IMF LENDING AND NEOLIBERAL POLICIES: REALIZING JOINT GAINS

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ABSTRACT

HEATHER BA: IMF Lending and Neoliberal Policies: Realizing Joint Gains
(Under the direction of Layna Mosley.)

Traditional IR theories of institutions focus on their ability to generate joint gains. However, in the literature on IMF lending, an empirically supported theory of joint gains is, as of yet, unidentified. This paper synthesizes functionalist, structuralist, and public-choice theories of IMF lending and proposes that the joint gains exist on different levels for creditor and borrower countries.

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Introduction

Scholars of international institutions have traditionally focused on their ability to produce joint gains. Yet scholarship on the International Monetary Fund (IMF) has produced a general lack of empirically supported theories identifying these joint gains. Explanations of IMF crisis lending, the main function of the institution since the early 1970s, have identified a variety of ways that either creditor nations or borrower nations stand to gain from either funding or accepting an IMF loan (some with more empirical support than others). But any complete explanation for why the institution lends needs to explain how both parties gain, or present evidence that suggests the institution redistributes gains via coercion. This paper proposes a slightly unconventional set of joint gains between creditor and borrower governments – unconventional in the sense that the gains sought by state actors exists on different levels.

This paper proposes that the policy conditions on IMF loan facilities serve the dual purpose of strengthening the international political power of the IMF's largest creditor and strengthening the domestic political power of borrower country governments who want some level of neoliberal reforms. More specifically, this paper argues that the United States, as the Fund's largest creditor, has used its unique position within the IMF to set a neoliberal policy agenda that is promoted through IMF lending programs and which advances its own long term economic interests. Meanwhile, governments in some borrower countries seek IMF lending because these same reforms, to one degree or another, serve to enhance their own domestic political power; committing to an IMF loan program provides them with bargaining power vis a vis domestic political opponents. In this way, the IMF is an institution that enables both borrowers and creditors to benefit from participation, generating positive joint gains.

This paper proceeds as follows. I begin with a brief discussion of what the IMF literature has offered to our understanding of joint gains so far. Then I develop the supply side of this story, focusing on US interests in promoting neoliberal reforms abroad via IMF lending. Following the section on the supply side of the story, I advance the demand side of the story, by articulating the domestic political gains to be reaped through neoliberal reforms by recipient countries. Finally, I explain how the IMF helps both sides to realize joint gains, advance two testable hypotheses, outline the empirical methodology for testing this theory of joint gains, and interpret the results. I conclude with an evaluation of the success of this study and its implications for the IMF literature as a whole.

Existing Perspectives on Joint Gains

The international relations literature on IMF lending has focused on three questions: To what extent does IMF lending diverge from the technocratic impartiality alluded to in the organization's charter? Whose interests motivate such divergences? And what types of interests motivate these divergences? Based on how theories address these questions, they can be assigned to one of three general categories – functionalist, structuralist, or public choice (Steinwand and Stone, 2008). When viewed synthetically, each of these categories of explanations leave at least one important question unanswered regarding the utility of the IMF for borrower and donor countries.

The functionalist perspective is rooted in early research on the role of institutions and focuses on the IMF's role as facilitating economic cooperation through multiple interaction, and largely accepts the premise that the institution serves a purely technocratic function as the lender of last resort. This approach has proposed a variety of rationalist explanations for IMF lending facilities. For example, scholars have proposed that countries experiencing balance of payments problems use the institution to resolve information and commitment problems with the private credit markets (Marchesi and Thomas, 1999; Mody and Saravia, 2003, 2006). However, it has presented no explanation of why developed countries (the G-5 in particular) have continued to support the Fund long after the collapse of the Bretton Woods system and long after they have ceased to use the Fund's lending services. Additionally, it has largely failed to confront empirical evidence that IMF lending actually fails to achieve its mission of promoting economic growth in borrower countries by motivating catalytic financing to resolve balance of payments problems (Vreeland, 2003; Cottarelli and Giannini, 2002; Bird and Rowlands, 2002; Killick, 1995; Manuel, 1991; Mody and Saravia, 2003).

The structuralist perspective described by Steinwand and Stone (2008), emphasizes the political gains to be realized via IMF lending, focusing instead on the political interests of creditor nations. Thacker (1999) is one of the earliest quantitative studies of IMF lending politics and lays the theoretical foundation for many of the subsequent structuralist, power-politics explanations of IMF lending. He points directly to the influence of the United States in the structure and operational procedures of the Fund and suggests that the US uses its influence to reward political allies with IMF loans, much the way it does with foreign aid. Following Thacker, other scholars such as Dreher, Sturm, and Vreeland (2009); Stone (2002, 2004, 2008); Oatley and Yackee

(2004); Copelovitch (2010) have also advanced theories that propose that the US or other major creditor nations (the G-5) uses its unique position of power in the organization to intervene in IMF lending decisions on a case-by-case basis to advance its security interests. However, structuralists, particularly those that emphasize intervention by the creditor nations on case-by-case basis, leave an important question unanswered – If the IMF only serves the interest of wealthy creditor nations, why do developing countries borrow? If the assumption is that IMF loans serve some economic function for borrower countries, it remains to be identified.

The third perspective, the public-choice perspective, recognizes the lack of empirical evidence for functionalist theories, and provides an answer to the question of why countries borrow despite the lack of economic gain by embracing the logic of two-level games. Scholars such as Putnam (1988) and Milner (1997) specify two separate levels of negotiating that occur when a nation engages with an international institution. At the international level, the government bargains with the institution and the governments of other nations, and at the domestic level, the executive bargains with other powerful political actors including other government officials, voters, and interest groups. According to the logic of two level games, the bargaining process on one level can be affected by the dynamics of bargaining process on the other level. However, this perspective on IMF lending has generally assumed a level of autonomous functioning on behalf of the institution that begs the question of why creditor nations would continue to fund the institution (Vaubel, 1986, 1996). Scholarship from this perspective has generally been silent on the role and interests of creditor nations.

Understanding IMF lending and its effect on the economies of member states requires an explanation that provides a logical argument for both side of IMF lending; an explanation that posits both why borrowers borrow and lenders lend in a logically consistent manner. Despite an abundance of research, the question of what joint gains the IMF produces for both creditor nations and borrower nations remains open. In this paper, I presents one such explanation: the IMF produces joint gains for both creditor and debtor nations by providing greater benefits to both than the costs of participation. The next three sections propose that IMF lending generates international economic (and hence political) gains for its largest creditor nation via the promotion of neoliberal policies, while producing domestic political gains for the borrower governments who seek to implement neoliberal reforms to varying extents in order achieve their own domestic political ambitions.

