Who Is Credible? Government Popularity and the Catalytic Effect of IMF programs

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Motivation

- Key purpose of IMF programs is "to unlock other financing acting as a **catalyst** ...It (IMF program) serves as a signal that the country has adopted sound economic policies, reinforcing policy credibility, and increasing investor's confidence" (IMF 2020).
- However, not all IMF borrowers successfully restore market confidence (ex. Greece 2010-12).

Q. Under what conditions do IMF programs generate positive reactions from international investors?

Existing studies

- Overall, there are mixed results on the "catalytic effects".
- Existing studies focus on semi-structural factors.
  - Regime type (Bauer et al. 2012)
  - Geopolitical ties (Chapman et al. 2015)
  - Gov't partisanship (Cho 2014)
  - Macroeconomic fundamentals (Eichengreen and Mody 2001; Breen and Egan 2019)

Theory

1. International investors reward governments that are credibly committed to implementing IMF conditionality.
2. Government popularity is a powerful cue to assess a borrower's credibility.

Theory

- Focus: International portfolio investors
- Key for investors: Implementation of IMF conditionality
  - IMF conditionality includes essential reforms and austerity targets
  - Not every borrower successfully implements IMF conditionality.

$\rightarrow$ Investors carefully select credible governments.

Theory

- Government popularity serves as a credibility cue for successful reform.

- Government popularity is **not** a reflection of underlying economy, esp. for countries under reforms.
  - People show prospective attitudes during reform.
    - Stokes 2001; Wayland 1998; Echegrary and Elordi 2001
  - Not all IMF participants suffer low popularity.
    - ex. South Korea 1998-2000

Theory

- High gov't popularity helps **enactment** of tough reforms.
  - Ostrom and Simon 1985; Canes-Wrone and de Marchi 2002; Calvo 2007; Henisz and Mansfield 2019.

- High gov't popularity facilitates public **compliance** with reforms.
  - People support gov't policies if they have a favorable opinion of the gov't (Franklin et al. 1995; Meneguello 2005).

$\rightarrow$ Investors show a more favorable reaction to a more popular borrower.

Theory

- However, the impact of gov't popularity **decays over time**.
  - In the initial years, cues are highly important because there is little information about the borrower's credibility.
  - As a program proceeds, cues become less important because investors learn about the borrower's actual economic performance.

Interviews

Interviews

"I am concerned about governments' capacity to make commitment, which would be affected by **politicians' popularity**.... When it's obvious that significant public sentiment is against, to the point that it weakens government's capacity, it's all negative."

- A senior investor

"Public opposition is the largest challenge. **Government that enjoys strong support has a much higher chance to deliver the program**."

- An IMF official

Data overview

- 52 countries, 1998-2017, Country-year
- Dependent variable: Sovereign Bond Spreads
  - source: JP Morgan EMBI
- Key explanatory variable: Government approval ratings * IMF program
  - Source: Global, regional and country-specific polls
  - IMF program
    - IMF program measured as 1) binary variable and 2) # conditionality
    - 2SLS with compound instrumental variables (See Stubbs et at. 2020)
- Controls: Terms of IMF programs, Borrower's macroeconomic indicators, affinity with the U.S., regime type, domestic veto players, etc.
- Error Correction Models w/ country, year, and region fixed effects

