version: January 13, 2010

PRODUCTIVE INCOHERENCE IN AN UNCERTAIN WORLD: FINANCIAL GOVERNANCE, POLICY SPACE AND DEVELOPMENT AFTER THE GLOBAL CRISIS

Ilene Grabel*
Professor, Josef Korbel School of International Studies
University of Denver; Denver, CO 80208; USA
Email: igrabel@du.edu

ABSTRACT

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

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

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

---

* This is a significantly abbreviated version of a paper that appears under the same title as Political Economy Research Institute (of the University of Massachusetts-Amherst) Working Paper No. 214. Please see this paper for fuller discussion of the issues, data and citations
(http://www.peri.umass.edu/fileadmin/pdf/working_papers/working_papers_201-250/WP214.pdf). Paper to be presented at the conference organized by IDEAs, "Reforming the Financial System: Proposals, Constraints and New Directions," Muttukadu, Chennai, India, January 25-7, 2010. I benefited from the research assistance of Camila Martins-Bekat and Kyle Barker and, in particular, from that of Jesse Golland.

1. INTRODUCTION

The current global financial crisis raises important questions for scholars of international political economy. Among the most important of these is how is it influencing various dimensions of financial governance vis-à-vis developing and transitional economies.

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

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

2. A LOOK BACK AT THE EFFECTS OF PREVIOUS FINANCIAL CRISES ON GOVERNANCE

Gauging and evaluating the institutional and policy response to the current crisis can benefit from a brief comparison with the outcomes of two previous crises that share important features with the present: the East Asian crisis of 1997-8 and the Great Depression. I am most interested in the imprint that each had on global financial and economic governance.

After the East Asian crisis, a cottage industry of forensic studies emerged, the majority and most influential of which uncovered in the crisis economies deeply rooted and pervasive, yet somehow previously undetected patterns of corruption, non-transparent business-government relations, and unsustainable financial fragilities. Given these diagnostics, it is not surprising that the IMF and the G-7 leaders in the post-crisis environment promoted reforms in economic and financial governance through a variety of fora that focused on greater dissemination of information, increased monitoring and

surveillance, the adoption of universal standards and codes, arms-length corporate governance, regulatory and institutional harmonization around Anglo-American norms, and an associated enhanced role for market discipline, market-adjustment mechanisms and private actors (such as credit rating agencies) in financial governance.

The East Asian crisis therefore amplified existing pressures toward neo-liberal conformance in a great many countries (even if a few countries, most notably China, bucked these trends). In fact, reform in the post-Asian crisis environment in both wealthy and developing countries cohered in the direction of enhancing neo-liberal, market-led, private financial governance. The post-Asian crisis environment was thus one in which developing countries as a whole faced a contraction in the policy space available to them.

Unlike the Asian crisis, the Great Depression ultimately represented a radical turning point in financial governance. But what the Great Depression and the East Asian crisis do have in common is that they both induced genuinely coherent institutional and policy responses. The Great Depression ushered in a broad complex of complimentary institutions and policies that secured substantial state management of vital aspects of domestic and international economic affairs. The response to the Asian crisis was organized around the goal of deepening neo-liberalism, increasing informational adequacy, and enhancing market discipline.

3. THE CURRENT FINANCIAL CRISIS AND GOVERNANCE

The heart of the paper considers how the current crisis is influencing various dimensions of financial governance vis-à-vis developing and transitional countries. I approach this issue by examining three related questions. How is the crisis affecting the role and governance of the IMF; the prospects of regional alternatives to the Fund; and the policy space available to developing and transitional countries?

3.1. The IMF: Global role and governance

I turn first to the IMF's global role and governance. We know that the current crisis has been good to the IMF. It has rescued the institution from its growing post-Asian crisis irrelevance by re-establishing its central place as first responder to financial distress. The April 2009 meeting of the G-20 played an important role in re-empowering the Fund by giving it pride of place in global efforts to respond to the crisis and committing vast new pools of funds to the institution.

At the same G-20 meeting several developing countries committed to purchase the IMF's first ever issuance of its own bonds. The support for the Fund coming from developing countries is surely a landmark event in the institution's life. For our purposes, what is most important about these new commitments is that they provide the Fund's new lenders with a means to press the case for reform of IMF governance.

