The Implementation of IMF-supported Programmes: An Empirical Investigation Using Complementary Methodologies

Ozlem Arpac

A thesis submitted to the University of Surrey for the degree of Doctor of Philosophy in the Department of Economics

March 2007
Abstract

Implementation of IMF programmes has been analysed in the literature on two fronts. Theoretical contributions have focused on the importance of special interest groups, while empirical studies have reported mixed results, and failed to provide compelling support for the theory. The econometric contribution of this thesis draws on the most-up-to-date theoretical work to identify a group of factors that could influence implementation. It uses a range of economic as well as political variables and applies probit and tobit regression techniques to a large data set covering 95 countries over the period 1992-2004. It is found that programme implementation depends on trade openness, the strength of veto players in opposing reform and the amount of resources committed by the Fund. The second contribution of the thesis is through the case study research which demonstrates that the political economy characteristics of countries play a vital role in determining the success of programme implementation. A role which has various layers and dimensions, hence, is better examined in the context of an exhaustive case study.
Acknowledgements

I would like to express my wholehearted gratitude to Professor Graham Bird for encouraging and guiding me through the various stages of my dissertation. This thesis represents the culmination of over three years work, and would not have been possible without his expert supervision. I would also like to thank my second supervisor, Dr. Alex Mandilaras for his guidance.

My family have provided me with, as always, their unconditional support throughout this journey. I would like to thank my father and mother, Sabri and Sukran Arpac, and my sister Ozge for their tremendous understanding and encouragement. I would also like to thank my loving husband Alexis Arconian for his continued support over the years.
Contents

1. Overview, Scope and Objectives ............................................. 1

2. Implementation of IMF Conditionality: Review of the Literature .......................... 5

   2.1 Effectiveness of IMF Programmes ........................................... 6
   2.1.1 Methods ............................................................................. 7
   2.1.2 Review of the Literature ...................................................... 12
   2.1.3 Discussion of Results ......................................................... 16
   2.2 The Measurement and Record on Implementation ......................... 21
   2.2.1 The Rate of Loan Disbursement ........................................ 22
   2.2.2 Interruption ................................................................. 23
   2.2.3 Implementation Index ........................................................ 24
   2.2.4 Record on Implementation .................................................. 27
   2.3 Conclusion ............................................................................. 31
3. Political Economy of Implementation

3.1 Conceptual Analysis of Implementation: Agency Models

3.1.1 Lobbying

3.1.2 Veto Players

3.2 Ownership

3.2.1 Definition

3.2.2 Consistency with Conditionality

3.2.3 Ownership and Implementation: Is there a link?

3.3 Conclusions

3. A Appendix to Chapter 3

3. A.1 Derivation of Fund’s Equilibrium Level of Assistance

4. Determinants of Programme Implementation:

Empirical Evidence

4.1 Existing Evidence on Implementation

4.2 A Conceptual Framework

4.3 New Empirical Investigation

4.3.1 Methodology and Data

4.3.2 Model Specification

4.3.3 Results

4.3.4 Interpretation and Discussion

4.4 Conclusion

4.A Appendix to Chapter 4

4.A.1 Variable Definitions and Data Sources

4.A.2 List of Countries and Programmes

4.A.3. Regression Results Based on the MONA Implementation Index
Figures

Figure 3.1. Indifference Curves of the Government and the Fund .......... 42
Figure 3.2. Indifference Curves of the Government and the Interest Group ........................................................................................................... 45
Figure 4.1. Outliers of Econometric Analysis of Programme Interruption ......................................................................................................................... 77
Figure 5.1. Turkey’s Export Development in 1980s .......................... 89
Figure 5.2. Turkey’s Growth Performance in 1980s .......................... 89
Figure 5.3. Current Account Balance: 1990-1994 ............................ 93
Figure 5.4. Central Government’s Budget Balance (%GDP): 1990-94 ......................................................................................................................... 93
Figure 5.5. Chronic Inflation in Turkey Over the Years ..................... 94
Figure 5.6. Debt Dynamics .................................................................. 94
Figure 5.7. Distribution of Factors of Programme Implementation in Turkey .............................................................................................................. 131

Tables

Table 2.1. IMF Programme Effects on External Balance.................... 18
Table 2.2. IMF Programme Effects on Policy Variables...................... 19
Table 2.3. IMF Programme Effects on Growth, Savings and Investment.. 20
Table 2.4. Correlations of Implementation Measures ........................ 26
Table 2.5. Record on Implementation ................................................. 29
Table 4.1. Empirical Evidence on Implementation .............................. 60
Table 4.2. Estimation Results .............................................................. 74
Table 4.3. Robustness Checks ............................................................. 76
Table 5.1. The Participants’ Evaluation of Implementation Determinants .............................................................................................................. 130
Chapter 1

Overview, Scope and Objectives

The International Monetary Fund (IMF) was created in the aftermath of World War II to help member countries resolve temporary balance of payments problems. The IMF’s lending operations have evolved over time and the conditionality attached to its loans has become the center of attention. Much has been written about IMF conditionality, though; research into its effectiveness has tended to overlook the issue of implementation. Intricately tied up with the question of conditionality is that of programme implementation. Conditionality cannot be an effective commitment device if governments do not implement the conditions attached to programmes. Hence, in the context of IMF activities, the question of implementation is central to the understanding of IMF programme effectiveness.

Earlier studies on IMF programmes do not usually differentiate between entering into a programme and complying with its conditionality. It is customary to treat participation uniformly across countries and examine the effects of ‘going’ to the Fund. But, when the policy intentions specified in the programmes are not fully carried out, a bias occurs in the evaluation of programme effectiveness. The fact is not all participating countries comply with Fund prescriptions, which renders the assessment of IMF programme effectiveness incomplete. The main objective of this thesis is to offer an understanding of programme implementation and examine the contributing factors. What determines the implementation of IMF programmes? This is the central question that this body of research seeks to answer.

The thesis hypothesizes that domestic politics perform a crucial role in shaping the economic policy and the interaction between the government, the IMF and interest

---

1 Throughout the thesis the term ‘IMF programme’ is used which refers technically to a country programme supported by the IMF.
groups. It is this interaction that ultimately determines the degree of implementation in a programme.

Analysis of the implementation of IMF programmes is built on three pillars. The first pillar constructs a formal modelling of the strategic relationship between the IMF and governments restricted by domestic political constraints. The second pillar, which is the econometric study, covers the years 1992-2004 and extends to the 95 countries that had participated in IMF-supported programmes. The strategy is to relate the various indicators of the probability of implementation of an IMF-supported programme to the underlying political and institutional factors of the borrowing country, and to its initial economic conditions. The main conclusion of both studies underlines the importance of the political economic environment of a country implementing a Fund supported programme.

The third pillar, which is central to the research, aims to test the findings of the econometric and theoretical work by examining the influence of political and macroeconomic conditions on implementation in a case study. The narrow conceptual modeling and large-scale econometric analysis of the completion of reform programmes cannot thoroughly capture the interaction between the IMF, governments and interest groups. Therefore, there is a need for a more in-depth approach in the analysis of programme implementation to investigate the dynamics of interaction.

The subject of the case study research is Turkey. Turkey has had an ongoing relationship with the IMF since the 1980s, with domestic politics lying consistently at the heart of its economy, which makes it a very good candidate for a case study examination.

The organization of the thesis is as follows. Chapter 2 provides the necessary background on IMF programmes for the subsequent chapters. It starts with a review of the empirical literature on the effectiveness of IMF programmes, followed by a methodological review assessing the advantages and shortcomings of the approaches used in the literature. The chapter then focuses on the issue of programme implementation. First, difficulties involving the measurement of implementation are examined. Second, using various assessment methods, a record on implementation is presented which illustrates that poor implementation often exists. This finding biases the results of effectiveness studies that do not distinguish between implemented and non-implemented programmes. Therefore, conclusions of the literature need to be re-assessed.
Chapter 3 provides a conceptual framework that builds on recent theoretical work and within which the implementation of IMF programmes may be considered. It examines the application of agency models to IMF conditionality in the presence of domestic policy constraints. The models involve the IMF and the borrowing country government, while domestic conflict of interest is usually modelled in the form of a special interest group opposing the IMF proposed reforms. These models point to the importance of interest groups and the influence they may exert on the degree of programme implementation.

Chapter 3 also looks at the concept of programme ownership. Poor implementation has often been attributed to lack of ownership. Subsequently, the literature has dealt mainly with the concept of ownership as a facilitator to the implementation of conditionality. The ownership concept, however, could be very confusing. The chapter aims to highlight problems associated with this concept and establishes its link with programme implementation.

The suggestions of the theory of implementation underline the importance of the political economic environment of a country implementing a Fund supported programme. Can the reflection of the propositions of the theory be observed empirically? The objective of Chapter 4 is to estimate a relationship between the implementation rate and the political and economic characteristics of borrowing countries that theory suggests may be important. This chapter, first, takes stock of the conclusions of the conceptual framework, and identifies a range of testable political economy factors that may exert an impact on programme implementation. It, then, estimates random effects regressions on a pooled sample for tobit and probit specifications, considering each implementation measure in isolation.

Many of the independent variables suggested by the theory are only imperfectly captured by the available data. Moreover, the dependent variable – the implementation of IMF programmes – cannot be observed and needs to be approximated. The results reported here, therefore, are indicative rather than definitive.

Indeed, just as studies of the determinants of IMF lending have been able to identify a range of variables that seem to be important in influencing the pattern of IMF arrangements, but have been less successful in explaining them in detail, so it may be that an investigation into the determinants of implementation will provide a list of factors that
influence it, but will be less efficient at estimating the probability of implementation in individual cases (Conway, 1994; Bird and Rowlands, 2001, 2002).

This assessment brings us to the necessity of case study research which is explored in Chapter 5. Chapter 5 presents an in-depth investigation of the determinants of programme implementation in Turkey between 1999 and 2004. It is based on extensive field research in Turkey and the IMF Headquarters in Washington, D.C. A detailed study of the relationship between the Fund and Turkey, based on a series of interviews with policy makers, programme negotiators, bureaucrats, interest groups and IMF officials can go beyond the thin description accessible in econometric form.

Accordingly, the case study research aims to highlight some key factors of the implementation of IMF supported programmes, emphasising aspects that have a wider significance for developing countries and focusing on the roles played by governments, interest groups and the IMF.
Chapter 2

IMF Programme Implementation: Measurement and Record

In the past 20 years, the IMF has lent over US$300 billion to more than 90 countries as part of its economic adjustment programmes. Given the economic and political importance of the IMF's lending operations, the impact of these programmes has been the subject of an extensive academic debate.

However, despite the large research effort, significant limitations exist in the literature. Firstly, much of the empirical literature has faced serious methodological problems. The results that do exist are either inherently sensitive to the counterfactual specifications or depend on instruments that are not entirely convincing.

Secondly, no consensus has emerged from the literature about the macroeconomic impact of IMF programmes. Most empirical studies find that Fund programmes improve the balance of payments and the current account, but views on the ultimate output and employment effects are much more diverse.

Finally, despite the substantial literature devoted to quantifying the impact of IMF programmes, there has been much less analysis of whether IMF programmes achieve the macroeconomic objectives specified in these programmes. This is an important omission, because not all Fund programmes are fully implemented. The effectiveness of programmes and their implementation are intrinsically linked to each other. The programme effectiveness could only be materialised, if the conditions attached to programmes are implemented. Yet, failure to implement Fund programmes is present and needs to be addressed.

The first section of the chapter reviews existing literature focusing on outcomes on macroeconomic indicators and policy targets. It also explores the methodological issues
and how they have been approached in the literature. Section 2 focuses on the issue of programme implementation. First, difficulties involving the measurement of implementation are examined. Second, the record on the implementation of IMF programmes has been examined looking at a number of studies spanning a period running from 1969 to 2002. These findings are then updated with the current study covering 218 programmes over 1992-2004, which confirms that poor implementation exists. This finding biases the results of effectiveness studies that do not distinguish between implemented and not implemented programmes. Therefore, conclusions of the literature need to be reassessed.

2.1. Effectiveness of IMF Programmes

Evaluating the performance of Fund programmes is an inherently difficult task. First of all, the performance of an economy is influenced by many factors, and it is quite difficult to distinguish the effects of other factors from those of a Fund programme.

There is also some ambiguity regarding period analysis. The time-lags between changes in policy variables such as the exchange rate, and domestic credit suggest a longer period analysis. However, the longer the period is, the louder becomes the extraneous ‘noise’ in the tests (Rodrik 1995, pp. 38). There are some studies in the literature that have distinguished significant differences between the short and long run effects of IMF programmes (Conway, 1994; Killick, 1995).

Another complication with assessing programme effects in cross-sectional tests is related to policy conditionality, which varies across programmes. Not only does it change for different programme types like PGRFs and Stand-bys, but also among programmes of the same type. Further, impact of conditionality may differ from programme to programme. Certain conditions might work better in a particular programme facilitating implementation, while some others work against it hindering programme implementation. The results, in this respect, may be expected to differ according to the severity and impact of conditionality, but cross-country tests treat all programmes equally.
However, the dominating issue in the effectiveness literature has been ‘the counterfactual’. The comparison of the actual effects of IMF policy advice to a counterfactual—what would have happened in the absence of the Fund’s policy advice—is the most common method to assess the effectiveness of IMF programmes.

Why is it desirable to use the counterfactual? Since most countries turn to the Fund when there is a crisis, the adverse initial effects on the economy can be disentangled from the effects of the programme itself by using the counterfactual.

The counterfactual is the most popular benchmark available to assess programme effectiveness, however, by definition, it cannot be observed. It has to be constructed, estimated or approximated. Thus, Khan (1990, pp. 198) has argued that the studies investigating IMF effectiveness in the literature should be assessed on the basis of the quality of their estimators of the counterfactual. The ideal counterfactual described by Khan and Sharma (2001) would be “equilibrium for the same economy facing the same exogenous factors, and differing only in its non-participation in the Fund-supported programme”. Various methods have been advanced to construct a counterfactual that can provide a good approximation to the ideal counterfactual.

2.1.1. Methods

The most frequently used methods in the empirical literature on IMF programmes are before-after, with-without, target-outcome comparisons, regression based evaluations, and comparison of simulations.

The before-after method (BA) is useful for obtaining positive information on IMF programmes, but it is not a good estimator of the counterfactual (Killick 1995, pp. 40). Its basic advantage is the ease of calculation. It is also intuitive and encapsulates the way most people think about programme evaluation. This approach gives information on whether programmes were associated with an improvement on the initial situation. Its main drawback is that this method assumes all other things remain equal, ignoring initial conditions, policy changes, external and internal shocks during the comparison period.

---

2 See Conway (1998) for the theoretical derivation of the counterfactual.
Therefore, it does not provide an estimate of the independent effects of programmes when non-programme determinants of the macroeconomic outcomes are changing between the pre-programme and the programme period. However, so called non-programme determinants do change year by year, such as terms of trade variations, movements in world interest rates, productivity shocks, shifts in weather conditions.

Consequently, the estimations of before-after tests are biased. This approach incorrectly attributes all the changes in outcomes during the comparison period to programme factors. The estimations will also be unsystematic over time, because the estimated programme effects for a given year will often be dominated by specific non-programme influences of that year. As a result, the outcomes may have nothing to do with the programme. There is only one way in which unbiased estimates can be obtained. Offsetting internal and external shocks during the comparison period against changes in domestic policy variables in the absence of the Fund programmes would give zero bias. It is, however, a very unlikely circumstance. 3

The main reason why the BA approach provides poor approximation of the ideal counterfactual stems from the fact that it uses the pre-programme period as a counterfactual, where macroeconomic outcomes are usually deteriorating. Therefore, the estimates are not likely to offer an accurate prediction of what would have happened in the absence of the IMF programme.

The with-without approach (WW) compares a sample of programme countries with a control group of non-programme countries. The experiences of non-programme countries are therefore used as a proxy to the counterfactual. The main assumption of this approach is that programme and non-programme countries are drawn from the same population, so that they face the same external environment. With this assumption, the WW method aims to overcome the shortcomings of the BA approach by distinguishing between programme and non-programme determinants of macroeconomic outcomes. Comparing changes in outcomes between programme and non-programme countries enables us to

---

3 See Goldstein and Montiel (1986) for a derivation of the bias and the conditions under which it will be zero. See also Conway (1998).
extract the effects of IMF programmes, since the influence of external factors cancels out as both groups of countries face the same external environment.

Nevertheless, this approach also has shortcomings. The great difficulty is to select a truly comparable group. Programme countries can systematically differ from non-programme countries. Further, the countries that turn to Fund as a result of poor economic situation are an example of adverse selection instead of random selection. Adverse selection implies that, programme countries are more likely to have below average reserves and current account balance prior to the programme leading to biased with-without test estimates. The WW estimator attributes the difference in outcomes to programme status of the countries, while, in effect, the difference is due to differing initial positions of the two groups of countries.

There are also political economy considerations associated with this approach. Even if we assume that two groups of countries have equally severe balance of payments difficulties, the control group’s decision to not to go to the Fund implies that these two groups do actually have incomparable characteristics of significant importance. The control group might not turn to the Fund on ideological grounds, or because of weak governance. Thus, this group’s economic experience is less likely to be a good proxy of counterfactual, with the resulting estimates attributing disproportionately positive results to the effects of Fund programmes.

Misrepresenting the impact of programmes is an inaccuracy both WW and BA methods fall into. Both ignore the systematic differences between the countries and periods where lending occurs and those where it does not. The generalized evaluation estimator (GEE) has been developed to overcome this shortcoming.

The GEE approach (also referred to as regression approach) compares performance in programme and non-programme countries, controlling for outside factors, as well as differences across countries and through time. It accepts the non-random selection of programme-countries, identifies the differences between two groups of countries prior to the programme period and then controls for those differences. It also aims to capture the effects of policy variables and various other factors on the macroeconomic outcomes. The GEE method specifies a reduced-form model which
controls for explanatory variables. The reduced form equations are used to determine the effects of alternative policies on the target variables, controlling for exogenous variables. Then, the policy reaction functions are constructed to determine what policies would have been chosen, given pre-programme conditions, in the absence of a Fund programme. Regression equations of the model include the BoP, inflation and economic growth as dependent variables, and the effects of IMF programme as a dummy variable. Testing of equations against cross-country data reveals the programme effects directly.

This approach is preferable to the BA and WW methods, as it uses more information about the programme and non-programme countries, helping to define a more accurate counterfactual. The method however requires a substantial amount of data and the specification of initial conditions, policy instruments, and exogenous factors into the model, which are not easy to collate. If not all factors are taken into consideration; this approach leads to errors, albeit smaller than those of previous methodologies.

The GEE has two serious limitations. First, policy reaction functions need to be stable over time and comparable across countries for unbiased results. Results are very sensitive to the specification of the reaction function and they can change as observations are excluded or included. Dicks-Mireaux et al. (2000) claim that the GEE approach does not rigorously test the underlying assumptions. Given the fact that the GEE framework has many restrictive assumptions that are necessary to define the counterfactual, the GEE estimates do not adequately evaluate the validity of the underlying model.

Second, unobserved factors may have an effect on participation in IMF programmes and policy performance. The GEE approach does not address this fundamental problem. A widely used solution advocated by Heckman (1979) suggests estimating a probability that an observation belongs to a particular state (post-programme period) and using a variable derived from that probability in the second stage of estimation. Though some innovative studies in the literature attempt to correct for selection bias (Bagci and Perraudin, 1997; Conway 2000; Przeworski and Vreeland 2000; Garuda 2000), both Hutchison (2001) and Barro and Lee (2002) argue that Heckman’s (1979) approach does not adequately control for selection bias.
Barro and Lee (2003) use instrumental variables to isolate the effects of IMF programmes on economic growth and on other economic and political outcomes. These variables are based on political-economy determinants of Fund lending, and include the country's share of IMF quotas, the share of a country's nationals among the IMF staff, and the country's proximity to the United States or major European countries. The problem associated with this method, however, is the difficulty of finding appropriate instrumental variables for IMF programme evaluation.

The target-outcome method compares actual outcomes with targets that are written into IMF programmes, giving an indication of to the extent to which programmes achieve targeted results. However, this method is insufficiently equipped to judge the effectiveness of a programme. A deviation from the targets may be due to country's non-compliance, as well as to circumstances beyond a country's control. Further, since the targets are based on the forecasting models generating them, one can also question the appropriateness of a forecasting model for describing the relationship between intermediate policy variables and targets. Discrepancies between targets and outcomes may be a result of poor models or unrealistic targeting rather than unsatisfactory economic outcomes (Polak 1991, pp. 45). Indeed, research examining the accuracy of IMF projections (Bird, 2005; Baqir et al., 2004; Atoian et al., 2003) reveals evidence of over-optimism on the Fund's part.4

Another approach, which departs from the methods described above, relies on the simulation of econometric models instead of actual outcomes to extract IMF programme effects. The simulation approach (SIM) is useful for the evaluation of the design and effectiveness of Fund programmes in general, but not for the assessment of specific programmes where the use of actual outcomes would be inevitable.

The main advantages of the simulation approach reflect the weaknesses of previous approaches. The researcher using this method is not restricted to a dataset, as the

4 Atoian et al. (2003) explain the divergence of actual and projected values by incomplete information concerning initial conditions, differences between the reforms assumed within the projections and those actually implemented, and differences in the 'model' underlying IMF projections as compared with that suggested by the data on out-turns.
database is not constrained to programme countries. The SIM method also overcomes one of the main difficulties in measuring the effects of programmes: the degree of implementation. Incomplete implementation blurs the results with other methods relying on actual outcomes. Here, the effects of implementation need not to be disentangled from programme effects, since policy simulations are specified (Haque and Khan 1998).

Problems with this approach are of a practical nature. It is extremely difficult to construct a full model capturing the complex ways in which policy variables interact with the programme targets. Further, even if it could be done, the parameters in the model may change responding to the variations in policy regime. As a result, the actual effects of a hypothetical programme could turn out to be quite different from the simulated results.

2.1.2. Review of the Literature

The early literature on IMF Programme Effectiveness mainly uses the BA method. Reichmann and Stillson (1978) analyse 79 stand-by programmes between 1967 and 1972. They examine the BoP, inflation and growth during the two-year periods before and after the programmes. The study finds that net foreign assets improve in 64 percent of the cases; this figure falls to 24 percent with a statistically significant coefficient. In 16 out of 29 cases where inflation was high, no statistically significant change in inflation is observed. They find that there was no significant change in the rate of expansion of total domestic credit (a key policy instrument in Fund programmes) in two thirds of the cases studied. The same is true for credit to the public sector in half of the programmes, although there is a significant deceleration in two fifths of the cases. In terms of growth performance, no adverse effects are observed overall.

Connors (1979) follows the same method and examines 31 programmes between 1973 and 1977. The study compares the main macroeconomic variables one year before and after the initiation of Fund programmes. He finds that IMF programmes had no visible effects on the current account deficit, the BoP, inflation and economic growth.

Killick (1984) uses both one-year and two-year comparisons, to capture the effects of lags on programme effectiveness. The study analyses 38 programmes between
1974 and 1979, and finds no statistically significant results on either the BoP, or current account deficit. The evidence shows a slightly positive effect on economic growth. The inflation rate is found to be higher.

A regional study by Pastor (1987) looks at 19 Latin American countries over the period of 1965-81. The study employs one-year comparisons and alternative statistical tests. It finds no effect on the current account, the inflation rate and the growth rate of nominal GDP. There is, however, a significant improvement in the BoP. The study also finds a statistically strong negative association between programmes and the share of wages in the functional distribution of income.

Killick, Malik and Manuel (1992) update the earlier Killick (1984) work with a study of 16 countries during 1979-1985, obtaining different results. They find statistically significant and positive results on the BoP, the current account, the economic growth rate and negative results on the inflation rate. Killick (1995) also employs a combination of before-after tests and case study evidence, which confirm that both the overall and current account balances strengthen, especially over a three year period.

A study by Schadler et al. (1993) analyses 19 countries and 55 SAF and ESAF programmes during 1983-93. They find that the BoP and the growth rate improved, while the current account balance worsened. The inflation rate is also found to decrease. Results however are not tested for statistical significance.

Zulu and Nsouli's (1985) study of 35 programmes for 22 African countries employs the BA method as well as the TO method. Their results suggest that IMF programmes lead to a reduction in the economic growth rate, an increase in the inflation rate, and no improvement with net foreign assets.

Using target-outcome comparisons, Beveridge and Kelly (1980) find that, in a group of 105 programmes between 1969 and 1978, fiscal deficit targets were achieved in about half, ceilings on credit to the government in 70 percent, and foreign financing targets in 30 percent of the cases. Reichman and Stillson (1978) find that 65 percent of the programmes that included domestic credit deceleration as a performance criterion achieved it and 72 percent of those programmes achieved a reduction in the rate of growth of
domestic credit to the public sector. Conversely, using the same approach, Edwards (1989) shows that neither fiscal nor monetary targets were achieved during 1983-85.

Khan and Knight (1981) use simulation method in their study, which consists of a small dynamic model, with a sample of 29 developing countries. The development of this study in 1985 incorporating a comparison of alternative policy packages compares the macroeconomic outcomes of a package of demand management policies with a combined package of demand management and structural policies. These simulation studies find significantly beneficial effects for the balance of payments and the inflation rate, although this approach does not test programme effects per se. The simulation tests predicted significant short-term reductions in growth. They also find that programmes which incorporate greater supply-side conditionality would incur smaller initial loss of output, with the subsequent recovery being steeper and the longer-term growth trend settling down about two per cent per annum higher.

The with-without approach is first used by Donovan (1981, 1982). These studies compare the performance of countries in stand-by programmes between 1971 and 1980 with that of a control group comprising non-oil developing countries. Time horizons for the comparison are one-year and three-year respectively. He finds evidence for comparative improvements for programme countries in the current account deficit as a percentage of GDP, the balance of payments as a percentage of exports and inflation. No difference in the economic growth rate is observed. Donovan does not report any tests of significance.

Loxley (1984) examines with-without outcomes over one and three years. His tests for 38 low-income developing countries in 1971-1982 show a better balance of payments outcome by comparison with non-programme countries, although these results fail significance tests. The statistically significant relative improvement is obtained for the rate of inflation in three-year comparisons. He also finds evidence for reduced investment levels in programme countries.

Gylfasson (1987) analyses the effects of IMF programmes in 32 countries over the period of 1977-1979. His control group consists of countries that had experienced economic difficulties similar to those undertaking IMF programmes. He finds that the balance of payments improvement in the programme group was greater than in the control
group, and this result is statistically significant. The reduction in the inflation rate and in the economic growth rate is found to be higher in the programme group than in the control group, but with no statistical significance. Another finding of the study is that the results of programmes which incorporated a currency devaluation are better sustained than those which did not.

Using the WW approach, Doroodian (1993) finds statistically significant improvements in the balance of payments, and non-significant reductions in inflation. No statistically significant results are reported on the rate of growth. His analysis included 27 programmes from 43 countries during 1977-1983.

Goldstein and Montiel (1986) developed the GEE approach to overcome the biases persistent in the BA and the WW methods. Using a sample of 68 programmes for 58 countries between 1974 and 1981, they find that programme countries experienced a deterioration in their BoP, a reduction in economic growth rates, and an increase in inflation rates, albeit these effects are not statistically significant.

Using a similar method but with a much larger sample of 259 programmes in 69 countries during 1973-88, where both one-year and two-year comparisons were used, Khan (1990) finds a statistically significant balance of payments improvement for two years after the inception of the programme. The current account deficit is found to be immediately reduced, its effect strengthening over time. The decrease in the inflation rate is not statistically significant.

With regards to the economic growth rate, it declines in the first year of the programme. But, supply-enhancing policies help to offset this negative impact after a lag. Bordo and Schwartz (2000) find negative effects on growth. They undertook a study of 24 countries and 88 programmes during 1973-98 using annual and quarterly data. They also found no effects on inflation, some improvement on the BoP and the current account.

In relation to growth, Haque and Wartenberg (1992) find a negative effect on the ratio of savings to GDP in their application of GEE to 15 countries. While Hutchison (2001) discovers a significant adverse effect over one to two years, Garuda (2000) suggests that impact on income distribution depended on the severity of initial conditions.
A study by Conway (1994) factors participation decisions of programme countries into the GEE method to allow for the endogenous determination of the programme participation. Using a sample of 217 programmes over the period of 1976-86 and two-stage least squares, he finds that the current account of BoP improved, inflation fell, and the economic growth rate first decreased and then increased. All the results are statistically significant. Similar analysis is done by Bagci and Perraudin (1997). Their study of 68 countries from 1973 to 1992, using a maximum likelihood estimation method, finds statistically significant evidence for improved balance of payments, the current account balance, reduced inflation and increased growth in the short-run.

Dicks-Mireaux et al (2000) examine the period of 1986-91 covering 61 countries and 88 programmes and find evidence that Fund programmes do reduce inflation, but with a statistically insignificant coefficient. They also find evidence for an immediate improvement in economic growth as a result of programme policies. This effect is found to be statistically significant. However, they also draw attention to the constraints posed by the GEE approach. Their conclusion is that identifying policy reaction functions and a structural economic model that are both simply specified and common to a wide range of developing countries is difficult. Therefore, to avoid model mis-specification, they suggest using single countries or a small group of relatively homogeneous countries for future applications of the GEE framework.

There is one study which is different from above studies in the sense that it investigates the importance of implementation to the effectiveness of programmes. Nsouli et al. (2004) discover that implementation exerts an influence over macroeconomic outcomes especially over shorter time horizons. Better implemented programmes are found to be associated with lower inflation, and with initially weaker but then stronger balance of payments and fiscal outcomes. No statistically significant impact of implementation is found on economic growth.

2.1.3. Discussion of Results

The literature’s results can be grouped into three sets of areas where the IMF programmes are expected to have an impact. Table 2.1 summarizes the findings in the
literature on the effects of IMF programmes on external balance indicators. These are the set of variables, upon which Fund programmes might be expected to have an impact. The results are mixed. The earlier research suggests no correlation while the more recent studies, which tended to use larger samples and more sophisticated methods, find that IMF programmes improved the balance of payments, and the current account. Two of them find that programmes led to a depreciating exchange rate.

Table 2.2 reviews the evidence on inflation, which is a key target variable, and on typical policy instruments included in conditionality: the government deficit, domestic credit, and the money supply. Whereas the balance of payments, the current account and the exchange rate may be subject to substantial exogenous shocks, these policy variables are under the direct influence of the government's policy. If governments implement IMF advice, IMF programmes should influence these variables. The literature's results are again mixed. Earlier studies offer ambiguous results, while studies conducted in the 1990s conclude that IMF programmes appear to reduce inflation rates. Only one study finds statistically significant results. On budget balance, two studies find significant evidence that the IMF improves budget balance. One study reports a statistically significant finding that the IMF succeeds in reducing the rate of growth of domestic credit. No significant results are reported on the effect of IMF programmes on government consumption.

