Chapter 3

THE POWER TO PERSUADE

The mission of the IMF and World Bank is not just to produce and propose ideas but to persuade borrowing countries to implement them. On the face of it, this may seem easy. The IMF and the World Bank are powerful and coercive instruments of the international community and bastions of a dominant way of thinking about economic policy and the global economy—or so they are perceived across developing, emerging, and transition economies. Wealthy countries dominate the board of each agency and have arrogated to themselves the right to choose the head of each organization. Furthermore, when the institutions lend, their wealthiest members can bolster conditionality by bringing to bear considerable political pressure of their own.

Yet the IMF and World Bank do not always succeed in their mission. As staff within each agency put it, "politics" too often gets in the way. To succeed the IMF and World Bank must find willing and able interlocutors in borrowing governments. In the 1980s the prospects looked hopeful. A wave of market-opening economic reforms in a host of borrowing countries brought to power technocrats and like-minded policymakers from Latin America across to parts of sub-Saharan Africa. On one view this wave was due to a shift in consensus about economic policy, which the IMF and the World Bank helped to disseminate across the developing world. This chapter examines this and how subsequently the institutions have sought to transmit ideas and how their work is affected by the configuration of politics within borrowing countries.

Fostering a Global Consensus

In the 1980s many Latin American countries embraced the market-oriented reforms of the Washington consensus. The explanation for the regionwide transformation was simple, or at least appears to be. Economically literate technocrats

came to power and implemented a new kind of economic policy. These technocrats, mostly trained in the United States, embraced the new economic consensus and networked with one another, sharing advice and information. Former participating policymakers who shared "similar educations and beliefs in neoliberal solutions to key economic problems," attended the same conferences, subscribed to the same journals, and exchanged views in the same publications describe always feeling only "a telephone call away from each other" (Interviews: Naím 1995, Aspe 1995, and see also Williamson 1994). Their ascendancy in turn created openings for the IMF and World Bank to give advice and further disseminate the new economic policies. The result was a tide of economic liberalization in the 1980s (Dominguez 1997, Naim 1993, Nelson et al. 1994, Kahler 1992a).

Sociologists of ideas look to economics to explain the rise of the new consensus. Some write of a transformation of the discipline into a highly internationalized discipline, dominated and defined by an emerging class of "global experts" with "highly internationalized training (usually American)" who "claim to possess a universally applicable variety of expertise" (Babb 2001, 12). Subsequently the values and norms of the new economics were diffused by institutions, producing normative changes (Meyer and Rowan 1977) as well as changes in preferences and routines (Hoffman 1989, DiMaggio and Powell 1991). Governments became persuaded through dissemination, performance monitoring, seminars, publications, and the like (Kraatz 1998) and through a range of transmission mechanisms that has been elaborated by scholars of policy convergence, policy diffusion, and policy transfer (Dolowitz and Marsh 2000, Stone 2000). The result was a transformation ostensibly driven by beliefs and disciplinary training.

In Argentina, for example, Harvard-trained finance minister Domingo Cavallo brought about a "homogenization of economic thinking in Argentina," providing "the bridge that brought to Argentina the 1980s international consensus in favor of economic liberalization" (Corrales in Dominguez and McCann 1996, 51). Prior to Cavallo, Argentina had been divided between the advocates of statism (the stronger and more vocal majority) and those of free markets (a weaker and less self-persuaded minority). Yet in 1996, it was said that "today a consensus exists in Argentina, even among the left, that Cavallo's harsher version of economics—free convertibility, free trade, privatized public services, simplified tax systems, fiscal austerity—ought to be indelible features of the new Argentina" (Corrales in Dominguez and McCann 1996, 51).

In Argentina Cavallo's consensus did not persist. Within four years the bridge described by Corrales had collapsed. Argentinians of widely different political views converged in an anti-IMF and antineoliberal view of economic policy in the wake of that country's financial crisis. However, the rise of individuals imbued with a vision of economic reform that converged with that of the IMF and the World Bank had been crucial to the successes of the institutions not just in Argentina but elsewhere. So what role had the international financial institutions played?

Both the IMF and World Bank had facilitated negotiations between debtor

countries and their creditors. When governments enter international negotiations they open themselves up to new ideas, creating incentives for their own bureaucracies to prepare and advance ideas on an issue, often requiring their own officials to hire new experts or access new intellectual technologies. During negotiations governments learn not only from one another, but equally from their own adapting bureaucracies. The results often change their preferences (Putnam and Bayne 1987, Putnam 1988, Evans et al. 1993).

If we consider the case of Argentina, we can see how this process might work. Negotiations with foreign creditors and the IMF began in earnest in the early 1980s. Successive finance ministers had to fashion accords with both private and public international creditors. These finance officials soon came to know their counterparts in other countries across Latin America and worked intimately with interlocutors in international agencies. Negotiations were closely focused around the issues of external financing and debt rescheduling. The conditions seemed ripe for the kind of learning and international influence on which scholars of international relations focus.

Policies requiring technical expertise are the most likely to induce the "learning" effects of international cooperation. This is because "the diffusion of new ideas and information can lead to a new pattern of behaviour and prove to be an important determinant of international policy coordination" (Haas 1992). Where governments face uncertainty in international policy, they turn to networks of professionals with recognized expertise and competence in a particular domain. These networks soon form "epistemic communities" whereby professionals brought in to frame policy share normative and causal beliefs as well as notions of validity and a common policy enterprise (Adler and Haas 1992). The "epistemic community" not only informs international agreements, but shapes agreements in ways that entrench the positions of experts at the national level, leading to international cooperation and convergence which would not otherwise occur.