IMF governance has long been a point of contention among developing countries and civil society organizations. After nearly 12 years of pressure, the "Singapore reforms" of 2006 have resulted in inconsequential changes in the voice and vote of developing

countries at the Fund. The April 2009 G-20 funding commitments by developing countries were not conditioned on specific governance reforms, though the matter was raised quite clearly by the institution's new funders. The September G-20 meeting resulted in an agreement to increase the quota share held by under-represented countries modestly, by at least 5% at the Fund and by at least 3% at the Bank. Details about how this quota change is to be operationalized are to be announced by January 2011.

Critics of the IMF have already predicted that negotiations over quota shares are not likely to increase the voice of developing countries. This is the case for three reasons. First, the G-20 charged the institutions with using the current quota formula as the starting point for reform. Second, it is expected that European countries, especially the smaller ones, will continue to put up roadblocks to serious reform since they stand to lose the most from more dramatic changes in governance. It is far too early to tell whether these fears will be realized.

But in my view, even a very modest adjustment of voting shares may reinforce other changes in the governance of the Bretton Woods institutions (such as the March 2009 commitment by the G-20 Finance Ministers to end the "gentlemen's agreement" to appoint a European to lead Fund and an American to lead the Bank). Governance at institutions as complex as the Fund and the Bank depends largely on informal practices, power and expertise in using back-channels to exert influence. This realm of informal governance is not likely to change overnight simply on account of changes in voting shares. This suggests that the effects of reform in formal voting rights and the new loans by developing countries will be long-term rather than immediate, and successful only to the degree that they are also associated with other changes, such as in personnel, ideologies and informal practices at the Fund.

3.2. Bilateral and regional alternatives to the IMF

The experience of East Asian countries with the IMF during the Asian crisis was the catalyst for two developments. It led many countries to self-insure against future involvement with the Fund via the accumulation of reserves. It also stimulated a great deal of interest in the creation of regional alternatives to the Fund. Of regions in the developing world, Asia has made the most progress towards the creation of facilities that might over time reduce or even obviate the role of the IMF in economic and financial governance in the region.

The vision and frustrations that inspired the aborted Asian Monetary Fund proposal formed the basis for the Chiang Mai Initiative (CMI). Despite the circumstances that led to its creation and expansion, the CMI did not challenge the role of the IMF. In fact, the main operational goal of the CMI (namely, the availability of bilateral swap agreements to countries in distress) reinforced the existence of the IMF conditionality that many Asian borrowers found so problematic. This is because the creditor countries within the CMI insisted that 80% of the amounts available to borrowing countries as medium-term balance of payments loans would only be disbursed to a borrower if they also agreed to an IMF program. And CMI swaps still seem somewhat notional today since none of them have ever been activated.

The current financial crisis culminated in a decision in May 2009 to “multilaterize” the CMI (hence, it is now known as the Chiang Mai Initiative Multilateralisation, CMIM). The CMIM is a $120 billion regional currency reserve pool from which member countries can borrow in times of crisis. The transformation of the CMI to the CMIM is significant because it increases the scope of central bank currency swaps and reserve pooling arrangements in the region. This introduces the possibility that countries that are members of the CMIM will not need to turn to the IMF when they face some liquidity crises. It may also (at least partly) eliminate the perceived need by individual member nations to over-accumulate official reserves for purposes of self insurance.

At the behest of creditor countries, however, disbursals from the CMIM in excess of 20% of the credits available to a country retain the same IMF link that was a key feature of the CMI. There is a plan to eliminate the 20% IMF link, but the specifics of that plan have been left for an unspecified future date when member countries can devise and staff a regional surveillance unit that would substitute for the Fund’s surveillance. If the regional surveillance mechanism in the CMIM is ultimately realized, then it is reasonable to expect that the initiative can go a long way toward realizing the prior goals of the Asian Monetary Fund—that is, towards replacing IMF with a regional governance mechanism. But as the recent experience of the EU indicates, devising and implementing regional surveillance is no simple matter since it involves criticizing the policies of neighbors and demanding changes. At present, the EU has largely outsourced the design and monitoring of conditionality to the IMF. And since political sensitivities among Asian neighbors may run even higher than in the EU, the design of a regional surveillance mechanism is a likely site of protracted negotiations (especially among China, Japan and South Korea), which would limit the extent to which the CMIM will fully displace IMF governance in the region in the near future.

