The International and Domestic Politics of IMF Programs

James Raymond Vreeland
Department of Political Science
Yale University

3 October 2005

Abstract: Many argue that governments use IMF programs to push unpopular policies past domestic political opposition. Many others have argued that the IMF is merely a tool of US foreign policy, providing loans without enforcing policy conditions. This paper addresses the inconsistencies between these two views, presenting large-n evidence supporting both. The domestic politics story, however, depends on international politics. The IMF can only be used to push through unpopular policies when the institution is not being used to reward friends of the US.

An earlier draft of this paper was prepared for the Reinventing Bretton Woods Committee and World Economic Forum conference on The Fund’s Role in Emerging Markets: Reassessing the Adequacy of its Resources and Lending Facilities. Amsterdam, November 18-19, 2004, De Nederlandsche Bank, Westeinde 1.
1. Introduction

How do politics influence international institutions? Are international institutions purely the tools of global hegemons? Do the domestic politics of countries where international institutions operate influence their actions? To address these questions, consider the International Monetary Fund (IMF or Fund). On paper, the economic reform programs of the IMF are intended to correct the economic problems that led the country to the Fund for assistance in the first place. Thus, these programs should be guided purely by technocratic considerations. Yet, many claim that politics at the international and domestic levels influence who participates in IMF programs and why.

On the international front, scholars have shown that powerful international actors, mainly the United States, use IMF lending to reward friends (e.g., Thacker 1999, Stone 2002, 2004). On the domestic front, scholars have focused on how recipient governments use IMF conditionality to push unpopular policies past domestic opposition (e.g., Putnam 1988, Drazen 2002). The international politics story, however, poses the following problem for the domestic politics story.

IMF arrangements consist of a loan of foreign currency and policy conditions attached to the loan. Governments can tie their hands with these imposed conditions as leverage to push unpopular policies past domestic opposition only if the Fund is willing to punish noncompliance by withholding the loan. In other words, IMF arrangements only work as commitment devices when the threat of punishment is credible. Yet, if the IMF is a tool of US foreign policy – where IMF loans reward US allies – punishment for
noncompliance is not credible. The IMF provides the loan to US-choice countries and the policy conditions are just window dressing.

If all IMF programs were with US allies, there would be no reason to expect the domestic politics story of IMF programs to hold. But not all programs are with US allies, and governments that are not particularly favored by the US do face punishment for noncompliance.\(^1\) In these situations, governments can use the IMF to push through unpopular policies. In this paper, I present evidence supporting both the international and the domestic politics story of IMF participation. Evidence of the domestic politics story is strongest when countries are not closely allied with the US, that is, when the threat of IMF punishment is credible. Thus, there is an interaction between domestic and international politics. The effect of domestic politics depends on international politics.

The paper is organized as follows. Section 2 reviews the international politics question. Section 3 presents the domestic politics story of IMF participation. Section 4 brings the two stories together, testing their interaction using cross national data. Section 5 concludes.

2. The international politics of IMF programs

A country’s influence at the IMF is supposed to be pegged to the country’s economic size. People are often surprised to learn that the United States only controls 17.4 percent of the votes at the IMF. While this is nearly three times the next largest

\(^1\) When private financial institutions assist by providing loans for the IMF arrangement, the IMF has even stronger incentives to enforce conditionality (Gould 2003).
member (Japan with 6.24 percent) and gives the US veto power over certain important decisions that require an 85 percent majority, it is a far cry from majority control of the day to day operations of the Fund.

The IMF, however, does not operate according to strict voting rules. Votes are rarely taken. Rather, the Fund operates by consensus. Many believe this “consensus” is dominated by the US. The IMF Managing Director, who usually chairs Executive Board meetings, guides the IMF according to the “sense of the meeting.” Moreover, the Managing Director has been reported to rarely act against the will of the US, perhaps as is fitting, since the US has veto power over his appointment (Lichtensztejn and Baer 1987, cited in Thacker 1999). To the extent that the US has the power to use the IMF to further foreign policy objectives, the Fund may be compromised as a technocratic institution.

