EMERGING MARKET CRISES AND THE IMF: RETHINKING THE ROLE OF THE IMF IN THE LIGHT OF TURKEY'S 2000-2001 FINANCIAL CRISES*

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Abstract

Recurring financial crises in the semi-periphery have raised serious question marks concerning the role of the IMF in the era of financial globalization, particularly in the aftermath of the Asian Crisis of 1997. The present paper attempts to provide a critical and at the same time a balanced perspective on the Fund's involvement in crisis-ridden emerging markets with special reference to the recent Turkish experience. The analysis points towards both the limitations underlying the Fund's approach itself as well as some of the dilemmas faced by the organization in trying to reform the economies of debtor countries given the nature of the domestic political environment in the countries themselves. It is also argued that the kinds of reforms promoted by the Fund are necessarily incomplete in so far as they focus only on the regulatory role of the state, neglecting issues relating to income distribution and longer-term development in the process. Two key conclusions follow. Firstly, crisis-ridden countries need to develop a domestic political base to "internalize" the kind of reforms sponsored by the IMF, which are important in terms of their ability to benefit from the process of globalization. Secondly, the countries concerned need to extend their horizons and develop their domestic capacities in areas such as income distribution and longer-term competitiveness, areas that not traditionally emphasized by the Fund.

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1. Introduction

The recurrent financial crises experienced primarily by countries on the semi-periphery of the international economic system following their exposure to financial globalization during the 1990s, raised deep questions concerning both crisis prevention and crisis resolution mechanisms. Not surprisingly, the role played by the IMF as a key institution at the center of the international financial system came under increasing scrutiny. The focus on the role of the IMF may be justified by the fact that the institution itself had played an instrumental role in worldwide push for capital account liberalization in the first place. A similar emphasis on the role of the IMF may also be rationalized on the grounds of the organization's intimate involvement in the crisis resolution process. The IMF, in its capacity as the "World Central Bank" and the "lender of last resort", has pushed for both short-term adjustment and longer-term reforms as part of its financial assistance. This in turn has raised considerable bitterness on the part of borrowing countries. On the lenders' side, major concerns have been generated in relation to the effectiveness of the IMF lending to countries whose commitment to reform appear to be rather questionable. Also from the lenders' perspective, serious considerations arise involving the mis-utilization of financial assistance, which imposes a major burden on their taxpayers. Indeed, the Fund's role in crisis prevention and resolution processes have been actively questioned and subjected to vocal criticism by both lenders and borrowers in recent years resulting on a variety of proposals for possible IMF reform.

The issue of the IMF reform is not a novel phenomenon. In fact it has been very much on the agenda right from its inception in the immediate post-World War II period and particularly since the 1970s following the collapse of the Bretton-Woods system. The cause for reform has intensified, however, during the recent era of financial globalization in the context of which the Fund's role has been redefined involving a transformation from a global institution to a more specialized institution dealing with a selected subset of emerging market countries. To be fair to the IMF, its job was made more complicated in the new environment where following capital account liberalization, the dominance of official flows was considerably reduced and the majority of flows became decentralized and private in nature. Moreover, a paradoxical tendency could be discerned with respect to the role of the IMF in the financially globalized environment. Whilst the range of countries attracting the Fund's attention became more narrowly defined, the actual depth of its involvement in these countries expanded[1]. It is this depth of involvement in a limited number of countries, which has been instrumental in raising the Fund's profile from a critical perspective. From the standpoint of borrower countries, major question marks were raised concerning the political legitimacy of the extensive range of policy reforms imposed by the IMF as part of the conditions for its official assistance. The intrusion of an external agency in the very heart of domestic policymaking process created deep resentment on the grounds of interference with the basic principles of national autonomy and sovereignty. From the standpoint of lending countries, Fund's heavy involvement in a limited number of emerging markets became a cause of concern for entirely different set of reasons. The more specialized role of the IMF increased the risk of failure especially in an environment of volatile capital flows with the significant possibility of contagion from one country to another. Given the domestic political constraints in the receiving countries, the ability to accomplish the necessary reforms over short periods of time did not appear to be particularly promising.

Our central objective in this paper is to question the nature and limits of the IMF involvement in the processes of crisis prevention and resolution in the era of capital account openness. This, in turn, will provide the basis for assessing possible avenues for improving the contribution of the IMF, highlighting some of the central dilemmas confronted in this process. In order render the arguments more concrete, the recent encounter of Turkey with the IMF, prior, during and after her 2000-2001 financial crises will be the focal point of our analysis. Rather than trying to understand the intricacies of the Turkish case in individual terms however, our aim is to elucidate the broader issues concerning the limits of IMF intervention in emerging market contexts with weak democratic institutions judged by the standards of Western democracies.

The paper is organized as follows. Some of the traditional criticisms of the IMF and the organization's attempts to come to terms with these criticisms are expounded in section 2. Fund's adaptation to the era of financial globalization is subjected to a critical examination in

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[1] The disproportionate focus of the Fund on a select group of emerging markets is clearly evident in the 11 Stand-by agreements in progress as of June 28, 2002. Among the total of approximately USD 59.37 billion, USD 54.73 billion have been allocated to three large emerging markets, namely, Argentina, Brazil and Turkey. One may contrast this with the total assistance provided to eligible countries under the heavily indebted poor countries initiative. The magnitudes committed as of the same date to 26 countries amounted approximately to a mere USD 2.1 billion. In addition, the Fund has provided poverty reduction and growth facility amounting approximately to USD 6.733 billion to 36 countries. This information has been drawn from http://www.imf.org/external/np/tre/activity/2002/062802.htm.

section 3. The Asian Crisis of 1997 marks a clear turning point in Fund's fortunes considering the fact that the intensity of criticisms leveled against the IMF has become more intense in the post-1997 period. The direction of IMF reform in the East Asian crisis will be evaluated in Section 4. The specific details of Fund's involvement in the recent Turkish context will be explored in section 5. The Turkish experience will be used, in turn, to highlight some of the broader limitations and dilemmas associated with IMF involvement in semi-peripheral settings. Our concluding observations are presented in section 6.