Underpinning the transmission of ideas are facilitating institutional arrangements. For a policy to succeed it will need to be taken up and pushed by an appropriate institution within government (Haas 1990, 1992). Indeed, international development agencies have long been aware of this. In the 1950s, the World Bank encouraged the creation of planning agencies, energy authorities, and the like within national governments that would be insulated from domestic pressures and responsive to bank preferences (Krasner 1999, 147). In the 1960s, the Inter-American Development Bank and the UN Economic Commission for Latin America gave technical support that bolstered the position of planning agencies and central statistics offices (Sikkink 1991, Tussie 1995). In the 1970s ideas about state-centered development "fit" very naturally in planning ministries (Sikkink 1991, Finnemore and Sikkink 1999, 268).

In the 1980s, the World Bank's desire to push trade liberalization did not find a home within trade ministries that derived power and revenue from tariffs and import duties. It was through other agencies with no stake in the protectionist regime that the World Bank pushed liberalization. For example, in Mexico the Central Bank supported trade liberalization, believing that trade liberalization

might assist in the control of inflation, not to mention in the control of the trade ministry (Heredia 1987).

The "epistemic" role of the IMF and World Bank is reinforced by the fact that they often step into crisis situations in which governments are uncertain. Armed with technical knowledge, the institutions foster the emergence of "technocrats" who understand and are sympathetic to their reform agenda. The practicalities of debt rescheduling and negotiations with the Bank and Fund constrain negotiations to a small, relatively insulated group. The result is to give specific policymakers and agencies considerable leverage. Hence the IMF and World Bank can bolster the position of policymakers who wish to undertake unpopular policies (Drazen 2001, Vreeland 2000, Ramcharan 2002, and see the older literature Putnam 1988, 457; Spaventa 1983, Remmer 1986, Edwards and Santella 1993, Vaubel 1986, and Dixit 1996). In Argentina, Cavallo's special relationship with the Fund and Bank gave him leverage over other agencies within the Argentine government, making him gatekeeper of the country's access to loans as well as to the ongoing support of the institutions, which was influential in persuading private capital markets to keep investing.

Behind the story of an emerging "epistemic community" lie political processes within countries that are equally if not more important. Economic reform during the 1980s was hugely contested in all countries and no less so in Argentina—as reflected in the vast literature on the politics of structural adjustment during the 1980s (Haggard and Kaufman 1989, Nelson et al. 1994, Remmer 1986). In other countries technocrats sometimes did not succeed in implementing neoliberal policies. Occasionally even in the absence of technocrats, neoliberal policies were put in place. In Argentina, a new democratically elected government took power from the military in 1983 and embraced a new and heterodox set of economic policies, which led it into confrontation with its creditors by the end of 1984 (Bouzas and Keifman 1985). Subsequently, as Robert Kaufman has analyzed, Argentina's policies were shaped by domestic politics and by economists with a different view of the IMF's then-orthodoxy (Kaufman 1990).

Far from snuggling into a new epistemic community, Argentinian policymakers attempted throughout the 1980s to play off the various actors within the community, variously invoking the U.S. Treasury and the World Bank in bids to persuade the IMF to soften its line. This alters the "epistemic community" view of why Argentina and other countries changed their economic policies, and it suggests two important caveats in respect to the relationship between "technical knowledge" and policy-making.

First, beneath every consensus lie many disagreements. In practice, technocrats often disagree about values, priorities, and even economic theories (Kapstein 1992). This is understated in the epistemic communities literature. Furthermore, even where experts or technocrats agree, the consensus among experts will not necessarily drive policy. John Ikenberry's account of the role of experts in the creation of the IMF and World Bank shows that the result was not driven by a pre-

existing expert consensus. Rather, what became a consensus was forged in response to policymakers' exigencies and questions. Politics drove the technocrats, and not vice versa (Ikenberry 1992). As evidenced in the previous chapter, the mission of the Fund and Bank is not informed by pure theory and empirical evidence. Institutional pressures and political factors also contribute to defining the mission of each institution. When they try to "sell" the result to borrowing countries, it is likely that even borrowers sympathetic to the underlying world view of the Fund and Bank will reject at least some elements of their prescriptions.

More profoundly, technical ideas shape politics only where they resonate with the political needs of the moment and provide opportunities to bridge old political divisions and build new coalitions (as elegantly put by Ikenberry 1992, 293). Ideas prevail not because they are the "best" ideas in a technical or professional sense but because they best meet the social, organizational, and political needs of key actors (Lakatos, and Musgrave 1970; Deane 1978; Blaug 1987). In the 1980s the Washington consensus offered a simple, intuitively appealing set of ideas and a vision of future competitiveness and wealth. In many ways this mindset fulfilled the role of an ideology in attributing blame and letting off steam, creating morale and optimism about the future, engendering solidarity or a particular identity, and permitting advocacy (Geertz 1964). Blame for the debt crisis and its aftermath was attributed to poor policy-making in developing countries. The future would be bright with the short-term pain of adjustment and reform leading to high growth and renewed access to capital markets. Old nationalist identities and solidarity were replaced with a new identity of entrepreneurialism, modernization, and integration into the world economy. Specific economic goals were prioritized and policies advocated. Neoliberal ideas offered not just a clear way to respond to a crisis but a whole new social language and rationale for reform (Woods 1995).

Like all politics, economic policy is the art of the possible. The IMF and World Bank operate in a marketplace not just of ideas but of politics and social forces. They supply ideas and prescriptions based (to some degree) on their technical analysis. They know that actual policies will be shaped by practical exigencies. Borrowing governments, for their part, will formulate policies in response to political, social, and institutional pressures, paying some heed to what Fund and Bank experts diagnose as the problem and propose as workable solutions.

In the 1980s the debt crisis discredited the more statist economic policies that preceded the Washington consensus and reconfigured social forces and priorities within debt-ridden countries. Thrown into crisis, policymakers in developing countries grappled for new solutions. In this context the prescriptions forged by the IMF and World Bank had attractions of their own. They offered governments a new paradigm that fitted policy into existing resources and promised a future of economic growth and recovery. The Washington consensus had the backing of institutions renowned for their technical expertise and resources. That said, it was also backed by significant bargaining power and leverage on the side of the international agencies.

