditionality programs that—while still unduly harsh—display a degree of incoherence in two respects that we have not seen previously. Some conditionality programs are characterized by an obvious inattention to how the “pro-poor spending” that the Fund emphasizes these days is to be financed in the context of fiscal retrenchment. There is also a lack of consistency between conditionality programs across countries.

I will postpone until the end of this paper the usual and even necessary caveats about the resilience of neoliberalism and the fragility of the new policy space, and instead turn straight away to the main focus of this paper. My goals are straightforward. First, I intend to demonstrate that the response to the current crisis has in fact been incoherent in important respects, from “who’s in charge here?” to “what is to be done?” As regards the former, we will see *inter alia* that the crisis has at once resurrected the IMF as a central actor in

crisis management at the same time that it has revealed its diminished influence as a consequence of the successful escapist strategies of large developing countries from the IMF's orbit. For the first time in recent memory, the IMF finds itself forced to respond after the fact to developing country economic strategies that flout the neoliberal prescription. In this context, the institution has demonstrated a new flexibility concerning some aspects of policy that should be striking to long-term IMF watchers.<sup>1</sup> Associated with

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<sup>1</sup> It is beyond the scope of this paper to investigate just why the IMF has evolved in the ways that I will examine here, but it is likely that some combination of these factors is responsible: (1) a pragmatic recognition by IMF leadership and staff that the institution has no effective choice but to amend its policy prescriptions, owing to its diminished influence in the developing world (which I examine below); (2) relatedly, concern at the IMF about existing and future competition with other institutions (such as the World Bank, the Asian Development Bank, Brazil's national development bank) and regional financial arrangements (such as the Chiang Mai Multilateralisation agreement involving members of ASEAN, and South Korea, China and Japan, the Latin American Reserve Fund, the Bank of the South, etc.) in the area of crisis management; (3) the influence of leading academic economists, who themselves have come to question and in some respects reject the traditional neo-liberal prescription for development; and (4) the current global financial crisis, coming just a decade after the Asian crisis, may be having the effect of encouraging those

these changes, the “what is to be done?” question is being answered today more inconsistently and pragmatically than in the recent past. Second and equally important, I will show that this incoherence is in fact productive in the sense of expanding policy space for development.

## **2. WHO’S IN CHARGE? THE RESURRECTION OF A DIMINISHED IMF IN A WORLD OF RELATIVELY AUTONOMOUS STATES**

The IMF has had a dominant and controversial role in financial governance from the developing country debt crisis of the 1980s through the immediate aftermath of the East Asian financial crisis of 1997-98. The IMF emerged from the East 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 US government and by private financial interests, its myriad failures in East Asia prior to and following the crisis, and its excessively harsh

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economists at the IMF (and the World Bank) who have long had reservations about the neo-liberal model to give voice to their concerns and to assert themselves more effectively. It is important to keep in mind in this connection that like any complex organization, the IMF comprises diverse constituencies that may very well disagree among themselves about some fundamental matters pertaining to the institution’s strategies.

and intrusive conditionality.

An important consequence of the Asian crisis and subsequent changes in the global economy was the loss of purpose, standing and relevance of the IMF. Indeed, prior to the current global financial 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].<sup>2</sup> In fiscal year 2005, just six countries had Stand-by Arrangements (hereafter, SBAs) with the Fund, the lowest number since 1975 [Kapur and Webb, 2006].<sup>3</sup> From 2003 to 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 seek its assistance [Chorev and Babb, 2009].

The current crisis has been good to the IMF [Chorev and Babb, 2009]. It has rescued the institution from its growing irrelevance by re-establishing its

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<sup>2</sup> In the years following the Asian crisis, the Fund eliminated as much as 15% of its staff [Thomas, 2009]. Note, however, that Ukraine returned to borrower status when it signed a \$15 billion SBA with the Fund in July 2010.

<sup>3</sup> SBAs are the IMF's basic short-term loan agreement.

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. The regional arrangements and institutions that have evolved in the developing world in response to the East Asian crisis and those that are evolving at present are not yet in a position to substitute for the Fund (though Fund staff may well be acting on the presumption that this may start to happen). Moreover, events in and on the periphery of the European Union (EU) have contributed substantially to the IMF's resurrection as a consequence of the need of the EU, European Commission and European Central Bank for the Fund's expertise, financial assistance and authority. Indeed, Lütz and Kranke (2010) argue that the EU has "rescued" the IMF by partnering with it on bailouts and by channeling its harsh conditionality circa the 1980s and 1990s.

In a similar vein, representatives at the April 2009 meeting of the G-20 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, 2009). 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, as Chowla [2009] demonstrates). 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. It also bears noting that the global crisis has reinvigorated not only the IMF, but also other multilateral financial institutions, such as the World Bank, the Inter-American Development Bank and the European Bank for Reconstruction and Development, EBRD.<sup>4</sup>

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

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<sup>4</sup> 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 Kulish [2009] on the reinvigoration of the EBRD.

There is some evidence that the Fund is beginning to face competition from other institutions. For instance, Wade [2010:fn10] points out that the IMF is losing new business to the World Bank outside of the European rescues. And he notes that even in Europe, Turkey broke off negotiations with the Fund in early March 2010 because of the severity of its conditions. A few weeks later the country negotiated a \$1.3 billion loan with the Bank.