Many scholars have proposed that the US does have this power. There are ample anecdotes, but when dealing with only one observation at a time, it is difficult to sort out economic explanations from political explanations. In seminal work, Strom Thacker (1999) undertook the first systematic study of this question. To test whether the US uses the IMF as a tool of foreign policy, he considered voting patterns at the United Nations (UN) determinant of IMF programs. Thacker found that countries that voted along similar lines as the US were more likely to receive an IMF program than countries that did not. More specifically, countries that changed their voting patterns (from one year to

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2 This widely reported and even published on the IMF website: www.imf.org.
3 See for example Vreeland (2002a).
the next) so that they became more similar to US preferences were more likely to get an IMF conditioned loan. Countries that changed their voting against the US were less likely to get a loan.

It may seem strange to consider voting at the United Nations as meaningful – many votes are symbolic and most are not of great importance to the US. But Thacker was careful to include in his study only those votes that the US State Department had identified as “key votes.” These were votes that the US state department had announced that it did care about and pressured other countries to vote along US lines.

Thacker’s variable is a straightforward measure: the change from one year to the next in the correlation between a developing country’s UN voting record and the US voting record on votes identified by the US State Department as “key” – published in Report to Congress on Voting Practices in the United Nations. The variable predicts IMF participation well, even after one controls for economic variables predicting participation. Thacker’s statistical analysis of 87 countries (for a total of 746 yearly observations) shows a strong and robust correlation between IMF participation and moving closer to the US on key United Nations issues. Thacker concludes that the US uses IMF loans to reward countries that move towards it and to punish those that move away.

Since Thacker’s study of US political influence over the IMF, others have explored other ways of measuring and testing US influence. For example, Randall Stone (2002, 2004) has looked at the connection between US foreign aid and IMF punishment
for non-compliance with the conditions attached to IMF loans. Stone considers the amount of foreign aid that a country receives from the US to be a proxy for how important the country is to the US. If the US can use the IMF to pursue its political objectives, countries that receive favorable amounts of US foreign aid are also likely to receive favorable treatment by the IMF.

Stone has undertaken two studies considering the effect of US foreign aid on IMF program punishment intervals – one on the Post-Communist countries of Eastern Europe (2002) and one on Africa (2004). Both studies confirm his hypothesis: the more US foreign aid a country receives, the shorter the duration of punishment for IMF programs that fall into non-compliance. In addition to the statistical studies, which include data from many countries from Eastern Europe and Africa, Stone also presents detailed case studies. For example, he shows that Russia, a country that was considered to be of great strategic importance to the US after the fall of Communism, received much lighter punishments for non-compliance than Poland, which was considered to be of less importance to the US. Stone concludes, “Although the United States holds a minority of votes, it does indeed call the shots at the IMF, as critics allege” (2002: 62).

4 Note that, in addition to the political motivations, the US may also influence the IMF to protect financial interests. Consider the findings of two unpublished studies by Thomas Oatley and Jason Yackee (2000) and Lawrence Broz and Michael Hawes (2004). Oatley and Yackee show that the amount of US bank exposure in a developing country is a determinant of the size of the IMF loans the country received. Broz and Hawes find that the total amount of US lending as a proportion of a developing country’s GDP is a significant predictor of both the IMF agreement and the size of the IMF loan. They take this as evidence of the influence of US banks operating through US political channels. This point of view is different from the arguments of Thacker and Stone. Rather than argue that the US uses the IMF to reward friends, Broz and Hawes, as well as Oatley and Yackee, argue that the US uses the IMF to protect US financial interests. This is a crucial difference with respect to conditionality because, when financial interests motivate the US, there may be an incentive to see policy conditions enforced.
So the international relations literature on IMF programs paints the following picture: Friends of the US are rewarded through IMF programs. Loans are granted and policy conditions are nothing more than window dressing. Yet, as the next section will show, this picture stands in contrast to the picture painted in comparative politics literature, where IMF conditionality has been described as much more meaningful.

3. The domestic politics of IMF programs

An IMF program does not just consist of a loan; strings are attached in the form of policy conditions. These imposed policies can be severe. The IMF views balance of payments shortfalls as a problem of excess demand for imports. To address such a problem, consumption of imports must be curtailed. This can be done through fiscal austerity, tight monetary policy, and sometimes by devaluing the national currency. The economic adjustment is often painful – there have been countless protests across developing countries that participate in IMF programs, and there have even been IMF riots.

