



THESIS

4
2000

LIBRARY
Michigan State
University

MICHIGAN STATE UNIVERSITY LIBRARIES



3 1293 02048 8395

PLACE IN RETURN BOX to remove this checkout from your record.
TO AVOID FINES return on or before date due.
MAY BE RECALLED with earlier due date if requested.

DATE DUE	DATE DUE	DATE DUE
MAR 07 2002		
11 2 0 0 2		

**LEVERAGE, POWER, AND IMF CONDITIONALITY:
A STRATEGIC BARGAINING MODEL OF CONDITIONALITY AGREEMENTS
BETWEEN THE IMF AND DEVELOPING COUNTRIES**

By

SEONJOU KANG

A DISSERTATION

Submitted to
Michigan State University
in partial fulfillment of the requirements
for the degree of

DOCTOR OF PHILOSOPHY

Department of Political Science

2000

ABSTRACT

LEVERAGE, POWER, AND IMF CONDITIONALITY: A STRATEGIC BARGAINING MODEL OF CONDITIONALITY AGREEMENTS BETWEEN THE IMF AND DEVELOPING COUNTRIES

By

Seonjou Kang

This dissertation analyzes the dynamics at work in negotiations for structural adjustment lending to developing countries from multilateral donor agencies such as the International Monetary Fund (IMF), dynamics which can account for the difference in conditionality agreements. The disappointing results associated with structural adjustment are more often than not identified with the onerous inflexibility of conditions imposed on developing countries by the IMF, with little consideration for differences in types of economies and level of development. I, however, find that the terms of policy reform varied significantly in content, scope, and timing country by country.

In order to explain such variance, conditionality agreements are modeled as outcomes of strategic bargaining between the IMF and developing countries, whereby the relative bargaining strength of each player determines the nature and variance in outcomes. The relative bargaining strength denotes *leverage* within a specific issue area, as distinguished from the conventional notion of aggregate structural power in international relations. Strategic interaction between the two players was constructed with a game model, which illustrates that bargaining leverage is a necessary condition for the differences in conditionality agreements.

Subsequent statistical analyses concentrated on measuring the effect of leverage relevant to the issue area of conditionality bargaining, using the number of agreed conditions extracted from *IMF Survey* as dependent variable, and supported the theoretical results of the game model. A case study of conditionality bargaining between the Republic of Korea and the IMF also showed that some exceptional conditions in its conditionality agreement, such as radical liberalization of financial market, were by and large a result of failure to mobilize effective leverage to the negotiation with the IMF.

The above findings suggest that there are major distinctions in the instruments, issues, and interests that developing countries could bring to their relationship with the IMF. The findings also suggest that the sophisticated and symbiotic interplay of interdependence between the IMF and recipient countries was not properly appraised in past scholarly works. The results of structural adjustment seem to be influenced by the choice of conditions through bargaining as much as they are by domestic implementation. Studies of structural adjustment should be reorganized so as to incorporate the consequences of politics at the negotiation stage. That is, without a clear idea of how the terms of conditionality were drawn and what the source of the variance in conditionality terms was, a diagnosis of where the conditionality implementation went awry is not reliable, and much less is a search for cure for that malady. Conditionality agreements have been plagued by political rationality from the beginning. Therefore, what is needed for better results from structural adjustment is an improvement in politics at the bargaining stage in order to bring their interests gradually closer together under the shadow of future.

© Copyright by
Seonjou Kang
2000

To All my family who kept faith and hope in me.

ACKNOWLEDGEMENT

It is exactly twenty years since I first dreamt of being a professor in political science. The past twenty years have been a series of seeking, planning, and executing endeavors in order to hold on to my dream, and the last seven years of them were the final dash to the finish line. Now that dream has become reality.

At that time I did not know how difficult it would be to obtain a Ph.D. and what it would take. Although this Ph.D. is to fulfill a dream and challenge of my choice, many people and institutes contributed and never hesitated to help and support me as I worked on this lifetime project. My Ph.D. is literally a work of collaboration and cooperation for a personal glory.

I finish my doctorate program with a dissertation topic I love to study. I cannot leave Michigan State University without expressing my genuine thanks to dissertation committee, Dr. Scott Gates, Dr. Dennis Patterson, Dr. Jeffrey Riedinger, and Dr. Nicolas van de Walle. All of them are established scholars in their specialties and maintain as high standard as possible over academic matters. I do not believe that I met all their demanding expectations in my dissertation, but its current quality is a glimpse of their outstanding guidance and my tenacity to keep up with it.

Especially Dr. Gates, my advisor, deserves special thanks from me. He gave me not only advice on dissertation substance but also on scholastic attitude. He was always enthusiastic about guiding me and I received lots of advice that enabled me to carry on. Furthermore, he played the most important role in making dissertation writing a pleasant and positive experience. Now he is my role model in academe and will remain a mentor-

colleague to me. I sincerely hope that I will be given an opportunity to replicate my experience with younger graduate students in the future.

During the last year of my dissertation writing, Hudson Institute in Indianapolis gave me generous support through the Herman Kahn Fellowship. Although I partially neglected my duty and responsibility there due to frequent trip to East Lansing, they neither mentioned it nor stopped encouraging me. I am glad that I became the first to finish a degree during the fellowship. I am thankful to all the Hudson members.

All of my family is at the center of my heartfelt appreciation. They are the ones who kept faith and hope in me and with whom I love to share the joy of this completion. Among them, I am very grateful to my eldest sister, Sun-Sook. As the oldest of the four children, she had a significant influence on me while I was growing up and did not spare emotional and material support during my Ph.D. program. I have nephews who will soon be adolescents and my Ph.D. teaches them, I hope, that this is a way of life worth pursuing in the future and, more importantly, that dreams will never leave us unless we give them up first.

I have many friends to thank for their beautiful friendship. Especially Soo-Young Kang, Barbara Czerny and Lucinda Deason, three close friends I made at MSU. They were understanding and supportive as allies working on their own Ph.D.'s in human nutrition, computer science and political science, respectively. Young-Soon Kim extended her friendship from our high school days to life of thirty something in the United States. And for the last, but not the least, I would like to remember Sameh Kamel for his invisible companionship and invaluable motivation for many years. My thanks are and will always be with him.

I am closing one chapter of my life and about to start a new one. This new chapter will essentially comprise returning all of the above. The best way I can keep my solemn promise is to be a successful scholar and a more mature individual, who they can count on whenever they need help and support in order to carry on their dreams and meet challenges.

TABLE OF CONTENTS

LIST OF TABLES	xii
LIST OF FIGURES.....	xiv
CHAPTER 1	
CONDITIONALITY: A PANDORA’S-BOX?	1
1.1 Puzzles of Conditionality	1
1.2 Theoretical Overview of the Subject	11
1.3 Research Strategy: How to Solve Puzzles.....	31
1.4 Expected Achievements: What We Will Learn from This Study.....	35
CHAPTER 2	
PRELUDE: THEORY OF BARGAINING IN INTERNATIONAL RELATIONS	39
2.1 Bargaining As a Way of Resolving Differences between State	39
2.1.1 Game Theory and Modeling International Negotiations	42
2.2 Factors Affecting Bargaining Outcomes	51
2.2.1 Bargaining Tactics: Commitment, Linkage, and Side Payment	54
2.2.2 Resources: National Power in International Negotiation	59
2.3 Asymmetry in Resources and International Negotiation	66
CHAPTER 3	
MODELING CONDITIONALITY BARGAINING GAME.....	74
3.1 Developing a New Concept of Leverage	74
3.2 A Model of Conditionality Bargaining Game	82
3.2.1 Strategic Interaction between Donor and Recipient in Conditionality Bargaining.....	82
3.2.2 Assumptions of Conditionality Bargaining.....	86
3.3 Expected Utilities and Preferences in Conditionality Bargaining	103
3.3.1 Expected Utilities of Outcomes.....	103

3.3.2 Preference Orderings and Restrictions in Conditionality Bargaining.....	106
3.4 Equilibrium of Conditionality Bargaining with Perfect Information.....	116
3.5 Theoretical Propositions of Conditionality Bargaining and Hypothesis.....	121
CHAPTER 4	
INTERMEZZO: BRIDGING ABSTRACT TO CONCRETE.....	133
4.1 Data for the Analysis of Conditionality Bargaining.....	133
4.1.1 Dependent Variable: TITNESS.....	134
4.1.2 Expected Utility Components	142
4.1.3 Independent Variable: Leverage.....	150
4.1.3.1 Operationalization and Measurement of Leverage for the IMF	151
4.1.3.2 Operationalization and Measurement of Leverage for the Recipient	160
4.2 Statistical Method: Poisson Model for Count Data	170
CHAPTER 5	
EMPIRICAL TESTS OF CONDITIONALITY BARGAINING MODEL	175
5.1 Controversies on Conditional Lending Practice.....	175
5.2 The IMF and Leverage.....	180
5.3 The Recipient and Leverage.....	192
5.4 Comprehensive Specification for Conditionality Bargaining	209
5.5 Theoretical Implications of Findings	219
CHAPTER 6	
LEVERAGE, CAPITAL MOBILITY AND CONDITIONALITY: INTERNATIONAL BAILOUT OF KOREA, 1997	226
6.1 Summary of Events.....	228
6.2 Reconstructing the Case to the Conditionality Bargaining	232
6.3 Implications to Debates on Conditionality	250

2017
2018

2019

2020

2021

2022

2023

2024

2025

2026

2027

2028

CHAPTER 7	
FINALE: CONCLUDING REMARKS AND FUTURE RESEARCH.....	267
Findings and Implications	267
Future Research Agenda	273
 APPENDIX 1	
METHOD OF DATA COLLECTING:	
COUNTING THE NUMBER OF AGREED CONDITIONS.....	278
 APPENDIX 2	
STATISTICAL RESULTS OF NEGATIVE BINOMIAL REGRESSION.....	283
 APPENDIX 3	
TREND IN TIGHTNESS OF CONDITIONALITY	293
 REFERENCES.....	294

LIST OF TABLES

Table 3. 1 Outcomes of Conditionality Bargaining with Perfect Information	118
Table 4. 1 Descriptive Statistic of Type of Arrangement.....	140
Table 4. 2 Descriptive Static of Tightness of Conditionality.....	140
Table 4. 3 Descriptive Statistic of Expected Utility Components	150
Table 4. 5 Frequencies of Donor's Leverage in Binary Form.....	160
Table 4. 6 Descriptive Statistic of Recipient's Leverage.....	166
Table 4. 7 Frequencies of Recipient's Leverage in Binary Form.....	169
Table 4. 8 Descriptive Statistic of IMF-Recipient Financial Transactions	169
Table 5. 1 Quota Proportionality and Conditionality	176
Table 5. 2 Type of Arrangement and Conditionality	179
Table 5. 3 Donor's Expected Utility Components and Conditionality	181
Table 5. 4 IMF Institutional Setting and Conditionality	183
Table 5. 5 Financial Relations and Conditionality	185
Table 5. 6 Bilateral Political Relations and Conditionality	188
Table 5. 7 Bilateral Economic Relations and Conditionality	190
Table 5. 8 Recipient's Expected Utility Components and Conditionality	193
Table 5. 9 Economic Crisis and Conditionality	196
Table 5. 10 External Debt and Conditionality	198
Table 5. 11 Economic Characteristics and Conditionality	203
Table 5. 12 Global Economic Opportunities and Conditionality.....	205
Table 5. 13 Politics of Special Interest and Conditionality	208

Table 5. 14 Comprehensive Specification for Leverage and Conditionality.....	211
Table 5. 15 Comprehensive Specification with Subjective Probabilities.....	213
Table 5. 16 Descriptive Statistic of the Alternative Dependent Variable	215
Table 5. 17 Comprehensive Specification with the Alternative Dependent Variable.....	215
Table 5. 18 Comprehensive Specification with the Alternative Dependent Variable and Subjective Probabilities	218
Table A2. 1 Quota Proportionality and Conditionality	283
Table A2. 2 Type of Arrangement and Conditionality.....	283
Table A2. 3 Donor's Expected Utility Components and Conditionality.....	284
Table A2. 4 IMF Institutional Setting and Conditionality.....	284
Table A2. 5 Financial Relations and Conditionality	285
Table A2. 6 Bilateral Political Relations and Conditionality	285
Table A2. 7 Bilateral Economic Relations and Conditionality.....	286
Table A2. 8 Recipient's Expected Utility Components and Conditionality.....	287
Table A2. 9 Economic Crisis and Conditionality	288
Table A2. 10 External Debt and Conditionality.....	288
Table A2. 11 Economic Characteristics and Conditionality.....	289
Table A2. 12 Global Economic Opportunities and Conditionality.....	289
Table A2. 13 Politics of Special Interest and Conditionality.....	290
Table A2. 14 Comprehensive Specification for Leverage and Conditionality.....	291
Table A2. 15 Comprehensive Specification with Subjective Probability	292

LIST OF FIGURES

<i>Figure 3. 1 Conditionality Bargaining Game</i>	83
<i>Figure A3. 1 International Context and Trend in Tightness of Conditionality</i>	293

CHAPTER 1

CONDITIONALITY: A PANDORA'S-BOX?

1.1 PUZZLES OF CONDITIONALITY

Since the early 1980s, structural adjustment as condition to lending from international financial institutions (IFIs)—especially from the International Monetary Fund (IMF or Fund) and the International Bank for Reconstruction and Development (informally known as the World Bank)—has dominated economic policy agenda in the developing world.¹ In academia, parallel efforts have been made to find the relationship between policy choice and economic performance, what policies caused macroeconomic imbalances compounded by national debt crises, and what corrective measures have been successful in managing them. A general conclusion that emerged from them is that structural adjustment was nothing but failure, as blatant titles such as “The Twilight of Conditionality?” (Nelson, 1996) and “The Failure of Conditionality” (Collier, 1997) suggest.

While conditionality was being established as a major research theme, a growing number of research on it increasingly depended on a presumption that failures in structural

¹ Taking a handy example, the average number of programs and committed funds indicates the degree of acceptance of structural adjustment in developing countries. Since 1982 through April 30 of 1998, 425 arrangements were contracted with the IMF in the name of structural adjustment. On average, 26.56 adjustment programs were annually arranged during that period; funds committed under those arrangements reached 142,910 SDR millions in total, of which annual average is 8931.88 SDR millions. On the other hand, for the first 30 years of IMF history from 1952, the annual average of arrangements was 17.37 with 1846.77 SDR millions annually committed. Source: IMF *Annual Report*. 1998. Washington, DC: International Monetary Fund.

adjustment were caused by the application of wrong policies from the IFI's, and that structural adjustment would succeed if the IFI's modify their economic model so as to apply a different set of policies.² This presumption also assumes away universal imposition of such policies by the IFI's, whereby process for policy choice was precluded from its discourse. However, reviewing closely its track record, conditionality appears to have varied case by case. Despite the contention of strict imposition of the same wrong economic model, some countries obtained easier terms, quantitatively and/or qualitatively, than others in the final agreements with the IFI's. This conflicting observation inevitably raises fundamental puzzles: what are the bases of these differences, and what made them settle for those unpromising policies in the first place; and can the contention of dictation or coercion by the two representative IFI's explain the discrepancy consistently within its theoretical boundary?

Such observation also presents a theoretical imperative that the policy choice process is explicitly endogenous to conditionality agreement rather than exogenous and, thereby, unfulfilling policies prescribed for structural adjustment become an outcome of deliberate action from both parties involved to make choices. Furthermore, the structure of their relationship based on the ability to influence their interaction, which can be dubbed *bargaining strength*, may determine the final choice of conditionality agreements. It is this missing political process of choice, specifically interaction and bargaining strength in

² There has been much discussion of the success of the IMF's role. However, reviewing the discussion or newly attempting to evaluate policy advice dispensed by the IMF is beyond the scope of this dissertation. For the review of evaluations and analytical issues, see Killick, Tony. 1995. *IMF Programmes in Developing Countries: Design and Impact*. London: Routledge, pp. 36-48; Lensink, Robert. 1996. *Structural Adjustment in sub-Saharan Africa*. London: Longman, pp. 95-108; and Williamson, John. 1983a. "On Judging the Success of IMF Policy Advice." in *IMF Conditionality*, ed. John Williamson. Washington, DC: Institute for International Economics, pp. 129-143.

negotiation for development finance between the IFI's and developing countries, that this dissertation intends to address.

These seemingly simple puzzles related to policy choice process of conditionality are something that converges to the core of debates revolving around structural adjustment, and answers to these puzzles are likely to shed a new light on the question of failure of conditionality and provide clues to viable solutions. To better understand the constellation of relational aspects of conditionality, specific issues and unsolved problems within the subject of conditionality are reviewed in depth.

The IMF, as part of Bretton Woods post-World War II economic architecture, was established to promote international monetary cooperation and world trade through exchange-rate stability. In the same light, the IMF was designed to be a financing institution, providing temporary finance to member countries experiencing balance-of-payments deficits and prescribing appropriate means of adjustment to help member countries overcome their deficit positions. On the other hand, the World Bank, the other pillar of the Bretton Woods system, was left with development assistance that provides long-term financing for specific development projects—first for post-World War II reconstruction and development efforts in Europe, and later for development projects in less economically advanced countries.

The role that the two Bretton Woods institutions played in the stability and prosperity of the post-World War economy cannot be understated in any event. Nevertheless, events in the 1970's, such as abandoning fixed exchange rates, undermined the global systemic role of the IMF—and under that circumstance, the IMF was almost forced to accept a new and more specific role: development finance (Killick, 1995;

Vaubel, 1991).³ This role reflected the evolving balance-of-payments problems that developing countries encountered in the wake of oil crises of the 1970's and became fixed with the outbreak of debt crisis in 1982. In response to the deepening debt crises in the developing countries and a growing sense that traditional sources of concessional lending were insufficient for the task—the IMF, as the lender of *last* resort,⁴ created two new facilities, Structural Adjustment Facility (SAF) in 1986 and Enhanced Structural Adjustment Facility (ESAF) in 1987, besides the existing credit under Stand-by Agreement (SBA) and Extended Fund Facility (EFF).⁵ Each of these facilities involves a condition that recipient countries should agree to undertake specific economic policy reforms over the fixed term. The agreed policy reform is typically associated with an orthodox IMF stabilization program, which is designed principally to reverse acute

³ The IMF has been mistaken as a development agency nowadays, and this triggered debates on the right place and role of the IMF in the world economy. See Finch, David C. 1988. "Let the IMF be the IMF." *International Economy* (January/February); Finch, David C. 1989. *The IMF: The Record and the Prospect*. Princeton Essays in International Finance, no. 175; Bergsten, C. Fred. 1990. "From Cold War to Trade War." *International Economic Insights* (July/August); and Bird, Graham. 1995. *IMF Lending to Developing Countries: Issues and Evidence*. London: Routledge.

⁴ The usage of this term requires caution. As a matter of fact, it is not that clear whether the IMF is a full-fledged lender of last resort. There are some qualifications that economists think the IMF should meet to be a lender of last resort in international monetary system just as central banks do in domestic monetary matters. Discussing this issue is beyond the scope of this dissertation. The IMF itself argues for the need for an international lender of last resort and steps up to achieve that status in the middle of debates on reforming the IMF. The use of this term here reflects this. For a theoretical discussion of this, refer to Fischer, Stanley. "On the Need for an International Lender of Last Resort." paper delivered at the joint luncheon of the American Economic Association and the American Finance Association, New York. [Online] Available <http://www.imf.org/external.np/speeches/1999/010300.htm>, January 3, 1999.

⁵ Features of SAF and ESAF are that, first, both facilities are available only to designated low-income countries; and they are granted for ten years at a half percent interest rate, compared to short-term (1-3 years) and higher interest rate up to 9% of SBA and EFF. For detailed description of each facility, refer to Treasurer's Department. 1998. *Financial Organization and Operations of the IMF*. Pamphlet Series, no. 45. Washington, DC: International Monetary Fund.

12/1/19

12/2/19

12/3/19

12/4/19

12/5/19

12/6/19

12/7/19

12/8/19

12/9/19

12/10/19

12/11/19

12/12/19

12/13/19

12/14/19

12/15/19

12/16/19

12/17/19

12/18/19

12/19/19

12/20/19

12/21/19

12/22/19

12/23/19

12/24/19

12/25/19

Balance-of-payments deficits by generating large trade surpluses in relatively short period of time.⁶ Those policy measures are also a catalyst that facilitates consensus formation on adjustment policies both within the recipient country and among international lending communities, and to provide a focus for the mobilization of additional funds (Bird, 1995).

In the meantime, the World Bank's development activities were also changed with a view to enhancing the IMF's mission of promoting balance-of-payments stability. Its traditional project lending was shifted toward policy-based lending under Structural Adjustment Loan (SAL) and Sectoral Adjustment Loan (SECAL), which are based on neoclassical economic models of development, promoting longer-term economic recovery through reduced government's intervention in economic activities and the strengthened role of market in resource allocation. These are efforts to institutionalize elements of the reform measures initially introduced as part of short-term IMF stabilization efforts (Biersteker, 1993).

This practice in international development finance in the early 1980's was the reinstatement of an age-old principle of conditionality in relation to developing countries (Cohen, 1982). Strapped for resources and faced with potential calls on its credit of unprecedented portions by developing countries, the Fund reasserted the framework of conditionality. Thus, the IFI's make loans based on the promise of borrowing countries to pursue a specified set of policies as conditions for financial support.⁷ It is in this context

⁶ For an authoritative exposition and discussion of IMF adjustment model, see IMF. 1987. *Theoretical Aspects of the Design of Fund-Supported Adjustment Programs*. IMF Occasional Paper, no. 55. Washington, DC: International Monetary Fund.

⁷ At the outset, this meant balance-of-payments stabilization in exchange for debt rescheduling. After 1985, under Baker Plan, debt crisis would be eased through continued reliance on market mechanisms, which meant that medium-term structural adjustment in debtor country economies would be financed by

that the IMF and the World Bank have been widely viewed as exercising tremendous influence over the design and implementation of economic reforms in the developing world since the early 1980's, and much of their influence is assumed to flow from the conditionality (Nelson, 1996).

Countries in debt crisis that appealed to the Fund or the World Bank for new loans were the ones who had already been judged to be uncreditworthy by normal market criteria. In such a treacherous circumstance, a fundamental assumption of conditional lending is that the IMF and the World Bank can compel, or at least induce, countries to undertake stabilizing actions in return for loans, thereby making the loans prudent even when the private capital markets have declared the country to be uncreditworthy (Sachs, 1989). Countries in crisis are often in poor economic shape in large part because of bad policy choices in the past, and the Fund and the World Bank's measures are appropriately focused on key policy weakness. Moreover, the IMF and the World Bank have the expertise and institutional clout to design high-conditionality programs, while the commercial banks that used to inundate developing countries with massive capital prior to the debt crisis do not.⁸

increased Fund and World Bank lending to provide the needed incentives for renewed private bank lending. This was replaced with Brady Plan in 1988 that called for debt relief in exchange for structural adjustment of debtor countries.

⁸ The Fund remains in a uniquely strong position to collect and interpret information of members' economic conditions and to act on the basis of it. Not all the information the Fund share with the member countries is openly available to banks, and confidentiality is maintained for the purpose of keeping the flow of accurate information, which would make the capital transfer mechanism less imperfect. On the other hand, private lenders possess less information than the Fund and, therefore, tend to reach inferior decisions, although the Institute for International Finance collects and processes information on behalf of the banks. As indicated by their reaction to debt crisis by simply taking decisions not to lend, which was followed by the resurgence of bank lending to some developing countries in the 1990's, their analysis of country risk is neither sophisticated enough nor closely related to significant economic factors determining the future ability to service debt (Bird, 1995). To the contrary, public choice theorists like Vaubel (1991) dismiss the superiority of the Fund in information processing on the ground that most of

Therefore, it is no wonder that the two leading IFI's have been the main targets of criticism for the disappointing results of structural adjustment. Some say that, to begin with, the intellectual underpinning of structural adjustment was no more than a mixture of ideology and common sense, with very little theory to recommend it (Buirra, 1983). Also, some believe that structural adjustment was too harsh for developing economies, and that such harshness had usually been the result of dictation or coercion by the IMF and the World Bank (Eckaus, 1986). The IMF and the World Bank imposed inflexible and onerous conditions on individual countries, with little consideration for differences in types of economies (Williamson, 1983b; Killick, 1990, 1995).

Nonetheless, both the role for high-conditionality lending and the influence of the IMF and the World Bank seem to be overstated. Conditionality, in reality, has a facade that makes the above arguments less convincing than they sound, particularly in some aspects. Among other things, against the coercion, compliance with conditions remains low, at around a 50 % level. Using as the indicator of performance discontinuance of a program before the end of its intended life—in which 20% or more of the total value of the credit remained undrawn as well—Killick (1995) found out that just over half (53%) of 305 Fund programs approved in the period of April 1979 through April 1993 were uncompleted. What was worse is that such poor performance was more serious with medium-term programs than short-term and delinquency seemed to be the main cause of failure.

the time the Fund's forecast has been less accurate than both private forecasts and forecasts by national public agencies.

Moreover, rather than finding the presumed strict imposition of same conditions, it was observed that the terms of policy reforms varied significantly country by country. Some countries got exempted from a key component of orthodox reform (such as the removal of a particular subsidy and devaluation), whereas others achieved qualitative changes (i.e., the size of cutbacks in government spending and money growth). Around the world, large debtor countries like Mexico, Brazil, and Argentina have tended to receive a prompt response from the IFI's, loans far exceeding preset access limits, and more discretion in their debt management than countries with relatively smaller debt burden. They have also pioneered more unorthodox debt rescheduling agreements and have been more successful in securing additional finance from commercial banks (Haggard and Kaufman, 1989; Stiles, 1991). It is indeed true that those policy reforms mentioned above typically define the initial position of the IFI's in confronting heavily indebted countries. However, the precise terms of the agreements finalized by developing countries were by no means all alike. Apparently, some developing countries managed to escape this externally thrusting plight, which indicates that within the general guidelines of orthodox stabilization and adjustment, there is room for considerable variation in policies to be chosen.

This obvious discrepancy demonstrates that past studies of conditionality started from a superficial or, at most, a partly accurate observation, and thereby were impaired by conceptualization problems. Conditionality intrinsically reflects power inequality due to the fact that one of the parties involved is the holder of readily disposable material resources, while the other is heavily dependent on those resources for its survival. It is this inequality between the two parties that makes the presumption of imposition sound

plausible. However, this is nothing but invoking to the subject of conditionality the **stereotyped** notion of power in international relations that stronger actors with the greater **resources** and capabilities (such as GNP and large population) will, by definition, prevail in **any** encounter with the weaker. It is well compiled that such single-minded applications of **the** concept of power could not explain numerous cases where weaker states won many of **their** objectives vis-à-vis stronger states. Presuming that the IFI's strictly imposed **conditions**, since there was power disparity between them and developing countries, is committing the same mistake prevalent in international relations. To the contrary, the variance in conditionality agreements indicates that the conceptualization of conditionality needs to go beyond the issue of power and, furthermore, that there are major distinctions in the instruments, issues, and interests that developing countries can bring to their relation to the Fund and the World Bank and draw easier terms of conditionality (Biersteker, 1993).

