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Effectiveness of IMF-supported stabilization programs in developing countries

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Abstract

This paper examines the effectiveness of Fund-supported stabilization programs by investigating whether the IMF achieves its own objectives in such programs. Even though the Fund's conditionality prescribes fiscal and monetary discipline in program countries, the results of the empirical analysis show that the IMF cannot impose its conditionality even during program years. Furthermore, when successive interprogram periods are considered, program countries enter a new program in a worse macroeconomic condition than they entered the previous program. These results and the fact that stabilization programs have a revolving nature are inconsistent with the effectiveness of IMF-supported stabilization programs and may signal the existence of moral hazard. © 2002 Elsevier Science Ltd. All rights reserved.

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1. Introduction

In its 58 years of existence, the IMF has been criticized because of its institutional structure and lending practices. Some argue that the IMF is a bureaucratic and non-transparent institution with no accountability for its actions. It has also been suggested that Fund-supported stabilization programs are ineffective and may create moral hazard.

The motivation to provide another study on the IMF is based on three points. First, although there are a large number of publications about the IMF and its pro-

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grams, most publications express opinions about the Fund without providing quantitative evidence. There are several quantitative evaluations of Fund programs, most of which have been provided by the IMF (Reichmann and Stillson, 1978; Donovan, 1982; Loxley, 1984; Goldstein and Montiel, 1986; Khan, 1990; Joyce, 1992; Doroodian, 1993; Conway, 1994; Killick, 1995; Santaella, 1996; Knight and Santaella, 1997).[1]

Second, the recent efforts to widen the IMF's responsibilities make a quantitative study on the effectiveness of Fund-supported adjustment programs both timely and appropriate. In 1997, the IMF introduced the Supplemental Reserve Facility that provides large, short-term loans to countries in financial crises, as in the cases of Korea, Russia, and Brazil. Third, motivated by the idea that Fund resources provide ex-post assistance in a crisis, but realizing that they do not reduce the frequency and intensity of financial crises, it has recently been suggested that the IMF should assume the role of an international lender of last resort (Fischer, 1999). However, before defining new responsibilities for the IMF, one should be concerned with the performance of the Fund in its traditional roles.

This paper focuses on the effectiveness of Fund-supported stabilization programs for developing countries and has four characteristics. First, this study does not question the IMF's existence, its rationale, its programs, and the content of conditionality associated with these programs.[2] This paper's approach to program evaluation is to use the IMF's criteria to see whether the IMF achieves its own goals in these programs. Second, this study uses a broader data set than previous program evaluations in terms of the types of balance of payments programs (four types), the number of program countries (91), and the length of the period under investigation (1971–97). Third, it provides a discussion of alternative evaluation methods and their weaknesses before the selection of the evaluation method. Fourth, the method of program evaluation is based on the observation of relevant variables during pre-program, program, and post-program years. Additionally, this paper attempts to relate program evaluation to moral hazard associated with the Fund's lending.

The organization of the paper is as follows. Section 2 describes this study's approach to program evaluation, and provides a critique of previous evaluations. Section 3 constitutes the empirical part in which Fund-supported stabilization programs are evaluated using the data on 91 developing countries for the period 1971–97. Finally, Section 4 summarizes the results of the empirical analysis and discusses the effectiveness of stabilization programs.

2. Approach to program evaluation

2.1. Alternative approaches to program evaluations

There are three alternative approaches to the evaluation of adjustment programs. First, the outcome vs. alternative outcome approach compares the actual outcome in

[1] Ul Haque et al. (1998) provide a review of previous program evaluations.

[2] See Vaubel (1991) and Willett (2000) on the political economy of international financial institutions.