Why does the IMF assign labor conditions? The Burden of Adjustment, Exchange Rate Regimes, and Labor Conditions

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Abstract

Why does the International Monetary Fund (IMF) assign more stringent labor conditions in some cases and not others? This paper argues that the Fund’s bureaucratic organizational culture and neoliberal economic beliefs dictate its interpretation of international economics and predict the stringency of labor conditions in its programs. Particularly, the Fund staff envisage that lower unit labor costs would indirectly increase competitiveness, boost exports, and contribute to the balance of payments in fixed exchange rate regimes, where currency depreciation is not possible. To this end, the Fund assigns more stringent labor conditions in fixed regimes compared to floating ones. To test this theory, the paper uses a mixed method. It firstly demonstrates the association between exchange rate regimes and the stringency of labor conditions in Fund programs in a global sample. It then complements this analysis by showing particular organizational habits and beliefs at work in two cases, namely in Latvia and Hungary in 2008 under their respective IMF programs. Furthermore, the paper shows that distribution of income away from labor groups (i.e. lowered wages) is in fact by design in IMF programs in an attempt to increase competitiveness in fixed regimes.

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Introduction

This paper investigates when and why the International Monetary Fund (IMF) assigns labor conditions. The IMF’s labor conditions are highly consequential: they have a direct impact on people’s income and job security. They might, for example, mandate lay-offs of public workers and advise creating caps on wage increases in the public and private sectors (e.g. in Latvia in 2008). Alternatively, they might lower the minimum wage, decentralize collective bargaining institutions, and ease the restrictions on firing in labor law (e.g. in Greece in 2010 and Portugal in 2011). Those measures reduce the bargaining power of workers and indirectly lower wages. Ninety-two countries received at least one labor condition between the years 1980 and 2013. Among those countries, Gabon, for instance, received thirteen separate labor conditions in 1996 (the highest number of labor conditions between those years). Yet, the Fund does not always assign labor conditions, such as in Hungary in 2008. Similarly, Madagascar did not receive any labor conditions in its eighteen programs between 1980 and 2013. Why does the IMF assign labor conditions to some borrowers but not to others? When and why does the Fund decide to include labor conditions in program design?

This paper argues that the IMF assigns a higher number of labor conditions in fixed exchange rate regimes compared to floating ones, all else being
equal. In fixed regimes, it substitutes internal devaluation with external adjustment. Labor conditions in fixed regimes lower unit labor costs, indirectly lower product prices, and reduce the aggregate demand in the borrowing country. The Fund envisages that this indirectly finances the ‘spending gap’ (i.e. corrects the balance of payments of the country). In floating regimes, currency depreciation in the lead up to the crisis and/or to the IMF program is assumed to make products cheaper and hence remove the need for stringent labor conditions. This explains why we observe cross-country variation in terms of design and stringency of labor conditions under IMF programs. Furthermore, this finding demonstrates that the burden of adjustment disproportionately falls on the shoulders of labor groups in fixed regimes. Both internal and external adjustment are plausible macroeconomic strategies, and the choice of one or the other is a political decision (Walter 2013, p.3). The paper demonstrates that IMF programs shift the burden to labor groups in fixed regimes.

In explaining the significant variation in the scope of IMF conditionality, previous studies looked at the role of economic ideas and norms (Chwieroth 2007, 2015; Nelson 2014, 2017), geostrategic interests (Dreher and Jensen, 2007; Dreher, Sturm, and Vreeland 2012, 2015; Stone 2002, 2008), international economic interests and composition of donors (Copelovitch 2010; Gould 2003, 2006), and organizational power of domestic groups (Caraway, Rickard, and Anner 2012; Nooruddin and Simmons 2006). This study complements the existing studies in three ways. Firstly, scholars have previously demonstrated that powerful labor groups’ interests would be represented at the negotiation table by their governments, and consequently they would avoid intrusive labor conditions (Caraway et al. 2012). This paper complements this analysis by looking at the other
side of the negotiation table and explains why the Fund might include (and perhaps insist on) labor conditions in some cases, controlling for the organizational power of labor groups. It, in other words, explains the Fund side of labor conditionality in addition to domestic politics. Secondly, it deepens the inquiry on conditionality by disaggregating the Fund’s conditionality and by specifically looking at labor conditions. Disaggregating conditionality is analytically and empirically important (Caraway et al. 2012; Nooruddin and Simmons 2006; Rickard and Caraway 2018; Stone 2008). Different geostrategic and domestic interests can compete to avoid (or include) subcategories of conditionality, and we can have a better understanding of which factors take precedence by employing a disaggregated approach. Thirdly, while there is a broad consensus in the literature that the Fund staff is socialized into neoliberal economic ideas and beliefs (Chwieroth 2007, 2015; Nelson 2014, 2017; Woods 2006) and that they are not essentially sympathetic to labor unions and labor rights (Caraway 2006), we do not know much about how those ideas translate into different subcategories of conditionality. This paper delves deeper into the specifics of the neoliberal agenda and specific policy choices made in line with its agenda. In other words, it contributes to the growing literature on how the IMF sees macroeconomic problems and their solutions in borrowing countries (Broome and Seabrooke 2007; Moschella 2012).

Furthermore, research on the IMF in the past two decades has focused on the international and domestic political interests surrounding IMF programs, and has ironically overlooked the original purpose of the Fund to regulate exchange rates (Dreher and Walter 2010). Indeed, recent studies on the IMF scarcely speaks to the literature on exchange rate regimes, which is surprising considering the original
purpose of the IMF. This paper bridges this gap between those two groups of studies.

The findings also have important policy implications especially for labor interests. Scholars have previously demonstrated that IMF programs distribute income away from labor groups (Pastor 1987; Garuda 2000; Vreeland 2002). Particularly, James Vreeland (2002) shows that labor’s share of income declines on average in countries under IMF programs compared to the countries outside of programs. In his conclusions, he notes that: ‘…reducing the income of labor may be by design. After all, the IMF presumes that balance-of-payments crises are due to excess demand’ and leaves it to future research to delve deeper into the reasons for labor groups’ lowered income under IMF programs (Vreeland 2002, p.133).

This paper builds on earlier studies showing that lowering the income of labor groups through labor conditions in fact happens by design and serves the purpose of financing the spending gap in borrowing countries. It, in other words, demystifies the income distribution away from labor groups and towards capital owners under IMF programs.

In this paper, I firstly show that exchange rate regime plays an important role in assigning labor conditions, by conducting a documentary analysis of Fund programs in Latvia and Hungary in 2008. Those two cases provide an excellent comparison. They are similar in many respects such as labor market regulation, firing costs, trade union density, overall macroeconomic indicators, type of economic crisis in 2008 (i.e. banking crisis), and their geostrategic alliances, but differ in exchange rate regime. I outline that the Fund assigned more stringent labor conditions in Latvia, with the motivation of lowering labor costs and financing the spending gap; since Latvia had a currency peg at the time. In Hungary, on the other
hand, from the Fund’s perspective there was no need for labor conditions, as the country had a floating regime.

I then test this association between fixed exchange rate regimes and the stringency and the number of labor conditions in a global sample of IMF borrowers over the years 1980 and 2013. I show that countries with fixed regimes receive a higher number (by simple count of labor conditions in programs) and also more stringent conditions (such as performance criteria) as opposed to less stringent conditions (such as structural benchmarks), controlling for geostrategic interests, economic factors, and the organizational capacity of labor groups. Moreover, the results are robust with alternative model specifications and measurement, inclusion of control variables, and time trends.