\$10 billion. Thus, \$90 billion of the \$500 billion in new resources for IMF lending will come from countries that have traditionally not played an important role in Fund governance. The support for the Fund coming from developing countries is surely a landmark event at the institution. For our purposes what is most important about these new commitments is that they not only contribute to the Fund's resurrection, but also reflect the global power and autonomy of these rapidly growing economies (see below). The Fund is continuing to seek additional resources: indeed, as of July 2010, it is soliciting an additional \$250 billion, a matter to be taken up at the November 2010 G-20 meeting in South Korea.

The reemergence of the IMF at the heart of the global financial system is significant since the IMF has played such a central role in shaping the policy space available to developing and transitional countries over the last three decades. Whether the IMF will use its renewed influence and financial resources in familiar ways that explicitly constrain policy space or in new ways that expand the space for policy heterogeneity and experimentation will depend on many factors. Not least among these factors is the extent to which developing countries are ultimately able to use the financial crisis to enhance their formal voting rights and informal influence at the Fund, and whether the IMF has to change to maintain its absolute and relative influence (in relation to competitor institutions and nations that are autonomous from it). As of this

writing, progress on governance reforms has not yet occurred [Weisbrot and Johnson, 2009].<sup>5</sup>

All this seems to bode well for the IMF. But the IMF's resurrection is tempered by events that have substantially diminished its geographic reach. Prior to the crisis, those developing countries that could do so had opted out of Fund programs. Indeed, one important impetus to their doing so was the IMF's handling of the Asian crisis. Developing countries across the globe sought to insulate themselves from the hardships and humiliations suffered by Asian policymakers at the hands of the IMF. The explicit goal was to escape the IMF's orbit. They did this by relying on a diverse array of strategies: self-insuring

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<sup>5</sup> IMF governance has long been a point of contention among developing countries and civil society organizations. 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. This issue has been taken up by the G-20. Representatives at the September 2010 G-20 meeting 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 will be announced by January 2011. However, the IMF itself has acknowledged that negotiations have stalled [IMF, 2010c].

against future crises through the over-accumulation of reserves; the attraction of international private capital inflows, including new sources of finance such as securitized remittances, and the establishment of swap arrangements among central banks; and a new reliance on trade finance, private investment and official development assistance from fast-growing developing countries such as China and Brazil [Kapur and Webb, 2006; Ketkar and Ratha, 2008; Economist, 15 July 2010]. The dramatic decline in the IMF's loan portfolio after the Asian crisis indicates the degree to which these escapist strategies proved to be successful. Even in the context of the current crisis, countries did their best to stay clear of IMF oversight. Indeed, during the current crisis, South Korea likely would have been a good candidate for a (precautionary) Flexible Credit Line with the Fund. But it did not apply for the credit line, presumably because of its prior experience with the Fund and to avoid the stigma of being one of its clients [Wade, 2010:fn10]. Instead, it activated an existing reserve swap arrangement with the US Federal Reserve.

Those developing countries that have been able to maintain their autonomy during the crisis have used the resulting policy space to pursue a variety of counter-cyclical macroeconomic policies and, lately, various types of capital controls (on the latter, see section 3). Their ability to do so indicates the degree to which the IMF's geographic reach has been compromised in the years following the Asian crisis. Equally important for the matter at hand, the

behavior of these autonomous states has served as an example for less powerful states which, in turn, have reacted to the crisis in ways that were taken to be unimaginable in previous crises [DeMartino, 1999].

In sum, then, the IMF has discovered new vitality as a first-responder to economic distress at the same time as it has faced diminished territory over which it can dictate economic policy. The newly resurrected institution faces a changed landscape. It no longer enjoys wall-to-wall influence across the developing world. The geography of its influence is, at present, significantly curtailed as a consequence of the rise of relatively autonomous states in the developing world. Equally important, even within its orbit of influence its economists are responding to the current crisis in some ways that diverge from their recent past practice. To that and related issues we now turn.

### **3. WHAT IS TO BE DONE? PRODUCTIVE INCOHERENCE IN THE IMF'S RESPONSE TO THE CRISIS**

In what follows we probe the IMF's response to the crisis—teasing out signs of tension and ambiguity within its conduct during the crisis period. We will see that the IMF has at once demonstrated both more flexibility in certain dimensions than in the past when managing countries in crisis, while also holding fast to neo-liberal strategies in other regards. On balance one must conclude that the IMF's behavior has been ambiguous during the current crisis.

This nevertheless represents a substantial shift from its unified and coherent response to the Asian crisis. To illustrate the present IMF incoherence, I will focus first and foremost on the normalization of capital controls and then turn to the character of numerous SBAs (and other assistance packages) it has signed during the current crisis.

### **Capital controls: The “new normal”**

The current crisis has achieved in a hurry something that heterodox economists have been unable to do for a quarter-century. It has provoked policymakers around the world to impose capital controls as a means to protect domestic economies from the ravaging effects of liberalized financial markets. What is perhaps more surprising and hopeful is that the new controls have been met variously with silence on the part of the IMF and the international business community and tacit acceptance of their necessity and prudence. This reception contrasts sharply with the IMF and investor condemnation that was provoked when Malaysia imposed stringent capital controls during the Asian financial crisis. At the time the IMF called these controls on capital outflows a “step back” (Bloomberg, 6 May 2010), and a representative article in the international business press stated that “foreign investors in Malaysia have been expropriated, and the Malaysians will bear the cost of their distrust for years” [cited in Kaplan and Rodrik, 2001:111]. More recently, capital controls in Thailand were reversed by the Central Bank within a

few days after their implementation in December 2006 (following a coup) after they triggered massive capital flight (Bloomberg, 6 May 2010).

The IMF's inconsistent stance on and response to the new capital controls makes it easier for other countries to follow suit, and it appears that they are doing so [DeMartino, 1999]. In my view, the normalization of capital controls is the single most important way in which policy space for development has widened in several decades.

