GLOBAL GOVERNANCE, POVERTY AND INEQUALITY

Edited by

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List of Abbreviations

AFL/CIO	American Federation of Labor/Congress of Industrial Organizations
AOSIS	Alliance of Small Island States
ATI	Appropriate Technology International
BRICS	Brazil, Russia, India, China, South Africa
BWFA	Better World For All
BWPI	Brooks World Poverty Institute
CCC	Corporate Code of Conduct
CEO	Chief Executive Officer
CGD	Center for Global Development
CGIAR	Consultative Group on International Agricultural Research
CHOGM	Commonwealth Heads of Government Meeting
CIA	Central Intelligence Agency
CIGI	Centre for International Governance Innovation
ComSec	Commonwealth Secretariat
CPA	Commonwealth Parliamentary Association
CSR	Corporate Social Responsibility
CVI	Children's Vaccines Initiative
DAC	Development Assistance Committee (of the OECD)
DDI	Diamond Development Initiative
DFID	UK Department for International Development
ECOSOC	UN Economic and Social Council
EMS	Environmental Management System
ETI	Ethical Trade Initiative
EU	European Union
FAO	Food and Agriculture Organization (of the UN)
FDI	Foreign Direct Investment
FFD	UN Finance for Development
FIS	Front Islamique du Salat
FUNDES	Fundación para el Desarrollo Sostenible
G-8	Group of 8 industrialized countries
GATT	General Agreement on Tariffs and Trade
GAVI	Global Alliance for Vaccines and Immunization
GCSE	General Certificate of Secondary Education
GDP	Gross Domestic Product
GFATM	Global Fund to flight Aids, Tuberculosis, and Malaria
GSB	Growing Sustainable Business
HDI	Human Development Indicator
HI	Horizontal Inequality
HIPC	Heavily Indebted Poor Country
HIV/AIDS	human immunodeficiency virus/acquired immune deficiency syndrome
IAB	Inter-American Bank
IARC	International Agricultural Research Center
IBRD	International Bank for Reconstruction and Development
ICC	International Criminal Court
IDA	International Development Association
IDGs	International Development Goals
IEO	Independent Evaluation Office (of the IMF)
IFC	International Finance Corporation
IFIs	International Financial Institutions
ILO	International Labour Organisation
IMF	International Monetary Fund
INGO	International Non-Governmental Organization

KP	Kimberley Process
MDGs	Millennium Development Goals
MDRI	Multilateral Debt Relief Initiative
MILF	Moro Islamic Liberation Front
MNC	Multinational Corporation
NGOs	nongovernmental organizations
NIC	Newly-Industrialized Country
ODA	Overseas Development Assistance
OECD	Organization for Economic Cooperation and Development
OFC	Offshore Financial Center
OIC	Organization of the Islamic Conference
OPEC	Organization of Petroleum Exporting Countries
PAC	Partnership Africa-Canada
PPP	Public-Private-Partnership
PRGF	Poverty Reduction and Growth Facility
PRSP	Poverty Reduction Strategy Paper
PSI	Poverty Support Instrument
R&D	Research and Development
RMB	Results-Based Management
SIDS	Small Island Developing States
SME	Small and Medium size Enterprise
TDR	Special Program for Research and Training in Tropical Diseases
UDHR	Universal Declaration of Human Rights
UN	United Nations
UNASUR	Union de Naciones Suramercianas
UNCLOS	UN Convention of Law of the Sea
UNCTAD	UN Conference on Trade and Development
UNDP	UN Development Programme
UNESCO	UN Educational, Scientific and Cultural Organization
UNFCCC	UN Framework Convention on Climate Change
UNGC	UN Global Compact
UNSC	UN Security Council
URI	United Religions Initiative
US	United States of America
WBCSD	World Business Council on Sustainable Development
WCC	World Council of Churches
WCRP	World Conference of Religions for Peace
WFP	World Food Programme
WHO	World Health Organization
WTO	World Trade Organization

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Chapter 4

The Effect of IMF Programs on Public Wages and Salaries

Irfan Nooruddin and James Raymond Vreeland

In developing countries, governments often face strategic incentives to devote public expenditures to public wages and salaries, and such expenditures can play a vital role in fostering economic progress and reducing income inequality. The means available to the government of a developing country to do this, however, may depend on the role it plays in global governance. In this chapter, we explore how the role a developing country plays in global governance impacts upon government policies that affect the domestic distribution of income, particularly when the country faces a financial crisis. We consider the effect of International Monetary Fund (IMF) programs of economic reform on public wages and salaries. We show that their effect is contingent on the role a country plays in international institutions – particularly whether the country is a member of the United Nations Security Council (UNSC).

In general, the dire economic circumstances that governments face when turning to the IMF typically lead them to cut public wages and salaries. This is not surprising. Governments turning to the IMF suffer from problems of excess demand. They may have large government budget deficits, high public debt, low levels of foreign reserves and an overvalued exchange rate. As a result, they are forced by their economic circumstances, along with conditions prescribed by the IMF in return for loans, to slash public spending, particularly the wages and salaries of civil servants. Developing countries often use the civil service to provide both public and private goods to constituencies to maximize their chances of surviving in office. Cutting expenditures on the wages and salaries of civil servants thus puts governments in jeopardy. But economic crises leave them little room other than to make the tough choice of cutting public spending.

