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IMF and Economic Growth: The Effects of Programs, Loans, and Compliance with Conditionality

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Summary. — In theory, the IMF could influence economic growth via several channels, among them being advice to policy makers, money disbursed under its programs, and its conditionality. This paper tries to separate those effects empirically. Using panel data for 98 countries over the period 1970–2000, it analyzes whether IMF involvement influences economic growth in program countries. Consistent with the results of previous studies, it is shown that IMF programs reduce growth rates when their endogeneity is accounted for. There is also evidence that compliance with conditionality mitigates this negative effect, while the overall impact, however, remains negative. IMF loans have no robust statistically significant impact.

Key words — IMF programs, growth, compliance, conditionality

1. INTRODUCTION

The International Monetary Fund has come under increased scrutiny and attack, with some of the most intense criticisms targeting the link between its programs and reduced economic growth in borrower countries (e.g., Hutchison, 2003; Przeworski & Vreeland, 2000). The channels by which the IMF could influence growth, however, have rarely been made explicit. In no study are those channels separated empirically. But how could IMF programs, which are designed to avoid growth-damaging policies, actually achieve the opposite?

In theory, the IMF can influence economic outcomes by its money, the policy conditions it attaches to its loans and, more generally, its policy advice. The overall effect of the IMF on economic growth depends on the net effect of those channels. Nevertheless, the literature so far made no attempt to separate them. No study has taken compliance with conditionality adequately into account. [1] As Joyce (2004, 12) put it:

> "This is a surprising omission, since presumably a country's economic performance will vary in response to its implementation of the program's policies. Assessing the performance of program countries without discriminating among them by their degree of compliance could give a misleading view of the effects of IMF programs. On the other hand, if no systematic linkages exist, then new questions arise about the effectiveness of Fund-supported policies and the need for conditionality."

This paper contributes to the literature in trying to separate the effects of programs, disbursed loans, and compliance with conditionality on economic growth. It analyzes whether implementation of IMF conditionality influences growth rates. The paper thus combines two strands of the literature on IMF programs: those on growth and those on compliance.

What I find is, basically, that IMF programs reduce growth rates when accounting for self-selection into those programs. There is also

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evidence that compliance with conditionality mitigates this negative effect; IMF loans do not robustly affect economic growth.

The next section summarizes what we know about the implementation of IMF conditions, the literature on the impact of the Fund on economic growth is shortly summarized thereafter. Section 4 discusses the various channels by which the IMF could influence economic growth; Section 5 describes the method and data employed. Section 6 presents the empirical analysis, while the final section concludes.

2. IMPLEMENTATION OF IMF CONDITIONALITY

Measuring the implementation of IMF conditions is not straightforward. Many earlier studies employed proprietary data, mostly from the Fund's internal documents. Using such documents, the first evidence on compliance with conditionality was presented by Beveridge and Kelly (1980). They showed that out of 105 countries with upper-credit-tranche programs implemented during 1969–78, only 60% achieved the target for the overall fiscal deficit and 54% complied with the credit ceiling. Another study on implementation of IMF conditions is Haggard (1985), reporting extremely low rates of compliance with conditions under the Extended Fund Facility (EFF) during 1974–84. Of the 30 cases studied, 16 were cancelled and eight more were not implemented in their original form. Zulu, Nsouli, and Saleh (1985) found similar results in a study of African adjustment programs during 1980–81. Only half of the countries achieved the negotiated credit ceilings. Moreover, compliance with fiscal targets has been poor. According to Edwards (1989), conditions on the government's deficit have been achieved in only 30% of 34 programs approved in 1983. In 1984, compliance was reduced further: the ceiling was observed in only 19% of the programs. One year later, 57% of these countries failed to comply. As for changes in domestic credit, compliance was highest in 1983 (54.8%). It reduced to 46.4% in 1984 and 40.9% in 1985. On average, compliance was higher for changes in net domestic credit to the government with 72% in 1983 and about 52% in 1984 and 1985. This study has been updated by Polak (1991), who added programs in place during 1988–89. According to his results, compliance with fiscal and credit targets has been 40% for the 17 SAF programs and 60% for the five ESAF programs included in the study.

Mecagni (1999) evaluated 36 countries with an IMF program under the Structural Adjustment Facility (SAF) or the Enhanced Structural Adjustment Facility (ESAF) approved between 1986 and end-94. His findings show that 28 of the evaluated countries interrupted their programs 51 times in total. Seventeen countries had more than one interruption. Only 10 programs were in effect for three or four years without any major interruption and policy slippage. Thirty-eight programs made it at least one year, in the second year, 22 programs remained in effect. Thirty-three interruptions were caused by slippage on conditionality; only eight programs broke down due to disagreements about future actions. In some cases, governments needed more time to get political support in their countries in favor of an IMF program. In 1988–89, only 40% of 17 countries with an SAF program complied with the postulated credit ceiling. The same is true for the overall fiscal deficit. In ten of the reviewed interruption episodes, there were political upheavals. Governments were therefore not able to make credible commitments.

Edwards (2001a) analyzed 347 programs during 1979–97. He gathered information from different sources, including the Fund's archives, on whether a program was suspended. His data are reproduced in Table 1, alongside other measures of interruptions that will be introduced below. As can be seen in column 1, interruptions have been particularly frequent during 1988–91. Over the whole period of study, 138 programs have been suspended prior to expiration. This corresponds to a completion rate of 60%.

Analyzing the reasons for low completion rates, Edwards finds that international power, proxied by a country's quota with the Fund, reduced the likelihood of program suspension. Edwards (2001b) reports that the IMF is more likely to suspend programs in democratic countries having fractionalized legislatures and proportional representation systems.

Since the beginning of the 1990s the IMF itself provides data on compliance with conditionality. Its database on Monitoring Fund Arrangements (MONA) contains data on the implementation of performance criteria and structural benchmarks that have been implemented under its programs. Mercer-Blackman and Unigovskaya (2004) use these data to give evidence on compliance in countries in transi-