2. Traditional Criticisms of the IMF and Fund's Own Response to These Criticisms in the Pre-Financial Globalization Era

It is striking to observe a certain degree of continuity in many of the criticisms leveled against the IMF right from its early encounters with the developing world. The traditional criticisms of the IMF have typically highlighted the inappropriate mix of conditions and incentives embodied in its programs designed to accomplish balance of payments adjustment. Countries, which approached the IMF in a situation of acute balance of payments crisis, found themselves confronted with rather harsh conditions with inadequate incentives to apply the mix of expenditure switching and expenditure reducing policies. The expenditure reducing components of the package posed special problems for implementation considering inadequate resources provided by the IMF for program support. Developing countries have typically drawn attention to the failure of the IMF to pay sufficient attention to the income distributional and real economy impacts of its programs[2]. The Fund's perennial concern with fiscal prudence desired to achieve balance of payments improvement in the short run often resulted in budgetary cuts with negative implications for prospects of economic growth as well as the living standards of the poorer segments of the society[3]. A parallel criticism which survived to the present day concerns a certain reluctance on the part of the Fund to appreciate the political costs or ramifications of austerity measures designed to restore external balance over the shortest possible period, protecting the safety of the lenders in the process with possible negative long-term consequences on the growth trajectories of the borrowing

[2] For a study which is rather representative of this perspective, see Ghai (1991)
[3] Ghai (1991) is directly relevant in this context.

countries[4]. It could be argued that four basic types of asymmetries have characterized operations of the IMF. First of these asymmetries reflects the Fund's inherent myopic bias involving a preference for short-term adjustment on long-term growth. The second asymmetry involves a preference for the interests of lenders over borrowers. Added to these, one could draw attention to the third asymmetry concerning Fund's operations namely the ability to discipline surplus countries with a disproportionate weight of adjustment falling on the deficit countries. The fourth asymmetry relates to the contrasts in the weight of influence exercised by the Fund prior and following the outbreak of crises. The Fund is in a relatively weak position in terms of its ability to implement the kinds of policies needed to prevent crises ironically up to the point where a crisis actually occurs. Once a crisis occurs however, the power and the influence of the IMF over countries' policies increase drastically. A key implication of this final asymmetry is that the IMF becomes a critical actor at a point when the crisis has already reached acute proportions. This inevitably renders the IMF medicine rather unpopular in the eyes of the citizens of the recipient country. In this kind environment, it becomes correspondingly difficult to generate broad-based political support for IMF style adjustment measures. Consequently, the IMF becomes even more vulnerable to criticisms grounded on the demise of national sovereignty. We should state from the outset that these asymmetries are not unique to the pre-financial globalization era. Indeed, they are highly relevant in the era of capital account openness, as will be elaborated in a subsequent context.

In spite of the fact that the IMF has been subjected to vocal criticisms during the 1970s and 1980s, the organization did not appear to be particularly threatened by these criticisms. This may, in part, be explained by the fact that the principal criticism originated from the periphery and not from the center[5]. The center, in this context, is defined as the dominant policy making, financial and the academic community. It would be wrong to assert, however, that the Fund was totally impervious to these criticisms. In fact, the Fund experienced a certain evolution and rethinking process during this period resulting in concrete steps in the direction of reform. In retrospect, the major element of reform involved the introduction of additional

[4] For a good overview of the various perspectives on IMF conditionality in the pre-financial globalization era, see the collection of essays in Williamson (1983)

[5] For a good example of the kind of early criticisms presented from the "periphery" focusing on proposals for the reform of the international monetary system, see Dell and Lawrance (1980). For a more recent version of criticisms stemming from the "periphery" in the context of financial globalization, see Wade (1998) and Wade and Veneroso (1998). There exists a clear line of continuity between the two sets of criticisms in the sense that both highlight the systemic nature of the crises observed in the semi-periphery and, hence, place primary emphasis on the reform of the international financial architecture.

facilities for countries experiencing acute balance of payments difficulties[6]. These facilities made more resources available to countries concerned at low cost and implied a certain relaxation of conditionality associated with the standard stand-by agreements. The introduction of these additional facilities helped the Fund to circumvent key criticisms concerning the limited financial base of its operations and excessively short adjustment periods embodied in its standard programs. Another striking development in this context concerned the Fund's increasing willingness to collaborate systematically with the World Bank and implement cross-conditionality from the beginning of 1980s onwards[7]. The willingness to collaborate systematically with the World Bank and the associated practice of "cross-conditionality" reflected a certain change of direction in Fund's thinking. This change displayed greater awareness of the need to combine short-term adjustment with longer-term reforms as a basis for resolving acute balance of payments difficulties. The IMF established itself as a central actor in promoting the "Washington Consensus" emphasizing the primacy of liberalization and reforms designed to achieve a "free market" [8]. Trade liberalization, privatization, as well as financial and capital account liberalization were conceived as the principal ingredients of this new consensus. Consequently, the Fund was able to defend itself from the criticisms, which highlighted its inherent myopic bias and anti-growth orientation. On top of all these considerations, the introduction of these new facilities raised fundamental question marks concerning the inherent moral hazard problems involving appropriate utilization. Indeed, these concerns on the part of the lenders became far more acute in the subsequent era of financial globalization.

3. The IMF in the Era of Financial Globalization: Explaining the Limits of Its Adaptive Capacity

The IMF has accelerated the process financial globalization considering the unambiguous support that it has provided for capital account openness as part of its promotion of the basic "Washington Consensus". It is rather paradoxical however that the environment of open capital account regimes rendered the job of the IMF much more complex and problematic

[6] For detailed information on the new facilities introduced, see Lastra (2000).
[7] On closer collaboration between the IMF and the World Bank in post- 1980 era and the principle of "cross-conditionality", see Mosley et al. (1995). In fact, Turkey was one of the major examples of a country where a joint IMF- World Bank program was implemented in the 1980s.
[8] The term Washington Consensus was coined by John Williamson. The term signifies a commitment to efficiency through liberalization of key markets in the economy. The single-minded commitment to efficiency is in turn associated with a distinct lack of emphasis on considerations regarding redistribution. For a recent re-evaluation of the principles associated with Washington Consensus, see Williamson (2000).

compared with the previous era. The complexity of the new environment was, in part, due to the massive increase in capital flows, which were decentralized and highly volatile in nature[9]. Hence, in spite of certain increases in the size of the IMF assistance during the past two decades, the resources provided represented an increasingly a small fraction of the private capital flows especially between the developed and emerging markets.[10] In retrospect, the IMF attempted to adjust itself to the new environment in several different directions.

The Fund placed far more importance on longer-term domestic policy reforms designed to create the basic infrastructure of an open market oriented economy in line with the principles of Washington Consensus. It is fair to argue that the Fund's concern with longer-term structural reforms predates the Asian Crisis of 1997. However, the Asian Crisis represented a clear turning point in the Fund's involvement with longer-term structural reforms. The Fund placed far more emphasis on promoting key reforms in the areas of banking and financial sector regulation and corporate restructuring as part of its conditional assistance in the post-Asian Crisis environment. Associated with its growing emphasis on longer-term reforms, the Fund appeared to place more weight on issues relating to the quality of governance. A key aspect of this concern was the transparency and the accountability of the budgetary process.