In the rest of the paper, I firstly provide a more detailed survey of the literature on IMF conditionality to show the theoretical and methodological progress in the literature in unpacking conditionality, and discuss how we can further deepen our understanding. Then I explain the politics of internal versus external adjustment and discuss how this translates into concrete labor conditions in Fund programs. Next, I discuss two cases, namely Latvia and Hungary in 2008, to show that exchange rate regime significantly influences labor conditions and that labor conditions are utilized as a substitute for currency depreciation. Then, I provide strong quantitative evidence that borrowing countries with fixed exchange rate regimes receive more stringent labor conditions and that there is indeed a particular pattern in the Fund’s labor conditionality. The final section summarizes the argument and concludes with some policy recommendations.
Geostrategic Interests, Domestic Groups, Ideas, and Conditionality

Studies of IMF conditionality broadly follow three schools of thought in the analysis of conditionality, namely realist/rationalist, liberal institutionalist, and constructivist schools of thought. The rationalist/realist accounts studying IMF conditionality stress the role of the U.S. in influencing the number of conditions assigned to the borrowing countries, and unequivocally establish that Fund conditionality is political. They find evidence that U.S. allies, allies of G7 countries, and temporary members of the U.N. Security Council receive fewer conditions compared to non-allies and non-members (Abouharb and Cingranelli 2009; Dreher and Jensen 2007; Dreher et al. 2012, 2015; Stone 2002, 2008). They argue that the U.S. (as the principal) puts its weight in directing the agent—the IMF—to assign fewer conditions (Dreher and Jensen 2007; Stone 2008; Vreeland 2003). A different strand of rationalist accounts looks at the variation in donor composition in IMF loans and finds evidence that private donors are likely to affect not only the number of conditions, but also the substance, such as pushing for bank-friendly conditions (Gould 2003, 2006; Copelovitch 2010). The strength of the rationalist/realist accounts lies in their novelty in challenging the ‘one size fits all’ myth in IMF conditionality, and studying the political factors (as opposed to the economic ones), as defended by the Fund itself.

The liberal institutionalists argue that the IMF is not only receptive to international political and economic interests, but also pays attention to domestic interests within the borrowing countries. Irfan Nooruddin and Joel Simmons (2006) for example argue that more cohesive groups such as the military can manage to avoid more intrusive conditionality, compared to less cohesive ones. Similarly, Teri Caraway, Stephanie Rickard, and Mark Anner (2012) find evidence that labor
groups with greater organizational power are more likely to avoid intrusive labor conditions under IMF programs. They particularly argue that democratic governments represent the interests of more organized labor groups at the negotiation table. Caraway et al. (2012)’s study is one of the pioneering works disaggregating the IMF’s conditionality and investigating the determinants of a specific subcategory of conditionality. The study explains variation in labor conditions by the variation in domestic organizational power of labor groups.

What of the IMF side of the negotiations over labor conditions, however? As demonstrated by realist/rationalist accounts of the Fund, the IMF adjusts its conditionality for reasons independent of domestic interests (Dreher et al. 2015; Stone 2008). In fact, one can also look at the other side of the negotiation table and explain why and when the IMF would propose and insist on the inclusion of labor conditions in the final Memorandum of Understanding. Negotiations are by definition back and forth processes; and, actors may not always achieve their pre-negotiation goals. There are probably cases where governments were not able to resist labor conditions, as well as cases where the Fund would give up on conditions due to the government’s insistence.

In an interview for this study, a senior advisor to the Prime Minister of Greece in 2012 argued that they very strongly resisted the cuts in the education sector in the second memorandum in 2012. Yet, Greece received substantial numbers of conditions cutting the number of workers in the public sector. While the government was able to represent the interests of the education sector, the Fund’s prescription of cutting employment in the public sector took precedence
over the government’s preferences.\footnote{Interview with a senior advisor to the Prime Minister, Athens, Greece, September 2014.} By conducting a quantitative analysis, this study looks at how much the Fund’s preference for including labor conditions would play a role, controlling for labor’s organizational power.

The constructivists in fact precisely focus on the Fund in explaining conditionality. Jeffrey Chwieroth (2015) demonstrates that a shared professional and educational background between the Fund officials and borrowing government policymakers reduces the overall number of conditions. Similarly, Stephen Nelson (2017) provides evidence that the IMF assigns fewer conditions to the countries where there is an ideational convergence between the top policymakers and the IMF staff on the validity of neoliberal economic policies. There are several novelties in the recent constructivist studies. Firstly, they quantitatively test essentially qualitative concepts, i.e. shared beliefs and ideas. Secondly, they are novel in systematically studying the agency of the Fund in determining conditionality in addition to the geostrategic interests of G7 countries and the U.S. and domestic interests groups. These studies can be further deepened by disaggregating conditionality. The Fund’s neoliberal ideas and beliefs can be unpacked and outlined more in depth by focusing on a specific subcategory of conditionality such as labor conditions.

The impact of IMF programs on labor groups is particularly controversial. It is known that the Fund is not very sympathetic to workers’ rights (Caraway 2006). Bernhard Reinsberg, Thomas Stubbs, Alexander Kentikelenis, and Lawrence King (2019) demonstrate that Fund labor conditions diminish individual and collective labor rights in borrowing countries. David Pion-Berlin (1983) argues
that repression of trade union representatives and leftist groups increase under IMF programs.² Manuel Pastor (1987), Gopal Garuda (2000), and James Vreeland (2002) demonstrate that programs negatively affect the income of labor groups. They look at participation in IMF programs and establish a link between the deterioration of labor’s income and program participation. However, they leave it to future studies to investigate whether this is by design or an inadvertent effect (Vreeland 2002). This paper builds on the empirical and theoretical insights of those previous studies on the impact of the Fund on labor groups. It unpacks the negative impact and argues that the lowered income is not an inadvertent consequence of programs; It is a deliberate policy choice to lower production costs by making labor ‘cheaper’ and to substitute currency devaluation. Unlike previous studies, it does not look at the impact on labor groups but explains why and when the Fund assigns labor conditions, which is intimately linked to this adverse impact. The next section explains the link between exchange rate regimes, labor conditions, and the impact on labor groups under programs in more detail.

The IMF, Politics of Hard Choices, and Labor Groups

The IMF lends credit to governments undergoing balance of payments crises, either in the form of a current account deficit (when a country’s imports are substantially higher than its exports) or a capital account crisis (when external investors pull their capital out of the country and the government does not have enough resources to finance the gap). In such circumstances, the Fund provides much needed credit, enables governments to service their debt, and has the catalytic effect of attracting new capital to the country (Chapman et al. 2015; Steinwand and

² Abouharb and Cingranelli (2009) demonstrate more broadly that political violence, repression, and human rights violations are more likely under IMF programs.
In other words, the Fund’s conditional lending arrangements are specifically targeted towards correcting the ‘spending gap’, either in the form of attracting new capital or reducing imports and increasing exports.

