Seeing Like the IMF
Institutional Change in Frontier Economies

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August 2007

A thesis submitted for the degree of Doctor of Philosophy
of The Australian National University
Statement of Authenticity

I declare that this thesis is my own original work and all sources have been acknowledged.

André Broome
29 June 2007
Abstract

The International Monetary Fund is commonly seen as a promoter of ‘one-size-fits-all’ policies and as an agent for its dominant Western member states that is able to enforce their reform preferences in borrowing states. If so, then we should expect the Fund to have a decisive influence over ‘frontier economies’ that require its resources, but the Fund’s programs often fail in these countries due to a lack of domestic political support. This thesis examines the process through which the Fund has attempted to persuade three Central Asian frontier economies to adopt its preferences for institutional change in the immediate post-communist transition. During the early-to-mid 1990s the Fund attempted to persuade the Kyrgyz Republic, Kazakhstan, and Uzbekistan to transform their monetary and financial systems, including reforms to exchange rate regimes, central bank independence, and the marketization of domestic credit allocation. These reforms represent what would normally be considered ‘IMF friendly’ reforms, and conform to global trends. The process of reform is traced through policy dialogue recorded in Fund archival materials, as well as supplementary interviews in Central Asia and with Fund staff in Washington DC and Warsaw.

The thesis puts forward the notion that ‘seeing like the IMF’ provides greater analytical leverage than approaches that assume the Fund seeks to enforce ‘one-size-fits-all’ policies or which focus on political power struggles among the Fund’s major shareholders. It suggests two factors not sufficiently highlighted in the literature. The first is that ‘seeing like the IMF’ tells us that much of what the Fund works on day to day is fostering its capacities as an intellectual actor. The Fund knows it must persuade political leaders to act as bricoleurs to implement reforms while also being attuned to domestic sensitivities. The second factor is that the Fund markets itself as a reputational intermediary; by promoting economic reform programs it served to assist Central Asian states to learn about world markets and vice versa. The thesis suggests that seeing the Fund as an intellectual actor and a reputational intermediary provides insights into the process of institutional change that are obscured by structural determinist explanations or constructivist understandings of change driven by actors operating in highly socialized contexts. In broader conceptual terms, the thesis suggests that frontier economies provide hard cases for the ‘bridge-building’ literature in international relations that seeks to identify scope conditions for actors to shift between a ‘logic of appropriateness’ and a ‘logic of consequences’. In sum, the thesis argues that ‘seeing like the IMF’ provides an analytical insight into the micro-level dealings that support macro institutional reform.
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<tr>
<td>CBR</td>
<td>Central Bank of Russia</td>
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<td>IMF</td>
<td>International Monetary Fund</td>
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<tr>
<td>EBRD</td>
<td>European Bank for Reconstruction and Development</td>
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<td>IPA</td>
<td>Institute for Policy Analysis</td>
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<td>BIS</td>
<td>Bank for International Settlements</td>
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<tr>
<td>CBR</td>
<td>Central Bank of Russia</td>
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<td>CBU</td>
<td>Central Bank of Uzbekistan</td>
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<td>CFF</td>
<td>Compensatory Financing Facility</td>
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<td>CPEs</td>
<td>Centrally Planned Economies</td>
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<tr>
<td>EBRD</td>
<td>European Bank for Reconstruction and Development</td>
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<td>EFF</td>
<td>Extended Fund Facility</td>
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<td>EMEs</td>
<td>Emerging Market Economies</td>
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<td>ESAF</td>
<td>Extended Structural Adjustment Facility</td>
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<td>EU</td>
<td>European Union</td>
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<tr>
<td>FDI</td>
<td>Foreign Direct Investment</td>
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<td>GDP</td>
<td>Gross Domestic Product</td>
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<td>IFIs</td>
<td>International Financial Institutions</td>
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<td>IMF</td>
<td>International Monetary Fund</td>
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<td>IMFC</td>
<td>International Monetary and Financial Committee</td>
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<td>IOs</td>
<td>International Organizations</td>
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<td>JVI</td>
<td>Joint Vienna Institute</td>
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<td>NBK</td>
<td>National Bank of Kazakhstan</td>
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<td>NBKR</td>
<td>National Bank of the Kyrgyz Republic</td>
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<tr>
<td>ODA</td>
<td>Official Development Assistance</td>
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<tr>
<td>OECD</td>
<td>Organization for Economic Cooperation and Development</td>
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<tr>
<td>PRGF</td>
<td>Poverty Reduction and Growth Facility</td>
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<td>Structural Adjustment Facility</td>
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<td>SBA</td>
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Acknowledgements

As with all Ph.D. theses, this study was only possible because of the assistance and support of a large number of people. I thank, first, both John Ravenhill and Leonard Seabrooke for their consistent professional and personal encouragement, their critical engagement with the topic, and their readiness to help me navigate the various intellectual twists and turns that I have travelled in the course of this project. My thanks also go to those who have provided me with written feedback and long talks over aspects of the thesis throughout its development. From the ANU, I thank in particular Daniel Biro, Sarah Graham, Stuart Harris, Barry Hindess, Matthew May, Joel Quirk, Taylor Speed, Shogo Suzuki, Shannon Tow, William Tow, and Ryan Walter. My gratitude goes to all the staff and students from the Department of International Relations in the Research School of Pacific and Asian Studies, for providing a very friendly and intellectually stimulating environment during my years at the ANU. I also wish to thank current and former staff from the Political Science and International Relations Programme at the Victoria University of Wellington, in particular Ralph Pettman, for their feedback and encouragement during my visits back to Wellington.

My fieldwork was made possible by financial support from the Department of International Relations at the ANU, as well as the generosity of an old friend, Gary Baker, for which I am very grateful. I also wish to thank the Australian Federal Government for funding my Ph.D. study through an Australian Postgraduate Award scholarship. The fieldwork for this study has included two visits to the International Monetary Fund headquarters in Washington DC in August 2005 and March 2006. My grateful thanks go to the current and former Fund staff in Washington who contributed their time for interviews, as well as to Christoph Rosenberg from the Fund’s regional office in Warsaw for granting me an extensive interview during my visit to Poland in September 2005. My gratitude goes especially to Madonna Gaudette, Clare Huang, Premela Isaacs, and Jean Marcoyeux for their research assistance during my visits to the International Monetary Fund Archives. My thanks go also to the many individuals from international organizations, from non-governmental organizations, and from the private sector who gave their time for interviews and offered candid advice on the research during my visits to Kazakhstan, Uzbekistan, and the Kyrgyz Republic during September to December 2005. A special note of thanks goes also to Ove K. Pedersen and the International Center for Business and Politics at the Copenhagen Business School, for a friendly welcome during my visit there in September 2005.
In addition to those already mentioned, my grateful thanks go to old and new friends who have helped to make social life enjoyable and who have been an important source of intellectual support while I was writing this thesis. From Australia and New Zealand, as well as further afield, this includes Seth Bateman, Chris Beer, Brett Bowden, Michael Boyle, Julie Broome, Jay Caldwell, Anna Carnerup, Jordan Carter, Lai-Ha Chan, Claire Donovan, Nick Henry, Jamie Hull, Gape Kaboyakgosi, Phil Larkin, Michael Leininger-Ogawa, Craig MacFarlane, David Mathieson, Sang-Bok Moon, Manuela Moschella, Arthur Muhlen-Schulte, Shruti Navathe, Anna Rajander, Emina Subasic, and Antje Vetterlein. My very special thanks go above all to Annie Williams for her love, humour, and affection, and for her incisive comments on earlier drafts of this thesis. My deepest gratitude goes also to my sister Adele, my father David, and my mother Wendy, who have been a wonderful source of support. In particular, my special thanks go to my mother for her constant encouragement throughout and for her generosity with financial assistance to cover fieldwork costs, especially when I found myself down and out in Uzbekistan in October 2005.
Introduction

How does the International Monetary Fund influence institutional change in its member states? Intuitively, it seems obvious that as a large international organization (IO) performing a critical role in the international economic order, with a well-trained professional staff and formal mechanisms to enforce state compliance, the Fund should be able to exert a significant independent influence over its member states’ institutional frameworks. While the Fund’s influence is less visible in creditor states that no longer draw on its financial resources, in the case of countries that continue to borrow from the Fund we might reasonably expect this relationship to have an observable impact on the direction of economic reforms. At first sight, the Fund might be expected to have an especially strong influence over institutional change in ‘frontier economies’ that cannot access alternative sources of external finance when faced with balance of payments crises.

There is more to these dynamics than first meets the eye. While the Fund’s influence might seem to be self-evident, a closer look reveals that even among states that are frequent borrowers from the Fund, program completion rates are poor and states tend not to comply with the Fund’s policy preferences (Bird, 2002a). Debates over whether the Fund exerts a significant independent influence on states’ economic policies often hinge on the method used for evaluating the Fund’s involvement. Results differ based on whether scholars are evaluating the Fund’s influence in a particular policy area or across-the-board, its influence in individual countries or in a large population of cases, and whether ‘success’ is judged by program completion rates, improved economic outcomes, or both (Bird, 1996; Vreeland, 2006). The Fund’s own frustration over the lack of program success in countries with appropriate institutions for economic governance has led it to blame a lack of ‘political will’ in borrowing states to implement unpopular reforms that the Fund believes are necessary to improve economic performance. Following this explicitly political angle, there is even greater controversy over the quality and appropriateness of the Fund’s policy advice, with the Fund often seen as the ‘bad cop’ dictating recipes for policy reform and enforcing economic discipline on developing and former centrally planned economies (CPEs) on behalf of its major shareholders (Willett, 2001: 594). From this perspective, the Fund has become part of the problem with the contemporary international economic order, rather than being part of the solution.

Much of this exchange has become like a cracked record, with critics repeatedly excoriating the Fund for promoting neo-liberal policy reforms and for abandoning the...
Keynesian wisdom of its founders, which seemed to allow for greater national policy flexibility than its programs have over the last quarter century (on the post-WWII ‘compromise’ between liberal multilateralism and domestic policy intervention, see most notably Ruggie, 1982: 393; see also Webb, 1995). In response, many scholars have turned to examining the various pressures that shape change within the Fund itself (Babb, 2003; Best, 2007; Momani, 2005a, 2007a; Vetterlein, 2006) as well as the external actors that influence the scope of its activities (Broz and Hawes, 2006; Gould, 2006a; Momani, 2004; Thacker, 1999). In recent years, however, scholars have focused less on exploring how the Fund may influence institutional change in borrowing member states (some notable exceptions include Stone, 2002; Vreeland, 2003a; Woods, 2006).

Central Research Questions

Three main lines of inquiry are identified here, based on if, how, and why questions. The first line of inquiry involves assessing whether the Fund exerts a significant influence over the evolution of states’ economic policies. States have historically defended their right to pursue economic policies both as a normative principle and as a means to build up material power, especially in the area of monetary policy. Many international relations scholars might therefore expect to find a negative answer here or to find that the Fund’s advice only counts at the margin, with the Fund simply firming up support for a policy change already being considered by national officials.

Where it seems that the Fund has exerted a significant influence on national economic policy, the second line of inquiry involves exploring how it has been able to do so. The evidence from quantitative research on the effectiveness of formal loan conditionality is mixed at best (Bird and Willett, 2004; Dijkstra, 2002; Kang, 2007; Killick, 1997), which suggests that the Fund’s influence cannot be assessed simply through quantitative measurements of a state’s compliance with loan program targets. The final line of inquiry involves assessing the quality of the Fund’s policy advice to individual member states to determine whether the advice was an appropriate match to their economic circumstances. To do so comprehensively requires making a distinction between assessing the Fund’s advice on its own terms (i.e., whether it achieved the intended outcomes) as well as assessing its advice based on external criteria, such as the outcomes that might have been achieved if alternative policies had been followed.

All three lines of inquiry involve the search for answers to intensely political questions. They cannot be comprehended if we only ask technical questions about how good the Fund’s advice is at achieving the intended material outcomes, because it is not possible in practice to draw a neat distinction between the Fund’s economic activities and the
politicking of its member states (Woods, 2006: 2). More broadly ‘economics’ is not a value-neutral science, no matter how much the Fund may insist that it is (cf. Fine, 2002). With regard to the Fund’s specific role in the process of post-communist economic reform, this thesis focuses primarily on the first and second lines of inquiry – whether the Fund was able to exert significant influence over states’ economic policies, and, if so, how this was achieved. Accordingly, this thesis addresses two central research questions, related first to the generation of policy advice, and then to its translation into a domestic context:

1. What are the sources of the Fund’s influence over states?
2. What conditions enable this influence?

Existing Explanations of the IMF’s Influence

Within the existing international political economy literature on the Fund, scholars commonly seek to answer these questions by focusing on: (1) the external factors that influence the Fund’s capacity to do its job; (2) the domestic factors that influence whether or not a government is ‘serious’ about adopting the Fund’s reform preferences; and (3) the compliance mechanisms employed by the Fund. The Fund’s long-term preferences are characterized throughout this thesis as ‘IMF friendly’ reforms – those that the Fund seeks to persuade most of its member states to adopt through policy dialogue. The Fund’s policy advice is not necessarily the same in different countries or over time in the same country, as it may see a number of policy alternatives as equally satisfactory. For these reasons, I prefer to use the term ‘IMF friendly’ to describe the Fund’s common reform preferences across countries rather than adopt the more hackneyed label of ‘Washington consensus’ policies.

In the first group of explanations of the Fund’s influence, scholars turn to external factors that are beyond the Fund’s control and can inhibit its influence over domestic policy change. Perhaps the most obvious constraint here is political interference in the Fund’s operations by its major shareholders through their dominance on the Fund’s Executive Board, which must approve all Fund loans. In this scenario, the formal decision-making process within the Fund – as well as the opportunity for major shareholders to exert informal pressure – shapes the Fund’s influence when loan decisions are ‘politicized’ and explicitly reflect the strategic interests of its powerful member states rather than the needs of the country in question. The capacity for the Fund to exert an independent influence on domestic policy change is therefore constrained from the start if its major shareholders push for ‘soft’ loan conditions for allies (Mомani, 2004: 895), veto loans for foes ( Boughton, 2001: 1031), or promote policy conditions that serve the private interests of their major firms (Soederberg, 2003: 11). As Randall W. Stone’s (2002, 2004) research
suggests, where political interference by the Fund’s major shareholders is absent, the 
Fund’s threats to enforce its loan conditions by withholding financing generate greater 
incentives for borrowing countries to enact ‘IMF friendly’ reforms.

The second group of explanations concentrate on the circumstances within a country 
that determine the effectiveness of the Fund’s actions. Most important here is whether or 
not a government is ‘serious’ about enacting ‘IMF friendly’ policy reforms (Bird, 1996: 
494), now defined by the Fund itself as the level of ‘country ownership’ of a reform 
program (Bird and Willett, 2004). As Ngaire Woods (2006: 72-3) suggests, the Fund’s 
capacity to influence domestic policy change depends on whether the Fund can find 
‘sympathetic interlocutors’ in a country’s policymaking community, who are willing to listen 
to the Fund’s advice and pilot reforms through the political process. For these sympathetic 
elites, Fund conditionality is not simply a straitjacket imposed as a penalty for poor policy 
performance, but can offer politicians and bureaucrats a constructive mechanism to force 

The third group of explanations of the Fund’s influence focus on the organization itself, 
in particular on the formal mechanisms it employs to achieve compliance on the part of 
borrowing states. Graham Bird (1996: 483) suggests that the Fund’s capacity to influence 
domestic policy change is greatest when the Fund insists on the achievement of explicit 
policy actions before a loan program begins (‘prior actions’), and when loan programs 
entail quantified performance criteria that provide the Fund with a clear snapshot of state 
compliance. In addition, Bird (2002b: 841-2) also argues that program completion depends on 
whether the net benefits of ongoing compliance (additional external finance) outweigh the 
costs that governments face from a loss of sovereignty over economic policy, which may 
increase over the life cycle of a loan program. Based on Bird’s research, the Fund’s 
influence is greatest when: (a) clear quantitative goals are set, including the conditions states 
must implement before a loan is disbursed; and (b) the marginal material benefits for states 
of maintaining compliance with the Fund continue to outweigh compliance costs.

Seeing Like the IMF on Institutional Change

This thesis aims to break new ground in understanding the sources of the Fund’s influence 
on states by exploring its role as an intellectual actor. I borrow from James C. Scott’s 
(1998) Seeing Like a State to suggest that by ‘seeing like the IMF’ we can increase our 
understanding of how the Fund seeks to achieve domestic policy change, the conditions 
that enable its influence, and how the Fund attempts to turn these to its advantage to 
sustain ‘IMF friendly’ institutional change. In particular, by exploring how the Fund sees its 
member states’ economies we can increase our understanding of how it seeks to remake
their institutional frameworks over the medium term. Scott’s work focuses on how states try to adapt societies to new forms of governance and control based on technical knowledge (1998: 5-7, 11), drawing attention to the importance of the informal context in which change takes place and how this can frustrate top-down efforts to alter actors’ behavior and the intersubjective ideas that drive their actions (1998: 318). As Scott (1998: 310) suggests, the introduction of new formal schemes of order always depends on changing informal processes in order for these to be effective in motivating new forms of behavior. In the frontier economies of Central Asia the Fund faced similar challenges, where the success of the Fund’s efforts to change actors’ behavior by persuading elites to institute new formal techniques of governance was often mediated by the salience of informal practices, leading to ‘hybrid’ institutional outcomes.

These cases do not fit a story where policy elites sought to use the Fund to drive domestic policy change because they were committed to ‘IMF friendly’ reform ideas per se. In addition, unlike other cases of post-communist reform such as Russia (Stone, 2002), the Fund was able to make credible threats to suspend financing in Central Asia, without major shareholder interference to soften loan conditions. Moreover, in all three cases the Fund made widespread use of ‘prior actions’ for loans – which were extensively used across the former Soviet Union (Thomas and Ramakrishnan, 2006: 8) – and set clear quantitative performance targets for loan programs. In the three cases examined here, these explanations fail to account for variation in the Fund’s influence over institutional change.

Rather than concentrate on quantitative analysis of program completion rates, which can both overstate and understate the Fund’s intellectual influence over the design and implementation of institutional reforms, the focus of this thesis is on exploring the nuances of how the Fund sought to change monetary ideas and practices over time. Drawing on qualitative content analysis of Fund archival documents, the Fund’s ‘success’ is assessed by examining the implementation of ‘IMF friendly’ monetary reforms over time – rather than measuring specific program completion rates – to build a more comprehensive understanding of the Fund’s influence over the medium term. I concentrate in particular on examining the Fund’s efforts to achieve central bank independence and current account convertibility in each case. Encouraging policymakers to enact these reforms posed a major challenge for the Fund because it involved persuading political elites to seize new ways to pursue their interests. Both changes would have significant implications for the capacity of political elites to maintain their newfound monetary policy autonomy gained with the demise of the Soviet Union and the subsequent collapse of the Russian-dominated ruble zone. Current account convertibility would link the Central Asian economies to the world economy, and would circumscribe the potential for political leaders to channel foreign
exchange to particular industries or to particular social groups. If adhered to in practice, central bank independence and reliance on indirect monetary instruments would also remove an important set of monetary tools that policymakers could use to influence domestic economic activity, employment levels, and the distribution of financial resources.

Recent research on international organizations has explored how IOs act to socialize policymakers in their member states to internalize new governance norms (Barnett and Finnemore, 2004; Checkel, 2005; Johnston, 2005; Zürn and Checkel, 2005). Rather than focusing on the alleged end point of socialization – the internalization of new norms by state actors (cf. Checkel, 2001: 554) – I concentrate instead on the means by which the Fund seeks to persuade actors to adopt its long-term preferences for the design of formal institutional change and to achieve compliance with these new ‘rules of the game’. In doing so I argue that the Fund’s ability to exercise a decisive influence on the process of institutional change in a particular state is a consequence of how policymakers interpret the economic and political circumstances that they face.

As these cases show, when states face a major economic crisis the responses by elites are informed by how they interpret their options – not simply by the list of options that are available. Of particular importance is how policymakers interpret their context, and whether this leads them to seek good relations with the Fund in order to achieve other economic and political objectives, such as accessing additional sources of external finance. When faced with a systemic crisis on the scale of the collapse of the Soviet Union, policymakers lack systematic knowledge that can help them to navigate uncertainty. In such circumstances, the ambiguity of information generates individual-level confusion, which may prompt ‘political bricoleurs’ to turn to the Fund’s intellectual resources in order to lessen uncertainty (see Samuels, 2003: 7-8; Rathbun, 2007: 535). Where this is the case, domestic reform is mediated by the Fund’s attempts to change ideas and practices, with the Fund drawing on its intellectual resources in order to shape both the direction and the content of institutional reforms.

Case Selection

This thesis examines the nature of the Fund’s influence over institutional change in its member states through examining its role in the construction of new monetary systems in three of the newly independent Central Asian states that emerged from the demise of the Soviet Union in 1991 – the Kyrgyz Republic, Kazakhstan, and Uzbekistan. These countries represent frontier economies in which the Fund might be expected to exercise a strong influence over the course of institutional change, due to each facing major economic shocks caused by the breakdown of the Soviet system and having few alternative sources of
external financing available. At independence, each state had little experience with macroeconomic policymaking and was accustomed to having monetary policy handed down from Moscow. Policymakers were therefore in need of the Fund’s advice on how to construct new monetary systems, and how to proceed with the transition to a market-based economy. Because of their common history, the similar institutional structures inherited at independence, and the similar trade and monetary shocks that they faced with the demise of the Soviet Union, these three Central Asian frontier economies provide a good testing ground to explore how the Fund seeks to influence new member states. These cases were selected because of their common starting points – each country became independent and joined the Fund at the same time, and each inherited similar institutional frameworks. In addition, political leaders in each country publicly committed themselves to the goal of enacting market-based economic reforms following the collapse of the Soviet Union. Because initial institutional conditions are the same, this allows us to study the sources of variation in ‘IMF friendly’ outcomes over time without assuming path dependence.

Plan of the Thesis

This thesis is divided into two parts. In Part One I examine the relevant theoretical perspectives that can assist in understanding the Fund’s contemporary role in the world economy, as well as the specific context in which the Fund was charged with being the main international organization to oversee the process of post-communist economic reform. In Part Two I conduct an in-depth comparative analysis of the Fund’s role in the construction of new national monetary systems in three Central Asian economies, and explore the reasons for the variation in ‘IMF friendly’ reform outcomes in each case.

Part One consists of three chapters. Chapter 1 reviews the recent theoretical literature on institutional change, and provides a set of conceptual definitions to understand different types of institutions and the roles they each play. Here I locate the theoretical direction of the thesis squarely in the emerging ‘bridge-building’ literature that aims to draw on the insights of both rationalism and constructivism to understand political outcomes. I outline the conceptual tools that can be used to understand the mechanisms of institutional change, and discuss how these are applied in the thesis. I then discuss the informational role the Fund can play in cases where actors undertake institutional change in conditions of acute uncertainty. In doing so, I argue that the Fund should be understood as a reputational intermediary that can act with a high degree of tactical independence from its member state principals, but must attract support from other important actors in the global political economy to boost its efforts to effect domestic institutional change.
Chapter 2 examines the sources of the Fund’s influence in the contemporary world economy. Here I examine how the Fund operates as an organization and discuss in detail how we might think about the Fund as an ‘intellectual actor’. I provide an overview of the toolkit that the Fund draws on to persuade its member states to adopt its long-term preferences for institutional change, and focus in particular on how the Fund seeks to persuade policymakers to adopt a common framework for analysis over time.

Chapter 3 provides an account of the expansion of the contemporary international monetary order to include the centrally planned economies of Europe and the Soviet Union. Here I focus in particular on the development of two key monetary norms that the Fund now seeks to persuade member states to adopt — currency convertibility and central bank independence. I then examine the different roles played by the Fund in the process of post-communist economic transformation in Europe and the Soviet Union. I show that the Fund recognized that establishing the conditions for ‘IMF friendly’ economic reforms in the Soviet republics was not simply a matter of presenting a fully furnished ‘one-size-fits-all’ model for policy change, but would depend upon building good face-to-face working relationships with local policymakers. In sum, the Fund’s influence would depend on its capacity for effective persuasion. Here I discuss the development of the Fund’s general approach to post-communist institutional change, the strains that its new role placed on the organization’s resources, and the organizational changes that the Fund adopted in order to overcome these challenges.

Part Two of the thesis consists of five chapters that explore the evolution of the Fund’s role in the former Soviet Republics of Central Asia. I provide an examination of the regional monetary environment that each state faced at independence, and explore how the Fund’s relations with policymakers developed during the dismantling of the Soviet empire. I then provide an in-depth comparative analysis of how the Fund sought to persuade Central Asian elites to construct new ‘IMF friendly’ national monetary systems once the future of the ruble zone became untenable during 1993, and how the Fund later sought to embed new monetary ‘rules of the game’ over time in order to alter actors’ intersubjective ideas and behavior.

Chapter 4 examines the breakdown of monetary control with the demise of the Soviet Union, in which informal practices led to demonetization and the growth of barter economies that frustrated the Fund’s attempts to establish monetary stability. Here I emphasize the social dimension of existing monetary practices and the monetary policy challenges that accompanied the breakdown of the Soviet economy and the chaotic shift from a central planning system. I also examine the political struggles that characterized the efforts to achieve monetary cooperation in the former Soviet Union, and discuss alternative
explanations for the inability of post-Soviet policymakers to make the ruble zone work despite their professed commitment to a multilateral solution.

Chapter 5 rounds out the discussion on the failure of the ruble zone by examining the rationale for the Fund’s advice on monetary reforms to post-Soviet states, and analyzes the severe collective action problem the Fund faced in attempting to foster multilateral monetary cooperation. Here I trace the internal debates within the organization to show how the Fund’s thinking evolved over the period from 1991 to 1993. In particular, I show that the Fund was constrained by how the Board and the staff interpreted the limits to the Fund’s authority with regard to the policy choice of whether governments should remain in the ruble zone or introduce new national currencies.

The final three chapters in the thesis investigate the following two factors to assess the sources of the Fund’s influence in its attempts to effect institutional change in post-Soviet Central Asia. First, I examine how the initial circumstances of each country at independence influenced its relationship with the Fund. Second, I examine the strategies that the Fund employed to change national actors’ preferences over time.

Chapter 6 compares the political and economic dimensions of the transitional context in each of the three cases at independence, and assesses whether these conditions were conducive to the reception of the Fund’s ideas for economic reform by political bricoleurs. Here I show that, despite inheriting similar political and economic institutions at independence, and facing many of the same political and economic challenges following the demise of the Soviet Union, the Kyrgyz Republic, Kazakhstan, and Uzbekistan confronted different transitional contexts that shaped policymakers’ openness to cooperation with the Fund. I then discuss how the Fund initiated a policy dialogue with each country as they underwent the process of becoming member states of the Fund. Here I show that even from their first contacts with the organization, the Kyrgyz Republic, Kazakhstan, and Uzbekistan each exhibited a different degree of openness to the Fund’s ideas for economic reform, based on how political leaders in each state interpreted the specific transitional context that they faced.

Chapters 7 and 8 examine the sources of variation in the Fund’s policy dialogue with the Kyrgyz Republic, Kazakhstan, and Uzbekistan over time. Here I concentrate on understanding how the Fund was able to influence each state, and explaining why the scope of its influence varied across the three countries. In each case, the Fund sought to change the financial behavior of the government, the central bank, commercial banks, and state-owned firms by restructuring the formal institutional relationships between them and constructing a new monetary system for determining the allocation of credit. I focus in particular on how the different transitional contexts that the Kyrgyz Republic, Kazakhstan,
and Uzbekistan faced continued to influence the scope for the Fund to mould institutional change over time.

The conclusion of this thesis reviews the central argument and findings, and reflects on the implications of understanding the Fund as an intellectual actor that seeks to persuade states to adopt its long-term preferences for institutional change, rather than acting as a 'policy enforcer'. Here I discuss the broader implications of the research for scholars who study the Fund, as well as for the study of international organizations in general, and draw three central lessons from the Fund’s experience with institutional change in the frontier economies of Central Asia. I conclude by outlining how understanding the Fund as a semi-autonomous intellectual actor, which aims to function as a reputational intermediary for its borrowing member states, can help to improve our understanding of the Fund’s role in the contemporary world economy.
PART ONE

Theory and Context

Uncertainty, IOs, and Institutional Change

This paper explores institutional change. How do international organizations play a changing role in organizations of an uncertain environment such as the development of the World Bank? This chapter attempts to frame the research questions by reviewing the current literature on institutional change and its contribution to the literature on institutional change. It is argued that the literature on institutional change and its contribution to the literature on institutional change is an important area of study, both theoretically and empirically. The question of how we should think about and approach the study of change has been addressed in a post-communist context, where the literature on institutional change has been an important area of study. It is argued that the theoretical perspectives on institutional change need to be developed to a more thorough understanding of the post-communist period. The chapter begins with an introduction to the literature on institutional change and its contribution to the study of institutional change. Here, I propose a conceptual framework and approach to understanding the nature of institutional change. Here, I compare qualitative and quantitative approaches to institutional change and outline the different perspectives that are used to study different types of institutional changes. The chapter concludes with a discussion of the implications of this study for understanding the development of international organizations, and how these approaches can be used to study institutional change and its contribution to the study of institutional change.
Uncertainty, IOs, and Institutional Change

What drives domestic institutional change? What role do international organizations play in changing domestic institutions in an uncertain environment such as the breakdown of the Soviet Union? This chapter addresses these questions by evaluating the main branches of neo-institutional analysis to provide a set of conceptual tools with which to investigate the process of institutional change, followed by an examination of the role that the International Monetary Fund has sought to play in states that embark on structural changes in an environment of acute domestic uncertainty. The question of how we should seek to understand institutional change is especially salient in a post-communist context, where the transformation of countries’ institutional infrastructures has been an important determinant of post-communist reform outcomes. Scholars have sought to show how institutions have influenced the level of states’ economic output and the soundness of public finances (Johnson, 1994; Campbell, 1995), the organization of political authority (Jones Luong, 2000; Grzymala-Busse, 2006), the diffusion of new cognitive frameworks (Zweynert, 2006, 2007), and the overall strength or weakness of the post-communist state (Ganev, 2005). Providing at least a qualified answer to the question of how we should understand institutional change itself is therefore an important pre-requisite in a study of the Fund’s relationship with post-communist states.

The chapter proceeds as follows. In the first section, I provide a set of conceptual definitions to understand different types of institutions and the sorts of roles they each play. In the second, third, and fourth sections, I develop a conceptual framework with which to understand the process of institutional change. Here I compare rationalist, sociological institutionalist, and constructivist approaches to institutional change, and outline the benefits that can be gained by ‘building bridges’ between these perspectives. I then discuss the merits of three different concepts with which to understand the mechanisms of post-communist institutional change – bricolage, diffusion, and translation – which can be used to complement rationalist, sociological institutionalist, and constructivist approaches. In the final three sections, I focus on the informational role that the Fund can potentially play in states that attempt to undertake structural economic reforms in conditions of financial crisis and acute domestic uncertainty. Here I discuss how an IO’s institutional reputation might provide it with an important political resource to
effect economic reform, at the same time as imposing constraints on its actions. The conventional wisdom in much of the international political economy literature suggests that the Fund’s actions are largely driven by its major shareholders, and in particular the United States (Thacker, 1999; Momani, 2004; Oatley and Yackee, 2004). It is commonly argued that the Fund’s dominant states influence the organization’s broad orientation towards structural economic reform, as well as the specific content of loan programs for countries where major powers have strategic interests at stake. While scholars have brought to light numerous instances where major powers such as the US have influenced the development of loan programs with borrowing states, existing research also suggests that the Fund staff retain considerable discretion over the performance of everyday operations (Martin, 2006; Babb, 2003; Momani, 2005a). I argue that the Fund should be understood as a semi-autonomous agent that can act with a high degree of tactical independence from its member state principals, but which aims to attract support from other important actors in the global political economy to boost its efforts to effect domestic institutional change.

Conceptualizing Formal and Informal Institutions

Institutions are commonly defined as the ‘rules of the game’ in a particular society (North, 1990). They exert a systematic influence over how people are likely to perform a given social activity and shape the definition of political goals by providing the tools that people use to make sense of the world (March and Olsen, 1989: 39-40). Specifically, institutions are formal and informal rules and processes that guide how people interact by constraining and enabling certain forms of behavior (Helmke and Levitsky, 2004: 727). While much of the earlier work that was based on neo-institutionalist approaches focused on exploring the role of explicit laws and regulations (formal institutions), recent studies have also investigated the role of implicit social norms and conventions (informal institutions). Formal institutions are officially sanctioned rules, such as constitutional structures or central bank legislation, and informal institutions are uncodified rules and unofficial structures. For investigating domestic institutional change, formal institutions are the most obvious units of analysis and the most open to observation over time. For instance, the formal institutionalized relationships among political actors in different countries may generate conditions that facilitate domestic policy change, such as a ‘winner takes all’ majoritarian electoral system in a unitary state. Alternatively, formal institutions might impede policy change by permitting a greater number of veto-players to influence the political process, such as a proportional electoral system in a federal state (Scharpf, 2000: 766-7). In these examples, while the informal ‘rules of the game’ also influence political outcomes, it is much easier to observe how a change in the formal institutional architecture
alters actors’ behavior.

When international organizations like the Fund seek to change states’ economic institutions, they do so by concentrating primarily on tracking and providing advice on formal institutional change. In this respect, a large part of the Fund’s work is concerned with ‘institutional engineering’, based on the assumption that formal institutions are not simply epiphenomenal but can influence actors’ behavior and political and economic outcomes independent of the informal order in a given society (Przeworski, 2004: 528-9). ‘Seeing like the IMF’ involves focusing on how the Fund tries to change formal institutions, while acknowledging that formal changes generate uncertainty that actors seek to mediate through informal processes (Scott, 1998: 310). Assessing the Fund’s influence (or lack thereof) therefore entails recognizing the informal context of institutional change, because this helps to ‘bridge the gap between official regulations and everyday practices’ (Tsai, 2006: 119).

Informal institutions are not merely the residual effects of cultural traditions or simply informal patterns of behavior. Nor are they only created and utilized by private or ‘civil society’ actors for they can also be integral to the functioning of formal state institutions, although they are not automatically implied by the existence of weak formal institutions. Rather, informal institutions are ‘socially shared rules, usually unwritten, that are created, communicated, and enforced outside of officially sanctioned channels’ (Helmke and Levitsky, 2004: 727, emphasis in original). Informal institutions interact with formal structures and procedures in a complex range of ways. They cannot be distinguished simply as dichotomous variables that either effect or block the functioning of formal institutions, but often exert a crucial influence over formal institutional outcomes. Because of the legacy of Soviet governance structures and the scale of the challenges of post-Soviet economic transformation, informal institutions have been significant factors shaping formal institutional change in post-communist contexts.

In the new states to emerge from the former Soviet Union and the countries of East Central Europe the formal rules of the game changed rapidly during the 1990s, and in the process societies experienced varying degrees of ‘deinstitutionalization’ and ‘reinstitutionalization’ (Soulsby and Clark, 1996: 476). In this uncertain environment, implicit social norms and informal networks sometimes became crucial determinants of political change as local actors responded to uncertainty and the institutional gaps produced by weak formal rules (Wedel, 2003: 429). This often made it difficult for the staff of IOs to understand using their usual analytical techniques how local systems actually worked (Way, 2002: 581), while a lack of knowledge about the key features of centrally planned economies contributed to inaccurate predictions and expectations regarding the
short-term outcomes of formal institutional reforms (Winiecki, 1995). These issues were especially pertinent in the frontier economies of Central Asia, where external actors promoting formal institutional change had to contend with informal systems of governance based on pre-Soviet social cleavages mobilized around ‘clan’ identities, which became increasingly salient when formal institutions were weakened or disestablished after the collapse of the Soviet Union (Collins, 2004, 2006). While the primary focus in this thesis is the role of the International Monetary Fund in shaping the evolution of formal monetary institutions in the frontier economies of post-Soviet Central Asia, appreciating the importance of informal institutions can help to broaden our understanding of the politics of institutional change and institutional continuity. The Fund’s concentration on achieving formal institutional reforms also generates new informal outcomes as actors respond to domestic uncertainty, which can affect how formal reforms are implemented and whether they are sustained over time. In the following four sections, I compare the main branches of neo-institutionalist theory and discuss the methodologies each perspective uses to understand institutional change, and how they can help to shed light on the Fund’s relationship with the frontier economies of Central Asia.

Rationalist Approaches to Institutional Change

From a rationalist perspective, elite actors are motivated to build institutions in an attempt to increase economic efficiency by reducing the transaction costs of doing business in a particular environment, thereby maximizing material gains (Campbell, 1997: 18-20; Grafstein, 1988: 579). A rationalist approach to institutional change suggests that both formal rules and informal constraints are essential for guiding ‘the way the game is played’ in a particular society, although most research still tends to focus on explaining change in formal institutions (North, 1999: 495; cf. Blyth, 2003: 696). Institutions, from this perspective, are the result of iterated games. Rationalist scholars assume that most of the time actors in the political and economic marketplace will exhibit calculating, self-interested behavior, and will seek to build or to reform institutions to maximize their expected utility gains according to their existing set of individual preferences (Ben-Ner and Putterman, 1999b: 17-22; Knight, 1995). The development of game theory in particular has provided an important theoretical stimulus for rationalist scholarship. Here institutions are conceived as equilibrium points, which are produced from the strategic interaction of the relevant players in a specific game (each with their own self-enforcing beliefs, preferences, and resources) and their responses to the exogenous circumstances they face (Calvert, 1995). As such, institutional change is motivated by an exogenous shock that alters the parameters of the game. Rationalist scholars tend to build upon these common analytical assumptions.
with the aim of constructing generalizable theories to explain political phenomena, approaching the object of their research from deductive philosophical foundations about how the political world works (Thelen, 1999: 373-4; Weyland, 2002: 59-60).

Rationalist institutionalism can contribute to an understanding of the process of institutional change in the frontier economies of post-Soviet Central Asia in two main ways. First, it points to an explanation for why formal institutional change was either difficult to achieve or why it was slow to result in a substantive alteration in economic practices, a phenomenon common across the three Central Asian economies examined here. Because the Soviet republics of Central Asia operated with a comparative absence of economic legality and effective formal institutions, the policy challenge was not simply a matter of replacing the existing formal Soviet institutions with formal market institutions (North, 1997: 16). Rather, post-communist institutional change involved establishing economic legality and effective formal institutions in an environment where people were accustomed to conducting business according to informal mechanisms, and where economic activity was governed by the use of discretionary bureaucratic power rather than universal rules (Litwack, 1991). A rationalist approach can therefore provide part of an explanation for the persistence and the expanded role of informal behavioral norms in post-communist economies, such as the importance of barter trade between firms and the dependence on personal connections to secure bank credit, which undermined attempts at formal institutional reform. As the regulatory impact of formal Soviet institutions diminished, individual actors sought to maximize their own material interests by engaging in micro-level survival strategies. But these strategies collectively undermined official attempts to effect institutional change by hastening a process of demonetization and a decline in governments’ fiscal capacities, as discussed in Chapter 4.

Second, with its emphasis on game theory and strategic bargaining, rationalist institutionalism suggests that the variation in institutional outcomes in Central Asia can be explained by examining variables such as the parameters of the ‘institutional game’ in each country, the relevant actors’ institutional preferences, and the bargaining resources available to them (Knight, 1995: 117-18). However, as Pauline Jones Luong (2000: 571-2) suggests in her study of electoral system design in post-Soviet Central Asia, rationalism has difficulty accounting for the creation and maintenance of ‘inefficient’ institutions. Nor can it account for the variation in ‘IMF friendly’ reform outcomes across the three cases, except by presenting domestic political conditions as distorting decision makers’ otherwise rational (utility-maximizing) behavior. Game theoretic studies of post-communism expect to see institutional actors who have already internalized the new rules of the game slugging it out against those who cling to the old rules. From this perspective, the outcomes of
institutional games will be decided by the group, reformists or conservatives, which has the greater power resources available to them and is able to prevail. Game theorists therefore assume that institutional change is determined at different points in time by the speed with which actors move up this learning curve to adapt to their new environment (Kyriazis and Zouboulakis, 2005: 112).

A potential shortcoming of this narrow definition of rationality is that it can distort our understanding of the context within which actors take decisions and develop new preferences (Boudon, 2003). Instead, we should take the post-communist context in each country as our starting point for understanding elite behavior in Central Asia because this produced a specific ‘intentional rationality’ that was informed by inherited conventions and social norms (Beckert, 2003: 770-1; see also Seabrooke, 2006a: 44-7, 2007a: 402-4). A conventional rationalist approach on its own is insufficient for understanding how the Fund seeks to shape a government’s policy orientation over time, because the chief focus is on a strategic contest between groups of reformers and conservatives that are assumed to pursue their policy preferences in accordance with a fixed set of interests. Instead, by seeking to understand actors’ intentionally rational strategies to improve their welfare, which are based on how they interpret the specific circumstances they confront, it becomes possible to increase our understanding of how actors’ interests, and hence their policy preferences, change over time. For a set of conceptual tools to understand post-communist institutional change more comprehensively, we must look beyond rationalist approaches to the recent contributions of sociological institutionalism and constructivism.

Sociological Institutionalist Approaches to Institutional Change
Whereas rationalist institutionalists assume that human behavior in the political and economic marketplace is mostly self-regarding and that individuals enter this environment already endowed with a fixed set of interests, constructivists emphasize the intersubjectivity of beliefs, identities, and interests, and therefore focus on understanding how these are socially produced (Ruggie, 1998; Finnemore and Sikkink, 1998; see also Berger and Luckman, 1966). Much of the recent work from the other two main branches of neo-institutionalist theory – organizational institutionalism and historical institutionalism – fits under a broad constructivist label, although each retains a different ontological and epistemological emphasis.

Studies drawing on organizational institutionalism tend to focus on exploring the processes through which actors constitute, rationalize, and frame institutions within particular cultural or organizational contexts, and stress the symbolic role of institutions in maintaining a system of meaning that defines ‘appropriate’ actions (Immergut, 1998: 15-16;
cf. Sending, 2002). In direct contrast to the fixed preference set that is usually assumed by rationalism, organizational theory suggests that the institutionalization of cognitive habits occurs precisely because individuals’ interests are often ambiguous. As a result, organizational institutionalists usually conceive of the institutionalization of symbolic frameworks as an unintentional process that is rarely driven by the conscious actions of specific groups or individuals, a view that downplays the role of human agency while emphasizing the structural function of institutions as determinative of social action (Campbell, 1998: 381-2; Sewell, 1992). From this perspective, ideas matter primarily as institutionalized frameworks. At the international level, such an approach can lead to overemphasizing the role of ‘world society’ as determinative of the global diffusion of common values and norms (see, for example, Meyer, et al., 1997). It also understates the significance of an unequal distribution of political resources and the use of coercion in generating conformity with such values and norms (see the chapters in Bowden and Seabrooke, 2006). A ‘world society’ perspective therefore seems unable to account for incomplete norm diffusion around the world, for norm innovation, or for varying degrees of norm adoption across individual cases (Finnemore, 1996: 343).

Studies drawing on historical institutionalism tend to focus on how institutions function to shape and constrain social action in path-dependent ways (Campbell, 1998: 380). Therefore, different kinds of institutions may either block or enable the emergence of new ideas that can drive policy change (see the chapters in Hall, 1989). Historical institutionalists pay particular attention to the context-bound nature of causality, as well as to how ‘alternative’ rationalities inform actors’ behavior. Scholars therefore seek to investigate how chance configurations of variables allow particular events to occur (Immergut, 1998: 18-19; see also Manis and Meltzer, 1994). Like rationalists, historical institutionalists recognize that material factors often drive institutional change, and see institutions as mechanisms that can solve collective action problems, lower transaction costs, and affect political outcomes. Rather than start from a set of a priori assumptions about individual preferences and human behavior, however, they seek to employ inductive methods to understand specific instances of institutional change. Like rationalist scholars, historical institutionalists often focus on the analysis of critical junctures that produce the social conditions that make institutional change possible, such as a national crisis which enables actors to break away from an established institutional path (Greif and Laitin, 2004: 635). Because of the intersubjective bases of actors’ intentional rationality and their social identities, the insights learned from these studies may not be generalizable to other contexts or even to the same context at a different point in time (Thelen, 1999: 370, 373; Campbell and Pedersen, 1996a: 10-11).
Constructivist Approaches to Institutional Change

The key assumption common to both 'conventional' and 'critical' strands of constructivism in contemporary international relations theory is that understanding the intersubjective bases of everyday social reality is essential for understanding political processes, practices, and outcomes (Hopf, 1998: 182). Constructivist approaches differ most from rationalist approaches because of the specific role they assign to ideational factors in the process of institutional change. That is, constructivist approaches understand ideas as constitutive of political practices and political power (Adler, 1997; Laffey and Weldes, 1997). Ideas, therefore, have autonomy from formal institutions, and may have an independent causal impact on institutional change. For constructivist scholars, ideas are considered to be an essential ingredient in the social production of both: (1) who an actor thinks he or she is within a particular context (their identity); and (2) what he or she is inclined to seek to gain through the performance of their social role (their interests) (Swedberg, 2005; Blyth, 2003). For the most part constructivist scholars have investigated the indirect effects of ideas. This tends to involve scholars exploring how political outcomes are shaped by a particular system of meaning, rather than constructing theoretical models that present ideas as direct causes of a specific outcome without anything else going on in-between (Tannenwald, 2005: 19; Hopf, 1998: 198). Following the work of Michel Foucault (2003 [1966]) and others, 'poststructuralist' or 'postmodern' scholars have conducted macro-historical studies to critically explore the conditions of possibility for specific social phenomena, such as the emergence of a particular system of thought, a prescriptive ideal, or a new mode of governance (Bartelson, 1995; Doty, 1996; De Goede, 2005). Others have drawn from constructivist methods to explore the role of intersubjective mental frameworks and discursive practices in particular political struggles, and how these have contributed to generating one political outcome rather than another (Best, 2005; Blyth, 2002; Hall, 2003; Hopf, 2002; Seabrooke, 2006a; Sharman, 2006).

From the vantage point of a decade and a half after the collapse of the Soviet Union, it now seems obvious that understanding the role of ideas is crucial if we wish to understand the politics of institutional change and continuity in the frontier economies of post-Soviet Central Asia. While new laws for a market economy were sometimes written 'overnight' based on an institutional blueprint supplied by an external actor, the diffusion of similar formal rules did not result in them being implemented in the same way as intended (Broome, 2006; Campbell, 2004: 77-9; Way, 2002). Instead, the intersubjective understandings that informed elite actors' intentional rationality in Central Asia following independence proved to be more resilient to the diffusion of new intellectual frameworks
than many scholars had expected in the early 1990s, similar to reform experiences in Russia and the European CPEs (Zweynert, 2006; Appel, 2000; Soulsby and Clark, 1996; Seleny, 1999). When new ideas did gain traction in post-communist economies, this was often because IOs acted as facilitators of change by supplying crucial intellectual and financial support (Appel, 2004a; Cooley, 2000, 2003).

A constructivist approach to institutional change provides a set of conceptual tools with which to explore how ideas played a key role in shaping variation in institutional reform outcomes across the frontier economies of post-Soviet Central Asia. In this regard, constructivism has an analytical advantage over rationalist theory because it prioritises an inductive approach to understanding how actors' interpretations of their circumstances informed political and economic change, with actors' interests understood as tightly linked with intersubjective ideas about appropriate forms of behavior and the appropriate role of state institutions. This avoids the analytical deficiency of assuming that actors' interpretations of their changing circumstances were distorted by a bounded rationality (Goldstein and Keohane, 1993), which would be stripped away to allow self-interest to guide decision making as economic reforms became naturalized (Hopf, 2002). Nevertheless, explaining individuals' strategic actions to maximize their material interests remains important for understanding institutional outcomes. If the ontological debates between rationalist and constructivist perspectives are put to one side (Nielson, et al., 2006: 115), combining both approaches can potentially provide a more comprehensive understanding of the process of institutional change than either rationalist or constructivist perspectives can achieve on their own.

Building Bridges between Rationalism and Constructivism

Recently, some rationalist scholars have attempted to broaden their range of conceptual tools in order to explain behavior that is not entirely consistent with the assumption that individuals are usually self-interested, focusing instead on instances when an actor's propensity for instrumentally rational behavior may be constrained by various contextual variables. These conditional factors may include an environment that creates the 'wrong' material incentives (Jones, 1999: 310), intellectual conditions that create uncertainty by widening the range of rational institutional options (Lieberman, 2002: 699), or an institutional choice set that is constrained by the operation of existing institutions and political processes (Campbell and Pedersen, 1996a: 5-6). ‘Soft’ rationalist scholars have begun to grapple with the more slippery concepts, familiar to sociology and interpretive political science, of values and norms as salient factors that can help to explain important aspects of individual preference formation and behavior (Blyth, 2003: 696-7). Some
scholars have also questioned the assumption that individuals are endowed with fixed preferences. They have sought instead to understand how actors may consciously re-evaluate their preferences or be socialized to adopt new interests, and how institutions may also influence actors’ values and identities rather than simply shaping their behavior (see, for example, the chapters in Ben-Ner and Putterman, 1999a; Schimmelfennig, 2005). Others have sought to show that institutional change may also be endogenous and can occur in a stable external environment, and that some institutional configurations may be able to insulate themselves and resist pressures for change resulting from exogenous shocks (Greif and Laitin, 2004: 649).

Within the field of international political economy, there is a need to foster diverse theoretical perspectives with which to understand the sources of change in the world economy (see Leaver, 1994). Explaining actors’ calculated pursuit of their material interests is important for understanding political outcomes, but ideas matter as well. Shared ideas may provide the impetus for actors’ preferences, and studying the role of ideas can therefore help us to understand the underlying motivations for an actor’s behavior. When we conceive ideas as inherently intersubjective, they are not simply normative commitments that either reinforce or compete with an actor’s material interests as alternative motivations for their behavior. Rather, shared ideas mould how actors conceive their interests in the first place (Blyth, 2003: 702; Laffey and Weldes, 1997: 199-201). At the same time, while constructivists have emphasized the constitutive role of shared ideas for actors’ identities and constructing a ‘logic of appropriateness’ that defines socially legitimate actions (cf. Zehfuss, 2001; Sending, 2002), shared ideas and norms do not necessarily perform this role in every political contest. Rather, regulative norms might drive behavior without actors necessarily believing them to be legitimate, and without reshaping an actor’s identity, based on an actor’s expectation that they will incur material costs if social norms are not adhered to.

Together, rationalist institutionalism, organizational institutionalism, and historical institutionalism comprise the three main branches of neo-institutional theory (Hall and Taylor, 1996; March and Olsen, 1989; Immergut, 1998). While conventional strands of rationalist and constructivist perspectives have often tended to engage in paradigm competition, with proponents seeking to ‘out-explain’ each other to prove whether ideas or interests ‘matter more’ for understanding institutional change, recent scholarship has suggested the need to surmount a strict ontological distinction between the two approaches (Seabrooke, 2007a: 408; Nielson, et al., 2006: 115). There has already been significant cross-fertilization or ‘bridge-building’ between these perspectives as scholars have attempted to integrate the analytical strengths of a ‘soft’ rationalist approach with those of organizational
and historical institutionalism, to illuminate the contingent and context-specific bases of collective ideas and social action (see Nielson, et al., 2006; Jones Luong, 2002; Seabrooke, 2006a; Sinclair, 2005; Thelen, 1999). This thesis is located squarely in this camp, and utilizes the analytical strengths of both rationalist and constructivist approaches to gain greater understanding of the process of institutional change.

Mechanisms of Change: Bricolage, Diffusion, and Translation
To understand how an external actor such as the Fund influences institutional change across different cases we should see this as a process of ideational translation that is similar to institutional bricolage. Bricolage is an innovative process of experimentation whereby actors recombine existing institutional components such as specific principles and practices to produce institutional change (Campbell, 2004: 69; Scott, 1998: 324). Conceiving institutional change as a process of bricolage involves a recognition that durable new institutions must be founded on the range of institutional materials and symbolic resources that actors in a particular social context already have at their disposal (Bourdieu, 1991: 166). For instance, ‘identity bricolage’ helps to illustrate how new behavioral habits emerge as institutions evolve, whereby the components of actors’ professional identities are recombined to produce new identities associated with different role expectations (Carruthers and Uzzi, 2000). Therefore, rather than constructing new institutions in a social vacuum unconstrained by the legacy of history, actors may engage in institutional recombination by adapting the existing ‘rules of the game’ to achieve new functions and to pursue new goals in response to changing circumstances (Crouch, 2005a: 154).

The concept of bricolage provides a useful analytical tool to understand what both constructivist and rationalist approaches still have difficulty explaining: the mechanisms that lead to institutional emergence (see Seabrooke, 2006a: 49-50). Bricolage incorporates an understanding of the structural constraints within which political entrepreneurs must act, but without presenting actors as unreflective ‘robots’ simply responding to external stimuli (Aligica, 2003: 91) or as ‘institutional dopes’ who lack the creative capacity to intentionally transform and experiment with the structural arrangements that they inherit (Campbell, 1998: 382). As a mechanism of social action, bricolage fits well with the concept of intentional rationality, whereby actors contribute to collective perceptions of what constitutes rational action through their repeated interpretative acts to make sense of a given situation (Beckert, 2003: 770). Bricolage becomes important here because it suggests that actors will usually seek to make sense of a new situation by relating it as much as possible to their previous interpretive acts, and will therefore utilize the existing institutional materials they have at hand because these already appear as rational tools to
use in an emergent interpretive framework.

As a conceptual tool, bricolage is usually used to understand circumstances where existing institutional materials are recombined in new ways (Campbell, 2004: 80). However, an important feature common to post-communist reform experiences across East Central Europe and the former Soviet Union was the supply of exogenous ideas for institutional reform. Instead of bricolage, therefore, scholars often use the concept of diffusion to describe the global spread of institutional innovations (Strang and Meyer, 1993; Simmons and Elkins, 2004; Weyland, 2005; Hays, 1996). The problem here is that the concept of diffusion risks representing ideas as static objects, which policymakers import into their jurisdiction as finished products without modification (Campbell, 2004: 77; Laffey and Weldes, 1997: 207). In this process, the choices made by political leaders matter – actors do not simply respond passively to their external environment but may act as ‘political bricoleurs’ to create change (Samuels, 2003: 2). How political leaders interpret their external environment informs how they select new ideas for institutional change to recombine with inherited institutional practices and social norms (Samuels, 2003: 7-8).

To avoid a reified understanding of how ideas travel it is therefore important to explore how actors seek to translate exogenous ideas into a particular local context. This typically involves some degree of modification and experimentation to enable unfamiliar ideas to mesh with those that are already entrenched in local conventions and behavioral norms (Kjør and Pedersen, 2001: 219; Bockman and Eyal, 2002: 314). The concept of ideational translation is therefore analogous to bricolage, but translation provides greater analytical purchase on the Fund’s role as an external promoter of policy reform, because it signifies the transfer of exogenous ideas which are subsequently ‘given another function, an altered meaning and often a new shape in the new context’ (Rottenburg, 1996: 214). This is important for a study of the Fund because it helps us to understand how national policymakers, who have a greater understanding of the informal context of domestic institutional change, may act as political bricoleurs to adapt the Fund’s ideas for economic reform in order to mitigate the uncertainty associated with new institutional outcomes.

The relationship between the diffusion of ‘IMF friendly’ ideas for policy reform, institutional path dependence, and actors’ translation/contestation of reforms to produce reform outcomes is simplified in Figure 1.1. Here we can see a state’s extant institutional architecture and intellectual framework, as well as the Fund’s promotion of policy reform and a new intellectual framework, as independent variables. We can see the political resources of local actors and the process by which they seek to translate (or contest) and recombine ‘IMF friendly’ reform options and an ‘IMF friendly’ intellectual framework with their existing institutional architecture and intellectual framework as intervening variables,
with the resulting institutional reform outcomes as dependent variables.

There are two key points to note here. The first is that generic advice from an external actor for policy reform must be tailored and framed to fit the particular conditions on the ground. As James C. Scott (1998: 318) observes, ‘The more general the rules, the more they require in the way of translation if they are to be locally successful’. Figure 1.1 depicts how local actors may implement external ideas that have been diffused in a common form, but they tend to do so through a process of ideational translation to ensure that institutional change does not involve a complete departure from familiar practices (Campbell, 2004: 80; Grzymała-Busse and Jones Luong, 2002: 535). The second point to note is that institutional reform outcomes are not final, and may not even be particularly stable. Rather, policymakers will continue to engage in a process of institutional recombination and experimentation. This may lead them to build institutions that more closely resemble what the Fund wants, or they may maintain a greater degree of similarity with inherited institutional forms, represented in Figure 1.1 by three broad categories of institutional outcomes depending on whether the Fund exercises strong, moderate, or weak influence over the path of institutional change.
Figure 1.1 IMF Friendly Institutional Change in Frontier Economies

- Path Dependence
  - Existing Intellectual Framework
  - Existing Institutional Architecture

- Diffusion
  - IMF Friendly Reform Options
  - IMF Friendly Intellectual Framework

- Domestic Translation/Contestation
  - Intentional Rationality
  - Political Resources

- a. Strong IMF Influence over Reform Outcomes
- b. Moderate IMF Influence over Reform Outcomes
- c. Weak IMF Influence over Reform Outcomes
The concept of translation is especially important for understanding institutional change in frontier economies. Specifically, it enables us to see that the prevalence of hybrid reform outcomes – where institutions have emerged that exhibit a seemingly contradictory mix of central planning and liberal market principles and practices – may be fully consistent with the intentionally rational strategies of political bricoleurs. As Hilary Appel (2004b: 435) has noted, outside academic observers and IOs have often dismissed hybrid reform outcomes as the worst of all possible worlds, seeing them as a pathology which develops from the institutional inertia that is produced when elite actors lack the political will to drive through the final stages of structural reforms or when their efforts are blocked by domestic veto players. Such criticisms imply an overly abstract and thin understanding of the mechanisms by which institutional change occurs, not least because they ignore the crucial question of what actors think they are doing in a particular situation. This disregards the possibility that, to be effective, external ideas that are imported as policy solutions to a domestic crisis will have to be reinterpreted over time to be made compatible with the particular circumstances and evolving conventions in the local environment (Zweynert, 2006: 174, 2007: 48). The concept of translation invites us to explore how reform outcomes may derive from actions that make sense to the local actors involved in executing institutional change even if they appear ‘irrational’ or ‘sub-optimal’ to outsiders, as well as suggesting that divergent institutional outcomes should be expected to be the norm rather than the exception (Campbell, 2004: 83; cf. DiMaggio and Powell, 1983).

Domestic Uncertainty and the Informational Role of the IMF

The preceding literature is important for understanding how an international organization such as the Fund tries to mediate domestic uncertainty to effect institutional change. The conventional wisdom in much of the political science literature suggests that structural crises open up crucial windows of opportunity that can allow actors to achieve radical institutional change at a rapid pace (Krasner, 1984; Keeler, 1993; cf. Cortell and Peterson, 1999). But the job of international organizations that seek to effect domestic institutional change based on exogenous ideas may in some cases be much more difficult in a crisis than it is during a period of institutional stasis or incremental institutional adaptation. The persuasive force of an IO’s arguments for change might have greater resonance when existing institutional structures and intellectual frameworks have been discredited by a major shock to the system, which potentially allows an IO to construct a shared understanding of a crisis by defining the problem, diagnosing the causes of the problem, and prescribing an appropriate solution (Hall, 2003: 73; Widmaier, 2003: 65-7). However, an IO may find that its analytical capacity to assess day-to-day developments in a particular
economy is severely impaired in conditions of acute uncertainty. This increases the likelihood that policy mistakes will be made, and that institutional reforms will be prescribed that cannot feasibly be implemented or that lead to unintended consequences (see Cortell and Peterson, 2001).

When political and economic uncertainty lead to systemic monetary instability, and when monetary instability prompts economic actors to engage in individual strategic behavior that further worsens a country’s macroeconomic conditions, IOs can find themselves facing a vicious circle that perpetuates uncertainty and undermines the impact of formal regulatory mechanisms on everyday behavior. When formal institutions must compete with unofficial ‘rules of the game’ that generate different outcomes – such as a system of personalized credit allocation when officials are trying to construct an impersonal system where financial resources are distributed through market mechanisms – IOs will struggle to achieve substantive institutional change. This problem was especially salient in the early period of post-communist transformations, where both elite and non-elite actors needed time to learn how new institutional rules based on ‘identity-blind’ market mechanisms were meant to work. New institutional structures, even when they are based on external blueprints, ‘do not come with an instruction sheet’ (Blyth, 2003). In such circumstances, IOs that are concerned with effecting institutional change may face a steep challenge in their efforts to effect behavioral change, despite having increased scope to achieve formal reforms.

In the environment of acute uncertainty that characterized the demise of union-wide central planning mechanisms, the Fund saw the achievement of monetary stability as a fundamental criterion for post-Soviet economic transformation (IMF, 1992b). In theory, the early achievement of monetary stability would help states to send a signal of ‘policy credibility’ to domestic and international audiences about the authorities’ commitment to a market-oriented reform program. It was hoped that strengthening governments’ ‘policy credibility’ would add further momentum to structural reform efforts by coordinating the price expectations of domestic actors, facilitating official development assistance (ODA) from major donor states, and improving the ability of transition economies to attract foreign direct investment (FDI) (Grabel, 2000: 3; cf. Treisman, 1998: 240-1). The Fund’s role in helping to coordinate the expectations of other multilateral and bilateral lenders was especially important in the case of the former Soviet republics because donors initially made the extension of financial support conditional upon a Fund program being in place, a point that is discussed further in Chapter 3.

To help establish the credibility of their plans for institutional change, post-Soviet states were expected to form a close working relationship with the Fund to enhance the chances
of successful monetary stabilization by tapping into the Fund’s pool of comparative knowledge on monetary reform, and to help ameliorate policy ambiguity. As Randall Stone (2002: 11) observes, ‘a sound investment climate is a state of mind that has to be painstakingly constructed’. In states that have a history of macroeconomic instability, or like the former Soviet republics have limited institutional capacity to manage an effective monetary framework, the policy conditions attached to Fund loan programs potentially ‘creates a focal point for investors to coordinate their expectations’ (Stone, 2002: 11). The perceived problem for states, as Agénor (1993: 6) points out, is that in an environment of acute uncertainty ‘the lack of policy predictability may create doubts about the sustainability of the reform process and affect the degree of credibility of an otherwise consistent and viable program’. Achieving ‘policy credibility’ is especially problematic if there are widespread expectations that policymakers’ rhetorical commitments to implement painful economic reforms will prove to be politically unfeasible. By maintaining a cooperative policy relationship with the Fund, it was expected that the former Soviet CPEs might ‘borrow credibility’ from the Fund’s institutional reputation for being excessively conservative about extending its public ‘stamp of approval’ for a government’s policy program (Cottarelli and Giannini, 1998: 14).

For frontier economies such as the newly independent states of Central Asia, even Fund membership itself could potentially speak volumes about the government’s policy orientation to international audiences. For instance, demonstrating a willingness to conform to international monetary standards such as current account convertibility, which is an obligation of Fund membership, might help to enhance the credibility of a government’s rhetorical policy commitments in the eyes of market actors (Simmons, 2000a). Although the Fund is often seen as a hard-nosed enforcer of policy prescriptions that are derived from economic theory with scant regard for the messy world of economic practice, the emphasis on establishing and maintaining ‘policy credibility’ with international and domestic audiences indicates a recognition within the Fund that actors’ intersubjective understandings help shape reform outcomes. This is especially important in an environment of policy ambiguity and monetary instability such as the conditions that characterized the early period of post-Soviet independence. In circumstances where it is difficult for most external observers to assess local economic conditions and a government’s policy intentions for themselves, the public pronouncements and lending decisions of a ‘conservative’ international organization such as the Fund potentially carry great weight. Nevertheless, the authority of the ‘speech acts’ of an IO such as the Fund rest not so much on the quality of its knowledge of local conditions, the depth and accuracy of which may be impossible for independent observers to evaluate at the time, but rather on
its institutional reputation in the eyes of key international audiences (Sharman, 2006: 135-8). Conceived in this way, an actor’s reputation is not an asset or a property that is owned by an IO and is directly under its control, but refers to the more common sense definition of reputation as how others intersubjectively view an actor (Sharman, 2007: 26). In this case, the Fund’s reputation in the eyes of bilateral and multilateral donors and international investors underpinned the causal impact of its judgments on a government’s reform program and a country’s economic prospects.

