The International and Domestic Politics of IMF Programs

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1. Introduction

How do politics influence International Monetary Fund (IMF or Fund) programs of economic reform? IMF programs consist of a loan of foreign currency and policy conditions attached to the loan. The policy conditions are intended to correct the economic problems that led the country to the Fund in the first place and thus should be guided purely by technocratic considerations. Yet, politics at the international and domestic levels influence who participates in IMF programs and why.

The purpose of this paper is to review the international and domestic politics of IMF programs. On the international front, scholars have addressed how powerful international actors, mainly the United States, use the IMF to reward their friends and punish their enemies. On the domestic front, scholars have focused on how recipient governments use IMF conditionality to push unpopular policies past domestic opposition. Both the international and the domestic literatures have been developed in recent years, but the two have not been studied together to see what they imply for one another and for IMF conditionality.

The domestic politics story requires that the Fund be willing to punish a country for failing to comply with imposed conditions. If the Fund cannot commit to punishing noncompliance, then the government does not gain any leverage over the opposition to policy change. Yet, if the IMF is used as a tool of US foreign policy, where IMF loans are extended to US allies, punishment for noncompliance is not credible. If *all* IMF programs were with US allies, there would be no reason to expect the domestic politics story of IMF programs to hold. But not all programs are with US allies, and governments who are not particularly favored by the US face severe punishments for noncompliance. When private financial institutions are involved, the IMF has even stronger incentives to enforce conditionality. Thus, the domestic politics story of IMF participation may hold, but only for countries where the threat of potential IMF punishment is credible. In this way, the international literature informs the domestic literature that IMF programs can be used to push through unpopular policies only in certain situations – where the US has not taken an interest in protecting the country. The domestic literature informs the international literature, on the other hand, that not all countries seek out IMF assistance just for the loan – sometimes governments want specific conditions to be imposed.

The paper is organized as follows. Section 2 addresses the international politics question: Who controls the IMF? Section 3 reviews the domestic politics arguments of IMF participation. Section 4 tests the two stories together. Section 5 considers what these two literatures together have to say about the usefulness of IMF conditionality. Because of the influence of politics on the two different levels, conditionality is useful only in very specific situations, and may be ineffective or even harmful in others. I conclude by suggesting that perhaps the IMF should do away with conditionality.

2. Who controls the IMF?

A country's influence at the IMF is supposed to be pegged to the country's economic size. But officials claim that voting is rare at the Fund. Rather, the Fund operates by consensus. Many believe this "consensus" is dominated by the United States. New evidence suggests that non-governmental actors, such as international financiers, also have an important voice in the shaping of IMF programs. To the extent that international actors use the IMF to further their own ends, the Fund may be compromised as a technocratic institution. Before considering these perspectives, however, consider the bureaucratic view of the IMF – that the IMF is hardly controlled by its principles and simply pursues goals to maximize its resources.

A Power Unto Itself?

The IMF can be thought of as a series of principal-agent relationships. Roland Vaubel (1986, 1991, 1996) has made the case that the principal-agent problems at the IMF are so severe that there is very little accountability at the IMF. The objectives of the IMF staff, he contends, are the same as those in any bureaucracy: "international bureaucracies…try to maximize their power in terms of budget size, staff and freedom of discretion and appreciate some leisure on the job" (1986: 52).[1] Because principal-agent problems are severe, the IMF can pursue these goals quite effectively.

To the extent that the IMF is unaccountable, IMF programs may simply exist to pad the IMF budget. The staff has an interest in extending loans, but not in enforcing conditions. Indeed, Vaubel contends that the reason the IMF kept (until recently) the details of program conditions secret is that this made it more difficult to know if the IMF was enforcing conditions. Thomas Willett (2001) agrees with Vaubel that, like any bureaucracy, the IMF has incentives to shirk some of its duties. Yet, he proposes a "soft-core" approach, where the bureaucratic motivations of maximizing budgets are acknowledged, but mechanisms of accountability are recognized as well. Principal-agent problems may damage accountability, but they do not appear to destroy it, as the following sections show.

The Influence of the United States

Protestors against the IMF are often surprised to learn that the United States only controls about 17 percent of the votes at the IMF. This gives the US veto power over certain important decisions that require an 85 percent majority, but it is a far cry from majority control of the Fund. The IMF, however, does not operate according to strict voting rules. Votes are rarely taken. Rather, the Managing Director, who usually chairs the Executive Board meetings, takes action according to the "sense of the meeting." This may open the door for a member of the Executive Board who represents small countries

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[1] Babb (2004) makes a related argument about the IMF, drawing on the arguments of Michels (1959 [1915]). Niskanen (1971) makes this argument about bureaucracies in general.

to influence the meeting with a carefully turned phrase, but it also means that opposition to the US by smaller countries cannot be expressed through block voting but must be voiced individually. Moreover, the Managing Director has been reported to rarely act against the will of the US, perhaps as is fitting, since the US has veto power over his appointment (Lichtensztejn and Baer 1987, cited in Thacker 1999).

Scholars have therefore proposed that the US has the power to use the IMF for political objectives. There are many anecdotes, but when dealing with only one observation at a time, it is difficult to sort out economic explanations from political explanations. Strom Thacker (1999) undertook the first systematic study of a large body of evidence on the question of US influence at the IMF. To test whether the US uses the IMF as a tool of foreign policy, he considered voting patterns at the United Nations as a determinant of IMF programs. Thacker found that countries that voted along similar lines as the US were more likely to receive an IMF program than countries that did not. More specifically, countries that *changed* their voting patterns so that they became more similar to the US preferences were more likely to get an IMF conditioned loan, and countries that changed their voting against the US were less likely to get a loan.

At first blush, it may seem strange to consider voting at the United Nations as meaningful – many votes are symbolic and most are not of great importance to the US. But Thacker was careful to include in his study only those votes that the US State Department had identified as "key votes." These were votes that the US state department had announced that it did care about.