The IMF also has a particular organizational culture (Chwieroth 2007, p.14; Momani 2007, p.42; Nelson 2017, p.29). It projects outward a particular vision and the ‘right thing to do’ when confronted with uncertainty (Nelson 2017). It has organizational habits and ‘tried and tested’ ways of responding to crises, and specifying particular reform changes that would bridge the ‘financing gap’ in the borrowing government. Especially regarding the lending arrangements, it would not be feasible to specify every particular circumstance in the organizational contract, as the local IMF offices often respond to unique challenges and conditions in borrowing countries. Moreover, there are often several international and domestic political and economic constraints, which constitute a ‘moving target’ in the specification of conditions in lending arrangements. In such cases, Fund staff refer back to an overarching and broadly accepted script that is believed to lead to the most efficient and successful outcomes. This can be broadly termed as neoliberal economic beliefs and agenda (Chwieroth 2015, 2007; Nelson 2014, 2017; Woods 2006).

A “neoliberal agenda” broadly rests on trust in market mechanisms to bring about the most efficient outcomes, and that varied and competitive interactions between market actors would ensure efficient allocation of resources. However, this does not mean that there are not trade-offs between different policy options. For instance, the choice of internal adjustment (i.e. lowered labor costs) as opposed

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3 It provides a ‘seal of approval’ and signal to international lenders that it is safe to lend their money (Chapman et al. 2015).
to external adjustment (i.e. depreciating the currency) creates different policy ‘winners’ and ‘losers’ (Walter 2013; Gartzke and Naoi 2011). The ‘hard choices’ made by the IMF staff in the specification of conditions render conditionality specifically political. The choices turn to a question of ‘who wins’ and perhaps more importantly, a question of ‘at the expense of whom’ (Casper 2015; Hartzell, Hodie, and Bauer 2010). Although the doctrine of neoliberalism promises efficient outcomes for everyone, in practice it often entails ‘trade-offs’ between different policy options and outcomes, as acknowledged by the Fund staff (IMF 2013a, pp.4-9). In other words, the Fund’s conditions are sufficiently predictable because of the organizational culture and yet sufficiently open to interpretation that they raise the intriguing question of ‘when and why does the Fund assign particular conditions?’

In this paper, I am interested in labor conditions and their impact on labor groups. I am particularly interested in why the Fund assigns labor conditions and explore whether the lowered income of labor groups is by design. The Fund’s particular interpretation of international and domestic economic problems and solutions to them, principally defined within the neoliberal agenda, give rise to particular types of conditionality in its programs. Regarding labor conditions, I argue that the Fund’s choices are closely linked to exchange rate regime of a country.

In floating regimes, the currency fluctuates freely in response to domestic and international factors (Broz, Frieden, and Weymouth 2008). In fixed regimes, on the other hand, during a crisis there is a difficult policy choice to be made: the Fund might assign conditions to devalue the currency (external adjustment) or

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4 I borrow the term from Nooruddin and Simmons (2006).
tighten fiscal and monetary policy and lower labor costs (internal adjustment) (Walter 2013, p.6). Both of these policy choices can finance the spending gap. Yet, they entail different trade-offs. Exchange rate depreciation makes domestic products cheaper in the international markets, increases exports, and raises the price of imports. Then, there would be less consumption in the economy (Frieden 1991; Walter 2013, p.6). This would also, however, destroy the savings of some domestic groups, especially those who hold domestic currency denominated assets. Another option is internal adjustment. Structural reforms can be implemented to increase the economy’s competitiveness. Lower labor costs would make production cheaper and indirectly contribute to exports (Walter 2013, p.6). Lowered income for labor groups would also reduce the consumption in the economy. The trade-offs between external and internal adjustment are extensively studied in the literature and are specified in textbook accuracy in terms of which groups win and which groups lose in the exchange rate politics (Bearce and Hallerberg 2011; Broz and Frieden, 2006; Copelovitch and Pevehouse 2013; Singer 2010).

In fixed exchange rate regimes, the IMF assigns labor conditions in order to substitute external adjustment, i.e. exchange rate depreciation with the internal adjustment. Labor conditions such as dismantling collective agreements and encouraging firm-level agreements (in other words, more decentralized and individual negotiations at the firm level) would result in greater inequality in wage distribution. While the wages of a minority of workers would increase, those of the low-skilled majority would decrease (Wallerstein 1999; Iversen 1998, p.472).5

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5 The neo-corporatist literature would argue that collective and centralized bargaining would compress wages in an attempt to reduce unemployment. However, this literature does not take into account that prices are set by the monetary authority, and disregard the potential pressure for high wages from the unions in case of high wage inequality (Iversen 1998, pp.471-472).
Measures such as changes to firing costs and employment protection legislation more generally would reduce the bargaining power of the labor groups vis-à-vis employers, which indirectly lowers wages. When it is relatively less costly to fire a worker, employers may be more reluctant to provide higher wages demanded by their employees. Privatizations of state-owned enterprises positively contribute to the government budget, but often result in lay-offs of public workers (Caraway et al. 2012). Finally, specific conditions on reducing the public sector wage bill result in the dismissal of public sector workers or cuts in their wages and pension rights (Rickard and Caraway 2018). This increases the competition in the labor market and again leads to an indirect decline in wages due to increased supply. To put it differently, those labor conditions in Fund programs almost invariably make labor ‘cheaper’.

A policy choice between internal and external adjustment has clear class implications. External adjustment harms those who have savings and those who hold large sums of domestic currency denominated assets. A depreciation in exchange rate, in other words, hurts capital-holders. Internal adjustment, on the other hand, affects wage earners’ income. Deregulation of the labor market, such as dismantling collective bargaining institutions and flexibility in hiring and firing, reduces the income of labor groups. To put it differently, through the choice of substitution of external adjustment with internal adjustment, income is distributed away from labor groups towards capital owners under IMF programs (Vreeland 2002).

In Greece, for example, the IMF program specified that ‘Unleashing growth potential requires… ensuring collective bargaining institutions that deliver wages commensurate with productivity’ and decentralized those institutions, which
reduced overall wages in the economy (IMF 2010a, p.7). In Portugal, labor market reforms were recommended in order to ‘enhance competitiveness through structural reforms’ (IMF 2011, p.13). Among those labor market reforms were the reduction in overall severance payments, reduction in the maximum duration of unemployment insurance, capping unemployment benefits, and promoting firm-level rather than sectoral-level agreements, and decentralizing the collective bargaining process (IMF 2011, p.14). In addition, the Fund may lower pensions and benefits, as in Latvia in 2008 (IMF 2009a, p.4). The duration of temporary contracts might increase, and benefits attached to part-time contracts in relation to full-time employment might diminish. All these measures lower labor costs for private sector companies, while distributing income away from labor groups.

In floating exchange rate regimes, neither the government nor the Fund has control over the value of the currency. Market forces respond to their own interpretations of the political and economic situation in the country. In floating regimes, the currency often automatically depreciates in response to the crisis and during the lead up to an IMF agreement. This ensures that products become cheaper in international markets and indirectly contributes to financing the gap and to the balance of payments. In such cases, the IMF would assign fewer labor conditions compared to in fixed regimes. Theoretically, the Fund could advise the borrowing country to switch to a fixed regime and to establish a currency peg. Yet, representing another particular choice, the Fund often supports floating regimes, capturing the post-1970s trend towards more capital account liberalization in the world economy (Chwieroth 2007).