Why would a government ever agree to such conditions of economic adjustment? The obvious answer is a country’s desperate need for an IMF loan. Under IMF arrangements, the IMF does not provide the entire loan upfront. Countries are subject to quarterly reviews. If a government fails to comply with the conditions laid out in the arrangement, the loan can be temporarily suspended or even cancelled. If a government needs the IMF loan, it may have little choice but to push through IMF policies.
Sometimes, however, governments actually want specific IMF policy conditions to be imposed on them for political reasons. There are various political stories as to why governments would want conditions imposed, such as the scapegoat story – where governments seek to blame anticipated poor economic performance and needed reforms on the IMF – and the signaling story, where the government uses the IMF to tie its hands to send a credible signal of its commitment to economic reform to investors and creditors. The most theorized political story, however, and the one most supported by both anecdotal and systematic evidence is a “tipping the balance” story, where governments use the outside pressure of the IMF to push through unpopular policies that the government actually wants to implement.

How does an IMF agreement help to push through unpopular reforms? Drazen (2002) suggests one mechanism. He shows that when a government faces domestic opposition to economic reform, the presence of an IMF loan can help the government persuade actors in a position to block reforms to approve them, lest they forgo the next installment of the IMF loan. Thus, Drazen suggests that the loan from the IMF program can be used as a carrot to entice opponents to accept IMF policies. The IMF program can also be used as a stick. In my work, I note that failing to comply with IMF programs has other costs in addition to not receiving the loan installment since creditors and investors follow signals from the IMF (Vreeland 2003: Chapter 3). To understand precisely how IMF programs can be used against domestic opposition, consider the following:
Note that, unlike other international agreements, chief executives enter into IMF arrangements unilaterally. The approval of potential opponents to IMF policies or “veto players” – such as the legislature in a presidential system or a coalition partner in a parliamentary system – may be required for policy change, but their approval is not necessarily required for the executive to enter into an IMF arrangement. IMF arrangements are spelled out in a “Letter of Intent,” written by IMF staff and government officials and formally sent to the IMF Managing Director from the country’s executive branch – usually signed by the finance minister and/or the president of the central bank, whom the IMF recognizes as the country’s “proper authority” over the economy. The Managing Director subsequently brings the Letter of Intent before the IMF Executive Board for approval. Once the Board approves the Letter of Intent, the country is under an IMF program. The approval of potential veto players is bypassed.

After an executive has entered into an IMF arrangement, failure to enact policy change becomes more costly because rejection of reform is not merely a rejection of the executive, but also a rejection of the IMF. Rejecting the IMF is costly to all domestic actors including veto players. The potential costs are various and severe. The IMF may restrict access to loans; it may preclude debt rescheduling with creditors who require an IMF arrangement to be in good standing; and it may result in decreased investment if investors take cues from the IMF. These increased costs may lead veto players to approve of policy changes that they otherwise would have opposed.

Such a strategy is available to executives in different types of regimes –
democracies and dictatorships alike – but it is more likely to be systematically pursued in situations where the role of veto players is institutionalized. Thus, this story has an important implication about how domestic political institutions play a systematic role in who participates in IMF programs. Using the IMF to help push through unpopular policy is most likely to be pursued when there is greater institutional resistance to policy change. I follow Tsebelis (1995, 2002) who argues that policy stability (or resistance to change) is a function of the number of veto players in a political system. The intuition behind his argument is straightforward: Policy change is less likely when more people are required to agree.\(^5\)

The number of actors who must agree – the number of veto players – depends on the political system. In most dictatorships, there is one just actor – either a single dictator, or a single party. In presidential systems, the president and the legislature must agree. In multi-party parliamentary systems, there may be many political parties who are part of the governing coalition who must agree.

When the number of veto players increases, this increases the probability\(^6\) that at least one of the veto players is opposed to the ideal point of the executive – in this situation, pressure from the IMF is useful to push policy change past veto player opposition. The ideal points of veto players may be correlated, so the resistance to policy change may increase at a decreasing rate. To capture diminishing returns from additional veto players, I will use the natural logarithm of the number of veto players when testing

\(^5\) For the full argument, see Tsebelis (1995, 2002).
\(^6\) Or, to be more precise, the probability does not decrease.
the argument statistically below.