Finally, numerous studies have been concerned with determining the effects of IMF programmes on economic growth. The IMF has long maintained that achieving its objective of stabilising currencies and prices promotes long-term growth by facilitating international investment. In the short run, however, the IMF programmes are associated with recession rather than growth. Table 2.3 reviews the evidence on economic growth. There is no consensus on the long-term effects of IMF programmes on growth, savings and investment. The results are again mixed. The studies differ in their time frames for evaluating the effects of programmes, but this alone does not explain the variations in the results. A few studies find that IMF programmes reduce domestic savings, one finds that they reduce domestic investment, and a number find that IMF programmes cause recessions. On the long term growth, only three studies claim statistically significant results.
Table 2.1. IMF Programme Effects on External Balance

<table>
<thead>
<tr>
<th>Study</th>
<th>Balance of Payments</th>
<th>Current Account / GDP Rate</th>
<th>Real Exchange Rate</th>
<th>Method used^</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reichmann &amp; Stillson (1978)</td>
<td>0</td>
<td></td>
<td>BA, TO</td>
<td></td>
</tr>
<tr>
<td>Connors (1979)</td>
<td>0</td>
<td>0</td>
<td>BA</td>
<td></td>
</tr>
<tr>
<td>Khan &amp; Knight (1981)</td>
<td>+</td>
<td>+</td>
<td>SIM</td>
<td></td>
</tr>
<tr>
<td>Donovan (1982)</td>
<td>+</td>
<td>+</td>
<td>WW</td>
<td></td>
</tr>
<tr>
<td>Killick (1984)</td>
<td>0</td>
<td>-</td>
<td>BA</td>
<td></td>
</tr>
<tr>
<td>Loxley (1984)</td>
<td>0</td>
<td></td>
<td>WW</td>
<td></td>
</tr>
<tr>
<td>Khan &amp; Knight (1985)</td>
<td>+</td>
<td>+</td>
<td>SIM</td>
<td></td>
</tr>
<tr>
<td>Zulu &amp; Nsouli (1985)</td>
<td>0</td>
<td>0</td>
<td>BA, TO</td>
<td></td>
</tr>
<tr>
<td>Goldstein &amp; Montiel (1986)</td>
<td>-</td>
<td>-</td>
<td>GEE</td>
<td></td>
</tr>
<tr>
<td>Gylfasson (1987)</td>
<td>+</td>
<td></td>
<td>WW</td>
<td></td>
</tr>
<tr>
<td>Pastor (1987)</td>
<td>+*</td>
<td>0</td>
<td>BA</td>
<td></td>
</tr>
<tr>
<td>Edwards (1989)</td>
<td>+</td>
<td></td>
<td>TO</td>
<td></td>
</tr>
<tr>
<td>Khan (1990)</td>
<td>+*</td>
<td>+*</td>
<td>GEE</td>
<td></td>
</tr>
<tr>
<td>Killick, Malik &amp; Manuel (1992)</td>
<td>+*</td>
<td>+*</td>
<td>BA</td>
<td></td>
</tr>
<tr>
<td>Doroodian (1993)</td>
<td>-</td>
<td></td>
<td>WW</td>
<td></td>
</tr>
<tr>
<td>Edwards &amp; Santaella (1993)</td>
<td>+</td>
<td></td>
<td>TO</td>
<td></td>
</tr>
<tr>
<td>Schadler et al. (1993)</td>
<td>+</td>
<td>-</td>
<td>BA</td>
<td></td>
</tr>
<tr>
<td>Conway (1994)</td>
<td>+*</td>
<td>0</td>
<td>GEE</td>
<td></td>
</tr>
<tr>
<td>Schadler et al. (1995)</td>
<td>-</td>
<td></td>
<td>BA</td>
<td></td>
</tr>
<tr>
<td>Bagci &amp; Perraudin (1997)</td>
<td>+</td>
<td>+</td>
<td>IV</td>
<td></td>
</tr>
<tr>
<td>Bordo &amp; Schwartz (2000)</td>
<td>+</td>
<td>+</td>
<td>IV</td>
<td></td>
</tr>
<tr>
<td>Lee &amp; Rhee (2000)</td>
<td>0</td>
<td></td>
<td>IV</td>
<td></td>
</tr>
</tbody>
</table>

Notes: "0" indicates no correlation between IMF programmes and variables; "+" indicates positive correlation, and "−" indicates negative correlation. If the variable is not included in a study, the corresponding cell is left blank. An asterisk indicates that the result is significant at .05 level.

Table 2.2. IMF Programme Effects on Policy Variables

<table>
<thead>
<tr>
<th></th>
<th>Inflation</th>
<th>Budget Balance / GDP</th>
<th>Gov’t Cons. / GDP</th>
<th>Dom. Credit Growth</th>
<th>Method used</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reichmann &amp; Stillson (1978)</td>
<td>0</td>
<td></td>
<td></td>
<td></td>
<td>BA, TO</td>
</tr>
<tr>
<td>Connors (1979)</td>
<td>0</td>
<td></td>
<td></td>
<td></td>
<td>BA</td>
</tr>
<tr>
<td>Donovan (1981)</td>
<td>-</td>
<td></td>
<td></td>
<td></td>
<td>WW</td>
</tr>
<tr>
<td>Khan &amp; Knight (1981)</td>
<td>- , 0&lt;sup&gt;a&lt;/sup&gt;</td>
<td></td>
<td></td>
<td></td>
<td>SIM</td>
</tr>
<tr>
<td>Donovan (1982)</td>
<td>-</td>
<td></td>
<td></td>
<td></td>
<td>WW</td>
</tr>
<tr>
<td>Killick (1984)</td>
<td>-</td>
<td></td>
<td></td>
<td>0</td>
<td>BA</td>
</tr>
<tr>
<td>Loxley (1984)</td>
<td>-</td>
<td></td>
<td></td>
<td></td>
<td>WW</td>
</tr>
<tr>
<td>Khan &amp; Knight (1985)</td>
<td>-</td>
<td></td>
<td></td>
<td></td>
<td>SIM</td>
</tr>
<tr>
<td>Zulu &amp; Nsouli (1985)</td>
<td>0</td>
<td>+</td>
<td>0</td>
<td></td>
<td>BA, TO</td>
</tr>
<tr>
<td>Kirkpatrick &amp; Onis (1985)</td>
<td>+</td>
<td></td>
<td></td>
<td></td>
<td>BA</td>
</tr>
<tr>
<td>Goldstein &amp; Montiel (1986)</td>
<td>+</td>
<td></td>
<td></td>
<td></td>
<td>GEE</td>
</tr>
<tr>
<td>Remmer (1986)</td>
<td>-</td>
<td></td>
<td></td>
<td></td>
<td>BA</td>
</tr>
<tr>
<td>Gylfasson (1987)</td>
<td>-</td>
<td></td>
<td></td>
<td></td>
<td>WW</td>
</tr>
<tr>
<td>Pastor (1987)</td>
<td>0</td>
<td></td>
<td></td>
<td></td>
<td>BA</td>
</tr>
<tr>
<td>Edwards (1989)</td>
<td>+</td>
<td></td>
<td></td>
<td></td>
<td>TO</td>
</tr>
<tr>
<td>Khan (1990)</td>
<td>-</td>
<td></td>
<td></td>
<td></td>
<td>GEE</td>
</tr>
<tr>
<td>Haque &amp; Wartenberg (1992)</td>
<td>-</td>
<td></td>
<td></td>
<td></td>
<td>GEE</td>
</tr>
<tr>
<td>Killick, Malik &amp; Manuel (1992)</td>
<td>-&lt;sup&gt;*&lt;/sup&gt;</td>
<td>+&lt;sup&gt;**&lt;/sup&gt;</td>
<td>-&lt;sup&gt;**&lt;/sup&gt;</td>
<td>-&lt;sup&gt;*&lt;/sup&gt;</td>
<td>BA</td>
</tr>
<tr>
<td>Doroodian (1993)</td>
<td>-</td>
<td></td>
<td></td>
<td></td>
<td>WW</td>
</tr>
<tr>
<td>Edwards &amp; Santaella (1993)</td>
<td>-</td>
<td></td>
<td></td>
<td></td>
<td>TO</td>
</tr>
<tr>
<td>Schadler et al. (1993)</td>
<td>-</td>
<td>+</td>
<td></td>
<td></td>
<td>BA</td>
</tr>
<tr>
<td>Conway (1994)</td>
<td>-</td>
<td>+&lt;sup&gt;**&lt;/sup&gt;</td>
<td></td>
<td>+</td>
<td>GEE</td>
</tr>
<tr>
<td>Schadler et al. (1995)</td>
<td>-</td>
<td></td>
<td></td>
<td></td>
<td>BA</td>
</tr>
<tr>
<td>Bagci &amp; Perraudin (1997)</td>
<td>+</td>
<td></td>
<td></td>
<td></td>
<td>IV</td>
</tr>
<tr>
<td>Jordan &amp; Schwartz (2000)</td>
<td>0</td>
<td></td>
<td></td>
<td></td>
<td>IV</td>
</tr>
<tr>
<td>Dicks-Mireaux et al. (2000)</td>
<td>-</td>
<td></td>
<td></td>
<td></td>
<td>IV</td>
</tr>
<tr>
<td>Lee &amp; Rhee (2000)</td>
<td>0</td>
<td></td>
<td></td>
<td></td>
<td>IV</td>
</tr>
</tbody>
</table>

<sup>a</sup>The two symbols indicate short-run and long-run effects, respectively.
Table 2.3. IMF Programme Effects on Growth, Savings and Investment.

<table>
<thead>
<tr>
<th>Study</th>
<th>Growth</th>
<th>Savings / GDP</th>
<th>Dom. Inv't / GDP</th>
<th>Methods used</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reichmann &amp; Stillson (1978)</td>
<td>+</td>
<td></td>
<td></td>
<td>BA, TO</td>
</tr>
<tr>
<td>Connors (1979)</td>
<td>0</td>
<td></td>
<td></td>
<td>BA</td>
</tr>
<tr>
<td>Khan &amp; Knight (1981)</td>
<td>-</td>
<td></td>
<td></td>
<td>SIM</td>
</tr>
<tr>
<td>Donovan (1981)</td>
<td>+</td>
<td></td>
<td></td>
<td>WW</td>
</tr>
<tr>
<td>Donovan (1982)</td>
<td>-</td>
<td></td>
<td></td>
<td>WW</td>
</tr>
<tr>
<td>Killick (1984)</td>
<td>+</td>
<td></td>
<td></td>
<td>BA</td>
</tr>
<tr>
<td>Loxley (1984)</td>
<td>0</td>
<td></td>
<td></td>
<td>WW</td>
</tr>
<tr>
<td>Khan &amp; Knight (1985)</td>
<td>-,+a</td>
<td>-</td>
<td>0</td>
<td>BA, TO</td>
</tr>
<tr>
<td>Zulu &amp; Nsouli (1985)</td>
<td>-</td>
<td>-</td>
<td>0</td>
<td>BA, TO</td>
</tr>
<tr>
<td>Goldstein &amp; Montiel (1986)</td>
<td>-</td>
<td></td>
<td></td>
<td>GEE</td>
</tr>
<tr>
<td>Gylfasson (1987)</td>
<td>-</td>
<td></td>
<td></td>
<td>WW</td>
</tr>
<tr>
<td>Pastor (1987)</td>
<td>0</td>
<td></td>
<td></td>
<td>BA</td>
</tr>
<tr>
<td>Edwards (1989)</td>
<td>+</td>
<td></td>
<td></td>
<td>TO</td>
</tr>
<tr>
<td>Khan (1990)</td>
<td>-*</td>
<td></td>
<td></td>
<td>GEE</td>
</tr>
<tr>
<td>Haque &amp; Wartenberg (1992)</td>
<td>-</td>
<td></td>
<td></td>
<td>GEE</td>
</tr>
<tr>
<td>Killick, Malik &amp; Manuel (1992)</td>
<td>+</td>
<td></td>
<td></td>
<td>BA</td>
</tr>
<tr>
<td>Doroodian (1993)</td>
<td>-</td>
<td></td>
<td></td>
<td>WW</td>
</tr>
<tr>
<td>Schadler et al. (1993)</td>
<td>+</td>
<td>-</td>
<td>0</td>
<td>BA</td>
</tr>
<tr>
<td>Conway (1994)</td>
<td>-</td>
<td>-</td>
<td>-*</td>
<td>GEE</td>
</tr>
<tr>
<td>Schadler et al. (1995)</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>BA</td>
</tr>
<tr>
<td>Bagci &amp; Perraudin (1997)</td>
<td>+</td>
<td></td>
<td></td>
<td>IV</td>
</tr>
<tr>
<td>Bordo &amp; Schwartz (2000)</td>
<td>-</td>
<td></td>
<td></td>
<td>IV</td>
</tr>
<tr>
<td>Dicks-Mireaux et al. (2000)</td>
<td>+,*</td>
<td></td>
<td></td>
<td>IV</td>
</tr>
<tr>
<td>Lee &amp; Rhee (2000)</td>
<td>+</td>
<td></td>
<td></td>
<td>IV</td>
</tr>
<tr>
<td>Przeworski &amp; Vreeland (2000)</td>
<td>-*</td>
<td></td>
<td></td>
<td>IV</td>
</tr>
</tbody>
</table>

*a The two symbols indicate short-run and long-run effects, respectively.
A mixed picture emerges from the literature assessing the effects of IMF programmes on macroeconomic policies and final outcomes. One also has to consider the limitations of the approaches used in the literature. Refinement of the empirical methodology needs to be continued to get closer to the ideal counterfactual.

Furthermore, the focus of the literature assessing programme effectiveness needs to be broadened. Taking a narrow focus, one can claim that IMF programmes ‘on balance’ work. But, if Fund programmes are not carried through to completion, these assessments of effectiveness should be considered far from complete. Indeed, studies that have been reviewed in this section have one essential omission. They have not controlled for the degree of implementation of Fund programmes. All programmes were treated in the same manner regardless of whether the policy intentions specified in the programmes were carried out or not. This no doubt creates a bias of the evaluation of programme effectiveness. Therefore, empirical approaches which incorporate the degree of implementation need to be developed and used. Until then, the literature’s conclusions have to be regarded as tentative.

2.2. The Measurement and Record on Implementation

The literature on programme effectiveness has tended to avoid the question of compliance. It can be said that this avoidance is not a coincidence. Measuring compliance of IMF programmes is complicated.

First of all, it is a data intensive effort. Details of most IMF programmes were confidential until the aftermath of the East Asian Crisis. This has been a major obstacle in assessing the implementation of Fund programmes.

Further, even when one can observe the details of IMF programmes, developing measures to assess implementation is not straightforward. One complexity is that IMF programmes have many dimensions. Governments may comply with several of the commitments they make, yet fail to comply with several others. The dimensions of programmes also vary for different programmes. The Fund prescription may involve large scale fiscal cuts in one programme, while major devaluation of the national currency is
proposed in another Fund programme. Even if we look at only one dimension, there may be different commitments made by different governments.

Despite these complexities, various proxies have been developed to assess the degree of programme implementation.

2.2.1. The Rate of Loan Disbursement

The most common proxy used is the extent to which a loan is disbursed (Killick, 1995; Mussa & Savastano, 2000; Joyce, 2003). The disbursement of IMF loans is tied to the completion of programme reviews, and thus to the fulfillment of conditionality. The IMF stops disbursing a credit if there is insufficient implementation.

The advantages of this proxy are that it provides continuous data and it is easy to measure. However, this proxy cannot capture some cases. In some cases of Fund programmes, policy actions might actually be taken, but no resources drawn. Some programmes are agreed as precautionary while some others turn into precautionary programmes. Sometimes countries do not draw down the full amount of IMF loan because they do not need to. Precautionary loans are granted as a safety net as a country embarks upon an economic reform programme. Since these countries do not need a loan, but are willing to enter into an IMF programme, they may actually achieve the highest levels of compliance. A ‘failure’ to complete a programme, as measured by the disbursement of Fund resources may reflect economic ‘success’ in as much as Fund financing is no longer needed.

Therefore, within the non-compliant group indicated by the disbursement proxy, there are really two completely different types of governments: (1) the least compliant governments who did not draw down the full IMF loan because the Fund officials deemed that the country is not in sufficient compliance with the programme, and (2) the most compliant governments who did not draw down the full IMF loan because they did not need it. Where the intention of drawing resources is non-existent, it would be inappropriate to evaluate these programmes on the basis of the rate of disbursement.
Another shortcoming of this proxy is that; in some other cases, all the money is drawn but implementation is not realized in full. A programme may be completed in the sense that all agreed resources are used, but conditions agreed at the initiation of the programme may be left unimplemented. Waivers may be granted or conditionality may be modified. The Fund may feel that the government has made a substantial improvement, and may allow deviations from the original targets. Therefore, degree of implementation in programmes with modified conditionality cannot be truly captured with this proxy.

Moreover, Fund lending is not completely isolated from political economy influence, which might bias the disbursement measure. The substantial explanatory power of political economy variables is found in the studies looking into the distribution and terms of Fund lending (Anderson et al., 2006; Barro and Lee, 2005; Bird and Rowlands, 2001, 2002; Dreher and Vaubel, 2002; Harrigan, Wang, El-Said, 2006; Killick, 1995; Rowlands, 1995; Stone, 2002; Thacker, 1999). A study by Harrigan, Wang, El-Said (2006) focusing on the Middle East and North Africa regions find that signing a peace treaty with Israel and improving democracy increase the probability of entering into an IMF programme and that the programme is more likely to be signed in the post-election year. Dreher and Vaubel (2005) also find democracy and elections to be important factors of IMF lending. While some studies find that there is a systematic ‘US influence’ (Thacker, 1999; Anderson et al., 2006), others conclude that the evidence for systematic US influence is less strong (Rowlands 1995; Bird and Rowlands, 2001, 2002). Barro and Lee (2005) conclude that IMF loans are also more likely and larger in size when countries have larger quotas, more nationals on the IMF staff and more connected to the US and Western Europe. Further, Killick (1995) and Stone (2002) suggest that strategically important countries or countries preferred by major powers, sign programmes with more favorable conditions. These programmes are also unlikely to be strictly enforced.

2.2.2. Interruption

An alternative approach to implementation is to see whether the programme is interrupted. Mecagni (1999) defines program interruption as either, an interval of more than six months between IMF arrangements, or a delay of more than six months in
completing a programme review. Schadler et al. (1995) examine the quarterly reviews of IMF programmes, and define non-compliance as situations where performance criteria are not met and the loans are suspended.

Ivanova et al. (2003) offer two binary variables measuring reversible and irreversible program interruptions. Reversible interruption is where the review of programme is delayed, but the programme is revived subsequently. Irreversible interruption is where after delayed or uncompleted reviews of programme, the instalments of the arrangement are not approved and the programme is eventually terminated. A replacement programme could be agreed upon afterwards, however, even in these circumstances, the interruption does provide a signal of the poor implementation of conditionality.

2.2.3. Implementation Index

A third measure of implementation uses the Fund’s Monitoring of Fund Arrangements (MONA) database, which contains detailed information about programme countries. It has been compiled since 1993 by the IMF’s Policy Development and Review Department. This database allows the use of actual conditions and actual policies the governments follow.

The Mercer-Blackman and Unigovskaya study (Mercer-Blackman and Unigovskaya, 2000) distinguish between two types of conditions- structural benchmarks and performance criteria, and create two indices of compliance. Both indices indicate the number of conditions that were met as a proportion of the total number of conditions that were prescribed. Because the IMF may deem a country as partially compliant at times, they include ‘partial credit’ in their indices for cases where the IMF deemed that the condition was met ‘to a certain extent’ or if it was ‘met after modification’.

Ivanova et al. (2003) also construct indices of implementation extracting from this database. The macro implementation index reflects compliance with quantitative criteria, while structural implementation index reflects compliance with structural benchmarks in Fund programmes.
The advantage of MONA based implementation indices is that actual conditions are being scrutinised. They show to which extent both the macroeconomic and structural conditions are implemented. Nevertheless, the database suffers from several problems.

The first is that observance of implementation is subjective. Rather than looking directly at what the agreement required and what was the outcome, the indices rely on the judgement of the IMF staff of whether the conditions were met. To the extent that external factors may influence IMF judgement, these measurements may be biased.

The second problem is that several different dimensions of a programme are combined into one overall measure of compliance. This assumes that implementation in one area is equivalent to implementation in another area. Our empirical knowledge is limited regarding the effects of compliance on fiscal, monetary, structural or debt repayment conditions. Therefore, it is premature to assume that implementation across any of these dimensions is interchangeable. Implementing monetary conditions could be relatively easier than implementing fiscal conditions. Implementing structural conditions of which the long term results could be ambiguous to politicians, could be even more challenging.

Furthermore, the MONA database only covers programmes coming up for review by the Fund’s Executive Board, and thereby excludes cancelled or interrupted programmes. Excluded programmes are more likely to exhibit poor implementation; therefore, the indices constructed using this database overstate implementation. Since the data that has been compiled starts from 1993, there is also limited data availability with regard to this measure.

The measures of implementation described above are found to be mutually correlated. As shown in Table 2.4., the correlation coefficients suggest that each measure is picking up a different dimension of implementation. They also show that there is a closer correlation between disbursement and interruption than between the MONA implementation index and either of the other two measures. Fewer interruptions coincide with higher disbursement rates with a correlation coefficient of −0.74.
Table 2.4. Correlations of Implementation Measures

<table>
<thead>
<tr>
<th></th>
<th>Overall Implementation Index</th>
<th>Share of Committed Funds Disbursed</th>
<th>Programmes Having Irreversible Interruptions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall Implementation Index</td>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Share of Committed Funds Disbursed</td>
<td>0.413</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Programmes Having Irreversible Interruptions</td>
<td>-0.403</td>
<td>-0.745</td>
<td>1</td>
</tr>
</tbody>
</table>


Source: Calculations based on IMF data.
2.2.4. Record on Implementation

The record on the implementation of IMF programmes has been explored in a number of studies. These are summarized in Table 2.5. Overall, they span a period running from 1969 to 2002.

Early studies focused on the implementation of fiscal conditionality or, in some cases, other components of conditionality. To assess implementation, many earlier studies employed proprietary data, mostly from the Fund’s internal documents.

The first evidence on compliance with IMF conditionality is presented by Beveridge and Kelly (1980). They showed that out of 105 countries with upper-credit-tranche programmes implemented between 1969 and 1978 only 60 percent achieved the target for the overall fiscal deficit and 54 percent complied with the credit ceiling. Another study on the implementation of IMF conditions is Haggard (1985), which reports extremely low rates of compliance with conditions under the Extended Fund Facility (EFF) between 1974-84. Of the 30 cases studied, 16 were cancelled and eight more were not implemented in their original form. In 1985, Zulu and Nsouli report equally low compliance, both for instruments and objectives. Of 35 programmes between 1980 and 1981, 61 percent achieved both objectives and instruments. At least one instrument has been achieved in 61 percent of the programmes, whereas almost 67 percent achieved at least two objectives. Even lower rates of compliance are reported by Edwards (1989). Out of 34 programmes approved in 1983, only 30 percent complied with conditions on the government’s deficit. In 1984, compliance was reduced further: the ceiling was observed in only 19 percent of the programmes. One year later, 57 percent of these countries failed to comply. As for changes in domestic credit, compliance was highest in 1983 (55 percent). It reduced to 46 percent in 1984 and still further in 1985 (41 percent). On average, compliance was higher for changes in net domestic credit to the government with 72 percent in 1983 and about 52 percent in 1984 and 1985.

This study is updated by Polak (1991), who added programmes in place between 1988 and 1989. The study reports that compliance with fiscal and credit targets, has been 40 percent for the 17 SAF programmes and 60 percent for the five ESAF programmes.
Killick (1995) is the first to examine the disbursement rate, using an 80 percent cut off point (20 percent undrawn) for judging whether a programme had been fully implemented. He examines a large number of programmes relative to earlier studies and discovers that only 47 percent of 305 programmes approved between 1979 and 1993 were implemented. A more recent study by Mussa & Savastano (2000) finds that 35 percent of programmes between 1973 and 1997 were fully disbursed.

The latest studies have continued to use the disbursement rate but have also examined programme interruption as well as the implementation index based on the MONA database. Ivanova et al. (2003) used disbursal rate as one of their measures, and found that 71 percent of the credit disbursed among 170 Fund programmes approved between 1992 and 1998. Nsouli et al. (2004) update Ivanova et al. (2003) with the addition of 25 Fund programmes and reach a disbursal rate of 75 percent.

Using the interruption measure, Mecagni (1999) finds 51 programme interruptions out of 36 ESAF/ SAF programmes in 28 countries between 1986-1999. 17 countries had more than one interruption. Only 10 programmes were in effect for 3 or 4 years without any major interruption and policy slippage. 38 programmes made it at least one year, in the second year, 22 programmes remained in effect. 33 interruptions were caused by slippage on conditionality; only 8 programmes broke down due to disagreements about future actions. In 1988-89, only 40 percent of 17 countries with an SAF programme complied with the postulated credit ceiling. The same is true for the overall fiscal deficit.

Edwards (2001) analyses 347 programmes between 1979 and 1997, and finds that interruptions have been particularly frequent between 1989 and 1992. Over the whole period of study, 138 programmes have been suspended prior to expiration. This corresponds to a completion rate of 60 percent.

Using binary measures of reversible and irreversible interruption, Ivanova et al. (2003) find that between 1992 and 1998, 70 percent of Fund programmes were interrupted reversibly, while 44 percent of them were irreversibly interrupted. Nsouli et al. (2004) find that 41 percent of 197 Fund programmes experienced irreversible interruption between 1992 and 2002. Improvement in implementation in this study reflects the fact that their sample contains more Stand-by Agreements, which usually have fewer interruptions.
<table>
<thead>
<tr>
<th></th>
<th>Programmes</th>
<th>Span</th>
<th>Countries</th>
<th>Implementation (%)</th>
<th>Proxy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beveridge and Kelly (1980)</td>
<td>105</td>
<td>1969-78</td>
<td>105</td>
<td>60</td>
<td>Fiscal Conditionality</td>
</tr>
<tr>
<td>Haggard (1985)</td>
<td>30</td>
<td>1974-84</td>
<td>30</td>
<td>20</td>
<td>Interruption and Conditionality</td>
</tr>
<tr>
<td>Zulu and Nsouli (1985)</td>
<td>35</td>
<td>1980-81</td>
<td>35</td>
<td>61</td>
<td>Objectives and Instruments</td>
</tr>
<tr>
<td>Killick (1995)</td>
<td>305</td>
<td>1979-93</td>
<td>-</td>
<td>47</td>
<td>Disbursement Rate (80%)</td>
</tr>
<tr>
<td>Ivanova et al. (2003)</td>
<td>170</td>
<td>1992-98</td>
<td>95</td>
<td>57/71/73</td>
<td>Non-interruption, Disbursement Rate, Conditionality by MONA</td>
</tr>
<tr>
<td>Nsouli et al. (2003)</td>
<td>197</td>
<td>1992-2002</td>
<td>95</td>
<td>60/75/75</td>
<td>Non-interruption, Disbursement Rate, Conditionality by MONA</td>
</tr>
<tr>
<td>Current Research</td>
<td>218</td>
<td>1992-2004</td>
<td>95</td>
<td>60/74/75</td>
<td>Non-interruption, Disbursement Rate, Conditionality by MONA</td>
</tr>
</tbody>
</table>

29
Using the MONA database, Mercer-Blackman and Unigovskaya (2000) find that of 33 transition economies, 17 implemented more than 50 percent of the structural benchmarks specified in country programmes between 1993 and 1997. Another study by the Fund (IMFa, 2001) reports 57 percent implementation of structural benchmarks in programmes over the period of 1987-1999. The implementation of performance criteria is found to be 67 percent, while implementation of prior actions is 80 percent. The worst implementation rates are found for conditions relating to privatization (45 percent), the social security system (56 percent) and public enterprise reforms (57 percent). With respect to the implementation of trade measures, the IMF (2001b) reports higher compliance. Overall, 61 percent of the conditions between 1987 and 1999 have been implemented. The implementation of trade measures are found to be 57 percent.

Ivanova et al.'s macro index (Ivanova et al. 2003) reports an 80 percent implementation rate, while structural index is found as 67 percent. Note that these indices of implementation give too much weight to implementation, since cancelled programmes are not included in the MONA database.

Of all measures, the interruption measure appears to be the most demanding test for implementation, with Ivanova et al. (2003) and Nsouli et al. (2003) reporting that only just over 40 percent of programmes passed this test.

Implementation measured by the disbursement rate and by the MONA-based index occur in over 70 percent of programmes; although, as Ivanova et al. show, the implementation of macro conditions in the MONA-based index is superior to that of structural conditions.

This research's calculations, based on 218 programmes over 1992 – 2004, confirm the results found by both Ivanova et al. (2003) and Nsouli et al. (2003). Not only do the research's results show that irreversible interruption is the most difficult test to pass, but they also suggest that implementation has not improved since 2002. However, the results reported in Table 2.5 suggest that, over a more protracted time period, there has been some improvement in implementation as judged by the disbursement rate. While Killick (1995) finds that implementation occurred in only 47 percent of programmes during 1979 – 93, it is found here that during 1992–2004 it occurred in 74 percent of programmes.
2.3. Conclusion

A mixed picture emerges from the literature assessing the effects of IMF programmes on macroeconomic policies and final outcomes. Most empirical studies find that Fund programmes improve the balance of payments and the current account, but views on the ultimate output and employment effects are more diverse. The literature also faces significant methodological problems. Obtaining estimates which are closer to the counterfactual is difficult and generates results that are sensitive to the specification of the counterfactual. Furthermore, the degree of implementation is not taken into account in most of this literature.

However, looking at poor implementation records measured by various proxies, one could further doubt the validity of results found on the studies of effects of Fund programmes. Were we to include implementation in effectiveness studies, the consequences of Fund programmes are largely unknown. An interesting result emerges from this. Why implementation records of countries borrowing from the IMF are so low? When countries go to the Fund for IMF credit, as well as policy advice, why don’t they implement it, if it is to their benefit? Or is it so? What are the dynamics and determinants of implementation in a country, which leads a government to going to the Fund, agreeing on conditionalities and then not implementing them? Following chapters will try to answer these questions.
CHAPTER 3

Political Economy of Programme Implementation

The conceptual study of programme implementation is a relatively new area, with few contributions to the literature. The nature of the strategic relationship between the IMF and governments is so complex that no one formal model could capture them all. However, a realistic appraisal of the implementation of IMF programmes needs to take them into account. Despite this complexity, this chapter aims to provide a conceptual framework that builds on recent theoretical work and within which the implementation of IMF programmes may be considered.

The first section examines the application of agency models to the IMF conditionality in the presence of domestic policy constraints. The models involve the IMF and the borrowing country government, while domestic conflict of interest is usually modelled in the form of a special interest group opposing the IMF proposed reforms. These models point to the importance of interest groups and the influence they may exert on the degree of programme implementation.

The second section looks at the concept of programme ownership. Poor implementation has often been attributed to lack of ownership. Subsequently, the literature has mainly dealt with the concept of ownership as a facilitator to the implementation of conditionality. The ownership concept, however, could be very confusing. The section aims to highlight the problems associated with this concept and establishes its link with programme implementation.

The final section takes stock of the conclusions of the conceptual framework, and tries to identify a range of testable political economy factors that may be expected to exert an impact on programme implementation. It also highlights the shortcomings of formal modelling of implementation and offers concluding remarks.
3.1. Conceptual Analysis of Implementation: Agency Models

International financial institutions and borrowing countries have a contractual relationship because international financial institutions provide countries financial resources in return for certain reforms. Due to this contractual relationship, agency theory has become the standard method for modelling conditionality of financial assistance programmes (e.g., Killick, 1997; Dixit, 2000; Drazen, 2000; Khan and Sharma, 2001; Mayer and Mourmouras, 2004; Mayer and Mourmouras, 2005). Scholars tend to use two types of agency models. The most basic models consider the international financial institution (IFI) as the single principal of the government and treat conditions as constraints to the government’s utility function.