Bargaining Power and Requiring Governments to Reform

The IMF and World Bank enjoy considerable bargaining power in their relations with borrowing governments. Countries mostly approach the institutions when they have little access to alternative sources of finance.[1] Bank and Fund loans are less attractive than private sector loans because they have many strings attached, including both formal conditionality and informal pressures and influences over the design, implementation, and procurement within programs and projects. For this reason governments heading into difficulty are often reluctant to approach the institutions—indeed, recall that in 1997 South Korea was determined not to approach the IMF. Only under strong U.S. pressure did South Korea eventually agreed to meet with the IMF's most senior officials dispatched to Seoul at the eleventh hour (Blustein 2001).

Once a country approaches the Bank or the Fund, it opens up a number of opportunities for the institutions and their most powerful government members to wield influence through penalties, conditionality, and advice. The institutions can refuse to lend to the country, thereby depriving a country of the emergency resources sought. Furthermore, when the institutions turn down a request for assistance, their action carries a second kind of penalty. Their refusal to lend will be interpreted by many other investors as an unwillingness to certify that a country's economic policies and prospects are sound. This can send a strong message to the markets and other potential lenders. Indeed, some countries will seek a positive certification even in the absence of a loan in the hope that this will help to catalyze funds from elsewhere.

When a loan is made to a country it is accompanied by conditionality. In practice, this involves some formal and some less formal requirements. In the World Bank rigorous requirements have always been complemented by looser, less formal agreements to undertake particular actions. Even three decades ago, as World Bank historians Mason and Asher detail, the Bank would complement detailed explicit conditionality with "supplementary letters" setting out the Bank's expectations with respect to borrowing government agencies on matters less formal than those covered in covenants, as well as "oral understandings concerning reciprocal obligations of lender and borrower" (Mason and Asher 1973, 420).

In the IMF conditionality is described across a spectrum from "hard" to "soft." Hard conditionality describes measures a country must meet in order to access any money. Typically this involves "prior actions" and "performance criteria," which are specified in the formal agreement. These can be waived where minor deviations from agreed targets are considered to be of a temporary or reversible nature. Soft conditionality refers to a wide range of other elements that the Fund will take into account in deciding whether or not to "complete" the reviews that are necessary to permit the disbursement of each portion of the loan.

[1] Normally this means they do not have adequate foreign reserves (Bird 1996). Economists debate the extent to which countries turn to the IMF because their balance of payments deficit increases (cf Santaella 1996, Goldstein and Montiel 1986 vs Knight and Santaella 1997, Conway 1994, Edwards and Santaella 1993).

Such soft conditionality includes things such as structural benchmarks, indicative triggers, and general undertakings in the country's letter of intent (Independent Evaluation Office 2002).

In formulating conditionality, the institutions' resources and "expertise" can be overwhelming. The technical weight of the analyses of the Fund and Bank staff put critics at a distinct disadvantage. In the words of one study, domestic actors simply cannot compete with the expertise and sophistication (or the "weight" and "depth") of the international financial institutions' technical work: "One interesting feature of the power dispute with the international agencies is the use of technical competence and research as a strategy to negotiate policy with the local administration and the intelligentsia. The imposition of technical criteria and the heavy emphasis on detailed and quantitative research about the problems at hand put local administrators at a great disadvantage" (Castro and Alfthan 1996, 18). In many cases, local officials wishing to present alternative policy recommendations have great difficulty matching the kind of technical work the Fund and Bank prepare. Proposing an alternative involves a long and arduous process of preparation to meet the Fund and Bank technicians head on.

Once agreed, conditionality is monitored by the IMF and the World Bank who have formal powers to apply sanctions if necessary on countries borrowing from them. If a country falls behind in implementing its agreed program or project, the institutions can suspend or cancel disbursements of loans (disbursements are made contingent on evidence that conditions being met). More serious sanctions can be imposed on a country if it falls behind in its repayments to the institutions. In the IMF this is covered by its arrears policy and in the World Bank by the nonaccrual policy. Further to this, until the late 1980s, the institutions would withhold funding from countries if they fell behind on their wider repayments obligations to the private sector.

The powers of the IMF and World Bank to require governments to reform are significant. They do not lend large proportions of global development financing but the timing of their loans gives them considerable leverage because they lend at times when governments have few alternative sources of finance. In spite of this advantage, it is easy to overstate their power and influence.

The imprimatur of the institutions is always cited by policymakers and commentators as an important signal to private investors, although in fact the evidence of the catalytic effect of IMF agreements is ambiguous at best (Mody and Saravia 2003, Cottarelli and Giannini 2002, Mosley 2000).

Conditionality is nowhere near as effective as either institution would like. They certainly can and do require a range of conditionalities from governments. But available evidence suggests that, for a number of reasons, they are seldom successful in imposing this (Killick 2002).

Where a country has strong support from a powerful shareholder within the IMF and World Bank, this can influence the package of policies the Fund and Bank are able to extract from a borrower. A government-in-need may be less compelled to agree if, as in the case of Russia, major shareholders on the boards of the Bank and Fund are prepared to exert informal pressure to ensure more

"understanding" agreements and conditions. In other words, when the economic and security interests of large powers are at stake, the Fund and Bank staff may find themselves on a leash. Similarly, when a country's crisis poses a threat to the international financial system, its government may find that it has more leeway since the institutions are under equal pressure to find a speedy solution—the usual package may be modified.