This may not be the case, however, for countries that are serving as temporary members of the UNSC. The UNSC is perhaps the most powerful arm of the United Nations, imbued with the responsibility of maintaining world peace and the power to take military action. Its governance structure gives it legitimacy because the most powerful members have veto power over resolutions and also because these resolutions need support from the weaker temporary members who are elected for two-year terms. Representation is thus incorporated into the governance of the UNSC, and developing countries who serve have a privileged voice on the international stage. Therefore, if a country is serving on the

UNSC, it has international political leverage to negotiate favorable treatment from the IMF. This is because the major shareholders of the Fund – notably the United States – can influence the terms of an IMF loan, and they are willing to do this favor because they care about how the country votes on the UNSC. Most developing countries face pressure to protect civil servants during economic downturns but typically lack the resources to do so. Yet developing democracies serving on the UNSC are exceptional – they have the same domestic incentives to protect civil servants as their non-UNSC counterparts *and* the international leverage to obtain the means to do so. IMF participation actually increases their budget allocation for public wages and salaries.

Our argument brings together three ideas from the broader literature in international and comparative political economy, and we review each in turn, proceeding with the following sections. In section two we discuss how governments use the civil service as a means to protect the middle class and why this is important for the survival of the government. We then turn to the role the IMF plays during an economic crisis. Thereafter, we explore connections across international institutions by considering how the governance of the UNSC is affected by the governance of the IMF. Armed with the implications of these three ideas, we put forth our principal hypothesis: the impact of IMF participation on public wages and salaries depends on UNSC participation. We then test this hypothesis before discussing our results in light of domestic political institutions, speculating as to why we might observe differential effects in democracies and dictatorships. The final section our concluding comments.

Government Survival, the Middle Class and the Civil Service

Public expenditure on the wages and salaries of civil servants is one way in which governments, whether democracies or dictatorships, pay off vital constituencies. Autocrats, who depend on a small coalition of loyal supporters to survive in office (Bueno de Mesquita et al., 2003)[1] use their resources to provide "private goods" to this small group, but they also maintain a powerful internal security apparatus, as repression and fear are common methods of keeping the larger population in check (Boix, 2003). Thus, they devote resources to the wages and salaries of their loyal clique, of the military, and of other security forces. Autocrats also employ favored constituents in large public sector bureaucracies that are typically immune to public accountability.

Democratic leaders, hoping to win reelection, target as large a portion of the electorate as possible and use their resources to provide "public goods," such as economic policies that will benefit the economy in the aggregate (Bueno de Mesquita et al., 2003; Nooruddin and Simmons, 2006). They also target swing voters, particularly the small but growing middle class (see Chhibber and Nooruddin, 2004). Building on Rudra (2008), Nooruddin and Rudra (2009) argue that in the face of the economic vagaries

[1] For a direct application to the IMF, see Smith and Vreeland, 2006.

of globalization, developing democracies have used the civil service as a way to protect the electorally vital middle class. Openness increases uncertainty about future job security in the private sector (even as it might increase employment opportunities) leading citizens to reward politicians who can offer stable employment in the form of civil service positions (see also Nooruddin and Simmons, forthcoming). Thus, public wages and salaries are doubly beneficial to the government. They allow the government to provide more public services by increasing expenditures on public works projects such as infrastructure development, which should benefit the electorate as a whole, and they enable the government to protect a crucial political constituency, the middle class. So, while dictatorial governments use public expenditures to benefit small and specific loyal followers as well as the military and security forces, and democracies use public expenditures to provide public goods and protect growing but vital the middle class, both regimes provide wages and salaries to key constituencies to maximize the chances of surviving in office.

This calculus changes when a government enters into a financial crisis, facing a shortfall in foreign exchange. Such a situation may result from large government budget deficits, high public debt, trade deficits, and an overvalued exchange rate. In short, the country suffers from excess demand, leaving the government little room but unpalatable reductions in public expenditures. Most developing countries would prefer to protect the wages and salaries of civil servants during economic downturns, but they simply lack the resources to do so. To generate the resources required to weather the crisis, developing countries often turn to the IMF.

The IMF and Income Distribution

The IMF was founded precisely to provide loans of foreign exchange to governments facing a financial crisis.[2] The loans are designed to help soften the blow of economic adjustment, but the IMF attaches stringent economic conditions to ensure that the loans do not allow the continuation of the excesses that led to the financial problems in the first place. So even with access to an IMF loan, governments reduce spending, using the loans to bring down national debt, fortify the stock of foreign reserves or defend the currency. Thus economic austerity and accompanying reform are expected to be part of the IMF package. Yet this relies on the IMF actually enforcing the conditions it attaches to loans. In principle, the IMF disburses a loan over time, provided the government complies with specific conditions of economic adjustment, such as cutting government expenditures. What if the IMF provides loans despite noncompliance? This is a possibility to which we will return.

[2] Originally, the idea was to make the IMF large enough to be capable of bailing out any country, but the world's largest surplus country at the time – the United States – did not trust an international organization with the resources that would have been required. So the IMF was never big enough to manage the ebbs and flows of the trade and financial exchanges in the developed world. The IMF soon found a more suitable clientele – the developing world.

First, it is important to understand that the IMF gets its resources from member contributions. Each member – these days, nearly every country in the world – holds a set amount of currency on reserve with the IMF, and the IMF uses this pool of reserves for its lending operations. The size of a country's contribution – called a "quota" – depends on the economic size of the country. In recent decades, approximately 17 percent of the resources come from the United States, with Japan, Germany, France, and the United Kingdom providing around 5 to 6 percent each. Governance of the IMF is tied to these contributions, with vote shares tied to quota size. While they lack a majority of the votes, it is widely believed that the IMF tends to be beholden to these five members, especially on matters they care a great deal about and especially when they agree (see Copelovitch, 2007).