Capital controls were the norm in developing and wealthy countries in the decades that followed WWII [Helleiner, 1996].<sup>6</sup> At that time, they were widely understood by academic economists, policymakers and officials at multilateral institutions to be an essential tool of economic management. Policymakers deployed capital controls in order to enhance macroeconomic policy autonomy, promote financial and currency stability, protect domestic industries/sectors

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<sup>6</sup> Capital controls refer to a range of policies that are designed to manage international capital flows. They can and have taken many forms in various countries over time. For example, they have involved restrictions on foreign investment in certain sectors or assets, minimum stay requirements on foreign investment, restrictions on capital outflows, taxes on foreign investment, restrictions on access to the domestic or to foreign currencies or to holding bank accounts outside the country, etc.

from foreign control or competition, and ensure the provision of adequate credit to favored sectors and firms at the right price [Epstein, Grabel, Jomo KS, 2004].

The reception that greeted Malaysia's capital controls during the Asian crisis was unremarkable inasmuch as it was consistent with the view of neo-liberal economists and policymakers at the time. Indeed, up until the Asian crisis the Fund was poised to modify its Articles of Agreement to make the liberalization of all international private capital flows a central purpose of the Fund and to extend its jurisdiction to capital movements. But despite the neo-liberal tenor of the times, some developing countries nevertheless maintained capital controls—most famously, Chile and Malaysia, but also China, India, Colombia, Thailand, and a few others.

Then a notable development occurred. In the wake of the Asian crisis, IMF research staff started to change their views of capital controls—modestly and cautiously to be sure. In the post-Asian crisis context, the center of gravity at the Fund and in the academic wing of the economics profession shifted away from an unequivocal, fundamentalist opposition to any interference with the free flow of capital to a tentative, conditional acceptance of the macroeconomic utility of some types of capital controls. Permissible controls were those that were temporary, market-friendly, focused on capital inflows, and were

introduced only when the economy's fundamentals were mostly sound and the rest of the economy was liberalized [Prasad et al., 2003; Ariyoshi et al., 2000]. Academic literature on capital controls in the decade that followed the Asian crisis reflected this view: as Gallagher [2010a] points out, cross-country empirical studies (many of which are reviewed in Magud and Reinhart, 2006) offered strong support for the macroeconomic achievements of controls on inflows. [See also David, 2008; Coelho and Gallagher 2010; Epstein et al. 2004 on inflow and outflow controls in seven countries; Chwieroth, 2010:ch.8.] Evidence supporting the achievements of outflow controls remains far more scant. Research on Malaysia by Kaplan and Rodrik [2001] finds strongly in favor of the achievements of Malaysia's controls on outflows. They find that compared to other countries in the region that had IMF programs during this period, Malaysian policies produced faster economic recovery, smaller declines in employment and real wages, and more rapid turnaround in the stock market. Magud and Reinhart's review [2006] bears out this view of Malaysia's outflow controls as well, though their survey also concludes that outflow controls had inconclusive effects in other countries.

The IMF itself took note of its own change in stance. A 2005 report by the IMF's internal watchdog, the Independent Evaluation Office (IEO, 2005:48), finds that during the 1990s the IMF "displayed sympathy with some countries in the use of capital controls and...even suggested that market-based

measures could be introduced as a prudential measure.” The report then finds that the IMF’s support for capital controls increased after the Asian crisis. That said, the report acknowledges (correctly) that there was a lack of consistency in the IMF’s advice on this matter during the post-Asian crisis period. Thus began the tepid, gradual and uneven practical and ideational process by which some types of capital controls came to be normalized conditionally by the IMF and by academic economists after the Asian crisis.

Although the seeds of an intellectual evolution had been planted in the post-Asian crisis context, there was push back in this period from stalwarts in the academic wing of the profession [e.g., Forbes, 2005; Edwards, 1999]. In addition, there was a curious disconnect between the research of IMF staff, on the one hand, and advocacy for capital account liberalization by the institution’s economists when they worked in the field with particular countries, on the other.<sup>7</sup> Hence, despite the modest intellectual progress on capital controls that began after the Asian crisis, capital controls were still largely viewed as

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<sup>7</sup> Though the matter is outside the scope of this paper, the disconnect between IMF research and advocacy work might be explained by the relative autonomy of different departments at the IMF, a lack of leadership from the top on capital controls, and the internal entrepreneurship of mid-range IMF staff when working in different contexts. The latter two issues are examined in Chwieroth [2010]

an exceptional measure that could achieve desirable outcomes only where state capacity was high and/or where investors were undeterred by controls because opportunities in the country were so attractive.

But something happened in the midst of the current global financial crisis. Policymakers quietly began to impose a variety of capital controls, often framing them simply as prudential policy tools (akin to what Epstein et al. 2004 termed “capital management techniques”). These controls are now becoming a part of the global financial landscape for several reasons that we will explore below. At the same time we see that the ideas of economists at the Fund on capital controls have continued to evolve with the consequent effect of now normalizing this policy instrument.

The case of Iceland is particularly interesting for the discontinuity that it demonstrates in connection with the IMF’s view of capital controls.<sup>8</sup> Iceland was the first country 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 these 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. What is most interesting about the

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<sup>8</sup> See the discussion of Iceland in Wade [2009].

Icelandic SBA is that it includes provisions regarding the need for stringent capital controls, something that we do not find in earlier SBAs that the IMF signed in connection with East Asian countries or in other crises during the neo-liberal era. Even more surprising, the SBA provided for controls even on outflows. In the words of the IMF's Deputy Managing Director, Murilo Portugal, Iceland's capital controls are "an essential feature of the monetary policy framework, given the scale of potential capital outflows" (cited in Krugman, 2010).

