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# IMF Programs: Do They Work? Can They be Made to Work Better?

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**Summary.** — A central issue in the debate about a new international financial architecture has been whether programs of policy reform supported by the International Monetary Fund work. The Fund claims that "on balance" they do, because of their positive effect on the balance of payments. Others claim that programs are ineffective, and suggest that they should be discontinued. This paper reviews the econometric evidence dealing with the macroeconomic effects of IMF programs. It goes on to provide additional evidence and judges success against alternative criteria. Although the record is not good, the paper argues that it would be unwise for the Fund to cease lending and to abandon conditionality altogether. IMF programs need to be redesigned and refocused. The paper concludes by identifying a number of principles that should underpin reform. © 2001 Elsevier Science Ltd. All rights reserved.

*Key word* — IMF programs

## 1. INTRODUCTION

International Monetary Fund (IMF) conditionality has been a subject of debate ever since it was introduced in the early 1950s. A number of recent reports have claimed that it has become excessive, and some commentators have suggested that there may be a conditionality Laffer curve with increased conditionality being linked to diminishing effectiveness. [1] The Meltzer Commission concluded that IMF programs are "unwieldy, highly conflictive, time consuming to negotiate and often ineffectual." With a new Managing Director in place the IMF has itself undertaken a review of conditionality (IMF, 2001). Central to the debate and its implications for policy is the question of whether conditionality and the programs that embody it "work." If they do, why change things? If they do not, then should conditionality be abandoned in its present form, as recommended by the Meltzer Commission, or reformed in some way, and if so, how?

This raises the fundamental question of how to judge whether IMF programs work. [2] A narrow criterion is to focus on their balance-of-payments effects. After all, the IMF is primarily a balance-of-payments institution. With this focus in mind a recent survey of the cross-country evidence conducted by the IMF (ul Haque & Khan, 1998) claims that its programs do indeed "on balance" work. This criterion may be broadened to include the effects of programs on other additional macroeconomic outcomes such as economic growth and inflation. There is a relatively large literature that assesses conditionality in this way. The literature also encompasses studies that examine the effects of IMF programs on intermediate policy targets such as fiscal deficits, monetary growth and the exchange rate. Very little attention has been paid, however, to other potential indicators of success or failure, which move beyond the macroeconomic effects of IMF programs.

The purpose of this paper is to identify these other indicators so that a broader definition of the concept of "work" may be offered, and to see what the evidence reveals using this definition. The findings may also give a clue as to the direction in which reforms to conditionality should go. The paper only seeks, however, to be indicative rather than definitive.

The layout of the paper is as follows. Section 2 undertakes a brief review of the existing literature on the effects of IMF programs. Rather than being comprehensive, it sets out to establish broad areas of consensus and to summarize what we know. Against this background, Section 3 extends the criteria by which the effects of IMF programs may be judged. It does this by identifying institutional objectives and

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examining the degree to which conditionality as currently practiced has enabled these objectives to be realized. If the objectives are achieved this is taken to indicate that Fund programs "work." If they are not, then a less positive conclusion seems justified. Section 4 draws on the available empirical evidence combining that from the existing literature with the additional evidence presented here to discuss the implications for policy. By isolating possible shortcomings in the design of conditionality it attempts to identify areas for reform. Finally, Section 5 offers a summary and some concluding remarks about the current debate surrounding conditionality in the light of the analysis undertaken in this paper.

## 2. THE MACROECONOMIC EFFECTS OF IMF PROGRAMS

This section sets out to provide a brief summary of the alternative methodologies that have been used to assess the macroeconomic effects of IMF programs and the results that have emerged. It cites some of the principal and most frequently quoted studies and by so doing attempts to provide a representative sample of research in this area. There are a number of studies that offer a more detailed critical analysis of the alternative methodologies and a more comprehensive summary of the literature (Killick, 1995; ul Haque & Khan, 1998). But, for our purposes this level of detail is not required.

Underlying all research into the effects of IMF programs is the problem of the counterfactual, that is, what would have happened in the absence of an IMF program and therefore what effects can be attributed to the program *per se* as opposed to other factors. In practice, there is no completely satisfactory means of dealing with this problem. Before-and-after tests implicitly assume that other things remain constant, which they do not. With–without tests assume that it is possible to formulate an accurate view as to what would have happened in the absence of an IMF program. One way of doing this is to compare countries that have negotiated Fund programs with other countries that have not. But there is a problem in finding countries that are similar in all respects apart from the involvement of the Fund. Otherwise some attempt needs to be made to allow for differences between those countries that do and do not have programs, in terms of their economic circumstances and how policy might evolve. This is what the "generalized estimator evaluation" approach attempts to do. But the very decision as to whether or not to turn to the IMF itself implies a significant difference in the approach to economic adjustment as well as in the political environment in which adjustment takes place, and this is difficult to capture empirically.

This problem may be overcome by endeavoring to simulate the performance of an individual economy under different sets of policies. But simulation analysis encounters another problem since it relies on being able to specify a model that accurately describes how individual economies function. In fact, economies differ, and no one model is likely to provide an accurate description of all countries that might turn to the IMF (Dicks-Mireaux, Mecagni, & Schadler, 2000). Furthermore, the response to policies undertaken under the auspices of the Fund may differ from the response when the same policies are pursued independently, and on top of this parameter values may be affected by the policies adopted. A case study methodology offers another approach but suffers from problems of generalization.

Other difficulties that get in the way of an unambiguous assessment of the effects of IMF programs relate to the time period over which the effects are monitored and the range of performance indicators that are studied. There is no reason to presume that program effects follow some linear path over time or that positive effects on some economic variables will be matched by similar positive effects on others. Economic variables may move in different directions over time and better performance in terms of one variable may be offset by worse performance in another. Unless a reasonably sophisticated social welfare function has been specified, it is difficult to say whether things overall have improved or deteriorated. [3]

While the search for methodological improvement in econometric analysis of the effects of IMF programs continues, there is an accumulation of evidence from studies using different methodologies and this has gradually provided an overall picture. Results that are robust across different studies and methodologies may engender greater confidence than those that are methodology-specific, or specific to individual studies.

Without undertaking a detailed review, we can make a number of important generalizations. In terms of the key performance indica-