One can argue that governments might propose labor conditions instead of the Fund. Reform-minded governments might go to the Fund (Vreeland 2003) and
request such arrangements. Alternatively, when labor groups do not have sufficient organizational capacity to disrupt the government, their interests may be overlooked at the negotiation table (Caraway et al. 2012). To be sure, the Fund responds to both international and domestic political constraints, particularly because its agenda is sufficiently vague. This simultaneously gives Fund staff leeway for decision-making and also obliges a certain degree of interpretation and choice on their part (Chwieroth 2013, p.268). We can tease out when the Fund itself proposes such conditions by controlling for labor’s organizational capacity in the borrowing country, and see whether fixed exchange rate regimes receive more stringent labor conditions compared to floating ones, controlling for the organizational capacity. This is in fact one of the strengths of quantitative methods: they can make probabilistic predictions controlling for confounding impact (see Chwieroth, 2007 for more discussion).

If the Fund makes hard choices that would deliberately lower labor’s income in fixed exchange rate regimes, in order to lower production costs and to boost exports, we should observe this specific logic in the memoranda of understanding (i.e. documents that specify the agreed conditions between the Fund and the borrowing government), staff consultations, and the Fund’s policy guidance documents. Moreover, we should observe a broad positive association between having a fixed exchange rate regime and receiving more stringent labor conditions in IMF programs, indicating that this particular logic indeed leads to labor conditions. In the next section, I firstly look at two cases, i.e. Latvia and Hungary in 2008, and outline that the borrowing country’s exchange rate regime played a significant role in the Fund’s evaluation of the need for labor conditions.
I then test this theory in a sample of 92 IMF program countries between the years 1980 and 2013.

**Currency Pegs and Internal Devaluation: Latvia and Hungary in 2008**

Latvia and Hungary under their respective IMF programs in 2008 provide an excellent comparison in terms of delving into the Fund’s evaluation of the need for stringent labor conditions. Both countries are former Eastern bloc members and completed their transitions to the market economy after the end of the Cold War. They had similar levels of trade union density by the time they borrowed in 2008 (14.4 per cent in Hungary and 15.1 per cent in Latvia) (OECD 2008) and similar GDP per capita income (16,348 U.S. Dollars for Latvia and 15,739 U.S. Dollars for Hungary). They had similar levels of firing costs and labor market regulation (Adam, Bastani, Bishop, and Deakin 2016). Moreover, both received substantial assistance from the Fund for their transitions and liberalized their economies under the external influence and aid of the EU and the IMF. They experienced similar economic shocks during the 2008 global financial crisis. The crisis that started in the U.S. spilled over to Europe and affected foreign capital inflow to both countries, putting their banking sectors under considerable distress and widening their ‘spending gap’ (IMF 2008, 2009a). They borrowed from the Fund to finance their volatile banking systems and to compensate for the drying up of liquidity in their financial markets. While Latvia had a currency peg due to the anticipated Eurozone membership in 2014, by the time it borrowed from the Fund in 2008, Hungary had transitioned to a floating exchange rate regime. While Latvia received a large number of labor conditions under its IMF program, the Hungarian program did not include any labor conditions (IMF 2008, 2009a). The comparison between those very similar cases with diverging outcomes in terms of the intrusiveness of labor
conditions provides strong support for the theory that prevalent exchange rate regime predicts labor conditions. Put differently, the Fund did not have any reason to treat these two countries differently in terms of their geopolitical alliances or the power of trade unions and labor market regulation except for their exchange rate systems.

The Latvian government borrowed an exceptionally large amount—1.7 billion Euro (1,200 times its quota)—from the Fund on December 12, 2008. The country’s competitiveness gap and exchange rate regime were two central issues in the Fund’s approach to the crisis in Latvia. Fund staff recommended ‘structural reforms to help address a remaining competitiveness gap and support higher growth and employment through stronger exports in the absence of other policy options’ (IMF 2010, p.4). In fact, Fund staff acknowledged that ‘Depreciation would have boosted exports, allowed lower interest rates, and eased pressures on international reserves’ (IMF 2010b, p.6). Yet, they also agree that this would entail a trade-off and would destroy the savings of Latvian citizens (IMF 2010b, p.6). Instead, the Fund encouraged wage and product price cuts and envisaged that this would boost exports and start the economic recovery (IMF 2010b, p.7).

We can see the workings of the Fund’s evaluation of the need for labor conditions in fixed regimes in practice in the Latvian case. The IMF envisaged short-term labor conditionality in Latvia as a way of boosting the economy (IMF 2010b). The “Committee to Promote Wage Restraint” was formed as one of the first steps of the program. The Committee, in cooperation with social partners and labor experts, advised reducing public wages and monitoring private wages (IMF, 2009a, p.13). The program set an indicative target for the government wage bill at 214 million Lat for the end of March 2009 (a cut of more than one billion Lat
compared to December 2008—1,248 million Lat) (IMF 2010b, 28). By 2010, there was around a ten per cent wage cut in the economy. The rate was higher—thirty per cent—for public employees. The cut for the private sector might indeed have been higher and underreported due to the pervasive informal economy (OECD, 2017, p.24) (the full list of labor conditions for Latvia in 2008 is in Appendix III). Of course, those measures disproportionately put the burden of adjustment on labor groups and required significant reduction in their income. Even though the conditions seem to be mainly focused on the public sector, a relative decline in the public sector naturally drives down the wages in the private sector as well. The unit labor costs declined in Latvia in the fourth quarter of 2008 to -4.7 under the IMF program, down from 8.4 in the third quarter of the same year (OECD 2018).

Hungary borrowed from the IMF on November 4, 2008—approximately one month before the Latvian stand-by arrangement. Similar to Latvia, the Hungarian financial and banking system experienced intense pressure following the 2008 global financial crisis. The country received 12.3 billion Euro from the Fund (1,015 per cent of its quota at the IMF) to provide necessary liquidity for its banking sector and to provide reassurances that the country could meet its debt obligations (IMF 2008, p.1). Unlike Latvia, Hungary did not have a currency peg at the time of borrowing. The country removed the exchange rate band and switched to a floating exchange rate regime in early 2008, before the onset of the crisis (IMF 2008, p.6). The main reason for the policy change was to meet the government’s inflation targets. Unsurprisingly, the Hungarian forint (HUF) depreciated quickly after the crisis.

Following the theory proposed in this study, Hungary’s stand-by arrangement did not have any assigned labor conditions. The conditionality
focused on reducing the government debt. The performance criteria established a ceiling for the central government’s primary balance and for increasing international reserves. The indicative target within the program established a ceiling for the government’s total debt stock. Another performance criterion was on the non-accumulation of external debt arrears (IMF 2008, p.7). Unlike Latvia, the Fund did not assign conditions to cut wages in the public and private sectors, to reduce pensions, or to make the labor market more flexible. In fact, the government promised to maintain nominal wages in the public sector and to cut the additional 13th month salary and pension for public sector workers at the start of the program (IMF 2008, p.3). In the end, however, government provided an allowance that would compensate public employees for cutting the 13th month salary (IMF 2009b, p.6). Moreover, small and medium enterprises received wage subsidies if they maintained or created new jobs financed through EU aid (IMF, 2009b, p.7). The unit labor cost increased in Hungary under the IMF program, unlike Latvia: it jumped to 3.4 in the fourth quarter of 2008 from -0.36 in the third quarter of the same year (OECD 2018).

