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The Currency of Power

The IMF and Monetary Reform in Central Asia

André Broome

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The Currency of Power

The IMF and Monetary Reform in Central Asia

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For Alexandra

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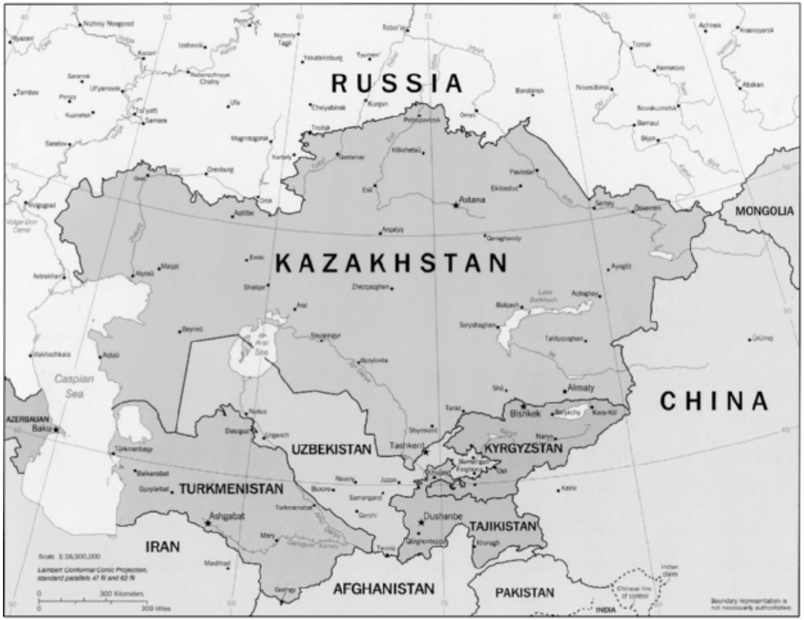

Map 1.1 The Former Soviet Republics of Central Asia
Source: University of Texas Libraries.

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List of Abbreviations

BIS	Bank for International Settlements
CBR	Central Bank of Russia
CBU	Central Bank of Uzbekistan
EBRD	European Bank for Reconstruction and Development
FDI	Foreign Direct Investment
FSU	Former Soviet Union
GDP	Gross Domestic Product
HIPC	Heavily-Indebted Poor Country
IEO	Independent Evaluation Office
IFIs	International Financial Institutions
IMF	International Monetary Fund
IPE	International Political Economy
MER	Multiple Exchange Rates
NBK	National Bank of Kazakhstan
NBKR	National Bank of the Kyrgyz Republic
NBU	National Bank of Uzbekistan
ODA	Official Development Assistance
OECD	Organization for Economic Cooperation and Development
SBA	Stand-By Arrangement
STF	Systemic Transformation Facility
USSR	Union of Soviet Socialist Republics
WWII	World War Two

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Preface

As with most books, this one was only possible because of the assistance and support of a wide range of people. My thanks go, first, to John Ravenhill and Leonard Seabrooke. As my doctoral supervisors at the Australian National University (ANU), I am immensely grateful for their consistent professional and personal encouragement, their patience, and their readiness to help me navigate the various intellectual twists and turns that I have traveled in the course of this project. My grateful thanks also go to those who have provided me with written feedback and long talks over aspects of the book throughout its development. I thank in particular Daniel Biro, Sarah Graham, Barry Hindess, Joel Quirk, Taylor Speed, Shogo Suzuki, Shannon Tow, Ryan Walter, and Annie Williams. 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 friendly and intellectually stimulating environment during my years at the ANU. A special note of thanks goes to the participants at the Warwick Manuscript Development workshop in May 2009, and especially to Ben Clift for helping push me to clarify the main contribution of the book. I am also grateful to my colleagues in the Department of Political Science and International Studies at the University of Birmingham, in particular David Bailey, Mark Beeson, Ted Newman, and Emily Pia for their friendship, advice, and encouragement.

