Implementation Uncertainty and the Design of IMF Conditionality

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Abstract:

While there is no shortage of studies evaluating the effects of IMF programs, little is known about how Fund programs are designed. This paper addresses this gap in the literature by focusing on the conditions under which the Fund imposes prior actions, which are policy changes that countries must adopt in order for the Executive Board to approve their programs. I find that countries in which previous IMF programs have failed are more likely to have prior actions. In addition, countries with approaching elections and countries with fragile legislative coalitions are also more likely to have prior actions. These findings suggest that the IMF takes into consideration political constraints as well as a borrower's past history in the design of conditionality.

International cooperation takes many forms. Agreements can be bilateral or multilateral, they can be tacit or require creation of an institution to monitor them, and they can have extensive provisions for renegotiation. A substantial literature notes the differences that exists in the forms that international agreements take (Lipson 1991, Abbott and Snidal 2000, Rosendorff and Milner 2001, Koremenos 2001). Additionally, a growing literature focuses on the consequences of these differences in contractual form, arguing that variations in the form of international agreements help explain their sustainability and duration (Koremenos 2005, Williamson 1985, Lake 1999, Leeds and Anac 2005, Downs, Rocke, and Barsoom 1996). Against this backdrop, consider the conditionality that is framed in the letter of intent that countries negotiate with the IMF. Letters of intent vary in terms of the extensiveness of their conditions and also in their structure (Dreher and Vaubel 2001, Gould 2003, Kang 2007). For the IMF, some conditions are so important that they must be implemented by the state *before* the Fund's Executive Board approves the agreement. These conditions are known as *prior actions.*

For scholars seeking to understand how international agreements are constructed, the use of prior actions offers an important window to understand the incentives facing the IMF when it designs agreements. In light of debates surrounding conditionality, more knowledge about how it is designed is essential. In the wake of the East Asian Crisis, there was an extensive debate over whether the conditions were appropriate medicine to address the underlying economic problem (Feldstein 1998, Fischer 1998, Kapur 1998). Some charge that conditionality is based on inappropriate economic models or insufficiently flexible in dealing with unique circumstances (Killick 1995; Sachs 1994; Vaubel 1994; Martin and Bargawi 2005). The increase in the amount and form of conditionality, moving the IFIs into areas outside of their core expertise, has also been noted by recent observers (Kapur 2005, Buira and Babb 2005) and it has been argued that more conditionality is unlikely to produce better outcomes (Bird 2001; Goldstein 2001). A related line of argument suggests that IMF's programs produce poor results because they fail to take into account the political conditions "on the ground" (Sanger 1998; Stiglitz 2002). The process by which IMF programs are negotiated, to the extent that it excludes legislatures and civil society, only reinforces the view that these programs are imposed by Washington rather than being developed by the countries themselves (Martin and Bargawi 2005). Of course, debates about conditionality largely take place because of ongoing concerns about its effectiveness as an instrument in obtaining policy reform. The above issues arise because of concerns about the information that the Fund uses (or does not use) in designing conditionality.

We cannot understand the incentives facing the IMF in designing conditionality without more information on the programs themselves. Unfortunately, much of the existing scholarship on the IMF does little to help us answer this question, as it is generally pitched at an aggregate level -- aimed at understanding when and how states enter programs, when states honor programs, and the consequences that result. For the most part, this literature frames the IMF program itself as a dummy variable; states are either under or not, states either are implementing the program or not. As a result, a different research strategy altogether is necessary to assess whether domestic conditions shape the design of conditionality.

Below, I assess how the IMF designs conditionality by focusing on when prior actions are used in letters of intent. If the IMF takes domestic political factors into account in the design of its letters of intent, then variations in the form of conditionality should have political antecedents. Specifically, I expect the incidence of prior actions to be higher in those states where institutions make program implementation more problematic, and lower in those states where program implementation is more likely. Using information taken from letters of intent for 38 countries between 1997 and 2003, I find that after controlling for economic variables as well as US influence, that states with approaching elections, states in which legislative support for austerity is fragile, and states with a poor history of program implementation are more likely to have prior actions incorporated in their letters of intent.

The implications of these findings touch on an array of broader theoretical issues dealing with conditionality as well as the influence of international organizations. Bird and Willett (2004) suggest that the IMF needs to recognize potential tradeoffs between economic reform and the political feasibility of those reforms. The Fund's failure to recognize these tradeoffs may mean that programs fail because of involuntary defection, as states cannot honor the promises that they make to the Fund. Put another way, the results in this paper help assess whether program design is a source of compliance problems. Finding that program design is invariant to domestic political conditions or a past history of failed programs helps to make that case.