By using statistical analysis of the experience of 87 countries (for a total of over 700 yearly observations), Thacker was able to control for other factors that determine IMF participation. He did find evidence that economic factors play an important role. But moving closer to the US in terms of voting on key issues at the United Nations plays a significant role as well. His variable is a straightforward measure: the change from one year to the next in the correlation between a developing country's the UN voting record and the US voting record on votes identified by the US State Department as "key" – where the US exerted explicit pressure on how to vote. The variable predicts IMF participation well, even after one controls for economic variables predicting participation. (I will employ this variable below in Section 5.) Thacker concludes that the US uses IMF loans to reward countries that move towards it and punish those that move away.

Since Thacker's systematic study of US political influence over the IMF, others have explored other ways of measuring and testing US influence. For example, Randall Stone (2002) has looked at the connection between US foreign aid and IMF punishment for non-compliance with the conditions attached to IMF loans. Stone considers the amount of foreign aid that a country receives from the US to be a proxy for how important the country is to the US. If the US can use the IMF to pursue its political objectives, countries that receive favorable amounts of US foreign aid are also likely to receive favorable treatment by the IMF.

Stone has undertaken two studies considering the effect of US foreign aid on IMF program punishment intervals – one on the Post-Communist countries of Eastern Europe (2002) and one on Africa (forthcoming). Both studies confirm his hypothesis: the more US foreign aid a country receives, the shorter the duration of punishment for IMF programs that fall into non-compliance. In addition to the statistical studies, which include data from many countries from Eastern Europe and Africa, Stone also presents detailed case studies. For example, he shows that Russia, a country that was considered to be of great strategic importance to the US after the fall of Communism, received much lighter punishments for non-compliance than Poland, which was considered to be of less importance to the US. Stone concludes, "Although the United States holds a minority of votes, it does indeed call the shots at the IMF, as critics allege" (2002: 62).

Note that, in addition to the political motivations, the US may also influence the IMF to protect financial interests. Consider the findings of two unpublished studies by Thomas Oatley and Jason Yackee (2000) and Lawrence Broz and Michael Hawes (2004). Oatley and Yackee show that the amount of US bank exposure in a developing country is a determinant of the size of the IMF loans the country received. Broz and Hawes find that the total amount of US lending as a proportion of a developing country's GDP is a significant predictor of both the IMF agreement and the size of the IMF loan. They take this as evidence of the influence of US banks operating through US political channels. This point of view is different from the arguments of Thacker and Stone. Rather than argue that the US uses the IMF to reward friends, Broz and Hawes, as well as Oatley and Yackee, argue that the US uses the IMF to protect US financial interests. This is a crucial difference with respect to conditionality because, when financial interests motivate the US, there may be an incentive to see policy conditions enforced.

The Independent Effect of International Financiers

Do private financial institutions have any direct impact on the IMF? Erica Gould (2003) argues that they do. Gould observes that the size of an IMF loan is often not sufficient for a country in economic crisis to balance its payments. Supplemental financing from various sources is thus commonplace. Gould identifies types of supplemental financiers: creditor states, private financial institutions, and multilateral organizations. These actors are willing to assist the IMF in bailing out developing countries because they rely on the IMF to monitor and enforce the economic conditions to improve countries' balance of payments situations, which in turn facilitates their own financial transactions and makes loan repayment more likely. Yet, since supplemental financing is vital for the success of an IMF program, these actors are in a strong position to make demands on the Fund about the design of the program itself. In particular, they have an interest in specifying the conditions that are attached to an IMF loan.

Powerful states and multilateral organizations may lend for political reasons, Gould argues. Indeed, as was explained above, the US may use the IMF to reward its friends and punish its enemies. If an IMF program is to be a reward, creditor states may push the IMF to have less stringent conditions or not enforce conditions strictly.

Private financial institutions, however, lend for profit, not for aid. Not only would these supplemental financiers seek stringent conditions: they may push for what Gould calls "bank-friendly" conditions – conditions that require the program country to repay commercial bank creditors.[2] Thus, by acting as a supplemental financier, private financial institutions can use the enforcement power of the IMF to have the loans they extend to a country repaid.

Gould tests her hypotheses using data on over 200 conditioned IMF arrangements in 20 countries from 1952 to 1995. Her statistical analysis reveals that if private financial institutions agree to debt restructuring with a country, the IMF is more likely to include a bank-friendly condition in the IMF program. The amount of lending and grants a country receives from the US, on the other hand, is negatively associated with bank-friendly conditions. Crucial to Gould's argument is the assumption that the IMF enforces its conditions under certain circumstances. This is a different take from that of the earlier work on the international politics of IMF programs, where the US was found to encourage the IMF not to enforce conditions. Yet, Gould also acknowledges that in certain situations – when pressured by creditor states who are rewarding allies instead of by private financial institutions – the IMF may not enforce strict conditions.

3. Why do governments participate in IMF programs?

The previous section indicates that the incentives driving the IMF vary according to international politics. Yet, participation in an IMF program is a joint decision between the IMF and the recipient country. The international politics that influence the staff and officials of the Fund tell only part of the story. For there to be an IMF program, both the IMF and a government must agree on the details of the arrangement. The decision of the government to enter into an IMF program is a function of the country's economic situation and the political constraints faced by the government. An IMF program does not just consist of a loan; strings are attached in the form of policy conditions. These imposed policies can be severe. The IMF views balance of payments shortfalls as a problem of excess demand for imports. To address such a problem, consumption of imports must be curtailed. This can be done through fiscal austerity, tight monetary policy, and sometimes by devaluing the national currency.