Outside the ASEAN+3, we see more modest and ad hoc signs that the current crisis has stimulated interest in bilateral and regional mechanisms that provide financial support to countries in distress outside the framework of the IMF. For example, at the outset of the current crisis, Iceland and Pakistan unsuccessfully appealed to reserve-rich countries for support in an effort to avoid resorting to the IMF, Russia provided modest support to some regional neighbors, and since December 2008 the US Federal Reserve opened temporary swap agreements with fourteen central banks, including several in East Asia and Latin America. The EU contributed significant funds to the SBAs of many neighboring economies, but it did so very much as a junior partner of the Fund.

In Latin America we find modest regional gestures toward creating mechanisms that might in the future play a role in providing financial support to countries in the region during crises. At present these mechanisms are too ill formed and/or under-funded to play a role of any significance. One such initiative is the Bank of the South. Another Latin American initiative, the Latin American Reserve Fund, has a very modest capitalization, but has thus far made modest loans to members during the crisis.

In sum, among regional or bilateral initiatives that have emerged or been expanded during the current crisis, ASEAN’s CMIM is the most likely candidate for displacing the

IMF in a significant part of the developing world. The articulation of a viable regional surveillance mechanism is an important and challenging prerequisite to the achievement of this goal. Were it to be realized, the CMIM might well serve as a model for other regions of the developing world that have thus far expressed interest in regional alternatives to the Fund, but have not made much progress toward that aim.

3.3. Policy incoherence and policy space for development

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

I call this incoherence productive because for several decades development policy has been imprisoned in an overarching regime that afforded little space for experimentation. If crisis signals a turning point—an inability of existing practices and institutions to continue on as they had previously—the prominent feature of the current crisis is not what will replace existing practices and institutions, since there is as of yet no fleshed out rival for neo-liberalism on the horizon. The prominent feature is multifaceted aperture that comprises both a profound loss of confidence in the economic theories that have sustained neo-liberalism, and the emergence of pragmatic policy interventions that seek to respond to the crisis. This aperture might create opportunities for enduring institutional innovation in development that we have not witnessed over the past quarter century.

In what follows, I will review evidence of the incoherence of crisis responses, and some factors that might ultimately contribute to a greater degree of policy space for developing and transitional countries in the post-crisis environment.

In the paper I probe the IMF response to the crisis—teasing out signs of tension within its conduct during the crisis period. I argue that the IMF has at once demonstrated more flexibility in the past in managing countries in crisis, while also holding fast to neo-liberal strategies in many cases. On balance one must conclude that the IMF's behavior has been ambiguous during the crisis. This nevertheless represents a substantial shift from its unified and coherent response to the Asian crisis. I will highlight several related issues in connection with the IMF's incoherence: the IMF's Flexible Credit Line (FCL), which demonstrates unambiguous continuity with neo-liberalism; IMF conditionality and the numerous SBAs it has signed in the context of the current crisis, which largely reaffirm neo-liberalism, but with some increased flexibility on the ground when it comes to fiscal policy; and capital controls, where the case of Iceland contradicts the IMF's

longstanding position and the case of Brazil reflects the tenuous situation the institution finds itself in as it seeks to manage when, how and by whom this instrument is employed.

The IMF's FCL

The FCL program was launched by the Fund in March 2009. It is essentially a precautionary line of credit designed for countries that meet the IMF's pre-established qualification criteria. The IMF has heralded the FCL as a key example of its new "modernized conditionality." Despite the Fund's rhetoric to the contrary, the FCL is hardly a major advance in regards to conditionality. The FCL transforms traditional structural (*ex-post*) conditionality into a demanding *ex-ante* conditionality that elevates precisely the same neo-liberal policy and institutional agenda that the Fund has been promoting over the last three decades. Thus, the FCL program demonstrates a strong continuity with the neo-liberal agenda and the associated contraction of policy space in the post-Asian crisis environment.