Hungary and Latvia brilliantly show that exchange rate regime plays a significant role in whether a borrowing country receives labor conditions. The IMF staff documents also show that currency depreciation and internal adjustment are evaluated with respect to their potential trade-offs. Labor conditions are designed for bridging the ‘competitiveness gap’ as in the case of Latvia. In floating regimes, on the other hand, the recovery is thought to be financed through currency depreciation, as in the case of Hungary. The next section tests this theory in a global sample of developing countries and shows strong support for the theory that exchange rate regimes receive more stringent and a higher number of conditions.
Quantitative Evidence: Fixed Exchange Rate Regimes and Labor Conditions in Fund Programs

This section tests the association between exchange rate regimes and labor conditions in a global sample controlling for other relevant variables. The sample consists of only those countries that received at least one condition (any subcategory of conditionality such as labor, fiscal, monetary, financial, privatization, poverty reduction, or social policy conditions) under their respective IMF program between the years 1980 and 2013. Scholars have previously demonstrated that selection into IMF programs is not random (Dreher 2006; Reinsberg et al. 2019; Stubbs et al. 2018; Vreeland 2003). In order to overcome potential selection bias, the sample is restricted to IMF program countries and the years that they have received at least one condition. There are 92 countries and 1,352 country-year observations in the data set over 33 years.

Precise identification of a causal impact remains a problem when working with observational data such as used here. Still, the strong theoretical expectations laid out above predict a previously undiscovered association between labor-condition stringency and fixed exchange rate regimes, given program participation and controlling for other factors commonly cited in the literature.

Data on labor conditions come from Kentikelenis et al. (2016)’s IMF conditions data set. They code any condition that would affect the benefits and rights of workers. This includes changes in hiring and firing practices, collective agreements, terms of contracts, minimum wage\(^6\), public sector lay-offs, the public

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\(^6\) Although the minimum wage presumably protects the income of labor and hence protects labor groups, IMF conditions regarding minimum wages often mandate a decrease in the minimum wage. Hence, this is included in the coding of conditionality.
sector wage bill, and pension rights as a labor condition. I weight each condition in accordance with its importance and give the highest weight to performance criteria and prior actions, and a relatively lower weight to benchmarks. Caraway et al. (2012) provide a robust defense for weighing the conditions, arguing that each condition does not have equal importance in the program. IMF staff monitor performance criteria and prior actions more closely than benchmarks: the program is not cancelled or the upcoming tranche is not held back if a benchmark is missed. The same is not true for prior actions and performance criteria (although the board can make exceptions). I follow Caraway et al. (2012)’s weighing scheme in order to establish comparability with earlier findings in the literature and code prior actions and performance criteria, which are more stringent conditions, as ‘4’, compared to benchmarks, which are coded as ‘3’. I also retest the theory with the total number of conditions without weighing them in accordance with their stringency for robustness checks. The highest number of labor conditions in the sample is thirteen. Romania in 1999 and 2003 and Gabon in 1996 received thirteen conditions. The unweighted average number of labor conditions in the sample is 1.22, and the weighted average according to stringency of conditionality is 4.2.

The main independent variable in the analysis is the exchange rate regime in the borrowing country. I draw a data set based on IMF’s Annual Reports on Exchange Arrangements and Exchange Restrictions (AREAER), which covers the years between 1988 and 2013. I code it as a binary variable: ‘1’ if the country has any type of fixed regime, and ‘0’ otherwise. Fixed exchange rate regimes include exchange arrangements with no separate legal tender such as European Union (EU) countries before 2006, currency board arrangements, conventional pegged arrangements, pegged exchange rate within horizontal bands, crawling peg, and
crawling band. Some of those arrangements provide governments with greater leeway compared to others. Yet, all of them restrict the exchange rate politics in some significant way.\(^7\) Managed floating, or floating, and free-floating regimes, on the other hand, are coded as ‘0’. In 2013, the most commonly preferred exchange rate regime in the world was the conventional peg (42 countries out of 168), while floating regimes were the close second (37 countries) (IMF 2013b).

Fixed regimes receive on average a higher number of quantitative performance criteria and structural performance criteria (the most stringent subcategory of IMF conditions, together with prior actions\(^8\)) and indicative benchmarks in the area of labor conditions. The two regimes receive around the same number of prior actions. Overall, fixed regimes receive approximately 0.5 more conditions compared to floating regimes. 57 out of 92 countries in the sample that received at least one labor condition between the years 1980 and 2013 had fixed exchange rate regimes. Figure 1 shows the difference in the mean number of labor conditions (weighed according to stringency) between the two regimes.

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\(^7\) An alternative strategy would be to code each arrangement separately and to create dummy variables for each one. This would, however, not contrast the fixed and floating regimes as sharply and would severely reduce the variation on labor conditions.

\(^8\) See the Kentikelenis et al. (2016) coding scheme for more discussion on the stringency of conditionality.
Figure 1. Mean Number of Labor Conditions in Floating versus Fixed Regimes, 1980-2013.

Source: IMF AREAR Reports; Kentikelenis et al. (2016) IMF Conditionality Dataset.

A simple t-test between the mean numbers of labor conditions for fixed and exchange rate regimes demonstrate that fixed regimes are more likely to receive higher number of and more stringent labor conditions (p<0.01). The results of negative binomial regression with robust standard errors clustered across countries also show that fixed regimes receive a higher number and more stringent conditions compared to floating ones. Table 1 shows the results.
Table 1. Fixed Exchange Rate Regimes and Labor Conditions

<table>
<thead>
<tr>
<th>VARIABLES</th>
<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
<th>(4)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Labor conditions</td>
<td>Labor conditions</td>
<td>Labor conditions</td>
<td>Labor conditions</td>
</tr>
<tr>
<td></td>
<td>(count)</td>
<td>(weighed)</td>
<td>(count, after 1999)</td>
<td>(weighed, after 1999)</td>
</tr>
<tr>
<td>Fixed regime</td>
<td>0.281***</td>
<td>0.257*</td>
<td>0.414***</td>
<td>0.378**</td>
</tr>
<tr>
<td></td>
<td>(0.103)</td>
<td>(0.132)</td>
<td>(0.143)</td>
<td>(0.184)</td>
</tr>
<tr>
<td>Constant</td>
<td>0.310***</td>
<td>1.549***</td>
<td>0.433***</td>
<td>1.673***</td>
</tr>
<tr>
<td></td>
<td>(0.0699)</td>
<td>(0.0876)</td>
<td>(0.0951)</td>
<td>(0.119)</td>
</tr>
<tr>
<td>Observations</td>
<td>1,025</td>
<td>1,025</td>
<td>431</td>
<td>431</td>
</tr>
</tbody>
</table>

Notes: Negative binomial regression with robust standard errors clustered across countries; Standard errors in parentheses; *** p<0.01, ** p<0.05, * p<0.1.

Table 1 shows that fixed regimes are more likely to receive labor conditions by several different measures. They receive more conditions in terms of total number of labor conditions (labor conditions count) and when conditions are weighed in accordance with their relative stringency (labor conditions weighed). Moreover, the impact is stronger in the post-1999 period. The 1999 financial crisis started a period of self-reflection at the Fund that resulted in the creation of Independent Evaluation Office (IEO) (Clift 2018). One can argue that this resulted in the reduction of the number of labor conditions. In addition, more countries transitioned into floating regimes following the currency crises in the mid-1990s. The results show that fixed regimes receive a higher number of conditions in the aftermath of the 1999 financial crisis, both in terms of sheer number of conditions and in terms of stringency.

Next, I add several control variables to the analysis, which were shown to affect labor conditions and/or the total number of conditions in previous studies:
**Economic determinants.** Economically powerful countries are perhaps less vulnerable to the IMF’s impact and can have more leverage in the negotiations vis-à-vis the Fund. Moreover, countries with higher GDP per capita may need fewer labor conditions for recovery. Finally, countries with greater external debt are more likely to be undergoing severe economic crisis and in greater need of IMF credit. They therefore might be more likely to receive conditions (Caraway et al. 2012). Data for GDP, GDP per capita, and external debt come from the World Bank Development Indicators database.