Do the programs of economic reform sponsored by the IMF have distributional consequences? Previous studies indicate that they do (Pastor, 1987; Garuda, 2000; Vreeland, 2002, 2003a). Even after accounting for the poor economic circumstances of countries turning to the IMF for assistance, they appear to experience an increase in overall income inequality and a decrease in labor's share of income. Presumably, if IMF programs have such an effect, the mechanism is through conditionality.

Note, however, that the precise mechanisms by which IMF conditions have an impact upon income inequality are unclear from a theoretical point of view. The direction and magnitude of the effects depend on the particular characteristics of the economy and the details of how policy reforms are structured.[3] Staff at the Fund have acknowledged that "Domestic political considerations will largely determine who bears the burden of reducing and restructuring aggregate demand" (Johnson and Salop, 1980: 23), and "the choice of policy instruments will be influenced by the political power of various income groups" (Johnson and Salop, 1980: 12).

One straightforward distributional consequence of IMF conditionality may be the cutting of public wages and salaries. The reduction of public expenditure is perhaps the most common feature of Fund-supported programs. In an analysis of 94 programs from 1980 to 1984, for example, Sisson (1986: 34) reports that 86 of them involved some restraint of central government current expenditure. As Johnson and Salop note,

> … the brunt of any downward adjustment of government expenditure to GDP is most commonly borne out by public sector employees engaged in projects that come to be

[3] Tight monetary policy, for example, affects groups according to their access to alternative sources of credit. Large, well-established firms are favored over small and medium sized firms, and the urban sector is favored over the rural sector (Johnson and Salop, 1980: 11). Trade liberalization, which has increasingly been part of IMF programs (see Clapp and Dauvergne, 2005: 59), may benefit labor-intensive sectors and eventually result in higher wages or lower unemployment, but these effects will be small and slow, while formerly protected sectors will contract first, lowering income in these areas (Handa and King, 1997: 915-916).

postponed, together with the private domestic suppliers of services associated with such projects. These tend to be highly capital-intensive ventures in construction and public utilities (1980: 12).

Wage freezes, limits on employment, and reduced benefits for public employees are also common. Sisson (1986: 34) reports that over three-fifths of programs involved wage restraint.[4]

Is IMF conditionality, however, always binding?[5] A growing literature on the international politics of IMF lending suggests that this is not always the case. Stone (2002; 2004) suggests that countries favored by the largest shareholder of the IMF, the United States, are likely to receive light punishments for noncompliance with policy conditionality and that loans are eventually disbursed despite noncompliance. A large and growing literature suggests that politically important developing countries are likely to be rewarded with loans from the IMF (Thacker, 1999; Barro and Lee, 2005; Dreher and Stürm, 2006; Reynaud and Vauday, 2007). If the IMF arrangement is supposed to be a reward, presumably economic austerity does not come with it. Indeed, Dreher and Jensen (2007) find that countries closer to the United States receive fewer conditions than other countries when they participate in IMF programs. International politics may thus condition the impact of the IMF, as the Fund's major shareholders use IMF loans to buy or reward favors provided by politically important developing countries.[6]

Global Governance Across International Institutions: the Security Council and the IMF

Not all developing countries hold the same importance to the major shareholders at the IMF, and favoritism is strongest when all major shareholders can agree (Copelovitch, 2007). We contend that one particular type of country is potentially important to all major shareholders: temporary members of the UNSC.[7]

Most research on the UNSC focuses on the five permanent members – China, France, Russia (formerly the Soviet Union), the United Kingdom and the United States – who have veto power over all

[4] Recent developments in country "ownership" of IMF programs represent a more proactive stance on the issue of income distribution. See Wilkinson and Hughes (2000). For a discussion for a stronger trend at the World Bank, see Marshall (2008). For a disappointing look at how the World Bank has fared, see Stewart and Wang (2006).

[5] It certainly can be, if the IMF chooses to make an example of a particularly non-complaint country. Not only does such a decision cut off IMF funds, it also sends a negative signal to creditors. See Callaghy 1997, 2002.

[6] Whether such leniency comes from weaker conditionality in the actual arrangement (as suggested by Dreher and Jensen, 2007) or from weaker enforcement (as suggested by Stone, 2002, 2004), we leave for other research. For case study analysis of the impact of international politics on IMF conditionality, see Momani (2004a, b). Large-n work on the content of IMF arrangements is found in Gould (2003). For a general look at the impact of the private sector on global governance, see Bull, Boas, and McNeill (2004).

[7] This is not to say that China and Russia are not important to the major shareholders. Of course they are. But since they are permanent members of the UNSC, we see no variation in their participation. Our decision to focus on the temporary developing country members of the UNSC rather than on China and Russia is thus driven mainly by methodology. We encourage others, with a different research design, to consider the ways in which the votes of China and Russia have been influenced as we consider this an important avenue of research.

resolutions. Less attention is given to the ten elected members of the UNSC, as their votes are not as crucial (see O'Neill, 1996). Yet governments like the United States and Japan have shown that they care a great deal about these seats. Japan has spent a great deal of resources to become elected to the UNSC more than any other country in the world (for their quest to get a permanent seat see Weiss, 2008). The United States has been known to increase the direct foreign aid it provides a temporary UNSC member when it wants the country to vote a certain way on a resolution (see Kuziemko and Werker, 2006).