Iceland's controls were initially imposed prior to the signing of the SBA in October 2008, though the agreement with the Fund made a very strong case for their necessity and maintenance as means to restore financial stability. The central bank formalized the capital control regime in November 2008, and then modified it via the issuance of new rules the next month. 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.) Not surprisingly, given the IMF's long-held allergy to capital controls, IMF staff were questioned repeatedly in news conference on what seemed to be an abrupt about face. Fund staff repeatedly said the capital controls in the country 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. Indeed, the country's central bank began a sequenced removal of its capital controls in November 2009.

Although the IMF's stance with respect to Iceland's capital controls initially appeared anomalous, it soon became clear that it marked a dramatic precedent. For example, the SBA with Latvia of December 2008 allowed for the maintenance of pre-existing restrictions arising from a partial deposit freeze at Parex, the largest domestic bank in the country [IMF, 2009a]. Soon thereafter, a joint World Bank-IMF report [2009:Table 1.4] on the current crisis notes without evaluation that six countries (namely, China, Colombia, Ecuador, Indonesia, the Russian Federation, and Ukraine) all imposed some type of capital control during the crisis.<sup>9</sup> Another Fund report acknowledges that

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<sup>9</sup> See Reuters.com [2009] for a brief description of Ukraine's controls and also those imposed by Nigeria during the crisis. An IMF report [2009a] notes in passing that in Ukraine and Pakistan it "encouraged timely elimination of exchange restrictions on current payments." If this is code for stronger opposition it would suggest the existence of a greater degree of continuity

Iceland, Indonesia, the Russian Federation, Argentina and Ukraine all put capital controls on outflows in place to “stop the bleeding” related to the crisis [IMF, 2009b]. These reports neither offer details on the nature of these controls nor commentary on their ultimate efficacy, something that further suggests that capital controls—even on outflows—have a kind of “taken for granted” aspect at the Fund these days.

The Brazilian case is also notable since it illustrates both the evolution and the continued equivocation in the views of Fund staff on the matter of capital controls. Moreover, it illustrates the policy space that is increasingly being appropriated by policymakers in developing countries that remain independent of the Fund. In late October 2009, Brazil imposed capital controls via a tax on portfolio investment. The controls were self-described as modest, temporary and market-friendly, and were aimed at slowing the appreciation of the currency in the face of significant international capital inflows to the country. Initially they involved a 2% tax on money entering the country to invest in

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between the IMF’s current view of capital controls and the view that it held during the Asian crisis. But no further details are provided in Fund reports on the negotiations involving Pakistan or Ukraine’s capital controls. Weisbrot et al. [2009] mentions that there was conflict between Pakistan and the IMF over capital controls, but information on the content of these discussions or any conflict is unavailable at this time.

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 initial reaction to Brazil's controls on capital inflows was ever so mildly disapproving. A senior official said: "These kinds of taxes provide some room for maneuver, but it is not very much, so governments should not be 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. In response, no less than John Williamson (with Arvind Subramanian) indicted the IMF for its doctrinaire and wrong-headed position on 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, 2009]. But Williamson's criticism misses the point that in fact the IMF reaction was quite muted, especially in comparison with its unequivocal 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. A week later the IMF's Strauss-Kahn reframed the message on Brazil's capital controls. The new message was, in a word stunning: "I have no ideology on this"; capital controls are "not something that come from hell" [cited in Guha, 2009].

As the crisis continued to grind on, other developing countries have implemented capital controls. Many of these are aimed at controlling capital inflows so as to reduce speculative or inflationary pressures and/or pressures on the currency to appreciate, while some target outflows. In December 2009 Taiwan imposed new restrictions on inflows that aim to reduce speculative pressures from overseas investors. The controls preclude foreign investors from placing funds in time deposits [Brown, 2010]. Around the same time, China added to its existing controls on inflows and outflows. Then, in June 2010, Indonesia announced what its officials awkwardly term a "quasi capital control" that governs short-term investment. Indonesia's new inflow controls seek to dampen speculation in the country via a one-month holding period for central bank money market securities, the introduction of longer maturity instruments, and new limits on the sales of central bank paper by investors and on the interest rate on funds deposited at the central bank [Wagsty, 2010]. In the same month, South Korea also announced controls on inflows. These controls seek to reduce the risks associated with a possible sudden reversal of inflows, rising short-term foreign borrowing and the use of derivative

instruments. The controls limit the amount of currency forward and derivatives trading in which financial institutions can engage, and limit the foreign currency loans extended by banks to local companies [Economist, 16 June 2010]. Also in June, Argentina and Venezuela implemented controls on outflows: in Argentina they involve stricter limits on US dollar purchases (Webber, 2010), and in Venezuela they involve new restrictions on access to foreign currency [Mander, 2010].<sup>10</sup> The response of investors (and credit rating agencies) to these initiatives? Silence and, in some cases, tacit approval. The response by economists at the IMF has been the same.

Ambivalence and inconsistency in IMF practice are echoed in its research and in the public statements of leading Fund officials. These evidence both a much more explicit and far-reaching acceptance of capital controls than we saw prior to and following the Asian crisis. In the raft of reports that the IMF has issued in the context of the crisis, we find frequent mention of the protective role of capital controls. For example, an IMF report on low-income countries states that the impact of the crisis on banking systems in these countries has been modest insofar as “[t]he existence of capital controls in several countries and

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<sup>10</sup> There have also been reports of new capital controls under discussion in India and in China (on India, Economic Times, 2010; on China, Bloomberg, 8 June 2010). The rumored new controls in China will seek to deter investors from betting on an end to its peg to the US dollar.

structural factors have helped moderate the direct and indirect effects of the financial crisis” (IMF 2009c:9, fn9).