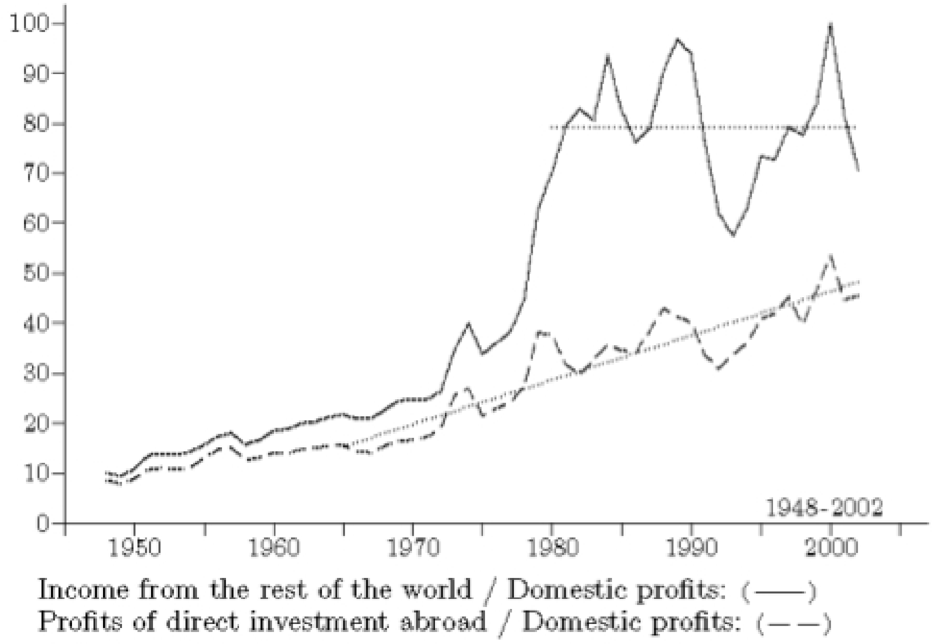
The Supply Side

This section argues that the US reaps economic gains from the implementation of neoliberal policies such as trade liberalization, capital account liberalization, privatization, and government deregulation. The IMF has championed these policies through its loan programs, and the US economy, and, by extension, the US hegemonic standing in the world has been strengthened as countries have adopted them.

Several scholars have documented the US's long term interest in promotion of neoliberalism in many regions of the world. For some scholars, this interest in neoliberalism was driven by self interest and that the US stood to gain from a system of liberal trade and investment. For example, Helleiner (1994) and Strange (1988) argue that the US interest in promoting free trade via international institutions in the Bretton Woods era was partially motivated by a desire to create new export markets and that the US promotion of capital account liberalization beginning in the late 1970s was related to US interest in maintaining a position of global influence as it slowly lost its trade advantage and began to develop large budget deficits and current account deficits. For other scholars, such as Melanson (2005), the US's interest in neoliberal policies came from foreign policy makers' belief in a capitalist peace.

Since the 1980s, neoliberal reforms implemented abroad have largely provided two significant benefits to the US economy. First, the combination of free trade, liberal capital flows (both in-flows and out-flows), privatization, and deregulation creates new markets for US-based global companies, which are some of the largest corporations in the world and are uniquely able to take advantage of the opportunities these new markets present. US corporate profits from activities abroad have risen considerably since the 1970s. Figure 1 below, generated by Dumenil and Levy (2004) with data from the US Bureau of Economic Analysis, shows the profit of US-based corporations from their investments abroad as a proportion of their domestic profits. Increasingly, US corporations are generating a significant amount of their profits in foreign markets.

Fig. 1: Profits from foreign investments as a percentage of domestic profits for US based global corporations



Additionally, Biglaiser and DeRouen Jr (2010) confirm the connection between neoliberal reforms implemented under IMF loan programs and US corporate investment. They find that countries that participate in IMF Stand-by Arrangements experience positive inflows of US Foreign Direct Investment. They conclude that this is likely the result of an improved policy environment following reforms.

Secondly, while providing new opportunities for portfolio and direct foreign investment abroad (though direct investment is the largest type of US investment made abroad) the US has also benefited from cheaper access to capital from abroad. For wealthy capital holders abroad, US securities and treasury bills are seen as a relatively liquid and low risk investment. Figure 2 below illustrates the apparent Return on Investment of US holdings abroad and foreign holdings on the US. The ROI on US holdings abroad is on average 4.4 percent higher than on foreign holdings in the US. The ROI is higher for US holdings abroad for both portfolio and direct investment. The data also show a marked increase in the difference between the ROI for US holdings abroad and foreign holders in the US after the onset of neoliberal reforms in 1980. The average difference in ROI on portfolio investments was .6 percentage points from 1960-1980, whereas the average difference in returns was 4.4 percent between 1981 and 2002. For direct investment, the difference in was 3 percent (average 1960-1980), while the average difference was

6.4 percent for 1981-2002. (Dumenil and Levy, 2004)

Fig. 2: Return on investment for US holdings abroad and foreign holdings in the US

Whether the US policymakers themselves determine that it is in the benefit of the country overall to promote neoliberal reforms abroad, or whether US private interests directly lobby for the promotion of such policies, is not easy to determine. Both mechanisms may be at work. Either way, there is evidence that the US seeks to use the IMF to promote neoliberal policies. When examining Congressional directives to the Treasury and the US Executive Director to the IMF, there is at least as much evidence to suggest that US Congressional influence has actively been applied to promote free trade and investment as there is evidence to suggest that congressional influence has been applied to bail out private financial institutions. There are ten Congressional mandates that require the US Executive Director (USED) to promote trade liberalization in one form or another. There are three such mandates that ask the USED to use IMF lending to encouraging countries to reduce barriers to investment. An excerpt from a mandate that addresses both trade and investment, 22 U.S.C. 286gg (Nov. 30, 1983), is illustrative. The mandate requires that the

"Treasury shall instruct the USED to consult with the IMF to reduce obstacles to and restrictions upon international trade and investment in goods and services, eliminate unfair trade and investment practices, and promote mutually advantageous economic relations. The USED shall also work to have the IMF obtain agreement with countries to eliminate certain unfair trade and investment practices and shall take a country's progress into account in formulating its position on requests for loans for periodic financial disbursement."