In this context, Mosley (1992) presents a two-player bargaining model, in which a key element of the solution is the outcome of an internal conflict within the recipient country between winners and losers from the implementation of conditionality. Mosley finds that some slippage is to be expected on any conditional loan contract, given the international financial institution’s desire to disburse the loan. The optimal degree of slippage, from the recipient’s point of view, depends on when it expects to emerge from the conditionality relation. He asserts that slippage in conditionality is substantial in all types of international lending, even when the recipient country is financially weak and has little apparent bargaining power. This slippage is frequently pardoned, a finding consistent with the Bulow and Rogoff (1989) model of renegotiating sovereign debt. These studies argue that forgiveness has a compelling financial rationale for the lender, which becomes more compelling as the borrower’s financial position deteriorates. Vaubel (1996) also explains the IFIs desire to disburse the loan by narrowly defined bureaucratic objectives of the IFI.

Models that are more complex recognize that borrowing governments are delegated authority from two sets of principals (Khan and Sharma, 2000; Mackinnon, 2003; Drazen, 2002; Mayer and Mourmouras, 2005). First, citizens of borrowing countries

---

5 For example, governments sign Letters of Intent with the IMF stating the policies the government will implement in return for the provision of financial assistance.

6 Others view the IFI as the agents of the shareholding principals, which could be influenced by financial interests of industrial countries (Stiglitz, 2002).
delegate to their governments the authority to govern; if the government cannot implement policies that are satisfactory to maintain sufficient popular support, it will lose its authority. Second, international financial institutions delegate the resources as well as the responsibility to borrowing governments for carrying out agreed policy reforms; if the recipient government does not implement the reforms, international financial institutions may cut off the flow of financial assistance. As a result, the borrowing governments confront “multiple principals”.

The problem of multiple principals illustrates the conundrum faced by borrowing governments (UNCTAD, 2001). The reforms required by the IFIs in return for financial assistance do not always give immediate favourable results, while the costs associated with reforms, such as high unemployment and slow growth, are felt more quickly. In the face of this cost-benefit asymmetry, governments wanting to stay in power, find it difficult to adopt IFIs policies.

The common agency theory, developed by Bernheim and Whinston (1986), offers a good platform to analyse governments’ conundrum. Common agency models are concerned with the strategic actions of multiple actors (principals) to influence a common decision maker (agent). The application of common agency to IMF conditionality involves domestic conflicts of interest in a country that prevent governments from implementing policy reform.

In this framework, Drazen (2002) and Mayer and Mourmouras (2005) present formal political economy studies looking at Fund conditionality and the implications of implementing it in game-theoretic settings. These agency models start from the proposition that conditionality must be consistent with a country’s domestic political equilibrium in order to be implemented. This equilibrium is determined by the strategic actions between the IMF, the government and various stakeholders in public whose consent is needed for reforms to be implemented.

The influence of organised interest groups in policy making has long been recognised in the political economy literature. The activities undertaken by special interest groups (SIGs) range from educating and persuading lawmakers and the general public about their specific agenda, to giving resources in the form of campaign contributions to
policy makers in order to buy influence, access, and credibility (Grossman and Helpman, 2001).

In the sections to follow, two common agency models will be examined. These studies model interest groups as strategic actors that can change the outcome of a Fund programme. In the first one, interest groups are positioned outside the government, lobbying the government for policies favourable for them. In the second model, interest groups are within the government and have the power to veto reforms.

3.1.1. Lobbying

Common agency provides a very general way of modelling the process of lobbying through campaign contributions. Domestic interest groups are assumed to be positioned outside the government, trying to influence the government by offering contribution schedules in return for economic policies to their benefit.


In this model, the economic policies of a developing country are shaped by the interactions between three different actors. First, an incumbent government chooses the country’s economic policies. Second, a domestic group that benefits from policies that distort the economy attempts to influence the policy maker. Third, an international financial institution acts as a gatekeeper of the world’s welfare, and provides financial assistance to the government.

Following the common agency literature, the model assumes that principals (the IMF and the interest group) make simultaneous, take-it-or-leave-it offers to the agent (the government), and no communication occurs between principals. Each principal plays a truthful strategy in a two-stage game where economic policies and economic assistance are chosen simultaneously in a perfect information setting.
Throughout the study, the IMF is assumed to be a benevolent institution offering loans for reform in a borrowing country. In line with the public choice theory, the recipient government is a self-interested agent and is subject to influences from interest groups.

For simplicity, it is assumed that there is a single interest group lobbying the government and a single national policy instrument that can be used by the government. This policy instrument is assumed to benefit the SIG, and damage the general welfare, such as distortive taxation, tariffs and quotas.  

The welfare of the developing country is measured by its national income, which depends on the amount of economic assistance received from the IMF and the degree of economic distortions generated by economic policies. The degree of distortions is measured by an index, $0 \leq p \leq 1$, and it is assumed that the distortion-caused loss in national income increases linearly with the distortion index. The equation for the borrowing country's net welfare therefore is;

$$W(p, S) = Y(p, S) - rS$$

where $S$ indicates the flow of financial assistance and $r$ denotes the rate of assistance repayment. The financial assistance is assumed to directly benefit the borrowing country's welfare, however at a decreasing rate, such that $W_s > 0$ and $W_{ss} < 0$. Further, the effectiveness of assistance is assumed to diminish or remain constant with the degree of distortions, $W_{ps} \leq 0$. 

---

7 Further examples of distortionary policy instruments that could benefit interest groups are subsidised foreign exchange and credit. Reforms attempting to remove these distortions threaten their privileged positions and associated capacity to earn rents.

8 Therefore, the models assume that distortions have a negative effect on welfare, and growth which is not always the case.

9 Mayer and Mourmouras (2005) do not examine problems arising when the government is totally captured by SIGs, channelling the financial assistance to its members. See Adam and O'Connell (1999) and Hellman and Kaufmann (2001) for state capture models.
The incumbent government chooses the economic policy. The government’s objective function is maximizing political support, which depends on the general welfare of the country, and financial support from the interest group.

The government’s welfare is given by;

\[ G(p, S; \lambda) = C(p) + \lambda [Y(p, S) - rS] \]  

(2)

where \( \lambda \) is a parameter that reflects government’s concern for general welfare and is positive. Its value depends on the government’s dependence on the goodwill of the public. If the country has a less democratic political system and weak political institutions, \( \lambda \) tends to be low, implying that the government is not very representative of the country. \( C(p) \) represents the interest group’s financial contribution schedule to the government which is contingent on the government’s choice of distorting policies favouring the interest group. Therefore, it is explicitly recognised in the model that the government values both contributions from the interest group and support from the public.

The interest group resists reforms when its privileges are reduced by the implementation of efficiency-enhancing measures. It gains from distorting policies, therefore, pressures the government to adopt them and is willing to pay for them. The SIG’s net welfare function, \( V(p) \), is formally defined as;

\[ V(p) = U(p) - C(p) \]  

(3)

where \( U(p) \) represents the utility the SIG gets from policy distortions, which is assumed to rise at a decreasing rate with the degree of distortions, \( U_{p} > 0, U_{pp} < 0 \). \( C(p) \) represents the financial contribution the SIG makes towards the government in return for these distortions. The interest group’s welfare also depends on its political influence, which may reflect its proximity to government officials, its capacity to influence public opinion, and its capacity to challenge the prevailing power structure through economic, financial or military means. These are not overtly captured by the model.
The Fund is modelled as an international lobby, which is concerned with the welfare of the borrowing country as well as the international welfare. Policy choices of the government have cross-border spill over effects. While the government and domestic interest groups may ignore such externalities, the IMF considers them in setting its conditionality.

The rationale is as follows. A highly distorted economy not only disadvantages the country itself but also the international welfare, \( W^* \). So, \( W_{p*} \leq 0 \) and \( W_{pp*} \leq 0 \). The IMF’s involvement, on the other hand, may improve the quality of policies when the authorities are restrained by the interest groups in policy making.

The welfare in the rest of the world is equal to: \( W*(p, S) = Y*(p, S) + rS \) which represents the gross welfare after the repayment of \( rS \) by the borrowing country. The IMF’s objective function is to maximize the weighted sum of the borrowing country and the rest of the world’s welfare, and given by:

\[
F(p, S) = \delta W(p, S) + W^*(p, S) = \delta Y(p, S) - \delta rS + Y^*(p, S) + rS
\]

where \( \delta \geq 0 \), is the weight which the Fund attaches to the welfare of the borrowing country.

Is the assertion that only recipient governments are subject to various interests while international financial institutions are fully benevolent plausible? The assumption of the model follows the soft-core public theory approach (Willett, 2000) which suggests that the Fund is a pure public interest institution. Alternative public choice analyses of the IMF also exist, which portray the Fund as a budget maximizing institution. This literature suggests that bureaucrats within the international financial institutions tend to have a preference for high aid disbursements and high levels of conditionality as a sign of relevance and power (Easterly, 2002; Mosley, 1996; Vaubel, 1991, 1996).

Subsequent to the construction of the objective functions of all the actors, the common agency game can be solved as follows. It is a two-stage game where the government’s choice of distortions, the IMF’s financial assistance and the SIG’s financial
support are determined at a truthful Nash equilibrium\textsuperscript{10}. At a truthful equilibrium, the contribution of the interest group and assistance schedules of the Fund accurately reflect their valuations of the government’s choices of policy distortions. Therefore, a principal who is truthful is indifferent with regards to the alternative that the agent ends up choosing.

In the first stage, the Fund and the SIG choose their contribution schedules simultaneously. The government selects the degree of policy distortions in the second stage. As Grossman and Helpman (1994) points out a sub-game perfect Nash equilibrium $(S, C, p)$ exists if and only if:

(I) Both the Fund’s and the SIG’s contribution schedules, $S$ and $C$ respectively, are non negative and not greater than their resources.

(II) Given the SIG’s contribution and the IMF’s financial assistance, $p$ maximizes the government’s objective function;

\[
\text{Max } C(p) + \lambda [Y[p, S(p)] - rS(p)]
\]

(III) $p$ maximizes the joint welfare of the SIG and the government;

\[
\text{Max } [U(p) - C(p)] + C(p) + \lambda [Y[p, S(p)] - rS(p)]
\]

(IV) $p$ maximizes the joint welfare of the IMF and the government;

\[
\text{Max } \delta Y[p, S(p)] + Y^* [p, S(p)] + C(p) + \lambda Y[p, S(p)] + (1 - \delta - \lambda) rS(p)
\]

Condition (III) and (IV) imply that both contribution schedules must be mutually beneficial, so that there are no better offers to be made from either the Fund or the SIG.

(V) There exists the level of distortions, $p^V$ and $p^-F$, which maximize the government’s welfare, $C(p) + \lambda [Y[p, S(p)] - rS(p)]$, such that $C(p^V) = 0$ and $S(p^-F) = 0$. This condition implies that there are levels of distortions existing, which bring zero contributions from both the Fund and the SIG, however, the government finds them as

\textsuperscript{10} A truthful Nash equilibrium is one in which all the principals follow truthful strategies and that is Pareto-efficient in a common agency game. See Dixit, Helpman and Grossman (1997), Grossman and Helpman (1994, 2001) for detailed theory and application of common agency games to government policy making.
attractive as equilibrium level of policy distortion, \( p \). Therefore, both the SIG and the Fund would be worried as to what policy would be chosen if their respective contribution and assistance payments were sufficiently low that the government opts for policies that disregard their respective interests.

First order conditions derived from (II), (III), (IV) and evaluated at \( p \) for truthful equilibrium schedules \( C \) and \( S \) are as follows:

\[
C_p + \lambda Y_p + \lambda (Y_S - r)S_p = 0 \quad (5)
\]
\[
U_p - C_p + C_p + \lambda Y_p + \lambda (Y_S - r)S_p = 0 \quad (6)
\]
\[
\delta(Y_p + Y_S S_p) + (Y_p + Y_S S_p) + C_p + \lambda (Y_p + Y_S S_p) + (1 - \delta - \lambda) r S_p = 0 \quad (7)
\]

From (5) and (6), we find that \( U_p(p) = C_p(p) \) which tells us that the SIG’s marginal benefit from more distortions is equal to its marginal cost in terms of additional contribution payments. So, the SIG’s contribution schedule is locally truthful, that it reflects the true preferences of the interest group at equilibrium level of \( p \).

The value of policy distortion level, \( p \), can be found, first by substituting (5) into (7) to get;

\[
S_p = \frac{\delta Y_p + Y_p^*}{\delta Y_S + Y_S^* + (1 - \delta) r} \quad (8)
\]

Equation (8) represents the slope of the IMF’s welfare function, indicating the rate at which the Fund is willing to offer more assistance for a small reduction in policy distortions. This is also locally truthful.
Next, going back to equation (5) and substituting \( S(p) \) with equation (8) and substituting \( U_p(p) = C_p(p) \), we get:

\[
U_p = \lambda \frac{Y_p (-Y_s^* - r) + Y_s'^* (Y_s^* - r)}{\partial Y_s + (1 - \delta) r + Y_s^*} 
\]

(9)

where it is evaluated at the equilibrium \([p, S(p), C(p)]\). At the equilibrium distortion level, \( p \), the joint welfare of the Fund and the government are maximized. The Pareto-efficient equilibrium in this model is sustained when the marginal rates of substitution between disbursements and distortions are the same for the Fund and the government. Therefore, the government’s willingness to accept additional assistance is equal to the Fund’s willingness to give additional assistance for a small reduction in distortion index (See Appendix 3.A.1 for a derivation of equilibrium level of Fund assistance).

Figure 3.1 portrays the sets of welfare contours in the \((p, S)\) plane. The diagram highlights the interactions between the IMF and the government while keeping the role of the interest group in the background. It shows the indifference curves of the government and the IMF when a domestic interest group influences economic policy choices through conditional financial contributions. GG denotes the indifference curve of the government, given the contribution schedule of the interest group. Its slope is negative for low values of distortions, \( p \) and positive for high values of \( p \). The indifference curve of the IMF, FF is backward bending. This is because; its slope is positive for sufficiently low values of lending, \( S \), but eventually turns negative with rising \( S \).

A maximum must occur in the range of \( p \) where both the government’s and the IMF’s indifference curves are negatively sloped. Equilibrium equation (9) states that the rate at which the IMF is willing to offer financial assistance for lower policy distortions is equal to the rate at which the government is willing to accept the IMF loan for lower
Figure 3.1. Indifference curves of the Government and the Fund
This condition is met at the tangency point between the government’s indifference curve, and the IMF’s indifference curve at point $E_{11}$.

This simple framework can accommodate a variety of adjustments that add more realism to the model. The perfect information assumption could be relaxed for instance, allowing for two-sided incomplete information. The IMF relies on government’s cooperation to collect the country-specific information they need to make conditionality decisions. It is more likely that the Fund’s knowledge on the effectiveness of economic assistance, the government’s concern for the general public, and the strength of interest groups is more restricted than the government. On the other hand, the IMF has an advantage in analytical and cross-country knowledge of what works and what does not, which is useful in designing economic reform programmes.

While the Mayer and Mourmouras study (Mayer and Mourmouras, 2005) provides useful perspectives, it does not offer definite findings. Rather, it provides an abstract framework for examining political economy considerations of a borrowing country under the influence of a SIG and the Fund. The implications for the theory of implementation that can be extracted from the above model are as follows. The IMF’s financial assistance raises the welfare of the general public in the borrowing country, as well as the world as a whole. The IMF supported programmes accomplish these welfare gains without weakening political support for the borrowing country’s government. The responsiveness of the government to the general public, the strength of interest groups, the effectiveness of economic assistance and the degree of damage from distortions are important variables affecting implementation, and all should be taken care of in designing Fund programmes. Lastly, as all these characteristics are specific to each country, politically optimal economic assistance packages are bound to differ across countries.

---

The IMF’s and the government’s welfare contours are tangent to each other at:

$$- \frac{U_F + \lambda Y_F}{\lambda (Y_S - r)} = \frac{\delta Y_F + Y_F^*}{\delta Y_S + Y_S^* + (1 - \delta) r}.$$  

The equation reduces to the equilibrium condition stated in equation (9).
3.1.2. Veto Players

Like lobbying models, veto player models of conditionality involve interactions of multiple players. A veto player could be defined as an individual or group, whose assent is necessary for the implementation of a new policy. The theory of veto players, which was developed by George Tsebelis, asserts that policy stability (or resistance to change) is a function of the number of veto players in a political system. As the number of veto players increases, accompanied by an increasing discrepancy between their objectives, the policy stability increases and reforms become harder to achieve (Tsebelis, 2001a and 2001b).

Drazen (2002) presents a veto players model represented by the legislature in a borrowing country. According to his model, the reform programme signed between the Fund and the government has to be approved by the legislature. The government and the IMF want to reduce distortions but the interest group within the legislature has a strong interest in maintaining the distortions in place, because of the benefits derived from them.

The model also differentiates between structural and macroeconomic policy distortions, represented by τ and e, respectively. An example of a structural distortion could be a tax credit granted to a certain interest group, while a macroeconomic distortion could be a subsidised exchange rate.

The government sets the agenda, and chooses policy distortions subject to the approval of the veto player, who will veto any programme lowering its utility below the status quo, $V^{SQ}$. The country's welfare, $Y$, depends on; distortionary policies ($e, \tau$) and the amount of Fund lending, $S$. Net output after a fraction, $r$, of the agreed loan paid is given by: $Y(e, r, S) - rS$. Since the Fund lending does not affect the SIG directly, an output-maximizing government has to take into account the interest group's indifference curve when choosing policy variables.

The maximization problem becomes;

$$\text{Max} \quad Y(e, \tau, S) - rS + \lambda [V(e, \tau) - V^{SQ}] \quad (1)$$

It is assumed that the SIG wants a higher level of distortion index than the government, $\frac{\partial V}{\partial e} > 0, \frac{\partial V}{\partial \tau} > 0$. Therefore, domestic conflicts of interest exist. First order conditions of the maximization problem are;
Figure 3.2. Indifference curves of the Government and the Interest Group
\[
\frac{Y_e(e, r, S)}{Y_e(e, r, S)} = \frac{V_e(e, r)}{V_e(e, r)} \quad (2)
\]
\[
V(e, r) = V^S \quad (3)
\]

Condition (2) implies that the indifference curve of the government over \( e \) and \( r \) is tangent to the indifference curve of the interest group over \( e \) and \( r \). The set of tangencies of these indifference curves yields the contract curve of Pareto optimal points from the viewpoint of the two agents.

Condition (3) determines which point on the contract curve is the equilibrium. Equilibrium points are given by \( [e^{IP}(S), r^{IP}(S)] \) at which all rents have been captured by the agenda-setter government, leaving the SIG no better off than the status quo (Figure 3.2).

The effect of changes in \( S \) on \( e \) can be derived from FOCs as follows;

\[
\frac{\partial e}{\partial S} \bigg|_{IP(S)} = -\frac{Y_{es}[e^{IP}(S), r^{IP}(S), S]}{Y_{ee} + V_{ee}} \quad (4)
\]

The government's response function to changes in \( S \) can be derived from the left hand side of the equation (2) as follows;

\[
\frac{\partial Y_e}{\partial S} \bigg|_{e} = -\frac{Y_{es}Y_e - Y_{es}}{Y_e} \quad (5)
\]

Equation (5) suggests an interesting result. The numerator on the right hand side of the equation is assumed negative, implying that the effect of an increase in \( S \) has a
bigger effect on $Y_e$ than $Y_i$ when these policy distortions are reduced. As $S$ gets bigger, the economic benefit of lowering $e$ gets higher. The responsiveness of $e$ to $S$ is increased; $Y_{es} \frac{Y_e}{Y_e} < Y_{is}$. The government will resort to increase structural distortion, $\tau$ in response to lowering macroeconomic distortion, $e$, to maintain the political support of the SIG. Consequently, in the presence of domestic political constraints, the macroeconomic component of programme improves, while structural distortions increase.

This suggestion seems to be in accordance with how IMF programmes have been evaluated in the literature, that they are more effective correcting balance of payments or exchange rate misalignments than correcting structural problems. Indeed, macro implementation index of the IMF’s MONA database points to an implementation rate of 80 percent over the period of 1992-2004, which is significantly higher than the structural implementation index at 67 percent.

With this model, Drazen (2002) places the conflicts of interest within the legislature, and assumes that the Fund’s objective function is the same as the government; maximizing output. The IMF chooses the level of assistance to maximize net output taking into account government’s politically constrained reaction functions, $e^{IP}(S)$ and $\tau^{IP}(S)$.

In this setting, the model asserts that the Fund can achieve better macroeconomic policy only at the price of worse structural policy, since the IMF’s financial assistance does not affect the SIG directly.

As a result, the government has to increase distortions in the economy in one area while reducing it in another. This may create conditions for the government to deal with one distortion- a macroeconomic one, devaluing an overvalued currency, for example. But it would aggravate the other structural distortion, because the government would be forced to compensate the interest group. Thus, a welfare improvement would not necessarily take place.

What if the IMF affects the interest group’s utility function directly? If the Fund’s financial assistance enters directly into the SIG’s utility function, the group will be willing to accept less macroeconomic and structural distortions in return for the financial assistance. The new set up would induce the interest group to agree to a policy change that
it would otherwise oppose. Thus, Drazen (2002) suggests that economic reform could be achieved if the Fund can alter the domestic political balance of borrowing country, neutralizing some opponents.

Suppose that the interest group is offered a reform package; $(e', \tau')$ that is preferred to the status quo; $(e^{SQ}, \tau^{SQ})$. In this setting, the welfare of the interest group displays the following characteristics:

$$V(e^{SQ}, \tau^{SQ}, 0) \leq V(e', \tau', S') \leq V(e^{SQ}, \tau^{SQ}, S')$$  \hspace{1cm} (6)

The interest group prefers reform with lending to no reform without lending but prefers lending with no reform to lending with reform. $S'$ affects the SIG's welfare and makes the status quo less attractive. If lending $S'$ is made without any policy conditionality and the interest group can veto reform programmes, it is clear that once the loan has been received the interest group will veto any programme $(e', \tau')$ relative to the status quo. Therefore, the programme is left as soon as financial distress is relieved, since the SIG and the IMF do not share the same objectives. On the other hand, if receipt of the loan were made conditional on adopting the programme, that is, if the policy configuration $(e^{SQ}, \tau^{SQ}, S')$ were not an option, the interest group would support the programme. Consequently, according to the model, when the unconditional option becomes unavailable, being left to choose between status quo values with no lending, and lending with a policy package, the SIG will have to adhere to the conditional lending package.

The political economy variables that could be identified from Drazen (2002) are as follows; the character of the veto player, the characteristics of political institutions, the interaction of political institutions and veto players. The time horizon of the politician and the size of the constituency are also important factors that should be considered in the analysis of programme implementation, as politicians will internalize the positive countrywide welfare effects of policy reforms.
3.2. Ownership

3.2.1. Definition

Ownership has been identified as being among the most important factors influencing the implementation of IMF programmes (IMF, 2001a; Boughton, 2003; Paloni and Zanardi, 2004). However, the term 'ownership' involves many definitions. Which definition is to be taken as a benchmark to observe and measure 'ownership'? And, is the concept of ownership operationally useful?

Khan and Sharma (2001, pp. 13) refer to ownership as “a situation in which the policy content of the programme is similar to what the country itself would have chosen in the absence of IMF involvement”. According to this definition, ownership is exogenous and the Fund has no influence on the policies that would be implemented by a borrowing country. Similarly, the Fund’s view (IMF, 2001b) contends that if countries do not own programmes, there is little that can be done by the Fund. It is also suggested that ownership can be strengthened by imposing fewer conditions, and by including wider segments of the country to the negotiations with the Fund. One can argue, however, that building ownership within this context implies that ownership is endogenous instead of being exogenously determined.

The Fund definition (IMF, 2001b, pp. 6) of ownership states that;

“National ownership refers to a willing assumption of responsibility for a programme of policies, by country officials who have the responsibility to formulate and carry out these policies, based on the understanding that the programme is achievable and is in the country’s best interests.”

The above definition is concerned with the national ownership that is represented by the views of country officials. It also underpins the feasibility of reform programmes. In a similar vein, Drazen and Isard (2004) point out that technical capacity and political ability to implement a programme is crucial to ownership as well as the willingness to implement reforms. Policymakers in a country with continuing large fiscal deficits might find it more difficult to implement a programme requiring fiscal discipline, not necessarily due to the lack of commitment on the government part, but due to technical and political difficulties.
associated with it. The lack of capacity to collect taxes or carry out other measures on which the programme crucially depends could hinder implementation despite government’s willingness. Further, even if the government is willing and technically able to carry out the programme, if powerful SIGs who can block reform do not agree to the fiscal austerity programme, country ownership could not be deemed complete.

In addition, Khan and Sharma’s idea of ownership stems from ‘trust in domestic institutions, the effectiveness of political structures, and whether the government negotiating on behalf of its citizens has sufficient support to speak for a fair majority’ (Khan and Sharma, 2001, pp. 15). This definition widens the scope of ownership, including the government’s ability to speak for the ‘majority’.

The varying range of definitions illustrates how vague the term is. Boughton and Mourmouras (2002) acknowledge the difficult task of ‘judging the breadth and depth of ownership’ and propose that an understanding of the country’s political economy is essential. They include political economy balances into the picture, making the term ‘ownership’ broader and more difficult to pin down. In these circumstances, the assessment of ownership is bound to be subjective. Consequently, the problem of coming up with a measurable, monitorable, and most importantly clearly defined notion of ownership limits its usefulness as an operational concept.

3.2.2. Consistency with conditionality

There is a strong view that conditionality and ownership are fundamentally inconsistent with each other. Conditions are unnecessary if they reflect the country authorities’ own agenda where the government is strongly committed to reforms. Further, they might impair implementation and ownership if national sovereignty is seen as damaged as a result of Fund conditionality imposed from outside. Alternatively, if the ownership is weak, and there is no commitment on the side of the government, conditionality would not work through to the implementation of a programme. Conditions are not enforceable if country authorities do not want to implement them. The rather strong conclusion of this argument is that “if ownership is indeed required for implementation, it is either redundant or ineffective” (Bird and Willett, 2005).
In the presence of partial ownership, where there is no unity in the government or in the society with regards to reforms (Killick, 1997; Drazen, 2002), conditionality may enhance the implementation of a country programme.

To illustrate the point further, drawing from Drazen (2002), suppose the interest group’s welfare depends on the weighted sum of the utility it is getting from policy variables, \( p \), and the country’s welfare, with \( \alpha \) representing the degree of ownership.

\[
V(p,S) = \alpha U(p) + (1-\alpha)[Y(p,S) - rS] \tag{1}
\]

The assumption relating to the utility preferences of veto players is as before;

\[
V(e^{\infty}, r^{\infty}, 0) \leq V(e', r', S') \leq V(e^{\infty}, r^{\infty}, S') \tag{2}
\]

The SIG prefers a first best reform programme with unconditional assistance to conditional assistance. Substituting equation (1) into the second part of equation (2) and combining distortionary variables into one policy distortion, \( p \), gives;

\[
V(p^{\infty}, S') = \alpha U(p^{\infty}) + (1-\alpha)[Y(p^{\infty}, S') - rS'] > V(p', S') = \alpha U(p') + (1-\alpha)[Y(p', S') - rS'] \tag{3}
\]

The equation above has some interesting implications. If \( \alpha \leq \alpha^{U}(p') \), the ownership is high enough that the SIG will support the first best policy package unconditionally, so conditionality is obsolete. On the other hand, if \( \alpha > \alpha^{U}(p') \), the SIG will veto reforms when assistance is unconditional.

Suppose equation (3) holds;

\[
\alpha U(p') + (1-\alpha)[Y(p', S') - rS'] \geq \alpha U(p^{\infty}) + (1-\alpha)[Y(p^{\infty}, 0)] \tag{4}
\]
Dividing by $\alpha$ and rearranging;

$$U(p') + \frac{1-\alpha}{\alpha} \left[ Y(p', S') - rS' \right] - Y(p^{\text{SQ}}, 0) \geq U(p^{\text{SQ}})$$

(5)

Note that the second term on the left hand side of the equation is positive for an output increasing reform. This is the factor that makes reform politically acceptable, although veto players’ utility from reform is smaller than the status quo; $U(p') < U(p^{\text{SQ}})$.

When (3) and (4) hold simultaneously, the situation is as follows. From equation (4) the critical value is $\alpha^C(p')$, when $\alpha < \alpha^C(p')$, and the SIG will support policy package. When $\alpha > \alpha^C(p')$, reforms are not politically feasible even with conditional lending, equation (4) is a binding constraint.

The second best policy package under political constraints is given by;

Max $Y(p^2, S) - rS$

subject to;

$$\frac{Y_c(e, \tau, S)}{Y_c(e, \tau, S)} = \frac{V_c(e, \tau)}{V_c(e, \tau)}$$

$$\alpha U(p') + (1-\alpha)\left[Y(p', S') - rS'\right] \geq \alpha U(p^{\text{SQ}}) + (1-\alpha)\left[Y(p^{\text{SQ}}, 0)\right]$$

where optimal policy choice is defined as $p^2(S)$.

Since, $Y(p^{\text{SQ}}, S') > Y(p^{\text{SQ}}, 0)$, $\alpha^C(p') > \alpha^U(p')$, there are sets of SIG types that will block reform if lending is unconditional, but support it if lending is conditional on implementation of reform. For these types, equations (3) and (4) hold simultaneously, and are given by;

$$\alpha^C(p') \geq \alpha \geq \alpha^U(p^2)$$

(6)

Drazen’s model (Drazen, 2002) reconcile arguments of ownership and conditionality when there are domestic conflicts of interest. It illustrates that conditionality requires a certain degree of ownership, that it will be ineffective if $\alpha > \alpha^C(p)$, however, it becomes obsolete once there is sufficient ownership, $\alpha \leq \alpha^U(p)$. When (6) holds, however,
there is a place for conditionality. Note that, in this model, it is assumed that the Fund and the government have the same objectives. Hence, government ownership naturally exists, but not necessarily country ownership. Therefore, ownership of the SIG becomes the deciding factor.

There are other cases where conditionality and ownership are consistent with each other. Conditionality can be endogenous and serve as a signalling device. It may well support a domestically owned programme by adding value, acting as a seal of approval from the IMF to the country's reform attempts, thereby, it may help to access other finance (Bird and Willett, 2004). In addition, ownership may change over time. At the outset of a programme there may be a high degree of ownership, where the need to strengthen the balance of payments is prominent. As time passes, the balance of payments constraint may relax, and other policy objectives may take priority such as regenerating economic growth. As a result, ownership of the policies regarding fiscal and monetary prudence might deteriorate (Bird, 2003a). Here, the use of conditionality may help to guard against a subsequent loss of ownership by discouraging governments from undertaking unsustainable policies.

3.2.3. Ownership and Implementation: Is there a link?

The IMF view asserts that ownership will assist in the implementation of programmes, and that it is necessary for the successful execution of Fund conditionality (IMF, 2001b). While it may no doubt be beneficial, it may not be an absolute requirement for implementation. Ownership rhetoric does not lend itself to solid conclusions that can be tested. What is really needed is a better understanding of the determinants of implementation that will then enable us to examine how factors related to ownership fit in.