Thus, I conjecture that executives are more likely to enter into IMF arrangements when there are more veto players. Note that this conjecture should only hold stochastically. Some particular cases will not fit. For example, there could be a country with many veto players in favor of reform and an executive who is opposed. I would not expect such an executive to bring in the IMF to gain leverage over veto players to force through reform. On the other hand, there could be a country with a pro-reform executive and just one veto player who is opposed to reform. Such an executive would be likely to bring in the IMF for political leverage, even though he faces only one veto player. My argument could best be tested if we could get inside of the heads of actors and measure their true preferences. Data on true “political will,” however, is unobservable. The argument can be tested using a measure of the number of veto players in a political system, and – on average – the relationship with IMF arrangements should hold.

The key for this story is that the threat of punishment by the IMF must be credible – otherwise the IMF arrangement is not much of a commitment. Yet, the evidence from the international politics story of IMF participation poses a problem. Often IMF lending merely rewards friends of the United States. When governments enter into IMF programs as a reward for cooperation with the US, the executive cannot credibly use the threat of IMF punishment for noncompliance to pressure veto players to enact policy change. In these situations, a threat of IMF punishment for noncompliance is hardly credible. The

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7 Indeed, the IMF often blames bad economic performance under IMF programs on a lack of domestic political will, which was unknown when the IMF arrangement was negotiated.
threat is valid, however, in situations where an executive enters into an IMF program without US support. The domestic politics story of IMF participation should hold when countries are not moving towards the US. Thus, the effect of domestic political institutions depends on international relations.

4. Testing the interaction of international and domestic politics

The above section shows that the international politics story of IMF participation has important implications for the domestic politics story. Governments may seek out an IMF program to help push through policy changes. This “push,” however, requires a credible commitment to punish if policy changes are not forthcoming. The commitment may be lacking if the IMF program is just a foil to reward allies of the US. The domestic politics story should hold only when the IMF can enforce the policy conditions attached to the loan, i.e., only for countries that are not being rewarded by the US.

The domestic politics story – that governments seek out the IMF when facing resistance to policy change – can be tested by using the number of veto players in the political system as a proxy for resistance political change. The effect of this variable on entering into IMF programs should be positive, but the effect should be weakest for countries that have moved closer to the US. Movement towards the US can be measured by the change in the correlation of voting records at the UN on issues identified by the US State Department as “key.” The interactive effect of the international politics story for the domestic politics story can be tested by interacting these two variables – the number of veto players and the UN voting variable.
Before testing the effects of these two political variables on entering into IMF programs, I first present a baseline specification of control variables to include in the analysis. The statistical model I employ is a dynamic version of probit. The easiest way to understand dynamic probit is to imagine all of the observations of countries not currently participating in an IMF program, then ask – which of them, the following year, enter into an IMF arrangement? The dependent variable in this analysis is, thus, entering into an IMF program.8

The baseline specification I employ is barebones, including only those variables that have been shown to robustly predict participation in IMF programs (for a review, see Bird 1996): To capture level of development, I include per capita income measured in 1995 purchasing power parity dollars (Penn World Tables 5.6 and Penn World Tables 6.1).9 This variable is expected to have a negative effect on participation, since countries at higher levels of development are less susceptible to economic crises. To capture a country’s need for an IMF loan, I include the current account deficit as a percentage of gross domestic product (GDP) (World Development Indicators 2000), and foreign reserves, measured in terms of monthly imports (World Development Indicators 2000). These variables also should have negative effects, since the need for an IMF loan goes up when either the current account is negative or foreign reserves are low. Besides these

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8 For the technical details, see Amemiya (1985: Chapter 11). Here, I distinguish between entering into a spell of agreements and continuing participation. Other studies show that the determinants of entering and continuing participation are quite different.
9 The Penn World Tables 5.6 data were originally taken from Przeworski et al. (2000); they were extended and merged with Penn World Tables 6.1 by José Antonio Cheibub, Jennifer Gandhi, Adam Przeworski, and Sebastian Satiegh.
economic variables, another predictor of participation in IMF programs is past participation. “Recidivism” is common, so countries that have participated in previous IMF programs are likely to return (for one explanation, see Vreeland 2003: Chapter 3). Thus I include a dummy variable coded 1 if a country has a history of IMF program participation and coded 0 otherwise. The variable should have a positive effect.