The notion that the IMF promotes neoliberal policies at the behest of the US is not an altogether new argument within the IPE literature. Several scholars from the critical IPE tradition have made this argument (Peet, 2003; Mueller, 2011). There are, however, other scholars who emphasize the role of the Fund's staff economists, who bring with them an ideological bias toward neoliberal policies as a result of their training in classical economics. Chwieroth (2009), for example, documents the role of Fund economists in promoting capital account liberalization in fund programs. He determines that while the US and other European countries embraced and supported capital account liberalization, it was Fund economists who championed the policy aggressively in the 1980s. However, as **?** and De Vries (1985) both note, the US's promotion of capital account liberalization in the 1972 Committee of 20 meeting to reform the international monetary system is the reason that Fund economists were given the freedom to promote capital account reform in the first place. In reality, both mechanisms are certainly at work to varying degrees. The argument presented here, in keeping with past literature that has emphasized the institutions' role in promoting neoliberalism **?**Stone:2011), is not that the US directly intervenes on a case-by-case basis to tell IMF program managers which conditions to set, but that the US is responsible for establishing the policy preferences of the institution in the first place because such policies provide an advantage for the US economy. This argument is rooted in the assumption that while institutions are certainly endowed with a level of autonomy, powerful states are essential to the existence of international institutions and these states never permit the autonomy of institutions to the degree that they would fail to reap a benefit.

The Demand Side

Many borrower countries seek IMF loans because they face financial hardship, usually relating to balance of payment issues, budget shortfalls, and inadequate reserves. However, as Vreeland (2003) documents, not all countries initiate IMF loan programs during dire economic times. Additionally, for some borrower governments, the conditions which accompany IMF loans are not entirely a bitter pill to be swallowed. Rather, some governments may desire the political consequences of implementing reforms.

Comparative politics literature on the political logic of neoliberal reform, along with the public choice literature on IMF lending, suggest several domestic political reasons borrower governments may seek neoliberal reform. First, borrower governments stand to benefit from the political support of particular classes or constituencies that will benefit from the redistributive effect of either domestic or external reforms. In seeking to explain why governments might borrow from the IMF despite the negative consequences of loan programs for economic growth, Vreeland (2003) examines the impact of IMF loans on the distribution of income. He finds that IMF programs significantly reduce labor's share of national income, and increases capital share of national income. His account fits with that of Stiglitz, who argues:

> "There is [...] a process of self-selection of reforms: the ruling elite has taken advantage of the reform process and the asymmetries of information – both between themselves and the citizenry and between the international aid community and themselves – to push those reforms that would benefit them." (2000, pg. 551)

Second, for newly empowered political leaders, liberal reforms may serve to destroy old systems of political patronage from which their opposition formerly benefited. Geddes (1995) argues that particularly in times of crisis, political outsiders are ushered into power via coups or elections and that these newly empowered leaders may see liberal reforms as strategic, in order to dismantle interventionist policies and bureaucracies that constituted a system of patronage for their opponents.

Finally, reforms often provide political elites with new opportunities for systems of patronage, corruption, rent seeking, or cronyism, particularly as wealthy multinational corporations seeks market entry and raise the stakes for these activities. While research has confirmed that in the long run economic liberalization reduces opportunities for corruption, other studies of developing countries' liberalization processes have found that, in the short term, corruption and cronyism can persist post-liberalization, just in different forms. This is particularly the case if reforms are partial or incomplete, implemented too quickly (or too long after political reforms), or if the quality of political institutions is poor at the time of reform and is not accompanied by political reform. Opportunities for corruption and cronyism post-liberalization include bribes, contracts, or managerial positions from large multinational companies looking to gain market access and political privilege, and rents from the sale of state owned enterprises, (which often accompanies trade liberalization). Given the increased investment and growth that results from the reforms, the stakes are even higher post-liberalization. (see Hellman, 1998; Lewis and Stein, 1997; Brown et al., 2009; Robertson-Snape, 1999; Di John, 2005; Celarier, 1997; Hoa and Johnston, 2002; Elliott, 1997; Tavares, 2007)

For governments interested in reform, borrowing from the IMF can strengthen their bargaining leverage vis vis domestic opposition. IMF loans can provide borrowers with several political benefits. First, loans provide political reformers with the leverage needed to implement neoliberal reforms in the face of domestic opposition by raising the stakes of not implementing reform (Vreeland, 2003). The IMF can withhold funds, signal to investors that the lending to the country carries high risk, or interfere with a countries' rescheduling of bilateral debt. The logic of this argument is stronger with regard to the second and third penalties since there is evidence to suggest that countries actually suffer from lower rates of economic growth while under IMF agreements – so the opposition has little incentive to relent if they fear only the loss of IMF funds.

Second, concluding an IMF loan agreement is a way for reformers to "tie their own hands" politically when negotiating with domestic political groups who oppose reforms in order to increase the likelihood of reform implementation. This amounts to making a more credible "bluff" about what they are willing or able to negotiate on. This explanation is stronger in that the bargaining leverage gained by the reformers is largely from its public commitment to a third party, and is not guaranteed only by the potential economic repercussions outlined above, but also by the political repercussions of not following through on its commitment. However, the strength of the political repercussions is, admittedly, debatable.

Third, committing to an IMF loan and the conditions it entails lowers the political cost of implementing unpopular reforms by using the institution as a scapegoat. This also works to reduce political pressure from domestic groups who oppose reforms. This explanation is strong so long as the regime can credibly scapegoat (Dixit, 1996; Vreeland, 1999, 2003). Such regimes may include those who do not embrace a platform of economic reform publicly, rely heavily on propaganda, or those regimes who maintain a high level of opacity or disinformation. Of course, this logic implies that governments who borrow from the IMF are not only those who are interested in reform, but those who need bargaining leverage, which in turn helps to explain why ultimately conditions are not fully implemented by borrowing countries – reformers face difficult circumstances with regard to implementing their agenda.

The Equilibrium

The previous two sections have identified the joint economic and political gains to be realized by creditor nations and borrower governments through the implementation of neoliberal policy reforms – a central function of IMF lending. But how does the IMF bring supply and demand together and what evidence do we expect to observe on the part of the IMF and borrower countries to support this theory of joint gains?

First, we would expect to see that this strategy on behalf of donor countries and borrower governments works to some extent. Evidence does exist that suggests the IMF is successful at promoting neoliberal reforms, even if conditions are not implemented fully. Systematic studies on the effect of IMF loans and loan programs on countries' trade and investment policies provide some evidence to support the notion that IMF loans actually work to advance trade and capital account liberalization. For example, Chwieroth (2005), finds that countries that participate in IMF loan programs are more likely to liberalize their capital accounts, after controlling for selection effects, and Mukherjee and Singer (2010) find that countries who participate in an IMF program and dedicate a significant amount of resources to welfare programs are likely to liberalize their capital account. Evidence on the effect of trade is a bit more mixed. Quantitative studies such as Rose (2005) find no support for the idea that IMF programs facilitate trade liberalization, but do not control for selection effects. Wei and Zhang (2010) find that countries whose loan agreements include conditions of trade liberalization, did in fact liberalize their trade restrictions. Sorsa and Sharer (1998) examine six country case studies in the 1990s – Bangladesh, Zambia, Zimbabwe, Egypt, Hungary, and Sri Lanka. They report that all countries increased the liberalization of the trade policies to varying degrees. Similarly, Calika and Corsepius (1994) examine 78 IMF loan programs implemented in the early 1990s and find that most liberalized their trade policies.