Data overview: Sample Countries

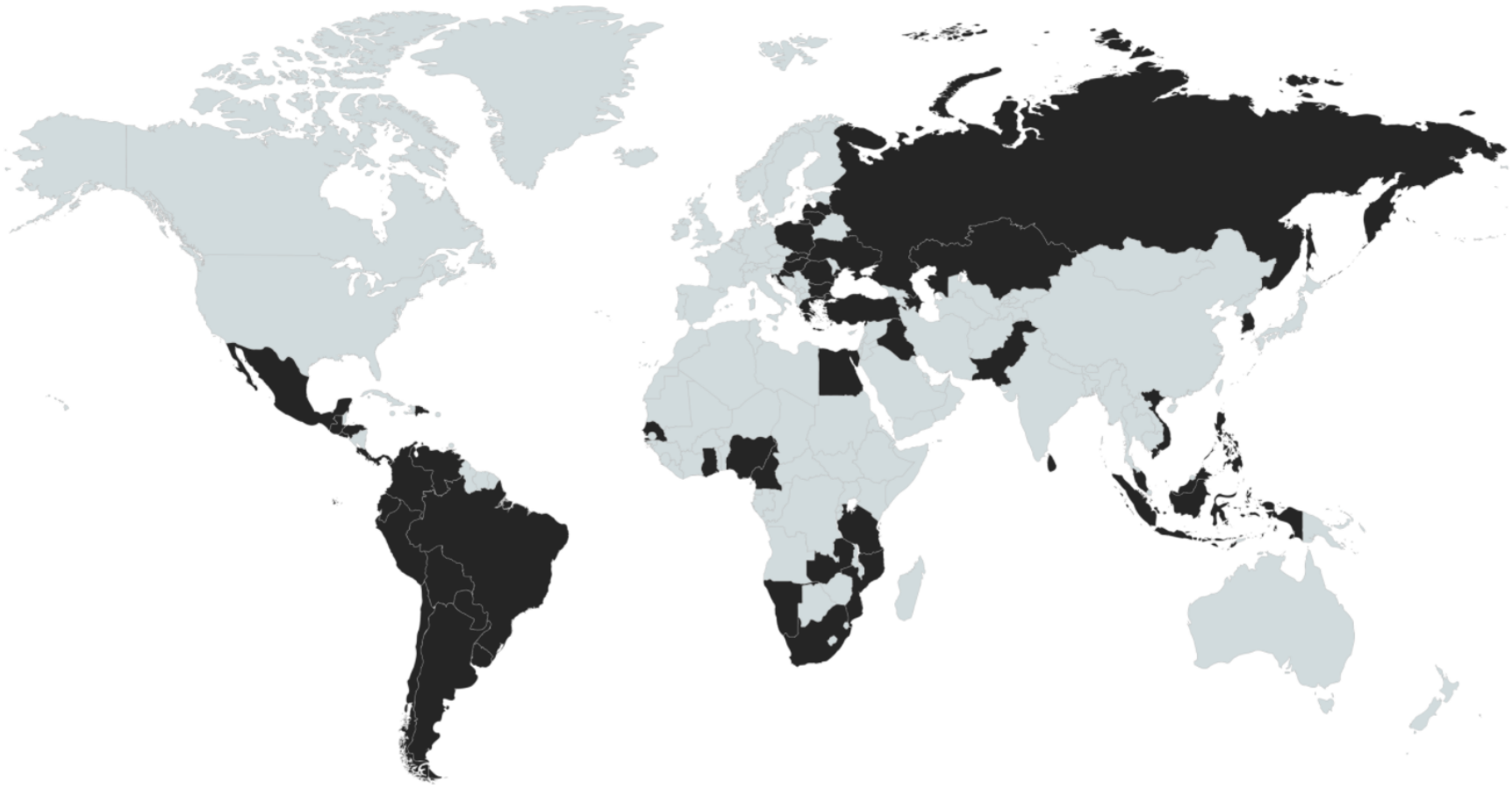