The possibility that IMF programs fail because their goals are too ambitious for leaders to adopt raises the question of why this inefficiency continues to persist. Presumably, if the Fund had more knowledge about domestic political constraints, it could design more effective programs. The link between program design and program failure is part of a much broader critique of international organizations outlined by Barnett and Finnemore (1999, 2005). They argue that because international organizations (like all bureaucracies) are centers of knowledge production, the manner in which the Fund applies its expertise to the developing world means that the problem of economic adjustment is framed purely as an issue of optimization rather than an issue of building a political consensus (Ferguson 1990; Harper 1998). As a result, the Fund's considerable expertise is a source of dysfunction, as problems are defined in ways that harm countries rather than help them. It further suggests that the Fund would have a difficult time taking politics within countries seriously, since this requires them to frame the issue that lies at the heart of conditionality somewhat differently (Woods 2006:56).

Finally, the research question posed has broad implications for the appropriate level of IMF autonomy. If program design is unrelated to domestic political conditions, then this indicates a real problem with the manner in which the IMF does business, implying that the IMF should have less autonomy in the area of program design and monitoring. The Fund cannot be expected to foster country ownership of adjustment programs if it cannot recognize ownership *ex ante*. On the other hand, finding that the Fund imposes prior actions when warranted implies more broadly that the Fund is doing its job well and supports retaining the Fund's existing level of autonomy.

This paper is divided into five parts. Below, I review existing knowledge about prior actions in Fund lending programs. Then I turn to extant research on the design of international agreements, which provides hypotheses on when prior actions should appear in letters of intent. I present a research design and results, and close with further implications.

Prior Actions as a Component of IMF Conditionality

The origins of prior actions in IMF conditionality date back to 1979. The conditionality guidelines promulgated in that year stated that a "member may be expected to adopt some corrective measures before a stand-by arrangement is approved by the Fund, but only if necessary to enable the member to adopt and carry out a program consistent with the Fund's provisions and policies" (paragraph 7). These measures are developed by Fund staff in the course of negotiations and included in letters of intent. Completing these prior actions is a precondition for the Executive Board to approve the loan. As this suggests, prior actions have been used to help build support for the program by requiring upfront implementation of key reforms critical to the program's success (IMF 2006:4). Exchange rate devaluation can be thought of in this light. For countries that enter Fund programs as a result of a balance of payments crisis brought on by an unsustainable fixed exchange rate regime, requiring a devaluation at the outset of the agreement helps reduce the reliance on demand compression as a means to address the balance of payments problem.[1] Prior actions are employed to ensure that the elements of the adjustment program work to complement each other in order to obtain the desired change in the balance of payments.

In more recent years, prior actions have to signal commitment rather than as complements to traditional performance criteria. Fund guidelines suggest that prior actions are to be used "particularly where there is no established track record or only a weak one - to demonstrate the authorities' determination and political will to implement the program as formulated." (EBS/96/194 as quoted in IMF 2002: 28). For countries with weaker track records (either because they have a poor history of implementation or there were slippages in the most recent program) front-loading the program through prior actions allows borrowers to signal to IMF staff that they are committed to implementing the program, increasing the likelihood that the Executive Board approves the program.

The Fund's discussion of when and how prior actions are used implies it takes these seriously. Because they precede the release of tranches, non-observance of these conditions is harder to overlook. Moreover, because they are included in letters of intent at the discretion of IMF staff, it is the job of the staff to ensure that they are carried out before presenting the loan agreement to the Executive Board for approval. Thomas and Ramakrishnan (2006:16) note that Fund-backed programs “cannot be initiated or maintained without the completion of these actions” which makes them different from traditional performance criteria, in which nonobservances can be waived. This raises an important question: what are the consequences if they are not fully implemented? After all, if the state chooses not to implement them, and the program proceeds apace, then it is difficult to claim that prior actions "matter." Evidence taken from country histories with the Fund suggests that the IMF does certainly take prior actions seriously. Disagreements over the non-implementation of prior actions led the Fund to suspend a PRGF program that it negotiated with Nicaragua in 1997 (IMF 2002:31). Non-implementation of prior actions in 2002 led to the breakdown of an Extended Fund Facility (EFF) negotiated between the IMF and Ukraine (IMF 2005:56). Benin's failure to implement a prior action regarding prices for petroleum products led to the suspension of its ESAF program in 1996. (IMF 2004:13). In other cases, non-fulfillment of prior actions has led the Fund's executive board to delay reviewing programs, as was done with Turkey in July 2001 (IMF News Brief 2001). In addition, one of Ghana's disbursements in August 2000 under a Poverty Reduction and Growth Facility (PRGF) was found to be the result of that country's misreporting of a prior action. Ghana was asked to repay this non-complying disbursement with interest (IMF Press Release 2001).