Bird (2003a) suggests a case where implementation may be possible without the ownership. In his model based on marginal benefits and costs of implementing a programme, he shows that ownership is related to the costs of implementation arising from the policy preference differences between the country and the Fund. The bigger this difference, the weaker the ownership. As the financial assistance and the catalytic effect increase, so do the benefits of entering into an agreement with the Fund. Joyce (2003)
offers a similar cost-benefit analysis based on the different perceptions of the benefits and costs of a programme between the Fund and a country. While the Fund adopts a globalist approach, since it pursues the interests of all of its members, the country evaluates a programme from a nationalistic point of view. This asymmetry of programme evaluation results from a different perception of benefits as well as different time frames and discount rates between the Fund and borrowing countries. More globally oriented countries will more likely adopt an approach that is more aligned with the Fund, which brings perceived marginal benefits together. While coalition governments, governments restricted by SIGs, or those who have been in power for a long time are more likely to exhibit lower implementation rates.

3.3. Conclusions

The political economy literature based on the “common agency models” shows that conditionality is useful when domestic political systems are imperfect. In such a framework, the authorities facing the IMF are not unitary actors; each economy is characterized by special interest groups. Policy choices thus reflect the concerns of diverse constituencies in the domestic economy following a non-cooperative game where the authorities, the IMF, the veto players and the SIGs strategically interact (Mayer and Mourmouras, 2005; Drazen, 2002). The distinctiveness of these studies of Fund programmes comes from the finding that Fund lending can actually affect the domestic political environment in borrowing countries. The function of conditional assistance is to alter the distortions on the country’s welfare due to this divergence of interests. By maximizing the joint welfare of the IMF and the recipient government, conditional assistance improves policy outcomes and raises output and national welfare as a consequence. But, as noticed by Boughton and Mourmouras (2002), these improvements are achieved at a price: the IMF “is injected more deeply in the affairs of the recipient country” and “becomes a second principal” (pp. 9). Indeed, like a lobbying interest group, the IMF attempts to influence the authorities’ policy choices.

These studies also have severe limitations. Formal modelling of programme implementation appears to be rather rudimentary, unable to capture the complex nature of
the interaction between the IMF and the recipient countries. In addition, they do not examine the micro-level causal processes of how financial assistance affects different groups within the recipient country (Khan and Sharma, 2000). The Fund’s assistance does not have a uniform and direct impact at the macroeconomic or macro-political level. Rather, the macro-level impact of Fund loan is the result of how it influences decision making across each of the groups in the recipient country. Because the incentives created by IMF assistance vary across groups, we can only understand how such assistance influences politics at the macro-level through examining its impact on micro-level incentives. The case study chapter attempts to fill the void left by existing studies, by directly testing at the micro-level the factors influencing the implementation of Fund programmes.

The political economy variables that could be identified from the formal theory could be partitioned into three groups. The SIG related variables include the strength of interest groups, the characteristics of political institutions, and the interaction of political institutions and interest groups. The government related variables point to the responsiveness of the government, to general welfare as well as to electoral pressures. The time horizon of the politician and the size of the constituency are also important factors, as politicians will internalize the positive countrywide welfare effects of policy reforms. The IMF related variables are the size and effectiveness of economic assistance, as well as the strategic importance the Fund attaches to the borrowing country’s welfare. Last and vital conclusion of the theory asserts that politically optimal economic assistance packages are bound to differ across countries, as all these characteristics are specific to each country.

The above conceptual survey also illustrates that a neat theory of implementation does not exist. While political economy variables may play a role in programme implementation, the precise nature of this role is theoretically unclear. One is therefore drawn towards empirical investigation. What factors in practice appear to significantly influence the implementation of IMF programmes, and to what extent is it a political rather than an economic phenomenon? Nevertheless, in light of the theories’ conclusions, it seems that an in-depth case study of programme implementation could be better placed to answer these questions.
3.A. Appendix to Chapter III
3.A.1. Derivation of Fund’s Equilibrium Level of Assistance

Going back to the condition (V) for sub-game perfect Nash equilibrium, the Fund provides the amount of financial assistance which makes the government indifferent between choosing policy distortions in the absence of assistance, and choosing policy under the conditional assistance. Formally it can be shown as follows;

\[ C(p^{-F}, W_{F}) + \lambda Y(p^{-F}, 0) = C(p, W_{F}) + \lambda \left[ Y[p, S(p, W_{F})] - rS(p, W_{F}) \right] \]  

(1)

where \( W_{F} \) and \( W_{v} \) denote welfare of the IMF and the SIG, respectively at the government’s optimal policy choice.

In the same fashion, the SIG offers the equilibrium contribution level to make government indifferent between its policy choice in the absence of the SIG lobbying and the policy choice when contribution schedule exists.

\[ 0 + \lambda \left[ Y[p^{-v}, S(p^{-v}, W_{F})] - rS(p^{-v}, W_{F}) \right] = C(p, W_{F}) + \lambda \left[ Y[p, S(p, W_{F})] - rS(p, W_{F}) \right] \]  

(2)

where \( p^{-v} = 0 \) since government would choose zero distortion in the absence of lobbying.

Substitution of \( U(p^{-F}) - U(p^{-v}) = C(p^{-v}, W_{F}) - C(p, W_{F}) \) into (1) gives;

\[ Y[p, S(p, W_{F})] - rS(p, S_{F}) = Y(p^{-F}, 0) + \frac{[U(p^{-F}) - U(p^{-v})]}{\lambda} \]  

(3)

which can be solved for \( S \) to determine the equilibrium level of Fund assistance.
Chapter 4

Determinants of Programme Implementation:

Empirical Evidence

Examination of the literature makes it clear that programme implementation plays an essential role in analysing IMF programme effectiveness. When the policy intentions specified within programmes are not fully carried out, a bias occurs in the evaluation of programme effectiveness. Indeed, the record on implementation illustrates that the failure to fully implement programmes is a prominent phenomenon.

Therefore, reasons behind non-implementation need to be explored. The theoretical chapter has given some answers. The suggestions of the theory of implementation underline the importance of the political economic environment of a country implementing a Fund supported programme. Can the reflection of the propositions of the theory be observed empirically? The objective of this chapter is to estimate a relationship between the implementation rate and the political and economic characteristics of borrowing countries that theory suggests may be important.

The lay out of the chapter is as follows. Section 1 surveys empirical evidence on the implementation of the IMF supported country programmes. Section 2 provides a conceptual framework that builds on recent theoretical work and allows to identify a range of economic and political factors that may be expected to exert an impact on implementation. Section 3 undertakes new large sample regression analysis of implementation based on a political economy model. The study estimates random effects regressions on a pooled sample for tobit and probit specifications, considering each implementation measure in isolation. The section then proceeds to present and discuss the results. Section 4 offers concluding remarks.
4.1. Existing Evidence on Implementation

The existing literature on the implementation of IMF programmes is summarized in Table 4.1. As shown here, the various measures of implementation, as well as various methodologies and time periods have been used. Areas of consensus have emerged, but there is also disagreement. Most studies concur that political factors are important in influencing implementation, although there is disagreement about the precise nature of the political influence.

An early analysis of programme implementation is presented by Mecagni (1999). He investigates programme interruptions in 36 ESAF programmes with the IMF, and finds that they reflect a combination of external shocks and domestic political economy factors. In his sample, 65 percent of the interruptions were caused by conditionality slippage, 16 percent resulted from disagreement on future actions, and 19 percent were due to political upheavals. The study implies that programme breakdowns are the result of factors that could not be influenced by programme design. These factors could range from major political upheavals to transition to multiparty political systems or election cycles, resulting in government overspending and disruption of programme policies.

The first rigorous econometric study of implementation is conducted by Ivanova et al. (2003) investigating the link between the implementation of Fund programmes and three groups of factors: the IMF conditionality and effort, political conditions, and the initial economic conditions of borrowing countries.

Ivanova et al. (2003) combine three measures of implementation using the Multiple Indicators and Multiple Causes (MIMIC) model and discover that borrowing countries' domestic political economy strongly affects the implementation of IMF programmes. The political economy variables associated with weak implementation are strong special interests, lack of political cohesion, inefficient bureaucracies, and ethno-linguistic divisions. Conversely, other group of factors- initial and external economic conditions, IMF effort and conditionality- do not have an effect on programme implementation.
<table>
<thead>
<tr>
<th></th>
<th>Programmes</th>
<th>Span</th>
<th>Countries</th>
<th>Proxy</th>
<th>Method</th>
<th>Results</th>
</tr>
</thead>
<tbody>
<tr>
<td>Edwards (1989)</td>
<td>34</td>
<td>1983-85</td>
<td>34</td>
<td>Conditionality</td>
<td>Case</td>
<td>Negative shocks</td>
</tr>
<tr>
<td>Polak (1991)</td>
<td>22</td>
<td>1988-99</td>
<td>-</td>
<td>Conditionality</td>
<td>Case</td>
<td>Negative shocks</td>
</tr>
<tr>
<td>Mecagni (1999)</td>
<td>36</td>
<td>1986-99</td>
<td>28</td>
<td>Interruption</td>
<td>Case</td>
<td>External shocks, domestic political economy factors</td>
</tr>
<tr>
<td>Ivanova et al. (2003)</td>
<td>170</td>
<td>1992-98</td>
<td>95</td>
<td>Combination of</td>
<td>MIMIC</td>
<td>Special interests, political cohesion, inefficient bureaucracy, ethnic</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Interruption, Disburse</td>
<td></td>
<td>fractionalization</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>ment, MONA</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Disbursement, MONA</td>
<td></td>
<td>involvement, corruption, ethnic tensions, growth, size of IMF loan</td>
</tr>
<tr>
<td>Joyce (2003)</td>
<td>384</td>
<td>1975-99</td>
<td>77</td>
<td>Disbursement Rate</td>
<td>Tobit</td>
<td>Democracy, trade volume, length of tenure, ethnic fractionalization</td>
</tr>
<tr>
<td>Dreher (2003)</td>
<td>104</td>
<td>1975-98</td>
<td>67</td>
<td>Disbursement Rate</td>
<td>Probit</td>
<td>Democracy, elections, government consumption, short-term debt, GDP pc,</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>budget deficit</td>
</tr>
<tr>
<td>Current Study</td>
<td>218</td>
<td>1992-2004</td>
<td>95</td>
<td>Interruption, Disburse</td>
<td>Tobit, Probit, Ordered Probit</td>
<td>Volume of Trade, Number of Veto Players, IMF Loans to Quota</td>
</tr>
</tbody>
</table>
The Ivanova et al. study (2003) embraces a similar approach in methodology to Dollar and Svennson's (2000) work on the World Bank programmes and reaches a similar conclusion. Dollar and Svennson (2000) find that the success of the World Bank programmes depends largely on political economy factors of lack of ethnic and linguistic divisions, lack of government stability, length of tenure of the incumbent and democratic regimes. The World Bank conditionality and effort did not seem to have a significant influence.

Using a similar approach to Ivanova et al. (2003), Nsouli et al. (2004) find further evidence of the importance of political factors and discover that there is better implementation where ethnic tensions are low, governments are stable and less corrupt and where the military are less involved in politics. They find that more time spent in previous IMF programmes, and more financing (relative to a country's IMF quota) aid implementation. They also find that superior implementation contributes to superior macroeconomic performance in terms of inflation and ultimately balance of payments and fiscal outcomes.

While there is a common theme that the political characteristics of a country are important to explain implementation, the above studies' treatment of various political economy variables differs. This difference is also reflected in their results.

For example, Dollar and Svennson (Dollar and Svennson, 2000) study does not take special interests within parliament into consideration, while Ivanova et al. (2003) find this variable to be highly statistically significant. As a proxy for strength of special interests, the maximum share of seats held by parties that represent nationalistic, religious, rural, and regional interests groups is used. Joyce (2003) finds no connection between the SIGs and implementation in his empirical study which was carried out for 77 developing countries between 1975 and 1999 using disbursal rates as a measure of completion and Tobit model for analysis. The Fund study (IMF, 2001c), in which reasons for poor implementation have only been studied on a small sample of countries, illustrates political and social opposition as the main reason for non-compliance.
Further, the cohesiveness of the executive and legislative branches of government is not found to be significant by Joyce (2003), while Ivanova et al. (2003) find it positive and significant.

Dollar and Svennson (2000) find that democracy helps implementation while Ivanova et al. (2003) finds no statistical link between electoral competitiveness and programme success. Joyce (2003) also finds that democracy helps, and politically and economically more open regimes have a better record of implementation.

Dreher's analysis (Dreher, 2003) of 104 IMF programme countries over the period 1975-1998, discovers only two political economy factors affecting implementation; democracy and elections. Non-compliance is more likely prior to elections. However, regimes that are more democratic are less likely to encounter programme interruptions around election times caused by poor implementation.

Joyce (2003) finds that newly elected governments are more likely to implement reforms while Ivanova et al. (2003) finds no link between government’s length of tenure and successful implementation.

Ethnic fractionalization is found to be negatively significant by Ivanova et al. (2003) and Joyce (2003). The impact of it is found to be nonlinear by Ivanova et al. (2003). Nsouli et al. (2004) also find that reduced ethnic tensions in the year preceding programme approval, improves implementation, while Ivanova et al. (2003) find the coefficients of quality of bureaucracy and the change in chief executive positively significant.

Earlier studies of implementation attribute the failure of compliance to unfavorable initial and external macroeconomic conditions. Edwards (1989) and Polak (1991) suggest that poor implementation during the 1980s is related to negative shocks. More recently, Joyce (2003) finds that the degree to which programmes are completed is positively related to the volume of trade preceding the programme.

Killick (1995) finds that countries with a less diversified export base encounter more programme breakdowns than exporters of manufactured goods, being more prone to exogenous shocks. In Killick (1995), results of 305 stand by programmes are compared with case studies on 48 programmes where matching outcomes of the two added weight to
the significance of the results of the basic tranche test. The study also provides evidence that highly indebted countries are less likely to complete a programme and that fiscal conditions are particularly unlikely to be met.

Dreher (2003) confirms Killick and find that initial conditions do matter, expressed in terms of government consumption relative to GDP, short-term debt relative to GDP and GDP per capita and the budget deficit. Coefficients of the first two are positive, and the latter two are negative. Nsouli et al. (2004) also find supporting evidence for growth. The coefficient of lagged growth rate of a country is reported to be statistically significant by the interruption measure, implying countries growing faster prior to programme are less prone to interruptions.

The implementation literature also looks into the IMF’s involvement with the country’s programmes and how it might influence programme prospects.

Killick (1995) suggests that implementation is positively related to the ratio of the amount of finance provided by the Fund to initial current account deficit. Ivanova et al. (2003) include the size of Fund programmes in their analysis measured as the ratio of the size of the loan to country’s quota, and do not find it affecting implementation. Nsouli et al. (2004), however, find that larger programmes have higher disbursement rates. IMF effort is also found to be marginally important. Interestingly, frequent borrowers from the Fund are found to have higher disbursement ratios, interpreted by the authors as reflecting the long term nature of the needs of low income countries.

The Ivanova et al. study (Ivanova et al., 2003) finds that IMF involvement has no visible effects on the implementation of a country’s programmes. The IMF’s financial and human effort measured by staff hours and the dollar cost of staff resources and the extent of conditionality are not statistically significant. In a similar vein, implementation is found to be unrelated to the number of conditions or the number of prior actions by another Fund study (IMF, 2001c). The existing literature leaves enough ambiguities that further empirical research is justified. New research can contribute by studying more recent evidence and better data, by drawing on ideas that have evolved from the literature, and by extending the methodologies adopted. The underlying purpose, however, remains to achieve a sound understanding of the implementation of IMF programmes.
4.2. A Conceptual Framework

As discussed in Chapter 3, formal theoretical modeling of implementation does not lend itself to specifying one particular and unique model that can be conveniently tested. Either models tend to be excessively narrow, or the data needed to test them are unavailable. The aim is to estimate a model that is informed by political economy considerations, and includes variables that are likely, in principle, to exert an impact. In some cases a priori reasoning may lead to a clear expectation of the sign of the relationships. In others, there may be opposing forces at work making it unsafe to form a particular a priori view.

A first component of the model relates to initial economic conditions at the outset of programmes, with these covering performance variables such as inflation, economic growth, the current account, and international reserve levels (which reflect the degree of currency misalignment), as well as policy variables such as fiscal deficits and monetary expansion. The most straightforward assumption is that the worse are the initial conditions, the less will be the degree of implementation. However, this need not necessarily be the case. It may be, for example, that the design of programmes is modified to take initial conditions into account. Targets may be less ambitious where initial conditions are weak. Or it may be that where economic performance and policy have deteriorated to a low level, a government's commitment to reform becomes stronger. As a consequence, there may be less disharmony between the government and the IMF, and implementation may be better.

A second component of the model captures a country's vulnerability to exogenous shocks. For low income countries, shocks may emanate from the current account and result from their heavy reliance on export revenue from producing primary products whose prices are unstable, while for emerging economies they may also come from the capital account. It is tempting to assume that shocks will have a negative impact on implementation and will blow programmes off course. At the very least they may create additional problems for economic management. Again, however, the relationship may be more nuanced than this. Shocks may be positive. Can such shocks necessarily improve implementation? They may instead allow governments to disengage from the Fund with the result that programmes lapse, as the country no longer needs to draw on IMF resources. Meanwhile, negative
shocks may lead the Fund to grant waivers, with the result that programmes remain uninterrupted and continue to be fully financed.

A third factor influencing implementation is adjustment capacity. In principle, it may be expected that implementation will be superior in economies that are more diversified and flexible, and possess greater scope for economic adjustment. This may be proxied by the level of economic development, which is itself proxied by per capita income. It may also be captured by the degree of trade openness. Yet again, openness may work both ways. From one point of view, economies that are more open may be expected to have higher foreign trade price elasticities, making conventional exchange rate policies more effective. Demand management policies may also have an effect on the current account at a lower cost in terms of domestic economic activity. However, greater openness may also make an economy more vulnerable to exogenous shocks. Moreover, economies that are less open may have greater scope to benefit from trade liberalization.

The fourth and fifth factors that may be expected to influence implementation are the level of financing from the Fund, and the ease with which future programmes may be negotiated. The theory of implementation suggests that higher levels of financing should provide greater incentives for governments to complete programmes since there is a greater financial reward for accepting the perceived costs of IMF conditionality. More resources will be available to compensate the losers from economic reform. However, things may again be more complex than this simple idea implies. Other things being given, higher levels of financing may encourage governments to substitute out of adjustment. The question is then the extent to which institutional arrangements surrounding conditionality allow them to do this.

With respect to the political factors, once more, the a priori reasoning is ambiguous and unclear. The theory of policy implementation points to the importance of special interest groups (SIGs) or 'veto players' that have sufficient power to block reform (Drazen, 2002; Mayer and Mourmouras, 2005). However, available data only allow imperfect measures to be used in empirical studies. For example, the role of SIGs may not be captured appropriately by simply looking at their number, although in general terms it may become more difficult to push through reform where there are many of them.
Opposition may, however, be more effective where there is just one well organized and influential SIG as compared to a large number of disorganized ones. In principle, the strength of SIG opposition need not necessarily be reflected by parliamentary opposition if there are non-proportional voting systems or non-participation by SIGs in the parliamentary process. The opposition may, in any case, be within the government rather than outside it, as different ministries may have different views about the design of IMF programmes. SIGs may furthermore influence the composition and nature of compliance rather than the level of compliance.

The relevance of the proposition of the theory chapter regarding the responsiveness of the government to general welfare and to electoral pressures could be tested with the following variables.

In a democratic society, opposition groups will have greater voice and influence and this may make implementation more difficult for an incumbent government as it seeks to implement an unpopular policy. At the same time, if democracy implies greater involvement by civil society in policy decision-making and majority support for policy reform, a higher level of ownership may, in principle, make it more likely that programmes will be implemented. Powerful leadership, whether under a democratic or totalitarian regime, may be more relevant than the political system itself, but again this is difficult to capture empirically.

Regime durability may foster a consistent and coherent approach to economic policy, but it may also make economic reform more difficult as special interests become more entrenched and able to resist any reform that threatens their status quo. Similarly, corruption is also likely to reduce the chances of implementation as distortions and rent-seeking occur. Although debatable, there is generally a broad consensus that corruption has a negative effect on economic growth, which in turn makes it more difficult to implement reform.

The stage of the electoral cycle may also be expected to exert an effect on implementation, although this is another case where there may be opposing forces at work.

Theories of the political cycle suggest that governments seek to pursue expansionary policies shortly before elections in order to raise consumption, reduce
unemployment and gain popular support. These policies are likely to be inconsistent with IMF programmes. After elections, governments may have to pursue counter-inflationary policies, which can either be blamed on the previous administration where there has been a change in the political party in power, or on the IMF where an IMF programme is in place. This would be consistent with a political cycle of implementation based on the timing of elections, with implementation falling when elections are imminent. However, while incumbent governments may be anxious to demonstrate national sovereignty over policy in the build up to an election, they may not want to send out negative signals about their economic management that may be associated with a failure to implement IMF programmes. Similarly, the IMF may be reluctant to withdraw support shortly before an election for fear of being accused of trying to exert political influence. Or, following an election, a new government may want to negotiate its own programme with the Fund, one to which it is committed. If so, this would imply that implementation would not improve immediately after an election, but might improve after a lapse of a few months. Much therefore depends on the circumstances in which programmes lapse.

4.3. New Empirical Investigation

4.3.1. Methodology and Data

The regression analysis is based on a pooled dataset in which each programme is treated as an independent observation. Since the number of programmes varies across countries the panel is unbalanced. Not all data are available for all countries or years and the number of observations for estimation depends on the choice of explanatory variables. The annual data cover the years 1992-2004 and extend to 95 countries that participated in a Fund-supported programme. All the variables, their definitions and the data sources are listed in Appendix.

The macroeconomic data come from the International Financial Statistics, World Economic Outlook and World Development Indicators databases of the IMF and the World Bank. For the political economy data, the Polity IV Dataset (Marshall and Jaggers, 2002), the Database of Political Institutions (Beck et al., 2001) of the World Bank and the
International Country Risk Guide datasets are used. The inherent subjectivity of some political datasets poses a limitation for the present study.

IMF programmes include stand-by and extended programmes, as well as programmes under the concessionary facilities (Enhanced Structural Adjustment Facility and Poverty Reduction and Growth Facility) for low-income countries. Precautionary programmes are excluded from the sample when the disbursement rate is used, since their inclusion would bias downwards the measurement of implementation. Programme countries included in the study are listed in Appendix. The results of the interruption measure are reported below, as well as the disbursement measure, which is used to check for robustness.\(^{12}\)

Many studies of IMF programmes encounter potential problems of selection bias, since IMF programme countries are not randomly selected. Furthermore, endogeneity, where factors affecting the impact of IMF programmes are generated by the programmes themselves, and reverse causality, where the causal connections run in the opposite direction to the ones implied can make interpretation difficult. Even though this study cannot claim full immunity from these methodological problems, they are less important in the case of research reported here. All the countries in the sample have chosen to sign agreements. They thus share this underlying characteristic. With regard to endogeneity, it may be that the factors that foster implementation can be encouraged over time via IMF conditionality. To an extent, and in principle, they may therefore be endogenous to the implementation of past IMF programmes. But, endogeneity seems extremely unlikely for contemporary programmes in terms of the variables included here. The implementation of contemporary programmes will not affect initial economic conditions, or primary product producing status. Nor will many of the political variables included be affected by

\(^{12}\) The MONA based measure is also used, but not reported here, as the estimates do not lend themselves to meaningful results. Indeed, the IEO study (IEO, 2002) finds substantial errors and gaps in the MONA database for tracking performance under programmes, especially with regard to data on outcomes. It concludes that “existing weaknesses in data on how programmes have performed are an impediment to efforts to enhance the IMF’s ability to learn from experience and to monitor the implementation and impact of its own policies”. 

68
contemporary implementation. Given the model specification, it seems reasonable to assume that endogeneity and reverse causality will not be a problem. Nevertheless, implementation of contemporary programmes may depend on the incidence of past programmes, not just because these have encouraged openness and other forms of economic liberalization but also because a better relationship may have been established between governments and the IMF, leading to a greater commitment to economic reform, or simply because there is a need to keep the IMF on side. By including a measure of past involvement with the IMF, the study therefore allows for the possibility of endogeneity and reverse causality, although this variable may also capture the probability as perceived by governments, that they will be penalized for poor implementation by being excluded from future access to IMF resources.

4.3.2. Model Specification

The choice of probit and tobit techniques is guided by the need to make efficient use of the information contained in the implementation measures and by the data available. The interruption proxy used in the econometric analysis is a discrete binary random variable taking the value of 1 for interrupted programmes and 0 for non-interrupted programmes, therefore, the appropriate technique to use is probit estimation. The disbursement proxy, on the other hand, is a continuous, censored variable, which takes values between 0 and 100; therefore, tobit estimation needs to be used.

The strategy is to relate the various indicators of the probability of implementation to the underlying political and institutional factors in the borrowing country, to institutional factors and to initial economic conditions. Although the probability of programme implementation is unobservable, it is related to an observable implementation proxy. The model can be described as follows:

\[ y_i^* = \beta' x_i + \varepsilon_i, \]

where \( y_i^* \) is the unobservable probability of successful programme implementation, vector \( \beta \) contains estimated coefficients, matrix \( x_i \) contains economic and political economy variables, and \( \varepsilon_i \) is a stochastic disturbance term. Assuming a normal
distribution, the above equation is estimated with a probit model when the interruption index is used as the dependent variable. The tobit model estimation is also carried out using the disbursement index to check for the robustness of the results.

To examine the influence of political and economic conditions on implementation, each of the chosen proxies is regressed on an explanatory variable set containing economic and political variables. To obtain a preferred specification of the model, a "testing down" approach is also used. The unrestricted model includes variables that have been identified in the literature as significant determinants of implementation. Regressors that do not have significant coefficients at the 10 percent level are dropped sequentially. Likelihood ratio tests are employed to test the joint significance of dropped variables.

The following were included as potential explanatory economic variables: net foreign direct investment as a percent of GDP, the rate of monetary expansion, trade as a percent of GDP, a dummy for primary product exporting countries, real GDP growth, GDP per capita, the central government balance relative to GDP, the rate of inflation, the current account balance relative to GDP, and international reserves in months of imports.

Although there is an array of political variables that could be included in the regression analysis, including most of them at the same time would lead to collinearity problems and a loss of precision. On the other hand, omitting relevant institutional and political variables would lead to biased estimates. The political economy variables included are: two election year dummies, one for pre-election years, and one for post-election years\textsuperscript{13}, the degree of democracy, the quality of the bureaucracy, corruption, ethnic tensions, the representation of special religious, nationalistic, regional and rural interests in parliament, regime durability, and the existence of veto players as captured by new DPI data.

\textsuperscript{13} To control for the influence of elections, an index is used which measures the share of the year which is within twelve months prior to a national (executive or legislative) election. For example, if an election is in February, the pre-election index would take the value of 1/12 and the post-election index would take the value of 10/12.
The last two variables are worth a closer examination. The theory of implementation suggests that veto players or special interest groups are key determinants of programme implementation. Various indices have been employed in the literature to capture the influence of those whose agreement is necessary before policies can be changed. For instance, a political cohesion variable has been used in two studies; Joyce (2003) for the period 1975-99 and Ivanova et al. (2003) for the period 1992-98. Ivanova et al. (2003) find it to be significant, while Joyce (2003) finds it to be insignificant. The political cohesion variable takes the value of zero for a one-party government, of one for a coalition government with two parties, of two for a coalition government with three or more parties, and of three for a minority government. Based on Roubini and Sachs (1989), this variable does not distinguish countries according to the effectiveness of electoral checks on government decision makers. Nor does the variable take into account the degree of parties’ control over members. Weaknesses with the political cohesion variable led the World Bank to delete it in versions of its DPI database after 2000.

The veto players (checks) variable in the newer versions of the same database attempts to correct for some of the weaknesses of the political cohesion variable. It counts the number of veto players in a political system, adjusting for whether these veto players are independent of each other, as determined by the level of electoral competitiveness in a system, their respective party affiliations, and the electoral rules.

The veto players (checks) variable has been modified and improved over the years (DPI2000, DPI2004). Earlier versions of it counted parties as veto players as long as they were in the government coalition (in parliamentary systems), even when the party was not needed to give the government the majority of the votes (e.g., Albania in the early 1990s, Finland in 1978, 1979). The current veto players (checks) variable only allows parties to count as veto players when their votes are needed for the government to sustain a majority. It therefore captures more efficiently the essential notion of veto players.

Ivanova et al. (2003) use a variable measuring the strength of special interest groups in parliament by computing the maximum share of seats held by parties representing special interests (religious, nationalistic, regional, and rural). Joyce (2003) uses a similar variable; a dummy indicating whether the government party represented a
special interest group. Ivanova et al. (2003) find their SIG variable to be significant, but Joyce (2003) does not. This research updates the composite indicator of the strength of special interests used by Ivanova et al. While it was found to be significant in some of the earlier regressions, the existence of veto players seems to exert a more significant influence over implementation. This may not be surprising since the number of seats that SIGs have in the parliament does not necessarily translate into effective veto power. On the other hand, the new veto players (checks) variable used in this study directly measures effective veto power.

Several IMF-related variables are also included in the regressions to test whether the nature of IMF involvement influences the implementation of programmes. The size of IMF credits relative to a country's quota and the incidence of past programmes with the Fund were also examined.

4.3.3 Results

Table 4.2 summarizes the probit estimation results, showing coefficients that were found to be significant. Simple parameters as well as marginal effects are reported. From amongst the economic variables included in the regressions, only the volume of trade is found to exert a significant effect. Open economies have a better chance of having uninterrupted access to IMF resources. This result was confirmed when disbursement proxy is examined as a check for robustness. The insignificance of past IMF programmes implies that the finding is not picking up reverse causality.

The size of programmes, as measured by the amount of IMF financing in relation to a country's quota, emerges as exerting a significant effect on programme interruption. Larger resources appear to assist implementation. However, this finding was not confirmed by the disbursement measure of implementation, where the size of IMF loans appeared insignificant.

Turning to the political dimension of implementation, the veto players variable is significant in explaining interruption. Robustness checks using the disbursement measure
confirm this result. Powerful veto players hinder the implementation of IMF programmes. However, none of the other political variables emerge as being significant.

Table 4.2 also reports the predictive accuracy of the preferred model. Overall the model predicts accurately 65 percent of the time. However, it is much better at explaining cases where programmes are not interrupted than those where they are. Historical descriptive data suggests that about 60 percent of programmes proceed without interruption. A straight guess of non-interruption would therefore be accurate about 60 percent of the time. The model exhibits 82 percent accuracy, which generates considerable additional explanatory power. For interruptions, however, the preferred parsimonious model performs much less well and no better than a straight guess based on past experience. In many cases where openness, veto players and the amount of IMF resources suggest that a programme would be implemented without interruption, some other factor gets in the way. However, these other factors are not sufficiently systematic to show up in the large sample regressions; they appear to be largely idiosyncratic.