As J.C. Sharman (2006: 137) points out in his study of the Organization for Economic Cooperation and Development’s (OECD) rhetorical battle with small state tax havens, the credibility of an IO’s institutional reputation for technical expertise among international audiences can outstrip the quality of its knowledge of local policy conditions. When an IO has a reputation for producing high quality statistics and economic surveillance among national policymakers, private market actors, the media, and other multilateral forums, its assessments may be consequential for these actors even in instances where the evidence on which they are based is thin (on the ‘scientific’ authority of Fund assessments, see Barnett and Finnemore, 2004: 67-8). In the post-Soviet context, the analytical capacity of IOs to understand local conditions was significantly impeded by the interface between formal and informal institutions, as discussed above. David Woodruff (2000) has shown how monetary reforms in Russia came awry because of the attenuated reach of formal institutions in post-Soviet society, with actors’ behavior instead regulated by other principles rooted in social norms. In post-Soviet Central Asia, this is aptly illustrated by the practice of managers remunerating workers through ‘payments in kind’ rather than simply sacking staff when a firm could no longer afford to pay their cash wages (Broome, 2006). A further example of the importance of Soviet-era regulative norms is the priority that some Russian banks continued to attach to providing easy credit to their industrial clients rather than prioritizing the objective of maximizing profit (Tompson, 1997: 1171).

These examples of the weak regulatory link between formal institutions and informal practices help to highlight the informational problem facing the international donor community in post-Soviet states in the early 1990s. In these circumstances bilateral donors and other multilateral lenders looked to the Fund to provide the ODA equivalent of a creditworthiness assessment on the newly independent states (cf. Sinclair, 2005), and made the extension of financial support dependent on a Fund reform program being in place with the expectation that the Fund’s involvement would help to ensure that their money was well spent. While the ‘screening function’ of IOs is often an important part of their work and can provide them with a crucial source of influence (Marchesi and Thomas, 1999: 112-13; Thompson, 2006: 232-3), the Fund is only accustomed to monitoring and
providing advice on changes in states’ formal institutional structures and *de jure* policy settings. It lacks analytical experience with exploring how informal institutions and practices may complement, accommodate, compete with, or substitute for the formal ‘rules of the game’ (Helmke and Levitsky, 2004: 727-9). In a context where the salience of informal institutions is high, the Fund’s institutional reputation might be sufficient to activate other sources of financial support when the Fund signs off on a government’s reform program, but the Fund’s lack of local information will make the job of economic transformation extremely difficult. Setbacks, policy failures, and unintended consequences are highly likely if the Fund promotes poorly-conceived institutional changes that fail to take into account the informal rules and processes that shape people’s everyday economic behavior.

Rather than simply a technocratic agency that acts primarily as a diffuser and enforcer of liberal economic policy reforms, the importance of the Fund’s activities for international audiences implies that the Fund also plays an important informational and symbolic role. Sharman’s (2006) research on the OECD suggests that whether an IO’s assessment of a state’s policies has a wider resonance will depend in large part on the strength of its institutional reputation. Like Timothy Sinclair’s (2005) work on the activities of credit rating agencies, the Fund’s role in this regard can be seen from a rationalist perspective as providing the function of a ‘reputational intermediary’ that helps states to improve their creditworthiness by communicating essential information to market participants and providing a symbolic assurance about a government’s policy intentions. But a rationalist approach only takes us so far in terms of its explanatory power. As Sinclair (2005: 52-4) points out in the case of credit rating agencies, the status and consequentiality of symbolic actions depends on ‘what people believe about them and act on accordingly, even if those beliefs are demonstrably false’. While it is difficult to uncover observable effects that are wholly independent of other causal variables, this symbolic interchange is pertinent to the Fund’s activities as well.

The Fund has frequently been criticized for espousing one-size-fits-all institutional blueprints based on a neoliberal ideological straitjacket. While the Fund’s proclivity to push for generic policy reforms in its member states is often exaggerated (see Broome and Seabrooke, 2007; Kang, 2007), in areas where the Fund does exhibit a high degree of consistency – such as urging governments to get inflation rates and budget deficits down – the search for ideological drivers of the Fund’s advice risks obscuring a more pragmatic motivation. As Jonathan Mercer (2005: 90) argues, the concept of reputation can potentially explain why an actor might behave in similar ways in very different situations. By promoting a narrow set of isomorphic policies that the Fund staff believe allow states
more autonomy in other policy areas in the post-Bretton Woods era of globalized capital markets, the Fund may also be trying to protect the value of its institutional reputation. More specifically, the symbolic impact of the Fund’s assessment of a state’s policy settings may depend upon its reputation for promoting conservative macroeconomic policies.

**International Audiences and the Credibility of the IMF**

Like national regimes (Lyall, 2006: 383), international organizations must ‘legitimate themselves in the eyes of their public’ by using rhetorical action to create and maintain a consistent reputation. In this sense, an IO might modify its behavior to conform to what member states believe is legitimate in order to enhance its authority (Hurd, 1999: 401). A sociological understanding of legitimacy is based upon whether actors in a particular IO’s international and domestic audiences generally believe that its actions are legitimate. In contrast, a normative concept of legitimacy is based on an assertion of whether or not an IO has the right to act in a particular way (Buchanan and Keohane, 2006: 405). The concept of legitimacy is understood here in its sociological rather than its normative meaning. Accordingly, what the Fund’s international and domestic audiences believe about the appropriateness of its actions is essential for legitimation to occur. While the Fund’s ‘social constituency of legitimation’ clearly includes non-elites, such as citizens within states who are directly affected by Fund-sponsored reform programs (Seabrooke, 2007b; cf. Thirkell-White, 2004), the focus here is on how the Fund seeks to have its actions legitimated by an elite audience. This entails maintaining the Fund’s reputation in the eyes of: (a) its membership as a whole; (b) its most dominant member states in particular; (c) other multilateral forums such as the Paris Club, the World Bank, and the European Union (EU); and (d) private actors such as banks, bondholders, and credit rating agencies. This allows us to see the Fund’s policy conservatism in a new light. It is not simply the product of a putative ideological consensus among the international financial institutions (IFIs) in Washington, and even less is it a straightforward expression of ‘the invisible hand of the American empire’ (Wade, 2003). Rather, the Fund’s reputation for policy conservatism constitutes a key source of the institution’s influence, which is likely to have become more salient with the rapidly increasing size of global capital flows and the marked decline of the Fund’s own financial resources as a proportion of world trade and international currency reserves (James, 1996: 153, 589).

The constraining effects of the Fund’s institutional reputation can be seen in both a positive and a negative light. On the one hand, the Fund’s focus on enhancing the credibility of a government’s policy settings in the eyes of private actors can be criticized as transforming the Fund into ‘a proxy disciplinarian for the market’ (Best, 2005: 133). On the
other hand, the Fund’s reputation for policy conservatism can potentially have a positive
effect by helping developing country governments to sell their policies to the international
donor community, to credit rating agencies, and to international investors (Lohmann, 2003:
108). This may allow states to achieve greater ‘wiggle room’ than was available under
previous international economic orders, where a state’s failure to conform with existing
global economic norms was commonly met with a military response by major powers
(Seabrooke, 2006c: 152).

As defined by Frank Schimmelfennig (2001: 63), rhetorical action consists of ‘the
strategic use of norm-based arguments in pursuit of one’s self-interest’. The Fund’s use of
rhetorical action to maintain its institutional reputation includes its public pronouncements
on a state’s policy settings as well as its material actions such as the approval of loan
agreements, which can send a powerful symbolic signal to international audiences about the
credibility of a government’s policy intentions. But in order to resonate with a wider
international audience the Fund’s use of rhetorical action must take advantage of the
shared values and norms of the ‘international community’, and especially those of the
‘international financial community’. Discussing the use of rhetorical action in political
debates over whether to enlarge the European Union, Schimmelfennig (2001: 62) is careful
to make clear that this is not the same as claiming that collective values and norms directly
shape actors’ preferences. But in this case, the Fund’s tendency to prescribe conservative
macroeconomic policies for its member states that aim to achieve ‘sound money’ and
‘sound public finances’ is compatible with shared norms and values among Western
bankers and financiers that date back to at least the nineteenth century (Babb, 2003: 18).
Existing evidence in international political economy scholarship suggests that
contemporary financial market actors prefer governments to have low inflation and small
budget deficits (Mosley, 2001: 766). It should therefore come as no surprise that the Fund
and other international financial institutions have promoted conservative policies such as
the restriction of public expenditure and an independent central bank that focuses on
achieving low inflation as a way to signal a state’s creditworthiness to private actors
(Seabrooke, 2006c: 155; cf. Eichengreen, et al., 2005). In addition, the Paris Club group of
official creditors and other bilateral and multilateral lenders are keen to assure themselves
that recipient governments will not fritter away the potential benefits of debt relief or
development loans by racking up large budget deficits or pursuing policies that stimulate
high inflation. This is backed up by evidence from a recent survey conducted by Fund staff
of 32 major bilateral and multilateral donors, which found that an overwhelming 97 percent
of donors stated that they used the Fund’s ‘information/signals’ to inform decisions on
extending aid for low-income countries (IMF, 2005b).
Figure 1.2 depicts how the institutional reputation of the Fund potentially allows governments to send positive signals to numerous actors in both international and domestic audiences. The list of actors represented in both audiences is by no means exhaustive, but is simply intended to illustrate the range of different actors at the international level and the domestic level whose behavior might be influenced by the quality of a state’s relationship with the Fund. Figure 1.2 also depicts a circuit of policy reform formation whereby the expectations of international audiences create incentives for the Fund to act in a way that remains consistent with its reputation in order to garner international support for its loan programs. That is, while the Fund’s reputation provides it with an important institutional resource, it also places constraints on its scope for action because key actors in the global political economy may sanction deviant behavior that does not correspond with their expectations by withholding international support (i.e., additional external financing for a state under a Fund loan program).
Figure 1.2 The Formation of IMF Friendly Policy Reforms and Reputational Constraints

A State's Existing Policy Settings

Policy Dialogue

Agreement on IMF Friendly Policy Reforms

Symbolic Signal to a Domestic Audience

The IMF's Reputation for Policy Conservatism

Symbolic Signal to an International Audience

Firms
Banks
State Institutions
Political Parties
Industry Lobbies
Households

Paris Club
Credit Rating Agencies
World Bank
Official Lenders
Private Lenders
Foreign Investors
The jury is still out on whether, when, and how Fund programs are effective ‘commitment devices’ that have a credibility-enhancing impact on the beliefs and actions of private lenders and investors (see Mody and Saravia, 2002; cf. Jensen, 2004). In particular, it is clear that the Fund’s support does not have a uniform ‘audience effect’ across borrowing countries that face a wide variety of economic circumstances (Rowlands, 2001). Bilateral donors, which do not seek a high return on their loans and are often involved ‘inside the tent’ with the design of Fund programs, are more likely than private actors to see the positive endorsement of a country by the Fund as providing an assurance about the quality of the local policy environment (Bird and Rowlands, 2000: 960-1). While survey research into the views of bankers, fund managers, and credit rating agencies suggests that international money managers are influenced by the Fund’s involvement in a state’s policy settings, it also shows that market actors form their own judgments about a government’s policy intentions and can be quite willing to disagree with the Fund’s assessment (Bird and Rowlands, 2000: 959). Moreover, although the Fund can play an important informational role for private actors by screening a state’s policy settings and awarding them a ‘good housekeeping seal of approval’, research by Fund staff has found little empirical evidence to show that the Fund actually has access to better quality information than investment banks or credit rating agencies (Bordo, et al., 2006: 240). This reinforces Sharman’s (2006: 137) argument that the potential influence of an international organization’s rhetorical actions is not necessarily linked to access to better quality information, but rather rests on its institutional reputation among international audiences. As Ashoka Mody and Diego Saravia (2002: 22) observe, while private investors seem to value the role of the Fund in assisting countries with balance of payments difficulties, this only informs their financial decisions in circumstances where they judge for themselves that the Fund’s activities are likely to be successful. What is at stake here, therefore, is the credibility of the Fund itself (cf. Stone, 2002, 2004).

**The Limits of the IMF’s Autonomy**

Whether the Fund’s policy advice and loan programs actually exert an independent causal effect on inflation rates and budget deficits in the countries it deals with is important, but this is not the main point here (cf. Vreeland, 2003a: 158-9; Bird, 2002a: 809-10). What may matter more is whether the various actors involved believe that the Fund’s intervention will help to ensure a greater degree of domestic certainty and will mitigate policy risk. Even more important is whether they act on this belief by extending loans, rescheduling debt, raising a country’s credit rating, and increasing capital flows (or at least not withdrawing capital). Because actors may make these decisions before the economic outcomes of a
Fund-sponsored reform program are apparent, they rely on an expectation that the Fund will act in accordance with its institutional reputation. Furthermore, the Fund itself believes that its involvement with a country’s policy settings will be consequential for international audiences. As the UK executive director at the Fund, David Peretz, argued in an Executive Board debate over a staff report that assessed Russia’s economic challenges in 1993, a full loan program with the Fund ‘is the best way to unlock further financial flows – not only official flows but also, and perhaps more important, flows of finance and inward investment from the private sector’ (IMF, 1993h). At both the Executive Board level and among the Fund staff, the assumption that the Fund’s actions are consequential for a host of other public and private actors is built into its decision-making process and the formulation of its advice on institutional change. But this causal chain runs both ways, and while the symbolic importance of the Fund’s actions for a range of other actors might amplify its influence many times over, it also operates as a potential constraint on its behavior.

A concrete demonstration of this argument can be found in the case of the Fund’s low-conditionality systemic transformation facility (STF), discussed further in Chapter 3. In 1993 the Fund attempted to adapt its existing lending arrangements to facilitate additional sources of external financing for the former Soviet republics by creating the STF, but found that the deviation from its conservative reputation for demanding tough loan conditionality proved to be an insufficient signal of a state’s ‘policy credibility’ in the eyes of key international actors. The Paris Club group of official creditors decided that an STF agreement with the Fund was an insufficiently strong economic policy framework to grant debt relief (with the notable exception of Russia). STF programs were also deemed insufficient by the World Bank, which surprised the Fund by ruling out the extension of structural and sectoral adjustment loans to countries based on an STF agreement alone. In addition, major donors such as Japan and the European Union declined to provide additional financial support for stand-alone STF agreements unless they were explicitly tied to a future stand-by arrangement (SBA) (IMF, 1995a, 1995b). In a twist on Erica Gould’s (2003: 553) argument that Fund conditionality is influenced by the various public and private actors that provide additional financing, these examples suggest that in practice the Fund’s authority to pass judgment on a state’s policy orientation for the international community depends upon the Fund’s actions corresponding with its conservative institutional reputation.

What the example of the STF tells us about the Fund’s role in the process of post-communist transformation is instructive for the debate over how international organizations as ‘agents’ are controlled by their member state ‘principals’ (Finnemore, 1993;
Nielson and Tierney, 2003; Gutner, 2005; Weaver and Leiteritz, 2005). While some scholars continue to see IOs such as the Fund as obedient agents of their most powerful member state principals, it is increasingly common for international relations scholars to treat IOs such as the Fund as ‘purposive actors’ in their own right rather than to see them simply as arenas for inter-state politics (Barnett and Finnemore, 1999: 726; Hawkins, et al., 2006a: 5; Hawkins and Jacoby, 2006: 200-1). The opposing positions in this debate are illustrated in clear terms by Darren Hawkins, et al., (2006a: 4), who suggest that:

...for some observers, IOs appear to be institutional Frankensteins terrorizing the global countryside. Created by their masters, they have slipped their restraints and now run amok. But for others, IOs seem to obey their masters all too well. Like the man behind the curtain in the Wizard of Oz, powerful Western countries use IOs to impose their will on the world while hiding behind the facade of legitimizing multilateral processes. Finally, other analysts claim that many IOs once served the purposes of their creators but were subsequently hijacked by other political actors to pursue undesirable ends. IOs became double agents, betraying their original purposes in serving new masters.

Within the confines of this debate, the Fund is seen as either: (a) an institutional Frankenstein; (b) a mask for the exercise of power by the real ‘Wizard of Oz’, (i.e., the US); or (c) a double agent that claims to serve its member states but now serves new masters, such as the interests of big banks and foreign investors. The example of the STF suggests the need for a more nuanced understanding of the Fund that comprises a mid-way point between these competing analytical perspectives. Here we do see the Fund behaving as a purposive actor in its own right, responding to the unique needs of the newly independent states of the former Soviet Union through organizational innovations that aimed to adapt its existing financial and intellectual capacities to a new set of challenges. In this instance, the Fund exhibited a degree of the ‘proposal power’ that is commonly seen as a key source of independent influence for domestic institutions (see Haftel and Thompson, 2006: 257). This suggests that the Fund is neither absolutely autonomous nor is it simply an obedient agent of its member states, but rather indicates that the Fund is able to use tactical discretion in how it goes about achieving the goals that member states set for it (Hawkins, et al., 2006a: 8). At the same time, due to the limits on its own organizational resources the Fund’s creation of the STF depended upon corresponding support from powerful member states, as well as other IOs, to be effective. We can therefore describe the Fund as a semi-autonomous agent that is able to maintain a high degree of ‘informal autonomy’. This potentially allows the Fund to have significant room to manoeuvre within the constraints of its formal organizational rules and the political oversight conducted by its member states (Martin, 2006: 141; see also Haftel and Thompson, 2006).
While the Fund has scope to use its own initiative, the success of its actions will often rely upon its initiatives receiving the support of other powerful actors in the global political economy. Moreover, the Fund’s influence over institutional change in target states – and the scope of its independence from major shareholders – varies over time and depending on the context in which it seeks to act (Gould, 2006b: 284-5). Because the Fund’s own financial resources have dwindled relative to global trade and capital flows, the involvement of both private and official ‘supplementary financiers’ has become essential to the success of the Fund’s lending programs (Gould, 2003). The notion that the Fund is neither wholly autonomous nor dependent on its leading member states but is a semi-autonomous agent reinforces the need to ‘bridge the rationalist-constructivist divide’ in the field of international relations in order to develop a comprehensive understanding of the influence and the behavior of IOs as actors in their own right (Nielson, et al., 2006). Doing so is not simply a matter of asking ‘who is in the driving seat?’ steering the Fund’s behavior, but is a matter of probing the political conditions in which the Fund is able to ‘get the car to start’ in the first place.

Summary

The review in this chapter of the main branches of institutional analysis, as well as the discussion of the informational role that the Fund plays in attempting to effect institutional change amid acute domestic uncertainty, is an attempt to build bridges between rationalist and constructivist approaches to institutional change. Here I have emphasized that these approaches can provide complementary insights for understanding the politics of institutional change and institutional continuity, a point that is developed further in the following chapters. For the particular cases of post-communist institutional change that are examined in this thesis, these analytical perspectives suggest the following points. Rationalist approaches suggest that institutional change will be difficult for an external actor such as the Fund to achieve when the effectiveness of existing formal institutions rests on complex interactions with informal rules. These will prove resistant to change if individuals seek to maximize their own self-interest by engaging in actions that further worsen macroeconomic conditions, and undermine the regulatory impact of the formal ‘rules of the game’. A rationalist perspective also suggests the need to examine the bargaining resources that are available to elite actors as they compete amongst themselves in iterative games in order to understand the variation in institutional outcomes between different countries. In addition, constructivist approaches suggest that intersubjective understandings help to inform local actors’ intentional rationality as they set about implementing the new formal rules that are promoted by IOs, whereby the strength of
existing intellectual frameworks might prompt policymakers to interpret policy challenges in unexpected ways.

Rather than simply pathologies that result from a lack of political will to push reforms through to their final stages, the hybrid reform outcomes that have characterized many post-Soviet economies should instead be seen as the product of a process of institutional recombination and translation. National elites do not simply shop for external ideas as pre-packaged commodities that they buy off the shelf. Rather, political bricoleurs reinterpret imported ideas in an attempt to make them compatible with local contexts and to make them intelligible within existing intellectual frameworks – although institutional translation does not imply successful institutional change. A high level of institutional translation might prove to be unworkable, leading to unintended consequences or policy failures. Combining the insights of rationalist, sociological institutionalist, and constructivist approaches with the concept of institutional translation allows us to see the distribution of material resources as critical for understanding economic transformation, while recognizing that actors develop a common intellectual framework to enable them to reinterpret their interests and to reconstruct their social roles. This informs how actors understand their interests, and shapes how they will choose to make use of the material resources they have at hand.

As this chapter has shown, while exogenous shocks to existing institutions may open a window of opportunity for actors to achieve systemic transformation, acute political and economic uncertainty can make it difficult for an external actor such as the Fund to effect substantive institutional change. To alleviate domestic uncertainty and to help states attract external assistance to bridge financing gaps, the Fund seeks to enable policymakers to signal their ‘policy credibility’ to international and domestic audiences by borrowing from its conservative reputation for demanding tough loan conditionality and restrictive macroeconomic policies. However, the Fund’s ability to be an effective reputational intermediary for states depends on its behavior corresponding with the expectations key actors in the international financial community have of it. While the Fund’s institutional reputation may provide an important underlying motivation for its actions – challenging those who see the organization as simply a foreign policy instrument of its leading member states or as a neoliberal ‘policy enforcer’ – the Fund is a semi-autonomous agent that relies on the support of other key actors in the global political economy. In particular, the example of the STF indicates that while Fund is able to innovate in response to changing circumstances, for its organizational innovations to be effective they must be viewed as credible in the eyes of the Fund’s own international audience.
The IMF as an Intellectual Actor

What are the sources of the International Monetary Fund’s influence? Created at the same time as the International Bank for Reconstruction and Development (the World Bank) following complex negotiations at the Bretton Woods conference in 1944, the Fund was charged with overseeing the re-establishment of a stable and prosperous world economy. The design of the Fund represented a desire among political elites for a new beginning in the post-WWII international economic order, based on a permanent institutional framework to regulate transactions between countries that could avoid the economic chaos of the 1930s. With the inter-war international organizations widely perceived as failed experiments in international cooperation, the new organizations set up in the aftermath of WWII were intended to remedy the design flaws of earlier schemes. To understand the sources of the Fund’s influence in the contemporary global political economy it is first necessary to examine the Fund as a purposive international actor in its own right. The purpose of this chapter is to examine the business of the Fund; how it operates internally, how it structures its relations with member states, and how it seeks to influence member states’ economic policies.

The Fund’s multilateral oversight functions were informed by the policy surveillance experiences of the Economic and Financial Organization of the League of Nations (see Pauly, 1997: Ch. 3). Despite this historical precedent for multilateral economic surveillance, the Fund’s surveillance functions continue to be hotly debated inside and outside the organization – especially in the wake of the currency crises of the 1990s and the global current account imbalances of recent years (cf. the chapters in Truman, 2006a; Kahler, 2004: 143-6). External surveillance by an international organization is controversial not least because it is often perceived as infringing upon national economic sovereignty. However, as Louis Pauly (1997: 40) observes, the Fund has no effective power to enforce adoption of the policy advice resulting from its surveillance of non-borrowing member states, nor can it necessarily compel borrowing member states to put its policy conditions into practice. Indeed, some borrowing states that have repeatedly failed to implement Fund loan conditions continue to have their applications for new loans approved (such as the Philippines, see Seabrooke, 2006b). Critics who see the Fund as an all-powerful enforcer of liberal market capitalism may therefore exaggerate the extent and nature of the Fund’s
authority over its member states – but the Fund is hardly a ‘toothless’ international organization either. How, then, should we evaluate its influence over its member states?

As Stone (2002: 2-3) points out, assessing whether the Fund has exerted a significant influence over a state’s economic policy involves more than merely tracking and cataloguing how closely a state’s policy shifts match the policy targets set out in loan performance criteria. While recognizing the intractable difficulties of doing so, Stone suggests that we should aim to address the following counterfactual question: ‘What policies would have been followed without the involvement of the IMF?’ To tackle this question Stone sets out to combine three different methods to analyze the effect of the Fund’s involvement in post-communist economies in Europe and the former Soviet Union. First, abstract formal modelling of the Fund’s expected influence and the intervening variables that may constrain that influence; second, large-N statistical analysis to test the formal model; and, finally, small-N qualitative case studies to gain greater understanding of the strategic bargaining context through thick description of the evolution of a state’s bilateral relations with the Fund (Stone, 2002: 3-4). To map the Fund’s expected causal effects Stone builds a game-theoretic model of the Fund’s influence. The focus of his work centres on an analysis of the material incentives for national policymakers to comply or defect in a strategic game over policy conditionality with the Fund, through which he investigates whether the Fund is able to enforce cooperation by making a credible threat to punish would-be defectors by withholding credit (Stone, 2002: 26-28, 240). The result is a powerful piece of research that contributes to our understanding of the Fund’s role in post-communist economies by detailing the specific conditions in which the Fund is likely to be an effective actor that can exert a meaningful influence over a government’s policies and national economic outcomes.

The aim in this thesis is to break new ground in understanding the sources of the Fund’s influence on states, while building on Stone’s work on the Fund and post-communist economies. The starting point of this research differs from Stone’s in one important respect; namely, how the Fund’s bilateral relationship with a member state is conceived. The focus here is not simply on the IMF–member state relationship conceived as a strategic game over policy conditionality, with actor A (the Fund) trying to establish the material incentives that will cause actor B (the member state) to comply. Rather, the aim of this thesis is also to explore how the Fund has attempted to gradually cultivate new intellectual frameworks among key state actors in post-communist economies, which might generate the ideational conditions for achieving – and, more importantly, sustaining – ‘IMF friendly’ policy reforms and institutional change. Changing the prevailing economic ideas in a country is a crucial part of the Fund’s role. While formal changes to a state’s policy
settings may produce evidence of reform success in the short-term this can result in reform failure over time in the absence of broader ideational changes. As Harold James (1996: 133) observes in his comprehensive history of the Fund and its member states, ‘The likelihood of a long-term success is greatest when a common framework for analysis is established’. While James sees potential for the Fund to play a major part in the formation of a state’s economic policies through the provision of material support for policy shifts, he views the Fund as having an even greater impact as a ready source of ideas and information. We can think of this difference as the distinction between a headline change in policy – which might easily be reversed – and a gradual change in policy orientation, which can be expected to have a more enduring effect.

Using Nicholas Stern and Francisco Ferreira’s (1997) characterization of the World Bank, we can understand the Fund’s role in this regard as that of an intellectual actor, which seeks to persuade national officials into a common way of thinking about economic policy. This is compatible with Oran Young’s (1991: 288) notion of intellectual leadership. While Young (1991: 298) suggests that only individuals can be ‘intellectual leaders’, this thesis argues that the Fund also relies on the ‘power of ideas’ to shape how national officials think about economic challenges and how they understand the range of policy alternatives that they might adopt to respond to them. The transmission of ideas from the Fund can be bolstered when the Fund lessens the potential transition costs of adopting its advice for a switch in economic strategy by extending loans, similar to Young’s (1991: 289) concept of ‘structural leadership’ when an actor is able to convert material resources into bargaining leverage. But external advice is unlikely to have an enduring impact if it is imposed through loan conditionality or other short-term material incentives. The Fund’s policy advice is more likely to result in substantive long-term change when the Fund can develop a common approach with member states to their economic problems and the design of policy solutions. This might be achieved by matching its advice with domestic perceptions of how to reason through uncertainty, as discussed in the previous chapter, which can potentially give the Fund’s advice greater legitimating force (Broome and Seabrooke, 2007: 578-9). The Fund has recently developed its own version of this argument (IMF, 2001; Best, 2007), where member states are expected to be more likely to achieve performance criteria under Fund loans if the relevant actors within a country feel that they ‘own’ the reform program. While ‘country ownership’ might be enhanced by greater input from national officials in the design of loan programs (Seabrooke, 2007b: 264), it also depends upon the Fund being able to persuade policymakers to adopt a common framework for analysis. This can be difficult for the Fund to achieve in the short life cycle of a single loan arrangement. As Young (1991: 298) suggests, intellectual leadership tends to be more time-
consuming compared with other forms of influence, because ‘new ideas generally have to triumph over the entrenched mindsets or worldviews held by policymakers’. Therefore, to establish whether the Fund is able to generate a gradual change in a state’s policy orientation requires an assessment of the Fund’s relationship with policymakers over time.

This chapter is organized as follows. First, I outline how the Fund works as an organization; what its various components are, what formal and informal avenues of influence each has, and the relationship in operation between the governing organs of the Fund that represent member states, such as the Board of Governors and the Executive Board, and the Fund management and staff. Second, I argue that international political economy scholars need to move beyond making sweeping criticisms of the Fund for promoting ‘Washington consensus’ policies, and I discuss in greater detail how we might think about the Fund as an ‘intellectual actor’. Here I argue that the way the Fund ‘sees’ its member states, and the analytical practices and organizational norms that it uses to do so, influence the scope and content of its work. Third, I provide a brief overview of the history of the Fund’s lending practices, discussing the controversial use of loan ‘conditionality’, how this has contributed to the popular perception that the Fund lacks legitimacy, and how the Fund has sought to address its negative image by shifting toward an emphasis on ‘country ownership’ of reforms and expanding domestic participation. This leads to a discussion of the Fund’s less controversial ‘technical assistance’ support, and how this may be a more effective mechanism of socializing national officials into a shared way of thinking with the Fund by helping to lay the foundations for greater implementation of ‘IMF friendly’ policy changes over time.

The Governance of the IMF

Within international organizations, actors who traffic in ideas always have masters that they must answer to, although no master can strictly determine the execution of ideas. In this respect, the Fund is not a homogenous intellectual actor. Contests over ideas between individual staff members, between different staff departments, and between the staff and the Fund management and its governing bodies has resulted in the Fund giving different advice for economic reform to different countries over time. Understanding the governance of the Fund, and in particular the means by which the staff are answerable to their political masters, is therefore important for understanding the Fund’s intellectual role in the global political economy.

The main organizational components of the Fund are the Board of Governors, the Executive Board (the Board), and the management and staff. The Board of Governors consists of one governor and one alternate for each member state (who are usually
ministers of finance or central bank governors), and usually only meets annually. In practice, the Board of Governors delegates most of its powers to the Executive Board, which is chaired by the managing director and currently consists of 24 directors (with 24 alternate directors) who represent either individual countries or groups of countries and meets several times a week to conduct the day-to-day business of the Fund. As one former executive director has noted, governors for the most part only attend annual meetings to deliver speeches, to vote on resolutions prepared by the management and the Executive Board, and to have an opportunity to interact with bankers and other invited guests (Southard, 1979: 3). With the need for organizational reforms following the breakdown of the 'par value' exchange rates system and because of the unwieldy nature of the Board of Governors, an Interim Committee was established in 1974 to provide political oversight of the work of the Executive Board on a more regular basis. In 1999, this was renamed the International Monetary and Financial Committee (IMFC). Made up of 24 Governors of the Fund, the IMFC reflects the composition of the Executive Board and usually meets twice a year. Among other things, the IMFC reports to the Board of Governors on significant developments in the international monetary system and considers Executive Board proposals to amend the Fund's Articles of Agreement (Van Houtven, 2002: 32-7).

The main business of decision-making in the Fund is conducted through the Executive Board. The Board meets for an average of 12 hours per week and spends approximately 30 percent of this time discussing policy issues, 60 percent discussing economic surveillance, and the rest discussing administrative and budget matters (Van Houtven, 2002: 15). The amount of time devoted to discussing policy relative to economic surveillance is subject to change, with surveillance discussions likely to increase during periods of rapid change for the Fund and the world economy, such as the debt crisis of the 1980s and the emergence of the former Soviet republics as independent states in 1991 (IMF 1993a: 2). In addition to surveillance discussions on current global economic conditions, the Board also discuss around 120 to 130 Article IV country consultation reports each year and consider requests for the use of Fund resources in loan programs as well as loan program reviews (Van Houtven, 2002: 15).

Formally, each member state’s influence in the Board is determined by a system of weighted voting, based on their financial quota in the Fund (Lister, 1984: Ch. 3). Fund quotas are subject to periodic review and are calculated using a complex set of formulas related to a country's relative economic strength (currently based on a weighted mix of gross domestic product, the values and variability of exports, import payments, and exchange reserves) (Rapkin and Strand, 2006: 307). When the Fund was set up, however, leading countries first agreed to the amounts and relative sizes of their own quotas, and
then devised a formula that would roughly achieve these results (Bird and Rowlands, 2006: 155). Because this system awards the greatest voting power to developed countries, the Fund has been criticized as an ‘unequal property-based democracy’ and has recently faced accusations of having a ‘democratic deficit’ (Evans and Finnemore, 2001: 6; cf. Seabrooke, 2007b). Such criticisms, combined with objections from emerging market economies (EMEs) that they continue to be under-represented in the Fund, have recently prompted the organization to embark on a two-year governance reform project. However, the main goal of these changes is to reform how quotas are calculated in order for voting power to reflect member states’ relative positions in the world economy more accurately, rather than to move to an alternative voting system that would redistribute greater influence toward the developing countries where the Fund is most heavily involved (IMF, 2006a).

Eight executive directors currently represent individual countries: the US, Japan, the UK, Germany, France, Saudi Arabia, China, and Russia. The remaining 177 member states of the Fund are organized into country groups that are represented on the Board by sixteen executive directors. Developed European countries are able to dominate several of the multiple-country constituencies where they hold a large proportion of the combined votes in the grouping (Bird and Rowlands, 2006: 163). Because their votes are dispersed across a number of constituencies developing countries are not able to vote collectively in the Board, a move which could otherwise help to enhance the overall impact of their ‘voice’ in the governance of the Fund (Woods, 2006: 27, 205). Moreover, the executive directors for multiple-country constituencies must cast their votes on behalf of all countries in the group, further diminishing the influence of countries with small quotas if they wish to present a dissenting view to the country in their group with the largest quota. Directors can note disagreement among the members they represent, but are not permitted to split their votes (Strand and Rapkin, 2005: 21). Indeed, once directors representing multiple-country constituencies are elected for a two-year term there are no formal rules that require them to vote in accordance with those countries’ directions. This may create a situation where elected directors are more responsive to the interests of the Fund itself than to the countries they represent compared with directors who represent single countries (Woods and Lombardi, 2006: 491-2, 510).

More than 50 categories of decisions in the Fund must reach a special majority of either 70 percent or, in the case of crucial decisions such as quota changes, 85 percent (Rapkin and Strand, 2006: 308). Although its quota has declined as a proportion of the total from 30 percent in 1949 to 17 percent today, the US still retains the largest share of votes in the Fund and is the only state capable of vetoing a decision that requires an 85 percent majority. By comparison, Japan now has the second largest quota with just over 6 percent.
In contrast to the early history of the Fund, where formal votes were more often taken, voting is now rare and most Board decisions are arrived at consensually based on the ‘principle of unconstrained debate’ (IMF, 1993a: 7). In the absence of a formal vote the chair has responsibility for summing up the ‘sense of the meeting’, which is then recorded in the meeting minutes and constitutes a final and binding decision (Southard, 1979: 6). As a 1993 internal staff report on the Board’s operations and procedures makes clear, the minutes of Board meetings ‘constitute an essential part of the decision-making process and of the policymaking history’ of the Fund (IMF, 1993a: 12). From brief summaries of Board discussions in the Fund’s early history Board minutes have evolved into an extensive record of ‘each speaker’s interventions’, which have increased the length of the minutes as directors have shifted from the practice of preparing only basic notes to attending Board meetings armed with fully prepared statements.

As is to be expected in the board of any large organization, the Fund’s Executive Board has developed a number of informal procedural norms to enhance the quality and the time-efficiency of discussions. One example is the ‘lead speaker system’ for the discussion of country items, which generally limits the number of main speakers per country item to six directors who are expected to keep their ‘interventions’ to approximately ten minutes. Under this voluntary practice ‘non-lead speakers’ are expected to focus on specific issues rather than making comprehensive statements, and to limit their own remarks to three to four minutes. Another example of the Board’s informal norms is early contact between directors and Fund staff about a specific issue before the Board meets to discuss it, which can then help to focus the Board’s deliberations. For instance, directors may seek to clarify answers to technical questions with the staff prior to Board meetings in order to avoid clogging up Board discussions with lengthy explanations of technical details (IMF, 1993a: 8). However, the most important organizational characteristic of Board discussion remains the strong emphasis that directors continue to place on the desirability of achieving a consensus, where possible, through rational and informed debate.

Consensus, of course, does not equal unanimity. The practice of avoiding votes by allowing the managing director to sum up the ‘sense of the meeting’ has been criticized for masking the exercise of power in the Board rather than making it explicit, and enabling the staff greater leeway to design tougher loan conditions than if loan criteria had to pass a formal vote (Eckaus, 1986: 247-8). If each loan arrangement faced a formal vote in the Board this could give rise to more direct confrontation between the Fund’s major shareholders and minority shareholders over the precise details of policy conditions. Instead, allowing states to express their approval or disapproval without the need to formally vote an agreement down can help to ‘maintain the fiction that the Managing
Director and the staff are providing unbiased and universally accepted economic analysis’ (Eckaus, 1986: 249). Moreover, Board debates can potentially be shaped by the scope of technical information and the recommendations put forward by the Fund staff (Bird and Rowlands, 2006: 163; Babb, 2003: 16, 19). The staff’s pivotal role in providing the background information to executive directors that informs their deliberations and the range of policy choices under discussion can allow the staff to nudge the Board towards a particular view of a given policy issue (such as the push towards capital account liberalization, see Leiteritz, 2005: 20; see also Momani, 2007). Furthermore, on individual country reports, ‘staff appraisal’ sections at the end of a consultation report are intended to lay out the staff’s rationale for their assessment and policy conclusions in order to help guide Board discussion of the document (IMF, 1993a: 11). Again, developing countries can find themselves at a disadvantage here, as they have fewer administrative resources and support staff at their disposal compared with developed countries to evaluate material provided to the Board by Fund staff or to develop alternative proposals (Woods and Lombardi, 2006: 503-4).

The IMF’s Management and Staff

The staff act as the primary ‘idea traffickers’ in the bilateral relationship between the Fund and its member states, although their capacity to use discretion is circumscribed by the control that the Fund management exercises over staff appointments and key elements of the Fund’s ‘corporate line’ in its dialogue with member states. The Fund management is made up of the managing director, the first deputy managing director, and, from 1994, two additional deputy managing directors. By convention the managing director is nominated by the developed European countries, with the first deputy managing director nominated by the US Treasury (Clark, 1996: 176, 189 fn. 39). The managing director reports to the Executive Board, and is appointed for five-year terms. In the day-to-day management of Fund personnel the managing director is solely responsible for the organization, hiring, and firing of Fund staff, apart from the requirement to give written notice to the Board when appointing staff above a given salary or rank (Southard, 1979: 8) and occasional struggles with the Board over staff pay rises (Boughton, 2001: 1050-6). As chair of the Board, the managing director plays a key role reconciling the different views of executive directors, and from early in the Fund’s history the managing director has set the agenda for Board meetings following informal consultation with individual executive directors (Hexner, 1964: 80). The office of the managing director has also developed a significant capacity to propose and garner Board support for new Fund initiatives. Notable examples include the Fund’s response to the 1982 debt crisis and the creation of the low-conditionality systemic
transformation facility to address the specific problems of the former communist countries (Clark, 1996: 173).

Given the nature of the role, it is perhaps not surprising that the position of managing director has been described as ‘one of the most influential official functions today in the world of international finance’ (Van Houtven, 2002: 16). Despite significant sources of formal autonomy, however, critics contend that the Fund management is subject to informal pressure from major shareholders, especially the US. For example, the US Congress can exert considerable pressure on the Fund where it is necessary to pass domestic legislation authorising an increase in Fund quotas (Broz and Hawes, 2006). Particular criticism has been directed at the executive branch of the US government, however, which is perceived to exert an undue influence over Fund activities and policies through what some observers have termed the ‘Treasury effect’.

Because of the Fund’s asymmetric dependence on the US as its largest shareholder which controls the central currency in the international monetary system, critics argue that the US Treasury is able to bypass the Board and lobby the Fund management directly to promote US foreign economic policy aims when its strategic interests are at stake (Babb, 2003: 16-7; Evans and Finnemore, 2001: 7). The potential for the Fund to be ‘controlled’ by the executive branch of the US government was increased by the decision to establish the headquarters of the Fund and the World Bank in Washington DC, rather than in the world’s financial centre in New York (James, 1996: 71). The ‘special relationship’ between the Fund and the US Treasury can sometimes be of mutual benefit to both institutions. This was illustrated during the 1997-98 Asian financial crisis, where the symbiotic discursive responses from the Fund and the Treasury provided a rhetorical shield with which the Fund management sought to deflect trenchant criticisms of the Fund’s policy advice to the affected countries by representing the causes of the crisis as endogenous to East Asian capitalism (Hall, 2003).

Most observers agree that the US continues to exert a significant influence over the parameters of the Fund’s activities. In addition to such forms of ‘external’ pressure on the Fund from the US Treasury, executive directors will often approach the staff that are negotiating a loan agreement with a country of strategic interest in an attempt to influence the design and scope of policy conditions in the program (Momani, 2004: 895). Strategic political imperatives can also limit the range of items that make it onto the agenda of Executive Board discussions. For instance, the Fund’s official historian has described how the managing director has occasionally declined to bring requests for loan programs before the Board after informal canvassing of executive directors has indicated that they would
not be approved (Boughton, 2001: 1031), something Ervin Hexner (1964: 87) earlier characterized as an expression of ‘deliberate nonaction’ by the Board.

As noted above, Fund staff can play a pivotal agenda-setting role in the background of Board discussions through controlling the provision of information and recommendations to the Board. The staff’s responsibility to collect specialized information to design loan programs and to build the Fund’s economic knowledge in general can enable the staff to exercise a high degree of autonomy from the Fund’s member states (Martin, 2006: 145-7). In some issue areas the staff may also have discretion to reinterpret how to operationalize the Fund’s mandate (Hawkins and Jacoby, 2006: 206-7), which can drive change within the Fund without necessitating modification of the organization’s written rules by altering the intersubjective understandings that shape the way Fund staff do their job.

The staff of the Fund currently consists of around 2,700 full-time international civil servants (Cottarelli, 2005: 6), most of which are organized into either ‘functional’ or ‘area’ departments based at the Fund’s headquarters in Washington DC.¹ The Fund also maintains a number of ‘resident representatives’ in national capitals, who liaise with country authorities and relevant domestic organizations and groups on a daily basis (IMF, 2005a: 24). Although the staff must formally act under guidance from the Board, they often have considerable autonomy in the field where they form the most important link in the chain for the Fund’s policy dialogue with member states. The Fund’s area departments consist of a front office, which includes the director, senior advisors, and division chiefs, and divisions, which each oversees a group of countries within the department. Divisions comprise a number of country desks where most of the information the Fund holds on a particular country is first gathered and produced (Harper, 1998: 106-7). While the Articles of Agreement require appointments within the Fund to be decided on merit, by convention the director of an area department is usually a national of one of the countries under the department’s responsibility (Southard, 1979: 8).

As is commonly the case with other international organizations set up in the aftermath of WWII, the activities of Fund staff have evolved over time in unexpected ways. For instance, the Fund’s early consultations with its member states took place between staff and state representatives in Washington, and were initially restricted to the countries that maintained ‘transitional’ current account restrictions under Article XIV of the Articles of Agreement.¹

¹ Functional departments are organized around speciality areas of policy. Departments currently include Finance; Fiscal Affairs; International Capital Markets; Legal; Monetary and Financial Systems; Policy Development and Review; Research; and Statistics. Also included here is the IMF Institute, the Fund’s training body, which provides courses in Washington DC as well as through the Joint Africa Institute, the Joint Vienna Institute, and the Singapore Training Institute. In addition to the functional departments there are currently five area departments, with responsibility for Africa, Asia and the Pacific, Europe, the Middle East and Central Asia, and the Western Hemisphere.
Agreement (Pauly, 1997: 87). This has since evolved into a more comprehensive mechanism whereby staff ‘missions’ are sent out to member states to consult with high level policymakers, a process of policy dialogue that was expanded to encompass the Fund’s entire membership in the early 1960s and was later formalized with the second amendment to the Fund’s Articles of Agreement in 1978 (James, 1996: 270-6).

The expansion of Fund surveillance was stimulated in part by the need to respond to a changing international monetary environment, which had shifted from a dollar shortage in the 1950s to a dollar glut in the 1960s, with the Fund’s role becoming more complicated following the emergence and rapid growth of the Euromarkets (Helleiner, 1994: 96). This prompted leading states to see Fund surveillance as a possible mechanism through which they could avoid damaging international disputes over the distribution of external adjustment burdens, which might otherwise lead to a replay of the experiences of the 1930s. The extension of Fund surveillance and data collection was also made possible with the realization by states that in practice the Fund could not directly force policy changes on unwilling governments. This had earlier been a cause for concern among some member states, which had sought to restrict the scope of the staff’s policy consultations (Pauly, 1997: 87-93).

Throughout the Fund’s history economists have dominated the top ranks of its staff, a trend that has increased since 1980 (Babb, 2003: 19). At lower levels, an increasing proportion of entry-level staff are now recruited through the Fund’s Economist Program, where economics graduates are sought from top universities around the world and then go through an initial screening process and interviews in Washington DC (Clark, 1996: 179; Momani, 2005: 172-6). Unlike the United Nations the working language of the Fund is English, which has resulted in a significant proportion of the staff being people who come from or who have attended university in countries such as the US, the UK, Canada, Australia, New Zealand, and Ireland (Clark, 1996: 182). As a result, while the Fund can boast of a professional staff with impressive qualifications in economics from universities based in developed countries, it has few staff who have experienced ‘working at the coal face’ with developing country institutions on the ground (Evans and Finnemore, 2001: 12).

Despite slow and uneven progress the Fund management has made attempts to improve the diversity of the staff in recent years, introducing mechanisms such as an annual Diversity Action Plan from 1996 – although ‘diversity’ has been defined in terms of staff nationalities and gender ratios rather than training background and professional experience (IMF, 2004; cf. Momani, 2005: 176-81).

The internal culture and the intellectual environment fostered within the Fund have always been very strongly set against inflation. This initially stood in contrast to the
popularity of Keynesian demand management ideas among many post-WWII economists, who took a comparatively benign view of the stimulatory effects of domestic price increases. This apparent paradox resulted from the early transfer to the Fund of public sector finance officials who were schooled in the anti-inflationary ‘rules of the game’ of the inter-war monetary system (Babb, 2003: 20-2; Helleiner, 1994: 53). In addition to these intellectual conditions, successive managing directors have encouraged the development of an organizational identity for the Fund as ‘the most analytically competent and action-oriented of the major international financial institutions’. This identity is underpinned by a strict organizational hierarchy with a strong emphasis on discipline, allowing the Fund to present a ‘single corporate line’ when dealing with member states or other international organizations (Clark, 1996: 177-8). Nevertheless, as argued above, the Fund is not a homogenous intellectual actor. While the organization has a uniform system for constructing its ‘negotiating position’ in dialogue with member states, discussed further below, the Fund’s internal dynamics produce variation in the execution of its policy dialogue with different countries. The following two sections build on this examination of how the Fund’s institutional machinery operates to explore the cognitive dimension of the Fund’s activities, focusing in particular on what the Fund ‘sees’ when it looks at its member states’ economies.

Moving Beyond Criticisms of the Washington Consensus

Working under strict operational guidelines determined by the Fund management, the staff are the primary conduit for the Fund’s relations with its member states – a fact which brings to the fore the intellectual frameworks and the organizational norms that the staff depend upon to perform their duties. Whether it is the United States, Sudan, Australia, or Uzbekistan, for the Fund staff a country is ‘an object that is looked at in a particular way’ (Harper, 1998: 183). This cognitive impulse was built into the Fund’s mandate when it was established and has since been reinforced by the cultivation of the Fund’s organizational identity as a bastion of ‘objective’ technical economic expertise. The staff are not expected to view member states as cultural, religious, or military entities, but as economic entities that are to be comprehended through an analysis of their economic policies and institutions, and by tracing the causal relationship between these formal ‘rules of the game’ and standardized indicators of economic performance to recommend how this might be improved. The intellectual frameworks used by the Fund to catalogue a pre-defined set of circumstances in their member states therefore constitutes an institutional discourse that can potentially become ‘a creative part of the reality it purports to understand’ (Keeley, 1990: 91), by rendering a country’s economy legible according to criteria produced by the
Fund’s own analytical practices. Simply put, the methods through which the Fund tries to establish what is going on in the economic affairs of a particular country necessarily shapes the picture that emerges. When translated into policy advice that a state may act upon, this can have a practical impact on a country’s economy by defining something as a problem, diagnosing the causes, and prescribing new forms of regulation as the solution.

To be clear, the contention here is that the Fund’s intellectual frameworks provide a cognitive impulse that influences how a country’s economy is looked at by the staff. The intention is not to portray the Fund’s activities as simply expressing the ideological interests of a transnational social class, hegemonic state interests, or as generic outcomes that are determined by the prevailing ideational conditions among the major international financial institutions. This view seems hard to sustain given their substantial differences, despite the 1990s hype of a ‘Washington consensus’ on economic policy (Bird, 2001; Broad and Kavanagh, 1999). The common tendency of IPE scholars during the past decade and a half to treat the notion of a ‘consensus’ between the IFIs as given ignores inconvenient empirical evidence that should constantly call into question such expedient charactizations (see Kanga, 2007). IPE scholars have too readily accepted as axiomatic the notion that the Fund goes about its business seeking to normatively diffuse or to coercively impose a standard set of neoliberal ‘Washington consensus’ policies in each case. At best, such an approach risks mis-conceptualizing how the Fund works by excluding analysis of its organizational culture and internal policy debates, and can easily exaggerate the Fund’s potential to exercise direct influence over national policymakers. At worst, scholars may inadvertently set out from the start to prove that the Fund has promoted ‘Washington consensus’ policies, making it unlikely that their empirical research can change this a priori theoretical position because disconfirming evidence may be summarily rejected or not uncovered at all.

Furthermore, sweeping criticisms of the IFIs for promoting ‘Washington consensus’ policies risk treating the putative consensus as an independent variable that explains political outcomes, rather than seeing this as a political outcome itself that needs to be specified and explained. This can create a ‘blind spot’ that prevents scholars from examining actions of the Fund or the World Bank that do not fit comfortably within a ‘Washington consensus’ framework. Among other things, this might diminish our capacity to explain change within the IFIs, or may prompt researchers to see evidence of change as simply indicating a superficial repackaging exercise that aims to improve the organizations’ public image (Fine, 2001) and to further embed the same policies by couching them in more ‘touchy-feely’ language (Jayasuriya, 1999). In short, taking the notion of the ‘Washington consensus’ as an axiomatic explanatory variable risks ignoring the importance
of everyday contests over ideas between and within the IFIs, as well as between the IFIs and their member states – and thus presents a static view of what might actually be a dynamic and changing terrain. At issue is not whether the Fund and the World Bank generally promote policies that could be accurately characterized as ‘economic liberalism’. Rather, the point is that within this broad field of apparent theoretical consensus are crucial debates over policy alternatives that can have significantly different political and economic outcomes (see Crouch, 2007: 262), debates that play out in diverse ways at different times and in different contexts.

Seeing Like the IMF

Rather than engaging in the binary debate between critics who see the Fund inappropriately pushing one-size-fits-all ‘Washington consensus’ policies and defenders who argue that the Fund has been made a political scapegoat for the inconsistent policy choices of national elites (Cooley, 2003: 31), we should instead aim to provide a more nuanced and context-sensitive analysis of how the Fund operates. Borrowing from James C. Scott’s work on the policy actions that flow from how states ‘see’ their societies (1998: 3), how the Fund staff in turn ‘see’ their member states impinges upon the scope and content of their advice for economic policy reform and institutional change (Barnett and Finnemore, 2004: 67; Broome and Seabrooke, 2007). These effects may be part-and-parcel of the contemporary activities of international organizations (on the World Bank, see Neu et al., 2006; on the OECD, see Dostal, 2004), but they are not manifested in uniform ways. Studying how they play out can therefore provide us with an additional ‘piece of the puzzle’ in seeking to understand the role that organizations such as the Fund perform in the global political economy. How, then, do the Fund staff’s intellectual frameworks and organizational norms work in practice in their policy dialogue with member states?

The most obvious instances of policy dialogue between the Fund and member states are staff missions to national capitals (and in some cases to other major metropolitan centres) to meet with public servants, politicians, and, increasingly, a variety of domestic interest groups. Contemporary staff missions to member states involve both the area department desk officer and division chief who are responsible for the country, in conjunction with staff from relevant functional departments (Harper, 1996: 108). Ideally, therefore, this process combines the institutional memory and country-specific knowledge that is ‘stored’ in the area departments (supplemented by the Fund’s resident representative in a country, where they exist) with the more generic technical expertise of the functional departments. However, recent research from interviews conducted with policy department staff at the Fund suggests that the balance between using country-specific knowledge and ‘universal’
abstract economic theory to design reform programs has tilted in favour of the latter in recent years (Seabrooke, 2007b: 261).

As Woods (2006: 54-5) points out, the application of abstract interpretive frameworks to understand a country crowds out local knowledge. Because each country has its own specific economic circumstances, the lack of local knowledge can undermine whatever advantages the use of general policy blueprints or cognitive maps for economic reforms may have for the operational efficiency of the Fund. In particular, this rarefied approach may decrease the domestic legitimacy of reforms and consequently diminish the likelihood of desired policy changes being achieved and then sustained over time (Seabrooke, 2007b: 264). Moreover, if we accept the critique that ‘any system of abstract and complex knowledge has blind spots’ (Evans and Finnemore, 2001: 8), then the apparent efficiency benefit gained from standardized solutions might instead produce new problems for a country where policies are not tailored to fit local circumstances, and could result in the failure of formal policy shifts to be translated into behavioral changes in practice. While scholars have suggested that Fund programs need to become more customized and context-sensitive to increase their legitimacy in the eyes of member states (Seabrooke, 2007b; cf. Best, 2007), such arguments presume that the Fund staff and national officials do in fact disagree. What may be more important in terms of understanding the Fund’s influence is to examine the areas where policymakers such as ministry of finance and central bank officials are able to reach agreement on policy reforms with the Fund.

How valid are the widespread criticisms that Fund staff adhere to a homogenous intellectual framework? Recent research conducted through content-analysis of internal Fund documents and interviews with staff has suggested that individuals recruited to the Fund quickly become socialized into a ‘technocratic’ and intellectually homogenous approach to economic policy, based on a narrow set of intersubjective understandings about how national economies work and how they should work (Momani, 2005a: 155-6, 2005b: 169-70). Moreover, as Woods (2006: 63) observes, the formal organizational structure of the Fund provides bureaucratic incentives that encourage intellectual conformity, because individual staff members face less risk to their careers when something goes wrong if they are operating within a uniform intellectual template. Rather than fostering the intellectual diversity that might be more appropriate to the diverse tasks the Fund now undertakes, critics have suggested that the internal socialization processes in the Fund tend to reproduce ‘intellectual monocropping’ among Fund staff (Evans and Finnemore, 2001: 10). Intersubjective agreement among Fund staff on how to comprehend and define economic problems – and what policy actions to recommend to states as appropriate solutions – allows them to represent Fund surveillance and advice as the
objective application of universal rules for sound economic management (Barnett and Finnemore, 2004: 68-9). While the input from area departments means that this might not quite represent the ‘cookie cutter’ approach to policy design that some critics of the IFIs have alleged (Xu, 2005: 660; Boone and Henry, 2004: 357), framing staff advice in terms of the diffusion of universally valid economic policy ‘best practice’ certainly has clear benefits for the Fund.

Framing their policy advice as ‘world’s best practice’ enables Fund staff to identify common economic problems across different national economies, and to link a diagnosis of the causes of a problem with a generic prescription for policy solutions. There is a clear efficiency advantage for the Fund in being able to deploy generic policy solutions rapidly in a crisis, rather than assuming that each economy is fundamentally different and designing more time-consuming reforms from scratch. Another possible advantage is that advocating similar policy advice may help the Fund to seem fair and even-handed in its relations with member states. Official ‘uniformity of treatment’ by the staff for all its member states is one of the primary ways that the Fund claims procedural legitimacy for its activities (Cottarelli, 2005: 19). But even if this is achieved in practice, which evidence from the Fund’s early and more recent history suggests it isn’t (Best, 2005: 101; Momani, 2004: 895-8), equal treatment is not always synonymous with fair treatment from the perspective of the Fund’s member states.

As Michael Barnett and Martha Finnemore (2004: 54-6) point out, the intellectual frameworks that the Fund has developed to respond rapidly to balance of payments crises see both the causes of and the solutions to such problems as endogenous to individual states (with the exception of deficits caused by external shocks such as a sharp rise in oil prices). As a result, the Fund focuses on the domestic policy changes necessary to correct imbalances case-by-case rather than taking a more systemic approach to their causes and solutions. In part, this is a response to the political parameters that constrain the Fund’s actions (Barnett and Finnemore, 2004: 55). In a state-based international system the Fund’s focus on individual national economies as the primary unit of analysis is politically difficult to change, despite recent calls from the Fund management to improve multilateral policy dialogue (De Rato, 2006: 129). The claim that states would receive ‘uniformity of treatment’ was therefore undermined early in the Fund’s history when the burden of adjustment in the event of balance of payments imbalances was placed entirely on deficit states. Despite the Fund having the right under the Articles of Agreement to declare a particular currency ‘scarce’ and to require countries to impose exchange restrictions and other measures to remedy the situation, this provision has never been used (James, 1996: 51, 88-9). The claim has become even harder to sustain with the emergence with the post-
1970s emergence of developed countries as persistent Fund creditors, subject in most cases only to annual or biennial policy surveillance by Fund staff (see Momani, 2006; Broome and Seabrooke, 2007; Lombardi and Woods, 2007). Developing country borrowers that are subject to intensive surveillance and an expansive range of policy conditions therefore undergo a qualitatively different experience in their policy dialogue with Fund staff (with some states continuing to be subject to a higher level of surveillance once loans are completed through ‘post-programme monitoring’, Bird, 2003: 234). This creates de facto differential treatment for states depending on whether they fall into the borrower or creditor categories, despite the Fund’s promotion of a ‘doctrine of economic neutrality’ (Swedberg, 1986).

How the Fund ‘sees’ its member states is also influenced by its strong emphasis on internal discipline. As Figure 2.1 shows, several other departments review the work of area departments to ensure that their policy dialogue with member states takes place within the framework of a ‘single corporate line’ presented by the Fund. Before a mission takes place, the mission chief submits draft terms of reference to the relevant functional departments for review, incorporates their feedback, then submits the revised document to the area department director who passes it on to be cleared by the management. The Fund’s negotiating position in its policy dialogue with member states is therefore the result of both a clear hierarchical chain of command and a set of internal review procedures that ‘are designed to ensure cabinet-like solidarity after decisions are made’ (Clark, 1996: 178). Following a mission, the draft of a staff report goes through a similar process, mapped out in Figure 2.2, which is sent to the Board for discussion only after it is again cleared by the management. As Richard Harper (1998: 129) has observed in his detailed study of the Fund’s internal operations, back-to-office reports that are drafted once a mission team returns to Washington are important because they allow the Fund to ‘talk about itself reflexively (which can involve making excuses for negative outcomes, self-criticism, and self-congratulation) and because they enable the staff to ‘talk to themselves in the future’ by building institutional memory. In Figure 2.3, I map out the hierarchical process through which the Fund generates its stock of ‘country knowledge’. This process starts from the country desks that store the detail of the Fund’s country knowledge, while the higher levels involved in the process up to and including the Executive Board retain greater scope of knowledge across countries.

The value of institutional memory can be degraded if texts such as the Fund’s back-to-office reports are designed to be safe and generic. As Harper (1998: 232) points out, the drafting and review processes that Fund country documents go through involve both technical and normative components. A staff report is intended to clearly lay out a state’s
current policies and to put them in a brief historical context, while each report also involves making a value judgement on those policies and often includes an evaluation of the authorities’ motivations for specific policy actions. This leaves a lot of room for controversy over Fund country documents, especially those stemming from a staff mission. The Fund has sought to neutralize potential disputes over staff country reports by balancing the need to produce country-specific knowledge with its rigorous internal review process. In the words of one former executive director, ‘the IMF tends to view its outputs as unique rather than as standardized products’ but the processes by which these outputs are produced are highly standardized (Clark, 1996: 177). This means that by the time a country report reaches the Board for discussion, the Fund’s internal review processes should enable the staff from the area and functional departments as well as the Fund management to stand by the document as an ‘objective’ assessment of a country’s current policy settings (Harper, 1998: 233). It can then be presented as an authoritative appraisal that communicates to executive directors how the Fund sees a state’s economy, with a wider base of support than if it only represented the assessment of the mission chief and his or her staff.
Figure 2.1 Generating an IMF Mission’s Negotiating Position

Mission Chief/Desk Officer Prepare Draft Terms of Reference → Area Department Director → Cleared by IMF Management

Reviewed by Functional Departments

IMF Mission Terms of Reference

Figure 2.2 Generating Back-to-office Staff Reports

Mission Chief/Desk Officer Prepare Draft Terms of Reference → Area Department Director → Cleared by IMF Management

Reviewed by Functional Departments

Executive Board Discussion
Figure 2.3 Generating IMF Country Knowledge
IMF Loan Conditionality

Conventional wisdom suggests that the capacity of the Fund to exercise influence over its member states’ economic policies comes primarily from its ability to enforce policy conditions attached to loans, at least in the case of states that seek to borrow from the Fund. As noted at the beginning of this chapter, Stone (2002: 240) sees the credibility of the Fund’s capacity to suspend financial support to non-complying states as the primary indicator of the Fund’s influence over a country’s economic policy. In contrast, other scholars have suggested that the Fund’s influence stems mainly from the cumulative effect of its analytical capacities, its comparative knowledge of reforms in other countries, and the policy dialogue process itself rather than the Fund’s capacity to grant or withhold loans (Nelson, 1996: 1557; Kahler, 1992: 123-4, 126).

The Fund began extending loans to member states in exchange for specific commitments to implement policy changes and to achieve economic performance goals following the establishment of stand-by arrangements in 1952. Each SBA usually lasts for a period of 12 to 18 months, with loan conditions increasing as states draw on higher credit tranches. In addition to SBAs Fund loan facilities have proliferated since the 1960s. While conditionality was not attached to the organization’s early loans and was applied unevenly during the 1950s and 1960s, it was formalized as standard practice following a 1968 review of lending policies with the first amendment to the Fund’s Articles of Agreement, which came into effect in 1969 (Boughton, 2001: 558). As new loan windows have been established Fund conditionality has varied for the different lending facilities. Early CFF loans and temporary facilities such as the Oil Facility and the STF involved low conditionality compared with the high conditionality of upper credit tranche SBAs, the EFF, and concessionary loans under the ESAF/PRGF (Bird, 2003: 231-2). These differences have reflected the Fund’s assessment of whether economic problems were temporary and resulted from external factors beyond a state’s control, such as a brief decline in exports and crises such as the oil shocks of the 1970s, or whether they were structural problems that resulted from major deficiencies in a state’s economic policies and its institutional arrangements.

At the time of the Bretton Woods negotiations, the UK argued for Fund resources to automatically be made available to countries with balance of payments problems while the US pushed for the inclusion of strict policy conditions on Fund lending, which largely

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2 The Compensatory Financing Facility (CFF) was established in 1963, renamed the Compensatory and Contingency Financing Facility in 1988 before recently being changed back to the CFF. The Extended Fund Facility (EFF) was established in 1974, along with the temporary Oil Facility that operated from 1974-6. Most controversial has been the structural adjustment facility (SAF) established in 1986, which was renamed the Enhanced Structural Adjustment Facility (ESAF) in 1987 and then repackaged as the Poverty Reduction and Growth Facility (PRGF) in 1999 (Bird, 2003: 231-3; Babb, 2003: 11-14).
reflected their divergent national interests at the time as borrower and creditor states respectively. The issue was later decided in favour of the US position (Babb, 2003: 10; Best, 2005: 50-1, 101-4). Today Fund conditionality continues to receive harsh criticism from many observers and remains a key source of tension with borrowing member states (Martinez-Vazquez et al., 2001: 502). For some, conditionality is seen as an infringement on national sovereignty that goes far beyond the encumbrance of external surveillance (Williams, 2000), raising questions about whether the Fund’s lending practices are compatible with democratic processes (Buira, 2003: 2). In addition to the argument that loan conditions will lead to better policies and improved national economic outcomes, the Fund has defended conditionality as necessary to achieve policy shifts that will ensure loan repayment, thereby safeguarding its financial base and maintaining the ‘revolving character’ of Fund resources (Buira, 2003: 3, 27-30). Due in part to unfavourable external economic circumstances, however, dozens of states have remained prolonged users of Fund resources over a sustained period (Bird, 2004), with twenty one states racking up substantial arrears to the Fund in the second half of the 1980s as they struggled to respond to the debt crisis (Boughton, 2001: 763-5).

As a direct mechanism to influence states’ economic policies, conditionality entails the threat of harmful consequences if states fail to comply. When borrowers go ‘off track’ during a Fund loan program by failing to achieve reform benchmarks in line with a formal timetable negotiated between the Fund staff and state representatives, the Fund can police the implementation of its loan conditions by threatening to withhold further credit. This punitive action can potentially have a snowball effect on a state’s financial health. In addition to the inconvenience of being denied access to Fund resources (at least temporarily), going ‘off track’ from a Fund program jeopardizes access to funds from the World Bank and other multilateral or bilateral donors. While compliance with Fund conditionality may not necessarily help to attract private capital as the Fund has claimed (Bird, 2002a: 809), statistical evidence suggests that non-compliance is likely to lead to capital flight and to make it harder to attract new foreign investment (Edwards, 2005: 869). Failure to correct ‘policy slippage’ under a Fund loan agreement will also inhibit a state’s ability to reach debt rescheduling or debt reduction agreements through the London Club and Paris Club processes (Marchesi, 2003).