This finding is important. In contrast to other conditions in a letter of intent, which may or may not be met by the borrower, the Fund expects prior actions to be fulfilled. As shown above, when prior actions are not met, the Fund staff delays or suspends the program.[2] While other facets of implementing conditionality are indeed hard to measure, in part because operationalizing compliance is difficult (Vreeland 2006, Author), focusing on prior actions helps mitigate this problem considerably, since these conditions are essential for the program to go forward. Studying when and how the Fund requires prior actions tells us about the Fund's view of the borrower. After all, if prior actions were not consequential for the program, the Fund negotiating team would not include them in the letter of intent. Thus, understanding how prior actions are employed gives us an insight into what the Fund staff is actually thinking. In order to build hypotheses on when the Fund includes prior actions, I now turn to a review of the literature on making international agreements. The notion that the Fund does not take a borrower’s degree of political constraints into account in designing conditionality is not only at odds with the Fund’s statements about when prior actions are used; it is also at odds with existing scholarship.

Making International Agreements: What Do We Know?

Previous research on the formation of international agreements stresses two mechanisms that account for variations in agreement design: uncertainty, which can exist at the dyadic and domestic levels, and transaction costs. For Koremenos (2005), the presence of uncertainty shapes not whether agreements are concluded, but what those agreements look like. In her model states do not know how gains will be allocated between them with certainty. The formal results indicate that as the variance in gains from a potential agreement increases, the negotiating states prefer shorter duration agreements with more renegotiation provisions in order to periodically realign the division of gains. In this manner, an adaptation to uncertainty through altering institutional form helps support compliance, as states are less compelled to breach an agreement they no longer benefit from.

Uncertainty can also refer to the potential for cheating rather than the distribution of gains. In some cases, uncertainty about whether other states will honor agreements can prevent them from being made in the first place (Fearon 1998, Leeds 1999). The existence of a signed military alliance may indicate that countries have decided that either that their alliance partners will honor the commitment in times of war or that the costs of noncompliance, should it occur, are small.

Uncertainty can appear at the domestic level as well, though this takes the form of whether or not a commitment that is made can actually be honored rather than who will win or lose from the agreement. In Downs and Rocke (1995), uncertainty over the future demands of interest groups leads states negotiating trade treaties to water them down. For Rosendorff and Milner (2001), the presence of domestic uncertainty leads to the inclusion of escape clauses in trade agreements. Importantly, the inclusion of escape clauses is actually beneficial as it makes agreements easier to reach. As these studies suggest, the presence of either international level or domestic level uncertainty leads negotiators to design agreements to mitigate its effects.

Distinct from uncertainty is the notion of transaction costs which also leads to variations in the design of agreements. Cooperation does not emerge in the one-shot Prisoners' Dilemma because both actors face incentives to cheat. This, however, is not the whole story about when and how international agreements are formed. In an important sense, while early works on cooperation theory produced useful insights, the early scholarship bracketed issues of institutional form. For Williamson (1985) the existence of incentives to cheat (what he terms opportunism) does not necessarily mean that deals will not be concluded, because actors can devise institutional rules to mitigate transaction costs and support cooperation.[3] Credible commitments through the use of hostages can still support exchange, even in the presence of opportunism and sunk-cost assets.[4] In Williamson's case, the hostage was a severance payment or penalty for breaching the contract. Including this hostage in a deal was efficient; by allaying fears of reneging, it made deals possible at lower prices than in their absence.

As this suggests, signalling credibility is an important rationale behind the use of ex ante commitments. Schelling (1966) notes that the US security guarantee to NATO was made more credible through basing US troops in Germany, since US units would inevitably fighting the Warsaw Pact as a result of an attack. In the literature on alliance formation, Weber (2000) finds that increases in transaction costs in combination with increasing threats lead to more binding alliances. For Smith (1995), more formalized alliances lead to more reliable alliances by raising the costs of breaking them.

