COMMENT TO
"HARD WORK, AND FOREIGN HELP –
HOW TO SUCCESSFULLY CONDUCT ADJUSTMENT WITH OFFICIAL ASSISTANCE"
BY MARTIN LARCH, KRISTIN MAGNUSSON BERNARD AND BALINT TATAR

*Nicola Giammarioli**

Summary and main conclusions of the paper

The paper provides a contribution to the issue on how to evaluate the conditionality and effectiveness of IMF programs. This is a very topical issue, highly debated in the academia, among practitioners and policy makers. Just as anecdotal evidence, a google research of "conditionality and effectiveness of IMF programmes" gives 95,000 entries.

In the current juncture, especially with European adjustment programmes expired or about to finish, there is an increasing demand for empirical and theoretical analysis aimed at ether challenging or confirming the common wisdom. Against this background, the paper constitutes an attempt to bring evidence on the relationship between program conditions and success of IMF programs from a historical perspective. It shows that actual policy adjustment, stringent conditionality and favourable external conditions are key factors of success for IMF programs.

The paper analyses 176 IMF supported programs in the period 1993-2010 and constructs an indicator to measure programs' success in terms of growth and public debt reduction. In particular, it identifies, performing an econometric analysis, those factors which are considered relevant in predicting successful adjustments.

Those factors can be summarised in "hard work", notably fiscal consolidation and decisive fiscal repair, as well as in "stringent programme conditionality". Supportive external conditions such as global growth or investors risk appetite also play a decisive role.

The analysis is finally utilised to draw some conclusions on the economic adjustment programmes which have been undertaken in the euro area since the eruption of the sovereign debt crisis.

General discussion

The evaluation of official assistance programs may concern different aspects of a country's domestic economy. How to incorporate different dimensions of valuation (e.g., post-program growth, post-crisis debt level, unemployment, financial market access, etc.) while keeping the criterion of successfulness meaningful and easy to interpret?

According to an OECD study, H. Blöchliger *et al.* (OECD, 2012), past successful consolidation events can be detected by a turnaround of the primary balance, form deficit to surplus. However in most of the episodes studied (Australia, Canada, Denmark, Finland, UK, Greece, Ireland, Italy, Japan, and Japan), the public debt at the end of the consolidation period was higher that at the beginning. Those cases would not classify as success in the Larch et al. paper, but indeed they were! Moreover the OECD analysis show that consolidation is possible outside an IMF programme. Is there scope to control for those episodes in the econometric analysis? Or for a counterfactual analysis?

* European Stability Mechanism.

The paper put together, without differentiating, a sample of countries with heterogeneous types of crises, both from a geographical point of view and different root causes. The demand for official assistance might be motivated by different reasons (as crises are of different nature): debt unsustainability (Russia), banking crises (Korea), massive currency depreciation (Mexico, Korea), balance-of-payments crises, etc. In essence, the sample includes countries which asked for official assistance for very different motives while the dependent variable only captures growth and debt reduction.

The conditionality requirements of the Fund changed throughout the sample. This could have had an impact on the "success" of the programs as well. The regressions do not control for such policy shift, though. Moreover the paper is silent about the common IMF practice to have successor programmes. Uruguay, for example, was under five different IMF programmes between 1991 and 2007. If we take the 5-year window utilised in the paper, between 1997 and 2002, Uruguay was contemporaneously under a programme, in post-programme and under distress and hence in need of a successor programme. Does it create an endogeneity problem? How to interpret the result in this cases?

To what extent is the post-program recovery related to the successfulness of the assistance program? It is commonly admitted that the rapid growth of Asian countries after the 1997-98 financial crisis is more related to national crisis management than IMF programs which were heavily criticized in Asia (even declined in Malaysia). Moreover, due to the existence of business cycles, downturns are most likely followed by periods of growth. It might be a good idea to control the boom-and-bust cycle in order to distinguish the effect of IMF programs from the cyclical effects.

The paper concludes by utilising its findings to draw lessons from the recent economic adjustment programmes undertaken in the euro area. However, the situation in Europe might be very different from other countries where IMF programs were solicited. First the programme were not managed by the IMF alone, but also the European Commission and the European Central Bank were involved. Second, the amount of financial assistance has been of a magnitude without precedents in the IMF history. Third, the countries under a programme were all members of a monetary union, a situation which determined additional elements of complexity, including the impossibility of utilising the nominal exchange rate channel. Finally, the nature of the crisis in Europe has its focus on sovereign debt and financial instability while IMF programmes rather deal with balance-of-payments crises.

Technical discussion

On the econometric analysis, the selection of "index of success" as a dependent variable raises some questions. First, there is a time difference between the descriptive statistics utilised to show the evidence where time period {T-2,T-1]; [T,T+2]; and [T+3,T+4} are utilised with respect to the more formal econometric analysis where (T+5, T, T+5) period is introduced. Second, the dependent dummy variable includes two aspects which can be reversely affected by independent variables. This makes the interpretation of regression results difficult. For example, an increase in public debt may stimulate economic growth but it is undesirable for the debt reduction objective. More importantly, it makes the conclusion weaker to include public debt both in the left and right hand of the regression equation. In other words, as *success* is partly defined as lower government debt, it is not surprising that fiscal consolidation leads to more *success*.

The paper criticise the use of "threshold analysis". However the authors themselves utilised thresholds for growth performances (less than 3 per cent, between 3 and 6 per cent, above 6 per cent) as well as thresholds for debt ratios (below and above 25 per cent). In addition, they compare growth outcomes before and after a crisis. It is worth however underscoring that not necessarily reaching pre-crisis levels is always feasible or warranted. Crisis episodes often represent structural changes in the economies hence making comparisons of pre-crisis and post-crisis periods difficult, unless those structural changes are controlled for.

On the definition of sustainability of public finances, the paper takes a very widespread shortcut of utilising the level of public debt as a proxy. However, as debated at length during the SADIBA workshop of 2000, sustainability of public finances depends on a wide range of parameters and also on the dynamic interaction among them (primary surplus, interest rates, inflation, exchange rates, etc.). While it is difficult to take care of all of them in a technical paper, in practice they play a major role. This is confirmed by the empirical evidence that crises happened in the past at very different levels of public debt.

Overall, there is a risk that the results of the paper might suffer either from type 1 or type 2 errors. In other words success episodes might be considered a failure, while lack of consolidation might be capture as a success story. Refining the technical analysis to minimise such risks is therefore advisable.

Conclusion

In conclusion, the paper is very interesting and deals with a "hot topic" in the current policy debate. The most interesting part is represented by the attempt of using empirical evidence from IMF past experience to draw some lessons for Europe.

The paper would however benefit from putting the European experience in perspectives by better appreciating the peculiarities of the programmes at stake (magnitude of financial assistance, length of repayment period, role of the so-called "troika") as well as the specific framework (monetary, union, institutional settings, etc.). Furthermore, the empirical analysis could be improved by adding a taxonomy of crises by taking into account the root causes (e.g., currency, balance of payments, financial, fiscal crises); by identifying the specific impact of a programme (controlling the sample by adding countries having experienced adjustment path without a programme); and by refining the index utilised to proxy "success".