Access to information about their borrowers is vital for the IMF and World Bank, for on this depends their capacity to structure and offer loans as well as monitor conditionality. Yet each institution has to negotiate how much access they are granted to crucial information, policy debates, and decision-makers. A government wishing to hinder or limit the role of either international institution can simply close off access, albeit in many cases at obvious costs to its relations with the Fund and Bank staff. For example, prior to 1983 the World Bank was constantly frustrated by the Mexican government, who denied it access to crucial sectors of the economy. In the months leading up to Mexico's debt crisis in 1982, the World Bank (who had considerable exposure to Mexico) had virtually no information at all on Mexico's external public debt situation (Interviews: Knox 1995, Husein 1995, Binswagen 1995). Apparently the government claimed that statistics were held up due to computer difficulties. Without access, however, it was difficult for the Bank or the Fund to do its job and sensibly advise on areas of key economic policy.

In a more subtle way the nature of access to information can facilitate the mission of the IMF and World Bank. For a long time both sides could negotiate almost entirely in secret (now all countries are under pressure to permit the IMF and World Bank to disclose the content of agreements). The result was to forge a particularly narrow relationship between the Bank and Fund staff and very senior officials in specific economic agencies (typically finance ministries and central banks), cemented by each side's privileged access to information. The Fund and Bank would gain access through special relations with officials who in turn would benefit from the fact that they were the only policymakers with full information about the negotiations and positions of the Bank and Fund staff. This gave them a special gatekeeping role vis-à-vis the rest of government, empowering the individuals and the agencies with whom the Fund and Bank deal most directly.

The Fund and Bank have significant bargaining leverage in the face of crises, which force governments to supplicate for assistance. But this does not give either institution the power to impose a Washington-prescribed medicine. Rather, their mission has to begin by seeking out sympathetic policymakers or persuading existing leaders that specified reforms should be undertaken.

Finding Sympathetic Interlocutors

Where the Fund and Bank staff share technical expertise, methodology, and an orthodox economist's understanding of problems and solutions with officials in a borrowing country, their capacity to transmit (or reinforce) ideas is heightened.

As analyzed in chapter 2, a particular professional mindset dominates the work of the IMF and the World Bank. Where they encounter officials who share that same mindset as a way of managing political and economic problems, the task of persuasion is a joint effort in which the Fund and Bank staff team up with sympathetic local decision-makers to persuade others.

Two cases that reach back into the 1960s and 1970s highlight the ways in which the international institutions and foreign donors have relied on relations with particular officials with whom they can forge jointly agreed projects or policies. The cases indicate that it is not just a question of finding individual policymakers. Equally critical are the structures of government within which those individuals work and the bureaucratic and political incentives they face. The first case is that of India where the country's considerable national economic policymaking capacity and active sense of sovereignty and independence have for a long time forced the IMF and World Bank very actively to seek out and work with sympathetic interlocutors.

In the early 1960s the U.S. administration worked very closely with the World Bank setting up what became the Aid India Consortium. Further close cooperation resulted in sending two expert missions to India to examine its economic policies: the "three wise men" led by Oliver Frank in 1960 and the Bell Mission of the mid 1960s. The latter resulted in significant pressure on Indian policymakers to reform agriculture, liberalize industrial and trade controls, and devalue the rupee. India had a deteriorating balance of payments driven by two successive monsoon failures and two wars—with China in 1962 and with Pakistan in 1965. The result was an increase in the economy's dependence on foreign aid and loans (Joshi and Little 1994, 49).

The IMF, the World Bank, and the United States collectively used promises of external assistance to induce India to devalue and rationalize its tariffs and export subsidies. There was little domestic support for the devaluation (Joshi and Little 1994, 49). Subsequently, its perceived negative impact was blamed on World Bank pressure (Frankel 1978, Thapar 1991, Lewis 1997). The IMF would much later reflect that the result was "political backlash which gave reform a bad name and resulted in a fifteen year period before reforms could be tried again" (Krueger 2003). In fact reforms were attempted in concert with the IMF some nine years later in India.

Our concern here is with the conditions under which the World Bank team was originally able to persuade the government to reform. Retrospectives of the World Bank's work in India during the 1960s focus closely on the able, sympathetic, and technically competent interlocutors within the Indian government (Lewis 1997; Kapur et al. 1997, 293–98, 463–67). These interlocutors fostered a sense of success and ongoing commitment in the Bank and likewise in the Fund and the U.S. administration. The architect of the agricultural policy reforms so desired by the World Bank in India was C. Subramaniam, food and agriculture minister from 1964 to 1966. His beliefs about Indian agriculture have been traced by Ashutosh Varshney who depicts their culmination in an agrarian model that complemented the World Bank's thinking about these issues (Varshney 1989).

Equally important to the uptake of the World Bank's model was the bureau-

cracy and the way in which Subramaniam's institutional base—the prime minister's Secretariat—rose while the hitherto dominant Planning Commission was tamed (Varshney 1989). Subramaniam was able to attract critical elements of party support and finance for his reforms, and to build up a base of sympathetic colleagues. It was with this group that the World Bank worked so successfully.

Once a relationship with key policymakers had been established, outside agencies could use that relationship discreetly to find ways to smooth over problems. From an official perspective, USAID official John Lewis details the way the United States and World Bank turned to Subramaniam in 1965 in order to break an aid log-jam. Confidential negotiations that included President Johnson resulted in a secret treaty in which the Indian minister agreed to undertake specific policy commitments—over the objections of his colleagues—in return for an unlocking of U.S. aid (Lewis 1997, 113).

Finding the right interlocutors in the Indian case did not mean that the Bank, or any other external agencies, enjoyed plain sailing with India. In dealing with their Indian interlocutors, Bank staff seemed to have oscillated between respect and frustration. Indeed, in their 1973 history of the Bank, Mason and Asher wrote that by the end of the 1960s "what had previously been viewed as technical excellence in India was characterized as doctrinaire arrogance" (Mason and Asher 1973, 683).

In the early 1970s a radical-populism defined India's economic policies as Mrs. Gandhi surrounded herself with radicals in the wake of winning a heady unconditional surrender from Pakistan when that country attacked India by air in December 1971. But the radical-populism was short-lived. Mismanagement of food supplies and the oil price shocks of 1973 and 1974 contributed to political and economic disarray that drove Mrs. Gandhi to alter course.