The research for this book was made possible by financial support from the Department of International Relations at the ANU, the Department of Political Science and International Studies at the University of Birmingham, as well as the generosity of an old friend, Gary Baker, for which I am very grateful. The research for this book has included three visits to the International Monetary Fund headquarters in Washington DC in August 2005, March 2006, and April 2008. My grateful thanks go to all 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. I am also grateful to the individuals

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from other international organizations, non-governmental organizations, and the private sector that 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.

In addition to those already mentioned, my grateful thanks go to both 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 book. In particular, this list includes Seth Bateman, Chris Beer, Mike Boyle, Julie Broome, Anna Carnerup, Nick Henry, Jamie Hull, Arthur Muhlen-Schulte, Shruti Navathe, Eleni Tsingou, and Antje Vetterlein. My deepest gratitude goes also to my sister Adele, my father David, and my mother Wendy, who have been a constant 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 help cover fieldwork costs, especially when I found myself down and out in Uzbekistan in October 2005.

This book is dedicated to Alexandra Homolar-Riechmann, whose laughter, love, and fierce intellect were indispensable to its completion. *Ich liebe dich mit meinem ganzem Herzen*.

André Broome
Birmingham, United Kingdom.

Introduction

States will aggressively defend their right to make national economic policy choices as a fundamental sovereign prerogative. This is especially so with respect to monetary change, the effects of which impinge upon the material interests of a country's political and business elites as well as the everyday lives – and the social and economic fortunes – of the broader population. This book examines how the International Monetary Fund (IMF, or the Fund) shapes monetary change in conditions of extreme economic uncertainty. Monetary system change can alter the pattern of economic incentives within a society, reconfigure a country's trade and financial relationships with other states, and generate a redistribution of wealth between different social groups, all of which provides a powerful motivation for governments to retain tight control over the process of enacting major monetary policy reforms at the national level.

Achieving structural economic change, however, often requires governments to seek external support, in particular when they attempt to introduce monetary policy reforms in the middle of an economic crisis where predictions of the outcomes of major policy changes are clouded by a high degree of uncertainty. When governments seek the IMF's help to design and implement structural reforms, this can give the organization enormous influence over the dynamics of institutional change within national economies, especially in situations where states lack sufficient financial resources of their own to bear the steep costs that systemic transformation entails. At the same time, the IMF's intervention brings with it a high political cost for governments. For this reason alone, achieving a decisive influence over domestic institutional change remains a complex challenge for the IMF, one that hinges on how effectively the organization can engage in the politics of economic ideas and intellectual persuasion.

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Two decades after the fall of the Berlin Wall in 1989 and the subsequent collapse of communism in East and Central Europe and the former Soviet Union, the postcommunist 'transition' to a market-based economy remains the archetype for studying the political economy of the IMF's influence over structural economic change in its member states (see, for example, Pop-Eleches, 2009). However, in contrast to the IMF's involvement with the process of economic reform in many of the postcommunist economies of East and Central Europe and Russia, the IMF's influence can be expected to be most clearly demonstrated in the case of the post-Soviet 'frontier economies' of Central Asia. These states had poor credit reputations in the international financial community throughout the 1990s, and therefore struggled to attract inward investment and to raise capital on their own after the demise of the Soviet Union in 1991. Prior to 1992 the Central Asian republics also had no previous experience of independent statehood and were tightly integrated during the Soviet era as a single economic unit, which makes them particularly useful cases for studying the impact that the IMF has had in 'new' states that lack a track record of previous interactions with external actors, and where new monetary policy frameworks have to be developed from scratch. This book suggests that the key to unlocking the black box of the IMF's involvement in institutional change is examining how the organization 'sees' its member states' economies, which informs the design of its advice for national policy reforms as well as the conditions under which states are able to access IMF loans.