The Limits of Conditionality and the IMF’s Legitimacy Crisis

As the Fund staff and several outside observers have pointed out, conditionality can also provide a strategic political advantage for national actors in certain circumstances (see Killick, 1997). For instance, borrowers may use the suggestion that the Fund has insisted
upon particular policy changes to send a signal to investors that their policy commitments are credible (Dhonte, 1997; cf. Bird, 2002a: 802), or to signal to political opponents and the wider public that they have had no choice but to accept the Fund’s policy reforms (Vreeland, 2003a: 13). In addition, ministry of finance or central bank officials might use the Fund’s advice to strengthen their arguments for particular policy reforms in bureaucratic contests with other state agencies (Broome and Seabrooke, 2007: 578).

As discussed in Chapter 1, states may draw on the credibility of the Fund’s institutional reputation for demanding tough conditionality and macroeconomic restraint as a way to signal to international and domestic audiences that they have chosen to ‘tie their hands’ (cf. Fearon, 1997). While the Fund’s institutional reputation can potentially provide states with an important means of ameliorating domestic economic uncertainty and policy ambiguity, if this is taken too far it may lead to severe unintended consequences that impede the process of institutional change. On the one hand, a ‘scapegoat’ strategy risks provoking widespread civil unrest or ‘IMF riots’. While this has occurred on a number of occasions (see Vreeland, 2003a: 6; Bienen and Gersovitz, 1985: 730), what may matter more is whether elites perceive that economic liberalization will increase the risk of political instability (Bienen, 1990: 715-16, 723, 727; Nelson, 1984: 987, 999). On the other hand, blaming the Fund might help to increase domestic acceptance of politically unpopular policy reforms if people perceive the changes to be inevitable.

Underlying much of the early criticism of conditionality from journalists, academics, and social activists was a largely unchallenged assumption that the Fund can successfully impose its policy conditions on states. Here the Fund is often viewed as a neoliberal ‘policy enforcer’, which performs the role of a global economic policeman and uses coercion to ensure compliance with the international ‘rules of the game’ (for an overview of the various criticisms of the Fund, see Willett, 2001). However, recent evidence suggests that Fund conditionality is in fact a blunt instrument that is poorly suited to achieving the introduction and the long-term maintenance of ‘IMF friendly’ policies. While loan programs commonly produce negative outcomes for a country’s economic growth rates and its pattern of income distribution (Vreeland, 2002; Garuda, 2000) most are not successfully completed (Bird, 2002a), which is often a result of low levels of compliance that prompt program interruptions (Joyce, 2006: 342). Rather than conditionality simply being an ineffective tool to ensure compliance, this might suggest that conditionality only functions well when it goes hand-in-hand with an effective process of intellectual persuasion, which can potentially alter how national actors perceive their policy preferences.
The Fund’s managing director from 2004 to 2007, Rodrigo de Rato, has recently emphasized this point, stating that the Fund cannot ‘dictate’ policies to member states and instead the Fund’s influence ‘comes almost entirely from its ability to persuade its members that they should follow its advice’ (De Rato, 2006: 128). However, in cases where the Fund has been able to persuade officials to implement its advice this has often failed to produce an observable improvement in economic outcomes, although assessing the impact of ‘IMF friendly’ policies based on a before/after comparison risks ignoring whether economic performance might have deteriorated further without the reforms (Nelson, 1984: 986).

Today, the expansive policy conditions and the price tag attached to Fund financing have prompted emerging market economies to seek to join developed states in avoiding the Fund at all costs (Woods, 2006: 209). Even in the case of ‘IMF recidivists’ – the states that are serial Fund borrowers and hence spend a sustained period of time under the Fund’s tuition – the Fund’s record of success in forging policies that improve economic performance is weak (Bird, 2004).

Some of these criticisms have gradually surfaced within the Fund itself. Facing a widespread perception that it is undergoing a ‘legitimacy crisis’ (Seabrooke, 2007b; Best, 2007), the Fund has recently sought to defuse criticism of its lending practices by commissioning independent reviews of some of its policies, which have led to several organizational reforms. In particular, the Fund has sought to pare back the number of conditions it attaches to loans, which expanded rapidly during the debt crisis of the 1980s and again with loans to transition economies in the 1990s and to East Asian countries during the Asian financial crisis (Momani, 2005a: 143; Best, 2007). The Fund has also sought to change the language in which it frames its lending activities, shifting from the discredited terminology of ‘structural adjustment’ to ‘poverty reduction’ and extolling the benefits of ‘country ownership’ of reform programs and broad domestic ‘participation’ (Woods, 2006: 3, 189-90; Best, 2006b: 317-8). The Fund moved in 2002 to ‘streamline’ the policy conditions attached to loans, with the logic that requiring fewer conditions would be perceived as less of an intervention in a country’s domestic affairs and could help to make Fund-sponsored reform programs a country-led process (Momani, 2005a: 143; Erbas, 2003). However, the top-down push within the Fund to reduce the scope and quantity of loan conditions has met with limited success, failing to budge the Fund’s organizational culture which favours ‘mission creep’ and the expansion of conditionality to deal with the complex economic challenges of borrowing member states rather than retrenchment (Momani, 2005a: 157).

The Fund has also sought to involve a greater range of domestic actors, engaging with non-governmental organizations and other civil society actors with the aim of enhancing
the ‘country ownership’ of reforms, and thereby hoping to increase the chances for reform implementation and to alleviate its crisis of legitimacy (Thirkell-White, 2004: 255). While broadening the Fund’s policy dialogue to include a greater range of domestic actors may seem to be a welcome response to the Fund’s legitimacy deficit, observers have concluded that the current results indicate that ‘ownership’ remains little more than a new rhetorical twist, which has involved pouring old wine into a new bottle and slapping on a catchy label. This helps to illustrate the differences in the organizational culture of the Fund compared with the World Bank, where engagement with non-governmental organizations seems to have had more of an impact in shifting the World Bank’s policies by altering its organizational identity and how it views the countries in which it operates (Park, 2005: 135; Vetterlein, 2006). In contrast to the World Bank, there is little to suggest that responsibility for setting the policy priorities of Fund loan programs has shifted away from Fund staff down to grass roots actors (Woods, 2006: 190), with the Fund continuing to maintain its role as the arbiter of what constitutes ‘good’ economic policy (Thirkell-White, 2004: 267).

Nevertheless, in the case of the Fund it is not clear whether simply bringing more actors ‘inside the tent’ is a good idea as this may greatly increase the workload of Fund staff, while efforts to bridge the divide between the Fund and its civil society critics might prove to be unworkable in practice. For instance, Fund staff have often become frustrated with single-issue interest groups. The staff argue these groups do not take into account the necessary policy trade-offs that are part-and-parcel of the Fund’s policy dialogue with member states (Dawson and Bhatt, 2001: 21-2). Engaging further with ‘civil society’ actors might also raise tensions with some states over the principle of sovereign non-interference (Seabrooke, 2007b: 263-4), which could conceivably decrease the Fund’s legitimacy even further if states perceive it to be interfering in domestic politics.

Some observers have suggested that rather than empowering those who are most affected by Fund-sponsored reforms, the Fund’s new ‘people-centred’ approach has further reduced the ‘voice’ of the poor by pushing local officials into a rigid consultation framework networked to external financial support (Craig and Porter, 2002: 65). Even if substantive participation involving a representative range of domestic actors could be achieved, as Graham Bird and Thomas Willett (2004: 435) point out: ‘Participation is not the same thing as ownership’. With the Fund remaining the final judge of ‘sound’ performance criteria in loan agreements, it seems difficult for the Fund’s new discourse on ownership to become much more than a public relations exercise, especially when the parameters of loan agreements must pass through the Fund’s internal review procedures that work against policy diversity, as outlined above. It is axiomatic to expect a government to be more firmly committed to reforms when policymakers and officials perceive them to
be based on their own ideas (Bird and Willett, 2004: 433). However, when the same loan conditions are simply dressed up as ownership, without greater policy flexibility or longer timeframes to design and implement customized programs (Momani, 2005a: 158), the concept remains more of a semantic shift than a substantive one. The Fund's focus thus remains centered on efforts to persuade other actors into a common way of thinking about economic policy, rather than diversifying its policy advice based on outside input.

**IMF Technical Assistance**

In addition to loan programs, the Fund now engages in a wide range of training activities and other forms of support that come under the rubric of ‘technical assistance’, amounting to around 300 person-years of staff time annually at a cost of US$80 million (IEO, 2005: 8). These activities tend to receive much less attention and to be far less controversial than Fund loans as they are not perceived to entail the same degree of external coercion usually associated with conditionality. As the term implies, the Fund does not consider technical assistance to constitute a political process so much as a value-neutral ‘scientific’ one (Barnett and Finnemore, 2004: 67-8), which aims to bring about the ‘transfer of knowledge’ among the Fund’s member states based on what works elsewhere. In this sense, the Fund sees its technical assistance role as similar to that of an external ‘service-provider’, with the aim of providing specialized support to governments that wish to enhance the technical expertise of domestic bureaucracies through accessing the Fund’s pool of comparative knowledge about policy reforms and institutional innovations elsewhere. Through staff missions, the placement of resident experts, the preparation of diagnostic reports, and the provision of training courses, seminars, and workshops, the Fund provides technical assistance to member states with the aim of strengthening both their policymaking capacity (i.e., human skills, the institutional structure of the state, and governance procedures) and the quality of policy design in specific issue areas.

In its capacity as a provider of technical assistance the Fund resembles less an agent of ‘coercive’ transfer of ideas and information and acts more as an agent of ‘voluntary’ transfer and persuasion (Dolowitz and Marsh, 2000: 11). Unlike loan agreements, for instance, the Fund does not usually link technical assistance to policy conditions and provides this support at no charge (IMF, 2003). Governments therefore tend to actively seek technical assistance from the Fund rather than being driven into its arms by the need for emergency credit in a balance of payments crisis. Technical assistance may be a more attractive option for states than Fund loan programs that involve a higher ‘participation threshold’ because they diminish decision-makers’ policy autonomy. Fund technical assistance still involves an element of constraint, as Fund staff do not present country
officials with a wide menu of policy options from which to choose so much as the diffusion of what the Fund sees as ‘world’s best practice’. However, because domestic factors will determine how successfully ‘best practice’ ideas take root locally, the Fund’s technical assistance can potentially involve a ‘transfer of policy knowledge but not a transfer of policy practice’ (Stone, 2004: 549).

While the Fund’s technical assistance has the semblance of a colonial-era ‘missionary’ project (Stiglitz, 2002: 13), it also has the potential to be a positive source of support to help with the functional requirements of institution-building, especially if the Fund helps states to develop roadmaps to achieve goals that countries set themselves. However, the practice of technical assistance more often involves the Fund as a ‘tutor’ attempting to transmit the right ideas to its member state ‘pupils’ (Jacoby, 2001), which constrains the capacity for Fund technical assistance to usefully inform domestic policy experimentation. But because of the lack of explicit coercion involved in technical assistance, national officials retain more agency to utilize the Fund’s advice to pursue domestic priorities than they might under a loan program. With the Fund’s technical assistance including features such as scrutiny of domestic legislation and institutional practices against a template of ‘world’s best practice’ constructed by its functional departments, this can potentially provide a more efficient means of socializing officials into the Fund’s way of thinking about economic management and economic problems because it goes on behind the scenes and attracts much less attention than formal loan agreements (on Fund technical assistance and central bank reform, for example, see Marcussen, 2005: 917). In addition, because acceptance of technical assistance recommendations from the Fund tends to be less controversial for states compared with loan conditionality, there may be greater scope for officials to achieve institutional recombinations gradually based on Fund advice than the headline policy changes that tend to be associated with loan programs (Broome and Seabrooke, 2007). Moreover, as discussed in Chapter 1, we can expect the Fund’s ability to design appropriate advice on institutional change to be greater when a country is not in the midst of an economic crisis that impairs its analytical capacity to navigate domestic uncertainty.

The Fund’s activities in this area remain geared towards altering a state’s economic policy orientation. For instance, Fund technical assistance can potentially establish conditions that set the foundations for reform implementation in future loan programs. Among other things, this can be achieved through the provision of economic training, priming officials to be more receptive to particular ideas by making them more familiar with how they work, or encouraging institutional changes that are essential for loan policy conditions to be effective such as changing the statistical techniques that are used to
measure economic indicators or overseeing the development of new legislation to establish central bank independence. In this regard, while the Fund's provision of technical assistance to its member states 'free of charge' utilizes only a fraction of the financial resources that it lends to support explicit reform packages, it can be a crucial mechanism by which the Fund staff reinforce the persuasion of states into adopting 'norm-conforming' behavior that gradually cultivates the ideational conditions necessary for a change of policy orientation (Schimmelfennig, 2005: 830-1).

Summary

This chapter has provided an overview of the Fund as an actor that is subject to external pressures from its leading member states and is engaged in a variety of activities that aim to alter the policy orientation of its borrowing members, and as an organization with its own unique internal culture, intellectual frameworks, and procedural norms. In particular, the chapter has emphasized the importance of the various ways in which the Fund operates as an intellectual actor that seeks to persuade national officials to share a common framework for analysis, and how this role influences its policy dialogue with both borrower and creditor states. As the discussion of the formal governance arrangements of the Fund has shown, the Fund staff and management retain considerable autonomy from even their largest shareholding member states over how they conduct the Fund's relationship with borrowers, although their freedom of manoeuvre can also be overridden by national political imperatives in certain circumstances.

Rather than making sweeping criticisms of the Fund for promoting 'Washington consensus' policies, this chapter has argued that international political economy scholars should pay closer attention to examining how the Fund's organizational culture and internal policy debates shape how the Fund works in practice. Instead of viewing the Fund as either a rogue policeman or a pawn of its major power shareholders, it is important to explore how the Fund functions as an intellectual actor in its policy dialogue with member states. One way to do this is by 'seeing like the IMF', which can help to increase our understanding of the sources of the Fund's influence in the global political economy. The examination of how the Fund 'sees' its member states has drawn a picture of the intellectual frameworks and organizational norms that underpin the everyday business of the Fund, which shape the design of policy reforms for states that seek access to the Fund's resources.

The evolution of loan conditionality, technical assistance, and economic surveillance has provided the Fund staff with the main tools they now use to seek to reform member states' economic policies and institutions. While loan conditionality provides material incentives
for states to implement ‘IMF friendly’ policy changes, it also affords opportunities for the Fund to transmit new economic ideas to national officials through the lengthy process of negotiation over policy conditions and through subsequent staff reviews of program compliance. Depending on local circumstances, if the Fund can persuade national elites to experiment with new policies this might gradually enable the Fund to influence how actors reconstruct their institutional preferences. Together, these tools can reinforce the persuasion of national policymakers into adopting the Fund’s norms of ‘good’ economic management. The following chapter examines how the Fund sought to perform this role in centrally planned economies undergoing a transformation to a market-based system. Here I discuss the evolution of the Fund’s role in the international monetary order, and examine how the Fund became the leading international organization charged with advising centrally planned economies on the ‘transition’ to a market economy.
The Post-Communist Expansion of the International Monetary Order

This chapter explores the evolution of the Fund’s role in the contemporary international monetary order, and in particular the expansion of its role in the post-communist transformations in East Central Europe and the Soviet Union. I discuss how the Fund’s systemic responsibilities changed with the breakdown of the Bretton Woods system, how the Fund came to be the main international organization coordinating the transition from central planning to market mechanisms in the East Central European communist economies and the Soviet Union, and the new challenges this posed for the organization. In contrast to the common caricature of the Fund as an institution that set out to impose a one-size-fits-all blueprint for policy change upon centrally planned economies, I draw from the Fund’s archival material to show that both the staff and the Executive Board recognized the need for different policy reform mixes in different cases of post-communist reform. The archival material also shows that the Fund recognized that the chances for rapid policy changes in post-communist economies would depend, among other things, upon what costs societies were willing to bear. By tracing the one-step forward, two-steps backward process of the Fund’s involvement with economic transformation in first the European CPEs and then the Soviet republics, I draw attention to the heavy burden that the responsibility to oversee the post-communist transition placed on the Fund. While the Fund is commonly criticized either for doing too much or for doing too little to help the CPEs transform their economic structures, I show how the Fund strained to cope with the needs of so many new member states, and I outline the innovative measures that the Fund implemented to try to adapt to this unprecedented challenge. In doing so I seek to reveal the constraints on what the Fund could achieve in an environment of acute uncertainty with its limited resources and, in the short-term at least, a lack of country-specific knowledge.

The format of the chapter is as follows. The first four sections examine the expansion of the contemporary international monetary order to include the European and Soviet centrally planned economies. Here I show how the Fund’s relations with member states evolved following the breakdown of the Bretton Woods system and the adoption of the
second amendment to the Fund’s Articles of Agreement, which altered the nature of states’ external economic obligations to each other through their membership in the Fund. I focus in particular on two monetary norms that the Fund now seeks to persuade member states to adopt – currency convertibility and central bank independence. The Fund sought to diffuse these two monetary norms to former communist economies for two main reasons. First, by the early 1990s they had become fundamental policy standards for states seeking membership in the contemporary international monetary order. Second, the Fund believed that the establishment of current account convertibility and central bank independence in transition economies was crucial for effectively responding to the immediate macroeconomic challenges that they faced, as well as for the broader project of transforming the nature of state intervention in the economy. The final four sections examine the role played by the Fund in the process of post-communist economic transformation. Here I discuss the development of the Fund’s general approach to post-communist institutional change, the strain that its new role placed on the organization’s resources, and the organizational changes that the Fund adopted in order to overcome these challenges.

The Contemporary International Monetary Order

The Fund staff and the Executive Board consider that ‘the working of the international monetary system is “the business of the Fund”’ (IMF, 1990a). Prior to the establishment of the Bretton Woods system, the traditional view, as expressed by the Permanent Court of International Justice in 1929, had been that ‘a State is entitled to regulate its own currency’ (Gold, 1984: 1533). With the signing of the Fund’s Articles of Agreement, states formally accepted the radically different principle that they should work together to prevent unfair currency competition and monetary disorder by pooling their authority to engage in permanent international monetary cooperation and consultation. As a result, the core objective of the Fund, endorsed by the 29 states that were original signatories to its Articles of Agreement in 1945, was to maintain fixed, unitary, and non-discriminatory exchange rates in accordance with common international monetary rules (Gold, 1984: 1534, 1536).

For the European and former Soviet CPEs seeking to enter the capitalist international monetary order in the early 1990s, the monetary rules of the Bretton Woods era had been transformed by structural changes in the world economy and the policy decisions taken by states in response to these developments during the 1970s and 1980s. The breakdown of the Bretton Woods system in the early 1970s and the emergence of ‘stagflation’, where capitalist economies experienced historically high inflation rates at the same time as high unemployment, precipitated a shift away from the post-war monetary norms of the
‘embedded liberal compromise’ (Ruggie, 1982; cf. Best, 2003). Until the 1970s, the post-war era had been characterized by national capital controls to allow for variation in domestic policy settings, combined with open current accounts and exchange rate coordination to provide a hospitable international environment for the expansion of world trade and economic growth. In contrast, the contemporary post-Bretton Woods international monetary order is characterized by the pursuit of low inflation and the deregulation of capital controls (Kirshner, 2003: 650-1). In these circumstances, the newly independent states of Central Asia were forced to be ‘policy takers’ if political leaders wished to integrate their economies and financial systems with the international monetary order.

The Fund’s systemic role changed in two major ways following the breakdown of the Bretton Woods system. First, the Fund became much more extensively involved with lending to developing countries, rather than being a revolving credit facility that was also used by industrialized economies when they experienced balance of payments difficulties (Bird, 1996). Second, the Fund lost its responsibility as a multilateral forum to oversee and approve adjustments in the par value of member states’ exchange rates, which had established a formal constraint on states’ domestic policies by committing governments to maintaining a fixed exchange rate (James, 1996: 588). The Fund’s role in maintaining the ‘dollar standard’ was superceded by a much weaker policy surveillance function that was sanctioned by an Executive Board decision on surveillance principles in 1977 and the second amendment to the Fund’s Articles of Agreement that became effective in 1978. These changes have been described by Joseph Gold (1983) – a former director of the Fund’s Legal Department and the chief draftsman of the first and second amendments – as a shift from ‘firm’ international monetary law to ‘soft’ law. This created a new international monetary order whereby states could choose from a range of exchange rate regimes to replace the par value exchange rates system (see Table 3.1), with the Fund now expected to encourage voluntary policy coordination among its member states through regular policy surveillance and consultations.
<table>
<thead>
<tr>
<th>Fixed Arrangements</th>
<th>Intermediate Arrangements</th>
<th>Floating Arrangements</th>
</tr>
</thead>
<tbody>
<tr>
<td><em>(An institutional commitment to a fixed rate)</em></td>
<td><em>(An explicit target zone around which a state intervenes)</em></td>
<td><em>(No explicit target zone for intervention)</em></td>
</tr>
<tr>
<td><strong>Currency Union</strong></td>
<td><strong>Adjustable Peg</strong></td>
<td><strong>Managed Float</strong></td>
</tr>
<tr>
<td><em>(Two or more countries use a common currency)</em></td>
<td><em>(Periodically changed)</em></td>
<td><em>(Intervention to respond to excessive volatility)</em></td>
</tr>
<tr>
<td><strong>Currency Board</strong></td>
<td><strong>Crawling Peg</strong></td>
<td><strong>Free Float</strong></td>
</tr>
<tr>
<td><em>(Monetary authority holds 100 percent reserves in foreign currency reserves against the monetary base)</em></td>
<td><em>(Regularly changed)</em></td>
<td><em>(Market determines exchange rate)</em></td>
</tr>
<tr>
<td><strong>Dollarization</strong></td>
<td><strong>Basket Peg</strong></td>
<td></td>
</tr>
<tr>
<td><em>(No national currency)</em></td>
<td><em>(Fixed against a basket of currencies)</em></td>
<td></td>
</tr>
<tr>
<td><strong>Fixed Exchange Rate</strong></td>
<td><strong>Target Zone or Band</strong></td>
<td></td>
</tr>
<tr>
<td><em>(E.g., CFA franc zone)</em></td>
<td><em>(Intervention to maintain a pre-announced target range)</em></td>
<td></td>
</tr>
</tbody>
</table>

Source: Adapted from Bordo (2003: 3-4).
With the ratification of the second amendment, Article IV section 3 of the Fund’s Articles of Agreement now states that the Fund ‘shall exercise firm surveillance over the exchange rate policies of members, and shall adopt specific principles for the guidance of all members with respect to those policies’ (www.imf.org). The reference to the Fund’s new responsibility for exercising ‘firm surveillance’ over states’ exchange rate policies was a linguistic compromise between France’s preference for the language of regulation and management, and the US’s preference for couching the Fund’s new mandate in the softer language of oversight and surveillance (Best, 2005: 121). The two negotiating positions were underpinned by conflicting assumptions about how best to resume economic growth and international monetary stability following the breakdown of the par value exchange rates system, assumptions that were shaped by the countries’ different economic circumstances as well as their conflicting policy priorities. While European states sought to maintain national policy autonomy in order to sustain their existing welfare systems, key economic advisors to the US government argued in favor of liberalizing the international monetary order as a way to discipline states’ fiscal and monetary policies (Helleiner, 1994: 116). The US argued that so long as governments maintained sound domestic economic policies a floating exchange rate would allow economies to adjust smoothly to ‘fundamental economic conditions’, a position that suited US policymakers’ interests at the time due to the relatively lower dependence of the US economy on international trade. European states and other countries that had a higher degree of dependence on international trade argued instead that a state’s domestic economic conditions and its exchange rate operate in an interdependent relationship, and that governments should therefore seek to achieve exchange rate stability to the greatest extent possible to aid domestic economic stability (Gold, 1983: 450-1).

The second amendment to the Fund’s Articles of Agreement was therefore an exercise in linguistic ambiguity among powerful states with different economic interests, which could not agree on a concise statement of purpose for the post-Bretton Woods international monetary order (Best, 2005: 121). The revised Article IV is silent on the Fund’s surveillance of its member states’ domestic economic policies, and section 3(b) specifically requires the Fund to ‘respect the domestic social and political policies of members’ (www.imf.org). However, because the Fund staff viewed exchange rates as reflecting the outcome of numerous domestic policy choices, the second amendment was subsequently interpreted broadly by the Fund to include in practice a responsibility to assess its member states’ economic policy settings as a total package (Lombardi and Woods, 2007). Following calls by the US to ‘clarify’ its exchange
rate surveillance principles (Adams, 2006), the Fund has recently updated the rules guiding its surveillance practices. A new Board decision adopted in June 2007 formally embracing the concept of ‘external stability’ – encompassing both current account and capital account balances – as a key principle for the Fund’s bilateral surveillance of its member states’ economies (IMF, 2007a). While billed by the Fund as simply updating the Board’s 1977 decision on guidance for the Fund surveillance in the light of how these have evolved in practice over time, the Fund’s 2007 decision faced some objections. Most notably, China expressed reservations towards the strong focus in the new decision on defining what behavior constitutes ‘exchange rate manipulation’ (The People’s Bank of China, 2007), which could potentially be used to pressure China to reform its exchange rate practices in order to ameliorate the US-China trade deficit. Although the new decision states explicitly that it is not intended to either directly or indirectly create any new legal obligations on the Fund’s member states (IMF, 2007a), the impact of the new decision will be determined by how it is interpreted by the Fund and its major shareholders in practice.

The international monetary order that the European and Soviet CPEs sought to enter in the early 1990s had evolved through the twentieth century from a ‘gold exchange standard’ in the interwar years (see Simmons, 1996), to a ‘dollar standard’ under the Bretton Woods system, to what James (1996: 612) terms an ‘information standard’ in the post-Bretton Woods era. Surveillance of its member states’ economic policies now constitutes the central component of the Fund’s global role. The Fund’s surveillance ‘is based on the principle that states are accountable to one another for the external implications of their internal policy decisions’ (Pauly, 1997: 141). For instance, the revised Article IV obliges states to ‘avoid manipulating exchange rates or the international monetary system... to gain an unfair competitive advantage over other members’ (www.imf.org). At the same time, the enforcement of states’ obligations and their accountability to each other through Fund membership rests primarily upon the Fund’s use of normative persuasion in the case of non-borrowers. In particular, the Fund’s influence rests on its ability to appeal for all member states to conform to common standards of economic behavior in an era of financial globalization when non-conformist policy actions can potentially result in a costly response by financial markets (Best, 2003: 375-6). The Fund’s contemporary surveillance of its member states’ economic policies is therefore premised upon ‘a continual exchange of information as a means of persuasion’ (James, 1996: 274). This clearly constitutes a much weaker source of leverage than the formal right to oversee the par value of states’ exchange rates. But it stipulates a central role for the Fund as an intellectual actor that is
expected to persuade its member states to accept common norms of behavior and a collective
understanding of what constitutes ‘good’ and ‘bad’ economic policies. Member states are
expected to take the Fund’s surveillance responsibilities seriously, although they are not
formally bound to accept its policy advice in practice precisely because of the greater degree of
ambiguity that is inherent in the ‘soft law’ definition of their external economic obligations as
members of the Fund following the second amendment.

Soft law is distinguishable from hard law because it refers to weaker binding obligations on
states, less precise obligations, or when authority for interpreting and implementing a state’s
legal obligations is not delegated to an external organization but remains with states themselves
(Abbott and Snidal, 2000: 421-2). In the case of the second amendment to the Fund’s Articles
of Agreement, the revised Article IV can be seen as: (a) weakening states’ legal obligations to
adjust their exchange rate policies in accordance with the Fund’s recommendations; (b)
creating ambiguity about the nature of their obligations with the compromise that the Fund
would only exercise ‘firm surveillance’ over their exchange rate policies; and (c) formally
relegating the responsibility to decide whether or not to act on the Fund’s policy advice back to
states themselves. During the 1970s, the balance of authority between the Fund and its
member states over exchange rate decisions that had characterized the Bretton Woods system
shifted firmly back towards exchange rate decisions becoming an internal decision for
individual states, albeit with policy guidance from the Fund (Gold, 1984: 1541). Following the
ratification of the second amendment, a state’s external economic responsibilities under Article
IV can best be characterized as comprising an ‘obligation to make an effort to achieve an obligation’,
rather than an ‘obligation to achieve a specified objective’ (Gold, 1983: 455). The current qualifications
on a state’s obligations to the Fund therefore allow substantial wiggle room for non-
compliance, or for the Fund’s advice to be entirely discounted. To be effective, the Fund’s
contemporary surveillance activities rely heavily on how a state’s international economic
obligations are interpreted in practice by the Fund and by individual member states. Effective
surveillance also depends upon the Fund establishing a good working relationship with
national policymakers to improve the opportunities for the Fund staff to have input into the
domestic decision-making process and to establish a common framework for analysis of
economic challenges. In this sense, while states’ economic sovereignty in the contemporary
international monetary order remains circumscribed by their formal acceptance of mutual
obligations to each other through their membership in the Fund, the Fund’s authority is
exercised in a much more indirect and ambiguous fashion than it was under the Bretton
The obligations of Fund membership clearly exert a different degree of constraint on different states. The majority of the Fund’s member states are effectively ‘policy takers’, compared with the major powers that continue to have the most input into making the rules of the international monetary order (see Drezner, 2007). The degree of policy constraint exercised through the Fund’s surveillance functions is also differentiated by whether states are subject to policy conditionality through Fund loans or whether they rely on other sources of finance to bridge balance of payment shortfalls (Thirkell-White, 2007: 22-3). But even in cases where the Fund does not have the capacity to exercise coercive leverage through policy conditions attached to loans, such as non-major power Western states that no longer borrow from the Fund, recent research suggests that these non-borrowing states continue to regard the Fund as an important actor. This is evidenced by their competition for influence on the Fund’s Executive Board (Woods and Lombardi, 2006) and by the commitment of the scarce time of national officials to consult with Fund staff (Pauly, 1997: 41). Moreover, as part of its surveillance function the Fund can call for states to justify and explain the rationale for their economic policy choices as an obligation of membership. This carries the risk that a negative assessment by the Fund staff may be used to ‘shame’ national authorities before their peers in Executive Board meetings or through the Fund’s public pronouncements and reports (Broome and Scabrooke, 2007; on shaming techniques and the OECD, see Sharman, 2006; on shaming techniques and the ILO, see Weisband, 2000).

**The IMF and Current Account Convertibility**

Two of the main international monetary norms promoted by the Fund are current account convertibility and central bank independence. Convertibility, which previously referred to the right to exchange a particular currency for gold at a given rate under the gold standard, is now commonly defined as ‘the right to convert freely a national currency at the going exchange rate into any other currency’ (Guitián, 1996: 22). Policymakers continue to see a strong central bank as an important source of financial power that can improve social welfare, enlarge the pool of capital available for domestic investment, and enhance the capacity to mobilize social resources in wartime (Broz, 1998). But in contrast to the strict political control that many governments previously maintained over their central banks, the prevailing wisdom among contemporary monetary policy elites is that national monetary goals can best be met by making a central bank legally ‘independent’ of the government of the day (see Polillo and Guillén,
The concept of ‘convertibility’ can be defined in a number of ways. Different degrees of convertibility define who is legally permitted to exchange a country’s currency, and the economic purposes for which a currency is permitted to be exchanged. Full, unrestricted currency convertibility encompasses both current account convertibility and capital account convertibility (Williams, 1991b: 376-7). Current account convertibility permits individuals and firms within a country to access foreign exchange in order to pay for external trade transactions, including goods, services, interest payments, share dividends, and overseas travel. Capital account convertibility permits a country’s residents to access foreign exchange to pay for financial assets abroad, and allows nonresidents to repatriate their capital overseas (Cooper, 1999: 89-90).

Many states initially continued to use multiple currency practices in the years following the establishment of the Fund, with thirty-six out of the Fund’s total membership of fifty-eight states using a form of multiple exchange rates in 1955 (Best, 2005: 84). In part, this was because an earlier attempt to establish sterling-dollar convertibility in 1947 had ended in disaster (Best, 2005: 66-9). After over a decade of preparation, European states eventually moved to accept the principle of current account convertibility between 1958 and 1961. This followed the creation of the ‘Euromarkets’ – ‘off shore’ currency markets outside the control of the Fund which emerged in 1957 as a means to buy and sell US dollars in response to national exchange restrictions (Burn, 1999: 230; James, 1996: 151; Helleiner, 1994: 71-2). Because the ideal of open current accounts was at the heart of the ‘embedded liberal compromise’ that comprised the Bretton Woods system of par value exchange rates, current account convertibility gradually became less controversial than capital account liberalization and today receives strong support, especially from the Fund’s industrialized member states. Although capital account liberalization remains more controversial than current account convertibility, an increasing number of governments have been willing to liberalize their capital accounts in the post-Bretton Woods era (see Chwieroth, 2007a, 2007b; Abdelal, 2007; Pauly, 1995; Simmons, 2001), a trend which has been reinforced and promoted by the Fund’s surveillance activities and its policy dialogue with member states (Leiteritz, 2005).

Governments may see the use of current account restrictions as beneficial to support particular developmental objectives or as a response to balance of payments shortfalls, but the Fund’s view has always been that such policies are ‘dangerous substitutes for economic adjustment’ that inhibit the proper functioning of foreign exchange markets (Simmons, 2000b: 77).
While the second amendment to the Fund’s Articles of Agreement removed the formal obligation for states to maintain a par value for their currency, it preserved the obligation under Article VIII for states to maintain an open current account as well as a unified exchange rate system (Simmons, 2000a: 574-5). Article VIII commits members of the Fund to uphold two main rules in this regard. First, Article VIII section 2(a) stipulates that ‘no member shall, without the approval of the Fund, impose restrictions on the making of payments and transfers for current international transactions’. Second, Article VIII section 3 stipulates that no member state shall engage in ‘any discriminatory currency arrangements or multiple currency practices… except as authorized under this Agreement or approved by the Fund’ (www.imf.org). Accepting ‘Article VIII status’ in the Fund is a voluntary choice for states, and policymakers are able to continue to maintain existing restrictions and currency practices that are in place when a country joins the Fund for an unspecified transition period (Simmons, 2000a: 581). This is formally permitted under Article XIV section 2 of the Articles of Agreement, which allows each state to ‘maintain and adapt to changing circumstances the restrictions on payments and transfers for current international transactions that were in effect on the date on which it became a member’. The same section nonetheless commits states to ‘withdraw restrictions… as soon as they are satisfied that they will be able, in the absence of such restrictions, to settle their balance of payments’ (www.imf.org).

Despite this allowance for national discretion, the Fund actively seeks to persuade states to change their behavior in order to shift them from maintaining restrictions under Article XIV towards accepting Article VIII status as quickly as possible (Simmons, 2000a: 581). It is important to note, however, that a state’s acceptance of Article VIII status does not necessarily mean that there are no current account restrictions in place. The Articles of Agreement explicitly give the Fund the power to approve temporary restrictions in certain circumstances, while some member states have occasionally introduced restrictions in violation of their Article VIII obligations without the Fund’s approval. The Fund has sought to encourage states to accept their Article VIII obligations only when: (a) they no longer have restrictions that would require the Fund’s approval under Article VIII; and (b) they are satisfied that they are unlikely to need to adopt such restrictions in the future. According to Vicente Galbis (1996: 45-6), this reflects a desire within the Fund for the acceptance of Article VIII status to be seen as ‘a public commitment on the part of the authorities to deal with balance of payments problems in future through appropriate adjustment policies (including exchange rate action) and financing rather than through recourse to restrictive exchange measures’. Simmons’s (2000a:
large-$n$ research on when states choose to commit to the obligations of Article VIII also suggests that the ability of states to comply with the norms of current account liberalization in the future is an important factor in the decision to shift to Article VIII – states do not take the decision lightly. If the Fund encouraged states to accept their Article VIII obligations while they maintained policies that would require the Fund’s approval, or when they were likely to reintroduce exchange restrictions, Article VIII status would carry less weight as a mechanism for the Fund to maintain compliance with the principle of current account convertibility or as a credibility signal to a state’s wider international and domestic audiences.

Although the Fund has always treated the currency restrictions that states are legally permitted to maintain under Article XIV as ‘transitional’, only 66 of the Fund’s 152 member states had formally accepted Article VIII status at the beginning of 1990. Moreover, among the majority of the Fund’s member states that had not accepted their obligations under Article VIII were some 36 countries that had remained under Article XIV for over three decades (Galbis, 1996: 14-17, 54). At the same time, a number of states no longer maintained restrictions under Article XIV – or maintained only minor restrictions – but had not yet formally accepted Article VIII status (Galbis, 1996: 38). The Fund has always had the formal right to push recalcitrant states to remove currency restrictions if it judges that they are no longer warranted by a state’s economic circumstances. Under Article XIV section 3 of the Fund’s Articles of Agreement, the ‘Fund may… make representations to any member that conditions are favorable for the withdrawal of any particular restriction, or for the general abandonment of restrictions, inconsistent with the provisions of any other articles of this Agreement’ (www.imf.org). However, the Fund prefers to use persuasion and policy dialogue to nudge its members towards the removal of exchange restrictions and the acceptance of Article VIII status, rather than to make use of this provision to explicitly request that states abandon restrictions (Galbis, 1996: 47).

In accordance with Article XIV section 3 of the Articles of Agreement, the Fund effectively ‘names and shames’ governments that maintain current account restrictions by publishing a summary of the exchange arrangements and the exchange/trade restrictions of each of its member states in its Annual Report on Exchange Arrangements and Exchange Restrictions, which has been published by the Fund since 1950. The entry for each member state of the Fund establishes the country’s status under the Fund’s Articles of Agreement (i.e., whether the state has accepted Article VIII obligations or whether it maintains restrictions under Article XIV), and presents an assessment of each country’s exchange arrangements within a common
classificatory matrix. Crucially, the report is a composite that is based on the Fund staff’s analysis of a country’s currency policies, rather than simply accepting what a government presents to the world as its official exchange arrangements. Because of the element of evaluation and interpretation by the Fund, the exercise constitutes a regular independent judgement by an external actor on the quality of a country’s currency policies, measured against common policy standards.

In January 1993, at the conclusion of the biennial review of the Fund’s surveillance policies, the Fund decided to make a renewed push to persuade member states to accept their obligations under Article VIII. The Board agreed that efforts to encourage the remaining member states that had not yet accepted Article VIII status to do so would take place within the existing surveillance framework of Article IV consultations, as well as negotiations over the use of Fund resources when member states sought approval for Fund-supported programs (Galbis, 1996: 46). Following this renewed emphasis by the Fund, the proportion of its member states to accept Article VIII status increased from 43 percent of members at the start of 1990 (66 out of 152 states), to 55 percent of members in February 1995 (100 out of 179 states), to 90 percent of members in November 2005 (165 out of 184 states) (IMF, 1995d, 2006b).

The IMF and Central Bank Independence

Although it is not mentioned in the Fund’s Articles of Agreement, another important monetary norm that the Fund has actively sought to diffuse among its membership in recent years is the principle of making central banks legally independent of the government of the day. Both inside and outside the Fund, the contemporary conventional wisdom now holds that central bank independence will help to establish a state’s monetary policy credibility in the eyes of key actors in both domestic and international audiences, although statistical evidence also suggests that central bank independence might contribute to a deflationary bias in a country’s domestic economy (Simmons, 1996: 436). Governments now charge their central banks with the responsibility to carry out a range of key tasks that influence the overall direction of economic policy and domestic economic outcomes, as well as shaping a state’s international financial and monetary relations (Maxfield, 1994). These functions can include influencing market interest rates by controlling the supply of money to the domestic economy, managing the payments system and foreign exchange reserves, maintaining financial stability through
supervision of commercial banks and by acting as a lender of last resort, determining the exchange rate, and functioning as banker to the government (Wagner, 1998: 4).

During the last two decades, monetary policy elites, private financial actors, international organizations such as the Fund, the World Bank, the OECD, and the Bank for International Settlements (BIS), and governments the world over have increasingly accepted the idea that central banks should be legally independent from governments. The concept of central bank independence from the government comprises at least three component parts: personnel independence; financial independence; and policy independence (either in setting monetary policy goals or in choosing the instruments to achieve those goals, or both) (Eijffinger and Haan, 1996: 2-3). The degree of a central bank’s personnel independence includes the legal methods by which central bank governors are appointed by their political masters, how long they serve, and the circumstances under which governments can dismiss them. Financial independence involves the nature of a central bank’s budgetary autonomy from the government. Policy independence is determined by the extent and nature of a government’s influence over monetary policy, whether the central bank has control over the setting of policy goals and the choice of monetary instruments, the central bank’s performance incentives, and the limits on central bank financing of budget deficits (Bernhard, et al., 2002: 696, 705).

As the idea of central bank independence as a public good has traveled the globe, a large number of states during the 1990s changed the legislation underpinning their central banks to grant them greater autonomy from governments (see Marcussen, 2005). The core argument for increasing central bank independence is that governments will seek to use monetary policy for short-term political gain at the expense of creating medium- and long-term economic problems such as high inflationary expectations. For example, monetary policy may be geared towards securing electoral support, or as a way to allocate financial resources to favored industries or even specific firms. This is the crux of the ‘time-inconsistency’ problem: although governments want economic actors to believe that their commitment to price stability over the long term is credible, politicians often have strong short-term incentives for influencing monetary policy in ways that aggravate inflation. Proponents expect central bank independence to deliver lower levels of inflation that will benefit all members of society, which will underpin stronger and more stable macroeconomic performance that might otherwise be jeopardized by the short-term interests of politicians (for a critical appraisal of the argument that central bank independence can solve the time-inconsistency problem, see Bibow, 2004).
The logic of this argument suggests that politicians need to find a way to demonstrate to economic actors that their commitment to low inflation is credible, and that only an effective signal of credibility will alleviate people’s inflationary expectations (Jayasuriya, 2001: 113). The time-inconsistency problem thus rests on the assumption that central banks and elected politicians such as ministers of finance have contrasting preferences, which prompt the latter to be more inflation-friendly and the former to be more inflation-averse. As James Forder (2000: 168) has noted in a review of the central bank independence literature, the idea that greater central bank autonomy enhances the credibility of a state’s monetary policy has become a crucial part of the argument for increasing central bank independence. Put another way, the attraction of the argument for devolving power over monetary decisions from politicians to technical experts does not rest on incontrovertible evidence that they will do a better job, but rather relies on the recognition that there is a widespread belief shared among monetary policy experts and private financial actors that they will do a better job. Proponents of central bank independence therefore assume that there is a significant symbolic advantage to be gained from taking politicians out of the equation. Indeed, Kathleen McNamara (2002: 48) has argued that an increasing number of governments have chosen to delegate monetary authority to central banks not to achieve the perceived material benefit of low inflation per se, but because of the ‘legitimising and symbolic properties’ that make central bank independence an attractive institutional innovation for states to adopt.

The relationship between the symbolic and the material factors driving central bank independence is especially salient in terms of the spread of central bank independence among developing and former communist countries. At a statistical level, economists have established that legal central bank independence does not generally correlate with low inflation in developing economies and former CPEs (Mas, 1995: 1645). While this may seem to support the argument that some countries have adopted legal central bank independence predominantly for its symbolic value, the evidence does not necessarily prove that this is the case, but rather suggests that other variables might often intervene. For example, Alex Cukierman, Geoffrey Miller, and Bilin Neyapti (2002: 251) have suggested that the effectiveness of central bank independence in former communist countries may be highly dependent on both the development of an effective legal environment, with formal rules that economic actors largely accept, and the extent of economic liberalization in general. General compliance with the formal ‘rules of the game’ is an especially important factor shaping the impact of central bank independence, because the drive for de facto rather than simply de jure
central bank autonomy depends on general acceptance of a form of ‘economic constitutionalism’ where key state institutions are split off and insulated from political decision making (Jayasuriya, 2001: 120). As Chapter 4 discusses in greater detail, the politics of money in post-Soviet states in the early 1990s did not represent a favorable environment in which to achieve de facto central bank independence, due to the breakdown of existing formal institutions as well as the salience of informal rules and practices. In a context where formal monetary rules do not have a high degree of acceptance among both elites and wider society, governments may follow the Fund’s advice and establish a strong form of de jure central bank independence that means little in practice.

The IMF’s Monetary Reform Template for Former Centrally Planned Economies

Even before major market-based reforms in the CPEs were underway, external observers viewed currency reform, and in particular the establishment of currency convertibility, as an essential component of the transition to a market economy in East Central Europe and the Soviet Union. A conference on currency convertibility and economic liberalization in communist countries was held in Vienna in January 1991, co-sponsored by the influential US-based thinktank the Institute for International Economics and the Austrian central bank. Participants emphasized the importance of establishing currency convertibility as a way of linking transition economies to the world economy, once certain preconditions had been met (see the chapters in Williamson, 1991a). One of the participants at the conference was Jacques Polak, the distinguished former executive director and staff member of the Fund who developed the Fund’s model for analyzing balance of payments problems, and who also worked as an economist for the League of Nations in the inter-war period. Polak (1991: 22) argued that currency convertibility would aid the process of transition by subjecting domestic economic producers to international competition, and by importing world market prices for goods to replace the administrative control of prices. This argument was based on the assumption that, despite the initial economic and social costs that would be involved, a rapid move towards establishing currency convertibility would force an adjustment from the distorted price structure in communist economies to the ‘rational’ price conditions in the world economy (Bofinger, 1991; Asselain, 1991). An additional argument in favor of the rapid establishment of currency convertibility was that it would circumscribe the potential for political authorities to distribute foreign exchange to preferred industries and firms, and would help to constrain the allocation of credit based on informal personal connections (Bomhoff,
In the early 1990s, external observers debated whether recycling the policy solutions that had been used to achieve monetary stabilization and economic cooperation in Western Europe after the end of WWII could help to resolve the monetary problems of the post-communist transition in East Central Europe and the former Soviet Union (Bofinger, 1991: 250-1; McKinnon, 1993: 160-1). By the second half of the 1990s, however, it was common for external observers to contrast the length of time that it had taken West European economies to establish full current account convertibility after the end of WWII with the rapid moves that post-communist states had taken towards convertibility. In the European CPEs the change was particularly fast, with most countries adopting current account convertibility in the first year of market-based economic reforms (Stolze, 1997; Pomfret, 2003a: 600). The Baltic republics also rapidly established current account convertibility, in an attempt to take ‘the fast track’ from central planning to the world economy (Feldmann, 2001). In contrast to the post-WWII experience of West European economies, international actors such as the Fund encouraged a rapid transition to current account convertibility in post-communist states primarily for two reasons. First, as discussed above, the international monetary order that the former Soviet republics and the European CPEs sought to enter in the early 1990s was characterized by a strong normative commitment to current account convertibility. Because it had become a strong symbol of economic openness and liberalization, post-communist states were encouraged to adopt current account convertibility in order to send a credible signal to international and domestic audiences of the authorities’ commitment to market-based reform. If states were to subsequently renege on their commitment to current account convertibility, Simmons’s (2000a: 600-1) research suggests that they would expect to face major ‘reputational consequences’ among key audiences. Second, a rapid move to establish currency convertibility in post-communist states was widely seen as an important part of the solution to the specific economic problems they faced – especially the perceived need to force a shift from administered prices to international prices and the need to open the CPEs to external competition (Van Selm and Wagener, 1995: 30).

A staff paper prepared by the Fund’s Research Department in consultation with other staff departments in November 1990 at the request of the Executive Board spells out the Fund’s intellectual position on the shift towards currency convertibility in CPEs and their integration into the international monetary system. The Research Department is the main unit of the Fund responsible for the production of the organization’s in-house academic knowledge (see 84.
Momani, 2007b), and its research output has helped to shape the outcome of important policy debates within the Fund (James, 1996: 277). It is also responsible for ‘keeping score’ of major developments in the world economy by producing the Fund’s flagship multilateral surveillance publication, the *World Economic Outlook* report (Boughton, 2001: 228).

For the Research Department staff, the establishment of current account convertibility in transition economies was considered to be important for achieving two purposes. First, it could help to reduce the costs of the administrative control of foreign exchange; and, second, because it had ‘become a key symbol of openness and economic freedom’, the establishment of convertibility would be ‘important for the acceptability and credibility of difficult reform programs’ (IMF, 1990c). In addition to the definitions of current account convertibility and capital account convertibility discussed above, the Fund also distinguishes between external and internal convertibility. For the Fund, internal convertibility is achieved when a country’s residents are permitted to hold domestic assets, such as bank deposits, which are denominated in foreign currencies. Domestic currency is therefore internally convertible into foreign currencies, but residents are not free to make international transactions or to hold foreign assets as they see fit. From the Fund’s perspective the establishment of internal convertibility can help countries where residents have large holdings of foreign currencies to intermediate foreign exchange through the banking system, and can assist in the integration of the black market with the formal economy (IMF, 1990c).

As the Fund’s Research Department staff point out in their 1990 report, the establishment of convertibility for international transactions is not a one-way bet but implies both benefits and costs for an economy. Convertibility may help to increase a country’s competitiveness and efficiency by exposing domestic producers to foreign competition and allowing firms to access foreign capital and intermediate goods, as well as expanding the range of choices available to domestic consumers. But it may also present a risk to domestic employment rates and household incomes, and may lead to more severe current account imbalances with a higher risk of macroeconomic instability. In the context of the CPEs that were embarking on a transition to a market-based economy, the Fund saw the potential benefits of convertibility in terms of helping to decentralize economic decisions over production and investment by increasing economic actors’ reliance on prices rather than centralized production plans to coordinate the allocation of resources and economic behavior. The Fund also believed that convertibility could help to blunt the market power of the large industrial monopolies that were common to both European and Soviet CPEs through exposing them to international
competitors, and that it could help to achieve efficiency gains through economies of scale by enlarging the export market available to domestic firms. However, the Fund staff noted that in the short term convertibility might lead to high unemployment, a cut in wages, and a substantial decline in domestic production if consumers and firms switched to imported goods and services over domestic products. In a worst case scenario, the Fund staff predicted that ‘If the environment for domestic enterprises grows too harsh, the strains imposed on the population can become unsustainable, thereby undermining political support for a reform program’ (IMF, 1990c).

The Research Department staff paper identified four preconditions that should ideally be achieved before an attempt is made to establish currency convertibility.

- First, an appropriate exchange rate should be adopted to help maintain macroeconomic stability and to achieve a viable current account balance.

- Second, a country should have access to adequate foreign exchange reserves and external financing in order to endure possible balance of payments shortfalls or trade shocks that may be exacerbated by currency convertibility.

- Third, the Fund staff argued that governments should have in place ‘sound’ macroeconomic policies – including fiscal restraint, the control of budget deficits, and an independent central bank that could stabilize economic activity and maintain monetary control through indirect market-based instruments.

- Fourth, the Fund staff suggested that transition economies must have instituted a program of price reform to enable economic actors to respond to the market incentives provided by changes in relative prices.

As Fund staff point out, accumulating substantial foreign exchange reserves prior to convertibility (e.g., enough reserves to sustain a country’s import payments for several months) would be particularly important for transition economies because there would be limited access to credit in international financial markets to cover balance of payments shortfalls. The speed with which a government should establish current account convertibility was considered to be dependent upon how quickly they could achieve these four preconditions. For the staff, this
was not simply a matter of putting appropriate policies in place and engaging in institutional reform to help decentralize economic decision-making, but also depended on the level of popular support for a government's overall reform program (IMF, 1990c).

To help ameliorate the potential economic costs and political opposition that convertibility might involve, Fund staff outlined possible options for countries that might wish to adopt a transitional system that would help to establish some of the benefits of convertibility while allowing the government to maintain control over the amount of foreign exchange that was available for imports. The Research Department staff discussed two possible alternative currency systems that could be used for transitional purposes. First, countries could establish a licensing system whereby actors bid for the right to access foreign exchange, which could be funded by foreign exchange surrender requirements for exporters. A system along these lines, which would in effect create a multiple exchange rate regime, would regulate the balance between the amount of foreign exchange entering the country through foreign payments for the country’s exports and the amount that was available for domestic importers to pay for foreign goods and services. Second, countries might quickly establish current account convertibility and a unified exchange rate while temporarily raising import tariffs to guard against a sudden and destabilizing switch in consumption from domestic products to imports. Currency convertibility combined with high trade tariffs, which the Fund staff argued should be phased out according to a pre-announced schedule, would give domestic firms a temporary breathing space to restructure their businesses and to make new investments before being fully exposed to international competition, and would have the added benefit, from the Fund’s perspective, of allowing countries to immediately accept Article VIII status (IMF, 1990c).

When the Board discussed the Research Department’s staff paper on currency convertibility in transition economies in December 1991, executive directors voiced support for the paper’s conclusions regarding the necessary preconditions for the successful establishment of current account convertibility. Several members of the Board emphasized the need for governments to make decisions regarding the timing of the introduction of convertibility on the basis of their individual economic circumstances and the progress of their reform programs. For instance, J.E. Ismael, the executive director representing the Indonesian constituency, emphasized the need for the Fund to ‘exercise due flexibility in urging members to move toward current account convertibility’, in accordance with the stated goals of the Fund in the Articles of Agreement to achieve high employment and income levels and to promote exchange rate stability. In particular, Ismael reminded the Board that the Fund has the formal right to
approve temporary currency restrictions where these are deemed necessary (IMF, 1990d).

Several executive directors, such as those representing the Netherlands, France, and Italy, argued in response that a rapid transition to current account convertibility would be the best way to aid the broader transition to a market-based economy. Renato Filosa, the Italian executive director, emphasized that establishing current account convertibility would help to send an ‘internationally visible signal’ that a country’s authorities were committed to implementing market-based policies consistently in the future. Filosa also argued against encouraging countries to resort to a gradual approach to current account convertibility, because the possible costs involved if reforms stalled would be much greater than the costs involved with a rapid move toward convertibility (IMF, 1990d). Striking a slightly different tone, the German executive director Bernd Goos argued that ‘the adoption of a cautious and more gradual approach might be advisable’ for transition economies. At the same time, his view, reinforced by the comments of other directors, was that ‘there was no risk-free or cost-free alternative to current account convertibility’. The main point of debate in the Board’s discussions over the issue of currency convertibility focused on the speed with which governments should move towards accepting their Article VIII obligations. Most speakers suggested that capital account convertibility should come much later in the reform process, and directors reached a consensus view that despite the inevitable short-term disadvantages and risks involved, the transition economies did not have any viable alternatives available to them that would allow them to maintain inconvertible currencies in the long-term (IMF, 1990e).

In response to several directors’ remarks on the need for the Fund to tailor its advice to countries on the move toward current account convertibility on a case-by-case basis, the director of the Research Department Jacob Frenkel strongly emphasized to the Board that ‘The most important prerequisite for the success of a program of economic transformation was credibility’. Without establishing policy credibility, Frenkel argued, reforms such as the establishment of current account convertibility would be likely to result in policy failure. In this respect, the authorities in transition economies would need to ‘change fundamentally their attitude toward policymaking and how it was carried out’ (IMF, 1990e).

Summing up the Board’s debate on the issue of currency convertibility and transition economies, the acting chairman noted that executive directors had expressed a range of views on how quickly countries should move toward the establishment of current account convertibility. Most agreed that current account convertibility would ideally be an early policy
change, but suggested that in practice countries might require some time to establish the appropriate preconditions and build new domestic institutions in order for the shift to current account convertibility to be successful. In addition, the acting chairman noted that several directors agreed with the staff’s suggestion that tariffs could potentially play an important role in helping domestic economic actors adjust to current account convertibility without facing overly high short-term costs, so long as there was a pre-announced timetable in place for phasing out transitional tariffs (IMF, 1990c).

Because of the Soviet legacy of centrally determining the allocation of financial resources without maintaining hard budget constraints on firms, encouraging a shift from direct to indirect monetary instruments would be crucial to the goal of achieving monetary restraint as well as for the Fund’s wider aims of changing the nature and scope of state intervention in post-communist economies. However, as a 1994 staff paper prepared by the Fund’s Monetary and Exchange Affairs Department on the adoption of indirect monetary instruments makes clear, the difficulties involved with shifting to indirect monetary instruments were particularly complex in the case of transition economies, which required policy changes and institution building on a number of fronts simultaneously (IMF, 1994c). Direct instruments of monetary policy – which tend to involve a ‘hands on’ regulatory role for monetary authorities – include credit controls, interest rate ceilings, and directed credits. Indirect instruments – whereby monetary authorities take a more ‘hands off’ role and rely instead on their ability to influence monetary demand and supply conditions – include the purchase or sale of financial securities by the central bank, central bank lending, credit auctions, and reserve requirements (IMF, 1994c).

The primary benefit of using a system of direct monetary controls is that they can be used to determine the growth of credit in the economy and the level of domestic interest rates. The main drawbacks include the potential for direct controls to lead to an inefficient allocation of financial resources, the potential for controls to hamper competition among domestic financial institutions, and the possibility that banks and borrowers may be able to circumvent controls (Hilbers, 1993: 4). In contrast, the potential benefits of indirect monetary instruments include the introduction of greater flexibility, efficiency, and competition into a state’s financial system by operating monetary policy through market-based mechanisms (Hilbers, 1993: 8-9). Although governments in industrialized economies increasingly moved towards a reliance on indirect instruments of monetary control as they liberalized their financial markets in the 1970s and 1980s, the particular circumstances of the former CPEs in the early 1990s meant that a
successful transition to indirect monetary instruments could only be achieved gradually. Currency reform would have to be undertaken incrementally if political momentum and public support for market-based reforms was to be maintained. Compared with industrialized economies the former CPEs had much less developed markets, highly vulnerable financial institutions, and severe macroeconomic imbalances, all of which would mitigate against the successful implementation of indirect monetary instruments. Because of these important differences, as well as the problems inherent to the politics of money in post-Soviet states that are discussed more fully in the following chapter, the successful introduction of indirect instruments of monetary control in the newly independent states of Central Asia was unlikely to occur in the short-term after the breakdown of the Soviet system.

*A New Mission for the IMF*

With the collapse of the Soviet economic system, the Fund faced an unprecedented challenge of overseeing systemic transformation and institutional change in a large number of economies at the same time. This required formulating advice on how to reconstruct economies of which the Fund had little or no prior knowledge, and in the case of the former Soviet republics advising on the construction of fifteen new national economies from the rubble of what had previously been a single economic unit. It also involved overseeing systemic change in the world economy, with a rapid expansion of the international monetary order as the former CPEs sought to engage the international financial community. For their part, most of the CPEs had little knowledge of the policies and functions of the Fund, while in Central Asia specialists in international affairs had been trained to denounce the international financial institutions as foreign policy tools of the capitalist powers rather than to see them as forums for multilateral economic cooperation (Gleason, 1997: 12).

Throughout most of the Cold War period the majority of the Soviet bloc CPEs had little or no contact with the Fund. The Fund continued to maintain a Central and Eastern European Division within the European Department, with staff occasionally conducting research on individual non-member CPEs based on data that was available within the Fund (IMF, 1966), as well as researching specific policy issues common to CPEs. For instance, the Fund explored the possibility of achieving currency convertibility and multilateralism in foreign trade within a communist economic system (IMF, 1965), and argued that there was no reason why ‘IMF friendly’ policies such as convertibility and multilateralism should be seen as exclusive to capitalist economies. The Soviet Union never joined the Fund, despite a Soviet delegation
taking part in the deliberations at Bretton Woods at the end of WWII and signing the draft Bretton Woods agreements (Assetto, 1988: 62-3). Poland withdrew its membership of the Fund and the World Bank in 1950 following increasing tensions over access to the organizations’ resources and disagreements over the country’s economic policies. Other Soviet bloc countries that were members of the Fund during the Cold War included Czechoslovakia, which was expelled from the Fund at the end of 1954 after failing to consult with Fund staff before implementing wide-ranging currency reforms the previous year. Yugoslavia arranged loans from both the World Bank and the Fund throughout the Cold War, helped by the country’s non-aligned foreign policy stance. Romania also became a member of the Fund in 1972, after shifting its foreign policy away from Moscow (Assetto, 1988: 73-4, 86-7, 132-3, 144-5).

Several CPEs began to express greater interest in becoming members of the IFIs during the 1980s, with China’s representation in the Fund shifting from Taiwan to the People’s Republic in 1980, Hungary joining in 1982, and Poland rejoining in 1986 (Boughton, 2001: 967). The Soviet Union also began to express interest in the Fund, and sent a delegation of senior officials from the State Bank of the USSR, the Ministry of Finance, and the Ministry of Foreign Affairs on an informal three-day visit to the Fund in November 1988. The Soviet officials stated that the purpose of the visit was: (1) to learn first hand about the Fund’s policies and activities; (2) to understand the obligations and responsibilities of Fund membership; and (3) to investigate the potential for establishing informal contacts between the Fund staff and Soviet officials and scholars (IMF, 1988). With the subsequent collapse of the Soviet system a band-wagoning effect took place as the former Soviet bloc CPEs, including the Soviet republics, sought to become legitimate members of ‘international society’ by joining the Fund and other multilateral organizations, which led to Fund membership increasing rapidly from 152 member states in 1989 to 178 in 1993 (James, 1996: 602-3).

By chance, the end of the Cold War coincided with the Fund’s search for a new mission. As discussed above, the Fund’s role managing adjustments to the Bretton Woods exchange rate system had been superseded by the shift to floating exchange rates and regional currency arrangements from the early 1970s, and its role in the Latin American debt crisis diminished after the mid-1980s (Woods, 2006: 108-9). With the Soviet system now discredited as an alternative to a market-based economy, and with most of the CPEs moving to adopt market mechanisms, the Fund was presented with a unique opportunity to oversee the expansion of the international monetary order and to solidify its international role as a key source of ideas.
for economic reform. Enlarging its membership would also allow the Fund to finally become a truly global organization.

The Fund’s interest in carving out a new role for itself converged with the interests of major donor states that sought a vehicle to support and oversee structural economic reform in the CPEs, preferably without having to provide large new aid outlays themselves (Zecchini, 1995: 117). While some observers called for large-scale direct financial assistance to the Soviet bloc CPEs similar to the post-WWII Marshall Plan for reconstruction in Western Europe (Gould-Davies and Woods, 1999: 5; cf. Collins, 1991), domestic political and economic considerations in major donor states meant that a similar-sized package would not be forthcoming. Moreover, because of its organizational identity as a pre-eminent source of ‘technical’ economic expertise, the Fund was seen as capable of enforcing policy conditions and fostering an elite domestic constituency in favour of structural economic reform without attracting the same criticisms that could be expected if countries such as the US played a more direct hands-on role (Woods, 2006: 108; Rutland, 1999: 189).

Because of these propitious circumstances, the Fund quickly assumed a leading role in the early period of post-communist economic reform as the primary international organization advising CPEs on plans for a new economic framework. The Fund’s central role was sponsored by the Group of 7 industrial economies, and was reinforced by the practice of cross-conditionality. In order to access financial support from other sources such as the World Bank, the European Investment Bank, the European Bank for Reconstruction and Development (EBRD), and major bilateral donors, policymakers in post-communist states had to maintain good relations with the Fund and had to reach agreement with Fund staff on their strategy for economic reform (Zecchini, 1995: 118). With Fund arrangements also necessary for states to access debt relief under the Paris Club process, the practice of cross-conditionality amplified the potential influence of the Fund’s advice by increasing the incentives for policymakers to establish and maintain a positive bilateral relationship with the Fund.

The Fund eagerly sought to expand into its new role as the chief international organization advising former CPEs on how to shift to a market economy, but in the process of taking on such challenging new responsibilities it risked what Pauly (1999) has called ‘the perils of international organizational overextension’. In addition to lacking an in-depth knowledge of the Soviet system, the Fund was ill-prepared for the wholesale reconfiguration of state structures that countries had to undergo, in what constituted a historically distinct episode of political and economic transformation and state building (Ganev, 2005: 435). The Fund’s
previous experience of advising on structural economic reform in ‘distorted’ market economies offered few lessons that it could use to model change in a context where the disintegration of the state-owned economy created a set of pressures that worked against the likelihood of successful reform, especially in the short-term.