Conditionality and recent SBAs

The matter of modernized fund conditionality deserves further discussion since this pertains not only to FCL countries, but also to recent SBAs insofar as the IMF pledged to eliminate structural performance criteria on all programs in May 2009. Many recent studies of the SBAs (and other assistance programs) negotiated during the current crisis have concluded that the IMF has promoted pro-cyclical macroeconomic policy adjustments or targets. This makes the IMF's response to the current crisis not too dissimilar to its response to the Asian crisis. In this sense, there is a strong continuity between the Fund's responses to both crises.

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

First, in the current crisis the IMF has narrowed the scope of some of its conditionality. For instance, certain reforms that have long been at the heart of IMF activity, such as privatization and liberalization, tend not to be features of the current SBAs. (This might simply owe to the fact that earlier IMF programs have left many developing countries with nothing to liberalize or privatize.)

Second, the IMF has demonstrated a greater degree of flexibility when countries fail to meet their fiscal targets. The IMF began to allow some countries to relax the fiscal targets in their SBAs as domestic and world economic growth decelerated and as serious political and social tensions emerged in various countries. But this flexibility, which for some countries has provided a rather large degree of relaxation, has been offset by the IMF's continued insistence on stringent monetary policy in many program countries. The result of these conflicting interventions is Stackleberg warfare that renders some of the IMF's programs incoherent. I would emphasize here that the instances of what I term policy incoherence grew far more numerous as the crisis

unfolded and the Fund allowed for more expansive fiscal targets, while maintaining its commitment to restrictive monetary policy.

Stackleberg warfare in some countries is also being aggravated by the decisions of national policy makers prior to the crisis. In the pre-crisis years, some countries made monetary and exchange rate policy decisions that have severely constrained their monetary policy autonomy owing to commitments to hard currency pegs, currency boards, currency substitution or plans to adopt the euro. In addition, the commitments of some national policymakers to adopt the euro in the coming years has also constrained fiscal space insofar as such countries must keep their fiscal deficits under 3%. And in some national contexts, policymakers themselves are proponents of fiscal restraint, even during the crisis.

Third, the current SBAs can be distinguished from those of the Asian crisis years by the IMF's emphasis on the importance of social protection for the poor and vulnerable. This is something that the IMF emphasizes in two recent (and congratulatory) reports. However, it is difficult to square this emphasis on protection of socially vulnerable groups with the fiscal policy constraints that are a key feature of so many of the SBAs negotiated in the context of the current crisis. The decline in tax revenues and ODA has further complicated the matter of financing programs of social protection during the crisis.

<u>The IMF and capital controls: What can we learn from Iceland and Brazil?</u>
The case of Iceland is particularly interesting for the discontinuity that it demonstrates in connection with the IMF's view of capital controls. Iceland's package of reforms was very much conditioned on the kinds of highly restrictive monetary and fiscal policy conditions that we saw during the East Asian and other developing country financial crises. In fact, monetary and fiscal policy constraints in Iceland go further and are more internally consistent than other SBAs signed during the current crisis. These highly pro-cyclical macroeconomic polices induced intense, prolonged social unrest in the country.

What is most interesting about the Icelandic SBA is that it includes provisions regarding the need for stringent capital controls, something that we don't find in earlier SBAs that the IMF signed in connection with East Asian countries and in other recent cases. The capital controls were initially imposed prior to the signing of the SBA in October 2008, though the agreement made a very strong case for their necessity. Not surprisingly, given the IMF's long-held allergy to capital controls, IMF staff were questioned repeatedly on what seemed to be an about face on controls. Fund staff repeatedly said the capital controls were crucial to prevent a free fall of the currency, that they were explicitly temporary, and that it was a priority of the Fund to end all restrictions as soon as possible. Accordingly, the country's central bank began a sequenced removal of its capital controls in November 2009.

What are we to make of the Fund's case for capital controls in Iceland? The Fund certainly did not encourage capital controls in other countries with which it signed SBAs during the present crisis. Indeed, there is no evidence available at this time that the IMF encouraged capital controls during any of the negotiations that led to the signing of the

numerous SBAs that have emerged over the past year, even though many countries faced significant capital outflows and pressures on their currencies to depreciate.