Taking this into account, much of the criticism mounted against structural adjustment and the role of international donors in laying down adjustment policies is polemical with little ground from empirical analyses utilizing reliable models. Research in the past, especially focusing on implementation, often proceeded without a clear exposition of the process of conditionality agreement and, instead of seeking it eagerly, it was blanketed altogether under the inequality in capabilities of the two actors involved. Within the contention of coercion or dictation by the IFI's, not only the relative autonomy of debtor countries is ignored, but also the sophisticated and symbiotic interplay of global and domestic forces in shaping relations of asymmetrical interdependence is not properly appraised (Zartman, 1987a).

The presumed relationship between coercive conditionality and its unsuccessful **results** of structural adjustment should be substantiated as a prerequisite to studies of **condition** implementation. This is likely to be most successfully carried out by answering a **series** of questions: how are the terms of conditionality drawn, how do the two actors **involved** interact with each other in that process, and what factors influence their **interaction** which eventually leads to the variance in terms of agreement? These questions fundamentally boil down to the so-called power relationship of the actors, but needs to transcend the traditional, as mentioned above. Therefore, as an attempt to solve the puzzles of conditionality, I propose research that lays out a framework for analyzing the relationship between the IFI's and debtor countries as a **strategic bargaining game in which leverage measuring relative bargaining strength largely determines the nature and variance of conditionality agreements**. In this dissertation leverage is revived as *a state's capabilities or endowments conducive to changing the outcomes of bargaining within a specific issue area, which otherwise would not occur*. This is a noticeable shift away from the conventional concept of power, and analytical issues related to leverage will be explicated in Chapters 2 and 3.

The concept of leverage has a special importance in this project since the process of negotiation is the process of creating outcomes, altering and modifying values, and bargaining strength based on national resources creates options that are useful within the context of specific encounters a state faces (Habeeb, 1988). Conceptualizing conditionality with leverage, this dissertation aims to show the dynamics at work in negotiations for conditionality agreements with the major IFI's—dynamics that can account for the difference in their outcomes and that cannot easily be explained away as the past studies

that presumed imposition of conditions would have us do. Thus, this research will constitute an integral part of making the study of structural adjustment complete, covering the whole gamut from agreement to implementation, so that we can grope for a better understanding of the subject.

1.2 THEORETICAL OVERVIEW OF THE SUBJECT

This section critically reviews the field, focusing on the conceptualization problem in conditionality. Identified failure in the past studies is the one that makes my project an imperative for reviving the field. Their success, on the other hand, will be absorbed, reorganized and developed further for my project to conceptualize conditionality from the perspective of power relationship.

Criticisms of IMF monetarist conditionality and the IMF's reply to them have a relatively long history dated back to the late 1950's and early 1960's. Since then, this debate has changed its outlook with new features added to the core, reflecting developments in international economy.⁹ Confining overview of the debate on conditionality more relevantly to that of the 1980's and 1990's, it can be entitled IMF's (neo)orthodoxy vs. (neo)structuralism, which falls on two dimensions: the coherence of structural adjustment as an economic program, and its implementation. While the first dimension is mainly about the formulation and design of structural adjustment as well as

⁹ Historical overview of debates is well compiled in Kahler, Miles. 1990. "Orthodoxy and Its Alternative: Explaining Approaches to Stabilization and Adjustment." in *Economic Crisis and Policy Choice: The Politics of Adjustment in the Third World*, ed. Joan M. Nelson. Princeton, NJ: Princeton Univ. Press.

its theoretical and ideological base, the second is concerned with the implementation of conditionality and its effects in real world followed by policy alternatives. Most studies of structural adjustment have concentrated on specific country experiences on the second dimension and took part in attacking the ontological base of conditionality at the end of their studies on the ground of disappointing results they found. Whichever dimension their research may stand for, however, their common starting point is that structural adjustment failed to achieve its proclaimed goals. Disappointing outcomes in terms of economic indicators and negative effects on human and social indicators have prevailed in the developing economies, even where the conditions were sincerely implemented. Not all adjusting countries had poor performance of this kind, but good performance among adjusting countries was the exception rather than the rule (Stewart, 1995). Still, to do justice with this debate, it should be admitted that these studies lack definite criteria to evaluate successful implementation of conditionality,¹⁰ and this only fuels the debate on the causes of failure and viable policy alternatives between the advocating IFI's and critical scholars.

On the first dimension, structural adjustment is criticized for its defects; while stabilization is a crucial element of adjustment, fiscal stringency, balance of payments and debt constraints overkill potentials for productive activity required for development.

¹⁰ Using the IMF's term, this is equivalent to performance criteria. The outcomes of performance could be multi-staged: first, a borrowing country implements each of agreed conditions but still it either can or cannot meet the targets of structural adjustment. Second, meeting the targets can lead to improving the balance of payments so that it can reimburse the Fund, repay its debts, and continue to honor its international obligations, or it does not. Of course, there is no rigid logical connection between the success at the first stage and the second. The success at the second stage can occur without the first. Thus, a natural question is success at which stage the performance criteria should count. Neither the IMF nor critical scholars are clear about this.

Moreover, the IMF insists on the same defected economic reform programs for every country requesting financial assistance. That is, they provide the same medicine for all the economic ailments of the developing world (Dell, 1983), which consequentially produces negative effects in developing countries, rather than positive ones. Basically, this line of criticism endorses many of orthodox principles, including full recognition of the economic costs of subsidies, overvalued exchange rates, and other price distortions, although it questions the legitimacy of highly detailed conditionality and external intervention. It is skeptical of certain elements of orthodox adjustment policies at the minimum and, thus, suggests that the IMF modify its methods: more sensitivity and flexible application.

An overarching assumption for policy recommendation from the above line is that developing countries are structurally different as a group, and that each developing country deserves independent analysis for its economic reform program. Thus, an adjustment program tending to this need is one that gives more careful attention to sequencing, a more realistic time horizon, greater priority to growth, and short-run current account balance and containing demand. Even before the advent of full-blown structural adjustment in 1983, Williamson (1983b) contended that a country should be able to decide for itself how best to adjust its balance of payments, and this simply resonated with more specific requirements by other scholars. For instance, Killick (1984) argues for extending and consolidating supply-side measures and longer-term adjustment periods: the Fund also ought to adapt to new problems created by the oil shocks and the world recession in a number of ways: increasing its lending power; making increased use of the EFF; reducing insistence on rigorous conditionality. In presenting alternatives to current structural adjustment, Taylor (1987) treats orthodox analysis as a hypothesis and stresses the need

for receptiveness to the economies in question and wisdom in applying institutional parameters to them. Related to Taylor, Rodrik (1990) says that a type of wise application of institutional parameters is prioritizing policy sustainability in a structural adjustment package—given the nature of the crisis—over liberalization, whereby private investment is resuscitated and generates lasting growth. In the case of Sachs (1987)—who is skeptical of the orthodox program but not orthodox analysis—he notes that market mechanisms, despite considerable potential, have their limits. He also suggests, from careful assessments of East Asian experience, a much more active role of state and more gradual and phased reform than current neo-orthodoxy prescribes. The search for adjustment programs that combine adjustment with growth and equity is also in this line. The so-called “adjustment with a human face” (Cornia et al., 1987; Stewart, 1995; Oxfam, 1995) represents concern about the distributional consequences of orthodox adjustment. Reporting adverse impact on particular vulnerable groups—children and the poor—and environmental damage in the wake of adjustment, they argue that alternative policies can be implemented within the orthodox framework.

Not too far from these economically oriented debates are ideologically charged criticisms of political function of conditionality. The IMF and the World Bank are overpoliticized, these critics charge, in that major creditors within the two organizations use them to increase the liberalization of international economic system, and directly to sustain the economic viability of nations considered strategic allies to them (Anunobi, 1992; Assetto, 1988). The Fund and the World Bank together serve merely as a debt collector and enforcer of the interests of the world capitalists, which is why and how they impose inflexible and painful conditions on developing countries, regardless of differences

in types of economies and level of development (Helleiner, 1986). Such an orientation **within** the IMF and the World Bank and their conditionality lead to fears in the developing **world** that the IMF and the World Bank intentionally perpetuate economic dependency **through** conditions that re-establish colonial economic patterns based almost wholly on **raw** materials exports and de-industrialization (Stein 1992; Cheru, 1992). In short, these **arguments** claim that conditionality is designed to take care of the well-being of developed **countries**, not developing countries. Thus, conditionality is based on a political rationale **rather** than economic theory.

The IMF's response to these criticisms has been that conditionality does, in fact, **vary** depending on the country concerned and its economy and history doesn't bear out the **allegation** that conditionality has a negative impact on developing economies. The IMF **asserts** that its institutional purpose and objectives have not changed over the years; the **IMF** has maintained its primary focus on sound money, prudent fiscal policies, and open **markets** as preconditions for macroeconomic stability (Fischer, 1998b). This means that in **stabilization** programs, many elements of the traditional orthodoxy remain central to Fund-**supported** programs. However, this continuity does not necessarily imply inflexibility and **insensitivity**, the IMF argues. While its purposes have not changed, the IMF has shown the **flexibility** to adapt its approaches to problems and the instruments it employs to an ever-**changing** global environment (Fischer, 1998a). The scope of its policy concerns has **broadened** to include other elements that also contribute to economic stability. A good **example** of this is upgrading economic growth to the status of primary objective of a **Fund-supported** program along with stabilization (Polak, 1991). The Fund's traditional **position** had been that its principle of political neutrality made it inappropriate to get

involved with domestic policy objectives that are pursued from equity, social, or political considerations (Gutián, 1987). Thus, the distributional impact of stabilization programs is the government's concern, not the Fund's. This position has gradually changed. The IMF now explicitly discusses distributional effects of adjustment. For more than a decade, the IMF has sought to understand the social and human dimensions of adjustment and, as a result, provided social safety-nets to vulnerable groups and an environmental consciousness, which have appeared in many adjustment programs since late 1980s.¹¹

Another area in which the IMF has been responsive to members' needs is the extension of the time span for stabilization. Recognizing that low-income countries' problems are deeply rooted in structural weakness, achieving balance-of-payments viability should take place over medium-term than short-term. The newly established SAF and ESAF largely reflect this change within the IMF. These facilities are to address problems in heavily indebted low-income countries suffering protracted payments difficulties, and substantial progress is supposed to be made within a three-year period. Although it continues to look at all its member countries through the same lens—the requirements for economic stability—the IMF has heeded the criticisms leveled at its approaches and dealt with distinctive problems in member countries in differentiated ways.

On the issue of negative effects of Fund programs, especially on economic growth, the IMF dismisses such criticism on methodological grounds. Critical studies of Fund programs apply various methods, each of which faces some intractable obstacles, and thus their evaluations do not give reliable results. Despite such methodological problems with

¹¹ Thus, Polak (1991) classifies objectives that conditionality pursues into two categories: primary and secondary. Stabilization, growth, and price stability are in the primary objectives; poverty alleviation, environment, military spending and political consideration are in the secondary.

evaluating the effects of conditionality, the IMF argues, one piece of solid evidence is that the balance of payments and the current account of countries with Fund programs have improved in short term. In other areas, the effects of programs are mixed and differ country by country, depending on the initial economic conditions that adjustment programs were introduced to and the developments after program periods (Khan, 1990; Schadler et al, 1995).¹² What the IMF suggests is that vigorous implementation of sound programs over medium-term periods will lead to more satisfactory outcomes in the long run.¹³

Regarding economic growth suppressed by stabilization, the IMF says that a distinction should be drawn between short and long-term issues relating to the effects of Fund-supported programs on growth.¹⁴ The decline in the growth rate is a necessary part of adjustment to eliminate underlying imbalances in the economy. However, balance of payments recovery should not conflict with economic growth when the time horizon for both objectives is properly specified to be the medium term. Indeed, adjustment and

¹² This evaluation is also applied to ESAFs. While Khan and Schadler focus on SBA and EFF, a staff report only on ESAF reaches a similar conclusion. See IMF, 1997. *The ESAF at Ten Years: Economic Adjustment and Reform in Low-Income Countries*, IMF Occasional Paper, no. 156. Washington, DC: IMF.

¹³ A very similar argument is forwarded about World Bank-supported programs. That is, the World Bank (1989) maintains that, on average, program countries had “moderately” better economic performance than non-program countries, in terms of economic growth and both internal and external balance. The differential in performance was greater for countries that had implemented a succession of program; thus, adjustment programs have a better chance of success in countries with an appropriate macroeconomic policy framework and a high degree of borrower ownership (World Bank, 1993). However, Mosley and his colleagues (1989, 1995) found that Bank programs had no measurable effect on real GDP, positive effect on export growth and balance of payments and negative effects on investment levels. They also found a rather larger rate of non-implementation of program policies than 40% as claimed by the Bank.

¹⁴ Lensink (1996) admits that methodological disparity hinders a generally acceptable conclusion on this matter, too. Even if focusing only on a few macroeconomic indicators—such as GDP, exports, investment, and savings—a unanimous answer cannot be given to the question whether the adjustment programs have had a positive or negative effect.

growth are complementary: by removing distortions and impediments to efficiency, adjustment establishes necessary conditions for sound growth. In the presence of imbalances, the choice that policymakers confront is adjustment *now* versus often harder adjustment *later*: the notion that adjustment is inimical to growth only serves to conceal that without adjustment, growth today is at the expense of often significantly less growth tomorrow (Guitián, 1987).

Note that no matter how much critics disagree with the IFI's in economics and politics, they do not discuss explicitly how conditionality agreements were reached. Rather, while ignoring that issue, they imply or assume that conditionality was dictated by the IFI's and coercive in nature, and as a consequence, negative results ensued. However, if donor conditionality is necessarily coercive, all of the conditions should always be implemented and always damaging to the recipient country. In this situation, there is no need for policy dialogue between the two parties, since the IMF and the World Bank always win on their own terms (Mosley et al., 1995). On the contrary, however, compliance roughly at a 50% level is almost a norm, as mentioned earlier, and has tarnished the reputation of the Fund and the World Bank. If the IMF and the World Bank's conditionality were truly coercive, such an ostensive evasion would not be allowed. This also implicates counter-evidence to the opposite case that implementation of the conditions is in the mutual interest of the IFI's and the developing countries; the actions recommended to those countries are desirable for them and, thus, they need not be compelled to undertake the policy reforms. Only a lack of mutual interests on both sides, however, can explain the fact that recipient governments did not spontaneously implement the conditions desired by the Fund and the World Bank without any prodding from them.

Apparently, both interpretations, which were taken with neglect, conflict with readily available evidence.

If the critics discussed above exaggerate the influence of the IFI's on conditionality, we should also recall that some analysts understate the influence of the IFI's in designing conditionality. Some influential scholars who emphasize the dimension of politics and public policy for structural adjustment in developing countries focus on the political factors that shape governments' adjustment choices and the implementation of those choices. They argue that the role of external agencies, while important to the details of particular cases, is less important than essentially internal factors as a determinant of adjustment choices and action (Nelson, 1990). This view seems willfully self-contradictory: while it admits that the IFI's have a strong belief in orthodoxy, it denies that they are interested in imposing their belief in the programs that they financially support. To the contrary, the apparent dominance of the orthodox program was due in large measure to the preferences of G-5 governments, which endorsed the prescriptions being offered and were in the course of implementing them in their own countries (Kahler, 1990). Their preferences have been reflected on the policies pursued by developing countries, particularly after the onset of the debt crisis when many developing countries undertook programs of adjustment supported by the IMF or the World Bank.¹⁵ Taking the influence of external agents as irrelevant to the choice process, or attempting counterfactual explanations—what would probably have occurred with external intervention—is likely to make explanations incomplete and distort the reality. The influence of the IFI's on the

¹⁵ The influence of the major donor countries within the IMF was not only on the conception of structural adjustment, but also on the changes in conditionality that the IMF went through since mid 1980's as discussed earlier.

choice of adjustment program has been there all the time, and thus deserves as much attention as we pay to domestic political factors. It should be clearly understood that political forces work not only at implementation, but also at choice stage.

Another stream of debates over the disappointing results of structural adjustment is focused on poor implementation, rather than the merits of structural adjustment. According to Sachs (1989), reneging on the agreed conditions is inherent in conditionality due to the fact that an appropriate debt relief was excluded from its design. Without debt relief, required structural adjustment acts as a tax on investment, which will benefit foreign creditors rather than domestic constituents. This will be a major disincentive against investment in the debtor country that would contribute to future debt service. Since the government will not undertake such investment, it is not likely that the debt-servicing capacity of the country will be enhanced.¹⁶ Adjustment is not occurring in the long run.

In this context, debt relief is a necessary, if not sufficient, condition for inducing the country to undertake needed reforms. Furthermore, debt reduction has a strategically important connection to the Fund's catalytic role, since the enhanced effectiveness of adjustment through debt reduction and better economic performance of a recipient country will draw in additional capital to the country, which will allow the burden of balance-of-payments financing to be spread between commercial lenders and the IMF (Bird, 1995). Unfortunately, however, the IMF failed to recognize this, and poor implementation continues.

¹⁶ A research has shown that there are actually the opposite incentive effects of debt relief and that this line of argument could be valid only under particular circumstances. Theoretic diagnoses of debt problem are collected in Frankel, Jacob A., Michael P. Dooley and Peter Wickham, eds. 1989. *Analytical Issues in Debt*. Washington, DC: International Monetary Fund; and Wells, Robin. 1993. "Tolerance of Arrearages: How IMF Loan Policy Can Effect Debt Reduction." *The American Economic Review* 83, no. 3:621-633.

Mosley (1987) puts such a situation in more generic terms. “Slippage,” or poor implementation, is induced by unnoticed disincentives. A debtor government accepts *ex ante* the need for policy adjustment as the *quid pro quo* for a loan, but the government has a strong incentive to avoid the policy change after the loan is arranged. Conditionality, as a course of future actions to which a recipient country will bind itself, makes sense today, but will become unattractive in the future. This even involves a possibility of disguised exploitation of the donor by the recipient: it often takes a long time for the donor to see whether the recipient is acting in the spirit of the policy measures it wants implemented, and the recipient who reluctantly seeks short-term conditional help from the donor can escape unscathed from it at the end. This “time inconsistency” is the ground for that recipient countries must be compelled to accept conditionality (Mosley, 1988).

This perspective shows that the conditional lending from the IMF and the World Bank does have positive sides, but conditionality faces inherent constraints given the limited enforcement power at the hands of the IMF and the World Bank. Domestic loans are normally balanced by collateral in the form of a security, or negotiable capital asset, to be handed over to the lender if the borrower cannot otherwise repay the loan. The conditionality of the Fund and the World Bank is an instrument intended to maximize the probability that the loan will be repaid as in the case of ordinary domestic loans. However, when IFI’s lend to overseas governments, the conditions often become more complex, and their application becomes controversial because the borrower is a sovereign body on whose assets the lenders have no legal claim. This makes the link between instrument and the ultimate target of economic policy change less certain (Mosley, 1987). Thus, what is implied by such a prevalent slippage in structural adjustment is that the alleged superiority

of the IMF and the World Bank in imposing conditionality to commercial banks, is probably correct in general but much oversold quantitatively (Sachs, 1989). The conditions for structural adjustment, whether by the IMF or the World Bank, should not on an *a priori* basis be expected to be implemented from A to Z.

This analysis of limited ability of the IMF and the World Bank to enforce contract vis-à-vis developing countries goes beyond just explaining low degree of implementation. It points to the general nature of the relationship between the IFI's and developing countries in the matter of conditionality as well. Neither actor involved in conditionality is so predominant as to manipulate their relationship thoroughly in its preferred way. Thus, this can be taken as a first step for developing a new framework to illuminate the nature of conditionality more accurately. What this perspective leaves still untouched, though, are questions of what could determine the nature and pattern of their interaction, and what outcome will result from it. Rephrasing these questions for conditionality, it is whether conditionality is necessarily or inevitably coercive; why conditionality agreements are so different case-by-case that they cannot be classified by a reasonable first-hand principle, such as economic difficulty; and what motivates the IMF, the World Bank, and developing countries to keep contracting sub-optimal agreements on conditionality given all the failure experienced in the past. To fill in the missing link between the newly burgeoning framework and its vital content, other facets of the relationship between the IFI's and developing countries must be further scrutinized.

It is a conventional notion that the IMF and the World Bank predominate over the developing economies. As a matter of fact, however, there are some sensible grounds to claim that both parties have been dealing with each other with certain caution and strategy

in conditionality agreement. Furthermore, while developing countries appear to have succeeded in finding chinks in the seemingly impenetrable wall of the IMF and the World Bank, these IFI's have been in a relatively weak bargaining position than many think.

Above all, the Fund and the World Bank are the clients of governments to whom they lend money. Because of this formal position of the IFI's as the clients of the member governments, they must accord a formal equality of treatment for all member governments with regard to conditionality negotiations (Sachs, 1989). This would render it difficult for the Fund or the World Bank to make invidious comparisons among countries concerning the likelihood that they will actually live up to commitments to economic policy reform. Another problem that the Fund and the World Bank face is that they have many goals other than profits, which can make them approach conditionality with a soft touch. Private capital markets operate under one principle, making profits out of loans. Conditionality, however, is expected to fulfill purposes other than the mere development of a healthy cash flow—such as nurturing the potential for growth and keeping political stability, which requires the Fund to settle for a sub-optimal program (Polak, 1991). These are the *raison d'être* of international institutions. These concerns do not always allow for a hard-boiled judgement about the potential success or failure of a conditionality package. On this Wiarda (1990) succinctly remarks that the IMF has not been nearly so draconian in the implementation of its austere measures as its popular image would lead one to believe; the IMF measures often sound fierce and mean on paper but in fact the IMF's bark is much worse than its bite.

Finally, other than fulfilling their founding purposes as international institutions, the IMF and the World Bank, as narrowly defined organizations, have an imperative to

protect their own existence, i.e., circulating quota subscriptions from member countries. Developing countries have tried to bypass the Fund whenever possible in their search for financing resources to fill in their external deficits. The refusal of the developing countries to use the IMF's high-conditionality resources, and the substantial loss of its clientele among the developing countries due to affluent liquidity in the world during the 1970's, were the most dramatic threat to the Fund's overall institutional purpose: financing mandate (Ferguson, 1988).¹⁷ This threat was evidently reflected in the establishment of new facilities, SAF and ESAF, in mid 1980's that departed from its traditional lending philosophy.¹⁸ The IMF cannot afford to watch countries reform on their own because it would risk revealing the IMF's irrelevance (Vásquez, 1998). The most recent innovation is the Supplemental Reserve Facility (SRF), which was created in December 1997 to assist emerging market economies. It allows the IMF to make large short-term loans at higher rates than it normally charges. This self-preserving imperative looks a little different within the World Bank, where country loan officers face lending pressure to meet country commitment target, whatever the posture may be adopted by the recipient government, and to meet country disbursement targets, however unpromising that government's subsequent implementation performance appears (Mosley et al, 1995). If a program looks good on paper, there is great pressure for the program to be approved, even if it seems

¹⁷ The inverse relationship between demand for IMF credits and world liquidity was tested by Cornelius. See Cornelius, Peter. 1988. "Some Arguments against a Global Stabilization Policy by the IMF." *Economia Internazionale* 41:3-18.

¹⁸ Furthermore, it is observed by Killick (1995) that, as the IMF established these medium-term stabilization programs, there has been some relaxation in Fund procedures, which has given its missions more freedom to accommodate recipient governments' views; some borrowing governments have acquired more of voice in the process of drafting Policy Framework Papers for SAF and ESAF.

unlikely that the program will actually be carried out. Thereby, these powerful internal pressures to lend not only act as a counterpoise to the more overt pressure to apply strict conditions, but also make their conditionality less credible. Without such lending pressure or organizational incentive for self-preservation, recidivism in conditionality agreements, with all the poor performance and disappointing results, will remain clueless.

On the part of developing countries, their motivations toward the IMF and the World Bank are double-edged. First, recipient countries understand that the Fund and the Bank are ongoing institutions, and that the ripple effects of rupturing relations with these institutions will impair their economic survival. While defaulting to some private creditors in particular syndicates might not forestall further borrowing from new lenders elsewhere, ruining relationship with the IMF and the World Bank by defaulting debt service to them will presumably endanger the entire opportunities. Nelson (1990) sees that the fear that multilateral support might be affected (not the hope for resumed long-term private flows) helped fuller default inhibited during the 1980s' debt crisis. This argument can be substantiated by the fact that the number of countries that have incurred protracted arrears to the IMF is much smaller than the number of countries that have failed to service their debt to other creditors and/or have had to enter into debt-rescheduling arrangements.¹⁹ Developing countries are likely to place relatively greater emphasis on meeting their financial obligations to the IMF, considering the IMF's status as a creditor and its role as a catalyst in attracting financing for them from other creditors (Aylward and Thorne, 1998).

¹⁹ The IMF regards arrears longer than six months as protracted. While 23 countries have had protracted arrears on principal obligations to the IMF during its history, 58 countries rescheduled their official debt through the Paris Club in the period 1980-92. Source: IMF (1983-1998) *Annual Reports*, Washington, DC: International Monetary Fund; and World Bank. 1994. *World Debt Table: External Finance for Developing Countries 1994-95*. Washington, DC: World Bank.

By this, it is suggested that the IMF and the World Bank be strategically permitted to dictate terms to a country while the private sector cannot (Sachs, 1989).

Second, and perhaps more important, the major creditor governments have made IMF and World Bank conditionality a precondition for a debtor country's future bilateral financial relations with them. With few exceptions, a debtor country in crisis must have a good relationship with the IMF and the World Bank in order to qualify for rescheduling official loans and new credits from official export credit agencies to the debtor government. Thus, a country's concern about foreign economic relations with the developed countries often strengthens the hand of the IMF and the World Bank indirectly (Cohen, 1985). By all means, it is indicated that developing countries maneuver their relationship with the IFIs under the wide shadow of future.

These stances that each party holds in international development finance indicate that, in spite of the apparent asymmetry in power, the relationship between the IFI's and developing countries is interactive rather than one-directional. And all-in-all, this boils down to the necessity to employ different analytical tools to understand their relationship correctly, and setting up conditionality agreement as an outcome of strategic bargaining process will find a perfect match. Considering the above situation, the borrower and the lender of conditional aid have both inherent conflicts and harmonies of interests, and the outcome of this love and hate relationship is not so much from predetermination as from circumstantial creation. That is, *conditionality agreements are negotiated outcomes on the continuum of absolute harmony to absolute conflict of interests, depending on strategy deployed by both parties and external circumstances*. In such negotiation, typically the lending party seeks to get consent from the borrowing country to conditions that will shift

economic policy in the directions that they think are desirable, while the borrower seeks to consent on conditions only palatable to it. Now the question is, what affects their abilities to deal with each other in their preferred way? In other words, where does the variance in conditionality agreements come from, if both sides perceive each other as qualified to negotiate and are doing so?

