Why does the IMF assign labor conditions? The Burden of Adjustment, Exchange Rate Regimes, and Labor Conditions

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Working Paper No. 18
September 2019

CGPE WORKING PAPER SERIES

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Why does the IMF assign labor conditions?

The Burden of Adjustment, Exchange Rate Regimes, and Labor Conditionality

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Introduction

This paper investigates when and why the International Monetary Fund (IMF) assigns labor conditions. are highly consequential: they They might, for example, mandate lay-offs of public workers and advise creating caps on wage increases in the public and private sectors (e.g. in Latvia in 2008). Alternatively, they might lower the minimum wage, decentralize collective bargaining institutions, and ease the restrictions on firing in labor law (e.g. in Greece in 2010 and Portugal in 2011). Those measures reduce the bargaining power of workers and indirectly lower wages. Ninety-two countries received at least one labor condition between the years 1980 and 2013. Among those countries, Gabon, for instance, received thirteen separate labor conditions in 1996 (the highest number of labor conditions between those years). Yet, the Fund does not always assign labor conditions, such as in Hungary in 2008. Similarly, Madagascar did not receive any labor conditions in its eighteen programs between 1980 and 2013. Why does the IMF assign labor conditions to some borrowers but not to others? When and why does the Fund decide to include labor conditions in program design?

This paper argues that the IMF assigns a higher number of labor conditions in fixed exchange rate regimes compared to floating ones, all else being

equal. In fixed regimes, it substitutes internal devaluation with external adjustment. Labor conditions in fixed regimes lower unit labor costs, indirectly lower product prices, and reduce the aggregate demand in the borrowing country. The Fund envisages s the balance of payments of the country). In floating regimes, currency depreciation in the lead up to the crisis and/or to the IMF program is assumed to make products cheaper and hence remove the need for stringent labor conditions. This explains why we observe cross-country variation in terms of design and stringency of labor conditions under IMF programs. Furthermore, this finding demonstrates that the burden of adjustment disproportionately falls on the shoulders of labor groups in fixed regimes. Both internal and external adjustment are plausible macroeconomic strategies, and the choice of one or the other is a political decision (Walter 2013, p.3). The paper demonstrates that IMF programs shift the burden to labor groups in fixed regimes.

In explaining the significant variation in the scope of IMF conditionality, previous studies looked at the role of economic ideas and norms (Chwieroth 2007, 2015; Nelson 2014, 2017), geostrategic interests (Dreher and Jensen, 2007; Dreher, Sturm, and Vreeland 2012, 2015; Stone 2002, 2008), international economic interests and composition of donors (Copelovitch 2010; Gould 2003, 2006), and organizational power of domestic groups (Caraway, Rickard, and Anner 2012; Nooruddin and Simmons 2006). This study complements the existing studies in three ways. Firstly, scholars have previously demonstrated that powerful labor interests would be represented at the negotiation table by their governments, and consequently they would avoid intrusive labor conditions (Caraway et al. 2012). This paper complements this analysis by looking at the other

side of the negotiation table and explains why the Fund might include (and perhaps insist on) labor conditions in some cases, controlling for the organizational power of labor groups. It, in other words, explains the Fund side of labor conditionality in addition to domestic politics. Secondly, it deepens the inquiry on conditionality by

conditions. Disaggregating conditionality is analytically and empirically important (Caraway et al. 2012; Nooruddin and Simmons 2006; Rickard and Caraway 2018; Stone 2008). Different geostrategic and domestic interests can compete to avoid (or include) subcategories of conditionality, and we can have a better understanding of which factors take precedence by employing a disaggregated approach. Thirdly, while there is a broad consensus in the literature that the Fund staff is socialized into neoliberal economic ideas and beliefs (Chwieroth 2007, 2015; Nelson 2014, 2017; Woods 2006) and that they are not essentially sympathetic to labor unions and labor rights (Caraway 2006), we do not know much about how those ideas translate into different subcategories of conditionality. This paper delves deeper into the specifics of the neoliberal agenda and specific policy choices made in line with its agenda. In other words, it contributes to the growing literature on how the IMF sees macroeconomic problems and their solutions in borrowing countries (Broome and Seabrooke 2007; Moschella 2012).

Furthermore, research on the IMF in the past two decades has focused on the international and domestic political interests surrounding IMF programs, and has ironically overlooked the original purpose of the Fund to regulate exchange rates (Dreher and Walter 2010). Indeed, recent studies on the IMF scarcely speaks to the literature on exchange rate regimes, which is surprising considering the original

purpose of the IMF. This paper bridges this gap between those two groups of studies.

The findings also have important policy implications especially for labor interests. Scholars have previously demonstrated that IMF programs distribute income away from labor groups (Pastor 1987; Garuda 2000; Vreeland 2002).

on average in countries under IMF programs compared to the countries outside of programs. In his conclusions, he notes that:

be by design. After all, the IMF presumes that balance-of-payments crises are due

rch to delve deeper into the reasons

for lowered income under IMF programs (Vreeland 2002, p.133).