Second, we would expect the IMF to promote reforms to the greatest extent possible by lending to those governments with the political will to implement reform. Indeed, there is evidence to suggest that this is the preference of the fund. As the IMF Managing Director Per Jacobsson said in 1959, "[IMF] programs can only succeed if there is the will to succeed in the countries themselves." Or, rephrased in more contemporary IMF rhetoric "Conditionality, cannot compensate for a lack of country ownership(IMF 2001)." Evidence from scholars, Fund bureaucrats, and the institution itself supports the idea that the IMF gives some amount of preference to reform-minded governments. The IMF considers carefully the domestic political context of borrowing countries when deciding to lend and when developing loan packages. For example, according to the Funds official guidelines on conditionality, composed in 1979, "The Managing Director will recommend that the Executive Board approve a member's request for the use of the Fund's general resources when it is in his judgement that the program is consistent with the fund's provisions and policies and that it will be carried out." While not officially speaking for the Fund, former First Deputy Managing Director of the IMF, Stanley Fischer (1997) commented on the political economy role of the IMF saying: "There can be little doubt that the ideal for the IMF is to support well-designed programs that are fully owned by their governments. But such situations are rare. More often, the IMF's political-economy role is to strengthen the hands of reformers within a given country." Additionally, case studies such as

Putnam (1988), which examines IMF lending to Italy in the late 1970s, and Bjork (1995) which examines Poland in the 1990s, and case studies of Uganda, Brazil, Bulgaria and Korea in the 1990s conducted by the fund itself (IMF, 2001) suggest that the IMF is keenly aware of the domestic political function of its lending in reform processes. While anecdotal, such evidence suggest that the fund would prefer to lend to governments who deem neoliberal reforms to be in their political interest.

However, a government's preference regarding neoliberal policy reform is difficult for the Fund to determine ex ante. Really, political leaders' policy preferences are difficult to observe in general since deception can be an important political tactic. There may be a variety of reasons that a government may prefer to implement neoliberal reforms, as discussed in the previous section. From the perspective of the IMF, one could conceive of three different indicators of policy preference. For example, the IMF could examine the rhetorical position of the government executive by assessing the party or campaign platform to determine whether the leader is sympathetic to neoliberal reforms generally. In addition to rhetoric, the IMF could look to the government executive's past actions – if they have implemented or been party to the implementation of some past neoliberal economic reforms during their tenure, this may be an indication of their reform-mindedness. A third way the IMF might assess the intentions of the executive may not be an assessment of the actions of the government executive himself, but of the advisors the executive appoints. An executive who is interested in reforms may be more likely to enlist the assistance of western educated economists in the faculty of finance minister or central bank manager, for instance. In context, any one of these factors might be an important indicator. Certainly a government executive who employed a Western-trained neoclassical economist as a finance minister, and whose rhetoric about neoliberal reform matched their track record, would certainly qualify as reform-minded. I employ measures of all three of these concepts in the next section.

It is worth noting that because this theory grants a level of autonomy to the IMF in that it does not assume that US intervenes on a case by case basis to set loan conditions, and because it acknowledges that the IMF also needs to sustain itself by lending for profit, this theory also implies that the IMF preference for lending to reform-minded governments may be stronger in certain periods than in others. In particular, the IMF likely gives stronger preference to reform-minded governments when its liquidity is low. During periods of low-demand (high liquidity) it is likely that the IMF does not consider government policy preferences as strongly, since it needs to lend to turn a profit.

Because this is a theory of joint gains, of both supply and demand, this theory also anticipates that reform-minded government executives are going to be more likely to approach the IMF for a loan. Vreeland (2003) examines the case of Uruguay in 1990, where President Lacalle faced tough domestic opposition to his plan to reduce ballooning fiscal deficits. By signing an IMF agreement, Lacalle was able to alter his negotiating posture via opposition within his coalition government and push through fiscal reforms. However, while economic conditions may make the IMF more interested in lending to reform-minded governments, reform-minded governments might be more likely to approach the IMF regardless of the state of the economy. In fact, Vreeland argues that the policy preferences of governments are one reason that countries who have sufficient reserves are observed entering an IMF program. One variable that may condition the effect of a government's policy preference on their likelihood to borrow from the IMF may be the degree of difficulty they face regarding implementation of reforms. If the institutional framework of a government presents fewer structural barriers to reform, reform-minded leaders may not need the bargaining leverage of the IMF. On the other hand, in a context where multiple veto-players with the power to block reform, a reform-minded government may be more eager to call in the IMF.

Summary and Hypotheses

To summarize, this section has proposed that if the theory of joint gains presented in first two sections holds merit, we should observe the following:

HYPOTHESIS 1: All else equal, countries with reform-minded governments will be more likely to borrow from the IMF loan than those who are not.

HYPOTHESIS 2: All else equal, countries with reform-minded governments will be more likely than those who are not to borrow from the IMF when they have sufficient reserves.

HYPOTHESIS 3: All else equal, the IMF will be more likely to lend to countries with reform-minded governments than those who are not.

HYPOTHESIS 4: All else equal, the IMF will be more likely to lend to countries with reform-minded governments than those who are not when liquidity is low.

In the next section, I develop a measures of reform mindedness using factor analysis and present an empirical test of these hypotheses.

Quantitative Method and Analysis

Dependent Variable

Empirical analyses in the literature on the politics of IMF lending generally use one of three different dependent variables – a bivariate measure of whether a country enters an IMF loan program, a continuous measure of the size of the loan granted by the IMF, and the number and/or stringency of conditions place on the loan by the IMF. It is possible, indeed likely, that there might be different political explanations for different aspects of IMF lending, i.e. the decision to lend, the amount of the loan, or the conditions placed on the loan, as suggested by the analyses of Copelovitch (2010) and Dreher (2006). However, most literature explores this possibility shallowly and offers minimal analysis as to why one aspect of IMF lending, as opposed to the others, might be more or less influenced by a particular political dynamic leaving the lack of robust empirical support to raise skepticism about the explanatory power of the theories themselves.