In 1974 Mrs. Gandhi gathered around her an interministerial task force of senior bureaucrats to devise an anti-inflationary policy. These technocrats introduced tax and monetary measures that brought inflation under control and successfully devalued by stealth, manipulating the currency basket to which the rupee was fixed (Joshi and Little 1994, 54–56). One result of the new policies was to reforge relations with the IMF and World Bank. In 1972–73 India received no credit from the IMF and net multilateral loans of US$473 million. In 1974–75 India accessed US$522 million from the IMF and US$961 million in multilateral loans, which rose to US$1.29 billion in the following year (Joshi and Little 1994, 137).

In India where failure pushed policymakers to seek a new approach in the economy, the World Bank and the IMF gained openings into the policy debate. However, these openings could only be used effectively where sympathetic interlocutors in the Indian government were prepared to work with the international institutions. This meant that the IMF and World Bank had to tailor their advice and aspirations to fit within the domestic Indian economic agenda. They were most influential when policy was made by a small group relatively insulated from the wider political system. A similar set of factors affected relations with Indonesia.

Indonesia offers another case in which the World Bank and the IMF became highly involved during the 1970s. U.S. strategic priorities set the backdrop for their involvement. The extent of the international agencies' work in Indonesia depended on their relations with government officials. As with India, a consortium, initially called the Inter-Governmental Group on Indonesia and later the Consultative Group on Indonesia, was formed to bring together Western donors and lenders to Indonesia. Under that umbrella more specific working partnerships were formed.

Indonesia joined the IMF in 1967 and was required to implement a series of economic reforms orienting the economy toward exports and limiting the country's budget deficit, initiating a period of significant IMF influence over policy (Sutton 1982). Subsequently a very close relationship developed between the staff of the Bank and Fund and their interlocutors in the Indonesian government—a group of young U.S.-trained economists (or "technocrats" as they came to be called) who were brought into government by General Suharto (MacIntyre 1993, Yoon 1991, Soesastro 1989). In 1968 the Bank set up a Resident Mission in Indonesia (the Bank's first ever such arrangement), cementing the close relationship that existed between the Bank and Indonesian counterparts. It then increased its lending rapidly during the 1970s, giving its most senior staff member in Jakarta unprecedented powers to make loans and report directly to the World Bank president (Operations Evaluation Department 1999, Kapur, Lewis and Webb 1997, 467–71). On the Indonesia side, the bureaucrats were important since they wielded a lot of power over economic policy due to the heavily statist, centralized, and clientelistic system that had developed under Suharto (MacIntyre 1989).

The Fund and Bank lost some degree of influence once their technocratic Indonesian interlocutors lost some of their special position and power as the constraints faced by Indonesia changed in the late 1970s. Yet even within the "special relationship" between the government and the World Bank there were drawbacks. As later reported in an official evaluation of the World Bank's relationship with Indonesia: "The special relationship . . . created a situation where the Bank did not succeed in persuading the Government to heed some crucially important, but unwelcome messages to the country, let alone impose unwanted policies, lest the relationship be broken" (Operations Evaluation Department 1999, 16). The same would happen later on in Mexico (see chapter 4).

It is important to recall that the World Bank depends on lending to countries such as Indonesia who can borrow and repay, thus generating both opportunities for the Bank to lend large sums, and net income for the Bank from its lending activities. Added to that, Indonesia's impressive record of economic growth and poverty reduction were seen as adding luster to the Bank's reputation.

Elements of the relations forged with India and Indonesia can be found in the Fund and Bank's work with many other strongly statist countries allied to the West with whom the World Bank and/or the IMF formed close relations during the late 1960s and 1970s: for instance, Turkey, Mexico, Iran (in particular in the late 1970s), and the Philippines. Strong relations were initially developed with a particular group of young technocrats. Economic difficulties enhanced the lever-

age of both the ideas and the resources proffered by the IMF and World Bank. However, once the technocrats lost influence in government, the Bank and Fund lost a degree of leverage and influence. For this reason we need to examine the political institutions within which technocrats either rise or fall.

The Bureaucracy and Institutions of Government

We have seen that the IMF and World Bank are most likely to succeed where economic decision-making is undertaken by the executive or an insulated elite at the top of the government bureaucracy. This does not imply that authoritarian governments are better placed to pursue economic reform than democracies (the debate about this is reviewed by Sirowy and Inkeles 1990, Przeworski and Limongi 1993, Helliwell 1994). Although early studies suggested that authoritarian governments undertake "tough" economic adjustment more readily than democracies (Haggard and Kaufman 1992), subsequent studies contest this (Hellman 1997, Joyce 2004). In the end, the studies of authoritarian versus democratic regimes do not tell us under what conditions economic reform is most likely to be undertaken (Haggard 1986, Remmer 1984, Geddes 1995, Edwards 2003). But core political structures do affect when and where the IMF and World Bank are likely to be most influential.

In some political systems economic policy is made away from the hurly-burly of politics. This gives greater scope for the IMF and World Bank to engage technocratic interlocutors. There are several ways economic policymakers can be insulated from the rest of a political system, permitting them to pursue economic policy in close cooperation with the IMF and World Bank with relatively little constraint. Obviously at times of economic crisis executive authority is expanded (Haggard 2000). Or put in the words of the first deputy managing director of the IMF, a crisis can suspend "politics as usual" and provide a government with "considerable freedom—more than is usual in politics—to undertake reforms"; furthermore, "new governments may enjoy something of an advantage, especially those in democracies that enter office with a mandate for change" (Krueger 2003). Economic policy-making can also be insulated from broader political processes through delegation to specialized agencies such as independent central banks (Cukierman, Webb, and Neyapti 1992; Eijffinger and de Haan 1996), quasi-judicial structures for the management of trade policy issues (Hall and Nelson 1992), and centralized budgetary processes (Alesina and Perotti 1996; Perotti 1997; succinctly described in Haggard 2000, 42).