One reason temporary members matter is that, while not individually pivotal, their votes certainly count. Resolutions require nine out of the 15 potential votes to pass. So, the votes of at least four temporary members are required, and if permanent members abstain, as is often the case, even more votes may be required. The vote-buying literature shows that seeking oversized coalitions is common (see, for example, Volden and Carrubba, 2004).

Secondly, votes matter for reasons of legitimacy: both moral and informational legitimacy.[8] From a moral point of view, while it is obviously important that the most powerful countries agree on matters of international peace and security before military action is taken, the UNSC is also designed to incorporate representatives from all around the world. Before 1966, there were only six elected members of the UNSC. The issue of representation was central in its enlargement. The current ten seats represent clearly defined regional caucuses: one country from Eastern Europe; two countries from the Western European and Others Group; and two for the Latin America and Caribbean Group; and five from Africa and Asia. In practice, the Africa and Asia region has always been split into two groups, with three seats for Africa, two seats for Asia, and exactly one of the five seats going to an Arabic country.

From an informational point of view, temporary members of the UNSC have access to sensitive documents and private discussions regarding the importance of taking international action. Indeed, adjacent to the public meeting room of the UNSC is a private room where many of the real negotiations take place. So regional representatives have greater access than their neighbors – some of whom are so poor they have a barebones staff at best at their permanent mission in New York, where negotiations take place. Thus, developing countries may follow the lead of temporary members in supporting the international actions called for by the UNSC.

Winning the votes of such a representational group can legitimize the actions of powerful countries – both in the eyes of the international community and in the eyes of domestic constituencies. Without

[8] Regarding the moral authority of the UNSC, see Hurd (2007), Voeten (2005), Claude (1966). Regarding the informational role of the UNSC, see Fang (2008), Chapman (forthcoming; 2007), and Thompson (2006).

UNSC legitimacy, domestic public support might be more difficult to achieve (Voeten, 2001, Hurd, 2007).[9] Chapman and Reiter (2004) indeed find that "Security Council support significantly increases the rally behind the president (by as many as 9 points in presidential approval) … This effect is unique among international institutions because other actions by the UN or regional security organizations do not significantly affect rallies."[10]

To the extent that powerful countries care about winning the votes of temporary UNSC members, they may be willing to use foreign aid to influence them. Indeed, Kuziemko and Werker (2006) show that they do, particularly in cases of great importance. This, of course, presents a conundrum. If the purpose of winning votes is to legitimize action, they should presumably be obtained legitimately, not bought.

This is where an international organization like the IMF becomes quite useful. Developing countries routinely turn to the IMF and negotiations always take place behind closed doors (even these days with increased transparency). Many argue that international organizations can be used to "launder" the actions of governments (Abbott and Snidal, 1998), or do their "dirty work" (Vaubel, 1996) out of the scrutiny of the public eye.[11] As Dreher et al. (2006; 2009) show UNSC members are more likely to receive World Bank and IMF loans.

The logic is as follows. Developing countries routinely turn to the IMF for support. Arguably, they care more about loans of international exchange than they do about votes on the Security Council. Meanwhile, the major shareholders of the IMF can easily agree on the potential importance of a country when it is elected to the Security Council. Funneling resources through the international organization obfuscates the buying of favors from such countries and shares the costs amongst all members. Now, an important vote may not come up during the two-year tenure of a UNSC member, but in case it does, it behoves the shareholders to have an arrangement in place so that leverage can be brought to bear on the situation. In a famous case reported in the international press, Zimbabwe was threatened with increased conditionality in return for IMF loans if it did not support Operation Desert Storm in the early 1990s (Pilger, 2002). So, as suggested by the epigraph of Dreher et al. (2009), the logic is eerily reminiscent of the famous opening scene to *The Godfather*, "Some day, and that day may never come, I'll call upon you to do a service for me. But uh, until that day, accept this justice as a gift on my daughter's wedding day."

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[9] Voeten (2001) provides examples. He cites the memoirs of James Baker (1995: 278), emphasizing domestic support to be the main reason for the US government to seek a multilateral solution to the Gulf War. He also cites Malone (1998: ix), arguing that it was easier for the Clinton administration to secure the support of the UNSC as compared to that of the US Congress.

[10] Also see Chapman (forthcoming), Kull and Destler (1999), and Mueller (1994). For a general argument and a case study of the Gulf War, see Thompson (2006a).

[11] Also see Hawkins et al. (2006) for more general arguments.

In summary, as the major shareholders of the IMF care about their influence over the temporary members of the UNSC, we predict that the latter will receive special treatment, and thus the impact of IMF conditionality on wages and salaries should depend on whether the country is serving on the UNSC at the time.

The Effect of IMF Arrangements on Public Wages and Salaries

We now consider empirically the impact of IMF participation on public wages and salaries as a proportion of total government spending.[12] Following the theoretical arguments laid out above, we expect that the effect of the IMF will be contingent on domestic political institutions – specifically whether a country is a democracy – and on the role the country plays in global governance, particularly whether the country is serving on the UNSC.

We observe a total of 2,354 observations of wages and salaries from 146 countries between 1970 and 1999.[13] On average, wages and salaries represent about 24 percent of total government expenditures (the median is also about 24 percent), with a minimum observed of 0 percent[14] and a maximum observed of 61 percent.[15] We observe 2,143 changes in wages and salaries from 139 countries during 1971 to 1999. Changes in wages and salaries average –0.19, although the median is only –0.13. The most drastic cut we observe is –26 percent,[16] and the greatest increase is 37 percent.[17] Some overall patterns are illustrated in Figure 4.1.

