International Negotiations in the Shadow of National Elections

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How do national elections affect international negotiations? The current study examines the role of elections in negotiations between states and the International Monetary Fund (IMF). IMF loans often require countries to introduce painful austerity measures that provoke a backlash from angry citizens. However, some governments negotiate more favorable loans than others. Using new data on the stringency of labor-related loan conditions, this study finds evidence that governments leverage their electoral vulnerability to obtain more favorable loan agreements. Governments facing imminent democratic election receive less stringent labor conditions, all else equal. Domestic politics, and specifically national elections, have important and systematic effects on international negotiations.

As more and more countries turn to the International Monetary Fund (IMF) for essential financial support in the wake of the 2008 economic crisis, the IMF and its lending practices have garnered increased attention. IMF loan programs often require countries to introduce painful austerity measures that provoke a backlash from angry citizens. In Greece, for example, citizens responded to the bailout package that required the government to make deep cuts to public sector employment and wages with strident and sometimes violent protests. In May 2012, Greek voters punished the two dominant governing parties by handing them their worst performance ever at the polls. However, not all IMF loan programs meet with such vociferous opposition. One reason for the varied domestic responses to IMF programs may be differences in the loan conditions, which stipulate policy reforms that must be undertaken by borrowing governments to receive monies from the IMF.[1] Some loan programs require significant reforms while others contain less stringent conditions. Why do some borrowers get a better deal from the IMF than others?

Building on the logic of Putnam's two-level game and Schelling's conjecture,[2] we hypothesize that some governments negotiate more favorable loans than others by leveraging their domestic vulnerability to strengthen their bargaining position with the IMF. Specifically, we examine the effects of imminent national elections on the terms of loan programs negotiated between national governments and the IMF using new data on the stringency of labor-related loan conditions. Labor-related loan conditions stipulate reforms to the country's domestic labor market and/or have direct effects on employment, wages, and benefits. These reforms have immediate, direct, and tangible effects on voters. Voters' support for a government that negotiated an IMF loan will

[1] Kahler 1993.

[2] Putnam 1988; Schelling 1960.

be closely conditioned on the specifics of the program.[3] Since democratic governments negotiate loan programs with an eye towards their future electoral prospects, they pay particular attention to conditions that are likely to elicit negative reactions from significant numbers of voters. Governments facing imminent elections will therefore demand less intrusive labor conditions. The IMF, moreover, responds to these demands because the successful implementation of an IMF program depends, at least in part, on the electoral fate of the government with which it is negotiated.

These findings have several important implications. First, the current study is one of the few empirical tests of Putnam's and Schelling's conjecture. Thus, the results present novel confirmatory evidence of a key argument that underlies a large body of research in international relations. Second, scholars have generally paid little attention to whether elections give countries leverage in their negotiations with international organizations. Instead, most previous studies examine negotiations between states. The current study aims to address this oversight by examining states' negotiations with one of the most important international organizations in the global economy: the IMF. Negotiations with the IMF are presumably a hard test of election effects. Loan negotiations occur during times of economic crisis and between states and unelected international bureaucrats. Given this, one might expect IMF loan negotiations to be particularly invulnerable to electoral pressures. Yet, the current study finds that proximity of national elections systematically affects the outcome of negotiations between democratic governments and the IMF by giving governments additional leverage. This finding has important implications for the scores of governments that negotiate new programs with the IMF each year.

[3] Putnam 1988.

Existing Literature

Putnam's classic essay on two-level games opened new avenues for studying international negotiations.[4] Putnam illuminated how domestic politics might empower or weaken national governments in international negotiations. Empirically, however, the extent to which governments can leverage domestic political factors in their negotiations remains unclear. Schelling hypothesized that the need to secure legislative ratification of international agreements could enable savvy executives to leverage hawkish legislatures to extract concessions from negotiating partners.[5] Scholars have found mixed support for Schelling's conjecture, and to date these arguments have been demonstrated formally rather than empirically.[6]

Implicit in Putnam's argument is the idea that there are different types of international negotiations and distinct sources of leverage that national governments can exploit. In interstate negotiations, the extent to which one state can leverage domestic political factors in its negotiations with another depends not only on domestic politics at home, but also on domestic politics in the negotiating partner. Given this, negotiations between a state and an international organization staffed by unelected bureaucrats should have distinct dynamics. International organizations do not have to worry about re-election or opposition parties, while many national executives do. How might elections matter for negotiations between democratic governments and international organizations?

Although no existing study directly addresses this question, previous studies find evidence that elections shape the politics of IMF lending in several ways. First,

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[4] Putnam 1988.

[5] Schelling 1960.

[6] Milner and Rosendorff 1997; Tarar 2005.

countries are more likely to conclude an IMF program after an election than before an election.[7] One reason for this, it is argued, is that "sovereignty costs" -- the penalty that governments incur from voters for sacrificing sovereignty to the IMF -- are higher prior to elections than after them.[8] Second, the likelihood of entering a new program is significantly lower prior to an election.[9] Third, borrowing is "significantly larger" prior to elections, especially in more democratic countries.[10] Fourth, programs are more likely to break down prior to elections, although this effect is less severe in more democratic countries.[11] Fifth, the Fund is less willing to enforce conditions rigorously on the eve of an election.[12] Elections clearly have consequences for many features of IMF loan programs.

Elections may also influence another important feature of IMF programs: conditionality. Loan conditions stipulate policy reforms that must be undertaken by governments in order to receive IMF money. A few previous studies of conditionality have included elections as a control variable. For example, Stone controls for the time until legislative elections when estimating the number of categories of loan conditions.[13] Stone finds no evidence that time until elections influences the “scope”

[7] Przeworski and Vreeland 2000; Moser and Sturm 2011.