Furthermore, exchange rate based stabilization programs became far more pronounced in the context of 1990s. Pegged-exchange rates were conceived of as key instruments for reducing inflation over relatively short periods of time. It is fair to argue that the Fund never considered pegged exchange rates as a single anti-inflationary instrument. Indeed, pegged exchange rates were regarded as being part of a broader package that included orthodox-expenditure reducing policies. Perhaps the most striking example of this kind of exchange rate based anti-inflation strategy was the Argentinean Convertibility Plan and the associated currency board

[9] It is striking to observe that bank lending, which constituted 66% of the total capital, flows during 1970s, accounted only for 16% of such flows by 1997. Given the large number of creditors involved, considerable problems of coordination emerged in the new era. For evidence concerning the increasingly decentralized nature of capital flows during the 1990s, see the Economic Report of the President (1999) available at http://www.access.gpo.gov/usbudget/fy2000/pdf/1999_erp.pdf

[10] For a comprehensive account of the distinct stages that the Fund has gone through to adopt itself to the new era of financial globalization, a process which has been accelerated following the Mexican and the Asian crises see Zhang (1998), Sharma (2000) and Chapter 7 of the Economic Report of the President (2002) which is available at http://a257.g.akamaitech.net/7/257/2422/05feb20021445/www.gpo.gov/usbudget/fy2003/pdf/2002_erp.pdf .

experiment in the 1990s. The Turkish experience at the end of 1990s represents a softer and milder version of this kind of exchange rate based strategy[11].

Another notable response of the Fund especially after the Mexican and the Asian Crises involved the introduction of new facilities. These facilities included the Supplementary Reserve Facility (SRF) introduced in December 1997 and the Contingent Credit Line (CCL) adopted in April 1999. SRF was intended to provide financial assistance to a member country experiencing exceptional balance of payments difficulties due to a large short-term financing need resulting from a sudden and disruptive loss of market confidence reflected in the pressure on the capital account and the member's reserves. The SRF constituted a clear step in formalizing the role of the IMF as the international lender of last resort. The CCL was, in turn, intended for members that were concerned with potential vulnerability to contagion but were not facing a crisis at the time of commitment. The CCL represented another step in the formulization of the lender of last resort on the part of the Fund.[12]

Having highlighted the adaptability of the Fund to the new environment of financial globalization, one can nevertheless detect certain notable limitations in the Fund's approach during this particular era. In certain critical respects, there appeared to be an important degree of continuity with the earlier era, highlighting the limits to Fund's adaptability to the new environment of financial globalization.

A degree of uniformity continued to characterize the Fund's operations. The Fund did not seem to take into account the diverse origins of crises in emerging markets arising from the inherent heterogeneity in their economic, political and institutional characteristics. In other words, the same prescription was applied, as part of its conditional assistance, irrespective of the underlying origins of the crises concerned. Expenditure reducing policies designed to achieve balance of payments equilibrium over short periods of time continued to be the dominant element in the Fund's stabilization programs. In fact, the Fund seemed to approach all emerging markets in a uniform manner, based on the premise that endemic budget deficits constituted the principal form of disequilibrium underlying the outbreak of financial crisis. The experience of the 1990s clearly contradicted the Fund's position in this respect. The

[11] Indeed, some commentators have labeled the monetary policy component of the Turkish stabilization program of the late 1990s as a "quasi-currency board" experiment.
[12] Concerning the details of these new facilities, see Lastra (2000).

Mexican and the Korean Crises are rather illuminating in this context. Both countries experienced major crises in an environment of fiscal prudence. Contrary to the expectations of the Fund, private rather than the public sector was the prime agent responsible for the outbreak of crises in both cases. In fact, it has been frequently alleged that the Fund has deepened the crisis in the Korean context by insisting on expenditure reducing policies in an environment of high domestic saving ratios[13].

Turning our attention to the mix of conditions and incentives provided by the Fund, assistance provided continued to be limited relative to the scale of adjustment required, in spite of the introduction of new facilities. The inadequate nature of the resources provided by the Fund failed to create appropriate incentives for political actors to implement necessary structural reforms. Consequently, countries found themselves in a vicious cycle of limited assistance leading to half-hearted reforms that, in turn, created the basis of a fragile recovery and rendered the economy vulnerable to future crises.

Another criticism that was frequently leveled against the Fund concerned its rather technocratic approach to the problem of constructing a regulatory state. Financial globalization required a new kind of state apparatus and the IMF through its longer-term reforms sought to contribute to the emergence of the new regulatory state. However, the Fund's intervention, in this particular sphere, appeared to be based on a false premise that passing laws and creating regulatory institutions notably in the areas of banking and financial sector regulation ensured automatic success in implementation. Hence there appeared to be over-optimism concerning the construction of an effective regulatory state as a result of the Fund's intervention. An interesting paradox seemed to characterize the Fund's involvement in this respect. The Fund is an inherently political actor due to the nature of its intervention in the domestic sphere raising important questions involving national sovereignty. Yet the Fund saw itself as an apolitical institution, by definition, and as a result failed to pay sufficient attention to the political requirements of building effective regulatory institutions.

Yet another paradox or dilemma relating to the Fund's role concerned the dichotomy involving the normal and crises periods. Countries approached and accepted the conditions posed by the IMF only during crisis periods, which inevitably resulted in a focus on short-

[13] For a detailed elaboration of this argument with specific reference to the Mexican and the Asian Crises, see Onis and Aysan (2000).

term crisis resolution strategies. Once the crisis was over and longer-term reform and restructuring issues occupied a dominant role on the agenda, the Fund's ability to implement such measures became correspondingly limited.

The kind of criticisms or dilemmas emphasized above also assumed relevance in explaining limited success achieved by the Fund with respect to its exchange rate based stabilization policies. The Fund once again proved to be "technocratic" in its approach to the implementation of exchange rate based anti-inflationary strategies and made the rather unwarranted assumption that the necessary accompanying measures would be properly implemented. To be more precise, it was assumed that the fiscal austerity and regulatory measures would be successfully implemented. The IMF in this process made two implicit assumptions. Firstly, political resistance by interest groups could be overcome without major difficulties. Secondly, politicians would behave in the interests of long-term economic rationality, discarding the possibility that short-term political gains might deviate from the longer-term considerations relating to the welfare of the population as a whole. In many cases however, the accompanying measures failed to be implemented suggesting the invalid nature of the assumptions made by the IMF at the outset of program implementation. In the absence of proper implementation of accompanying measures, exchange rate based stabilization policies resulted in loss of export competitiveness and large current account deficits on the one hand and financial sector problems involving sharp capital outflows.