The baseline specification is tested on a sample of 764 country-year observations of 96 countries from 1970 to 1998 (the panel is unbalanced due to missing observations). Table 1 presents the results.

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>Standard error</th>
<th>P-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>-0.93</td>
<td>0.17</td>
<td>0.000</td>
</tr>
<tr>
<td>Per capita income (PPP 1995 $)</td>
<td>-0.0001</td>
<td>0.00002</td>
<td>0.000</td>
</tr>
<tr>
<td>Current account (% GDP)</td>
<td>0.01</td>
<td>0.01</td>
<td>0.336</td>
</tr>
<tr>
<td>Foreign reserves (in months of imports)</td>
<td>-0.09</td>
<td>0.03</td>
<td>0.002</td>
</tr>
<tr>
<td>Debt service (% exports)</td>
<td>0.01</td>
<td>0.00</td>
<td>0.003</td>
</tr>
<tr>
<td>Past participation</td>
<td>0.49</td>
<td>0.14</td>
<td>0.000</td>
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<tr>
<td>Number of observations</td>
<td>764</td>
<td></td>
<td></td>
</tr>
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</table>

All of the variables have expected effects that are statistically significant, except for current account, which has the opposite sign and is not statistically significant. The current account result is somewhat surprising, since the IMF Articles of Agreement state explicitly that countries borrowing from the IMF must show a need either in the balance of payments or in their foreign reserve position, but other studies have produced similar results (Knight and Santaella 1997, Conway 1994, and Edwards and Santaella 1993). The
other variables, however, do have effects in line with expectations: The effect of per capita income is strong. Increasing per capita income from the median value of $3,813 by one standard deviation up to $6,792 reduces the estimated probability of entering into an IMF program from 0.18 to 0.12 (holding other variables to their median values). The effect of foreign reserves is similarly strong. Increasing it from the median of 2.72 average times monthly imports by one standard deviation up to 6.12 times average monthly imports reduces the estimated probability of entering into an IMF program from 0.18 to 0.11. The effect of increasing a country’s debt service from the median value of 11.5 percent of exports by one standard deviation up to 25.6 percent of exports increases the probability of entering into IMF programs from 0.18 to 0.22. The biggest effect comes from past participation. Countries that have participated in past IMF programs have a baseline probability of 0.18 of entering again. Those who have never participated in the past have only a 0.08 probability of entering. Armed with these baseline results, I turn to testing the politics of IMF participation.

The argument that the IMF is a tool of US foreign policy can be tested, following Thacker, using the yearly change in the correlation between a given country and the US on UN votes that the US State Department announced as “key.” Thacker’s original study had 746 country-year observations of this variable. Many of these observations, however, are of countries already participating in IMF programs. In this study, I estimate the probability of entering into IMF programs given that a country is not currently participating. There are 333 observations of countries not currently participating in IMF program, covering 68 countries from 1985 to 1994. The variable ranges from –0.3, for
countries whose voting pattern at the UN diverged from the US voting pattern, to 0.64, for countries that moved closer to the US.

Figure 1 depicts the percentage of observations entering into IMF programs according to the UN voting variable. For three quarters of the observations, there is a clear upward trend as predicted: among countries moving away from the US, there are fewer entering into IMF programs; among countries moving towards the US, there are more entering into IMF programs. The upward trend slightly drops off for countries that moved the closest to the US. This may be because these countries are similar to the US in other respects, such as economic development, making them less likely to require a loan from the IMF. This highlights the importance of controlling for other factors when testing this relationship. Hence, I return to the more rigorous analysis of dynamic probit.
Table 2: Testing the international politics story