[8] Vreeland 2003.

[9] Dreher 2003. Governments that conclude an agreement within six month prior to an election, however, are more likely to be reelected when GDP growth is low (Dreher 2004).

[10] Dreher and Vaubel 2004.

[11] Dreher 2003.

[12] Stone 2004.

[13] Stone 2008.

of loan conditions. Similarly, Dreher and Jensen fail to find a consistently robust election effect on the total number of loan conditions.[14] These non-findings are surprising since loan conditions have real and lasting consequences for voters' economic well-being. Voters, and hence governments, should not be indifferent about the conditions attached to IMF funds. One reason for these null findings may be that voters do not care about the total number of loan conditions. Instead, voters' support for governments that negotiate IMF loans should be closely conditioned on the specifics of the program.[15] Given this, it is possible that examining the total number of loan conditions obscures the role national elections play in IMF negotiations. The current study seeks to overcome this impediment by examining the content of loan conditions and identifying those likely to be of greatest concern to voters.

Labor Conditions

Voters will be especially attentive to loan conditions that have a direct, negative effect on their economic well-being. Conditions relating to long-term foreign debt sub-ceilings, for example, are unlikely to motivate many people to protest in the streets. Voters may not know about such conditions or understand how these types of conditions will affect their economic well-being.[16] In contrast, voters can easily comprehend conditions that require a reduction in the minimum wage, for example. This type of labor-related condition has an easily understandable effect on citizens' economic well-being. Labor-related conditions therefore tend to generate intense public scrutiny. In Ireland, for example, one of the most frequently discussed conditions of the 2010 loan was a €1 per hour reduction in the minimum wage. This

[14] Dreher and Jensen 2007.

[15] Putnam 1988.

[16] Kono 2006.

condition was mentioned over 600 times in Irish newspapers in the twelve months leading up to the conclusion of the loan negotiations and became a decisive campaign issue in the subsequent national elections.[17] In contrast, there was far less public discussion of loan conditions relating to "terms of reference for the due diligence of bank assets" or the requirement that the Central Bank "achieve a capital ratio of 12 percent core tier 1".[18]

Since voters are most attuned to policies that directly affect their economic well-being, an examination of the intrusiveness of labor-related conditionality in IMF programs provides a more appropriate test for how democratic elections shape loan negotiations. Labor conditions stipulate reforms to the country's domestic labor market and/or have direct effects on employment, wages, and social benefits (e.g., privatization, wage freezes, and pension reform). Reforms of this nature are costly for groups of voters in the short to medium term. Public sector reforms such as privatization, reductions in the size of government, and freezes on government salaries, result in layoffs and reduced wages for state employees. Likewise, demands to reduce or limit increases in minimum or private sector wages affect worker incomes in the private sector. Structural reforms to public pensions and healthcare systems affect the benefits that workers covered by these programs receive. Enhancing labor market flexibility by reducing the cost of firing workers, legalizing non-permanent labor contracts, or decentralizing collective bargaining affects workers by making jobs more precarious and/or by weakening unions' bargaining power.

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[17] LexisNexus.

[18] IMF Country Report No. 10/366 December 2010. The capital ratio condition was mentioned fewer than 60 times in Irish newspapers in the twelve months prior to the conclusion of loan negotiations (LexisNexus).

Although labor-related conditions became increasingly frequent during the period from 1980 to 2000, labor conditionality varied considerably from loan to loan. We argue that the variation in labor conditionality is due, in part, to pending democratic elections in borrowing countries.

Argument

As Putnam argued, governments negotiating IMF loans play a two-level game, one at the national level, the other at the international level.[19] At the national level, governments seek to maintain office.[20] They must therefore weigh the potential benefits of obtaining an IMF loan against the potential costs incurred by accepting a loan. Although many discussions of IMF programs stress their costs, borrowing from the IMF also provides substantial benefits to governments. IMF loans provide much-needed resources that make economic adjustment easier and prevent a bad economic situation from deteriorating further.[21] Governments facing elections, moreover, gain access to resources that can be mobilized to strengthen their position going into the polls.

IMF programs, however, also come with considerable costs. They usually include conditions that impose painful short-term adjustment costs.[22] Accepting such conditions entails "sovereignty costs" that make the government vulnerable to charges of "selling out" to foreign interests.[23] Citizens who oppose a program, moreover, may mount disruptive protests against the government. Accepting an IMF loan can

[19] Putnam 1988.

[20] Smith and Vreeland 2006.

[21] Bienen and Gersovitz 1985.

[22] Przeworski 1991.

[23] Bienen and Gersovitz 1985; Kahler 1993; Vreeland 2003.

therefore induce political instability.[24] Governments that are weak (e.g. a fragile coalition government) or divided may be especially reluctant to take on the risks of borrowing from the IMF for fear that it will give ammunition to their opponents.[25]

The salience of these costs, however, depends in part on the government's time horizon. If governments have long time horizons, they can enter an IMF program, obtain much needed financial resources, and weather the short-term political fallout. If, however, government have short time horizons (i.e. they face imminent elections), the calculus changes dramatically. Governments do not have the option of riding out the negative backlash engendered by the IMF program, since voters suffer from "recency bias" -- they attach greater weight to the recent performance of incumbent politicians when assessing their accomplishments.[26] Governments that face elections in the near future will therefore be especially reluctant to conclude risky international agreements that entail short-term costs.

If governments with short time horizons can secure loans with less intrusive conditionality, however, then the attractiveness of borrowing increases. They can secure the benefits of borrowing and substantially reduce the potential costs. A loan with fewer conditions reduces the short-term adjustment costs that voters must endure and the sovereignty costs that governments must bear which gives the opposition less ammunition and reduces the likelihood that voters will punish governments at the

[24] Bienen and Gersovitz 1985; Dreher and Gassebner 2012.