Figure 4.1: Descriptive Statistics of Changes in Public Wages and Salary by UNSC and IMF Status

[12] The results reported below are robust to measuring spending on wages and salaries in *per capita* terms. Available upon request.

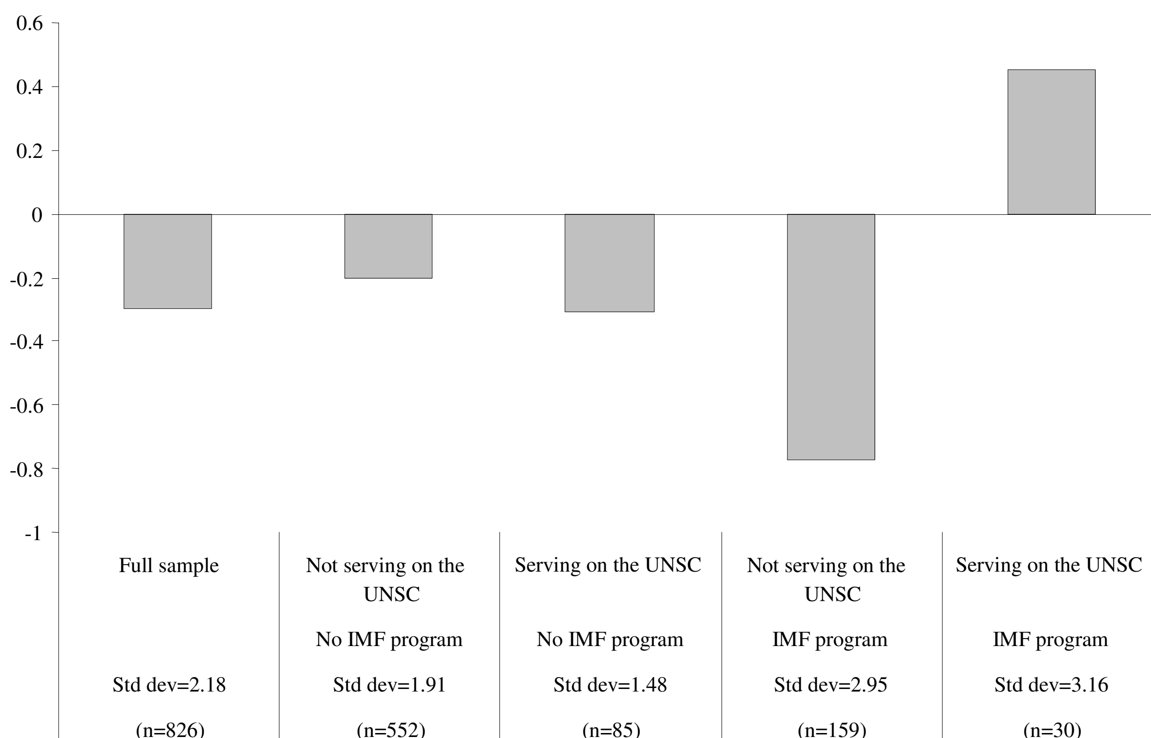
[13] The panel is unbalanced due to missing data and the fact that new countries emerge and others cease to exist over time.

[14] Brazil 1972-3, as a dictatorship under an IMF program not serving on the UNSC.

[15] Yemen 1993, a dictatorship not participating in an IMF program nor serving on the UNSC.

[16] Kuwait 1991, a case of invasion.

[17] Zaire 1995, dictatorship not participating in an IMF program, not serving on the UNSC.



We analyze the impact of IMF participation on the change in public wages and salaries. First, we use OLS regression with robust standard errors clustered by country. Then we introduce a two-step instrumental variable approach to control for non-random selection. We estimate first a linear probability model of IMF participation (the method is explained in technical detail in Appendix 4.1 and the first-stage results are presented in Appendix Table 4.1A) and use the predicted probability of IMF participation in the second stage. To the extent that the variables used to predict IMF participation are not correlated with changes in wages and salaries, the predicted probability of IMF participation can be used as an instrument to correct for bias associated with non-random selection into IMF programs. The reason we use two steps rather than estimating a standard 2SLS model is that we want to interact IMF participation with the international relations variable, UNSC service, separately for democracies and dictatorships.

Into these statistical models, we introduce a number of control variables. We mainly follow the IMF's Independent Evaluation Office's (2003) and Nooruddin and Simmons' (2006) specification of social expenditures as a baseline. To address possible autocorrelation in the data, we include the lagged value of change in wages and salaries, as well as the lagged value of wages and salaries itself. We also include the natural log of GDP, both as a lagged variable and a differenced variable, as well as growth of GDP and change in growth. Additional economic indicators are an indicator for whether the country

experienced negative growth in the previous year and whether that situation continued into the present, as well as the country's growth-rate volatility. We control for the lagged value of political regime as well as change in political regime. Demographic variables are also included: percentage of the population aged 0 to 14, and percentage of the population greater than 65.[18] We also include a time trend variable.