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>Standard error</th>
<th>P-value</th>
</tr>
</thead>
<tbody>
<tr>
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<td>0.34</td>
<td>0.060</td>
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<td>Per capita income (PPP 1995 $)</td>
<td>-0.0002</td>
<td>0.0001</td>
<td>0.001</td>
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<td>Current account (% GDP)</td>
<td>0.01</td>
<td>0.02</td>
<td>0.551</td>
</tr>
<tr>
<td>Foreign reserves (in months of imports)</td>
<td>-0.03</td>
<td>0.05</td>
<td>0.557</td>
</tr>
<tr>
<td>Debt service (% exports)</td>
<td>0.01</td>
<td>0.01</td>
<td>0.138</td>
</tr>
<tr>
<td>Past participation</td>
<td>0.45</td>
<td>0.28</td>
<td>0.105</td>
</tr>
<tr>
<td>Change in alignment between country &amp; US (UN voting)</td>
<td>1.77</td>
<td>0.70</td>
<td>0.012</td>
</tr>
</tbody>
</table>

Number of observations 218

Table 2 presents the results of the dynamic probit estimation. First consider the effects of the control variables from the baseline specification. The coefficients all have the same sign in both Tables 1 and 2, and the coefficients have remarkably similar values, but most are not statistically significant. This appears to be because of the reduced sample size due to missing observations on the UN voting variable. (It appears not to be due to the inclusion of the UN voting variable, per se, because similar results are obtained with this smaller sample excluding the UN voting variable.) Only per capita income is statistically significant – this finding is robust throughout all of the specifications in this paper. After controlling for per capita income, the effect of the international politics variable is clearer:

Moving closer to the US dramatically increases the likelihood of entering into an IMF program. The effect is statistically and substantively significant: Increasing the movement towards the US from the median value by one standard deviation, from −0.01
to 0.15, increases the probability of entering into an IMF program from 0.14 to 0.21 (holding all other variables to their median values). The full range of the effect of the international politics variable is depicted in Figure 2. Countries moving towards the US are much more likely to enter into IMF programs than countries moving away from the US. Note, however, that sometimes even these latter countries do enter into IMF programs. This is an important observation to remember when considering the domestic politics story of IMF participation.

![Figure 2: Effect of international politics on entering into IMF programs](image)

Turning to the domestic politics story, consider the effect of the number of veto players on the probability of entering into IMF programs. The data for the number of veto players comes from Beck, Clarke, Groff, Keefer, and Walsh (1999), who code the
variable as follows (the following paraphrases from the new codebook, Keefer 2002):
The variable is coded 1 in countries where the legislature is not competitively elected. In presidential democracies the variable is the sum of: 1 for the chief executive, 1 if the chief executive is competitively elected, 1 if the opposition controls the legislature, 1 for each chamber of the legislature (unless the president’s party has a majority in the lower house and a closed list system is in effect, implying stronger presidential control of his/her party, and therefore of the legislature), and 1 for each party coded as allied with the president’s party and which has an ideological orientation closer to that of the main opposition party than to that of the president’s party. In parliamentary democracies, the variable is the sum of: 1 for the chief executive, 1 if the chief executive is competitively elected, 1 if the opposition controls the legislature, 1 for every party in the government coalition (as long as the parties are needed to maintain a majority), 1 for every party in the government coalition that has a position on economic issues closer to the largest opposition party than to the party of the executive (the prime minister’s party is not counted as a check if there is a closed rule in place – the prime minister is presumed in this case to control the party fully).

Figure 3 presents 2,686 country-year observations of 178 countries from 1975 to 2000, where the average number of veto players is 2.4 and the median number of veto players is 1 (1,382 observations are of dictatorship). The picture does not follow the suggested pattern that governments facing more veto players are more likely to participate in IMF programs. One reason for this, however, is that the number of veto players in a political system is correlated with per capita income, and per capita income,
in turn, is correlated with IMF participation. For example, all dictatorships have only one veto player, average per capita income is lower in dictatorships than in democracies, and participation in IMF programs is more likely in countries with lower per capita income. Thus one should control for per capita income. Consider Figure 4. Looking just at countries with per capita income of less than $8,000, IMF participation rates exhibit an upward trend with diminishing returns as the number of veto players increases.
The veto player picture becomes clearer when one specifies the level of economic development. This suggests the importance of controlling for other factors when testing this story. Besides controlling for per capita income, it is particularly important to control for other economic variables that have been addressed above because it is possible that countries with many veto players may simply be more likely to have economic crises. The additional veto players may make these political systems less able to make economic policy adjustments, so governments end up needing an IMF loan for economic reasons. To check for this, I present a more rigorous statistical test. Again I employ dynamic probit with the baseline specification. To capture the idea that the effect of the number of veto players may have diminishing returns, I use the log of this variable. The results are presented in Table 3.
### Table 3: Testing the domestic politics story