In its 65-year history, the IMF has become one of the most controversial and well-known institutions within the contemporary architecture of global economic governance (see Willett, 2001), and yet the IMF remains one of the most commonly misunderstood international organizations. In particular, there is a basic inconsistency between how the global role and influence of the IMF is commonly discussed in the International Political Economy (IPE) literature and the organization's actual track record. On the one hand, the IMF is assumed to be a uniquely powerful international organization – at least with respect to its borrowing member states – because it can apply material incentives to achieve compliance with its policy reform preferences, while a country's access to additional sources of external finance may hinge on maintaining cooperation with the IMF (Stone, 2008; Gould, 2003; Killick, 1997). On the other hand, despite being able to pull on these levers of material power, IMF-sponsored structural reform programs often fail to meet their targets, either in terms of policy reform bench-

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marks, expected economic performance, or both (Bird, 2002a; Bird and Willett, 2004; Woods, 2006). Focusing on understanding the sources of the IMF's influence in the political economy of the postcommunist 'transition' in post-Soviet Central Asia provides an important platform for resolving this tension in the existing literature on the impact of the IMF on national policy change. As this book illustrates, the IMF is not able to simply impose policy reforms on unwilling governments. Rather, this study shows how weak states can resist global pressures, and how the behavior of weak actors within those states matters for understanding national processes of economic transformation.

Since the 1980s the effectiveness and the broader political and social impact of the IMF's activities have become a central concern among IPE scholars who work on the evolution of the contemporary architecture of global economic governance, prompted by the IMF's problematic legacy in shaping structural adjustment programs during the Latin American debt crisis and subsequent financial crises in emerging market economies during the 1990s (cf. Best, 2005; Momani, 2005a, 2007; Moschella, 2009; Pop-Eleches, 2009; Woods, 2006; Vetterlein, 2006; Vreeland, 2003a). Research in this field has tended to divide between three distinct areas of focus: (1) the IMF's impact on economic development in borrower countries; (2) the use of the IMF as a foreign policy tool by its major power creditors such as the United States; and (3) the sources of change and continuity within the organization itself. Within this three-fold division of analytical inquiry, the most common theoretical divide has centered on the differences between a rationalist approach – inspired by game theory and principal-agent theory – and a constructivist approach that attempts to understand the importance of ideas, norms, and organizational culture in shaping the actions of international organizations (see Nielson et al., 2006; cf. Hawkins et al., 2006; Barnett and Finnemore, 2004).

At a broader level, the IMF has been an important object of study in its own right as one of the chief proponents of globalization. Indeed, if globalization is defined narrowly as the international integration of national markets for trade in goods, services, and capital then the IMF's interactions with borrowers and the policy conditions it attaches to loans makes the organization a powerful 'globalizer' (Woods, 2006). This vein of research on the IMF and international integration tends to split between scholars whose primary focus is tracing and understanding international processes of policy transfer and norm diffusion (Chwieroth, 2007a, 2007b; Simmons, 2000), and those who are interested in investigating the sources of ideological hegemony in

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the world economy and understanding the shift between distinct international economic orders in the post-World War Two (WWII) era (Best, 2003; Babb, 2003; Hall, 2003).

The complex issues examined in this book are important for each of these debates, but will be of most interest to those interested in understanding how the IMF acts as a diffuser of global economic policy norms. If the IMF's influence over monetary change is to be found in any national context, it should be clearly observed in the three frontier economies of post-Soviet Central Asia examined here, because these states sought substantial loans, policy advice, and technical assistance from the IMF during the 1990s, and commenced the 'transition' to a market economy from similar institutional starting points. The IMF's attempt to integrate the former Soviet republics of Central Asia into the world economy is also an important case of the limits of formal policy reforms and institutional change in practice, which shows the necessity of studying informal processes of change and how everyday economic actions can frustrate formal policy changes. In Central Asia, the IMF was not able to drive through neoliberal reforms that transformed the Central Asian economies into paragons of market-based capitalism, despite their high level of dependence on the IMF for external support. Instead, people's everyday economic behavior contributed to hastening the end of the ruble zone monetary union in the early 1990s, while Central Asian governments often paid lip service to adopting the IMF's policy preferences at the same time as undermining them in practice.