The factors that differentiate actors' negotiation ability for conditionality agreements can be generically dubbed **leverage**. This subject was first explored by Haggard and Kaufman (1989) in their early study of debt scheduling and later by Chan (1993). They argued that the differences in debt rescheduling is best explained by bargaining power of developing countries represented by three factors: the size of the country's debt, its strategic significance, and its access to other nonconditional resources. Larger debtor countries in the Southern Cone in a position to threaten the international financial system as a whole (largely through the potential of their unilateral action) and capable of sustaining relatively autarkic economic measures, at least for a time, have tended to receive lower interest rates, longer maturities, and a longer grace period in their debt rescheduling than countries with relatively smaller debt burdens. Geography, history, ideological affinity and alliance behavior of debtor countries have also played an important role in determining creditor countries' consideration of debt rescheduling.²⁰ The

²⁰ The importance of those factors in economic relationship has been enlisted in various ways. According to Haggard and Kaufman (1989), the United States has been relatively more concerned with relief for Latin American countries, Germany for central Europe and Turkey, France for its former colonies in Africa, and the Great Britain for the indebted members of the Commonwealth. The beginning of the debt crisis in 1982 coincided with the height of the second cold war, and accordingly, there has been a relatively close association historically between favorable terms in international financial negotiations and the strategic relationship of the debtor country with the United States or its allies. Therefore, countries with poor reputations for meeting performance criteria, such as Zaire or the Philippines, consistently obtained financing from the IMF throughout this period. Biersteker (1993) says that the cold war may be over, but alliance behavior remains important nonetheless, as indicated by the generous debt relief

availability of nonconditional financial resources (i.e., petroleum revenues or proceeds from commodity price boom) enhances a debtor country's bargaining position and the final terms it is likely to receive. Those additional resources render a country less vulnerable to external pressure from the IFIs because it will probably have fewer political incentives to make a difficult economic adjustment. The credibility of a debtor country's bargaining position in international financial negotiations is influenced by various types of resources that enable it to sustain itself without immediate IMF support.

In addition to these factors, Haggard and Kaufman outline how a country's internal or domestic bargaining space can be crucial to understanding both the terms it receives in international financial negotiations and the different degree of implementation of such terms. This argument is more clearly explicated with what Putnam (1988) refers to as a classic "two-level game": a situation of simultaneously negotiating on two different fronts. Putnam says that the size of "win-set" or room to maneuver negotiation is allowed by domestic constituencies. The size of the win-set is a function of the distribution of power, preferences, and possible coalitions among domestic constituents, as well as the political institutions and strategies of international negotiators. Therefore, a number of different domestic factors can influence the outcome of international financial negotiations, including the degree of internal cohesion, the salience of the issue, the potential for issue

provided to Egypt following its involvement in the allied coalition against Iraq during Gulf War. This is also supported by the other studies; Timothy McKeown and his colleagues find out that ideological affinity, which is measured by the nature of regime in developing countries and voting at UN approaching the US position, affects the amount of aid extended and the degree of conditionality in that aid relationship. See McKeown, Timothy, Leona Pallansch, and Strom Thacker. 1999. "Political Conditionality in U.S. Bilateral and Multilateral Foreign Assistance." paper presented at the 40th Annual Convention of the International Studies Association, Washington, DC, February 16-20. Even the lending behavior of international banks is affected by the political relationship between banks' home country and a borrowing country. See Jain, Arvind and Douglas Nigh. 1989. "Politics and the International Lending Decision of Banks," *Journal of International Business Studies* 20, no. 2 (Summer):349-359.

linkage, or the articulation of an indigenous alternative to orthodox IMF or World Bank conditions.

In developing countries' political setting, Putnam's two-level game is quite persuasive. Economic adjustment creates a dilemma for borrowing countries because the state as an actor must bargain with two distinct groups whose interests are often opposed to each another. On the one hand, the state needs to satisfy key domestic constituencies in order to maintain political stability and its hold on power. On the other hand, the state needs to convince its international creditors of continuing to provide capital or at least to accept the periodic rescheduling of old debt service (Lehman, 1992). The conflict between these two relationships has intensified as the IFI's have increasingly attached strings to their financial support on economic policy reforms that would negatively affect the material interests of those key domestic constituencies. The more a government agrees to creditors' demand, the greater risk it faces of political instability—but if it continues to meet the demands of domestic constituencies, it runs the risk of losing the financial support from international creditors. Agreeing upon conditions that ignore a win-set determined by the distribution of power among domestic constituents and political institutions already conceives of possibility of sloppy implementation. Thus, by delivering this to the bargaining table, whether with or without sincere intention to comply with the program, recipient countries can adjust the level of toughness in conditionality.²¹

²¹ In two-level game, the opposite situation is also possible. That is, negotiating developing countries make an excuse of external pressures to domestically deliver economic policy change. Kapur (1998) argues that, in many cases, the IMF devised loan conditions at the behest of borrowers, whether local officials who felt powerless to sway their political leaders or politicians who used the IMF to shield themselves from popular rejection of policies that they too recognized as essential.

The factors that Haggard and Kaufman enumerate to explain different bargaining outcomes in debt restructuring are good examples of leverage. Unfortunately, they do not explicitly discuss creditors' leverage to keep things on their side, but this imbalance seems to be related to their purpose to stress that developing countries fare relatively well thanks to those leverages. In any event, Haggard and Kaufman's argument should be interpreted as that each actor's relative, not absolute, strength calibrated by leverage plays a key role in bargaining process, and that many national characteristics and contextual factors of developing countries have a legitimate potential to be leverage.

Summing up the state of the field, many areas of conditionality have been explored, and some of their findings were convincing enough to change IFIs' lending policies and content of structural adjustment. Nonetheless, the agreement process of conditionality at the very beginning still remains unexplored or poorly charted if explored.²² Although there has been plenty of evidence against the stereotyped view of predominance by the IFI's, they have not been orderly put together to bring a Copernican revolution to the study of conditionality. Based on the above theoretical grounds, conditionality agreements are neither inevitably coercive nor invariably compromising. Rather, each agreement is struck somewhere on the continuum of absolute coercion to absolute compromise, and the distance from the center toward either extreme will be critical to determining the nature of the agreement. Furthermore, the distance carried from

²² The word bargaining or negotiation on conditionality appears in the text more often than expected, but it stops there. Not many scholars showed a serious interest in developing the bargaining process of conditionality. Biersteker (1993), Mosley (1987, 1988, 1995), Stiles (1990, 1991), and van de Geest (1994) are those scholars who attempted to explore bargaining relationship between the IFIs and developing countries in conditionality agreement, but the analytical tools they applied didn't match their research purpose very well in a strict sense.

the center is largely a function of strategy and players' relative strength based on mobilized resources. Now it is only a matter of applying a matching analytical tool to get satisfactory results.

1.3 RESEARCH STRATEGY: HOW TO SOLVE PUZZLES

Haggard and Kaufman's work gets closer to showing the nature of conditionality agreements by incorporating the notion of leverage into debt rescheduling and identifying various sources of bargaining power. Recently, Aggarwal (1996) completed a similar work titled "Situational Theory" using game matrix and focusing on several cases in depth over a long period. The notion of leverage will be extensively used in this dissertation, as well. Although these literatures contributed to opening our eyes to the possibility of bargaining between the IFI's and developing countries, they are limited in showing the big picture of the subject they are studying. These studies describe each tree in the woods, but do not give us the equipment with which to view the whole woods. While we have accumulated enough case studies so far, we still lack a generalized framework under which those case studies can be incorporated.

In addition to needing a generalized framework, the manner that they chose their cases is called into a question. To begin with, we are not informed of why particular cases should be studied and what their selection criteria were. The problem with their selection process is that they focus exhaustively on the occurrences of an independent variable, here

leverage, and select exclusively those occurrences.²³ The attainment of answers to the questions they pose is already logically precluded by their method of selecting cases. By examining all of those occasions in which the independent variables occurred, but only those cases, these analysts are testing the questions of sufficiency (Most and Starr, 1989). With that method, however, they cannot draw any conclusions about whether or not those independent variables are necessary conditions for dependent variable.

Although my research design owes a lot to Haggard and Kaufman and to Aggarwal in terms of conceptualization of bargaining and leverage, mine differs from theirs in four points in addressing the puzzle of coercion or compromise in conditionality agreement. First, I will explicitly use game theory. Of the approaches to model building that one might take—including models of evolutionary processes, cognition, structural imperatives, temporal imperatives—models of choice processes as part of goal-oriented behavior show the most promise for clarifying the nature of conditionality agreement. Although I set out with a bargaining model of conditionality, it does not necessarily mean that the outcomes produced would tilt toward a particular nature. There is no predisposition toward the nature of interaction and its outcomes. Rather, the logic and evidence developed in this model will show that conditionality bargaining is open to a wide range of outcomes, not doomed to produce only one type of outcome, and all of them are results of strategic choice made by the players.

Relying on a game theoretic model to explain conditionality also has an additional merit of methodological inclusiveness. Assetto (1988) and Stiles (1991) set up two or

²³ Chan's work (1993) should be excluded from this category, however. He conducts a single-point (1986) cross-national analysis of the relationship between leverage and debt rescheduling of 87 developing countries, using the terms of loans—interest payment, maturity, and grace period—as dependent variable.

three different models to explain differences in conditionality agreements. This inductive method has a problem that it has to produce new models whenever odd cases turn up. In the worst case, we will see islands of model spawning in the same number of individual cases, which will make generalization impossible. But a game model that will be built in this dissertation will provide a solution to such a problem. It is deductive and free from particular cases at its construction stage, thus it is generalized. Moreover, what Assetto and Stiles call cases of political or functional model can be explained as one of the outcomes produced by the game model based on the concept of leverage. That is, the type of mobilized leverage and the degree of leveragedness determine whether those cases were political or functional. In this sense, the emerging game model is comprehensive and has more explanatory power.

Second, whereas most studies of conditionality use only one or a small number of cases that were selected before their theorizing, or selected because they fit the theory (a common violation of the principle of scientific research), my empirical assessments will be derived independently from the theoretical structure. By using a wider range of cases (i.e., all the eligible conditionality agreements), I will focus on identifying necessary, not sufficient, conditions for variance in the outcomes of conditionality bargaining, which will be led to generalize the arguments and provide an analytical framework within which case studies can be incorporated. For this purpose I deliberately concentrate on the conditionality agreements made only with the IMF as eligible because IMF's conditionality is designed to correct disequilibrium in balance of payments within a short period of time; therefore, it applies a well-structured and clear-cut policy measures than that of the World Bank. While these characteristics of IMF conditionality are more apt to preserve

continuity and inflexibility in its application than change and flexibility, such characteristics at the same time make it easy to notice variance in conditionality agreements, if it occurs, and enable us to classify them and understand their nature better. My research is matching the cases it considers with the questions it asks and the methods that it employs.

Third, while many studies of structural adjustment cover both bargaining and implementation as one dimension, my research is strictly confined to the initial bargaining process. One reason that previous studies were not so successful in revealing the nature of conditionality, even though they viewed conditionality from a bargaining perspective, seems to have to do with combining and analyzing two different processes of different contexts at one dimension (see Mosley, 1995, p. 76). Once a conditionality agreement is contracted, however, the arena of interaction is changed from the international for bargaining to the domestic for implementation, where actors, expectations and strategies are different. Unlike at the bargaining table, where one voice through a unified channel is quite expected, there is likely to be a considerable diffusion of power within the government, and the department within the government negotiating the conditionality agreement may well lack the authority to implement the agreement. Therefore, the analysis of the two processes requires different reasoning and should remain separate. Even though this fact was perceived, it was not well incorporated in the previous works. Bargaining conditionality is one thing, and implementing it another.

Lastly, this study will pay a special attention to testing the validity of the model. Let alone exploring the internal validity of the model persistently, its external validity will also be pursued through a detailed case study. For the external validity's sake, it is not enough to identify general characteristics of conditionality bargaining through a game

model and supportive cross-national statistical analysis. For more satisfactory results, going the extra mile with a case study is essential. The case chosen for this purpose is the international bailout of the Republic of Korea in 1997. The Korean case is interesting enough in terms of context and outcomes of bargaining. As a model of miraculous economic development to be ranked at the 11th largest economy in the world, the financial disaster that forced South Korea to rush to the IMF for rescue, and the entire process that defined how the Korean crisis was handled, show vividly the dynamics working in conditionality agreement in the era of extreme capital mobility. The examination of South Korea's recent experience with the IMF will concentrate on two things. The first is confirming the fitness of the theoretical model to a specific context. The presence of each ingredient of the game model within the case and their influence on the outcome must be the ultimate test of the external validity of the edifice as a whole. Second, the distinctive content of the agreement between the IMF and the Korean government, which was lost during operationalization for data analysis, will be brought to light with details. This is to determine the effectiveness of the leverage that the Korean government could mobilize in the bargaining and will also be compared with general statistical results.

1.4 EXPECTED ACHIEVEMENTS: WHAT WE WILL LEARN FROM THIS STUDY

This research seeks to obtain a better understanding of structural adjustment or conditionality by tracking down the nature of conditionality agreement between the IMF and developing countries. A game theoretic model combined with statistical analysis and a case study will make it possible to test theoretical outcomes and validate them against real

world experience. When this research is successfully conducted, three academically and practically meaningful achievements are expected.

First, this research will provide a decisive answer to some of the controversies revolving around conditionality, which could not form consensus on the fundamental causes of failure and their remedy due to the lack of appropriate framework and evaluation criteria to rely on. This dissertation will provide a general idea of the domestic and international factors that influence conditionality agreements by opening up their bargaining process, which has been put aside as black box so far. Based on this, we will be able not only to determine the nature of conditionality agreements but further pinpoint factors that may lead to success or failure of structural adjustment in individual cases. In order to put study of conditionality implementation on the right track at the next stage, it is necessary to figure out which of those factors is likely to have what influence on domestic implementation, helping achieve or abandon the intended goals. As a preliminary step, examining the correlation between the types of conditionality agreements and the degree of implementation will be helpful, which is possible by classifying the existing conditionality agreements to the outcomes produced by the game model.

Second, in practice, findings from my research will have implications to viable policy alternatives to current lending practice of the IFI's. Although my research is solely focusing on the IMF, its framework and findings from it can be applied to all international financial institutions owing to its high level of generalization. As suggested by the conception of this research, economic reform package and supportive international development financing are highly political decisions that are produced through coordination and coalition of various forces operating at international and domestic level

from the stage of negotiation through implementation. Therefore, the IFI's should take factors other than economics into account when formulating lending policies and supervising their progress, which will make a necessary condition for increasing the probability that the purported goals of each lending will be achieved.

Recently, the notion of 'ownership' of reform, for instance, is gaining momentum in international development community. The results of this research can be used as a guide to map out under what conditions the ownership is created and what role the IFI's should play to nurture it. In this regard, this research will be providing an essential part in seeking viable solutions to the problems of current conditionality and reorient the IFIs' lending policies. By this merit, my dissertation will be in line with establishing measures to use limited international resources with efficiency. International resources for development are limited in the sense that most funds operated by the IFI's come mostly from tax payers within limited number of industrialized countries; therefore, maximizing its efficiency and productivity should be a part of the goals that international development finance tries to achieve altogether.

Lastly, in addition to its contribution to a specific area of structural adjustment, this study will contribute to the study of international bargaining in general, as well. My research is equally concerned with theoretical development of the concept of leverage in the bargaining process: how to define and measure leverage, under what condition leverage works, and how effective it is. This is a sophisticated conceptualization of power that demonstrates how power is translated into action in a causal process that leads to outcomes, with emphasis on issue-specificity in international interaction. This research is also an advanced scientific study of bargaining, focusing on systemic factors, rather than a

diplomatic account based on negotiators' skill as in the past. In this regard, it deserves to be called a progress.²⁴ Therefore, the theoretical findings of leverage based on the asymmetric relationship between international organizations and developing countries can be applied to other forms of international bargaining with subtle modifications.

We learned from experiences that many things in life are path-dependent: previous choices constrain next choices available. This quasi law of life may be applicable to conditionality; that is, the way that adjustment is chosen is likely to set courses for the remaining parts of it. Thus, without a correct understanding of the first process that sets the courses, any attempts to understand the rest could be easily disoriented and leave a hollow hope for achieving the intended goal somehow. In this sense, the study of conditionality may be a Pandora's Box in academia. Curiosity opened the Box and many good things, as well as bad, popped out instantly. But all of a sudden, fear intervened and the Box was hastily closed at the very moment that hope, one of the vital things for life to move forward, was about to come out. Having it kept in the Box, life was nothing but miserable. As we see the state of the field, almost all parts of conditionality but the bargaining process are out of the Box and floating freely around us now. It is time to reopen the Box and set the bridled part free. When it floats free with the other goods already out, the field will become complete and function better.

²⁴ There are researches that describe the Fund's flexibility at interpersonal level, namely personal involvement of Managing Director and mission officials with country officials. Putting conditionality bargaining under judgmental approach by technocrats is more likely to produce erratic and inconsistent explanation for variance in bargaining outcomes. Thus, my dissertation attempts to examine the outcomes of conditionality bargaining at a systemic level. For a comparison, refer to Stile, Kendall. 1991. *Negotiating Debt: The IMF Lending Process*. Boulder, CO: Westview Press; and Martin, Matthew. 1991. *The Crumbling Façade of African Debt Negotiations*. New York: MacMillan.

CHAPTER 2

PRELUDE: THEORY OF BARGAINING IN INTERNATIONAL RELATIONS

The necessity of using a game theoretic model for the study of conditionality rose to an imperative in the previous chapter, with a view to clarifying the process and nature of conditionality agreements to a higher standard of science. Before moving on to real modeling, it will be worthwhile to confirm the appropriateness of applying a game theoretic bargaining model to conditionality agreements by reviewing general bargaining theory in international relations. The purpose of this chapter is to survey various components of the existing bargaining theories and extract from them contents useful to constructing a theory of leverage and conditionality bargaining model based on it in the next chapter.

2.1 BARGAINING AS A WAY OF RESOLVING DIFFERENCES BETWEEN STATES

Resolution of international disputes can follow two paths, war or negotiation. Negotiation as a means of resolving disputes and managing relations, has played an important role in interstate relations for centuries from the beginning of modern international system, and has become a primary activity of states with the advent of massive destruction weapons since World War II. This is more so as the current international system is getting closer to what Keohane and Nye (1989) called “complex interdependence,” which is characterized by multi-layered transnational relations rather than military competition and confrontation. For the larger part of the world, military

security is not at the top of a clear hierarchy of issues for government but just one of the multiple and complex issues. Moreover, force as a counterpart measure to negotiation is usable only at high cost. Thus, the fact that the utility of force declines and issues become more equal in importance leads states to rely on negotiation more than ever in order to wield power and resolve disputes.

What do we then legitimately expect from the word of negotiation? The most basic definition of international negotiation showed up in one of the early systematic studies of negotiation; Fred C. Iklé (1964) defined negotiation as a process in which explicit proposals are put forward ostensibly for the purpose of reaching an agreement on an exchange or on the realization of a common interest where conflicting interests are present. This definition denotes one of the fundamental features of negotiation called mixed motives in negotiation. Interests of two parties involved conflict with each other, but they also share a common interest in solving their problem through negotiation rather than leaving it unsolved (Brady 1991). Relations between any two parties or more may fall on a continuum of completely identical interests to totally incompatible. At one end of this continuum, the two parties' interests are in harmony so that they need not coordinate their interests through negotiation; even if each party behaves as it prefers, this does not hinder the other from achieving its goals. At the other end of the continuum, on the other hand, the interests of the two parties cannot be realized simultaneously, and thus, the dispute will almost inevitably be resolved by force or coercion rather than by diplomacy and negotiation. Virtually all of international relations fall on this continuum, perhaps at times tending toward one or the other end of the continuum, but most times

somewhere in-between. It is within this middle territory that Iklé's essential condition for negotiation is met.

The second feature of any definition of negotiation is that it entails a situation of interdependent decision making, where two parties make decisions and thereby the outcome of the negotiation is not exclusively under their control. The result of their interaction will in part be influenced and constrained by the action of the other as much as by that of one. In such joint decision-making, it is no longer possible for any party to optimize the outcome alone. However, it is usually possible to create conditions in which one's decision will produce a mutually acceptable outcome that will at least serve the fundamental interests of all of the parties affected by the decision (Hopmann, 1996). With two parties simultaneously participating in decision-making, negotiation becomes a dynamic or moving event, not simply a static situation, and an event concerning the selection of a single value out of many for implementation and action (Zartman, 1976).

One thing to be noted about the theory of negotiation is that scholars of international relations use the terms "negotiation" and "bargaining" interchangeably without any hesitation. To draw a fine line between them, however, John Cross (1969) defined them respectively: the term bargaining will refer to the process of demand formation and revision which provides the basic mechanism whereby the parties converge toward an agreement, while negotiation will refer to the whole situation within which bargaining occurs. It is clear that Cross portrays negotiation as a more comprehensive concept, within which bargaining forms the nucleus. This dissertation is concerned not only with bargaining *per se*, but also with the whole negotiation procedure by Cross' definition. It will keep balance between the narrow bargaining aspect of conditionality and a broader range of contextual elements

affecting the magnitude of the parameters of bargaining. Nevertheless, these two words will be used interchangeably in this dissertation as well.

2.1.1 Game Theory and Modeling International Negotiations

In light of the essential nature of negotiation as a process of joint decision-making that combines conflicting positions into a common outcome, game theory provides a good logical underpinning of interdependent decision making in any situation that involves at least some conflicting interests between two or more parties. The logical structure of game theory is independent of any concrete content and helps visualize the underlying principles without being distracted by specifics of particular situations. Rather, it organizes them in a systematic way so as to begin with the most basic choices that an analyst must make, namely starting with the simplest assumptions that may provide the most general explanations, and then to move along to more refined choices and complex analyses that may offer a more differentiated explanation of the process in particular categories of negotiations (Hopmann, 1996). Thus, the analysis of negotiation using game theory enables us to go beyond a simple reductionist typology of negotiations or *ad hoc* list of factors that might account for the behavior of actors in international negotiations.

The basic bargaining model in game theory is a simple representation of two-party negotiation.¹ These two players are self-interested and rational in the sense that they

¹ Game theoretical approaches to bargaining more or less assume an agreement given the game, and attempt to predict the nature of that agreement. It should be noted, however, that while some sort of agreement is inevitable in some context, there are many social contexts where reaching any agreement is quite difficult.

have goals and attempt to realize those goals through their strategic actions. A utility is a summary measure of all of the costs and benefits that may be collectively associated with a particular outcome. Actors' preferences over the outcomes are formed in accordance with the costs and benefits associated with each alternative and how the other player will respond to their decision. The players respond to the circumstances by making choices of strategies that they believe maximize their *expected utility*.²

The outcomes of interaction are structured in two settings, zero-sum and nonzero-sum. In zero-sum games, players' payoffs are always inversed of each other, and hence, they have no interest in communicating or coordinating their strategies for mutual benefits; no negotiated solutions are possible that can benefit both parties simultaneously. The nature of this negotiation process is so competitive that each party seeks to maximize his relative share in the context of fixed sum payoffs, whatever value is being divided and to protect themselves from being exploited by the other (Friman, 1993). The structure of the game itself determines outcomes for the players.

On the other hand, nonzero-sum game represents a situation in which one player's gain is not automatically the other's loss. The players have both competitive and cooperative interests and may find outcomes that are preferred by both of them to others. Since there are generally no determinate solutions in this type of game, the players may try to communicate joint strategies that will improve payoffs for both, compared to unilaterally determined strategies. In this sense, nonzero-sum game captures the mixed motives in negotiation better and highlights more cooperative efforts to enlarge the simultaneous joint gain of both parties in otherwise conflictual situation (Morrow, 1994).

² The reason that utility is expected, not decided in advance, is explained later in this chapter.

Unilateral strategies, however, are still usable even in nonzero-sum bargaining, because even in this situation one can always compare negotiated outcomes with what one could obtain by playing the game as if it were a zero-sum game in which one plays one's best unilateral strategy (Hopmann, 1996). The players will only accept resulting agreements that leave both of them better off than they would be in the absence of an agreement. This is due to the fact that players can act only in anticipation of their opponent's actions, but cannot precommit themselves to one or another course of action—a typical situation in international relations. This inability to make precommitments springs from a fundamental of international relations that there is no higher authority to enforce agreements between states, although this condition does not preclude cooperation among self-interested states (Bueno de Mesquita and Lalman, 1992).

The above structures of a game can be reorganized around two major paradigms in international negotiation: bargaining and problem-solving. These distinctions and the implications drawn from them are also in parallel in many important respects to realism and liberalism that have divided the larger bodies of general theory about international cooperation.³ Indeed, there is a strong correspondence between the central concepts of bargaining theory and realist approach to larger international relations theory, whilst the problem-solving paradigm is closely linked to the liberal tradition toward international relations in basic assumptions and concepts (Hopmann, 1995). The most conspicuous difference between them, which is relevant to bargaining, is the perception of gains, whether they are relative or absolute: the pursuit of gains in international negotiations

³ For a critical review of contrasting theoretical traditions of realism and liberalism in international relations in terms of the possibility of cooperation, see Grieco, Joseph M. 1988 "Anarchy and the Limits of Cooperation: A Realist Critique of the Newest Liberal Institutionalism." *International Organization* 42, no. 3 (Summer):485-507.

could be at the expense of the other in a largely zero-sum competition or joint gains through cooperative search.

In realism, national interests are charted as fixed preference and the magnitude of demand in negotiation is endogenous to the structure of the game so that it is selected to maximize expected utility (Bueno de Mesquita and Lalman, 1992). Therefore, states will even forgo agreements that will produce benefits greater than the status quo or their next best alternative to an agreement, if their potential competitors were perceived to be gaining more than they are from that agreement. It is perceived as a strategic disadvantage that could do serious harm to one over the long run if the other gains more relative to one, even if both are absolutely better off (Grieco, 1993).⁴ In realist perspective the goal of international negotiations is winning them at the expense of the other by remaining firm, while the other should be flexible and offer compromises.