Finally, as our independent variables of interest, we include participation in IMF programs, service on the UNSC, and the interaction of these two variables. For the two-step instrumental variable approach, we use the predicted probability of IMF participation and interact the predicted probability with UNSC service. We introduce our variables first into the full sample, and then into the democracy and autocracy samples separately. Our measure of political regime comes from the Polity IV data (see Jaggers and Gurr, 1995). We dichotomize the variable coding democracies 1 if the Polity index is greater than six and dictatorships 0 otherwise.[19]

The full set of results is presented in Table 4.1. With many variables included along with complex interactions across international and domestic political variables, the results of Table 4.1 are not straightforward to interpret. Thus, we also present Tables 2 and 3, which contain our principal results of interest.

First, note the following. Changes in public wages and salaries as a proportion of total government expenditures are highly idiosyncratic. Most of the control variables we include are not significant. There appears to be high autocorrelation as lagged changes have a negative effect on current changes – presumably because increases are followed by cuts and vice versa. High overall wages and salaries also have a negative effect – presumably because there is more to cut (or, inversely, low wages and salaries are more likely to go up than down).[20]

Next, note the effect of IMF participation. Absent a control for non-random selection (the first three columns, labeled "OLS"), the IMF appears to have a substantially strong impact. Participation in general lowers public wages and salaries by about 0.54 percent – they are cut by about 0.72 percent in autocracies and by about 0.68 percent in democracies. Importantly, change in participation status also

[18] We prefer including these variables separately rather than combining them into a single age dependency ratio because it allows to see if public wage expenditures are shaped more by pressures from the youth (in the form, say, of education expenditures) or from the old (in the form of health-care or pension expenditures)., thereby clarifying the politics at work.

[19] Our measure of political regime comes from the Polity IV data (see Jaggers and Gurr, 1995). We dichotomize the variable coding democracies 1 if the Polity index is greater than six and dictatorships 0 otherwise. For our dataset, Polity IV has better coverage than perhaps a measure of political regime that is more suitable to our purposes, the ACLP (Przeworski et al., 2000). For future work, however, we suggest the update version of ACLP (see Cheibub, Gandhi, and Vreeland, 2009).

[20] This is consistent with Nooruddin and Simmons (2006).

matters, and actually has the most substantial impact of any of our statistically significant results. Entering into IMF programs appears to lower wages and salaries by 1.17 percent, while leaving the IMF has the opposite positive effect. The impact in autocracies is 1.66 percent, and in democracies it is 0.66 percent.

These effects largely disappear, however, when we control for non-random selection (the last four columns, labeled "Two-step instrumental variable approach"). What does this imply? Most likely, the drastic swings in wages and salary associated with IMF participation are not because of the inherent effects of IMF programs, but rather the dire economic straights that countries find themselves in when turning to the IMF. It is not the IMF program but the circumstances surrounding participation. The effect of service on the UNSC is similarly negligible, as we expect.

Now consider the interaction of UNSC service and IMF participation (UN Security Council*IMF participation). Whether we control for non-random selection or not, the interaction term is not significant for the sample including both regimes, nor is it significant for just autocracies. For democracies, however, we get rather interesting – statistically significant – results.

When we do not control for non-random selection, the interaction term is significant at the 0.05 level, with a coefficient of 1.03. This coefficient in isolation is not informative. Table 4.2 presents the full spectrum of results. The marginal effect of IMF participation for democracies not serving on the UNSC is approximately –0.68 percent, and we can say with 90 percent confidence that the true impact is to lower wages and salaries between 1.23 percent and 0.13 percent of total government expenditures. The impact of the IMF for UNSC members, however, is not distinguishable from zero with reasonable statistical significance. This is an important finding. It implies that while typical democracies are constrained to cut wages and salaries under IMF programs, democracies of international political importance to the IMF major shareholders face no such consequences. Turning to the impact of service on the UNSC, for democracies not participating in IMF programs, service has no statistically significant effect. But for democracies participating in IMF programs, the marginal impact of UNSC service is to increase public wages and salaries by approximately 0.81 percent, and we can say with 90 percent confidence that the true effect is between 0.08 and 1.53 percent, a wide but always positive margin.

When we control for non-random selection, the results become more nuanced but the qualitative implication remains. Table 4.3 presents easily interpretable results. Service on the UNSC does not have a statistically significant effect, nor does IMF participation for democracies not serving on the UNSC. But for democracies serving on the UNSC, the effect of IMF participation is to raise public wages and

salaries by about 0.92 percent of total expenditures, and we can say with 90 percent confidence that the true effect is between 0.11 and 1.74 percent. Once again, we see that democracies that are politically important to the major shareholders of the IMF receive benefits. It seems that the apparent negative effects of IMF participation presented in Table 4.2 are really the result of the selection circumstances of countries turning to the IMF. Apparently, their circumstances would warrant reductions in expenditures on wages and salaries with or without the IMF. But membership in an important body like the UNSC has its privileges. Democracies can use their leverage at the UNSC to vie for soft loans and conditionality so that they can increase public wages and salaries under IMF programs.

Discussion of Results: the Role of Domestic Political Institutions

Our analysis suggests that democracies serving on the UNSC receive favorable treatment from the IMF, easing the budget constraint they face and allowing them to protect their civil servants. But, why only democracies? Our argument about the importance of countries serving on the UNSC should hold for both democracies and autocracies, unless the former play a stronger legitimizing role in international politics and thus their votes on the UNSC are more valuable. While this would be an interesting avenue to pursue, we may simply fail to find an effect for dictatorships because we are considering the wrong dependent variable. As noted in section two above, both types of regime may attempt to protect important constituencies serving in the public sector. Yet they do so in different ways.