Thus, existing research makes plain that both high levels of uncertainty and high transaction costs affect the way that agreements are negotiated. Where there are high levels of each, ex ante commitments should appear in agreements.[5] This literature addresses the incentives that states face in negotiating with one another rather than how international organizations devise agreements that regulate states. Critics of the IMF charge that the IMF does not respond to similar incentives. In the case of the Fund, conditionality is focused on bringing specific economic variables back into line so as to create a more sustainable balance of payments position (Woods 2006:41-43, Barnett and Finnemore 2004:51-56). If IMF staff are inattentive to domestic political constraints, the policies that they proscribe can backfire (Stiglitz 2002:52; Bird and Willett 2004). A review of IMF surveillance by a team of external experts suggests this is a danger, as they report a common perception among IMF staff that they "did not see it as their function to come up with policies that, while less than first best, moved the country in the right direction and were politically and institutionally acceptable" (IMF 1999:43).

However, there are reasons to suspect that the IMF responds to variations in uncertainty and transaction costs by requiring prior actions in its letters of intent. The environment that the Fund faces with developing countries is also one of high uncertainty and high transaction costs. First, compliance with IMF programs is an ongoing problem, as many programs are suspended by the Fund prior to their intended completion date (Author, Stone 2002, Stone 2004, Dreher 2003). Because IMF programs do not often run their full duration, the IMF cannot know with certainty if borrowers are committed. Second, IMF programs cause domestic dislocation. IMF conditionality means politicians have to raise interest rates and lower government spending, basically inducing a recession. This causes domestic discontent, and can lead to demands to end austerity and in so doing breach the commitment to the Fund. This creates incentives to read the domestic political environment, because the same leaders that pledge their commitment to implementing austerity at the beginning of an adjustment program can take actions that cause the IMF to pull the plug on the program at a later date. Third, renegotiating these programs is costly to both the IMF and the borrower. Failed IMF programs produce capital flight (Author), and with the suspension of the program, macroeconomic performance worsens as the borrower reverts to fiscal and monetary profligacy. Increasing effort is required to close the gap in a borrower's current account, which translates into more (or more stringent) conditions.[6]

These three observations make clear that the IMF faces an environment in which the transaction costs are high, and there is uncertainty regarding whether the program will be implemented. Both these conditions should lead a higher likelihood of ex ante commitments in these agreements. Focusing on prior actions tells us about how the fund responds to implementation uncertainty first because these conditions must be met before the program is approved --- so they suggest that the negotiating team placed a very high priority on them. But also, because they are preconditions, they have to be met for Executive Board approval. Otherwise the program will not go forward. So, their binding nature is not in question.

A recap of the argument at this point is in order. The existence of prior actions in IMF letters of intent is important and understudied, and theoretical work on the formation of international agreements suggests that contractual devices such as prior actions are responses to uncertainty. In this instance, the uncertainty takes the form of the Fund's assessment of whether the adjustment program will be implemented. If this is correct, then it is essential to consider what factors might systematically shape the Fund's assessment of implementation uncertainty. I offer two such lines of argument below focusing on elections and federalism.

The notion that politicians are led by the threat of impending elections to embark on pre-electoral spending sprees is not new. In the context of IMF supported programs, elections are important because they lead politicians to value political survival over compliance with austerity measures. It is not surprising then, that impending elections are often correlated with the suspension of IMF programs (Dreher 2003, Mecagni 1999).

This result is not at all qualified by regime type. That is to say that evidence of pre-electoral spending sprees have been found in non-democratic systems, including case studies of Mexico and

Turkey (Gonzalez 1999; Krueger and Turan 1993) and large-N studies as well (Ames 1987; Schuknecht 1999; Shi and Svensson 2000). Spending in these systems serves to deter challengers rather than win the election outright.

Another important institutional attribute with important consequences for the ability of a country to carry out fiscal austerity is the makeup of the legislature. We know that IMF programs traditionally require fiscal restraint – and that this can be politically infeasible in a legislature in which representatives are unwilling to consent to cuts to services that benefit their constituents. This problem is especially more severe in legislatures that are divided among a large number of parties, since collective action on cutting expenditure is more difficult (Haggard and Kaufman 1992, 1995; See also Tsebelis 1995). Many studies have linked the composition of the legislature – specifically the number of parties – to fiscal policy outcomes (InterAmerican Development Bank 1997; Kontopoulos and Perotti 1999; Mukherjee 2003).