[25] Bienen and Gersovitz 1985.

[26] Conconi, Facchini and Zanardi 2011. The idea of a recency bias in voting goes back to the influential contribution of Weingast, Shepsle and Johnson (1981) and is supported by a large empirical literature. See, for example, Lewis-Beck and Stegmaier (2000) for a comprehensive review of this literature.

polls. Voters, in fact, may reward governments for securing a "good deal" from the IMF.[27] Given these dynamics, governments that anticipate an election in the near future have strong incentives to borrow if they can negotiate lenient conditionality.[28]

Governments will be especially attentive to reducing labor conditionality.[29] Labor-related conditions are retrenchment policies--they reduce rights and benefits, threaten job security and pay. As Pierson has argued in the context of welfare state retrenchment in advanced industrial democracies, taking away rights and benefits follows a different political logic than extending them.[30] It is more difficult to take away benefits than to grant them. Individuals respond more negatively to certain losses than to potential gains,[31] so voters that face assured reductions in pay, benefits, or job security will react more strongly than voters who may benefit from altering these policies in the long-term, since the gains to possible beneficiaries are both

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[27] Vreeland 2003.

[28] Governments that face looming elections are unlikely to ask for harsh conditions and then scapegoat the IMF. This is not to say that scapegoating does not happen but rather that scapegoating is unlikely in the immediate run up to democratic elections.

[29] Of course, interest groups and consequently governments may also be concerned with non-labor conditions. For example, banks may have strong preferences regarding capital reserve conditions and may lobby governments. However, this lobbying often takes the form of contributions rather than votes and consequently affects governments at all times, not just when elections loom. Voters' electoral support is critical precisely at election time and thus explains why voters' interests most strongly shape IMF loan programs negotiated in the shadow of impending elections.

[30] Pierson 1996.

[31] Kahneman and Tversky 1979; 1984.

indirect and uncertain.[32] For example, privatization entails immediate costs to state enterprise workers, but the potential benefits to other voters are indirect and indefinite. In addition, these policies have constituencies that will respond vigorously to efforts to alter policies in ways that negatively affect them, and they are more likely than other voters to live in urban areas and to belong to organizations that can facilitate disruptive protests that will tarnish the government's reputation in the run-up to elections.

While the government has strong incentives to negotiate for less intrusive labor conditionality in the shadow of an imminent election, the IMF could reject the government's pleas, fearing that the government would use low-conditionality loans to increase spending prior to the election or because the Fund wants to tie the hands of an incoming government. Since countries often go to the IMF during times of dire economic need, the Fund has considerable leverage in demanding rigorous loan conditions. But the IMF is not blind to the domestic constraints that governments face, and to influence policy, it must lend. When the IMF knows that elections are in the cards, governments' claims about political vulnerability are credible, which in turn increases governments' bargaining leverage with the IMF. Elections essentially bind the government, and as Schelling has argued, binding oneself can constrain an adversary.[33] It is this *credible* domestic vulnerability that gives the government leverage in its negotiations. If the IMF insists on intrusive labor conditionality, the government may abstain from borrowing rather than accept a loan that will jeopardize its performance at the polls. If the IMF concedes to less intrusive conditionality,

[32] Bienen and Gersovitz 1985; Kahler 1993.

[33] Schelling 1960.

however, it has input in the formulation of economic policy, and it can push harder for sensitive policies later in the program, i.e. after elections have passed.

The IMF, moreover, is cognizant that the successful implementation of its programs depends on the survival of the government with which it negotiated. Intrusive conditionality increases the odds that the IMF's negotiating partner will be defeated at the polls, since such a program would provide ammunition for the opposition to use in its campaign against the government.[34] The possibility of program failure is especially acute when governments change, since newly elected governments often feel little commitment to abide by agreements made by the previous government. Finally, as Putnam has argued, strengthening the government's popularity weakens its bargaining power in subsequent negotiations with the IMF, so the IMF will be in a stronger position to wrest concessions from the government.[35]

The possibility of using elections to gain leverage gives rise to two possible endogeneity problems. First, governments might strategically time loan requests in order to gain bargaining leverage. However, this is unlikely given that many governments in negotiations with the IMF can no longer borrow from private markets and therefore need IMF financing. In such circumstances, governments do not have the luxury of strategically timing a loan request.[36]

Second, in parliamentary systems, governments may call early elections to gain bargaining leverage. Although governments may call snap elections, few actually do so during negotiations with the IMF. Calling an early election trades the certainty of more time in office for the possibility of obtaining leverage in loans negotiations

[34] Bienen and Gersovitz 1985.

[35] Putnam 1988.

[36] Kahler 1993.

and being cast out of office prematurely. Few governments are willing to make such a trade-off. Furthermore, snap elections may actually weaken a government's hand with the IMF. As Kahler observes, the snap 1983 election in Jamaica resulted in a one-party parliament, which strengthened the Prime Minister's internal position, thereby weakening his bargaining position with the IMF.[37] Additionally, anecdotal evidence suggests that governments are reluctant to call early elections during loan negotiations because doing so effectively suspends talks. The IMF is usually unwilling to negotiate with lame duck and caretaker governments.[38] In Greece, for example, IMF officials suspended discussions in the months prior to the June 17, 2012 elections. As the IMF deputy director of external affairs said, "We take note that elections have been called and we look forward to being in contact with the new government when it has been formed." In short, there is little evidence that governments attempt to manipulate the timing of loan requests or national elections.[39]

The theoretical discussion leads to a straightforward hypothesis:

In comparing IMF loans to democratic countries, those agreed with governments facing imminent elections will contain fewer and less intrusive labor conditions than those agreed with governments not facing imminent elections.