It is critical then to select the most appropriate dependent variable. For the empirical test of the theory and hypothesis presented in this paper, this is a bivariate measure of IMF program entry. This is the case for several reasons. First, the theorized effect is a selection effect. Second, the theory does not suggest that loan size matters for the adoption of liberal reforms; rather it suggests that the important mechanism is the bargaining advantage gained by sympathetic political elites from simply accepting a loan and the accompanying conditions. Thirdly, the conditions themselves are also part of the bargaining process, and this theory suggests that both parties have an ideal set of conditions they would like to see implemented. The observed set of conditions is simply the set that is mutually agreeable to both. Thus, the number and type of conditions attached to a loan likely have a different set of determinants.

Data for the dependent variable is taken from Copelovitch (2010) which uses a sample of 59 middle income countries from 1983 - 2003. The regional distribution of the data can be found in Table 7 in the appendix. Of 1050 country-year observations, 205 are observed as marking the beginning of an IMF loan program. A list of IMF programs by country is listed in Table 6 in the appendix.

Method

While the dependent variable is a dichotomous measure of IMF program entry, this variable is in fact a bivariate measure of a joint agreement between the IMF to lend and the country to borrow. Evaluating the hypotheses outlined, however, requires isolating these two separate decision making process – of the the IMF to lend and the country to borrow – using two different sets of explanatory variables. This is difficult since this decisions are not directly observable. However, a bivariate probit model can usually be used to estimate the parameters of both models despite this partial observability, as long as there is one different exogenous variable in the two equations (Poirier, 1980). However, bivariate probit models are notoriously difficult to estimate, and often encounter convergence problems with the most common maximum likelihood algorithms. This proved to be the case with the data used in this paper. Due to convergence problems, a Heckman (1979) selection model is used to attempt to model and empirically account for the two separate decision making processes that produce the dependent variable. This is not an ideal choice. While the Heckman model does at least capture the two stages of the data generating process that produced the dependent variable used here, the Heckman selection model assumes the dependent variable in the first stage (country request to borrow from the IMF) is observed when in fact it is only partially observed. Using the same dependent variable for both the first and second stage models means that it is very likely that none of the coefficients on the reform mindedness variables will be statistically significant in the second stage model because the variation they explain in the dependent variable is being controlled for via the inverse mills ratios generated from the first stage model.

Independent Variables for Predicting IMF Willingness to Lend

The main independent variables of interest used to test the hypotheses presented in this paper are three different proxy measures for the reform-mindedness of a country's government. Measuring the reform-mindedness of governments is not easy since there are a variety of reasons a government may want to seek reforms. Not to mention that a politicians policy preference cannot necessarily be ascertained from their rhetoric. The first obvious way to assess the reform-mindedness of a government is by examining their past record of reform. Joseph Gold (1979), a Senior Consultant and General Counsel at the IMF, acknowledged that prior actions behalf of nations states was a consideration for lending by the Fund and Polak and Reisen (1991) acknowledge that some countries, such as India in 1982, actually design and implemented preemptive reforms with the intention of seeking IMF financing.

As a measure of past reform, I employ the restrictions component of the economic sub-index of the KOF index of globalization. This measure assesses the restrictions on both capital account openness and trade. It relies on the IMF's Annual Report on Exchange Arrangements and Exchange Restrictions, which includes 13 different types of capital controls, to assess capital account controls and utilizes on data on the mean tariff rates and hidden import barriers to asses trade restrictions. This measure is similar to that employed by Gwartney et al. (2011) in their Index of Economic Freedom. I measure the change in this index since the executive took power. For leaders who have been in power for longer than five years, the five year change is used. This measure is available for most of the sample, missingness is more common for African countries in the sample, but these countries are a smaller percentage of sample. This measure ranges from approximately -13 to 30 for the sample. The mean is 2.9 and standard deviation is 5.25. The mean for Latin American countries and East Asian countries are higher than the mean, while the mean for African and Eurasia is lower.

A second potential measure of a government's reform-mindedness is the orientation of their party's platform on economic issues. The Database of Political Institutions (Thorsten Beck, George Clarke, Alberto Groff, Philip Keefer, and Patrick Walsh, 2001) contains a cross-sectional measure of party orientation with respect to economic policy. The measure is categorical: right, left or center. Right is for parties that are defined as conservative, Christian democratic, or right-wing. Left is assigned for parties that are defined as communist, socialist, social democratic, or left-wing and Center characterizes parties that are defined as centrist or when party position can best be described as centrist (e.g. party advocates strengthening private enterprise in a social-liberal context). To improve the accuracy of this measure, the data for countries in Latin America are replaced with data from the Latin American and the Caribbean Political Dataset (Huber, Stephens, Mustillo, and Pribble, 2012). Their 5 categories are collapsed into three to correspond to the rest of the DPI database. The main challenge of this categorization is that there are a significant number of regimes that do not fit because they are military regimes or other autocratic regimes whose party does not have a clear economic policy platform. I also construct measures of leftist or rightist regimes by collapsing the three categories into dichotomous measures. This measure is also available for most of the sample. By region, missingness is concentrated in Eurasia and African countries in the sample. According to this measure,leaders in African and Latin American countries tend to belong to parties with a neoliberal economic platforms more often than their counterparts in Eurasia and East Asia.

The third indicator of a regime's reform-mindedness that I employ is the professional training of a country's finance minister. If a leader is truly interested in implementing neoliberal reforms, they may require the expertise of technocrats, in particular they may appoint a finance minister whose professional training was completed at a university whose economics department espouses neoliberal economic principles. I use data from Chwieroth (2007), which is unfortunately only available for half of my sample. This variable is not available for any of the African countries in the sample and there is also a significant degree of missingness for Eurasian countries. Descriptive statistics for this variable and the two other main independent variables can be found in Tables 8-10 in the appendix.

The IMF liquidity ratio is also included as a control variable to account for explanations that emphasize the importance of the state of the IMF portfolio in their lending decision. An interaction term with the three different measure of reform-mindedness is also generated.

Other control variables are included based on previous work that attempts to explain why the IMF lends. The main political control variables are the US-UN voting affinity score Thacker (1999); G-5 Bank exposure as well as the variance of G-5 Bank exposure Copelovitch (2010); a dummy variable for whether a country experiences a domestic currency crash; economic control variables including GDP per capita, current account/GDP, the value of a country's short term debt as a percent of their currency reserves, their external debt/GDP ratio, and their ratio of debt service to exports. the number of global currency crises is also included as a control variable. This variable measures the number of currency crises that occurred in the world at the time of IMF loan. This variable is one way to measure systemic risk. If a country is borrowing from the IMF during a period in which many countries are experiencing domestic currency crises, then it could be that such crises are connected and any one crisis might be the result of the others.