Given the small sample size, several specifications are estimated to check for the robustness of the study’s conclusions. Table 4.3 reports the robustness results. Probit model assumes that the error term is normally distributed. On the assumption that the cumulative distribution is logistic, the logit model is also used to check for the sensitivity of the results. The results of the logit regression confirm the findings from the probit regression. The estimated coefficients and marginal effects are very similar, with same degrees of significance.

The robustness of the results was also tested by using a different proxy of implementation. The rate of disbursement of IMF loans is a continuous variable, which takes values between 0 and 100. Since the implementation itself is not observable, and proxied by the disbursement ratio, the independent variable is censored (above 0 and below 100). Therefore, the tobit model is used. The study employs the same procedure of dropping regressors that do not have significant coefficients at the 10 percent level and testing the joint significance of dropped variables with likelihood ratio tests. The results provide support for two of the three variables that have been found significant by the
Table 4.2. Estimation Results

<table>
<thead>
<tr>
<th></th>
<th>Probit Analysis of Programme Interruption</th>
<th>Probit Analysis of Programme Interruption (Without Specified Outliers)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Coefficients</td>
<td>Marginal Effects</td>
</tr>
<tr>
<td>Trade Volume to GDP</td>
<td>-0.006 (0.003) *</td>
<td>-0.002 **</td>
</tr>
<tr>
<td>Veto Players</td>
<td>0.119 (0.063) *</td>
<td>0.046 *</td>
</tr>
<tr>
<td>IMF Loans to Quota</td>
<td>-0.172 (0.096) *</td>
<td>-0.067 *</td>
</tr>
<tr>
<td>Constant</td>
<td>-0.026 (0.339)</td>
<td></td>
</tr>
<tr>
<td>No. of Observations</td>
<td>145</td>
<td></td>
</tr>
<tr>
<td>R-squared (McFadden)</td>
<td>0.061</td>
<td></td>
</tr>
<tr>
<td>Log-likelihood</td>
<td>-92.622</td>
<td></td>
</tr>
<tr>
<td>Prediction success</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interruption</td>
<td>41%</td>
<td></td>
</tr>
<tr>
<td>Non-interruption</td>
<td>82%</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>65%</td>
<td></td>
</tr>
</tbody>
</table>

Notes: Standard errors are reported in parentheses.

*** indicates significance at 1 percent;

** indicates significance at 5 percent;

* indicates significance at 10 percent level.
interruption proxy. Trade volume is positively related to the disbursal rate of IMF loan and significant at 5 percent. Its marginal effect is 0.15 percent. The number of veto players is also significant, at 1 percent and has a negative coefficient. Its marginal effect is notable. For one unit increase in the number of veto players, the disbursal rate of IMF loan seems to be decreasing by 3.7 percent.

Additionally, two other implementation indices were created by breaking down the disbursement rate into four and five intervals. The first index of implementation classifies programme countries as non-compliers for 0 to 25 percent, poor compliers for 26 to 50 percent, weak compliers for 51 to 75 percent and good compliers for 76 to 100 percent. The second index breaks the disbursement rate into 5 intervals; 0-20 percent, 21-40 percent, 41-60 percent, 61-80 percent and 81-100 percent. Using the ordered probit model and following the same procedure of log likelihood tests for dropping insignificant variables, the ordered probit regressions offer support for the significance of the veto players variable. It is significant at one percent and has a negative coefficient in both specifications. The marginal effects are significant at one percent but small in magnitude. The regressions also seem to predict more countries as good compliers. There were 67 actual good compliers, the model predicted 105. There were 19 actual poor compliers, the model predicted only 5. There were 8 non-compliers and 16 weak compliers, the model predicted none for both.

To identify outliers, the probit estimation is employed. There are no clear outliers in the case of inaccurately predicted implementation. But there are with respect to interruption. To identify them, the predicted values for the probability of interruption are compared with the binary indicator of interruption. A residual is then computed which is the actual value minus the fitted probability.\(^\text{14}\)

\[^{14}\text{The precise computation of the residual taking account for the variation of the estimator is as follows;}\]

\[ r_i = y_i - \hat{F}_i / \sqrt{1 - h_n}, \]

\[ h_n = F(\hat{\beta}' x_i) \left[ 1 - F(\hat{\beta}' x_i) \right] x_i, 'Est.\ Asy.\ Var\ \hat{\beta} x_i, \] and \( \hat{F}_i \) denotes the fitted probability estimator.
Table 4.3. Robustness Checks

<table>
<thead>
<tr>
<th></th>
<th>Probit Analysis of Programme Interruption</th>
<th>Logit Analysis of Programme Interruption</th>
<th>Tobit Analysis of Disbursement Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Coefficients</td>
<td>Marginal Effects</td>
<td>Coefficients</td>
</tr>
<tr>
<td>Trade Volume to GDP</td>
<td>-0.006 (0.003) *</td>
<td>-0.002 **</td>
<td>-0.010 (0.005) *</td>
</tr>
<tr>
<td>Veto Players</td>
<td>0.119 (0.063) *</td>
<td>0.046 *</td>
<td>0.195 (0.102) *</td>
</tr>
<tr>
<td>IMF Loans to Quota</td>
<td>-0.172 (0.096) *</td>
<td>-0.067 *</td>
<td>-0.306 (0.179) *</td>
</tr>
<tr>
<td>Constant</td>
<td>-0.026 (0.339)</td>
<td>-0.001 (0.561)</td>
<td>95.587 (13.205)***</td>
</tr>
<tr>
<td>No. of Observations</td>
<td>145</td>
<td>145</td>
<td>112</td>
</tr>
<tr>
<td>Log-likelihood</td>
<td>-92.622</td>
<td>-92.503</td>
<td>-349.216</td>
</tr>
</tbody>
</table>

Notes: Standard errors are reported in parentheses.

*** indicates significance at 1 percent;

** indicates significance at 5 percent;

* indicates significance at 10 percent level.
Figure 4.1. Outliers of Econometric Analysis of Programme Interruption

- Indonesia 1997
- Guyana 1998
- Jordan 1996
- Congo 1996
- Kyrgyzstan 1998
- Philippines 1998
When outliers are defined as cases where the residual is +/- 1.5, the following cases are identified where the interruption is totally unexpected: Indonesia in 1997, Guyana in 1998, Jordan in 1996, the Philippines in 1998, Kyrgyzstan in 1998 and the Congo in 1996 (Figure 4.1). As would be expected, removing these outliers improves the predictive performance of the model.

4.3.4. Interpretation and Discussion

The results reported in the previous section can be interpreted in terms of the conceptual framework introduced in Section 4.2. It would seem that initial conditions, as reflected by a wide range of macroeconomic variables, exert no significant influence over the implementation of IMF programmes. This is broadly consistent with what has been found in earlier studies. Relatively large current account or fiscal deficits do not foretell poor implementation. The study does not support the view that programme implementation is more difficult to achieve where initial conditions are relatively weak. One potential inference is that, in negotiating programmes and designing conditionality, the size of the economic disequilibria that need to be corrected is taken into account.

From the economic variables examined, only trade openness has a significant effect on implementation. This is a robust finding and applies irrespective of whether implementation is gauged by the interruption or the disbursement measure. It also confirms the findings reported by Joyce (2003). Open economies are more likely to implement IMF programmes successfully. It could be that conventional IMF-supported policy measures have a greater chance of being effective in open economies. Foreign trade elasticities, for example, may be higher making exchange rate adjustment or the management of aggregate demand more effective policy instruments. It may also be that, as suggested by Joyce (2003), greater openness reflects a closer proximity between the policy preferences of governments and those of the IMF. This finding is consistent with the claim that implementation depends on commitment and on the degree of ownership of the programme. Countries that have open economies may be more likely to accept and endorse the IMF’s analysis and therefore carry through agreed programmes.
There is, however, a potential downside to openness. Open economies may be more vulnerable to trade shocks. In principle, it could therefore be that open economies are not only more likely to implement IMF programmes, but are also more likely to turn to the Fund for assistance. However, studies of the determinants of IMF lending do not identify openness as a significant factor (Bird, 1996). Moreover, various measures of exposure to shocks were incorporated in the regression analysis, such as a primary product exporter dummy, a measure of export concentration. And, none of them was significant. This may imply that the Fund has used waivers and programme modifications to protect programmes from interruption and to sustain the flow of IMF resources to the affected countries. As noted in Section 4.2., shocks can be either positive or negative. In principle, non-disbursement of an IMF credit could be as much to do with a positive trade shock that raises export revenue and reduces the need for IMF support, as with a negative shock that makes it more difficult to comply with the original conditionality. The connection between the incidence of shocks and the implementation of IMF programmes is likely to be more subtle and nuanced than is allowed for in this research. As with other variables that are found to be systematically insignificant, there may be a more complex story to be told in which factors that are significant idiosyncratically, and in different ways, wash out in large sample regression analysis.

Openness measure used in the study as proxied by the volume of trade is generally adopted in the literature, though, the concept merits further discussion as openness may be affected by both structural factors such as country size and policy related measures such as tariffs. Countries with high tariffs may find it more difficult to implement the fiscal component of IMF programmes, as they rely on this form of tax revenue. This makes it problematic to disentangle the connection between trade policy and implementation, as there are various measures of outward orientation that attempt to capture the thrust of trade policy, but they are not correlated (Pritchett, 1996).

The econometric evidence suggests that the Fund can also affect implementation through the amount of financial assistance it stands ready to provide. The most obvious interpretation of this finding would be as follows. IMF resources ‘bribe’ countries to pursue unpleasant and politically costly policies. The bigger the ‘bribe’, the bigger the incentive to implement the IMF programme, since the losers from the reforms
can be better compensated. However, the reality could be more complex. In other studies of IMF operations, and in particular in some studies of IMF catalysis, it is reported that the significant effect of the size of IMF loans is conditional upon the loans not being fully used (Mody and Savaria, 2006). It appears that having the resources in reserve, while showing they are not needed, is what is important. The way in which the size of loans affects implementation may again be subtler than a simple interpretation suggests.

The research's results strongly confirm that domestic politics exert a significant influence over implementation whether measured by interruption or by disbursement. This is a robust finding and one that provides evidential support for the theoretical analyses of implementation that emphasize the importance of powerful opposition to the reforms favored in the IMF programme. Up until now empirical investigations into the importance of special interest groups (SIGs) have been hampered by poor data. The empirical proxies have only loosely reflected the theoretical ideas. For example, the number of political parties in parliament will be a very imprecise measure of the influence of SIGs. The important question is whether those opposed to the economic reforms embedded in IMF programmes possess the power to disrupt implementation; are they 'veto players'. The data used in this research comes closer than previous studies to capturing the influence of opposition groups. As a consequence, it is found that while conventionally used measures of SIGs generate insignificant results (Joyce, 2003; Dreher, 2003), the veto players measure used in this study gives significant results. This finding provides empirical support for the theory of special interests in Chapter 3. The political economy of implementation requires the IMF to temper the design of its programmes in terms of technical economics (Bird and Willett, 2005) and the findings reported in this study further reinforce this suggestion. They also suggest that the Fund needs to offer more effective support to governments in explaining the rationale of proposed economic reforms to the public and opposition groups.
4.4. Conclusion

The empirical investigation presented in this chapter draws on the most up-to-date theoretical work to isolate a group of factors that may be expected a priori to influence implementation. It suggests empirical proxies for these factors drawing on the most up-to-date data. It uses a range of economic and political variables and applies appropriate regression techniques to a large data set covering 95 countries over the period 1992 – 2004. It also tests for robustness by examining various measures of implementation.

In terms of economic variables, conventional indicators of macroeconomic performance and policy emerge as being insignificant. Instead, it is trade openness that makes a difference; economies that are more open have a better record of implementation.

Confirming recent theoretical contributions and using the best available data, the study also discovers that implementation is disadvantaged by the existence of veto players, although other political factors appear to be systematically insignificant.

Although the research provides value added to our understanding of implementation, it does not as yet allow us to predict, with confidence, the probability that individual programmes will or will not be implemented. However, the results reported here do suggest that predictions will be wide off the mark if they fail to include salient political factors.

Further research also needs to focus on formulating a more sophisticated political economy approach to implementation. Given the shortcomings of large sample data relating to political variables, this is likely to involve collating a series of structured case studies that can more successfully capture idiosyncratic economic and political variables.
4.A. Appendix to Chapter IV
### 4.A.1. Variable Definitions and Data Sources

<table>
<thead>
<tr>
<th>VARIABLE</th>
<th>DEFINITION</th>
<th>SOURCE</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>PROXIES FOR THE DEPENDENT VARIABLE OF IMPLEMENTATION</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Disbursement Ratio</td>
<td>Share of committed funds disbursed</td>
<td>IMF Country Reports</td>
</tr>
<tr>
<td><strong>MACROECONOMIC VARIABLES</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>FDI</td>
<td>Net Foreign Direct Investment as percent of GDP</td>
<td>WDI</td>
</tr>
<tr>
<td>Money Growth</td>
<td>Rate of monetary expansion</td>
<td>WDI</td>
</tr>
<tr>
<td>Trade Volume</td>
<td>Sum of imports and exported divided by GDP</td>
<td>WDI</td>
</tr>
<tr>
<td>Growth</td>
<td>GDP growth rate</td>
<td>WEO</td>
</tr>
<tr>
<td>Government Balance</td>
<td>Central Government Balance/GDP</td>
<td>IFS</td>
</tr>
<tr>
<td>Inflation</td>
<td>Inflation</td>
<td>IFS</td>
</tr>
<tr>
<td>Current Account</td>
<td>Current Account Balance/GDP</td>
<td>WEO</td>
</tr>
<tr>
<td>Reserve/Imports</td>
<td>Reserves to Imports in months</td>
<td>WEO</td>
</tr>
<tr>
<td>Primary Product Exporter</td>
<td>Dummy for Primary Product Exporter</td>
<td>WDI</td>
</tr>
<tr>
<td>GDP per capita</td>
<td>Initial GDP per capita (constant at 2000)</td>
<td>WDI</td>
</tr>
<tr>
<td><strong>IMF RELATED VARIABLES</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loans to Quota</td>
<td>Approved IMF Credit in relation to a country’s quota</td>
<td>Nsouli et al. (2004)</td>
</tr>
<tr>
<td>Fund months spent</td>
<td>Number of months spent in IMF-supported programmes</td>
<td>Nsouli et al. (2004)</td>
</tr>
<tr>
<td><strong>POLITICAL ECONOMY VARIABLES</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pre-election</td>
<td>Share of the year which is within twelve months prior to a national election</td>
<td>Dreher and Vaubel (2005)</td>
</tr>
<tr>
<td>Post-election</td>
<td>Share of the year which is within twelve months after to a national election</td>
<td>Dreher and Vaubel (2005)</td>
</tr>
<tr>
<td>Veto Players</td>
<td>Number of veto players in the legislature</td>
<td>DPI</td>
</tr>
<tr>
<td>Democracy</td>
<td>Indicator of type of regime. Includes measures of (a) competitiveness of political participation, (b) competitiveness of executive recruitment and, (c) constraints on the chief executive. Ranges from strongly autocratic (-10) to strongly democratic (+10)</td>
<td>Polity IV</td>
</tr>
<tr>
<td>Strength of Special Interest</td>
<td>Computed as the maximum share of seats in the parliament held by parties representing religious, nationalistic, regional and rural interest groups.</td>
<td>DPI</td>
</tr>
<tr>
<td>Regime Durability</td>
<td>Regime Durability, the number of years since the most recent regime change</td>
<td>Polity IV</td>
</tr>
<tr>
<td>Quality of Bureaucracy</td>
<td>Institutional strength and quality of the bureaucracy measured on a 4 point scale.</td>
<td>ICRG</td>
</tr>
<tr>
<td>Corruption</td>
<td>Corruption within the political system, 6 points.</td>
<td>ICRG</td>
</tr>
<tr>
<td>Ethnic Tensions</td>
<td>The degree of tension within a country attributable to racial, nationality or language division. Higher ratings suggest minimal tension, 6 points.</td>
<td>ICRG</td>
</tr>
</tbody>
</table>
4.A.2. Countries and Programmes

<table>
<thead>
<tr>
<th>Country</th>
<th>Years</th>
<th>Country</th>
<th>Years</th>
</tr>
</thead>
<tbody>
<tr>
<td>Korea</td>
<td>1997</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
### 4.A.3. Regression Results Based on the MONA Implementation Index

<table>
<thead>
<tr>
<th>Tobit analysis of programme implementation as proxied by the MONA implementation index</th>
<th>Coefficients Standard errors</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Macroeconomic Variables</strong></td>
<td></td>
</tr>
<tr>
<td>FDI to GDP</td>
<td>0.123 (0.938)</td>
</tr>
<tr>
<td>Money growth</td>
<td>0.093 (0.562)</td>
</tr>
<tr>
<td>Trade volume to GDP</td>
<td>-0.063 (0.530)</td>
</tr>
<tr>
<td>GDP growth</td>
<td>-0.866 (0.182)</td>
</tr>
<tr>
<td>Central government balance to GDP</td>
<td>62.421 (0.552)</td>
</tr>
<tr>
<td>Inflation</td>
<td>-0.0891 (0.406)</td>
</tr>
<tr>
<td>Current Account to GDP</td>
<td>-51.568 (0.328)</td>
</tr>
<tr>
<td>Reserves to Imports</td>
<td>0.148 (0.926)</td>
</tr>
<tr>
<td>Primary product exporter dummy</td>
<td>2.581 (0.378)</td>
</tr>
<tr>
<td>GDP per capita</td>
<td>0.002 (0.310)</td>
</tr>
<tr>
<td><strong>Political Economy Variables</strong></td>
<td></td>
</tr>
<tr>
<td>Pre-election</td>
<td>-7.928 (0.323)</td>
</tr>
<tr>
<td>Post-election</td>
<td>6.466 (0.399)</td>
</tr>
<tr>
<td>Veto Players</td>
<td>2.511 (0.446)</td>
</tr>
<tr>
<td>Democracy</td>
<td>1.247 (0.575)</td>
</tr>
<tr>
<td>Strength of SIGs</td>
<td>-8.434 (0.350)</td>
</tr>
<tr>
<td>Regime Durability</td>
<td>0.001 (0.997)</td>
</tr>
<tr>
<td>Quality of Bureaucracy</td>
<td>3.248 (0.453)</td>
</tr>
<tr>
<td>Corruption</td>
<td>-3.807 (0.348)</td>
</tr>
<tr>
<td>Ethnic Tensions</td>
<td>-3.326 (0.261)</td>
</tr>
<tr>
<td><strong>IMF Related Variables</strong></td>
<td></td>
</tr>
<tr>
<td>IMF Loans to Quota</td>
<td>-0.683 (0.838)</td>
</tr>
<tr>
<td>Months spent in IMF programme</td>
<td>0.082 (0.390)</td>
</tr>
<tr>
<td><strong>Constant</strong></td>
<td>83.054 (0.455)</td>
</tr>
<tr>
<td><strong>No. of Observations</strong></td>
<td>54</td>
</tr>
<tr>
<td><strong>Log-likelihood</strong></td>
<td>-211.651</td>
</tr>
</tbody>
</table>
Chapter 5

Another Perspective on Implementation: The Case Study of Turkey and Other Country Experiences

Ever since Turkey implemented one of the very first IMF programmes in 1948, encounters with the IMF have been frequent occurrences. Populist cycles and periodic fiscal crises have emerged as persistent features of the Turkish economy over the past few decades. As a result, the Fund’s involvement in the Turkish economy has been almost continuous (See Appendix for a list of Turkey’s programmes with the Fund over the years).

The first section of this chapter is a brief survey of Turkish reform attempts, with the IMF as one of the main actors. A comprehensive, quantitative analysis of Turkey’s development experience is beyond the scope of this chapter. Instead, it aims to provide background information for the section that follows.

The second section comprises an in-depth investigation of the determinants of programme implementation in Turkey between 1999 and 2004. The case study of Turkey is informed by the theory and by large sample econometric research, and it is seen as a complementary rather than a competing methodology. It is based on extensive field research in Turkey and the IMF Headquarters in Washington, D.C. A detailed study of the relations between the Fund and Turkey, based on a series of interviews with policy makers, programme negotiators, bureaucrats, interest groups and IMF officials can go beyond the thin description accessible in econometric form. During the interviews, participants were asked to share their own ideas about which variables contributed to the degree of implementation of Turkey’s programmes, based on their first-hand experience.
The third section aims to relate case study results to the existing large sample cross-country research by undertaking a brief examination of other individual country cases, which were identified as outliers by the probit analysis in Chapter 4.

Consequently, the Chapter aims to highlight some key factors of the implementation of IMF supported programmes, emphasising aspects that have a wider significance for developing countries and focusing on the roles played by governments, interest groups and the IMF.

5.1. The Characteristics of the Turkish Economy and Reforms

Turkey began implementing liberal reforms in 1980. The programme initiated in 1980 was one of the first of its kind and was devoted to both short-term stabilisation and long-term structural adjustment. The World Bank was responsible for the structural adjustment, while the IMF was only involved with macroeconomic stabilisation. Based on close collaboration between the IMF and the World Bank and involving the application of "cross-conditionality", the programme was radical and far-reaching. At the same time, it was a gradualist programme that envisaged a stage-by-stage liberalisation and integration into world markets.

The elimination of payments imbalances and the reduction of inflation were identified as the immediate objectives of the programme. The principal instruments included monetary contraction, exchange rate devaluation and the liberalisation of key relative prices such as interest rates on bank deposits. The longer term objective of structural transformation aimed to overcome the limits on economic growth imposed by the previous import substitution industrialisation strategy. The programme sought to lay the foundations of sustained economic growth by way of financial reform and the liberalisation of the foreign trade regime (Onis 1986, Onis and Ozmucur 1988).

A three-year programme- the first in the Fund's history- envisaged a financial assistance of 1,250 million SDRs, which was disbursed in full. This amount constituted the
highest credit extended up to that point by the IMF and represented 6.5 times the Turkish quota with the Fund (Okyar, 1983). ¹⁵

In June 1983, an additional one-year follow-on stand-by arrangement was approved for 225 million SDRs (75 percent of quota). This was seen as a continuation of the earlier arrangement, and the conditionality was similar to the 1980 programme. At the end of 1983, the newly elected government requested cancellation of the existing arrangements. In April 1984, a final one-year arrangement was approved for 225 million SDRs (52 percent of quota) to replace the cancelled arrangement. The stand-bys in 1983 and 1984 had 25 percent and 75 percent disbursement ratios, respectively.

Nevertheless, this period was highlighted as a model of successful adjustment by both the IMF and the World Bank¹⁶. An examination of the stylised facts associated with the post-1980 performance suggests that the policies have been reasonably successful with respect to growth and balance of payments objectives with exports (Figure 5.1 and 5.2). Per capita growth averaged about 2.5 percent a year, social indicators improved, and in the 1980s, Turkey became a star performer in terms of growth in manufactured exports (Appendix 5.A.3).

A key factor, which explains the ability of Turkey to implement the comprehensive adjustment programme, was the widely held belief that every other alternative had been tried and discredited. There was a close correspondence between the views of the Turkish government and its economic policy-makers and the IMF staff. The programme was not seen as being imposed by external forces against the will of the government; on the contrary, the Turkish authorities were highly successful in presenting the programme as having been formulated by them. As a result, the policy package was successfully internalised.

¹⁵ For details of the January 1980 programme, see Okyar (1983)

¹⁶ A review by the IMF in March 1982 showed that performance in implementing the stand-by arrangement was satisfactory, and in April 1983, the IMF review concluded that all performance criteria had been met. These views of the Fund were cited by the Bank in their structural adjustment loan proposal document as supporting evidence (Okyar, 1983).
Figure 5.1. Turkey’s Export Development in 1980s

Source: State Institute of Statistics, Turkey

Figure 5.2. Turkey’s Growth Performance in 1980s

Source: State Institute of Statistics, Turkey
After a decade of successful implementation, the momentum of the reform process was in decline towards the end of the 1980s. Despite the IMF's willingness to resume the reform process, the Turkish authorities declined to sign a stand-by arrangement with the IMF on the grounds that this would be associated in the public's mind with the failure of economic policies implemented almost a decade earlier. After all, the balance of payments problems were resolved and access to international capital markets was restored; the IMF's role was officially over. However, the IMF and the international financial community, in general, continued to exercise an indirect influence during the post-1984 phase. For example, the practice of extra-budgetary funds and export tax rebates was subjected to strong criticism from the Fund, resulting in a transfer of 30 percent of revenues from these funds to the consolidated budget in 1986 and the eventual removal of the export tax rebate system by the end of 1988. Yet, the direct conditionality, which had characterised the early 1980s was to a large extent absent in the second half of the decade.

Nonetheless, during this period, domestic political pressures increasingly replaced external constraints, which had significant ramifications in terms of the pattern of economic performance during the 1990s. One significant turning point in this context is September 1987, which marked the return of unrestricted party competition. The distributional pressures that had been largely repressed in the early eighties manifested themselves in the form of larger fiscal deficits and higher rates of inflation. Finally, the August 1989 measures completed the last stage in the liberalisation of the capital account and the establishment of the full convertibility of the Turkish lira. This resulted in a dramatic increase in inflows of short-term international capital. In worsening economic conditions, the Turkish government perceived large inflows of capital as a key mechanism to restore growth and did not focus on basic structural deficiencies in the economy; the large fiscal imbalances. In this way, Turkey entered into a highly fragile pattern of debt-led economic growth, which resulted in successive financial crises in the post-1990 era.

The financial liberalisation process has also altered the process whereby public deficits have been financed. The establishment of domestic capital markets presented the government with the opportunity to borrow domestically. As a result, domestic debt started
to increase. While Turkey had a domestic debt stock close to zero in 1987, this increased continuously and reached 25-30 percent of GDP by 2000.

Another striking feature of the Turkish economy during the 1990s was high real interest rates. The size of the government’s financial requirement compared to the size of the domestic financial system was at the heart of these high real interest rates. The growth in the government’s financial requirements outstripped the increase in the size of the financial system. This naturally increased the burden on the financial markets, and the domestic financial system responded by adjusting prices. Not surprisingly, the increase in real interest rates has caused an increase in interest payments and hence an increase in budget deficits. As a result, Turkey has been caught in a vicious circle of increasing deficits and rising interest rates.

The financing policy of the government being based on short-term borrowing led the commercial banks to change their asset management policies. They shifted from direct loan extensions to purchasing government securities. This indirect form of borrowing by domestic agents replaced direct borrowing by the public sector from international capital markets.

In addition, the deficit financing policies led the commercial banks to open short positions in foreign currencies. In order to finance their massive investment in government bonds, many Turkish banks made short-term borrowings from international markets against which the government bonds were pledged as collateral. Essentially, banks were borrowing short-term money to hold long-term Turkish government bonds. The high rates of return on government bonds made the banks reluctant to manage the market risks. However, as the banks started to operate in short positions in foreign currency denominated assets, financing policy based on short-term borrowing made the banking sector progressively more vulnerable to foreign exchange and interest risks.

In the context of a highly fragmented party system, successive coalition governments in the 1990s lacked the capacity and the incentives necessary for undertaking fiscal stabilisation and regulation of the banking sector.

There were a few attempts of reform well before the onset of the 2001 financial crisis. For example, the coalition government that had come into office in 1991 appeared to
be strongly committed to undertake a drastic stabilisation programme designed to
overcome macroeconomic instability in the economy. Yet, it was evident from even a
superficial examination of the support base of the coalition government that powerful
forces were present that would prevent the government from implementing a far-reaching
reform programme. The government represented a coalition of losers from the reform
waves of 1980s. The principal constituencies of the coalition included organised labour, the
farming community and small businesses that were strongly oriented towards the domestic
market. Paradoxically, the government in office was committed to reform on paper and yet
elected on a populist agenda of redistribution. In this context, the inflows of capital
provided a major escape route for policy makers confronted with acute distributional
dilemmas. They allowed the economy to expand at a faster rate than would otherwise have
been possible, a process which at the same time helped to satisfy the distributional claims
of the key groups involved. By the end of 1993, it was clear that the rapid growth of the
Turkish economy in the early 1990s was built on shaky foundations. The process was
unsustainable on two counts. The budget was in disarray, given the rapid increase in
expenditures without a corresponding increase in tax revenues. The process was also
unsustainable because the balance of payments equilibrium was very fragile, as a growing
current account deficit was covered by inflows of primarily short-term capital flows.
Hence, the traces of an impending crisis could be observed at the end of 1993 by observing
the position of the budget and the balance of payments (Figure 5.3 and 5.4).

When two major credit institutions had reduced the country’s credit rating in
response to the growing disequilibria, a crisis of confidence on the part of investors set in,
resulting in a major outflow of short-term capital.17 Thus, the financial crisis manifested
itself as a balance of payments crisis leading to massive depreciation of the exchange rate
in the early months of 1994. The process culminated in the decision of the government to
implement a major stabilisation programme in association with the IMF in April 1994.

---

17 The credit rating agencies involved were Standard and Poor’s and Moody’s. In January 1994,
first Moody’s reduced Turkey’s credit rating, signifying a shift from “quality investment” to
“speculative investment” bracket. Standard and Poor’s followed.
Figure 5.3. Current Account Balance: 1990-94

Source: State Institute of Statistics, Turkey

Figure 5.4. Central Government’s Budget Balance (% GDP): 1990-94

Source: State Institute of Statistics, Turkey
Figure 5.5. Chronic Inflation in Turkey Over the Years

Source: State Institute of Statistics, Turkey. Based on Wholesale Price Index.

Figure 5.6. Debt Dynamics

Source: State Institute of Statistics, Turkey
A 14-month Stand-By Arrangement was built around a large, front-loaded, fiscal correction and a tighter stance on monetary policy. The programme implementation was satisfactory to begin with. At the end of the second programme review in April 1995, the programme was extended by six months. However, in September 1995, the governing coalition was dissolved unexpectedly and early elections were called.\textsuperscript{18} This resulted in a sharp deviation from the programme understandings and the final review was never completed.

The 1994 crisis and ensuing policy measures, however, were not serious enough to generate deep-seated structural changes in the Turkish economy. Following the smooth recovery process from the crisis, many of the key elements of the disequilibrium that characterised the early 1990s, such as huge budget deficits, chronic rates of high inflation and heavy dependence on short-term capital inflows remained intact.

An extreme fragmentation of the political system, with one unstable coalition after another, the tenure of an average minister lasting just over one year, and decision making on economic matters spread over a growing number of ministries did not make implementing significant reforms possible to remedy the worsening economic situation. The chronically high inflation was averaging 60 percent and country’s debt rose from about 30 percent of GDP at the beginning of the decade, to over 70 percent in 1999 (Figure 5.5 and 5.6).

Consequently, by the end of the 1990s, policy makers had discovered that progressively smaller amounts of resources were available for populist redistribution once the principal sum and interest on domestic debt had been paid out. This realisation forced the politicians to seriously reconsider the feasibility of continuing on a populist path.

\textsuperscript{18} The coalition of centre-right True Path Party (DYP) and the centre-left Republican People's Party (CHP) was threatened repeatedly by the attempts of the social democrats to assert themselves and regain some of the popular support lost by their acquiescence in unpopular government decisions. Following a leadership change at a party convention in September, the new CHP leader Baykal withdrew his support from the coalition.
The December 1999 Stand-By and the Economic and Political Background to the
Crises of November 2000 and February 2001

In July 1998, the Staff Monitoring Programme was agreed with the IMF, which
initiated a number of targets and provisions related to the budget, monetary policies and
various structural reforms. This was followed by a proper Stand-by in December 1999,
after the general elections. With the December 1999 programme, Turkey took a serious
step to deal with the structural causes of chronic inflation and budget deficits.