Sample

Ultimately, we are interested in explaining the variation in labor conditions included in IMF loan programs. We argue that this variation is due, in part, to imminent democratic elections. Therefore, the appropriate sample for study includes all democratic countries under IMF programs. This sample allows for a comparison of

[37] Kahler 1993.

[38] Hillman 1980.

[39] Kahler 1993.

conditions in loans made to countries that could, in theory, face democratic elections. Variation is therefore possible on both the key explanatory variable (i.e. election timing) and the key outcome variable (i.e. labor conditionality).

To identify democratic countries, we use the 21-point Polity index constructed by Gurr et al., Jaggers and Gurr, and Marshall and Jaggers. The Polity index ranges from -10 for a highly autocratic state to 10 for a highly democratic one. This index is constructed based on factors such as: (1) the competitiveness of the process for selecting a country's chief executive, (2) the openness of this process, (3) the competitiveness of political participation within a country and (4) the degree to which binding rules govern political participation within it. These factors are directly related to the theoretical emphasis on elections and democratic representation in this study and thus make the use of Polity particularly appropriate. Borrowing countries with a Polity score equal to 6 or above in a given year are included in the sample.

The maximum sample consists of 297 observations and covers the period from 1980 to 2000. This sample includes the universe of democratic countries that borrowed from the IMF during this period.[40] In later sample years, there are relatively more observations. For example, there are 23 observations in 1999 but only four in 1981. A further complication is that the IMF's use of conditionality changed over this period. Conditionality was not originally stipulated in the IMF's Articles of Agreement and as late as the late 1970s, only 26 percent of IMF loans included any substantial conditions.[41] The use of conditions increased steadily from the late 1970s

[40] Each observation is a unique country-loan-year. There are a total of 52 countries in the sample.

[41] Stone 2008, 591.

until the year 2000.[42] By the end of the 1980s, for example, two-thirds of IMF loans involved substantial conditionality.[43] The scope of conditionality also expanded during this period as the Fund ventured into new areas of domestic economic policy traditionally outside its purview.[44] Labor conditions are one such example. Labor-related conditions became increasingly frequent from 1980 to 2000. Variation in the stringency of conditions across loan programs consequently depends, at least in part, on the timing of the program and therefore all estimated models include year fixed effects.[45]

Variables

IMF loan documents are used to construct a novel measure of labor conditions. Specifically, the Letters of Intent are examined for nine labor-related loan conditions.[46] Letters of Intent are most often drafted by the IMF staff after lengthy

[42] Steinwand and Stone 2008.

[43] Stone 2011, 77. During the period from 1974 to 1982, the average number of performance criteria in an IMF program was 7.1. This rose to 12.1 in the period between 1983 and 1990 (Gould 2006).

[44] Vreeland 2007; Stone 2008, 591.

[45] The individual year coefficients are not reported. The key election effects are robust to alternative specifications, including the exclusion of year fixed effects and the addition of a time trend variable.

[46] Letters of Intent are usually, but not always, called Memoranda of Economic and Financial Policy. For a complete list of all nine labor-related conditions coded, see Appendix A. It is important to note that our data differ from the IMF's Monitoring of Fund Arrangements (MONA) data. Our sample period is 1980 - 2000 and includes over 950 country-years of coded loan documents. MONA has two data sets, archived

negotiations with the borrowing government.[47] Upon agreement between the government and the IMF on the terms of the loan and the loan conditions, the Letter of Intent is signed by the governments' national executives, frequently the Minister for Finance and/or the Governor of the Central Bank, and announced publicly.[48]

Not all conditions included in the Letters of Intent are equally binding. Performance criteria, for example, are particularly strict; failure to meet performance criteria results in the loan's suspension. In contrast, benchmarks are conditions that the IMF expects countries to meet, but failure to do so does not result in an automatic suspension of the loan. To account for the variation in stringency, each labor condition is weighted by its relative intrusiveness. Prior actions are weighted by a value of 2 because they outline steps that a country must take before the IMF releases any monies (or completes a review). Performance criteria are weighted by a value of 2; benchmark conditions are weighted by a value of 1. Indicative targets are similar to benchmarks, except that they are quantitative (e.g. a ceiling on the public wage bill), and thus are also weighted by a value of 1. Indicative targets are rare; only 24 labor-related indicative targets are included in IMF programs during this period. Labor-related prior actions are also rare; only 5 percent of conditions in the sample are prior actions. Ten percent of labor-related conditions are performance criteria while 20 percent are benchmarks.

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data for 1993 - 2003 and another for 2002 to the present. The archived data set includes about 300 total arrangements (and the supporting review documents). Many arrangements are omitted. MONA's more recent data includes most arrangements but covers different years than the data set used for this study.

[47] Negotiations typically take a minimum of three months (Stone 2011, 136).

[48] In contrast, the actual loan contract is often confidential (Stone 2011).

To measure the proximity of elections to loans, an original variable is constructed that equals 1 if an election was held within 6 months of the date on which the Letter of Intent was signed by the borrowing government and 0 otherwise (*Pending Election*). Legislative elections are included for all countries because although loan programs are negotiated with the national executive, the legislature must pass many of the reforms required by labor-related loan conditions. If elections are expected to return a body of legislators that will not pass the required labor market reforms, the executive may, in anticipation of this, press for less stringent loan conditions when negotiating with the IMF.[49] Upcoming legislative elections are therefore potentially relevant for labor conditions even in presidential and semi-presidential systems. In the semi-presidential country of Ukraine, for example, the Fund agreed to relax conditions in light of the upcoming legislative elections in March 1998.[50] In addition to legislative elections, presidential elections are also included in presidential and semi-presidential systems. Where there are multiple rounds of voting, the date on which voting started for the entire election event is used. In elections that span multiple days, the first day of voting is used as the election date.[51]

Fifty-two of the 297 loans in the sample were signed within 6 months of an upcoming election. In other words, 17% of the sample loans were agreed within 6 months of a pending election. Of these, only six involved elections that were held

[49] Vreeland 2006, 373.