**Geopolitics.** Previous studies have shown that the allies of the U.S. and G7 countries, and the UN Security Council’s temporary members receive fewer conditions due to the specific weight of the U.S. and G7 countries in the Fund’s decision-making and the potential exchange of UNSC votes for more generous IMF loans (Dreher and Jensen 2007; Dreher 2006; Dreher et al. 2015; Stone 2008). I add the UN General Assembly voting in line with the U.S. (UN voting with the US), voting with the G7 countries (UN voting with G7), and the binary variable for the UNSC temporary membership (UNSC member) to the analysis. Higher values on UN voting indicate greater alignment in voting trends and hence closer alliance between the borrowing government and the U.S. and G7 countries. I code UNSC temporary members as ‘1’ and non-members as ‘0’ in a particular year. Data come from Dreher and Sturm (2012) for General Assembly voting and Dreher et al. (2009) for UNSC membership.

**Left-wing government.** Grigore Pop-Eleches (2009) finds evidence that left-wing governments receive a higher number of conditions. This argument is in line with the recent findings in the literature that the IMF assigns fewer conditions to the governments when there is an ideational agreement between the Fund and
the government policymakers (Chwieroth, 2015; Nelson, 2014, 2017). If the existing government is more left-leaning, it is coded as ‘1’ and ‘0’ otherwise. Data come from World Bank Database of Political Institutions (DPI).

**Democracy.** Caraway et al. (2012), Nooruddin and Simmons (2006), and Stone (2008) find evidence that the regime type might affect the scope of IMF conditions. Data come from Polity II project and the variable is coded on a 20-point scale, in which ‘0’ denotes the most authoritarian countries and ‘20’ the most democratic ones.

**Lagged strikes.** Caraway et al. (2012) demonstrate that the IMF would assign fewer conditions in democratic countries where labor groups have the potential to disrupt the government by staging strikes, riots, and/or demonstrations. They measure labor power by looking at the ratio of skilled labor to unskilled labor multiplied by inverse unemployment ratio and use Rudra (2002)’s potential labor power (PLP) data set. In this data set, highly-skilled labor is operationalized as the number of employees in certain manufacturing sectors that require greater specialization and low-skilled labor is measured as the number of employees in more generic-skill based manufacturing sectors. The data set covers the years between 1980 and 2000. I do not use this data set to measure the organizational power of labor groups, primarily because a skill measure based on the manufacturing sector may not be representative of the economy in the post-2000 era. There is a growing shift away from the manufacturing sector and the number of workers in other sectors grew in developing countries as well as in developed ones. The share of manufacturing output as a percentage of total output demonstrate a declining trend and even in extreme cases does not exceed seven per cent of total output (UNIDO, 2018). An economy-wide measure might be better at gauging the
organizational power of labor groups rather than a narrow focus on the manufacturing sector.

In this study, I include the one-year lagged strikes variable in the analysis as a more direct measure of labor groups’ organizational power. Strikes require substantial organizational capacity on the part of workers, and strikes in the previous year might condition the IMF’s and the government’s preferences regarding labor conditions in the following one.\(^9\) Particularly, if labor has significant disruptive capacity, they may choose not to include labor conditions in the program. Lagged strikes might indeed capture the organizational power more accurately for the purposes of this study, as they directly indicate the mobilization capacity of labor groups rather than their potential based on more (or less) specialized skills and unemployment rate. Furthermore, it is an economy-wide measure. Finally, it allows a more stringent test for the theory proposed in this paper. Data come from Robertson and Teitelbaum (2011)’s high-profile strikes data set. For robustness checks, I estimate the number of conditions using the PLP data set as well. I also test the theory without the lagged strikes variable as well as with the strikes variable from the Banks (2012) data set.

**Regulated labor market.** The IMF might assign a higher number of, and more stringent, conditions in countries where employment is heavily protected; where there are safeguards against overtime work; collective agreements are extended in the labor market; and where there are stringent conditions for dismissal (Caraway et al. 2012). In order to control for such impact, I add the variable *regulated labor market* into the analysis. It is a composite variable based on legal

\(^9\) Results are very similar when I lag the variable for five years instead of one. They are available upon request.
protection of employment and safeguards against overtime work. This measure is more extensive than firing costs. It not only includes firing costs but also collective agreements and wage protection, which are intimately related to the cost and bargaining power of labor. The measure also extends to the areas covered by IMF labor conditionality. The data come from Centre for Business Research Labor Regulation Index and span the years between 1980 and 2013. The full list of variables included in the composite index is in Appendix I. Higher numbers indicate a more regulated labor market. For robustness checks, I also include firing conditions following Caraway et al. (2012) for comparability purposes.

Controlling for economic and geopolitical variables, legal safeguards in the labor market, and the organizational capacity of labor groups, I estimate the impact of exchange rate regime on the stringency of labor conditions by using negative binomial model with robust standard errors clustered across countries. Negative binomial regression is ideal for this study, as the dependent variable is a count variable and is non-normally distributed (Cameron & Trivedi 2015). I also re-run the tests with Poisson for robustness checks. The sample includes only those countries that were under an IMF program in a particular year and received at least one condition in that particular year (not necessarily labor condition but also fiscal, structural, and monetary conditions). This overcomes the potential selection bias problem in terms of self-selection into IMF programs, since the analysis includes only IMF program countries. The empirical results section reports the findings that provide strong support for the theory.
**Empirical Results**

The results of the negative binomial regression show that countries with fixed exchange rate regimes are more likely to receive more stringent labor conditions compared to ones with floating regimes. The impact is significant at five percent level when we measure stringency of labor conditions (the weighed measure) as well as the total number of conditions (without weighing the conditions in accordance with their stringency). Table 2 reports the results.

Having a fixed exchange rate regime is the strongest predictor of receiving labor conditions, followed by being an ally of the G7 countries. Fixed regimes receive more than a half-point more conditions compared to floating ones (when conditions are weighed according to their stringency or simply counted as the total number of labor conditions). As the mean number of labor conditions in the sample is approximately four, the impact is substantively significant as well.
### Table 2. Exchange Rate Regimes and Labor Conditions