At an elite level, the shift away from central planning helped to stimulate a process of resource extraction from the state by ‘predatory elites’, creating a situation where the immediate interests of key players in post-communist states were often diametrically opposed to the establishment of stable new state structures (Ganev, 2005: 435-7). In these circumstances the state risked becoming effectively privatized, thereby undermining the social bases for economic policy reform and institutional change and leading to the emergence of a ‘rent-seeking state’ (Van Zon, 2001: 75). For non-elites, who faced severe disruptions to their cash incomes and who struggled to maintain access to food and other basic goods, the imperative of day-to-day survival and the need to sustain a basic level of household welfare prompted individuals and groups to engage in everyday practices that further impeded attempts at structural economic reforms. With the breakdown of the existing economic system, non-elites who participated in the ‘official’ economy that was the target of Fund-supported reforms were simultaneously active in non-monetized ‘social’ economies, as well as ‘uncivil’ economies where cash payments avoided state regulations and taxes (discussed further in Chapter 4). These alternative forms of economic activity helped to provide an informal safety net for non-elites but worked against the achievement of macroeconomic goals – such as sustaining tax revenues, reversing demonetization, and increasing social spending to cope with unemployment – despite being wholly rational at an individual level as basic survival strategies (Rose, 1993: 420, 422). To illustrate the scale of the economic and social costs experienced by post-communist states, the combined decline in official economic output experienced in the first five years of the transition by the twenty-seven former Soviet bloc and Soviet republic CPEs exceeded the contraction experienced by Western economies during the Great Depression (Bunce, 1999: 764). The precipitous decline of the ‘official’ economy and the rising importance of ‘social’ and ‘uncivil’ economies also impeded the analytical capacity of international organizations such as the Fund to evaluate what was going in post-communist states. In particular, these trends made it difficult for Fund staff to quantify the impact of policy changes and to assess whether formal policy changes were being implemented in practice.
The Fund’s early experiences advising Soviet bloc economies on the shift from central planning to market mechanisms took place with the European CPEs, such as Hungary, Poland, Bulgaria, Czechoslovakia, and Romania. As a 1991 staff report indicates, the Fund appreciated the daunting challenges involved in the task of transforming the CPEs. In addition to the impediments listed above, Fund staff noted the difficulty of advising on the design of macroeconomic policy changes in an economic environment characterized by acute uncertainty. In particular, staff recognized that it was difficult to predict how economic actors would respond to particular policy changes because of the lack of experience with market mechanisms. Nevertheless, in line with standard practice staff continued to use quantitative benchmarks based on such predictions to monitor the progress of Fund programs. In assessing the implementation of policy changes and judging the need for external financing, the staff emphasized the need for flexibility and for different policy reform mixes in different cases, as well as noting that ‘domestic social tolerance… limits the acceptable immediate impact of adjustment’ (IMF, 1991a). The Fund is often caricatured as an organization that seeks to impose one-size-fits-all economic reform blueprints based on abstract theoretical models without regard for local context (Stiglitz, 2002). Such criticisms are not new. During the 1980s debt crisis, for example, the Fund was accused of promoting generic reform programs for developing countries (Buira, 1983; Eckhaus, 1986). However, the inclusion of such concerns in its reports at this early stage of post-communist transformation indicates that there was some recognition of the social limits of radical policy changes, as well as a recognition that the policy mix in reform programs would have to be tailored to local circumstances to be effective.

The Fund sought to guide the process of economic transformation in European CPEs by providing general advice on the design of policy reforms, by providing loans aimed at achieving specific reform benchmarks, and by providing substantial technical assistance that drew on the expertise of the Fund’s functional departments in coordination with the European Department. Such technical assistance included commissioning specific studies of CPEs by Fund staff or outside consultants; policy advice given during staff visits; day-to-day advice given by the Fund’s resident representatives; as well as regular courses of economic training and special seminars for national officials provided by the IMF Institute. In theory, as discussed in Chapter 2, the Fund’s technical assistance advice is aimed at transferring knowledge to national policymakers about ‘how to do’ things, rather than telling them ‘what to
do'. This involves making a distinction between influencing policy decisions and the process of policy formulation in a specific direction, and providing advice on the range of possible policy options. As an external evaluation of the technical assistance provided by the Fund’s Monetary and Exchange Affairs Department indicates, however, this distinction is unlikely to be strictly maintained in practice (IMF, External Evaluation, 1996). In the uncertain environment that characterized policymaking in the CPEs during the early years of their shift to a market-based system, this distinction between providing advice on ‘how to do things’ and advising ‘what to do’ was largely irrelevant.

As the Fund commenced full-scale engagement with the European CPEs, a major debate was taking place both inside and outside the Fund over the optimal speed and sequencing of the post-communist transition to a market economy. This debate emerged as a dualism between a ‘shock therapy’ or ‘big bang’ approach to economic liberalization on the one hand, and a ‘gradualist’ approach to institutional change on the other. The ‘big bang’ approach, typified by the policies recommended by Jeffrey Sachs and Anders Åslund who advised the Polish and the Russian governments on economic reforms, prioritised the need for a sudden shift to economic liberalization with simultaneous reforms across different areas of economic policy. This approach was based on the assumption that change in one policy area but not in others would be ineffective because of the interdependent and symbiotic nature of economic relationships (Marangos, 2002: 261). In addition, it was expected that rapid institutional change would decrease the transaction costs faced by firms because they would be forced to adapt more quickly to the new rules, whereas incremental changes would increase transaction costs because firms would face a longer period of uncertainty without the necessary information to plan for future investment (Ovin, 1998). A radical approach to economic transformation, it was argued, would lead to both a faster transition to a market economy and a more rapid return to economic growth, as well as minimizing the risk of large-scale corruption and the emergence of rent-seeking behavior (Lane, 2004: 52). In contrast, the ‘gradualist’ approach prioritised the need to maintain public support for reforms by mitigating the risks of mass unemployment and a large fall in household living standards. Instead of a rapid economic policy revolution, new political and economic institutions would have to be crafted, tested, and embedded prior to big policy changes such as the liberalization of foreign trade and domestic prices (Marangos, 2002: 261). A decade after the start of post-communist reforms this debate had still not been resolved, with proponents of both approaches claiming vindication from the diverse track record of policy reforms and economic outcomes in post-communist states (see
Aslund, 2001; Stiglitz, 1999).

For the most part, the Fund saw a ‘gradualist’ approach to economic reform in the Soviet bloc CPEs as unworkable, due to the specific circumstances in which the Soviet system collapsed (Auty, 1999: 3). Reviewing the Fund’s early experience with transition economies in 1994, the Fund staff argued that the conditions required for a ‘gradualist’ approach to work were absent in most of the Soviet CPEs (IMF, 1994a). From the staff’s perspective, by the time the Fund became actively engaged in the reform process the political and economic changes that were already underway between the USSR and the European CPEs and among the Soviet republics required a rapid policy response, especially with regard to trade and price liberalization. With the previous trade and monetary relationships between the CPEs breaking down, an incremental approach to key reforms lacked feasibility (Borensztein, 1993: 3).

Within the Executive Board, directors expressed a range of views on the ‘shock therapy’ versus ‘gradualism’ debate over transition strategy. J.E. Ismael, the Indonesian executive director who also represented Asian CPEs such as Laos and Viet Nam, expressed a favourable view of a gradualist approach on the basis that many CPEs had limited state capacity to plan and implement rapid reforms. Other directors contended that the ‘shock’ in CPEs resulted from the breakdown of the Soviet system itself rather than from the subsequent ‘therapy’, concluding that in such difficult circumstances adjustment was always going to be painful but rapid reforms would lead more quickly to economic gains. The debate in the Fund revolved around the political economy of the reform process as well as how to achieve the ‘best’ economic outcomes. For instance, Godert Posthumus, the Netherlands executive director who represented several former Soviet republics such as Armenia, Georgia, Moldova, and Ukraine, stated categorically that ‘gradualism was the worst possible advice, because gradual measures strengthened conservative forces and weakened reforming forces’ (IMF, 1994b).

Despite the range of views expressed, the Board was in general agreement on several points. Most directors agreed that the speed and sequencing of reforms in CPEs would have to be assessed pragmatically on a case-by-case basis, and that institutional change would take time to gestate. Several directors also argued that the terms of the ‘shock therapy’ versus ‘gradualism’ debate were misleading and established a false dichotomy (IMF, 1994b). This last point has since been emphasized in the academic literature on post-communist transformation. In particular, scholars have noted that there was often a significant degree of inconsistency between the policy programs of ‘gradualist’ and ‘big bang’ approaches, and that both sought to encourage gradual market-driven institutional change (Marango, 2002: 271).
The IMF under Strain: Economic Transformation in the Soviet Union

Some of the European CPEs, such as Poland and Hungary, had a long history of policy experiments with economic decentralization (IMF, 1989; Borensztein, 1993: 4). In contrast, the Fund faced a much greater challenge in the Soviet republics (Lane, 2004: 54). First, the Soviet CPEs had undergone a much longer period of central planning than the East Central European economies. Second, most of the Soviet republics had no experience with market-based reforms. Third, they were accustomed to having economic policy run entirely by Moscow, and it was initially unclear whether the union institutions would continue to guide economic policy or whether the republics would become independent. Finally, there were vital geopolitical interests involved with the possibility of the Soviet Union becoming a member of the Fund, and compared with many of the European CPEs there was a greater likelihood that the Fund’s dominant member states such as the US would seek to directly influence its relationship with the Soviet authorities.

An overall aim of the Fund is to persuade national policymakers to cooperate with each other in order to enhance international economic integration. In 1991, as a precursor to membership, the Fund and the USSR established a ‘special association’ as a means for the Fund to provide technical assistance and advice to the USSR, to increase the Fund’s knowledge of the Soviet economy, and to begin the process of integrating the Soviet Union into the capitalist world economy. The terms of the agreement stipulated that the Fund would conduct economic reviews of the USSR similar to Article IV consultations, which would be discussed by the Executive Board, with the managing director communicating the Board’s views to the Soviet authorities. The Fund also agreed that the staff would monitor the Soviet reform program and produce analytical reports on reform progress. While the ‘special association’ arrangement did not allow the USSR access to the Fund’s financial resources, it enabled the Fund to provide Soviet officials with economic training as well as technical assistance on a wide range of projects. This included assistance with macroeconomic policies, financial programming, exchange and payments systems, fiscal, monetary, banking, and statistical issues. The main requirement for the USSR was a stipulation that Fund staff be granted access to vital economic information, which would enable the Fund to continually update and enhance its understanding of conditions in the Soviet economy (IMF, 1991b).

The ‘special association’ would enable the Fund to begin more intensive engagement with the Soviet Union following a joint study of reform possibilities for the Soviet economy that
had been conducted by the Fund, the World Bank, the EBRD, and the OECD (James, 1996: 578-9). However, shortly after the G-7 summit that agreed to create the ‘special association’ arrangement as a channel for external assistance to the USSR, the Soviet authorities made an unexpected application for full membership of the Fund and the World Bank to avoid the stigma of ‘second-class citizenship’ in the world economic order. US policymakers rejected this unilateral attempt by the Soviet Union to re-enter the international financial community. The US Senate passed a foreign aid bill amendment that required the US to veto the USSR’s application, while the US Treasury Secretary stated categorically to the press that Soviet membership in the Fund was ‘not going to happen’ (Bradsher, 1991).

During the second half of 1991, the Fund began providing policy advice and technical assistance at both the union and the republic level at the same time as the USSR was experiencing various ‘sovereignty problems’ with regard to the future economic and political relations between the Soviet republics. The Fund staff had their first contact with the Central Asian republics during a mission to the Soviet Union in October 1991 with a visit to Kazakhstan. In his report to the Executive Board on the outcomes of this mission in early November, the managing director, Michael Camdessus, emphasized the need for the staff to organize early initial visits to the other Soviet republics, in order to learn more about their local economic circumstances and to gauge the nature of their relationships with the central Soviet authorities. As an indication of the strain that the Fund’s new activities were placing on the staff, Camdessus recommended a series of major short-term measures to cope with the increasing demand for the Fund’s services. These measures included postponing a number of scheduled Article IV consultations, temporarily placing several countries on biennial consultation cycles, and shifting staff from other departments – including the non-European area departments and the Treasurer’s and Research departments – to alleviate the increase in staff workload. Camdessus also called for the recruitment of additional Fund staff, seconding economists from member governments and from other international organizations, and hiring outside consultants (IMF, 1991c). This led to a surge in staff recruitment to the Fund in 1992 when the Fund almost doubled the number of graduate recruits to the Economist Program, and more than doubled the number of mid-career recruits in order to enlarge the pool of experienced economists, a trend which continued through 1993 (Momani, 2005b: 176).

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3 The Board agreed with the Managing Director’s proposal that the Article IV consultations to be postponed would be those that the European Department was scheduled to undertake with industrial economies (excluding major economies of systemic importance) and other area departments’ scheduled consultations with non-borrowing developing economies.
In late November 1991 the managing director reinforced the scale of the Fund’s challenge to the Executive Board, noting that eight of the Soviet republics had made public commitments to design economic reform programs in consultation with the Fund in early 1992. Camdessus told the Board that ‘with eight programs to prepare, the staff will almost be starting from scratch, except in Russia, in the sense of collecting economic data for the republics, establishing relationships with the key policymakers, and agreeing on economic programs with them’ (IMF, 1991d). As this statement indicates, the Fund recognized that establishing the conditions for ‘IMF friendly’ economic reforms in the Soviet republics was not simply a matter of presenting a fully furnished model for policy change, but would depend upon building good face-to-face working relationships with local policymakers. In sum, the Fund’s influence would depend on its capacity for effective persuasion. The notion that the influence of the Fund is conditioned by its capacity to persuade national actors of the merits of its arguments has been acknowledged by the organization itself, as discussed in Chapter 2, and has also begun to receive more attention in the scholarly literature on the Fund. For example, Woods (2006: 72-3) has argued that the Fund’s success in influencing economic reform in its member states depends upon it finding ‘sympathetic interlocutors’ among a country’s policymaking community, individuals who are willing to listen to what the Fund has to say and to put its ideas into practice. This does not simply involve the Fund seeking out officials who already agree with its ideas, but also fostering relationships with local policymakers that might help to persuade them to become ‘sympathetic interlocutors’, through a process of mutual learning, lesson drawing, and the persuasion of national policy elites into a shared way of thinking about economic problems.

Towards the end of 1991, the Executive Board’s discussions on the USSR focused on the slow progress being made in the negotiation of agreements to settle political and economic relations between the republics, with the Fund trying to gauge whether attempts to establish a new union were likely to succeed or whether the republics would slide further towards independence. A key issue was whether the chain of events then underway would lead to the maintenance of a ‘common economic space’ even if the republics sought greater political independence. Board debates over the future of the Soviet Union and the Fund’s proposals for economic reform were often coloured by the conventional wisdom in economic theory that integration produces more optimal outcomes than independence (see Palei and Petr, 1992).

On the one hand the Fund expected Russia’s economic reforms to provide strong incentives for the other republics to emulate Russia’s policy changes, while on the other hand
the Fund expressed its concern to the Russian authorities about the risk of trade shocks if Russia pursued economic reforms unilaterally without persuading the other republics to follow suit. Engagement with Russia was in full flight by November 1991, with Fund missions including staff from the Central Banking, Exchange and Trade Relations, European, Legal, Statistics, and Treasurer’s departments as well as the IMF Institute. Missions also included representatives from the World Bank, the OECD, the BIS, and Eurostat, together with external consultants and staff seconded from member state central banks (IMF, 1991d). However, despite intensive engagement with Russia relations with many of the other republics remained almost non-existent. As the deputy director of the European Department pointed out to the Board, the staff lacked basic information about the level of political support for economic reform in the individual republics apart from Russia. The Fund began to realize that, if the trend towards separation continued, most of the other republics would face even greater difficulties than Russia if they were suddenly required to formulate macroeconomic policies that had been controlled by the Soviet authorities in Moscow and with which they had no previous experience (IMF, 1991d).

As an initial step towards improving relations with the other Soviet republics, the staff conducted a series of brief missions during December 1991 to ‘introduce the IMF’ to the republics they had not yet visited (1991c). Events were moving fast, and with its staff and institutional resources under strain it is hardly surprising that the Fund struggled to keep up. At a meeting in Kazakhstan later that month, eleven communist party officials signed the ‘Alma-Ata Declaration’ announcing that the Soviet republics were now sovereign and independent and that ‘the USSR shall henceforth cease to exist’, and agreeing instead to set up the Commonwealth of Independent States (Gleason, 1997: 1). From the Fund’s perspective this decision ended the uncertainty over whether the Soviet CPEs would re-establish a political union, but created new challenges and continued uncertainty over the nature of economic relations between what had suddenly become nominally-sovereign and independent states. As the managing director emphasized to the Board in January 1992, ‘In the area of monetary policy, it is painfully apparent that the republics are still feeling their way and do not have the institutional structures or expertise to design and implement an active monetary policy’ (IMF, 1992a). The Fund quickly made plans to send out new staff missions of around two weeks duration to discuss reform programs and Fund membership with policymakers in each republic in early 1992. An exception was made in the case of Uzbekistan, where the authorities had indicated a lack of interest in participating closely with the Fund at that time, which
foreshadowed the difficulties the Fund staff would have in the future in their attempts to establish good relations with Uzbek policymakers (IMF, 1992a).

Adapting the IMF

When the USSR was dissolved, the five Central Asian states of Kazakhstan, the Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan had no previous experience of independent statehood and had only limited experience with economic management. Most of the important economic decisions for the Central Asian republics had been centrally determined in Moscow for the past seventy years. Moreover, policy experiments conducted elsewhere in the USSR during the Gorbachev era, such as in the Baltic republics and the Russian republic, had not been extended to the Central Asian republics (Pomfret, 2006: 1-3). Predominantly agricultural producers, the Central Asian republics had been tightly integrated into a set of privileged trading relationships with the other republics of the USSR, exchanging mostly agricultural goods for over-priced manufactured goods and cheap oil and gas imports (Orlowski, 1993: 1007). The few manufacturing industries that were established in Soviet Central Asia had depended on the guarantee of state purchases and the extension of soft credit for their survival (Chavin, 1994: 161-2). These circumstances left the Central Asian republics with a very high level of trade dependence with the rest of the Soviet Union, and consequently in a poor position from which to build distinct ‘national’ economies (Kaser, 2004: 147).

Although all five new states had identical formal political structures at independence, Central Asian policymakers faced the added challenge of imposing formal institutional change upon strong informal social networks that were accustomed to resisting attempts at top-down change by the Soviet state (Collins, 2006: 332).

The Fund quickly recognized that the process of economic transformation in the frontier economies of Central Asia would pose major new challenges for the organization. Unaccustomed to the particular set of problems this would involve, the Fund had to confront the cognitive and practical challenge of ‘learning to learn’ (see Haas and Haas, 1995). First, the Fund would need to build a capacity to provide advice on day-to-day policy changes, as well as to help with the design of an overall policy reform strategy. Second, it would need to provide extensive technical assistance to help policymakers adapt existing institutions or to build new ones in order to establish a new national structure of economic governance. Third, the Fund would need to oversee a learning process to increase the level of understanding about market mechanisms among policymaking elites, through regular contact by staff missions and resident
representatives as well as through the provision of economic training. To respond to these challenges, the Fund implemented several organizational changes in an attempt to adapt its financial and intellectual resources to the unique needs of the former Soviet republics. Such changes included: (1) establishing a new area department dedicated to focussing on the former Soviet CPEs; (2) creating a new temporary lending facility with low policy conditionality; and (3) cooperating with other international organizations to establish the Joint Vienna Institute to provide economic policy training to officials.

In an Executive Board meeting on 11 December 1991, Camdessus informed directors that he intended to establish a new area department drawn from units in the European Department to consolidate the Fund’s work on the USSR, the individual Soviet republics, and the Baltic CPEs (1991e). The creation of the new area department was unusual as it was the first that would initially deal entirely with states that were not yet members of the Fund (Prowse, 1992). Because the Fund could not lend to states until they became members, in the short term it depended upon rhetorical action, policy advice, and technical assistance to shape the direction of economic policy in the newly independent states of Central Asia. As the director of the new department, John Odling-Smee, explained to the Board on 10 January 1992 the staff was relying on the use of ‘moral suasion’ and intellectual arguments to influence the direction of economic policy in the former Soviet republics, rather than attempting to exercise more direct leverage (IMF, 1992a).

In a report on reform strategies in the former Soviet republics in July 1992 (IMF, 1992b), the staff of the European II Department made it clear to the Board that:

…the Fund must be ready to adapt its policy advice in response to unexpected developments. The enormous changes taking place in the societies and economies of the FSU, the lack of experience of monetary and fiscal policy institutions, the weak statistical and information base supporting policy decisions, and the immature political institutions make the prediction of economic developments and the choice of appropriate instruments unusually hazardous. Mistakes, surprises and setbacks are inevitable, and changing circumstances may call for corrections in course along the way. Program objectives should not be cast rigidly, but should ensure that the process of economic transition maintains sufficient momentum for the FSU economies to achieve a return to stability and growth within a medium-term horizon.

4 The Fund named the new area department the European II Department, with the existing European Department renamed European I. The European II Department was subsequently disestablished in 2003, when Belarus, Estonia, Latvia, Lithuania, Moldova, Russia, and the Ukraine were incorporated into the European Department. Armenia, Azerbaijan, Georgia, Kazakhstan, the Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan were incorporated into the Middle East Department, which was renamed the Middle East and Central Asia Department (IMF, 2003d).
Quoted here at length, this report indicates that the Fund staff with the primary responsibility for coordinating relations with the new Central Asian states recognized that they would have to adapt their advice to suit rapidly changing local economic circumstances. It suggests a recognition that the outcomes of policy actions would be difficult to predict, given the weak institutional capacity of the new states to design and implement macroeconomic policies and the uncertain political and economic environment in the region. Significantly, the above quote also shows that the staff accepted that unexpected setbacks would be an inevitable occurrence in the economic transformation of Central Asia, leading the staff to conclude that the policy benchmarks in loan programs should be flexible enough to maintain momentum for reform without setting the bar too high.

In order to foster the process of economic transformation and to encourage international economic integration, in early 1993 the Fund sought to devise a way to help the former Soviet republics cope with the severe economic shocks caused by the breakdown of existing trade, monetary, and credit relationships among the newly independent states. In the short-term, most of the Fund’s new member states were unlikely to develop economic reform programs that the Fund could support through its regular loan facilities. The Fund therefore sought to establish a temporary lending facility that would help governments to cope with severe balance of payments difficulties, and would constitute the first step towards developing comprehensive ‘IMF friendly’ reform programs (IMF, 1993b).

Compared with standard upper credit tranche drawings or loans under the Extended Fund Facility, the proposed new lending window would come with few policy conditions (James, 1996: 580). The main qualification proposed was the rather ambiguous stipulation that the Fund needed to be satisfied that states would cooperate with staff in devising solutions to their balance of payment problems and in formulating ‘IMF friendly’ policies that could qualify for financial support under the Fund’s regular loan facilities. To establish whether member states met these qualifications, the Fund would assess economies on four criteria. First, the Fund would require that the authorities implement certain ‘prior actions’ in crucial policy areas, the use of which is discussed further below. Second, the Fund would require the authorities to present a policy statement specifying their main macroeconomic objectives for the next year and expressing the intention to design a comprehensive reform program with the Fund. The policy statement would also include an undertaking that the authorities would not tighten existing exchange or trade controls or introduce new multiple exchange rate practices. Third, the Fund would require that policymakers move quickly towards putting in place a quantifiable
quarterly financial program that could be monitored by the staff. Finally, policymakers would have to adopt structural reforms aimed at facilitating the shift to market mechanisms, including price liberalization, the elimination of import subsidies, and exchange rate and trade liberalization. Under the proposed low conditionality loan facility, funds would be phased in over two purchases, with the second purchase available after six months and subject to review by the Board. Approval of the second purchase would be conditional upon a judgment of whether states had implemented agreed policy reforms and had maintained their commitment to cooperate with the Fund, which included making satisfactory progress towards a regular loan program (IMF, 1993b; 1993c).

The application of prior actions that states must achieve before loans are approved is commonly used by Fund staff to test the strength of policymakers’ commitment to achieving ‘IMF friendly’ economic reforms, as well as to help safeguard the use of Fund resources. Prior actions therefore serve as a ‘screening device’ for the Fund, to help staff establish the credibility of a government’s reform intentions before the Fund commits financial resources to a loan program (Thomas and Ramakrishnan, 2006: 8). These constitute explicit benchmarks for states to achieve, and are often identified by Fund staff on the basis of previous Executive Board discussions of a country’s policy settings. At the same time, the use of prior actions provides the staff with an additional source of autonomy from the Executive Board, because staff have the responsibility to define policy preconditions and to assess a state’s compliance without requiring the Board’s endorsement (Martin, 2006: 159-60). Insisting upon the implementation of prior actions provides a way for staff to get around the fact that policy reform can be a long and arduous process, which makes it difficult to achieve the Fund’s policy objectives within the relatively short life cycle of a loan arrangement. As a 1996 staff paper on the rationale for prior actions by the Policy Development and Review and Legal Departments makes clear, the Fund considers that the ‘viability of most programs depends on certain policy measures being in place early in the program period’. Requiring governments to begin the reform process before a loan arrangement is underway is believed to enhance the chances of the program’s success, and helps to increase the Fund’s confidence in a state’s policy intentions by demonstrating the level of ‘the authorities’ determination and political will to implement the program as formulated’ (IMF, 1996a: 1-2).

The formulation of a timetable of specific prior actions that a state will be asked to implement highlights the importance for states of maintaining good relations with Fund staff. While they are guided by previous Board discussions on a country’s policy settings, staff have
the main responsibility for deciding on prior actions based on an assessment of the importance of a particular policy change, the feasibility of it being implemented before a program is in place, and a state’s track record with policy implementation. As the staff report on the use of prior actions by the Fund implies, the process of successfully progressing from prior actions to an IMF loan arrangement might simply involve states learning to use an ‘IMF friendly’ policy discourse rather than actually implementing policy changes in the way envisaged by the Fund. Unlike the strict quantitative performance criteria that are standard fare in loan arrangements, the staff primarily rely upon a state communicating to the Fund when prior actions have been implemented, although if prior actions include legislative changes documentary evidence of the new laws will usually be requested. The Board’s decisions on loan arrangements are not usually made conditional upon the implementation of prior actions, so if a state is subsequently found to have ‘misreported’ its progress on prior actions a loan arrangement will not immediately be affected if it has already been approved, although instances of misreporting might jeopardize a state’s future access to Fund resources either in a new loan application or in the review stage of the existing arrangement. However, in the 1996 report by the Policy Development and Review and Legal Departments the staff concluded that cases of states misreporting their progress in implementing prior actions was rare, which suggests that states usually take into account the benefits of maintaining a consistently good working relationship with the Fund over time (IMF, 1996a: 2-3).

The main rationale for the relatively low level of policy conditions that would be attached to the use of the STF was the need to balance the limited capacity of the former Soviet republics to design and implement rapid policy reforms with the Fund’s desire to effect macroeconomic stabilization and institutional change (IMF, 1995a). Although the Iranian executive director, Abbas Mirakhor, questioned the need for a new loan facility when the managing director first brought the proposal before the Board at the beginning of April 1993, most directors recognized a need for the Fund to develop a new form of assistance for the former Soviet republics (IMF, 1993d). The decision to establish a temporary Systemic Transformation Facility to operate until the end of 1994 (later extended until April 1995) was subsequently adopted on 23 April 1993, in time for the next meeting of the Fund’s Interim Committee at the end of the month (IMF, 1993e).

Between April 1993 and December 1994, eighteen countries borrowed SDR 3.4 billion through the STF. Although it was intended to play a catalytic role in facilitating other sources of external finance, a 1995 staff review of the STF found that the Fund’s assumptions of the
amount of bilateral and multilateral external financing that STF agreements would facilitate were often wide of the mark, leaving significant shortfalls that skewed the outcomes of the programs (IMF, 1995a). The STF did play a catalytic role in facilitating additional external financing for Russia, with up to US$10 billion of loans dependent upon the Fund’s approval of a US$1.5 billion second tranche payment to Russia through the STF in late 1993. However, Russia’s geopolitical importance relative to most of the other former Soviet republics in the early 1990s led the Clinton Administration to apply US pressure on the Fund to relax its enforcement of policy conditions, which softened the influence of the Fund’s direct attempts to generate policy reform by delaying access to its resources (Stone, 2002: 128-9; Woods, 2006: 114-17). As discussed further in Chapters 6 and 7, because of the shortfall in external financing in some countries as well as domestic obstacles to economic reform, the Fund’s experiment with the STF had mixed success in generating the conditions for achieving ‘IMF friendly’ institutional change in Central Asia.

A third way in which the Fund sought to adapt its financial and intellectual resources to the challenges of assisting economic transformation in the former Soviet republics was through the establishment of the Joint Vienna Institute (JVI) in 1992. As advisors who were on the ground in the former Soviet republics during the early years of independence have observed, a major problem facing local policymakers was that Soviet-trained economists had very little understanding of how market mechanisms worked (Pomfret, 2002a: 122). While the Fund’s technical assistance programs have aimed to encourage institutional change and the Fund’s policy dialogue with national authorities aims to foster systemic change in the former CPEs, the Fund has sought to foster social learning and ideational change among individual officials through the JVI and other courses run by the IMF Institute (Nsouli, 2003: 8). The JVI was a joint venture sponsored by the Austrian central bank and Ministry of Finance as well as the Fund, the World Bank, the BIS, the OECD, the EBRD, and the European Commission. The aim of this venture was to collaborate to pool the respective resources of each international organization, although the Fund would initially play the lead role in the new organization. The Fund’s Legal Department was responsible for drawing up the draft statute that established the JVI as an international organization with its own legal personality separate from the sponsoring organizations, and, as Figure 3.1 illustrates, the Fund took on the heaviest teaching load during the first year, drawing on staff expertise from the IMF Institute (IMF, 1992d). Intended to be a forum for transnational learning and to help fertilize the ideational conditions for a transnational central banking culture (Marcussen, 2005: 918), the JVI provides short courses in
economic policy training to mid- and senior-level policymakers and private sector managers in former CPEs, as well as a ten-week course in Applied Economic Policy for junior policymakers. Demand for economic training through the JVI has been high, and since its establishment the JVI has trained approximately 15,000 former CPE officials.

Summary

The international monetary order that post-communist states in Europe and the former Soviet Union sought to enter in the early 1990s was characterized by a strong normative commitment to the principles of current account convertibility and central bank independence. The Fund believed that the implementation of both major monetary changes would be a crucial part of the reform process, as states shifted from central planning to a market-based economic system. Yet despite a clear preference for the rapid international integration of post-communist economies, the Fund’s monetary reform template for transition economies was not simply a uniform blueprint for neoliberal reforms. Rather, the Fund staff produced alternative policy strategies that states might adopt to guard against the severe economic costs that monetary reforms such as current account convertibility might entail, including the temporary use of high trade tariffs to give domestic producers time to adjust to changing economic conditions.
The Fund has been a lightning rod for criticism of the policy failures of the external advice given to states undergoing the transition from central planning to market mechanisms. Leaving aside for the moment the substantial domestic obstacles that the Fund faced in seeking to persuade policymakers to implement ‘IMF friendly’ economic reforms, this chapter has shown that the Fund itself suffered from severe organizational constraints that impeded its ability to do the job that member states expected of it. While the Fund staff and the Executive Board recognized the need to tailor policy reform mixes to local circumstances, chronic staff shortages initially hampered its capacity to build the necessary country-specific knowledge that would make this possible. Staffing constraints also meant that the Fund had a late start in establishing working relationships with local policymakers in the Soviet republics, which would be essential for the persuasion of elites towards a consensus on adopting ‘IMF friendly’ policy reforms and institutional changes. With limited financial resources at its disposal and with most of the newly independent states in no position to apply for funding under its regular loan facilities, the Fund created an innovative new lending window that was intended to provide the assurances necessary to facilitate concessional external financing from other multilateral and bilateral donors. In the event, the Fund’s expectations for the STF to catalyze other sources of official financing were overly optimistic, and many countries experienced significant shortfalls in external financing compared with initial STF projections (IMF, 1995a). Due to the limits on its own organizational resources, the Fund’s response depended upon financial support from other multilateral and bilateral donors to be effective.
PART TWO
The IMF and Monetary Reform in Central Asia
The way money and credit are organized within a particular society and across societies has important implications for the institutional capacity of states, as well as for the life chances of the individuals who live within them (Reddy, 2003). Because the right to issue and validate money provides an important power resource that can be used to expand national economic wealth and military strength, modern centralized states tend to place great importance on maintaining the privilege to control the organization of monetary arrangements within their borders (Dodd, 1994: 31-5; Cohen, 1998: 42-4). Moreover, because monetary arrangements influence how wealth is distributed throughout a society as well as the extent of a government’s policy autonomy from economic decisions taken by other countries, monetary policy choices continue to be regarded as sensitive aspects of state sovereignty despite moves toward the legalization of international monetary relations through the Fund after WWII (Simmons, 2000a; Gold, 1983; cf. Cohen, 1998).

Chapters 4 and 5 explore the regional context in which the Fund sought to persuade Central Asian policymakers to adopt ‘IMF friendly’ monetary reforms. As these chapters show, the political and economic environment in the former Soviet during the period in which the ruble zone common currency area was maintained was characterized by both a ‘logic of appropriateness’ and a ‘logic of consequences. Economic actors continued to act in accordance with extant social norms and relied on interpersonal trust for exchange, but these actions collectively helped to undermine macroeconomic stability. This chapter explores the background conditions that shaped the breakdown of the ruble zone common currency area from 1991 to 1993, and focuses in particular on the social and economic consequences of the haphazard attempts to maintain a monetary union among the Soviet republics after the political union was dissolved. As the following discussion shows, the politics of money became crucial to the process of institutional change in the ruble zone, where money formed a ‘critical nexus’ between economic policy reform and post-Soviet state-building (Abdelal, 2003a: 56).

The chapter proceeds as follows. The first two sections discuss the breakdown of monetary control with the demise of the Soviet Union. This initially led to demonetization and the growth of barter economies, rather than the market-based monetary system that Western
governments hoped could quickly replace Soviet economic institutions. Here I emphasize the social dimension of existing monetary practices and the monetary policy challenges that accompanied the breakdown of the Soviet economy and the chaotic shift from a central planning system. The third and fourth sections focus on the political struggles that characterized the efforts to achieve monetary cooperation in the former Soviet Union. I chronicle the key events in the demise of the ruble zone during 1991 to 1993, and discuss alternative explanations for the inability of post-Soviet policymakers to make the ruble zone work despite their professed commitment to a multilateral solution. As the chapter shows, rationalist and constructivist approaches to institutional change can help to explain different dimensions of the politics of money in the former Soviet Union, which tells us more about the process of institutional change than relying on one approach alone. By combining both perspectives, we can obtain a more comprehensive understanding of the factors that motivated actors' responses to the acute economic uncertainty and the rapid economic changes they faced following the political dissolution of the Soviet Union.

*The Breakdown of Soviet Monetary Control*

People’s beliefs about money and ideas about how monetary rules should be organized have real effects. Monetary systems work best when money is commonly taken for granted as representing a ‘true’ measure of value, and when the system itself has strong collective legitimacy (Seabrooke, 2006a: 191), but there is nothing natural about the contemporary uses of money in everyday life or the institutional frameworks governments devise to regulate such uses. Rather, the creation of money and debates over alternative regulatory frameworks and policy targets are intensely political processes at every step of the way. To borrow Jonathan Kirshner’s (2003: 646) metaphor: ‘Even if all the passengers on an otherwise sound plane don’t think it will take off, it will. But if just enough of the holders of a given currency don’t think an otherwise sound monetary reform makes sense, it won’t fly’. Actors’ intersubjective understandings about a currency – and the actions taken based on such understandings – therefore help to shape aggregate monetary outcomes (Widmaier, 2004: 436).

The shift from central planning to market mechanisms involved a fundamental clash between entrenched intersubjective understandings about the function of money in the Soviet economy and new monetary ideas supplied by the Fund. Unlike aspects of post-communist economic transformation such as privatization and labor market reform, where other international organizations such as the World Bank played the central role, helping its member
states to achieve monetary stability and to cooperate in response to international monetary problems is a core part of the Fund’s mandate (James, 1996: 612). The construction of post-communist monetary systems involved a massive redistribution of financial resources from some groups in society to others, as well as the risk that economic actors would seek to transfer a large volume of wealth overseas (see Brovkin, 2001). One of the most pressing monetary issues during 1991 was the question of whether the ruble would be maintained as the common currency among the Soviet republics, or whether policymakers would choose to adopt independent national currencies with the associated risks of widespread disruptions to inter-republican trade and production networks. As one commentator observed at the time, decisions about the future of the ruble would be a key determinant of the future economic links between the constituent republics of the Soviet Union (Ellman, 1991: 495). With the rapid disintegration of the USSR during the second half of 1991, the politics of money became crucial to the Fund’s ability to influence the process of post-communist economic transformation.

The Fund quickly realized that transforming the structure of economic governance in the former Soviet CPEs to market mechanisms would depend upon fundamentally changing the role that money and credit played in economic activity (IMF, et al., 1990). Under the Soviet system, bank money functioned mainly as a passive unit of account to assess firm compliance with an economic plan designed in Moscow, with cash money mostly used to pay wages and to purchase the consumer goods that firms produced (McKinnon, 1993: 124-5). Interest rates played no role in determining the allocation of credit among economic actors. Instead, firms in the Soviet economy were accustomed to a financial system that set no hard constraints on the extension of credit, with the balance between supply and demand approximated by central planning (McKinnon, 1991: 110). The state savings bank (Sberbank) received household deposits at low rates of interest, most of which were transferred to the State Bank of the Soviet Union (Gosbank). Based on a credit plan and a cash plan decided by the central planning authorities, the Gosbank then determined the volume and allocation of credit to different sectors of the economy, as well as the volume and allocation of cash issuance (Pazarbaşıoğlu and Willem van der Vossen, 1997: 27). The main function of the banking system was therefore to ‘lubricate’ the economy with soft credit, to ensure that firms had access to enough funds to fulfill centrally determined production targets (Bigman and Leite, 1993: 3).

The uncertainty over future political and economic relations between the Soviet republics as well as their different rates of economic reform contributed to growing monetary disruptions
in the Soviet economy during 1991, which only intensified following the political disintegration of the USSR and the emergence of the republics as nominally sovereign and independent states. The decline of central planning mechanisms and other Soviet institutions caused major disruptions to inter-republican trade, which hampered efforts to reach new agreements on economic relations between the newly independent states as well as creating incentives for policymakers in each republic to ignore the agreements that were already in place (Melliss and Cornelius, 1994: 5, 7). The acute uncertainty generated by the rapidly changing environment severely hampered the capacity of firms and households to cope with the ruptures of the economic transition. Russia’s liberalization of 90 percent of prices in January 1992, which was quickly emulated to varying degrees by the other former Soviet republics, immediately led to rapid inflation. In this environment, firms faced a high ‘inflation tax’ on their bank deposits because policymakers continued to maintain nominal interest rates at a very low level (Poser, 1998: 165).

Figures 4.1 to 4.5 trace the monthly rate of inflation in Russia, Kazakhstan, the Kyrgyz Republic, and Uzbekistan as well as the average inflation rate across the four countries from 1991 to 1995. As the figures show, inflation shot up following the shock liberalization of prices at the beginning of 1992, rising from under 15 percent in December 1991 to between 100 and 300 percent in January 1992. In most countries, inflation did not fall below ten percent per month until 1995. Inflation trends in all four countries remained similar during 1991-2 but diverged during 1993-4, before gradually converging again in 1995.
Figure 4.1 Monthly Consumer Price Inflation in Russia, Kazakhstan, the Kyrgyz Republic, and Uzbekistan, 1991

Source: Koen and De Maai, 1997: 27

Figure 4.2 Monthly Consumer Price Inflation in Russia, Kazakhstan, the Kyrgyz Republic, and Uzbekistan, 1992

Source: Koen and De Maai, 1997: 27
Figure 4.3 Monthly Consumer Price Inflation in Russia, Kazakhstan, the Kyrgyz Republic, and Uzbekistan, 1993

Source: Koen and De Mass, 1997: 27

Figure 4.4 Monthly Consumer Price Inflation in Russia, Kazakhstan, the Kyrgyz Republic, and Uzbekistan, 1994

Source: Koen and De Mass, 1997: 27
The breakdown of monetary control in 1992 made a mockery of the Fund’s demand for Russia to commit to achieving a monthly inflation target of 3 percent in the second half of the year in order to help achieve macroeconomic stabilization and avoid a high ‘inflation tax’ (Stone, 2002: 119). Instead, one study has estimated that Russia’s ‘inflation tax’ reached 31 percent of GDP in 1992 (Easterly and Vieira da Cunha, 1994: 13). The rapid rise in inflation contributed to widespread shortages of cash currency throughout the former Soviet Union during 1992, and the inability of firms to pay wages and governments to make pension and social welfare payments in cash prompted economic actors to purchase essential goods on credit wherever possible (Conway, 1997: 7). In such circumstances the exchange value of cash rubles (nalichnyye) and credit rubles (beznalichnyye) diverged, which further depreciated the value of household savings and firm deposits leading to rapid disintermediation, a lack of trust in the banking system, and a consequent growth in barter economies (Poser, 1998: 165). Although price liberalization was intended to stimulate a shift from the central allocation of resources among economic actors to the decentralized allocation of resources via relative price changes, rapid inflation initially impeded the potential for market mechanisms to function at all (Pomfret, 2002: 32).
The Growth of Barter Economies

As firms and households developed survival strategies in response to the crumbling Soviet financial system the newly independent states had inherited, their actions contributed to a swift process of demonetization that worked against official efforts to achieve monetary stability. The contributors to Paul Seabright’s (2000a) The Vanishing Ruble show that demonetization and the rise of barter economies in the post-Soviet states stemmed from two interconnected factors. First, as firms became heavily indebted due to cash flow problems, banks had strong incentives to withhold new loans that might only be used to repay other creditors rather than to enhance a firm’s capacity to repay the bank by investing in productive activity. Large firms facing the problem of ’debt overhang’ sought to induce their suppliers to extend credit for payment in kind, as a way to bypass the claims of existing creditors on cash revenue. Second, because of the uneven distribution of credit constraints among firms in post-Soviet states, allowing some industrial customers to pay for goods through barter still enabled a firm to sell its products for a high cash price to those who could afford to pay with currency. While this strategy helped firms to prop up selling prices and thereby maintain cash revenue that would have been lost if a firm simply slashed its prices to a level that its credit-constrained customers could afford to pay, it hindered policymakers’ efforts to control the rate of inflation (Seabright, 2000b: 5-6).

As Seabright (2000b: 6) points out, post-Soviet production chains were highly conducive to the emergence of barter arrangements because the immediate economic interests of industrial partners in trading networks were interdependent. In addition to inhibiting official attempts to lower inflation, once barter economies had emerged they quickly became an entrenched feature of the economic environment, with firms limiting their operations to a virtual ’information island’ shared by the members of their traditional trading networks. This phenomenon made the job of economic transformation even more difficult as firms sought to shelter from competition within the mutual interdependence of defensive trading networks, rather than reorienting their products toward new customers (Seabright, 2000b: 6-8). While barter trade had also played an important informal role in economic relations between firms during the Soviet era, the currency shortages following price liberalization and the authorities’ subsequent attempts to impose hard constraints on bank credit prompted a rapid growth in barter economies. In a 1999 EBRD/World Bank enterprise survey, 64 percent of Kazakh firms in the sample reported that they had resorted to barter and non-monetary exchange transactions for some sales. The figures were somewhat lower for other Central Asian states.
but still indicated the development of an extensive non-monetary economy, with 53 percent of Kyrgyz firms and 32 percent of Uzbek firms in the sample reporting that they had arranged barter transactions (Carlin, et al., 2000: 214). Rather than embarking on a process of marketization, firms in the former Soviet CPEs shifted toward the *barterization* of their economic relations, which worked against official efforts to achieve monetary stability and structural economic transformation.

Demonetization and rapid inflation in the post-Soviet economies hit most households even harder than firms because they were accustomed to paying for consumer goods with cash. On average, households in the newly independent states of Central Asia experienced falling living standards and rising income inequality as the changes wrought by the breakdown of the Soviet system led to a redistribution of wealth between different social groups, radical changes in people’s life chances, and the abolition of social benefits that people previously took for granted (Pomfret, 2006: 139). In these circumstances informal social organizations, or ‘clans’, became increasingly important as social networks that enabled individuals to meet basic needs and helped to provide the trust necessary for economic exchange in the absence of effective formal rules (Collins, 2006: 50). Like firms, many households relied on strategies of reciprocity to cope with the monetary chaos that characterized the early period after independence, epitomized in the popular Russian proverb ‘better a hundred friends than a hundred rubles’ (Kuehnast and Dudwick, 2004: 13). Such strategies included the reciprocal exchange of gifts consisting of cash money and other everyday necessities, the giving and receiving of help among relatives and friends similar to barter, as well as the exchange of illicitly obtained resources (Nazpary, 2002: 75-81; Coudouel, et al., 1997). Similar to barterization among firms, the strategy of resorting to circuits of mutual obligation within social networks also worked against official efforts to establish new market institutions, as individuals struggled to survive by relying on informal social networks that were geared towards resisting or illicitly profiting from structural economic change (Nazpary, 2002: 89; Collins, 2006: 49). Household survival strategies further undermined the government’s tax base, depreciated the value of firms’ assets, and increased the process of demonetization when households faced with cash shortages withdrew from the formal economy by cutting consumption expenditure and engaging in non-taxable barter activities (Howell, 1996: 57-9; Clarke, 2000: 194-5).

Accompanying the emergence of barter economies among firms, the increase in a refusal to pay for goods led to a rapid build up of informal inter-enterprise arrears, defined as the nominal value of ‘payment demand orders’ not executed by banks due to insufficient funds in
the payer’s account. Following price liberalization in Russia, for instance, firms faced a debt blowout as inter-enterprise arrears increased to 3 trillion ruble during the first half of 1992, at the same time as firms accumulated large arrears on bank loans and tax payments (Bigman and Leite, 1993: 1). Because the Soviet tax system was based on a firm’s revenues and running up tax arrears did not attract interest penalties, firms had an incentive to reduce their taxable revenue through barter and to delay tax payments by reducing their bank balances to benefit from the surge in inflation shown in Figure 4.2 (Noguera and Linz, 2006: 721). This contributed to a severe budget crunch, as the newly independent states faced a precipitate decline in tax revenue at the same time as the demand for public spending increased (Pomfret, 2002: 37). In Russia, local governments began to accept ‘non cash’ tax payments by firms, a practice later accepted by the federal government that led to an estimated 25 percent of state revenue accounted for by ‘in kind’ payments in 1996 (Abdelal, 2003a: 58-9). The growth of inter-enterprise arrears was accelerated via a chain of strategic actions by firms pursuing their immediate economic interests, a situation made worse by the inefficiencies and delays of the paper-based Soviet payments system. Some firms engaged in ‘refusals to pay’ as a necessary survival response to the new phenomenon of rapid inflation and the emergence of credit constraints following price liberalization, causing more firms to suspend their payments when customers refused to pay. Other firms that could afford to settle their accounts with suppliers then suspended payments with the expectation that, in line with existing financial norms, the central bank would be forced to step in and cancel inter-enterprise debts to avoid a systemic economic collapse (Bigman and Leite, 1993: 5-6, 9).

Economic actors continued to exhibit a ‘central planning mentality’ in other ways. For example, firms maintained existing norms of reciprocity in an attempt to reduce the transaction costs of exchange (cf. Ouchi, 1980: 137-8). In particular, firms continued to supply goods and services to each other without expecting to receive payment, assuming that if they reached their production targets the authorities would help them to cover their wage costs (Bigman and Leite, 1993: 9). The erosion of the tax base made this unlikely as governments found themselves increasingly strapped for cash, while the monetary situation deteriorated further when firms began to seek innovative ways to convert rubles into dollars in order to avoid a depreciation of their capital through inflation. Some firms established their own insurance companies or small companies registered overseas as a way to export capital, while others founded their own banks in order to acquire a license to operate on foreign exchange markets where they could exchange their depreciating rubles for hard currency (Poser, 1998: 119).
The weakening of Soviet institutions also led to the growth of ‘uncivil’ economies, where economic actors began to rely on private security forces and the threat of violence as a means to enforce contracts and protect their profits (Clarke, 2000: 178-9; Volkov, 2000).

These micro-level actions by firms collectively obstructed the ability of policymakers to achieve macroeconomic stability from which all ‘viable’ firms would have benefited, as well as diminishing the likelihood that states would see a gradualist approach to the construction of new monetary systems as a feasible policy option, without running the risk of generating even greater economic and social costs. In the variety of firms’ responses to the radical uncertainty they faced following price liberalization in 1992, we see economic actors exhibiting different forms of intentional rationality. Based on a ‘logic of consequences’, a rationalist approach suggests that it was in their material interests for firms to: (a) run up arrears in payments to suppliers and commercial banks, in the expectation of a systemic government bail out; and (b) to delay paying tax to take advantage of high inflation rates, which would rapidly decrease the real amount of tax owed (Bigman and Leite, 1993: 9). The strategy of using the threat of violence to enforce contracts and protect profits can be construed as instrumentally rational in the case of ‘state failure’ in the provision of basic public goods.

The practice of continuing to deliver goods to non-paying customers and thereby maintaining employment levels even when firms could not afford to pay cash wages can also be seen as an instance of instrumental rationality. For instance, firms may have expected to receive government funds to reimburse wage costs they accumulated by continuing to produce and deliver goods to non-paying customers, so maintaining their existing workforce could be accounted for as a strategy to increase the likelihood of systemic debt cancellation by deliberately escalating the level of inter-enterprise arrears (Perotti, 1998). On its own, however, this explanation implies an unrealistic and highly asocial view of the environment to which Soviet firms were accustomed in 1992. A different interpretation is that at the same time as pursuing their immediate economic survival, the behavior of managers in many firms was also prompted by strongly held ‘prescriptive beliefs’ (Boudon, 2003: 14) regarding their obligations to the economic welfare of workers and the role of the state as a provider of easy credit to maintain full employment.

Within the Soviet system, firms held tightly combined both employment and social protection objectives, and were responsible for administering numerous social benefits. Many firms had also created implicit rules that determined what employees could legitimately steal from the workplace to supplement their cash wages (Clarke, 2000: 192). With the shift away
from central planning, World Bank studies of the former Soviet republics found that many managers were initially reluctant to lay off workers due to long-standing social norms of full employment (see, for example, World Bank, 1993). Managers instead allowed employees to develop work-sharing arrangements, or to take unpaid vacations in order to maintain access to social benefits (Silverman and Yanowitch, 1997: 102; Broome, 2006). These normative routines suggest that the behavior of firms, as they responded to rapidly changing monetary conditions, can be understood by considering what would constitute socially legitimate actions based on a ‘logic of appropriateness’ (Seabrooke, 2006a: 45). This does not mean that firm managers themselves necessarily believed that such benefits were legitimate, but rather that they understood that workers considered them to be an integral part of workplace norms, the violation of which might generate material costs for firms if workers responded by engaging in greater theft or widespread industrial conflict. To avoid violating workplace norms, managers acted in accordance with a ‘logic of consequences’ (Sending, 2002: 456).

The Political Economy of the Ruble Zone

These micro-level actions by firms and households collectively led to the breakdown of monetary control across all of the former Soviet republics. Despite widespread agreement among international actors on the urgent need to achieve monetary stability in post-Soviet states in the early 1990s, opinions diverged on whether this would be best achieved by maintaining the ruble zone currency union or the introduction of independent national currencies (Goldberg, et al., 1994; Melliss and Cornelius, 1994). Increasing economic decentralization, driven by the lack of effective policy coordination, caused monetary conditions in the ruble zone to deteriorate rapidly following the formal dissolution of the USSR and Russia’s subsequent price liberalization. In addition, the demise of the USSR created ambiguity among the newly independent states about the status of future economic relations with Russia. This led to local debates over whether post-Soviet states should seek to reintegrate into a common economic space with the Russian Federation, or whether they should go down the nationalist route and seek greater economic sovereignty through monetary independence. The three Baltic states quickly took the latter choice during 1992. The Estonian kroon was introduced as sole legal tender in June, the temporary Latvian ruble was made sole legal tender in July, and Lithuanian talonas became sole legal tender in October (Pomfret, 1996: 120).

Even among the post-Soviet states that continued to seek close economic cooperation with Russia, many governments were wary of Russia further strengthening its regional hegemony.
(Abdelal, 2003b: 913-4). As a result, when the Central Bank of Russia (CBR) assumed the responsibilities of the Soviet Union’s Gosbank in January 1992, despite lacking the same power to make monetary policy across the newly independent states (Johnson, 2000: 77), the governments in the other fourteen post-Soviet states proved unwilling to cede effective monetary authority to the CBR. Formal declarations during 1992 from many of the former Soviet republics intending to continue to use the ruble as a common currency notwithstanding, the lack of appropriate federal institutions and the difficulties of achieving policy coordination among the newly independent states would eventually make this goal impossible to achieve in practice (Daviddi and Espa, 1995: 39).

At first sight, many of the problems that contributed to the monetary instability of the ruble zone can be explained by a rationalist approach. By taking over the responsibilities of the Gosbank, the CBR became the sole issuer of cash rubles in the ruble zone due to the location of all the Soviet printing presses in Russia. However, the fourteen other central banks in the ruble zone at the start of 1992 — established from the republican branches of the Gosbank — were each able to create domestic credit denominated in rubles (Johnson, 2000: 78). As a response to the shortage of cash rubles and Russia’s attempts to restrict the money supply (Pomfret, 1996: 119), the other former Soviet republics began using their new central banks to extend a large volume of credit rubles to local commercial banks and firms during 1992 (Daviddi and Espa, 1995: 40). The authorities in each of the newly independent states in the ruble zone thus confronted a ‘prisoner’s dilemma’ that inhibited effective cooperation, because each stood to gain by maximizing their own interests at the expense of other states (Aslund, 1995: 108). Without enforceable formal rules of the game, policymakers in each state had strong incentives to ‘cheat’ by emitting domestic credit in order to maintain production, thereby enlarging their ‘piece of the pie’ in terms of ruble zone output. Rather than working towards policy coordination to achieve mutual welfare gains, the former Soviet republics engaged in competitive credit creation in response to what observers have described as a classic ‘free-rider problem’ (Pomfret, 2002: 83; Schoors, 2003a: 4).

Increasing credit creation in each of the newly independent states further contributed to rapid inflation across the ruble zone as a whole, which had an uneven impact on the fortunes of different economic actors. For instance, the scarcity of cash rubles and rising prices imposed hard budget constraints on most households as individuals’ cash incomes declined (Silverman and Yanowitch, 1997: 84-5), further hastening the demonetization of the post-Soviet economies as outlined above. Among households, the initial ‘winners’ in the early post-

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Soviet period were workers in energy industries and the financial sector, as well as firm directors and senior managers, who saw their wages increase in both absolute and relative terms. The principal ‘losers’ were the already low-paid public sector workers such as teachers, manufacturing employees in the light industry, machine-building, and metalworking sectors, and workers in agriculture (Silverman and Yanowitch, 1997: 86-7).

For firms whose managers had good personal connections, however, the expansion of credit rubles allowed them to continue to operate within soft budget constraints. Rather than price liberalization enabling markets to allocate credit as the Fund had intended, commercial banks used their new financial freedom and their privileged relationship with the central bank to secure highly subsidized credit, funded by the difference between the high rate of inflation and low central bank refinancing rates. This was used to generate income by passing cheap credit on to favored clients (sometimes in return for bribes), extending credit to firms co-owned by the bank or senior bank managers, and in some cases engaging in financial speculation (Treisman, 1998: 251).

During the period in which the post-Soviet ruble zone was maintained subsidized credit continued to be supplied to firms on a massive scale, although a firm’s ‘creditworthiness’ was determined by the quality of its managers’ personal connections (Tompson, 1997: 1166). Natalia Dinello (1999) has characterized the post-Soviet business culture as ‘the Russian F-connection’ – which involves tight interdependent links between finance, firms, friends, families, and favorites. In response to underdeveloped market institutions and a lack of confidence that formal rules would be enforced, economic actors shunned ‘identity-blind’ transactions and instead chose to do business with well-known customers (Dinello, 1999: 25-6). For instance, a survey of the Russian financial sector in May 1993 found that 92 percent of commercial banks were extending subsidized credit to favored clients with whom they had personal relationships (Treisman, 1995: 949-50). As a result, in early 1993 Russian firms were reportedly able to borrow credit from banks at interest rates that ranged from 30 percent to 240 percent per annum (cf. Figure 4.3 for monthly inflation rates at the time), with total subsidized credit equal to approximately 23 percent of Russia’s GDP in 1992 (Treisman, 1995: 950, 958). Even as the uncontrolled creation of bank credit undermined the sustainability of the ruble zone, many policymakers in the non-Russian republics still sought to remain in the monetary union in the hope of retaining the direct and indirect financial transfers from Russia and easy market access that had characterized the Soviet period (Aslund, 1995: 109).

Following the CBR assuming the Gosbank’s responsibilities, Russia made a number of
changes to inter-republican monetary relations during 1992 in an attempt to achieve monetary stability. In the first half of 1992 inter-republican payments were channeled through ‘correspondent accounts’ set up by the CBR. While in theory the system of correspondent accounts would allow the CBR to limit the extension of bilateral credit to the non-Russian republics, in practice the other republics were initially able to overdraw their correspondent accounts without facing penalties due to delays and inefficiencies in the payments system (The Economist, 1992a). Russia had instructed commercial banks to process all inter-republican transactions through the CBR, but with 1,400 payments centres all processing paper records of transactions independently the system was impossible to monitor. This initially led to the automatic financing of republic overdrafts by the CBR. When the CBR tried to restrict payments to its 82 main branches, continued slow reporting of payments meant that the system remained too congested to enable the CBR to impose restraint on the republics’ correspondent account overdrafts (see Aslund, 1995: 120-4; Schoors, 2003a: 4-5).

These abysmal circumstances were further aggravated by the lack of consensus and sometimes open conflict between Russian institutions that often worked at cross-purposes as a result of their different views on macroeconomic reform, such as sharp policy disagreements between the CBR, the executive government, and the parliament over the future of the ruble zone. In response to the inefficient payments system – and amid accusations that the CBR was using payment delays to engage in financial speculation – the Russian parliament exerted political pressure on the CBR in May 1992 leading to the resignation of the CBR’s chairman Georgii Matiukhin (followed in December by the removal of Russia’s reformist prime minister, Yegor Gaidar), and his replacement by Victor Gerashchenko, who was more willing to extend large volumes of credit to maintain production and to liquidate inter-enterprise arrears (Johnson, 2000: 83-4, 86-89).

As noted above, at first sight the political economy of the ruble zone might seem explicable solely by reference to rationalist theories, and game theory in particular. But comprehending actors’ motivations in this instance as driven primarily by material incentives in the face of an intractable ‘prisoner’s dilemma’ and ‘free rider’ problems would be misunderstanding the social dimension of the politics of money in post-Soviet states. While material incentives, the distribution of benefits, and the potential for illicit financial gains were undoubtedly important factors shaping individual actors’ behavior, an important additional feature of the ruble zone saga is its important place as part of ‘a long struggle over the nature and meaning of money’ in the newly independent states (Woodruff, 2000: 459).
Two facets of this struggle are particularly important here. First, whether intersubjective understandings about the appropriate role of credit could be changed to make credit money symbolically and functionally equivalent to cash money, and hence crucial to attempts to restrain inflation despite the incommensurability of cash money and credit money in the Soviet economy (Woodruff, 2000: 453). Second, whether the role of the state should be circumscribed in such a way that credit would be withheld from ‘unviable’ firms, which would then be forced to make a definitive choice between labor retrenchment and reorienting their trade networks towards new markets or ‘hitting the wall’. Both of these elements of the post-Soviet struggle over the meaning of money worked together, because the passive function of credit money had been tightly linked to employment and production objectives in the Soviet economy.

To be clear, this is not to claim that ‘norms matter more’ than material incentives in explaining the political dynamics of the ruble zone. Rather, the point is to place both a ‘logic of appropriateness’ and a ‘logic of consequences’ side-by-side in order to understand how both operate as symbiotic drivers of political economy outcomes. Along with material incentives, high stakes political struggles over prescriptive beliefs provided an important impulse to monetary policy decisions, as well as non-decisions, regarding the future of the ruble zone during 1992-93. It is also probable that while Soviet-era monetary norms functioned as contextual variables that shaped the behavior of some actors, they functioned simply as utilitarian justifications for others who could appeal to an extant ‘logic of appropriateness’ to disguise their own self-interested behavior. For example, some commercial banks sought cheap central bank credit on the grounds of enabling industrial clients to maintain their labor force and production output, but delayed passing credit on to firms in order to engage in financial speculation (Tompson, 1997: 1171). In both cases, however, understanding actors’ intersubjective prescriptive beliefs is an important step in explaining what animated their behavior, without denying the centrality of self-interested conflict over the distribution of economic resources.

As well as struggles over material benefits and prescriptive beliefs helping to explain policy decisions and everyday monetary practices in the ruble zone, these two sides of the same proverbial coin also help to account for the acute uncertainty that actors faced. For instance, the disagreement among Russian policymakers had the effect of signaling to the non-Russian republics that they could expect continuing economic uncertainty and policy ambiguity, with the CBR continuing to support production by extending credit to ruble zone central banks at
the same time as Russian President Boris Yeltsin’s economic team was attempting to enforce monetary restraint. The maintenance of a system of correspondent accounts that were effectively unmonitored and the divergence in the value of cash rubles and credit rubles created powerful incentives for each state to engage in competitive credit creation. At the same time, the ideational uncertainty and policy ambiguity that was a product of elite disagreements among Russian policymakers further reinforced the advantage for policymakers in the non-Russian republics of seeking to preserve the monetary status quo.

While commensurate with actors’ intentional rationality, this triggered ever-higher economic costs. The benefits of competitive credit creation, in terms of maintaining employment and economic production in accordance with actors’ prescriptive beliefs, accrued to each post-Soviet state individually, while the material costs of increased inflation were distributed evenly across all the ruble zone economies. These ambiguous monetary arrangements – whereby the CBR effectively subsidized inter-republican trade while raising ‘seigniorage’ revenue from the republics – resulted in Russia continuing to be a net contributor to the ruble zone economies. The Fund and the Russian government estimated that Russia financed inter-republican trade to the tune of more than one trillion rubles in 1992 (Goldberg, et al., 1994: 315, fn. 39).

The End of the Ruble Zone Façade

On 1 June 1992, Russia became a member of the Fund and became eligible to access loans, although disagreements over monetary stabilization targets delayed the Fund’s approval of a stand-by arrangement until the beginning of August. While the Fund was unable to induce Russia to agree to collective action that could help to make the ruble zone viable, the government subsequently took new moves to restrict the flow of credit to the non-Russian republics. The CBR decided in July 1992 to enforce fixed limits on the financing of inter-republican trade, set at the amount of rubles the CBR had credited to the importing republic’s correspondent account, with payments now processed centrally in Moscow in an attempt to insulate the Russian economy from ruble zone inflation (Schoors, 2003a: 5). Requiring republican governments to balance their correspondent accounts with the CBR created a market where firms bought republic rubles to pay for imports from each of the ruble zone members, which briefly limited the degree to which inflation fuelled by domestic credit creation in one state was exported to other ruble zone members (Daviddi and Espa, 1995: 40). Instead, the rate of credit expansion in each republic contributed to an effective depreciation
of the value of each republic’s credit rubles, at the cost of restricting the non-Russian central banks’ ability to access cash rubles or to accumulate seigniorage (Goldberg, et al., 1994: 304).

To ease the process of adjustment and to support Russia’s inter-republican exports, the CBR extended new credit lines in the form of ‘technical credits’, which allowed loans to the non-Russian republics to continue to grow from 325 billion rubles at the end of June to 1545 billion rubles at the end of 1992. While the new credit lines helped to soften the blow of the July policy change for the non-Russian republics, the system still had a negative effect on inter-republican trade (Schoors, 2003a: 5-6). The shortage of cash rubles and the emergence of a spread between cash rubles and credit rubles – as well as differences between the exchange value of each republic’s credit rubles – helped to stimulate the harmful speculation that a currency union is intended to mitigate (Conway, 1997: 7). By the end of 1992, the divergence between the respective values of what had become de facto multiple ruble currencies had created mounting pressure for states to establish de jure independent currencies, in order for each state to assert independent monetary control in place of what had now become the ruble zone ‘façade’ (The Economist, 1992b).

Following the example of the Baltic states, which had moved first to introduce independent currencies during the second half of 1992, most of the other former Soviet republics chose to exit the ruble zone and establish new currencies (or temporary ‘coupons’ leading to new currencies) between the end of 1992 and November 1993. As Table 4.1 shows, the Kyrgyz Republic was the first of our three Central Asian states to introduce an independent currency in May 1993, followed by Kazakhstan and Uzbekistan in November 1993 after attempts to agree to new rules to resurrect the ruble zone with Russia had failed.