The new coalition government formed after the general elections of April 1999,
incorporating the left nationalist Democratic Left Party (DSP) under the leadership of
Bulent Ecevit, the radical-nationalist Nationalist Action Party (MHP) under Devlet Bahceli,
and the right-of-centre Motherland Party (ANAP) under Mesut Yilmaz, gave the
impression of having significant commitment towards implementing a far-reaching
programme of disinflation and reform. The fact that an IMF programme was agreed for the
first time in Turkish history without the presence of a major crisis seemed to provide
additional support for an optimistic assessment. The wide ideological spectrum that
characterised the coalition government did not seem to affect the prospects of the
programme at the beginning.

The Stand-By programme was ambitious; aiming to bring inflation down to 25
percent by the end of 2000, 12 percent by the end of 2001, and to 7 percent by the end of
2002. A tight fiscal policy, an incomes policy in line with targeted inflation and monetary
and exchange rate policies formulated in line with decreasing inflation were the basis of the
disinflation programme. A pre-announced exchange rate strategy constituted a novel
element in an otherwise rather standard programme of inflation stabilization. The new
exchange rate regime envisaged a gradual and smooth transition to a flexible exchange rate
after the first critical 18-month period.

The programme was based on targeting an exchange rate, pre-announcing the
exchange rate depreciation and ensuring that the Central Bank operated in a fashion that
was compatible with the pegging of the exchange rate- effectively operating as a currency
board. The Turkish lira was allowed to depreciate gradually, until 2003, against a currency
basket made up of the US dollar and the euro. Essentially, Turkey implemented a framework whereby the crawling peg actually behaved like a currency board. With currency-board rules, a monetary authority sets the exchange rate, but has no monetary policy. The monetary authority can't increase or decrease its monetary liabilities by buying or selling government debt. Changes in net foreign reserve assets, which are required to back monetary liabilities one-for-one, exclusively drive changes in monetary liabilities.

The crawling peg employed in Turkey, required authorities to manage both the exchange rate and monetary policy. What made the crawling peg behave like a currency board was a condition on the letter of intent on the Central Bank’s Net Domestic Assets (NDA). Namely that, there would be a floor on net international reserves of the Central Bank and the liquidity would be expanded only when it purchased foreign exchange. Additionally, there was a ceiling on the net domestic assets of the Central Bank to ensure that no money would be printed to finance public sector deficits (See Appendix for a detailed description of Turkey’s exchange-rate based stabilisation programme).

The stand-by also aimed to tackle fundamental structural problems in the key areas of taxation, privatisation, banking regulation, and the reform of agricultural price support schemes.

The programme had a good start. During the early months of 2000, there appeared to be considerable optimism concerning the prospects for stabilisation and reform in Turkey. To a significant extent, this optimism was the outcome of the European Union’s (EU) Helsinki summit, which took place during the same month as the signing of the IMF stand-by agreement. The endorsement of Turkey’s candidacy for full membership at the Helsinki summit of the European Council provided a powerful incentive for undertaking both political and economic reforms.

Throughout the year, exchange rate devaluation followed the programmed schedule and the Central Bank successfully controlled the expansion of the monetary base by constraining its net domestic asset position within the programme limits. During 2000, the quantitative performance criteria defined in the stand-by arrangement were met. However, whilst the government appeared to display an initial commitment to the fiscal component of the programme, this commitment ultimately proved to be half-hearted. Extra
budgetary funds, which constituted another black hole in public finances, had mostly remained intact, despite the elimination of these funds as a structural benchmark. Fiscal management and transparency reform—another structural conditionality was also not put into effect.

With time, the performance of the coalition government failed to match the optimistic mood that prevailed in the early months of 2000. Although the coalition government displayed a unified front during its early months, it soon became apparent that the government lacked the necessary coherence and commitment to the reform process. Serious conflicts emerged during the year between the nationalist MHP and the two other partners over key aspects of economic policy. Key parts of the reform agenda such as bank regulation, privatisation, and the reform of the system of agricultural subsidies faced considerable resistance.

In particular, the MHP opposed central elements of the economic programme that involved the reduction of agricultural subsidies and the sale of state assets in telecommunications. Reduction of agricultural subsidies generated resistance on income distributional grounds, while the sale of majority of the shares in the state telecommunications enterprise to foreign investors was considered unacceptable on the grounds of the alleged strategic importance of the enterprise and the loss of national sovereignty entailed by this decision.

The formation of the key regulatory agency—the Bank Regulation and Supervision Authority (BRSA) constituted a key component of the programme. The Board of the BRSA had to be named by the end of March 2000 so that it could become fully operational by late August—a structural benchmark. However, by the end of August, the members of the board were just approved. Furthermore, the ability of the agency to play a constructive regulatory role was severely hampered by the presence of private banking lobbies that resisted any kind of regulation. Bank regulation also faced resistance from politicians and policymakers.

---

19 A major source of rent distribution in Turkey involved extra-budgetary funds. Policy makers in Turkey progressively relied on extra-budgetary means to finance government expenditures, which were free from the supervision and control of the parliament.
who perceived private banks as a major means of government financing and the public banks as a serious source of rent distribution for building up and sustaining electoral support.

As a result of powerful pressures stemming from banking lobbies, vital provisions have been left out from the Act of 4389 that was put into operation following the establishment of the new government. Six months later, the Banks act was amended by Act Number 4491 to remove the loopholes present in the earlier piece of legislation. Perhaps the most significant amendment embodied in Act No. 4491 involved the granting to the BRSA the right to issue new banking permits, which until then had been a political decision left to the domain of the Council of Ministers.

Another contentious structural reform topic was agricultural subsidies. Reduction of agricultural support prices and their replacement by direct income support schemes were crucial components of the programme since the support prices involved were substantially above the EU norms and, consequently, the agricultural sector continued to be a major source of disequilibrium in the Turkish economy. The MHP, the second dominant member of the coalition, opposed the reduction of agricultural subsidies. Perhaps, this was not surprising, given that the party drew its support primarily from the rural poor; implementing the programme would seriously jeopardise its future electoral prospects.

Approaching to the autumn of 2000, the programme failed to inspire enough confidence on the part of market participants, even in the presence of IMF support. The structural benchmarks were being missed and structural reform packages were not being put into effect. The absence of a leader who seemed truly committed to the programme was also an important factor in this. The governor of the Central Bank has been pushed to the front having to defend the programme in public, as the coalition government seemed reluctant display strong ownership of the programme.

The weak commitment, in turn, undermined the credibility of the programme in the minds of private investors and increased the vulnerability of the Turkish economy to speculative attacks during 2000 and beyond. The rise of the current account deficit during the course of 2000 was also a factor that progressively undermined investor confidence and raised deep questions concerning the sustainability of the programme. The steady increase
in the size of the current account originated from the fact that interest rates dropped rapidly in the initial stages of the programme. This helped to sustain a consumption boom and made it difficult to control overall demand, resulting in a major surge in imports with negative repercussions on the current account. Incomplete implementation of fiscal measures also contributed to a drastic increase in the trade deficit, given the contribution of the public sector deficits to the overall demand in the economy.

The external factors in force during the course of the programme also rendered the task of policymakers increasingly more complex. The international financial environment had become much more volatile and investors far more risk-averse following the Asian crisis of 1997 and Argentina's situation. Turkey suffered from higher energy prices, higher euro as well as higher interest rates on external borrowings in 2000.

Thus, incomplete implementation of the fiscal measures and structural conditionality displayed the weak commitment of the coalition government to the programme that in turn increased the possibility of sudden capital outflows. When confidence in the reform programme started to decline in fall 2000, the markets started to wait for a signal.

This signal came from the banking sector. In September 2000, the BRSA, presumably, making up for the lost time, started very aggressively by launching a series of raids on the ex-owners of failed banks taken under the umbrella of the Savings and Deposit Insurance Fund (SDIF). The ex-owners were charged with "organised crime". These raids caused profound anxiety in the sector. An equally important BRSA act that intensified anxiety among bankers came in mid November, when the agency asked the banks to reduce their open positions in order to ensure that they were within the legal limits by the end of the year. This generated a growing demand for foreign currency among certain banks.

The deteriorating sentiment led to an increase in liquidity pressure and exposed the weaknesses of those banks that had positioned aggressively in the fixed income market and relied heavily on overnight borrowing in the hope of steadily decreasing interest rates. As the market became more reluctant to lend to such agents, the liquidity problem resulted in the November liquidity crisis, which began on November 20 with the failure of a medium-sized bank, Demirbank that had too much exposure to government bonds and
could not withstand the sudden rise in interest rates. Initially, the Central Bank did not supply the needed liquidity so as not to violate the performance criteria on its net domestic assets, and the troubled market maker bank was forced to start selling chunks of its government securities. This led to increased interest rates in the secondary markets, generating further sell-offs in the fixed income market. Foreign currency demand surged as well, due to the collateral problem, and the increase in interest rates continued. To defend the nominal anchor, the Central Bank decided to breach the limits and supply liquidity to the market, which was converted to foreign exchange, and left the system- leaving the Central Bank with drained reserves and the market with still increasing interest rates. The amount of capital outflow reached $5 billion in the first week of the crisis. With no solution in sight for Demirbank, the Central Bank declared, on the last day of November, that it would respect the NDA limits as funding the liquidity-drained market was only serving to further deplete the Central Bank reserves. In the days that followed, the overnight market interest rate soared to over 2000 percent. 20 The capital outflow stopped only on December 6, when an IMF-led package amounting to over $15 billion was announced. On the same day, Demirbank was taken over by the BRSA and it was announced that all credits of Turkish banks were to be brought under government guarantee.

The revised agreement with IMF and the Supplemental Reserve Facility of $15 billion replenished reserves and tranquilised the markets for a while. In the aftermath of the November crisis, confidence in the stabilisation programme weakened, despite the strong support of the IMF. In December and January, this weakened confidence manifested itself in the very short-term basis (mostly overnight) of capital flows and demands for higher interest.

In February of 2001, Turkey was still in the zone of vulnerability. Thus, an exogenous shock in the form of an unexpected and extraordinary event could have easily triggered a crisis. This event came on February 19, when Prime Minister Ecevit disclosed that he had had a serious dispute with the President Sezer during a meeting of the National Security Council and that as a result, the country was in the midst of a “political crisis”. The dispute was related to the President’s concerns about bank supervision and the

---

20 Radikal (Turkish daily), Dec. 5, 2000
accusation that the Ecevit government was not undertaking the necessary measures to fight corruption among public officials. The announcement immediately translated into the perception in the financial markets that the ruling coalition- and hence the stabilisation programme- could be falling apart. In the two subsequent days, a major speculative attack on the lira took place as panicky investors tried to convert their lira-denominated investments into foreign exchange. The sudden and massive demand for foreign exchange caused a tremendous liquidity squeeze for banks as they rushed to the interbank market to raise liras to be used to buy foreign exchange from the Central Bank. Unlike during the November crisis, this time the Central Bank refused to act as lender of last resort. Overnight interest rates skyrocketed to over 4000 percent. When two public banks were unable to meet their lira obligations to other banks on February 21, the interbank payments system ceased to function altogether. Thus, on February 23, the government announced the flotation of the lira, bringing the exchange rate-based stabilisation programme to an early end.

Beyond February 2001: the Economic and Political Consequences of the Crises

The February 2001 crisis constituted the deepest economic crisis faced by Turkey. The striking magnitude of the crisis may be illustrated by the fact that GNP in real terms declined by 9.4 percent during the course of the year. The result was a dramatic drop in per capita income from $2986 to $2110 per annum and a massive increase in unemployment by 1 million people. The crisis, moreover, had a deep effect on all segments of the society. Unlike the previous crises, highly educated and skilled employees also lost their jobs in large numbers. Small and medium sized businesses were severely affected that led to widespread bankruptcies and layoffs.

At a more fundamental level, the two consecutive crises revealed the total exhaustion of a model of development based on patronage networks. This model was the root cause of the problems involving chronic inflation, massive build-up of domestic and
external debt as well as level of corruption 21. Hence, the crises marked a drastic loss of legitimacy on the part of Turkish state. The lack of trust on the part of the public concerning the politicians and the political parties in general- already a strong sentiment prior to the crises- was amplified considerably in the aftermath.

The government stayed in power in spite of the severity of the economic crisis. The bureaucrats, the Central Bank governor and the undersecretary of Treasury resigned, but all the members of the government remained in their seats. In an effort to increase its credibility, the government brought in an external actor.

That person was Kemal Dervis from the World Bank, who was appointed as the Minister of Economic Affairs and assigned responsibility for defusing the crisis. Dervis was originally offered the role of the Central Bank Governor, but declined and argued that “only a minister of economic affairs with strong coordinating powers would have any chance of succeeding” (Besley and Zaga, 2005, pp. 86).

So, Dervis was offered the position of minister of the Treasury, as well as coordinating responsibilities for the Central Bank and BRSA and responsibility for negotiations with the IMF and World Bank. But, no authority over the ministries of finance, planning, foreign trade or privatisation was assigned to Dervis, as each coalition party still wanted to retain some control over the economic management.

Dervis formed a core team including the new governor of the Central Bank, Sureyya Serdengecti, the undersecretary of the treasury, Faik Oztrak and the new head of Banking Regulation and Supervision Agency, Engin Akcakoca. The Dervis team prepared a new national programme based on shock fiscal policy and front-loaded structural reforms. On May 15, Dervis submitted a new letter of intent to the IMF and announced the “Strong Economy Programme”. Essentially, the 1999 stand by agreement remained intact except for the fixed exchange rate component. However, the programme clearly aimed at implementing a series of “structural reforms” and transforming “the old ways of policy

---

21 According to one of the best known indicators, the Transparency International Corruption Perceptions Index, Turkey shares the 77th place with Benin, Egypt, Mali and Morocco among 102 countries in the Index (higher numbers imply more integrity).
making” (Letter of intent dated May 2001, pp. 1). Indeed, the reform process initiated by the 1999 programme significantly accelerated during the post-crisis setting.

With the immense efforts of Dervis’s team, the same coalition government, which had been responsible for the outbreak of two crises, played an instrumental role in the passing of a record number of laws through parliament. In less than a year, Parliament passed 19 important structural reform laws or regulations. The most important of which were a law granting full independence to the Central Bank, a banking law, a complete reorganisation of state banks (including substantial downscaling), an overhaul of agricultural policies (moving from distorting price supports to direct income support), a civil aviation law, a telecommunications law, a tobacco law, a law on sugar industry regulation, a public procurement law, and a law on public debt management. More than half of the 19 new laws were passed in the four months following the February crisis.

Nevertheless, resistance to reforms had not disappeared altogether in the aftermath of the February crisis. Major clashes occurred between the newly appointed Economy Minister, Kemal Dervis, and the MHP, key members of the coalition, over a number of key issues of reform. One striking example of this kind of conflict occurred in the context of reforming the Telekom board, one of the key conditions of the stand-by programme. The MHP was determined to maintain its control over the company and insisted on choosing four of the seven board members. The major conflict between Dervis and the Transport Minister, Enis Oksuz, resulted in a certain loss of confidence and led to a delay in the IMF loan. The IMF was decisive in resolving the issue, however. The board was reappointed two weeks later and the episode ended with the resignation of Oksuz. The strength of the IMF, in line with the scale of assistance it provided post-crisis, played a key role in breaking the resistance to reform.

---

22 The authorities took significant steps strengthening the role and augmenting the autonomy of key regulatory institutions such as the BRSA. The BRSA has been playing an active role in the restructuring and reform of the banking sector, which was clearly not the case in the pre-crisis period.
Overall, the reforms were successful and the speed and determination in implementing them sent markets and the general public a strong message of radical change, restoring confidence. The IMF First Deputy Managing Director Stanley Fischer:

“Turkey has already made impressive progress in implementing this very ambitious program: it has undertaken important banking sector and other structural reforms, continued strong fiscal adjustment despite difficult economic circumstances, carried out an extensive legislative agenda, and undertaken a successful voluntary domestic swap”.

Dervis resigned from the government in August 2002 due to increasing strains within the coalition. But, the implementation of the programme stayed in place despite a general election in November 2002.

The New Government, the Same Stand-By

Following the November 2002 elections, the political sea change reflected the deep impact of the economic crises. Members of the coalition government were clearly penalised by the electorate for their poor economic performance. A number of other key political parties represented in parliament, which constituted key opposition groups of the coalition government, were also voted out. Consequently, a number of political leaders who had been influential in Turkish politics for a long time were forced to quit Turkish politics, paving the way for the emergence of a new political party, the Justice and the Development Party (the AKP). The AKP, a party with Islamist roots but more moderate in its outlook compared with its predecessors, took centre stage in Turkish politics.

The November 2002 elections were also important in putting an end to an era of political fragmentation of successive coalition governments, which had been associated with severe economic and political instability, a pattern present in Turkey since 1991.

In the early days of the government, there were mixed feelings concerning the electoral success of the AKP. On the one hand, the ability to form a single majority government was welcomed by domestic business and the international financial community. On the other hand, the Islamist roots of the new party and its lack of
experience in office were causes for concern. There were also fears that, given its broad-based electoral support, the new government might be tempted to indulge in a new round of populist expansionism and deviate from the IMF supported programme. The AKP government, to the surprise of many, has adopted a strong reformist policy orientation. Capitalising on its broad-based political support, the new government was able to accelerate the pace of economic and political reforms, with mutually reinforcing consequences. The “Strong Economy Programme”, which was put into practice in the aftermath of the 2001 crisis, has continued to be implemented in an uninterrupted fashion. The outcome judged by the principal macroeconomic indicators has been impressive (See Appendix for main macroeconomic indicators over the period of 1980-2004).

Turkey has been able to accomplish tight fiscal discipline. Inflation, for the first time over a period of three decades, has been stabilised at single digit levels. This dramatic fall has been accompanied by a strong surge in economic growth. The debt-GNP ratio has been falling steadily from the record level it reached during the crisis period, due to a combination of sharp fiscal adjustment and high rates of economic growth.

At the heart of this process of rapid recovery was a single-minded commitment to fiscal discipline. In spite of a serious interest burden, the government was able to accomplish and sustain a surplus in the primary balance in line with the IMF targets. In addition, the government has been able to continue with key institutional reforms such as banking sector regulation.

Having argued that the macroeconomic performance during its early term of office has been broadly successful, it would be rather unjust to attribute this success exclusively to the AKP. The Turkish economy had been undergoing a series of reform initiatives the previous coalition government. Ironically, the AKP capitalised on some of the important initiatives that the coalition government introduced, notably after the crisis, whilst benefiting immensely from the loss of popularity that the coalition government had suffered due to precipitating twin economic crises.
5.2. Determinants of Programme Implementation in Turkey

In this section, Turkey’s relationship with the IMF is examined in more detail, in a case study framework. The methodology is to undertake a series of structured interviews informed by the theory and by large sample econometric research with those involved in the process over the period 1999-2004. The aim is to cover a reasonably representative and balanced sample of participants, ranging from key Turkish politicians, bureaucrats, the leaders of special interest groups to relevant IMF personnel including mission chiefs and resident representatives. The schedule of the interviews and the interview guide are presented in Appendix.

In order to create an analytical framework for the discussion, the investigation is based on the factors that have been identified by the theoretical research into implementation and by the large sample regression analysis.

The results of the case study point towards a range of political economy variables in explaining the various degrees of programme implementation in Turkey between 1999 and 2004.

The most significant of these is the strength of special interest groups within the country. The theory of policy implementation, which was reviewed in Chapter 3, also suggested the importance of special interest groups or ‘veto players’ that have sufficient power to resist reforms. And this variable was found to be a statistically important determinant of implementation in the econometric study, as well. However, the modelling of the special interest groups in Chapter 3 was rather narrow, and the data sources used in Chapter 4 were limited. As a result, the results from theory and econometrics could not lend itself to a complete analysis of their effects on implementation. The contribution offered through the case study completes the analysis.

In line with the theory, political parties in Turkey have been acting as patronage networks serving narrowly based sectional interests as opposed to serving the interests of broad segments of the society as a whole. This narrow focus also prevented governments from playing a more constructive role in terms of policy implementation.
For instance, Carlo Cottarelli, the IMF Mission Chief to Turkey during the 1999 programme, attributed delays in banking reforms to the existence of a strong banking lobby. “The pressure was on the government not to do anything before 2001. The tackling of problems in the banking system was delayed and delayed, clearly because of the banking sector’s resistance to reforms and because of the difficulty the government had in acknowledging that public sector money was to be used to bail out the failing banks”. He also mentioned that there were other groups complaining and lobbying the government. Among these were the exporters who complained about loss of competitiveness and the unions who complained about falling real wages.

The former Minister of Finance, Sumer Oral’s explanation of the government’s position is a succinct summary of the theory of policy implementation. According to Oral, the government’s role had to be a balancing act, between the SIGs and the IMF’s requests. However, during the autumn of 2000, the government could not sustain the balance, and as the government gave in to the interest groups’ demands, delays in implementation occurred.

After the February 2001 crisis, though, the interference of the interest groups in policy making was significantly reduced.

To begin with, vested interests have a lot to lose in a severe crisis. Thus they are more likely to accept reform even if it means a long-term loss of advantage and privilege. With a further deepening of the crisis, they could lose almost everything. As Kemal Dervis also pointed out: “The industrialists and the bankers would have had great losses, had the economy sunk totally. People who invested in the country were hoping that the programme would offer an exit. Some of them were against some parts of the programme. For instance, businessmen were initially against the free float. But, there was an overall support”. This is the reason Dervis’s team chose to front load structural reforms. But while doing so, they made an enormous effort to get all the major groups on board, at least on key elements of the programme. As a result, there was little controversy or resistance at the outset. Because the way the crisis hit, it did not leave many options to policy makers or interest groups.

Faik Oztrak, who was the Undersecretary of the Treasury and a close aide of Dervis at the time, agreed. According to Oztrak, the SIGs (unions and business world) were
initially on the same side as the government because of the shock. However, when the programme started to offer good results, they wanted a share of the glory. Those who did not want to give up the political rents acquired in the past started pressurising the politicians which led to impediments in structural reforms. The IMF, on the other hand, was pressing the government for implementation. He added:

“The SIGs have a certain influence on politicians. The structure of Turkish politics is inclined to conservatism. Some industries, organizations and unions which lost from reforms formed coalitions in order to influence the politicians. For instance, Tekel (a state monopoly of alcoholic beverages and tobacco) is under the control of a minister who is from Izmir-Aydin region, where the tobacco production takes place. This is not a coincidence. The minister had to resign. During the crisis, this group couldn’t say anything, as with all other groups who were in a difficult position. But as soon as the situation got better, the resistance to reforms started”.

Dervis stated that they did not give in to the demands of the interest groups, simply because they had no choice but to implement the programme under crisis conditions; the other option was a moratorium. Except on labour wages for which they disagreed with the IMF. The IMF wanted wage increases to be inline with the budget targets, while the government faced a strong labour lobby. Dervis said that in order to prevent a social crack in the country, they would not serve the IMF’s demands on wage policy. However, with other groups such as the tobacco lobby, the cotton lobby, he said that they did not even go into correspondence with those groups.

Juha Kahkonen, the IMF Mission Chief to Turkey after the crisis, explained that the IMF team was always stopping by in Istanbul to listen to the views of various businessmen and to explain the broad plan. But he maintained the view that the main purpose of the programme was to dissolve vested interests. He continued: “There were rough times because of the effect of SIGs during the programme, for instance Turk Telecom, delays in other privatisation projects, banking sector problems. Any slippage which occurred during the programme, and any structural reform that was resisted was due to the pressure of the SIGs”.
Dervis’s team also had enormous problems convincing domestic business circles and the general public of the necessity of a tough fiscal policy. As the recession deepened in the late spring and summer of 2001, the argument for fiscal stimulus rather than fiscal restraint gained momentum. And by late summer the cabinet of 36 ministers, with just 2 or 3 exceptions, was pressuring Dervis, both privately and publicly, to relax the fiscal target. However, Dervis held firm and stayed committed to the fiscal target despite the mounting pressures. Resistance against the pace of structural reforms, the new exchange rate regime, and the tough fiscal policy stance mounted in June and July, raising interest rates, and pulling the exchange rate down. Only after late August when the reward came with the stabilizing exchange rate and declining interest rates, the pressure levelled off a little.

Hugh Bredenkamp, the IMF Resident Representative to Turkey, pointed to the government’s logic for bailing out interest groups. He gave the implementation of tax policy under the AKP government as an example. By raising tax rates in one sector, and lowering it in another, the government was playing off the different constituencies, whereas the IMF favoured a broad based tax regime that would not allow the manipulation of the allocation of resources by the government. The tax policy was the main stumbling block between the AKP government and the IMF for the 2002 programme.

Nevertheless, the patronage networks in the Turkish political economy were in the process of being dismantled under the impact of powerful pressures for change. However, it has proved to be extremely difficult in the presence of fragile institutions. A few years are not enough for a new system to gain deep roots, and the danger remains of a return to many of the old rent-seeking ways.

According to Sumer Oral, there was a strong need to protect weak institutions from political influence, enabling them to operate independently. Kahkonen also maintained the view that weak institutions created vulnerability, and that this necessitated the reform. Therefore, the improvement of regulatory capacities of the Turkish state had to be backed up by further institutional reforms. For example, legal changes introduced in 2001 enhanced the autonomy of the Central Bank which was important in terms of the government’s ability to adopt a strong anti-inflationary stance and resist popular pressures for populist expansionism. In fact, the new phase could be described as an era where new
regulatory institutions started to occupy the centre stage in Turkey’s political economy. The institutions themselves were not new. What was novel, however, was their enhanced powers and autonomy, clearly backed by an all-powerful IMF in the aftermath of a costly crisis. Powerful regulatory bodies made their presence felt in key sectors of the economy.

Perhaps the most striking and publicised of such regulatory institution was the BRSA. Although the BRSA had been set up in 1999 prior to the onset of the crisis, it was largely ineffective given the powerful resistance of bank lobbies against any kind of strong regulatory action. Engin Akcakoca, who became the head of BRSA in the aftermath of the February crisis, explained the demands of the banking sector as follows: “The banking sector did not want harsh regulation, and they wanted less money leaving their pockets. There was a big gap between what the sector wanted and what the Banking Agency and the IMF wanted. There was less transparency, less prudential adaptation”.

However, in the aftermath of the crisis, the power and autonomy of the BRSA against the powerful interest groups through their influence on national political figures expanded by a considerable margin. The positive effect of this development has been a significant improvement in the regulation of the banking system in line with international norms. On the negative side, the experience of the BRSA and other similar public bodies raised certain question marks about the accountability and their compatibility with a democratic and participatory political system. The central question raised was whether the new regulatory state in Turkey meant the creation of a state above the political process, deriving its legitimacy from powerful external actors such as the IMF and the EU, leading to marginalisation of domestic politics in the process. Akcakoca described the government’s and the banking sector’s reactions to the BRSA’s actions: “The government was not used to independent agencies. They wanted to solve problems on their own, out of habit. The banking agency had to warn them against this and of course there were reactions from the sector, but once the bankrupted banks were taken out of the system and the remaining ones got stronger, they saw that what has been done was good”.

Another imperative factor of implementation was the degree of cohesion in policy making. Juha Kahkonen argued that a divided government made the implementation of the programme very difficult. Indeed, throughout the programme, some of the members of the
three-party coalition government were not even on speaking terms to each other. Oral, a member of the government at the time, admitted that one of the most important weaknesses of their programme was the lack of unity in the coordination of the economy. “There was a government coalition with three parties with quite different perspectives on how the economy should be run; this sort of government could not execute a single handed economic implementation”.

Even after the crisis, when a need for strong implementation in unison became very clear, the coalition government did not let Dervis have a unifying and coordinating role, because everyone jealously guarded their territory. He was given the position of minister of the treasury, and coordinating responsibilities for the Central Bank and the BRSA, and responsibility for negotiations with the IMF and World Bank. No overseeing over ministry of finance (responsible for taxation), planning, foreign trade, or privatisation was given. As a result, the Planning Office, the Treasury, the Privatisation Agency, the Foreign Trade Bureau couldn’t work in a coherent way.

The November 2002 election produced a solid majority government. Without having to manage a coalition, the AKP government single-handedly took over the economic management. This, no doubt, had a positive effect on the degree of implementation.

Another instability factor which was detrimental to implementation was political instability during the coalition government’s term. The instability resulted mainly from the fragility of the coalition government.

For instance, in explaining the slow arrival of foreign direct investment, Dervis pointed out the political uncertainty prevailing in the country: “The health condition of the Prime Minister, the upcoming elections, questions on the new government, the Iraq war...Because of all these extreme political uncertainties, the investors were very careful”.

Certainly, the fragility of the coalition government and the various political uncertainties also determined the degree of political ownership that the programmes contained.
In December 1999, the coalition government had agreed to implement the economic programme in the face of major external pressure—originating from both the international financial community and the European Union—in an environment where the fiscal situation was diagnosed as unsustainable. This, however, did not mean a deep commitment to reform on the part of all coalition partners, and the half-hearted nature of the commitment became increasingly apparent by the summer of 2000. Cottarelli described the earlier days of the programme as follows:

“At the beginning, fiscal tightening was in place and a series of reforms were implemented. There was a strong backing of the programme by the politicians. At the end of 1999, everyone supported the programme. Weakening of the will to implement appeared as we went through 2000. The main issue was the difficulty to respond promptly to developments such as speed of decrease in the inflation and sharp recovery. Inflation was declining to levels that were never seen in Turkey for a long time. It became politically difficult to keep going as things got better”.

Cottarelli started to feel that there was less consensus on the programme’s objectives during the September mission. The impression he had at the time from talking with bankers, businessmen, as well the members of the government, was that they had done well. For instance, the IMF projections were pointing to a current account deficit of five to six percent of the GDP and Cottarelli talked in public about ‘fine tuning’ in September 2000, but, in response, policy makers were pointing out the market analysts’ projections of three percent to him. So, the policy makers were essentially backed by the private sector, which explains the delay in taking measures to a certain extent. Cottarelli went on: “It wasn’t fatigue, it was the impression that they had already won the football match. Although there were people that did say this was not a 100 meter race, rather a marathon”.

Gazi Ercel, who was the Governor of the Central Bank at the time, asserted that there was not enough commitment on the part of the government, even from the start: “...Only a half-hearted commitment which was galvanised by the prospect of joining the EU. The prime minister for a start did not think the IMF programme could achieve what he wanted most; growth. And true enough, it wasn’t the primary goal of the programme. The growth was to arrive later, once the stabilisation of the economy was achieved”. Ercel
stated that he was forced to shoulder the programme on his own as the Governor of the Central Bank: “The politicians did not want to take responsibility. They said if this ends badly, let’s put the blame on someone else”.

Sumer Oral, a life-long politician and Minister of Finance at the time, did not accept this view, may be not very surprisingly. Oral claimed that despite the coalition government, the political ownership of the programme was present, because the political future of all three parties was hanging on the success of the programme. However, he also seemed to accept that the real implementation came later in the aftermath of the February crisis.