To be fair to the IMF, what appeared to be inherent limitations at first sight could also be interpreted as an intractable dilemma. Many of the regulatory changes or codes of conduct promoted by the IMF could only be effectively accomplished over long periods of time. There was no guarantee that Fund's more active involvement in the domestic politics of the countries concerned would necessarily generate reform implementation over reasonable periods of time. Moreover, Fund's active involvement in the implementation of the long-term regulatory reforms raised fundamental question marks on grounds of national sovereignty, challenging the very legitimacy of IMF intervention in the process.

4. The Evolution of the IMF in the Aftermath of the East Asian Crisis: A Critical Perspective

The Asian Crisis of 1997 represented a striking turning point in Fund's fortunes. Hitherto the principal source of criticism had originated from the "periphery". After the Asian Crisis the IMF has been subjected to serious criticisms from the center for the first time[14]. The center-periphery dichotomy is important in terms of understanding criticisms of the IMF and proposals for reform. As discussed previously, the center, in broad terms, refers to the dominant financial community including the associated academic establishment in the core group of industrialized countries notably in the US. The periphery, on the other hand, refers to the policy-making and intellectual elites of developing countries as well as their representatives in the industrialized world. A typical dividing line between the two groups is that criticisms from the center focus on domestic failures of developing country borrowers whilst criticisms from the periphery highlight the underlying weaknesses of the international financial system as a whole. Not surprisingly, the line of criticism adopted by the respective group point towards a certain direction for reform. Those from the center, naturally, point towards domestic policy reform in the borrowing semi-periphery country as the principal domain of adjustment. Those from the periphery, on the other hand, tend to underline the need for a reform of the international financial system as a whole, relegating into the background issues relating to domestic policy reform.

Given the distribution of international power structure, the preferences of the center have effectively dictated the nature and direction of IMF reform as well as the distribution of adjustment between lenders and borrowers. It is also important to emphasize in this context that voting power at the IMF is heavily dependent on quotas of member countries, which in turn depends on a number of variables representing the country's relative weight in international trade and its level of development. Consequently, the developed countries have been able to exercise a disproportionate degree of power and influence over IMF policies and the direction of IMF reform. Following the Asian Crisis, the Fund became the focal point of criticism from the center, which has been seriously divided for the first time. This

[14] Particularly striking in this context was the criticisms that originated from the then chief economist of the World Bank, Joseph Stiglitz. Given the academic statue of Stiglitz and his position in the dominant intellectual community of the "center", his criticisms have forced a major re-thinking process within the Fund. For details of Stiglitz's position, see Chang (2001).

development in turn precipitated a major identity crisis on the part of the IMF as well as a serious reevaluation of its position in an attempt to counteract some of these criticisms. The vocal criticisms stemming from the center might be explained on the following grounds. Firstly, the lenders appeared to have suffered significant losses in the aftermath of the Asian and Russian Crises in spite of Fund's substantive financial assistance[15]. Secondly, lenders became increasingly concerned about the burden imposed by the scale of IMF assistance on developed country taxpayers. These concerns were aggravated by the inherent fears concerning the likely mis-utilization of IMF financial assistance to a limited number of emerging markets characterized by deep political uncertainty and fragile economic structures.
Proposals for IMF reform originating from the center have proceeded in two very different directions.

The first group of what could be classified as ultra-conservative analysts has emphasized the need to limit the scope of the IMF. Some members of this category have gone even further as to suggest the need to abolish the IMF altogether.[16] Scholars in this category have frequently highlighted the excessive burden of intervention and the financial assistance on the part of the IMF on developed country taxpayers. They have also highlighted the moral hazard problems associated with IMF bailouts, which provided few incentives for policymakers in borrower countries to undertake the set of appropriate adjustments and for private lenders to monitor developments in the countries concerned. A salient characteristic of scholars in this group concerns their distrust of heavy IMF involvement in the domestic long-term reform process of borrowing countries. Given the inherent lack of familiarity of the IMF with the domestic political and institutional environments of borrowing countries and the highly controversial issues pertaining to national sovereignty, the best option for the IMF was to keep out of longer term policy issues while keeping involvement with short-term issues at a bare minimum.

The second major strand of thinking originating from the center, in contrast, envisaged an expanded role for the IMF admittedly in the context of a limited number of emerging markets. For this group, a strengthening of the Fund as a lender of last resort for insurance against

[15] For evidence on the heavy involvement of IMF in a select group of emerging markets including East Asia as a whole, Brazil and Russia with the scale of financial approximately amounting to USD 65 billion, see Sharma (2000), p.50 based on information derived from IMF surveys.
[16] Typical representatives of this extreme tendency as documented in Sharma (2000) include Robert Barro, Milton Friedman, George Schultz, Anna Schwartz, William Simon and Walter Wriston.

systemic risk was considered to be of critical importance[17]. In addition to assuming the role needed as a short-term crisis manager, the Fund's role in the long term reform process and the construction of an effective regulatory apparatus were highlighted as being central to the process of creating a sound economic structure which would help to eliminate potential crises in the future. Whilst this group also displayed an awareness of the budgetary costs involved from the lender's point of view, the implicit assumption made was that the costs of recurrent crises and contagion in the semi-periphery would far outweigh the budgetary costs of the IMF involvement. Some members of this second group have put forward proposals involving institutional reform focusing on the creation of new or separate institutions that would replace the IMF[18]. Proposals of this nature have been subjected to critical appraisal on the grounds of major coordination problems involved.

In response to heightened criticisms, the Fund increasingly subjected itself to a self-evaluation process and tried to reform itself rather in line with the recommendations made by the second group associated with the center. IMF reform in the post-Asian Crisis Era has focused on the following key elements. Firstly, the Fund appeared to place far more weight on the promotion of banking and financial sector reform. Secondly, far more attention was given to the issue of fiscal transparency and accountability. In both cases, the Fund envisaged a more active role for itself in the realms of institution building and "proper governance". Thirdly, there was an active attempt on the part of the Fund to make its own operations more transparent and accountable attempting to set an example to national governments in the process[19]. Finally, the Fund has recognized the importance of explicit and voluntary participation of the private sector in crisis resolution process[20].