That said, the IMF is trying to avoid going too far in embracing this policy instrument. One Fund report warns that capital controls should be considered only as a last resort. The costs of even temporary capital controls are enumerated with great care; e.g., a country “could as a last resort regulate capital transactions—though these carry significant risks and long term costs.” Later on the report argues that “even temporary standstills will have long-lasting legal implications” (IMF, 2009d: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, 2009:65).

In February 2010 IMF economists (Ostry et al.) reached far beyond the Fund’s public statements or practice to date in regards to controls on inflows. Ostry et al. [2010] commend controls on capital inflows for preventing economic contraction in countries that relied on them; reducing financial instability; and reducing financial fragility by lengthening the maturity structure of countries’ external liabilities and improving the composition of capital inflows. These findings pertain to capital controls that were in place prior to and after the

Asian crisis, as well as during the current crisis. The report also indicates that "such controls, moreover, can retain their potency even if investors devise strategies to bypass them....the cost of circumvention strategies acts as 'sand in the wheels'" (p. 5) The paper argues that "policymakers are again reconsidering the view that unfettered capital flows are a fundamentally benign phenomenon. ...even when flows are fundamentally sound...they may contribute to collateral damage..." Not exactly your grandfather's IMF!

Other parts of the Ostry et al. policy note qualify this new openness toward controls on inflows, however. The report hedges in the expected ways—identifying the restrictive conditions under which capital controls can work (or be justified). But in comparison with earlier reports by the IMF the qualifications are just that---they are not offered as insuperable obstacles to the use of controls. And that, in itself, represents a major advance, as many observers have acknowledged. After the Ostry et al. [2010] policy note was released, several prominent IMF watchers praised the Fund for finally embracing a sensible view of capital controls. For example, Ronald McKinnon stated "I am delighted that the IMF has recanted" (cited in Rapoport, 2010); former IMF official, Eswar Prasad states that the paper represented a "marked change" in the IMF's advice (cited in Wroughton, 2010), and Dani Rodrik stated that the "the stigma on capital controls [is] gone," and the [Ostry et al. 2010] "policy note is a stunning reversal – as close as an institution can come to recanting without saying, 'Sorry, we messed up'" [Rodrik, 2010]. No less telling is the sharp rebuke to the empirical work in Ostry et al. by noted economist William Cline, which is illustrative of the discomfort that "true believers" in capital account liberalization have with what they see as the Fund's troubling and wrong-headed embrace of capital controls

[Cline, 2010].

In the lead up to the spring 2010 IMF-World Bank meetings, the IMF's Global Financial Stability Report (GFSR, IMF 2010a) also dealt with capital controls in surprising ways. Many analysts responded to the GFSR (one of the Fund's most important regular publications) by indicating that the Fund is already renouncing what seems to be a new openness to capital controls. It is certainly true that the discussion in the GFSR contains more caveats than we find in the other recent studies of controls discussed here. But the basic and very important message that appears in Ostry et al. (2010) and elsewhere that "capital controls may have a role in the policy toolkit" is retained in the GFSR [see also IMF, 2010b]. It is also notable that the GFSR acknowledges conflicting empirical findings on capital controls among empirical researchers, and even acknowledges empirical work on the achievements of capital controls by heterodox economists, such as Coelho and Gallagher (2010).

Recent statements by top officials at the Fund (and the Bank) further illustrate a general normalization of capital controls as a policy tool. For example, the IMF's First Deputy Managing Director, John Lipsky, in an address to the Japan Society in December 2009 stated that "[c]apital controls also represent an option for dealing with sudden surges in capital flows." In this address he makes clear that controls should be used when the surge in capital inflows is temporary (though we have to wonder when sudden surges would not be

temporary?), and that the controls themselves should be temporary. Despite these caveats, he argues that “Above all, we should be open-minded.” The same views are articulated in a June 2010 speech in Moscow [Lipsky, 2010]. After the Governor of the Bank of Thailand made a speech in the summer of 2010 embracing the rise of capital controls in Asia, the IMF’s Strauss-Kahn stated that he was “sympathetic” to emerging countries embracing controls as a last resort to counter foreign investors’ inflating asset bubbles, but warned that “[y]ou have to be very pragmatic...long-term capital controls are certainly not a good thing...But short-term capital controls may be necessary in some cases: it is matter of balancing the costs of different options” [cited in Johnston, 2010]. He argued in July 2010 that “it is just fair that these [developing] countries would try to manage the inflows” as a last resort against a flood of investors pumping up inflation and asset values [cited in Oliver, 2010]. Top officials at the World Bank have also gone on record in support of capital controls. For example, Bank president Robert Zoellick had this to say of the reemergence of capital controls in Asia: “it’s not a silver bullet but it doesn’t surprise me that people are trying them and they may help at the margin” [cited in Gallagher, 2010b].