<table>
<thead>
<tr>
<th>VARIABLES</th>
<th>Labor Conditions (count)</th>
<th>Labor Conditions (weighed)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed regime</td>
<td>0.555**</td>
<td>0.609**</td>
</tr>
<tr>
<td></td>
<td>(0.273)</td>
<td>(0.294)</td>
</tr>
<tr>
<td>GDP</td>
<td>0.000</td>
<td>0.000</td>
</tr>
<tr>
<td></td>
<td>(0.000)</td>
<td>(0.000)</td>
</tr>
<tr>
<td>GDP per capita</td>
<td>0.000</td>
<td>0.000</td>
</tr>
<tr>
<td></td>
<td>(0.000)</td>
<td>(0.000)</td>
</tr>
<tr>
<td>External debt</td>
<td>-0.000</td>
<td>-0.000</td>
</tr>
<tr>
<td></td>
<td>(0.000)</td>
<td>(0.000)</td>
</tr>
<tr>
<td>UN voting with G7</td>
<td>4.230***</td>
<td>5.102***</td>
</tr>
<tr>
<td></td>
<td>(1.313)</td>
<td>(1.474)</td>
</tr>
<tr>
<td>UN voting with US</td>
<td>1.052</td>
<td>1.206</td>
</tr>
<tr>
<td></td>
<td>(1.495)</td>
<td>(1.392)</td>
</tr>
<tr>
<td>UNSC member</td>
<td>-0.119</td>
<td>-0.0519</td>
</tr>
<tr>
<td></td>
<td>(0.301)</td>
<td>(0.343)</td>
</tr>
<tr>
<td>Left-wing gov.</td>
<td>0.0367</td>
<td>0.0195</td>
</tr>
<tr>
<td></td>
<td>(0.166)</td>
<td>(0.184)</td>
</tr>
<tr>
<td>Lagged strike</td>
<td>0.0173</td>
<td>0.0131</td>
</tr>
<tr>
<td></td>
<td>(0.115)</td>
<td>(0.140)</td>
</tr>
<tr>
<td>Regulated market</td>
<td>-0.230**</td>
<td>-0.278**</td>
</tr>
<tr>
<td></td>
<td>(0.109)</td>
<td>(0.127)</td>
</tr>
<tr>
<td>Constant</td>
<td>-1.423**</td>
<td>-0.532</td>
</tr>
<tr>
<td></td>
<td>(0.592)</td>
<td>(0.669)</td>
</tr>
</tbody>
</table>

Observations | 403 | 403

Notes: Negative binomial regression with robust standard errors clustered across countries; Standard errors in parentheses; *** p<0.01, ** p<0.05, * p<0.1.

In addition to fixed regimes, G7 allies receive more labor conditions, all else being equal. This finding is surprising, since previous studies confirm that U.S. allies receive fewer conditions in total—although it corroborates Caraway et al. (2012)’s findings. They also find that U.S. allies receive more stringent labor conditions. Perhaps, the U.S. and G7 countries support labor market reform more than fiscal budgetary cuts and look after their allied governments in terms of fiscal conditions, which are by far the largest portion of conditionality (Stone 2008). It is
likely that the earlier studies that looked at the total number of conditions captured this impact. In fact, labor and fiscal conditions are negatively correlated when the total number of conditions are controlled in the sample; and the U.S. and G7 allies receive fewer fiscal conditions.\footnote{Results are not reported here for space considerations and are available from the author.} Those results firstly prove the analytical and theoretical importance of disaggregating conditionality. Secondly, they are in line with the theory proposed in this study: whenever the spending gap cannot be bridged by alternative measures such as fiscal cuts, labor groups bear the burden of adjustment and receive more stringent conditions in an attempt to increase competitiveness. The negative association between labor and fiscal conditions disappears when we control for the exchange rate regime.

The findings also suggest that more regulated markets receive fewer and less stringent conditions. This is counter-intuitive, as we would expect the IMF to assign more conditions in more regulated markets. The results remain robust when labor market regulation is replaced by firing costs or the regulation variable is lagged for one year. This result can be attributed to the strength of the labor movement in a borrowing country. Trade union density would be a great measure of labor union strength. Regrettably, data on unionization levels are notoriously difficult to obtain in developing countries (Rudra 2002). In the robustness checks section, I fit the model with the PLP measure, which is vigorously defended by Nita Rudra (2002) and Teri Caraway, Stephanie Rickard, and Mark Anner (2012). With this measure as well, fixed regimes receive more stringent conditions. The fact that the lagged strikes variable does not have a statistically significant impact is also surprising. This does not change when the strikes variable regressed on the stringency or the count of labor conditionality or when lagged two years instead of
Banks’ (2012) strike data yield similar results. There might be more a complicated connection between the strength of labor groups and the market regulation legislation and labor conditionality than previously assumed. Future studies can look at the impact of labor market regulation on labor conditionality and investigate further the negative association. Perhaps, more robust measures of labor union power can explain the outcome. Alternatively, the impact of fixed exchange rate regimes might be offsetting this impact.

Economic determinants such as GDP, GDP per capita, and external debt and other variables capturing geostrategic interests such as UNSC membership and alliance with the U.S. do not seem to affect the stringency of labor conditions to a significant degree. Neither do the variables on democracies or left-wing governments reach statistical significance.

For robustness checks, I re-run the models without the strikes and labor market regulation variables. On those variables, data are less complete, leading to a significant loss in the number of observations. For additional robustness checks, I also fit the model only with the firing costs. I also add the PLP to the analysis. The impact of fixed regimes remains robust when we include PLP measure in the analysis instead of lagged strikes (an additional model including PLP and time trend as well as firing costs is in Appendix II). Following Caraway et al. (2012), I interact PLP with the democracy variable, since the impact of PLP would only be observed in democratic regimes (Caraway et al. 2012). Democratic government would be receptive to and represent the labor interests at the negotiation table. For robustness checks, I also include the PLP without interacting it with the democracy

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11 The variable democracy is added for robustness checks and is not reported here for space considerations. They are available from the author.
Finally, I add a time trend variable, since labor conditionality might demonstrate an increasing (or decreasing) trend in time. Table 3 reports the full results. The impact of fixed regimes remains robust with the addition of alternative measures and control variables. When we exclude lagged strikes and regulated labor market, fixed regimes receive more conditions. When PLP is included alone or when interacted with the democracy variable, the impact remains statistically and substantively significant. Similarly, when the labor market regulation is replaced with firing costs and when a time trend is added, we still observe statistically significant results. When year dummies are included in the analysis, rather than the time trend, the impact of fixed regimes increases in terms of statistical significance and in substantive terms. The results remain robust when the model is estimated with OLS or Poisson regression. There is very strong evidence that fixed regimes are more likely to receive labor conditions compared to floating ones under an IMF program.

\footnote{Results are not reported for space consideration and are available from the author.}
Table 3: Alternative Model Specifications

<table>
<thead>
<tr>
<th>VARIABLES</th>
<th>(8) Labor conditionality (count)</th>
<th>(9) Labor conditionality (weighed)</th>
<th>(10) PLP and time trend</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed exchange</td>
<td>0.394** (0.172)</td>
<td>0.519** (0.253)</td>
<td>1.063** (0.516)</td>
</tr>
<tr>
<td>PLP</td>
<td>-0.009 (0.007)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Democracy</td>
<td>-0.099** (0.044)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>PLP*Democracy</td>
<td>0.001 (0.001)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Logged GDP</td>
<td>-0.000 (0.000)</td>
<td>-0.000 (0.000)</td>
<td>0.194 (0.282)</td>
</tr>
<tr>
<td>GDP per capita</td>
<td>-0.000 (0.000)</td>
<td>0.000 (0.000)</td>
<td>-0.000 (0.000)</td>
</tr>
<tr>
<td>External debt</td>
<td>0.000 (0.000)</td>
<td>-0.000 (0.000)</td>
<td>0.000 (0.000)</td>
</tr>
<tr>
<td>UN voting in line with G7</td>
<td>3.174*** (1.152)</td>
<td>3.625*** (1.299)</td>
<td>-13.30 (10.14)</td>
</tr>
<tr>
<td>UN voting in line with U.S.</td>
<td>1.195 (0.984)</td>
<td>1.684 (1.333)</td>
<td>20.30*** (6.875)</td>
</tr>
<tr>
<td>UNSC member</td>
<td>0.023 (0.275)</td>
<td>-0.137 (0.279)</td>
<td>1.114** (0.510)</td>
</tr>
<tr>
<td>Left government</td>
<td>-0.206 (0.151)</td>
<td>0.026 (0.165)</td>
<td>0.044 (0.423)</td>
</tr>
<tr>
<td>Firing costs</td>
<td>-0.200 (0.190)</td>
<td>-1.641** (0.820)</td>
<td></td>
</tr>
<tr>
<td>Time trend</td>
<td></td>
<td>0.248 (0.320)</td>
<td></td>
</tr>
<tr>
<td>Constant</td>
<td>-0.270 (0.512)</td>
<td>-0.826 (0.571)</td>
<td>-3.496 (5.979)</td>
</tr>
<tr>
<td>Observations</td>
<td>818</td>
<td>527</td>
<td>90</td>
</tr>
</tbody>
</table>

Notes: Negative binomial regression with robust standard errors clustered across countries; Standard errors in parentheses, *** p<0.01, ** p<0.05, * p<0.1.