Focusing on the political institutions that affect program implementation through fiscal policy brings with it important consequences for the research design. Rather than look at the total number of prior actions, the focus here is only on those that address fiscal policy. In a sense, these represent a most likely case to draw clear inferences from implementation uncertainty to the design of conditionality. Focusing on the fiscal side makes the most sense, because electoral cycles work through higher spending, and because the biggest cause of program noncompliance is shortfalls on the fiscal side and not in some other area.

Research Design

To better assess the determinants of fiscal prior actions, I built a panel dataset of 38 countries that initiated IMF programs from the third quarter of 1997 to the second quarter of 2003. Information on the dependent variable comes from Dreher and Vaubel (2001). These 38 countries are a random sample of states under any Fund agreements during this time period.[7] Dreher and Vaubel recorded information about the content of conditionality from letters of intent publicly available on the IMF website. I built on their work by focusing on prior actions that dealt with fiscal policy exclusively.

Fiscal prior actions take many forms. In most cases, when states have prior actions, they entail mandates to adopt measures to increase revenue. Russia's 1999 letter of intent included a provision requiring that the executive branch delay a parliamentary motion calling for reducing the value-added tax.[8] Pakistan's 2001 program had a prior action requiring mandatory increases in rates for electricity and gasoline.[9] The second most prevalent type of prior action involves organizational design or coordination between government agencies. For example, a letter of intent for Uganda required that it reorganize its Parastatal Monitoring Unit in order for it to function more efficiently. In addition, the same letter required that the government implement a pilot system to better plan and track expenditures in several government ministries.[10] The third most prevalent type of prior action dealt with the budget. This was a simple requirement that the state's legislature ratify a budget that was fully in compliance with the IMF's targets and the policy understandings that were negotiated with the government.

The count of fiscal prior actions varied from zero to nineteen. In 64% of the cases, there were no fiscal prior actions. This range is also heavily skewed. One case, the Ukraine, had 19 fiscal prior actions for its program in the 3rd quarter of 1998. Because this case was more than eight standard deviations from the mean, I created a dummy variable for this specific case. Excluding this observation, the range of fiscal prior actions went from zero to eight.

The independent variables are grouped into three categories. First, I include a number of economic variables as controls, which come from the IFS CD-Rom. In the baseline model, I control for the policy stance of the country prior to entering the agreement. Thus, I include controls for the lagged level of gross domestic product, the lagged growth of reserves, and the lagged growth of expenditure. I expect poorer countries to have greater capacity problems and more fiscal prior actions. I also control for the growth of reserves since this tells us something about the extent of the state's economic crisis; states that are losing reserves at a faster rate have a greater demand for adjustment, and more prior actions as a result. I also expect states in which expenditures are growing rapidly to be more likely to have fiscal prior actions.

Second, I include three controls for political influence factors. I dummy out the agreements by type. The Fund's Poverty Reduction and Growth Facility (PRGF) is geared toward low income countries, and here I expect more conditions and more fiscal prior actions. I also include US influence, measured by US foreign aid as a percentage of GNP, as a control. If the US seeks to lighten the burden of conditionality on its allies, this coefficient would be negative. Finally, it is important to ensure that the findings are being driven by staff perceptions about the borrowing state. To more conclusively demonstrate that the link between uncertainty and prior actions, I also control for the number of public sector performance criteria in the arrangement. This ensures that the results are more likely a result of staff assessment of implementation uncertainty rather than the extent of a state's need for conditionality more generally.

Finally, I include three variables to test the argument developed above. To tease out the effect of approaching elections on the program's design, I include a dummy variable for whether an executive election is six months or less away. An executive election means just that --- a presidential election, or a legislative election in a pure parliamentary system. In systems where the executive is chosen by an assembly on a separate date from public elections, (like Indonesia) this counts as an election as well. Data on elections was taken from issues of the Statesman's Yearbook and the Database of Political Institutions (Beck et al 2001). Past program status is also a dichotomous variable for whether or not the IMF interrupts a program. Using the Annual Reports of the IMF, I initially developed a list of suspended programs based on Killick's (1995) approach. Killick operationalizes a program as suspended if more than 20% of the loan remains undrawn at its expiration. I developed a candidate list of program suspensions by looking at the percentage of the previous loan that was undrawn at the program's conclusion. I doublechecked the status of these programs using quarterly country reports of the Economist Intelligence Unit. Lastly, I include a variable for the degree of legislative fractionalization taken from Beck's (2001) Database of Political Institutions. This measures the probability that any two legislators drawn at random will be from different parties. The specific measure here applies to only the fractionalization of parties in the government's legislative coalition. I choose this because this represents a closer read of the political landscape.

