Panos Tsakloglou
Athens University of Economics and Business
Hellenic Observatory (LSE) and IZA (Bonn)

Discussion of

HARD WORK AND FOREIGN HELP

How to successfully conduct adjustment with official assistance

by

Martin Larch, Kristin Magnusson Bernard & Balint Tatar
European Commission

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Short description of the paper (1/2)

- Research Question: What are the determinants of a successful exit form an IMF Program?
- Data: 176 IMF-supported Country Programs; unbalanced panel of countries covering the period 1993-2010
- Successful Exit: Defined in terms of GDP growth and debt decline (probit estimation)
- Explanatory Variables: Indicators of policy action and external conditions
- Results: Both policy action (fiscal consolidation, financial sector repair *and structural reforms?*) and external factors (global demand, low volatility) play a significant role

Short description of the paper (2/2)

- Interesting paper; a lot of work
- Issues covered closely associated with current policy debates in the EU (and the euroarea, in particular)
- Paper aims to identify cross-country regularities; Country-specific idiosyncrasies matter a lot
- Extensive sensitivity analysis / many checks for the robustness of the results
- Most, but not all, of the results not surprising / unexpected

Discussion: Sample selection

✓ Control group (non-program countries)?
Difficult and, perhaps, quite arbitrary

✓ Analysis requires a 11-year window. Hence, is it appropriate to use adjacent or almost adjacent years as distinct programs/observations?
Example: Latvia 1993, 1995, 1996, 1997, 1999, 2001, 2008

Discussion: Dependent variable

✓ Rather arbitrary, but several robustness checks

✓ Ultimate target of IMF-supported programs: Growth and fiscal stability.

✓ But immediate target: Access to capital markets

✓ Many countries not included in the analysis follow similar patterns in comparable time frames. Difference with sample countries: Access to capital markets

✓ Hence, appropriate dependent variable: <u>Sustainable</u> access to capital markets (*not-problem free choice*).
Tried, but results not reported; far fewer "successful" cases

Discussion: Explanatory variables included in the analysis (1/2)

✓ Many of the variables included likely to be endogenous
Admission but no attempt to instrument, at least the most obvious candidates

✓ Thresholds are likely to be important / non-linearities
For example, effect of 120% Debt/GDP likely to be much higher than four times the effect of 30% Debt/GDP

✓ Business cycle matters. Preferable indicator of fiscal effort: structural (cyclically adjusted) primary balance adjustment, rather than simple primary balance adjustment

Discussion: Explanatory variables included in the analysis (2/2)

✓ Effect of Banking Crisis strongly counter-intuitive (positive, large and highly significant). Probably, other factors at work.

✓ Effect of World Growth positive and highly significant, as anticipated. Coefficient substantially larger than corresponding domestic growth coefficient (although not strictly comparable).
Important policy implications for Europe
Not significant in "market access" regression!

✓ Effect of Nominal Effective Exchange Rate change positive (as anticipated?) but, perhaps, change in Real Effective Exchange Rate more appropriate variable?

Discussion: Explanatory variables <u>not</u> included in the analysis

✓ Political Economy research: Importance of institutions; in this context esp. sociopolitical stability and social cohesion

✓ Composition of fiscal adjustment: Role of tax increases and expenditure cuts

But, data availability?

Discussion: Minor points (1/2)

✓ Descriptive part (graphs): Are "Mean", "25 percentile", "75 percentile" defined per period (T-1, T, T+1, etc) or with reference to the position of the country in year T?
If the former, fallacy of composition

✓ Descriptive part (graphs): Use employment rates instead of or in addition to unemployment rates to account for the "discouraged worker" effect

✓ Some of the Programs considered started in 2009 or 2010. Hence, unlike the claim made, the paper does rely on forecasts, at least to a limited extent.

Discussion: Minor points (1/2)

- ✓ Provide share of "successful" predictions for each model
- ✓ Many Programs front-loaded. Use T-1, instead of T, in the baseline.
- ✓ Extensive research along these lines carried out by the Commission Services in late 2000s; not mentioned in the paper