[50] Stone 2002, 195.

[51] Election dates are from Hyde and Marinov (2012).

early relative to the date they were supposed to be held per established procedure.[52] There is no evidence that these early elections were called in response to or anticipation of negotiations with the IMF.[53]

As a robustness check, a second election variable is constructed that equals the number of months elapsed between the signing of the Letter of Intent and the nearest subsequent election (*Months until Elections*).[54] Ten Letters of Intent were signed within one month of upcoming elections. This includes, for example, Estonia's 1995 Letter of Intent, which was signed just five days before regularly scheduled parliamentary elections. The modal value of *Months until Elections* is 11 months.

Given the relatively small sample size, the estimating equations are parsimonious. All estimated models include year fixed effects and at least two important control variables:

- the log of *GDP per capita* as a proxy for overall economic development — Previous studies consistently find a negative correlation between economic development and the number of IMF loan conditions.[55] Countries with fewer total conditions may receive fewer labor conditions.

[52] Authors' own coding based on Hyde and Marinov's (2012) variable *neldan6* and additional information from the Inter-Parliamentary Union and Keesing's World News Archive.

[53] Keesing's World News Archive.

[54] Up to a maximum of 24 months. Days are rounded up to a whole month.

[55] Steinwand and Stone 2008, Table 4.

- *GDP*—Larger countries may be better able to resist IMF conditions[56] and thus GDP is included to control for countries' economic size.

Several additional control variables are also included, although their inclusion in the estimating equations reduces the sample size and degrees of freedom:

- *Debt service*, measured as a percent of exports (excluding remittances)—Countries that use a large portion of their exports for debt service are likely to be particularly dependent upon non-market sources of financing. Previous studies have found that countries with significant external debt are more likely to seek IMF support.[57] High-debt countries may be more willing to accept labor conditions in return for IMF programs.

- Existing labor policies—Some part of the observed cross-national variance in labor conditionality may be due to existing labor market policies and regulations. The IMF is unlikely to demand that a country liberalize its labor laws if the labor market is already very flexible.[58] Instead, the IMF will likely seek greater reforms in countries with heavily regulated domestic labor markets.[59] We therefore include an estimate of a country's *Firing Costs*,

[56] Stone 2002.

[57] Steinwand and Stone 2008, Table 4.

[58] See, for example, the IMF's staff report for Ireland (http://www.imf.org/external/pubs/ft/scr/2010/cr10366.pdf).

[59] See, for example, the IMF's staff report for Greece (http://www.imf.org/external/pubs/cat/longres.cfm?sk=23839.0)

which measures the cost of severance pay and advance notice (in weeks of pay) for laying off one worker with twenty years of service.[60] Higher firing costs are an indicator of more restrictive labor market regulations.[61]

- Geopolitics—We include a measure of how closely countries are allied with the United States based on voting in the UN General Assembly. This variable, *UN Voting*, measures the extent to which a country votes in line with the United States. Votes in agreement with the US are coded as 1, votes in disagreement are coded 0, and abstentions or absences are coded 0.5.[62] Votes where more than 80 percent of the countries agreed are discarded. The resulting numbers are then divided by the total number of votes in each year. Higher values indicate greater correspondence between a country's UN voting record and the voting record of the United States. Previous studies find that a greater the correspondence between a country's UN voting record and the voting record of the United States results in more favorable treatment of the country by the Fund.[63]

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[60] We coded national labor legislation that was in effect from 1980 to 2000 when it was available in English, French, Portuguese, or Spanish; otherwise we relied on secondary sources.

[61] This also accounts for the possibility that existing labor market regulation may be a function of the power of domestic labor.

[62] Thacker 1999.

[63] Stone 2002.

All models are estimated using negative binomial regression. The negative binomial regression model is appropriate given the discrete, non-negative properties of the dependent variable. The dependent variable equals the sum of the labor conditions included in a country's loan program in a given year with each condition weighted by its relative stringency, as described above. This variable ranges from zero to fifteen. The modal value is zero.[64] In fact, 60% of the sample observations have no labor market reform conditions. Given this, one might argue that the zero inflated negative binomial model may be more appropriate here. However, the large number of zeros in the count variable may be the result of unobserved heterogeneity.[65] Unobserved heterogeneity can cause both overdispersion and an increase in the proportion of zeros. The negative binominal model can account for the overdispersion and the excess zeros in the raw data. The negative binominal model responds to the under prediction of zeros in the Poisson regression model by increasing the conditional variance without changing the conditional mean.[66] In contrast, zero modified count models change the mean structure to explicitly model the production of zero counts. This is done by assuming that zeros can be generated by a different process than positive counts. However, the theory advanced in the current study does not suggest that the zeros are generated by a different process. Given this, it is difficult to justify theoretically the use of the zero inflated negative binomial model.

[64] The mean value of the dependent variable is 1.3 and the standard deviation is 2.2. The maximum value is 15 (Honduras 2000).

[65] Long 1997; Cameron and Trivedi 1998.

[66] Long 1997.

Results

A simple t-test provides preliminary support for the hypothesis. On average, labor conditions in loan programs negotiated more than six months before an election are twice as stringent as labor conditions in loans negotiated within six months of a pending election. The dependent variable, which can be interpreted as the stringency of labor conditions, equals 1.5 for democratic countries without an election pending in the next 6 months, on average. In contrast, the stringency of labor conditions is less than half that (0.7) in loan programs agreed within six months of an election. This difference is statistically significant at the 0.01 level, as demonstrated by a two-sample t-test with equal variances.

