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Journal of International Money and Finance
22 (2003) 991–1014

Journal of International Money and Finance

www.elsevier.com/locate/econbase

Macroeconomic effects of IMF-sponsored programs in Latin America: output costs, program recidivism and the vicious cycle of failed stabilizations

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Abstract

We investigate the effects of IMF stabilization programs, and the reasons behind the unusually high IMF activity and relatively low program completion rates in Latin America. We base our tests on a panel, and distinguish between IMF program approvals and completion. We find that Latin America has higher output costs of IMF programs (especially when completed), no improvement in the current account, and a much higher likelihood of program failure and recidivism than other regions. The common finding that entering into an IMF-supported program incurs real short-run costs on the economy is entirely driven by the experiences in Latin America.
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JEL classification: E63; F32; F34; F41; O19

Keywords: IMF; Latin America; Macroeconomic stabilization; Output growth

1. Introduction

Latin America is a volatile region with a history of exceptionally high inflation rates, substantial macroeconomic instability, and a record of unsuccessful monetary and fiscal stabilizations. Not surprisingly, the credibility of stabilization efforts

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doi:10.1016/j.jimonfin.2003.09.007

with the public is low, making the task of successfully implementing new stabilization programs very difficult. Latin American countries are also the most frequent users of IMF loans and associated IMF-supported stabilization programs (Table 1). These programs' primary official objective is to restore balance of payments equilibrium and, in this context, IMF loans are granted (and the funds disbursed incrementally) conditional upon specific macroeconomic and other criteria being met.[1]

This study investigates the macroeconomic effects of IMF-supported stabilization programs in Latin America, relative to other parts of the world, focusing in particular on output growth and balance of payments adjustment. We also consider the reasons behind the unusually high IMF program activity in Latin America, relatively low program completion rates, and how these characteristics may be associated with macroeconomic instability and the history of failed macroeconomic stabilizations in the region.

There is considerable debate over the effects of IMF-supported stabilization programs but no consensus has emerged about the macroeconomic impact of these programs.[2] Most empirical studies using panel data sets and regression techniques find that IMF-supported programs improve the balance of payments and the current account, but views on the ultimate output and employment effects are much more divergent.[3] Studies measuring the output costs of IMF-program participation have reached radically different conclusions—with estimates ranging from sizeable declines in output growth (e.g. Przeworski and Vreeland, 2000), to little or no adverse output effects (Hutchison, 2002, 2003), to quite strong positive output effects (e.g. Edwards and Santaella, 1993; Dicks-Mireaux et al., 2000).[4]

To our knowledge, no study has specifically focused on the output and current account effects of IMF-supported programs for Latin America over the past two decades. In an early unique contribution, Pastor (1987) considered IMF programs in Latin America in 1960–1981 (using developments before/after program participation, as well as differences between years when countries were in and out of programs, as the benchmarks), and concluded that the current account and output

[1] A key purpose of the IMF is "...to give confidence to members by making the Fund's resources temporarily available to them under adequate safeguards, thus providing them with the opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity" (IMF Articles of Agreement, Article I (v)).

[2] There is a large literature reviewing the effects of IMF-supported stabilization programs. See, for example, Beveridge and Kelly (1980); Bordo and James (2000); Connors (1979); Conway (1994); Edwards (1989); Gylafson (1987); Hutchison (2002, 2003), and Pastor (1987).

[3] For a survey of these results, see Ul Haque and Khan (1998).

[4] These conflicting results arise from several sources, including differences in the types of IMF programs that are investigated, differences in the groups of countries or the time periods that are investigated (e.g. poor developing vs.s emerging market economies or pre- and post-Bretton Woods), differences in the methodologies that are employed, and, perhaps most important, how other factors influencing output growth are taken into account. See Hutchison (2003) for a detailed discussion.

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