The killer blow to the ruble zone came in July 1993. On 24 July, Russia announced that a new Russian ruble would become sole legal tender inside Russia from September and the banknotes of old pre-1993 Soviet rubles would become invalid. The CBR had begun issuing the new banknotes in Russia at the beginning of 1993, but had not included them in cash shipments to the other republics (Abdelal, 2001: 53). Russia adopted this radical change in ruble zone policy unilaterally without discussing the move with the other ruble zone members or consulting with the Fund (IMF, 1993f), which immediately prompted Azerbaijan, Georgia, Moldova, and Turkmenistan to announce plans to introduce new currencies (Abdelal, 2001: 54-5). Russia had used its dominant position of power as the other republics’ main export market and the sole issuer of cash rubles to unilaterally change the monetary ‘rules of the game’, as well as altering the ‘payoff matrix’ that determined the distribution of material
benefits in the ruble zone (cf. Krasner, 1991: 340-2). As each state introduced a new currency as sole legal tender and exited the ruble zone, it increased the inflationary pressure on the remaining members due to old Soviet rubles flowing out of the states that exited the ruble zone and into neighboring states where the ruble remained legal tender (Conway, 1995: 41).
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<th>Country</th>
<th>Date of IMF Membership</th>
<th>Date of New Currency</th>
<th>Sole Legal Tender</th>
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Source: Snoek and van Rooden, 1999.
If the intention of Russian policymakers was to force the other republics out of the ruble zone entirely, the July policy change did not immediately have this effect. Five post-Soviet states, including Kazakhstan and Uzbekistan, remained publicly committed to a 'ruble zone of a new type' (rublevaia zona novogo tipa). These states signed bilateral monetary agreements with Russia during September 1993, in which they effectively agreed to centralize the power to make monetary policy in Moscow. However, when Russia tightened the entry conditions for states wishing to use the new Russian ruble as a common currency even further in November, the cost of staying in a revamped ruble zone became too high. Russia proposed providing cash rubles to the republics that would be recorded as credits for an initial trial period of six months, on which the non-Russian central banks would be required to pay interest and to deposit half the value of these 'credits' with the CBR in hard currency or gold for security. Pre-1993 Soviet ruble banknotes would be exchanged for the new Russian ruble banknotes at the unattractive rate of approximately three to one (Abdelal, 2001: 56-8). If the non-Russian republics had accepted the conditions that Russia set out for membership in the ruble zone, they would have greatly increased their monetary dependence on Russia (cf Kirshner, 1995: 116-17). In particular, the new concessions Russia demanded for continued participation in a monetary union would reverse the republics' capacity to extract wealth from Russia through subsidized credit and domestic credit creation, and would consolidate monetary power over the ruble zone members in the CBR. These terms proved to be unacceptable to the governments of the five remaining non-Russian republics and the faltering ruble zone finally collapsed.

With the benefit of hindsight, Anders Åslund (2002: 50) has described the initial effort to maintain the ruble zone as having proved to be 'the worst single mistake in the post-communist transition in terms of its costs' for all the former Soviet republics. Within scholarly literature on the demise of the ruble zone there are two markedly different interpretations of the circumstances that led each of the newly independent states of the former USSR to exit the ruble zone and introduce national currencies. The first, and by far the most dominant, primarily focuses on the failure to establish an effective inter-state monetary institution to oversee a unified monetary policy among the former Soviet republics, combined with the inflationary conditions caused by having a single issuer of cash rubles but multiple issuers of credit rubles. Here institutional failures, disagreements over the distribution of seigniorage revenue in draft proposals for a single monetary authority, and the material incentives for 'free riders' to issue credit are seen as the main factors that assisted in the breakdown of the currency union. The decision to introduce national currencies is therefore explained as primarily driven by each state's calculation of
the perceived economic costs and benefits (see Goldberg, et al., 1994; Daviddi and Espa, 1995; Pomfret, 1996: Chapter 9). Some of the scholars who support this explanation sharply disagree on the role of the Fund in the demise of the ruble zone (cf. Aslund, 2002; Granville, 2002; Odling-Smee and Pastor, 2002; Pomfret, 2002), but they all agree on the set of variables that caused this particular outcome.

A second interpretation of states’ decisions to exit the monetary chaos of the ruble zone during 1991-93 is provided by Rawi Abdelal (2001, 2003a, 2003b), who supplements explanations based on material incentives with a focus on the importance of political debates over ‘national identity’ in the former Soviet republics. In the Central Asian states, the collective interpretation of ‘national identities’ was either ambiguous or was highly contested in the early post-Soviet period, which helps to explain Kazakhstan and Uzbekistan’s willingness to remain in a Russian-dominated ruble zone even after Russia resorted to power politics with its unilateral policy changes in July 1993 (Abdelal, 2001: 81). The Kyrgyz Republic’s haste in departing from the ruble zone earlier than its Central Asian neighbors is put down to the influence of the Fund (Abdelal, 2001: 50), which by 1993 had changed its tune and was advising the newly independent states to introduce new currencies as a pre-requisite for achieving monetary stability, discussed further below.

With the structure of material incentives working against inter-state cooperation and policy coordination, and the emergence of nationalist pressures for greater independence and monetary sovereignty in many of the post-Soviet states, the ultimate failure of the ruble zone seems from today’s vantage point to have been almost inevitable. As Barry Eichengreen has observed (1996: 7), with the notable exception of the Bretton Woods system, monetary agreements do not usually result from inter-state negotiations but are the product of the individual choices that governments make, with policymakers ‘constrained by the prior decisions of their neighbors and, more generally, by the inheritance of history’. The case of the ruble zone seems to bear out this point remarkably well, highlighting the importance of inherited monetary norms as well as the need for governments to react to the monetary policy decisions taken by neighboring states. It should also give pause to critics of the Fund who argue that the organization did not do enough to achieve monetary cooperation among the former Soviet republics. As the above discussion indicates, it is not feasible to suggest that the Fund should have sought to impose a solution to the unfolding ruble zone crisis on the former Soviet republics after the dissolution of the USSR in December 1991. With the emergence of nationalist pressures and the desire for greater independence and monetary sovereignty in many of the post-Soviet states – or at least independence from the Russian Federation – it is unlikely that the Fund could have successfully coerced a critical mass of the ruble zone members to implement a new
framework for effective monetary control and cooperation. In any case, its Articles of Agreement prevented the Fund from attempting to do so. Therefore, the important question to ask is not ‘why didn’t the Fund do more?’, but rather, during the collapse of the ruble zone, what was the Fund’s advice and how did it influence the post-Soviet states? This is addressed in the following chapter, which explores the evolution of the Fund’s thinking and its advice on monetary developments to the former Soviet republics, and highlights how the Fund’s influence was constrained by political realities on the ground as well as by the way that it interpreted the limits of its authority.

Summary

This chapter has highlighted the complex nature of the monetary challenges facing the former Soviet republics as they attempted to construct a functioning new common monetary system following the demise of the Soviet Union. With the breakdown of monetary control in the former Soviet Union, barter economies emerged, as credit-constrained firms and households relied on reciprocal exchange arrangements that were informed by extant social norms, in response to rapid inflation and the shortage of cash rubles. The intentionally rational actions of firms and households further worsened the process of demonetization in post-Soviet economies, thereby undermining official attempts to establish macroeconomic stability and maintain tax revenues, leading to the growth of illicit economies. In these circumstances, the governments of the newly independent states faced strong incentives to engage in competitive credit creation to help maintain production and employment levels and to secure material gains at the expense of other ruble zone members. Despite being rational responses to the immediate economic circumstances that governments faced and reflecting the inherited conventions and social norms that had shaped the operation of the Soviet system, these official actions gradually eroded the advantages of maintaining the ruble zone. When the Russian government sought to monopolize monetary power over the remaining ruble zone members in the second half of 1993, the material costs and the loss of policy autonomy generated by continued participation became too large a sacrifice for most of the non-Russian republics.

Both rationalist and constructivist approaches help to explain different dimensions of the political economy of the ruble zone during 1991-93, where developments were driven both by individual actors’ immediate economic interests (a ‘logic of consequences’) and their prescriptive beliefs based on long-standing intersubjective economic norms (a ‘logic of appropriateness’). Specifically, the politics of money in the ‘common economic space’ of the Soviet Union was driven by the set of material incentives that different actors faced as well as by Soviet-era regulative norms regarding the appropriate role of the state and the
passive function of money in maintaining production output and employment levels. While governments may implement the formal architecture for a new monetary system by fiat, actors’ beliefs about how monetary rules should be organized and the survival strategies they employ in response to acute uncertainty in a rapidly changing economic environment can diminish the effectiveness of formal changes, and can undermine the political conditions necessary for inter-state monetary cooperation to be sustained.
Dismantling the Soviet Empire

The ultimate collapse of the ruble zone in November 1993 heralded the introduction of new national currencies in the remaining non-Russian former Soviet republics that had continued to rely on the ruble, despite a complete lack of experience with monetary independence within their territorial borders. It also represented the conclusion of one of the last major chapters in the historically unique process of dismantling the Soviet empire, nearly two years after the political dissolution of the Soviet Union. This chapter traces the Fund’s role in the process that led to the abandonment of attempts to maintain a monetary union among the former Soviet republics. As discussed in Chapter 4, the official process was driven by political disagreements among the former Soviet republics and conflict among different political actors within Russia over the terms of future monetary cooperation in the former Soviet Union, as well as disagreements over whether a continued monetary union was even a desirable goal. The monetary environment in which multilateral negotiations between the former Soviet republics took place was shaped by the micro-level actions of firms and households that contributed to rapid inflation and demonetization. These actions in turn helped to undermine the government’s tax base in most of the newly independent states at the same time as public demands for social spending, subsidized credit, and debt cancellation increased.

Following on from the discussion in Chapter 4 of the context within CPEs during the demise of the Soviet Union, this chapter explores the Fund’s reasoning and advice to CPEs while they remained in the ruble zone. As the chapter shows, the Fund’s actions did not automatically flow from the preferences of its dominant shareholders. Rather, the Fund had to reason through how it should advise states on monetary reforms in the volatile environment that followed the dissolution of the Soviet Union, which informed the case for policy persuasion in the post-ruble zone era that is detailed in the following chapters. This chapter establishes that the Fund is an intellectual actor with significant sources of tactical independence, rather than simply an agent of its member state principals.

The chapter proceeds as follows. The first section provides a brief overview of the rationale for the Fund’s advice on monetary reforms to post-Soviet states, and discusses the severe collective action problem the Fund faced in attempting to foster multilateral monetary cooperation. The following three sections trace the internal debates within the
organization to show how the Fund’s thinking evolved over the period from 1991 to 1993. Here I show that the Fund was constrained by how the Board and the staff interpreted the limits to the Fund’s authority with regard to the policy choice of whether governments should remain in the ruble zone or introduce new national currencies.

By determining that the decision on the ruble zone was a ‘sovereign’ choice for the newly independent states to decide themselves, the Fund restricted its role to providing advice to post-Soviet policymakers on: (1) the potential economic benefits and costs of both actions; and (2) the necessary institutional changes for either monetary union or monetary independence to be successful. The Fund therefore sought to influence governments’ monetary decisions at a macro level by defining the policy choice set they had at their disposal. In doing so, the Fund faced the steep challenge of formulating appropriate advice in an environment of acute uncertainty and policy ambiguity, which impeded the Fund’s analytical capacity to evaluate monetary conditions in the former Soviet republics as the relationship between formal monetary rules and financial behavior became further attenuated.

Too Many Cooks Spoil the Broth: The IMF and the Ruble Zone Crisis

The Fund’s initial advice on currency reform to the former Soviet republics was informed by two key assumptions. First, the Fund expected that regional monetary cooperation to maintain the ruble zone could be achieved, given the long-standing governance ties and economic interdependence between the newly independent states. Second, the Fund initially believed that maintaining the ruble zone would be the best possible outcome for the former Soviet republics because it would help sustain the level of economic production and trade, a belief that was also shared by other international actors such as the European Commission (Aslund, 1995: 110-11).

This assumption was based on the theory of ‘optimum currency areas’ (Mundell, 1961; McKinnon, 1963), which hypothesizes that a currency union between multiple countries can help to improve the welfare of each country above the level that would be expected if states maintained independent currencies (Grubel, 1970: 319; Ricci, 1997: 33). For instance, a common currency area eliminates the uncertainties associated with currency risk to interstate trade and investment among member countries, and enlarges the potential market available to all producers, thereby enabling firms to achieve economies of scale through product specialization. Deepening foreign exchange markets through a currency union can also help to alleviate the potential for harmful currency speculation and exchange rate fluctuations, as well as contributing to domestic price stability by providing a ‘nominal anchor’ for economic actors’ price expectations and establishing a source of discipline on

Despite the Fund’s initial assumptions about the economic benefits of maintaining the ruble zone, and leaving aside for the moment the substantial political obstacles this would entail, some observers have since argued that these expectations were ill founded. Several economists have suggested that because Soviet trade networks reflected the legacy of allocating resources through a non-market system, a large amount of inter-republican trade was not rational and therefore arguments in favor of maintaining a common currency area to avoid trade shocks did not apply in the post-Soviet era (Dąbrowski, 1997; van Selm and Wagener, 1995: 31). Even before Russia’s price liberalization, several foreign economic advisors to the Russian government disagreed with the Fund’s stance and urged policymakers in late 1991 to move quickly to isolate the Russian ruble from the rest of the former Soviet Union. The foreign advisors argued that the other post-Soviet states should only be permitted to remain in a currency union with Russia if they agreed to the establishment of a single monetary authority (Åslund, 1995: 114), bringing to the fore the political constraints that a continued monetary union would involve for the non-Russian republics. At the beginning of 1992, however, the economic space of the former Soviet Union seemed to be especially fertile ground for the maintenance of a common currency area due to inter-republican trade being much greater than external trade (Pomfret, 1996: 118). As a result, most observers implicitly assumed that the existing monetary arrangements that had operated under the Gosbank would remain broadly unchanged (Melliss and Cornelius, 1994: 9).

The Fund’s initial advice was also informed by an awareness that most of the new states lacked the necessary institutional capacity to design and implement independent monetary policies. In particular, Soviet-trained policymakers often had a poor grasp of how market-based monetary systems work. Many national officials in post-Soviet states initially failed to comprehend the dangers associated with inflation (Pomfret, 2002: 35), or saw no contradiction between attempting to restrain inflation at the same time as they extended a large volume of subsidized credit to firms because they were used to understanding credit as simply a unit of account that was quite distinct from cash money (Johnson, 2000: 79). With the establishment almost overnight of fifteen new central banks, staffed by Soviet-trained officials, most of whom had little familiarity with market-based monetary policies, the Fund was concerned that officials should undergo an initial period of policy learning about market mechanisms before considering the introduction of new national currencies (Åslund, 1995: 111).

Like other international monetary challenges the Fund has faced in its history (see, for example, James, 1996: 421-32), the ruble zone crisis that developed during 1992 and 1993
illustrates the difficulties an international organization faces in its attempts to promote inter-state policy coordination when national policymakers continue to pursue domestic priorities that inhibit the chances for successful collective action. The existing literature on IOs suggests that we can expect the Fund to have a hard time encouraging cooperation among its member states to realize collective welfare gains in the future when non-cooperation may yield greater benefits in the short-term (Koremenos, et al., 2001: 776). Although the Fund was set up to achieve precisely this purpose, it has become especially difficult for the Fund to achieve inter-state monetary cooperation in the post-Bretton Woods era. As Michael Oliver (2006: 114) observes, the Fund must now ‘play the role of headmaster in a school of unruly pupils who refuse to sit still, become easily distracted and irritable with each other, and have considerable difficulty in behaving harmoniously’.

In addition to facing a severe collective action problem, the Fund also had less room to maneuver in the case of Russia compared with the other former Soviet republics, especially after senior officials in the US administration publicly called for the Fund to relax its policy conditions for Russia in December 1993 (Stone, 2002: 129). Nevertheless, as discussed further below, the Fund made concrete efforts to engage its ‘unruly pupils’ in the ruble zone as a purposive actor in its own right and not simply as an agent of its dominant member states (Barnett and Finnemore, 1999: 700). The Fund designed proposals for common rules that would address the newly independent states’ collective action dilemma by delineating economic responsibilities and monetary authority among the ruble zone members and defining the work of their central banks. But when dealing with states in an environment characterized by low levels of trust and monetary competition, in the short-term the Fund’s direct influence over policy choices is quickly diluted if states refuse to play ball. The Fund might be more influential by gradually helping to persuade policymaking elites to adopt a shared way of thinking about economic problems and a shared normative orientation toward ‘civilized’ standards of monetary and financial conduct (Best, 2006: 143; cf. Simmons, 2000a: 584). But this incremental process can take a long time to come to fruition, and is therefore of little help when the Fund is called to act as a ‘firefighter’ in response to immediate monetary challenges such as the ruble zone crisis.

To the casual observer, it might seem that the Fund had a somewhat ‘schizophrenic’ position on monetary policy in the ruble zone during 1991-93. The Fund appeared to shift from strongly advising the Soviet republics to maintain the ruble as a common currency in 1991 in order to mitigate the damage of substantial trade shocks, to equivocating over whether the newly independent states should introduce national currencies in 1992, to demanding that states exit the ruble zone and introduce separate currencies in 1993. The remainder of this chapter traces the development of the internal debates within the Fund,
both at the staff level and at the level of the Executive Board, in order to show how the Fund’s thinking on monetary policy in the ‘common economic space’ of the Soviet Union evolved from 1991-93.

The Problem of Sovereignty: 1991

A staff paper prepared by the Fund’s Research Department in May 1991 for the Executive Board spells out the broad thinking of Fund staff towards the potential benefits of currency unions (IMF, 1991f). For Fund staff, the main function of money in relation to the debate over ‘optimum currency areas’ was that the widest possible use of a single currency, provided its value is stable, could help to increase economic efficiency by minimizing the transaction costs of exchange and reducing uncertainty among economic actors. In particular, the staff paper argued that the social benefit of money is enhanced by price stability, which rests on the credibility of a government’s monetary policy framework. While the report largely focused on the proposals for an economic and monetary union in Europe, the staff paper also suggested that if the Soviet republics moved to introduce separate currencies this could generate a high level of uncertainty among economic actors because of the long history of inter-republican economic integration. The staff concluded that in addition to lowering transaction costs, currency unions can help to discipline economic behavior and can enhance policymakers’ credibility where a central monetary authority is able to commit to achieving low inflation. Even at this early stage in ruble zone developments, however, the Fund staff flagged the potential for high inflation and uncontrolled credit expansion in the ruble zone to increase the pressure for the republics to introduce independent currencies (IMF, 1991f).

Discussing the staff paper in a Board seminar in July, executive directors emphasized the insufficient attention the staff paper had given to issues of political sovereignty and the need for a high degree of political consensus to enable currency unions to function effectively (IMF, 1991g). Sustained political support is a crucial ingredient for a monetary union to be successful. As Benjamin Cohen (1998: 84) argues, in any attempt to achieve a successful monetary union ‘economics may matter, but politics matters more’. Cohen suggests that two particular political factors are relevant here. First, whether there is a dominant state, such as Russia in the case of the ruble zone, which is prepared to act to maintain a monetary union based on conditions that each member state will consent to. Second, whether there is a sufficiently dense set of institutional linkages and a shared sense of ‘community’ among member states that compensates members for the loss of policy autonomy that a monetary union entails. Cohen (1998: 87) concludes that where these two political conditions are absent, monetary unions will fail. By neglecting the need for
political support, the Fund staff presented an economic case for sustaining a monetary union between the Soviet republics, while overlooking the significant political obstacles that would eventually bring about the ruble zone’s collapse. This is perhaps unsurprising, however, as we might expect the staff to frame the debate in terms of the technical requirements for and the economic costs and benefits of currency unions in order to play to their institutional strengths, while the nature of the Board means that executive directors are more predisposed to engage in explicitly political discussions.

As an organization with clear rules for engaging with its member states and a strict decision-making hierarchy, the Fund often finds it difficult to respond to unfolding events rapidly. This point is aptly illustrated by the Executive Board’s discussions on the Fund’s relations with the Soviet Union in late 1991. Although the Fund had been working on the assumption that the single economic unit of the USSR would remain intact, the managing director reported to the Board in November that a mission to the USSR the previous month ‘was struck by the accelerating deterioration and dismemberment of union-level economic structures, combined with growing republican assertiveness and expressions of national autonomy’ (IMF, 1991c). In particular, the managing director drew attention to the political difficulties of achieving agreement on inter-republican economic relations because of the declining authority of union-level institutions, with the non-Russian republics reluctant to accept the Russian Federation simply assuming control over the USSR’s levers of power.

In a Board meeting on 6 November, the German executive director, Bernd Goos, pushed for a clear identification of the general strategy the Fund would pursue in assisting with the process of economic reform in the USSR, and for clarification on whether the Fund would present a clear opinion on the choice of maintaining a common monetary system. How the Fund should act in accordance with its mandate in this instance was not unambiguous (see Hawkins and Jacoby, 2006: 207). Rather, the Fund had to reinterpret its mandate in order to determine the appropriate limits to its authority over a country’s choice between monetary independence and continued monetary union. The managing director’s reply to the German executive director indicates the difficulties the Fund faced in grappling with these questions, especially due to their significant geopolitical implications that closely concerned its dominant member states. He stated that the Fund wished to avoid the perception that it was ‘presupposing a particular solution to the problems of sovereignty’ the USSR was experiencing and therefore needed to exercise flexibility until this major political decision was resolved, and in the meantime should restrict its role to providing advice on the benefits and costs of alternative policy options. Presciently, the managing director pointed out that while the Fund could make available its pool of
comparative policy knowledge on currency unions, 'the Fund's theoretical views about the optimal size of a monetary union or economic space would not be a predominant consideration in the solution that ultimately prevailed'. This clearly demonstrates an appreciation by the Fund's management that while the organization operates at the nexus between politics and economics, its mandate – as well as the juridical sovereignty of its member states – prevents the Fund from overly seeking to exercise direct influence over such crucial political decisions (IMF, 1991c). Concern about the appropriate limits to the Fund's authority in this matter was not the only consideration in the Fund’s internal debates over whether to advise post-Soviet states to introduce new currencies. Commenting in a subsequent Board meeting at the end of November on the scale of the challenge the Fund faced in the USSR, the managing director emphasized that the staff would initially focus on providing advice on fiscal reforms in each republic rather than monetary policy. This was because ‘in the short term it would be unrealistic for the republics to attempt to introduce separate currencies’ due to a lack of institutional capacity and technical know-how to operate market mechanisms (IMF, 1991d). In response to the managing director’s remarks, the executive director of the Iranian constituency expressed concern that the Fund was not advising the republics to establish independent monetary systems given that the apparent trend towards economic decentralization might make such a move inevitable. This prompted the deputy director of the European Department to clarify to the Board that the Fund’s position was not to insist on the maintenance of the ruble currency union, but rather to provide advice to the republics on the technical preparations, policy learning, and institutional changes that would be required should policymakers wish to introduce independent currencies.

For Central Asian policymakers, the demise of the ruble zone and the introduction of independent currencies would involve a shift from ‘strategic uncertainty’, where actors knew what they stood to gain from ruble zone participation, to ‘analytical uncertainty’, where the distribution of costs and benefits from alternative policy decisions might be unknown (Iida, 1993: 433-4). Under analytical uncertainty, policymakers would be entering a ‘brave new world’ where both the ‘rules of the game’, and the potential outcomes from different policy choices, were unclear. However unsatisfactory the ambiguity of the situation was, the deputy director informed the Board that the Fund ‘was approaching the immediate need for macroeconomic policies and economic reform on the assumption that the single currency might continue for a while’. The Fund’s lack of knowledge about local conditions was a key factor here that inhibited its capacity to provide timely advice. The deputy director emphasized that the Fund ‘did not have full information’ about Russia’s monetary policy intentions towards the other republics, and had even less information
about the economic plans of the non-Russian republics (IMF, 1991d).

Following the return of a diagnostic staff mission to the USSR by the Central Banking Department, the managing director reiterated to the Board in early December 1991 the high level of uncertainty regarding monetary policy that characterized developments in what proved to be the final days of the USSR. The managing director noted that the central banking mission had found that central banks in Russia, the Ukraine, Belarus, and Kazakhstan as well as the State Bank of the USSR were not adhering to any overall framework for the coordination of inter-republican monetary policy, which was contributing to a breakdown in monetary control. As the managing director again emphasized to the Board, the republican central banks had limited institutional capacity and in order to manage a market-oriented monetary system they would need to be rebuilt ‘almost from scratch’ (IMF, 1991e).

Confusing Signals: 1992

Following the initiation of Russia’s reform program with the liberalization of prices at the beginning of 1992, the Fund staff voiced their concern to the Russian authorities that the lack of a clear monetary policy would lead to high inflation in the ruble zone. In response to executive directors’ questions on the reform of payments arrangements among the former Soviet republics during an Executive Board meeting on 10 January 1992, the managing director informed the Board that the Fund’s role would be to ‘help to design and implement, in a flexible manner, mutually consistent monetary policies in each republic’. The managing director again reiterated that the ‘final sovereign choice’ between remaining in the ruble zone and adopting an independent currency would be up to the authorities in each of the newly independent states (IMF, 1992a). The Director of the new European II Department, John Odling-Smee, reported to the Board that the staff mission to Moscow in November and December 1991 had ‘stated unequivocally… that the fiscal and monetary policies being conceived at that stage were not tight enough, and that there was a severe risk of inflation getting out of control’. The Director of the European II Department noted that Russia’s financial authorities had reacted positively to this assessment, and had ‘agreed with the Fund’s thinking’. Because Russia and the other former Soviet republics were not yet members of the Fund, the staff was relying on ‘moral suasion’ and ‘intellectual arguments’ to influence the course of economic policy decisions in the newly independent states (IMF, 1992a). At the same time, through the IMF Institute, the Fund was actively engaging in the diffusion of programmatic ideas about how to run market-based monetary systems by providing macroeconomic training to central bank officials. In early 1992, this included a three-week course in Moscow in January for twenty-five central bank officials.
from eight of the former Soviet republics, as well as training officials at the IMF Institute in Washington (IMF, 1992e).

Similar to the situation at the end of 1991, in 1992 the Fund continued to have difficulty evaluating monetary policy in Russia, and noted that effective credit control in some of the republics had almost entirely broken down in the absence of inter-republican monetary cooperation and policy coordination. The challenge of enhancing the Fund’s understanding of monetary policy in Russia and helping the Russian authorities to establish monetary control would prove crucial to efforts to improve inter-republican monetary relations. As a result, and because of the continuing lack of information about economic policy decisions in many of the non-Russian republics, Executive Board discussions about the former Soviet Union focused predominantly on developments in Russia in the first quarter of 1992.

In February, the managing director reported positively on his face-to-face discussions with Yegor Gaidar, the First Deputy Prime Minister in charge of Finance and Economy for Russia, and noted that Gaidar himself ‘had no difficulty with the prescriptions of the Fund’. Illustrating the perceived importance of the Fund’s engagement as a way for states to signal their policy credibility to international audiences, the managing director communicated to the Board that Gaidar ‘was particularly knowledgeable of the central role that the Fund was playing in helping the international community to pass judgment on Russia’s reform efforts and in catalyzing external support’. Significantly, the managing director observed that ‘it was not clear… that Russia’s parliament enjoyed the same degree of understanding’ (IMF, 1992e). The remarks by the managing director, which were reinforced by the UK executive director who had recently met Gaidar in London and the alternate executive director representing Austria who had met Gaidar in Vienna, indicate that the Fund saw Gaidar as a man with whom they could do business, in accordance with Woods’s (2006: 72-3) concept of ‘sympathetic interlocutors’. The Executive Board’s discussions make clear that the Fund’s governing body saw its role in the former Soviet republics as strengthening the hand of domestic reformers in debates over economic reform, by opening a gateway for reforming states to enter the capitalist world economy and become legitimate members of the international monetary order. As a further illustration of this point, the UK executive director remarked that the Fund should ‘send a signal to the reformers’ in post-Soviet states that adoption of ‘IMF friendly’ policies would open up other forms of international assistance, such as debt relief through the Paris Club process and multilateral lending by the World Bank (IMF, 1992e).

To place the Fund’s role in the protracted demise of the ruble zone in the wider political context, it is important to acknowledge the public commitments and rhetorical signals that
the former Soviet republics communicated to the Fund regarding their monetary policy intentions, especially on the part of Russia. Here we discover one of the reasons the Fund had for continuing to discuss the possibility of maintaining a ruble currency union during 1992, bearing in mind the Fund’s stated position that the final choice over whether to remain in the ruble zone or to introduce separate currencies was a sovereign decision for the states themselves. For example, when the Executive Board met at the end of March 1992 to discuss the staff report on Russia’s Pre-Membership Economic Review, a Russian delegation present at the meeting gave the Fund a clear indication that Russia intended to maintain the ruble zone through inter-republican monetary cooperation. The delegation was led by Konstantin Kagalovsky, the Plenipotentiary Representative of the Russian Government for Interaction with International Institutions, who clearly stated to the Board that Russia wanted to ‘maintain a common economic space’ among the former Soviet republics (IMF, 1992f).

In the debate that followed, executive directors strongly emphasized the urgent need for Russia to establish an effective monetary framework. The main issue for the Board was the need for the Russian authorities to establish monetary credibility by eliminating the policy ambiguity that characterized the current situation. The Board’s recommendations on how to achieve this included measures to build public confidence in the CBR’s willingness to exercise tight monetary control, by establishing positive real interest rates and enforcing hard limits on the extension of central bank credit to the government and firms. In terms of the objective of maintaining a ‘common economic space’ in the former Soviet Union, executive directors highlighted Russia’s unique role as a regional hegemon and noted that the Russian authorities therefore had ‘special responsibilities’ to help coordinate monetary and exchange rate policies in the ruble zone (IMF, 1992f).

In May 1992, the Fund sent a staff team to Tashkent to participate in a meeting of the Interbank Coordinating Council of Heads of Central Banks, which had earlier been created at a meeting in Bishkek to provide a multilateral forum for discussion of monetary and credit policies in the ruble zone. The Fund staff helped to chair the Tashkent meeting, and presented central bankers with a set of proposed guidelines for monetary cooperation among the ruble zone members. The Fund’s plan for the ruble zone envisaged inter-state policy coordination on four main fronts. First, the establishment of credit ceilings for individual central banks to restrict the growth of credit, as well as an aggregate credit ceiling for the ruble zone as a whole. Second, capping the credit extended by the CBR to the other central banks and reaching an agreement on the distribution of currency among the republics. Third, the establishment of uniform bank reserve requirements and central bank

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3 Kagalovsky was later appointed to be Russia’s first executive director at the Fund in November 1992.
refinance rates, as well as movement towards a unified foreign exchange rate system. Finally, improving inter-state data collection and the transparent exchange of monetary and credit information among the ruble zone central banks (IMF, 1992c).

The Tashkent meeting began a pattern that dogged the Fund’s efforts to establish inter-state monetary cooperation in the ruble zone. The heads of central banks failed to reach substantive agreement on any specific actions, while agreeing in principle that they should cooperate in the setting of monetary policy (IMF, 1992c). Even so, the Fund’s efforts helped actors to frame potential policy agreements by suggesting boundaries on the ‘thinkability’ of different options for policy coordination. As the Fund staff noted, their efforts to develop a multilateral policy solution to monetary problems in the ruble zone ‘yielded broad agreement on the principles of effective coordination, which in turn may assist the continuing search for practical arrangements’ (IMF, 1992b). The managing director explained to the Board that while it might prove difficult to translate the principles of the Tashkent agreement into substantive actions, the Fund had been able to use the event to improve the level of understanding among post-Soviet central bankers on the need for inter-state monetary policy coordination to reduce inflation. The managing director also used the Fund’s experience at the Tashkent meeting to illustrate to the Board the evenhanded approach the Fund was trying to take in providing advice on post-Soviet monetary relations. For instance, he noted that while representatives of the non-Russian republics had initially expected that the Fund would simply support the CBR’s position, they were grateful that the Fund had instead encouraged Russia to take a more cooperative stance towards ruble zone negotiations (IMF, 1992c). Nevertheless, the Russian authorities subsequently signaled that they had decided to formulate ruble zone monetary policy through bilateral negotiations with ruble zone members despite the proposals to achieve multilateral cooperation that were agreed in principle at the Tashkent meeting, bypassing the Fund through discussions in which Russia would have a clear asymmetric power advantage (Odling-Smee and Pastor, 2001: 6-7).

The managing director communicated to the Board on 12 June 1992 that the post-Soviet states had failed to agree on the form that inter-state monetary cooperation should take. The key sticking point was between the Russian authorities, who preferred a single monetary authority under their direct control, and the non-Russian republics who favored the Fund’s proposals that envisaged multilateral agreement on a rule-based system with multiple monetary authorities. The information communicated to the Fund by the former Soviet republics individually, as well as from an Interbank Council meeting held in Estonia on 5 June, indicated that a majority of the non-Russian central banks continued to believe that the Fund’s plan provided ‘a good basis for a cooperative monetary policy in the ruble
area'. At the same time, the non-Russian central banks had growing doubts over whether Russia would cooperate in accordance with common rules, given that on 29 May the CBR had raised its refinance rate to 80 percent without discussing the move in advance with other ruble zone central banks. Russia had indicated to the Fund that it intended to offer a stark 'take it or leave it' choice to the non-Russian central banks: either to submit to the CBR as the single monetary authority for the ruble zone or to exit the ruble zone entirely and introduce independent currencies. The managing director informed the Board that the staff would continue to emphasize to ruble zone policymakers that the implementation of a framework such as the Tashkent guidelines would remain a pre-requisite for approval of a loan arrangement with the Fund. In the Board’s discussion of recent events in the ruble zone, directors emphasized the potential economic damage that a collapse of the ruble zone would entail and reaffirmed their preference for a multilateral monetary arrangement, which was the stated position of executive directors representing Japan, the Netherlands, the UK, and France (IMF, 1992g).

Only six weeks later the situation had changed markedly. On 24 July the deputy managing director reported to the Board that there was ‘a growing sentiment among all members of the ruble area other than Russia that their interests might be better served by introducing their own national currencies’. Russia was pushing ahead with bilateral negotiations with other ruble zone members conducted through a working group on ruble area issues, and the Fund staff continued to seek to demonstrate their evenhanded treatment of the former Soviet republics by formulating advice for the Russian working group while also transmitting the same advice to the non-Russian republics (IMF, 1992h). The dominant perspective among the Fund staff (as well as several executive directors) was that the economic benefits of maintaining the ruble zone were clear – at least until monetary stabilization was achieved and market-oriented reform was on track. In providing advice on this process while formally seeking not to influence the choice between a common currency and monetary independence, the Fund continued to suffer from a lack of information about local economic conditions in many of the former Soviet republics. However, the Fund was quickly learning from experiences on the ground that the republics faced a wide range of economic circumstances and were pursuing diverse (and sometimes counterproductive) policy responses (IMF, 1992h).

Divergent policies further worsened the prospects for multilateral monetary cooperation by sharpening the differences in monetary conditions between ruble zone economies. For instance, in July 1992 central bank refinance rates varied from 12 percent in Azerbaijan and Georgia to 80 percent in Russia (IMF, 1992i). The above quote from the deputy managing director highlights the interpretive challenges the Fund faced at the time. In these
ambiguous conditions, the Fund had to formulate its own advice based on assessments of policy intentions, national interests, and the political ‘sentiment’ among ruble zone policymakers. While this posed analytical difficulties for the organization, it also provided staff with a window of opportunity to shape how policymakers viewed the economic costs and benefits of alternative policy options.

An IMF working paper by the director of the European II Department John Odling-Smee and Gonzalo Pastor (2001: 20) describes how ‘the balance of the economic arguments for and against national currencies and a cooperative ruble area shifted’ during the course of 1992. According to Odling-Smee and Pastor, the Fund’s advice changed to private support for independent currencies in the remaining ruble zone members by September 1992. In November, Odling-Smee wrote to the governments and central banks of the former Soviet republics to set out the Fund’s view on the clear choice between maintaining a common currency managed by a single monetary authority and introducing independent national currencies. The Fund spelled out that it would not approve a loan program with a government until one of these two options had been firmly put in place (Odling-Smee and Pastor, 2001: 41-44).

This choice remained complicated by the lack of trust between Russia and the newly independent states. The non-Russian republics were unwilling to allow the CBR de facto control of ruble zone monetary policy, especially following the CBR’s unilateral decision-making style during 1992, while Russia was unwilling (or, due to internal disagreements, unable) to agree to a cooperative multilateral arrangement. However, due its dominant economic size and hegemonic role in the region, the Fund believed that the ball was squarely in Russia’s court. Publicly defending the Fund’s role in the former Soviet Union in an opinion article in the Financial Times in December 1992, Odling-Smee (1992) argued that inflation could ‘escalate into hyperinflation unless the Russian authorities act vigorously to reimpose financial discipline’. Commenting on the delay in approving an upper credit tranche loan agreement with Russia, Odling-Smee observed that the loan negotiations had been impeded by ‘the authorities’ inability so far to decide on firm monetary and fiscal policies’.

At a meeting in Bishkek in October 1992, the leaders of the former Soviet republics had agreed to establish an interstate bank involving the remaining ruble zone members (Åslund, 1995: 127). However, as the Fund staff noted in a paper for the Executive Board in December, like the outcomes of previous meetings, this remained an agreement in principle rather than a practical solution to the problem of policy coordination in the ruble zone that policymakers were committed to implementing. Because of the lack of success in generating agreement on a new multilateral monetary system among the former Soviet
republics in 1992, the staff finally concluded that individual republics should make contingency preparations to introduce a new national currency (IMF, 1992i). The internal processes within the Fund then began to shift gear from an official policy of non-intervention on the question of independent currencies, to intellectual support for the construction of national monetary systems in the ruble zone economies.

*The Dustbin of History: 1993*

In an Executive Board debate over Russia’s progress under its first stand-by arrangement with the Fund in January 1993, directors voiced harsh criticism of Russia’s inability to resolve questions over the future of the ruble zone. The Italian executive director Renato Filosa argued that although the Baltic states may have been motivated to introduce independent currencies to reaffirm their national sovereignty, the introduction of independent currencies for the remaining members of the ruble zone had become ‘a rational consequence of the failure of the Central Bank of Russia to achieve monetary stability’. Clearly illustrating the view that (a) the ruble zone could have been successfully maintained, and (b) it had been up to Russia to take tough policy decisions to make this happen, Filosa concluded that ‘Russia had indeed missed the opportunity to play the role of anchor country for the stabilization programs of the other states of the FSU’ (IMF, 1993g).

Ingimundur Fridriksson, the Icelandic executive director representing the three Baltic former Soviet republics, also argued that Russia had ‘a special responsibility for the establishment of functioning payments relations throughout the region’. Fredriksson stated that macroeconomic stabilization and economic recovery in the former Soviet republics would be dependent upon the capacity for the newly independent states to ‘maintain traditional trade relations’, which was tightly linked to the implementation of stable inter-republican monetary arrangements. Douglas Smee, the Canadian executive director, observed that ‘The most difficult aspect of the “Russian problem” is the capacity of the Russian Government and people to implement and accept unpopular but necessary measures’ (IMF, 1993g). Smee’s remarks help to capture the frustration that the Fund felt at both the Board level and among the staff over the deteriorating policy relationship with Russia.

Critics of the Fund could no doubt see the Fund’s debate over the problems of the former Soviet Union as driven by neoliberal ideology, where getting the ‘right’ policy framework in place is prioritized above people’s everyday economic and social needs. This may indeed be the case, but simply pinning the neoliberal label to the Fund provides little analytical purchase on the motivations for and the discursive justifications used to support the Fund’s intellectual position. For instance, in addition to blaming the Russian
authorities, a recurring theme in Board debates over the problems of achieving monetary control in the former Soviet Union is an emphasis on the social costs of inflation. As the UK executive director stated to the Board: ‘The real losers from hyperinflation would be the Russian people’ (IMF, 1993g). The Fund saw monetary expansion and soft central bank loans as mostly benefiting political and economic elites, especially commercial banks and large firms, while the high inflation they helped produce was seen as undermining public support for economic reform by hurting those who were already poor and further impoverishing large sections of the population.

During the first half of 1993, the Fund’s willingness to supply loans to the former Soviet republics became more tightly linked to their choice between remaining in the ruble zone and introducing independent currencies. As the staff made clear in a document in April discussing the new STF lending window, countries remaining in the ruble zone would only be allowed to access an STF arrangement after they took ‘convincing action’ to tighten monetary policy, with the emphasis on the need for tough monetary policy decisions by Russia (IMF, 1993c). The views of executive directors, expressed in a 21 April Board meeting that discussed Russia’s 1993 Article IV Consultation with the Fund, focused on continuing to push Russia to tighten monetary policy in the ruble zone. Daniel Kaeser, the executive director representing several Central Asian states including Uzbekistan and the Kyrgyz Republic, argued that Russia’s policies had created a ‘speculative inflation mentality’ among economic actors and had undermined the credibility of the government’s reform program (IMF, 1993h).

As discussed above, actors’ beliefs and their interpretation of a government’s policy actions and the local economic environment clearly impact on the potential success or failure of attempts to establish monetary stability. The view from both the Board and the Fund staff was that a government’s ‘policy credibility’ had to be established by tough action in pursuit of monetary restraint. The US executive director, Thomas Dawson, summed up this position, stating that ‘at its root, inflation is simply a monetary phenomenon – in Russia or anywhere else’ (IMF, 1993h), a view that the Fund staff had emphasized in talks with CBR officials (IMF, 1993i). Yet again, the social costs of inflation were emphasized, with Dawson concluding that ‘Russia’s inflation problem imposes a very cruel tax on Russian society and reform. We urge the Central Bank to stop it’ (IMF, 1993h).

With the staff now concluding that ‘attempts to coordinate monetary policies in the ruble area had failed’ (IMF, 1993i), executive directors began to speak more categorically against further attempts to maintain or to resurrect the ruble zone. For instance, the UK executive director argued that the need to settle monetary arrangements in the ruble zone ‘almost certainly means moving to separate currencies as quickly as possible’ (IMF, 1993h).
Within Russia, however, disagreements among different political actors amid vacillation over whether to prioritize the pursuit of monetary stability in Russia or the pursuit of Russia’s geopolitical interests by maintaining a unified monetary system with the former Soviet republics hampered the ability of Russian policymakers to take a clear decision one way or the other. The staff assessed that while most Russian officials were now in favor of the non-Russian republics introducing independent currencies, policymaking elites were concerned about how to best serve Russia’s long-term political interests. In addition, the staff noted that several of the former Soviet republics had continued to pressure the Russian authorities to maintain the ruble zone. In the staff’s view, the uncertainties over inter-republican trade and monetary relations had now ‘placed in jeopardy the entire thrust of the reform program’ in Russia (IMF, 1993i).

In April 1993, the Executive Board’s debate on the staff’s proposals for the new systemic transformation facility again raised the need to resolve the institutional arrangements in the ruble zone. Directors discussed whether, and under what conditions, to allow the non-Russian ruble zone members access to the STF and what impact this might have for the drift towards national currencies or the prospects for maintaining the ruble zone. Jacques de Groote, the executive director representing the Belgium constituency that included Kazakhstan, argued that states should be allowed rapid access to the STF if they decided to exit the ruble zone, in order to enable the Fund to play a key role in the introduction of a new currency. In the current circumstances, de Groote argued, states should only have to make a rhetorical commitment to introduce an independent currency to enter an STF program, as a first step towards an upper credit tranche SBA (IMF, 1993e).

With the establishment of the STF, it became clear that a conclusive decision over ruble zone membership versus independent national currencies would be crucial for the approval of an IMF loan program for the non-Russian former Soviet republics, which further complicated the Fund’s official position of leaving the choice over monetary arrangements up to the individual states themselves. The remarks by Oleh Havrylyshyn, the alternate executive director for the Netherlands constituency that included several former Soviet republics, illustrate the bureaucratic gymnastics involved in the Fund’s attempt to avoid making a ‘sovereign’ decision regarding monetary arrangements for its new members. On the one hand, Havrylyshyn observed that the Fund could find itself unable to approve STF programs for states that remained in the ruble zone because their monetary policy would remain harnessed to developments in Russia – although these were the very states that the STF was designed to assist. On the other hand, he argued that the Fund should refrain from overstepping the bounds of its authority by requiring a state to exit from the ruble
zone as a prior action for an STF program. Like de Groote, Havrylyshyn agreed that a 
rhetorical commitment to introduce an independent currency should be a sufficient 
criterion to access an STF loan. In effect, this formula would provide incentives for states 
to exit the ruble zone without directly exposing the Fund to the charge of overriding the 
monetary sovereignty of its member states (IMF, 1991c).

The proposal that the former Soviet republics should be allowed to access an STF loan 
once they had rhetorically committed themselves to introducing an independent currency 
was opposed at the Board level by the director of the Policy Development and Review 
Department, who sought to retain the staff's discretion to assess states on a case-by-case 
basis. Although the STF was designed to provide relatively easy access to the Fund's 
resources, for the staff simply allowing states to make a rhetorical pledge of their monetary 
intentions was a step too far in this direction. Fund staff were keen to retain the right to 
assess policymakers' reform intentions for themselves, which might increase the incentives 
for governments to cooperate with staff on everyday policy decisions.

Nevertheless, while the Fund bases its claim to expert authority on providing top quality 
analyses grounded in hard statistical data, the final Board decision on the STF included a 
strong element of ambiguity in the assessment of a state's eligibility to use the STF. 
Summing up the sense of the meeting, the managing director stated that 'Where there is a 
reasonable case for eligibility, but the statistical case is unclear, the member will be given 
the benefit of the doubt' (IMF, 1991c). This would enable the Fund to establish an initial 
loan program with states in uncertain circumstances, in order to allow staff to build a 
stronger case for policy persuasion and compliance over time.

The Fund's deliberations over watering down the conditions that states would have to 
meet to access the STF may have inadvertently undermined the extent to which other 
 multilateral and bilateral donors were willing to support the new loan facility with 
 supplementary financing. It is standard practice for World Bank representatives to attend 
Executive Board meetings as observers, while directors themselves will convey the key 
points of Board discussions back to their governments. These other key actors in the 
international donor community are therefore aware of the Fund's internal deliberations and 
the guidance given by the Executive Board to the Fund staff. As a result, it is perhaps easy, 
with hindsight, to understand why other important actors in the international donor 
community such as the Paris Club creditors, the World Bank, and the EU declined to 
participate as 'supplemental financiers' under stand-alone STF arrangements. In this 
instance the Fund faced a classic 'catch 22' situation. The more the Fund deviated from its 
institutional reputation for promoting conservative macroeconomic policies and 
demanding tough policy conditionality and sought to act flexibly to accommodate the
unique needs of the former Soviet republics, the less likely it was that its actions would facilitate other sources of financial support.

From April 1993, the tone of Board discussions on monetary developments in the ruble zone changed and became for the most part in favor of the former Soviet republics introducing independent currencies. In May, with the Fund’s assistance the Kyrgyz Republic became the first Central Asian state to introduce its own currency, an action that received substantial praise from the Executive Board. At the same time, the country became the first state to draw from the systemic transformation facility (IMF, 1993j). Two months later, Kazakhstan’s application for an STF loan was approved by the Board amid intense debate over whether the country should immediately sever its monetary links with Russia and introduce a national currency (IMF, 1993k).

As late as September 1993, however, the Fund staff continued to attempt to formally maintain a neutral position on the question of whether states should exit the ruble zone (IMF, 1993l). The Fund’s public position changed to categorical support for new currencies following Russia’s policy changes in November 1993, which tipped the balance for the five remaining members of the ruble zone in favor of monetary independence. The Fund’s stance was finally resolved when managing director, Michael Camdessus, released a press release on 15 November, the same day that Uzbekistan and Kazakhstan introduced their new currencies, publicly spelling out the Fund’s clear intellectual and financial support for monetary independence in the former Soviet republics while reinforcing the need for states to back up their new currencies with tight monetary and fiscal policies (IMF, 1993m).

Summary

Monetary developments in the ruble zone were characterized by acute uncertainty and policy ambiguity in the final two years before the monetary union finally collapsed at the end of 1993. While some states sought a quick exit from the currency union to establish monetary independence and to burnish their claims to national sovereignty, others were reluctantly pushed out of the ruble zone by rising economic costs throughout 1992 and 1993 and the adverse policy actions of the Russian government. The Central Asian states were among those that were reluctant to exit the ‘common economic space’ of the former Soviet Union, due in part to a complete lack of experience with running an independent monetary system as well as actors’ intersubjective beliefs that they could expect to access greater credit subsidies and trade benefits by maintaining a common monetary system with Russia.

As Richard Pomfret (2002b: 37) observes, the Fund ‘has been given a hard time over its policies towards the former Soviet Union’. It has been criticized by some observers for not
doing enough to help the newly independent states, while others have criticized it for overstepping the formal bounds of its authority and doing too much. This chapter has shown how the Fund’s thinking on monetary reform options in the ruble zone evolved over the period from 1991 to 1993, and has sought in particular to highlight the political constraints that it faced in its attempts to foster multilateral cooperation.

In reasoning through these challenges, the Fund had to rely on its assessments of actors’ intentions rather than grounding its policy advice and decisions on economic data. In an unprecedented situation where the Fund was expected to provide quick fix solutions for countries that were strangers to independent statehood and to the obligations of Fund membership, the Fund struggled to manage the simultaneous challenges that it faced. The Fund’s role was especially complicated because it had to formally respect the juridical sovereignty of its members, which the staff and the Executive Board initially interpreted as prohibiting the right of the Fund to categorically favor monetary independence over the maintenance of the currency union or vice versa. A further complication in this dilemma was the geopolitical importance of Russia for the Fund’s dominant member states.

This chapter has made clear that the Fund saw decisive action by the Russian authorities as the key to stabilizing monetary relations among the former Soviet republics. Here the Fund’s influence was blunted by internal conflicts within Russia’s policymaking elite over whether to seek monetary independence to stabilize the Russian economy or whether to use the ruble zone as a foreign policy instrument to shore up its regional hegemonic role by maintaining monetary and credit links with the other republics. The Fund’s capacity to exercise leverage over Russian policymakers by withholding loans was further inhibited by the geopolitical interests of its dominant member states, especially the US, which pressured the Fund to extend financial support for Russian President Boris Yeltsin’s administration. In addition, some observers have suggested that the Fund’s negotiations with Russia during the early 1990s indicates that on monetary issues the Fund may have been ‘willfully deceived’ by their Russian interlocutors (Hedlund and Sundstrom, 1996: 908).

Despite these constraints the Fund was by no means marginal to monetary developments in the ruble zone, and its efforts to initiate multilateral cooperation and to develop bilateral relationships with policymakers in post-Soviet states helped to frame the range of alternative options that were on the table. At the same time, however, the Fund was forced to be a back seat driver, which often led to it proffering advice on what should or should not be done after the fact. In Central Asia, as the following chapters demonstrate, the Fund’s influence was greater after the newly independent states chose to exit the ruble zone and turned to the Fund for advice on the construction of a new national monetary system. The final three chapters in this thesis examine the Fund’s role in the
construction of new national monetary systems in Central Asia, and explore how the Fund sought to influence the introduction of new currencies and the reform of central banks in the Kyrgyz Republic, Kazakhstan, and Uzbekistan after the ruble zone had finally collapsed.
When they became members of the Fund in 1992, the Kyrgyz Republic, Kazakhstan, and Uzbekistan each initially maintained transitional currency restrictions permitted under Article XIV of the Fund’s Articles of Agreement and continued to exercise direct political influence over central bank operations. But by the end of the first decade of economic transition in the former Soviet Union, observers concluded that the Kyrgyz Republic and to a lesser extent Kazakhstan had been the leading market-oriented reformers among the post-Soviet states of Central Asia (Åslund, 2003: 77; Huskey, 2003: 123; Schroeder, 1997: 266-7). The Kyrgyz Republic became the first Central Asian state to formally break away from the ruble zone by introducing its own currency, the Kyrgyz som, in May 1993 with strong financial and rhetorical support from the Fund. Kazakhstan moved somewhat more slowly towards the introduction of a national currency but, as will be shown below, Kazakh policymakers established a much more cooperative policy relationship with the Fund compared with their counterparts in Uzbekistan.

In the final three chapters in this thesis, I investigate the following two questions to assess the sources of the Fund’s influence in its attempts to effect institutional change in post-Soviet Central Asia. First, how did the initial circumstances of each country at independence impact upon its relationship with the Fund? Second, what strategies did the Fund use to change national actors’ preferences over time? Through examining these questions, Chapters 6 to 8 aim to establish how the Fund sought to influence institutional change in Central Asia after the collapse of the ruble zone, whether it was able to do so in each case, and the enabling factors that permitted it to do so.

As the foregoing chapters have argued, reconstructing how actors perceive their interests, and therefore changing their policy preferences, is not simply a matter of providing material incentives for states to adopt headline policy changes under Fund loan programs. As discussed in Chapter 1, how actors understand their material interests flows from how they interpret the circumstances that they confront (Beckert, 2003: 773). Therefore, understanding the strategies that Central Asian policymakers adopted in response to the challenges of independent statehood, and establishing whether this aided or
hindered their openness to the Fund’s ideas for economic reform, requires an examination of how the Fund sought to shape actors’ interpretations of the transitional context they faced. Seen through the eyes of the Fund, winning a strategic game over policy conditionality with states may allow the Fund to achieve a degree of loan program ‘success’ in the short-term if states formally adopt the Fund’s preferred institutional changes. However, in an environment characterized by acute uncertainty – where the informal ‘rules of the game’ may shape economic behavior more than official regulatory changes – the Fund must achieve a change in a state’s broader policy orientation in order to entrench an ‘IMF friendly’ path of economic reform over time. This depends on the Fund’s efforts to change policymakers’ intersubjective understandings about how the economy should work, the monetary policy options at their disposal, and the appropriate role of state intervention in the economy. In short, this involves an attempt to persuade policymakers to adopt a common framework for analysis to design solutions to a state’s economic challenges.

From research conducted in the Fund archives and interviews with current and former Fund personnel responsible for Central Asia, I seek to establish the following factors:

1. The composition of the Fund’s core advice on monetary reform for the post-Soviet states of Central Asia.
2. Whether the Fund considered it was able to exert a significant influence over institutional change.
3. The reasons the Fund identified for its impact (or lack thereof).
4. Whether the evidence suggests the Fund did in fact exert an observable influence on states’ policy orientation over time.

As James Vreeland (2006: 363) observes, studies that attempt to measure compliance with Fund loan program conditions by creating aggregate indices of policy compliance risk treating reforms across different policy areas as functionally equivalent. The problem with this approach is that the Fund is likely to find some policy areas easier to reform than others, with the consequence that the Fund’s influence over domestic policy change may either be exaggerated (in the case of reforms in less-demanding policy areas) or understated (in the case of difficult policy areas where the Fund may only achieve change slowly). Policymakers in all three cases examined here at various times indicated an intention to defect on their policy commitments to the Fund. I attempt to establish the Fund’s influence over structural economic reforms in Central Asia through a qualitative assessment of four features of the Fund’s relationship with national policymakers, focusing specifically on monetary policy reform rather than overall policy compliance. First,
assessing how quickly the Fund was able to put an initial STF loan program in place with each of the newly independent states. Second, assessing how the Fund attempted to persuade policymakers to stick with ‘IMF friendly’ policies following instances of ‘policy slippage’. Third, assessing whether the Fund was able to embed an ‘IMF friendly’ policy orientation with regard to the conduct of monetary policy, indicated by the speed with which governments moved to adopt *de jure* central bank independence and Article VIII status. Fourth, and finally, assessing whether these formal changes were reflected in the day-to-day practice of monetary policy as seen by the Fund.

This chapter proceeds as follows. In the first two sections, I compare the political and economic dimensions of the transitional context in each of the three cases at independence, and assess whether these conditions were conducive to the favorable reception of the Fund’s ideas for economic reform. Here I show that, despite inheriting similar political and economic institutions at independence and facing many of the same political and economic challenges following the demise of the Soviet Union, the Kyrgyz Republic, Kazakhstan, and Uzbekistan faced different transitional contexts that shaped policymakers’ openness to cooperation with the Fund. In the third section, I outline the initial technical assistance that the Fund provided to each state to advise on immediate legal and operational changes to their economic institutions, and to accumulate local knowledge that could inform the staff’s assessment of institutional changes in the medium term that could be supported by Fund loans. In the final three sections of this chapter, I discuss how the Fund initiated a policy dialogue with each of the three newly independent states as they underwent the process of becoming member states of the Fund, which provided the initial opportunities for Fund staff to persuade Central Asian policymakers to follow their advice. Here I show that even from their first contacts with the Fund, the Kyrgyz Republic, Kazakhstan, and Uzbekistan each exhibited a different degree of openness to the Fund’s ideas for economic reform, based on how political leaders in each state interpreted the specific transitional context that they faced.

*The Political Dimension of the Transitional Context in Central Asia*

With any attempt to build new formal institutions designed to achieve fundamentally different social and economic goals, the past matters. As discussed in the foregoing chapters, in a period of systemic change actors do not construct new institutions in a social vacuum, but are constrained by the legacy of previous institutional frameworks and shared understandings about how the economy works (and how it ought to work). Historical legacies were especially significant in the post-Soviet states of Central Asia, where the political transition from the Soviet Union to national independence, concomitant with the
need to construct a new national economic system, was carried out by many of the same leaders and officials who were accustomed to the rules and incentive structure of the previous system. At the same time, exogenous shocks – such as the political disintegration of the USSR and the subsequent dismantling of the inter-republican monetary relationships that had characterized the Soviet empire – can open up a window of opportunity for rapid institutional change. What domestic actors choose to do with this window of opportunity is shaped by their existing understandings of their interests, but their interests are also mutable because of the acute uncertainty they face (see Widmaier, et al., 2007).

In the post-communist context, international organizations such as the Fund stepped into this uncertain environment offering a wealth of comparative policy knowledge and an ability to reduce transaction costs by constructing reform templates that national elites could use to pilot institutional change. As Pauline Jones Luong (2002: 104) observes, because of the uncertainty and the historical contingency that characterize systemic economic and political transitions, 'Not only is the endpoint of the transition unclear, so is the process'. This might suggest that although institutional legacies will continue to be an important determinant of change, we can expect reform templates provided by international organizations to have a significant impact when actors seek quick policy fixes to ameliorate immediate uncertainty. However, Raquel Fernandez and Dani Rodrik (1991) have argued that when individual actors are uncertain who the 'winners' and 'losers' from economic reforms are likely to be, this individual-specific uncertainty generates a bias in favor of maintaining the institutional status quo. In the early 1990s, as discussed above, Central Asian policymakers faced an environment of acute uncertainty and were unfamiliar with how market-based mechanisms would work, circumstances which made it difficult for elites to ascertain in advance who would benefit and who would lose from economic reforms. While the Fund was presented with a window of opportunity to effect large-scale formal institutional change with the collapse of the ruble zone, uncertainty regarding the specific effects of economic reforms on different social groups made it unlikely that governments would be either willing or able to fully abandon their existing institutional frameworks and informal practices in the short-term. How open policymakers were to the Fund's ideas for economic reform following independence would therefore depend in large part on how they interpreted the economic and political challenges they confronted.

In contrast to other post-communist transitions, where popular social movements demanded political independence and economic reform (Jones Luong, 2002: 104-5; Abdelal, 2001), the scope and speed of economic change in Central Asia was largely determined by ruling elites (Akiner, 2004: 119). Political leaders in each country rhetorically embraced the idea of systemic economic reform to establish a market-based system, while
pursuing different national strategies towards these goals (Gleason, 2004: 46; Pomfret, 2003a). All three states established strong presidential systems following independence that were commonly characterized as authoritarian patronage-based regimes, albeit with considerable variation in the degree of domestic political competition, media criticism, and social dissent that rulers tolerated (Kubicek, 1998; Katz, 2006; Roeder; 1994; cf. Hale, 2005). In effect, the post-Soviet constitutional structure adopted in each of the Central Asian republics gave presidential rulers the power to pass laws by decree (Gleason, 2004: 46; Matv^eeva, 1999: 27-8).

Despite these commonalities, there were also some important variations in the political dimension of the transitional context in Kazakhstan, the Kyrgyz Republic, and Uzbekistan. While each country established a strong presidential system with weak or simply ‘rubber stamp’ legislatures, the different approaches of Central Asia’s post-Soviet presidents to the challenges of independent statehood informed the development of each government’s relationship with the Fund. For instance, several observers have credited the Kyrgyz Republic’s first post-independence president, Askar Akaev, with playing the key role in the direction of the country’s market-based reform program after 1992 (Gleason, 1997: 95; Jones Luong, 2002: 115). Akaev held a doctorate in physics and had a background as President of the Kyrgyz Academy of Sciences rather than within the Communist Party hierarchy (Pomfret, 2006: 73). He only joined the Communist Party in 1981, and has been described as an academic, first and foremost, rather than a committed Communist Party apparatchik (Brooker, 2004: 139-40). As an indication of how Akaev interpreted the Kyrgyz Republic’s policy options, during the debates over the future direction of economic policy that accompanied the demise of the Soviet Union Akaev, is reported to have argued that ‘although it was true that there were both poor countries and rich countries among the market economies, in the socialist world there were only poor countries’ (Gleason, 1997: 95). According to Central Asia specialist Kathleen Collins (2006: 159), ‘Akaev, alone of the Central Asian leaders, was personally committed to the goals of perestroika’. After the country gained political independence, Akaev quickly sought to establish the Kyrgyz Republic’s international reputation as a rapid reformer in the region (Anderson, 1999: 75-6).

In comparison with the Kyrgyz Republic, the first Kazakh president Nursultan Nazarbayev had been a more prominent and longer-serving member of the Communist Party elite before the country gained independence (Blackmon, 2005: 398; Brooker, 2004:

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6 In the three cases examined here, the Kyrgyz Republic’s first post-independence president, Askar Akaev, was forced to step down in 2005, while the first post-independence presidents in Kazakhstan and Uzbekistan still remain in power today.
In policy debates over the appropriate reform strategy for Kazakhstan following independence, decision makers considered whether to adopt blueprints from the economic reform experience of countries such as South Korea, Turkey, and Hungary rather than follow the Fund’s template for institutional change (Conway, 1994: 165-6). In addition, Nazarbayev brought in a team of high-level German economists in 1993 to advise on the country’s economic transformation and to provide policymakers with an independent source of advice to the reform proposals put forward by the Fund staff (Hoffman, 2001: 1-3). However, despite elite debates over whether to adopt a particular country’s model of reform, in practice the government introduced most major economic changes through an incremental and sometimes erratic process of institutional change (Conway, 1994: 166; Jones Luong, 2002: 147), with the government intermittently switching from the Fund’s ideas for market-based monetary reforms to Soviet practices of directing cheap credit to firms to maintain production and employment.

Uzbekistan’s post-independence president Islam Karimov was trained as a Soviet economist and worked for the Uzbek branch of Gosplan, a background which has been credited with influencing his heavy-handed approach to Uzbekistan’s post-independence economic reforms (Blackmon, 2005: 396). As Collins’s (2006: 163) interviews with former government officials indicate, the predominant concern among the Uzbek political elite during the collapse of the Soviet Union and the early days of independence in 1992 ‘was holding the republic together’. Karimov sought to maintain regime stability and to build up an authoritarian state through the centralization of economic and political power in the office of the president (Collins, 2004: 251), with a particular focus on establishing and maintaining Uzbekistan’s sovereignty from Russia (Kazemi, 2003: 208). Like Kazakhstan, Uzbek policymakers in the early 1990s eschewed simply accepting the Fund’s advice and publicly discussed whether to adopt models for economic reform from countries such as South Korea and China (Ruziev, et al., 2007: 11). However, these examples were usually used to justify the government’s self-proclaimed ‘gradualist’ policy orientation rather than as blueprints that the authorities actively sought to follow (Pomfret, 2000: 734).

Following the dissolution of the Soviet Union, Akaev, Nazarbayev, and Karimov each initiated new regime legitimation projects in order to burnish their claims to the ‘right to rule’. They sought to at least partly reverse the ‘Russification’ of Central Asia that had occurred under Soviet-rule, such as the decisions in the late 1930s to implement mandatory Russian-language instruction and to switch from the Latin alphabet to Cyrillic for local languages in all Soviet schools (Blitstein, 2001). Soviet decision makers had deliberately created the republics as territorial political units that contained heterogeneous ethnic groups, at the same time as fostering titular nationalities to lend Soviet-installed institutions
a veneer of legitimacy (see Martin, 2001; Khalid, 2001). As a result, some observers predicted that in the post-Soviet era Central Asian societies might be plagued by ethno-national conflict, especially between the titular ethnic groups and each republic’s sizeable Russian minorities (see Brubaker, 1994). Central Asian leaders also lacked the popular mandate they might have gained if they had been swept into power on the back of ethno-nationalist sentiment after leading a push for independence from Soviet imperialism (Jones Luong, 2004: 12). The post-Soviet presidents therefore sought to produce new state ideologies in an attempt to compensate for the lack of political choice and the lack of tangible economic benefits from independence apart from greater wealth accumulation by privileged elites (Adams, 2004; Dave, 2004).

In the Kyrgyz Republic, Akaev initially sought to cultivate an image of the country as representing a ‘democratic island in an authoritarian Central Asian environment’ (Pétric, 2005: 319), by providing a hospitable setting for numerous IOs and international non-governmental organizations (Schatz, 2006: 274-5), holding comparatively ‘free’ elections, and pursuing a rapid process of economic liberalization in cooperation with the Fund. Bereft of the resource wealth that would enable Kazakhstan and Uzbekistan to build up patronage networks tied to political support for the ruling regime (Matveeva, 1999: 28-9), Akaev based his regime’s main claim to domestic legitimacy upon securing international recognition of the country as a legitimate member of international society (Pétric, 2005: 323; Huskey, 2003: 123). This would allow the Kyrgyz government to ameliorate some of the costs of transition in the short-term by accessing substantial foreign aid, which amounted to an average of 14.6 percent of the country’s GDP during the 1990s (Bayulgen, 2005: 60). Efforts to pursue domestic legitimacy for the regime through a program of ‘indigenization’, most notably through measures to increase the use of Kyrgyz as the country’s official language, were haphazard and ambiguous (Dave, 2004: 141-7). Compared with the domestic focus of other leaders in the region, Akaev instead focused greater attention on courting international audiences as a proxy for domestic legitimacy – seeking support from the West as well as from Russia in return for the country’s commitment to the regional institutions set up under the Commonwealth of Independent States (Huskey, 2003: 122). Above all, Akaev sought to transform the Kyrgyz Republic into an attractive destination for foreign investment and foreign aid, representing the country to the world as ‘the Switzerland of Central Asia’ (Huskey, 2003: 115; Jones Luong, 2002: 117).