In the face of the economic vagaries of globalization and an open economy, developing democracies have used the civil service as a way to protect the electorally-vital middle class (Nooruddin and Rudra, 2009). They also may use the public sector as a means to provide public goods to the broader electorate (Bueno de Mesquita et al., 2003). Dictatorships survive in office by paying off other groups: their loyal clique, the military, and other security forces (Nooruddin and Simmons, 2006). Yet our data source (the World Bank) distinguishes the salaries and wages of military personnel from other public wages and salaries, instead including all military expenditures together (including military hardware). Nevertheless, our results imply that the impact of a financial crisis on income distribution may be contingent both on the role a government plays in global governance and also on domestic political institutions. We suspect that both democracies and dictatorships can leverage UNSC membership for favorable treatment from the IMF, but do so in different ways. So, while it may be more difficult in a large-n setting to detect just how dictatorships use leverage gained from playing privileged roles in global governance to pay off domestic supporters, our framework provides suggestions for where to look (such as at military spending) in future research on dictatorships.

Conclusion

It is well known that there are distributional consequences when governments face an economic crisis. Some groups lose more than others. Participation in IMF programs during such crises has been associated with increased inequality of income. The major contribution of this chapter is to show that these local distributional consequences are contingent on the role that the government of a developing country plays in global governance. Specifically, developing democracies use IMF loans of foreign exchange to soften the blow on civil servants if the government has the international leverage to do so. While most countries reduce public wages and salaries as a proportion of public expenditures when facing an economic crisis – independent of IMF participation – democracies serving on the UNSC actually increase such expenditures when participating in an IMF program.

Thus the governance of two international institutions – the IMF and the UNSC – impacts upon local decisions of the distribution of public resources. Powerful countries like the United States have strong influence over the IMF, and they care about how countries vote on the UNSC. Because UNSC resolutions require the agreement of the powerful permanent countries as well as some of the temporary members, who represent developing countries all over the world, the votes of these temporary members can prove important to the IMF's major shareholders. Countries like the United States, Japan, Germany, France and the United Kingdom – the most powerful members of the IMF – rely on the UNSC to legitimize international action. Perhaps because the legitimacy of UNSC votes is at stake, relying on an international organization like the IMF proves all the more useful as it obfuscates the process by which votes are bribed and rewarded.

So the IMF can be the dark knight – whether for good or for ill requires more research. Some would argue that IMF conditionality is too stringent, thus when IMF lending comes with fewer conditions attached, this might be a good thing. Others would argue that the problem with IMF lending is precisely that conditionality is too often ignored, in which case lending to provide political favors may be a bad thing. Either way, political favoritism is certainly beyond the mandate of the IMF, as laid out in its *Articles of Agreement*. Providing bribes or rewards for members of the UNSC is definitely outside of what it was intended to do, and the UNSC is certainly not supposed to be manipulated like this. Thus, a discussion of reform of global governance is appropriate.

Appendix 4.1 Methods
We use a barebones selection model to maximize the number of observations available.

For the two-step instrumental variables approach, we use a linear probability model (OLS) for the selection stage. We use two steps rather than the standard 2SLS approach so that we can interact the selection variable in question (IMF participation) with the international relations variable (UNSC service).

We make the model dynamic by including the lagged dependent variable along with the lagged dependent variable interacted with each of the independent variables. The mathematics are straightforward:

$$y^*_{i,t} = \beta' x_{i,t-1} + \alpha' \left(x_{i,t-1} \times y_{i,t-1} \right) + e_{i,t-1} ,$$

where $y^*_{i,t}$ denotes the latent probability of IMF participation in country *i* in year *t*, $x_{i,t-1}$ represents the independent variables determining IMF participation, β captures the effects of these variables on the probability of *entering* IMF participation (when lagged participation, $y_{i,t-1}$, equals 0), and $\beta + \alpha$ captures the probability of *continuing* IMF participation (when lagged participation, $y_{i,t-1}$, equals 1). In the table below (Appendix Table 4.1A), we report results for the quantities of interest, β and $\beta + \alpha$ (not α).

The barebones model we use introduces just four determinants of IMF participation: GDP growth (annual %), Current account balance (% of GDP), Budget balance (% of GDP), and the Log of GDP. We find that GDP growth (annual %) has a negative effect on both entering and continuing – countries participate when growth is low. Current account balance (% of GDP) does not have a statistically significant impact on entering, but countries with low current account balances are likely to continue IMF participation. Countries with a budget surplus are not likely to enter into IMF programs, but they are likely to continue participation, perhaps indicating that compliance with tight fiscal policy is necessary for countries to continue participation. Countries with low GDP are more likely to enter IMF participation, but the variable has no statistically significant impact on continuation. Poor countries are likely to turn to the IMF, but once under, GDP plays no role in continued participation.