By contrast, a problem-solving approach to international negotiations is generally associated with a more liberal or institutionalist stance on international relations theory. Reflecting the changing nature of post-Cold War world, liberalists have focused on interdependence and contributed to a substantial reconceptualization of the international relations and negotiation process. To liberalists, the most fundamental purpose of negotiation is solving common problems that parties face and finding solutions to those

⁴ This statement could be controversial in light of recent developments in international relations theory, especially regarding state's preferences over relative and absolute gains and cooperation. For example, Snidal proved that even if states stick to relative gains, its impact on cooperation dramatically decreases as the number of actors involved in interaction increases. On the other hand, Powell proved formally that it is not states' preferences over the type of gains that hinders cooperation among nations but international environment, namely, anarchy that lacks a central authority to enforce contract. Nonetheless, this statement is given here for the purpose of caricaturing conflicting theoretical traditions as reference at the expense of details. See Snidal, Duncan. 1991. "Relative Gains and the Pattern of International Cooperation." *American Political Science Review* 85, no. 3 (September):701-726; and Powell, Robert. 1991. "Absolute and Relative Gains in International Relations Theory." *American Political Science Review* 85, no. 4 (December):1303-1320.

problems that will optimize mutual gains for both parties (Hopmann, 1995). It also assumes that a state can accept and implement agreements that serve its interests, even if they also serve the interests of other states at the same time. This is thanks to international institutions, formal and informal, that create a set of norms and rules within which negotiations take place and facilitate cooperation for joint gains. Keohane (1983; 1984) argues for the positive role of international regimes, saying that their most important function is to facilitate negotiations leading to mutually beneficial agreements among self-interested states by reducing uncertainty and transaction costs and allowing states to redefine their national interests.

The choice of bargaining tactics, too, is shaped in accordance with players' selection of a bargaining framework. Given the emphasis on power within its tradition, the realist prescription for negotiation has tended to emphasize the tactics of manipulation such as commitments, threats, and promises, which are likely to win a larger share of good for one party (Hopmann, 1995). States make commitments to reinforce their offers and demands; they manipulate information to disguise their true preferences and their actual alternatives to agreements in order to gain settlements that are unilaterally favorable to their own interests; they issue threats and promises concerning punishments and rewards, which are in turn made credible by demonstrating that the states have sufficient (military) capabilities to carry them out. However, this tactic concomitantly entails a risk of stalemate or sub-optimal solution, if the opponent is similarly motivated and then both parties become engaged in a contest of wills. This, Grieco argues (1993), is the risk inherent in avoiding exploitation at the hands of the other by the search to expand benefits with a potential competitor.

On the other hand, to the liberalists, negotiation is increasingly viewed as a tool to resolve conflicts in such a way that mutual benefits for the parties are produced rather than exclusive benefits for one at the expense of the other. Therefore, as long as a mutually satisfactory agreement is possible, both parties have an interest in avoiding tactics or other mistakes during the bargaining process that will prevent them from achieving an agreement (Walton and McKersie, 1991). Moreover, the players will apply tactics that will facilitate reaching an agreement such as issue linkage and side-payment. For them, it is not just the outcome of the negotiation that is important but also the improved nature of the long-term relationship between the parties that results from achieving mutually beneficial agreements (Fisher, 1987). It serves their long-term interests because agreements based on mutual benefits have more potential to endure, while agreements that may undermine the fundamental interests of at least one of the parties are likely to be violated and eventually dissolve.

With the above bargaining strategies in mind, how do the parties then reach an agreement as outcome? The primary problem for negotiating states is to identify the approximate range of bargaining space within which mutually acceptable agreement can be realized. Each player may enter into a negotiation with an absolute bottom line set according to some abstract criteria of gains and losses. This bottom line is not set arbitrarily, but rather determined by identifying a point at which agreement would no longer be beneficial for the party. Fisher and Ury (1991) refer to this as a resistance (security) point or BATNA—the Best Alternative To a Negotiated Agreement—that represents the point of minimum acceptable agreement. The BATNA is a minimum both for the amount of utility to be satisfied and the degree of success to be individually

judged in negotiation. In game theory players can determine their BATNA by playing the game as if it were a zero-sum game and by calculating their minmax strategy. No matter what method of calculation may be applied, however, the principle is that negotiators should determine their resistance points by comparing the value of agreement at any stage with the value of no agreement. And the criteria for an acceptable agreement within this framework should be coming out ahead compared to one's own alternatives, not compared to the other party.

The logic of BATNA gives us criteria to evaluate what is often referred to as *status quo* and an outcome of no agreement from bargaining. These two points can undoubtedly be considered at BATNA since they are calculated on the basis of the amount of losses that each player will suffer from noncooperative outcomes and will presumably lead each party to pursue its next best available options. A negotiator must always be conscious of what benefits or harm he will receive in the absence of an agreement, and should never be pressured or coerced into an agreement that will leave him worse off than would be the case if he walked out of the negotiation and pursued the next best alternative to the negotiated agreement (Hopmann, 1996). Failure to agree may not necessarily be very costly if there is a perfectly satisfactory alternative to rupture. This means that any failure to reach agreement will not be treated as a defect of the international political market, nor as breakdown of rationality in a political process in which states' interests collide and shift (Blair, 1993).

As long as the resistance points of the parties are not mutually exclusive, there should exist a range of acceptable agreements between them—the bargaining space. Once the bargaining space is located, the task is to find a precise point of agreement that gives

it a larger share of the profit than the others do. Thus, it may be rational for each party to try to move the agreement along issue dimensions toward positions that will maximize its interests, while engaged in making concessions until the positions of the parties converge somewhere within that space. Such a process of locating a point of agreement is described as concession-convergence process; from the initial positions on issues do the parties converge to a jointly acceptable outcome based on a process of mutual concession. Concession-convergence process in negotiation posits that the parties start at some point of stalemate and approach an outcome through an action-reaction process of responding to each other's concessional behavior (Bartos, 1977; Cross, 1969).⁵ This is also similar to what Zartman and Berman (1982) call formula, a conscious attempt to arrive at a joint definition of problem and solution and to combine both parties' relevant positions into a common justification for terms of trade as the basis of agreement. Here the provision of trade-offs forms the essential part of the creation of a formula. For negotiation is less a matter of making a decision than of putting together a package of counterbalancing payoffs and establishing the terms of trade among them in order to make a positive decision possible (Zartman, 1987b). No matter what we call the process, however, the final landing point of negotiation still seems to be dominated by the mixed motives in negotiations, the simultaneous presence of a common interest in reaching an agreement within the available bargaining space and a conflicting interest in achieving an unbalanced agreement within that space that favors one's own position.

⁵ Concession/convergence theory of negotiation even assumes that actors will behave in a predictable way, and thus, the outcome can be predicted once the bargainer's concession rates are known. However, this negotiation theory does not provide a clear explanation about what makes actors concede, what determines the rate of their concession, and how it affects the process of converging toward outcome. The only way to deal with this is bringing the concept of power by the back door, which will be seen later.

As the negotiation proceeds through concession-conversion, the final agreements rarely leave one party with all of its demands satisfied, or the other with no satisfaction, since there is always some element of compromise involved. Each side avails itself of some influence in negotiation to elicit compromise out of the other. Thus, the outcome of such compromise is not known for certain and even comprises risky components as lotteries. Negotiations are risky events in that one can expect to obtain something between one's own demands and the demands made by the opponent (Bueno de Mesquita and Lalman, 1992). In negotiation neither participant anticipates fully satisfying his or her initial demand. This is why the utility of the negotiation is expected, not predetermined; the utility is calculated as the value gained if one's demands are won, weighted by the subjective probability of winning, and again summed with the value of the opponent's demands, which is weighted by the subjective probability of losing.

Once bargaining is finished, it is natural to ask whether the negotiation was successful. What criteria are used to judge success in negotiation after all? A simple sign of success is the emergence of settlements that two or more sides are willing to sign. However, this should not be read to indicate that the settlement terms were or were not the best available alternative to *status quo*. Although nothing can prove that better alternative could have been negotiated, neither does agreement on one set of terms prove that better (or worse) agreements were not possible (Zartman, 1987b). Furthermore, the emerging set of terms says nothing about mutual satisfaction and equal better-off. Pareto-optimal criteria do indicate that the parties should be able to improve their positions, with or without depriving the other parties of their advantages, but insisting that the parties benefit equally from the outcome may be imposing too stringent a condition for success

(Zartman, 1987a). Also, the very nature of game theory does not allow interpersonal comparison, and success must be evaluated against the problem, not against the adversary. Players act rationally on the basis of their preferences, which are exogenously given. It is possible to trace back to the rationality presumed to exist through reasoning, but not possible to judge the appropriateness of rationality itself through comparison. This nature of bargaining game makes evaluation of success a matter of subjectivity, where universal rule of judgements is not available.

A second criterion for success is the degree of compliance by the signatories with negotiated agreements. Agreements that are essentially one-sided cannot endure indefinitely. This is due to the fact that the party that has been coerced into accepting an agreement against its interest will resent that agreement and the other party that imposed it. The coerced party will have every incentive to avoid, fail to implement, or even cheat outright on such agreements. However, it is also noted that compliance to agreements comes down to the domestic level from the international, which is engaged in different dynamics among concerned players. The causes of noncompliance cannot solely be ascribed to the process of negotiation.

2.2 FACTORS AFFECTING BARGAINING OUTCOMES

Negotiation outcome is a result of causal process. The analysis of negotiation is the analysis of outcomes, specifically, an analysis of what causes a particular outcome instead of any other (Zartman, 1976). A causal definition of negotiation focuses attention on the process of change and the end result of change, namely, an understanding of

operating process and investigation of factors that seem to have contributed most to the attainment of agreement between parties involved. With that regard, notwithstanding that game theory is a useful framework for describing how states actually negotiate or for explaining specific outcomes of international negotiations, still a good deal of the actual behavior of negotiators cannot be adequately explained only by axiomatic foundations of game theory (Rapoport, 1960). Within the bargaining space, many other variables that are not taken into account by the game theory can also be influential in determining actual outcomes. In other words, the outcome of a particular negotiation can equally depend on other factors than mere calculations of the most rational, utility-maximizing strategy for responding to circumstances. Thus, we need to expand our focus on to those factors to understand better when and why theoretical expectations of game model will be realized in any particular international negotiation.

As one of the extended foci, examination of the process of interest change appears qualified. Transforming initial conflicting positions into compatible ones is the same with changing players' interests; the change in interest is brought about by affecting the negotiation process, which is possible by developing alternative agreements in more favorable terms to the players. Increasing chances for more favorable terms may be owing to various conditions exogenous to the bargaining structure that can assist states to strike agreements in their preferred terms. Therefore, if an agreement is reached, certain influence can have been exercised on the players: one or both players have changed their positions during negotiation, presumably because of certain actions by the other player.

In a similar vein, whereas it is true that opportunities for joint gains often exist, it is equally true that even mutually beneficial agreements bring greater gains for one party

than for the other. The point of agreement is rarely halfway between each party's position, but tends to be closer to the preferences of a certain party. Even when negotiations are aimed at creating a bigger pie for all, the question inevitably arises as to how much of the bigger pie each side will get, and how much each side should pay to increase the size of the pie (Blair, 1993). A corollary question to this situation is what makes one party concede more than the other, what efforts each party deploys to obtain an outcome favorable to one but at the same time attractive enough for the other to shift away from its unilateral solution through interest change and to accept the agreement. Answering these questions necessitates injecting exogenous dynamics into the negotiation process, namely bargaining strength.

It is important to note that in a search for such bargaining strength, a commonly cited unit-level variable, bargaining skills, is ruled out. Good diplomacy alone will not guarantee success in achieving one's national objectives in a world still characterized by a great deal of anarchy, although it is a necessary condition for being able to advance one's interests (Brady, 1991). The successful negotiation of international agreements ultimately depends on far more than negotiators with an impressive repertoire of international skills. Moreover, judging the level of skill in bargaining is a highly subjective matter, and settling on bargaining skill as an explanatory variable is likely to derail the research into "analyzing agent rather than the process" (Zartman, 1977). Bargaining skill is not a factor that can be easily ignored, but a means to measure its level and influence should be developed first so that it will not be used as an *ad hoc* rationalization of outcomes. Even if there were a widely accepted standard of bargaining skill, assessing the skill manifested in negotiations would require an intimate knowledge

of the bargaining process, which is neither presently available for this study nor fits the purpose to generalize necessary conditions for conditionality bargaining. Therefore, this factor is not considered.

2.2.1 Bargaining Tactics: Commitment, Linkage, and Side Payment

Negotiation tactics are a means of communication; they are a means of communicating preferences to each other. Tactics are judged as successful when they alter or modify the interests or alternatives of the other player within the relationship. However, the elements of mixed motivation in negotiation create a dilemma for negotiators regarding the tactics that they will employ.

As a starting point, commitment to seek disproportionately large gains in the distributive phase of negotiations is considered. Commitment, as ‘the power to bind oneself’ (Schelling, 1960), refers to the extent and degree to which a player desires and/or needs its preferred outcome. Commitment is based on the values that parties attach to various possible outcomes. This tactic, however, is apt to pave a way to the classical paradox of Toughness Dilemma: the tougher (more unyielding) a party acts, the greater its chances for an agreement to its position but the greater the chances for no agreement at all, whereas the softer (more yielding) a party acts, the greater the chances for an agreement but the less chances for a favorable one. Thus, the tactic of commitment is haunted by the dilemma that winning a larger share of good for one party may create a stalemate and thus detract from the ability of the parties even to reach an agreement. Schelling (1960) observes on this tactic that they all run the risk of establishing an

immovable position that goes beyond the ability of the other to concede, and thereby provokes the likelihood of stalemate or breakdown. Unyielding confrontationism can be unproductive; holding firm on a one-sided compromise can work to produce an agreement only when it is done by the stronger side—the side with less to lose in breakdown—and when the weaker side is not prepared to live with its losses (Zartman, 1987b).

In moving the other player away from its committed position, one can think of a tactic that a state threatens to take a certain action that would impose significant costs on the other state. In that case, the interest in the issue being negotiated could be overridden by the interest in avoiding the threatened action (Blair, 1993). Any agreement desired by the threatening party can be contracted since the cost of non-agreement has gone up due to the threat; outcomes that were previously only marginally beneficial or perhaps even negative may now become much more positive relative to the more costly condition of non-agreement since benefits must always be compared with the value associated with non-agreement (Hopmann, 1996). The tactic of threat works under the condition of unequal loss from non-agreement and difference in the ability to cope with it, and consequently, produces asymmetric outcomes. It is so because the party that stands to lose less from the failure to agree can threaten the other with an outcome of non-agreement more credibly and, thus, be in a better position to demand a greater share of the gain from cooperative outcomes. If both players have equal losses from non-agreement, then the anticipated compromise outcome of negotiation will be akin to “split the difference” (Rubinstein, 1982), which is equivalent to the fifty-percent solution. This

tactic of threat is usually accompanied by a promise of punishment for not consenting and/or reward afterwards. This is probably better characterized as coercion.

While the strategies of commitment and threat pertain to distributive bargaining, we can think of two counterparts from problem-solving that deliberately manipulate the external environment of negotiation. Tactics from the problem-solving perspective are to resolve distributional disputes by enabling actors to rationalize backing down from prior commitments (Walton and McKersie, 1991). First, if bargaining space does not exist, players may try to create one through linkage among nonnegotiable issues if treated separately but that may produce a negotiable package of issues when combined. An agreement becomes acceptable to players contingent upon changes in the behavior of the other with regard to issue having no direct bearing on the negotiation (Friman, 1993). Linkage is an action of creating trade-offs, in which issues are linked together to create a mutually beneficial agreement as formula and enhance the prospects for solutions to disputes. This tactic is more likely to be sought when the problem under negotiation is complex and involves multiple dimensions, issues or parties to the negotiation, or when the issue involves very fundamental interests or beliefs that are not readily amenable to solution by compromise, easily suggesting no presence of bargaining space along a well-defined dimension (Hopmann, 1996). Also, this is a tactic to make use of instruments or issues where its bargaining position is relatively strong in order to promote or defend interests where it is weak (Keohane and Nye, 1989). The effectiveness of linkage tactic in facilitating agreement depends on the degree of changing the relative costs and benefits

associated with agreement versus their BATNA.⁶ Thus, linkage facilitates bargaining by offering “more potential quid for the quo” (Keohane, 1984).

Together with the tactic of issue linkage, side-payment refers to a compensatory measure aimed at facilitating agreement between players by roughly balancing inequities arising from cooperation. When negotiation outcome is intended to be distributive, side-payments to make up difference in concessions can offer a means to generate more egalitarian agreements.⁷ Hence, side-payment is a tactic that can facilitate a shift toward a more positive-sum bargaining. This compensatory tactic can take a number of forms from direct proffer of monetary reward to non-monetary concessions on other issues.⁸ Furthermore, side-payment is in a complementary relationship with the linkage tactic. Since issue linkage changes the nature of negotiation from distributive to cooperative by joining issues for bargaining purposes, offering side-payments is an integral step in order for issue linkage to take place successfully (Keohane, 1984).

⁶ In the text, examination of conditions under which each tactic will succeed and fail is almost skipped simply to limit the scope of discussion. As briefly discussed for the tactics of commitment and threat, the issue linkage tactic also has a possibility of failure and such cases are well compiled by scholars who are against this tactic. For such topics, see Morgan, T. Clifton. 1990. “Issue Linkages in International Crisis Bargaining.” *American Journal of Political Science* 34, no. 2 (May):311-333; and Tollison, Robert D. and Thomas D. Willett. 1979. “An Economic Theory of Mutually Advantageous Issue Linkages in International Negotiations.” *International Organization* 33, no. 4 (Autumn):425-449.

⁷ The usage of side-payments as a bargaining tactic is not restricted to international bargaining. It can be used domestically. For domestic use, it is to garner support when faced with other governmental officials or societal interest groups blocking ratification of international agreements, which comes to complement two-level games by Putnam (1988). As a theoretical discussion, see Mayer, Frederick. 1992. “Managing Domestic Differences in International Negotiations: the Strategic Use of Internal Side-payments.” *International Organization* 46, no. 4 (Autumn):793-818; and for an application, Friman, H. Richard. 1993. “Side-payments versus Security Cards: Domestic Bargaining Tactics in International Economic Negotiations.” *International Organization* 47, no. 34 (Summer):379-410.

⁸ For a detailed typology of side-payments, see Pruitt, Dean G. 1981. *Negotiation Behavior*. New York: Academic Press, pp. 143, 157-60.

However, the conditions under which policymakers are more or less likely to attempt bargaining tactics and choose particular tactics remain underspecified (Friman, 1993). While the nature of tactics does not answer the question of when to shift, it is easily expected that confrontation is the parties' initial positions and they will move at some point toward a more flexible and creative behavior to construct a mutually satisfactory agreement. It is in this respect that politics of negotiation draws our attention. So far, the discussion of negotiation has proceeded as if international negotiations took place in a political vacuum. To the contrary, international negotiations constitute a subsystem of larger international relations, and the employment of negotiation tactics to resolve conflicts and its outcome depend very much on the state of relationship between parties within the international context, which makes negotiation a political process.

The context of negotiation is based on the parties' perception of "relationship," that is, "how negotiators visualize their interdependence, the type of commitment the negotiator has made to the other party and the degree of indebtedness he or she feels" (Brady, 1991). Most international negotiations are not one-shot affairs but occur in the context of a preexisting relationship that will be maintained over a long period. Thus, the history of interaction between the parties and expectations about the nature and value of continued relationship influence negotiations. Negotiators make decisions about strategies and tactics based on previous experience with their negotiating partners. In turn negotiations not only lead to specific agreements on issues at hand but also function progressively to shape attitudes and policies toward future relationship.

Thus, political considerations may even override so-called rational decision-making based on the structure of the negotiation. Viewed from this perspective, the

process of bargaining represents not only the convergence of positions but also the deliberate act of political compromise. Politics influences decision of when to enter negotiations; politics shapes negotiating positions; politics enters into the formulation of interests and objectives; and politics often influences outcomes after international agreements are signed (Ibid.). This explains why states under similar conditions have reaped different outcomes from negotiation with the same counterpart. In short, politics is the critical dimension of international negotiation.

2.2.2 Resources: National Power in International Negotiation

Incorporating the concluding remarks of the previous section, international negotiation takes place not in a vacuum but within the international system where individual states are its components. While denying the existence of higher authority over them, states are differently placed by their power, and differences in placement explain their behavior (Waltz, 1979). The difference in power is of special explanatory importance in such a self-help political system. For the same reason, international negotiation cannot be separated from power. As noted above, negotiation is a process of value creation, reflecting changes that have occurred to actors' positions, expectations, and goals. These changes seem to be caused largely by the tactics mentioned above and by the existence and use of power for that purpose. The unequal distribution of power across states in international system results in different abilities to employ the negotiating tactics successfully. Tactics flow from conscious or unconscious deliberation in which power is estimated, options assessed, and consequences anticipated (Lawler, 1992). As a

conditional statement, states' behaviors in negotiations and consequent outcomes depend heavily upon power with which to implement chosen tactics and the credibility perceived by the other state. Thus, power serves as the foundation of a state's bargaining strength. Power lies between basic causal variables and results.

Power is exogenous to the structure of bargaining game. When power is inserted into it, however, the outcome of the bargaining is no longer predetermined by the structure of the game; rather it is directly influenced by the (potential) application of power to manipulate the positions of the other party. This is why mere emphasis on negotiator's bargaining skill to draw preferred outcomes is out of the general context where international negotiation constitutes a subsystem and why isolated focus on moves and tactics without looking at their sources or underlying capabilities leaves us with hollow explanations. Thus, this section examines the conceptualization of power in international negotiation and the way it affects bargaining outcomes.

To start, noting a persistent theoretical problem with the concept of power is proper. The concept of power in international relations has been largely illusive. Sometimes power was portrayed as national interest; at others, it was designated as the one and only means to achieve national goals.⁹ Nevertheless, it is inevitable to use the concept of power in research. No matter how power may be defined, a guideline to follow is that the concept of power should be not only sufficiently comprehensive but also purposely relevant to the subject in question, if it is to illuminate what happens in the causal process that leads to bargaining outcomes. An easy way to meet this requirement

⁹ A representative of example of such an ambiguous use of the power concept is found in Morgenthau, Hans. 1973. *Politics among Nations*, 5th ed. New York: Alfred A. Knopf.

may be to break the concept of power down into its various components and then utilize the most relevant one in explaining international negotiation.

Power is defined as the way in which actor A uses its resources in a process with actor B so as to bring about changes that cause preferred outcomes in its relationship with B (Habeeb, 1988). This conception of power refers to two elements of power, namely, resources that the states to the negotiation may hold, and their ability to exert influence on the other through the process of interaction. For the part of resources, state's structural capabilities are usually considered—states' potential and actual capabilities and thereby determined relative position vis-à-vis others in the international system. Structural capabilities are a measure of a state's total resources and possessions that states may utilize in various ways in international relations.¹⁰ Thus, power is the result of having resources.

There are of course many elements that make up the potential and actual capabilities of states. In the past, realist writings on international politics have tended to stress military capabilities almost exclusively, although more recently a much greater emphasis has been placed on economic capabilities by so-called neorealists (Waltz, 1979). Regardless of their composition, however, the distribution of capabilities provides not only a picture of the structure of international system but also that of states' behaviors constrained by that structure. Hence, the global hierarchy based on state capabilities was considered to be an essential factor for the analysis of outcomes in international negotiation. For often in negotiations, states' demands and expectations are determined in

¹⁰ Refer to Cline, Ray. 1975. *World Power Assessment*. Washington, DC: Georgetown Center for Strategic and International Studies; Knorr, Klaus. 1975. *The Power of Nations*. New York: Basic Books.; and Organski, A.F.K and Jacek Kugler. 1980. *The War Ledger*. Chicago. The Univ. of Chicago Press for the assessments of structural power.

part by their positions within the hierarchy and corresponding preferences, even before they are directly communicated by any behavior; states usually determine their opening positions, in part, on the basis of evaluation of each other's preferred outcome and possible response (Hopmann, 1996). Thus, structural capabilities operate as a background factor that implicitly affects the behavior of states as they negotiate, even without being explicitly mentioned.

However, possession or existence of capabilities alone does not cause outcomes. They should be used to create outcomes. The capability-based definition of power says nothing about the interaction of actors. A concept of power relevant to negotiation must contain intentionality and anticipated reactions. States' capabilities are meaningful only when states can explicitly utilize them in order to manipulate the negotiation process.¹¹ Power measured in terms of (potential) resources may look different from power measured in terms of influence over outcomes. This is why we must also look at the 'translation' of power in the bargaining process (Keohane and Nye, 1989). This translation of power is what is known as behavioral power, which is related to the 'ability' of the two elements of power.

As the name implies, behavioral power is concerned with the exercise of power: the process by which they maneuver and use their resources to achieve preferred outcomes (Habeeb, 1988). It is through influencing behavior that capabilities are converted from static attributes of states into dynamic instruments that affect interactions in international negotiations. In negotiation, behavioral power is revealed by states' tactics to support their interest relative to the others'. The structural capabilities,

¹¹ The best-known example of non-performing capabilities is Vietnam War. Although the United States possessed preponderant military capabilities, including nuclear arsenals, over Vietnam, it could not win.

channeled through tactics, can directly serve to modify other states' interests. Thus, actual power in negotiations is a combination of the structural power, actor's position at the commencement of the process, and the dynamic or behavioral dimension, namely, changing positions of the counterpart during the course of negotiation.

A problem with the above conception, notwithstanding, is that power is still conceived not only as structural but also aggregate. This conception is useful indeed in picturing an actor's overall ability in international affairs but of limited use in analyzing the role of power in specific international negotiations. It describes power at system level but not at issue and relationship level; that is, by not specifying the scope and domain of power, it "implies either highly fungible power resources or a single dominant issue-area" (Baldwin, 1979). Yet power resources may not be that fungible. What functions as power resources in one policy-contingency framework may be irrelevant in another; the only way to determine whether something is power resources or not is to place it in the context of a real or hypothetical policy-contingency framework (Ibid). From this perspective, the distribution of capabilities for particular issues is likely to better explain the relationship among states and the outcomes of their negotiations.

Determining the relevance of power in international negotiations is in large part issue and issue area in question. Issues in international negotiation seem more broadly defined than in just military and economic terms. Keohane and Nye (1989) say that issues are not the same as delimited objective problems; issues are problems about which policymakers are concerned, and which they believe are relevant to public policy. Thus, an issue is partly circumscribed by a subjective consideration since it needs people, who especially exert influence over policy, to perceive a problem as such. An issue area is

also formed in a similar manner: when a government sees a set of issues as interdependent and deals with them collectively, that set of issues establishes itself as an issue area. Thus, an issue area pertains to actors' beliefs and behavior rather than the objective reality of problems. This is why it is difficult to precisely define the boundaries of an issue area; this difficulty is complicated by the fact that these boundaries can change over time as issues and their groupings change (Ibid).

Despite the prevailing balance in aggregate power between actors, the outcome of negotiation is likely to be determined by the balance of power within that issue area. The premise of issue area power is that power in one issue area loses some or all of its effectiveness when applied to others. Power resources cannot be easily transferred and, thus, may not be fungible. In other words, capabilities relevant to one issue area may not be relevant to another due to the unfixed nature of issue area. Each issue area often has different political structures that are more or less insulated from the overall distribution of economic and military capabilities among states.¹² Within each issue area states will pursue their relatively coherent self-interests, and stronger states in that issue area will dominate weaker ones and determine the rule of the game (Ibid.) A state's net capabilities will be some combination of its capabilities on all dimensions but its effectiveness may also vary from issue to issue depending on capabilities most relevant to producing the negotiated outcomes (Baldwin, 1979). Therefore, it is essential to look at their relative capabilities at issue dimensions beside overall capabilities of individual states.