Because this project involves quarterly data with developing countries, missingness for the economic variables is a problem. Specifically for the fiscal variables, the percentage of missingness approached forty percent of the sample. I used Gary King's Amelia II program (King, Honaker, Joseph, and Scheve 2001) to generate estimates to fill in the gaps via multiple imputation. The results that I present are averaged over five datasets with imputed data. The use of this technique is standard in this type of setup (see Stone 2002, 2004).

The dependent variable is count data, so I use what is called a negative binomial model.[11] Because these data are both bounded and discrete, OLS would not be appropriate here. In order to address differences between countries, I use a population averaged estimator which allows us to cluster the standard errors by country. The results use annual dummies to address temporal issues, since many have noted important trends in conditionality over time. The results of the baseline model are detailed below.

Table One About Here

This table suggests that prior actions are assigned to countries in part on the basis of their economic conditions when they begin negotiations with the IMF team. The variable for GDP per capita is negative and significant at a .10 level – suggesting that wealthier states are less likely to have a fiscal prior action. In Model Two, trade was positive and significant, suggesting that trade dependent states are more likely to have fiscal prior actions. Moreover, the variable for change in expenditure was positive, suggesting that states that demonstrate a greater inability to control spending are more likely to have fiscal prior actions. Finally, the content of the program matters, as the count for the number of performance criteria was positive and significant in Model One. Those states with more conditions not surprisingly have more prior actions. This result was not robust across specifications, however, as it was not significant in Model Two.

There were no differences in the incidence of fiscal prior actions between states with high and low levels of US aid. Nor were there differences in the incidence of fiscal prior actions across states with differing types of IMF programs. This is not to imply that political influence by great powers does not matter at the IMF, since this has been established in many studies (Thacker 1999; Stone 2002, 2004). Rather, at this fine-grained level, we do not see evidence that US allies are differentially advantaged in terms of the number of fiscal prior actions.

Turning to our independent variables of interest, the findings in Table One suggest that prior actions are used by IMF staff in response to failed previous programs, and also in response to impending elections. Moreover, the findings in Model Two suggest that countries with highly fractionalized pro-government coalitions are those in which prior actions are used.

To assess the impact of these variables, I generated a series of predicted probabilities. With a count model, these represent the change in probability for each value of the dependent variable. A slightly simplified account appears in the table below.

Table Two About Here

Holding the economic variables at their mean values, changing a country from a compliant prior program to a noncompliant one increases the probability that there will be a fiscal prior action by 19%, an approaching election increases the probability that there will be a fiscal prior action by 15%, and doubling the level of fractionalization increases the probability that there will be a fiscal prior action by 13%. In practice, this means increasing the probability that two legislators in a pro-government coalition are in two different parties from thirty percent to sixty percent.

Taken as a whole, these findings suggest that the IMF uses fiscal prior actions as part of its conditionality in response to implementation uncertainty as well as domestic economic conditions. Those states in which compliance with the IMF program is more imperiled are those that have conditionality front-loaded. Looking more deeply at the actual conditions themselves, in light of the circumstances under which they are imposed, helps demonstrate this point.

As a means of underscoring the findings from the substantive significance, I provide some examples of how conditions are designed in different country contexts using the terms of the letters of intent. These are all taken from public documents that appear on the IMF's website. Countries with impending elections had prior actions entailed specific reforms aimed at developing greater budget transparency. For example, a prior action for Azerbaijan in 2002 mandated a decree indicating that subsidies paid to state owned energy companies must be an item included in the national budget.[12] Rwanda was required to take stock of all extrabudgetary account items in a 2001 letter of intent.[13] Uganda was required to develop a composite system of fiscal controls for all spending units.[14] Each of these reforms is intended to develop greater clarity over exactly what is and what is not in the national budget.

In other cases, countries were required to adopt specific fiscal reforms aimed at raising revenue or controlling expenditure. For example, Armenia was required to meet the central government target for tax revenue collection in the first ½ of 2002.[15] Ukraine was required to implement service fees to collect 100 million hrivnia for the remainder of 1999.[16] These prior actions are in addition to traditional IMF performance criteria, which are generally set on the level of government expenditure.

The use of prior actions in these cases indicates a level of seriousness. While performance criteria can be missed, changed, or waived due to exigent circumstances, prior actions are necessary for the program's approval. In these instances, the Fund required that countries adopt necessary reforms as a precondition for the program to go forward. In a sense, greater budgetary transparency and fiscal reforms are the "price" attached to the Fund's loan in a setting in which the implementation of the program (namely, the temptation for pre-election spending binges) is not assured.