Given the inertia at the IMF, its actions during the current crisis mark by its standards a minor revolution. Change at the Fund has been uneven, however, with one step back for every two steps forward. In the growing pile of reports that the Fund (and the World Bank) have issued in the context of the current

crisis, we find positive statements about the protective role of capital controls followed immediately by warnings about their use only as a temporary, last resort, and an enumeration of the significant risks and potential long-term costs of capital controls. This should not be surprising. We would expect that long-held ideas—especially those that have hardened to the level of ideologies and been codified in institutional practices—have long half lives (Grabel 2003b). The process of changing these ideas and practices is necessarily uneven; moreover, progress will inevitably generate push back from within the institution itself. Hence we should expect to find continuing evidence of tension and equivocation in future IMF reports that preclude a clear and decisive Fund verdict on capital controls.

This new intellectual openness towards capital controls on the part of the IMF is about to be tested in practice. Asset bubbles are continuing to emerge in many rapidly growing developing countries as private capital flows are flooding the most dynamic of these markets. This is largely due to the low interest rates and dismal prospects in the USA and the Eurozone countries. It is quite likely that some of these countries (and perhaps others) will soon find it necessary to expand or introduce additional capital controls. It will be important to watch the IMF closely as it tries to figure out just how to respond. This will be the real test of the Fund's new "open-mindedness" regarding capital controls. It may be that the patience of economists at the Fund will be severely taxed as other countries test the limits of the

developmental policy space that has arisen as a consequence of the crisis.

What is clear from the foregoing is the tenuous situation in which the IMF now finds itself, as it has begun to acknowledge the reality of its diminished influence across the developing world and 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.

### **Macroeconomic policy: The old normal (mostly)**

We turn now to the macroeconomic policy changes that have been an integral part of the SBAs (and other assistance programs, such as the Exogenous Shock and the Poverty Reduction and Growth Facilities) that the IMF has negotiated with countries in distress during the current crisis. The SBAs with transitional countries have been jointly funded by the IMF, the Bank, the EBRD and the EU and, in some cases, the Nordic countries. Across these many SBAs we find both continuity and puzzling discontinuities with past IMF practice.

#### *Continuities in IMF conditionalities*

A large number of recent studies of the SBAs (and other assistance programs) negotiated during the current crisis have established that the IMF has promoted pro-cyclical macroeconomic policy adjustments or targets [UNICEF, 2010; Van Waeyenberge, Bargawi and McKinley, 2010; UN, 2010; Muchhala,

2009; Eurodad, 2009; Solidar, 2009; Cordero, 2009; Weisbrot et al., 2009]. Indeed, only two studies conclude otherwise, and both are self-congratulatory reports by the Fund [IMF 2009a, 2009e]. The evidence overwhelmingly supports the conclusion that current IMF conditionalities are similar to those during the Asian (and previous) crises. For example, a study by Van Waeyenberge et al. [2010] of thirteen low-income countries with IMF programs in place prior to and during the current crisis concludes that they preclude countries from utilizing countercyclical policies and public investment programs. Similarly, a study by Weisbrot et al. [2009] of forty-one countries that had Fund programs in 2009 finds that thirty-one of these agreements involve tightening fiscal or monetary policy or both. Fund programs across the European periphery are also illustrative of the pro-cyclical policy adjustments that we have seen in previous crises. Interestingly, in cases involving European countries, the EU and the German government appear to be going even further than the IMF in regards to demands for fiscal austerity. (See discussion of this dynamic in the cases of Hungary, Romania and Latvia in Lütz and Kranke, 2010.)

A few illustrative cases will suffice to substantiate the case for continuity. Iceland's package of reforms was conditioned on the kinds of pro-cyclical macroeconomic policies that we saw during the East Asian and other

developing country financial crises.<sup>11</sup> These highly pro-cyclical macroeconomic policies induced intense, prolonged social unrest in the country. Tension between the IMF and Iceland intensified during the late spring and summer of 2009 concerning cuts in public spending, an increase in the value-added tax (VAT) to 18% and an increase in income taxes, and the central bank's decision to reduce the interest rate on four occasions, 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 in the summer of 2009 around negotiations concerning the Icesave bill, which provides compensation to British and Dutch depositors for losses on savings accounts of the collapsed Landsbanki bank in Iceland.

El Salvador signed an agreement with the Fund in January 2009 that also 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. The IMF has since allowed the deficit to rise to around 5%, and the government has committed to reduce it to 3.3% by 2011. Since El Salvador is officially dollarized, monetary policy is effectively precluded, as it is in countries that use or maintain hard pegs to the euro. Romania's May 2009

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<sup>11</sup> E.g., Iceland has to turn a fiscal deficit that is presently equal to 13% of GDP to a balanced budget by 2013.

SBA specifies a 25% wage cut for public employees and a reduction in the number of public sector employees. In May 2010 the government of Greece signed an agreement for a three-year loan package (with \$35 billion to come from the IMF and €100 billion from Eurozone countries). This package necessitated stringent fiscal retrenchment along several dimensions, including cuts in public sector spending, reductions in wages and pensions paid to public employees, increases in the value-added tax, and the imposition of other taxes.

As in Iceland, the fiscal contraction required by the SBAs has caused considerable political turmoil and conflict between national governments and the IMF. For example, Pakistan signed a SBA with the Fund in November 2008. But as of this writing, its most recent disbursement of \$1.8 billion is being withheld because of a disagreement with the Fund over the imposition of a VAT and a commitment to further fiscal tightening in 2010-11. Similarly, the IMF has refused since February 2010 to release \$2.6 billion to Sri Lanka because the government failed to bring the budget deficit down to 7% of GDP in 2009. The governments of Romania and Serbia are also locked in a stalemate with the Fund over fiscal retrenchment.<sup>12</sup>

The case of Hungary is particularly illuminating. The government of Hungary was granted a \$25 billion rescue package by the IMF, the EU and the World

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<sup>12</sup> Some details in this paragraph are drawn from BWP [June/July 2010].