Independent Variables for Predicting Country Willingness to Borrow

The main independent variables in the model predicting country borrowing are the three different measures of reform-mindedness outlined above. Also, an interaction term is included with a measure of the ratio of a country's short debt to reserves in order to assess the second hypothesis. An important political variable that may predict an executive's willingness to borrow from the IMF is the number of veto players within the government. The higher the number of veto players, the more likely a government executive will need the bargaining leverage that an IMF agreement provides in order to implement reforms. Other variables that may affect a country's decision to borrow include a series of economic variables such as whether a country experiences a domestic currency crash, GDP per capita, current account/GDP, the value of a country's short term debt as a percent of their currency reserves, their external debt/GDP ratio, and their ratio of debt service to exports. '

Results and Interpretation

The results from the first stage probit model with variables predicting country's willingness to borrow are presented in Table 1, including the three different measures of reform mindedness. The results vary according to model, suggesting that the three proposed measures of the independent variable are indeed proxy variables, one component of which may be the latent variable of interest (reform mindedness). Each variable certainly includes a large amount of measurement error and does not capture the concept completely. Indeed, when the three variables are regressed on each other, only two are positively correlated with one another; government executives with neoliberal finance ministers are more likely to have implemented past reforms. Executives whose parties espouse neoliberal economic policy platforms are actually *less* likely to have neoliberal finance ministers, raising the question of how good of an indicator of reform mindedness is party policy orientation. The results of these regression are included in the Appendix. The executive's party orientation is seemingly unrelated to their past record of reform.

With regard to estimated effects of the three independent variables, none of the coefficients are statistically significant at the $\alpha = .05$ level of significance, even when interacted with the ratio of short term debt to reserves. However, examining the marginal effects plots for the interaction terms of the three independent variables with the ratio of short term debt to reserves, we find support for Hypothesis 2, using the measure of past reform. In Figure 3, we can see that the marginal effect of past reforms is positive and statistically significant when the (logged) ratio of short term debt to reserves is low. This suggests that government executives who are more reform-minded, in that they have implemented past reforms, are more likely to borrow from the IMF when they do not economically need to. The marginal effects plots for the neoliberal party orientation also supports hypothesis 2, with the probability of entering an IMF loan program increasing as the ratio of short term debt to reserves decreases. However, the effect is never statistically distinguishable from zero. The marginal effects plot for neoliberal finance minister is quite different. The marginal effect of having a neoliberal finance minister is the opposite of what hypothesis 2 proposes – decreasing the probability of entering an IMF program as a country's reserve position improves. It is also is never distinguishable from zero.

The coefficients of the control variables that are statistically distinguishable from zero vary from model to model. The economic control variables perform well in models one and two, but are not significant in model 3, and this is probably attributable to the reduction in sample size that occurs when the neoliberal finance minister variable is used. It is worth noting that in the first two models, the number of veto players in a government increases the probability of entering an IMF program, which is consistent with the theory presented here and with past findings of Vreeland (2003).

Table 1: Probit Regression for Country Borrowing

	Model 1	Model 2	Model 3
(Intercept)	-1.53*	-1.58*	-1.65*
	(.23)	(2.25)	(.35)
Num Fin Crises	.02	.03	(.04)
	(.02)	(.02)	(.03)
Currency Crash	.24	2.71*	-.25
	(.15)	(.15)	(.22)
Current Acct to GDP	-.04*	-.01	-.04*
	(.01)	(.008)	(.02)
Veto Players	0.18*	.23*	.165
	(0.08)	(.09)	(.13)
Ext Debt to GDP	.004*	.004*	.005
	(0.002)	(0.002)	(.003)
Trade Deficit to Exp	.004	.005	.001
	(0.003)	(.003)	(.006)
Short Trm Debt to Res	.14*	.16*	.12
	(0.06)	(.05)	(.09)
Past Reform	.008		
	(.01)	(1.99)	(2.04)
Reform*STDR	-.01		
	(.009)		
Right Party Orientation		.004	
		(.12)	
RPO*STDR		-.14	
		(.08)	
Neoliberal Fin Minister			.21
			(.2)
NLFM*STDR			.12
			(.24)
N	838	914	402

Note: * indicates a p-value < 0.05
Standard errors are reported in parentheses.

Fig. 3: Marginal effect of past reform on the probability of entering an IMF loan program at various levels of (logged) short term debt to reserves

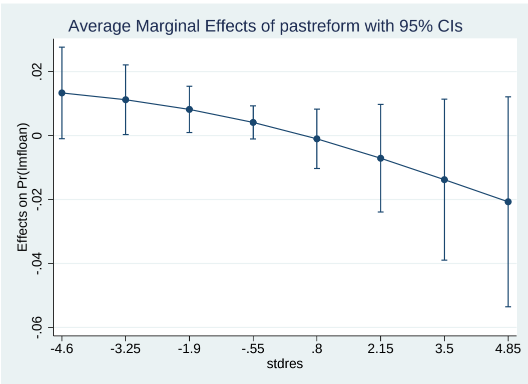


Fig. 4: Marginal effect of neo-liberal party orientation on the probability of entering an IMF loan program at various levels of (logged) short term debt to reserves

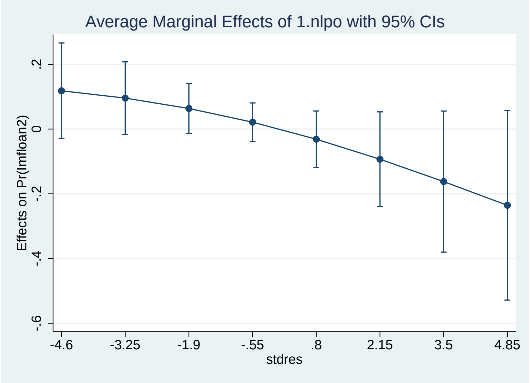
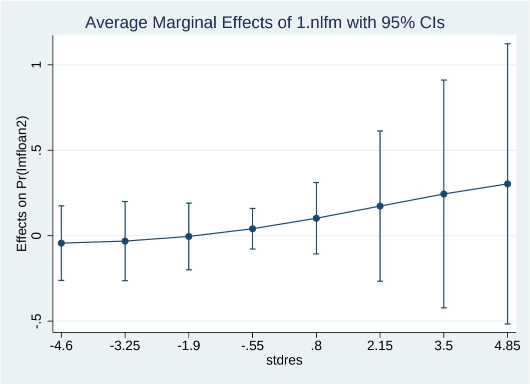


Fig. 5: Marginal effect of having a neoliberal finance minister on the probability of entering an IMF loan program at various levels of (logged) short term debt to reserves



The results from the second stage probit model estimating IMF willingness to lend are summarized in Table 2. Again, the coefficients on the independent variables are not statistically significant, even when interacted with the IMF liquidity ratio. The marginal effects plots show that the average marginal effect of all three independent variables increases as the IMF liquidity ratio increases. This lends more support to hypothesis 3 than hypothesis 4. However, the marginal effect of all three variables is never statistically significant. Additionally, the effect of all of the economic covariates become indistinguishable from zero in this second stage model. This could be due to the inclusion of the inverse mills ratio, but model fit is also very poor. The fact that virtually all the variables (with the exception of the US-UN vote alignment score) have a statistically insignificant effect on the the dependent variable is probably an indication that the 2-stage model is not the best fit for the data. The poor model fit is confirmed when one considers the very low pseudo r-squared value of approximately .05 and .08 in the two stages respectively.