Where economic policy is mostly made within part of the bureaucracy, we must delve inside the bureaucracy to discover under what conditions the IMF and World Bank are most likely to find or persuade willing interlocutors. For inside government institutions, the impact of particular ideologies or ideas is affected by patterns of recruitment and administration as well as the capacity of institutions to innovate (Evans 1995, Evans et al. 1985, Hall 1986, Steinmo 1989, Adler 1987). The kinds of experts appointed to senior jobs and the qualifications de-

manded and recognized can shape the upper echelons of a government. If recruitment takes place almost exclusively among individuals with a particular type of training or degree, this can easily bias receptivity toward one set of ideas (Haas 1989, Miller-Adams 1997, Ascher 1983, Finnemore 1996).

Equally important are the bureaucratic structures that permit, or hinder, a turnover of staff. In the United States and Mexico, for example, the political appointment of senior civil servants means that each new president brings to office a new staff and potentially a new mindset. Change is thus more likely and more rapid than in the erstwhile UK-style career civil service where new ideas wait behind a long queue of retiring civil servants (Weir 1989 and others in Hall 1989). In the post-Communist world, Steven Fish has shown that "elite turnover" deeply affected the propensity of governments to reform (Fish 1998b).

Bureaucracies powerfully shape the actions of those who work within them. This requires us to pay attention to the norms, values, and processes of any agency tasked with economic policy. March and Olsen remind us that institutions are "collections of standard operating procedures and structures that define and defend values, norms, interests, identities, and beliefs" (March and Olsen 1989, 17). James Q. Wilson, in his empirical study of bureaucratic agencies, reminds us that preexisting attitudes, predispositions, preferences, and peer judgments, combined with the imperatives of the situation, all powerfully shape the responses and actions of bureaucrats (Wilson 1989).

Until recently the IMF and World Bank could work relatively easily with bureaucracies who enjoyed relative independence from the rest of the political system within borrowing countries. Each international institution could exercise some influence over domestic policy struggles by using the timing and quantity of small amounts of rapidly disbursable resources together with conditionality to bolster the position of their favored interlocutors. They could enhance the authority and resources of individual policymakers, privileging some and disempowering others. They were aided in this by the secrecy surrounding negotiations with the Fund and Bank and the fact that only a chosen few were party to negotiations. As required by their Articles of Agreement, they negotiated exclusively with one small group of officials—those at the head of the Ministry of Finance, Ministry of Planning, Central Bank, or the like. As a result, their interlocutors had privileged information and influence within their own political system.

More recently, the nature of relations between the Fund and Bank and borrowing governments has changed. Increasing transparency and publicity has opened the work of the institutions, making the old, more secretive approach difficult to sustain. Furthermore, as the reform agenda has deepened to include far-reaching institutional and social reforms, it has become apparent that a top-down approach does not produce sustained reforms. In the 1980s and early 1990s the "top-down" macroeconomic policies and trade liberalization reforms being urged by the IMF and World Bank did not require "deep" political implementation—a small group of technocrats *could* take these kinds of decisions. However, the deeper "good governance" reforms being urged by the mid 1990s could not be pursued in the same way (Naim 1995, Nelson et al. 1994). Recent thinking in

the Fund and the Bank recognizes the fragility of a reform process that relies on key individuals, suggesting that sustained reform requires a deeper commitment or support from the broader political system and society.

In several cases the mission of the IMF and World Bank has been blocked by the actions of parliaments. For example, in Russia in July 1998, the parliament flatly rejected a number of the tax reforms that were key conditions of an IMF loan that had been approved a day before. As will be discussed in chapter 5, the Russian president then turned to instituting the required reforms by decree. In Argentina in December 2001, after defaulting on $155 billion in foreign debt, the government acceded to IMF demands for monetary adjustments, spending cuts, and politically sensitive reforms to the system of revenue-sharing with the provinces. However, the parliament refused to move on a bill converting savings to bonds and flouted IMF orders by passing bills reforming bankruptcy rules and punishing "economic subversion"—removing money from the cash-strapped economy even though this sank Argentina further into threat of default on its loan payments to the World Bank (Valente 2002). In Turkey in 1998, parliament forced the government to break its promise to the IMF to hold down the wage increases of public sector workers.[2] In 1999 and 2000, the Moldovan parliament repeatedly rejected IMF-mandated privatization of wine, brandy, and tobacco enterprises in a political fight that brought down a government. (Eventually, despite Communist opposition, the privatization took place and the IMF relationship was restored.)[3] The Indonesian government declared in January 2003 that it would break free from its commitments to the IMF; parliamentary pressure, including a decree in October 2002 requiring the government not to extend the current IMF program, was a vital part of this decision.[4]

Both the IMF and the World Bank now adopt the view that they must go beyond ensuring that their counterparts are intellectually convinced about new policies, prepared to initiate reform, and use their political will to implement new policies and build a consensus around them (Johnson and Wasty 1993, Frischtak and Atiyas 1996). Each institution has begun to work with and to consider more systematically a wider range of processes within borrowing countries.

Nonetheless, there has always been an awareness within the IMF and World Bank of the way political institutions affect their role. A comparison of Mexico and Brazil is instructive. The Bank built a closer relationship with key government bureaucracies in Mexico than in Brazil, which had a far more complex political structure, a more open society, and a more prescriptive constitution. As the former director of the Latin American and Caribbean Department of the World Bank put it to me in an interview in 1995, when Bank-friendly technocrats came to power in Mexico, they all too quickly passed through (Husein interview 1995).

Within the political process there are several actors who may have a veto over

[2] "Politics cloud the economic horizon," *Middle East Economic Digest* (7 August 1998): 7.

[3] "Moldovan Government Resigns," *Deutsche Presse-Agentur,* 9 November 1999. "Moldova 'may face default' after parliament rejects privatization," *BBC Worldwide Monitoring,* 18 April 2000.