Table 1 reports the coefficient estimates for the negative binomial regressions of the stringency of labor market reform conditions on *Pending Election, Months until Elections* and key control variables. The coefficient estimates demonstrate that imminent elections reduce the stringency of labor conditions. In Columns 1 and 2, the key variable of interest is *Pending Election,* which is coded 1 if an election was held within 6 months of the Letter of Intent and 0 otherwise. In Column 1, a parsimonious model is estimated using the full sample of 297 observations. In Column 2, additional control variables are added, which reduces the sample size and degrees of freedom. In both models, the estimated coefficient on *Pending Election* is negative and statistically significant. Loans agreed within six months of an upcoming election have fewer and less stringent labor conditions than loans agreed further away from an election, all else equal. More precisely, labor conditions included in programs agreed within six months of an upcoming election are, on average, 50% less stringent than those in loans agreed further away from pending elections, holding all else constant. In the run up to national elections, governments get a better deal from the Fund in the

form of fewer and less stringent labor-related conditions. Conditionality is a negotiated outcome between borrowing governments and the IMF in which imminent national elections appear to play a critical role.

[Table 1 about here]

Similar results are reported in Columns 3 and 4 of Table 1. In these columns, the key variable of interest is *Months until Elections*, which equals the number of months that elapsed between the signing of the Letter of Intent and the nearest subsequent election (up to a maximum of 24 months).[67] In both columns, the estimated coefficient on *Months until Elections* is positive and statistically significant. The positive coefficients illustrate that loans negotiated further away from national elections contain more stringent labor conditions, all else equal. An increase in the time until elections by one standard deviation over the mean value of *Months until Elections* increases the stringency of labor conditions by 31%, all else equal. Governments appear to be more willing to accept stringent labor conditions when elections are further away. This result is consistent with the estimated coefficients on *Pending Elections* reported in Columns 1 and 2. In sum, the proximity of elections in borrowing countries has a significant, systematic effect on labor-related loan conditions.

A few words about the control variables are in order. Firing costs are not a robust predictor of the intrusiveness of IMF labor conditionality. If loan conditions were set in response to economic conditions, countries with more rigid labor markets would receive more labor market reform conditions. However, the estimated coefficients on *Firing Costs* in Table 1 are statistically insignificant. Countries with

[67] Results are robust to using the full range of values for *Months until Elections*; however, the magnitude of the coefficient is smaller.

strict labor market regulations (i.e., high firing costs) are no more likely to receive labor conditions than countries with flexible labor markets (i.e., low firing costs), all else equal. This null result suggests that labor conditions are not set solely in response to economic concerns. Instead, labor conditions are determined, in part, by political considerations, such as upcoming elections. This finding calls into question the image of the IMF as a technocratic lender immune to national-level politics.

As expected, *GDP per capita* and *GDP* have significant negative effects on labor conditionality. Previous studies consistently find a negative correlation between economic development and the number of IMF loan conditions.[68] The current study finds that more developed countries receive fewer labor conditions. Similarly, larger countries tend to receive fewer and less stringent labor conditions, which may be because larger countries are better able to resist IMF conditionality.[69] The estimated coefficients on *UN Voting* are positive and statistically significant. This finding suggests that the greater the correspondence between a country's UN voting record and the voting record of the United States, the more labor conditions the country will receive. In contrast, previous studies generally find no robust correlation between *UN Voting* and the scope of loan conditions.[70] It is possible that concessions made to US allies on non-labor-related conditions are offset by more stringent labor conditions.[71]

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[68] Steinwand and Stone 2008, Table 4.

[69] Stone 2002.

[70] Stone 2008.

[71] Although it is not possible to directly test this idea using the data under investigation here, potential tradeoffs between different types of loan conditions is a potentially fruitful area for future research. Stone's (2008) finding that elections do

Debt is not a robust predictor of labor conditionality. High-debt countries receive no more (or less) stringent labor conditions than low-debt countries, all else equal. Interestingly, this null result suggests that domestic politics (i.e. elections) give governments more bargaining power with the Fund than national economic conditions (i.e. debt levels).

The sample in Table 1 includes the universe of IMF loans to democratic countries during the period from 1980 to 2000. However, selection into this sample is not random. Only some countries enter into IMF programs and these countries differ systematically from countries not under IMF programs. The non-random selection of countries into IMF programs may affect the relationship between elections and labor conditionality. It is possible, for example, that governments facing imminent elections simply choose not to sign a Letter of Intent until after the election. To test for this possibility, a two-step Heckman selection model is estimated.[72] In the selection equation, the dependent variable is equal to one for years in which a country is under an IMF program and zero otherwise. Three variables enter only the selection equation. The first variable unique to the selection equation is total reserves in months of imports, which serves as a proxy for governments' liquidity concerns.[73] Previous studies show that reserves are one of the best predictors of participation in an IMF

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not affect the scope of loan conditions suggests that the IMF does not go easy on some types of conditions and ratchet up other types of conditions.

[72] An alternative would be to estimate a partial observability model. Partial observability models have poor convergence properties and the results are not generally robust to specifications changes (Stone 2011, 135). Using the data for this study, convergence could not be achieved.

[73] Pop-Eleches 2009.

program.[74] Governments facing severe liquidity concerns are more likely to approach the IMF for a loan. Although reserves are a good predictor of participation in loan programs, they are unlikely to influence the stringency of labor conditions because labor-related conditions do not help countries overcome low foreign reserve levels. Consequently, there is little reason to expect a correlation between labor conditions and reserves.