Table 2: Probit Regression for IMF Lending

	Model 1	Model 2	Model 3
(Intercept)	.28	-.17	1.08
	(1.06)	(.91)	(1.4)
G5 Bank Exposure	.05	.05	(.20)
	(.07)	(.07)	(.132)
Covariance	-.0004	-.00002	-.003*
	(.001)	(.001)	(.001)
Cov*G5 Bank Exp	-.0004	-.00002	-.00005
	(001)	(.0001)	(.0003)
US-UN Vote Alignment	.69*	.69*	- .05
	(.23)	(.23)	(.40)
Num Fin Crises	.02	.02	.01
	(.02)	(.02)	(.03)
Currency Crash	-.02	.02	-.64*
	(.18)	(.17)	(.26)
Current Acct to GDP	-.0001	-.005	-.0005
	(.02)	(.02)	(.03)
Ext Debt to GDP	.002	.002	.001
	(0.002)	(0.002)	(.003)
Trade Deficit to Exp	.004	.003	-.004
	(0.004)	(.004)	(.006)
Short Trm Debt to Res	.01	.03	.06
	(0.07)	(.06)	(.10)
Liquidity Ratio	-1.33	-.61	.84
	(.88)	(.87)	(1.1)
Past Reform	-.07		
	(.04)	(1.99)	
Reform*LR	.24		
	(.15)		
Right Party Orientation		-.08	
		(.47)	
RPO*LR		.24	
		(1.49)	
Neoliberal Fin Minister			-.27
			(.8)
NLFM*LR			1.95
			(2.51)
Mills Ratio	-1.11*	-.96*	-1.6*
	(.51)	(.45)	(.77)
N	830	830	394

Note: * indicates a p-value < 0.05
Standard errors are reported in parentheses.

Fig. 6: Marginal effect of past reform on the probability of entering an IMF loan program at various levels of IMF liquidity ratio

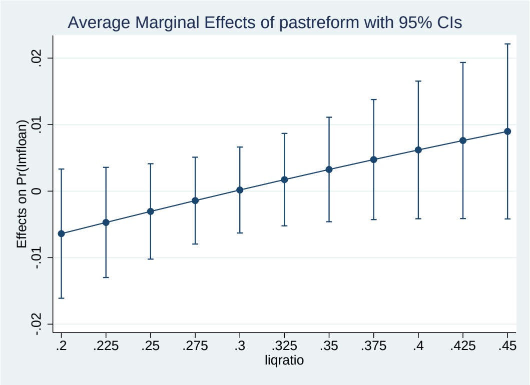


Fig. 7: Marginal effect of neo-liberal party orientation on the probability of entering an IMF loan program at various levels of IMF liquidity ratio

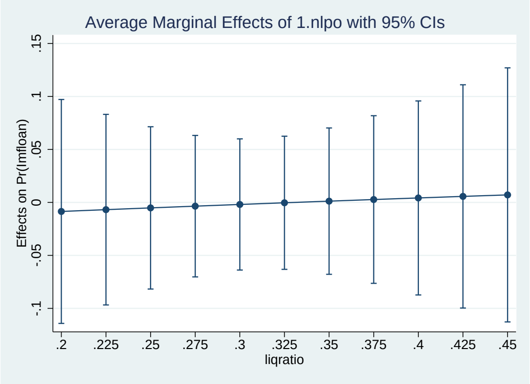
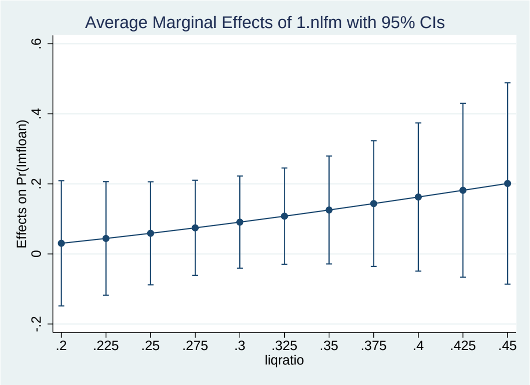


Fig. 8: Marginal effect of having a neoliberal finance minister on the probability of entering an IMF loan program at various levels of IMF liquidity ratio



Conclusion

In light of evidence that the IMF fails to achieve its major goal of supporting economic growth in borrowing countries, this paper has proposed an alternative set of joint gains for creditor and borrower countries. It has proposed that the IMF serves the international political and economic goals of the institution's largest creditor, and the domestic political interests of many of its borrower countries in promoting neoliberal economic reforms. Unfortunately, testing this theory empirically is difficult due to measurement issues. Reform mindedness as a concept is inherently difficult to observe. If it were not, the IMF would almost certainly lend only to those government executives. This paper proposed three different proxy variables and found support for one of the proposed hypotheses using one of the measures. Perhaps the best way to ascertain what signals the IMF does use to determine the policy preferences of government executives would be to interview staff directly. But the reality is that the main independent variable presented here may be unobservable and unmeasurable to any sufficient degree of accuracy in a large-N analysis; the IMF may make its decision to lend based on back room discussions, hidden from view. While case-study analysis could prove illuminating, it would be insufficient to determine whether the dynamics proposed here occur frequently enough to lend sufficient support to this theory of joint gains. In additional to measurement problems with the main independent variable, the limited availability of software capable of estimating the appropriate model only compounds the difficulty with testing the theory presented herein.

There are a few other shortcomings to the theory and empirical analysis presented here which may explain the Null findings. First, the theory presented here tends to view creditor nations' interests as fixed throughout time. This is likely an oversimplification since the international systems certainly evolves over time and creditor nation interests change in response. Empirically, these changes over time are also not accounted for. Additionally, and perhaps more fundamentally, the empirical analysis conducted assumes that cases of IMF lending are independent of one another. This assumption is likely inaccurate. The events that motivate one country to borrow from the institution at a particular point in time certainly influence other countries in the same regard.

