The Effect of IMF Programs on Labor

JAMES RAYMOND VREELAND *
Yale University, New Haven, CT, USA

Summary. — Previous studies find that IMF programs have negative effects on income distribution [The International Monetary Fund and Latin America: Economic Stabilization and Class Conflict, Westview Press, Boulder, 1987a; World Dev. 15 (1987b) 365; World Dev. 28 (2000) 1031]. No study, however, has used parametric methods to control for nonrandom selection. Using a dynamic version of the Heckman selection model, I study the effect of IMF programs on the labor share of income from manufacturing. My conclusions are supported by 2,095 observations of 110 countries during 1961–93. © 2001 Elsevier Science Ltd. All rights reserved.

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1. INTRODUCTION

According to the former Managing Director of the International Monetary Fund (IMF), Michel Camdessus, "Our primary objective is... high-quality growth," not merely "growth for the privileged few, leaving the poor with nothing but empty promises" (Camdessus, 1990). A goal of IMF structural adjustment programs is not only to increase overall economic output, but to improve the distribution of income.

Regarding economic growth, while early studies did not find that IMF programs improve growth, no study found programs to have adverse effects either (Connors, 1979; Gylfason, 1987; Killick, 1995; Pastor, 1987a,b; Reichmann & Stillson, 1978). Yet IMF austerity programs, which involve fiscal austerity and tight monetary policy (Taylor, 1993), were widely believed to have contractionary effects, at least in the short-run. Recent studies—which account for nonrandom selection into IMF programs—have found evidence of these contractionary effects. Conway (1994) finds that the immediate impact of IMF programs on economic growth is negative.[1] Przeworski and Vreeland (2000) find that IMF programs lower annual economic growth by 1.5% each year that a country participates, and find no evidence that programs help in the long-run. Apparently, the IMF has not achieved the goal of promoting economic growth. How has the Fund faired on the question income distribution?

Two large-*n* studies on the effects of IMF programs on income distribution show that they have negative effects (Garuda, 2000; Pastor, 1987a,b). Neither study, however, uses parametric methods to control for nonrandom selection. The purpose of this study is to apply a methodology which accounts for nonrandom selection into IMF programs to the question of income distribution. Do governments under IMF programs structure economic reforms in ways that favor one group over another or does the negative finding of previous studies disappear when one controls for other variables and nonrandom selection?

This study is the first to evaluate the longest single series of data available on distribution: the labor share of income from manufacturing. The obvious disadvantage of this series is that it includes data only on the manufacturing sector. The advantage of using this series, however, is that it includes 2,095 observations of 110 countries over 1961–93. The importance of using this series of data is that previous studies

using data with fewer observations were unable to use parametric methods to control for other factors that may influence both IMF participation and income distribution (Garuda, 2000).

If my results are consistent with the findings of Pastor (1987a,b) and Garuda (2000), we will have confidence that even controlling for the fact that countries participate in IMF programs under bad economic conditions, the inherent effects of programs are negative on income distribution. If my findings are not consistent, then we must question whether the previous findings are simply driven by nonrandom selection.

2. BACKGROUND

Early in its history, Fund officials claimed that domestic political issues—such as income distribution—were not the business of the IMF (see Polak, 1991; Williamson, 1983). But officials began addressing the issue after countries went off the gold standard in the 1970s, and the Fund shifted from a currency regulating institution to a manager of balance-of-payments problems, deeply involved in the national policies of much of the developing world. Officials claimed that their programs do not necessarily have a negative effect on income distribution (see Johnson & Salop, 1980, and Sisson, 1986, cited in Pastor, 1987a, p. 52). Indeed, as the statement by Camdessus suggests, the Fund has even indicated that its programs can help improve the distribution of income within a country.

Note that the theoretical links between IMF economic reform programs and income distribution are not clear-cut. IMF programs typically include many policy changes that can influence the distribution of income such as reductions in budget deficits, increases in interest rates, and currency devaluations. The direction and magnitude of the effects of such changes, however, depend on particular characteristics of the economy and the details of how reforms are structured. Economists at the Fund have claimed "the distributional effects of IMF stabilization programs are so complex that they defy simple categorization" (Pastor, 1987a, p. 54).

Devaluation, for example, decreases the price ratio of nontradable to tradable goods. If the poor are rural farmers producing goods for exports, this can improve the distribution of income, but if the poor are urban consumers facing higher food prices or rural farmers producing for domestic consumption, it can hurt the distribution of income (Garuda, 2000, p. 1033). Devaluation can also worsen the distribution of income if elite groups engage in capital flight prior to the devaluation (Pastor, 1987a, p. 54). Reducing access to domestic credit, by increasing interest rates or bank reserve requirements, or by imposing explicit credit ceilings, affects groups according to their access to other sources of credit. Large, well-established firms are favored over small and medium-sized firms, and the urban sector is favored over the rural sector (Johnson & Salop, 1980, p. 11). Trade liberalization, which has increasingly been part of IMF programs, may benefit labor-intensive sectors and eventually result in higher wages or lower unemployment, but these effects will be small and slow, while formerly protected sectors will contract first, lowering income in these areas (Handa & King, 1997, pp. 915–916).

Reduction of public expenditure is the most common feature of Fund-supported programs. In an analysis of 94 programs during 1980–84, for example, Sisson (1986, p. 34) reports that 86 of them involved some restraint of central government current expenditure. Fifty-six programs involved restraint on capital outlays and net lending (Sisson, 1986, p. 34). As Johnson and Salop note,

> the brunt of any downward adjustment of government expenditure to GDP is most commonly borne out by public sector employees engaged in projects that come to be postponed, together with the private domestic suppliers of services associated with such projects. These tend to be highly capital-intensive ventures in construction and public utilities (Johnson & Salop, 1980, p. 12).

Wage freezes, limits on employment, and reduced benefits for public employees are also common. Sisson (1986, p. 34) reports that over three-fifths of programs involved wage restraint. The overall effect of reducing the government budget deficit on income distribution depends on the composition of the budget cuts, the mobility of producers, and the adaptability of consumer patterns (Garuda, 2000, p. 1033). As Garuda explains, "virtually any overall result can be achieved, provided that overall expenditures are reduced" (2000, p. 1034). [2]

Because programs can be achieved in many different ways with different consequences for distribution, study after study has noted that the political power of various groups may