Throughout the crisis the IMF, in fact, has had little to say on capital controls. This makes it difficult to assess whether the crisis has caused the institution to rethink its views on capital controls. I should note, however, that the institution's views on capital controls had evolved from unequivocal opposition to them during the Asian crisis to a tepid, conditional endorsement of temporary market-based controls in some circumstances. In the raft of reports that the IMF has issued in the context of the current crisis, the Fund and the Bank mention capital controls only very briefly and on few occasions. In these various reports, the IMF warns that capital controls should be considered only a temporary and last resort, and the costs of even temporary capital controls are enumerated with great care. These brief cautionary mentions of capital controls suggest that--despite the Icelandic case—that the Fund's view on capital controls has evolved only slowly since the Asian crisis. Iceland's capital controls then appear as something of an anomaly at the present time. The more they come to be viewed as having succeeded the more difficult it might be for the Fund to dismiss the policy tool in the face of future economic crises.

The new equivocation at the IMF regarding capital controls is evidenced in its response to the imposition of controls in Brazil. In late October 2009 Brazil imposed a self-described modest, temporary and market-friendly type of control that was designed to slow the appreciation of the currency in the face of significant capital inflows. The IMF's response was mildly disapproving. The IMF's muted reaction (especially in comparison with its "doctrinaire" reaction to Malaysia's capital controls during the Asian crisis) was likely intended not to deter Brazil (a new lender to the IMF) from its strategy but to warn other developing countries against following Brazil's lead down a policy path that the IMF views as a last resort. The case demonstrates the tenuous situation in which the IMF now finds itself, as it begins to acknowledge the necessity of capital controls in cases of financial disruption while not wanting to lose control over just when, how and by whom this policy instrument is employed.

Discontinuity in IMF discourse

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

Two notable reports of the IMF issued in October 2009, reveal the shift in discourse that I am speaking of here. In these reports, the IMF catalogues many complaints of the NGO community about its handling of economic crisis in the developing world. They include (for instance) the claim by NGOs that the IMF is continuing to impose too many egregious conditions on countries. The IMF response is notable: rather than defend

these conditions on the basis of Washington Consensus types of arguments, the IMF instead presents evidence that it has in fact substantially reduced the number of conditions in the new SBAs as compared with those that it negotiated in earlier periods. This discursive shift gives credence to NGO complaints about the ways in which IMF interventions have historically reduced developing country policy space. Hence, in defending itself, the IMF implicitly indicts its prior practice—and in so doing legitimates NGO demands for protecting and enhancing policy space.

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

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

Other developments that bear on policy space and governance

There are a number of other factors that may ultimately shape policy space and governance in the post-crisis context. I will just outline them briefly in the interests of space (see the full-length paper). One factor is the effect of the crisis on economic ideas. I argue in the paper that while it is too early to say with certainty whether the crisis will have a lasting effect on economic thought in the academy and beyond, it is certainly quite conceivable that we will see a much greater degree of pluralism, heterogeneity and even incoherence in economic ideas in the coming years. Another issue that I discuss in the paper concerns the momentum behind the movement to impose universal standards and codes (based on Anglo-American practices) to govern global finance. The current crisis may well undermine the US-led effort to impose a universal set of standards and codes on developing countries. What appears to be emerging out of the current crisis is a reaction against universalism. To the extent that the standards and codes idea continues to have traction it is most likely that we will see development of more regional or even country specific standards and codes.

The current crisis may also create more policy space for developing and transitional countries by highlighting the benefits of national economic policies that depart rather significantly from the neo-liberal model with which so many developing countries conformed after the Asian crisis. Those developing countries that were able to resist pressures to replicate the extreme financial openness and the financial liberalization of the Anglo-American model were in a better position to weather the current global financial turbulence. Relatedly, it is conceivable that enthusiasm for externally-oriented models of development will be substantially diminished as a consequence of the current

crisis. We may see a return to more domestic, demand-led rather than externally-oriented development strategies in the coming years as a component of a more diversified set of economic strategies.