In spite of the Fund's vigorous attempts to reform itself in the post-Asian Crisis era, certain inherent limits could be nevertheless diagnosed in this process. Firstly, it could be argued that the recent reform proposals were far more in line with the interests of lenders rather than

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[17] Stanley Fischer, as a representative of the second of our analytical categories, argues convincingly that it is the Fund's inability to act as a reliable lender of last resort that should be blamed for the existence of moral hazard and investor volatility.

[18] A good example of this approach is the proposal by Sebastian Edwards. Edwards (1998) proposes the creation of three new entities to replace the IMF. The three institutions proposed are a Global Information Agency, a Contingent Global Financial Facility, and a Global Restructuring Agency.

[19] The various steps involved on the part of the Fund to make its own actions more transparent and accountable are extensively documented by Sharma (2000).

[20] For an extensive review of bail-in, burden sharing and private sector involvement of crisis resolution, see Roubini (2000).

borrowers. The Fund continued to display a weak interest in the social and political implications of its programs in the context of emerging markets and made limited attempts to uncover the complexities of the institutional and political environments of individual countries. The Fund tried to present itself as an apolitical and technocratic institution in spite of the fact that its interests in building a regulatory state made it a fundamentally political institution. Additionally, the Fund could be criticized from a borrowing country perspective for being interested only on the regulatory aspects of state reform, failing to emphasize the crucial role that the semi-peripheral state needs to play in the areas of long-term development and income distribution management. Furthermore, insufficient attention is being paid to the political and institutional problems faced in the process of constructing an effective regulatory state, which reduces the likelihood of adequate implementation of the promoted reforms. In spite of the greater importance attached to longer-term regulatory reforms in principle, the Fund continued to be pre-occupied with fiscal adjustments in the short run. The Fund persisted with the implementation of exchange rate based stabilization programs in spite of frequent evidence of failure in the context of such programs in an era of high capital mobility. Financial assistance provided by the Fund remained rather inadequate considering the magnitude of capital flows to and from the countries involved. Once again the problem originated from the Fund's over-optimistic view concerning the ability of the individual countries to implement the supporting measures needed to generate success in the context of such programs.

The Fund is yet to respond fully to some of the more sophisticated criticisms and proposals originating from the periphery or the so-called "financial stabilizers" in the terminology of Armijo (2001). The Fund's vision of global capital markets has been very much influenced by neoclassical principles that assume perfectly competitive and well functioning markets. As a result, the Fund tended to underplay global market imperfections and the need to assume a more active regulatory role with respect to restricting inflows of volatile short-term capital inflows especially before strong and mature financial markets are instituted in the semi-periphery. It is fair to say that in spite of recent reform attempts, the Fund has been rather impervious to attempts to introduce any restrictions on capital flows, especially on capital outflows, both in the national and global spheres[21]. The limitations highlighted above are

[21] The Fund's position on capital controls has become ambiguous following the Asian Crisis. The Fund had pushed vigorously for capital market liberalization in the early 1990s. In the late 1990s however, there was at least some recognition as testified by Stanley Fischer that a "more nuanced approach" to capital market opening

perhaps not surprising given the aforementioned existing power structure within which the Fund is situated and the web of interests that the organization represents[22].

5. Turkey's Financial Crises in the Era of Capital Account Liberalization: The Extent of the IMF's Contribution

Turkey's complete encounter with the process of financial globalization occurred following the decision to establish full capital account liberalization in August 1989 almost a decade after the inception of Turkey's neo-liberal experiment in January 1980. In spite of the fact that full capital account liberalization took place at a later stage of the program, many observers have rightly considered the full opening of the capital account to be premature. Turkey had not accomplished a stable macroeconomic environment and a strong regulatory infrastructure for the financial sector for capital account liberalization to produce the desired outcomes in the form of lower real interest rates and higher economic growth on a sustainable basis[23]. Given the weakness of the domestic environment, Turkey failed to capitalize on the benefits of financial globalization. A lopsided pattern emerged in which a disproportionate share of capital flows were of a short-term nature. Turkey failed to attract significant long-term foreign direct investment (FDI). The annual inflow of FDI has remained below USD 1 billion, which is clearly a dismal figure compared with the performance of other emerging markets of similar size and level of development.[24] Turkey's weak FDI performance was, in part, due to an unstable macroeconomic and political environment. However, other factors were also at work including bureaucratic barriers and deficiencies of the legal framework[25]. The pattern of economic growth in the Turkish economy became heavily dependent on inflows of short-term capital which were highly volatile in nature[26]. This in turn, resulted in highly cyclical pattern

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would create greater benefits in the long run. Such a nuanced approach would involve a sequencing of capital account liberalization that would give priority to long-term inflows, whilst making sure that the short-term inflows are not permitted until financial markets are fully developed. The Fund also took a more pragmatic approach to individual cases where reinstitution of capital controls took place whilst maintaining opposition to capital controls in general.

[22] The literature emphasizing the impact of the Treasury-Wall Street complex on the Fund is directly relevant in this context; see Wade and Veneroso (1998). The political role of the Fund and its linkage to the US foreign policy objectives have become more explicit in the post-September 11 environment.

[23] See Alper and Onis (2003) for an analysis of the Turkish experience in the era of capital account liberalization.

[24] The extent of Turkey's inability to attract FDI is clearly highlighted in Figure 1.26 in UNCTAD (2001), page 41. Turkey is among the bottom 20 out of 137 countries according to the inward FDI index.

[25] These issues have been frequently highlighted by Foreign Investors Association of Turkey (YASED). See for example, Ariman (2001).

[26] See Alper and Saglam (2001) for evidence on the effect of sudden capital outflows on the Turkish economy.

of economic growth[27]. In retrospect, the economic performance of 1990s proved to be considerably weaker than the early phase of neo-liberalism in the 1980s. 1990s were characterized by a pattern of recurrent financial crises with costly consequences and lower economic growth.

An important question to pose is the extent to which the IMF itself was responsible for the premature opening of the capital account in Turkey. This decision appears to be primarily the outcome of the domestic political process. In retrospect, a striking myopic element could be discerned in this decision, in the sense that it was trying to capitalize on short-term gains based on short-term capital inflows without paying adequate attention to the disastrous medium and long-term consequences in an environment of political fragmentation and under-regulated financial system[28]. There is no evidence, however, that the IMF resisted Turkey's transition to full capital account liberalization. Anecdotal evidence suggests that the Fund favored the build up of domestic financial regulation right after the inception of the new capital account regime by promoting the creation of a new regulatory institution. This reflected the broad preference of the Fund in favor of rapid capital account liberalization based on the somewhat overoptimistic assumption that the necessary accompanying regulatory institutions could be constructed and be rendered effective in a relatively smooth manner over short periods of time. Yet, the Fund was not successful in instigating such a regulatory agency in a non-crisis environment[29]. It is striking to observe that the kind of regulatory institution that the Fund was trying to promote namely, the Banking Regulation and Supervision Agency, (BRSA) could only be founded in 1999, at a time when the Fund was much more powerful in promoting its reform package as part of its conditions for access to financial assistance[30].