Why would a government ever agree to such conditions? The obvious answer is a country's desperate need for an IMF loan. Yet, sometimes governments actually *want* specific IMF policy conditions to be imposed on them. There are various political stories as to why governments would want conditions imposed, such as the scapegoat story, where governments seek to blame anticipated poor economic performance and needed reforms on the IMF, and the signaling story, where the government uses the IMF to tie its

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[2] For example, the program country must "set aside certain fiscal revenues to match…international loans with fiscal revenues, " use a percentage of the IMF loan for "debt-reduction payments or replenishment of reserves," and "make debt-service payments, as agreed with commercial banks and/or official creditors" (Gould 2003).

hands to send a credible signal of its commitment to economic reform to investors and creditors. The most theorized political story, however, and the one most supported by both anecdotal and systematic evidence is a "tipping the balance" story, where governments use the outside pressure of the IMF to push through unpopular policies that the government actually wants to implement. Before returning to these political stories of participation, however, this section begins by addressing the evidence in favor of the economic story of participation in IMF programs.

The Need for a Loan Story

Article V, Section 3 of the IMF *Articles of Agreement* notes that lending should be confined to situations where "the member represents that it has a need to make the purchase because of its balance of payments or its reserve position or developments in its reserves." Obviously, then, balance of payments problems should predict when governments enter into IMF programs. This, however, is not born out in all studies. Knight and Santaella (1997), Conway (1994), and Edwards and Santaella (1993), for example, have not found that the balance of payments is a statistically significant predictor of IMF participation. On the other hand, the Santaella (1996) and Goldstein and Montiel (1986) studies do find that increasing the balance of payments deficit significantly predicts participation. As for foreign reserves, this variable does predict participation in IMF programs fairly well. In a review of statistical studies of participation in IMF programs, Bird (1996) reports that there is consensus over foreign reserves: low levels of foreign reserves predicts IMF participation. Governments may also need to turn to the IMF for a loan when the service on their outstanding debt becomes too burdensome. Several statistical studies show that high levels of indebtedness are associated with IMF program participation (Conway 1994, Santaella 1996, Knight and Santaella 1997, Przeworski and Vreeland 2000).

Recidivism

Economic factors do explain – in part – participation in IMF programs. But they tell only part of the story. One non-economic factor that has been cited in the literature to predict IMF program participation is past participation (see Bird 1996). Consider what we observe. Since the first IMF agreement in 1952 until 2000, governments entered into 936 separate IMF arrangements (SBA, EFF, SAF, ESAF/PRGF) that spanned a total of 1,838 country-years. Some of these arrangements lasted only one year, others dragged on for over five years. The average length of a spell of participation – where I define spell as consecutive years of participation in conditioned IMF arrangements, regardless of how many times agreements were signed – was 5.5 years. In the meantime, countries that had ended a spell of participation were likely to return. The average spell of non-participation for countries with a past history of IMF programs was 6.4 years.

What explains "recidivism"? Certainly part of the reason that countries return to the Fund again and again is that IMF programs have been largely unsuccessful in

promoting economic development. Indeed, to the extent that IMF policies hurt economic growth, they may set the stage for continued reliance on IMF loans. In this sense, IMF programs have been compared to an addictive and harmful drug. If recidivism were driven entirely by economics, however, then the correlation between past participation and continued participation would disappear once one controlled for economic factors. It does not. Indeed, statistical work that distinguishes between the probability of entering into IMF programs and the probability of continuing IMF programs reveals that economic factors predict entering far better than they predict continuing (Przeworski and Vreeland 2000, Vreeland 2002, Vreeland 2003). There seems to be something about past participation that actually causes countries to return and continue participation.

One possibility is that participation in IMF programs establishes connections between individuals in a country's government and individuals at the IMF. Such interpersonal connections may lower the transaction costs of future agreements, thus making the next IMF program more readily available. There have been no empirical studies of such a possibility, although there is evidence that individual connections matter. Barro and Lee (2002) study the relationship between the proportion of IMF staff that comes from a particular country and the likelihood of that country participating in an IMF program. They find that, in fact, countries with more nationals on the staff of the IMF are more likely to participate in IMF programs.

Another story concerns the domestic politics of developing countries. In particular, it has to do with the domestic audience costs of participating in IMF programs, something I call "sovereignty costs." Bringing in the IMF allows those opposed to the government to accuse it of "selling out" to the international institution (Remmer 1986: 6). As the IMF has come to symbolize Western Imperialism in the minds of many throughout the developing world, this can be a serious accusation, one that has led to protests and evening rioting in some countries.[3] In a country where IMF programs have become business as usual, however, the costs of "selling out" are smaller. The IMF may not be popular, but it is difficult for opposition to claim that the current leadership is selling out any more than previous leaders. Indeed, if the opposition leaders have ever been in power, it is likely that they have actually signed IMF agreements themselves.

Note, however, that there are other reasons – besides nationalism – for certain people to oppose the IMF. IMF programs have proven to exacerbate income inequality (Pastor 1987, Garuda 2000, Vreeland 2002, 2003). So there are winners and losers under IMF programs, and the potential losers are likely to oppose the imposition of an IMF program on the grounds of self-interest. The winners, on the other hand, have a self-interest in bringing in the IMF. This leads to a domestic political story of why governments enter into IMF programs.

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[3] For detailed examples of this phenomenon see Vreeland (2003: Chapter 2) and Vreeland (forthcoming: Chapter 3).

The Domestic Desire for Conditions

There are three domestic political stories of why governments may want conditions imposed: a "blame" story, a "signaling" story, and a "policy push" story. The most obvious is the blame story. Governments may desire conditionality so they can blame the IMF for unpopular policies. Remmer (1986: 7, 21) contends that the presence of the IMF "allows authorities to attempt to shift blame for austerity to the Fund" and that the "power of the IMF remains a useful myth to explain difficult economic decisions." Edwards and Santaella (1993: 425) argue that governments facing domestic opposition to devaluation get the IMF to do their "dirty work." Vaubel (1986: 45) states that international organizations enable politicians "to shirk domestic responsibility for unpopular policies."