[4] Smitha Francis, "Indonesia's battle of will with the IMF," Network Ideas, 25 February 2003, http://www.networkideas.org/themes/trade/feb2003/tp25_Indonesia.htm.

economic policy. At the apex of any political system is the executive—the president or prime minister whose authority and strength depends on how much he or she must rely on the support of a political party, coalition, or legislature. The president, cabinet ministers, parliament, parliamentary committees, bureaucracy, and implementing agencies may all need to agree in order for a measure to be adopted and implemented. In theory, the more actors along the way who can veto or block a policy, the more difficult it will be to reform but the easier it will be to maintain stability and credibility (Tsebelis 1995). In practice, outcomes will depend on the respective roles of the executive, parliaments or legislatures, and political parties.

A large number of political parties within a political system will produce "fragmentation." Forging agreement among a large number of parties is difficult and further compounded when the system is strongly polarized, meaning that strong ideological differences drive actors in the system to differentiate themselves as occurred in Russia and in Turkey in the late 1980s (Haggard 2000).

Equally important is how political parties are organized and what incentives politicians face—such as to fall in behind a leader or to focus on individual, narrower interests. Some political systems encourage politicians to seek publicity and popularity for themselves with little need for party backing or support. This makes top-down economic reform difficult. The evidence demonstrates this in respect to "open list" systems where political parties do not control who gets to run for election (Carey and Shugart 1995) and multiple-member constituencies where there are several representatives from each constituency and so politicians have an incentive to appeal to selective parts rather than the electorate as a whole (Cox 1990, Myerson 1994). The structure of campaign financing can magnify these effects. By contrast, in a single-member constituency in a closed-list system, politicians face a much stronger incentive to tow the party line and the result, according to one study, is a greater provision of public goods and less spending on special interests (Edwards 2003).

In sum, political parties and the way they compete for power will affect the kinds of economic policy a government favors. So too will the electoral cycle. Econometric studies tell us that the higher the uncertainty about whether a government will be reelected, the more likely a government is to spend more and to tax less in order to try to buy support for itself (Roubini 1991, Edwards and Tabellini 1991, Annett 2000). Furthermore, a government facing an election is unlikely to initiate a program with the IMF within six months before the election (Bird and Rowlands 2000, Vreeland 1999, Dreher 2002, 2003), and more likely to enter into an agreement with the IMF after the elections are over (Przeworski and Vreeland 2000).

Political institutions heavily influence the leverage of the international financial institutions over policy. The IMF and World Bank have the most scope for influence where policy-making is highly centralized and insulated from the broader political arena. But this has increasingly failed to translate into an ability to ensure implementation. This is because each institution is trying to foster policies that require broader support and implementation by agencies outside the

narrow circle with whom the Fund and Bank negotiate. The result is a difficult trade-off between centralized and insulated policy-making that prioritizes a particular view of economic effectiveness, versus a messier, complex democratic process that is more open and transparent but can result in poor economic policies. Specific cases of this trade-off are further explored in subsequent chapters. Playing into either system are actors outside the political institutions—first and foremost among which are powerful interest groups whose support or rejection of particular measures can often influence policy.

The Role of Interest Groups and the Scope for Policy Capture

The IMF and World Bank have long held the view that they must persuade and garner support not just from governments but also from the private sector and other parts of civil society within countries if their mission is to succeed. Although they must work formally through the government, both the IMF and the World Bank engage and consult with an increasing range of interest groups in borrowing countries. So too they have begun to analyze the impact of policies on such groups through stakeholder analysis, which examines which societal groups will benefit or lose out from reform (World Bank 1996b). But where and how do interest groups shape policy and thereby the influence of the Fund or the Bank?

Governments rely on some degree of support from interest groups to stay in power (Ilchman and Uphoff 1969). These interest groups "enter the political arena in pursuit of their interests, with major effects on political outcomes" (Frieden 1991a, 7). As the incentives for groups and sectors changed—such as in the 1980s in the wake of the debt crisis in Latin America—so too government policies changed to accommodate new powerful interests (Bates 1981, Olson 1982). Put simply, international economic shocks created new opportunities and constraints that altered the agenda of powerful interest groups, empowering some and disempowering others (Frieden 1991b). On this view economic reform will be possible when a crisis or shock reconfigures social interests.

But what role does this suggest that interest groups play—do they set the agenda for politicians or do they exercise a veto over policies forged by politicians? The answer is to be found in political economy research. If interest groups were to set the agenda they would need to be organized in stable coalitions with dynamic sources of ideas that best reflect the interests of members. But this is not borne out by the evidence. Imperfect information means that interest groups simply do not know or are uncertain about the benefits they will enjoy if a particular policy is pursued (Rodrik 1996, Fernandez and Rodrik 1991). Alternatively, interest groups know how they will benefit but are hindered by uncertainty about how the overall benefits are distributed and how their rivals and others will benefit (Drazen and Grilli 1993, Alesina and Drazen 1991).

Imperfect information and uncertainty mean that interest groups tend not to set the agenda. Rather they respond to an agenda set by the government. In Africa, for example, Robert Bates depicts politicians creating and maintaining

coalitions of interests in order to ensure their political survival (Bates 1981). Sophisticated cross-class coalitions *result* from government policies. For example, farmers who benefit from seemingly adverse policies by using the market defensively coalesce with urban clienteles including both business and workers created by governments' use of nonmarket instruments. In this analysis, interest group coalitions are fluid and reactive.