This paper builds on earlier studies showing that lowering the income of labor groups through labor conditions in fact happens *by design* and serves the purpose of financing the spending gap in borrowing countries. It, in other words, demystifies the income distribution away from labor groups and towards capital owners under IMF programs.

In this paper, I firstly show that exchange rate regime plays an important role in assigning labor conditions, by conducting a documentary analysis of Fund programs in Latvia and Hungary in 2008. Those two cases provide an excellent comparison. They are similar in many respects such as labor market regulation, firing costs, trade union density, overall macroeconomic indicators, type of economic crisis in 2008 (i.e. banking crisis)0h(i.e. banking crisis)0h(i.e. bankingnk100(provide)5( )-9

hand, there was no need for labor conditions, as the country had a floating regime.

I then test this association between fixed exchange rate regimes and the stringency and the number of labor conditions in a global sample of IMF borrowers over the years 1980 and 2013. I show that countries with fixed regimes receive a higher number (by simple count of labor conditions in programs) and also more stringent conditions (such as performance criteria) as opposed to less stringent conditions (such as structural benchmarks), controlling for geostrategic interests, economic factors, and the organizational capacity of labor groups. Moreover, the results are robust with alternative model specifications and measurement, inclusion of control variables, and time trends.

In the rest of the paper, I firstly provide a more detailed survey of the literature on IMF conditionality to show the theoretical and methodological progress in the literature in unpacking conditionality, and discuss how we can further deepen our understanding. Then I explain the politics of internal versus external adjustment and discuss how this translates into concrete labor conditions in Fund programs. Next, I discuss two cases, namely Latvia and Hungary in 2008, to show that exchange rate regime significantly influences labor conditions and that labor conditions are utilized as a substitute for currency depreciation. Then, I provide strong quantitative evidence that borrowing countries with fixed exchange rate regimes receive more stringent labor conditions and that there is indeed a particular pattern in the Fu

the argument and concludes with some policy recommendations.

Geostrategic Interests, Domestic Groups, Ideas, and Conditionality

Studies

groups with greater organizational power are more likely to avoid intrusive labor conditions under IMF programs. They particularly argue that democratic governments represent the interests of more organized labor groups at the negotiation table. is one of the pioneering works

specific subcategory of conditionality. The study explains variation in labor conditions by the variation in domestic organizational power of labor groups.

What of the IMF side of the negotiations over labor conditions, however? As demonstrated by realist/rationalist accounts of the Fund, the IMF adjusts its conditionality for reasons independent of domestic interests (Dreher et al. 2015; Stone 2008). In fact, one can also look at the other side of the negotiation table and explain why and when the IMF would propose and insist on the inclusion of labor conditions in the final Memorandum of Understanding. Negotiations are by

over the go [1] By conducting a quantitative analysis, this

or conditions

would play a role,

The constructivists

Stone 2008, p.141).[3]

to external adjustment (i.e. depreciating the currency) creates different policy

2011). [4]

made by the IMF staff in the specification of conditions render conditionality

Hodie, and Bauer 2010). Although the doctrine of neoliberalism promises efficient

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policy options and outcomes, as acknowledged by the Fund staff (IMF 2013a, pp.4-

because of the

organizational culture and yet sufficiently open to interpretation that they raise the

In this paper, I am interested in labor conditions and their impact on labor groups. I am particularly interested in why the Fund assigns labor conditions and

particular interpretation of international and domestic economic problems and solutions to them, principally defined within the neoliberal agenda, give rise to particular types of conditionality in its programs. Regarding labor conditions, I argue that the Fund

country.

request such arrangements. Alternatively, when labor groups do not have sufficient organizational capacity to disrupt the government, their interests may be overlooked at the negotiation table (Caraway et al. 2012). To be sure, the Fund responds to both international and domestic political constraints, particularly because its agenda is sufficiently vague. This simultaneously gives Fund staff leeway for decision-making and also obliges a certain degree of interpretation and choice on their part (Chwieroth 2013, p.268). We can tease out when the Fund itself

borrowing country, and see whether fixed exchange rate regimes receive more stringent labor conditions compared to floating ones, controlling for the organizational capacity. This is in fact one of the strengths of quantitative methods: they can make probabilistic predictions controlling for confounding impact (see Chwieroth, 2007 for more discussion).