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>Standard error</th>
<th>P-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>-0.97</td>
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<td>Per capita income (PPP 1995 $)</td>
<td>-0.0001</td>
<td>0.0003</td>
<td>0.000</td>
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<td>Current account (% GDP)</td>
<td>0.01</td>
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<td>0.399</td>
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<tr>
<td>Foreign reserves (in months of imports)</td>
<td>-0.10</td>
<td>0.03</td>
<td>0.002</td>
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<tr>
<td>Debt service (% exports)</td>
<td>0.01</td>
<td>0.00</td>
<td>0.004</td>
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<tr>
<td>Past participation</td>
<td>0.42</td>
<td>0.15</td>
<td>0.004</td>
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<tr>
<td>log(# of veto players)</td>
<td><strong>0.25</strong></td>
<td><strong>0.10</strong></td>
<td><strong>0.011</strong></td>
</tr>
</tbody>
</table>

Number of observations: 666

As in Table 1, the control variables presented in Table 3 have the expected effects and are statistically significant (except for current account). Even after controlling for these variables, the log of the number of veto players in the political system has a statistically significant positive effect on entering into IMF arrangements: 0.25 (p-value=0.01). To get a picture of the substantive effect of the number of veto players, consider Figure 5, which depicts the probability of entering into an IMF program for political systems with different numbers of veto players.
To further test the effect of domestic politics on IMF participation, I reintroduce the international politics variable into the specification. Table 4 presents the results when both the log of the number of veto players and the UN voting variables are included together. As in Table 2, the control variables are not statistically significant (again due to missing observations), except for per capita income, which has a statistically and substantively significant negative effect on entering into IMF programs. The two political variables also have significant effects, as they did before. The number of veto players has a positive significant effect on entering into IMF programs, as does the UN voting variable.
Table 4: Testing the international and domestic stories together

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>Standard error</th>
<th>P-value</th>
</tr>
</thead>
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<td>0.082</td>
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<td>Per capita income (PPP 1995 $)</td>
<td>-0.0003</td>
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<td>0.000</td>
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<td>Current account (% GDP)</td>
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<td>0.288</td>
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<td>Foreign reserves (in months of imports)</td>
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<td>0.303</td>
</tr>
<tr>
<td>Debt service (% exports)</td>
<td>0.01</td>
<td>0.01</td>
<td>0.118</td>
</tr>
<tr>
<td>Past participation</td>
<td>0.38</td>
<td>0.28</td>
<td>0.176</td>
</tr>
<tr>
<td>log(# of veto players)</td>
<td>0.42</td>
<td>0.18</td>
<td>0.020</td>
</tr>
<tr>
<td>Change in alignment between country &amp; US (UN voting)</td>
<td>1.92</td>
<td>0.73</td>
<td>0.008</td>
</tr>
</tbody>
</table>

Number of observations 217

Finally, Table 5 introduces the interaction effect of domestic and international politics. The effect of the number of veto players should depend on international politics, because domestic resistance to policy change should matter only when the IMF poses a credible threat to punish noncompliance of the policy conditions in their programs. An executive can only use the IMF to push through unpopular policies when the IMF is willing to withhold loans for noncompliance. Punishment is not credible when countries are closely allied with the US. So the effect of the number of veto players should be strongest when countries are moving away from the US and weakest when countries are moving towards the US.
Table 5: Testing the interaction of international and domestic politics

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>Standard error</th>
<th>P-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>-0.66</td>
<td>0.36</td>
<td>0.067</td>
</tr>
<tr>
<td>Per capita income (PPP 1995 $)</td>
<td>-0.0003</td>
<td>0.0001</td>
<td>0.000</td>
</tr>
<tr>
<td>Current account (% GDP)</td>
<td>0.02</td>
<td>0.02</td>
<td>0.265</td>
</tr>
<tr>
<td>Foreign reserves (in months of imports)</td>
<td>-0.05</td>
<td>0.05</td>
<td>0.286</td>
</tr>
<tr>
<td>Debt service (% exports)</td>
<td>0.01</td>
<td>0.01</td>
<td>0.112</td>
</tr>
<tr>
<td>Past participation</td>
<td>0.39</td>
<td>0.28</td>
<td>0.164</td>
</tr>
<tr>
<td>log(# of veto players)</td>
<td>0.44</td>
<td>0.18</td>
<td>0.015</td>
</tr>
<tr>
<td>Change in alignment between country &amp; US</td>
<td>2.69</td>
<td>1.10</td>
<td>0.015</td>
</tr>
<tr>
<td>Interaction of log(# of veto players) and Change in alignment between country &amp; US</td>
<td>-1.01</td>
<td>1.07</td>
<td>0.343</td>
</tr>
</tbody>
</table>