The weak ownership, in turn, progressively undermined investor confidence and constituted one of the underlying sources of the speculative attack and the massive outflow of short-term capital in November 2000. The fact that the crises occurred in the midst of an IMF programme is in itself rather surprising, but clearly demonstrates that even in the presence of IMF support, the government’s commitment failed to inspire sufficient confidence on the part of market participants.

Despite a better implementation record after the February crisis, the political ownership of the coalition government was never complete. The reforms were pushed through by a group of economists and technicians with support from civil society but without organised political support. Kemal Dervis stated that it was not quite possible for the government to own the programme because of the political crisis the government itself was in. “To what degree a government existed, that could be discussed even.” He added: “However, the PM was convinced about the necessity of the programme, and during critical times, he gave his support to it, even though he complained or created difficulties at times”.

The Undersecretary of Treasury Oztrak held the view that politicians owned the good parts of the programme and put the blame on bureaucrats and the IMF when the results were bad. According to Oztrak, when politicians observed that the technicians behind the programme were getting a high praise, they started resisting reforms and went after populist rent. Especially, once the economic fundamentals got better and the capital
flows started coming in, the government started listening to the IMF less and less. The
discipline lessened particularly in the structural reform area.

The AKP government which took over after the elections, on the other hand,
exhibited a stronger commitment to the programme. The fact that a majority government
was in power as opposed to a coalition of different parties certainly helped to maintain this
commitment. Hugh Bredenkamp, resident representative to Turkey, also argued that the
previous government’s legacy helped the AKP government to continue with the good
programme implementation. It also helped that as they were implementing these policies,
good performance was being recorded. So, good implementation coincided with the bounce
back phase which in turn enforced further implementation. According to Bredenkamp, the
AKP government knew that a healthy economy was their biggest asset. Therefore, they
were not going to endanger it by taking risks. “The only thing they could do is to not to
mess things up, and not allow the economy to deteriorate”. So, that was what they did.

The country ownership, reflecting itself in the form of a general willingness by the
population to support anti-inflationary policies and reforms, also allowed politicians some
space, facilitating implementation. As Dervis explained, the crisis was so big; it had created
a big fear. The determination to do something was very strong because of this. Oztrak also
believed that the programme had the support of all sections of a society shocked by the

“Everyone was scared of what had happened, and was ready to give in to anyone
with a solution. That is why structural reforms were frontloaded to take advantage of the

The reform coalition in Turkey embodied a strong domestic component. Domestic
business, from large conglomerates to small and medium sized businesses, were broadly in
favour of the kind of economic and political reforms in line with the requirements of the
IMF and the EU. For the domestic community, the combination of political and economic
reforms constituted the means for establishing a rule-based economy, thereby, transcending
the highly unstable and perverse patterns of development of the previous decades where
economic success largely depended on clientelistic political ties and easy access to state
favours.
Considering the intensity of the economic collapse experienced, the crisis failed to produce a collapse of the government in power or a major dislocation in society. Occasional protests by civil society associations were observed, but these were not comparable to the massive waves of social protest that have accompanied the crises elsewhere in the world. The country’s social fabric proved to be quite resilient in the face of a major economic collapse. The presence of strong informal networks involving the family and other informal mechanisms of social support performed a stabilising function; thus, preventing massive social and political dislocation. The unusual size and strength of the informal economy also provided a natural escape route for those who lost their jobs in the formal labour market. On the other hand, the very strength of the informal economy also posed a threat of preventing the urgency to undertake reforms designed to enlarge the size of the recorded economy.

The informal sector and ties constituted an element of social capital in Turkey, which facilitated the implementation of reforms in the aftermath of the crisis. Bayram Meral, the former leader of a major labor union, emphasised the solidarity the public have shown during the time of crisis and the preservation of social peace despite the massive drop in peoples’ incomes.

The political and countrywide ownership of reforms were definitely influential on programme implementation. Added to that, the Fund’s ownership of the programmes was not just desirable but necessary. The IMF, itself, had varying degrees of commitment to Turkey’s programmes in this period. The scale of the IMF’s commitment, in terms of both financing and involvement, considerably increased after the February 2001 crisis, and particularly after September 11.

The 1999 programme envisaged $4 billion to be disbursed in three years, while, during the course of 2001 and 2002, Turkey managed to attract a total of $24.5 billion of IMF assistance. This clearly highlights the validity of the criticism that the scale of assistance provided to Turkey as part of the 1999 programme was of a rather limited magnitude given the scale of ex post facto adjustment involved.
Cottarelli seemed to agree:

“The 1999 programme was backed up with nothing. There were 4 billion to be disbursed in 3 years, 1 billion in the 1st year. That’s the critical issue in explaining why the exchange rate was pegged. Our goal was to bring down the interest rates by pegging the exchange rate and with an exit strategy. It is a high pay-off strategy, if it works. It also contains high risk. But, we didn’t have money; there was nothing else to be done”.

Indeed, to many, the 1999 programme, based on a quasi-currency board, contained ambitious programme targets given the political coalition in place, the amount of financial assistance provided and structural weaknesses in the banking system. The head of the IMF Mission, Cottarelli described the objectives of the programme as follows: “In the 1999 programme, the authorities (and the IMF) were trying to bring Turkey out of 1999 recession, while trying to eliminate inflation at the same time. May be, we were trying something impossible”. He continued by saying that they had to design a programme without money, and risks had to be taken when there was no money. He claimed that the 1999 programme would have worked, but that it would have required impeccable implementation.

The Fund’s desire for impeccable implementation was not realised. Gazi Ercel argued that the Fund, disappointed by the slow progress of structural reforms, signalled its disapproval to markets, and, in a way, penalised non-implementation through capital markets. He also seemed to think that the structural reforms that were expected from the government at the time, such as Telecom privatisation, were put in a very ambitious time frame.

In the post-crisis period and even after the currency peg was abandoned, there were still reservations related to the design of the programme. Juha Kahkonen believed that the programme was an ambitious one, almost like a gamble.

“A lot of uncertainties involved, yet the programme was very ambitious envisaging action in many structural areas where various interests were at play. There was a weak government; some parts of the coalition were not even on speaking terms. It was clear that it would be a rough period. The whole structural part of the programme was meant to change the way the business was done in Turkey. It can’t be easy in any country.
It is a transformation. Very ambitious, but high degree of ambition was needed given the challenges.

As for the scale of Fund assistance, the former IMF Mission Chief to Turkey offered few explanations. Carlo Cottarelli explained the limited amount of assistance in 1999 with the absence of a balance of payments problem in Turkey at the time: “In 1999, when the stand-by agreement was being signed, there was a crisis situation for Turkey, but it was not a balance of payments problem”. He argued that the international community came up with a big international package when there was already a crisis, but it was less willing to do so to prevent a crisis. He added that it was also politically very difficult for the international community to come up with big rescue packages because it was seen as bad practice to use taxpayers’ money to bail out the private banks.

In the aftermath of the February crisis, the increased magnitude of financial assistance not only rendered the IMF far more powerful in the policy space, but also allowed Turkey to ride the crisis much more smoothly than would otherwise have been possible. Juha Kahkonen affirmed that there was no alternative to having a big international package to restore credibility after the crisis, but added: “Later on, it might have had a negative effect, as too much money can hamper the adjustment process”.

Kemal Dervis highly praised the financial support they had from the INIF and concluded that if the Fund’s financial support had been half-hearted, it would have been worse than useless: “We wouldn’t have been able to avoid default and the IMF would have had a failure to explain. If the Fund believes in a reform programme, they should go all the way in financing it. And if they do not believe in it, they should not provide any resources.”

The strength of support was crucial to restoring market confidence and easing Turkey’s liquidity squeeze. However, according to Oztrak, the IMF got involved in Turkey’s programme to an important degree especially after September 11 when it

---

23 An example of this was Argentina in 2001. The IMF staff did not want to give the $6 billion support, but the board did. The result was a programme addressing debt financing instead of Argentina’s structural problems. As quoted from Roque B. Fernandez: “The money came in one window, went out another” (Besley and Zaga, 2005).
provided an extra credit. This extreme involvement of the Fund and the possibility of a bail out increased the resoluteness of the Fund and resulted in more pressures for programme implementation.

Another aspect of the IMF’s increased commitment reflected itself in the form of flawless teamwork between the IMF staff and Turkish policy makers. According to Dervis, ‘mutual confidence’ is the most important ingredient for a successful reform programme: “The domestic policy makers must believe that the IMF team is sincerely trying to find the best solutions, is highly competent, and is trying to maximize financial support. And the IMF team must believe that the domestic team is not playing games and will do its best to implement what is agreed”. Dervis as a leader provided such confidence on Turkey’s side. Despite some differences between the teams on certain issues such as public sector wage negotiations and exchange rate policy, he was able to convince them at the end.

Engin Akcakoca, the former head of the BRSA, also talked about the significance of mutual confidence among the teams. He asserted that the IMF team was flexible and open to persuasion. “When teams disagree, if they try to come to a solution by arguing, tension mounts and subjectivity starts to surface. The result is reciprocal stubbornness. There are examples of failed programmes in the history for such reasons. During our term, we introduced two technocrat teams to each other, created a social space. They saw that the Turkish team wasn’t as stubborn, and we saw that they hadn’t come to bankrupt our banks. Everyone was there to do their job. We were in the same boat, if the programme did not work, everyone’s seat was in danger”.

In this period, the U.S. support also played an important role. The political environment after September 11 has worked in favour of Turkey. Turkey benefited from its geo-strategic location, involving its vicinity to the troubled region of the Middle East, whose importance was accentuated in the post-September 11 global context. The United States did not want an important country in the region to be under the threat of defaulting and losing its stability. Dervis described the events below:

24 The IMF approved stand by arrangements of 20.5 billion $ in 99 and 16.6 billion in 2002, among its largest programmes ever.
“The positive developments created after the crisis up until September could have been reversed by the worldwide crisis atmosphere created by the September 11 attacks. Turkey was particularly vulnerable because of the economic importance of its tourism sector and its proximity to the Middle East”.

Under these circumstances, the U.S. Treasury offered bilateral credit to Turkey, but Turkey wanted a multilateral arrangement. The US administration had to back down from its campaign of ‘no big bailouts’ when confronted with the stark reality of a major ally facing the harsh choices of debt default with a bank meltdown, hyperinflation, or a large package of international financing. After some negotiation new financing commitments from the IMF were agreed upon, amounting to $10 billion. Dervis continued: “A promptly negotiated enhancement to the IMF programme, with new financing commitments for 2002, allowed us to overcome the fears triggered by September 11 and from the end of October onward, resume the progress that had started in August”.

In essence, Turkey faced two interlocking external anchors, the IMF conditionality and the European Union (EU) criteria. While the IMF conditionality provided the short-term anchor, the EU provided the kind of long-term institutional anchor that was needed in terms of promoting stability and breaking down long-standing resistance to reform in Turkey’s domestic political arena. Gazi Ercel claimed that in the absence of the powerful pressures for change applied by both the EU and the IMF, the politicians would continue to resist reforms in both economic and political arena as long as a crisis-free environment prevailed. According to Sumer Oral, most of the regulations that came with the programme were also on the roadmap for the EU, and the anchors reinforced each other.

The Helsinki decision in itself was important in underlining Turkey’s membership of the EU as a concrete possibility. Gazi Ercel argued that the main impetus for reform originated from the EU. He stated that the IMF programme was presented to the government in 1999 as a prerequisite to start negotiations for the full EU membership: “The approaching Helsinki Summit and the prospect of entering into the EU have brought the political willingness to the IMF programme, albeit a half-hearted one.”

A large portion of this financing was used to repay short-term loans to international creditors, meaning that Turkey’s total debt did not decline, but increased, although the terms improved significantly.
However, at that moment, membership appeared to be a rather distant prospect. The impending Copenhagen summit of the EU where the country’s status as a potential EU member would be subjected to a critical review, really made the EU anchor more visible. The prospect of full EU membership contributed to the emergence of a vocal pro-reform coalition, which was willing to undertake the kind of reforms necessary to facilitate the country’s progress towards the EU. Increasingly, EU membership has become a common motive creating a bond between diverse elements of Turkish society.

According to Oztrak, the EU anchor had two different effects: “Firstly, a transformation was taking place from playing developing country rules to OECD rules, and the EU decisiveness definitely created an optimistic atmosphere, and attracted capital inflows. At the same time, though, when focused on the EU reform process in the political sphere, the economic reform was delayed”. Nevertheless, as policymakers realised that the rising confidence of markets, both domestic and international, increasingly rested on the ability to press ahead with both the economic and political components of the Copenhagen criteria, the implementation on both fronts eventually came through.

The crisis also rendered the prospect of eventual membership all the more important given the material attractions of the EU for ordinary citizens in the midst of severe economic hardships. As a result, it became progressively easier to generate popular support for EU membership, providing a favourable environment for passing difficult reforms on sensitive issues—such as the extension of cultural rights for the Kurds and the abolition of the death penalty— with relative ease, despite the presence of a powerful “anti-EU coalition”26. The crisis also increased the power and influence of the EU as well as the Fund pushing through major economic and political reforms.

In fact, the economic crisis, in itself, has been an important explanatory factor of programme implementation in the post-crisis period. The 2001 crisis inflicted great damage

26 The military-security establishment and the MHP constituted the leading elements of a highly organised and vocal anti-EU coalition. This coalition was not opposed to EU membership per se but was strongly opposed to key conditions associated with full EU membership because the fulfilment of such conditions would undermine national authority and threaten the unity of the state.
on the Turkish economy but it also dramatically highlighted the inherent deficiencies of Turkish economic development during the 1990s, creating an important avenue for political change and economic transformation. The realisation that the old system had reached its limits came when the debt-to-GDP ratio rose above 90 percent.\textsuperscript{27}

Kemal Dervis, who was appointed Minister of Economic Affairs and assigned responsibility for defusing the crisis, explained years later:

"The severity and extent of the crisis gave us only two choices: either to implement a programme encompassing serious structural transformation and macroeconomic stabilisation, or to accept moratorium. A deep loss of confidence in the government and the entire political system was present. The crisis provided a unique opportunity to push reforms through Parliament that otherwise might have taken years to enact. There is an argument against selling the precious political capital all at once and instead to advance step by step, building required coalitions a few at a time. But a severe crisis creates a different situation. The need for reform is more urgent and a message of change also needs to be given for markets to respond to".

Faik Oztrak, who worked with Kemal Dervis as the Secretary of Treasury, also shares the view that the psychological shock triggered by the crisis created the opportunity for deep structural reforms: "Everyone was scared of what happened. Business people, unions, all interest groups were supportive of the reforms. The moment we exited the crisis, the government was provided with the opportunity to go back to the rules of the old game".

Sumer Oral, who was the Minister of Finance both before and after the crisis, agreed with the positive effect the crisis had on the implementation of the programme in 2001. According to Oral, the conditionality of the programmes was essentially the same before and after the crisis, but the implementation came with the latter. The coalition saw the need to agree on reforms without much delay, and showed the determination to stick to the programme. To this end, the government even sacrificed two of its ministers.\textsuperscript{28}

\textsuperscript{27} According to the IMF's Staff Report of July 2002, Turkey's net public sector debt to gross national product (GNP) ratio stood at 93.3 percent at the end of 2001.

\textsuperscript{28} Enis Oksuz was the Ministry of Transportation and did not agree with the IMF's conditionality on the privatisation of Turkish Telecom. He had to resign after the pressures from the IMF and
Carlo Cottarelli who was the Mission Chief of the IMF’s Turkey desk from 1999 till the crisis, pointed out the economic space the crisis had provided: “It is impossible to defeat inflation without creating a major recession. The crisis explains the later success”.

Juha Kahkonen, who took over from Cottarelli after the crisis admitted that the IMF made good use of the crisis situation: “It was much easier to make strong decisions at the time of the crisis. During good times, it would be difficult to push for change. At times of crisis, radical solutions become more acceptable and we were aware of that”. Kahkonen was also quick to point out that the pro-reform groups and Dervis’s team in particular were also very determined to use the crisis as an opportunity to turn long waited reforms into reality.

Another IMF official, Hugh Bredenkamp, who is the resident representative of the IMF in Ankara, suggested that the shock of the crisis had changed the mentality and “made some things possible that wouldn’t have been perhaps acceptable previously”. Bredenkamp also suggested that an element of good luck was in part responsible for successful implementation that came after 2001, particularly during the term of the AKP majority government. He argued that the government’s continuation with orthodox economic policies coincided with the recovery process and created a self-reinforcing process. This made implementation easier, because they could immediately see the economy recovering as a result of their policy decisions.

The economic crisis has also helped promote a new kind of leader in the person of Kemal Dervis. Dervis was brought into the government in the immediate aftermath of the crisis as an “above politics” technocrat to coordinate the adjustment process. His professional background as a highly successful top-level economist at the World Bank was particularly important in terms of generating confidence and credibility, for the kind of programme that needed to be implemented, on the part of both domestic business and the international financial community.

the other members of the coalition government. Similarly, Yuksel Yalova, who was against the removal of subsidies on tobacco, had to resign under pressures from his party leader.
The strong credentials of Dervis provided a kind of legitimacy to the programme, which would otherwise have been missing if the programme was portrayed simply as an externally imposed set of disciplines. He performed the function of “mediator” to effectively administer the government’s relations with the IMF and the WB. These organisations also needed him because not only would he effectively translate policy ideas and policy paradigms into domestic policy but also he would facilitate policy formulation and implementation. This, in turn, would prevent both a debtor moral hazard and a “road accident” similar to one that happened in the design and implementation of the previous programme.

According to the former Mission Chief to Turkey Juha Kahkonen, Dervis wanted to change the way business was done in Turkey: “He was the outsider, not your usual politician”. Arguably, without such a “policy entrepreneur” Turkey could not develop trust on the part of external anchors, which was necessary to attain large-scale financial assistance without which it would have been very difficult to generate a successful restructuring process.

Oztrak agreed with the impact Dervis had on the fortunes of the programme: “A leader like Dervis made a lot of difference because he could communicate with the IMF on every level and he had the ability to convince them. It is very important to be able to explain yourself to the IMF at every level. Dervis had these contacts”.

Although Dervis was formally a member of the coalition government with strong affinities to the Prime Minister’s party, he was an above politics figure at the same time. His role was a kind of technocrat who was brought into office, not as an elected politician or a party member. However, Dervis positioned himself in Turkey’s domestic politics as a ‘social democrat’ and used this concept as a necessary part of building a broad-based, pro-reform coalition that incorporated the winners of the reform process and tried to compensate the losers to a certain extent. He played a critical role in terms of forming a bridge between the domestic political sphere of the country and the international financial community. Dervis described his involvement in the following way:

“There was a pro-reform bureaucracy already in existence in Turkey and they were waiting for all these reforms. My contribution was to bring them together as a
coherent whole. I haven’t invented any of these on my own. I was making sure the reforms were consistent, and their timings were right. One of my jobs was to convince politicians on the necessity of implementation of reforms. My other function was resource mobilisation, to find the necessary financing needs of the country during the crisis”.

There were other factors at force making Dervis’ job a little easier. The favourable external environment facilitated the restructuring process. According to Oztrak, the low amount of liquidity in the market contributed to the implementation of the programme: “The speeches made by ministers were having an important effect on markets. Few ministers had to resign as a result”. The low liquidity acted as a government disciplining mechanism. In the fourth quarter of 2001, the international liquidity increased and the economy was healed. The increase in capital inflow gave confidence to the government. “They started listening to the IMF and the bureaucrats less and less. As the pull factor turns into a push factor, the markets showed a blind eye to what was happening inside. The discipline was loosened particularly in the structural reform area”. Nevertheless, the capital inflows helped to relax the country’s constraints and helped programme implementation at the outset, despite causing a loss of discipline later on.

According to Hugh Bredenkamp, the IMF’s resident representative to Turkey, there was an element of good luck in the implementation: “It has been a very good external global environment, for Turkey and emerging markets in general. Lots of finance, no big crises for the past three-four years that could have had knock on affects in Turkey”.

The newness of the AK Party in government after the 2002 elections- *time in power* in political economy terms- also had a contributing effect to programme implementation. Bredenkamp believed that the fact that the AKP government comprised a totally new cast of characters made a good difference: “There were people who had never been in government before. The party itself had never been in government. Therefore, they brought a refreshing outlook. They had the willingness to take what was working and to stick with it. They did not assume that they knew better, and did not change everything around”.

125
5.3. Programme Implementation in Other Countries

Six programme countries emerged as a result of the residual analysis of the econometric study in Chapter 5. The interruption took place in these programmes, but could not be captured by the econometric model. On the other hand, the model seemed to predict no-interruption rather well, as indicated by the small magnitude of negative residuals.

This section looks into these six countries where poor implementation observed by the IMF and resulted in the cancellation of programmes. The aim is to try and find similar political economy characteristics to those identified with the Turkey case study. By doing so, it will be possible to get some generalised results that would usefully complement the econometric study.

The examination of events surrounding programme interruptions lent itself to two main political economy variables as having a significant influence over the outcome of programme implementation: the strength of veto players and political instability. 29

29 In Kyrgyzstan and Jordan, the veto players and political instability links were not very direct. The programmes seem to have gone off track as a matter of principle on the IMF’s part. Kyrgyzstan’s Poverty Reduction and Growth Facility (PRGF) programme was approved in June 1998, and was worth about US$100 million. In July of 2001, the Fund decided not to disburse the final tranche of US$35 million. The reason for withholding of the IMF tranche was related to the decision by Kyrgyz authorities to reduce top tax rates on corporate profits and individual incomes by about two-thirds. The president had signed the measure in July without consulting the IMF. Although Kyrgyzstan’s poverty reduction strategy paper, released weeks before the cut, had called for tax revenues to increase from 13.3 percent relative to GDP to 14.2 percent in 2005. Following meetings with Kyrgyz government representatives in mid-September, the IMF announced another three-year programme with US$90 million credit.

Jordan signed the EFF in February 1996, which was allowed to lapse in 1998 in the aftermath of data revisions that cast doubt on the credibility of programme monitoring. IMF management called for a series of internal reviews and subsequently commissioned an independent inquiry into the episode. Meanwhile IMF staff and the authorities were unable to agree on measures to bring the programme back on track; no further reviews (beyond the fourth) were completed, and the EFF was allowed to lapse.
In July 1998, Guyana signed a three-year programme with the IMF, shortly after the national elections were held. The IMF supported programme combined both the Enhanced Structural Adjustment Facility (ESAF) and the Poverty Reduction and Growth Facility (PRGF) with a credit line of about US$70 million.

However, the agreement was followed by political unsteadiness over the reliability of election results. The president, Janet Jagan’s party - People’s Progressive Party (PPP) won 55 percent of seats in the parliament. The main opposition party, People’s National Congress (PNC), which won just under 40 percent of the vote, disputed the results, alleging electoral fraud. Public demonstrations and some violence followed, until a Caribbean Community (CARICOM) negotiated an accord between the two parties, calling for an international audit of the election results, a redrafting of the constitution, and elections under the constitution within three years.

The pace of structural reform inevitably slowed down amidst this political tension. Slippages in fiscal and structural policies led the program off track in the first half of 2001, and the programme’s midterm review could not be completed. So, just before the 2001 elections took place, the IMF suspended the ESAF/PRGF programme with 46 percent disbursement rate. After the 2001 elections, Guyana entered into a new three-year arrangement under the IMF’s PRGF programme supported by a credit line of US$73 million.

The degree of political instability was even more serious in the case of the Democratic Republic of Congo (DRC). Zaire, as it was named at the time, entered into a three-year ESAF programme with the IMF in June 1996. By the end of 1996, it had made substantial progress in implementing targeted reforms. It made significant strides toward macroeconomic stabilization through improving public finances and restructuring external debt. Planned privatizations of key state organisations, primarily telecommunications and transportation monopolies, were launched. The reform programme came to a halt, however, in May 1997.

In May 1997, the Alliance of Democratic Forces for the Liberation of Congo (AFDL), supported by Rwanda and Uganda, led by Laurent Kabila, overthrew the regime of Mobutu Sese Seko. Kabila declared himself president, consolidated power around
himself and the AFDL, and renamed the country the Democratic Republic of Congo (DRC). The political turmoil was followed by the armed conflict, which broke out in August 1998, and relations with the IMF and World Bank were put into complete disarray.

In Indonesia both of the above political economy factors were at play. The Asian crisis conditions led to widening distrust of the people to the authoritarian regime led by Soharto. Under domestic pressures, Soharto invited the IMF and signed the first letter of intent in October 1997. It was believed that inviting the IMF would restore confidence both at the domestic and international levels and furthermore would help to reduce speculative attacks against the currency. In October 1997, Indonesia and the International Monetary Fund (IMF) signed a three-year Stand-By agreement aimed at macroeconomic stabilization and structural reform. The programme envisaged tight monetary policy, reducing subsidies, tax reform, bank restructuring, import liberalisation and privatisation of state-owned enterprises.

The programme success, however, was strongly jeopardised by vested interest groups. For example, the Indonesian government, based on the LOI, established the Indonesian Banking Restructuring Agency (IBRA) to manage privatization and bank restructuring. The IBRA achieved only 30 percent of restructuring. Moreover, most of the privatised assets were illicitly transferred back to its former bankrupt owners and to the inner-circle of the government.

The deteriorating economy led to riots throughout the country and Suharto was forced to resign in May 1998. As a result, the three-year programme signed in October 1997 had been driven off track by social disturbances and political change. A new EFF programme was signed in August 1998, under the newly elected President BJ Habibie.

The Philippines also signed an IMF programme as the Asian crisis unfolded, and entered into a two-year Stand-by agreement in April 1998. The programme was on track and the momentum of the policy was maintained until 2000. But, over time policy slippages, both fiscal and structural, led the programme to end without the last review being completed in March 2000. The weakening of the reform process has been largely attributed to strong political resistance by veto players to implementing some key structural reforms (IEO, 2002). The Philippine’s political system required a strong political
commitment of both executive and legislative branches to ensure the passing of reform legislation. While, the programme was negotiated between the IMF staff and the executive branch, the implementation of it stalled in Congress or ran into judicial challenges.

The majority of the outlier cases support findings of the Turkish case, suggesting a strong link between vested interests, political instability and programme interruption.

5.4. Conclusion

The case study methodology in the form of a series of interviews conducted in Turkey and in Washington D.C., revealed a magnitude of perspectives on the implementation of Fund programmes in Turkey. The policy makers, programme negotiators, bureaucrats, interest groups and IMF staff each offered their own ideas about various factors affecting Turkey’s programme record. Table 5.1. shows each participant’s evaluation of important factors, while Figure 5.7 offers a break-down of these variables.

It is possible to interpret Table 5.1 in various ways. Firstly, it is possible to see from the table that the significance of variables differs between the 1999 and the 2002 programmes. While initial economic factors and programme design matters in the 17th Stand-By; the US support, a favourable global environment and IMF commitment seem to of consequence in the 18th Stand-By. Nevertheless, factors such as EU criteria, interest groups and government ownership are present in both episodes. This distinct difference between two consecutive programmes in one country is testament enough to the need for a subtler approach required in the analysis of programme implementation.

Secondly, an interesting picture appears when we group the participants’ responses by their affiliation. Members of the government, bureaucrats and the IMF staff seem to have differing views on factors affecting implementation. Interestingly though, the bureaucrats’ and the IMF staff’s views seem to be more aligned with each other, while the politicians and the representatives of interest groups seem to have similar views on why programmes worked (or did not work). For example, Finance Minister Sumer Oral would not accept the weakening of the government’s ownership, or would acknowledge the impact of vested interests on the government. While, Bayram Meral, leader of the labour
Table 5.1. The Participants’ Evaluation of Implementation Determinants

<table>
<thead>
<tr>
<th>Variables Affecting Implementation</th>
<th>Government</th>
<th>IMF Staff</th>
<th>Bureaucrats</th>
<th>SIGs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Initial Economic Factors</td>
<td>Kemal Dervis-Oral-Prime Minister of Economic Affairs (18th Stand By)</td>
<td>Carlo Cottarelli-Mission Chief (18th Stand By)</td>
<td>Hugh Bredenkamp-Resident Mission Chief (18th and 19th Stand By)</td>
<td>Gazi Erce-Governor of the Central Bank (17th Stand By)</td>
</tr>
<tr>
<td>Crisis</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>-</td>
</tr>
<tr>
<td>(Ambitious) Programme Design</td>
<td>-</td>
<td>-,+</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Favorable External Environment</td>
<td>+</td>
<td></td>
<td>+</td>
<td></td>
</tr>
<tr>
<td>European Union Criteria</td>
<td>+</td>
<td></td>
<td>+</td>
<td></td>
</tr>
<tr>
<td>US Support</td>
<td>+</td>
<td>-</td>
<td>+</td>
<td></td>
</tr>
<tr>
<td>IMF Commitment</td>
<td>+</td>
<td>-</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Size of IMF Loan</td>
<td>-</td>
<td>-,+</td>
<td>+</td>
<td></td>
</tr>
<tr>
<td>Government Ownership &amp; Commitment</td>
<td>+ and -</td>
<td>+</td>
<td>+ then -</td>
<td>-</td>
</tr>
<tr>
<td>Country Ownership</td>
<td>+</td>
<td>+ then -</td>
<td>+</td>
<td></td>
</tr>
<tr>
<td>SIG Influence</td>
<td>-,+</td>
<td></td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Weak Institutions</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Political Cohesion</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Political Instability</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Leadership of Dervis</td>
<td></td>
<td>+</td>
<td></td>
<td>+</td>
</tr>
<tr>
<td>Less Time in Power</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Bayram Meral-Leader of Labor Union Confederation
Figure 5.7. Distribution of Factors of Programme Implementation in Turkey

<table>
<thead>
<tr>
<th>Determinants of Implementation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Domestic Political Economy Factors</td>
</tr>
<tr>
<td>Government Ownership &amp; Commitment</td>
</tr>
<tr>
<td>Country Ownership</td>
</tr>
<tr>
<td>SIG Influence</td>
</tr>
<tr>
<td>Weak Institutions</td>
</tr>
<tr>
<td>Political Cohesion</td>
</tr>
<tr>
<td>Political Instability</td>
</tr>
<tr>
<td>Leadership of Dervis</td>
</tr>
<tr>
<td>Less Time in Power</td>
</tr>
<tr>
<td>IMF Related Factors</td>
</tr>
<tr>
<td>IMF Commitment</td>
</tr>
<tr>
<td>Size of IMF Loan</td>
</tr>
<tr>
<td>(Ambitious) Programme Design</td>
</tr>
<tr>
<td>External Factors</td>
</tr>
<tr>
<td>Favorable External Environment</td>
</tr>
<tr>
<td>European Union Criteria</td>
</tr>
<tr>
<td>US Support</td>
</tr>
<tr>
<td>Initial Economic Factors</td>
</tr>
<tr>
<td>Initial Economic Factors</td>
</tr>
<tr>
<td>Crisis</td>
</tr>
</tbody>
</table>

* Number of times each variable has been cited by participants
union confederation, admitted the influence of interest groups, but pointed towards corruption and powerful business lobbies, not themselves.

On the whole, judging by the number of times each variable has been referred to; domestic political economy factors seemed to dominate the fate of a successful programme implementation, at 57 percent. It is followed by IMF related factors and initial economic factors, both standing at 17 percent. External factors such as favourable global environment or US support have an impact of 9 percent. In the domestic political economy group, the influence of interest groups was the most commonly mentioned variable on programme implementation. The second mostly cited factor was the economic crisis. The government and the IMF’s ownership, institutions and political cohesion followed as the most common reasons put forward for programme success or failure.