If the Fund makes hard choice

income in fixed exchange rate regimes, in order to lower production costs and to boost exports, we should observe this specific logic in the memoranda of understanding (i.e. documents that specify the agreed conditions between the Fund and the borrowing government), staff consultations, and policy guidance documents. Moreover, we should observe a broad positive association between having a fixed exchange rate regime and receiving more stringent labor conditions in IMF programs, indicating that this particular logic indeed leads to labor conditions. In the next section, I firstly look at two cases, i.e. Latvia and Hungary in 2008,

played a signific

I then test this theory in a sample of 92 IMF program countries between the years 1980 and 2013.

Currency Pegs and Internal Devaluation: Latvia and Hungary in 2008

Latvia and Hungary under their respective IMF programs in 2008 provide an excellent comparison in terms of delving into the

stringent labor conditions. Both countries are former Eastern bloc members and completed their transitions to the market economy after the end of the Cold War. They had similar levels of trade union density by the time they borrowed in 2008 (14.4 per cent in Hungary and 15.1 per cent in Latvia) (OECD 2008) and similar GDP per capita income (16,348 U.S. Dollars for Latvia and 15,739 U.S. Dollars for Hungary). They had similar levels of firing costs and labor market regulation (Adam, Bastani, Bishop, and Deakin 2016). Moreover, both received substantial assistance from the Fund for their transitions and liberalig0 G[oth)-mlW* ne(tr)-8(a)4(ns2(ve)4( )-9a)-5

conditions provides strong support for the theory that prevalent exchange rate regime predicts labor conditions. Put differently, the Fund did not have any reason to treat these two countries differently in terms of their geopolitical alliances or the power of trade unions and labor market regulation except for their exchange rate systems.

The Latvian government borrowed an exceptionally large amount 1.7 billion Euro (1,200 times its quota) from the Fund on December 12, 2008. The ate regime were two central issues in

reforms to help address a remaining competitiveness gap and support higher growth and employment through stronger exports in the absence of other policy p.4). In fact, Fund staff acknowledged t would have boosted exports, allowed lower interest rates, and eased pressures on p.6). Yet, they also agree that this would entail a trade-off and would destroy the savings of Latvian citizens (IMF 2010b, p.6). Instead, the Fund encouraged wage and product price cuts and envisaged that this would boost exports and start the economic recovery (IMF 2010b, p.7).

We can see the w evaluation of the need for labor conditions in fixed regimes in practice in the Latvian case. The IMF envisaged short-term labor conditionality in Latvia as a way of boosting the economy (IMF

first steps of the program. The Committee, in cooperation with social partners and labor experts, advised reducing public wages and monitoring private wages (IMF, 2009a, p.13). The program set an indicative target for the government wage bill at 214 million Lat for the end of March 2009 (a cut of more than one billion Lat

compared to December 2008 1,248 million Lat) (IMF 2010b, 28). By 2010, there was around a ten per cent wage cut in the economy. The rate was higher thirty per cent for public employees. The cut for the private sector might indeed have been higher and underreported due to the pervasive informal economy (OECD, 2017, p.24) (the full list of labor conditions for Latvia in 2008 is in Appendix III). Of course, those measures disproportionately put the burden of adjustment on labor groups and required significant reduction in their income. Even though the conditions seem to be mainly focused on the public sector, a relative decline in the public sector naturally drives down the wages in the private sector as well. The unit labor costs declined in Latvia in the fourth quarter of 2008 to 14.7 under the IMF program, down from 8.4 in the third quarter of the same year (OECD 2018).

Hungary borrowed from the IMF on

focused on reducing the government debt. The performance criteria established a ceiling for the primary balance and for increasing international reserves. The indicative target within the program established a ceiling for the total debt stock. Another performance criterion was on the non-accumulation of external debt arrears (IMF 2008, p.7). Unlike Latvia, the Fund did not assign conditions to cut wages in the public and private sectors, to reduce pensions, or to make the labor market more flexible. In fact, the government promised to maintain nominal wages in the public sector and to cut the additional 13th month salary and pension for public sector workers at the start of the program (IMF 2008, p.3). In the end, however, government provided an allowance that would compensate public employees for cutting the 13

Quantitative Evidence: Fixed Exchange Rate Regimes and Labor Conditions in Fund Programs

This section tests the association between exchange rate regimes and labor conditions in a global sample controlling for other relevant variables. The sample consists of only those countries that received at least one condition (any subcategory of conditionality such as labor, fiscal, monetary, financial, privatization, poverty reduction, or social policy conditions) under their respective IMF program between the years 1980 and 2013. Scholars have previously demonstrated that selection into IMF programs is not random (Dreher 2006; Reinsberg et al. 2019; Stubbs et al. 2018; Vreeland 2003). In order to overcome potential selection bias, the sample is restricted to IMF program countries and the years that they have received at least one conditionder their respective

sector wage bill, and pension rights as a labor condition. I weight each condition in accordance with its importance and give the highest weight to performance criteria and prior actions, and a relatively lower weight to benchmarks. Caraway et al.

crawling band. Some of those arrangements provide governments w1hvh

Figure 1. Mean Number of Labor Conditions in Floating versus Fixed Regimes, 1980-2013.