The account of the IMF's interactions with the frontier economies of Central Asia presented in this book aims to strengthen our empirical understanding of how global economic policy norms are extended to regimes at the margins of the contemporary society of states. The book has two major focal points. First and foremost, the IMF spends a great deal of its time to acquire and transmit comparative policy knowledge among national economies. While the foundation of the IMF's influence over national governments that draw on its resources is conventionally understood as stemming primarily from its lending capacity and loan policy conditionality, this study gives particular attention to how Fund staff engage in the politics of ideas with national policymakers to influence formal processes of policy reform and institutional design. This is important in order to comprehensively understand the pattern of the IMF's interactions with its borrowers, and how the IMF's influence over structural economic reforms is achieved in practice. Rather than access to IMF loans being tightly controlled by the organization's dom-

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inant member states through their influence on the IMF's Executive Board, this study of the IMF's interactions with Central Asian economies shows how Fund staff play a primary role in determining whether – and under what conditions – member states are able to borrow from the IMF.

The second major focus is the IMF's role as a *reputational intermediary* for its borrowing member states. Drawing on its own institutional reputation for enforcing strict policy conditions, the IMF can potentially help states to signal their policy credibility to broader domestic and international audiences. Through these reputational tactics, the IMF seeks to improve the sovereign creditworthiness of borrowers as a destination for private investment and official development assistance (ODA). This increases the importance for national policymakers of cooperating with the IMF in order to achieve broader political and economic objectives, which amplifies the organization's influence over the everyday process of institutional change.

The IMF and macroeconomic stability in fragile economies

One of the primary roles of the IMF is to help shore up macroeconomic stability in fragile economies. Central to this process is the organization's ability to exert external influence over a state's economic policy settings and – in the medium term – to foster institutional change to enable countries to improve their macroeconomic performance. In performing this controversial role, the IMF constitutes one of the most important sources of policy diffusion among national economies, which has attracted heated criticism from across the political spectrum. Despite the surge of criticism directed against the IMF in recent years, however, the organization has never been likely to win a popularity contest among international organizations since it opened its doors in the aftermath of the Second World War. Over the last two decades in particular, the IMF has attracted greater political controversy due to its support for neoliberal monetary reforms that reconfigure the state's role in managing economic outcomes. Specifically, the IMF has promoted monetary policy changes that are intended to constrain political influence over the allocation of credit and financial resources within national economies, such as legally establishing central bank 'independence' from the government and liberalizing access to foreign exchange. While the IMF argues that creating a market-based monetary system will help to achieve greater macroeconomic stability over the long term, these reforms often run into a wall of political resistance. In

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particular, for the Central Asian economies that are examined in this book the regulation of money was intimately connected to regime stability, postcommunist state-building, and the extraction of economic rents after the breakdown of the Soviet Union.

It is common for scholars who study the IMF's influence on national policy change to investigate how closely the policy conditions detailed in IMF loan packages are reflected in a borrower's economic reforms during the life span of a short-term loan agreement. In many cases, however, a long-term analysis that qualitatively traces the IMF's relationship with a particular state over time can provide a more comprehensive picture of the political economy of policy diffusion, which is an inherently dynamic and ongoing process. In addition, in order to assess the IMF's influence over national policy change it is important to examine the local context in a particular country, and the probable level of difficulty associated with different types of economic reforms. For instance, studies that attempt to measure the influence of the IMF by creating aggregate indices of policy compliance risk treating reforms across different policy areas as functionally equivalent (Vreeland, 2006: 363). The problem with this approach is that the IMF is likely to find some policy areas easier to reform than others are. As a consequence, its 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 IMF may only achieve change through incremental steps). Quantitative research on the total number of reforms that a country enacts over time that match the IMF's policy preferences, or limiting analysis to a short period of IMF engagement, is therefore insufficient to comprehend how – or how much – policy diffusion takes place.