In hindsight, the premature capital account liberalization delayed the reform process in Turkey. Certainly it is possible to argue that Turkey's early exposure to financial

[27] See Onis (2000) for a long-run analysis of the correlation between capital flows and real output growth for Turkey and Alper (2002) for a short-term cyclical analysis of the strong correlations of real output with capital flows.

[28] Turgut Ozal, then prime minister and the architect of Turkey's neo-liberal experiment, played an instrumental role in the capital account liberalization decision. Indeed there is evidence that this decision was met with strong opposition by key elements of the economic bureaucracy at the time notably the Central Bank, see Onis and Webb (1994), Ersel (1996)

[29] Interview with Ercan Kumcu, a former vice president of the Central Bank.

[30] The evolution of financial sector regulation in the post 1989 era in Turkey is extensively investigated in Alper and Onis (2002).

globalization aggravated the underlying disequilibria, which to a large extent, were rooted in Turkey's domestic politics[31]. In the presence of severe distributional constraints, which could not be adequately managed in a fragmented party system with weak institutions, lack of fiscal discipline emerged as an endemic source of instability leading to the crisis of April 1994, and subsequently the November 2000 and the February 2001 crises[32]. Indeed, we cannot predict with any confidence that Turkey's cycle of recurrent crises is over with February 2001.

Turning specifically to the role of the IMF in the aftermath of the 1994 crisis, it is striking to observe the Fund's active involvement in the reform implementation phase, long before the stabilization program of December 1999. Indeed through its Article IV Consultations with Turkey and its Country Staff Reports, the Fund has monitored the macroeconomic developments in Turkey and frequently highlighted the deficiencies concerning the fiscal disequilibrium and financial sector fragility, deficiencies that have contributed to the subsequent crisis of November 2000 and February 2001[33]. Yet the Fund's position in the intra-crisis period (1994-2000) shows the inherent dilemma that the Fund faces. This dilemma as we have tried to highlight in our broader discussion is not an attribute, which is unique to Turkey. In all fairness, even though the Fund was actively involved in the policy process, it did not possess executive power during this period. Consequently, its role could not be extended beyond a mere advisory role to include an ability to impose key policy changes in the desired direction. Only when the sustainability of the fiscal position seemed to be seriously jeopardized, did the Turkish policy making elite reluctantly yield to the Fund's pressure. This half-hearted commitment to the Letter of Intent of December 9, 1999, in retrospect, proved to be a major cause of the ensuing crises.

It would be interesting to provide a brief reference to the political background underlying the implementation of the 1999 program. A coalition government involving three political parties came into office following the April elections of 1999. At first sight, the new coalition government appeared to be an unlikely candidate for implementing an IMF style program. The two dominant members of the coalition were elected on explicitly populist agenda and

[31] See Alper and Onis (2003) for an account of the recurrent crises based on the interaction of the early capital account liberalization and Turkey's democratic deficits.
[32] These crises have been extensively analysed from a variety of different perspectives. See Alper (2001), Yeldan (2001), Akyuz and Boratav (2001), Ozatay and Sak (2002), and Uygur (2001).
[33] Among these documents the following may be identified as being rather illuminating: Article IV consultation on August 5, 1997; Memorandum of Economic Policies on June 26, 1998; Article IV Consultation on August 13, 1998; Article IV Consultation discussions and Third Review of the Staff Monitored Program on July 2, 1999. Documents concerned can be accessed at http://www.imf.org/external/country/TUR/index.htm.

represented poorer segments of the Turkish society. Nonetheless, for the first time in Turkish history, a coalition government appeared to display a certain commitment towards the implementation of an IMF program. Furthermore, a government agreed to implement a program in a non-crisis environment, although it may be argued that such a commitment would not have been forthcoming in the absence serious fiscal disequilibrium and a possibility of an impending crisis. It became apparent after a certain period however, that the coalition government's commitment to the program was rather superficial partly due to failure to recognize the seriousness of the situation and partly because of the political and economic costs of the program[34]. This brings us back to the more general point that political ownership of the program by key domestic constituencies is crucial for program success. In the Turkish case, there was no guarantee that the program would succeed in an environment of weak political ownership. This clearly draws attention to one of the central dilemmas facing the IMF not only in Turkey but also in other national settings like Argentina, Indonesia and Russia, which has already been highlighted. It would perhaps be unfair to accuse the IMF directly in this context; yet at the same time, the Fund's failure to recognize problems associated with political ownership has often proved to be a major cause of program failure.

The November 2000 and February 2001 crises in Turkey, in a rather paradoxical fashion, occurred during the implementation of the IMF program. We tend to differ from certain accounts of the recent crises that tend to place the sole responsibility on the shoulders of the IMF[35]. Nonetheless, the Fund's contribution to the outbreak of the twin crises should not be underestimated. Looking back, the Fund underestimated the fragility of the Turkish financial system, notably in an environment where the success of the program relied heavily on the availability of short-term capital inflows on a sustained basis. Steady availability of capital inflows, however, rested on a knife-edge equilibrium based on steady implementation of the program. Given the uncertain environment within which the program was introduced, this proved to be an unwarranted and simplistic assumption. The Fund underestimated the scale of adjustment involved partly because of information problems and consequently the financial assistance provided by the Fund, totaling approximately USD 4 billion extended over a three year period, was not commensurate with the scale of adjustment notably in the context of the

[34] To give a specific example, a substantial reduction in agricultural subsidies was a key component of the 1999 program. The implementation of this measure, in turn, came into direct conflict with the political interests of one of the dominant coalition partners, whose principal base of political support originated from the rural constituencies.