The failure of interest groups to set the agenda is also born out in a later study by Bates and a team of researchers examining and comparing eight developing countries. They reported that "one of the most surprising findings of our case studies is the degree to which the intervention of interest groups fails to account for the initiation or lack of initiation of policy reform" (Bates and Krueger 1993, 454). A similar finding is made in a study of Indian agricultural policy (Varshney 1989). Indeed, sometimes interest groups are even unwilling to support policies that favor their interests. In Brazil, Chile, Ecuador, Egypt, Ghana, Korea, Turkey, and Zambia, scholars found that "in the context of comprehensive economic policy reform it is difficult for particular groups to calculate where their interest lie. Ideological struggles therefore can outweigh competition among organized interests as a determinant of policy change" (Bates and Krueger 1993, 456).

The power of interest groups lies in shaping policies within the preferences set out by governments and bureaucrats. Sometimes they even succeed in capturing the process of detailing and implementing policy. For example, Korea's financial liberalization began in earnest in 1991 when the government began to license merchant banks and to lift administrative controls on commercial credit. The result, as described by Stephan Haggard and Jungkun Seo, is "a case-study in how financial reforms can be captured not only in their implementation but in their basic design" (Haggard 2000, 37). The government was captured by the intense lobbying efforts of corporate conglomerates who used kickbacks to bureaucrats and politicians in order to shape both the design and application of policies.

The private sector is a powerful lobby within government, and sometimes this includes the lobbying of foreign direct investors. It is often assumed that increasing foreign direct investment (FDI) will open up an economy and result in lower protectionism (Bhagwati 1987 gives evidence of this). However, more recent studies show that the opposite can occur. For example, when foreign direct investors moved into import-competing sectors in Mexico, those sectors became more highly protected than other import-competing sectors with no FDI (Grether and Marcelo 1999). Industrial groups as a whole were very active in lobbying the government (Kraemer 1995). Foreign director investors were yet more effective in lobbying a government increasingly sensitive to their interests (Grether and Marcelo 1999). Overall, as a trade policy review of Mexico reported in 1993, a very high level of well-organized cooperation and linkage between the government and the private sector pervaded Mexican policy-making through the 1980s and early 1990s (GATT 1993). The real question is what should balance this influence?

In Africa although organized interest groups play virtually no role in setting the economic agenda, this has not prevented subsequent capture by specific in-

terests (Van de Walle 2001). The weakness of government capacity to implement policies and achieve outcomes has resulted in a government apparatus in many countries that has been used to create and extract rent (Mbaka and Paul 1989). Indeed, in some countries politicians are seen as "brokers of wealth transfers between the various interest groups" (Kimenyi and Mbaka 1993). Key to perpetuating such systems is the lack of any checks on governments by societal pressures, parliaments, opposition parties, or a free press (Migdal 1989).

The IMF and World Bank have long recognized private interests as a powerful force in politics. In an interview, a senior Bank official recounted that in Venezuela in the early 1990s the Bank failed adequately to understand rent-seeking and its relationship to particular government institutions. After strongly supporting a reformist government, they soon found that the well-established rent-seekers struck back, collapsing the reforms and revealing deep shortcomings in the Bank's analysis of fundamental policy structures and relationships and the likely impact of change (Husein interview 1995). Subsequently World Bank researchers have begun to flesh out the conditions under which policy becomes "captured" by private sector interests (Hellman 1998, Hellman et al, 2000).

The challenge for the IMF and World Bank is that they are likely to have influence where "rational economic policy" can be formulated away from the hurly burly of politics (Krueger 2003). Yet so too are vested interests, who may capture and distort outcomes for their own benefit. The alternative is economic policy made in a more transparent, openly contested, publicly debated, and democratic way. That process is likely to be messy, complex, and time-consuming, it will often thwart rapid reform, and it will certainly marginalize the role of the IMF and World Bank.

The IMF and World Bank transmit ideas about economic policy to a wide range of countries. Their influence depends not just on the individuals with whom they work but on the configuration of political institutions within borrowing countries. The rise of the Washington consensus in Latin America was facilitated by U.S.-trained technocrats prepared to embrace prescriptions proffered by the IMF and the World Bank. However, this occurred only in the context of an economic crisis that had thrown previous policies into discredit and imposed a new resource constraint on governments. Even then, however, not all governments facing similar circumstances adopted the same policies at the same time—Brazil and Mexico, for example, each responded differently in the 1980s and early 1990s to fiscal constraints.

The IMF and World Bank deploy a mixture of technical advice and coercive power in bargaining with borrowing governments. Each institution can variously lend or withhold resources, disburse or suspend payments, and impose various forms of conditions. Yet the institutions can successfully deploy this power only where they find and work with sympathetic interlocutors.

Sympathetic interlocutors must be both willing and able to embrace the priorities preferred by the institutions. Their willingness is influenced by circumstances and prevailing sets of ideas. For example, the debt crisis not only

discredited some existing ideas about economic policy but also demolished the resources necessary to implement them. In that context, new policies were actively sought and taken up by indebted governments. The Washington consensus offered one solution. Its persuasiveness was doubtless bolstered by the resources and expertise thrown behind it by the IMF and World Bank, as well as its roots in prevailing economic theories of the time in which many finance officials had been trained. But even then, the Washington consensus was implemented only under particular political conditions.

The ability of interlocutors to implement reforms is shaped by the configuration of political institutions, or "governance" within countries. Where economic policy is centralized and relatively insulated from other political pressures, the potential influence of the IMF and World Bank is high, particularly in bureaucracies with high turnover and adaptive capacity. Nonetheless, such systems are often characterized by only the narrowest form of accountability. Where economic policy is subject to a broader set of processes, party politics and electoral cycles will have a strong influence. The results will be messier and less easily controlled—albeit more open, and more transparent. In more open systems, the capacity of the government to change policy will depend on the number of "veto players" in the policy process.

Among potential veto players in economic policy, interest groups play a rather specific role. They do not set the agenda. Rather they respond to priorities set by the government. Despite their reactive nature, interest groups can capture the process of policy implementation, thereby altering the outcomes of economic policy. Their capacity to do this is greatest in systems that are not transparent and where formal systems of accountability do not function. These effects are illustrated in the next chapters.