

# The International Politics of Austerity: The Puzzling Case of Public Sector Reforms

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# Motivation

- Many governments have recently undertaken austerity drives
- When and under what conditions is austerity politically sustainable?
  - Greece
  - Public sector cuts

# Motivation

- Governments face competing pressures re public sector spending
  - Domestic: sustain spending
  - International: cut spending

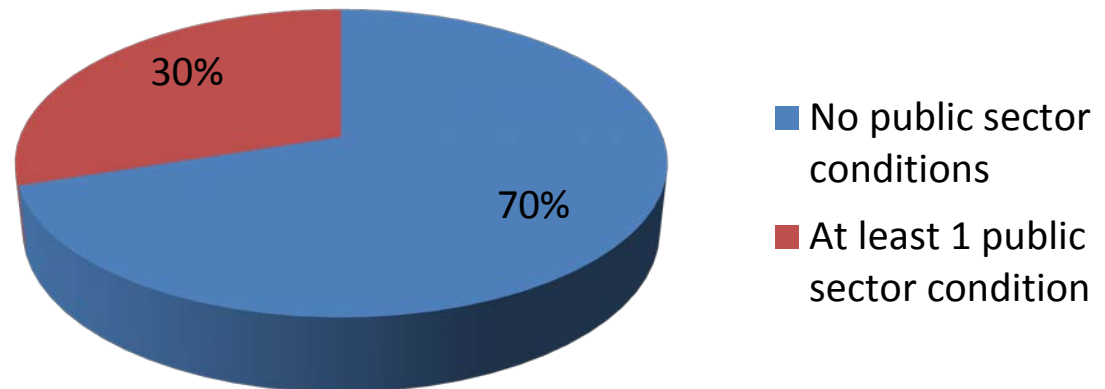
# Motivation

- Critics allege that deep spending cuts follow IMF borrowing
- Scant systematic evidence:
  - Nooruddin and Rudra (2009) find no public sector layoffs
  - Nooruddin and Vreeland (2010) find no reduction in wages or salaries

# Innovation

- Previous studies treat all IMF loans as being equal but conditions vary
- Identify loan with public sector conditions

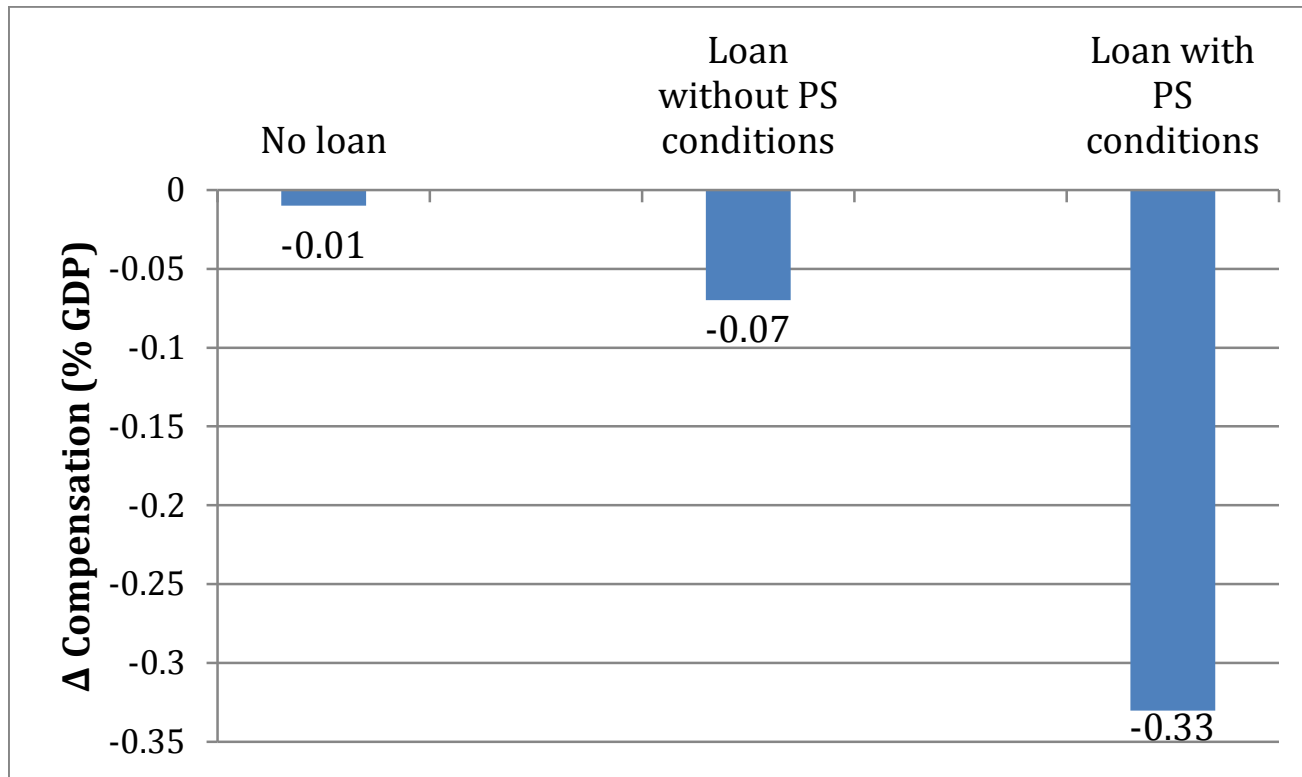
Figure 1: IMF loans (1980-2000) with public sector conditions