While this study was not entirely successful, it does make a couple contributions to political economy literature of IMF lending. First, it raises an important, yet unanswered question within the political economy literature on the IMF: What are the joint gains which permit the persistence of the institution? While this question is rooted in the functionalist paradigm, functionalist literature on the IMF has not identified exactly what these gains are. The finding that the IMF lowers growth has not be challenged or explained. Most of the existing political literature on the IMF rests on the assumption that the IMF provides an economic benefit to borrower countries. Yet that economic benefit remains to be identified and supported with empirical evidence. Furthermore, the theory presented here suggests that cooperation via international institutions serves political ends and occurs when the gains state actors seek exist on different levels. Traditional theories of institutions, particularly economic institutions, have suggested that the cooperation is made possible by each state's concern with absolute, as opposed to relative, gains. This theory shifts the focus from relative versus absolute gains to the level at which the actors accumulate the benefit of cooperation. However, this dynamic presupposes a hierarchical nature to the international system that is more in line with the structuralist paradigm, then the functionalist. In this way, the research presented here synthesized existing scholarship on the politics of IMF lending, and considered the possibility that three strands of literature on the IMF – structuralist, functionalist, and public-choice theories – each contain one part of the answer to the yet unanswered question of why both borrower and creditor nations use the institution when it apparently fails to provide a clear economic benefit to either. Given the large body of quantitative literature on IMF lending, understanding how the various findings fit together is in itself an interesting puzzle.

Appendix

Table 3: OLS regression for neoliberal finance minister on past reform

(Intercept)	3.52*
	(.26)
Finance Minister	2.58*
	(.68)
N	433

Note: * indicates a p-value < 0.05
Standard errors are reported in parentheses.

Table 4: OLS regression for neoliberal party orientation on past reform

(Intercept)	2.77*
	(.20)
Party Orientation	.46
	(.38)
N	927

Note: * indicates a p-value < 0.05
Standard errors are reported in parentheses.

Table 5: Logistic regression for neoliberal party orientation on neoliberal finance minister

(Intercept)	-1.4*
	(.15)
Party Orientation	-.72*
	(.3)
N	442

Note: * indicates a p-value < 0.05
Standard errors are reported in parentheses.

Table 6: List of countries and IMF programs included in sample

Country	Year(s)
1. Algeria	1989,1991,94,95
2. Argentina	1984, 87,89, 1991,92,96,98,2000, 01,03
3. Belarus	
4. Belize	1984
5. Bosnia-Herzegovina	1998,2002
6. Botswana	
7. Brazil	1983, 88, 1992, 98, 2001,02
8. Bulgaria	1991, 92, 94, 96, 97, 98, 02
9. Chile	1983,85, 89
10. China	1986
11. Colombia	1999, 2003
12. Costa Rica	1985, 87, 89, 1991,93,95
13. Croatia	1994, 97, 2001, 03
14. Czech Republic	1993
15. Dominican Republic	1983, 85, 1991, 93, 03
16. Ecuador	1983, 85, 86, 88, 89, 1991, 94, 2000, 03,
17. Egypt	1987, 91, 93, 96
18. El Salvador	1990, 92, 93, 95, 1997, 1998
19. Estonia	1992, 93, 95, 96, 97, 2000
20. Fiji	
21. Gabon	1986, 89, 1991, 94, 95, 2000
22. Guatemala	1983, 88, 1992, 2002, 03
23. Hungary	1984, 88, 1990, 91, 93, 96
24. Indonesia	1997-98, 2000
25. Iran	
26. Jamaica	1984, 85, 87, 88, 1990, 91, 92
27. Jordan	1989, 1992, 1994, 1996, 1999, 2002
28. Kazakhstan	1994, 95, 96, 99
29. South Korea	1983, 85, 1997
30. Latvia	1992, 93,95, 96, 97, 99, 2001
31. Lebanon	
32. Lithuania	1992, 93, 94, 2000, 01
33. Macedonia FYR	1995, 2000, 03
34. Malaysia	
35. Mauritius	1983, 85
36. Mexico	1983, 86, 89, 1995, 99
37. Morocco	1983, 85, 86, 88, 1990, 92
38. Oman	
39. Panama	1983, 85, 1992, 95, 97, 2000
40. Paraguay	2003
41. Peru	1984, 93, 96, 99, 2001, 02
42. Philippines	1984, 86, 89, 91, 94, 98
43. Poland	1990, 91, 93, 94
44. Romania	1991, 92, 94, 97, 99, 01
45. Russia	1992, 95, 96, 98, 99
46. Serbia and Montenegro	2001, 02
47. Seychelles	
48. Slovak Republic	1994
49. South Africa	
50. Swaziland	
51. Syria	
52. Thailand	1986, 1997
53. Trinidad and Tobago	1989, 90
54. Tunisia	1986, 88
55. Turkey	1984, 1994, 99, 2000, 02
56. Turkmenistan	
57. Ukraine	1995, 96, 97, 98
58. Uruguay	1983, 85, 1990, 1992, 96, 97, 99, 2000, 02
59. Venezuela	1989, 1996

Table 7: Frequency of observations by Region

Region	Frequency
Africa	126
Latin America	378
East Asia	147
Eurasia	399

Table 8: Descriptive Statistics for Main Independent Variables

Variable	Obs	Mean	St. Dev.	Min	Max
Neo-liberal Finance Minister	442	.1652		0	1
Neo-liberal Party Orientation	906	.2728		0	1
Past Reform	786	2.9096	5.2483	-13.2372	29.9586

Table 9: Descriptive Statistics for Main IVs Latin America

Variable	Mean	St. Dev.	Freq.
Neo-liberal Finance Minister	.2431		255
Neo-liberal Party Orientation	.412		378
Past Reform	3.5260	5.8315	373

Table 10: Descriptive Statistics for Main IVs Eurasia

Variable	Mean	St. Dev.	Freq.
Neo-liberal Finance Minister	0		17
Neo-liberal Party Orientation	.2355		276
Past Reform	2.5508	4.3643	207

Table 11: Descriptive Statistics for Main IVs East Asia

Variable	Mean	St. Dev.	Freq.
Neo-liberal Finance Minister	.1294		357
Neo-liberal Party Orientation	.1633		147
Past Reform	2.9912	4.5341	144

Table 12: Descriptive Statistics for Main IVs Africa

Variable	Mean	St. Dev.	Freq.
Neo-liberal Finance Minister	0		17
Neo-liberal Party Orientation	.3142		105
Past Reform	1.347	5.8474	62

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