¹² Difference in political structures of issue area can be influenced even by domestic politics, namely their characteristic patterns of politicization and interest groups that are active in them. For instance, international trade issue usually brings about broader and keener domestic reaction to international bargaining than financial ones, which makes it more difficult to reach an agreement and get it ratified by legislative bodies of the states involved.

Whereas aggregate structural power is concerned with an actor's capabilities and position vis-à-vis the external environment as a whole, issue-specific power is concerned with an actor's capabilities and position vis-à-vis another actor in a specific mutual issue (Habeeb, 1988). Such issue-specific power comes from the structure of bilateral relationship than overall constellation of individual states in the system and, thereby, becomes a particularly relevant component of power to the analysis of international negotiation. When states enter into a bargaining relationship with one another, it is the capabilities in that particular issue-area that ultimately count (Jönsson, 1981). The effectiveness of tactics will also be differentiated issue area by issue area. Their objective is to alter the issue-power balance, since the issue-power balance determines negotiation outcomes.

Summing up, power is an important intervening factor between causes and outcomes. However, power is by no means homogeneous, so the "search for power" takes many different forms, whose characteristics depend in part on the ultimate goals of the actor as well as on the particular contexts within which attempts at exerting influence take place (Baldwin, 1979). We need to apply it in a more sophisticated manner for a better explanation of bargaining outcomes. In this sense, power-as-resources differentiated by issue area appears to be a more appropriate beginning, if not the end.¹³ The conception of power at an issue-specific level is also likely to capture the behavioral aspect of power better than at the structural level.

¹³ It will become clear in Chapter 3 why this is only a beginning, but not an end.

2.3 ASYMMETRY IN RESOURCES AND INTERNATIONAL NEGOTIATION

A general model of bargaining assumes equality and symmetry in power between players so that it is possible to completely interchange them in explaining bargaining process and reach conclusions that need not be distinguished on the basis of difference in power. However, not every negotiation in reality takes place under this condition. As far as our memory stretches out, there have been a lot of negotiations, collectively and bilaterally, among states of different power in the international arena. Therefore, this section will be devoted to discussing the feasibility of applying bargaining theory to asymmetric relations and points to consider in modeling it. This is especially important to consider since the relationship between the IMF and developing countries, which this dissertation is to model with game theory, is fundamentally asymmetric.

The relationship between states of different power, mostly between developed and developing countries dubbed North-South, is characterized not only by conflict of interests but disparity in power. The essence of their relationship is that the two parts of the world are at different stages of development, so that the South produces raw material for industry in the North and sells them at fluctuating prices in order to buy more expensive finished goods from the North. Although the two parties are locked into interdependence through the roles they play in world economy, it is hard to miss that there is neither equality of present status nor equality of opportunity for future, and the inequality of condition is mirrored and magnified by the inequality of capability of changing it (Zartman, 1987a).

With respect to international negotiation, this prevalent inequality and disparity in power does trigger a stereotyped conjecture that states with greater capabilities, *ceteris paribus*, have an advantage over ones without. Indeed, were North-South negotiations only a power play, they could be dismissed as not only unimportant but even uninteresting, given the asymmetrical context (Zartman, 1987b). However, there is a substantial number of cases that the stronger party did not prevail over the weaker in negotiations. Often the outcome of negotiations was closer to the preferences of weaker states, and even when stronger states got their way, it was not always due to their superior capabilities. What this indicates is that even within the basic structure of international system that changes slowly, temporary adjustments may occur and basic patterns of conflictual or cooperative interests may also be subject to short-term changes in emphasis (Hopmann, 1996). In other words, under particular conditions, relatively weak states may utilize temporarily special capabilities that assist them in negotiating with their stronger counterparts, hence, achieve a more or less equal footing on bargaining.

These seemingly anomalous results of international negotiations where the weaker prevail are puzzling in a theoretical venue. They are obviously at odds with traditional power theory and the causes of this problem seem to lie more or less with the conceptualization of power in negotiation, which was discussed in the previous section. The conventional approach to power emphasizes overall distribution of power among states in international system and does not differentiate it significantly among issue areas in world politics. It predicts a strong tendency toward congruence of outcomes among issue areas, since power is considered fungible. Power resources are moved around to secure equal marginal returns in all areas that the stronger are expected to prevail even in

their weak issues by using their overall dominance (Baldwin, 1980). In the conventional conceptualization of power, world politics is treated as a seamless web and power fungibility ensures congruence between the overall structure of military and economic power and the pattern of outcomes on any issue area (Keohane and Nye, 1989). Applying this conception of power, traditionalists have too often jumped directly from the assessment of states' capabilities in a particular negotiation to a conclusion about the outcomes of the negotiation, without examining the negotiation process that intervenes.

Although it is true, indeed, that overall distribution of aggregate structural power plays a key role in many aspects of international relations, by itself it provides a small part of the explanation of successful asymmetric bargaining. Regarding this failure, Zartman (1971) argues that the aggregate power position of a state cannot be directly translated into relevant and available power in any particular situation. The mere existence of superior power resources does not guarantee that they will be effectively used or that the knowledge of their existence will be sufficient to influence the behavior of others. While criticizing the application of traditional conception of power to asymmetric bargaining, Lockhart (1979) maintained that national power must be utilized to create useful options within the context of the specific encounters that states face in order to have any significant influence on negotiation. Thus, asymmetry in power is not the determining factor in negotiation. Rather, the situational relevancy of power resources and the process through which power is channeled into negotiation dominate bargaining outcomes, even if it does not determine them completely.¹⁴

¹⁴ Negotiation theory based on contextual and procedural elements, through which we can gain insight into the process of negotiation itself, was recently developed in Duchesne, Erick. 1997. "International Bilateral Trade and Investment Negotiations: Theory, Formal Model, and Empirical Evidences." Ph.D. dissertation, Michigan State University.

The situational relevancy of power resources brings the concept of issue-specific power of the previous section to any attempt to theorize bargaining between states of different capabilities. It was concluded that power as an intervening factor in the bargaining process has a limited fungibility; power resources in one issue area lose some or all of their effectiveness when applied to others. Issue-specific structural power, i.e., an actor's capabilities and position vis-à-vis another actor in a specific issue area of mutual interest, is a more relevant conception of power to the analysis of international negotiation. By the same token, therefore, the ability of the weak to escape from their definitional inferiority and obtain something from negotiations with the strong, depends more on their power balance in specific issue areas than on overall balance.

Hopmann (1978) illuminates the issue-specific power in depth in the following way: asymmetry refers to a situation not only in which there is imbalance in power resources but also in which control of relations is unequal. This means that the relationship itself between two actors is as important as their overall power resources since the relationship between them is also a source from which each actor can derive its power. Thus, negotiation outcomes are based on the dynamics of actor behavior within the parameters of their relationship. Among other things, unequal costs from failure to agree, combined with unequal capability to modify the structure of the bargaining relationship, are two determining parameters of negotiation outcomes; more precisely, power balance in an issue-specific relationship is determined by alternatives and control. Alternatives denote an actor's ability to substitute relationships with others for the one with the opposing actor in order to gain similar or better outcomes. Thus, despite an aggregate power balance favoring the opponent, the availability of alternatives may

increase actor's issue power by decreasing its stakes at bargaining with the opponent and enable it to achieve its preferred outcomes in a particular issue area. The party that has many options does have an advantage over the opponent.

Control as a determinant of the issue power balance is defined as the degree to which one side can unilaterally achieve its preferred outcome despite the costs involved in doing so. Any interdependent relationship implies that both parties would incur costs if the relationship broke down. However, it does not imply that each actor would suffer the same cost if it happens. Actors are not equally dependent upon each other, so the less dependent actor is in a stronger position than its partner in a particular issue area because changes in the relationship will be less costly to that actor than to its partner. This often gives the actor a significant political resource rather than economic in that the less vulnerable actor will try to use such asymmetric interdependence to gain a greater share of its preferred outcome from negotiation than its opponent.¹⁵ Thus, control is a concomitant effect of asymmetric interdependence that lets the holder obtain more of its preferred outcomes than its opponent does.

A handy example of alternatives and control in international relations can be found in trade: the most common indicator of trade power has traditionally been the degree to which a country relies on exports for its economic well-being, measured in terms of ratio of exports to GDP, and its share in total world exports. However, a

¹⁵ There is a caveat, however, to asymmetrical economic interdependence for political influence over the other state. Wagner argues that, by the logic of game theory, the use of economic interdependence for political influence still requires that the exchange of economic resources for political concession make both parties to a relationship better off than they would be if they bargained over the distribution of gains from economic relationship alone. This means that political influence from asymmetric economic interdependence is independent of the degree of asymmetry in the economic relationship or its direction. For a full explanation, see Wagner, R. Harrison. 1988. "Economic Interdependence, Bargaining Power, and Political Influence." *International Organization* 42, no. 3 (Summer):461-483.

situation more relevant to asymmetric relationship in trade may be the so-called market access. That is, if country A is more dependent on access to markets in country B than B is on A, then B may be in a position to use its relatively lower dependence to exact concessions from A in trade negotiations or to enforce trade agreements by threatening to block A's access to its market, since it would suffer relatively lower costs from cutting off trade with A (Blair, 1993). It is possible for a country to be relatively weak at trade talks, while being relatively strong in terms of competitiveness of its industries, if its economic performance depends on access to foreign markets. Thus, in measuring the distribution of issue-specific power in a set of trade negotiations, the competitiveness of industries under negotiation would not necessarily be considered. Bargaining power in trade would rather be determined by such factors as relative dependence on the markets of opponents and the ability to offer subsidies to domestic exporters and suppliers.¹⁶

Also, in creating useful options in asymmetric bargaining, as Lockhart said, one must pay attention not only to the absolute or the relative distribution of capabilities among states, but also to the specific processes through which differences in capabilities are introduced into the negotiations. There are a number of factors that should be taken into account when evaluating the power balance in international negotiation. Asymmetries in areas outside the issue in negotiation may be of equal importance; intangible, or qualitative, factors that operate at state level may play an important role in the translation of capabilities into control over outcomes, either by facilitating or hindering the mobilization of capabilities (Blair, 1993). Consideration of these variables

¹⁶ Blair examines the impact of each trade issue structure in export credits, agriculture, steel and ship on trade agreements within the multilateral framework of OECD and finds that bargaining positions of OECD member countries tended to influence to a great extent by domestic groups.

has a legitimate place in explaining the outcomes of asymmetric international negotiations. Because the direct impact of power resources on negotiation outcomes are less sure than their advocates would have us believe, it is worth focusing on the process of negotiation where it is combined with economic, political, and institutional determinants and translated into actions to produce particular outcomes.¹⁷

A conspicuous example of such process and outcomes in North-South negotiation was well recorded by John Odell (1980). Using trade negotiations between the United States and Latin American countries, Odell finds an explanation for weak states' victories in types of strategy. He points out three strategies in particular: (1) the Latin American countries often took advantage of the pluralist system in the United States to build domestic allies within the United States to help fight for their cause; (2) in cases in which the Latin American states possessed a commodity of particular importance to the United States, or represented a market of significant size to U. S. exporters, the threat of retaliation often resulted in an enhanced negotiation outcome; and (3) the Latin American states often came to the negotiating table with careful technical preparation and made persuasive technical arguments.¹⁸ This is a sheer dynamic of negotiation between the weak and the strong, how behavioral aspects of power affect the negotiation's outcome. It indicates that countries lacking traditional capabilities such as military and economic resources can compensate for this in part by seeking attractive alternative outcomes through tactics. Weak states are not so inhibited from applying bargaining tactics

¹⁷ Again, Duchesne's dissertation on US-Canada trade and investment negotiations sets a good example of this.

¹⁸ Odell reaches a similar conclusion about US-South Korean trade negotiations. See Odell, John. 1985. "The Outcome of International Trade Conflicts: The U.S. and South Korea, 1961-1981." *International Studies Quarterly* 29:263-286.

strategies as we have thought, either; for instance, weak states can link unrelated issues with lower cost compared with their strong counterparts, partly because their domestic interests are less complex. Such conditions in the weaker states may provide not only a better option if negotiations fail, but also improve their relative position in influencing the outcome of negotiations in a direction favorable to them.

At the closing of this chapter and in bridging it to the next, the following should be borne in mind. If inequality is the nature of the relationship, negotiation is the more appropriate means of changing the structure of negotiation on the margins and of providing new positions that are more satisfactory to both sides (Zartman, 1987a). Although material resources determine the structural power of an actor and its position vis-à-vis the external world as a whole, an actor's power and its position within a relationship is issue-specifically established by the degree of dependence. The extent to which each side can alter its dependence through alternatives and control with commitment can in part compensate for weakness in aggregate power and accordingly bring success in various degrees to negotiations in issue areas.

CHAPTER 3

MODELING CONDITIONALITY BARGAINING GAME

Thanks to the review in the previous chapter, we refreshed ourselves with a sanguine memory of components both endogenous and exogenous to bargaining models based on game theory. Among exogenous factors that facilitate bargaining outcomes, the concept of national power was critically examined and the possibility for bargaining among actors of asymmetric capabilities in international relations was firmly confirmed. Capitalizing on that, we are now well equipped to model bargaining on conditionality agreements between the IMF and developing countries, whose relationship is allegedly asymmetric. Thus, this chapter will be devoted to building a game-theoretic bargaining model for conditionality agreement. A novelty of conditionality bargaining game developed here, however, lies with a refined concept of power, i.e., *leverage*. Hence, it starts with the introduction of leverage theory and its role in conditionality bargaining.

3.1 DEVELOPING A NEW CONCEPT OF LEVERAGE

The general conclusion about the possibility of negotiation among states of different capabilities becomes a prelude to portraying conditionality agreements between the IMF and developing countries as negotiated outcomes. Conditionality intrinsically reflects inequality in power due to the fact that one of the two parties involved is the holder of readily disposable material resources and the other is dependent on those resources for its economic survival. That inequality surrounding the relationship has been

easily taken as the ground to believe that all the developing countries rushing to the IMF for financing would contract much similar conditionality agreements, which are usually imposed by the IMF, and alter their economic policies as directed. To our surprise, however, reality has been quite different from this expectation. The IMF, arguably the stronger party of the two thanks to the abundant resources it controls could hardly be said to prevail over developing countries, the weaker one, in every encounter either to settle conditionality agreements or subsequently implement agreed conditions, as mentioned earlier. When in search for the reason as to why the expectation went awry against the reality, it was found to be related to the conventional conception of national power—namely aggregate structural power—projected on the relationship between the IMF and developing countries.

As a matter of fact, the relationship between the IMF and developing countries is highly confined to dealing with economic policy change, and the resources conducive to forming power are exclusively monetary. To rephrase this along theoretical lines, the relationship between the two is very issue-specific, even though it does not necessarily preclude the possibility of linkage with unrelated issues, which makes their power-balance more or less independent of aggregate capabilities. This is why past attempts to analyze the relationship between the two with the concept of aggregate capabilities have been largely unfruitful. Therefore, conditionality agreements as bargaining outcomes are likely to be better illuminated with the issue-specific concept of power, and theorizing international bargaining at a general level will be similarly benefited, too.

Insofar as the concept of issue-structural power is invoked, that concept needs further tailoring in order to explain bargaining outcomes for two reasons. First, as seen in

the previous chapter, negotiations proceed to reach an agreement for the realization of a common interest through joint decision-making, where conflicting interests are simultaneously present (Ikle, 1964; Brady, 1991; Hopmann, 1996). This means that the core of bargaining situations is reciprocity and the interdependence of decisions, and an appropriate concept of power should be the one that emphasizes both the interdependent nature of bargaining and the importance of relative as opposed to absolute influence (Young, 1968). Strictly speaking, however, issue-specific power is still structural power deprived of fungibility and it remains the same for issue-specific power that the stronger party within a concerned issue area will impose change unilaterally on the weaker. Unilateral achievement of preferred outcomes by issue-specific power does not meet the characteristic of negotiation (Habeeb, 1988). Thus, if we are to explain bargaining outcomes as a causal process with the concept of power, such a concept should capture not only the ability to impose a change without using brute force (Nagel, 1975), but also do it reciprocally, satisfying the fundamental nature of negotiation as a chain of mutual attempts at exercising power.

Second, power is always multidimensional; power varies in degree with respect to scope, weight, domain, and cost (Baldwin, 1985). Analyzing the outcomes of bargaining in terms of power at a single dimension can be misleading. In order to make a meaningful analysis of bargaining outcomes, one must be able to specify who has the capacity to influence in what domain with respect to scope. This concomitantly means that the power relevant to an international negotiation may rest on various bases. Who is affected and on what basis can be determined only by inquiry into the specific content of power in a given situation (Ibid.). There would be situations in which one form of power bases is

100

101

102

103

104

105

106

107

108

109

110

111

112

113

114

115

116

117

118

119

120

121

122

123

indeed sufficient in international relations. Nonetheless, the relative importance of other power bases in bargaining cannot and should not be prejudged.

Bound by the above arguments, this dissertation introduces **leverage** as a concept more relevant to explaining bargaining outcomes. Although leverage is always defined in terms of power, it is nonetheless a distinct form of power (Nachmias, 1988).¹ In bargaining literatures as well as everyday language, the word leverage broadly refers to or is commonly understood as the ability to demand more favorable terms (Werner, 1998). In line with such conceptualization, Barston (1971) noted that a small state's *ability* to resist doing what a larger state wants it to do is a critical source of small state power, even if it does not have the ability to persuade the large state to do something; and Bjol (1971) says that a weaker state's *ability* to hold out, or to ignore a demand made by the stronger state, may allow it to achieve its preferred outcome. These two remarks correctly incorporate mutual influence in negotiation, which takes place without resorting aggregate or issue-structural power. The only problem with this conceptualization of leverage, however, is that it is too vague to empirically test. Its analytical insufficiency becomes noticeable especially when asked what constitutes such ability and how it can be operationalized.

Inferring from the above and refining further, leverage in this research is defined as a state's *capabilities or endowments conducive to changing the outcomes of bargaining within a specific issue area, which otherwise would not occur*. The merits of

¹ Leverage is also different from statecraft. Statecraft refers to the selection of means for the pursuit of foreign policy goals. The main purpose of statecraft is concerned with deciding what kind of policy alternatives available to a decision-maker is most likely to succeed in pursuing a given set of objectives. For an in-depth study of statecraft, see Baldwin, David. 1985. *Economic Statecraft*. Princeton, NJ: Princeton Univ. Press.

this definition are that it allows for not only meeting the nature of negotiation but also providing testable analytical distinctions. First, leverage refers to properties and characteristics of actors as foundation. Of course including capabilities, leverage comprises other capabilities and endowments, both changeable and unchangeable, movable and immovable, and convertible and inconvertible to production capability, such as geopolitical location and historicity.² For that nature of leverage, Barston (1971) remarks that, if a small state occupies territory of strategic importance to a larger state, it may be able to exercise bargaining influence disproportionate to its “objective” capabilities. It is this possessional nature of leverage that easily renders it operationalized without controversy.

Leverage as properties and characteristics needs further explication in two aspects, which distinguishes it from power. While the traditional concept of power exclusively focuses on the positive aspect of national capabilities and endowments, leverage counts not only on positive capabilities and endowments but also on negative or even dysfunctional ones to the holder but can be effectively used in relation to the other. Negative capabilities and endowments, like positive ones, can hold potentials to widen the range of options available to the players in a bargaining situation; the only difference between them would be the extent, usage, and effectiveness. Second, properties and characteristics eligible to be leverage consist of both permanent and temporary ones.³

² Some scholars perceive leverage as the outcome of bargaining. In my dissertation, however, leverage is strictly existing properties or characteristics of states, which affect bargaining outcomes. For comparison, see Nachmias (1988).

³ Vital distinguishes further between “permanent and intrinsic” resources and “ephemeral and contingent” resources. Intrinsic and contingent resources, however, appear to be more or less related to bargaining strategies discussed in Chapter 2 than the properties and characteristics as leverage. See Vital, David. 1971. “The Analysis of Small Power Politics.” in *Small States in International Relations*, ed. August Schou and Arne O. Brundtland. Stockholm: Almqvist & Wiskell.

While the former represents fixed material resources of an actor, the latter time-bound resources, which may be neither available nor useful over time. Agenda for bargaining are different negotiation by negotiation, and we cannot prejudge the importance of the former over the latter in determining bargaining outcomes without considering the issues at hand. Hence, the most relevant and effective resources of states for bargaining cannot be fixed and will be contingently selected against projected goals.

Due to the above natures, possessing leverage does not necessarily mean a permanent shift in the power relationship or a change in tangible power bases between actors. It is frequently asserted that an increase in the power of one actor necessitates a decrease in the power of another actor.⁴ Possessing leverage, however, allows a temporary adjustment within an issue-specific bargaining relationship that may change slowly or not at all⁵ and the pattern of interaction between actors during bargaining may be subject to this adjustment. In other words, under particular conditions, relatively weak states may utilize temporarily special capabilities and endowments that assist them in negotiation and hence achieve their preferred outcomes (Hopmann, 1996). In this sense, the concept of leverage is even different from issue-structural power, which implicitly

⁴ The entire debate on relative and absolute gains between realists and liberalists was tantamount to a debate on whether power is zero-sum. Regarding those debates, see Grieco, Joseph M. 1988 "Anarchy and the Limits of Cooperation: A Realist Critique of the Newest Liberal Institutionalism." *International Organization* 42, no.3: 387-423; Powell, Robert. 1991. "Absolute and Relative Gains in International Relations Theory." *American Political Science Review* 85, no. 4 (December):1303-1320; and Snidal, Duncan. 1991. "Relative Gains and the Pattern of International Cooperation." *American Political Science Review* 85, no. 3 (September):701-726.

⁵ There is a consensus that international negotiations are not single-shot affairs but occur in the context of a preexisting relationship that will be maintained over a long period. Thus, this statement does not preclude a possibility that current adjustment will lead states to reassess their relationship in future encounters, which will influence their dyadic relationship cumulatively. Leverage, when correctly used, may result in more power.

assumes constant power relationship within the concerned issue area, and leverage is exactly what forms the base of relative bargaining strength between states.

Second, another analytic merit provided by the definition of leverage is that it captures the relational or behavioral aspect of power. Negotiation is a process of joint decision-making through two-directional influence, and this perspective directs the focus of attention to the process involved in exercising power rather than to power base. When leverage is defined as such, not only the common fallacy of equating power with simple power bases, whether aggregate or issue-specific, is overcome (Jönsson, 1981), but also strategic action aimed at controlling the other actor's policy choices is implied, which is pertinent to exercising power (Nachmias, 1988). Leverage becomes a means to manipulate negotiation in order to make the other state conform its policy or actions to the desires of the state. Leverage intervenes in the bargaining process and gets the other actor to do something that it would not otherwise do in the framework of interdependency. And it is this relational aspect of leverage that evidences the ongoing influence between the actors and explains why bargaining outcomes are often not in line with objective capabilities.

When leverage is strategically cast by the possessor in order to achieve compliance of the other actor, it is played out through two primary tactics: (1) coercion (a threat of punishment) and (2) inducement (a promise of reward) (Ibid.). Leverage can be combined with tactics as examined in Chapter 2; it can be associated either with threat to inflict cost for non-cooperative behaviors or reward for cooperative behaviors through side-payments and issue linkage in order to manipulate the other actor's choice. The success or failure of bargaining, in other words getting preferred outcomes, is likely to

depend on the skillful application of these two tactics. It is difficult, however, for observers to distinguish which tactic of the two is applied in a bargaining situation since, whereas coercive measures may be used without accompanying inducement, rarely are inducements offered without being preceded or accompanied by coercive measures (Ibid). Leveraged actors are expected to practice the two tactics simultaneously.

Drawing on the above discussion, I argue that the variance in conditionality agreements is a function of leverage rather than issue-specific or aggregate structural power between the IMF and recipient countries. Although there is an ostensibly huge gap between the IMF's and recipients' capabilities, both sides' bargaining power should be measured in terms of leverage and the gap in leverage may not be so big as in capabilities. The versatile leverage appears to be more responsible for the success or failure of conditionality bargaining than the fixed capabilities are, and, thus, more suitable for analyzing bargaining outcomes.

In conditionality bargaining, leverage will enable actors to directly modify a proposal or induce the other to rearrange its preference orderings, which result in different conditionality agreements. This is tantamount to stating that without leverage, conditionality agreements would have been the same across cases. Such a counterfactual consideration makes leverage a necessary condition to the various outcomes of conditionality negotiation. In next section I proceed to model conditionality bargaining framed in game theory in order to show how the two actors reach final agreements and what effect leverage has on conditionality agreements, as exogenous to the game structure, but as a necessary condition.