# Innovation

- Connect specific loan conditions to precise outcomes
  - Conditions in IMF loans from 1980 to 2000
    - Wage limits
    - Employment limits
    - Privatization
  - Outcome
    - Wage bill (compensation of employees % of GDP)

Figure 1: Year-to-year change in *Compensation* (mean)



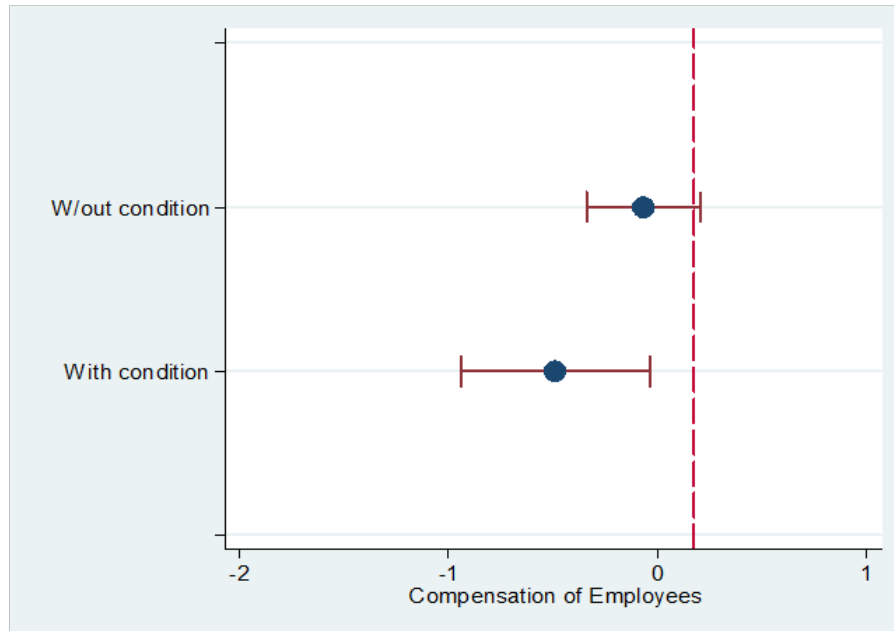
Estimated effect of IMF loan conditions

	(1) Full sample
L.Loan with public sector conditions	-0.488** (0.231)
L.Public sector condition	
L.Loan w/out public sector conditions	-0.066 (0.139)
L.Loan (predicted)	
L.GDP per capita (log)	-1.368*** (0.295)
L.Negative growth	0.226* (0.120)
L.Democracy	-0.629*** (0.208)
Constant	17.81*** (2.45)
Observations	1,114
R-squared	0.047
Number of countries	89

Notes: All models include country fixed effects. Standard errors in parentheses; \*\*\*  
p<0.01, \*\* p<0.05, \* p<0.1