Figure: Sample countries shaded in black

Data Overview: Government popularity

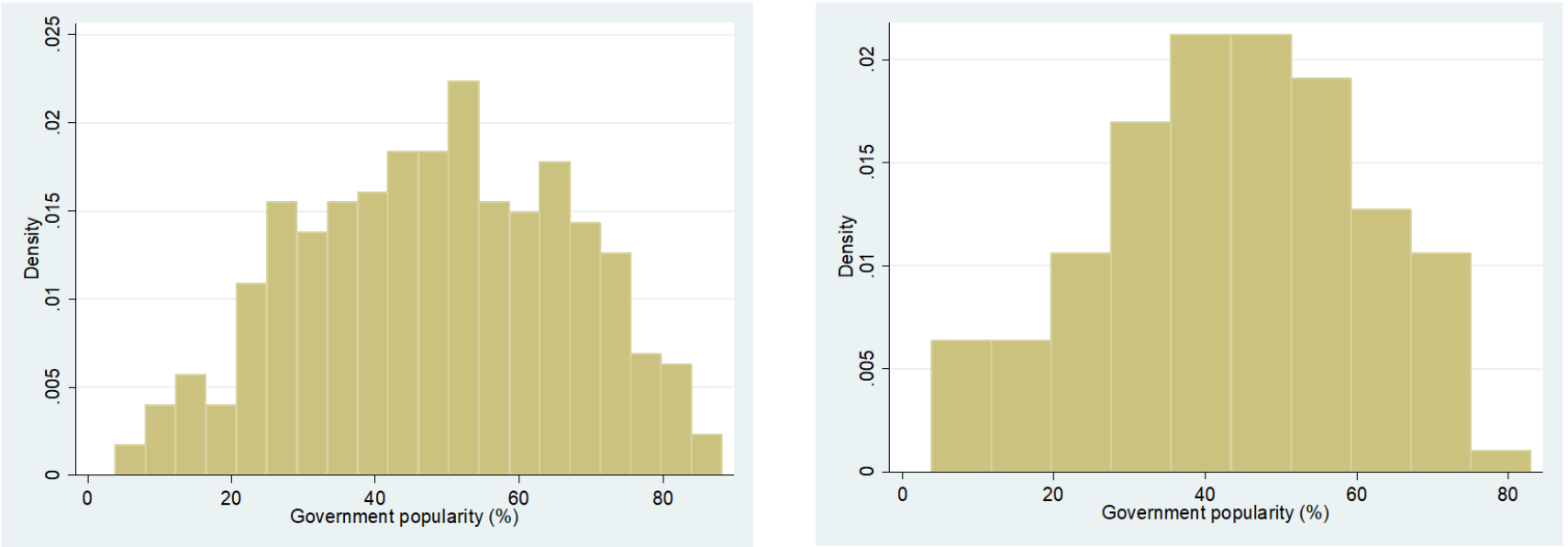
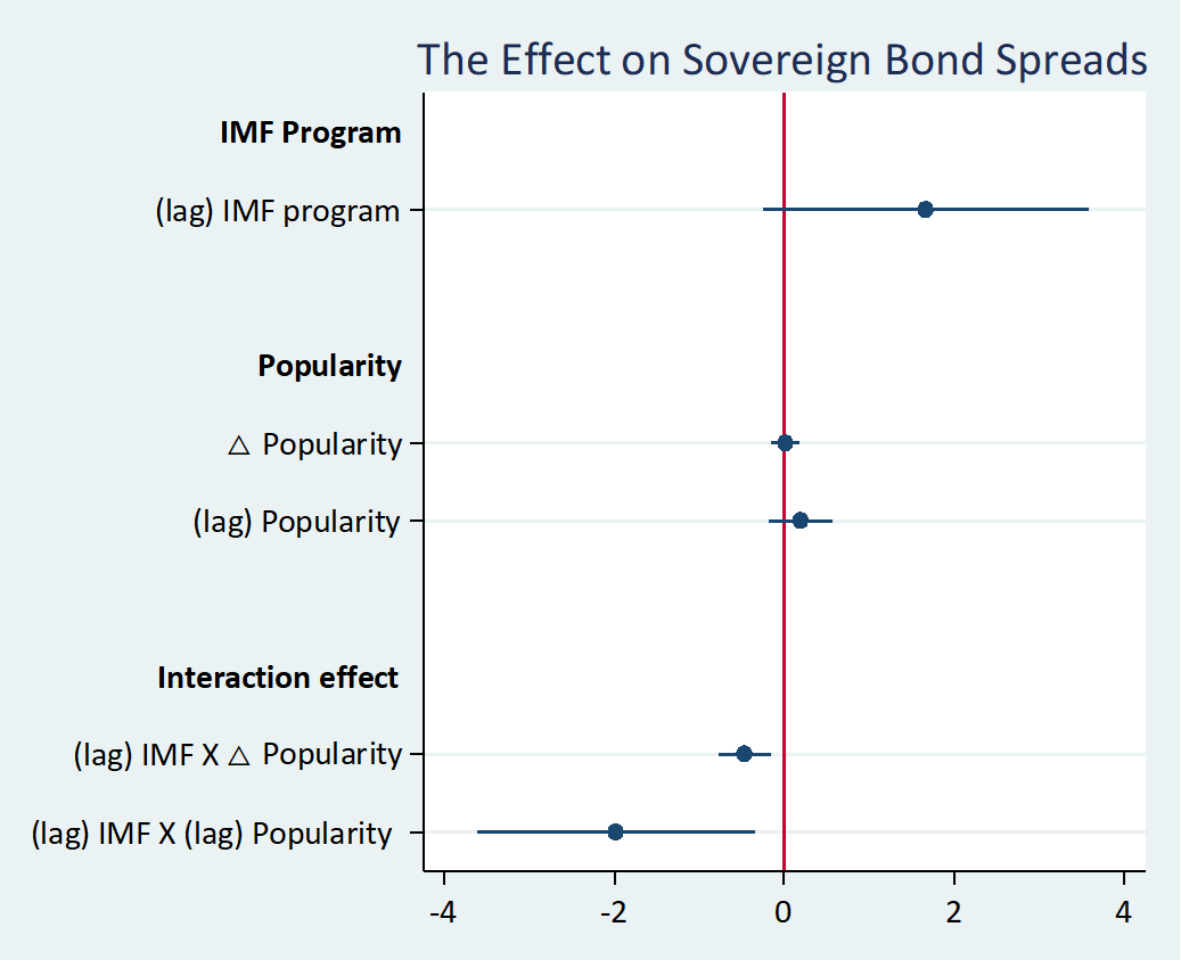