I conducted a series of robustness checks on these results. I addressed the possibility of omitted variables. I reestimated the model with different specifications including variables for democracy. Both the Freedom House measures as well as a dummy for a Polity score of six or greater were used. In neither case were the variables significant. The Fund does not seem to attribute prior actions differently across different regime types

Second, I addressed the possibility of specification errors. Random and fixed effects specifications with the negative binomial distribution model the dispersion parameter rather than the error terms, as in an OLS panel regression. A fixed effects specification was not employed in this paper because it unduly limited the degrees of freedom by censoring 13 states and 67 observations either because each state only appeared once in the data or because there was no variation in the count of prior actions for that states' letters of intent. Likelihood ratio tests suggested that a random effects specification was not significantly different than a pooled estimator (with a constant dispersion).

Finally, I reassessed these results using a more detailed view of political institutions. Since the focus of this paper is on fiscal policy making, and an established literature dealing with institutional effects already exists, the extensiveness (or depth) of implementation uncertainty can be assessed. While our approach has been a simple one to focus on key factors that should affect the probability of successful fiscal policy implementation, more profound political feasibility assessments are certainly possible. Since an established literature deals with the effects of veto players on fiscal policy (Tsebelis 2002, Tsebelis and Chang 2004, Crepaz and Moser 2004) and also presidentialism on government spending (Persson and Tabellini 1999), I can assess if these factors also shape the incidence of fiscal prior actions. Reestimating the above models with dummies for whether the electoral system is presidential or parliamentary or a count of veto players (both taken from Beck 2001) did not change the results. In neither case were these variables significant.

In an important sense, this finding is not surprising. Because IMF country teams are prone to frequent turnover due to reassignment (Woods 2006, Momani 2007:49, who also cites IMF 2004:19), members of missions who are already overtaxed in drafting letters of intent have weak incentives to acquire additional information about the country in question. Institutional incentives at the Fund further emphasize on adopting orthodox economic solutions. This orthodoxy is stressed through the use of formal macroeconomic models used to develop adjustment programs (Barnett and Finnemore 2004:68-69) Overcoming the disciplinary barrier in moving from economics to political science is daunting enough without sufficient incentives.[17] Recognizing the domestic political barriers that might impede program implementation and then designing conditionality in light of these constraints can conflict with a desire to push forward 'first-best' policies. It is no accident that Fund staff "appear in general to be reluctant to give advice….that takes into account the political and institutional constraints within which policymakers need to operate" (IMF 1999:95). The Fund's understanding of implementation uncertainty is, from the standpoint of modern institutional scholarship, no doubt a limited one. In a sense, then, these findings are empirical support for the claim advanced by Stanley Fischer (1998) when he was at the IMF that the staff avoid forming "sophisticated judgments about the political forces" in borrowing countries and instead "form a judgment on whether the government will do what it says it will do in an overall satisfactory way." Simple rules seem to prevail.

Further Implications

These findings provide important insight into how the IMF designs conditionality, specifically in how it imposes prior actions. The evidence suggests that the Fund responds to higher levels of implementation uncertainty with a greater number of prior actions. Several implications follow from this result.

First, because the IMF does design conditionality strategically, explanations for the failure of conditionality that focus on information have less support. That is, claims that conditionality fails because the Fund does not do full-bore "political feasibility" assessments are less valid overall. The evidence here suggests that program design is less of a barrier to program effectiveness than previously thought.

Second, these findings suggest that the Fund's expertise is less a source of dysfunction than previously argued. These results suggest that the Fund, while staffed with economists, can still employ simple rules in the design of conditionality that address potential problems with implementation ex ante. The Polak model of balance of payments that underpins the IMF's approach to conditionality is not necessarily a constraint to incorporating more political considerations. More work is clearly necessary on this front, not merely to assess the extent to which these simple rules are applied, but also to map out how more detailed ones can be developed.

Finally, these findings hold implications for the degree of the Fund's autonomy. In a sense, these findings vindicate those who seek to keep the Fund an autonomous international organization. The results do not demonstrate that US allies are treated systematically differently in terms of the number of prior actions. These results also point to a clear question for follow-up research: how do prior actions matter? That is to say, is it the case that states with more prior actions evince better performance under their respective programs? Thomas and Ramakrishnan (2006) find that programs with prior actions produce improved fiscal outcomes. The implication of this line of argument is profound: the future of IMF conditionality lies in ascertaining when and how prior actions should be used rather than in reducing the number of conditions overall.