In contrast to the existing rationalist literature on the IMF, the relationship between the IMF and its borrowing member states should not be conceived simply as a strategic game over policy conditionality, with actor A (the IMF) trying to establish the short-term material incentives that will cause actor B (the national government) to comply. Rather, what matters more for understanding the IMF's influence over both the scope and the durability of policy change with respect to borrowing states is examining how external material incentives are repeatedly used to establish a pattern of interaction between Fund staff and national officials – a *policy reform corridor* – which creates recurring opportunities for domestic actors to be persuaded to re-conceptualize their interests. This involves studying how the IMF has attempted to incrementally cultivate new policy frameworks among key actors in an

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economy through normative persuasion over a medium- or long-term time horizon, which can gradually generate the ideational conditions for achieving – and, more importantly, sustaining – the implementation of global economic norms at the national level.

This broader understanding of the sources of the IMF's influence *vis-à-vis* its borrowing member states suggests that the following four points are important for comprehending how the organization has attempted to diffuse global monetary norms to the frontier economies of Central Asia. First, persuasion, in this sense, is less about encouraging actors to reform their behavior in order to achieve social recognition, as a response to social cues, or to avoid public shaming, and is more about exploiting the use of positive material inducements to reconstruct how actors perceive their interests. Second, the process of achieving normative change is not a straightforward matter of exchanging material rewards for nominal shifts in a government's policy stance. Third, the attempt to diffuse global economic norms to frontier economies is unlikely to follow a unilinear trajectory whereby a new norm is introduced, becomes familiar, and is subsequently internalized by the recipient somewhere down the track. Rather, diffusing global normative standards to frontier economies is likely to be a much more irregular process, whereby any policy gains that are achieved might quickly be eroded by backward steps, or what the IMF terms 'policy slippage'. Finally, seeking to achieve reforms in monetary behavior by frontier economies can be expected to be particularly difficult because changes in monetary policy and exchange rate arrangements have important distributional consequences, which are likely to be most salient in countries that previously maintained intensive exchange controls such as the former Soviet republics.

The IMF's long-term policy preferences are characterized throughout this book as 'IMF-friendly' reforms – those that the IMF seeks to persuade its member states to adopt through policy dialogue and ongoing negotiation. The IMF's policy advice is not necessarily the same in different countries or over time in the same country, as the organization may see a number of policy alternatives as equally satisfactory. For these reasons I use the term IMF-friendly policies to describe the IMF's common reform preferences across countries, rather than adopt the more hackneyed label of the 'Washington consensus' or 'neoliberalism' (cf. the chapters in Macdonald and Ruckert, 2009).

An investigation of the sources of the IMF's influence over national policy change suggests two main lines of inquiry. The first line of inquiry involves assessing whether the IMF exerts a significant influence over

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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 IPE scholars might therefore expect to find a negative answer here or to find that the IMF's advice only counts at the margin, with the IMF simply firming up support for a policy change already being considered by national officials. Where it seems that the IMF 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 existing evidence from quantitative research on the effectiveness of formal loan conditionality is mixed at best, which suggests that the IMF's influence cannot be assessed simply through quantitative measurements of a state's compliance with loan program targets.

Both 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 IMF's advice is at achieving the intended material outcomes because it is not possible in practice to draw a neat distinction between the IMF's economic activities and the politicking of its member states. Economics is not a value-neutral science, no matter how much the IMF may insist that it is. Therefore, this book focuses primarily on whether the IMF was able to exercise significant influence over monetary reform in post-Soviet Central Asia, and how this was achieved.