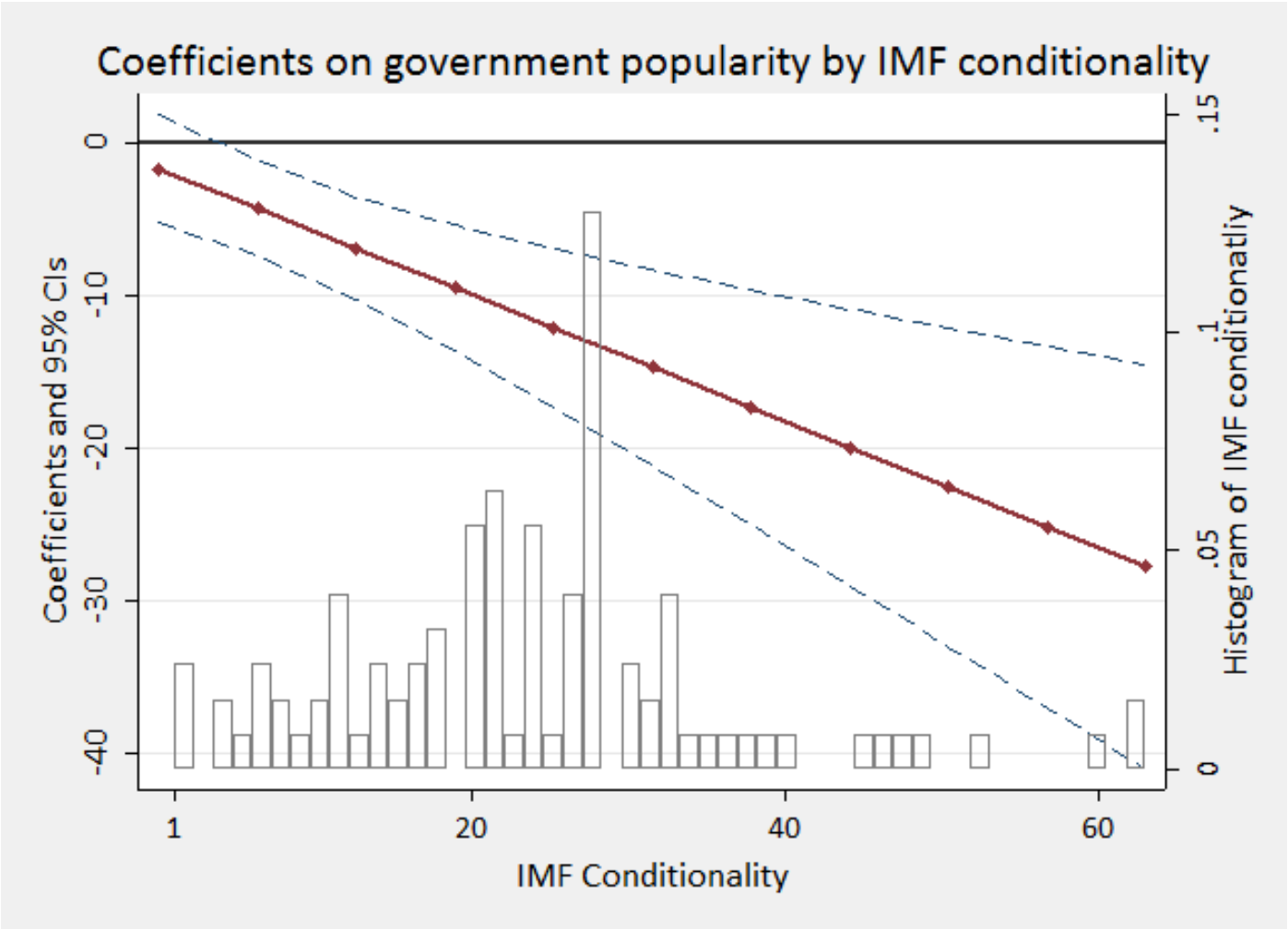
Figure: All sample (left) and IMF participants (right)