Appendix Table 4.1A: Selection Stage – Participation in IMF Programs

Dynamic OLS model

Variable	Determinants of entering into IMF participation	Determinants of continuing participation
GDP growth (annual %)	-0.006**	-0.006**
	(0.002)	(0.002)
Current account balance (% of GDP)	-0.0003	-0.004**
	(0.001)	(0.002)
Budget balance (% of GDP)	-0.004**	0.01**
	(0.001)	(0.002)
Log of GDP	-0.037**	-0.016
	(0.005)	(0.010)
Constant	0.391**	1.001**
	(0.048)	(0.074)
Total number of observations:	2,554	
Number of observations entering/not entering:	1,680	
Number of observations continuing/not continuing:	874	
Total number of countries:	149	
Number of countries entering/not entering:	134	
Number of countries continuing/not continuing:	99	
F:	706.980	
R-squared:	0.643	

Table 4.1: The Impact of IMF Participation on Public Wages and Salaries (% of total expenditures)

	OLS			Two-step instrumental variable approach			
Variable	Both regimes	Autocracy sample	Democracy sample	Both regimes	Autocracy sample	Democracy sample	Democracy sample
Lagged change in wages and salaries	-0.08** (0.04)	-0.08* (0.05)	-0.05 (0.06)	-0.06 (0.04)	-0.08 (0.05)	-0.01 (0.07)	-0.04** (0.01)
Lagged wages and salaries	-0.09** (0.01)	-0.13** (0.02)	-0.05** (0.01)	-0.09** (0.01)	-0.13** (0.03)	-0.05** (0.01)	
Lagged IMF participation	-0.54** (0.26)	-0.72* (0.39)	-0.68** (0.33)	-0.22 (0.38)	-0.37 (0.67)	-0.43 (0.37)	0.03 (0.28)
Change in IMF participation	-1.17** (0.40)	-1.66** (0.61)	-0.66* (0.39)	-0.50 (0.41)	-0.58 (0.60)	-0.54 (0.51)	-0.25 (0.43)
Log GDP (lagged)	0.22* (0.12)	0.54** (0.24)	0.02 (0.15)	0.21 (0.14)	0.49 (0.30)	0.06 (0.13)	
Change in logged GDP	4.11 (11.62)	-2.14 (17.67)	1.30 (14.65)	-5.70 (12.57)	-14.51 (19.35)	2.62 (15.64)	
Year (lagged)	0.003 (0.01)	0.020 (0.03)	-0.002 (0.01)	0.00 (0.01)	0.01 (0.03)	0.00 (0.01)	
Lagged democracy	-0.40 (0.25)	-2.10 (2.01)	-0.26 (0.67)	-0.41 (0.26)	-2.06 (2.11)	-0.19 (0.68)	
Change in democracy	0.50 (0.79)	(dropped)	(dropped)	0.44 (0.81)	(dropped)	(dropped)	
Population 0-14 (% of total, lagged)	0.03 (0.03)	0.12** (0.05)	-0.01 (0.03)	0.02 (0.03)	0.11* (0.06)	-0.01 (0.03)	
Population 65+ (% of total, lagged)	-0.11** (0.05)	0.08 (0.12)	-0.07 (0.05)	-0.09* (0.05)	0.08 (0.13)	-0.09 (0.05)	
GDP growth (annual %, lagged)	-0.09 (0.10)	-0.05 (0.16)	-0.01 (0.13)	0.02 (0.11)	0.13 (0.17)	-0.06 (0.14)	
Change in GDP growth (annual %, lagged)	-0.067 (0.11)	-0.004 (0.16)	-0.024 (0.14)	0.05 (0.12)	0.16 (0.19)	-0.06 (0.15)	
Negative growth	-0.44 (0.58)	-0.17 (1.14)	-0.47 (0.55)	-0.62 (0.61)	-0.04 (1.29)	-0.82 (0.54)	-0.59* (0.33)
Change in Negative growth	-0.15 (0.38)	0.16 (0.80)	-0.36 (0.33)	-0.29 (0.40)	0.22 (0.86)	-0.65** (0.31)	-0.31** (0.15)
Lagged Growth Volatility	0.12** (0.06)	0.04 (0.07)	0.13 (0.10)	0.11** (0.06)	0.05 (0.08)	0.10 (0.10)	
UN Security Council	-0.30 (0.20)	-0.49 (0.58)	-0.22 (0.16)	-0.41* (0.23)	-0.95 (0.70)	-0.21 (0.16)	-0.20 (0.12)
UN Security Council*IMF participation	0.26 (0.39)	-0.11 (0.73)	1.03** (0.48)	0.53 (0.56)	0.59 (1.12)	0.97* (0.58)	0.89* (0.47)
Constant	-6.30 (26.96)	-44.40 (58.86)	5.52 (30.19)	-3.75 (29.85)	-27.27 (68.31)	-7.15 (29.87)	0.49** (0.17)
Number of observations	1,447	639	808	1311	563	748	826
F	4.34	4.14	2.35	3.46	4.2	2.67	3.71
R-squared	0.08	0.11	0.06	0.06	0.09	0.05	0.04
Number of countries	107	63	62	107	63	62	66

Note: In parentheses, robust standard errors clustered by country. * Significant at the 0.10 level. ** Significant at the 0.05 level.

Table 4.2: Marginal Effects of IMF Participation and UN Security Council Service under Democratic Regimes

	Marginal effect of IMF participation	90% confidence interval
Non-UNSC member:	-0.68*	-1.23, -0.13
UNSC member:	0.35	-0.43, 1.13

	Marginal effect of UNSC service	90% confidence interval
Not participating in IMF programs:	-0.22	-0.49, 0.04
Participating in IMF programs:	0.81*	0.08, 1.53

Table 4.3: Selection-corrected Marginal Effects of IMF Participation and UN Security Council Service under Democratic Regimes

	Marginal effect of IMF participation	90% confidence interval
Non-UNSC member:	0.03	-0.43, 0.49
UNSC member:	0.92*	0.11, 1.74

	Marginal effect of UNSC service	90% confidence interval
Not participating in IMF programs:	-0.20	-0.39, 0.001
Participating in IMF programs:	0.70	-0.01, 1.40

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