## Estimated effects of IMF loans



Estimated effect of IMF loan conditions

	(1) Full sample	(2) Only IMF borrowers
L.Loan with public sector conditions	-0.488** (0.231)	
L.Public sector condition		-0.948*** (0.303)
L.Loan w/out public sector conditions	-0.066 (0.139)	
L.Loan (predicted)		
L.GDP per capita (log)	-1.368*** (0.295)	-1.653* (0.853)
L.Negative growth	0.226* (0.120)	0.284 (0.243)
L.Democracy	-0.629*** (0.208)	0.103 (0.402)
Constant	17.81*** (2.45)	17.89*** (6.15)
Observations	1,114	288
R-squared	0.047	0.069
Number of countries	89	53

Notes: All models include country fixed effects. Standard errors in parentheses; \*\*\* p<0.01, \*\* p<0.05, \* p<0.1

Estimated effect of IMF loan conditions

	(1) Full sample	(2) Only IMF borrowers	(3) Two-stage model
L.Loan with public sector conditions	-0.488** (0.231)		
L.Public sector condition		-0.948*** (0.303)	-0.525** (0.239)
L.Loan w/out public sector conditions	-0.066 (0.139)		
L.Loan (predicted)			-0.353* (0.195)
L.GDP per capita (log)	-1.368*** (0.295)	-1.653* (0.853)	-1.406*** (0.333)
L.Negative growth	0.226* (0.120)	0.284 (0.243)	0.312** (0.133)
L.Democracy	-0.629*** (0.208)	0.103 (0.402)	-0.706*** (0.230)
Constant	17.81*** (2.45)	17.89*** (6.15)	18.18*** (2.74)
Observations	1,114	288	947
R-squared	0.047	0.069	0.059
Number of countries	89	53	80

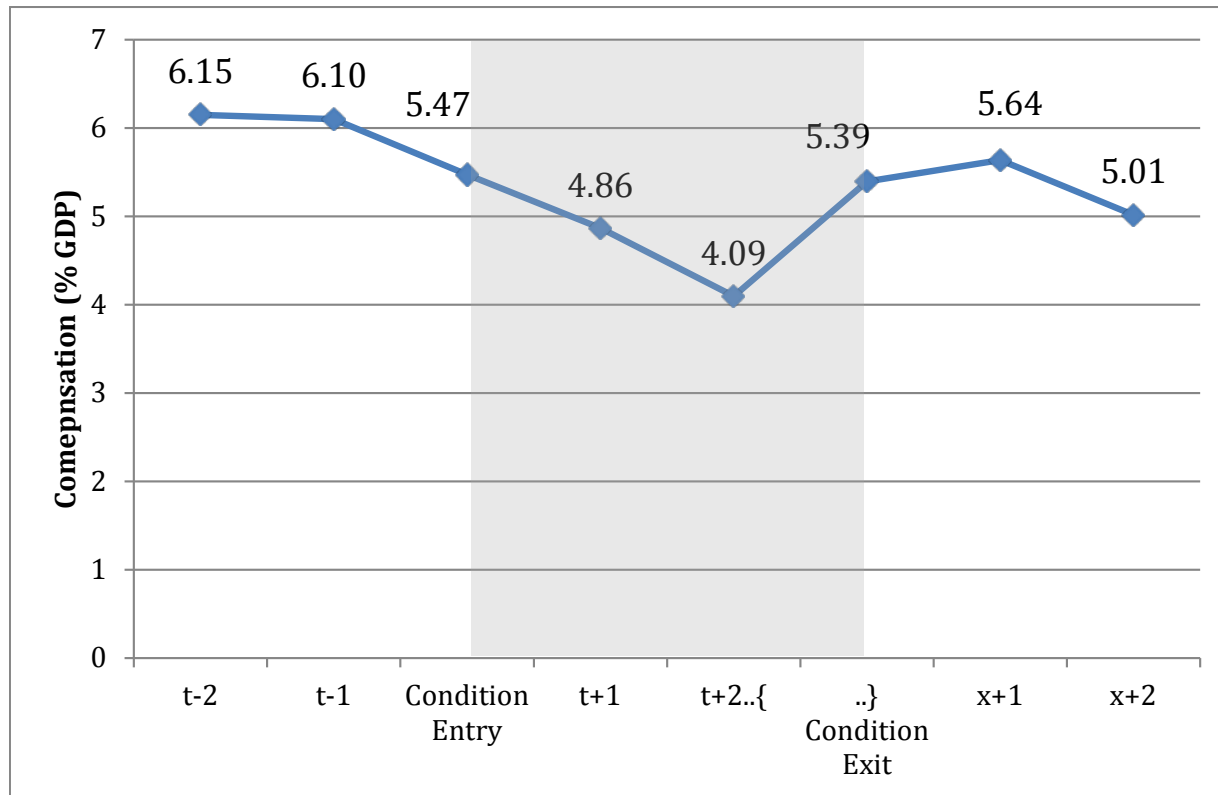
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# Key finding