3.2 A MODEL OF CONDITIONALITY BARGAINING GAME

3.2.1 Strategic Interaction between Donor and Recipient in Conditionality Bargaining

Conditionality bargaining is depicted in Figure 1. Conditionality negotiation consists of two players, the IMF as the donor, and a developing country as the recipient. A recipient government, noted as R, initiates a bargaining game. Facing a severe balance-of-payment gap, a government of developing countries has to decide whom to go for an emergency financial rescue, i.e., multilateral, including regional, financial institutions like International Monetary Fund and World Bank, bilateral aid agencies of developed countries, or international commercial banks. Such a choice forms its initial move that it starts a talk with the IMF, noted as D, by making a proposal (P^R) for structural adjustment, or forgoing to make a proposal ($\sim P^R$). Moving second, the IMF has three options at node 2: first, it can make a proposal (P^D) of its own as a response to the recipient government's. The IMF's proposal could be based on the original proposal by the recipient country or completely new one but usually expected to be tighter than the original since the IMF reinforces conditionality by adding more items. Any modification of the proposal can take the form of qualitative as well as quantitative change of conditions. Second, the IMF can accept the proposal formulated by the recipient government (A^D) as it is, yielding the outcome of Agreement ①. And the last option open to the Fund is refusing to proceed with any type of appraisal or negotiation of the proposal ($\sim A^D$), resulting in $VETO_D$. When veto is announced by the donor, the conditionality bargaining game ends there and the recipient has to reformulate a proposal

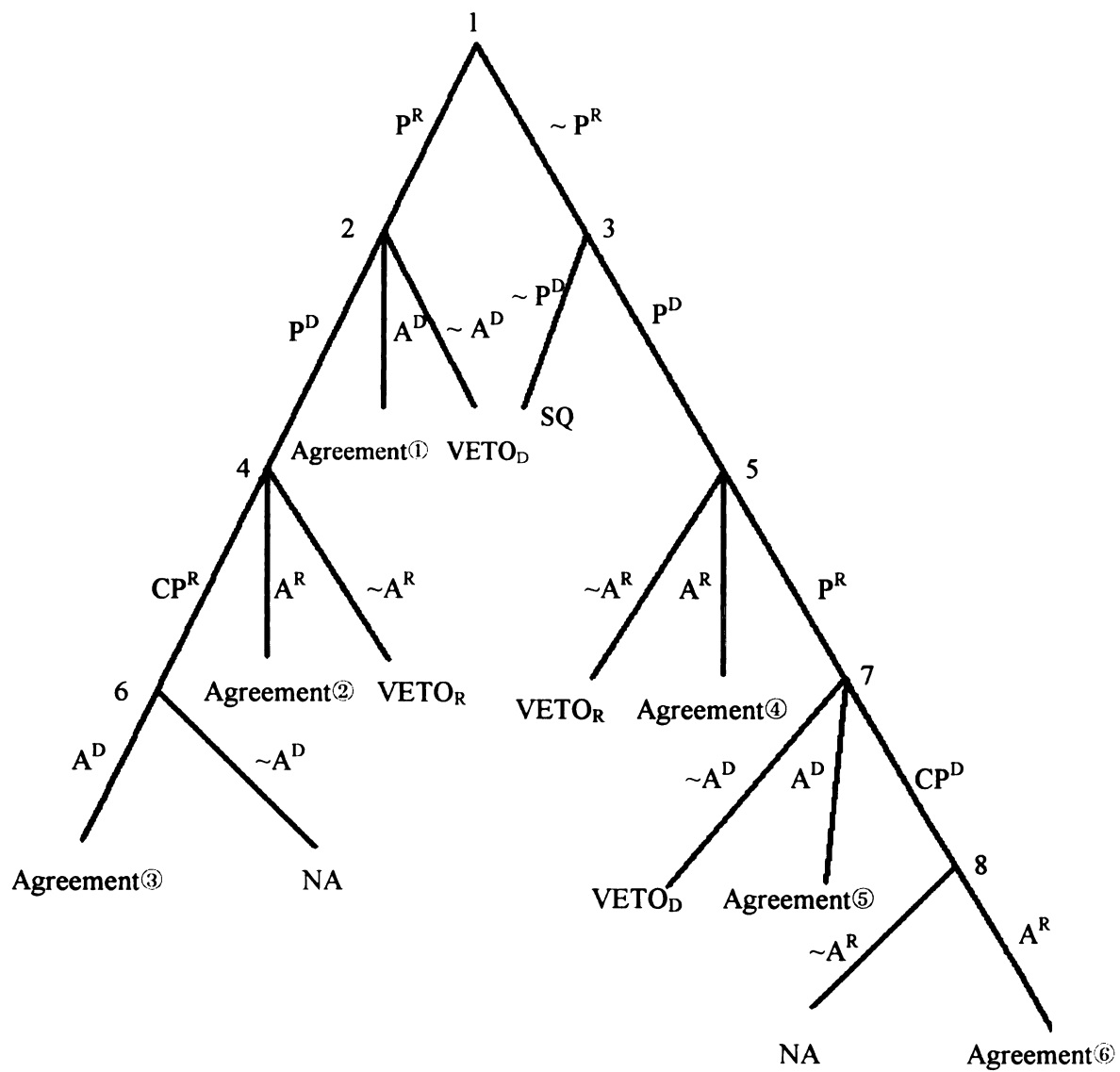


Figure 3. 1 Conditionality Bargaining Game

if it still wants the IMF to bail it out. In the case that the IMF opts for the first, the recipient government at node 4 has to make a choice among three options just as the IMF did at node 2: whether to accept the IMF's proposal (A^R), producing Agreement ②, or to repudiate it ($\sim A^R$), which will result in $VETO_R$, or to formulate another proposal for structural adjustment (CP^R). The counterproposal is equivalent to taking the IMF's proposal back to its original one by inserting its interest to a certain degree, which will eventually pose it at a middle point from each initial position. If the IMF approves the counterproposal by the recipient country (A^D), the conditionality bargaining ends with a policy package, Agreement ③, which has passed through two times of modification from the initial proposal that the recipient country made. If the Fund does not accept the counterproposal made by the recipient country ($\sim A^D$), no specific agreement on structural adjustment is contracted between the two players and the outcome is called NA (Non-Agreement). This situation could occur when negotiation breaks down mainly due to both sides' intransigence.

The other path leading to conditionality agreements is located on the right hand side of the tree. If a recipient country does not make a proposal for structural adjustment ($\sim P^R$) and the IMF does not take any action on it ($\sim P^D$), not only nothing is going on between the players but any effort to revitalize the economic condition of the recipient country occurs without the IMF's involvement. Therefore, the outcome is *Status Quo* (SQ) at node 3. Nonetheless, the IMF can take an initiative for structural adjustment and recommend a policy package to that developing country in exchange for a loan at node 5 (P^D).⁶ This might occur due to either the IMF's ongoing surveillance over member

⁶ A legitimate question at this point is whether bargaining outcomes will be different if the IMF takes the initiative. On the surface, conditionality bargaining initiated by recipient is based on the IMF Articles of

countries or internal lending pressure. At node 5 the options available to the recipient government are three: simply accepting the proposal proposed by the Fund (A^R) in order to alleviate its economic hardship, accordingly yielding the outcome of Agreement ④, or making a counterproposal (CP^R) that modifies the original proposed by the Fund and strengthens its position in relation to the Fund, or disapproving it ($\sim A^R$) so as to yield $VETO_R$. If the recipient makes a counterproposal and the IMF responds to it with acceptance (A^D) at node 7, the bargaining process ends with a conditionality agreement modified from the Fund's proposal (Agreement ⑤). If the IMF repudiates it ($\sim A^D$), even though it initiated the bargaining process, the final outcome of the bargaining is $VETO_D$. However, if the IMF proceeds with another proposal that reinstates its position (CP^D), the recipient will have another chance to make a choice at node 8 and wrap up the bargaining process: if the recipient accepts the second proposal from the IMF (A^R), the bargaining produces an agreement labeled Agreement ⑥; otherwise ($\sim A^R$), all the bargaining efforts from both sides become futile, yielding NA.

Agreement specifying that a member's transactions with the IMF in the General Resource Account take place wholly "on the initiative of such member" and not that of the IMF (Article V, Section 2(a)). Thus, there is no obligation on the member's part to approach the IMF at any specified time with a request for use of its resources. However, this limitation does not preclude the IMF from entering into discussions with a member to explore the desirability of a request for possible use of its resources. This procedure was recognized by the Executive Board in 1992 that the Fund, that is, the Managing Director and staff, acting in accordance with the general policies adopted by the Executive Board itself, might take the initiative in discussing with one or more members transactions which it believes suitable for the Fund and helpful to the members concerned" (Source: Treasurer's Department. 1998. *Financial Organization and Operations of the IMF*. Pamphlet Series, no. 45. Washington, DC: International Monetary Fund). Having all considered, a proper game-theoretic interpretation of this is that the effect of initiative may be some quantitative on the outcome but not qualitative, if a game has infinite rounds. That is, the magnitude of the difference in what the players get may differ slightly, dependent on the modeling approach, but it will not affect which player gets more than the other depending upon the magnitude of other parameters. For a full explanation, see Ståhl, Ingolf. 1994. "The Rubinstein and Ståhl Bargaining Models: A Comparison and an Attempt at a Synthesis." EFI Research Paper 6535. Also, the reason why 'who goes first' does not matter in real conditionality bargaining will be clarified further at the end of this chapter.

In a realistic environment where many developing countries have suffered from protracted balance-of-payments problems and each of them has contracted more than one conditionality agreement, it makes more sense to represent the situation as a repeated game. Under such conditions, the bargaining outcome of a previous encounter may reshape the context as well as the process of the current negotiation. Integrating such a nature of conditionality bargaining, however, would add many complexities to a model that already consisted of many factors. Thus, as a first cut of to modeling conditionality bargaining, this dissertation will be content with a single-shot model but still be attentive to the phenomenon of iterated nature of bargaining and will partly capture it in empirical test later.

3.2.2 Assumptions of Conditionality Bargaining

Modeling conditionality bargaining starts with the assumption of a **unitary and rational actor**. The assumption of rationality here is the same as mentioned earlier, which needs not more explication. It will be enough to give a simple statement that the two players have goals and attempt to realize those goals through their strategic actions that they believe maximize their expected utility.

The unitary actor assumption implies that actions and strategies are chosen by a single, rational leader. This actor is who is actively involved in the bargaining with the other party and responsible for selecting the strategic actions required to implement its objectives to the best of his or her ability, and eventually such decision serves his interest as well. This assumption, however, is posed with a question of who is the final decision

maker and whose interests are served through such decision, if one of the players is an international organization that is composed of member countries. The IMF as an international organization has two active groups of actors. As the first group, we can think of top rankers, who are usually representatives of (powerful) member countries, and, therefore, highly political. As of March 1999, the Fund is composed of 182 member countries. Each country is represented by a governor (usually either the finance minister or a central bank member), whose voting power is determined by the country's capital subscription in the Fund. The Board of Governors exerts ultimate control within the Fund but delegates most of its authority to the twenty-two-member Executive Board headed by Managing Director. Within the Executive Board, through a system of weighted voting, five Directors appointed by the countries with the largest quotas have the most voting power: the United States, Japan, Germany, the United Kingdom, and France. Quota subscriptions from these five countries take around 40% of total fund formation and, thereby, give them equivalent number of votes to cast. The remaining positions within the Executive Board are elected by the Board of Governors. Each Director represents a country or group of countries from the same geographical location and/or with similar economic interests. In routine practice, formal votes are rarely taken within the Executive Board; instead, a general consensus among the Directors is ordinarily achieved on each loan and policy decision.

The second group of actors are "disinterested" and "dispassionate" experts, whose role is to best interpret the financial information at hand in the light of a consistent economic tradition. The day-to-day operational core of the Fund is a staff of nearly 2,700 economists, financial analysts, and functional specialists who work with member country

officials on the formulation of macroeconomic policies suitable for Fund financing and who supervise and monitor the progress of those policies. And in this organizational structure, the Managing Director is especially noteworthy as bridging personnel between the Executive Board and the rank-and-file staff. The Managing Director takes part in conditionality bargaining from the stage of pre-mission preparation through approval of provisional agreements with member countries, and it is by virtue of his role within the institution that he has considerable leeway in the application of Fund principles and brings the Board members and the staff to agree with his interpretation of the problems and appropriate solutions (Stiles, 1991).

In any event it would be absurd to assume that one group or the other dominates the whole process of policy making within the Fund. Rather, these groups share influence on policy making, depending on the circumstances. Nonetheless, on the basis of the organizational reality that the final decision on conditionality, i.e., approving conditionality agreements, is conferred onto the Executive Board, the question of unitarity is solved. This endorsement is supported by the fact that the five major donor countries as a collective actor form the core of the Executive Board.⁷ The bulk of the debt in developing countries is owed to those five countries, and this is true for oil, non-oil, low-income, and middle-income developing countries. As the principal sources of external financing, the major creditor countries exercise enormous control over the overall development finance (Hardy, 1987). In addition to their common ground as

⁷ The effects of unique institutional arrangement within the IMF, weighted voting system and decision-making concentrated in a body of limited size, are discussed in Lister, Frederick K. 1984. *Decision Making Strategies for International Organizations: The IMF Model*. Monograph Series in World Affairs. Graduate School of International Studies, Univ. of Denver. Lister views that such mechanism enabled the Fund to achieve organizational stability and consistency in decision making. This line of assessment broadly supports the unitary actor model.

creditors, there are two more factors that bind them together: high level of consensus on loan program to members and shared economic ideology. In terms of the scarceness of the resources available to developing countries, it is agreed upon among those countries that there must be a way to guarantee the efficient use of resources such as conditionality (Eckaus, 1986). And in conjunction with the rising tide of opposition to “big government” in the United States and United Kingdom, neoclassical economics of the early 1980s in those countries has been conducive to shaping the adjustment policies in recipient countries later on (Nelson, 1990).

As mentioned in Chapter 1, the IMF projects many objectives of different priority.⁸ Which of them will give the highest utility to the IMF? Or is there something else? As long as conditionality is concerned, the IMF’s utility will be maximized if structural adjustment can guarantee the repayment of loans by imposing as many conditions as possible.⁹ The notion of conditionality is designed to encourage appropriate economic adjustment and ensure that the member’s use of IMF credit is temporary and that it will have the capacity to repay the IMF in time. Since the IMF generally makes its financial resources available to countries only in the context of a macroeconomic adjustment program, the conditionality associated with this support should, in principle, strengthen a country’s capacity-to-repay prospects (Gold, 1979; Guitián, 1982; Aylward and Thorne, 1998).

⁸ Recall Polak’s classification of objectives of conditionality as in Footnote 11, Chapter 1.

⁹ The IMF’s utility can be set up differently, depending on how we portray it. For an analysis of the IMF from a narrower public choice model, Vaubel, Roland. 1991. “The Political Economy of the International Monetary Fund: A Public Choice Analysis.” in *The Political Economy of International Organizations*, eds. R. Vaubel and T. D. Willett. Boulder, CO: Westview Press. For an opposite portrayal of the IMF as a honest broker or catalyst, see Nowzad, B. 1989. “The Debt Problem and the IMF’s perspective.” in *Third World Debt: The Search for a Solution*, ed. Graham Bird. London: Edward Elgar; and Vásquez, Ian. 1998. “The IMF’s Dubious Purpose.” *The Freeman* 48, no. 10 (September):600-601.

Such utility for the Fund has practical supports, too. The IMF obtains its usable funds from three sources: quota subscriptions from member countries, income (periodic charges on the use of Fund resources and service, etc), and borrowing from member countries to provide a temporary supplement to usable quota resources. In the past, the IMF has experienced a new development in its financial soundness, the growing problem of arrears. The failure of some member countries to repay obligations on time, which was a problem only to other creditors, became a matter of serious concern for the IMF toward the end of the fourth decade of the IMF's history—around the mid-1980s, a few years after the debt crisis began. Until 1983, only one member country had experienced protracted arrears to the IMF, and a handful of others, arrears of short duration. Then, every year from 1983 until 1990, the amount of outstanding overdue obligation to the IMF grew substantially. Total arrears rose from SDR 25 million in the first quarter of 1981 to a peak of SDR 7 billion in 1992 (5 billion in US dollar), which was equivalent to almost an eighth of the Fund's total outstanding credits. Since 1992 the level of arrears fell sharply, and from 1995 to present, it has changed little. Thus, over 1989-90 the IMF's Executive Board developed a strengthened cooperative strategy to resolve the problem of protracted overdue obligations to the IMF¹⁰: the IMF affirmed that the Fund's policy of non-toleration of arrears to official creditors remained unchanged and emphasized that countries should build up their reserves in order to ensure that they will be able to meet their commitments to the Fund.

¹⁰ For a description of the main elements of this strategy and its implementation, see IMF *Annual Reports* (1991 and onward). One of IMF measures to enhance recipients' debt service to the IMF is adjusting the rate of charge on the use of IMF resources. The rate of charge has been adjusted up- or downward in line with the size of overdue payments. Although those charges are refunded when overdues are paid, such adjustments are intended to protect the IM's financial assets by encouraging members to meet their financial obligations to it.

the an

provid

perce

mane

group

man's

for de

paym

devel

relat

along

questi

Direct

This

from

search

1998

zone

foreign

with

However

machine

The Fund's utility associated with loan repayment can also be well justified with the amount of credits from the Fund to developing countries. Although the Fund may provide significant amounts of financial assistance to individual countries expressed as a percentage of their balance-of-payments current account deficits, it has provided only a rather small amount of assistance relative to the deficits of developing countries as a group. While the IMF has been a quantitatively significant source of finance to some individual developing countries at certain times, it has been quantitatively insignificant for developing countries as a whole when assessed against the size of their balance-of-payments deficits and financial flows from other sources (Bird, 1995). At a time when developing countries have experienced severe payment difficulties, the Fund's financial relationship with developing countries was rather as a net recipient of return flows than as a large net provider of assistance (Killick, 1995; Sachs, 1989).¹¹

What then makes the IMF so keen about loan repayment? No one can answer this question more tersely than the IMF's own staff, Stanley Fischer, First Deputy Managing Director (1998a):

Let me emphasize that the IMF is not a charitable institution, nor does it carry out its operations at taxpayers' expense. On the contrary, it operates much like a credit union. They [member quotas] are often described as an expense to the taxpayer. We are deeply aware in the IMF that our support derives ultimately from the legislatures that vote to establish their

¹¹ This is also graphically shown in Figure 7 in *IMF Annual Report* (1998, p. 88). During the period (1985-1990) when structural adjustment following debt crisis was at its highest peak, the Fund was receiving repurchases (repayment) more than purchases (loan) by about 100%. This trend was reversed in the early 1990s with a small gap, and repurchases picked up again in 1994. For a better terminology, none of the above transactions is technically a loan because each is part of a country's quota. A country purchases foreign currencies and SDRs with its own currencies and then, over time, has to repurchase its currency with foreign currencies or SDRs. Consequently, the transactions are not legally or operationally loans. However, these purchases and repurchases are similar to loans and repayments, and they are often, either mistakenly or out of convenience, referred to as loans.

Asio

whit

to ex

intern

occum

end w

interd

new fa

high

the A

grad

in to

had

de

P-

inf

agene

is y

countries' quotas—their deposits—in the IMF. We must justify that support.

As long as an international organization depends on members' donation for its operation, which requires approval from domestic legislative body, it is so natural for larger donors to exert pressure on that organization to show productivity and efficiency and for that international organization to respond to such pressure in one way or another. Under the circumstances, the IMF has chosen a high rate of loan repayment as a proof of efficiency and worth for continued support.

At a glance, this goal that the IMF projects on conditionality is contradictory to its imperative to circulate the subscription from member countries, who even established a new facility in the 1970s in order to stimulate developing countries to use the IMF's high-conditionality resources. However, when we look at these from the perspective of the IMF's overall institutional purpose, financing mandate, repayment as the pursued goal of conditionality is not odd at all. Simply put, the IMF needs to keep funds flowing in to circulate it. Guaranteeing repayment is nothing but a prerequisite to implement its financing mandate.

The counterpart unitary actor in the recipient country is the national leader who decides what foreign economic objectives to choose and what strategy to implement in pursuit of those objectives. Even if we assume the existence of various sources of influence on economic policy such as domestic political process, the unitary actor is an agent charged with implementing actions in pursuit of whatever the objective may be. In a word, the unitary actor in the recipient country is who is actively involved in the

bargaining with the donor agencies and responsible for selecting strategic actions required to implement the society's objectives to the best of his or her ability.

The unitary actor assumption has a special implication to the goal that the recipient pursues through conditionality bargaining. Each nation's chief executive, whether a monarch, a dictator, or a freely elected representative of the people, acts as if his or her welfare and the preferences of those whose support is needed to retain power were the same (Bueno de Mesquita and Lalman, 1992). National leaders have strong personal incentives to tie their own actions to the general welfare of their supporters who become his or her power base.¹² Under prospectively tough circumstances the structure of the situation procreates to all leaders a significant interest in maximizing those interest of the state that ensures for themselves the opportunity to survive in a leadership position and the concomitant opportunity to pursue their more individualistic preferences. During structural adjustment, various demand-curbing measures hurt particular groups within the society, although the pain inflicted by policies of financial restraint is likely to be widely distributed. The identity and the power of distributional coalitions important to any particular adjustment effort vary with the structure of the economy (Haggard, 1985). Against the expected pressure from groups that are hurt by such measures, not all leaders are able to marshal a sufficiently strong coalition of broad segments of the population that can be expected to benefit from the structural adjustment measures and from the avoidance of excessive reliance on demand-management policies, which is critical to

¹² The concept of support base is not identical with popularity, which usually fluctuates, and predictably falls if adjustment is pursued. Rather, the term refers to groups bound to the regime by more durable ties of ethnic identity, ideological compatibility, ingrained party loyalties, and/or patron-client networks. For further discussion of political support base and structural adjustment, refer to Nelson, Joan M. 1988. "The Political Economy of Stabilization: Commitment, Capacity and Public Response." in *Toward a Political Economy of Development: A Rational Choice Perspective*, ed. Robert Bates. Berkeley: Univ. of California Press.

their continued political survival. For this reason, the would-be borrowers prefer to use traditional macroeconomic policies to more intrusive measures of structural adjustment (Polak, 1991).¹³ Therefore, aware of possible political turmoil and temporary or enduring adversary effects on economy, which will have certain impact on his stay in power, the utility of conditionality agreement will be maximized for the leader when it consists of a substantially large amount of loan but few conditions. Such a conditionality agreement would not only cover the country's projected balance-of-payments gap, but also allow him to utilize the resources in ways that may prolong his leadership at the same time (Mosley, 1988).

In any event, however, it should be noted that these utilities are highly simplified extreme cases. Needless to say about individual recipient countries, even the IMF may pursue different goals from each agreement depending on who is the other part of the negotiation and where a particular agreement fits into the bigger picture of international political economy. Such particularistic aspects of individual bargaining, however, have to be dropped in deriving the goals of conditionality bargaining for schematic as well as generalizable presentation's sake. These utilities have only the benefit of facilitating analytical tractability and predictability of the bargaining model. Also, those goals were deliberately chosen since they appear more or less common and pivotal across individual conditionality agreements, on top of their substantive issues at stake, and, empirically,

¹³ Macroeconomic measures to restore equilibrium of economy are traditionally demand control through monetary instruments such as money growth and credit and fiscal restraint. These measures spread the adjustment burdens throughout the society. On the other hand, structural measures or so-called supply-side economics are to enhance efficiency in resource allocation through strengthened role of market, for example, privatization, liberalization, and exchange rate changes. Structural measures tend to hurt special interest groups.

comparison of costs and benefits from conditionality agreements becomes easy. Therefore, they are simplifying, not problematic.

Other than the above fundamental assumptions of game-theoretic modeling, which are reconstructed in the context of conditionality bargaining, particular assumptions relevant to this research are specified below:

Assumption 1: As utility maximizers, players choose strategies to get the outcomes that they believe maximize the expected utility under the circumstance where their choice of action is constrained by the other player's strategies. The players anticipate the consequences of their action in terms of reaction from the other player to the chosen course of action.

Assumption 2: The desirability of a conditionality agreement is determined by the number of conditions and/or the toughness of specific conditions and the amount of agreed loan, which can be traded off. However, an agreement that is regarded as desirable by one actor is not necessarily undesirable to the other.

Assumption 3: Both players prefer to reach an agreement on conditionality rather than to come to a rupture in which no specific agreement on conditionality and, accordingly, on loan is contracted between the two players at the end.

Assumption 4: A package deal of policy reform is an outcome of strategic interaction between the two players who maximize their expected utilities. Hence, the utility of a conditionality agreement is not known with certainty and yields an expected value, assessed according to the subjective probability of reaching conditions preferred by one player (P^i) and the subjective probability of reaching conditions preferred by the other ($1 - P^i$). Such probabilities are restricted between 0 and 1 ($0 < P^i < 1.0$).

Assumption 5: The conditionality bargaining process is characterized by efforts to modify a proposal in a way that accommodates one actor's needs more. However, the

ultimate magnitude or materialization of such modification during bargaining, which is noted as γ (>0), is not known with certainty. Rather it is directly influenced by the probability each player projects on the negotiation. Therefore, it is $\gamma_i P^i$.

Assumption 6: Each bargaining outcome can be associated with potential costs. Three types of costs, domestic political costs (θ), reputation costs (ϕ), and opportunity costs (β) will selectively affect players' utilities for bargaining outcomes. All these cost terms are greater than zero and will be restricted by the subjective probability (P^i) in the form of $\theta_i(1 - P^i)$, $\phi_i P^i$, and $\beta_i P^i$.

Assumption 7: Conditionality bargaining takes place over several time periods. The utility of an outcome after one time period is discounted by δ , which falls between 0 and 1. The sooner actors reach desirable outcomes, the more utility the outcome brings to the actors.

Assumption 1 stipulates that we are dealing with decisions made in a game-theoretic manner. Regardless of the internal political or organizational processes involved, conditionality bargaining carries with them the promise of economic policy change made according to coherent, well-ordered preferences.

In Assumption 2, unlike many studies of conditionality that assume only conflict of interest and thereby make it convenient to advocate the coercive nature of conditionality, this model is not predisposed to either a conflict or harmony of interests between the two players. By the partly supplementary nature of goals that the IMF and recipient countries pursue respectively, structural adjustment could be portrayed as economic interdependence that involves a possibility of joint gains and joint losses. The joint gains here mean that recipient countries could improve their economies with loans contracted with the IMF and the IMF, on the other hand, could get its funds circulated

and collect accrued interest. The joint losses would be that such gains are not realized and rather costs are inflicted by failing to agree. Mutual awareness of their potential gains and losses can limit the danger of worsening each actor's position through overly rigorous struggles over the distribution of the gains. Their mixed motivation is evidenced by the fact that around half of the agreed conditions has been adhered to, which indicates that their interests converge at some points and diverge at others. Therefore, the nature of the conditionality bargaining game is not fixed in the sense of zero-sum or constant sum.

In relation to the unfixed nature of the conditionality bargaining game, the utilities of winning its own demand on conditions, $U'(\Delta_i)$, and accommodating the other's, $U'(\Delta_j)$, should be explicated in comparison with the status quo. The preceding situation to conditionality bargaining is internally and/or externally perceived economic hardship in the prospective recipient country, which has latent costs to leaders in power. The value of leaving economic problems unsolved, which represents *status quo*, is weighed against costs involved in structural adjustment and can make it more attractive or less than accepting the donor's demand for policy change. The recipient country admits a certain need for economic policy change but wants to pick palatable ones out of a wide range of policy options from the consideration of ensuing costs. From this, what determines the utility of accepting the donor's demands on structural adjustment is the similarity between economic policies pursued by both players. The more similar the patterns of revealed economic policy choices of two players, the smaller the utility of winning any demand that one player makes on the other and, concomitantly, the smaller the difference between $U'(\Delta_i)$ and $U'(\Delta_j)$ or vice versa. Conversely, the more dissimilar the revealed economic policy commitments of two players, the greater the assumed utility for

achieving the conditions contained in his demand and the greater the difference between $U'(\Delta_i)$ and $U'(\Delta_j)$ or vice versa. A real life parallel is the unorthodox adjustment implemented by large debtors in Latin America in the 1980s, which indicates a big difference between $U'(\Delta_i)$ and $U'(\Delta_j)$. This is an essential collateral of conditionality bargaining that is neither necessarily zero-sum nor nonzero-sum game. Thus, the relationship of $U'(\Delta_i)$ and $U'(\Delta_j)$ is not automatically opposite, and the utility of accepting the other's demand, $U'(\Delta_j)$, is not predetermined to be inferior to status quo.

This logic can also be used to determine the nature of the (initial) proposals made during bargaining. The intensity of one's interest inserted in the proposals is not predetermined simply by the fact that one is making a proposal but under what conditions the one is making the proposal. In other words, the strength or weakness of the proposer's interest stated in the proposal is determined purely by economic urgency for contracting a conditionality agreement to get a turbulent economic period over, or concoction of politico-economic calculations based on leverage available, which may overshadow economic needs and make the difference between $U'(\Delta_i)$ and $U'(\Delta_j)$ various. A recipient country can make a proposal that is immediately acceptable to the IMF from its judgement that it lacks leverage and needs strict guidance from the Fund in order to improve its economic conditions. In a similar vein even when the Fund initiates a negotiation, it can propose a proposal from certain needs that can be accepted by a recipient country without resistance.