Result



- For 1% increase in gov't popularity, we see 7% bond spreads decrease within a year.

Result


Coefficients on government popularity by IMF conditionality
Coefficients and 95% CIs
0
-10
-20
-30
-40
Histogram of IMF conditionatliy
.15
.1
.05
0
1
20
40
60
IMF Conditionality

Result

Does the effect of government popularity decay over time?

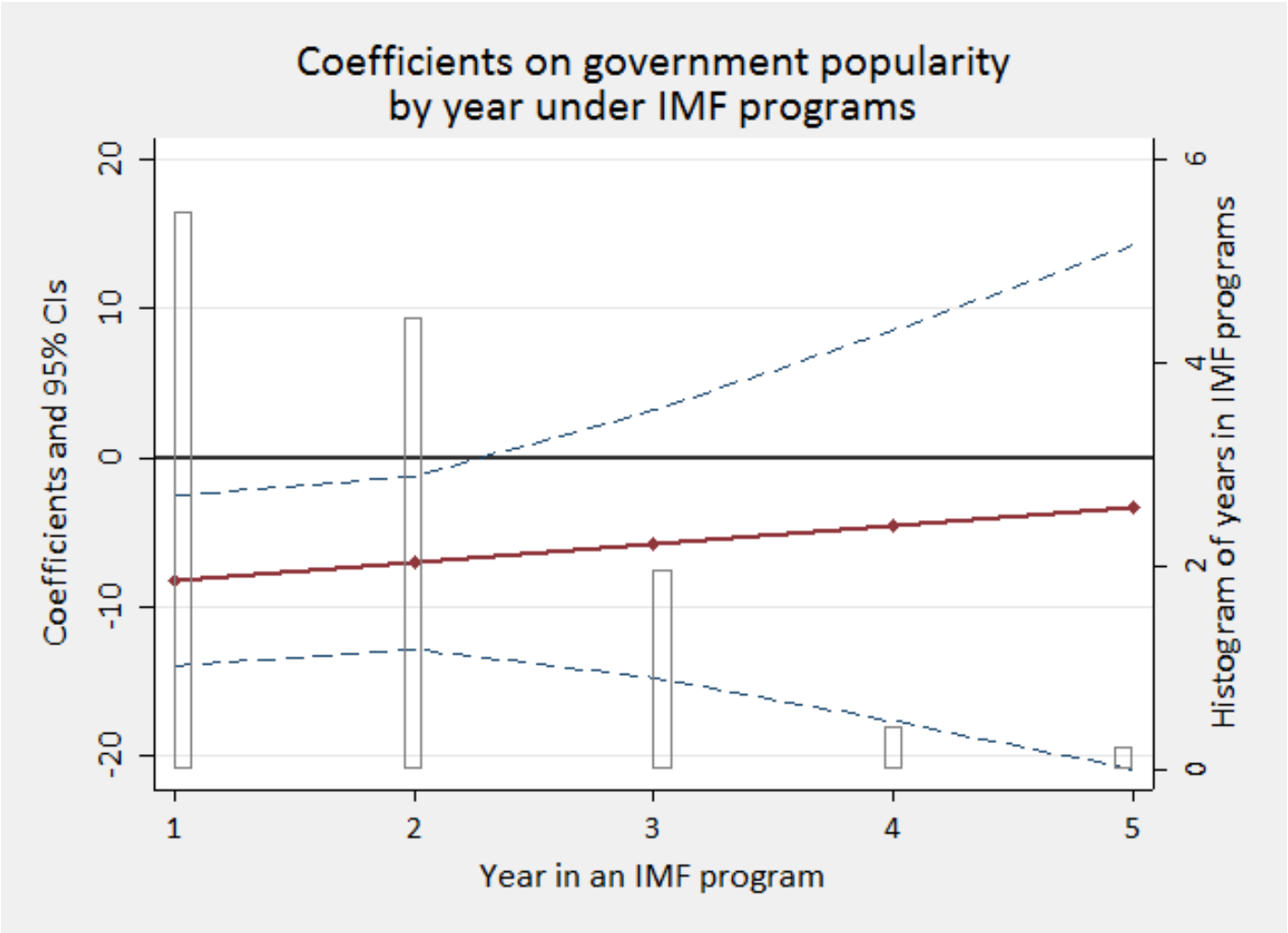
1) Long-run multiplier

- Total effect of 1 % increase in gov't popularity = 121 bp spreads $\downarrow$
- It takes first two years for fully half of the total effect to occur
  - 22 % in *t*, another 22% in *t+1*, and another 6% in *t+2*

Result

Does the effect of government popularity decay over time?

2) Marginal effect



Robustness Checks

- Monthly analysis, Jan 1998- Dec 2015, 26 countries
- Extra controls (CBI, inflation, Total debt % GDP, etc)
- Democracy vs Non-democracy
- Presidential vs. Parliamentary System

Implications and Conclusion

- Policy implications
  - A well-designed IMF program is not enough.
  - IMF conditionality does not have a linear effect.
- Scholarly implications
  - Mass public can influence international capital movements.
  - Much more attention needs to be given to public opinion to study the IMF, international finance, and the global economy.
  - Public opinion mediates IO's commitment mechanism.

Thank you for your attention!

I look forward to your questions and comments.

