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Catalyzing Aid? The IMF and Donor Behavior in Aid Allocation

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Summary. — The International Monetary Fund (IMF) has often asserted that its programs encourage aid by signaling policy credibility, commonly referred to as aid catalysis. Our study investigates this claim for sector-specific aid and for bilateral and multilateral donors using data on 136 recipient countries for the 1986–2009 period. We employ a two-part quantitative model to match the donor decision-making process, consisting of a first-stage recipient selection equation and a second-stage allocation equation on selected recipients. We find strong support that IMF programs catalyze aid on aggregate, but the evidence varies across different types of aid. Aid catalysis is stronger and more robust in sectors linked to the IMF's core competency areas, namely debt-related relief and general budget support, but weaker and less robust for infrastructure, production, multisector, and humanitarian aid, and non-existent for health and education. Across donors, IMF programs are associated with increases in aid by countries with larger voting shares in the IMF, such as the United States and Japan, but less so by countries with few votes or for multilateral agencies. This finding is consistent with research in international political economy arguing that the IMF's powerful stakeholders drive the organization's decisions and policies. Taken together, our findings emphasize the IMF's multi-dimensional impact on the global development agenda—an erstwhile overlooked factor in studies of aid allocation—while refuting the purported positive effects of IMF programs on aid for social policy.

Key words — aid allocation, aid catalysis, International Monetary Fund

1. INTRODUCTION

In February of 2014, following months of violent demonstrations, Ukrainian President Viktor Yanukovych stepped down. An interim government came to power promising swift economic reforms. The acting president, Oleksander Turchinov, and the new prime minister, Arsenii Yatseniuk, wrote to the International Monetary Fund (IMF or Fund) in April to request a $17bn loan to support "ambitious reforms" that spanned fiscal issues, banking supervision, privatizations, energy policy, and "improvements in governance and the business environment" (IMF, 2014). The Fund's decision to lend was reported to unlock billions in aid from foreign donors, including the United States, Canada, Japan, many European countries, and the World Bank (Reuters, 2014b). The following month, donors followed another Fund decision; this time to turn off the financing tap. Malian President, Ibrahim Boubacar Keïta, purchased a $40m jet for his office without a competitive bidding process, which left the IMF "concerned about the quality of recent decisions" of this nation's government (The Wall Street Journal, 2014). The World Bank promptly halted a $63m aid disbursement, and announced that it "may be in a position to resume budget support operations to Mali" only once the IMF concludes its review of country policies (Reuters, 2014a).

This article probes the relationship between IMF programs and aid flows. Among the multiple determinants of such flows, this dimension has received little attention, despite far-reaching implications for developing countries. Programs of the IMF commonly stipulate the introduction of extensive policy reforms. Among the advertised benefits of IMF programs, Fund staff have highlighted that they spur additional aid inflows by signaling to donors policy credibility and commitment to reforms (Clements, Gupta, & Nozaki, 2013; IEO, 2002, 2007; IMF, 2004). This promise can provide *ex ante* justification for intrusive conditionality, including "mission creep" into policy areas—like health and education—that are not directly related to the Fund's mandate (Babb & Buira, 2005; Kentikelenis, Stubbs, & King, 2015). For critics, the Fund's policy prescriptions are understood to shrink policy space and thus constrain the developmental paths available to these countries (Chang, 2006; Stiglitz, 2002).

Here, we investigate the purported catalytic effect of IMF programs in greater detail. Does the presence of Fund programs in developing countries catalyze aid? If so, does the effect vary by donor or type of aid? The few attempts to empirically investigate such links have not examined variation in this relationship across country donors (referred to here as bilateral donors) and international or regional donors (referred to here as multilateral donors). In addition, past work has overlooked potential variation across types of aid (e.g., for health versus budget support). This omission is all the more surprising given that no *a priori* rationale exists for assuming different types of aid respond in the same manner.

This article addresses these shortcomings by presenting a conceptual framework for modeling IMF aid catalysis and empirically tests relevant hypotheses using panel data for 136 recipient countries between 1986 and 2009. We examine the relationship between the presence of IMF-supported programs and total aid flows, as well as flows in eight disaggregated aid categories—education, health, economic infrastructure and services, production sectors, multisector/crosscutting, general budget support, debt-related relief, and humanitarian aid. Subsequently, we examine the dyadic relationships of IMF aid catalysis for 23 Development Assistance Committee (DAC) donor countries—the world's largest aid contributors—and eight multilateral institutions.

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Our results indicate that, overall, IMF programs catalyze aid. However, the evidence across different types of aid varies. IMF catalysis is stronger and more robust in sectors linked to its core competency areas, namely debt-related relief and general budget support, weaker and less robust for infrastructure, production, multisector, and humanitarian aid, and non-existent for health and education. These findings suggest that the Fund's credibility is maximized in its own areas of "comparative advantage," and that donors are not influenced by IMF programs in areas not closely linked to its mandate. IMF aid catalysis also exhibits variation across bilateral and multilateral donors. For bilateral donors, the catalytic effect of Fund programs is strong among those with larger voting shares in the IMF, such as the United States and Japan, but weak or non-existent among donors with fewer votes. These findings are consistent with research in international political economy arguing that the Fund's powerful stakeholders drive the organizations' decisions and policies (Dreher, Sturm, & Vreeland, 2013; Thacker, 1999). For multilateral donors, the African Development Bank, Asian Development Bank, and International Development Association display Fund catalysis but results are mixed or non-significant across the other agencies we cover.