The over-riding variables suggested throughout the thesis, such as the importance of interest groups, political cohesiveness, programme ownership by the government and the IMF were all supported by case study findings. Through in-depth examination of the Turkish case, it was also possible to assess these variables from different aspects. In the case of interest groups, for instance, it was possible to look into the groups both inside and outside the parliament, as well as at their varying degrees of veto power, as the political agenda changed day to day. Similarly, the concept of ownership examined in the context of politicians’ ownership, in addition to country and the IMF ownership.

Moreover, numerous other factors which were interacting with these variables were discovered through the Case. There were some country specific effects, such as the EU conditionality and US support which reinforced the view that IMF conditionality itself is never enough to galvanise support for reforms. Another variable suggested from the Case was the importance of a good leadership. In the Turkish context, the crisis played the most important role in reinforcing implementation. This effect could not be found in the form of initial economic conditions in an econometric study. Simply because, the causal link was more of a psychological one, and was not necessarily based on a macroeconomic equation. The devastating effect of the crisis created a huge scare and essentially brought the ownership together in the Turkish context.
Implementing the combined macroeconomic policy and structural reform agenda was possible in Turkey, despite the opposition of groups with vested interests, because it was generally understood that the alternative would have had consequences that were more far-reaching. While there may not have been strong support for reforms from interest groups, the opposition was less vigorous than in a non-crisis situation. Turkey’s positive experience was largely aided by the fact that as much time was given to communicating reform strategies to the public, as to actually implementing them. The leadership’s ability to mobilise much of the civil society in support of reforms was crucially important. In addition, the IMF was flexible in terms of programme design, recognizing that outcomes, although perhaps not exactly as planned, were still favourable and, therefore, merited support. Turkey’s experience also shows how reformers can seize the moment at a time of crisis and achieve structural reforms that would be extremely difficult in normal times.

The Turkish experience has provided an interesting case for the study of the elusive triangle: the relationship between the state, society, and the international system and the precise nature of their interaction at a particular point in time. The Case Study’s results were interesting in the sense that, not only did it reinforce the suggestions of the theory of implementation and the econometric study, but also offered new explanations for programme implementation that could not be captured otherwise. The variables identified through the case study included not only a range of domestic political economy factors, and the nature of IMF commitment, confirming the theory and econometric evidence, but also other idiosyncratic factors such as the existence of a crisis, the EU anchor and influential technocrats.

The thesis hypothesised, at the outset, that domestic politics have performed a crucial role in shaping the economic policy and the manner of the interaction between the government, the IMF and interest groups. Any attempt to investigate the dynamics of policy making within the narrow framework of the government and the IMF, is likely to generate a highly inadequate and misleading picture. The case study of Turkey and the subsequent examination of other country experiences clearly demonstrate that political economy characteristics of countries do play a vital role in determining the success of programme implementation. A role, which has various layers and dimensions, hence, is better examined in the context of an exhaustive case study.
5.A. Appendix to Chapter V
5.A.1. Arrangements with the IMF: 1948-2005

<table>
<thead>
<tr>
<th>Date</th>
<th>Cancellation</th>
<th>Months</th>
<th>Number of Months</th>
<th>Amount (SDR Millions)</th>
<th>Disbursed (SDR Millions)</th>
<th>Disbursement rate (%)</th>
<th>Arrangement type</th>
</tr>
</thead>
<tbody>
<tr>
<td>1948</td>
<td>12</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>100</td>
<td>Gold tranche</td>
<td></td>
</tr>
<tr>
<td>1953</td>
<td>12</td>
<td>10</td>
<td>10</td>
<td>10</td>
<td>100</td>
<td>Gold tranche</td>
<td></td>
</tr>
<tr>
<td>1954</td>
<td>12</td>
<td>20</td>
<td>20</td>
<td>20</td>
<td>100</td>
<td>Gold tranche</td>
<td></td>
</tr>
<tr>
<td>1957</td>
<td>12</td>
<td>13.5</td>
<td>13.5</td>
<td>13.5</td>
<td>100</td>
<td>Gold tranche</td>
<td></td>
</tr>
<tr>
<td>1958</td>
<td>12</td>
<td>25</td>
<td>25</td>
<td>25</td>
<td>100</td>
<td>Gold tranche</td>
<td></td>
</tr>
<tr>
<td>1961</td>
<td>12</td>
<td>37.5</td>
<td>16</td>
<td>16</td>
<td>42.6</td>
<td>Stand-By</td>
<td></td>
</tr>
<tr>
<td>1962</td>
<td>9</td>
<td>31</td>
<td>15</td>
<td>15</td>
<td>48.4</td>
<td>Stand-By</td>
<td></td>
</tr>
<tr>
<td>1963</td>
<td>11</td>
<td>21.5</td>
<td>21.5</td>
<td>21.5</td>
<td>100</td>
<td>Stand-By</td>
<td></td>
</tr>
<tr>
<td>1964</td>
<td>11</td>
<td>21.5</td>
<td>19</td>
<td>19</td>
<td>88.4</td>
<td>Stand-By</td>
<td></td>
</tr>
<tr>
<td>1965</td>
<td>12</td>
<td>21.5</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>Stand-By</td>
<td></td>
</tr>
<tr>
<td>1966</td>
<td>12</td>
<td>21.5</td>
<td>21.5</td>
<td>21.5</td>
<td>100</td>
<td>Stand-By</td>
<td></td>
</tr>
<tr>
<td>1967</td>
<td>11</td>
<td>27</td>
<td>27</td>
<td>27</td>
<td>100</td>
<td>Stand-By</td>
<td></td>
</tr>
<tr>
<td>1968</td>
<td>9</td>
<td>27</td>
<td>27</td>
<td>27</td>
<td>100</td>
<td>Stand-By</td>
<td></td>
</tr>
<tr>
<td>1969</td>
<td>12</td>
<td>27</td>
<td>10</td>
<td>10</td>
<td>37</td>
<td>Stand-By</td>
<td></td>
</tr>
<tr>
<td>1970</td>
<td>12</td>
<td>90</td>
<td>90</td>
<td>90</td>
<td>100</td>
<td>Stand-By</td>
<td></td>
</tr>
<tr>
<td>1978</td>
<td>1979</td>
<td>24</td>
<td>300</td>
<td>90</td>
<td>3</td>
<td>Stand-By</td>
<td></td>
</tr>
<tr>
<td>1979</td>
<td>1980</td>
<td>12</td>
<td>250</td>
<td>230</td>
<td>92</td>
<td>Stand-By</td>
<td></td>
</tr>
<tr>
<td>1980</td>
<td>36</td>
<td>1250</td>
<td>1250</td>
<td>1250</td>
<td>100</td>
<td>Stand-By</td>
<td></td>
</tr>
<tr>
<td>1983</td>
<td>12</td>
<td>225</td>
<td>56.3</td>
<td>25</td>
<td>25</td>
<td>Stand-By</td>
<td></td>
</tr>
<tr>
<td>1984</td>
<td>1984</td>
<td>12</td>
<td>225</td>
<td>169</td>
<td>75</td>
<td>Stand-By</td>
<td></td>
</tr>
<tr>
<td>1994</td>
<td>1996</td>
<td>14</td>
<td>610</td>
<td>460</td>
<td>75</td>
<td>Stand-By</td>
<td></td>
</tr>
<tr>
<td>1999</td>
<td>36</td>
<td>15038</td>
<td>11738</td>
<td>78</td>
<td>Stand-By and EFF</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2002</td>
<td>36</td>
<td>12821</td>
<td>11914</td>
<td>92.9</td>
<td>Stand-By</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2005</td>
<td>36</td>
<td>6662</td>
<td>Continuing</td>
<td>6662</td>
<td>Stand-By</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

5.A.2. The Liquidity Generation Mechanism under the 1999 Stabilisation Programme

The Turkish disinflation programme adopted the monetary approach to balance of payments as its theoretical foundation for the determination of the liquidity generation mechanism. This approach expects the real exchange rate to be in long-run equilibrium at its purchasing power parity level, and maintains that the domestic supply of money be “endogenised” in a regime of open capital account.

Accordingly, the programme limited the monetary expansion to changes in the net foreign asset (NFA) position of the Central Bank, and fixed the Bank’s stock of net domestic assets (NDA) at its December 1999 level. It was further announced that the Central Bank would be allowed to change its net domestic asset position within a band of +, - five percent of the monetary base, to be revised at three month intervals. The implication of the rule necessitated the following identity:

Monetary Base = Net Foreign Assets + Net Domestic Assets

As a result of the restrictions set on the upper ceilings of the net domestic assets, the programme limited the monetary expansion to increases in the stock of net foreign assets. This means that, the Central Bank would not be able to increase the stock of money supply by, for example, borrowing foreign exchange from the banking system or by using the IMF’s credit facility. Thus, the Central Bank would be able to issue Turkish lira and expand its monetary base only by purchasing foreign currency from the banking sector in manner where its foreign liabilities would not be increased.

According to this rule, the liquidity generation mechanism available to the Central Bank practically entailed a monetary regime of a semi-currency board reminiscent of its Argentine counterpart. Within this mechanism, the monetary policy is restricted to the
direction of the foreign exchange flows, and, as such, the most important element- to be able to sustain the liquidity needs of the economy- would depend upon the proper continuation of the foreign credit flow into the system.

The expansion of the monetary base was ultimately linked to the foreign exchange inflows, indicating that the Central Bank was committed to the strict rule of no-sterilisation throughout the programme. Therefore, it was expected that the available liquidity in the domestic economy would be managed by the interest signals inherent in financial markets; rising domestic interest rates would invite foreign inflows, allowing for monetary expansion. Excess liquidity would, in turn, be signalled through lower rates of interest, allowing foreign capital outflows to balance the equilibrium level of liquidity in the domestic financial markets.

Crisis conditions emerged in due course, mainly as a result of the increasing fragility in the financial system. This fragility was generated by the uncontrolled and excessively volatile capital flows with an exceedingly speculative component. Under the liberalised account system, capital inflows intrinsically necessitated a higher rate of return on domestic assets in comparison to the rate of depreciation. This commitment stimulated further foreign capital inflow, and the domestic currency continued to appreciate-inviting an even higher level of speculative capital inflow.
### 5.A.3. Main Economic Indicators: 1980-2004

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP Growth</td>
<td>-2.4</td>
<td>4.9</td>
<td>3.6</td>
<td>5</td>
<td>6.7</td>
<td>4.2</td>
<td>7</td>
<td>9.5</td>
<td>2.1</td>
<td>0.3</td>
<td>9.3</td>
<td>0.9</td>
<td>6</td>
<td></td>
</tr>
<tr>
<td>Inflation, WPI %</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>69.6</td>
<td>54.8</td>
<td>58</td>
<td>65.5</td>
<td></td>
</tr>
<tr>
<td>Domestic debt / GNP</td>
<td>13.6</td>
<td>12.4</td>
<td>12.6</td>
<td>22.8</td>
<td>20.9</td>
<td>19.7</td>
<td>20.5</td>
<td>23</td>
<td>22</td>
<td>18.2</td>
<td>14.4</td>
<td>15.4</td>
<td>17.6</td>
<td>1</td>
</tr>
<tr>
<td>External debt / GNP</td>
<td>19.34</td>
<td>20.21</td>
<td>25.06</td>
<td>31.8</td>
<td>34.96</td>
<td>38.09</td>
<td>42.7</td>
<td>46.79</td>
<td>45.02</td>
<td>38.82</td>
<td>32.59</td>
<td>33.61</td>
<td>35.05</td>
<td>3</td>
</tr>
<tr>
<td>Total debt / GNP</td>
<td>32.94</td>
<td>32.61</td>
<td>37.66</td>
<td>54.6</td>
<td>55.86</td>
<td>57.79</td>
<td>63.2</td>
<td>69.79</td>
<td>67.02</td>
<td>57.02</td>
<td>46.99</td>
<td>49.01</td>
<td>52.65</td>
<td>5</td>
</tr>
</tbody>
</table>


| Export volume, Million US$ | 2910 | 4704 | 5890 | 5905 | 7389 | 8255 | 7583 | 10322 | 11929 | 11625 | 12959 | 13593 | 14715 | 15   |

| Net International Reserves, Million US$ | 1209 | 1658 | 1979 | 2089 | 3482 | 3279 | 4347 | 5212 | 6428 | 9283 | 11387 | 12250 | 15252 | 17   |

138
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP Growth</td>
<td>-5.5</td>
<td>7.2</td>
<td>7</td>
<td>7.5</td>
<td>3.1</td>
<td>-4.7</td>
<td>7.4</td>
<td>-7.5</td>
<td>7.8</td>
<td>5.8</td>
<td>8.9</td>
</tr>
<tr>
<td>Inflation, WPI %</td>
<td>118.4</td>
<td>88.5</td>
<td>78.7</td>
<td>80.5</td>
<td>70.1</td>
<td>52.6</td>
<td>50.9</td>
<td>66.2</td>
<td>51.3</td>
<td>23.9</td>
<td>12.2</td>
</tr>
<tr>
<td>Domestic debt / GNP</td>
<td>20.6</td>
<td>17.3</td>
<td>21</td>
<td>21.4</td>
<td>21.7</td>
<td>29.3</td>
<td>29</td>
<td>69.2</td>
<td>54.5</td>
<td>54.5</td>
<td>52.3</td>
</tr>
<tr>
<td>External debt / GNP</td>
<td>48.29</td>
<td>41.93</td>
<td>43.45</td>
<td>43.74</td>
<td>46.66</td>
<td>55.58</td>
<td>59.28</td>
<td>78</td>
<td>71.98</td>
<td>60.75</td>
<td>54.03</td>
</tr>
<tr>
<td>Total debt / GNP</td>
<td>68.89</td>
<td>59.23</td>
<td>64.45</td>
<td>65.14</td>
<td>68.36</td>
<td>84.88</td>
<td>88.28</td>
<td>147.2</td>
<td>126.48</td>
<td>115.25</td>
<td>106.33</td>
</tr>
<tr>
<td>Current Account Balance,</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Export volume, Million US$</td>
<td>18106</td>
<td>21636</td>
<td>32067</td>
<td>32110</td>
<td>30662</td>
<td>28842</td>
<td>30721</td>
<td>31334</td>
<td>36059</td>
<td>47253</td>
<td>63167</td>
</tr>
<tr>
<td>Net International Reserves,</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Million US$</td>
<td>16514</td>
<td>23923</td>
<td>24966</td>
<td>29823</td>
<td>29499</td>
<td>34128</td>
<td>34159</td>
<td>30192</td>
<td>38067</td>
<td>44957</td>
<td>53788</td>
</tr>
</tbody>
</table>

Source: State Institute of Statistics, Turkey

<table>
<thead>
<tr>
<th>Date</th>
<th>Event Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>18 April 1999</td>
<td>Parliamentary Elections held. Coalition government of Democratic Left Party (DSP), Nationalist Action Party (MHP) and Motherland Party (ANAP) came to power.</td>
</tr>
<tr>
<td>10 December 1999</td>
<td>Turkey’s candidacy for full membership was endorsed at the Helsinki Summit of European Union</td>
</tr>
<tr>
<td>19 December 1999</td>
<td>A three year Stand-By Programme agreed with the IMF (17th Stand-By Agreement of Turkey)</td>
</tr>
<tr>
<td>10 April 2000</td>
<td>First Review of the 17th Stand-By completed</td>
</tr>
<tr>
<td>22 June 2000</td>
<td>Second Review of the 17th Stand-By completed</td>
</tr>
<tr>
<td>31 August 2000</td>
<td>The Banking Supervision and Regulation Agency became operational</td>
</tr>
<tr>
<td>20 November 2000</td>
<td>Banking crisis started</td>
</tr>
<tr>
<td>06 December 2000</td>
<td>The Supplemental Reserve Facility of the IMF was granted, and capital outflow stopped. Third and Fourth Reviews of the 17th Stand-By completed</td>
</tr>
<tr>
<td>30 January 2001</td>
<td>Fifth Review of the 17th Stand-By completed</td>
</tr>
<tr>
<td>19 February 2001</td>
<td>Public dispute between President Sezer and Prime Minister Ecevit. The short term interest rates rocketed to over 5000 percent</td>
</tr>
<tr>
<td>23 February 2001</td>
<td>The exchange rate based stabilisation programme failed, the lira left to float</td>
</tr>
<tr>
<td>02 March 2001</td>
<td>Dervis appointed as the Minister of Economic Affairs</td>
</tr>
<tr>
<td>15 May 2001</td>
<td>“Strong Economy Programme” announced by Dervis</td>
</tr>
<tr>
<td>03 May 2001</td>
<td>Sixth and Seventh Review of the 17th Stand-By completed</td>
</tr>
<tr>
<td>31 March 2001</td>
<td>State Minister Yuksel Yalova resigned over disagreements over Tobacco Law</td>
</tr>
<tr>
<td>26 June 2001</td>
<td>Eighth Review of the 17th Stand-By completed</td>
</tr>
<tr>
<td>17 July 2001</td>
<td>Minister Enis Oksuz resigned over disputes on Telekom privatisation</td>
</tr>
<tr>
<td>31 July 2001</td>
<td>Ninth Review of the 17th Stand-By completed</td>
</tr>
<tr>
<td>20 November 2001</td>
<td>Tenth and last review of the 17th Stand-By completed</td>
</tr>
<tr>
<td>Date</td>
<td>Event</td>
</tr>
<tr>
<td>-------------------</td>
<td>------------------------------------------------------------------------</td>
</tr>
<tr>
<td>18 January 2002</td>
<td>New three-year Stand-By agreement with the IMF signed (18th Stand-By agreement of Turkey)</td>
</tr>
<tr>
<td>03 April 2002</td>
<td>First Review of the 18th Stand-By completed</td>
</tr>
<tr>
<td>19 June 2002</td>
<td>Second Review of the 18th Stand-By completed</td>
</tr>
<tr>
<td>30 July 2002</td>
<td>Third Review of the 18th Stand-By completed</td>
</tr>
<tr>
<td>10 August 2002</td>
<td>Kemal Dervis resigned from the government</td>
</tr>
<tr>
<td>End August 2002</td>
<td>The legislation of financial sector reform, agricultural reform, and privatisation accomplished, satisfying both IMF conditionality and EU’s Copenhagen criteria</td>
</tr>
<tr>
<td>03 November 2002</td>
<td>Parliamentary elections, the AKP majority government came to power and declared they would continue implementing the Stand-By programme</td>
</tr>
<tr>
<td>12-13 December 2002</td>
<td>Copenhagen Summit of the European Union where the decision to start accession talks with Turkey was taken, on the condition that Turkey meets all the Copenhagen criteria by December 2004</td>
</tr>
<tr>
<td>05 April 2003</td>
<td>Fourth Review of the 18th Stand-By completed</td>
</tr>
<tr>
<td>09 April 2003</td>
<td>Parliament passed first phase of direct tax reform into law, in line with programme's performance criterion</td>
</tr>
<tr>
<td>25 July 2003</td>
<td>Fifth Review of the 18th Stand-By completed</td>
</tr>
<tr>
<td>31 October 2003</td>
<td>Turk Telekom privatisation plan target missed for the third time (Programme benchmark, previous targets: April 2002, end-November 2002). Sixth Review of the 18th Stand-By completed</td>
</tr>
<tr>
<td>02 April 2004</td>
<td>Parliament approved the second phase of direct tax reform completing a prior action for the seventh review. Seventh Review of the 18th Stand-By completed</td>
</tr>
<tr>
<td>15 July 2004</td>
<td>Eighth and last review of the 18th Stand-By completed</td>
</tr>
</tbody>
</table>
5.A.5. List of Interview Participants

Kemal Dervis- Head of the United Nations Development Programme, Former Economy Minister of Turkey, 2001-2002. 30 minute meeting on 16 February 2006, in New York City.


Sumer Oral- Former Finance Minister of Turkey, 1999-2002. 120 minute meeting on 14 April 2006, in Ankara.

Engin Akcakoca- Former Head of Banking Regulation and Supervision Agency of Turkey, 2001-2003. 30 minute meeting on 20 April 2006, in Washington D.C.

Bayram Meral- Member of Turkish Parliament, 2002 to date, Former Secretary-general of the Turkish Confederation of Labor Unions, 1992-2002. 100 minute meeting on 13 April 2006, in Ankara.


Carlo Cottarelli- Former Mission Chief of IMF to Turkey, 1999-2001. 50 minute meeting on 23 February 2006, in Washington D.C.

Hugh Bredenkamp- Senior Resident Representative of IMF to Turkey, 2002 to date, 90 minute meeting on 13 April 2006, in Ankara.


Marcelo Selowsky- Assistant Director of the Independent Evaluation Office of the IMF, 2001 to date. 50 minute meeting on 21 February 2006, in Washington D.C.

Note: In addition to above interviewees, academics Professor Ziya Onis, Nazif Ekzen and Senior Tax Auditor of Turkey Ministry of Finance, Ahmet Veyssel Ozer provided their valuable comments.
5.A.6. The Interview Guide

1. **Pre-programme condition.**

- Background info: Initial/external macroeconomic factors. What are the factors leading to the adoption of a programme supported by the IMF? Domestic political economy factors. What are the prominent sources of power in the country. how are they organised and what is the extent of their influence on the government?

- Government’s position: What does the government expect to gain from this arrangement? What does the government expect to lose/sacrifice in return for the benefits? How would you rate and explain the government’s ownership of this programme? Are there any opposition/resentment within the government towards the arrangement? If so, in which areas?

- The Special Interest Groups’ (SIG) position: What do the SIGs expect to gain and/or lose from this arrangement? How would you rate and explain the SIGs’ ownership of this programme?

- The Fund’s position: What is the Fund’s motivation to go into the arrangement? (the Fund’s cost-benefit analysis) How would you rate and explain the Fund’s ownership/involvement of this programme?

- At which points, the conflict is expected? What are the premeditated responses of the involved parties to these conflicts, if any? Is there a threshold of quitting the programme for the government under pressures from the SIGs?

2. **During the programme.**

- The negotiation of the programme: What are the highlights? How long did it take? Leaders’ personal involvement in programme negotiations? What are the conditions of the programme? What are the performance criteria? To what extent the government’s and the Fund’s preferences are aligned? Who is formulating the policies, the Fund or government officials? Do they include one another into their calculations? To what extent? The extent to which the programme is designed in order to obtain support from previously opposing groups?

- The implementation: To what extent the programme is implemented? Where did the slippages occur? Are they in the expected conflict areas?

- How are the expectations of each party realised at the end?

- Has an optimum point, where all parties would gain, existed at the course of the programme? What would it have been like?

- What was the SIGs’ response to reforms? What did the government and the Fund do to neutralise/convince the SIGs?

- The breakdowns of programmes usually attributed to the poor diagnosis of economic conditions and/or slippages in implementation. How did it work for this particular programme?
Chapter 6

Concluding Remarks

"Economic problems are almost invariably political problems"

Michael Deppler

This thesis assesses the determinants of IMF programme implementation on three fronts using complementary methodological approaches. Chapter 2 reviews the IMF programme effectiveness literature and demonstrates that the literature overlooked the extent to which programmes were implemented. It then presents a record on implementation using various assessment methods. Chapter 3 presents selected theoretical work most appropriate to the analysis of programme implementation and identifies a range of economic, political and institutional factors that may be expected to exert an influence on programme implementation. New econometric evidence is offered in Chapter 4. It estimates random effects regressions on a pooled sample for tobit and probit specifications, for various implementation measures. Chapter 5 tests the findings from the theoretical and econometric work in a case study framework.

A mixed picture emerges from the review of the literature assessing the effects of IMF programmes on macroeconomic policies and final outcomes. Most empirical studies find that Fund programmes improve the balance of payments and the current account, but views on the ultimate output and employment effects are more diverse. This literature also faces significant methodological problems. Obtaining estimates which are closer to the counterfactual is difficult and generates results that are sensitive to the specification of the
counterfactual. Furthermore, the degree of implementation is not taken into account in most of this literature. Poor implementation record discovered through the use of various implementation proxies casts further doubt on the validity of results. Were we to include implementation in effectiveness studies, the consequences of Fund programmes are largely unknown.

Further, poor implementation record suggests that IMF conditionality has not worked as an effective commitment device. If conditionality is designed to send out a signal that governments are committed to economic reform, poor implementation weakens this signal.

A similar implementation pattern can also be observed in the context of World Bank lending. Research by Mosley, Harrigan and Toye (Mosley, Harrigan and Toye, 1995) on the World Bank’s policy lending demonstrates that there is no discernible relation between the intensity of conditionality and success in implementation of promised reforms. This finding is supported by the World Bank’s case studies in African countries, which state that conditionality attached to adjustment loans failed to induce policy changes (Devarajan, 2001).

What is the point of negotiating conditionality if it is not implemented? The substantial discussion centred on conditionality needs to take the relevance of its implementation into account. Further research also needs to consider in more detail what components of conditionality have a better implementation record, since this may have implications for the design of conditionality.

The IMF view asserts that ownership will assist in the implementation of programmes, and that it is necessary for the successful execution of Fund conditionality (IMF, 2001b). However, the ownership is not an operational concept and it does not lend itself to solid conclusions that can be tested. It is imperative to look behind ownership and examine variables that influence a government’s commitment to a particular programme of policy reform and its ability to implement it. Therefore, what is really needed is a better understanding of the determinants of implementation that will then enable us to examine how factors related to ownership fit in.
Chapter 3 provides a conceptual framework that builds on recent theoretical work and within which the implementation of IMF programmes may be considered. It examines the application of agency models to the IMF conditionality in the presence of domestic policy constraints.

These models show that conditionality is useful when domestic political systems are imperfect. In such a framework, the authorities facing the IMF are not unitary actors; each economy is characterized by special interest groups. Policy choices thus reflect the concerns of diverse constituencies in the domestic economy following a non-cooperative game where the authorities, the IMF, the veto players and the SIGs strategically interact (Mayer and Mourmouras, 2005; Drazen, 2002).

The political economy variables that could be identified from the formal theory could be partitioned into three groups. The SIG related variables include the strength of interest groups, the characteristics of political institutions, and the interaction of political institutions and interest groups. The government related variables point to the responsiveness of the government, to general welfare as well as to electoral pressures. The time horizon of the politician and the size of the constituency are also important factors, as politicians will internalize the positive countrywide welfare effects of policy reforms. The IMF related variables are the size and effectiveness of economic assistance, as well as the strategic importance the Fund attaches to the borrowing country’s welfare.

The suggestions of the theory of implementation underline the importance of the political economic environment of a country implementing a Fund supported programme. However, while political economy variables may play a role in programme implementation, the precise nature of this role is theoretically unclear. One is therefore drawn towards empirical investigation. What factors in practice appear to significantly influence the implementation of IMF programmes, and to what extent is it a political rather than an economic phenomenon?

Chapter 4 undertakes new large sample regression analysis of implementation based on the suggestions of the political economy models. It uses a range of economic and political variables and applies appropriate regression techniques to a large data set covering
95 countries over the period 1992 – 2004. The study estimates random effects regressions on a pooled sample for tobit and probit specifications, considering each implementation measure in isolation. The results suggest that significant determinants of implementation are trade openness, the existence of veto players and the amount of resources committed by the Fund.

The model’s predictive accuracy is much better at explaining cases where programmes are not interrupted than those where they are. Interruption took place and could not be predicted by the model for the following country programmes in the study sample; Indonesia in 1997, Guyana in 1998, Jordan in 1996, the Philippines in 1998, Kyrgyzstan in 1998 and the Congo in 1996. Interestingly, an investigation of the political and economic environment in these countries during the interruption periods supports the over-riding variables suggested throughout the thesis, suggesting a strong link between vested interests, political instability and programme interruption.

The econometric model just about manages to predict non-interruption correctly for Turkey. Between 1992 and 2004, Turkey had three Fund programmes (1994, 1999, 2002), and only the 1994 programme was interrupted. The model’s predicted probability of interruption for Turkey’s 1994 programme is found to be 49 percent. As stated in the case study chapter, Turkey’s 1994 programme was interrupted unexpectedly. Further, while the 1999 and 2002 programmes reached to completion, these were also challenged by numerous political economy factors and by no means were they fully implemented. Therefore, these programmes merit a closer look in the form of a case study in order to strengthen the conclusions of the econometric work.

From amongst the economic variables included in the regressions, only the volume of trade is found to exert a significant effect. Open economies have a better chance of having uninterrupted access to IMF resources. The size of programmes, as measured by the amount of IMF financing in relation to a country’s quota, also emerges as exerting a significant effect on programme interruption. Larger resources appear to assist implementation. In terms of political economy variables, it is found that powerful veto players hinder the implementation of IMF programmes. This finding provides empirical support for the theory of special interests in Chapter 3. Additionally, the veto players data
used in this research comes closer than previous studies to capturing the influence of opposition groups. While conventionally used measures of SIGs generate insignificant results (Joyce, 2003; Dreher, 2003), the veto players measure used in this study gives significant results.

While large sample econometric work offers interesting results in terms of the importance of political economy factors, the precise nature of these will vary from case to case. This is where the case study examination plays an essential role. Chapter 5 complements the theoretical and econometric work, and presents an in-depth investigation of the determinants of programme implementation in Turkey between 1999 and 2004.

The case study methodology in the form of a series of interviews conducted in Turkey and in Washington D.C., reveals a magnitude of perspectives on the implementation of Fund programmes in Turkey. Not only does it reinforce the suggestions of the theory of implementation and the econometric study, but also offers new explanations for programme implementation that could not be captured otherwise.

On the whole, the over-riding variables suggested throughout the thesis, such as the importance of interest groups, political cohesiveness, programme ownership by the government and the IMF are all supported by case study findings. Through in-depth examination of the Turkish case, it was also possible to assess these variables from different aspects. In the case of interest groups, for instance, it was possible to look into the groups both inside and outside the parliament, as well as at their varying degrees of veto power, as the political agenda changed day to day. Similarly, the concept of ownership examined in the context of politicians’ ownership, in addition to country and the IMF ownership.

Moreover, numerous additional factors which were interacting with these variables were discovered through the case study research. There were some country specific effects, such as the EU conditionality, the US support and a good leadership. In the Turkish context, the crisis also played the most important role and brought the ownership
together. Turkey's experience also shows how reformers can seize the moment at a time of crisis and achieve structural reforms that would be extremely difficult in normal times.

Consequently, this body of research demonstrates, both theoretically and empirically, that political economic characteristics of countries play a vital role in programme implementation. Further research needs to focus on formulating a more sophisticated political economy approach to implementation. Given the limitations of large sample data relating to political variables, this is likely to involve collating a series of structured case studies that can more successfully capture idiosyncratic economic and political variables.
Bibliography


Egilmez, Mahfi, 2005. “IMF ile İlişkiler”, Radikal (Turkish Daily), October, 21, 2005


IMF Press Release No. 02/42 on Turkey, September 13, 2002

IMF Staff Reports on Turkey, 2000-2004.


Ivanova, Anna, Wolfgang Mayer, Alex Mourmouras, and George Anayiotas, 2003. "What Determines the Success or Failure of Fund-supported Programs?" IMF Working Paper, 03(8), Washington, D.C.


Radikal (Turkish daily), Dec. 5, 2000.


159


Tsebelis, George, 2001b. "Veto Players and Institutional Analysis." mimeo, Department of Political Science, UCLA.