The second variable that enters only the selection equation is an indicator of whether a country was previously under an IMF program. Past participation in IMF programs is a strong predictor of present participation.[75] The selection equation also includes a variable, *Election Year,* which is coded 1 for election years and zero otherwise. This variable reports different information from the variable *Pending Election*, which is coded only for country-years in which an IMF loan occurs. In contrast, *Election Year* is coded for all country-years, irrespective of the presence or absence of an IMF loan program. It is possible that elections influence the likelihood of a loan agreement. Governments may be more reluctant to sign a loan program during an election year. Given this, the selection of countries into IMF loan programs may be determined, in part, by national elections. To test this possibility, *Election Year* is included in the selection equation. Several additional variables are included in the selection equation, namely debt levels, GDP per capita and GDP. These three variables are also included in the outcome equation.

The results from the Heckman selection model are reported in Table 2. The coefficient estimates from the second stage of the Heckman model confirm that elections systematically influence the stringency of labor conditions. Correcting for

[74] Bird 1996; Vreeland 2003.

[75] Vreeland 2003; Vreeland 2007.

the non-random selection into IMF programs increases slightly the standard errors on *Pending Election.* However, the estimated coefficients remain statistically significant at conventional levels and the magnitude of the coefficients are not meaningfully different from those estimated using the negative binominal model. Loans negotiated within 6 months of a pending democratic election have significantly less stringent labor conditions than loans negotiated with democratic countries where elections are more than 6 months away.

[Table 2 about here]

As expected, reserves are a robust predictor of participation in IMF programs. Countries with low foreign reserve levels are more likely to enter an IMF program. Countries with high levels of debt service are more likely to enter an IMF program as are countries with past experience with IMF loan programs. These results are all consistent with previous studies.[76] *Election Year* is not a robust predictor of participation in IMF loan programs. Governments are no more or less likely to enter IMF programs during election years than non-election years. Perhaps this is because it is infeasible to delay the decision to go to the IMF when the costs of borrowing from private capital markets become prohibitively expensive.

Up to this point, election dates have been treated as exogenous. However, election dates are not fixed in all democratic countries. In parliamentary systems, for example, governments can call early elections.[77] This raises the possibility that governments might call early elections in order to increase their negotiating power

[76] Vreeland 2007; Steinwand and Stone 2008.

[77] Leblang (2002) addresses the possibility of early elections by creating a variable called, *Campaign,* coded as the three months prior to an election and the election month itself.

with the IMF. Although this is possible in theory, there are only six early elections in our sample. There is no evidence that any of these six early elections were called in response to (or anticipation of) negotiations with the IMF.[78] Excluding the six early elections from our sample does not change significantly the estimated coefficients on the key variables of interest, *Pending Elections* and *Months until Elections*.

[Table 3 about here]

Despite the paucity of early elections in the sample, it may be useful to examine the effects of potentially endogenous elections on conditionality. In Table 3, the estimating equations include an additional variable that is coded 1 if election dates are not fixed and zero otherwise. More precisely, the variable *Endogenous Elections* is coded one for parliamentary and semi-presidential systems and zero for presidential democracies. The estimated effects of election proximity on labor conditions are robust to the inclusion of *Endogenous Elections*, as illustrated by the estimated coefficients and corresponding standard errors on *Pending Elections* and *Months until Elections* in Table 3. Furthermore, the potential for early elections does not have a robust effect on labor conditionality. The estimated coefficient on *Endogenous Elections* is insignificant across all four models. The capacity to call early elections does not appear to give governments a bargaining advantage. Governments that have the ability to call early elections receive no fewer or less stringent labor conditions than governments that face exogenously fixed election dates, all else equal.

Conclusion

Although a substantial body of research examines the domestic effects of democratic elections, considerably less research examines their international consequences. The current study offers a novel investigation into how elections matter

[78] Keesing's World News Archive.

for international negotiations. In one of the first empirical tests of Schelling's and Putnam's conjecture, the current study finds evidence that elections influence states' negotiations with the IMF. Governments facing imminent elections get better loan terms: IMF loans agreed within six months of an upcoming election have less stringent labor-related conditions than loans agreed further away from an election, all else equal.

This evidence has several significant implications. First, national governments can leverage electoral vulnerability in loan negotiations with one of the most powerful international organizations in the global economy today: the IMF. Negotiations with the IMF are arguably a hard test of election effects. They occur during times of economic crisis and between states and unelected international bureaucrats. Given this, one might expect IMF loan negotiations to be particularly invulnerable to electoral pressures. Yet, the proximity of national democratic elections systematically affects the outcome of negotiations between democratic governments and the IMF by giving national governments additional leverage in their negotiations with the Fund. This finding has important implications for the scores of governments that negotiate new programs with the IMF each year.

Second, our finding that national governments can leverage electoral vulnerability in IMF loan negotiations has implications for the broader literature on international negotiations. Previous research on the influence of elections on international negotiations has concluded, contrary to this study, that electoral uncertainty weakens rather than strengthens the bargaining position of the national government.[79] One reason for the disparity in the findings may be that existing research has mainly focused on interstate negotiations, not negotiations between states

[79] Milner 1997.

and international organizations. The dynamics of interstate negotiations should differ from those between states and international organizations. In interstate negotiations, both sides must deal with the domestic political fallout of any negotiated agreement, and the requirement to obtain legislative approval of interstate agreements affects the structure of the domestic game. Consequently, domestic political factors such as elections may provide national governments with leverage in some negotiations but not others. The current study provides novel evidence regarding negotiations between states and non-state actors, specifically international organizations. Further empirical research that attends to the differences in the structure of the negotiating "game" and the actors involved could shed further light on the conditions under which national governments can leverage domestic politics in international negotiations.