This is a difficult story to test. Certainly there are anecdotes of politicians claiming that they disagreed with IMF policies after the policies had failed to improve their country's economic situation. It is not so common, however, for politicians to claim that they are implementing bad policies at the behest of the IMF as they are pushing the policies through. The reason for this has to do with the sovereignty costs discussed above. A government that blames the IMF for bad policy advice as it is following that very policy advice appears impotent. The IMF may be used as a scapegoat, but usually only after the fact. When entering into an IMF arrangement, a government may anticipate that blaming the IMF after the fact will be useful in case the economic program fails, but this is something that is difficult to demonstrate ex ante. Indeed, ex ante, governments often argue that the IMF program, while painful, is best for the country.

One reason governments argue that the program is necessary, even if the policies themselves are painful, is that the IMF program sends a "signal" to investors and creditors that the country is a good investment risk. The pain of economic austerity indicates that the country is willing to pay a high price to keep its promises of repaying debt and that the country is dedicated to maintaining a safe environment for investors. The IMF "seal of approval" is supposed to bring in what has become known as "catalytic finance."

Evidence in favor of a "seal of approval" effect, however, is bleak. Bird and Rowlands (1997, 2000, 2001, 2002, forthcoming) have found little evidence that investment increases when countries participate in IMF programs: "the catalytic effect is at best modest, nuanced and unreliable." Jensen (2004) has found that participation in IMF programs actually has a negative effect on foreign direct investment in developing countries. There is one piece of evidence of the signaling story. Brune, Garrett, and Kogut (2004) find that the value of national assets that are privatized under the auspices of an IMF program is significantly higher than the value of assets privatized without the IMF. The reason for this, they argue, is that privatizing under the IMF sends a credible signal to the world that investment is safe. Perhaps the most powerful signal IMF programs can send, however, is not a positive one for countries in good standing but rather a negative one for countries whose programs fall apart. Rejecting the IMF is costly because it limits access to IMF credit (Schadler 1995) and sends negative signals to

creditors (Callaghy 1997, 2002; Aggarwal 1996) and investors (Stone 2002; Edwards 2000). The country as a whole suffers from such negative signals.

This leads us to the "policy push" or "tipping the balance" story of why governments desire IMF conditions to be imposed. How does an IMF agreement help to push through unpopular reforms? Drazen (2002) suggests one mechanism. He shows that when a government faces domestic opposition to economic reform, the presence of an IMF loan can help the government persuade actors in a position to block reforms to approve them, lest they forgo the next installment of the IMF loan. Thus, Drazen suggests that the loan from the IMF program can be used as a carrot to entice opponents to accept IMF policies. Certainly the loan helps, but may not be enough to convince intransigent opposition. The IMF program can also be used, however, as a stick. In my work, I note that failing to comply with IMF programs has other costs in addition to not receiving the loan installment since creditors and investors follow signals from the IMF (Vreeland 2003: Chapter 3). The IMF can threaten to send a negative signal to creditors and investors.

Note that, unlike other international agreements, executives enter into IMF arrangements unilaterally. The approval of potential opponents to IMF policies or "veto players" – such as the legislature in a presidential system or a coalition partner in a parliamentary system – may be required for policy change, but their approval is not required for the executive to enter into an IMF arrangement. IMF arrangements are spelled out in a "Letter of Intent," written by IMF staff and government officials and formally sent from the country's executive branch – recognized as the country's "proper authority" – to the IMF Managing Director. The Managing Director subsequently brings it before the IMF Executive Board for approval. Once the Board approves the Letter of Intent, the country is under an IMF program. The approval of veto players is bypassed.

After an executive has entered into an IMF arrangement, failure to enact policy change becomes more costly because rejection of reform is not merely a rejection of the executive, but also a rejection of the IMF. Rejecting the IMF is costly to all domestic actors including veto players. As noted, the IMF may restrict access to loans, it may preclude debt rescheduling with creditors who require an IMF arrangement to be in good standing, and it may result in decreased investment if investors take cues from the IMF. These increased costs may lead veto players to approve of policy changes that they otherwise would have opposed.

Such a strategy is available to executives in different types of regimes – democracies and dictatorships alike – and the best way to test how often governments use this strategy would be to get inside their heads and measure their true preferences. This, of course, is impossible, as true preferences (or "political will," as it is sometimes called) are unobserved. But there are other observable implications of this strategy that one can test.

Using the IMF to help push through unpopular policy is most likely to be pursued when there is greater institutional resistance to policy change. I follow Tsebelis (1995,

2002) who argues that policy stability (or resistance to change) is a function of the number of veto players in a political system. The intuition behind his argument is straightforward: Policy change is less likely when more people are required to agree.[4]

The number of actors who must agree – the number of veto players – depends on the political system. In most dictatorships, there is one just actor – either a single dictator, or a single party. In presidential systems, the president and the legislature must agree. In multi-party parliamentary systems, there may be many political parties who are part of the governing coalition who must agree.[5]

As the number of veto players increases, the probability that one of the veto players is opposed to policy change increases.[6] The ideal points of veto players may be correlated, of course, so the resistance to policy change may increase at a decreasing rate. In other words, the effect of adding a second veto player has a greater impact than adding a third, which has more impact than a fourth, etc. So, there may be diminishing returns from additional veto players. To capture diminishing returns from additional veto players, I will use the natural logarithm of the number of veto players when testing the argument statistically below.