[35] For examples of such analyses, see Yeldan (2001) and Akyuz and Boratav (2001).

banking sector[36]. Furthermore, the amount of resources provided by the IMF failed to provide sufficient insurance considering the magnitude of capital flows involved[37]. One could also detect a sequencing problem in the Fund's approach to Turkey in the post-1999 period. Ideally, the reform process should have given immediate priority to banking sector restructuring, considering that the private banks played an instrumental role in the November 2000 and the public banks were the prime contributors to the February 2001 crises[38]. Admittedly, banking sector reform constituted an integral part of the 1999 stabilization program very much in line with that the self evaluation process that IMF has gone through following the Asian Crisis. Yet, one could argue that far more emphasis was placed by the Fund on the elimination of the budget deficit in the short-term, putting much less weight on the longer-term problem of banking sector regulation in the process. Perhaps, given the uncertain political environment and the scale of adjustment involved, there should have been some consideration of the need to institute temporary controls over short term capital flows right at the inception of the program. This is the kind of policy, however, that the IMF is opposed to by definition.

The IMF has played an instrumental role in the creation of the regulatory apparatus needed for the creation of a sound financial and banking system. The creation of the Banking Regulation and Supervision Agency (BRSA) was a direct outcome of IMF pressure[39]. This undoubtedly constituted a major source of progress in terms of establishing a well-regulated banking sector, which is a fundamental prerequisite for full capital account openness. Looking back, however, the Fund seems to have underestimated the political problems associated with the

[36] In retrospect, the severe information problem manifested itself in the Fund's under-estimation of the scale of the duty losses of the public banks and the problem of financing these losses in the inter-bank market. For an elaboration of this issue, see Alper and Onis (2002).

[37] As mentioned in Alper (2001), during just the first 9 months of the program, the net capital inflow amounted to USD 11.1 billion. Also, during the week of the November 2000 and February 2001 crises, approximately equal amounts of USD 8 billion have been withdrawn.

[38] See Alper and Onis (2002) on the links between the banking sector under-regulation, soft budget constraints and the latest wave of crises.

[39] Resistance by politicians and the interest groups in the domestic sphere to banking reforms in general and the formation of the BRSA as an independent actor in particular, manifested itself at an early stage. As a result of powerful pressures stemming from banking lobbies, vital provisions have been left out from the Act of 4389 that was put into operation following the establishment of the new government. Six months later, the Banks Act was amended by Act Number 4491 to remove the loopholes present in the earlier piece of legislation. Perhaps the most significant amendment embodied in Act No. 4491 involved the granting to the BRSA the right to issue new banking permits, which until then had been a political decision left to the domain of the Council of Ministers. Political pressures also manifested themselves as delays in the formation of the BRSA board. The IMF clearly played a vital role in this process. The appointment of the Board was actually a "structural performance criterion" as stated in the letter of intent of December 9, 1999. The Article number 53 of the Letter of Intent (can be accessed at http://www.imf.org/external/np/loi/1999/120999.htm) stated that the BRSA was expected to be in full operation by end-August 2000.

institution of a regulatory state. The operation of the BRSA has been subjected to significant delays and the institution was not in a position to prevent the twin crises, which were very much associated with a malfunctioning banking system. It is not at all clear whether the Fund has seriously addressed the issue that the long-term viability of the regulatory institutions depends on a delicate mix of autonomy and legitimacy. To be effective these institutions must enjoy a considerable degree of independence from short-term political considerations but at the same time, they must enjoy broad political support. The danger is that these institutions can be discerned by the public purely as the creation of an external agency. In that case, these institutions will fail to elicit political legitimacy and hence may fail to be viable institutions in the longer run. Indeed, these considerations apply not only to BRSA but also to other components of the regulatory state, including the Central Bank, the Competition Board and a host of other institutions. It is fair to say that the Fund's approach so far has been to place disproportionate weight to the issue of independence as opposed to the issue of political legitimacy. Furthermore, given its technocratic bias emphasized earlier, the Fund seems to assume to readily that institutional engineering will work and independent regulatory agencies can be smoothly instituted without paying much attention to the domestic political process.

The post-1999 experience of Turkey also illustrates some of the limitations of the exchange rate based anti-inflationary programs typically sponsored by the Fund in many developing country settings in an environment of open capital accounts and high capital mobility. Admittedly, the Turkish experiment represented a much softer and flexible version of an exchange rate based program compared for example with the earlier Argentinean experiment involving a rigid convertibility plan and a currency board[40]. The Turkish version involved an explicit exit-strategy which involved a gradual transition to a more flexible exchange rate system following the first 18 months of the program, the initial period characterized by a pre-announced exchange rate regime. The Turkish experiment was also more flexible in terms the monetary counterpart of the exchange rate strategy in the sense that the Central Bank was not totally restricted to function as a currency board. Under a currency board system, the money supply increases should be accompanied by capital inflows, and cannot be due to the domestic credit expansion by the central bank. In the Turkish context there was some degree of flexibility in this respect. Whilst ceiling values on the domestic credit expansion (net domestic assets) by the central bank were determined on a quarterly basis as part of the performance

[40] On the nature of the Argentinean experiment and its limitations, see Eichengreen (2001) and Baer et al. (2002).

criteria, within each quarter, the central bank is allowed to expand and contract domestic credit within certain limits[41].

In retrospect, the post-1999 experience of Turkey highlighted two central dilemmas associated with exchange rate based-cum-currency board stabilization strategies. As argued earlier, the IMF typically assumes that the fiscal component of the program will be smoothly implemented and consequently underestimates the incentives, which exist in the political sphere which operates in the direction of partial or weak implementation. Whilst the Turkish government appeared to display an initial commitment to the fiscal component of the program, this commitment proved to be ultimately half-hearted. Major problems of implementation appeared to manifest themselves in the areas of privatization and reduction of agricultural subsidies. Perhaps this was not surprising given the electoral base of the principal members of the coalition government in office and considering the weight of the rural component of the Turkish electorate. Incomplete implementation of the fiscal measures displayed the weak commitment of the coalition government to the program that in turn increased the possibility of sudden capital outflows. Incomplete implementation of fiscal measures also contributed to a drastic increase in the trade deficit, given the contribution of the public sector deficits to the overall demand in the economy. The inability to control domestic demand resulted in a strong import boom raising questions about the sustainability of the balance of payments equilibrium. By undermining investor confidence, the set of mechanisms considered above clearly contributed to the outbreak of the 2000-2001 crises.

The second dilemma relates to the lack of flexibility in the use of the monetary policy associated with "quasi-currency board" practices. The IMF may be defended on the grounds of trying to provide credibility to a program by introducing a powerful external anchor. Yet, there is also a negative side to this approach, which became obvious in the context of the twin crises. Given the constraints imposed on the central bank in terms of its ability to influence its domestic credit expansion, the central bank is unable to fulfill its role as the "lender of the last resort." This meant effectively that the central bank was not in a position to provide the implicit insurance on inter-bank loans; this in turn increased the fragility of the Turkish banking sector also contributing to the outbreak of the crises.