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Avg. development of Gov't approval ratings

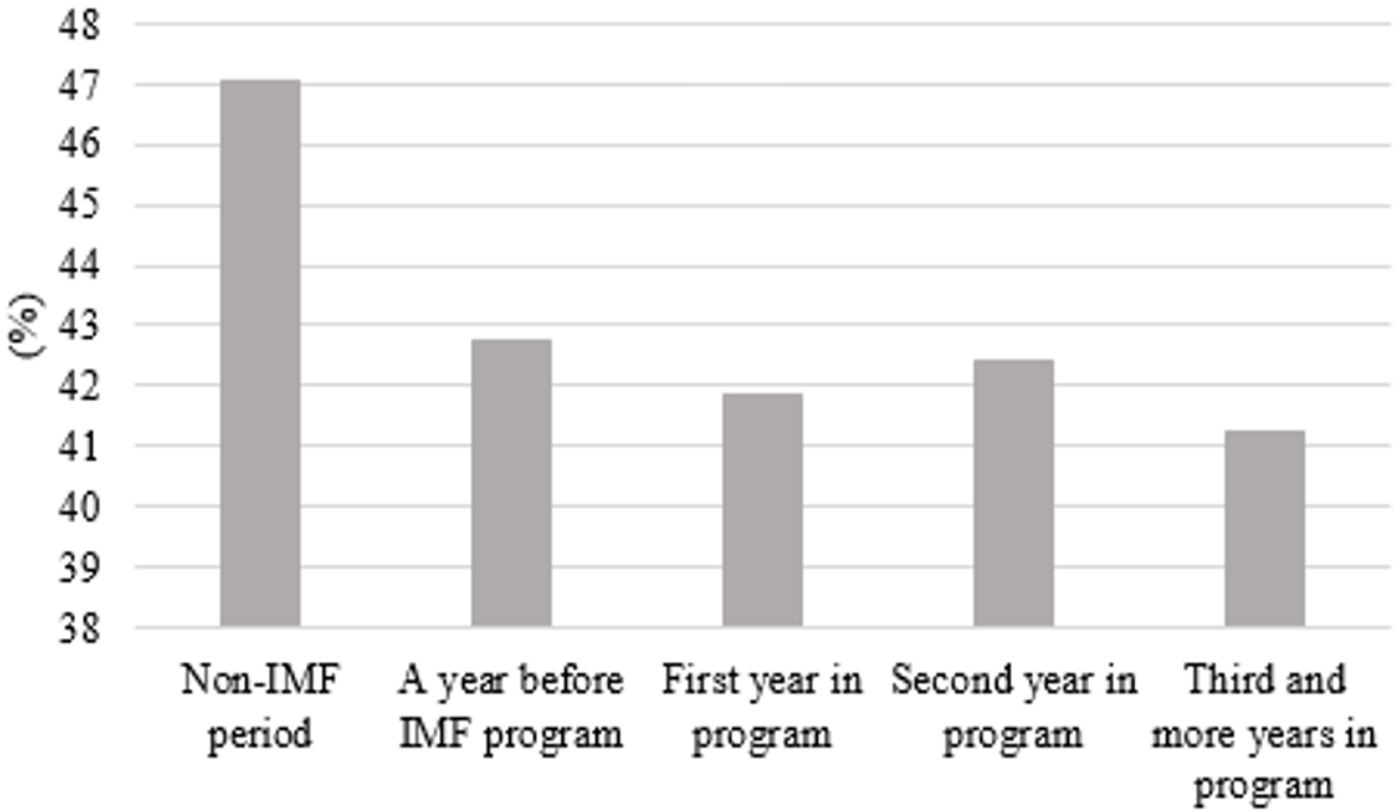


Figure: Avg. Development of Gov't Popularity before and during IMF program

QPC vs SPC

Does the impact of government popularity vary depending on IMF conditionality?