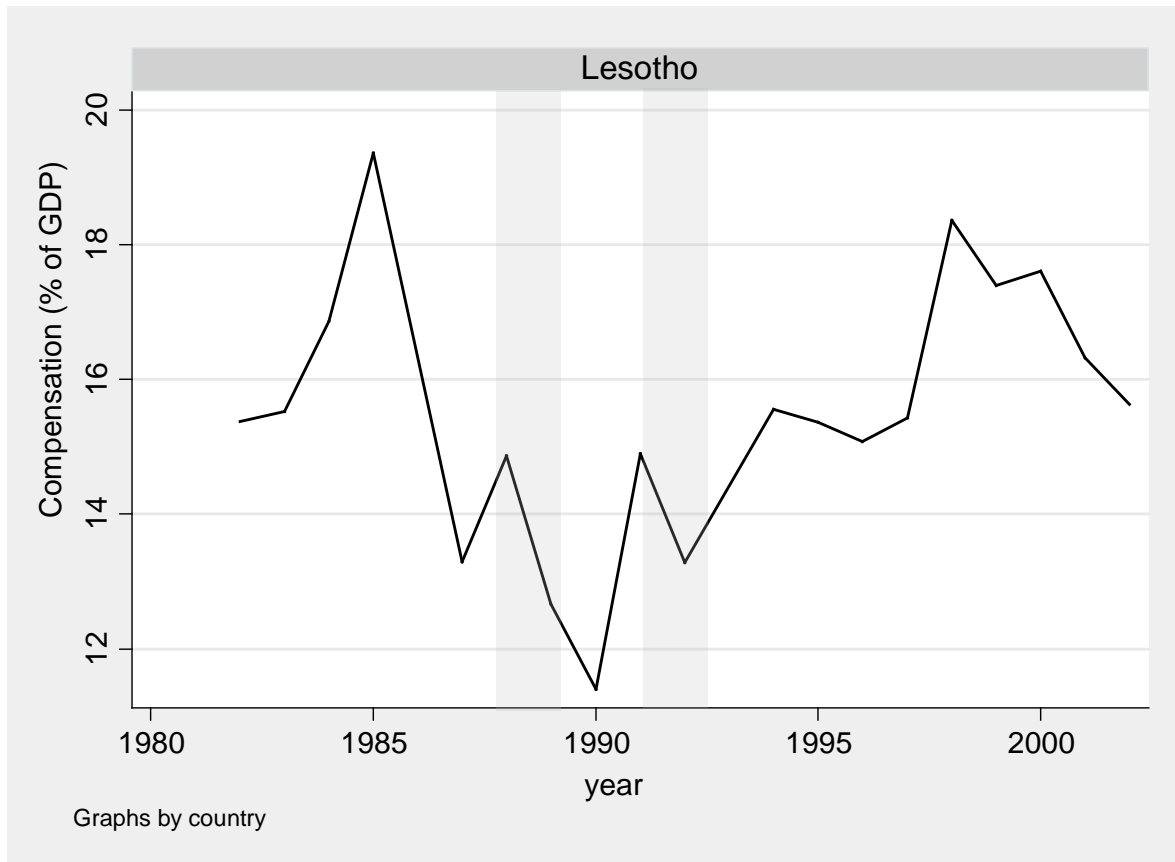
- Conditions link IMF loans with governments' spending decisions
- Governments with generic conditions protect the public sector from spending cuts

# Backsliding

Figure 4: *Compensation* spending over time (mean)



# Backsliding



# Implications

- Externally imposed austerity tends not to stick
- Variance in conditions may explain the varied political and economic effects of IMF loans