Kazakhstan began independent statehood faced with several political challenges that distinguished the new state’s prospects from those of its Central Asian neighbors. In particular, Kazakhstan was much more closely entwined with Russia, both economically and socially (Fierman, 1998: 173). Unlike the other Central Asian republics where the titular
ethnic group was in the majority, for most of the post-WWII period Kazakhs were outnumbered by Russians, and both groups made up roughly equal proportions of the population when the country gained its independence in 1991. Concerned about the possibility of ethnic strife or secessionist pressures, the authorities subsequently espoused the goal of constructing a new national ideology that could nurture a ‘civic, all-Kazakhstani state identity’ without repressing the cultural identities of other ethnic groups, which formed the foundation of the elite’s post-Soviet legitimation project (Cummings, 2006: 177). As an indication of how seriously the post-independence Kazakh elite treated these concerns, in 1995 Nazarbayev announced that the country’s capital would be moved at great expense from Almaty in the south to the northern city of Aqmola, which in 1998 was renamed Astana (the Kazakh word for capital) (Anacker, 2004: 518-19). The new capital was designed to be ‘market-friendly’ and ‘to present to the world an image of a stable, multi-ethnic society’, similar to the image cultivated by Lee Kuan Yew in Singapore (Anacker, 2004: 522). Like the Kyrgyz Republic, Kazakh elites sought to define a new national identity through increasing the political prominence of Kazakh as the official language of Kazakhstan, while somewhat ambiguously still recognizing the official status of Russian in order to maintain a ‘civic’ identity for the new state (Fierman, 1998: 179). Compared with the half-hearted attempts in the Kyrgyz Republic to promote a new national identity through greater use of the Kyrgyz language, a nationalistic language policy was implemented much more vigorously in Kazakhstan (Dave, 2004: 152). However, the nation-building project in Kazakhstan struggled to gain wider acceptance among the population, in large part due to the continuing legacy and the perceived legitimacy of the previous Soviet order (Cummings, 2006: 194-5).

In Uzbekistan language was again an important component of the representation of a new national identity, with the government choosing to switch from Cyrillic to the Latin alphabet that had been used from the mid-1920s until the end of the 1930s (Jones Luong, 2004: 19). However, in Uzbekistan’s case the promotion of a new regime legitimation project centered on Karimov’s ‘Ideology of National Independence’, which formally placed the maintenance of economic and social stability above all other goals (March, 2003: 310-11). Concerned first and foremost with regime survival (Naumkin, 2006: 128; Ilkamov, 2007: 79), Karimov attempted ‘to equate national culture with his own ideological project’ in order to forestall domestic criticism of his policies, and to claim legitimacy for the regime on the basis that it embodied the authentic expression of the Uzbek nation’s ‘uncoerced interests, values, and aspirations’ (March, 2003: 313). The construction of Uzbekistan’s post-independence social contract – with ‘authenticity’ in the place of political contestability – excluded competing viewpoints and political criticism as prejudicial not
only to the ruling regime, but also to the interests of the Uzbek people (March, 2003: 314-15).

Despite the focus on stability to protect the population from the costs of a sharp change in economic strategy, focus group research conducted in Uzbekistan in 1996 and 1997 suggests that non-elites held a negative view of the government’s handling of the post-communist transition. In particular, both Russian and Uzbek focus group participants expressed a belief that the economic benefits from the transition had gone to officials and those tied into elite patronage networks, although many supported the symbolic adoption of Uzbek as the official language (Hopf, 2002: 418-19). Unlike the Kyrgyz Republic and Kazakhstan, Uzbekistan’s post-independence regime legitimation project involved explicitly embracing a gradualist approach to market-based reforms to ameliorate the perceived threat of social unrest from rapid economic change, which led the government to attach far less value to engaging with the international financial community if it also meant relinquishing state control over the economy (Jones Luong, 2002: 130-1). This diluted the force of the argument that the authorities should ‘borrow credibility’ from the Fund to signal their reform commitment to international audiences, because this goal initially ranked low on the government’s agenda. As discussed further below, in the Kyrgyz Republic and Kazakhstan a public commitment to market-based economic reforms and engagement with the international financial community featured much more prominently in each government’s attempt to legitimate its right to rule. Therefore, while post-Soviet elites across Central Asia sought to foster new ‘national identities’ to garner popular support for their regimes, this did not lead them to pursue similar economic strategies but rather prompted them to adopt a range of policy programs intended to increase national wealth and to improve social welfare (cf. Helleiner, 2002: 322-4).

The Economic Dimension of the Transitional Context in Central Asia

The newly independent states’ economic legacies from seventy years of Soviet rule were critical in shaping the degree of Central Asian policymakers’ openness to the Fund’s ideas for market-based monetary reforms. At independence, the Central Asian republics inherited similar institutional legacies from their subordinate roles in the Soviet economic system, although each faced different economic prospects. Like the other former Soviet republics, the newly independent states of Central Asia were accustomed to receiving large budget subsidies from Moscow in addition to implicit financial transfers through the centralized Soviet trading system as recipients of cheap oil and gas imports. Lucjan Orlowski (1993: 1006-7) has estimated that in 1990 these indirect subsidies amounted to approximately 2.72 percent of GDP in the Kyrgyz Republic, compared with 1.26 percent.
of GDP in Uzbekistan. Because of its greater endowment of natural resources in comparison with its neighbors (including rich reserves of oil, minerals, and natural gas), Kazakhstan received smaller indirect financial transfers from the other Soviet republics, estimated at only 0.5 percent of GDP in 1990.

Direct fiscal transfers from the central Soviet budget were an even greater source of support for the republican governments. Orlowski (1995: 64) has estimated that in 1989 net direct fiscal transfers to the republics as a proportion of their total revenue comprised 24 percent of the republican budget in Uzbekistan, 20 percent in Kazakhstan, and 17.8 percent in the Kyrgyz Republic. Figure 6.1, based on Fund calculations, indicates that direct fiscal transfers accounted for between 5 and 10 percent of each republic’s GDP in the late 1980s. This rose in 1990 and 1991 to nearly 20 percent of GDP in Uzbekistan before the Central Asian republics were cut off after Russia took over the Gosbank at the end of 1991, although some fiscal transfers to Kazakhstan continued during 1992. The loss of fiscal revenue further compounded the enormous economic difficulties faced by the republics from price and trade shocks, rapid inflation, and demonetization during 1992 and 1993. As Figures 6.2 and 6.3 indicate, the end of Soviet budget subsidies placed intense pressure on the fiscal capacities of the newly independent states. Public deficits rapidly increased at the same time as governments faced calls for greater subsidies to prop up domestic production and consumption and increased social spending to ameliorate the pressure on firms to maintain wage levels (Broome, 2006: 127, 129-30).
Figure 6.1 Net Union Transfers to Kazakhstan, the Kyrgyz Republic, and Uzbekistan - 1988-92


Figure 6.2 Government Expenditure in Kazakhstan, the Kyrgyz Republic, and Uzbekistan - 1988-92

At the start of 1992, the monetary system in each of the newly independent states was dominated by the republican branches of the Gosbank, which had been legally restructured as national central banks, as well as the specialized banks (spetsbanki) that had been created during the late 1980s as part of Mikhail Gorbachev’s program of perestroika. The spetsbanki included the state savings bank (Sberbank), as well as the state banks that catered to particular sectors of the economy, such as foreign trade (Vneshekonombank), agriculture (Agroprombank), industry and construction (Promstroiбанк), and housing and social development (Zhilsotsbank) (see Schoors, 2003b). All the Central Asian republics followed Russia’s lead in liberalizing prices at the beginning of 1992, although the Uzbek government initially retained a much greater degree of administrative control over prices than either the Kyrgyz Republic or Kazakhstan (Pomfret, 2000: 737). Partly as a result of the continuation of price controls on a larger number of goods, the spike in Uzbekistan’s inflation rate and the contraction of economic output following independence was markedly less than in the Kyrgyz Republic and Kazakhstan, as shown in Figures 6.4 and 6.5.

During 1992, the republics’ central banks relied on two main instruments of monetary control. The first instrument was commercial bank reserve requirements based on the
maturity of deposits, which were unremunerated and therefore constituted a tax on the financial system. The second instrument was central bank refinance facilities for commercial banks and the government. In the Kyrgyz Republic and Kazakhstan, low interest rates on central bank financing for the budget were established in 1992 to replace the previous practice of providing the government with credit at no charge (IMF, 1992: 34-5; IMF, 1992: 8), while in Uzbekistan central bank credit to the government initially remained interest free (IMF, 1992o: 7). In each republic the central bank’s refinance rate for commercial banks was raised from 8 percent to 12 percent in mid-1991, which was further increased at varying rates during 1992 following increases in the CBR’s refinance rate. However, interest rates in all three countries remained negative in real terms given the high rate of inflation. In January 1992 monthly inflation shot up following price liberalization to 157 percent in the Kyrgyz Republic, 212 percent in Kazakhstan, and 118 percent in Uzbekistan, and remained in double figures each month for most of the next two years before a downward trend was established during 1994 (see Figure 6.4).
Figure 6.4 Monthly Consumer Price Inflation in Kazakhstan, the Kyrgyz Republic, and Uzbekistan - February 1992 to December 1994

Source: Koen and De Masi, 1997: 27
Figure 6.5 Growth in Real GDP in Kazakhstan, the Kyrgyz Republic, and Uzbekistan - 1989-2004

Source: EBRD, cited in Pomfret, 2006: 8
In each republic, the *spetsbanki* were heavily dependent upon central bank credit for loanable funds. As discussed in Chapter 4, many firms were either unable or were unwilling to service their debt during 1992 and 1993, and banks struggled to attract new savings in the inflationary environment as the population became increasingly distrustful of the banking system (IMF, 1993u: 40-1). A significant proportion of central bank lending to commercial banks took place on preferential terms well below the official interest rate. During 1992, refinance quotas and preferential refinance rates were commonly used by the republics’ central banks as a way to allocate credit to particular sectors of the economy through the specialized commercial banks, in order to maintain production and employment levels (IMF, 1992l: 8; IMF, 1992j: 34-5; IMF, 1992m: 15). In addition to direct methods of control through differential refinance rates, republican central banks exercised moral suasion over commercial banks by insisting on discussing with bank managers the purposes for which credit would be used before approving loans, which ensured that a high proportion of refancing credit was tied to specific goals (IMF, 1993u: 36-7).

Despite inheriting similar economic challenges at independence, there were also important economic differences in the transitional context each state faced. For instance, households in Kazakhstan were significantly wealthier compared with households in Uzbekistan or the Kyrgyz Republic. During the late 1980s Kazakhstan ranked in the middle-income group of Soviet republics, well above the poorest republics such as Uzbekistan and the Kyrgyz Republic, while still substantially below the much wealthier Baltic republics (Alexeev and Gaddy, 1993: 31). In contrast, the average income level in Uzbekistan was estimated to be among the lowest of the Soviet republics in the 1980s, with Uzbekistan ranking as the poorest Central Asian republic next to Tajikistan (Alexeev and Gaddy, 1993: 31).

Kazakhstan’s economic legacy from the Soviet era shaped its prospects for economic transformation in a distinct way compared with its Central Asian neighbors. At independence, Kazakhstan’s economy was much more tightly integrated with the Russian economy than other Central Asian republics, especially in terms of physical infrastructure such as its systems of electrical power, coal production, and oil pipelines (Blackmon, 2005). Despite having the advantage of inheriting a very favorable endowment of natural resources, it would take Kazakhstan most of the 1990s to reorient its economy and the infrastructure for exploiting its natural resources away from total dependence on Russia.

The attempt to establish a greater degree of economic independence by Kazakh policymakers, which involved the construction of a national economy within geographical boundaries that were previously irrelevant to economic planning and production, would
require substantial external financing. Given the higher degree of integration between Kazakhstan’s economy and Russia’s, compared with its Central Asian neighbors, in the early 1990s the Kazakh authorities faced a choice between maintaining their subordinate position within Russia’s production system and undertaking an expensive reorientation of the economy towards new markets. The government subsequently chose the latter option, and decided to engage with the international financial community to access the foreign investment and technological expertise necessary to develop the potential of the country’s petrochemical sector (Blackmon, 2005: 395). Kazakhstan was less dependent than the Kyrgyz Republic on cooperation with the Fund as a means of securing ODA because of the attractiveness of its natural resources to foreign investors. However, establishing a good working relationship with the Fund staff provided a means through which the authorities could signal their policy credibility to foreign investors as a safe and predictable environment for multinational businesses (Libman, 2006: 281-2; Bayulgen, 2005: 63; Esanov, et al., 2001: 9).

To a far greater extent than either Kazakhstan or the Kyrgyz Republic, Uzbekistan’s economy in both the Soviet and post-Soviet eras centered on cotton production, referred to in Central Asia as ‘white gold’. By the late 1980s, Uzbekistan produced almost two thirds of the total Soviet cotton production, accounted for around one third of the Soviet Union’s gold production, and was the third largest producer of natural gas among the Soviet republics, most of which was utilized by local industries (Blackmon, 2005: 395-6; Lubin, 1989: 622). Therefore, despite the country’s low per capita income level among the Soviet republics, Uzbekistan could rely on the country’s cotton and gold exports in the early 1990s as a ready source of foreign exchange.

As an economic advisor to the president observed in the early 1990s, Uzbekistan remained ‘tied to Russia by thousands of strings’ (Kangas, 1994: 182). Compared with Kazakhstan, however, Uzbekistan’s infrastructure was not as tightly integrated with the Russian republic, which enabled the Uzbek authorities to exercise more control over local energy supplies and to maintain a higher level of economic production following independence (Blackmon, 2005: 396; Ruziev, et al., 2007: 12). Moreover, due to Uzbekistan’s much smaller military industries compared with Kazakhstan, the economy did not suffer as much from the collapse in demand for military goods brought about by the end of the Cold War. With favorable terms of trade in the early 1990s for its main exports gold and cotton, which could easily be sold to new markets, Uzbekistan faced independence with much more promising economic circumstances in the short-term than either the Kyrgyz Republic or Kazakhstan (Agzamov, et al., 1995: 33). Also, unlike most other former Soviet republics the Uzbek authorities did not face the same severe problems
with the collection of domestic tax revenue, despite the loss of Soviet fiscal transfers. This allowed Uzbek policymakers to maintain greater fiscal capacity in the early period of the post-Soviet era than their Central Asian neighbors (IMF, 1995i: 10).

Compared with the economic dimension of the transitional context in both Kazakhstan and Uzbekistan, the Kyrgyz Republic faced independence with very poor economic prospects. In particular, the country lacked an identifiable source of revenue to maintain fiscal solvency, to substitute for its heavy reliance on existing Soviet trade and monetary arrangements, a legacy which Kyrgyz economist Turar Koichuyev described as leaving the country with a ‘psychology of dependence’ on external support (Lloyd, 1993). The Kyrgyz Republic inherited a domestic economic structure that lacked either a ready source of foreign exchange or an endowment of raw resources that could attract large-scale foreign direct investment in the short-term (Pomfret, 2003: 444-5). In these circumstances, external financing by the international financial institutions and other major official donors was the most readily accessible option that was available to Kyrgyz policymakers to alleviate the enormous economic and social costs associated with the breakdown of the USSR and national independence. However, in order to access official sources of external finance, the Kyrgyz Republic would need to cultivate and to consistently maintain a good relationship with the Fund due to the widespread use of cross-conditionality by major bilateral and multilateral donors.

To sum up their initial circumstances, the three Central Asian states examined in this thesis inherited similar institutional frameworks at independence but faced very different economic prospects in the immediate post-Soviet period. As a resource-poor country, the Kyrgyz Republic’s political and economic circumstances left policymakers in need of significant external financing to fill the hole left by the withdrawal of direct and indirect Soviet subsidies to avert a full-blown fiscal collapse and to mitigate political opposition to the post-independence regime (see Esanov, et al, 2001: 14). These circumstances suggest that Kyrgyz political leaders had little choice but to go cap-in-hand to the Fund for policy advice and loans, a decision also influenced by President Akaev’s strong public commitment to enacting market-based reforms. Kazakhstan, by contrast, was much wealthier at independence than either the Kyrgyz Republic or Uzbekistan. In general, states with considerable resource wealth combined with weak formal institutions are likely to face less pressure to enact market-based economic reforms, especially where there is also a long legacy of central planning (Auty, 1999: 9, 27; Auty, 2003: 257). In the case of Kazakhstan, the country’s geographical proximity and integrated physical infrastructure with Russia inclined Kazakh policymakers to seek good enough relations with the international financial community to secure the foreign investment that the country would require in
order to take full advantage of its significant resource wealth (Esanov, et al., 2001: 9). Unlike the Kyrgyz Republic, Kazakhstan could offer numerous investment opportunities to foreign businesses once the basic elements of a foreign investment-friendly environment were established, ‘anchored’ by cooperation with the Fund (Esanov, et al., 2001: 20), which would generate rents to enable Kazakh policymakers to buy off potential sources of political opposition. Uzbekistan suffered the most from the loss of Soviet budget subsidies in the early 1990s, as indicated by Figure 6.1, but faced initial circumstances that enabled the country to maintain a higher level of economic production compared with its Central Asian neighbors. In particular, Uzbekistan’s crop-based resource wealth was easier to exploit and to redirect to new markets than Kazakhstan’s energy and mineral wealth (Auty, 1999: 28; Esanov, et al., 2001: 9; Jones Luong and Weinthal, 2001: 378-9). Combined with the authorities’ ardent concern with maintaining economic and social stability, these conditions predisposed the government of Uzbekistan to be less open to the Fund’s ideas for economic reform than either the Kyrgyz Republic or Kazakhstan.

Introducing the IMF to Central Asia

Crucial for persuading the Central Asian CPEs to adopt an ‘IMF friendly’ path of institutional reform after independence was the speed with which the Fund was able to initiate a policy dialogue with Central Asian elites. This would allow the Fund to commence the necessary groundwork before the former Soviet republics could gain membership in the Fund and apply for a loan program. Although the Kyrgyz Republic, Kazakhstan, and Uzbekistan each applied for membership in the Fund at the start of 1992, even at this initial stage after independence Central Asian policymakers exhibited varying degrees of openness to the Fund’s ideas for economic reform, as indicated by Table 6.1, which summarizes the formal monetary reforms each country adopted between 1992 and 1996.
Table 6.1 Chronology of Key Monetary Reforms in the Kyrgyz Republic, Kazakhstan, and Uzbekistan, 1992-1996

<table>
<thead>
<tr>
<th>Year</th>
<th>KYRGYZ REPUBLIC</th>
<th>KAZAKHSTAN</th>
<th>UZBEKISTAN</th>
</tr>
</thead>
</table>
| 1992 | *Introduction of interest charges on government debt  
*Price liberalization  
*Legal central bank independence | *Introduction of interest charges on government debt  
*Price liberalization | *Partial price liberalization |
| 1993 | *Introduction of credit auctions and quarterly credit ceilings  
*Central bank control over foreign exchange  
*Introduction of a national currency as sole legal tender  
*Current account and capital account convertibility  
*Liberalization of commercial interest rates  
*Introduction of foreign exchange auctions | *Legal central bank independence  
*Introduction of credit auctions and quarterly credit ceilings  
*Introduction of a national currency as sole legal tender  
*Partial current account convertibility  
*Partial liberalization of commercial interest rates  
*Introduction of foreign exchange auctions | *Legal central bank independence  
*Introduction of credit auctions and quarterly credit ceilings  
*Introduction of a temporary national currency  
*Partial current account convertibility |
| 1994 | *Positive real interest rates  
*Expansion of credit auctions  
*Liberalization of commercial interest rates  
*Positive real interest rates | *Expansion of credit auctions  
*Liberalization of commercial interest rates  
*Positive real interest rates | *Expansion of credit auctions and introduction of quarterly credit ceilings  
*Positive real interest rates  
*Current account convertibility  
*Legal central bank independence |
| 1995 | *Acceptance of Article VIII status | | |
| 1996 | *Current account convertibility  
*Acceptance of Article VIII status | | *Introduction of new exchange restrictions |
Following the formal dissolution of the USSR, the Kyrgyz Republic applied to join the Fund on 21 January 1992 and Kazakhstan applied even earlier on 13 January. Uzbekistan was initially reluctant to establish contact with the Fund, and delayed its membership application until 3 March (IMF, 1992o: 1). As seen by the Fund, the varying progress of the staff’s early contact and policy dialogue with Central Asian policymakers after their membership applications reflected their interpretations of the different political and economic circumstances faced by each state. In all three cases, the Fund began by sending a range of technical assistance missions to each country to advise on legal and operational changes to their existing economic institutions, as well as staff missions to conduct pre-membership reviews of each country’s economic circumstances, their existing policies, and their structural reform programs. On the basis of these diagnostic reports, the Fund then advised all three countries to adopt similar immediate monetary changes. In their initial engagement with the region, Fund staff encouraged policymakers to restrain the growth of central bank credit to commercial banks, to cease directing credit to particular sectors of the economy on preferential terms, and to establish positive real interest rates to enable the price of credit to play a greater role in determining the allocation of financial resources.

The Fund’s initial technical assistance missions gathered information on how local systems functioned, began the process of designing institutional reforms, and educated local officials about market-based economies. In the Kyrgyz Republic, the Fund sent five technical assistance missions during 1992, including two missions from the Monetary and Exchange Affairs Department to the National Bank of the Kyrgyz Republic (NBICR) in April and July to advise on the process of central bank reform and monetarist reform in general. The mission staff also helped officials to draft new banking legislation, which largely reflected the Fund’s advice. The Fund established a resident representative in Bishkek in August 1992 to provide a mechanism for regular policy dialogue between the Fund and the Kyrgyz authorities. In early 1993 the Fund sent two further Monetary and Exchange Affairs Department technical assistance missions to advise the central bank on issues related to the introduction of the new currency and the modernization of the NBICR (IMF, 1993o).

The Fund sent four technical assistance missions to Kazakhstan between November 1991 and March 1992, including staff missions from the Fund’s Central Banking Department to provide initial advice to the National Bank of Kazakhstan (NBK) on legal and institutional changes (IMF, 1992m: 21). Further technical assistance missions from the Fund in April, August, and November 1992 aimed to implement a comprehensive program to reform the central bank’s legislative role and monetary operations. In addition to staff missions, training seminars provided by the Fund’s policy departments, and courses
provided by the IMF Institute, the Fund coordinated extensive training in monetary policy for Kazakh officials that was provided by Western central banks. This included courses run by the National Bank of Belgium in foreign exchange management, the Bank of England in banking supervision, and the Bank of France in accounting, while a team of officials from the Bank of Japan visited Kazakhstan in November 1992 to assess how to reform the country’s payments system. The Fund also established a resident representative in Kazakhstan in August 1992, and arranged for consultants from the Austrian National Bank and the US Treasury to take up 1 year positions within the NBK to provide day-to-day advice on monetary reforms (IMF, 1993u: 81-2).

From the beginning of 1992 to the middle of 1993 the Fund sent out seven technical assistance missions to Uzbekistan, including three visits by staff from the Monetary and Exchange Affairs Department to advise the authorities on central bank reform (IMF, 1993aa: 25-6). The State Bank of Uzbekistan had been created from the Uzbek branch of Gosbank in February 1991, and was renamed the Central Bank of Uzbekistan (CBU) in March 1992. The Fund also provided monetary policy training for Uzbek officials at the IMF Institute in Washington and at the Joint Vienna Institute, in addition to courses and seminars provided by the IMF Institute and the Fund’s policy departments in Tashkent during 1993 (IMF, 1993aa: 32).

As the following three sections show, policymakers in each country responded with varying degrees of enthusiasm to the initial attempts to ‘introduce the IMF’ to the Central Asian republics, despite receiving a similar level of technical assistance from the Fund over 1992-93. Seen by the Fund, the Kyrgyz Republic was initially the most ‘IMF friendly’ of the Central Asian states, and Kyrgyz policymakers were willing to adopt many of the recommendations of the Fund’s technical assistance missions. Kazakhstan was open to some of the Fund’s early technical advice on ‘how to do things’ in the move to a market-based economy, but the level of cooperation was initially lower than the welcome reception the Fund appeared to receive in the Kyrgyz Republic. Uzbekistan, in contrast to both states, sought to limit the scope for these initial technical assistance missions to influence the course of the country’s institutional reforms, except where the Fund’s technical assistance recommendations posed little threat to the authorities’ preference for relying on interventionist economic policies. Policymakers’ initial reactions to the Fund’s early technical assistance missions to the region were informed by their interpretation of the transitional circumstances they were facing. The initial receptiveness (or lack thereof) to this advice helped to set the tone for the varying progress that the Fund was able to achieve in persuading Central Asian policymakers to accept its ideas for economic reform as the newly independent states began the process of joining the Fund during 1992.
Initiating a Dialogue with the Kyrgyz Republic

The diagnostic information gathered by Fund technical assistance missions was collated with pre-membership discussions held between the staff and the authorities to form the Fund’s initial assessments of the Central Asian economies and of Central Asian policymakers’ reform intentions, which were subsequently debated by the Executive Board in discussions over the countries’ membership applications. The pre-membership reports and the Board meetings where directors discussed them reveal some early differences in how the Fund saw the potential for enacting market-based institutional reforms in the Kyrgyz Republic, Kazakhstan, and Uzbekistan. For instance, in the Fund’s Pre-Membership Economic Review of the Kyrgyz Republic in March 1992, the Fund staff praised Kyrgyz policymakers for acting ‘rapidly to adapt the institutional and policymaking structure to a more liberal political system and the needs of a market economy’ (IMF, 1992j: 4). Executive Directors also praised the government’s approach to economic reform, with the US alternate executive director Quincy Krosby opening the Board’s discussions on the country’s Pre-Membership Economic Review in April 1992 with the observation that ‘The Republic of Kyrgyzstan sets an impressive example of how far advanced reforms can be, given the will’. In particular, Krosby praised the government’s rapid progress towards passing privatization and trade liberalization laws in 1991 (IMF, 1992k: 3), rule changes that had to be pushed through by presidential decrees in the face of stiff parliamentary opposition (Gleason, 1997: 96).

The US alternate executive director also called for the government to grant the NBKR greater independence from the political decision-making process, to raise the central bank’s refinance rate to positive real levels, and to abolish a law that gave the parliament the right to set the level of central bank financing for the government (IMF, 1992k: 5). As an illustration of the link between the views expressed by the executive directors representing the Fund’s major shareholders and the staff’s negotiations with national officials, these policy recommendations all featured in the staff’s subsequent list of prior actions the Kyrgyz authorities had to implement before they could apply for a loan arrangement with the Fund. In general the Board expressed strong support for what was judged to be an ‘IMF friendly’ program of economic transformation in the Kyrgyz Republic. While noting room for improvement in certain areas – especially with regard to limiting the use of the central bank’s refinance facility and establishing positive real interest rates – executive directors praised the Kyrgyz authorities’ early progress toward implementing market-based reforms (IMF, 1992k).
After becoming a member state of the Fund in May 1992, the Fund assessed that the Kyrgyz Republic had moved rapidly compared with its Central Asian neighbors to implement the advice of technical assistance missions and the policy preconditions that would allow the authorities to finalize a loan agreement with the Fund (IMF, 1993o). The high level of cooperation between the government, central bank officials, and the Fund staff prior to the introduction of the country’s new currency in May 1993 indicates that key players in the executive were initially receptive to the Fund’s advice on monetary reform. Furthermore, the government chose to prioritize parliamentary discussion of its reform program with the Fund above important debates over the Constitution and other significant pieces of legislation, and showed a willingness to overrule domestic opposition and push through ‘IMF friendly’ legislative changes by presidential decrees where necessary (Jones Luong, 2002: 115).

Initiating a Dialogue with Kazakhstan

When the Fund staff visited Kazakhstan in January 1992 to prepare their pre-membership report on the Kazakh economy, the authorities were still publicly committed to maintaining a common economic space among the former Soviet republics. The Fund’s monetary policy dialogue with Kazakhstan during 1992 focused on encouraging authorities to adopt measures to tighten the expansion of credit, such as establishing quarterly limits on commercial banks’ access to the central bank’s refinance facilities and raising the refinance rate in line with inflation (IMF, 1992l: 21). In the second half of 1992, the central bank extended some 68 billion rubles to commercial banks in order to clear the bulk of domestic arrears among ‘creditworthy’ enterprises, but sought to prevent banks from extending new credit to enterprises that had failed to service their debts. In terms of currency reform, the Kazakh authorities emphasized to the Fund staff in early 1992 that their preference was to remain in the ruble zone, although policymakers began making initial preparations for introducing a separate currency in the event that the ruble zone became unworkable (IMF, 1992l: 23). Like the Kyrgyz Republic, in their appraisal of the most important immediate challenge facing Kazakhstan the Fund staff argued that the authorities needed to take measures to halt the almost automatic and unlimited extension of credit from the central bank to commercial banks, which were then passed on to state-owned enterprises on preferential terms (IMF, 1992l: 27).

In contrast to the Executive Board’s largely positive view of the Kyrgyz Republic, executive directors quickly formed a common view that Kazakh policymakers needed to make a greater effort to demonstrate the credibility of their intentions to enact market-based institutional change in cooperation with the Fund. Addressing the Board at the start
of discussions on the country’s membership application, Kazakhstan’s First Deputy Prime Minister Daulet Sembayev told directors that ‘we would not be a Soviet people if we did not attempt to solve all problems simultaneously’. However, Sembayev went on to explain to the Board that the government’s intentions to adopt far-reaching economic reforms, particularly new measures to constrain credit growth, often ran into the difficulty of working against ‘public psychology’. Illustrating the authorities’ difficulties in attempting to overturn entrenched intersubjective ideas through formal policy changes, Sembayev told directors: ‘We can always sign a decree to liberalize prices and introduce new prices in the morning, but those imbued with a subsistence psychology often place great pressure on the Government to resist such measures’ (IMF, 1992n: 19-20). As the First Deputy Prime Minister sought to convey to the Board, even when changes were introduced through new legislation, some economic reforms initially failed to be implemented because they went against people’s entrenched beliefs about the appropriate role of the state and how the economy should work.

Following Sembayev’s statement, the Board encouraged the Kazakh authorities to heed the staff’s advice to constrain the growth of credit, specifically by raising interest rates to positive real levels, and urged the government to resist any temptation to respond to political pressure for the reintroduction of price controls or for large wage increases to compensate for the rise in inflation. Executive directors voiced support for the Kazakh authorities’ decision to remain in the ruble zone in the immediate future, so long as monetary policy coordination could be achieved among the former Soviet republics (IMF, 1992n: 47-9). Despite the daunting economic challenges the country faced, the Board praised the Kazakh authorities’ decision to pursue a market-based economic system and commended the policy changes that had already been adopted, while urging the government to develop a more comprehensive program that could be supported by a Fund loan arrangement.

The German executive director, Bernd Goos, drew particular attention to the Fund’s uncertainty regarding the authorities’ commitment to establishing a market-based monetary system, which would require the authorities to refrain from providing preferential credit to enterprises and to set positive real interest rates (IMF, 1992n: 30). The need for further credit restraint was seen by the Board as a crucial prerequisite for lowering inflation and establishing the credibility of Kazakhstan’s economic reforms among international audiences, and indicated the Board’s skepticism of Sembayev’s assurances that ‘enterprises’ unlimited access to credit was a thing of the past’ (IMF, 1992n: 45). The executive director representing the Canadian constituency, Gabriel Noonan, emphasized that ‘Unless inflation is brought under control, many of the structural and other measures already taken and
planned, including price liberalization, will be built on sand’ (IMF, 1992n: 32). These concerns were shared by other directors, and were reinforced by the US alternate executive director, Quincy Krosby, who stated that ‘Despite the authorities’ good intentions, efforts to stabilize and reform the economy have so far been fragmented, often ineffective, and in some cases, even counterproductive’ (IMF, 1992n: 34-5). Notably absent from the tone of the Board’s discussions was the high level of praise that executive directors had given to Kyrgyz policymakers for developing a comprehensive program of economic transformation in close cooperation with the Fund staff. Reflecting the views of several other directors, Krosby observed that ‘we see some promise in the authorities’ policy intentions’, but concluded that policymakers would ‘need to work hard to define and implement more consistent policies for this potential to be achieved’ (IMF, 1992n: 36).

*Initiating a Dialogue with Uzbekistan*

In Uzbekistan, the style of the authorities’ early policy measures following independence was reflected by their lukewarm response to initial contacts with the Fund. As one of Karimov’s advisors stated in an interview with Jones Luong (2002: 133) in 1995, the president wanted to achieve economic and political self-sufficiency ‘to avoid another situation like before, when we took orders from Moscow... and were dependent on it economically’. When the Fund began arranging staff visits to the former Soviet republics of Central Asia following the disintegration of the USSR, Uzbekistan was the only former Soviet republic where the Fund wasn’t planning to send a staff team for initial diagnostic discussions on the country’s economic circumstances and structural reform program. As discussed above, these early Fund missions were important because they offered the staff a chance to quickly establish a good working relationship with local policymakers and to lay out the range of policy alternatives for devising a comprehensive reform program and building a new national economy. Although staff missions of approximately two weeks duration were scheduled for the other Central Asian republics during the first quarter of 1992, the Fund’s managing director informed the Board in January 1992 that ‘Uzbekistan seems disinclined to cooperate closely at this stage, and a staff visit is not planned in the immediate future’ (IMF, 1992a: 11). Staff visits were subsequently arranged two months later after Uzbekistan had indicated its intention to apply for membership in the Fund.

From the start of their policy dialogue with the Fund, the Uzbek authorities emphasized that their main priority was maintaining the country’s economic and social stability. For instance, in March 1992 the authorities informed the Fund that the two-week delay in liberalizing prices after Russia’s price reforms ‘reflected concerns at the social impact of sharp price increases in a country with a relatively young and poor population’ (IMF,
The authorities had partially reintroduced price controls on a number of important goods following student protests over price rises in January, when clashes between university student protesters and police in Tashkent resulted in reports of at least six deaths and over thirty injured (Nadler, 1992). In discussions with the Fund staff, Uzbek policymakers made clear ‘their commitment to implementing economic reform policies with a view to transforming the economy into a market-based system’ (IMF, 1992o: 9). The caveat, as the staff reported to the Board, was that ‘the authorities believe that the social and economic circumstances of Uzbekistan warrant a more gradual and measured pace of adjustment – and systemic change – than that followed in the Russian Federation, or in most other republics in the region’ (IMF, 1992o: 11). In short, Uzbek policymakers prioritized the goal of achieving ‘stability at any cost’ after the country gained its independence, and were suspicious of outside influences over the country’s political and economic changes (Ruziev, et al., 2007: 11). This provided a stark contrast to the start of the Fund’s relations with both the Kyrgyz Republic and Kazakhstan, where the authorities rhetorically committed themselves to introducing a rapid pace of economic reforms from the beginning, although it took time for the Fund to persuade them to follow this up with concrete measures. In Uzbekistan, the Fund faced a government that signaled its suspicions of an ‘IMF friendly’ approach to economic reform from the start.

In response to the Uzbek government’s account to the Fund of its policy intentions, the staff sought to persuade policymakers to change track by spelling out the economic and symbolic costs that, in the staff’s view, would be associated with a gradualist approach to market-based reforms. Drawing on the Fund’s intellectual resources, ‘The staff cautioned the authorities against believing that they could afford a gradualist approach to systemic reforms’ (IMF, 1992o: 11). In addition to the distortionary effects that the staff believed would result from a slow approach to economic transition, the staff argued that the economic linkages between the Central Asian republics were so strong that rapid reforms in other republics would greatly increase the fiscal costs associated with a gradualist approach. For instance, the staff suggested that a gradualist approach could stimulate illicit cross-border trade if prices were subsidized in one country but not in others. To bolster their case, the staff also drew on the argument that cooperation with the Fund was necessary to improve Uzbekistan’s reputation in the international financial community, and that developing an ‘IMF friendly’ reform program would help to improve Uzbekistan’s creditworthiness by signaling to international audiences that the government was committed to adopting market-based reforms. The staff argued that to attract new external financing and investment ‘it was critical to convince international investors of the seriousness of reform intentions’, which the staff concluded ‘would be possible only with
bold and rapid steps to restructure the economy and reduce state intervention'. While they did not openly disagree with the Fund staff on these points, Uzbek policymakers perceived the benefits of economic and social stability as more important in the short-term (IMF, 1992o: 11). Like other Central Asian republics in early 1992, Uzbekistan was still committed to remaining in the ruble zone, although the authorities were concerned about the disruptions to inter-republican trade and monetary developments in other republics. Uzbek policymakers indicated to the Fund that they would only consider introducing a national currency if a tipping point was reached where most of the other republics chose to establish monetary independence from Russia (IMF, 1992o: 17).

When the Board discussed Uzbekistan’s application for Fund membership in April 1992, executive directors encouraged the Uzbek authorities to embrace a more rapid approach to market-based reform. A delegation from Uzbekistan that was present at the Board meeting included the Minister of Finance Erkin Bakibaev, the Chairman of the National Bank for Foreign Trade Activities Roustam Azimov, and a representative of the Uzbek president, Farid Maqusudi. The comments of the Austrian alternate executive director, Johann Prader, help to capture the focus of the Board’s debate. Prader argued against the Uzbek authorities’ plans for taking a slow approach to economic reform in order to protect the poor and to maintain social stability. Reflecting the Fund’s general preference for targeted rather than universal social protection systems, Prader contended that ‘the well-being of the vulnerable segments of society depends less on the pace of economic reform than on the quality of the social safety net’. In addition, he suggested that the ‘best way to avoid social unrest is to establish sustainable economic growth and an improved living standard’, which would more easily be achieved under a rapid and comprehensive reform program (IMF, 1992p: 33-4). Even at this early stage, however, there was recognition within the Fund that a gap existed between the Uzbek authorities’ rhetoric and their actions. For instance, Prader stated to the Board that ‘what the authorities had described as a gradualist approach toward reform was very much a matter of presentation and perception’. Following discussions with the Uzbek delegation, his assessment was that economic policy changes were in fact occurring more rapidly. Prader also drew attention to the fact that ‘contacts between Uzbekistan and the Fund had thus far been limited to two staff missions’. Illustrating the Board’s confidence in the capacity of the staff to persuade Central Asian policymakers to adopt an ‘IMF friendly’ program of reform, he argued that, as contact intensified, ‘the logic of events and the laws of economics would ensure that the views of the staff and the authorities would converge over time’ (IMF, 1992p: 34).

In response to Prader’s comments Uzbekistan’s Minister of Finance, Erkin Bakibaev,
informed the Board that, due to the country’s demographic profile (including a very high population growth rate, with half of the population under the age of 19), the authorities had ‘been forced consciously to support via the budget the more socially needy stata of the population’. Bakinbaev told the Board that this support ‘is a guarantee of the preservation of social and political stability in the country and the basis of civil agreement’, but he also accepted the need to move towards more comprehensive price liberalization (IMF, 1992p: 35). In response to Bakinbaev’s comments, directors strongly urged the Uzbek authorities to adopt more rapid market-based reforms. Alejandro Végh, the executive director for Argentina’s constituency, provided a clear assessment of the differences between the Fund’s evaluation of Uzbekistan’s policy orientation compared with the other Central Asian republics. Végh observed that in other former Soviet republics ‘good policies were being implemented weakly’, whereas Uzbekistan’s approach ‘contained some very basic flaws’ (IMF, 1992p: 41). Summing up the Board’s views at the conclusion of the meeting, the managing director noted that ‘directors underscored the need [for policymakers] to assign a higher priority to the reinforcement of structural reforms and the immediate implementation of macroeconomic adjustment policies’ (IMF, 1992p: 47).

After Uzbekistan became a member of the Fund in September 1992, the authorities continued to move slowly over the next two years toward developing closer policy dialogue and cooperation with the staff. Prior to the Fund’s first Article IV consultation with Uzbekistan in October 1993, the Fund had sent out four staff visits in May 1992 and in January, March, and April 1993 to discuss the development of a reform program for Uzbekistan that could be supported by a Fund loan. Despite receiving a level of technical assistance from the Fund that was comparable to both the Kyrgyz Republic and Kazakhstan, Uzbek policymakers had proven much more reluctant to act on the Fund’s policy recommendations. In the staff’s assessment, ‘positive actions have been taken only in areas affecting the internal functioning of the Central Bank or areas which do not infringe on central planning or administrative allocation of credit’, while more substantive advice ‘has been largely ignored by the Government’ (IMF, 1993aa: 30, 33). Moreover, the staff was concerned that the government had taken ‘regressive actions’ against the advice of technical assistance missions, such as strengthening the CBU’s direct control over cash money operations.

Like the Fund’s advice to the Kyrgyz Republic and Kazakhstan, the main monetary policy recommendations offered by technical assistance missions to Uzbekistan included the introduction of credit auctions, increasing the refinance rate, removing preferential terms of credit and controls on commercial banks’ interest rate margins, and transferring the management of foreign exchange reserves to the central bank (IMF, 1993aa: 34).
However, such reforms would first require changes in how Uzbek policymakers’ conceived their interests. This can account for the government’s program of expanding state intervention in the economy, compared with the Kyrgyz Republic and Kazakhstan where policymakers saw cooperation with the Fund as a means to access overseas development aid and foreign direct investment. In response to the Uzbek authorities’ actions to increase state control over the distribution of financial resources, in addition to the lack of progress in implementing technical assistance recommendations, the Fund chose to reduce its technical support program to the Uzbek authorities until the advice of earlier technical assistance missions was implemented (IMF, 1993aa: 31, 33).

Summary

As this chapter has shown, the Kyrgyz Republic, Kazakhstan, and Uzbekistan each inherited similar political and economic institutional frameworks following the breakdown of the Soviet Union, but each faced very different economic prospects. The Kyrgyz Republic was an example of a resource-poor country in need of significant external financing to ameliorate the loss of Soviet budget and trade subsidies, which predisposed President Akaev to seek good relations with bilateral and multilateral donors by establishing a strong relationship with the Fund. As discussed in the foregoing chapters, in certain conditions the Fund’s role as an intellectual actor also enables it to play an informational role as a reputational intermediary for its member states by drawing on the organization’s conservative reputation for insisting on tough loan conditions to achieve sound money and sound public finances. For the Kyrgyz Republic, good relations with the Fund helped to pave the way for the country to access ODA from other official sources during circumstances where it was unlikely to be able to access private financing and had few options for earning hard foreign exchange. While the conventional wisdom suggests that resource-rich countries are better able to resist pressure for economic reform, Kazakhstan also needed to access ODA in the short-term to meet balance-of-payments shortfalls, and sought to draw on the Fund’s reputation to help establish a foreign investment-friendly environment and attract private financing to develop its energy and mineral industries. Uzbekistan, by comparison, provides an example of a resource-rich country that was better placed to resist pressure for reform. At independence, Uzbekistan’s domestic energy sources were already geared towards domestic production, while its heavy reliance on cotton production initially provided the authorities with a ready source of foreign exchange and enabled the government to maintain greater fiscal capacity than its neighbors.

These differences in the countries’ initial circumstances were reflected in policymakers’
initial openness to the Fund’s ideas for economic reform when the organization began sending technical assistance missions to Central Asia to lay the groundwork for ‘IMF friendly’ reforms. The Fund staff’s pre-membership economic reviews of each country, and the Executive Board meetings where these were discussed, also reveal early differences in how the Fund saw the potential for enacting market-based institutional reforms in the Kyrgyz Republic, Kazakhstan, and Uzbekistan, based on the speed of each state’s initial progress and the staff’s assessments of policymakers’ reform intentions. In the Kyrgyz Republic, the Fund staff found that policymakers were open to the recommendations of technical assistance missions, as well as the staff’s advice on policy changes that would form the basis of prior conditions for an initial loan program. While Kazakhstan did not receive the same high level of praise from the staff and the Board as the Kyrgyz Republic, the Fund saw the country as an intermediate case where policymakers might be persuaded to pursue ‘IMF friendly’ policy changes over time, once outstanding issues such as Kazakhstan’s participation in the ruble zone had been resolved. In Uzbekistan, however, the Fund found a government it perceived to be distinctly ‘IMF unfriendly’ from the start, which prioritized the goal of achieving ‘stability at any cost’ well above the goal of structural economic reform.

In all three cases, the Fund had to deal with a high level of domestic uncertainty. This impeded the staff’s capacity to formulate appropriate reform programs, as well as making it difficult for the Fund to persuade national policymakers to adopt reforms when the outcomes were indeterminate and elites were preoccupied with the need to ensure regime survival. The systemic crisis caused by the demise of the Soviet Union opened a window of opportunity for systemic change in Central Asia, as each new state would have to take on macroeconomic responsibilities previously controlled from Moscow. At the same time, the Fund initially lacked much in-depth knowledge about the Central Asian economies, while the countries themselves faced extreme shocks in dealing simultaneously with political and economic independence, the end of Soviet subsidies, very high inflation, as well as precipitous declines in economic output. In these circumstances, the Fund’s initial capacity to persuade Central Asian policymakers to adopt its reform preferences was largely determined by how policymakers interpreted the challenges that they faced, and, in particular, whether or not they believed that they needed the Fund’s help to cope with those challenges. As the following two chapters will show, where policymakers exhibited a degree of openess to its ideas the Fund’s role as an intellectual actor came to the fore – even if this was driven by the need for governments to access additional external financing rather than a commitment to adopting ‘IMF friendly’ reforms for their own sake.
Conditionality and Compliance in Central Asia

This chapter examines the development of the Fund's policy dialogue with the Kyrgyz Republic, Kazakhstan, and Uzbekistan, and focuses in particular on how quickly the Fund was able to put an initial loan agreement in place. The Fund staff only supported loan applications when they were satisfied that national policymakers intended to work with the Fund to devise appropriate monetary reforms. In these cases, discretion lay with how staff interpreted each government's intentions, rather than the implied voting weight of major shareholders on the Executive Board. The speed with which an initial loan agreement was reached therefore provides an indicator of the staff's progress in their early policy dialogue with each state.

As the foregoing chapters have shown, by formally accepting the obligations of Fund membership, the post-Soviet states of Central Asia publicly agreed to adopt a set of explicit rules and guiding norms about how to regulate their monetary frameworks and national currencies that contrasted starkly with the function of money in the Soviet economy. The principles of current account convertibility and central bank independence were already widely entrenched in many countries around the world when the former communist economies began their transition to a market economy. For the Kyrgyz Republic, Kazakhstan, and Uzbekistan, both changes would have significant implications for the capacity of political elites to maintain their newfound monetary policy autonomy that they gained with the demise of the Soviet Union and the subsequent collapse of the Russian-dominated ruble zone, and would therefore require a change in how political elites sought to pursue their interests. Current account convertibility would link the Central Asian economies to the world economy, and would circumscribe the potential for political leaders to channel foreign exchange to particular industries or to particular social groups. If adhered to in practice, central bank independence and reliance on indirect monetary instruments would also remove an important set of monetary tools that policymakers could use to influence domestic economic activity, employment levels, and the distribution of financial resources.

This chapter proceeds as follows. The first three sections explore how the Kyrgyz Republic became the first Central Asian state to access both an STF and an SBA loan program, and how the country performed under these loan programs as seen by the Fund.
Here I show how the Fund sought to change the financial behavior of the government, the central bank, commercial banks, and state-owned firms by restructuring the formal institutional relationships between them and constructing a new monetary system for determining the allocation of credit. The next three sections explore the development of the Fund’s policy dialogue with Kazakhstan, which lagged behind the Kyrgyz Republic in the speed with which the country was able to establish a loan program with the Fund while the government was preoccupied with maintaining the ruble zone. Again, under the country’s first STF loan, the Fund sought to change financial behavior by restructuring the formal institutional relationships between economic actors and the state. Here I show how, despite reform lagging behind the Kyrgyz Republic, the Fund was still able to persuade the Kazakh authorities to adopt key formal monetary changes, which could help to harden the budget constraints on commercial banks and firms. Once the country’s new currency, the tenge, was in place in November 1993, this cleared the way for Kazakhstan to access an SBA loan with the Fund.

The final three sections of this chapter explore the Fund’s developing relationship with Uzbekistan, the Fund’s most difficult case for market-based economic reform from the three Central Asian countries examined here. Uzbekistan lagged well behind both the Kyrgyz Republic and Kazakhstan in its policy dialogue with the Fund during 1993, when policymakers were preoccupied with supporting domestic production and employment rather than engaging in ‘IMF friendly’ monetary reforms. Here I show how the Fund gradually improved its relations with Uzbek policymakers following the final collapse of the ruble zone in late 1993, when the country began to face greater economic difficulties and lacked information on how to operate a national monetary system. This progressively allowed the Fund to exercise greater influence over the direction of monetary reforms in Uzbekistan, although changes continued to be implemented at a much slower pace than that preferred by the Fund staff.

Establishing an IMF Loan Program with the Kyrgyz Republic

Before the Fund staff would support loan applications from the Central Asian CPEs, policymakers would have to demonstrate to the Fund that they were serious about abandoning Soviet-era monetary practices and adopting ‘IMF friendly’ monetary reforms. As discussed in the foregoing chapters, the general monetary reform template that the Fund constructed for post-communist economies focused on establishing current account convertibility as a means of decentralizing economic decision making, increasing the role of relative price changes in determining the allocation of financial resources, and encouraging greater competition to breakup the monopolistic trading arrangements among domestic
firms. The Fund saw the establishment of an independent central bank and the development of indirect market-based monetary instruments as key preconditions for the establishment of current account convertibility, which could help to enforce monetary restraint and provided a means of altering the financial relationship between the government, the central bank, commercial banks, and state-owned firms. These reforms would also allow states to signal their policy credibility to the international financial community, and would conform to the Fund’s reputation for diffusing economic ideas that promote ‘sound money’ and ‘sound public finances’.

As discussed in Chapter 3, the Fund relies on the application of prior actions as a means to test the strength of policymakers’ commitment to achieving ‘IMF friendly’ economic reforms. The early demonstration of Kyrgyz policymakers’ willingness to implement the Fund’s advice from technical assistance missions enabled the government to move rapidly to finalize the terms of a loan arrangement with the Fund staff. In March 1993, only ten months after becoming a member of the Fund, the staff supported the government’s request for a stand-by arrangement amounting to SDR 40.2 million. In the intervening period, the Fund staff had successfully persuaded the Kyrgyz authorities to adopt numerous prior actions, which encompassed the Fund’s four preconditions for establishing current account convertibility.

Of the eight prior actions adopted by the Kyrgyz authorities when they applied for a stand-by arrangement, five were connected to monetary reform. First, Kyrgyz policymakers had nearly completed a process of price liberalization, which the Fund wanted in place prior to the introduction of a new currency. Second, the government had adopted a budget for 1993 that would restrict public deficits from the point when the new currency was introduced, which the staff encouraged on the basis that it would help to shore up confidence in the value of the new currency by enforcing hard credit constraints and would signal an end to credit subsidies. This followed the extension of credit to enterprises at very low interest rates in the first quarter of 1993, which accounted for an estimated 17 percent of the country’s GDP. Third, the government had passed new legislation governing the role of the central bank and commercial banks, which legally established the central bank’s independence from the government and stipulated an arms-length relationship between the NBKR and commercial banks. Fourth, from February 1993 the government had begun to allocate a proportion of central bank credit to commercial banks through credit auctions. This was a key change that the Fund wanted on the basis that it would help to create incentives for banks to act in accordance with market principles. Combined with increases in the central bank refinance rate, the introduction of credit auctions reduced the monetary benefits that had previously been available to state-owned firms in three ways. First, by
increasing the cost and restricting the availability of bank credit; second, by stabilizing the value of enterprise debts that had declined because of negative real interest rates; and, third, by shifting the central bank towards a more arms-length relationship with commercial banks. Finally, the government had centralized the control of foreign exchange reserves and gold in the central bank, which the Fund wanted in order to depoliticize decisions over the distribution of foreign exchange (IMF, 1993o: 21-2).

Within the first year of the country’s membership in the Fund, the Kyrgyz authorities had therefore moved comparatively quickly to implement some of the key monetary policy reforms and institutional changes that the Fund promoted for the former Soviet CPEs, by taking significant steps towards changing the nature of domestic monetary arrangements among different economic actors and re-orienting the economy in a market-based direction. Before the staff would recommend that the Board approve the Kyrgyz Republic’s application for a stand-by arrangement, however, two monetary prior actions that remained to be implemented included introducing a new currency and passing legislation to establish a new liberal exchange rate regime (IMF, 1993o).

The staff appraisal of the Kyrgyz Republic’s application for a stand-by arrangement indicated that the staff believed that the government had in general accepted their policy advice on monetary reforms during 1992. In particular, the staff hailed the introduction of credit auctions as a key mechanism for phasing out the administrative allocation of credit to commercial banks, and praised the government’s decision to introduce a convertible currency based on a free-floating exchange rate regime without intervention to influence the exchange rate by the NBKR. The staff was nonetheless critical of the government’s loose credit policies in the second half of 1992 and early 1993, and urged the government to resist demands from the agriculture sector and state-owned enterprises for the continued extension of easy credit (IMF, 1993o: 21, 23).

The performance criteria the staff proposed to the Board for the first and second reviews of the stand-by arrangement, which were scheduled to be held in September and December 1993, centered on assessing the Kyrgyz Republic’s implementation of the policies set out in its Memorandum of Economic and Financial Policies to the Fund that defined the government’s key reform objectives. Based on the staff’s advice, the government’s reform objectives included establishing quarterly limits on commercial banks’ access to refinance credit from the NBKR, discontinuing the practice of directed credits, and allocating all refinance credit through competitive auctions. The government committed itself to discontinuing the practice of automatically rolling over refinance credit upon maturity by the end of 1993. In addition, the maximum maturity period for central bank credit would be halved to 6 months in order to encourage commercial banks to use
the NBKR’s refinance facility only to meet short-term cashflow requirements, rather than as their main source of loanable funds (IMF, 1993q).

Through the application of prior conditions and the loan performance criteria designed by the staff for the Kyrgyz Republic, the Fund attempted to persuade Kyrgyz policymakers to set new parameters for the ‘institutional game’ that could help to change actors’ preferences in favor of a market-based monetary system. In particular, the Fund staff wanted to change the behavior of Kyrgyz banks by encouraging them to attract domestic savings as their main source of loanable funds, thereby increasing domestic financial intermediation and the allocation of finance based on prices and creditworthiness assessments rather than administrative discretion and banks’ traditional financial relationships with firms. To help achieve these objectives, the staff persuaded the government to commit to removing controls on commercial banks’ interest rates (IMF, 1993q). The authorities also agreed to meet the Fund’s quantitative performance criteria, which included meeting targets for domestic credit ceilings, a minimum level of convertible currency reserves, and limits on the growth of the money supply, as well as a prohibition on assuming further noncessional debt (IMF, 1993o: 33).

Based on recommendations made by the Fund’s technical assistance missions, the NBKR also introduced changes to commercial banks’ ‘risk concentration ceilings’, which lowered the percentage of capital that banks could lend to a single customer or an individual bank shareholder (IMF, 1993o: 15). Because of the close relationship that had existed between the central bank and the spetsbanki in the Soviet system, such changes would radically alter the central bank’s role in the domestic economy. This would also provide incentives for economic actors to adapt to a new market-based environment rather than resisting pressures for change by relying on traditional financial relationships. The Fund staff believed that this was crucial for the long-term maintenance of an ‘IMF friendly’ policy orientation. As the Fund had learnt from the ruble zone crisis, achieving de facto central bank independence in the former Soviet republics of Central Asia would require not only embedding an arms-length relationship between the central bank and the government in the everyday operation of monetary policy, but also establishing an arms-length relationship between the central bank and commercial banks. Because of the impact that these changes would have on the capacity of commercial banks to continue to extend large credit flows on preferential terms to their traditional industrial customers, central bank reform became a key focus of the Fund’s attempts to break up the close financial arrangements that existed between commercial banks and major public enterprises. The Fund staff argued for these policy changes on the basis that they would help to reduce the segmentation of credit markets and were in line with best practice international prudential
norms. Moreover, if they were fully implemented such changes would diminish the bargaining power of individual economic actors to lobby for continued access to ‘easy money’ based on inherited financial norms. This could help to consolidate the political dominance of policymakers who were willing to support the Fund’s approach, which was one of the major challenges for the Fund’s intellectual role in Central Asia.

Before the Executive Board had considered the Kyrgyz Republic’s application for the use of Fund resources under a stand-by arrangement, the government made an additional request for Fund resources at the beginning of May 1993 under the newly established systemic transformation facility. The Fund staff supported this move because it would allow the authorities to build up their foreign exchange reserves in preparation for the introduction of the new convertible currency. The Kyrgyz authorities applied to reduce their SBA purchase to SDR 27.09 million in combination with a proposed purchase of SDR 32.25 million under the STF because the STF funds would be on concessional terms. The two requests for access to the Fund’s resources added up to a total of 92 percent of the Kyrgyz Republic’s quota in the Fund. It is a measure of the Kyrgyz Republic’s positive policy relationship with the Fund that the staff supported the country’s application for a stand-by arrangement in conjunction with a systemic transformation facility loan, when the other Central Asian states had to successfully graduate from an STF loan before the staff would support applications for an SBA.

As discussed in Chapter 1, the Fund was expected to perform a ‘screening function’ for other multilateral and bilateral donors in the former Soviet republics, by assessing the credibility of policymakers’ reform intentions and reinforcing their commitment to market-based reforms through loan conditionality. Highlighting the importance of establishing good relations with the Fund in order to gain access to other official sources of external finance, if the Kyrgyz Republic’s proposed stand-by arrangement was approved the World Bank had agreed that the country would be granted a US$60 million import rehabilitation credit on concessional terms. Faced with high monthly inflation, a sharp drop in economic output, and a large fiscal deficit, there was a great deal riding on the Kyrgyz Republic’s capacity to achieve an early loan agreement with the Fund in 1993 (see Figures 6.3, 6.4, and 6.5). Between the authorities’ first request for an SBA in March and the new application in May, the Kyrgyz parliament had approved the introduction of a new national currency, and the president had issued decrees abolishing foreign exchange surrender requirements for exporters and established a new liberal exchange rate regime. These policy changes addressed the two remaining prior actions relating to monetary reform that the Fund staff had wanted. The staff therefore recommended that the Board approve the Kyrgyz Republic’s SBA and STF loan applications based on the reasoning that the authorities’
reform program constituted ‘a clear indication that Kyrgyzstan is cooperating with the Fund in an effort to find appropriate solutions to its balance of payments difficulties’ (IMF, 1993p: 4).

Following intensive technical assistance and training provided by the Fund, as well as technical assistance provided by consultants from the central banks of Estonia and Slovenia in early 1993, the Kyrgyz authorities moved to introduce its new national currency, the Kyrgyz som, following parliamentary approval by a large majority on May 3. The government announced on May 7 that the som would enter circulation on May 10, with the conversion period lasting until May 14. All Kyrgyz citizens as well as nonresidents were permitted to convert an unlimited amount of cash rubles into som at the rate of 200 rubles per som. Deposits in the Savings Bank would be converted at the more favorable rate of 150 rubles per som to partly compensate account holders for the depreciation of their bank balances due to high inflation. Because the Kyrgyz authorities had insufficient foreign exchange reserves to defend a fixed or a semi-fixed exchange rate regime, the government took the Fund’s advice and chose to introduce a free-floating exchange rate regime for the som. As a further demonstration of the government’s willingness to listen to and implement the Fund’s advice – even when this might severely disadvantage politically-important domestic industries such as agriculture – policymakers also took the bold step of establishing full currency convertibility by removing all restrictions on both current account and capital account transactions (IMF, 1993n: 61-2).

The Executive Board and the Battle of the Som

As the first Central Asian state to establish monetar)' independence from the ruble zone and to adopt full currency convertibility, the Kyrgyz Republic received strong support from the majority of directors on the Executive Board. The Board’s discussions on the Kyrgyz Republic’s application for an SBA and an STF arrangement with the Fund took place on 12 May 1993, when the country was halfway through the process of converting from the ruble to the som. In his introductory remarks, Daniel Kaeser, the executive director representing the Kyrgyz Republic, argued that the Fund should support the country’s reform program ‘because of the seriousness of the commitment and the competence shown by the Kyrgyz authorities’. Kaeser drew particular attention to the need for the Fund to offer strong support for the introduction of the first national currency in Central Asia, especially because of initial distrust of the currency amid local press reports that the som’s value ‘was worthless because it was without backing’ (IMF, 1993j: 29). The initial response from the Kyrgyz Republic’s neighbors had added to domestic uncertainty about the new currency, with Uzbekistan closing the Kyrgyz-Uzbek border, freezing monetary and trade
transactions, and shutting off the country’s gas supplies (Lloyd, 1993). In response, Kaeser called for the Fund to perform an intermediary role by signaling strong rhetorical support for the new currency by communicating to the Kyrgyz press that its value ‘was guaranteed mainly by the economic program that the authorities had agreed on with the Fund’ (IMF, 1993): 29).

Despite broad support for the Kyrgyz Republic, not all executive directors shared this rosy assessment of the Kyrgyz authorities’ commitment to market-based reform. The Russian executive director, Konstantin Kagalovsky, questioned the strength of the Kyrgyz authorities’ commitment to maintain tight credit policies given the large expansion of central bank credit in the first quarter of 1993. Drawing attention to the outstanding bilateral differences between the two countries, Kagalovsky pressed for a resolution of the Kyrgyz Republic’s outstanding technical credits that were owed to Russia before the Russian government would consider the extension of new bilateral credit to bridge the government’s financing gap. Although he concluded his remarks by supporting the country’s application for an SBA and STF arrangement, the Russian executive director indicated that supplementary financing from Russia for the Kyrgyz Republic’s loan program would be withheld until the issue of technical credits was resolved. As Kagalovsky stated to the Board: ‘My authorities are ready to consider Russia’s contribution to the gap coverage the day after such an agreement [on the outstanding technical credits] has been signed; however, we cannot commit to giving even a penny today’ (IMF, 1993): 36).

With the exception of the Russian representative, most other executive directors extended a high level of praise for the Kyrgyz authorities’ commitment to implement a market-based reform program in cooperation with the Fund staff. Some directors even questioned whether the Kyrgyz Republic had gone too far too fast in pursuit of an ‘IMF friendly’ program of economic reform, although their views were in the minority. The Japanese alternate executive director, Naoki Tabata, questioned the staff over whether the Fund should consider recommending the introduction of new exchange restrictions if the som became unstable, possibly including the re-introduction of exchange surrender requirements for exporters or restricting internal currency convertibility by not permitting residents to hold foreign currency-denominated bank deposits. In addition, Giulo Lanciotti, the executive director representing the Italian constituency, questioned the staff over whether the authorities might have been better to rely on bank-specific credit ceilings rather than non-discriminatory credit auctions for allocating central bank refinance credit in the short-term. Lanciotti argued that this would help to ensure that commercial banks with a high level of bad loans did not simply outbid more creditworthy banks to gain new finance. The temporary alternate executive director representing France, Patrice Bonzom,
also mooted the potential for greater use of direct instruments of monetary control to achieve macroeconomic stability (IMF, 1993j: 38, 41, 47).

Kaeser’s request for the Fund to play an intermediary role by providing a strong public demonstration of its confidence in the soundness of the Kyrgyz authorities’ reform program as well as the new currency itself was reinforced by the comments of Oleh Havrylyshyn, the alternate executive director for the Netherlands constituency. Havrylyshyn argued that ‘the soundness of the som is a reflection of the soundness of the economic stabilization and reform program’. He urged the Fund’s management to express its strong confidence in the program through a press release in support of the currency, with the ‘hope that someone locally can then shout this from the rooftops of Bishkek to offset the early skepticism shown toward the som’ (IMF, 1993j: 50). The directors hoped that the Fund’s capacity to act as a reputational intermediary for its borrowing member states among international audiences could also help to shore up local confidence in the new Kyrgyz currency. Among Western commentators, the introduction of the som was subsequently described by the financial press as a crucial test case not only of the strength of the Kyrgyz authorities’ commitment to market-based economic reform, but also of the credibility of the Fund itself. For example, John Lloyd (1993), writing in the Financial Times, suggested that the ‘battle of the som’ would determine ‘the future of the state itself, the viability of new currencies in the post-Soviet world and the reputation of the multilateral financial institutions’.