Bank in October 2008. But in July 2010 a conflict emerged between the Hungarian government and the Fund. The IMF said the country has to do more to cut its deficit. In the context of this conflict, the country's currency depreciated by more than 3%, and the Budapest stock exchange also fell by almost 3%. This raised doubts about existing IMF loan arrangements with Hungary, particularly once IMF officials said additional measures were needed for Hungary to achieve its deficit target of 3.8% of GDP in 2010 and 3% of GDP in 2011. The conflict came to a head during the IMF's July 2010 two-week visit to the country, when IMF officials sought to assess the country's economic progress since signing the 2008 agreement. Hungary's Prime Minister, Viktor Orban, angrily responded to the IMF that his government would only negotiate with the EU and not with the IMF when its current credit line expires in October 2010. Consequently, the IMF halted talks with the government and ended its review. But within a few days of this turmoil and a rebuke from the Fund and the EU, the Hungarian government backed away from its refusal to work with the IMF in the future.

As this survey illustrates, IMF assistance is conditioned on the same kinds of pro-cyclical policy adjustments that we saw in the Asian and other previous crises. Indeed, the IMF's Dominique Strauss-Kahn seemed to be channeling his predecessor, Michel Camdessus, when he stated in June 2010 that he was

“totally comfortable” with deficit cuts “even if it has some bad effect on growth” (BWP, June-July 2010).<sup>13</sup>

It should be said that despite all of this, the IMF has recently demonstrated a somewhat greater degree of flexibility than in the past when countries have failed to meet their fiscal targets. The IMF has allowed some countries, especially those on the eastern side of the European periphery, to relax the fiscal targets in their SBAs as domestic and world economic growth decelerated and as serious political and social tensions emerged in many countries. Pakistan is illustrative. Its SBA provides for significant spending cuts (as well as rising interest rates). Because of the worsening situation in the country, the Fund allowed an increase in Pakistan’s fiscal deficit from 3.4% to 4.6% of GDP (although it has not increased the flexibility of the monetary policy targets). However, this relaxation of fiscal targets in several countries was from initial levels that were already unsustainable and dangerous to economic performance, living standards, and social stability. In addition, this relaxation pertains only to a very short time period. Indeed, the Fund has called for more severe fiscal tightening in the later part of 2010, and the pace of fiscal contraction is to accelerate further in 2011.

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<sup>13</sup> This view, unfortunately was echoed by the G-20 Finance Ministers.

In addition to their pro-cyclicality, there are other ways in which today's conditionality programs are consistent with those of previous crises. The IMF has marketed heavily the idea that it has narrowed the scope of its conditionality, owing to prior criticisms. In fact, various Fund reports issued during the current crisis herald the end of conditionality<sup>14</sup> and emphasize country ownership and national policymaker involvement in the reforms mandated by SBAs. The purported end of conditionality was marked by the announcement in May 2009 that the Fund had eliminated structural performance criteria on all programs. Initially this seemed to be the case with the early SBAs, but more recently the same package of reforms that have long been at the heart of IMF activity, such as privatization and liberalization, have become essential features of new SBAs. For example, privatization of the national railway was a condition in the SBA with Greece, while privatization of the national airline was a feature of Jamaica's SBA. Many of the European and

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<sup>14</sup> The process of rethinking conditionality began after the Asian crisis. This led to the adoption of new guidelines on conditionality in September 2002.

However, change proved illusory: 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 the Fund continued to promote some conditions that were not necessary to achieve program goals [see IMF, 2009f].

developing country SBAs also call for all manner of pension system and public sector reforms, as well as the elimination of various subsidy programs.

In March 2009 the IMF introduced the Flexible Credit Line (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.<sup>15</sup> Funds are available through the FCL as a single up-front disbursement or may be treated as a precautionary line of pre-approved credit. The IMF has heralded the FCL as a key example of its new

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<sup>15</sup> 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. One wonders whether even the USA could qualify for this program!

modernized conditionality since disbursements are not conditioned on the usual ex-post policy conditions (i.e., structural performance criteria). As of this writing, only three countries have applied for and received funding 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 hardly marks an 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. 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.

In sum, we find that several important aspects of Fund conditionality evidence strong continuity with the policy adjustments associated with past crises. The IMF continues to apply pressure to secure compliance with stringent, pro-cyclical fiscal and monetary policy targets. Expansive forms of conditionality have also returned as a key feature of Fund programs.<sup>16</sup> Finally, the greater degree of fiscal flexibility granted by the Fund in some country contexts has little to no practical significance.

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<sup>16</sup> At the same time, the World Bank also continues to promote its usual program of small government and liberalization, as Wade [2010] argues.

### *Discontinuities and incoherence in IMF programs*

There are, nonetheless, two subtle discontinuities emerging in the SBAs of the current crisis.