Within the existing IPE literature on the IMF, scholars commonly seek to answer these questions by focusing on: (1) the external factors that influence the IMF's capacity to do its job; (2) the domestic factors that inform whether or not a government is serious about adopting the IMF's reform preferences; and (3) the compliance mechanisms employed by the IMF. In the first group of conventional explanations of the IMF's influence, it is common for rationalist scholars of the IMF to turn to external factors that are beyond the organization's control and can inhibit its influence over domestic policy change. The most obvious constraint here is political interference in the IMF's operations by its major shareholders through their dominance on the IMF's Executive Board, which must approve all IMF loans. In this scenario, the formal decisionmaking process within the IMF – as well as the opportunity for major shareholders to exert informal pressure – shapes the IMF'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. In rationalist scholarship, the capacity for the IMF to exert an independent influence on domestic

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policy change is therefore constrained from the start if its major shareholders push for soft loan conditions for allies (Thacker, 1999), veto loans for foes (Boughton, 2001: 1031), or promote policy conditions that serve the private interests of their commercial banks (Gould, 2003). Where political interference by the IMF's major shareholders is absent, however, it is expected that the IMF's threats to enforce its loan conditions by withholding financing generate greater incentives for borrowing countries to enact IMF-friendly reforms (Stone, 2002, 2004, 2008).

The second group of explanations concentrate on the circumstances within a country that determine the effectiveness of the IMF's actions. Most important here is whether or not a government is serious about enacting IMF-friendly policy reforms (Bird, 1996: 494, Bird and Willett, 2004), which is now defined by the IMF itself as the degree of 'country ownership' for a reform program. Here the IMF's capacity to influence domestic policy change depends on whether the IMF can find 'sympathetic interlocutors' in a country's policymaking community who are willing to listen to the IMF's advice and pilot reforms through the political process (Woods, 2006: 72–3). For these sympathetic elites, IMF conditionality is not simply a straitjacket imposed as a penalty for poor policy performance, but can offer politicians and bureaucrats a powerful political tool to force policy change (Vreeland, 2003b: 339).

The third group of conventional explanations of the IMF's influence focus on the organization itself, in particular the formal mechanisms it employs to achieve compliance on the part of borrowing states (see Dijkstra, 2002; Killick, 1997). The IMF's capacity to influence domestic policy change is considered to be greatest when the IMF 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 IMF with a clear snapshot of the degree of state compliance (Bird, 1996: 483). In addition, program completion is thought to depend upon 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 (Bird, 2002b: 841–2). The IMF's impact is therefore expected to be most decisive 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 IMF continue to outweigh compliance costs. In contrast to these conventional explanations of the IMF's influence, this book examines how the IMF engages in the

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politics of ideas at the national level in borrowing states, with a particular focus on the role played by Fund staff in persuading national policymakers to adopt IMF-friendly reforms.

Seeing like the IMF on institutional change

An important source of power for the IMF lies in its capacity to build reputational authority to shape how other actors view a particular policy problem and how they determine appropriate political solutions, which rests on the organization's intellectual resources. This is a point that is often highlighted in constructivist scholarship on international organizations (Barnett and Finnemore, 1999, 2004), and yet this insight is seldom applied to studying the impact of the IMF's involvement with borrowing member states. An essential dimension of the postcommunist 'transition' in the former Soviet Union was the effort to adapt societies to new forms of governance and control based on a fundamentally different form of technical knowledge. This highlights the importance of the informal context in which change takes place, because 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 everyday behaviour (Scott, 1998: 310). 'Seeing like the IMF' increases our understanding of how the IMF seeks to use its intellectual resources to achieve domestic policy change, the conditions that enable its influence, and how the organization attempts to turn these to its advantage to sustain IMF-friendly institutional change. By exploring how the IMF sees its member states' economies, we can therefore increase our understanding of how the organization seeks to remake their institutional frameworks over time.

Rather than concentrate on quantitative analysis of program completion rates, which can both overstate and understate the IMF's influence over the design and implementation of institutional reforms, the focus of this study is on exploring the nuances of how the IMF sought to change monetary ideas and practices in post-Soviet Central Asia over multiple years. I trace the footsteps down what I call through the 'policy reform corridor' (explained in Chapter 1) by drawing upon archived policy documents, Executive Board debates, and interviews with current and former IMF staff. Drawing on qualitative content analysis of IMF archival documents and background interviews with staff, the IMF's 'success' is assessed by examining the gradual implementation of IMF-friendly monetary reforms. In contrast to measuring specific program completion rates, this helps to build a more comprehensive under-

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