With regard to the broader objectives of the loan program, other executive directors reinforced the need for the Kyrgyz authorities to signal their intention to maintain a strong commitment to market-based reform by consistently implementing the policies that had been designed in cooperation with the Fund staff. The temporary alternate executive director for the US, John Abbott, urged the Kyrgyz authorities to ‘stand firm on intentions to harden the budget constraints of public enterprises’ by refusing to allocate credit on preferential terms. In this regard, Abbott praised the decision to move towards the market-based allocation of credit through auctions and the enactment of legislation to establish central bank independence. Commenting on the fact that the Kyrgyz Republic would be the first state to access the Fund’s brand new STF lending window – and in a nod to the Russian authorities playing hardball in negotiations with the Fund over the terms of their own STF arrangement (Stone, 2002: 126) – Abbott stated that ‘as a cooperative Fund member that has earned this access, Kyrgyzstan clearly provides an apt example for the others that will follow’ (IMF, 1993j: 54-5).

Justifying the staff’s advice in response to questions from the Board, a representative from the European II Department explained that the staff had explicitly advised the
Kyrgyz authorities against introducing direct monetary controls such as credit ceilings for individual banks. This was based on the staff's view that encouraging a reliance on market-based monetary instruments, beginning with credit auctions, would quickly enable interest rates to become positive in real terms, and corresponded with the need to make a decisive break with policymakers' past practices of directing credit to specific industries and firms (IMF, 1993: 57). In response to the Japanese executive director suggesting the possible use of exchange restrictions, the staff representative argued that such a move would be inappropriate and that the free-floating exchange rate regime would provide the necessary flexibility for the som to quickly reach an appropriate level (IMF, 1993: 60). A staff representative from the Policy Development and Review Department reinforced this view, arguing that the introduction of bank-by-bank credit ceilings would constitute a 'second-best solution'. Following the Board's request for the Fund to offer rhetorical support for the country's program of monetary transformation, the staff representative from the European II Department agreed that the Fund's press release communicating the Board's decision on the loan applications would signal the Fund's strong endorsement of the new currency and approval of the authorities' policy settings in general (IMF, 1993: 61).

Executive directors subsequently approved the Kyrgyz Republic's two applications for access to the Fund's resources through an SBA and an STF arrangement, based on the staff's assessment of the strength of policymakers' commitment to enacting market-based reforms. In making their decision, directors cited in particular the government's early track record of implementing policy reforms in cooperation with the Fund, as indicated by the rapid achievement of the staff's prior actions and technical assistance recommendations. Most directors agreed that while the economic outlook for the Kyrgyz Republic was very poor, they supported granting the country access to loan arrangements based on the reasoning that the authorities' demonstrated commitment to reform deserved the Fund's financial and rhetorical support (IMF, 1993r). As this case suggests, the way the Fund sees a government's track record of cooperation and constructive policy dialogue with the staff is significant for a state's capacity to access Fund loans. The Board's deliberations help to illustrate the greater importance that can be attached to the quality of a country's policy dialogue with Fund staff – at least when this is backed up with observable policy changes – compared with its actual economic circumstances (and hence the capacity to repay Fund loans).

The Kyrqyz Republic's Performance under the 1993 STF and SBA Loan Arrangements
The evidence quickly suggested that the Fund might have been overly optimistic about the willingness, or the political capacity, of the government to sustain an 'IMF friendly'
approach given the scale of the economic crisis that the country faced. The Fund’s first review of the Kyrgyz Republic’s progress under the stand-by arrangement took place in July and August 1993, and indicated mixed success in the implementation of ‘IMF friendly’ policy changes. The Kyrgyz authorities may have successfully signaled a pro-market policy orientation to the Fund, but in practice the government adopted several policies that the Fund opposed and failed to meet some key performance criteria under the SBA.

As discussed in Chapter 1, while the Fund concentrates primarily on tracking and providing advice on formal institutional change, this can potentially be derailed when actors seek to mediate uncertainty by operating through informal processes. While the Kyrgyz government adopted the majority of the Fund’s recommended reforms to legislation and to the institutional design of monetary arrangements, a degree of ‘policy slippage’ occurred with regard to the Fund’s quantitative targets that aimed to constrain the growth of cheap credit through traditional financial relationships. The staff noted that the government had failed to meet the performance criteria for increasing the net domestic assets of the central bank, limiting bank credit to the government, and limiting non-concessional debt, while inflation rates continued to exceed program targets. The Fund staff was especially concerned by the banking system continuing to function in practice according to informal monetary norms, with commercial banks channeling the bulk of credit to traditional customers, especially the large state-owned industrial and agricultural businesses that were bank shareholders (IMF, 1993s: 18). Furthermore, only one quarter of the cash rubles that were estimated to be in circulation when the som was introduced had been converted into the new currency (Melliss and Cornelius, 1993: 68). The high level of cash rubles remaining in the domestic money supply further circumscribed the NBKR’s capacity to breakup the existing monetary arrangements between commercial banks and their traditional customers.

Seen from the Fund’s perspective, however, the staff had achieved some notable successes in their efforts to persuade policymakers to stick with ‘IMF friendly’ reforms when policymakers had indicated an intention to defect on their policy commitments to the Fund. While the Kyrgyz authorities failed to meet several of the Fund’s performance criteria under the SBA, in several policy areas where decision-makers had seemed likely to waver in their commitment to market-based reforms the staff had successfully persuaded the government against taking policy actions that were seen as backward steps. Because the Fund had been able to establish a good working relationship with national policymakers, this enlarged the scope for the Fund staff to have input into the country’s everyday decision-making process. For instance, despite the Kyrgyz authorities’ concerns about firms continuing to run up large inter-enterprise arrears in the absence of significant credit assistance from the government and the threat to the economy and the government’s
revenue base this posed, the staff persuaded policymakers to agree that any proposed solution to the arrears problem would resist the strong domestic pressure for a further credit bail out (IMF, 1993s: 10).

Despite ongoing economic difficulties and instances of policy slippage, therefore, the Fund staff remained convinced of the authorities’ commitment to a comprehensive ‘IMF friendly’ reform process. This was due in large part to the staff’s success in persuading the Kyrgyz authorities to remain committed to the original policy intentions set out in the government’s Memorandum of Economic and Financial Policies. In particular, the authorities had maintained their commitment to an open current account and capital account (with the exception of restrictions on the settlement of outstanding correspondent account balances with several of the other former Soviet republics), and the staff reported that officials had maintained a constructive relationship with technical assistance missions. During the review, the staff also took into account as mitigating factors the unexpected economic challenges the country had faced since the approval of the SBA. These included worsening trade relations with the country’s traditional trade partners in the former Soviet republics, as well as unforeseen shortfalls in the amount of external financing made available to the government. The staff therefore recommended that the Executive Board approve the government’s requests for waivers of the non-observance of performance criteria and modifications of future targets under the SBA (IMF, 1993s: 17).

In reaching their decision to support the Kyrgyz Republic’s application for waivers of the performance criteria in September 1993, executive directors emphasized the substantial progress that the country had already made. They also took into account that the performance criteria had been missed by relatively small margins, and that these shortcomings were related to the unforeseen economic challenges the country had faced rather than weaknesses in policy. These unforeseen circumstances included a large shortfall in external financing, especially from Russia which had extended only one fifth of the approximately US$100 million of financial support it had initially promised to commit in April 1993, energy price shocks, and trade disruptions arising from worsening relations with neighboring states (IMF, 1993s: 11). Despite these mitigating circumstances, Oleh Havrylyshyn, the Netherlands executive director, drew the Board’s attention to the continued allocation of credit according to the country’s inherited informal norms. He emphasized that the creation of a market-based monetary system would continue to be hampered if commercial banks maintained close connections with their traditional customers and continued to automatically extend them new credit. Havrylyshyn suggested that the Kyrgyz authorities could help to change these monetary relationships by expanding the proportion of central bank refinance credit allocated to commercial banks through
auctions (IMF, 1993t: 9). In addition, other directors strongly emphasized the need for the Kyrgyz Republic to establish positive real interest rates as soon as possible to aid the transformation of the monetary system (IMF, 1993t: 11, 13, 18, 20).

Despite these criticisms, the Board singled out for praise the government’s decision not to extend a general credit bailout to resolve the problem of inter-enterprise arrears. The temporary alternate executive director for the US, Jeremy Wire, praised the authorities’ ‘tremendous vision and courage’ in pursuing market-based economic transformation. In addition, the Japanese representative, Toshio Oya, praised the government’s decision to eliminate export and import licensing requirements despite most other former Soviet republics maintaining trade and exchange restrictions in the face of strong domestic resistance to change (IMF, 1993t: 12, 16). Because the Board accepted the staff’s assessment that the missed targets were mostly the result of economic circumstances that were beyond policymakers’ control, they saw the high degree of compliance with the broad thrust of the loan program as further evidence of the authorities’ strong commitment to market-based economic reform and their willingness to maintain close cooperation with the Fund. In the first stage of the Fund’s relationship with the Kyrgyz Republic, therefore, the Fund had achieved some important successes in persuading policymakers to adopt its ideas for formal institutional changes. Nevertheless, these achievements were partly undermined by the unfavorable economic environment the country faced, and the readiness of banks and firms to resist formal changes and to mediate the uncertainty these changes produced by continuing to maintain their traditional financial relationships.

Developing the IMF’s Policy Dialogue with Kazakhstan

After Kazakhstan became a member of the Fund in July 1992, Kazakh monetary officials faced substantial political difficulties that hampered attempts to restrain domestic credit expansion. For instance, although the National Bank of Kazakhstan raised its refinance rate to 65 percent in July after the Russian central bank had raised its rate to 80 percent, the bulk of central bank refinancing credit for commercial banks continued to be allocated on preferential terms in response to political pressure from the parliament and the government. Following widespread domestic resistance to its efforts to constrain credit growth by raising the refinance rate, the NBK had extended a high proportion of credit to commercial banks at interest rates between 0 and 25 percent in 1992, well below inflation, over half of which was allocated to the agriculture sector. Like the Kyrgyz Republic, the Fund attempted to persuade Kazakh policymakers to set new parameters for the ‘institutional game’ that could help to change actors’ preferences in favor of a market-based monetary system. To circumscribe the potential for political interference in the distribution
of financial resources, the Fund staff urged the central bank to adopt measures that would help to shift the financial system towards the allocation of credit on the basis of interest rates rather than administrative discretion. In particular, the Fund staff sought to persuade policymakers to make greater use of auctions as an impersonal way of pricing and allocating credit (IMF, 1993v: 14-15).

In their efforts to shape the conduct of monetary policy in the early period of Kazakhstan’s independence, the Fund staff faced the problem of disagreements between the parliament, the government, and the central bank over whether to continue the practice of allocating credit to particular sectors on preferential terms. While a new constitution adopted in January 1993 enshrined legal independence for the NBK from both the parliament and the government, the parliament had the formal right to supervise the central bank’s operations and in practice the government was able to exert a high degree of informal influence over the central bank. The Fund wanted subsidies to enterprises to be fully costed and made explicit by incorporating them into the budget. However, the government continued to extend subsidies implicitly by allocating cheap money to firms through to the banking system, although policymakers did agree to the Fund’s request to limit the overall volume of preferential credit (IMF, 1993v: 16-17). In addition to the problem of achieving agreement on monetary reform among different actors within Kazakhstan, the Fund staff continued to see the lack of regional monetary cooperation and policy coordination between the former Soviet republics in the ruble zone as the most urgent monetary challenge facing the Kazakh authorities in 1992 and early 1993.

With regard to the authorities’ general orientation towards economic policy change, the Fund staff noted in their first Article IV consultation with Kazakhstan in early 1993 that there had been initial difficulties in trying to establish a comprehensive agenda for reform with policymakers. In the staff’s assessment, the government had been largely pre-occupied with the need to react to urgent political problems and events elsewhere in the former Soviet Union in 1992, especially the policy decisions taken by the Russian government, and had only begun to implement more significant institutional changes and policy reforms towards the end of the year (IMF, 1993v: 24). With the staff initiating discussions on a possible loan arrangement with Kazakhstan, the strength of the authorities’ commitment to reform was an issue of significant debate in Executive Board discussions on Kazakhstan’s first Article IV consultation.

The Board was concerned that while the authorities had appeared to make a strong start with price liberalization, they had since progressed more gradually than other former Soviet republics on major economic reforms. Directors strongly urged the authorities to act decisively to restrict the state’s involvement in production, trade, and investment, and to
move more rapidly towards the adoption of a comprehensive package of market-based reforms in close cooperation with the Fund staff. One issue in particular raised by directors was whether Kazakhstan’s new constitution actually provided for legal central bank independence given the oversight role accorded to the parliament, and whether domestic political conditions would allow it to act autonomously in practice (IMF, 1993w: 46).

Responding to concerns that Kazakhstan was vacillating in its commitment to structural reform, the Belgium executive director representing Kazakhstan, Jacques de Groote (IMF, 1993w: 44), reminded the Board that:

...there are many, many possible roads to systemic change and we should not allow dogma or “fetishism”... to persuade us that all countries must follow a standardized route in their journey toward market orientation. Countries have widely varying local circumstances and differ radically in the kinds of political options that are available to them, and it is not hard to imagine that we will sometimes have to recognize, within an overall process of economic transmutation, that some sectors need to remain under government control, always providing that in these sectors, too, the necessary measures are taken to introduce efficiency and economic rationality.

The need for Kazakhstan’s representative on the Board to defend the authorities’ policy decisions in this manner illustrates the qualitative differences in how the Board assessed Kazakhstan’s approach to economic transformation and its level of cooperation with the Fund compared with the Kyrgyz Republic. Whereas the Board heaped praise on Kyrgyz policymakers for their rapid adoption of an ‘IMF friendly’ program of reforms, executive directors were concerned that the government of Kazakhstan was leaning more towards half-steps and incremental changes that would maintain a large interventionist role for the state in the country’s economy, which would hinder the development of a market-based monetary system.

With regard to Kazakhstan’s currency arrangements, the Fund staff now believed that ‘the balance of arguments’ had shifted in favor of monetary independence and the establishment of a national currency, due to the inability of the member states of the ruble zone to solve their collective action problems (IMF, 1993v: 24-5). Again, this was an issue of much debate in the Executive Board’s discussions. For instance, the US executive director, Thomas Dawson, questioned whether there was now any point in Kazakhstan’s continuing efforts to resurrect a functioning ruble zone ‘given the effects policies in Russia and other republics are having on Kazakhstan’ (IMF, 1993w: 18). In response, the Russian executive director, Konstantin Kagalovsky, observed that Kazakhstan’s economic reforms ‘seem to have begun to lose momentum’. Kagalovsky stated bluntly that, while Russia agreed with the Fund staff that the choice of whether to stay in the ruble zone or to establish monetary independence was a sovereign decision for the newly independent states
to take themselves, ‘Realistically, there is little hope of credible and efficient arrangements for common monetary and credit policies’. In these circumstances, the Russian executive director suggested that ‘It would probably be worth considering a contingency plan for the introduction of a national currency’ (IMF, 1993w: 20). Both the Board and the staff emphasized the need for the Kazakh authorities to cooperate more closely with the Fund in devising market-based economic reforms, backed up with the promise of financial assistance if the government was willing to develop an ‘IMF friendly’ program of institutional change. The staff concluded their first Article IV consultation with Kazakhstan by offering an inducement for the authorities to deepen their policy dialogue with the Fund, noting that the Fund stood ‘ready to assist the authorities with policy advice and technical assistance – as well as financial support once agreement is reached on a comprehensive adjustment program’ (IMF, 1993v: 26).

Establishing an IMF Loan Program with Kazakhstan

Prior to the Fund’s Article IV consultation with the authorities in early 1993, the staff had already visited Kazakhstan to discuss the possibility of designing a reform program that could be supported by a loan arrangement with the Fund on four occasions during 1992 (IMF, 1993v: 34). Although the advantages of the authorities agreeing on a Fund-supported reform program would greatly exceed the specific monetary value of any Fund loans, the earlier staff visits had produced only gradual progress towards the development of an ‘IMF friendly’ reform program for Kazakhstan. As with the other former Soviet republics, approval of a loan arrangement with the Fund would enable Kazakhstan to access loans from other bilateral and multilateral donors such as the World Bank, starting with an import rehabilitation credit of US$180 million. Discussions subsequently proved more fruitful during a staff team visit to Almaty in May 1993, when the Kazakh authorities found themselves under greater financial pressure, following a decision by the Central Bank of Russia to suspend its unlimited credit line to the National Bank of Kazakhstan (IMF, 1993x: 1, 3). In talks over the development of an upper credit tranche stand-by arrangement, however, the principal sticking point for the Fund remained the inability of Kazakh policymakers to establish greater control over inflation and the exchange rate while the country remained within the ruble zone. However, for the Kazakh authorities the importance of the country’s ‘unique political relationship with Russia’ was seen as limiting the possibility of rapid movement to establish an independent currency (IMF, 1993x: 12).

In order to lay the foundation for a future SBA application, following further negotiations over policy reforms with the staff, in July 1993 the government applied to the Fund for a loan under the systemic transformation facility of SDR 61.875 million (IMF,
Although the STF loan did not entail the same level of policy conditions that would be attached to a stand-by arrangement, the government had to agree to comply with a series of quantitative targets and structural reform benchmarks. The Fund's quantitative targets included quarterly ceilings on the extension of credit by the central bank to commercial banks and on total lending to the government, as well as floors for the level of convertible currency reserves. The principal monetary reform benchmarks included raising the refinance rate to equal the rate set by the Russian central bank, temporarily raising the foreign exchange surrender requirement on export earnings in order to shore up international reserves, and progressively increasing the proportion of new central bank credit that was allocated through competitive auctions. The staff was able to persuade the authorities to agree that the central bank's refinance facility would only be used to meet the short-term cashflow needs of commercial banks rather than to selectively allocate credit to particular industries on preferential terms. Policymakers also agreed that the use of market-based mechanisms would be gradually increased by allocating twenty percent of new central bank credit via competitive auctions in the second half of 1993, rising to 50 percent of new credit during the second quarter of 1994 (IMF, 1993x: 33, 36). In the context of the proposed STF arrangement with the Fund, bilateral and multilateral donors pledged to support Kazakhstan's economic reform program to the amount of around US$400 million. In addition to loans from the World Bank, this included credit of 150 billion rubles from Russia, ECU 300 million from the EBRD, and around US$50 million from Austria, Belgium, Canada, Germany, and the US (IMF, 1993z: 32).

Establishing Monetary Independence in Kazakhstan

As discussed in Chapter 4, political commitment is essential for a common monetary area to survive (Cohen, 1998: 84-7). Although Kazakhstan continued to remain in the rapidly disintegrating ruble zone in July 1993, the Executive Board's discussions of the country's application for an STF arrangement and the possibility of a future SBA loan illustrate the extent to which any political basis for monetary cooperation among the former Soviet republics had evaporated since 1992. The Russian executive director was blunt when he informed the Board of Russia's view on the future of the ruble zone: 'This is the opinion of my authorities: no national currency, no stand-by arrangement' (IMF, 1993z: 37). Russia's position did not pass without comment, and the executive director for the Netherlands, Godert Posthumus, quizzed Kagalovsky on 'why he thinks that Kazakhstan cannot have a stand-by arrangement while it remains in the ruble area even if Russia has a stand-by arrangement' (IMF, 1993z: 39-40). During the subsequent debate over this issue Kagalovsky argued that in order to remain in the ruble zone the National Bank of
Kazakhstan ‘would have to be a branch of the Central Bank of Russia’ (IMF, 1993z: 41). The managing director carefully sought to draw a line under the issue to allow the Board to move on by emphasizing that there was a Board consensus that Kazakhstan should be eligible for a stand-by arrangement in the near future. He also noted that, in his view, ‘the process was moving speedily towards the desired separation of currencies with the support of not only the international community but also the Russian authorities’ (IMF, 1993z: 43).

The Russian executive director’s cavalier treatment of the Central Asian republic that had most assiduously sought to maintain a common monetary area among the newly independent states of the former Soviet Union illustrates two important dimensions of the politics of money in post-Soviet Central Asia. First, it shows that Kazakh policymakers were fighting a losing battle in their efforts to protect their close economic relationship with Russia. Second, Kazakhstan’s continued desire to remain in a revamped ruble zone despite such a categorical statement of Russia’s preference for countries to adopt independent currencies, as well as Russia’s previous decision to cut off credit from the CBR, indicates that political considerations were the main driver of decisions about monetary arrangements within and between the former Soviet republics in the early post-Soviet period. The latter, in particular, initially impeded the efforts of the Fund staff to persuade the Kazakh authorities to fully commit to an ‘IMF friendly’ reform program with the promise of greater long-term economic benefits. By the middle of 1993, the staff saw the enormous costs of remaining in the ruble zone as unsustainable even in the short term. But because Kazakhstan’s economy and physical infrastructure was so tightly integrated with Russia, Kazakh policymakers faced incentives to move slowly on the issue of monetary independence. Russia would always be their much larger neighbor to the north, and the new state’s external economic relations, as well as domestic social relations between ethnic Kazakhs and Russians, would continue to be shaped by the terms of the Russian-Kazakh bilateral relationship.

In the remainder of the Board’s discussions over the country’s application for an STF arrangement, executive directors extended a more positive endorsement of the authorities’ policy stance than during the first Article IV consultation with Kazakhstan only a few months earlier. The US executive director, for instance, commented that ‘There can be no doubt at this point that Kazakhstan is in the front ranks of the reforming countries of the former Soviet Union’ (IMF, 1993z: 3). The US executive director also observed that ‘The National Bank of Kazakhstan has become a pacesetter among the countries of the former Soviet Union in using credit auctions to allocate central bank credit’ (IMF, 1993z: 4). As discussed in the foregoing chapters, the emphasis the Fund placed on transforming the way financial resources were distributed – in particular the objective of shifting to a system of
competitive credit allocation based on interest rates – was driven by a belief that changing the role of money in post-Soviet economies was essential for changing people’s behavior and their expectations of the role of the state. The Fund’s approach was shaped by the emerging consensus among economists that monetary reforms are most likely to be successful when governments provide clear and credible signals to their domestic and international audiences that reforms will be consistently maintained (see Grabel, 2000). A statement by the representative for the Italian constituency, Enzo Quattrociocche, helps to illustrate the connection the Board saw between monetary reform and the task of economic transformation in the former Soviet Union. Quattrociocche (IMF, 1993z: 6) observed that:

The creation of a market economy requires fundamental changes in the institutional setting and in people’s habits. Coherent and firm implementation of economic policies during the transition period is therefore essential in order to validate the expectations of economic agents... Dispelling the uncertainties surrounding the monetary arrangements [in Kazakhstan] is crucial in order to provide a clear signal of the future course of the stabilization process.

The Board’s main concern thus continued to be the need to achieve greater macroeconomic stability by moving towards the establishment of monetary independence in Kazakhstan. Executive directors cited the steps already taken by the government towards relying on market-based mechanisms to allocate credit and recent increases in interest rates as positive changes that informed their decision to approve the country’s application for an STF arrangement. Nevertheless, most directors concluded that a new currency would have to be introduced in order for Kazakhstan to qualify for an upper credit tranche stand-by arrangement with the Fund.

The government subsequently introduced a new national currency, the tengе, on 15 November 1993, in response to the tough conditions that Russia had set out for continued membership in a new ruble zone, as discussed in Chapter 4. Following the substantial preparations made by the authorities in consultation with technical assistance missions from the Fund, including financial penalties for any business that refused to accept payment in the new currency or which sought to take advantage of the change to raise prices, the conversion process was relatively trouble-free. The ruble was converted at the rate of 500 tengе to 1 ruble, with individuals allowed to convert up to 100,000 cash rubles from November 15-20. The limit on the amount of cash rubles that could be converted to the new currency was an attempt to cope with the flood of old Soviet rubles that had flowed into the republic from elsewhere in Central Asia. However, in practice these controls were often circumvented, with individuals able to breach exchange limits by
paying a premium to residents who had less than the full 100,000 rubles to convert (IMF, 1994i: 26). Following its establishment as sole legal tender on November 18, the authorities introduced a managed float exchange rate regime for the tenge with the currency traded on a new Interbank Currency Exchange. The National Bank of Kazakhstan initially intervened extensively in foreign exchange auctions to help establish sufficient liquidity for the new market to function effectively, prompting the Fund staff to agree on an 'appropriate intervention policy' with the central bank (IMF, 1994k: 26). The introduction of the tenge cleared away the final major hurdle preventing Kazakhstan from accessing an upper credit tranche loan with the Fund, and the authorities applied for a stand-by arrangement as well as a second purchase under the STF in December 1993 (IMF, 1994i: 1-2, 5). In comparison with the Kyrgyz Republic, therefore, the Fund's progress during the first stage of its relationship with Kazakhstan was much more uneven during 1993. This was in large part due to Kazakh policymakers' reluctance to move quickly to establish monetary independence because of their more intensive political and economic ties with Russia. However, the Fund was able to persuade the Kazakh authorities to adopt key formal monetary reforms – such as the introduction of credit auctions and quarterly credit ceilings – that the staff wanted in place in order to harden the budget constraints on commercial banks and firms.

The Difficult Case of Uzbekistan

Compared with both the Kyrgyz Republic and Kazakhstan, Uzbekistan has remained a troublesome pupil for the Fund. At times, the government of Uzbekistan has acted like a 'renegade regime' and has refused to be persuaded to implement international monetary norms in domestic policy except at its own protracted pace, despite Uzbek leaders espousing the goal of implementing market-based economic reforms along with their Central Asian neighbors following the demise of the Soviet Union.

As seen by the Fund, while policymakers in the Kyrgyz Republic and Kazakhstan faced political and economic obstacles to implementing 'IMF friendly' reforms they were at least open to persuasion by the Fund on how to construct national monetary systems, whereas the Uzbek authorities were for the most part unreceptive to the staff's advice for market-based monetary reforms throughout 1993. In the Fund's first Article IV consultation with Uzbekistan in October 1993 the staff strongly encouraged the government to restrain the rapid expansion of domestic credit, which according to staff calculations had increased by 97 percent of GDP in 1992 and 72 percent of GDP in 1993. By comparing the CBU's refinance rate with the commercial bank rate in Russia (both of which remained negative in real terms), the staff estimated that the growth of preferential credit in 1992 had amounted
to an interest rate subsidy equal to 22 percent of Uzbekistan’s GDP (IMF, 1994p: 39). The financial system continued to operate within soft budget constraints throughout 1993, and was geared towards achieving the government’s objectives of maintaining production and employment levels rather than achieving the changes in financial behavior sought by the Fund staff. For example, the CBU continued to channel credit to priority areas of the economy through commercial banks, which were permitted to run up large overdrafts to ease the pressure of repayments, and chose not to enforce the formal rules on banks’ reserve requirements. The Fund had persuaded the authorities introduce credit auctions for the first time in August 1993, which the staff interpreted as marking ‘a significant change of policy direction’, but initial auctions had amounted to less than 5 percent of total credit expansion (IMF, 1993aa: 6-7).

In response to the harsh terms for continued ruble zone participation set down by Russia, the Uzbek authorities opted to introduce the sum coupon as a temporary currency on November 15 at the same time as Kazakhstan introduced the tenge. However, the sum coupon continued to circulate in addition to both old Soviet rubles and the new Russian rubles introduced by the CBR in July. Moreover, the introduction of the sum coupon was undertaken without the advice and assistance of the Fund. The Fund had previously provided the Uzbek authorities with substantial information on how to prepare for the introduction of a new currency, but most of this advice was ignored. The uncertainty generated by the conversion process contributed to a lack of acceptance of the new currency among the population, and caused further disruptions in inter-republican trade when other former Soviet republics refused to accept the sum coupon at the government’s official exchange rate as payment for goods (IMF, 1993aa: 7).

During discussions in Tashkent with Uzbek officials for the 1993 Article IV consultation, the staff nonetheless found some reasons to anticipate that the authorities’ attitude towards economic reform might slowly be changing as a result of the final breakdown of the ruble zone and the monetary problems associated with the introduction of the sum coupon. For instance, officials in the government and in the central bank agreed with the staff that the expansion of credit had been too large during 1993, although this was justified on the grounds that it had been necessary to finance the year’s cotton harvest. In addition, CBU officials agreed to follow the staff’s advice to tighten credit growth and to channel a larger proportion of central bank lending through credit auctions – policy changes that the Fund was also pushing for in the Kyrgyz Republic and Kazakhstan. While the Fund staff ‘welcomed this apparent determination to strike out a new path’, they sought to persuade the CBU that the best way to demonstrate the credibility of a change in policy direction was to institute a large increase in the central bank’s refinance rate to close the
gap between the refinance rate and the credit auction interest rates. The staff also wanted the central bank to institute a single price for all credit, so that new lending to the government and commercial banks would take place at the interest rate determined by credit auctions. But the authorities wished to retain administrative control over credit allocation and the price of central bank lending, and told the staff that they intended to continue their program of allocating preferential credit to the agriculture sector (IMF, 1993aa: 11).

Despite some evidence that the authorities were gradually becoming more receptive to the Fund’s advice, this led the staff to conclude that ‘it was not clear from the discussions whether there is a convergence of views within the Government on either the scope or the direction of reform, and the policy stance remains highly interventionist’ (IMF, 1993aa: 11-12). In addition to the policies detailed above, the government had introduced various measures to subsidize domestic consumption with the aim of maintaining social stability, which included maintaining an overvalued exchange rate, external borrowing, gold sales, widespread administrative controls, and large domestic credit expansion. The mission concluded its report with the stark assessment that ‘The staff regards this approach as having no chance of success in bringing about sustained economic growth’. Instead, the Fund staff argued that ‘The Government’s economic reforms... have reached a critical stage, and policies urgently need to be reoriented’ (IMF, 1993aa: 14-15).

The staff found so little to be positive about in Uzbekistan that they recommended that the Fund’s early technical assistance should not be extended in the future unless the government took concrete steps to demonstrate a commitment to ‘IMF friendly’ economic reform. Before Uzbekistan would be able to apply for a loan arrangement with the Fund the staff wanted to see a significant demonstration of the government’s commitment to adopting market-based reforms, which would be measured by the implementation of the Fund’s earlier technical assistance recommendations (IMF, 1993aa: 17). In this regard, the staff urged the government to use the planned introduction of a new currency in 1994 to replace the *sum* coupon as an opportunity ‘to demonstrate a new commitment to strong and credible adjustment policies’. In particular, the staff wanted to see the introduction of the new currency accompanied by the establishment of a unified floating exchange rate regime, the development of a competitive domestic market for foreign exchange, and the adoption of full current account convertibility (IMF, 1993aa: 15). Whereas Kyrgyzstan had moved very rapidly to adopt full currency convertibility, and Kazakhstan had gradually but steadily reduced its exchange restrictions, the Uzbek authorities’ policies had intensified a de facto system of multiple exchange rates. Among other exchange restrictions that the government had continued, the *sum* coupon, old Soviet rubles, and new Russian rubles
were all circulating in the economy simultaneously with multiple rates of exchange. An official exchange rate was set by the CBU, which was used to record trade transactions, to estimate taxes, and for debt servicing. A second commercial exchange rate was set by the National Bank for Foreign Economic Activity, the former Uzbek branch of the Soviet Vneshekonombank that continued to maintain control over the management of international reserves, which the Fund wanted the government to transfer to the CBU’s control (IMF, 1994p: 35-6).

Developing the IMF’s Policy Dialogue with Uzbekistan

Despite the organization’s difficult history with Uzbekistan, on several occasions a negative assessment by the staff resulted in the authorities making an effort to improve their relations with the Fund. Following the poor report from the 1993 Article IV consultation with the Fund, the Uzbek authorities submitted a statement to the staff on their reform program for the coming year, with the aim of furthering discussions on a possible STF loan arrangement with the Fund (IMF, 1994n: 1). For the Fund staff, the government’s policy intentions for 1994 signaled a substantial shift in policy orientation, although the staff wanted clarification on the timing and extent of particular reforms.

Among other things, the new program envisaged a significant change in credit practices. This included commitments that the CBU would cease to extend credit to banks on preferential terms from 1 January 1994 and the bulk of central bank refinance credit would be allocated through auctions (although this had not yet occurred when the staff prepared a supplementary report on the new program for the Executive Board on 13 January 1994). The program set a target of reducing inflation to a monthly rate of 5 percent by the middle of the 1994, and committed the government to introducing several of the Fund’s key technical assistance recommendations. These changes included a revision of central bank legislation, reversing the CBU’s centralization of control over cash operations, and the establishment of a foreign currency auction (IMF, 1994n: 3-5). Although the staff stuck to their original evaluation in the Article IV consultation of the poor quality of the government’s overall policy orientation, they cautiously commended the new program as ‘a necessary and welcome shift in the right direction’. The staff continued to hold the door open for the Uzbek government to intensify its cooperation with the Fund, stating that they would ‘offer to reinforce technical assistance missions in several areas, if there are indications that earlier recommendations are being implemented’. The staff also set benchmarks that would be used to assess the strength of the government’s commitment to its new program, noting that the efficient introduction of a new national currency to replace the sum coupon ‘would be important for the credibility of the Government’s reform
When the Executive Board discussed the country's first Article IV consultation with the Fund the following week, directors heavily criticized the Uzbek authorities' track record of resisting the implementation of market-based economic reforms and continuing to rely on 'the methods of the command economy' (IMF, 1994o: 20). The US executive director, Karin Lissakers, stated unambiguously that 'Uzbekistan appears to have made little real progress toward adoption of the macroeconomic policies and institutions necessary for a market economy', and had instead embraced a policy orientation 'that can barely be deemed “gradualistic”'. Lissakers observed that 'The staff seems to have been kept at arm's length, even as the Uzbek authorities express interest in financial support from the Fund' (IMF, 1994o: 28). Moreover, the Board concluded that the Uzbek authorities appeared to have deliberately hindered the Fund's access to the government's economic statistics, which obstructed the staff's ability to conduct effective policy surveillance and constituted a violation of a key obligation of Fund membership. In this respect, the US executive director warned the Uzbek authorities that a loan arrangement with the Fund would only be forthcoming 'if the authorities work urgently, in cooperation with the staff, to bring their policies in line with their rhetoric'. In order to achieve this, Lissakers continued, 'the Government needs to undergo a major philosophical shift in attitude regarding its role in the economy and the pace of reform' (IMF, 1994o: 28-9).

With regard to monetary policy reform, Lissakers stated categorically that the government should abandon the use of cheap credit to maintain production and employment levels. The US executive director also encouraged the establishment of greater autonomy for the central bank, a shift towards the use of indirect instruments of monetary control, and the establishment of positive real interest rates. Lissakers applauded the government's stated intentions to adopt further moves towards market-based reform, but urged the authorities to follow this through with concrete actions in cooperation with the Fund staff (IMF, 1994o: 30). The US executive director's comments were echoed by most other members of the Board, who called for a change in Uzbekistan's economic policy orientation in the strongest possible terms, toward a greater reliance on market-based mechanisms. Despite the substantial criticism of the Uzbek authorities' policy orientation, however, executive directors did not take issue with the social goals that formed the government's public justification for adopting a gradual approach to market-based reforms. Rather, they disagreed that these goals could be achieved by the policy measures the government was using and argued that, contrary to what policymakers believed, the government's policy settings were more likely to prove detrimental to their stated economic and social goals (IMF, 1994o: 42-7).
In response to the US executive director's comments, a staff representative from the European II Department pointed out that the staff was not yet recommending the adoption of indirect instruments of monetary control in either Uzbekistan or Kazakhstan. Due to the undeveloped nature of state institutions and credit markets in both countries, the staff was instead recommending that central banks allocate credit through auctions as an alternative to the administrative allocation of credit on preferential terms, in order to help develop local credit markets and to establish a market price for central bank lending (IMF, 1994o: 37). In response to criticism from the Iranian representative, Mohammad Mojarrad, that Uzbekistan had received less technical assistance from the Fund compared with other former Soviet republics, the staff representative replied that technical assistance to the country ‘had been extensive in virtually every area of economic activity’. The problem from the staff’s perspective was not that Uzbekistan was receiving insufficient policy advice and technical assistance from the Fund, but that unless the authorities were willing to implement the Fund’s advice, the Fund’s intellectual resources ‘could be used better in other republics’ (IMF, 1994o: 34, 37). In response to the Board’s robust discussions, the managing director observed that in Uzbekistan ‘the Fund was confronted with a difficult case’. Before summing up the sense of the meeting, he reminded the Board that previous experience had shown that ‘from time to time the Fund must be clear-sighted and patient in its efforts to ensure that its members followed the best course of adjustment and reform’ (IMF, 1994o: 56). In his closing remarks, the managing director noted that the consensus view of the Board was to encourage the Uzbek authorities ‘to further their policy dialogue with Fund staff’, in order to work towards putting in place a comprehensive program of market-based economic reform that could be supported by a loan arrangement with the Fund (IMF, 1994o: 58).

Establishing an IMF Loan Program with Uzbekistan

It took the whole of 1994 before the Fund staff was sufficiently satisfied with the Uzbek government’s economic policy reforms to recommend approving a Fund loan even under the relatively low policy conditionality of the systemic transformation facility. The staff had visited Tashkent in March-April and in October-November 1994 for negotiations over the government’s application for a loan agreement with the Fund. In the intervening period the Fund had increased the level of its technical assistance support to Uzbekistan, with missions from the Monetary and Exchange Affairs Department (May), the Fiscal Affairs Department (January, June-July), the Statistics Department (January, March, April-May, May-June, and November-December), and the Legal Department (April). From the staff’s perspective, the authorities were now showing greater willingness to implement the policy
recommendations of technical assistance missions. In addition, the IMF Institute had provided a further course on macroeconomic policymaking for senior officials in May, and the Fund had arranged for a resident advisor within the CBU to provide ongoing advice on monetary policy reforms from November 1994 (IMF, 1994q: 32-3).

The improvement in relations between the Fund and the Uzbek authorities followed a decree issued by President Karimov on 21 January 1994, which set out specific measures to increase the pace of economic reforms. This was deemed sufficient for the Fund staff to enter into negotiations with the authorities over whether to put in place an STF arrangement to support the planned introduction of the new national currency, the Uzbek sum, in July. However, when the authorities failed to implement key prior actions required by the staff, such as substantially increasing interest rates, depreciating the exchange rate, and introducing auctions for the allocation of foreign exchange, plans for an STF arrangement to support the new currency were put on hold. After the introduction of the sum in July, however, the authorities implemented several of the prior actions that the staff had been promoting since October 1993. These changes included increasing the refinance rate of the CBU from 150 to 225 percent and aligning it more closely with the credit auction interest rate, increasing the deposit rates of the Savings Bank, and unifying the official and the cash exchange rate for the sum. From mid-October 1994, the government also implemented the Fund’s advice requiring that all payment transactions within Uzbekistan be undertaken in sum as the country’s sole legal tender (IMF, 1994q: 2, 5-6). For the first time, the staff assessed that Uzbek policymakers had ‘cooperated fully with the staff in establishing a comprehensive systemic and macroeconomic program’ for the rest of the year and for 1995. While the staff still sought to convince the authorities to further increase the pace of economic reforms, the authorities justified their stance to the Fund on the grounds that ‘it would not be feasible politically and institutionally to speed up the process further at this stage’. Despite this continued caution, the Uzbek government signaled to the staff that they were interested in preparing the ground for an upper credit tranche stand-by arrangement with the Fund as soon as possible (IMF, 1994q: 7-8).

The staff finally supported the Uzbek government’s application for an STF loan of SDR 49.875 million with the Fund on 16 December 1994 (which constituted 25 percent of the country’s quota in the Fund). Under the STF arrangement, the Uzbek government agreed to adopt several key ‘IMF friendly’ monetary policy reforms. These included commitments to increase the CBU’s refinance rate in line with inflation in 1995, to increase the proportion of new central bank refinance allocated through credit auctions to 40 percent in the final quarter of 1994 and all new credit in the first half of 1995, and to allow the credit auction interest rate to play a greater role in determining the interest rate structure of the
financial system. Policymakers also agreed to the Fund’s request to limit the central bank’s intervention in the exchange rate to allow the sum’s value to be determined through weekly currency auctions (IMF, 1994q: 10-11). Like the Kyrgyz Republic and Kazakhstan, the Fund required Uzbekistan to agree to quarterly ceilings on total credit to the government and central bank credit to commercial banks, a floor for international reserves, and a ceiling on new nonconcessional external debt. Among other structural benchmarks for the STF program the authorities also committed to introducing new foreign currency regulations in consultation with the Fund staff by the end of the first quarter in 1995, which the staff hoped would move the authorities closer to the establishment of current account convertibility (IMF, 1994r: 17-19). Despite these reforms, the country still had a long way to go to reverse its early post-independence reputation in the international financial community. As executive directors stated when the Board approved Uzbekistan’s STF application in late January 1995, the STF program was ‘only the first step in a long process’ (IMF, 1995h: 2). But for the Fund staff a more intensive reform process was finally in train with the approval of the STF loan arrangement, following which Uzbekistan would become eligible for a US$160 rehabilitation loan from the World Bank (IMF, 1994q: 1). Although the country lagged well behind both the Kyrgyz Republic and Kazakhstan, the next step for the staff would be to reach an agreement on a reform program for Uzbekistan that would be eligible for an upper credit tranche stand-by arrangement with the Fund.

**Summary**

Despite inheriting similar institutional legacies from the Soviet Union, the Kyrgyz Republic, Kazakhstan, and Uzbekistan pursued very different economic strategies in the initial period following independence, and exhibited varying degrees of openness to the Fund’s ideas for economic reform. Despite their need for policy advice and external financing, all three countries presented ‘hard cases’ for the Fund. In particular, they were each new to the Fund and the Fund was new to them. Central Asian policymakers were not attuned to internalizing new policy norms from international organizations like the Fund (cf. Checkel, 2005: 813), and could be expected to be hostile to external attempts to change how they perceived their interests. However, the Fund quickly found that some Central Asia policymakers would prove harder to persuade to adopt market-based reforms than others would.

Initially, the most ‘IMF friendly’ Central Asian state was the Kyrgyz Republic. As this chapter has shown, the Fund was able to use the authorities’ desire to access financial support from bilateral and multilateral donors to persuade Kyrgyz policymakers to adopt a comparatively rapid program of market-based reforms, backed up by the material
incentives attached to early loan arrangements with the Fund. The key tools that the Fund used to persuade the Kyrgyz authorities to adopt ‘IMF friendly’ institutional reforms included the application of prior conditions, which were not subject to Board approval and afforded the staff opportunities to directly influence the policymaking process even before a reform program was agreed, and loan performance criteria for the country’s STF and SBA loans. Through these mechanisms, as well as the staff’s provision of technical assistance advice, the Fund attempted to persuade Kyrgyz policymakers to set new parameters for the formal ‘institutional game’ that could help to change actors’ preferences in favor of a market-based monetary system. In particular, the Fund staff sought to change financial behavior among economic actors by increasing domestic financial intermediation and the allocation of credit based on prices and creditworthiness assessments, rather than administrative discretion and banks’ traditional financial relationships with firms.

Reflecting the Kyrgyz government’s willingness to implement the Fund’s advice, the country became the first Central Asian state to introduce an independent national currency as well as being the first to establish full currency convertibility, removing all restrictions on both current account and capital account transactions. Despite its healthy ‘report card’ from the Fund, the staff judged that the Kyrgyz Republic initially achieved mixed success under STF/SBA loans in the second half of 1993. The Fund, as discussed above, concentrates primarily on tracking and providing advice on formal institutional change. The case of the Kyrgyz Republic demonstrates how formal changes can be disrupted when actors seek to reduce their immediate economic uncertainty by operating through informal processes – such as personalized financial relationships – that retard macroeconomic reforms. Nevertheless, the staff was able to persuade policymakers to stick with an ‘IMF friendly’ program of reforms when they indicated an intention to take policy actions that would be seen as backward steps by the Executive Board.

Kazakhstan was initially an intermediate case for the Fund; it was not as open to the Fund’s ideas for economic reform as the Kyrgyz Republic, nor was it as closed to the Fund’s advice as Uzbekistan appeared to be in 1993. Like the Kyrgyz Republic, the Fund attempted to persuade Kazakh policymakers to set new parameters for the ‘institutional game’ that could help to change actors’ preferences in favor of a market-based monetary system and would circumscribe the potential for political interference in the distribution of financial resources. The staff notched up some notable successes in Kazakhstan, such as persuading the authorities to increase their reliance on credit auctions to allocate central bank credit. However, the staff and executive directors were initially concerned that Kazakh policymakers were leaning more towards incremental changes while still maintaining a large interventionist role for the state in the country’s economy, which from
the Fund’s perspective would hinder the development of a market-based monetary system. The Fund’s main concern throughout 1993 continued to be the need to achieve greater macroeconomic stability by moving towards the establishment of monetary independence in Kazakhstan and ending the country’s ill-fated participation in the ruble zone. While the Fund was willing to enter an STF loan program with Kazakhstan to help to persuade the authorities to head in an ‘IMF friendly’ policy direction, the government would have to follow the Kyrgyz Republic’s lead and successfully introduce a new national currency before the Fund would support an application for an upper credit tranche SBA loan.

As seen by the Fund, while policymakers in the Kyrgyz Republic and Kazakhstan faced significant obstacles to implementing ‘IMF friendly’ reforms they were at least open to persuasion by the Fund on how to construct national monetary systems, whereas the Uzbek authorities were initially unreceptive to the staff’s advice for market-based monetary reforms. Against the Fund’s advice, Uzbekistan continued to direct a massive amount of subsidized credit to firms to maintain domestic production and employment levels throughout 1993. Even in Uzbekistan, however, the Fund’s ideas for economic reform had some impact. The staff was able to persuade the authorities to introduce credit auctions on a limited basis for the first time in August 1993, although the Fund’s advice was subsequently ignored when the government introduced the *sum* coupon as new legal tender in November 1993. In contrast with the Kyrgyz Republic and Kazakhstan, therefore, in Uzbekistan the Fund did not play an active role as a reputational intermediary to endorse the new currency, although the staff agreed with the decision to break from the ruble zone.

The government’s interventionist approach to economic policy led the staff to produce a highly negative report on the authorities’ policy stance at the end of 1993, which led the Fund to scale down its technical assistance operations in the country until the authorities’ were more willing to cooperate with the staff and generated strong criticism from the Executive Board. Following these actions the Fund’s relationship with Uzbekistan began to improve slowly over the course of 1994, especially following the introduction of a new currency, the Uzbek *sum*, in July. Uzbekistan, therefore, was lagging well behind both the Kyrgyz Republic and Kazakhstan when the Fund finally approved an STF loan with the government at the end of 1994. Like the loans with its Central Asian neighbors, through Uzbekistan’s STF loan the Fund sought to persuade the authorities to enact institutional changes that would help to change actors’ preferences in favor of a market-based monetary system, and could gradually alter actors’ intersubjective ideas regarding the appropriate objectives of monetary policy and the role of the state in the economy.
Changing Monetary Norms in Central Asia

Following the establishment of loan programs with the Central Asian CPEs, the Fund's main objective was to build on the initial steps to construct national market-based monetary systems in order to sustain an 'IMF friendly' program of institutional change over time. By increasing compliance with the new formal 'rules of the game', the Fund sought to bring about a permanent change in actors' financial behavior, regardless of the informal political and economic order in Central Asian societies (cf. Przeworski, 2004: 528-9).

However, as discussed above, the Fund's concentration on achieving formal institutional reforms also generates new informal outcomes as political leaders respond to domestic uncertainty, and this can affect how political bricoleurs translate ideas for formal reforms into domestic contexts and whether such reforms will be sustained over time. As this chapter shows, the informal context of institutional change in Central Asia helped to shape the results of the Fund's efforts to persuade policymakers to sustain 'IMF friendly' reforms in each country, especially in the difficult case of Uzbekistan.

As discussed in the foregoing chapters, formal institutional changes are not final, and may not even be particularly stable. Instead, policymakers continue to engage in a process of institutional recombination and experimentation, which may lead them to build institutions that more closely resemble what the Fund wants or they may maintain a greater degree of similarity with inherited institutional forms. In Central Asia, despite the Fund's intellectual efforts to persuade policymakers to adopt a common framework for analysis, the common result of the Fund's influence was hybrid reform outcomes — where institutions emerged that exhibited a mix of central planning and liberal market principles and practices. Hybrid outcomes were not simply pathologies that resulted from a lack of political will or from checks on reform imposed by domestic veto players, but derived from actions that made sense to the actors involved with executing institutional change in each country as they sought to translate the Fund's ideas into local contexts. Table 8.1 provides a simple snapshot of the Fund's overall influence on key monetary reforms in each case.

Here we see that the Fund generally achieved a strong degree of influence over formal monetary reforms, including de jure central bank independence, the marketization of domestic credit allocation, and acceptance of current account convertibility. Informally, the story is quite different. In general, the Fund's influence over informal monetary practices
was strongest in the Kyrgyz Republic and weakest in Uzbekistan, with Kazakhstan an intermediate case (but closer to the Kyrgyz Republic than Uzbekistan). Changing informal practices was essential to achieve the implementation of formal reforms. However, as this chapter shows, the Fund’s influence altered over time across the three cases. Although each state achieved hybrid institutional outcomes, the different transitional contexts that the Kyrgyz Republic, Kazakhstan, and Uzbekistan faced continued to shape the degree to which the Fund was able to mould institutional change over time.

This chapter proceeds as follows. In the first four sections, I examine how the Fund sought to build on its early progress with constructing new national monetary systems in the Kyrgyz Republic and Kazakhstan to change domestic monetary norms. Here I show how, despite some setbacks, the Fund was able to persuade policymakers in these cases to embed an ‘IMF friendly’ policy orientation with respect to monetary practices through back-to-back loan programs, which led to the acceptance of Article VIII status in the Kyrgyz Republic in 1995 and in Kazakhstan in 1996. In the final four sections of this chapter, I explore the greater difficulties that the Fund faced in seeking to persuade the Uzbek authorities to sustain an ‘IMF friendly’ policy orientation over time, especially when the country’s economic circumstances deteriorated during 1996. Here I show how policymakers switched back to a more interventionist policy stance in response to a balance of payments shortfall, which prompted the Fund to suspend its loan program with Uzbekistan. Uzbekistan’s domestic circumstances differed in important ways from the Kyrgyz Republic, which needed to maintain good relations to the Fund to maintain access to ODA, and from Kazakhstan, where the construction of an ‘IMF friendly’ monetary system helped the country to establish a foreign investment-friendly environment that increased the opportunities for elites to extract resource rents. In contrast to its neighbors, the construction of an ‘IMF friendly’ monetary system in Uzbekistan threatened the interests of powerful elite groups that were accustomed to extracting rents from the financial system and from the foreign exchange earned by the country’s cotton exports.
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Changing Monetary Norms in the Kyrgyz Republic

Following the completion of the Kyrgyz Republic's first SBA in April 1994, the authorities applied to the Fund for a further three-year loan arrangement amounting to SDR 70.95 million (110 percent of the country's Fund quota) on concessional terms from the Fund's Extended Structural Adjustment Facility (ESAF). The Fund intended the new program to build on the government's monetary reforms under the SBA and STF loans, in particular the need to make further progress in reducing inflation and to increase the pace of reform of the banking system. This would involve efforts to increase compliance with the new formal 'rules of the game', including disciplinary action against commercial banks if they continued to run up large overdrafts with the NBKR (IMF, 1994d: 7).

In the government's Memorandum on Economic and Financial Policies for the ESAF application, the Fund persuaded the authorities to re-commit to channeling all central bank refinance credit through credit auctions and to completely refrain from directing credit to specific areas of the economy. The government had successfully maintained open current and capital accounts following the introduction of the som in 1993, and policymakers signaled to the Fund that they intended to adopt Article VIII status before the end of the scheduled Article IV consultations in 1995 (IMF, 1994d: 8). With regard to the recurrent problem of inter-enterprise arrears, in early 1994 the government had adopted a severe method with which to harden the budget constraint on firms through requiring businesses to prepay for goods prior to delivery, despite the harsh cashflow constraints that this would place on all firms. In May, based on the Fund's advice, the government ramped up the pressure on firms even further, by limiting vital energy supplies to firms that had not moved to reduce their level of inter-enterprise arrears. Once more, the government reaffirmed to the Fund that they would resist domestic pressure for a generalized credit bail out for firms struggling with a high level of inter-enterprise debt, which suggests that the authorities had been persuaded by the Fund's arguments for hardening the budget constraints on firms. Similar to the 1993 SBA, the proposed performance criteria devised by the Fund for the ESAF arrangement consisted of a floor for convertible foreign exchange reserves, domestic credit ceilings, and ceilings on non-concessional debt. Policy benchmarks also included decreasing the limit on commercial bank lending to individual customers from 35 to 30 percent of a bank's capital, and decreasing the limit on lending to 'related parties' from 20 percent to 15 percent of capital (IMF, 1994d: 12). As noted above, the Fund wanted these changes because they were squarely aimed at circumscribing the close monetary relationships that existed between the major sectoral banks and their traditional customers, especially major customers that were also bank shareholders.

A crucial test of the central bank's new role in trying to generate a change in financial
norms had occurred under the SBA in the final months of 1993. In an effort to tighten credit policies in accordance with the Fund’s advice, the government suspended regular refinance credit auctions in October, which led commercial banks to accumulate large overdrafts with the central bank when major enterprises refused to repay maturing bank loans. A few months earlier, the growth in inter-enterprise arrears and commercial banks’ overdrafts with the NBKR had motivated the government to extend further credit to banks to allow the enterprises to continue to rollover their debts, with a large credit expansion in the first quarter of 1993, an action that was criticized by the Fund. The method the NBKR chose to deal with the arrears problem at this time helps to demonstrate the progress the Fund had achieved in persuading the central bank to adopt a new institutional role in the financial system. Following the advice of the Fund staff the central bank responded by suspending auctions for refinance credit until April 1994, when the NBKR rescheduled commercial banks’ outstanding debts over three years, including overdue interest penalties, and instructed the banks not to extend any new credit to state-owned firms facing financial difficulties (IMF, 1994e: 4). Furthermore, with technical assistance from the Fund the central bank moved to strengthen its prudential supervision of the financial system by conducting audits of most commercial banks in 1994, with the NBKR revoking the licenses of three banks that failed to meet the new standards. The authorities also announced that they would establish direct credit controls over any bank that continued to run up large overdrafts with the NBKR, and if necessary would implement disciplinary action against the bank’s management (IMF, 1994e: 12).

From the Fund’s perspective, Kyrgyz policymakers had for the most part been receptive to their advice, but had faced significant economic challenges that had compromised the country’s performance under the initial SBA and STF loans. As an indication of the difficult economic circumstances the Kyrgyz authorities had faced during 1993, and as a forewarning of future debt problems, the country’s external debt in convertible currency had rapidly increased from almost nothing at the beginning of the year (after the Kyrgyz Republic’s share of the Soviet Union’s debt had been assumed by the Russian Federation) to 18 percent of GDP, most of which was used to finance imports (IMF, 1994e: 5). In a report to the Executive Board on the government’s application for an ESAF arrangement, the Fund staff sought to apply the lessons they had learned from the unexpected economic challenges that had plagued the Kyrgyz Republic under the SBA. In particular, the staff built in contingency plans to guard against the risk of the new ESAF program going ‘off track’ due to similar circumstances that were largely outside of the government’s control. For instance, the staff included automatic adjustments to the ESAF performance criteria and quantitative benchmarks in the case of any unexpected developments in external
financing. If external balance of payments assistance managed to exceed the program’s targets, the floor for the NBKR’s convertible foreign exchange reserves would automatically rise upwards by 50 percent. In addition, if supplementary financing for a planned World Bank loan fell short of the Fund’s projections, the ceiling on domestic bank credit for the government would rise by one third of the financing gap. The Fund staff had also agreed in advance to the temporary tax changes the government would make in the event of unexpected shortfalls in government revenue (IMF, 1994e: 15).

The Fund did not excuse all the problems associated with the SBA program as the result of exogenous circumstances, however. The staff’s report to the Board on the ESAF application makes clear the ongoing difficulties the Fund faced in persuading policymakers to maintain a consistent approach to the implementation of ‘IMF friendly’ economic policy reforms, even though policymakers had continued a cooperative relationship with the Fund staff. For instance, following the successful review of the SBA in September 1993, the Kyrgyz authorities had delayed the introduction of important reforms and had switched back to looser credit policies to support domestic production and employment (although monetary policies were quickly tightened the following month). The Fund staff concluded that ‘These slippages reflected an ill-considered reaction by the authorities to the unavoidable but sharp decline of the economy and, in particular, the deteriorating performance of public sector enterprises’ (IMF, 1994e: 19).

Although the SBA had gone ‘off track’, the staff supported the Kyrgyz Republic’s application for an ESAF arrangement on the basis that the authorities had subsequently followed the Fund’s advice and tightened their monetary and fiscal policies in late 1993 and early 1994, as outlined above. The government’s tightening of monetary policies had also resulted in deposit interest rates at most banks becoming positive in real terms in early 1994, thereby realizing one of the key policy outcomes the staff and the Executive Board had strongly encouraged all of the Central Asian CPEs to achieve in 1993. In the staff’s assessment, ‘in early 1994, there was... strong evidence of a renewed impetus to structural reforms’ (IMF, 1994e: 19). Policymakers had also continued to take a cooperative approach towards implementing the advice of technical assistance missions, and, in addition to the Fund’s resident representative, the authorities had welcomed a long-term advisor for the NBKR as well as a long-term budgetary advisor for the Ministry of Finance (IMF, 1994e: 36). The staff warned, however, that the main risks to the country’s progress under an ESAF arrangement would come ‘from the uncertainty regarding the strength of the political support for the reform and stabilization efforts’. They therefore urged the government to put in place a social safety net that could help to alleviate some of the political pressures that had impeded the success of reforms during 1993 (IMF, 1994e: 21).
In another area where the Fund staff had drawn lessons from their experiment with the 1993 SBA, the staff recommended to the Board that the Fund should ‘backload’ the provision of finance under the ESAF in the first year compared with the ‘frontloading’ of finance under the previous SBA. This had left the staff with relatively weak short-term financial incentives at their disposal to persuade the Kyrgyz authorities to maintain their policy intentions when the program had begun to go ‘off track’ in September/October 1993, because the bulk of the SBA credit had already been disbursed (IMF, 1994e: 21).

In the Executive Board’s discussions on the Kyrgyz Republic’s application for an ESAF arrangement, the country’s representative on the Board noted that in late 1993 the authorities had not been able to resist political pressure for access to credit from state-owned enterprises, but had established a greater degree of monetary control since the beginning of 1994 (IMF, 1994f: 3). This assessment was generally shared by other executive directors, with many directors expressing the Fund’s disappointment with the Kyrgyz authorities’ performance following the positive review under the SBA in September 1993, noting that poor policy performance had undermined credibility in the government’s commitment to market-based reform in the international financial community. But directors praised the government for tightening monetary policies from the end of 1993, and in particular welcomed the government’s recent success in achieving positive real interest rates. Because the authorities had successfully maintained their early decision to establish open current and capital accounts, the country was now encouraged to accept Article VIII status as soon as possible (IMF, 1994f: 7, 10). In approving the ESAF arrangement, the Board strongly emphasized to the Kyrgyz authorities that the success of the program would depend upon a high level of ‘political will’ to implement unpopular policy decisions that would generate significant domestic resistance, especially from banks and major state-owned firms. However, in response to the Board’s discussions, the executive director representing the Kyrgyz Republic suggested that the authorities had learned from their experience with ‘policy slippages’ in September. He argued that the government was now ‘seriously trying to regain the lost momentum in its economic transition’, as indicated by the large number of prior actions that policymakers had implemented before the staff brought the ESAF application to the Board for approval (IMF, 1994f: 31).

Embedding an ‘IMF Friendly’ Policy Orientation in the Kyrgyz Republic

Under the ESAF arrangement, the Kyrgyz Republic subsequently achieved a high degree of compliance with the program’s performance criteria, including the landmark achievement of being the first Central Asian state to accept Article VIII status in the Fund in March
During the mid-term review of the ESAF arrangement in early 1995, the staff noted the government’s success in doubling the level of convertible foreign exchange reserves, achieving a stable exchange rate for the *som*, and maintaining tight credit policies. Deviations from the program had still occurred, including a higher rate of credit to the government and lower tax revenue than ESAF targets. The Fund staff had also experienced disagreements with *Goskomstat*, the government’s statistical agency, over how the country’s GDP was calculated (IMF, 1994g: 48). Overall, however, the staff was satisfied with the government’s policy performance in very difficult economic conditions, with GDP declining by an estimated 26.5 percent in 1994 as a result of ongoing trade disruptions between the former Soviet republics when the ESAF program had initially projected only a 5 percent decline (IMF, 1994g: 26).

In line with the Fund’s advice and ESAF performance criteria, the NBKR continued to rely predominantly on market-based instruments of monetary policy, with central bank refinance credit allocated through competitive auctions conducted on a weekly basis. Following recommendations from the Fund’s monetary technical assistance missions, the NBKR had closed three poorly performing banks and put six other banks under direct supervision. The government had also altered its approach to exchange rate management, with the central bank intervening to help establish an informal exchange rate target of approximately 10.6-10.8 *som* to the US dollar, a policy objective endorsed by the staff due to the improvement in the country’s level of convertible foreign exchange reserves. Indicating the Fund’s recognition that the country still faced a high degree of economic uncertainty and that program targets remained vulnerable to unexpected shocks, the Fund again agreed to establish provisions for automatic adjustments of benchmarks, such as the NBKR’s credit ceilings and bank financing to the government, if economic circumstances changed. In the staff’s assessment, the Fund’s ongoing technical assistance missions were ‘well received by the authorities and cooperation with Fund experts is excellent’. Once again, the staff determined that where the authorities had failed to meet the performance criteria agreed under the ESAF arrangement, this in part reflected economic conditions outside the government’s control. In particular, the staff was pleased that the authorities had adjusted their policies in close consultation with the staff in order to get the program back ‘on track’ (IMF, 1994g: 21).

Building on the country’s performance in the mid-term review, a staff paper on the Kyrgyz Republic’s application for a second annual arrangement under the ESAF in November 1995 praised the Kyrgyz authorities for making significant progress in implementing market-based reforms with close policy surveillance by the staff. In particular, the staff praised the government for maintaining a fully convertible currency in
exceptionally difficult economic circumstances. Because the government had achieved a high degree of success in complying with Fund program targets, or had consulted with the Fund before adjusting policies in response to unforeseen changes in economic circumstances, the staff recommended a continuation of the ESAF arrangement in order to lock-in the direction of reforms over the medium term (IMF, 1994h: 16).

Despite policymakers’ efforts to maintain a high degree of cooperation with the Fund, the Kyrgyz Republic continued to experience lackluster economic performance during the 1990s, with the partial exception of achieving a sharp decline in inflation during 1994, as indicated in Figure 6.4. As the country’s experience demonstrates, being an exemplar case of ‘IMF friendly’ policy reforms is no guarantee of future economic success. Figure 6.5 shows that the Kyrgyz Republic experienced a severe contraction in economic output during the 1990s – recording the worst output decline of the three Central Asian cases examined here. The country’s GDP in 1999 has been estimated as constituting only 63 percent of its 1989 level, which had increased to 78 percent of its 1989 GDP by 2003 (Pomfret, 2006: 8). By 2002, the country was putting its case to the Paris Club of official bilateral creditors for a debt rescheduling agreement (Pomfret, 2006: 82-3), and in 2006 the country was granted Heavily-Indebted Poor Country (HIPC) status by the World Bank and the Fund (IMF, 2006c). Gaining HIPC status has cemented the country’s position as a poor ‘frontier’ economy for the foreseeable future, and has frustrated the country’s ambitious goal of becoming the ‘Switzerland of the East’ that was often talked about by Kyrgyz political leaders in the early 1990s (Anderson, 1999: 65). This also shows the potential negative side to the Fund’s role as a reputational intermediary. By enabling the Kyrgyz Republic to access additional sources of external finance, this allowed the country to build up an unsustainable level of debt over the course of the 1990s. Policymakers then turned to the Fund to play another dimension of its intermediary role, as a gatekeeper to enable heavily indebted states to access debt relief through the Paris Club process (cf. Marchesi, 2003).

Changing Monetary Norms in Kazakhstan

With the adoption of a new national currency in November 1993, the Fund expected the Kazakh authorities to be able to achieve much greater macroeconomic stabilization and monetary control, with the staff projecting a decline in GDP of only 3 percent in 1994 and the achievement of single digit monthly inflation rates by the middle of the year (IMF, 1994i: 8). The staff was satisfied that Kazakhstan had now implemented most of the prior actions specified for the country to be eligible for a stand-by arrangement with the Fund. In addition to the introduction of the tenge, the authorities had removed further
administrative controls on prices and profits, increased the amount of central bank credit that was allocated through competitive auctions, raised the central bank's refinance rate to the market level established through the credit auctions, and expanded the weekly foreign exchange auctions (IMF, 1994i: 14). Again, the main quantitative performance criteria that the authorities would have to meet under the proposed SBA included quarterly credit ceilings on central bank credit, quarterly credit ceilings on domestic and external government borrowing, and floors on the level of international currency reserves. The government also committed to a further liberalization of the trade and payments system, and agreed not to modify or adopt any new exchange and trade restrictions that were incompatible with the provisions of Article VIII (IMF, 1994i: 14).