Joint-significance test for interacted variables (log(# of veto players), change in alignment between country & US, and their interaction) chi2 = 11.79 | 0.008 |

Number of observations | 217 |

Table 5 indeed shows that the effect of the number of veto players depends on international politics. The veto players variable and the UN voting variable have positive effects (as before) and their interaction effect is negative. Individually, the interactive effect is not significant, but the Wald test of the joint significance of the three variables together indicates that the overall relationship is highly significant (p=0.01). To see clearly how this supports the hypothesis of this paper, consider Figure 6, which shows how much the overall effect of the number of veto players depends on the UN voting variable. When a country is moving towards the US in terms of voting at the UN voting, the effect of the number of veto players is low. For example, when UN voting variable is equal to 0.2, the effect of the log of the number of veto players is just 0.24. When a country has not changed its UN voting position vis-à-vis the US, e.g., when the UN voting variable is 0, the effect of the number of veto players is higher: 0.44. When a
country moves away from the US, the credibility of punishment by the IMF is strong and the domestic politics story has the most bite. For example, when the UN voting variable is equal to –0.2, the effect of the number of veto players is 0.65.

Figure 6: The effect of domestic institutions depends on international politics

5. Conclusion

Spaventa (1983) first observed that IMF conditions can be used to push through unpopular policies. Since then, many have argued this to be the case. Yet, many others have argued that the IMF provides loans without enforcing policy conditions because the institution is just a foil for the foreign policy objectives of the US. This paper addresses the inconsistencies between these two views, presenting evidence supporting both. The domestic politics story, however, depends on international politics. The IMF can only be used to push through unpopular policies when the institution is not being used to reward
friends of the US. There is an interaction between domestic political institutions and international relations.

The impact of politics on IMF arrangements has important implications about the usefulness of IMF conditionality. For IMF arrangements with countries favored by the US, IMF conditionality has no bite. This is implied here and in the work of Thacker (1999), and confirmed by the empirical work of Stone (2002, 2004). Yet, in countries not particularly favored by the US conditionality can help to push through important policies of economic reform. For example, Stone (2002) found that in Eastern Europe, countries participating in IMF programs that were not favored by the US – where the threat of punishment was credible – succeeded in curtailing inflation. IMF conditionality has also been used, however, to push through policy changes that favor one constituency over another. Stiglitz contends:

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.

Such “self-selection” of reform or partial compliance has been used to protect elite interests while shifting the burden of austerity to labor and the poor. Systematic studies indicate that IMF programs typically exacerbate income inequality (Pastor 1987a,b, Garuda 2000, Vreeland 2002b, 2003). Pastor (1987) found that “the single most
consistent effect the IMF seems to have is the redistribution of income away from workers” (1987a: 89).

Thus, regarding conditionality, one may imagine 4 sets of countries: (1) There are countries favored by the US for political reasons – conditionality has no bite. (2) There are countries not favored by the US whose governments agree with the policies prescribed by the IMF and face no opposition – conditionality is not needed. (3) There are countries not favored by the US whose governments use the IMF agreement to favor domestic elite interests – conditionality is abused. (4) There are countries not favored by the US whose governments agree with conditions but face opposition – conditionality helps push through Pareto improving reforms.

Whether or not IMF conditionality is a good thing depends on the frequency of situation (4). How common is it that IMF programs help to push through policies that are unpopular in the short-run but actually have positive effects in the long-run? Judging by the dearth of evidence of program success, this is probably not so common. Perhaps the IMF should scale back its operations, lending only during times of severe crisis and providing policy advice without imposing conditions.
References