[41] More specifically, within each quarter, net domestic assets were allowed to fluctuate within a 5% band on either side of the previous quarter's value of the stock of the monetary base, for further details on this component of the program, see, http://www.imf.org/external/np/loi/1999/120999.htm.

At this point, the scale of IMF assistance provided also enters the picture. To be more precise, one possible criticism of the IMF is that it failed to provide sufficient resources at the right time due to its inherent bias towards protecting the interests of the lenders of the "center". In the absence of sufficient financial backing, the IMF failed to provide proper implicit insurance for the Turkish program as a systemic lender of the last resort. However, it would be wrong to place the full responsibility of the crises on the IMF taking into account the fact that the root causes of the problem were located in the domestic political sphere. Nevertheless, the scale of IMF involvement increased after the February 2001 crisis. During the course of 2001 and 2002, Turkey managed to attract a total of USD 24.5 billion of IMF assistance[42]. This clearly highlights the validity of the earlier criticism that the scale of assistance provided to Turkey as part of the 1999 program was of a rather limited magnitude given the scale of *ex-post* adjustment involved[43].

Finally at a more fundamental level, the Turkish experience in the post-2001 crisis period reflects a certain lack of attention on the part of the IMF to the issue of long-term economic growth. One can criticize the IMF for paying too much attention to the issue of fiscal prudence at the expense of real economic recovery, whilst recognizing the existence of a certain dilemma in this context, namely, an artificial recovery of the real economy contributing to a possible outbreak of yet another crisis in the near future. Yet it is also clear that without a sustained recovery of the real economy, debt servicing becomes increasingly problematic. At a deeper level, the IMF may be criticized on the grounds of not paying adequate attention to the problems concerned with long-term growth and competitiveness of the real economy. A narrow vision that concentrates simply on the regulatory role of the government, as has been clearly the case in the Turkish setting, deemphasizing its other functions, notably, its contributions to long-term economic development may not be sufficient in terms of creating a robust real economy that would be less vulnerable to the future economic crises.

[42] This is the amount approved by the IMF.
[43] The earlier point made about the IMF as an explicitly political actor becomes evident from the dramatic increase provided to Turkey in the course of the year 2001 which to some extent reflects the impact of September 11 and the associated shift in the US foreign policy priorities.

6. Concluding Observations

In spite of its relatively closed nature, the IMF has tried to learn from and reform itself in response to criticisms both in the pre-financial globalization era of the 1970s and 1980s and the financial globalization era of the 1990s. On the whole, the IMF has been much more sensitive to criticisms originating from the "center" and, indeed, the organization appears to have experienced a significant identity crisis in the aftermath of the Asian crisis of 1997. The crisis was a turning point in the Fund's fortunes in the sense that for the first time in its history, major criticisms stemmed primarily from the "establishment" itself.

In an ideal world, semi-peripheral states would clearly benefit from the presence of a truly global financial authority. A truly global financial authority would be in a position to deal with systemic aspects of crises experienced by emerging markets originating from the inherent imperfections in global financial markets. Semi-peripheral states, however, should not expect too much progress in this direction in the short-run. Given the existing distribution of power resources in the international economy (as reflected in the distribution of voting rights at the Fund), some of the more sophisticated proposals originating from the "periphery", such as an international Tobin tax on short-term capital flows are unlikely to exercise much impact on the evolution of IMF policies in the foreseeable future. Hence, it seems more sensible to focus our discussion at the level of the individual nations, which are the primary focus of IMF attention.

Perhaps the most fundamental criticism that can be leveled against the IMF, at the level of the individual nation states, concerns the timing of capital account liberalization. The IMF seems to have pushed for rapid capital account liberalization in many developing countries on the assumption that a strong regulatory infrastructure in the banking sector and reforms in government finances would be accomplished over short periods of time. In retrospect, this rather technocratic assumption has proved to be rather naïve in practice. Whilst the IMF itself is an inherently political institution, it seems to have underestimated the inherent political problems associated with building an effective regulatory stated needed in the era of financial globalization.

Our analysis of the Turkish case has clearly exposed the limitations of premature opening of the capital account in the presence of acute fiscal disequilibrium and an under-regulated banking sector which, in turn, are a reflection of weak democratic institutions. The Turkish case illustrates some of the dilemmas that IMF-style programs face in emerging market settings given the nature of the domestic political environment and the type of incentives that seems to govern the actions of politicians and policymakers in such settings. To be fair to the IMF, a major dilemma could be identified in this context that even the radical critiques of the IMF should be concerned with. The Fund, as the international lender of the last resort, should take into account the interests of both lenders and borrowers. Simply making more resources available without attaching any conditions to undertake reforms will inevitably create moral hazard problems. These, in turn, will reduce incentives to adjust in post-crisis settings.

Ultimately, many of the reforms pushed by the IMF are desirable and countries themselves need to develop an internal political base to enhance the legitimacy of such reforms. At the same, countries in this category like Turkey and Argentina need to develop strategies for long-term growth that extend well beyond the regulatory role for the state envisaged by the IMF. In a sense, the Fund's reform agenda is incomplete in so far as it fails to pay sufficient attention to the developmental and distributional functions of the state and places undue emphasis on the external determinants of economic growth. Hence, individual countries need to develop their capacities well beyond the areas identified by the IMF and pay attention to the domestic determinants of long-term growth. They should also concern themselves explicitly with social and distributional issues, which are of critical importance for building and sustaining a broad-based reform coalition. Whether middle-income countries that lie in between the extremes of authoritarianism and established democracies will exhibit the capacity to transform their domestic institutions to be able to capitalize on the benefits of globalization presents a major challenge in the current historical juncture.

Finally at a deeper level, a question that is inevitably raised is whether individual countries can develop the type of domestic capacities required in the absence of IMF interference. Stated somewhat differently, the Fund fails to provide a continuous external anchor for the development of appropriate regulatory institutions given the central dilemma emphasized earlier, namely, the ability of the Fund to intervene effectively in the reform process only in times of crises. Indeed, there is a serious possibility that sporadic intervention by the Fund may aggravate the situation as the Fund's financial assistance provides temporary relief to the ruling political elite whose underlying interests are likely to be jeopardized by the reform process, consequently undermining the power of the domestic pro-reform coalition. One should consider as a serious possibility, at least in predominantly democratic settings, that countries might, through their internal evolution process, successfully reform their economies in the absence of IMF involvement. Even though the pace of internal evolution process might be slow in the initial stages, the process is likely to gain significant momentum over time.

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