Source: IMF AREAR Reports; Kentikelenis et al. (2016) IMF Conditionality Dataset.

A simple t-test between the mean numbers of labor conditions for fixed and exchange rate regimes demonstrate that fixed regimes are more likely to receive higher number of and more stringent labor conditions ($p<0.01$). The results of negative binomial regression with robust standard errors clustered across countries also show that fixed regimes receive a higher number and more stringent conditions compared to floating ones. Table 1 shows the results.

Economic determinants.

organizational power of labor groups rather than a narrow focus on the manufacturing sector.

In this study, I include the one-year lagged strikes variable in the analysis as a more direct measure of organizational power. Strikes require substantial organizational capacity on the part of workers, and strikes in the

regarding labor conditions in the following one.[9] Particularly, if labor has significant disruptive capacity, they may choose not to include labor conditions in the program. Lagged strikes might indeed capture the organizational power more accurately for the purposes of this study, as they directly indicate the mobilization capacity of labor groups rather than their potential based on more (or less) specialized skills and unemployment rate. Furthermore, it is an economy-wide measure. Finally, it allows a more stringent test for the theory proposed in this paper. Data come from Robertson and Teitelbaum -profile strikes data set. For robustness checks, I estimate the number of conditions using the PLP data set as well. I also test the theory without the lagged strikes variable as well as with the strikes variable from the Banks (2012) data set.

Regulated labor market. The IMF might assign a higher number of, and more stringent, conditions in countries where employment is heavily protected; where there are safeguards against overtime work; collective agreements are extended in the labor market; and where there are stringent conditions for dismissal (Caraway et al. 2012). In order to control for such impact, I add the variable ***regulated labor market*** into the analysis. It is a composite variable based on legal

[9] Results are very similar when I lag the variable for five years instead of one. They are available upon request.

protection of employment and safeguards against overtime work. This measure is more extensive than firing costs. It not only includes firing costs but also collective agreements and wage protection, which are intimately related to the cost and bargaining power of labor. The measure also extends to the

Empirical Results

The results of the negative binomial regression show that countries with fixed exchange rate regimes are more likely to receive more stringent labor conditions compared to ones with floating regimes. The impact is significant at five percent level when we measure stringency of labor conditions (the weighed measure) as well as the total number of conditions (without weighing the conditions in accordance with their stringency). Table 2 reports the results.

Having a fixed exchange rate regime is the strongest predictor of receiving labor conditions, followed by being an ally of the G7 countries. Fixed regimes receive more than a half-point more conditions compared to floating ones (when conditions are weighed according to their stringency or simply counted as the total number of labor conditions). As the mean number of labor conditions in the sample is approximately four, the impact is substantively significant as well.

likely that the earlier studies that looked at the total number of conditions captured this impact. In fact, labor and fiscal conditions are negatively correlated when the total number of conditions are controlled in the sample; and the U.S. and G7 allies receive fewer fiscal conditions.[10] Those results firstly prove the analytical and theoretical importance of disaggregating conditionality. Secondly, they are in line with the theory proposed in this study: whenever the spending gap cannot be bridged by alternative measures such as fiscal cuts, labor groups bear ng gap cannot be

one. Banks (2012) strike data yield similar results. There might be more a complicated connection between the strength of labor groups and the market regulation legislation and labor conditionality than previously assumed. Future studies can look at the impact of labor market regulation on labor conditionality and investigate further the negative association. Perhaps, more robust measures of labor union power can explain the outcome. Alternatively, the impact of fixed exchange rate regimes might be offsetting this impact.

Economic determinants such as GDP, GDP per capita, and external debt and other variables capturing geostrategic interests such as UNSC membership and alliance with the U.S. do not seem to affect the stringency of labor conditions to a significant degree. Neither do the variables on democracies[11] or left-wing governments reach statistical significance.

For robustness checks, I re-run the models without the strikes and labor market regulation variables. On those variables, data are less complete, leading to a significant loss in the number of observations. For additional robustness checks, I also fit the model only with the firing costs. I also add the PLP to the analysis. The impact of fixed regimes remains robust when we include PLP measure in the analysis instead of lagged strikes (an additional model including PLP and time trend as well as firing costs is in Appendix II). Following Caraway et al. (2012), I interact PLP with the democracy variable, since the impact of PLP would only be observed in democratic regimes (Caraway et al. 2012). Democratic government would be receptive to and represent the labor interests at the negotiation table. For robustness checks, I also include the PLP without interacting it with the democracy

[11] The variable democracy is added for robustness checks and is not reported here for s

specifications, too. Democracies receive less stringent conditions when PLP is at zero. Certainly, the results on Model 10 should be cautiously interpreted, as there are fewer observations.

LeP is not utize

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