In their appraisal of Kazakhstan's application for a stand-by arrangement, the staff noted the substantial progress the government had already made in moving towards a market-based economy, but concluded that 'structural reforms must be accelerated if the improvement in financial performance is to be durable and accompanied by the stabilization and subsequent recovery of output'. The Fund staff was satisfied that the program they had agreed with the government for the SBA would help to achieve these goals (IMF, 1994i: 16). The program was also supported by significant financial support from bilateral and multilateral donors to bridge Kazakhstan's expected external financing gap of US$450 million in 1994. This included a US$145 million parallel financing loan from Japan that was linked to the Fund's loan arrangement, which was the first time that Japan had extended supplementary financing to support a SBA (IMF, 1994j: 3).

When Kazakhstan's SBA application came before the Board, most executive directors voiced strong support for the authorities' renewed commitment to an 'IMF friendly' program of economic reform. In particular, directors endorsed the country's strong track record under the STF arrangement in the difficult monetary conditions accompanying the final collapse of the ruble zone in late 1993, an event the Board saw as undermining the authorities' attempts to lower inflation. Several directors, including the Japanese representative Hiroo Fukui, praised the government's continued commitment to market-based reform. Fukui suggested that the Fund should provide financial assistance to Kazakhstan not only to enhance the country's own prospects for economic recovery, but because this would 'also have very important spillover effects on FSU countries as a whole by reviving the momentum for accelerating reforms', given Kazakhstan's regional political and economic importance. Fukui informed the Board that Japan's decision to extend parallel financing for a SBA loan for the first time was made on the basis of Kazakhstan's 'strength of commitment' to economic reform over the medium term, as indicated by the policy conditions the authorities had agreed with the staff for the SBA as well as the
country’s prior track record in implementing reforms (IMF, 1994k: 16-7).

Before the Board had begun discussions on Kazakhstan’s SBA application, executive directors had briefly debated whether the Fund should publicly respond to recent press reports – most notably Jeffrey Sachs’s article ‘The Reformers’ Tragedy’ in the New York Times three days earlier – which heavily criticized the Fund’s approach to economic transformation in the Russian Federation (IMF, 1994k: 3-4). Sachs, along with Anders Aslund, had resigned his position as an advisor to the Russian government on January 21, citing Prime Minister Viktor Chernomyrdin’s decision to apply the breaks to economic transformation, but placing most of the blame on the Fund for the collapse of elite support for rapid reforms (Erlanger, 1994: 4). This direct criticism of the Fund’s role in the former Soviet Union by a prominent American economist partly coloured the Board’s debate on Kazakhstan. For example, the French executive director Marc-Antoine Autheman suggested that the approval of Kazakhstan’s SBA application would ‘demonstrate that… Fund support is not irrationally conditioned on the achievement of overly precise numerical targets or on the implementation of a specific model, but that it is in fact dependent upon the steady and firm pursuit of stability oriented policies’ (IMF, 1994k: 17). His remarks were reinforced by Daniel Kaeser, the Swiss executive director representing both Kyrgyzstan and Uzbekistan, who observed that ‘Judging from the number of Fund missions and the volume of technical assistance to Kazakhstan, it is clear that Kazakhstan has been put under intensive care’ (IMF, 1994k: 23-4). In this context, and with most directors extending a favorable endorsement of the Kazakh authorities’ policy stance and their level of cooperation with the Fund staff, the Board subsequently approved the government’s applications for a 1 year SBA loan of SDR 123.75 million and a second purchase under the STF arrangement of SDR 61.875 million (IMF, 1994k: 46).

Embedding an IMF Friendly’ Policy Orientation in Kazakhstan

Despite the Fund’s high hopes of achieving a permanent shift in the Kazakh authorities’ policy orientation, the government’s policy performance and the quality of its cooperation with the Fund under consecutive stand-by arrangements over the next two years was mixed at best. In the first review of the stand-by arrangement in mid-1994, the staff assessed that ‘impressive progress was achieved in many areas’, but several key performance criteria and quantitative targets had not been met. Missed program objectives included the targets on credit ceilings, following a rapid monetary expansion in the first half of 1994 in response to a significant growth in inter-enterprise arrears that had been generated by the tight credit policies the authorities had established when they introduced the tenge the previous year (IMF, 1994l: 1-2). Unlike the Kyrgyz Republic, the Fund had not been able to persuade
Kazakh policymakers to resist political pressure for a credit bailout of indebted firms.

Kazakhstan continued to face severe economic challenges on a number of fronts that impeded the Fund’s efforts to achieve a sustained change in policy orientation. For instance, the country’s indicative targets for inflation were not met, with monthly inflation rising by over thirty percent in April and May and nearly 50 percent in June, rather than the single digit monthly inflation figures that the program had originally envisaged. Furthermore, economic output continued to decline rapidly, with a 30 percent decline in GDP from January to May compared with the staff’s ambitious initial estimate of a 3 percent decline for 1994 as a whole (IMF, 1994: 1-2). As these figures suggest, in difficult circumstances the Fund failed to accurately predict the short-term outcomes of formal institutional reforms (see Winiecki, 1995), which served to increase Kazakh policymakers’ uncertainty regarding the likely impact of ‘IMF friendly’ reforms.

An area where the authorities complied more closely with the SBA program conditions was the implementation of institutional changes relating to the conduct of monetary policy, in particular the expansion of the use of interest rates to allocate credit. In addition, the government had continued to allow the unified exchange rate for the tenge to be set by weekly foreign exchange auctions and had built up the level of international reserves, although reserves still remained below the program’s initial targets (IMF, 1994: 7-8). During ongoing discussions between the authorities and the Fund staff during May-July 1994, Kazakh officials emphasized to the staff that the policy slippages that had occurred were temporary, and the result of specific problems requiring a quick response in the early part of the program. The authorities reiterated to the staff that both the government and the National Bank of Kazakhstan were fully committed to implementing the loan program’s key objectives (IMF, 1994: 9). As an indication of the strength of this commitment, from May the authorities had significantly tightened monetary policies in an attempt to bring the program back ‘on track’.

In response to the mixed results of the authorities’ compliance with the program conditions in the first half of 1994, the staff proposed to push back the date when Kazakhstan would be able to make another purchase under the SBA until the second staff review had been completed. The staff also recommended extending the length of the program by four months to May 1995, with additional funds made available in January and April 1995 based on future program compliance. The staff sought to use the purchase delay and the program’s extension as incentives for the authorities to work harder to establish and to maintain an ‘IMF friendly’ policy orientation (IMF, 1994: 16-17). In particular, the staff criticized the efforts by the government to pressure the NBK to extend credit to clear domestic inter-enterprise arrears and to defer repayments on loans to the agricultural
sector, noting that the government’s decisions had circumscribed the central bank’s capacity to act autonomously (IMF, 1994: 17-18). Overall, however, the staff evaluation supported the revised SBA program, observing that ‘the policy package being put in place by the Kazakh authorities is strong and realistic’, and ‘represents a serious effort to recoup the ground lost earlier’ in pursuit of the Fund’s primary goal of lowering inflation (IMF, 1994: 20).

In the second review of the country’s performance under the SBA in September and October 1994, the staff praised the authorities’ success in adhering to tight credit policies and achieving positive real interest rates. The staff believed these measures had helped to change financial behavior among banks and firms that had previously worked against the success of the program. In particular, from the staff’s perspective the changes had broken the country’s high inflation-exchange rate depreciation cycle that occurred in the first half of the year. Commercial banks had previously borrowed central bank credit on preferential terms only to use the funds to speculate against the exchange rate of the tenge (IMF, 1994: 8), thereby exploiting inherited financial norms to pursue their own material gains under the guise of an extant ‘logic of appropriateness’.

Furthermore, the staff approved of the government’s efforts to develop the foreign exchange market, as well as the limited exchange rate intervention by the central bank in accordance with the agreement previously reached with the staff (IMF, 1994: 10). The NBK had also gradually increased its convertible currency reserves and had increased the amount of refinancing credit allocated through auctions, and agreed with the Fund staff that credit auctions would be used to allocate 80 percent of total central bank lending to commercial banks by the end of the year (IMF, 1994: 44). While the government had removed most of the exchange restrictions that had initially been maintained under Article XIV when Kazakhstan joined the Fund, some restrictions remained in place for export proceeds that were deposited in non-resident bank accounts denominated in tenge. Rather than recommend that the Board approve the maintenance of these restrictions, however, the staff chose to rely on their continuing efforts to persuade the government to set in place a timetable to remove the controls (IMF, 1994: 18), which would pave the way for Kazakhstan to accept Article VIII status in the Fund.

In their assessment of the government’s overall performance, the staff praised the authorities for taking tough policy decisions in the face of stiff domestic opposition, and commended the government for successfully making up for the ground that had been lost under the first half of the SBA. Evaluating the country’s reforms since the first Article IV consultation with Kazakhstan in April 1993, the staff concluded that ‘a great deal of progress has been made in the overall direction and pace of economic reform policies’
Towards the end of 1994, however, the government again failed to achieve some of the SBA performance criteria, largely due to firms refusing to meet their payment obligations on government-guaranteed debt.

Despite the government's ongoing difficulties with generating changes in firms' financial behavior, these policy slippages had little negative impact on the authorities' relationship with the Fund. This was due to the tough actions taken by the central bank to tighten the flow of credit to commercial banks and to maintain positive interest rates, which enabled inflation to decline to a monthly rate of 10 percent in December 1994 and helped to stabilize the exchange rate of the tenge against the US dollar. The central bank's stance on credit to the banking system was further tightened in early 1995 when the NBK's total refinancing credit to commercial banks decreased by 20 percent, with almost all new lending to banks passing through the central bank's credit auctions held three times each week. As a result of this evidence of behavioral changes in the conduct of monetary policy, the staff assessed that the country's 'performance during the year was uneven although the momentum of reform was generally maintained' (IMF, 1995e: 3, 12).

The staff subsequently supported the authorities' application for a new SBA loan of SDR 185.6 million in May 1995 in order to encourage the government to continue the process of economic policy reform in cooperation with the Fund (IMF, 1995e). Kazakhstan continued to require waivers for the non-observance of some performance criteria, specifically with regard to the accumulation of government-guaranteed external debt by firms. But the staff supported these moves because of the authorities' overall success in complying with the SBA program conditions as well as satisfactory evidence of an ongoing change in the authorities' economic policy orientation, especially with regard to the role and operations of the central bank (IMF, 1994m: 21, 1995f: 6; 1996b: 1-2).

The staff also welcomed the authorities' intention at the end of 1995 to remove remaining exchange restrictions and to move towards the acceptance of Article VIII status in the near future, an aim which led the staff to recommend that the Board approve the retention of existing exchange restrictions until the middle of 1996 (IMF, 1995g: 26). Following a technical assistance mission from the Fund's Legal Department and Monetary and Exchange Affairs Department in November 1995 to advise the authorities on Article VIII compliance requirements (IMF, 1996c: 36, 39), Kazakhstan subsequently removed the remaining exchange restrictions on non-residents' bank accounts in June 1996 (IMF, 1997a: 59). After the completion of Kazakhstan's second SBA loan the country applied for its first loan under the Extended Structural Adjustment Facility in June 1996. The Board approved the ESAF application, which began the following month the day after Kazakhstan became the second Central Asian state to accept Article VIII status in the Fund on 16 July (IMF, 1995e).
While Kazakhstan never quite achieved the same degree of close cooperation with the Fund compared with the Kyrgyz Republic, the country’s policymakers invested considerable time and energy in implementing key ‘IMF friendly’ policy changes and reaching compromises with the Fund staff in other areas where reforms required greater adjustment in order to be translated into the difficult informal environment. From the date when Kazakhstan’s application for an STF loan with the Fund was approved in July 1993, the country remained under back-to-back loan programs with the Fund until 2002. Despite the uneven progress towards establishing an ‘IMF friendly’ policy orientation during the early period of Fund membership, the country subsequently fared much better than the Kyrgyz Republic in terms of its economic outcomes, largely as a result of its greater natural resources.

After the shock of the Russian financial crisis in 1998, Kazakhstan devalued its currency and benefited from a substantial increase in oil revenues, with the country’s oil production doubling between 1998 and 2003 at the same time as the world price of oil more than doubled (Pomfret, 2006: 42). In contrast to the other Central Asian states, Kazakhstan was recognized by the United States as a market economy in 2002, and in the same year graduated from speculative- to investment-grade status with a credit rating of Baa3 by Moody’s Investors Service (Junisbai and Junisbai, 2005: 385). Among all fifteen former Soviet republics, Kazakhstan was second only to Russia in the total amount of foreign direct investment the country received during the 1990s, which reached US$1 billion in 1996 and 1997 (Meyer and Pind, 1999: 205). The far greater level of foreign investment, export revenues, and oil-driven economic growth that the country experienced compared with other Central Asian republics enabled Kazakhstan to graduate early from the Fund’s ‘tuition’ compared with the Kyrgyz Republic, with the Kazakh authorities choosing to repay their outstanding debt to the Fund ahead of schedule in May 2000 (IMF, 2000). When a 1999-2002 ESAF arrangement expired without the government choosing to make any purchases under the loan, the Fund decided that there was no longer a need to maintain its resident representative office in the country, which closed at the expiry of the last resident representative’s term in August 2003 (IMF, 2003b).

The Challenge of Changing Monetary Norms in Uzbekistan

For the Fund staff, it finally seemed as though Uzbekistan might have turned a corner in 1995. While the country was still considered to be lagging well behind the Kyrgyz Republic and Kazakhstan, Uzbek policymakers achieved a relatively high degree of policy cooperation with the Fund under the country’s STF arrangement during 1995. This
enabled the authorities to successfully apply for an upper credit tranche stand-by arrangement with the Fund of SDR 124.7 million and a second purchase under the STF of SDR 49.9 million in November 1995 (IMF, 1995i: 37). Under the STF program, the CBU had further tightened monetary policy in line with the Fund’s advice, increasing the refinance rate to 250 percent in February 1995 and then to 300 percent in March, to combat an inflation rate which averaged 14 percent per month in the first quarter of 1995. From April, all refinance credit from the central bank was allocated through credit auctions, which were held on a daily basis (IMF, 1996e: 29).

In line with the Fund’s advice, the CBU had also begun to tackle inherited financial norms by establishing harder credit constraints on commercial banks. Although several commercial banks had continued to experience difficulties with making repayments on central bank loans, rather than increase the rate of credit growth, new refinancing credit from the CBU declined in the first quarter of 1995 by 37 percent in real terms. Following the staff’s advice, the CBU also took disciplinary action against commercial banks that failed to repay refinancing credit, including barring them from credit auctions until their debts to the central bank were repaid (IMF, 1996e: 29). With a significant decline in inflation during the second and third quarter of 1995 (see Figure 4.5), the CBU was able to lower the annual refinance rate to 125 percent in August (IMF, 1995i: 3-4). In negotiations with the staff over the objectives of the proposed stand-by arrangement, the authorities had continued to emphasize their view that the country’s ‘political and social stability could best be maintained at a measured pace of reform’. For their part, the staff had continued their efforts to persuade the authorities that more rapid reforms would lead to quicker benefits, but they ‘accepted the political choice made by the authorities’, acknowledging ‘the right of each country to choose its own path of reform’ (IMF, 1995i: 5).

With the exception of the staff’s failure to persuade the Uzbek government to speed up the pace of reforms, in general the staff had achieved a high degree of policy cooperation with the Uzbek authorities under the STF. As a prior action for the SBA, the staff had required the signing of a written agreement between the Minister of Finance and the Chairman of the CBU, which explicitly stated that the government would pay interest on any funds it borrowed from the central bank at the same rate as the CBU’s refinance rate (IMF, 1995j: 2). This performative act formally put the government’s credit relationship with the central bank on the same footing as commercial banks. In addition, the authorities had removed their remaining restrictions on current international transactions during 1995, and the staff expected the government to accept Article VIII status in the Fund before the end of the year (IMF, 1995i: 13). Finally, the Uzbek parliament passed a new law governing the role of the central bank in December 1995, which the staff judged as conforming with
international best practice and which legally established a high degree of central bank
independence from the government (IMF, 1996e: 51-3).

Under the proposed SBA loan, the authorities had agreed to undertake further policy
measures to strengthen the central bank’s supervision of the banking system, and to
address commercial banks’ non-performing loans in cooperation with Fund technical
assistance missions (IMF, 1995i: 12). The Fund staff thus saw the development of an SBA
loan with Uzbekistan as a way to build on the progress made by the authorities in the
previous year under the STF loan and technical assistance missions, and to gradually
entrench a reduction of the state’s role in the economy. While the staff was not yet fully
satisfied with the pace of the government’s reform program, they supported the SBA
application on the basis that the authorities’ plans were ‘sufficiently ambitious’ to warrant
the Fund’s support. In addition, at only 62.5 percent of Uzbekistan’s quota the
commitment of the Fund’s financial resources under the proposed SBA was relatively
modest compared with loans to the Kyrgyz Republic and Kazakhstan.

The SBA would therefore commit the Uzbek authorities to achieving explicit policy
goals and to maintaining a close working relationship with the Fund staff, but the program
would be largely funded by the government’s own international reserves (IMF, 1995i: 17).
Despite the relatively small size of the SBA, the disbursement of funds would be staggered over
the course of 1996. Following an initial disbursement of SDR 6.2 million when the Board
approved the SBA in December 1995, the remaining purchases would be made available to
Uzbekistan in 5 payments of SDR 23.7 million over the course of 1996 and early 1997,
depending on the government’s compliance with program targets (IMF, 1995i: 21).
Compared with the earlier stand-by arrangements with the Kyrgyz Republic and
Kazakhstan, the Fund sought to keep the government of Uzbekistan on a short leash, in
order to increase the incentives for ongoing compliance with program targets (see Bird,
2002a: 842).

Despite the improvement in the Fund’s relationship with Uzbekistan throughout late
1994 and 1995, several problems quickly emerged under the SBA loan in early 1996. When
the staff conducted their first review of the government’s progress under the SBA in
February and March, the Uzbek authorities had already been blocked from making a
second purchase under the SBA due to the failure to meet performance criteria at the end
of December 1995. This included the failure to meet ceilings for the expansion of credit
from the CBU and for government borrowing from the banking system. While the CBU
tightened monetary policy in early 1996, this was not sufficient to achieve the CBU’s credit
ceiling target for the end of March (IMF, 1996f: 1-2, 6). The government had also broken
its commitment not to introduce new current account restrictions, with measures
introduced in April to control access to the foreign exchange auction based on whether the terms and conditions of import transactions were deemed ‘optimal’ by officials (IMF, 1996f: 15). The Fund staff subsequently made the termination of this requirement an essential prior action in order for the first review of the SBA to be successfully completed (IMF, 1996f: 51). While the government had originally committed to fully eliminating the surrender requirement on foreign exchange earnings by exporters by mid-1996 as a structural benchmark for the SBA program, this target was also changed to a gradual reduction in the second half of the year with full elimination rescheduled for the beginning of 1997 (IMF, 1996f: 11).

The staff’s appraisal of Uzbekistan’s early performance under the SBA focused on the need for the authorities to ensure ‘strict implementation’ of future policy targets. For the staff, it was ‘critical that the Central Bank of Uzbekistan maintains the control over monetary expansion which it has recently achieved’ (IMF, 1996f: 20). In light of the efforts by the CBU to tighten credit growth, the staff recommended granting waivers for the missed performance criteria and rephrasing the SBA payment timetable to have four further purchases of SDR 29.625 million scheduled for May, August, and November 1996, with the final payment in February 1997 (IMF, 1996f: 22, 25).

Unlike the cooperative policy relationships that the Fund had been able to establish with the Kyrgyz Republic and Kazakhstan, the staff had not achieved the same level of input into the domestic policymaking process in Uzbekistan, and the authorities remained much more reluctant than their neighbors to consult with the Fund before introducing changes in monetary policies. While the Board subsequently approved the government’s requests for waivers under the first review – based largely on the corrective actions taken by the CBU in early 1996 – executive directors drew attention to this point, and urged the authorities to involve the staff more closely in future policy decisions that might affect performance criteria under the program (IMF, 1996g: 1-2).

After Uzbekistan made another purchase under the SBA in June 1996, the staff’s second review of the country’s progress took place in July. Although the authorities had maintained a tight credit policy and inflation was relatively low, the staff held concerns about the government’s exchange rate policies, which suggested that the authorities were only selectively complying with the new formal rules. In the first review in March, the staff had voiced concerns over the 20 percent spread between the official auction-determined exchange rate and the cash exchange rate charged by commercial banks that had emerged at the start of the year. The staff had been unable to verify the cause of this difference due to the authorities’ reluctance to provide further information on how the cash market functioned, which led them to assume that it had been caused by collusion among the
Prior to the second review, however, the gap had re-emerged and had increased to approximately 25 percent in July. Despite the government’s claim that the spread was caused by non-competitive behavior by commercial banks, the staff was increasingly concerned that it was the result of informal rationing practices or other forms of financial intervention by the authorities. Anecdotal evidence gathered by the staff also suggested that both firms and individuals were sometimes unable to access foreign exchange (IMF, 1996h: 8-9). As a result, while the staff commended the government’s efforts at establishing macroeconomic stability during the course of 1996 they expressed disappointment at the failure to create an efficient market for foreign exchange. The staff argued that the lack of an efficient market-based exchange system was ‘the single most important obstacle to foreign investment and the main reason why such investments remain relatively modest in Uzbekistan’ (IMF, 1996h: 12). From the staff’s perspective, having the right institutional structures in place would help to build the country’s reputation among international audiences, with potential flow-on effects for ODA and foreign investment. In this respect, the staff welcomed recent measures by the CBU to expand the exchange market, as well as the government’s stated intentions to allow market transactions to determine the sum’s exchange rate.

Overall, the staff was broadly satisfied with the authorities’ attempts to put the SBA program back on track and with their stated intentions to adhere closely to the program targets for the rest of 1996. The staff therefore agreed to the authorities’ request to modify the SBA performance criteria by lowering the floor for international reserves, which would increase the scope for the CBU to intervene in the foreign exchange market in order to provide greater liquidity, and recommended to the Board that the review be successfully completed (IMF, 1996h: 13). With the Board’s subsequent approval of the second review, Uzbekistan was able to make a third drawing under the SBA in September. But despite the authorities’ rhetorical commitments to achieve the reforms agreed with the Fund under the SBA program, including the acceptance of Article VIII status, by the end of 1996 Uzbekistan’s policy settings had been reoriented in the opposite direction.

**The Suspension of Cooperation between Uzbekistan and the IMF**

Immediately following the staff’s second review of Uzbekistan’s performance under the SBA the Fund’s relations with the Uzbek authorities took a turn for the worse, with the government failing to achieve a number of quantitative targets and structural benchmarks that were due at the end of September. The authorities faced severe balance of payments...
problems during the second half of 1996, due to a decline in export earnings as the world
price of cotton decreased, at the same time as the country experienced a poor cotton
harvest. The country’s import costs also substantially increased after the price of wheat rose
from US$153 per ton in 1995 to US$251 per ton in 1996 (Blackmon, 2005: 398). Uzbekistan’s current account deficit subsequently increased from a projected 4.6 percent of
GDP under the SBA program to 7.7 percent in the last three months of the year, following
a deficit that had reached 13.4 percent of GDP in the third quarter (IMF, 1997b: 29, 34).
At the end of the year, Uzbekistan’s current account deficit of approximately US$1.1 billion
was its largest since 1991 (IMF, 1997c: 45). In addition, following a rapid increase in credit
expansion to the agriculture sector to help clear inter-enterprise, wage, and pensions
arrears, the budget deficit reached 7.3 percent of GDP for 1996 in the last quarter of the
year, compared with the government’s target under the SBA of a 3.2 percent deficit (IMF,
1997c: 29).

In response to the worsening economic situation, the authorities broke the terms of the
SBA and intensified exchange restrictions in the last three months of the year without
consulting with the Fund. These measures included reducing the number of commercial
banks granted access to the exchange auction from twelve to two (the National Bank of
Uzbekistan and Promstroibank), and the creation of a list of ‘priority’ importers and import
transactions that were granted preferential access to foreign currency. The CBU also issued
a list of 28 categories of ‘non-priority’ consumer goods for which importers were explicitly
denied access to foreign exchange through the official auction (IMF, 1997b: 40-1). The
authorities eliminated the system of foreign exchange patents, a requirement under the
SBA, but replaced this with a more strict system of conversion licenses. These changes
created a large backlog of requests for access to foreign exchange, with the staff receiving
reports of processing times up to several months in some cases (IMF, 1997c: 12). The
abrupt switch in policy settings added credence to the earlier concerns voiced by the Fund
staff of a credibility gap between the authorities’ formal policy changes towards a market-
based exchange rate regime and their continued interventionist approach in practice, based
on a selective application of the new formal rules.

Following a decree by President Karimov, a new multiple exchange rates (MER) system
was formally introduced on 1 January 1997. The Fund subsequently suspended the SBA
program without conducting the scheduled third review when it became clear that the
Uzbek authorities were not prepared to contemplate any changes in the new policies (IMF,
1997b: 4). Rather than persuading Uzbek policymakers to accept an ‘IMF friendly’
approach to market-based economic reforms, the Fund now found itself shut out of the
domestic policymaking process entirely. Moreover, the Fund staff noted that the new
exchange rate regime was ‘now more restrictive and distorted than before the approval of the stand-by arrangement in late 1995’ (IMF, 1997b: 12-4).

Under the new exchange rate regime export earnings from cotton and gold were subject to a 100 percent surrender requirement, while foreign exchange earnings from other exports were subject to a 30 percent surrender requirement. Priority areas included basic food imports, raw materials, and capital goods, for which importers received foreign currency at a highly preferential rate of exchange termed by the government the ‘auction’ rate. Other favored importers were able to access foreign exchange at the ‘commercial bank rate’, which was also highly preferential with only a 12 percent spread permitted between the commercial rate and the auction rate. By comparison, the black market exchange rates in early 1997, the sole alternative for importers who were denied access to either of the official markets, commonly differed from the auction rate by over 100 percent. This system effectively transferred financial resources from exporters to a select group of importers. It also greatly benefited commercial banks, who acquired foreign exchange at the highly appreciated official ‘auction’ rate through the 30 percent surrender requirement on exports but sold it on at the commercial bank rate (IMF, 1997b: 14). In addition to the new exchange measures, the government also raised existing tariffs and extended the scope of tariffs across a wider range of imports.

The Fund made several attempts to get the SBA program back on track, including a high-level meeting in Tashkent in May 1997 between President Karimov and the First Deputy Managing Director of the IMF, Stanley Fischer. But despite Karimov’s confirmation to Fischer that the government wished to complete the policy reforms that had been envisaged under the SBA program and to work towards a new loan arrangement with the Fund, the Fund staff subsequently made little progress in this direction in their policy dialogue with the Uzbek authorities (IMF, 1997b: 1, 17-18). Relations continued to deteriorate, with the Fund staff criticizing the authorities for a lack of candor in their discussions, if not outright obfuscation by withholding economic data (IMF, 1997b: 25-6). In response to the staff’s efforts to persuade the government to abandon the multiple exchange rates system, the authorities again drew on their standard argument that ‘a substantial correction of the exchange rate would reignite inflation and contribute to social instability’. To alleviate the political impact of the severe exchange controls on imported consumer goods, the government channeled foreign exchange to importers of basic food goods at the preferential ‘auction’ exchange rate ‘to help preserve social stability’ (IMF, 1997c: 59).
In the four years following the introduction of Uzbekistan’s multiple exchange rates system, the Fund’s research on the Uzbek economy and its Article IV consultations with the Uzbek authorities sought to emphasize the negative welfare effects of the government’s policies, in an attempt to use the Fund’s intellectual resources to change the authorities’ belief in the benefits of the system. However, rather than persuade the government to change track, the Uzbek government responded to the Fund’s criticism by defending the multiple exchange rate regime as an assertion of its sovereignty (Pomfret, 2000: 741). As Miroslav Nincic (2006) suggests, extending negative material sanctions on a ‘renegade regime’ – in this case the suspension of IMF loans to a state which violated a key principle of the contemporary international monetary order – can potentially have a counter-productive psychological effect on a country, in addition to the intended material effect. While the economic cost of sanctions might be expected to help undermine domestic political support for the government’s policy stance, it also allows the authorities the opportunity to portray themselves as standing up for the country’s independence and its right not to be dictated to by outside actors. This can be a crucial reason for why ‘sticks often fail’ to generate political change, and why they may have the counter-productive effect of increasing domestic support for a country’s leaders, support for their policy agenda, or both (Nincic, 2006: 323-4). In the case of Uzbekistan, crying foul over Fund ‘bullying tactics’ chimed with President Karimov’s efforts to legitimize his regime by propagating an ideology of national independence, with Karimov representing the country’s independence from the Soviet Union as allowing the Uzbek people to finally become ‘the true masters of the tremendous wealth of their native land’ (cited in March, 2002: 375).

A further reason for the failure of negative sanctions to lead to a change in state behavior outlined by Nincic (2006: 324) is the potential for the penalties for ‘bad behavior’ to fortify the economic interests of powerful domestic actors and thus strengthen the political constituency opposed to change. This is what occurred in the case of Uzbekistan, where the multiple exchange rates system ensured that powerful economic elites benefited from state protection of their sources of wealth against the possibility of foreign competition if the government followed the Fund’s advice and established current account convertibility. Despite the formal centralization of political power in the hands of the President, the evidence suggests that Karimov lacked sufficient autonomy from powerful informal social networks in Uzbekistan to successfully implement policies that cut across their interests.

The crucial difficulty for the Fund was that the informal political and economic context in Uzbekistan inhibited the potential for formal institutional changes to be sustained. The
adoption of convertibility would have threatened the large rents that elite clan groups were able to extract from the banking system as well as the exchange earnings from the cotton industry (Collins, 2004: 252-3). For instance, rival clan groups struggled with each other and the government-controlled CBU for control of the National Bank of Uzbekistan (NBU), which held 80 percent of the country’s financial assets. Control of the NBU permitted clan groups opportunities for foreign exchange speculation through the NBU’s links with foreign banks, as well as the ability to demand side payments from the bank’s major customers in return for the approval of loans (Said, 2000). However, despite the domestic political economy benefits gained by the authorities through avoiding current account convertibility, such benefits clearly came with substantial costs. The spread between the black market exchange rate and the two ‘official’ rates continued to grow between 1997 and 1999 (see Figures 8.1 and 8.2), with a steadily increasing proportion of foreign exchange transactions being conducted at the black market exchange rate as importers were unable to gain sufficient foreign currency through official channels (Rosenberg and de Reeuw, 2000: 9).
Figure 8.1 Average Exchange Rates in Uzbekistan - 1997-99 (Uzbek Sum per U$).


Figure 8.2 Estimated Exchange Rate Market Shares in Uzbekistan - 1997-99.

Under the multiple exchange rates system, the Uzbek authorities gradually succeeded in achieving a positive current account balance in 2000 for the first time since 1994 (see Figure 8.3). However, this was achieved through the further tightening of exchange and trade restrictions to depress imports in response to continued low world market prices for cotton (IMF, 2001b: 11-12), while the foreign exchange surrender requirement for exports apart from cotton and gold was increased from 30 percent to 50 percent in January 1999 (Rosenberg and de Reeuw, 2000: 4). In 2000, the net transfer of financial resources from exporters to importers through the government’s trade and exchange restrictions was estimated as constituting up to 16 percent of the country’s GDP (Rosenberg and de Reeuw, 2000: 18). In addition to the high level of implicit taxation, importers also faced high administrative hurdles, with the CBU requiring the submission of seven separate documents before officials would consider granting approval for import transactions (Spechler, 2003: 53). In these circumstances, relations between the Fund and the Uzbek authorities failed to improve and in some respects further deteriorated throughout the late 1990s. The Fund staff responsible for Article IV discussions with Uzbekistan reported that the authorities had even attempted to negotiate with the staff over the figures that the Fund would record for Uzbekistan’s economic growth and inflation rates (Author interview, 2005a).
The Limits of the IMF’s Influence as an Intellectual Actor

Despite the lack of any tangible progress, the Fund continued to maintain its office in Tashkent and appointed a new resident representative, Christoph Rosenberg, to take up the post in January 1998. Rosenberg made numerous attempts to persuade the Uzbek authorities to repeal the multiple exchange rates system and move towards the establishment of current account convertibility. These efforts included conducting research on the welfare costs of the system of trade and exchange restrictions compared with transferring the same benefits to importers through the tax system (Rosenberg and de Reeuw, 2000; Author interview, 2005b). In February 2001, Rosenberg put up a detailed page on the IMF’s Uzbekistan website, based on his personal views, to establish the validity and the misconceptions of the 15 most common arguments against current account convertibility he had encountered from Uzbek officials in defence of the multiple exchange rate system. This added an element of ‘public shaming’ to support the Fund’s earlier attempts at persuasion. Besides inaccurate comparisons with other countries’ experiences of current account convertibility, these 15 arguments included the contention that ‘The IMF pushes Uzbekistan to introduce convertibility because this benefits the West’. In response, Rosenberg (2001) contended that Uzbekistan would be the principal beneficiary from convertibility, and that ‘The IMF itself has neither the intention nor the means to “push” a country to pursue certain policies’. The Fund staff continued to have disagreements with officials over how they should calculate the rate of inflation, and experienced ongoing difficulties with gaining access to accurate economic information. In response, the Fund’s resident representative began regularly collecting information to construct his own informal inflation index based on the prices of a basket of goods assessed each week in different cities. Such methods earned him some harsh words from the Uzbek leadership, but in the short-term had little impact on the authorities’ policy stance (Author interview, 2005b).

Following a series of broken promises by President Karimov that he would undertake an imminent move towards the reintroduction of current account convertibility (Author interview, 2005b), the Fund eventually decided not to appoint a new resident representative to its Tashkent office when Rosenberg’s term expired. When it was publicly announced, the news was widely perceived as a signal that the Fund could ‘no longer do business with the government’ (BBC, 2001). The Fund’s office was not actually closed, but in the future it would only be maintained by local staff. In their appraisal of Uzbekistan’s economic policies for the 2000 Article IV consultation, the staff again encouraged the authorities to adopt a rapid program of reforms, but noted that they were ‘willing to accept the
authorities’ goal of gradual progress toward the implementation of reform’ in the design of a new Fund-supported program. The key condition here was that the government took tangible measures toward the introduction of current account convertibility. In addition, the staff was concerned by ‘political interference’ in the production and use of official statistics, with the government seeking to present a favorable picture of the country’s economic conditions (IMF, 2001c: 27-9). The authorities were increasingly concerned with the image that they wanted to portray, both to the outside world and domestically, and their actions led the staff to believe that they were deliberately withholding information in order to ‘blind’ the Fund from their economic practices (Author interview, 2005b).

Relations between Uzbekistan and the Fund only began to thaw after the withdrawal of its resident representative in early 2001. Later that year the Uzbek authorities consulted with the staff on the possibility of developing a new reform program with the Fund, and agreed to establish a staff-monitored program (SMP) to run from January to June 2002. Staff-monitored programs are not supported by a loan from the Fund and are not subject to approval by the Executive Board. However, they still include performance criteria and are used to establish closer policy dialogue in countries that have a poor record of implementing policy changes agreed with the Fund. The SMP therefore enables a country’s authorities to build up a favorable track record of policy implementation that can allow them to apply for a loan arrangement in the future (Author interview, 2005c). Under this arrangement, the Uzbek authorities finally agreed to remove all current account restrictions and to unify the exchange rate by June 2002 (IMF, 2002a). This time the government followed through on its rhetorical commitments with action, and implemented most of the agreed performance criteria and structural benchmarks for the SMP, including lifting official restrictions on current account transactions (IMF, 2002b). Following further consultations with the staff, the Uzbek authorities finally accepted Article VIII status in the Fund in October 2003 (IMF, 2003c), although the staff believe this was driven by the authorities’ desire to portray a symbol of economic reform to the international financial community rather than by a substantive change in the government’s policy preferences (Author interview, 2005b).

Despite achieving a key ‘IMF friendly’ reform landmark by finally establishing current account convertibility, Uzbekistan has not yet entered a new loan arrangement with the Fund and the staff remain dissatisfied with the government’s conduct of economic policy. Monetary policy has simply shifted from formal exchange restrictions to reliance on informal measures and the exercise of moral suasion over commercial banks (Author interview, 2005d), while the government has sought to achieve many of the same goals that it did through the multiple exchange rates system by increasing trade restrictions (Author
interview, 2005e). Staff in the Fund’s Middle East and Central Asia Department who are responsible for Uzbekistan remain convinced that the CBU continues to have little autonomy in practice, and that key decisions over monetary policy are centralized in the hands of the President and Deputy Prime Minister (Author interview, 2005c, 2005h).

Despite the government’s acceptance of Article VIII obligations, some firms have continued to encounter difficulties in accessing foreign exchange (Ruziev, et al., 2007: 15). Reports from local and foreign businesses, private bankers, and foreign diplomats suggest that the CBU operates informal monthly limits on the sale of foreign exchange to finance consumer imports, which are usually exhausted after only a few days. Unfulfilled applications for foreign exchange are then held over until the following month. Despite numerous reports of Article VIII violations, the CBU has continued to deny that any restrictions on convertibility still exist (Gemayal and Grigorian, 2006: 242). According to the deputy chairman of one private bank in Tashkent, however, illegal practices are systemic (Author interview, 2005c). The authorities have maintained the 100 percent surrender requirement on foreign exchange earnings from cotton and gold exports as well as the 50 percent surrender requirement on most other exports. Furthermore, extensive restrictions remain in place that prevent banks from effectively intermediating savings from the population, while the economy continues to experience severe cash shortages, which constrains the ability of individuals to access enough *sum* to buy foreign exchange in the first place (Gemayal and Grigorian, 2006: 244-5). It is common for banks to interrogate depositors seeking to withdraw their funds over what the money will be used for, leading individuals as well as firms to seek to avoid the banking system altogether (Author interview, 2005c, 2005f). Nevertheless, despite these ongoing restrictions, local observers in Tashkent suggest that the Fund’s role was crucial in gradually bringing the authorities to formally accept the principle of current account convertibility, with the country manager for one local economic NGO concluding that ‘it probably wouldn’t have happened without the IMF’ (Author interview, 2005g).

Summary

One of the principal lessons that can be learned from the Fund’s experience with promoting market-based monetary reforms in Central Asia is that the organization’s capacity to persuade policymakers to enact systemic change based on its ideas rests heavily on how policymakers interpret the circumstances that they face. When Central Asian policymakers’ intentionally rational strategies to cope with the challenges of the post-communist transition intersected with a need to engage and cooperate with the Fund, the organization was able to shape the process of monetary reform over time through setting
prior conditions for loan programs, loan performance criteria, technical assistance advice, and involvement in the everyday policymaking process. In the former Soviet Union, the Fund’s capacity to influence economic reform as an intellectual actor was shaped in large part by the informal context of institutional change. This suggests that the Fund’s ideas can only be persuasive for policymakers in difficult cases, such as the frontier economies of Central Asia, when the authorities can be persuaded that their interests lie in maintaining cooperation with the Fund.

The ‘scope conditions’ that an IO such as the Fund must operate within are of enormous consequence for the organization’s ability to persuade policymakers to enact politically difficult reforms (cf. Zürn and Checkel, 2005: 1055-6). This is not to suggest that a desire on the part of national policymakers to acquire the Fund’s ‘seal of approval’ for their economic policies is a sufficient condition for the Fund to persuade them to adopt its preferences for institutional change and to sustain ‘IMF friendly’ reforms over time. The Fund must engage in ongoing bargaining and negotiation with member states over the scope and direction of policy changes, and must be able to achieve compliance with formal changes that help to reconstruct how actors conceive their interests in order to embed an ‘IMF friendly’ institutional framework. However, when cooperation with the Fund is not a principal concern for a country’s political leaders, the Fund can find that it is quickly shut out of the policymaking process and is left with few levers of influence.

As the Fund’s experience with the Central Asian CPEs illustrates, inheriting common systems of political and economic governance and shared historical experiences is no guarantee that policymakers in newly independent countries will approach economic reform in a similar fashion. When the ruble zone finally collapsed during 1993, the Kyrgyz Republic moved rapidly to establish a new national currency and quickly adopted full currency convertibility in line with the advice of the Fund. Throughout the next three years the Fund staff was able to achieve a high degree of input into the domestic policymaking process, and on several occasions they successfully dissuaded the Kyrgyz authorities from implementing policy measures in response to political pressure that were seen as backward steps. Moreover, a shift away from the government’s early commitment to full currency convertibility was never openly countenanced. Despite the country’s poor economic outlook after independence, the high level of cooperation that the authorities maintained with the staff enabled the Kyrgyz Republic to be the first Central Asian state to access financial support through systemic transformation facility and stand-by arrangement loans with the Fund in 1993. In addition, the Kyrgyz Republic became the first Central Asian state to accept Article VIII status in the Fund in 1995.

Kazakhstan also achieved a relatively high degree of cooperation with the Fund during
the first half of the 1990s despite an uneven start, although the government moved slower than the Kyrgyz Republic in its approach to market-based monetary reforms. Compared with the Kyrgyz Republic, where policymakers initially proved more receptive to the Fund's advice and to the development of an 'IMF friendly' reform program, the Kazakh authorities were initially more concerned with maintaining their close economic relationship with Russia than establishing good relations with the Fund. When this proved to be politically impossible, the government began to make greater progress in implementing the staff's advice on monetary reforms. Kazakh policymakers began an intensive process of engagement with the Fund through technical assistance missions and back-to-back loan arrangements after they made a final break with the ruble zone and introduced a new national currency at the end of 1993. Despite instances where the government applied pressure to the NBK to ease the burden of adjustment on domestic firms by providing cheap credit, under Fund loan arrangements the authorities implemented many of the Fund's preferences for the construction of a market-based monetary system. From the Fund's perspective, the inability to take tougher measures to change the financial behavior of firms partly undermined the authorities' progress with building a new institutional framework for the conduct of monetary policy. However, on crucial issues such as unification of the exchange rate, current account convertibility, formal central bank independence, and the use of competitive auctions to distribute financial resources, the Fund was successful within the space of only a few years in persuading Kazakh policymakers to share a common framework for analysis with regard to monetary challenges.

In stark contrast with both the Kyrgyz Republic and Kazakhstan, Uzbekistan's relations with the Fund from 1992 to when the government finally accepted Article VIII status in 2003 remained poor. A brief improvement occurred from the end of 1993 to the completion of the country's STF loan at the end of 1995, when relations between the Uzbek authorities and the Fund substantially improved and the staff believed that they were making real progress in gradually shifting the government's policy stance in a market-oriented direction. Despite the introduction of some important formal changes during this period, the Fund's relations with Uzbekistan soured again towards the end of 1996 and the beginning of 1997 when the government broke one of the Fund's golden rules by introducing a strict system of multiple exchange rates.

Despite some early warning signs that the Uzbek authorities were adopting formal policy changes that the Fund staff wanted and then subverting them through informal means in practice, it took a long time for the government to realize that the Fund was serious about economic reform, and for the Fund to realize that Uzbekistan was not
The government’s actions at the end of 1996, as well as the failure to heed the Fund’s advice to take corrective actions during 1997, can be seen as a measure of the Fund’s lack of success in persuading Uzbek policymakers to adopt a common intellectual framework. Unlike their neighbors in Kazakhstan and the Kyrgyz Republic, the government failed to consult with the staff before directly violating the terms of its stand-by arrangement with the Fund. Faced with a major economic challenge, the government turned to Soviet-style practices for a familiar remedy that would be less likely to jeopardize the regime’s stability – or at least its ability to control economic activity and to allocate rents – rather than taking the Fund’s advice to adopt current account convertibility. In contrast to 3 years in the Kyrgyz Republic and 4 years in Kazakhstan, it took the Fund 11 years to persuade Uzbekistan to formally accept Article VIII status after the country became a member of the Fund, while recent evidence suggests that the government has simply shifted to a more informal system of exchange restrictions.
Conclusion

As an intellectual actor, the Fund is not a homogenous ‘policy enforcer’. The organization has a clear preference for governments to open markets in order to increase competition, and to allocate resources through price incentives rather than administrative discretion. Above all, the Fund believes that states will benefit from policies that aim to achieve ‘sound money’ and ‘sound public finances’, which can improve their credit reputation among international audiences. But rather than blindly promoting ‘one-size-fits-all’ policies (Stiglitz, 2002), the Fund recognizes the need for different policy reform mixes in different cases. In this respect the Fund constructs templates for institutional change, based on similar characteristics among like-economies (see Broome and Seabrooke, 2007; Seabrooke, 2007b), especially when the Fund perceives that states confront common economic challenges in a crisis.

In cases where the Fund must persuade policymakers to adopt its ideas in an environment of acute uncertainty, the informal context in which formal institutional change takes place can thwart the Fund’s efforts to sustain an ‘IMF friendly’ policy orientation over time. Institutional change in an environment of acute cognitive uncertainty is not a matter of the Fund socializing actors to ‘internalize’ norms that then direct their behaviour (Checkel, 2005; Zürn and Checkel, 2005). Rather, at every step of the reform process, the Fund must persuade actors to adopt, and to sustain, its long-term policy preferences – the end point of ‘IMF socialization’ is never reached in practice because of the range of political variables and unexpected events that intervene. Moreover, because the Fund seeks to encourage compliance with international monetary principles that only constitute ‘soft law’, the costs of defection are very low, even for frontier economies. The Fund’s persuasive influence will therefore depend upon how policymakers interpret the political and economic circumstances that they face, and whether this leads them to see the Fund as a useful means to achieve other objectives.

The IMF as an Intellectual Actor

‘Seeing like the IMF’ helps to reveal that the Fund’s actions cannot simply be explained by a crude principal-agent model in which the staff are kept on a tight leash by the interests of major shareholders on the Executive Board. Fund staff have significant sources of autonomy in generating country knowledge for the design, processing, and assessment of the Fund’s advice for institutional change. They are the main conduit for the Fund’s relations with policymakers in its member states. As such, the staff play a crucial role
evaluating the policy intentions of state actors and attempting to reconstruct their preferences over time.

Chapters 1-3 in this thesis help to show the dynamic relations between different parts of the Fund, and demonstrate that while the Fund has a strict hierarchical process for producing country knowledge and policy advice, this is shaped at different levels before the Fund achieves a ‘single corporate line’ on preferred reforms that staff seek to persuade policymakers to adopt. We should therefore be sceptical of claims that the Fund uniformly promotes the same policies, and should pay closer attention to studying the sources of variation in the Fund’s advice in different countries over time. In this endeavour, Fund archival documents provide a useful way to trace the dynamic process that goes on within the Fund before loan programs are approved and financial resources committed. However, there are clear limits to relying on Fund documents to explain policy change. In particular, they can only provide a one-sided view of the Fund’s relationship with a country’s policymakers. In addition, they have limited utility when seeking to explain intra-elite political struggles over policy reforms in a particular country, or when exploring how formal reforms play out through everyday politics among non-elites (cf. Hobson and Seabrooke, 2007), as Chapter 4 demonstrates.

Fund persuasion is not simply about supporting the strategic interests of powerful creditor states. Nor is it about enforcing ‘one-size-fits-all’ universal templates for policy change. The value of ‘seeing like the IMF’ through its own documents, like Scott’s (1998) work on states, is to provide an analytical cut into seeing how an international organization tries to change governance techniques in its member states through persuasion over time. The Fund is not simply a global economic police force or an agent of major powers – although it may sometimes be forced to play these roles in particular cases. Despite the means available to the Fund to insist on compliance with its reform preferences, such as the removal of exchange restrictions and the acceptance of Article VIII status (Galbis, 1996: 47), where possible the Fund prefers to combine the ‘stick’ with the ‘carrot’ and uses persuasion through policy dialogue to nudge its members in an ‘IMF friendly’ direction over time.

As an agent of persuasion, a key component of the Fund’s role is to provide the function of a reputational intermediary that helps states to improve their creditworthiness by communicating essential information to private actors and providing a symbolic assurance about a government’s policy intentions to bilateral and multilateral donors. As Gould (2006a: 205) points out, if Fund programs are to help states improve economic outcomes, ‘the real silver bullet is external financing’. This does not mean that the Fund’s role as a reputational intermediary will lead to positive outcomes. As the case of the Kyrgyz
Republic indicates, improving the capacity of states to access additional sources of external financing might simply lead to an unsustainable debt cycle, prompting states to turn to the Fund to access debt relief through the Paris Club process. Again, the Fund's role as a reputational intermediary comes to the fore here, with states relying on the Fund's conservative reputation for a credibility-enhancing mechanism to secure concessions from private and official creditors (cf. Marchesi, 2003).

In performing this informational function, the Fund's authority to pass judgment on a state's policy orientation on behalf of the international financial community depends upon its actions corresponding with its conservative institutional reputation. This provides a pragmatic motivation for the Fund to promote policies that aim to achieve 'sound money' and 'sound public finances' in borrowing member states. In doing so, the Fund counsels states on how to improve their ability to attract external financing within the structural constraints imposed by the contemporary international economic order, while the organization is also cognizant of its own resource constraints in an era of globalized capital markets. This does not substantiate arguments that the Fund is acting in the interests of private investors or major official donors against the interests of borrowing states (cf. Best, 2005: 133; Gould, 2006a: 203), although the line between helping states to act responsibly within structural constraints and reproducing those constraints may sometimes be very fine. The Fund's role as a reputational intermediary is especially important for states wishing to make the transition from 'frontier' to 'emerging market' economies, because global financial trends indicate that this transition is largely dependent on a state's capacity to signal their creditworthiness in order to attract public and private investment into sovereign debt (Mosley, 2003: 103-4, 108; Seabrooke, 2006c: 157-9). In the three cases examined here, the only state that has so far been able to graduate to the ranks of 'emerging market' economies is Kazakhstan, which achieved an investment-grade rating from Moody's Investors Service in 2002.

Lessons from the Frontier

In its dealings with the Kyrgyz Republic, Kazakhstan, and Uzbekistan the Fund relied primarily on the use of persuasion to achieve domestic policy change, backed up with its ability to approve or to deny loan arrangements and the associated financial and symbolic benefits that a Fund agreement can deliver. The staff's responsibility to assess reform intentions before a state can apply to the Board for a loan agreement – as well as the Fund's capacity to approve, deny, or suspend loans – can provide scope for the Fund to exert a persuasive influence over policymakers' economic policy choices. The application of 'prior actions' and loan conditionality are an important part of the Fund's toolkit. They are
not simply incentive mechanisms that the Fund employs to 'buy' compliance with its preferences during the life cycle of a loan program. If this was the case, there would be little left to explain the maintenance of an 'IMF friendly' orientation towards monetary policy after a loan program has ended except for a crude 'path dependence' argument, especially if a program does not result in improved economic performance. Rather, we should see the Fund's conditionality tools, both prior to and during loan programs, as affording opportunities for staff to persuade policymakers to change the way they think about the economy. The scope for persuasion may be even greater when states are likely to request back-to-back loan agreements, because this reinforces the importance of the staff's role in assessing past compliance and future intentions.

IO scholars that work on state socialization typically pick 'slam dunk' cases of socialization in order to make their point, such as studies of socialization in the European Union where actors can strategically deploy norm-based arguments that draw their power from the community's common standard of legitimacy (Schimmelfennig, 2001: 48). Middle-range cases of socialization tend to receive much less attention because it is more difficult to measure the weight of norms. In such cases, persuasion remains an ongoing process and states may frequently exhibit an intention to defect. This makes these cases important for understanding the effects of an IO's tools of persuasion and compliance, at the same time as making it more challenging to do so.

The three cases examined in this thesis suggest that the Fund's ability to use financial incentives and intellectual arguments to encourage Central Asian governments to adopt 'IMF friendly' monetary reforms depended heavily on whether policymakers could be persuaded that they had good reasons for intensifying cooperation with the Fund. The intentionally rational strategies that Central Asian leaders developed at independence, which flowed from how elites interpreted the transitional context in each country, informed whether actors saw good relations with the Fund as a means to an end to shore up support for the new regime, or as a potential threat to social stability and regime survival. This might seem to suggest that the Fund had little independent influence at all, and what mattered was simply whether good relations with the Fund fit in with policymakers' own political and economic goals. But these 'scope conditions' only set the stage from which the Fund draws on its intellectual resources to shape the design, process, and implementation of institutional change.

For an external actor such as the Fund, material incentives provide openings for ideational persuasion. The ability to offer 'positive inducements' to states in return for policy compliance might produce two different effects on state behavior. First, by offering rewards for improved conduct, positive inducements might help to tip the balance in favor
of compliance, without changing the underlying agenda and incentive structure of the regime. Here, as Nincic (2006: 325) points out, ‘the best that can be expected is to bribe finite political concessions from a basically bad regime’. In this respect, a government may adopt a posture of apparent compliance with the Fund in order to access a loan arrangement and the opportunities for greater support from the international financial community that good relations with the Fund imply. However, a government’s commitment to maintaining a good policy relationship with the Fund in these circumstances will be weak, with compliance likely to be short-lived, as it was in the case in Uzbekistan.

The second effect that positive inducements can potentially have on a state’s behavior is to contribute to a more fundamental realignment of a state’s policy agenda. Here, ‘the regime’s incentive structure is reconfigured, decreasing the need for bribes’ (Nincic, 2006: 325). Where fundamental change occurs, this suggests that the Fund has successfully persuaded national elites into a shared way of thinking about the economy and the appropriate role of the state. In addition, it may suggest that elites have taken into account the future material benefits that can be gained through cooperating with the Fund, such as the potential for greater external financing from either private or public sources. However, given the considerable political investment in institutional change and policy learning that is necessary to demonstrate substantive compliance with the Fund’s policy preferences over time, both processes are likely to play important symbiotic roles in shaping political outcomes. These two effects comprise the difference between a straightforward change in policies, which governments might quickly abandon as the case of Uzbekistan demonstrates, and a substantive change in a regime’s policy orientation. We can expect the latter to be more durable, as evidenced by the ‘IMF friendly’ policy actions that were taken by the Kyrgyz Republic, and to a lesser extent Kazakhstan, when governments encountered domestic resistance towards top-down changes in monetary practices.

The Kyrgyz Republic exhibited a strong desire from the start to work cooperatively with the Fund, in order to gain access to additional sources of official aid. However, the maintenance of ‘IMF friendly’ policy reforms despite considerable resistance from commercial banks and major state-owned firms – which policymakers believed would have a major negative impact on state revenues – also suggests that the Fund had a relatively high degree of success in persuading national officials into a common way of thinking about economic policy options. Backed up by the use of material incentives, the Fund was able to cultivate a new intellectual framework for understanding economic problems among Kyrgyz officials. Policymakers subsequently chose to apply ‘IMF friendly’ policy solutions in response to the severe monetary problems that emerged at the end of 1993, in
contrast to their continued reliance on Soviet practices in similar circumstances at the start of the year.

Compared to its neighbors, Kazakhstan was an intermediate case for the Fund. Kazakh policymakers were not as open to the Fund’s ideas for economic reform as the Kyrgyz Republic, but nor were they as resistant to the Fund’s advice as Uzbekistan. Like the Kyrgyz Republic, the Fund attempted to persuade Kazakh policymakers to set new parameters for the ‘institutional game’ that could help to change actors’ preferences in favor of a market-based monetary system and would circumscribe the potential for political interference in the distribution of financial resources. The staff notched up some notable successes in Kazakhstan during 1993 and 1994, such as persuading the authorities to increase their reliance on credit auctions to allocate central bank credit, although the Fund was not initially able to persuade Kazakh policymakers to resist political pressure for further credit bailouts of indebted firms. Kazakhstan’s policymakers invested much time and energy in implementing key ‘IMF friendly’ policy changes and reaching compromises with the Fund staff in other areas where reforms required greater adjustment in order to be translated into the difficult informal environment. From the date when the Kazakh authorities’ application for an STF loan with the Fund was approved in July 1993, the country remained under back-to-back loan programs with the Fund until 2002. Despite the uneven progress during the early period of Kazakhstan’s membership in the Fund towards establishing an ‘IMF friendly’ policy orientation, the country subsequently fared much better than the Kyrgyz Republic in terms of its economic outcomes, largely as a result of its greater natural resources.

Compared with both the Kyrgyz Republic and Kazakhstan, Uzbekistan has remained a troublesome case for the Fund. From the Fund’s perspective, the government of Uzbekistan has behaved like a renegade regime and refused to be persuaded to implement international monetary norms in domestic policy except at its own protracted pace, despite a concern among Uzbek leaders to maintain the appearance of cooperation with the Fund. A brief period of intensive cooperation between Uzbek policymakers and Fund staff occurred during 1994 and 1995, when the Fund was able to achieve a tightening of monetary policy, increased use of credit auctions for allocating financial resources, and tougher budget constraints on commercial banks and major firms. This led to a significant decline in inflation under the country’s STF loan in 1995, new legislation stipulating de jure independence for the central bank, and the removal of exchange restrictions and measures to expand the market for foreign exchange. However, cooperation broke down again during 1996, due to Uzbek policymakers’ response to a balance of payments crisis caused by declining foreign exchange earnings for cotton exports. By breaking the terms of their
SBA loan without first discussing possible changes with Fund staff, the actions of Uzbek policymakers prompted the Fund to suspend the agreement to pressure the authorities to rescind new measures that intensified foreign exchange restrictions. Studying ‘outlier’ cases like Uzbekistan, where the Fund is able to make a credible threat to suspend financing without undue political interference from the Executive Board, helps to show the limits of the Fund’s influence. While it is often reported that the Fund uses its loan programs to ‘impose’ policy changes on unwilling governments, the Uzbek case illustrates that sovereign governments can still exercise the right to break the terms of such agreements when the domestic costs of compliance become too high – although, like Uzbekistan, they risk a high reputational cost among international audiences.

The principal lessons from this study of the Fund’s experience with institutional change in the frontier economies of Central Asia are threefold. First, while a systemic crisis might open up a window of opportunity enabling the Fund to persuade policymakers to enact formal institutional changes, in conditions of acute uncertainty formal changes can quickly be frustrated by informal practices. Second, a crucial driver of the relationship between policymakers and the Fund is how staff interpret the policy intentions of their interlocutors. This informs how staff assess compliance with ‘prior conditions’ before submitting loan applications to the Board, and how staff judge a country’s track record under a loan program. Perhaps most important is the fact that staff assessments of a government’s policy intentions and compliance under a loan program are not simply a matter of quantifying formal changes. Rather, staff must interpret whether instances of ‘policy slippage’ and missed targets constitute evidence of deliberate non-compliance, or whether local circumstances mitigated the potential for loan conditions to be fulfilled. These judgements matter when the Executive Board is considering whether to grant waivers for unfulfilled loan performance criteria, such as in the cases of the Kyrgyz Republic and Kazakhstan during 1993-6, or whether to suspend a loan program in conditions of deliberate non-compliance, as in the case of Uzbekistan in 1996.

The third main lesson from the Fund’s experience with Central Asian economies is that the organization’s influence often leads to unexpected outcomes. In the Kyrgyz Republic, the Fund’s ‘star pupil’ in Central Asia, the Fund’s intermediary role enabled the government to contract an unsustainable level of foreign debt during the 1990s, which undermined the potential for reforms to lead to improved economic performance. In Kazakhstan, the creation of a foreign-investment friendly climate through ‘IMF friendly’ monetary reforms enabled policymakers to build up a patronage system based on resource rents. Using state power to exploit rent-seeking opportunities does not necessarily prevent economic growth and increased economic efficiency (see MacIntyre, 2000: 270; Lim and
Stern, 2002). However, in Kazakhstan the creation of a ‘rentier economy’ stymied the implementation of reforms in other areas of the economy (Pomfret, 2006: 11; Gleason, 2001: 172-3), leading to recent calls by the Fund for intensified structural reforms to enhance corporate transparency and governance (IMF, 2007b: 17). Finally, although Uzbekistan’s track record with the Fund suggests that it was largely non-cooperative during the 1990s, the Fund’s policy dialogue with the authorities led to reforms in some areas. In this respect, Uzbekistan is a case of slow monetary reforms, rather than simply a case of no reform. This suggests that even in non-cooperative cases, the Fund’s advice can inform domestic institutional change by providing policymakers with a package of reform ideas, from which they might select those they consider least likely to threaten their interests. These three principal lessons from Central Asia have broader relevance for the Fund’s relations with other frontier economies as well as emerging market economies, and warrant further comparative research.

Implications for Future Research

The argument and findings in this thesis have important implications for recent debates over the Fund’s role in the contemporary world economy – especially for debates over the sources of the Fund’s influence on institutional change in borrowing states – and for the study of international organizations more broadly. In particular, seeing the Fund as an intellectual actor can help to improve recent principal-agent approaches to understanding international organizations (cf. the chapters in Hawkins, et al., 2006b), by orienting the focus of analysis from member state control of IOs to the sources of their autonomy as intellectual actors, and how this dynamic varies across cases and over time. ‘Seeing like an IO’ in the case of international economic organizations such as the World Bank, the Bank for International Settlements, the Organization for Economic Cooperation and Development, and the World Trade Organization can shed light on how these organizations try to change techniques of governance in their member states by exploring how they ‘see’ particular policy areas that are of concern.

Understanding the importance of the informal context in which reform takes place can also contribute to the wider literature on institutional change, by helping to improve our understanding of how institutions are reformed without seeing outcomes as resulting from path dependent formal rules, which confuses ‘ideal type’ economies with real types (Crouch, 2005b). More important than the path dependence of inherited institutions when states are confronted with a systemic crisis may be how political leaders interpret the options that are available to them – especially if these same leaders remain in power over an extended period of time, as they did in each of the cases examined here. Based on these
interpretive acts, political bricoleurs make choices that might lead them to seek good relations with the Fund as a means to achieve other ends, or they may choose to maintain a greater distance. How reforms are translated into a local context will depend in large part on informal processes and practices. The emerging literature on informal institutions has already made significant strides in opening up the ‘black box’ of institutional change (for an overview, see Helmke and Levitsky, 2004; see also Hobson and Seabrooke, 2007). This thesis suggests that a great deal can be gained from linking the study of the informal or ‘everyday’ sources of institutional change with the study of IOs and externally-sponsored economic reforms, rather than IO scholars simply panning organizations like the Fund for failing to heed the importance of local context.

A final avenue for future research suggested by this study is to explore in greater detail the Fund’s role as a reputational intermediary for its member states, especially in emerging market and frontier economies that rely on external financing to fund economic development. Again, there is potential in studying how other IOs act as ‘reputational intermediaries’, such as the United Nations Development Program, which has recently cooperated with the US State Department to finance credit ratings for African economies with the aim of improving access to international capital markets (see Sagasti, et al., 2005: 62). In the case of the Fund, most of the existing research in this area has come from economists, many from the Fund itself, who have sought to establish through quantitative analysis whether, when, and why the Fund might have a catalytic effect on additional sources of finance (Bird and Rowlands, 2002; Edwards, 2005; Marchesi and Thomas, 1999; Mody and Saravia, 2002; Rowlands, 2001).

To tackle this issue from another direction, future research might draw on the recent international relations scholarship on the importance of ‘reputation’ (Mercer, 2005; Sharman, 2006, 2007) to explore how the Fund’s reputation provides it with an important institutional resource as well as a constraint. By further unpacking the Fund’s role as a reputational intermediary, we might increase our understanding of what explains change within the Fund by orienting the focus of analysis beyond the ‘usual suspects’ (such as recent contributions by Gould, 2003, 2006a). In particular, this could help to improve principal-agent approaches to the study of IOs by expanding the type of ‘principals’ that are studied.

**Conclusion**

In the frontier economies of Central Asia, the common result of the Fund’s influence was hybrid reform outcomes – where institutions emerged that exhibited a mix of central planning and liberal market principles and practices. Hybrid outcomes were not simply
pathologies that resulted from a lack of political will or from checks on reform imposed by domestic veto players, but were derived from actions that made sense to the actors involved with executing institutional change in each country as they sought to translate the Fund’s ideas into local contexts. The Fund was not necessarily opposed to the construction of ‘hybrid’ institutions, at least where it perceived these to be a step in the right direction (as in the Kyrgyz Republic and Kazakhstan) rather than a continuation of state intervention by other means (as in Uzbekistan). Although each state achieved hybrid institutional outcomes, how policymakers interpreted the different transitional contexts they confronted in the Kyrgyz Republic, Kazakhstan, and Uzbekistan shaped the degree to which the Fund was able to mould institutional change over time.

In this thesis I advance a straightforward argument: the International Monetary Fund is not simply a neoliberal policy enforcer that is tightly controlled by its major shareholders, rather it is an intellectual actor that has significant sources of tactical independence. To do its job well it must persuade policymakers in its member states to adopt a common intellectual framework for understanding new institutional challenges. To do so the Fund employs a range of formal mechanisms to ensure compliance in the case of borrowing states. But the Fund is not a monolithic actor. Understanding the Fund as simply expressing the interests of its major shareholder principals (Stone, 2004: 578-9), with little else going on in-between, is of limited utility in understanding how the Fund produces the policy advice that it seeks to persuade member states to implement. Especially in cases where its major shareholders are less likely to intervene, it is the staff that are the driving force behind the Fund’s efforts to change actors’ intersubjective ideas and behavior. In particular, how the staff interpret actors’ policy intentions is crucial for a state’s ability to maintain access to Fund loans, while the Fund’s capacity for independent action is dynamic across different cases. We should therefore understand the Fund as a semi-autonomous actor, rather than simply reading the interests of its member state principals in Fund loan decisions.


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