The results on Table 3 closely follow the original model. Fixed exchange rate regimes are more likely to receive more stringent labor conditions with alternative model specifications as well. Similarly, allies of G7 countries and U.S. seem to receive more stringent labor conditions with alternative model
specifications, too. Democracies receive less stringent conditions when PLP is at zero. Certainly, the results on Model 10 should be cautiously interpreted, as there are fewer observations included in the model. However, the impact of fixed exchange rate regimes remains robust when PLP is replaced with the labor rights variable from Mosley and Uno (2007)’s data set, which has around 658 observations. The statistical tests confirm that there is a significant difference in terms of the number and stringency of conditions assigned to fixed regimes. There is compelling evidence that the IMF substitutes external adjustment with internal adjustment in fixed regimes and lowers the labor costs through extensive labor conditions. The next section summarizes the findings of this paper and concludes with some policy recommendations.

**Conclusion: Design of Programs**

The origin of the IMF is rooted in exchange rate stability, and this paper shows that exchange rates still influence IMF’s conditionality. Particularly, the Fund assigns labor conditions when the currency cannot be depreciated and hence substitutes external adjustment with internal adjustment. In such cases, the Fund assigns labor conditions to lower labor costs, make production cheaper, make the economy more competitive in international markets, lower the aggregate demand, and thus finance the spending gap.

This study contributes to the existing body of knowledge on IMF conditionality in several ways. There is a long line of excellent studies documenting the adverse impact of Fund programs on labor groups. They specifically look at the impact on labor groups under and outside of IMF programs. This study complements them by looking at labor conditions and explaining why some
countries receive more stringent labor conditions than others. More importantly, it unpacks the income redistribution away from the labor groups under Fund programs and in a way demystifies the impact. Previous studies demonstrated that labor’s income is lowered, while the income share of capital increases under IMF programs (Vreeland 2002). This paper argues that the Fund’s labor conditions and its political choice of financing the ‘spending gap’ by lowering labor costs leads to this outcome.

In addition, scholars have previously demonstrated that governments might represent labor groups’ interests at the negotiation table, and that particularly strong labor with greater organizational capacity can avoid stringent conditions. This study looked at the other side of the negotiation table and discussed why the Fund might propose, and be more likely to insist on, the inclusion of labor conditions. Finally, there is no doubt that the Fund responds to multiple international and domestic political factors. By employing a mixed methodology, this study answers how much of conditionality comes from economic and geostrategic interests, domestic political constraints, and the Fund’s diagnoses of macroeconomic problems and solutions to them.

The study has important policy implications. Labor groups in borrowing countries are often less powerful compared to capital owners, especially when they are not organized. If the Fund follows particular guidelines and habits in its conditionality, such as assigning labor conditions in fixed exchange rate regimes as argued in this study, then the onus is on the Fund and on governments to make the necessary changes and adaptations. In fact, the research department of the Fund agrees that some labor security is necessary for a healthy economy and that flexibility should be balanced with security (IMF 2013a, 20).
The next step then might be the reconsideration of Fund’s conditionality in practice and a greater coordination between the Fund’s local offices and the research department. The IMF has recently been undergoing some significant shift in its policy advice towards countercyclical and more Keynesian policies in the wake of the global financial crisis (Clift 2018). A re-evaluation of labor conditions in fixed regimes is perhaps a necessary part of this conversation for more equitable outcomes under IMF programs.
References


Appendix I: Indicators included in the Strictness of Employment Protection

Variable

Maximum duration of fixed-term contracts

Overtime premia

Limits to overtime working

Maximum daily working time

Legally mandated notice period

Legally mandated redundancy compensation

Minimum qualifying period of service for normal case of unjust dismissal

Law imposes substantive constraints on dismissal

Extension of collective agreements

Lockouts (Equals 1 if lockouts are not permitted. Equals 0 if they are.)
### Appendix II: Potential Labor Power, Fixed Regimes, and Labor Conditionality

<table>
<thead>
<tr>
<th>VARIABLES</th>
<th>Labor conditionality (weighed)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed exchange regime</td>
<td>1.117**</td>
</tr>
<tr>
<td></td>
<td>(0.541)</td>
</tr>
<tr>
<td>PLP</td>
<td>-0.013</td>
</tr>
<tr>
<td></td>
<td>(0.008)</td>
</tr>
<tr>
<td>Democracy</td>
<td>-0.071</td>
</tr>
<tr>
<td></td>
<td>(0.053)</td>
</tr>
<tr>
<td>PLP*Democracy</td>
<td>0.001</td>
</tr>
<tr>
<td></td>
<td>(0.001)</td>
</tr>
<tr>
<td>Left government</td>
<td>-0.326</td>
</tr>
<tr>
<td></td>
<td>(0.386)</td>
</tr>
<tr>
<td>Firing costs</td>
<td>-2.826***</td>
</tr>
<tr>
<td></td>
<td>(0.990)</td>
</tr>
<tr>
<td>UN Voting in line with the U.S.</td>
<td>13.11</td>
</tr>
<tr>
<td></td>
<td>(8.161)</td>
</tr>
<tr>
<td>Log GDP</td>
<td>0.069</td>
</tr>
<tr>
<td></td>
<td>(0.287)</td>
</tr>
<tr>
<td>Log GDP per capita</td>
<td>-1.246***</td>
</tr>
<tr>
<td></td>
<td>(0.439)</td>
</tr>
<tr>
<td>External debt</td>
<td>0.000</td>
</tr>
<tr>
<td></td>
<td>(0.000)</td>
</tr>
<tr>
<td>Time trend</td>
<td>0.272</td>
</tr>
<tr>
<td></td>
<td>(0.186)</td>
</tr>
<tr>
<td>Constant</td>
<td>4.851</td>
</tr>
<tr>
<td></td>
<td>(6.634)</td>
</tr>
</tbody>
</table>

**Observations:** 90

*Notes: Negative binomial regression with robust standard errors clustered across countries; Robust standard errors in parentheses; ***p<0.01, **p<0.05, * p<0.1*
Appendix III: List of Labor Conditions in Latvia under its IMF Program in 2008

- An indicative ceiling on the general government wage bill. (Quantitative indicative target)

- National Tripartite Co-operation Council to establish a Committee to Promote Wage Restraint. (Structural benchmark)

- Wages: prepare a comprehensive report on proposed revisions to the public-sector wage grid and the relative wage adjustment across public institutions. (Structural benchmark)

- Put in place a wage-setting mechanism in line with the fixed exchange rate regime. (Soft condition)

- Indexing pensions only to inflation. (Soft condition)