This article is structured as follows. First, we outline recent debates on the role of the IMF in the aid allocation process. Second, we present a model that explores the mechanisms via which IMF catalysis operates before establishing a set of testable hypotheses. Third, we describe the data employed and outline our adopted methods. Fourth, we present our findings. In the final section, we contextualize the findings and identify some limitations, policy implications, and directions for future research.

2. BACKGROUND: RECENT DEBATES

A repeated claim by researchers linked to the Fund is that their programs can leverage additional aid flows (Clements et al., 2013; IEO, 2002, 2007; IMF, 2004). The basis for this claim is that IMF programs purportedly transmit positive signals to donors about the recipient country's commitment to policy reform (Bird, 2007; Edwards, 2005; Fang & Owen, 2011). At first glance, the relationship is intuitive given that donors have been known to tie aid flows to the presence of an IMF-supported program and have frequently had input in designing them (Bird & Rowlands, 2000, 2002; Birdsall, Claessens, & Diwan, 2004; Dijkstra, 2004; Fraser & Whitfield, 2009; Oxfam, 2006). There is also anecdotal evidence of IMF aid catalysis based on media reports and donor statements, as the cases of Ukraine and Mali alluded to in our introduction illustrate.

Even so, this evidence is not systematic, and there is reason to suspect that the relationship may be more nuanced. First, donor motivations are not necessarily homogeneous (Berthélemy, 2006), and different types of aid may have varying determinants (Neumayer, 2005; Thiele, Nunnenkamp, & Dreher, 2007). That is to say, there is no *a priori* justification for assuming that any relationship between the IMF and aid flows will be the same across donors or aid types. Second, Fund programs often go off-track and therefore signing an IMF agreement may do little to confirm government commitment to the policies spelt out in the program (Bird, 2007).[1] Third, geopolitics have been shown to influence the lending decisions of the Fund (Dreher et al., 2013; Thacker, 1999), thereby casting doubt to the proposition that Fund borrowers may be the most committed to reform. Finally, even if IMF programs were an accurate indicator of merit, existing evidence is far from unequivocal on whether donors actually respond to such indicators (Alesina & Dollar, 2000; Claessens, Cassimon, & Campenhout, 2009; Clist, 2011; Dreher, Nunnenkamp, & Thiele, 2011; Hoeffler & Outram, 2011).

To our knowledge, only four peer-reviewed studies investigate aid catalysis by the IMF (Bird & Rowlands, 1997, 2000, 2002, 2007), and one IMF staff working paper on aid allocation controls for the presence of Fund-supported programs (Dabla-Norris, Minoiu, & Zanna, 2010). In earlier analyses, Bird and Rowlands (1997, 2000, 2002) found no compelling support for positive aid catalysis by IMF programs. But more recently, the authors observe strong evidence of such a relationship among 48 low-income recipients (Bird & Rowlands, 2007), a finding corroborated by Fund staff research (Dabla-Norris et al., 2010).

Extending our understanding of these issues has important implications for the study of international political economy, in particular around questions of control over the activities of intergovernmental organizations and the linkages between donors' aid commitments and their behavior vis-à-vis debtor countries in other fora. In addition, the link between IMF policies and aid commitments raises important policy issues, and is related to current debates over reforms to the IMF. We return to these issues—in light of our findings—in the conclusions.

3. LINKING AID FLOWS AND THE IMF

(a) *Conceptual framework*

We posit that the purported relationship between IMF programs and aid flows operates via three general pathways. First, the presence of Fund programs may serve as a catalyst for donors because they signal policy credibility; that is to say, they provide a "stamp of approval" to borrowing countries (Bird & Rowlands, 2007; IEO, 2002, 2007). The conditionality component of Fund programs stipulates long lists of reforms on issues such as public spending, bureaucratic organization, and domestic legal environments (Babb & Carruthers, 2008; Kentikelenis, King, McKee, & Stuckler, 2015; Kentikelenis et al., 2015).[2] Insofar as donors value the introduction of such reforms (Claessens et al., 2009), they may follow the IMF into developing countries. Fund programs therefore signal recipient merit, as borrowing countries show they are committed to "putting their house in order"—information that would have been difficult and expensive for donors to collect and interpret *ad hoc*.

Second, IMF-supported programs can play into the calculus of bilateral donor self-interest via an expectation effect. To the extent that donor countries wish to further their own commercial interests but are not in a position to unilaterally advocate them, either for lack of authority or fear of political backlash, the IMF may function as a proxy, carrying both a carrot (funds and the promise of aid catalysis) and a stick (policy conditionality). Given this scenario, if donor countries expect that an IMF program will promote policy reforms that foster commercial opportunities, aid may be increased to garner favor with recipient countries in future dealings. This mechanism is broadly consistent both with established self-interest arguments viewing aid as a foreign policy tool (Alesina & Dollar, 2000; Berthélemy, 2006; Kuziemko & Werker, 2006; Younas, 2008), and with the fact that Fund programs typically entail policy prescriptions amenable to foreign commercial interests, including privatization, trade liberalization, and deregulation (Buira, 2003; Goldstein, 2001). It also aligns with