Note that when there are too many veto players in the political system, there may be so many hurdles to policy change that the IMF does not believe compliance is possible or the government may insist on a program that is too soft for the IMF to approve. In previous work, I have shown a non-linear effect of the number of veto players on the probability of IMF participation (Vreeland 2003: Chapter 4). Below I simply drop the outlying observations of the number of veto players – those with greater than 5 veto players, which is less than 5 percent of the observations.[7]

Figure 1 shows the rates of participation in IMF programs for different numbers of veto players. The data for number of veto players comes from Beck, Clarke, Groff, Keefer, and Walsh (1999), who code the variable as follows (the following paraphrases from the new codebook, Keefer 2002): The variable is coded 1 in countries where the legislature is not competitively elected. In presidential democracies the variable is the sum of: 1 for the chief executive, 1 if the chief executive is competitively elected, 1 if the opposition controls the legislature, 1 for each chamber of the legislature (unless the president's party has a majority in the lower house and a closed list system is in effect, implying stronger presidential control of his/her party, and therefore of the legislature), and 1 for each party coded as allied with the president's party and which has an ideological orientation closer to that of the main opposition party than to that of the president's party. In parliamentary democracies, the variable is the sum of: 1 for the chief executive, 1 if the chief executive is competitively elected, 1 if the opposition controls the

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[4] This is a simplification of the full argument. See Tsebelis (1995, 2002).

[5] This is a simplification of the range of variation across political systems. Sometimes, for example, there are coalition governments under presidential systems. See Przeworski, Cheibub, and Saiegh (2004).

[6] Or, to be more precise, the probability does not decrease.

[7] With the new updated data I use here, one can obtain a nonlinear effect, but the peak is around 7 veto players – about the 99th percentile of the distribution, which is at such an extreme point in the overall distribution that it makes more sense to consider these observations outliers.

legislature, 1 for every party in the government coalition (as long as the parties are needed to maintain a majority), 1 for every party in the government coalition that has a position on economic issues closer to the largest opposition party than to the party of the executive (the prime minister's party is not counted as a check if there is a closed rule in place – the prime minister is presumed in this case to control the party fully).

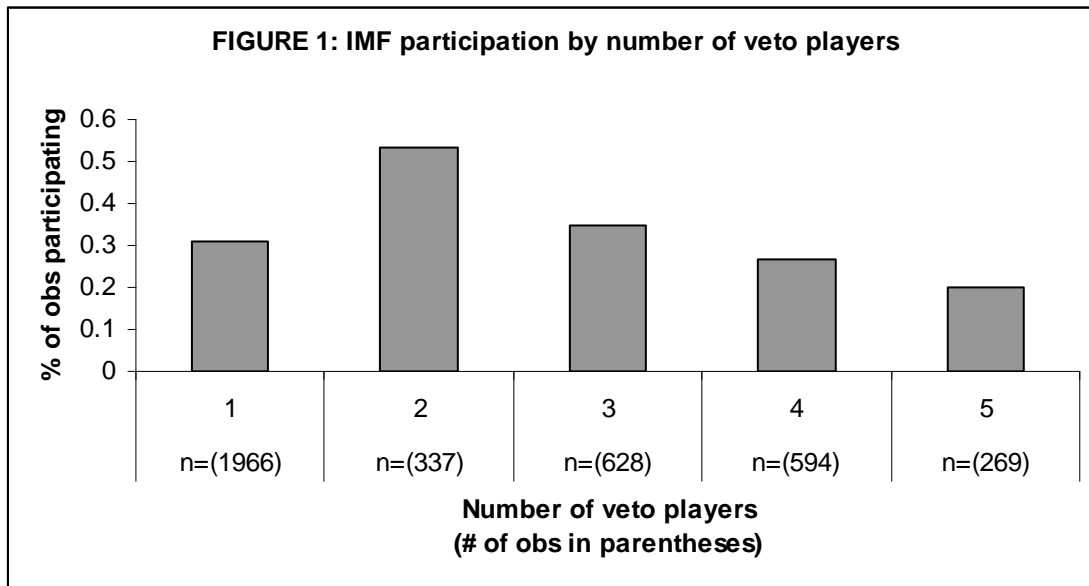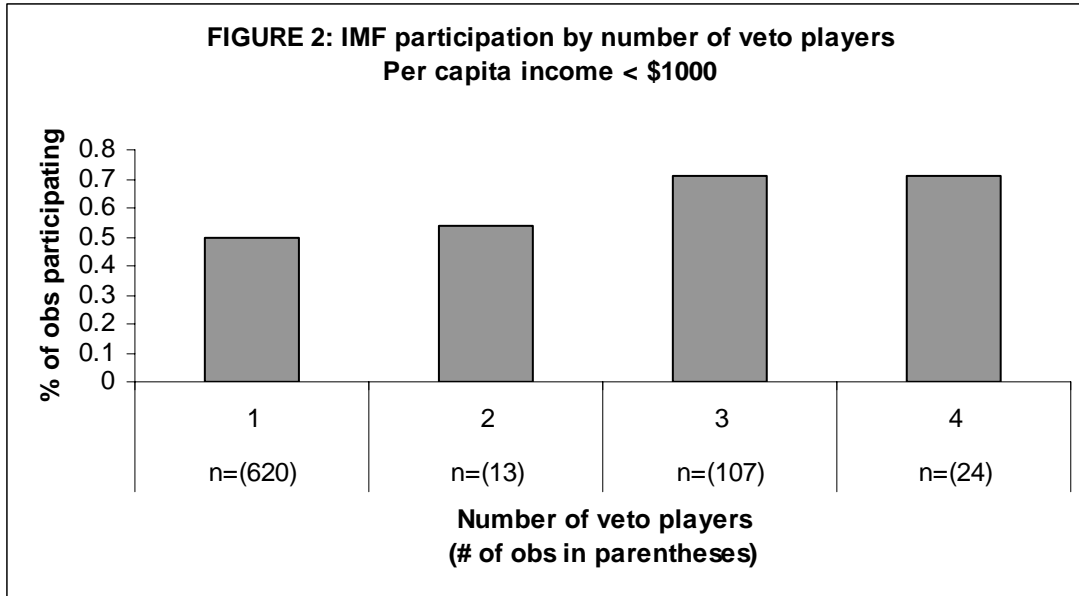FIGURE 1: IMF participation by number of veto players

        Figure 1 presents 3,794 observations of 180 countries from 1975 to 2000, where the average number of veto players is 2.3 and the median number of veto players is 1. The picture does not follow the suggested pattern. One reason for this, however, is that the number of veto players in a political system is correlated to per capita income, and per capita income, in turn, is correlated to IMF participation. For example, all dictatorships have only one veto player, average per capita income is lower in dictatorships than in democracies, and participation in IMF programs is more likely in countries with lower per capita income. Per capita income is an intervening variable that one should account for. If we countries with per capita income of less than $1,000, for example, we see an upward trend in IMF participation rates as the number of veto players increases with diminishing returns, as predicted above. Consider Figure 2. The proportion of observations participating in an IMF program with one veto player is 0.50; the proportion of participation when there are two veto players is 0.54; with three veto players it is 0.71; and with four veto players it is 0.71.[8]

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[8] There are no observations with more than four veto players at this level of per capita income.