Assumption 4 is concerned with the probability of a recipient or a donor being ultimately successful in gaining its goals, given the alternative combinations of strategic choices by the other player. The probability of succeeding in bargaining is a function of

the possession of the financial capabilities the players expect to have available, although there could be other factors that influence the subjective probability of success in conditionality bargaining. The value of negotiation lottery is, then, the expected compromise outcome of negotiation. In negotiation, neither player anticipates satisfying his or her initial demand intact.

Assumption 5 is showing negotiation or bargaining as the process of altering and modifying values. The modification term, γ , is based on the concept of leverage and developed so as to measure value change and creation process. This also incorporates the concession-convergence process into the model, which was discussed in the previous chapter.

In Assumption 6, I assume that the conditionality bargaining involves costs. All types of anticipated costs vary as a function of each side's subjective estimates of probability of success (P' , P') and of the value it attaches to *status quo*. First, any resources used to produce certain goods cannot be used to produce others. The values of the forgone goods measure the cost of that economic activity. The opportunity materializes 'alternatives' of bargaining theory mentioned in the previous chapter. Alternatives denote an actor's ability to substitute relationships with others for the one with the opposing actor in order to gain similar or better outcomes (Hopmann, 1978). The availability of alternatives may increase actor's bargaining power by decreasing its stakes at bargaining with the opponent and enable it to achieve its preferred outcomes. The opportunity cost is equal to giving up alternatives. To apply this concept to developing countries engaged in conditionality bargaining, opportunity cost, β , represents lost opportunities to bargain with other private and/or bilateral donors, who are known for

softer conditionality, while negotiating with the IMF. On the other hand, for the IMF who is known to be under two kinds of institutional pressures, i.e., disbursing fund and ensuring loan repayment by recipients, the opportunity cost means losing chances to lend its fund to a creditworthier candidate and receive consistent debt service from it. Since opportunity cost is equal to the value of the required resources in their best alternative use, it has a positive relationship with the subjective probability of gaining the preferred conditionality ($\beta_i P'$).

Domestic political cost, θ , comes from two sources as follows: Basically, the introduction of intrusive adjustment to alter the state of economic affairs is likely to prompt domestic opposition unless the *status quo* is extremely unbearable. Furthermore, leaders of leveraged states are likely to face greater cost at the introduction of an adjustment program compared to those of unleveraged states, all else being equal. The rationale behind this is that capable states are in a better position to achieve what they want through other measures and at least to manage a relationship with the donor. However, if they subject themselves abruptly to foreign economic pressures, not only failure of their economic policies is publicly declared but so is failure to capitalize on their leverage in managing their relationship with the international donor. After all, self-supported economic policy change is generally preferred to one foreign-planted.

The second source of domestic cost is the well-known side effect of structural adjustment: any policy package for structural adjustment is bound to have various distributional impacts on different social segments within the society and this sometimes threatens the stability of the regime in developing countries implementing adjustment policies (Bienen and Gersovitz, 1985). Leaders of prospective recipient countries are

aware of this and try to contract conditionality agreements that minimize domestic political costs.¹⁴ In any event, however, the actual magnitude of political costs will be adjusted by the subjective belief one has regarding the prospect of success. In particular, one's anticipated political cost will decrease as the relative probability of gaining a preferred conditionality rises. This relationship is captured in $\theta_i(1 - P^i)$. The anticipated losses from conditionality in the form of political instability and economic adversity will also vary with leverage. The irony here is that a developing country will suffer from this cost even when it fails to strike a conditionality agreement with the IMF, because it does not get a loan it needs for its economic revitalization.

On the other hand, reputation cost, ϕ , is a different form of political cost, which only the IMF will pay. There are a few cases when the Fund should be concerned about its reputation: the Fund can be criticized for being harsh during bargaining; its inconsistent treatment of recipient countries in conditionality bargaining can also give it a bad reputation; and defaulted debt service to the Fund and consequential financial loss will raise questions about the soundness of its lending decisions and lessen its creditworthiness in the international financial community that it is expected to lead. In all these cases, the reputation cost increases with the probability that the Fund will obtain its preferred conditionality agreement. Thus, $\phi_i P^i$.

Recipient countries are exempt from this cost for two reasons: first, repetition of similar programs in developing countries indicates that present transactions with the IMF

¹⁴ The inclusion of domestic political cost is not to argue for a systematic relationship between the introduction of Fund-supported adjustment program and political instability, as studied by Bienen and Gersovitz and Sidell (1988). Regardless of its direct causal relationship to political instability, domestic political cost means to incorporate (temporary and/or lasting) abnormal political reactions that could coincide with the introduction of an adjustment program and worry politicians in power.

are not influenced much by poor performance, namely not meeting performance criteria, in past IMF programs. Rather, a case that the IMF hesitates or is inhibited from striking agreements with a recipient is that it neglected its financial obligation as a member to the IMF. The IMF has a track record of suspending members' eligibility to use its general resources and voting rights due to overdue quota payment or loan repayment. Once these arrears are paid off, however, the IMF resumes the members' voting rights instantly and even arranges new financial programs for them.¹⁵ Second, a recipient's reputation is already reflected on its opportunity cost. The opportunity cost is in direct relationship with the size of financial windows open to the recipient, and the presence of opportunity cost to pay altogether connotes its good reputation in international financial markets as a creditworthy borrower. Thus, it is not necessary to add reputation cost term to recipient's expected utility function.

Assumption 7 is needed to materialize the players' willingness to continue a bargaining with an expectation of a better outcome. Both players expect the chances for a more preferable conditionality agreement to increase, as they continue to negotiate. These chances, however, are realized with certain costs and players have to decide when to stop bargaining and accept the result. The volume of discount rate will also be an indicator of the position that a player holds in conditionality bargaining on the basis of bargaining leverage.

¹⁵ Announcements of suspension of members' voting rights due to neglected financial obligation and immediate resumption following fulfillment are found in various issues of *IMF Survey*. To name them, Guyana (1985), Sudan (1990), Zaire (1994) are just a few among many.

3.3 EXPECTED UTILITIES AND PREFERENCES IN CONDITIONALITY BARGAINING

While reviewing bargaining theory, it was confirmed that, as joint decision-making, negotiations are risky events involving compromise in that one can expect to obtain something between one's own demands and the demands made by the other actor. This makes bargaining outcomes expected utility. The expected utility is calculated as the sum of value gained if one's demands are won, weighted by the subjective probability of winning (P'), and value gained if the opponent's demands are won, which is weighted by the subjective probability of losing ($1 - P'$). The expected utilities of conditionality bargaining game are formed in this spirit with cost terms added.

3.3.1 Expected Utilities of Outcomes

The recipient and the donor realize gains and losses according to the strategies available to them. As stated in the assumptions, those gains and losses involve certain costs that reduce the utility of the demand the players make and are cast as probabilistic payoffs except for combinations of strategies that lead to immediate acceptance of the proposal (Agreement ① and ④), VETO, maintenance of *status quo*, and Non-Agreement. The values that each player associates with the event at each of the terminal nodes are provided below:

Expected Utilities for a Recipient Country i

SQ: $U'(SQ)$

VETO_D: $-\theta_i(1 - P') + \beta_i P'$

VETO_R: $\beta_i P'$

NA: $-\left[\theta_i(1 - P') + \beta_i P'\right]$

Agreement ①: $U'[\Delta_i - \theta_i(1 - P') - \beta_i P']$

Agreement ②: $\delta_i \{P' [U'(\Delta_i - \theta_i(1 - P') - \beta_i P')] + (1 - P') [U'(\Delta_j - \theta_i(1 - P') - \beta_i P')]\}$

Agreement ③: $\delta_i^2 \{P' [U'(\Delta_i + \gamma_i P' - \theta_i(1 - P') - \beta_i P')] + (1 - P') [U'(\Delta_j + \gamma_i P' - \theta_i(1 - P') - \beta_i P')]\}$

Agreement ④: $U'[\Delta_j - \theta_i(1 - P') - \beta_i P']$

Agreement ⑤: $\delta_i \{P' [U'(\Delta_i + \gamma_i P' - \theta_i(1 - P') - \beta_i P')] + (1 - P') [U'(\Delta_j + \gamma_i P' - \theta_i(1 - P') - \beta_i P')]\}$

Agreement ⑥: $\delta_i^2 \{P' [U'(\Delta_i - \theta_i(1 - P') - \beta_i P')] + (1 - P') [U'(\Delta_j - \theta_i(1 - P') - \beta_i P')]\}$

Expected Utilities for a Donor j

SQ: $U^j(SQ)$

VETO_D: $-\phi_j P' + \beta_j P'$

VETO_R: $\beta_j P'$

NA: $-(\phi_j P' + \beta_j P')$

Agreement ①: $U^j(\Delta_i - \phi_j P' - \beta_j P')$

Agreement ②: $\delta_j \{P' [U^j(\Delta_j + \gamma_j P' - \phi_j P' - \beta_j P')] + (1 - P') [U^j(\Delta_i + \gamma_j P' - \phi_j P' - \beta_j P')]\}$

Agreement ③: $\delta_j^2 \{P' [U^j(\Delta_j - \phi_j P' - \beta_j P')] + (1 - P') [U^j(\Delta_i - \phi_j P' - \beta_j P')]\}$

Agreement ④: $U^j(\Delta_j - \phi_j P^j - \beta_j P^j)$

Agreement ⑤: $\delta_j \{ P^j [U^j(\Delta_j - \phi_j P^j - \beta_j P^j)] + (1 - P^j) [U^j(\Delta_i - \phi_j P^j - \beta_j P^j)] \}$

Agreement ⑥: $\delta_j^2 \{ P^j [U^j(\Delta_j + \gamma_j P^j - \phi_j P^j - \beta_j P^j)] + (1 - P^j) [U^j(\Delta_i + \gamma_j P^j - \phi_j P^j - \beta_j P^j)] \}$

The basic logic that forms the utilities of VETO_D, VETO_R, and NA is that these outcomes do not produce conditionality agreements and neither player's demands or preferred conditions (Δ_i and Δ_j) are completely fulfilled. Thus, they do not include any demand term. Facing a huge gap in their preferences, the players may be better off by not negotiating rather than hammering away incessantly at intractable problems. Neither would be prepared to accept the other's offer as it stands, and both might perceive that nothing would be gained by continuing negotiations in search for better terms; this leaves them only one option—breaking off negotiations by vetoing. In the case the conditionality bargaining comes to rupture by the recipient's veto, that developing country must be confident of breaking through its economic hardship even without bailout by the IMF. Such a recipient may also make domestic political cost caused by its veto almost obsolete. On top of this, this rupture leaves alive opportunities to contact with other bi- and multilateral donors. Therefore, the expected utility of veto by the recipient consists of spared opportunity cost. On the other hand, forced to leave the bargaining table by veto from the donor, the expected utility for the recipient is composed of negative domestic political cost in addition to spared opportunity costs. This is related to two sources of domestic political cost mentioned above: if the recipient is leveraged, its source of domestic political cost is the first type. Its leverage should have properly managed to have the bargaining done with Agreement ①. This is a case of

mismanagement. If the recipient country is unleveraged, the origin of political cost lie with continued economic hardship with no-loan situation, which it can no longer afford.

On the donor side, veto by the recipient does relieve it from worry about reputation cost for being tough with the recipient during negotiation. It may be the recipient country that could be blamed for its uncooperative behavior, not the donor. So the expected utility for the donor is formed only with opportunity costs put aside. If the donor vetoes a conditionality agreement, on the other hand, it should expect to incur consequential reputation cost, even if it spares opportunity cost. So, the combination of negative reputation and opportunity is the utility for the donor when the bargaining ends abruptly by its veto.

Non-Agreement has similar disastrous utility for both players. Their desire to win in the competitive negotiation, claiming more value than they really can achieve, would have prevented them from reaching a progressive agreement in which they both could have created a mutually valuable deal. What is worse is they should presumably walk away even after squandering all other opportunities to sound out other windows of financial contracts while engaged in a long, drawn-out and tough bargaining process that failed anyway. Therefore, the cost for lost opportunities is added to domestic political and reputation cost from the failure as the utilities for the recipient and the donor respectively.

3.3.2 Preference Orderings and Restrictions in Conditionality Bargaining

The above assumptions imply that certain restrictions are applied to the ten outcomes in terms of the order of preferences that leaders are allowed to hold. First, the

ranking of SQ is very flexible in relation to all other outcomes except for Agreement ①. A rationale for this is that for the recipient the *status quo* is equivalent to ongoing economic hardship regardless of the degree of severity, which may or may not involve explicitly detrimental costs to the leader of the country. This situation could be potentially problematic to the regime in power but, fortunately, has not been reified yet. In addition to this, opportunities for economic rescue by international donors are not consumed at all. Therefore, the placement of SQ can be moved up or down according to the leader's perception of the situation.

Second, among the non-negotiated outcomes of $VETO_R$, $VETO_D$, and NA, $VETO_R$ is preferred over the others by the recipient since it results in saved opportunity costs:

$$VETO_R - VETO_D: \beta_i P^i - [-\theta_i(1 - P^i) + \beta_i P^i] = \theta_i(1 - P^i) > 0 (\because \theta > 0, 0 < P < 1)$$

$$\therefore VETO_R > VETO_D.$$

$$VETO_D - NA: -\theta_i(1 - P^i) + \beta_i P^i - [-\theta_i(1 - P^i) - \beta_i P^i] > 2\beta_i P^i (\because \beta > 0, 0 < P < 1)$$

$$\therefore VETO_D > NA.$$

Accordingly $VETO_R > VETO_D > NA$. $VETO_R$, however, is always inferior to Agreement ① due to the assumption stating that both players prefer to reach an agreement on conditionality rather than to come to a rupture.

Third, among the cooperative outcomes, Agreement ① is superior to all others for a recipient country. This outcome is so, since negotiations are evaluated as the expectations from a lottery over the demands made by both parties. Negotiated outcomes

are never obtained with certainty, and the probability of gaining its full demand is never equal to zero or one: $0 < P < 1.0$. As P^i approaches arbitrarily close to 1.0, a recipient country i prefers Agreement ① to the other negotiated outcomes:

$$U'[\Delta_i - \theta_i(1 - P') - \beta_i P'] > P'[U'(\Delta_i - \theta_i(1 - P') - \beta_i P')] + \\ (1 - P')[U'(\Delta_j - \theta_j(1 - P') - \beta_j P')] \\ U'[\Delta_i - \beta_i P'] > P'[U'(\Delta_i - \beta_i P')].$$

Gaining one's demands with certainty when the other party accepts them is preferable to negotiating and obtaining them with something less than certainty or obtaining something less than the initial demand. Thus, the remaining negotiated outcomes are inferior to Agreement ①.

Fourth, with the same components of utility functions, the preference for Agreement ③ over Agreement ⑥ is determined by the existence of modification term, γ , after all other components are canceled out:

$$\delta_i^2 \{ P'[U'(\Delta_i + \gamma_i P^i - \theta_i(1 - P') - \beta_i P')] + (1 - P')[U'(\Delta_j + \gamma_j P^j - \theta_j(1 - P') - \beta_j P')] \} \\ > \delta_i^2 \{ P'[U'(\Delta_i - \theta_i(1 - P') - \beta_i P')] + \\ (1 - P')[U'(\Delta_j - \theta_j(1 - P') - \beta_j P')] \} \\ \gamma_i P^i > 0 (\because \gamma > 0, 0 < P < 1).$$

Through the same process above, Agreement ② is inferior to Agreement ⑤:

$$\begin{aligned} & \delta_i \{ P^i [U'(\Delta_i - \theta_i(1 - P^i) - \beta_i P^i)] + (1 - P^i) [U'(\Delta_j - \theta_i(1 - P^i) - \beta_i P^i)] \} \\ & - \delta_i \{ P^i [U'(\Delta_i + \gamma_i P^i - \theta_i(1 - P^i) - \beta_i P^i)] + \\ & (1 - P^i) [U'(\Delta_j + \gamma_i P^i - \theta_i(1 - P^i) - \beta_i P^i)] \} < 0 \\ & - \gamma_i P^i < 0 (\because \gamma > 0, 0 < P < 1). \end{aligned}$$

Fifth, relationships between Agreement ② and Agreement ③, Agreement ⑤ and Agreement ⑥, Agreement ② and Agreement ⑥, and Agreement ③ and Agreement ⑤ are not determined due to the unknown magnitude of γ , θ , β and δ in addition to $U'(\Delta_i)$, $U'(\Delta_j)$, and P^i . For instance, the comparison between Agreement ② and Agreement ③ results in:

$$\begin{aligned} & \delta_i \{ P^i [U'(\Delta_i - \theta_i(1 - P^i) - \beta_i P^i)] + (1 - P^i) [U'(\Delta_j - \theta_i(1 - P^i) - \beta_i P^i)] \} \\ & - \{ \delta_i^2 \{ P^i [U'(\Delta_i + \gamma_i P^i - \theta_i(1 - P^i) - \beta_i P^i)] + \\ & (1 - P^i) [U'(\Delta_j + \gamma_i P^i - \theta_i(1 - P^i) - \beta_i P^i)] \} \} \end{aligned}$$

setting $X = P^i [U'(\Delta_i - \theta_i(1 - P^i) - \beta_i P^i)] + (1 - P^i) [U'(\Delta_j - \theta_i(1 - P^i) - \beta_i P^i)]$,

$$\delta_i X - \delta_i^2 [X + P^i(\gamma_i P^i) + (1 - P^i)\gamma_i P^i]$$

$$X - \delta_i [X + \gamma_i P^i]$$

$$X(1 - \delta_i) - \delta_i \gamma_i P^i.$$

As P^i gets arbitrarily closer to 1.0 or 0, X becomes $U'(\Delta_i - \beta_i)$ or $U'(\Delta_j - \theta_i)$ respectively. Although $(1 - \delta_i)$ is always greater than zero ($0 < \delta_i < 1$), the sign of the equation $X(1 - \delta_i) - \delta_i \gamma_i P^i$ will take either of positive or negative according to the real magnitude of each ingredients, since any relationship among cost terms is not presumed.

Sixth, Agreement ④ is another outcome with certainty. However, it consists only of utility of the demand made by the donor and related costs for the recipient. In any case, $U'(\Delta_i)$ will be greater than $U'(\Delta_j)$ and what determines the ultimate utilities of $U'(\Delta_j)$ is necessity of policy reorientation, as mentioned before. Therefore, the recipient country's preference for this outcome is purely up to the perceived similarity of policy packages that both sides bring to the bargaining table, which is situational in proportion to leverage.

On the donor side, first, similarly, SQ does not involve clearly visualized costs. Keeping things as they are saves the organization from the risk of lending funds to less creditworthy borrowers and international criticism for being a tough bargainer. What might hold the IMF back from going for *status quo* is the so-called internal lending pressure. With the dramatically reduced demand for the IMF's fund from the developed states, staying out of development financing will give rise to a problem of generating revenue by circulating it. However, the utility of SQ could be very flexible below Agreement ④.

Second, among the non-negotiated outcomes, preferences go in the order of $VETO_R$, $VETO_D$, and NA. This is proved as shown below:

$$\text{VETO}_R - \text{VETO}_D: \beta_j P' - (-\phi_j P' + \beta_j P')$$

$$\phi_j P' > 0 \quad (\because \phi_j > 0, 0 < P' < 1).$$

$$\text{VETO}_D - \text{NA}: -\phi_j P' + \beta_j P' - (-\phi_j P' - \beta_j P')$$

$$2\beta_j P' > 0 \quad (\because \beta_j > 0, 0 < P' < 1.0).$$

Therefore, $\text{VETO}_R > \text{VETO}_D > \text{NA}$.

Third, in terms of cooperative outcomes, the donor's preference over them is reversed of the recipient's. Agreement ④ is preferred by the donor for the same reason that Agreement ① is preferred by the recipient. Despite the probable costs, this outcome is better than any other negotiated result since it is a sure thing. The placement of Agreement ① is variable as a reflection of the donor's perception of its leverage and dissimilarity of the adjustment proposal the recipient tries to advance to its own. Its ranking among negotiated outcomes cannot be predetermined but are situational.

Fourth, the comparison between Agreement ② and ⑤, is the only difference of which is the modification term, and results in $\gamma_j P'$ that is invariably greater than zero:

$$\delta_j \{ P' [U'(\Delta_j + \gamma_j P' - \phi_j P' - \beta_j P')] + (1 - P') [U' \Delta_i + \gamma_j P' - \phi_j P' - \beta_j P'] \}$$

$$- \delta_j \{ P' [U'(\Delta_j - \phi_j P' - \beta_j P')] + (1 - P') [U'(\Delta_i - \phi_j P' - \beta_j P')] \}$$

$$\text{setting } Y = P' [U'(\Delta_j - \phi_j P' - \beta_j P')] + (1 - P') [U' \Delta_i - \phi_j P' - \beta_j P'],$$

$$\delta_j (Y + \gamma_j P') - \delta_j Y$$

$$Y + \gamma_j P' - Y = \gamma_j P' > 0 \quad (\because \gamma_j > 0, 0 < P' < 1).$$

Through the same process of subtracting one from the other, Agreement ⑥ is left with $\gamma_j P^j$, which is proved above to be greater than zero when subtracted by Agreement ③. Therefore, Agreement ⑥ is preferred to Agreement ③.

Fifth, as with the recipient's case, the relationship between Agreement ② and Agreement ③, Agreement ⑤ and Agreement ⑥, Agreement ② and Agreement ⑥, Agreement ③ and Agreement ⑤ cannot have fixed signs due to the unknown terms of utility components. For instance, the relationship between Agreement ⑤ and Agreement ⑥ turns out:

$$\delta_j \{P^j [U^j(\Delta_j - \phi_j P^j - \beta_j P^j)] + (1 - P^j) [U^j(\Delta_i - \phi_j P^j - \beta_j P^j)]\} \\ - \delta_i^2 \{P_j [U^j(\Delta_j + \gamma_j P^j - \phi_j P^j - \beta_j P^j)] + (1 - P^j) [U^j(\Delta_i + \gamma_j P^j - \phi_j P^j - \beta_j P^j)]\}$$

setting $Y = P^j [U^j(\Delta_j - \phi_j P^j - \beta_j P^j)] + (1 - P^j) [U^j(\Delta_i - \phi_j P^j - \beta_j P^j)]$,

$$\delta_j(Y) - \delta_j^2 [Y + (\gamma_j P^j) P^j + (1 - P^j) \gamma_j P^j]$$

$$Y - \delta_j(Y + \gamma_j P^j)$$

$$Y(1 - \delta_j) - \delta_j \gamma_j P^j.$$

If the subjective probability of winning its demands on conditionality, P^j , approaches 1.0, Y is equal to $U^j(\Delta_j - \phi_j - \beta_j)$, and if the probability goes to 0.0, Y remains to be $U^j(\Delta_i)$. All three cost terms of ϕ_j , β_j , and δ_j are positive magnitudes and there is no presumed relationship such that $Y(1 - \delta_j) - \delta_j \gamma_j P^j$ can take either a plus or minus sign. Therefore, nothing is told as to which one is the greater of the two.

The following are all the fixed restrictions on preference orderings put together:

Restrictions to Recipient's Preferences

Agreement ① > all others

Agreement ③ > Agreement ⑥

Agreement ⑤ > Agreement ②

VETO_R > VETO_D > NA

Restrictions to Donor's Preferences

Agreement ④ > all others

Agreement ⑥ > Agreement ③

Agreement ② > Agreement ⑤

VETO_R > VETO_D > NA

With the above restrictions, we are getting one step closer to the entire picture of the conditionality bargaining process and its outcomes. Utility functions simply represent an individual's preference over gambles as willingness to accept risk, not his "true" intensity of preference (Morrow, 1994). Preference intensity is difficult to identify, let alone measure, hence we are allowed only to arrange preferences ordinally. In conditionality bargaining, the way the players put the expected utilities in ordinal ranking is the indicator of how willing each player is to impose its demands on the other or accommodate the other player's in order to facilitate the negotiation. Thus, the preference ordering is the key factor that determines the so-called *types of players*. The order in which the players arrange possible outcomes tells us whether they are a hard bargainer or a soft one. The types of players are closely related to the concept of BATNA. The types of players reflect how seriously they will consider non-agreement or *status quo* as their best alternative to negotiated agreements and where they will place them among the possible outcomes. By all means this underscores a propensity for reaching an agreement as the final outcome of bargaining.

In addition to the types of players, the intensity of self-interest inserted in the proposal determined by the perceived situation should be considered in order to properly capture the conditionality bargaining. Driven by the urgency of contracting an agreement in one way or another, the players tune the tone of self-interest and its correspondence with its counterpart's, using leverage. The tone of likeness between the two self-interests stated in the proposals is revealed by the difference between $U'(\Delta_i)$ and $U'(\Delta_j)$. Therefore, a proposal of strong self-interest is likely to have a sufficiently big difference between them, whereas a weak proposal is expected to show a small difference.

By combining the types of players shown as a propensity for agreement under the restriction of assumptions with the types of proposal determined by the intensity of self-interest, I can set up three cases of conditionality bargaining: bargaining of strongly self-interested proposal with high propensity for reaching an agreement, bargaining of strongly self-interested proposal with low propensity for an agreement, and bargaining with weakly self-interested proposal with high propensity for agreement.¹⁶ Therefore, it is possible to form nine different games in total by multiplying three cases for each player and map the nature of conditionality with the outcomes generated by those nine games. One last note to the preference orderings of outcomes for each case is that it is only a set of many possibles since the undetermined relationship among utilities allows more arrangements. Note that ten is the highest ranking, and one is the lowest.

¹⁶ I purposely omit the combination of accommodative proposal with low orientation toward agreement on purpose because a proposer who makes an accommodative proposal and risks rupture at the same time does not make much sense theoretically and realistically.

Recipient *i*

	Strong proposal with High propensity for agreement	Strong proposal with Low propensity for agreement	Weak proposal with High propensity for agreement
SQ	4	7	4
VETO _D	2	2	2
VETO _R	3	3	3
NA	1	1	1
Agreement ①	10	10	10
Agreement ②	7	5	7
Agreement ③	9	9	6
Agreement ④	5	4	9
Agreement ⑤	8	8	8
Agreement ⑥	6	6	5

Donor *j*

	Strong proposal with High propensity for agreement	Strong proposal with Low propensity for agreement	Weak proposal with High propensity for agreement
SQ	4	7	4
VETO _D	2	2	2
VETO _R	3	3	3
NA	1	1	1
Agreement ①	5	4	9
Agreement ②	8	8	8
Agreement ③	6	5	5
Agreement ④	10	10	10
Agreement ⑤	7	6	7
Agreement ⑥	9	9	6

3.4 EQUILIBRIUM OF CONDITIONALITY BARGAINING WITH PERFECT INFORMATION

This conditionality bargaining game is built on perfect and complete information. Each player knows the payoffs of the outcomes and preference over them. This information is common knowledge in that all players have that information and that the other player knows that information, and so on. Equilibrium for nine cases of conditionality bargaining games will be sought in a manner of subgame perfect. A subgame perfect equilibrium for a game is an equilibrium for every part of the game from that node forward and requires players' forward-looking behavior rather than short-sighted. Players select strategies from alternative paths available to them, anticipating their subsequent effects and reactions of the other to the chosen course of action.