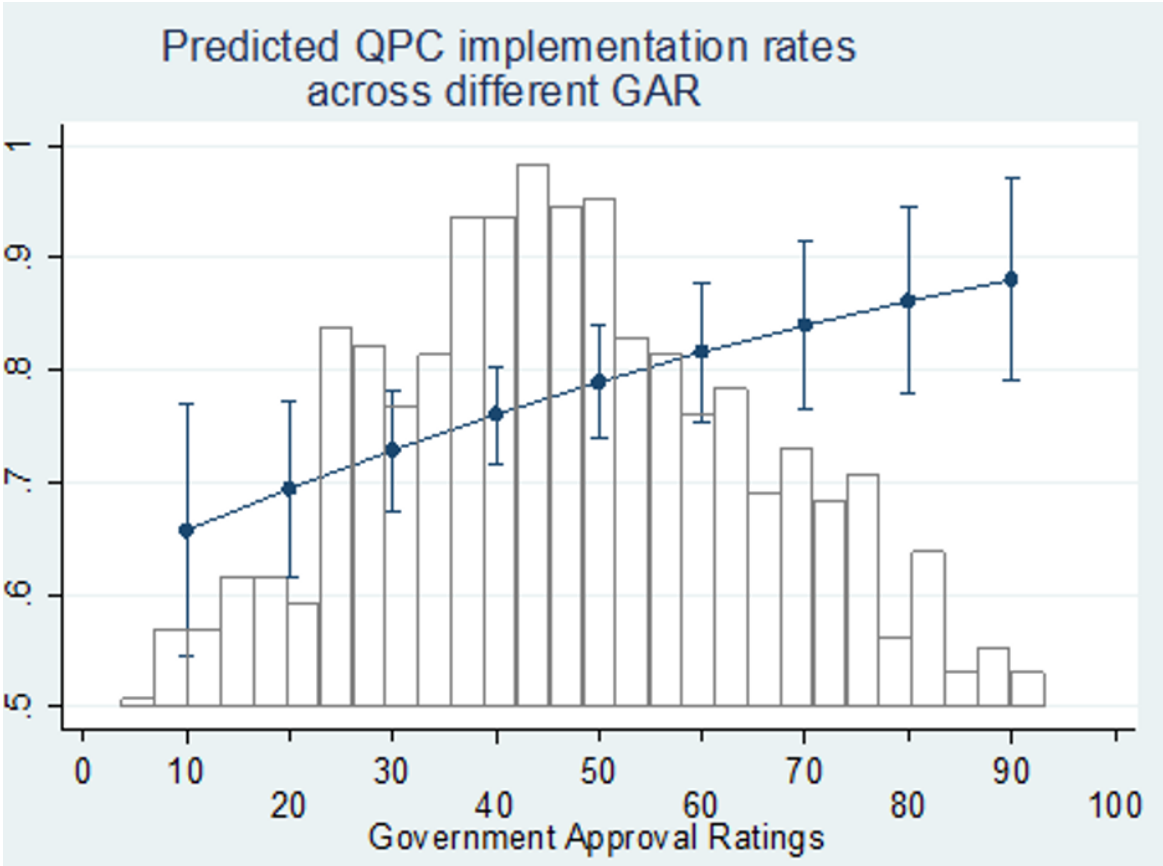
- Quantitative vs. Structural

DV: △ Bond Spreads	Coef	S. E.
l. Bond spreads	-0.359**	-2.29
l. QPC	54.17***	2.74
l. QPC x △Gov't popularity	-0.735**	-2.33
l. QPC x l. Gov't popularity	-1.314**	-2.26
l. SPC	172.1	0.45
l. SPC x △Gov't popularity	1.206	0.30
l. SPC x l. Gov't popularity	-3.534	-0.42
l. Gov't popularity	0.0846	0.02
△ Gov't popularity	-0.215	-0.08
Controls	✓	
Fixed effects	✓	

* $p < .10$, ** $p < .05$, *** $p < .01$

Is the cue correct?

Is a higher government popularity actually associated with a successful implementation?



Gov't popularity and IMF programs