FIGURE 2: IMF participation by number of veto players
Per capita income < $1000

Number of veto players	1	2	3	4
% of obs participating	0.50	0.54	0.71	0.71
# of obs	n=(620)	n=(13)	n=(107)	n=(24)

The veto player picture becomes clearer when one specifies the level of economic development. This suggests the importance of controlling for economic factors when testing this story. Besides controlling for per capita income, it is important to control for other economic variables that have been addressed because it is possible that countries with many veto players may simply be more likely to have economic crises. The additional veto players may make these political systems less able to make economic policy adjustments, so governments end up needing an IMF loan for economic reasons. To check for this, I present a more rigorous statistical test.

Estimating the probability of entering IMF programs statistically

The purpose of this section is to test for the relationship between the number of veto players in a political system and IMF participation, as well as to test for the effects of the other variables discussed above: per capita income, current account balance, foreign reserves, debt service, and past participation.

Note that the argument about the effects of veto players in a political system is not about participation in general, but rather about the likelihood of *entering* into IMF programs. Thus, I employ a dynamic statistical model which analyzes the transition probability of going from non-participation to participation in an IMF program. The model is a dynamic version of logit. The easiest way to understand dynamic logit is to imagine all of the observations of countries not participating in an IMF program. Then we ask: Which of them, the following year, enter into an IMF arrangement? The dependent variable in this analysis is the participation status of a country, given that the country was not participating during the preceding year. (For the technical details, see Amemiya 1985: Chapter 11.)

Variable	Coefficient	Standard error	P-value
Constant	-2.02	0.39	0.00
Per capita income ($1,000s)	-0.23	0.08	0.01
Current account (% GDP) LAGGED	-0.03	0.02	0.06
Foreign reserves (in months of imports) LAGGED	-0.24	0.07	0.00
Debt service (% exports) LAGGED	0.02	0.01	0.02
Past participation	0.99	0.30	0.00
log(# of veto players)	0.48	0.21	0.02
Number of observations	648		

The results presented in Table 1 confirm and summarize all of the results that were reported in this section. Before going through the results one by one, it is useful to note that the estimated baseline probability of entering into a spell of IMF programs, holding all variables in the specification to their median values, is 0.13.

Per capita income (measured in $1,000s 1985 PPP) has a negative effect: –0.23. This effect is statistically significant; note the low p-value of 0.01. Thus, countries with higher per capita incomes are less likely to enter into IMF programs. To give this result more substance, consider the following: If per capita income were to increase from its median value of $2,370 by one standard deviation ($2,131), the probability of entering into an IMF program would go down from the baseline probability of 0.13 to 0.09.

The negative effect of current account (–0.03) is significant at the 90 percent confidence level, but the effect is small. If current account were to increase from the median value of –3.72 percent of GDP by one standard deviation (8.05 percent of GDP) the probability of entering IMF agreements goes down from the base probability of 0.13 to 0.11.

The –0.24 effect of foreign reserves is also statistically significant (p-value of 0.00) and larger. When countries have higher foreign reserves, measured in terms of average monthly imports, they are less likely to enter into IMF programs. Substantively, if foreign reserves were to increase from the median value of 2.84 times monthly imports by one standard deviation (3.36 times monthly imports), the probability of entering into an IMF program would go from the baseline probability of 0.13 down to 0.06. Countries are more likely to turn to the IMF when they face a shortfall in foreign reserves.

Debt service has a positive significant effect of 0.02 (p-value of 0.02). When debt service, measured as a percentage of exports of goods and services, goes up, a country is more likely to turn to the IMF. If debt service were to increase from its median value of 13.04 percent of exports by one standard deviation (14.39 percent of exports), the probability of entering into an IMF program would go from 0.13 up to 0.17.

Past participation predicts returning to the IMF. The positive coefficient of 0.99 is highly significant (p-value of 0.00). As noted above, the baseline probability of entering into a spell of IMF programs is 0.13. This is for countries that have already experienced IMF program participation in their past (the median country has already participated). For countries that have never participated, however, the probability of entering is a mere 0.05. Imagine two identical countries that have the sample median level for the control variables – per capita income, current account, foreign reserves, debt service, and number of veto players – but one has already participated in IMF programs and the other never has. The one with past participation is more than twice as likely to participate as the one that never has.

Finally, consider the effect of the number of veto players: 0.48 (p-value=0.02). Even after controlling for all of the variables discussed above, the number of veto players in the political system has a statistically significant positive effect on entering into IMF arrangements. To get a picture of the substantive effect of the number of veto players, consider Figure 3, which depicts the probability of entering into an IMF program for political systems with different numbers of veto players.