Third, this study points to the importance of moving beyond examining the total number of conditions and looking instead at the substance of loan conditions. By knowing what reforms the IMF requires as conditions of loans, it is possible to trace the distributional impacts of the loan conditions. Political opposition to IMF lending comes from the distributional impacts of the specific loan conditions.[80] Understanding the potential winners and losers from IMF loan conditions helps to elucidate the politics and coalitions surrounding these controversial lending programs.

Finally, the distributional impacts of specific loan conditions may also shed new light on the patterns of compliance with loan conditions. The economic effects of IMF loan programs depend critically on governments' implementation of the conditions. Loans with more stringent labor conditions, for example, may result in lower levels of compliance than those with less stringent conditions. This is an

[80] Bienen and Gersovitz 1985.

important avenue for future research – one made possible, in part, by the original data and novel results described in this study.

Table 1: Estimated effects of election proximity

	(1)	(2)	(3)	(4)
Pending Elections	-0.815***	-0.720***		
	(0.213)	(0.233)		
Months until Elections			0.036***	0.040***
			(0.010)	(0.012)
L.GDP per capita (ln)	-0.269*	-0.363**	-0.284*	-0.417**
	(0.150)	(0.156)	(0.163)	(0.192)
L.GDP (ln)	-0.137	-0.261**	-0.093	-0.237**
	(0.091)	(0.113)	(0.096)	(0.120)
L.Debt		-0.000		0.008
		(0.008)		(0.016)
L.Firing		0.002		0.000
		(0.004)		(0.005)
L.UN Voting		4.412***		4.645***
		(1.240)		(1.445)
Constant	6.370***	8.941***	4.777***	7.939***
	(1.709)	(2.280)	(1.731)	(2.416)
Alpha (ln)	0.034	0.015	-0.017	-0.053
	(0.226)	(0.250)	(0.280)	(0.297)
# of Countries	52	40	51	40
Observations	297	221	235	171

Notes: Negative binominal regression with robust standard errors clustered by country reported in parentheses. All estimated models include year fixed effects. *** $p<0.01$, ** $p<0.05$, * $p<0.1$

Table 2: Two stage Heckman selection model

		(1)	(2)
Labor Conditionality	Pending Election	-0.685*	-0.752*
		(0.377)	(0.423)
	L.GDP per capita (ln)	-0.013	-0.297
		(0.178)	(0.214)
	L.GDP (ln)	-0.236**	-0.332***
		(0.092)	(0.115)
	L.Debt		0.010
			(0.015)
	L.Firing		0.003
			(0.005)
	L.UN Voting		9.077***
			(2.347)
	Constant	8.244***	9.958***
		(1.904)	(2.562)
IMF Loan	L.Reserves	-0.036*	-0.036*
		(0.019)	(0.020)
	Election Year	-0.075	-0.091
		(0.101)	(0.108)
	L.Debt	0.010***	0.009**
		(0.004)	(0.004)
	L.IMF Loan	1.212***	1.156***
		(0.091)	(0.105)
	L.GDP per capita (ln)	0.235***	0.197***
		(0.051)	(0.052)
	L.GDP (ln)	-0.019	-0.023
		(0.029)	(0.030)
	Constant	-2.628***	-2.262***
		(0.565)	(0.595)
	Sigma (ln)	0.764***	0.799***
		(0.056)	(0.103)
	Observations	1,278	1,252

Notes: Heckman selection model with standard errors reported in parentheses. The second stage model includes year fixed effects. *** p<0.01, ** p<0.05, * p<0.1

Table 3: Estimated effects of endogenous elections

	(1)	(2)	(3)	(4)
Pending Election	-0.822***	-0.747***		
	(0.212)	(0.231)		
Months until Election			0.038***	0.040***
			(0.010)	(0.012)
Endogenous Elections	0.205	0.246	0.332	0.427
	(0.259)	(0.355)	(0.323)	(0.363)
L.GDP per capita (ln)	-0.242	-0.295	-0.250	-0.307
	(0.153)	(0.206)	(0.162)	(0.229)
L.GDP (ln)	-0.145	-0.288**	-0.101	-0.278**
	(0.091)	(0.120)	(0.094)	(0.126)
L.Debt		0.002		0.011
		(0.009)		(0.016)
L.Firing		0.003		0.002
		(0.003)		(0.005)
L.UN Voting		3.764**		3.534**
		(1.525)		(1.798)
Constant	6.278***	9.064***	4.530***	8.028***
	(1.693)	(2.246)	(1.688)	(2.362)
Alpha (ln)	0.008	0.001	-0.075	-0.104
	(0.218)	(0.240)	(0.273)	(0.285)
# of Countries	52	40	52	40
Observations	294	221	235	171

Notes: Negative binominal regression with robust standard errors clustered by country reported in parentheses. All estimated models include year fixed effects. *** $p<0.01$, ** $p<0.05$, * $p<0.1$

Appendix A

Nine labor-related issue areas are identified and coded. If there are multiple actions at the same level of conditionality for a particular issue-conditionality pair in a Letter of Intent, then we only count it once:

- Public sector wage levels
- Public sector employment levels - includes capitalization and outsourcing/contracting of functions formerly within a public enterprise
- Privatization - includes reorganization, denationalization, divestiture
- Minimum wages - private sector
- Private sector wage restraint other than minimum wages
- Social security - reducing social security provisions, including health care, disability provisions, unemployment insurance and payroll taxes
- Public pension reforms - reducing costs and changing public pension system
- Labor market flexibility – includes facilitating layoffs, reducing severance pay, the easing of limitations on fixed-term contracts, the easing of conditions for labor supply/outsourcing, and rationalization, modernization, deregulation, or other “general labor reforms”
- Collective bargaining decentralization

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