First, the IMF's response to the crisis across countries appears ad hoc. A review of various IMF assistance programs in 86 countries (28 of which are low income, 37 of which are lower-to-middle income, and 21 of which are upper-to-middle income countries) by UNICEF [2010] finds that in 2/3 of the countries reviewed, the IMF advised governments to contract total public expenditure in 2010 and to further their fiscal contraction in 2011. However, upon examination the report reveals (but fails to examine) a pronounced and curious inconsistency. While fifty six countries have been told to curtail or adjust public expenditure, 31 have been instructed instead to expand or maintain public expenditure [UNICEF, Table 1]; while 35 are told to cap or cut the wage bill, 8 countries are told to increase it [Table 2]; while 16 were told to rationalize, cut or narrow eligibility for transfer programs, 23 countries were advised to expand these programs [Table 2].<sup>17</sup> Other studies note that a few IMF programs have strong counter-cyclical elements. Notably, programs in Georgia, Mozambique, Niger, and São Tomé and Príncipe involve expansionary

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<sup>17</sup> The report also acknowledges that at the peak of the crisis the IMF granted increased fiscal flexibility to governments.

fiscal policy, and that of Tanzania involves both expansionary fiscal and monetary policy [Eurodad, 2009; Weisbrot et al., 2009]. It is not at all clear why some program countries are being told to pursue counter-cyclical fiscal adjustments, while others are being pushed in the opposite direction. This is suggestive of the ad hoc nature of the IMF's response to the current crisis. In this context, it is important to note the IMF's de facto movement away from the standard "one size fits all" approach of the past, even if the institution has not yet gone so far as to repudiate that approach or to announce a replacement.

Second, as part of its new approach to conditionality, the Fund has made much of its new commitment to social and pro-poor spending during the current crisis. Indeed, the current SBAs can be distinguished on paper from those of the Asian crisis years by the IMF's emphasis on the importance of social protection for the most vulnerable. This commitment appears in two recent IMF reports, one that surveys fifteen SBAs between July 2008 and September 2009 [IMF 2009a] and another that surveys diverse assistance packages in nineteen low-income countries during the same period [IMF, 2009e, especially Annex 3]. One example involves the IMF's stipulation that rather than eliminating the "13th month pension" in Hungary in response to fiscal difficulties, the government should put in place a cap on it to insulate poorer pensioners from the harshest effects of the crisis. There was a similar

initiative in the SBAs with Latvia and Romania [Lütz and Kranke, 2010]. However, it is difficult to square this emphasis on protection of socially vulnerable groups with the severe fiscal constraints that are a key feature of so many of the current SBAs. The decline in tax revenues and official development assistance has further complicated the matter of financing programs of social protection during the crisis. On the practical matter of where the funding for social protection is to come from, especially in the short run, the IMF has been utterly silent.

### **Summing up: The IMF's response to the crisis and the implications for policy space**

Where does this review of the evidence leave us? The foregoing discussion sustains the following tentative conclusions. The IMF's response to the current crisis is different from and far less coherent than its response to the Asian crisis. Though the IMF certainly continues to apply pressure to secure compliance with stringent fiscal and monetary policy targets and programs of liberalization and privatization, it has chosen to exhibit a degree of flexibility in some cases that was absent during its response to the Asian financial crisis. In particular, to a very limited extent it has relaxed fiscal constraints in some countries facing crisis, and has emphasized the need to protect the dispossessed even in the face of what it takes to be the need to impose fiscal and monetary discipline. Although it has failed to move beyond rhetoric in this

regard, the rhetoric itself marks a break with the past that legitimizes a concern for the poor as a criterion for evaluating Fund policies in the future. Moreover, and more importantly, in the case of Iceland the IMF made a forceful case for the necessity of temporary capital controls, even on outflows. Intentionally or not, its practice in this regard, coupled with some of its recent research and public statements, are having the effect of normalizing the use of capital controls as a tool of prudential macroeconomic management. In a context of increasingly autonomous states and geographically curtailed IMF influence, a raft of developing countries have availed themselves of the new policy space that they enjoy to regulate international capital flows. The Fund's response has been inconsistent—ranging from outright endorsement of capital controls, to tepid support, to equally tepid warnings about their potential misuse.

#### **4. CONCLUSION**

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 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 onset of 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.<sup>18</sup> And on that score, the evidence seems to suggest that policymakers are not waiting for the permission granted by the emergence of a new, coherent theoretical model. They are instead muddling through (Colander, 2003)—experimenting, among other things, with diverse types of capital controls---and from the ad hoc and even inconsistent 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.

Of course, the ultimate outcome of these developments is uncertain. It is possible that the neo-liberal worldview may re-establish itself again, not least because advocates of this view have proven remarkably adept at “paradigm maintenance” over the last three decades as Wade [1996] has noted and as Polanyi [1944:143] suggested long ago. Mirowski [2010] and Hodgson [2009]

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<sup>18</sup> 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.

are pessimistic about the economics profession's ability to learn from its mistakes. And it might be that the center of the battle over policy space has shifted from the IMF to other arenas. As Gallagher [2010a] has shown, for example, there are powerful restrictions on the right to impose capital controls embodied in US trade and investment agreements.

On balance, though, I would argue that it is best to conclude that the present conjuncture is one of increasing uncertainty and aperture—in economic ideas, IMF influence and policy, and, as a consequence of these, in developing country policy space. Helleiner [2010] is instructive on this point. He argues that those who are disappointed that the current crisis has not already generated a “Bretton Woods moment” marked by a new consensus over the contours of a new and progressive global policy regime fail to appreciate the nature of the time consuming, contested and politically contingent process that culminated in the kinds of policies we associate with the Bretton Woods era. Helleiner emphasizes that the Bretton Woods agreement was preceded by an “interregnum”—a period of disturbance and discontinuity in the existing order—that in turn led to a constitutive phase of policy formation. Viewed from this perspective, we are now in another interregnum—a productive moment marked by the shaken confidence among economists and policymakers in the current economic order; increasing pragmatism among economists and leadership of governing economic institutions; diminished authority and

influence of those institutions; and increasing willingness and ability of national governments to chart their own course as they wrestle with the effects of the global crisis. It is vital that heterodox development economists not overlook the opportunities provided by these developments—incoherent though they may be—to press an agenda that enhances developmental policy space.

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