FIGURE 3: The estimated probability of entering into IMF arrangements by number of veto players (holding other variables constant)
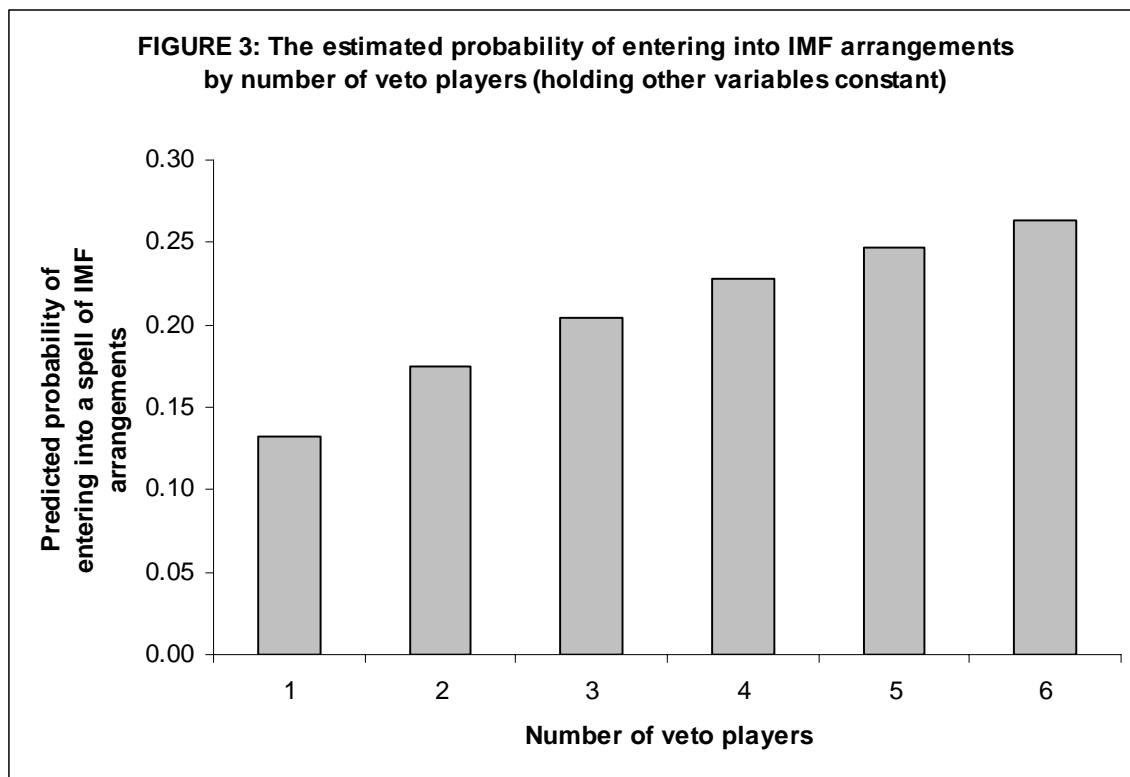
One concern about the results presented here is the small number of observations (648). The sample is small because we are looking only at the probability of entering into IMF programs, but also because there are so many missing observations for current account, foreign reserves, and debt service. Thus, Table 2 presents a stripped down specification of a larger sample, including only per capita income, past participation, and number of veto players. The substantive results for these variables hold.

**Table 2: Estimating the probability of entering into a spell of IMF arrangements
using Dynamic Logit and the larger sample**

Variable	Coefficient	Standard error	P-value
Constant	-2.15	0.18	0.00
Per capita income ($1,000s)	-0.31	0.04	0.00
Past participation	1.09	0.19	0.00
log(# of veto players)	0.32	0.15	0.04
Number of observations	2,057		

4. The Interaction of International and Domestic Politics

So far in this paper I have reviewed the international and domestic politics literatures on IMF participation. These literatures have remained somewhat separate, yet they have important implications for one another. An obvious direction for scholars to take, therefore, is to begin to study how these two levels of politics interact.

Below, I present a preliminary attempt. At this stage of research, I do not have access to all of the variables employed by the scholars working on the international politics of IMF arrangements, but I do have the data from Thacker's 1999 study. The key variable in his study was the *change* in correlation between the voting records of a developing country and the United States on "key votes" – as defined by the US – at the United Nations. The data do not cover as many years or countries as the data in the analyses in Tables 1 and 2 above, but they do include several hundreds of observations from 1985 though 1994. In Table 3, I introduce Thacker's variable into the specification from Table 1 above. The results are surprising.

**Table 3: Estimating the probability of entering into a spell of IMF arrangements
using domestic and international political variables**

Variable	Coefficient	Standard error	P-value
Constant	-0.67	0.70	0.34
Per capita income ($1,000s)	-0.46	0.19	0.02
Current account (% GDP) LAGGED	-0.01	0.03	0.74
Foreign reserves (in months of imports) LAGGED	-0.27	0.13	0.04
Debt service (% exports) LAGGED	0.00	0.02	0.94
Past participation	0.70	0.57	0.22
log(# of veto players)	0.62	0.40	0.13
Change in alignment between country & US	2.45	1.32	0.06
Number of observations	206		

When Thacker's variable measuring the change in correlation between the voting records of a developing country and the US is introduced, the domestic political variable measuring the impact of the number of veto players is significant only at the 85 percent

confidence level. Several other variables surprisingly drop significance completely: current account, debt service, and past participation. Per capita income and foreign reserves still have significant effects.

In Table 4 I re-estimate the specification above leaving out the insignificant variables. In this specification, the effect of veto players is significant at the 95 percent confidence level. The effect of a change in voting patterns towards the US on key votes at the United Nations is also significant. While I caution that these results are preliminary, they speak to the power of politics – at both the international and the domestic levels – to explain IMF participation.