Another matter that bears mention is that the current crisis has been marked by the pursuit of countercyclical policies by developing countries that have not been forced to negotiate SBAs. In the aftermath of the Asian crisis only Malaysia pursued countercyclical policies. During the current crisis, many developing countries have been able to use the policy space created by substantial reserves, initial current account positions and the degree of openness of their capital accounts to pursue countercyclical fiscal and monetary expansions. (Recall that the exchange rate arrangements in some countries have made it impossible for them to respond to the crisis with countercyclical monetary policy.)

4. CONCLUSIONS

It is necessarily too early to say with any confidence precisely how the lessons of the current crisis will be imprinted on national and global financial reform. But it is certainly likely that the current crisis will have a number of important, lasting effects on financial governance. I would suggest that the most likely outcomes of the current crisis are less hubris on the part of the American economics profession and policymakers, more institutional and policy divergence across developing countries (with the exception being those that have committed themselves to currency substitution or currency board arrangements), a greater role for regional governance arrangements, and a greater role for the state in mediating some types of financial flows in some countries.

In addition, the IMF seems to have emerged from the current crisis as a clear winner in a couple of senses. The IMF's financial resources have been buttressed, the global reach of its loan portfolio has been restored, and it has been rescued from possible irrelevance. What is less certain about the current crisis in connection with the IMF is whether this event will result in fundamental, consistent changes in the institution's relationship with developing countries and in the character of its policy recommendations to these countries. The IMF's response to the current crisis is somewhat different and far less coherent than was its response to the Asian crisis. Though the IMF certainly continues to apply pressure to secure compliance with stringent fiscal and monetary policy, it has chosen in the face of the unfolding crisis to exhibit a degree of flexibility that was absent during its response to the Asian financial crisis. In particular, it has relaxed fiscal constraints in countries facing crisis, and has at least paid lip service to the need to protect the dispossessed even in the face of what it takes to be the need to impose fiscal and monetary discipline. Moreover, in the case of Iceland it made a forceful case for the necessity of temporary capital controls, and it has begun to speak cautiously of the possibility of using capital controls in response to crisis conditions in developing countries; while in the case of Brazil its reaction reflects a growing pragmatism in the face of events it cannot control combined with an effort to warn others against imprudent use of a policy tool it does not yet fully trust. At the same time, however, the IMF has not demonstrated a willingness to exhibit flexibility with respect to monetary targets. As a consequence, its restrictions on monetary loosening

contradict its new fiscal flexibility. Missing here is the confidence that comes from the consistent, universal implementation of an elegant, coherent model.

The upshot of all this is that at present there is no one unifying narrative at the IMF that coherently captures its approach to the crisis. This incoherence, coupled with a crisis of confidence among erstwhile neo-liberal economists and with initiatives taken independently by developing countries during the crisis, suggests that we have entered a period of "productive incoherence" as concerns economic governance in the developing world. There is a new uncertainty among economists and a new ad hocery in evidence today that we have not seen for the past quarter century or so. While such confusion and ambiguity are generally seen by economists to be a problem in policy design and implementation, in the current context of the decay of the neo-liberal project it should instead be taken as productive insofar as it may be creating the opportunity for developing countries to engage in policy experimentation of their own design. And on that score, the evidence seems to suggest that they are not waiting for the permission granted by the emergence of a new, coherent theoretical model. They are instead muddling through, and from the ad hoc, incoherent strategies now underway just might emerge a widely diverse platform of new interventions that are tailored to the diverse contexts that policymakers face across the developing world.

It is unlikely (though still uncertain) that the current crisis will ultimately have lasting, radical and universalizing effects on financial governance that followed the Great Depression. Even if we are not on the brink of an epochal shift in governance, the current crisis holds the promise of changes in facets of governance that can create more space for development, policy and institutional experimentation and heterogeneity, and a greater degree of pluralism in the governance of the world economy. The incoherent responses to the current crisis that we are witnessing might ultimately be productive of development.

REFERENCES

(For reference list, see:
http://www.peri.umass.edu/fileadmin/pdf/working_papers/working_papers_201-250/WP214.pdf