Table One: Determinants of Fiscal Prior Actions		
	Model One	Model Two
Prior Program Noncompliance	.8401** (.3016)	0.5713* (.2812)
Approaching Elections	.6646* (.3243)	.7313* (.3037)
Government Fractionalization		.9862* (.4172)
GDP per capita *t-1*	-0.00033† (0.000176)	-0.00034† (0.000174)
Trade / GDP *t-1*	0.0055 (0.00577)	0.0104* (0.0049)
Change in Expenditure / GDP *t-1*	0.01496 (0.00767)	0.0156* (0.0056)
Change in Total Reserves *t-1*	2.8e-05 (0.000035)	4.1e-05 (0.00004)
PRGF Dummy	-0.3293 (0.4004)	0.0144 (0.4028)
US Foreign Aid / GDP *t-1*	.2864 (0.5602)	.2568 (0.7045)
Public Sector Performance Criteria	0.1377* (0.0653)	0.0739 (0.0736)
Dummy for Ukraine Program	2.5484*** (0.3631)	2.3874*** (0.3888)
Constant	-1.0859 (0.7486)	-0.6510† (0.3481)

Number of Observations / Groups: 199/38 (Model One) 185/35 (Model Two)
Model Chi-sq: .00000 (For Both)
Year Dummies omitted to save space.
Chi-sq test for year dummies: .0000 (For Both)
† .10 or better * .05 or better ** .01 or better *** .001 or better

Table Two: Predicted Probabilities				
	Pr(0 PA)	Pr(1 PA)	Pr(2 PA)	Pr(3 PA)
Baseline	**58.01%**	**22.63%**	**10.16%**	**4.76%**
Prior noncompliance	-18.86%	-1.43%	+3.05%	+3.84%
Approaching election	-15.07%	-0.62%	+2.82%	+3.23%
Double fractionalization score	-13.45%	-0.35%	+2.66%	+2.94%
Baseline case defined as all econ variables at their means, mean fractionalization, prior noncompliance and approaching election at zero.				

Table Three: Summary of Findings (Model Two)	
Type of explanation	Results of Joint Wald Tests
Economic Circumstance	0.0000
Implementation Uncertainty	0.0063
Country / Program Differences	0.9241

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[1] Thomas and Ramakrishnan (2006) note this is conventionally how prior actions worked for IMF programs during the Bretton Woods era.
[2] Note as well that the list above includes both smaller and larger states – suggesting that the Fund does not treat borrowers differently in choosing whether to delay or suspend on the basis of nonfulfillment of prior actions.
[3] Transaction costs can be thought of as having both ex ante (the costs of negotiating an agreement) and ex post (the costs of monitoring and altering an agreement) components.
[4] Put another way, Koremenos (2001) argues that states do not opt out of deep cooperation because the terms of the contract are endogenous.
[5] It is no accident that this is one of Abbott and Snidal's (2000) hypotheses on when we are likely to see "hard law."
[6] It is no accident that IMF program suspensions are highly duration dependent. One of the biggest determinants of whether a program will be suspended in a given year is whether it was suspended in the previous year (AUTHOR).
[7] Albania, Argentina, Armenia, Azerbaijan, Belarus, Benin, Bolivia, Brazil, Bulgaria, Burkina Faso, Cambodia, Cameroon, Cape Verde, Central African Republic, Colombia, Croatia, Estonia, Georgia, Ghana, Guinea, Indonesia, Jordan, Kazakhstan, Korea, Latvia, Mali, Moldova, Nicaragua, Pakistan, Panama, Peru, Russia, Rwanda, São Tomé & Príncipe, Uganda, Ukraine, Uruguay, and Zimbabwe.
[8] Available from http://www.imf.org/external/np/loi/1999/071399.htm.
[9] Available from http://www.imf.org/external/np/loi/2001/pak/01/031801.pdf
[10] Available from http://www.imf.org/external/np/loi/1999/071599.htm
[11] Specification tests consistently rejected a poisson distribution.
[12] Available from http://www.imf.org/external/np/loi/2002/aze/01/index.htm
[13] Available from http://www.imf.org/external/np/loi/2001/rwa/01/index.htm
[14] Available from http://www.imf.org/external/np/loi/1999/071599.htm#table3
[15] Available from http://www.imf.org/external/np/loi/2002/arm/01/091102a.pdf
[16] Available from http://www.imf.org/external/np/loi/1999/052099.htm