Table 4: Estimating the probability of entering into a spell of IMF arrangements using significant variables

Variable	Coefficient	Standard error	P-value
Constant	-0.53	0.32	0.09
Per capita income ($1,000s)	-0.30	0.12	0.01
Foreign reserves (in months of imports) LAGGED	-0.24	0.09	0.01
log(# of veto players)	0.60	0.30	0.05
Change in alignment between country & US	2.21	1.02	0.03
Number of observations	302		

The effect of the two variables proxying the effects of international and domestic politics hold when they are included together in one specification, but I have not yet modeled statistically the implications that the international and domestic stories have for each other. Recall that when IMF programs are used to reward allies of the US, conditionality should not be strictly enforced. If conditionality is not strictly enforced, then the IMF program is useless to push policies past veto players. So, the effect of the number of veto players on the likelihood of entering into an IMF program should depend on whether the country is moving towards an alliance with the US. When the country is moving towards the US, the effect of the number of veto players should be smaller because the IMF cannot be used very effectively for political leverage. This suggests that an interaction variable – between the veto players variable and the UN voting variable – should have a *negative* effect. In other words, the effect of the number of veto players should only hold when the US does not favor a country.[9]

Table 5 presents the results when I test this hypothesis, and the hypothesis turns out to be supported by the data. The interaction term does have a negative effect, and a Wald test of the joint significance of the three variables together (log of the number of

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[9] There is an additional reason to expect a negative interaction effect, suggested by Emily Fenner in a paper currently in progress. Fenner suggests that during the Cold War, the US rewarded only dictatorships. Democracies were viewed as fickle alliance partners. After interacting the change in UN voting correlation variable with variable measuring regime (democracies versus dictatorships), Fenner indeed finds that the effect suggested by Thacker holds only for dictatorships. Recall that the veto players variable is coded 1 for dictatorships and democracies are all coded >1, hence the negative effect of the interaction term between the number of veto players and voting with the US at the UN.

veto players, change in voting patterns at the UN towards the US, and their interaction) indicates significance at the 95 percent confidence level.

Table 5: Estimating conditional effects of international and domestic politics on the probability of entering into a spell of IMF arrangements

Variable	Coefficient	Standard error	P-value
Constant	-0.58	0.32	0.07
Per capita income ($1,000s)	-0.29	0.12	0.01
Foreign reserves (in months of imports)	-0.24	0.09	0.01
log(# of veto players)	0.64	0.30	0.04
Change in alignment between country & US	3.20	1.54	0.04
Interaction of log(# of veto players) and change in alignment between country & US	-1.60	1.85	0.39
Joint-significance test for interacted variables (log(# of veto players), change in alignment between country & US, and their interaction)	**chi2 = 8.52**		**0.04**
Number of observations	302		

5. Conclusion

The impact of politics on IMF arrangements has important implications about IMF conditionality. In an IMF agreement with a country favored by the US, conditionality may have no bite. Yet, in countries not particularly favored by the US conditionality may help to push through important policies of economic reform. Stone (2002) found in Eastern Europe that countries participating in IMF programs that were not favored by the US – thus, where the threat of punishment for noncompliance was credible – succeeded in curtailing inflation. IMF conditionality may be used in these situations, however, to push through unpopular policy changes that favor one constituency over another. Stiglitz contends:

> There is…a process of self-selection of reforms: the ruling elite has taken advantage of the reform process and the asymmetries of information – both between themselves and the citizenry and between the international aid community and themselves – to push those reforms that would benefit them.

Partial compliance allows countries to avoid IMF punishment and to push through policies to protect elite interests while shifting the burden of austerity to labor and the poor. Systematic studies indicate that IMF programs typically exacerbate income inequality (Pastor 1987, Garuda 2000, Vreeland 2002, 2003). Pastor (1987) found that "the single most consistent effect the IMF seems to have is the redistribution of income away from workers" (1987a: 89). His finding has been confirmed in more recent studies with broader data and updated methods. Indeed, of all the areas where the IMF may have an impact, income distribution appears to be the one area where there is the most consensus in the literature on the effect of IMF programs.

Thus, we may imagine 4 sets of countries: (1) There are countries favored by the US for political reasons – conditionality has no bite. (2) There are countries not favored by the US whose governments agree with the policies prescribed by the IMF and face no opposition – conditionality is not needed. (3) There are countries not favored by the US whose governments use the IMF agreement to favor domestic elite interests – conditionality is abused. (4) There are countries not favored by the US whose governments agree with conditions but face opposition – conditionality helps push through Pareto improving reforms.

Whether or not IMF conditionality is a good thing depends on how common situation (4) is. Dollar and Svensson (2000) have argued that the IMF should specifically target such situations. This might be a wise move, but it may be politically unfeasible – both at the international and domestic levels. At the international level, how can the IMF resist the pressure to help US allies? At the domestic level, how can the IMF know the true intentions of governments? Yet, unless IMF conditionality is used for situation (4), conditions are useless at best and harmful at worst.

How common is it that IMF programs help to push through policies that are unpopular in the short-run but have positive effects in the long-run? Judging by the dearth of evidence of program success, this is probably not so common. So, perhaps the IMF should scale back its operations, lending only during times of severe crisis and providing policy advice without imposing conditions per se.

Yet, recall the argument of Gould. She finds that private financial institutions provide supplemental financing to countries in crisis only provided that "bank-friendly" conditions are included in IMF arrangements. Using the IMF to enforce developing countries' commitments of to repay loans may be Pareto enhancing. Without the IMF, private financial institutions may be unwilling to loan to countries in crisis. With the IMF, however, crisis countries – who receive the loans – and private financial institutions – who receive a credible commitment of repayment – are both better off.

This suggests a scaling back of conditions to the level of debt repayment. This is something with which the IMF has been quite successful. IMF loans, for example, are almost always repaid. Governments would still have to make tough decisions about how to cut back domestic consumption to repay loans, but they would do so on their own terms.

Scaling back conditionality would have little impact where the IMF lends under political pressures from the US because conditions have never been strictly enforced in these situations. It would have a great impact on other countries, particularly where governments have sought out IMF conditions to push through unpopular policies. This would be a loss in the handful of cases where well-intentioned governments need IMF leverage to make policy changes that will help the country in the long-run. But it would prevent other governments from misusing IMF conditionality to push through policies that shift the burden of austerity on labor and the poor in the name of the IMF.

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