In a game where both players make proposals reflecting their respective interest strongly with high hopes that they will be able to induce the other to agree on their proposal, their interaction proceeds $P^R, P^D, CP^R, A^D \rightarrow \text{Agreement } \textcircled{3}$. In a game that the recipient remains unchanged but the donor is determined to conclude a conditionality bargaining only with an agreement that reflects its interest strongly, and, accordingly, not so enthusiastic about hammering out an agreement with the recipient country, their interaction generates Agreement $\textcircled{3}$ through P^R, P^D, CP^R, A^D , too. In the case in which the recipient of this type faces a donor who is very willing to accommodate the developing country's demand on conditions, the moves of the game are $P^R, A^D \rightarrow \text{Agreement } \textcircled{1}$.

In the game where the recipient wants to conclude a negotiation only with an agreement that carries its interest fully, accordingly, coming to the bargaining table with low inclination to concede to the donor, and the donor, on the other hand, expresses a

high hope not only for reconciling but fulfilling its demands to the maximum, the conditionality bargaining follows the process of $P^R, P^D, CP^R, A^D \rightarrow \text{Agreement } \textcircled{3}$. If both players are less enthusiastic about reaching an agreement, adhering to their interests, the game ends up with Agreement $\textcircled{3}$ through P^R, P^D, CP^R, A^D . However, when the recipient who holds firm onto its interests with little willingness to concede confronts a donor who is by contrast very willing to accommodate the developing country's demand in conditionality agreement, their interaction produces Agreement $\textcircled{1}$ through P^R, A^D .

However, in a different setting in which the recipient does not advance its interests strongly and take any chance to rupture the bargaining process with a donor who is passionate about reaching an agreement and realizing its interest to the maximum at the same time, the conditionality bargaining goes through $\sim P^R, P^D, A^R$ to yield Agreement $\textcircled{4}$ on the right hand side of the game tree. If such a recipient confronts a donor who wants to swing the bargaining to its interest, accordingly, coming to the bargaining table with low inclination to concede to the recipient, the conditionality bargaining is likely to proceed $\sim P^R, P^D, A^R$ to obtain Agreement $\textcircled{4}$. On the other hand, if both players are very accommodative in dealing with each other's demand, the conditionality bargaining moves back to the left hand side of the tree and produces $P^R, A^D \rightarrow \text{Agreement } \textcircled{1}$.

The table below summarizes the above outcomes. The information contained in the table supports the validity of the theory developed, which states that leverage is a necessary condition for different conditionality agreements. A closer look at the table enables us to observe the following: first, both players' propensity toward producing negotiated agreements, in other words the types of players, is not the determinant of different conditionality agreements, if both players possess some sort of leverage to

Table 3. 1 Outcomes of Conditionality Bargaining with Perfect Information

Recipient	SH	SL	WH
Donor			
SH	Agreement ③	Agreement ③	Agreement ④
SL	Agreement ③	Agreement ③	Agreement ④
WH	Agreement ①	Agreement ①	Agreement ①

Note: SH: Strong proposal with High propensity for agreement

SL: Strong proposal with Low propensity for agreement

WH: Weak proposal with High propensity for agreement

mobilize to the bargaining. *Similar outcomes cluster by the nature of the proposal based on leverage, not by the propensity for agreement.* It appears that the outcomes of conditionality bargaining are determined by whether or not the players can mobilize leverage and how effective it is rather than how willing they are to negotiate despite the lack of leverage. Second, under the circumstance that both players mobilize leverage for bargaining, the recipient seems to use it with more efficiency than the donor, since at the conclusion of a game, the outcomes bring higher utility to the recipient than to the donor. Third, in a bargaining situation where both players possess leverage, the recipient can endure a lengthy bargaining process and eventually attain a relatively desirable outcome, Agreement ③, which is ranked second highest. Fourth, when conditionality bargaining is asymmetric, that is, only when one party of the bargaining possesses leverage and capitalizes on it, this player can end the bargaining with its most preferred outcome, namely, Agreement ① or Agreement ④. This is similar to taking advantage of the other player's constrained situation. Finally, if players lack leverage, there is a tendency for

them to take a course that can quickly finish the bargaining with outcomes that do not involve discounting, which is in both players' interest.

In interpreting the outcomes, three Agreement ①'s on the bottom row need special attention. Both cases where a strong recipient meets a weak IMF and a weak recipient meets a weak IMF produce the same outcome, Agreement ①. However, the content of the agreement or its meaning of three of them will differ. That is, in the case that both players are weak, their priority is contracting an agreement more than anything else and, thus, their policy proposals will show high similarity to each other, which will make the difference between $U'(\Delta_i)$ and $U'(\Delta_j)$ $\{U'(\Delta_i) - U'(\Delta_j)\}$ small as explained earlier. On the other hand, in a bargaining where a strong recipient deals with a weak IMF, their proposals have more dissimilarity than similarity so that the difference between $U'(\Delta_i)$ and $U'(\Delta_j)$ is substantial and most of $U'(\Delta_i)$ will be satisfied. Therefore, Agreement ① resulting from negotiations between players with low leverage means joint gains for both players, while negotiations involving asymmetric leverage mean that players will benefit differentially.

In conclusion, the results of conditionality bargaining games show that the imposition of strict conditions by the IMF is neither inevitable nor universally applied. The conditionality bargaining games, with only three sets of preference orderings, show enough diversity in outcomes and identify leverage to be an important factor that determines such differences. The presumed dominance of the donor in conditionality agreements, rather, seems to be a matter of frequency: that is, what we count as leverage has been relatively simple and limited and, thus naturally, the number of leveraged developing countries is smaller than unleveraged ones, which make cases of imposition

more noticeable. For instance, if we count oil endowment as leverage, the number of developing countries leveraged in that sense is only 14 out of 169 (8.3%) in the low- and middle-income brackets.¹⁷ Often, conditionality bargaining involves a strong IMF and a weak recipient, whereby both parties exhibit a high propensity for agreement. In such a situation, a high frequency of Agreement ④ is expected. If that is the case, this automatically resolves the issue of whether the results will be different depending on the bargaining initiator. Not many developing countries might initiate negotiations with the IMF unlike the IMF's official statement on the initiation of conditionality dialogue.¹⁸ To the contrary, they would wait for the IMF to approach them first and instantly accept the solutions that IMF comes up with.¹⁹ On the other hand, leveraged developing countries in any case would capitalize on their ability in order to reap preferred outcomes from the IMF even in a crisis, although it is not that observable to outsiders. The point to be made here is that, as the outcomes of the game model developed in this chapter show, the possibility of negotiation and subsequent outcomes exists in every bargaining situation, no matter what developing country may be involved. The differences in results come from whether or not and how they take advantage of such possibilities.

¹⁷ The classification of countries and the number are from World Bank. 1994. *World Development Report*. Washington, DC: World Bank.

¹⁸ Recall Footnote 6 of this chapter.

¹⁹ Evidence supporting this is implied in the IMF's response to the criticism of its intrusive and same old measures for Southeast Asian countries that had experiences in indigenous economic development. The IMF said that intrusiveness, if any, was inevitable due to the urgency of the crisis; many developing countries, including Southeast Asians, did not heed warnings from the IMF nor come to the IMF until their economic problems became a total disaster. Thus, while coping with crises with little time and prioritizing stabilization, IMF-supported programs had been perceived as such. For the full text, see Fischer, Stanley. "The IMF and the Asian Crisis." Forum Funds Lecture at UCLA, Los Angeles. [Online] Available <http://www.imf.org/external/np/speeches/1998/032098.htm>, March 20, 1998b.

3.5 THEORETICAL PROPOSITIONS OF CONDITIONALITY BARGAINING AND HYPOTHESIS

The equilibrium outcomes serve as the basis for generalizing conditionality bargaining. The propositions that follow specify under what conditions tough or soft conditionality agreements are contracted. The underlying theory is that toughness and softness are a function of leverage. The propositions of conditionality bargaining are categorized into two groups: the first is concerned with the impact of utility components on the equilibrium outcomes; and the second pertains to the effects of exogenous factor, i.e., leverage, on conditionality agreement. Each proposition is accompanied by proof and, at the end, testable hypotheses are derived from them for future empirical analysis.

Proposition 1: In a conditionality bargaining, as a recipient country applies a higher subjective probability of leading the bargaining in its preferred way, the toughness of conditionality will decrease. For the IMF, as its subjective probability increases, the toughness of conditionality will increase.

The subjective probability is a comprehensive indicator of players' confidence in bargaining, which is based on self-evaluation of related economic, political, social, and international conditions. Thus, for a recipient whose utility is maximized with soft conditionality, a high subjective probability should be in an inversed relationship with the toughness of conditionality. On the other hand, for the IMF, of which the utility is maximized with loan repayment by the recipient, tough conditionality as a means to achieve its goal is in a direct relationship with its subjective probability of concluding a bargaining. Mathematically speaking, as the players' subjective probability increases up to 1.0, $(1 - P^i)$ and $(1 - P^f)$ get closer to zero, which are combined with the utility of

accepting the opponent's demand. This eventually makes the second part of the utility function obsolete and the negotiated outcome becomes similar to their most preferable outcomes that do not involve negotiation lottery such as Agreement ① and Agreement ④. Therefore, the toughness of conditionality as utility will be adjusted in their preferred directions, as the players' subjective probabilities increase.

Hypothesis 1a: If a recipient has capital inflows adequate enough to meet its financial needs for balance-of-payments gap, its subjective probability goes up and the toughness of conditionality will decline.

Hypothesis 1b: If the IMF has adequate capacity to meet recipients' loan requests, it can apply a high subjective probability to conditionality bargaining and thereby impose tougher conditions on recipients.

Proposition 2: In bargaining over conditionality, as the expected opportunity cost incurred by the negotiation process rises, the IMF will increase the toughness of conditionality. On the other hand, a recipient country, which has a mounting opportunity cost for contracting a conditionality agreement with the IMF, will not be forced to contract an agreement with tough conditions.

The opportunity cost represents loss in exchange for benefit from a conditionality agreement and functions to reduce the size of benefit, assuming that fixed preference over the magnitude of (Δ_i) and (Δ_j) . If the opportunity cost comes into the utility function, reducing the total utility of a conditionality agreement, adjusting the fixed magnitude of conditionality will be a way to compensate for the loss and maintain the total utility of conditionality, holding other things constant. Under that circumstance, the IMF will increase its demand for the toughness of conditionality as its opportunity cost increases.

On the other hand, the recipient's incentive to continue a negotiation with the IMF will be maintained if conditions get less severe as its opportunity cost increases. Otherwise, it will quit bargaining with the IMF and talk to other donors available that attach soft conditions to loans. Thus, the opportunity cost has a direct relationship to the toughness of conditionality for the donor but an inversed relationship to the recipient.

Hypothesis 2a: If the IMF expects an increasing part of its funds to be consequently apportioned for a recipient in bargaining, its opportunity cost goes up, whereby it will intensify the toughness of conditionality.

Hypothesis 2b: If a recipient has more capital flowing in from private lenders than the IMF, its opportunity cost for negotiation with the IMF will increase, whereby the toughness of conditionality will decline.

Proposition 3: In a conditionality bargaining, as the domestic constraints on the contents of agreement rise in the recipient country, the toughness of conditionality will decrease.

As with opportunity cost, the existence of domestic political cost itself functions negatively to the total size of utility for the recipient, and thereby, adjustment in the magnitude of demand for toughness will follow to compensate for the loss relative to the size of the domestic political cost. Even if the domestic political cost is combined with the recipient's subjective probability of losing, the influence pattern of domestic political cost remains the same. Holding the recipient's subjective probability constant, larger domestic political cost should be offset by increase in the demand for soft conditionality. Thus, either combined with the subjective probability or not, the toughness of conditionality will decrease as the domestic political cost increases.

Hypothesis 3: In a recipient country, if its regime is more democratized, the domestic political cost that conditionality bargaining with the IMF causes to it will also be on the rise, whereby the toughness of the conditionality agreement it contracts will decrease.

Proposition 4: In bargaining over conditionality, if the reputation cost for the IMF has already increased or is on the rise, the toughness of conditionality will decrease.

The IMF will acquire a bad reputation if it treats recipients harshly or Fund supported adjustment programs do not produce expected results in recipient countries. The existing reputation cost, which is carried over from its past lending, lessen the size of utility that the IMF pursues as the other cost terms do. The Fund, which believes that tough conditionality increases the probability of loan repayment by the recipient, will strengthen the conditionality if the existing reputation cost looms large for the future. Thus, the IMF will intentionally adjust its demand for tough conditions upward in order to level the reputation cost in the current bargaining. Thus, as the reputation cost for the Fund is on the rise, the toughness in conditionality agreement will increase.

Hypothesis 4: If it suffers from increasing arrears in loan repayment from previous conditionality agreements, the IMF will tighten further conditionality to increase debt service from the recipient.

Proposition 5: In a conditionality bargaining, as the cost for delaying agreement decreases for the recipient, the bargaining will be repeated over rounds, which will decrease the toughness of conditionality. On the other hand, the low delaying cost means increase in toughness of conditionality to the donor.

The value of goods is reduced by time factor. In conditionality bargaining the value of negotiated agreement will be discounted as much as it comes late. Thus, assuming that the final outcomes have the same value, obtaining it now as undiscounted brings more utility to the recipient than discounted. Nonetheless, if the delaying cost or discounting is sufficiently low for the recipient, the recipient would rather prolong bargaining to next rounds and wait for a proposal with softer conditions to be presented than accept a proposal against its interest. On the other hand, if the donor discounts the future value a lot, concluding the negotiation “quickly” becomes more important for it than imposing high conditionality on the recipient and, thus, the toughness of conditionality will be lessened as the discounting rises. A donor under internal lending pressure would behave like this. Thus, the less the recipient discounts future agreement, the more likely it is to contract agreements in their favor for soft conditionality. For the donor, the opposite case is applied.

Hypothesis 5a: If a recipient has a declining discount rate, it values the future bargaining outcome as much as the present one, and can lessen the toughness of conditionality agreement which it will be contracting with the IMF.

Hypothesis 5b: If the IMF suffers an increasing cost as it delays conditionality agreement, it will rush to conclude the negotiation with fewer tough conditions.

Proposition 6: In a conditionality bargaining, as the cost involved in rupturing the negotiation for both players or at least for one is on the rise, the likelihood of concluding the bargaining will increase.

The utility from rupturing conditionality bargaining, whether by vetoing in the middle of bargaining process or at its last round, does not include any demand term but only cost terms. Non-agreement after consuming all of the opportunities for loan arrangement with other lenders and borrowers is the worst among them because, while vetoes save at least one cost term, opportunity cost for both players, NAs have the players relentlessly pay all the costs involved in bargaining, which even makes it more attractive to accept a proposal made by the opponent. As showed in the above propositions, the presence of cost terms should be compensated for by changes in demand for toughness of conditionality in the players' preferred definition, namely increasing or decreasing toughness. Thus, unless the players can afford these bare costs, they have a strong incentive to finish the bargaining with some sort of agreement rather than no result.

Proposition 7: Holding other conditions constant, the more leverage players have, the more likely they will contact a conditionality agreement that is closer to their preference.

All negotiated outcomes have similar utility ingredients. What distinguishes them one from another is discount factor and the ability to modify proposals, γ , presented by the other player. The ability to modify proposal combined with subjective probability has a positive influence on the total utility, which can be identified as leverage. Under that circumstance, unless the subjective probability is zero, such ability compensates for the loss incurred by other costs in addition to upgrading the demand for toughness of conditionality. Moreover, leverage is the factor that enables the players to extend bargaining into subsequent rounds. Considering that the player's total utility gets smaller by time factor as the bargaining is extended, the players will be better off by settling for

an agreement in earlier rounds that do not involve discounting than continuing negotiation unproductively if it goes without inputs from leverage. Thus, if the players possess the ability to modify presented proposals, the conditionality agreement that they contract will get closer to their preference because they have leeway to modify the terms of agreement to a certain degree.

Hypothesis 7a: If the five Executive Board member countries increase their financial contribution to the IMF, they are more likely to request a tough conditionality agreement.

Hypothesis 7b: If the IMF has disbursed loans to a particular developing country disproportionately out of its total lending budget, the likelihood that the Fund will impose tough conditions on that country will decline.

Hypothesis 7c: If the five major donors within the Fund have a special bilateral relationship with a recipient, they are more likely to lessen the toughness of conditionality for the recipient.

Hypothesis 7d: If the five Executive Board member countries have contributed to a recipient's economy with official development aid, commercial investments and export market access, they can increase the toughness of conditionality by linking bilateral economic relationship to multilateral conditionality.

Hypothesis 7e: When a developing country has been experiencing a deteriorating economic condition before a negotiation with the IMF, such a economic condition will have a direct impact on intensifying the toughness of conditionality agreement contracted with the IMF.

Hypothesis 7f: As the recipient country accumulates more external debt, the possibility that it lessens the toughness of conditionality agreement by threatening debt moratorium will increase.

Hypothesis 7g: If a recipient has depended more on the IMF as a source of foreign capital than on other international lenders, that recipient is more likely to conclude a bargaining with the IMF with an agreement of tough conditionality.

Hypothesis 7h: If a recipient has an economic system that is characterized by endowment of natural resources valuable to the five major donors, the recipient is less likely to contract a tough conditionality agreement with the IMF. On the other hand, if its economic system depends much on trade with other countries or is under systemic transition, the recipient is likely to receive tougher conditions.

Hypothesis 7i: If a recipient has provided profitable investment opportunities for the five major donors within the IMF, that recipient country will be able to reduce the toughness of conditionality by using its economic potentials.

Hypothesis 7j: If a developing country negotiating with the IMF is dependent on domestic market more than on foreign markets for its economic growth and has been pursuing import-substitution strategy with a heavy public sector, the likelihood of high conditionality will decrease.

Hypothesis 7k: If a conditionality negotiation is not the first encounter between a developing country and the IMF, such a record of previous transactions will increase the likelihood of high conditionality for the IMF's sake.

Proposition 8: In a conditionality bargaining, the more a prospective recipient lacks leverage, the less likely it is to initiate bargaining with the IMF and a greater chance it will have to conclude the bargaining with a tough agreement preferred by the IMF, once it begins.

As seen in Proposition 7, leverage compensates for the loss from costs and discounting. Without leverage, the recipient can avoid loss from discounting by concluding the bargaining in the rounds that do not involve discounting. The outcomes that come without discounting are Agreement ① and VETO_D on the left-hand side of the tree and Agreement ④, VETO_R, and SQ on the right-hand side. Among these, VETO_D and VETO_R are not affordable outcomes due to their costliness as shown in Proposition 6. Thus, the choice is narrowed down to Agreement ①, Agreement ④ and *status quo*. If a weak recipient is to initiate the negotiation and conclude it with Agreement ① without help from leverage, it has to make a proposal in which its demand for toughness of conditionality, namely (Δ_i) , is equal to (Δ_j) in order to assure that the IMF will accept the proposal immediately, knowing that the IMF is also weak. However, if the recipient is not sure of the IMF's strength and accidentally makes a proposal where (Δ_i) and (Δ_j) are not of the same magnitude, initiating the bargaining, the outcome could be Agreement ② at the node 4. In this case, Agreement ② is not attractive to the recipient lacking leverage since its accordingly low subjective probability makes the first part of utility function close to zero and its actual utility will become the same with Agreement ④ but discounting. If Agreement ② and ④ have the same value but the former is discounted, the recipient will be better off by choosing Agreement ④, and thus, it will not initiate the bargaining with the IMF unless it is leveraged.

Proposition 9: In bargaining over conditionality, as the recipient's leverage increases, the credibility of a threat from it to rupture the bargaining increases, which will decrease the likelihood of tough conditionality.

Facing a proposal made by the IMF at node 2, a leveraged recipient will not accept the proposal but make a counterproposal to the IMF at node 4 with the anticipation that the IMF will accept its proposal and thereby conclude the bargaining with its second best alternative, Agreement ③. The leveraged recipient can threaten to rupture the bargaining at the node 4 in order to strengthen the IMF's incentive to accept its counterproposal at node 6, which will otherwise inflict more damage to the IMF than finishing the bargaining with Agreement ③ does. Regardless of its strength and propensity for agreement, the IMF will be better off with Agreement ③ than NA by the given preference orderings. For a strong recipient, $VETO_R$ is always inferior to Agreement ②. Nonetheless, the possession of leverage can make the utility of $VETO_R$ equivalent to saved opportunity cost enlarged while relatively reducing the utility of Agreement ②. Thus, threat from a recipient with leverage is more credible than that lacking and the IMF will be induced to accept a counterproposal from it, which will contain fewer tough conditions than the previous one.

Proposition 6 is not given hypotheses derived from it. The reason is that Proposition 6 itself is related to the endogeneity of agreement as bargaining outcome, that is, whether or not the players contract a conditionality agreement. An assumption of the conditionality bargaining model says that the players prefer contracting an agreement at the end of the bargaining to rupturing it and, as the model is constructed so, it is related mainly to what kind of agreement they contract rather than to whether or not the IMF and recipients strike a bargain. In addition to this theoretical reason, not forming a testable hypothesis about Proposition 6 can be justified with the existing numerous conditionality

agreements. The long-term dependency between the IMF and developing countries was mentioned earlier, and such recidivism in conditionality agreement evidences the size of costs that the opposite case, namely, not-contracting-agreement, inflicts on both players and their strategy to avoid them. Thus, a hypothesis for Proposition 6 is already tested.

Propositions 8 and 9 also lack pertinent hypotheses. They partly share qualities of Proposition 6 in deriving testable hypotheses. However, a more severe obstacle to verifying those Propositions does not lie with deriving testable hypotheses from them but with testing them with proper empirical records. As for now, there are no compiled or publicly available data on who initiated negotiation with the IMF and whether any bargaining ruptured at the end. Thus, Propositions 8 and 9 should be content with their theoretically proven validity for the time being.

This research represents a modest attempt to move beyond the conceptualization of conditionality based on unilateral imposition by the IMF in order to explain various outcomes of conditionality bargaining. In this regard, this chapter has successfully proved that conditionality agreements are an outcome of circumstantial creation depending on players' strategy and exogenous factor called leverage, but not of predetermination. The subsequent propositions generalized conditions under which the nature of conditionality agreement is differentiated in terms of toughness. Although the entire edifice is constructed on theoretically driven assumptions of the world, we should remain assured of its robustness due to the exhaustive list of possible outcomes that it provides. Even the conventional argument of imposition by the IMF, which has been forwarded without scientific delves, is explained by the model as part of the diverse outcomes rather than

discarded for being incorrect. Our remaining interest from now on is to see its structural stability and firmness: that is, whether the edifice can hold up even when it is thrown into the real world full of random noises. Its next challenge is to weather empirical tests.

CHAPTER 4

INTERMEZZO: BRIDGING ABSTRACT TO CONCRETE

The previous chapter theoretically proved that conditionality agreements are a complex product of factors that players consider as important. Among those factors, leverage was presented as an essential component in shaping the product in their preferred ways with regard to toughness or softness of conditionality. Now the validity of the conditionality bargaining model should be tested by its correspondence with the record of conditionality agreements contracted in the past. Deriving testable hypotheses from generalizing propositions at the end of the previous chapter was to serve this purpose. In this chapter a statistical model for those hypothesis tests will be discussed. Operationalization of various concepts included in the hypotheses—such as utility ingredients and leverage—as well as their measurements in variables will be laid out in detail. Later in the chapter, the issue of selecting a statistical method that properly reflects the purpose of the analysis and collected data will be discussed.

4.1 DATA FOR THE ANALYSIS OF CONDITIONALITY BARGAINING

No matter what statistical method may be chosen to test the hypotheses with, leverage must be placed on the right-hand side of equation as an independent variable that likely affects the outcomes of conditionality bargaining. Selecting independent variables needs to remain relevant to the specific issue, conditionality, and operationalize leverage, not power. The following is operationalization and measurement of dependent

and independent variables and expected utility components for each player. All of the data for financial transactions between the IMF and recipient countries came from *IMF Annual Report* of various years, and *1998 World Development Indicator* CD-Rom was the key source for other economic data of recipients. Other sources of data are listed at the end of the variable description. Abbreviated capitals of variables will be used in each specification. Boxes contain descriptive statistic of variables grouped by their nature.

4.1.1 Dependent Variable: TITNESS

The most important factor to consider in statistical modeling of conditionality bargaining is choosing a proper dependent variable that can capture the operation of leverage. The operation of leverage is not directly observable and we can only offer conjecture that leverage was mobilized and had a certain effect on the bargaining process by looking at outcomes comparatively. Thus, it is critical to such a conjecture to choose a correct dependent variable that likely reveals the operation of leverage and thereby variance in conditionality agreements in terms of toughness.

Although measuring variance in conditionality agreements can be addressed in many ways, the number of conditions each recipient country agreed upon with the IMF, **TITNESS** (tightness) is proposed as a possible outcome of leverage. Supposing that the conditions are generated through a process of unobservable factors, it is also plausible that those numbers are positively correlated with the operation of leverage. The underlying effect of leverage is estimated backward, using those numbers. Even with this

simple arithmetic number of conditions per program, it should suffice to indicate the toughness of a conditionality agreement.¹

The most reliable source for counting conditions is by all means the Letters of Intent (LOIs), final documentation of negotiation between the two parties. Nonetheless, LOIs have never been systematically available in the public domain and are not likely to be so in the near future, either.² Although there exist alternative sources for extracting conditions such as country reports and working papers prepared by IMF staff, the number of agreed conditions for structural adjustment will be counted from press releases contained in *IMF Survey*, the semimonthly newsletter of the IMF.

Press releases in *IMF Survey* were deliberately chosen for several merits it provides. First, press releases are not independent of original LOIs; they are based on them. Modeling bargaining process with game theory is unavoidably limited to the part of process publicly observable, and LOIs convey the outcomes from such process. Press releases of conditionality agreements constitute a concentrated public face of LOIs. Therefore, the information and data extracted from press releases are good enough, although not perfect, for the analysis. Then, a consequential question is how close are press releases to original LOIs? To answer this, content comparison of two documents,

¹ Measuring the tightness of adjustment programs in terms of the number of conditions was developed first for the World Bank's conditionality in Mosley, Paul, Jane Harrigan, and John Toye. 1995. *Aid and Power: The World Bank and Policy-based Lending, Volume I Analysis and Policy Proposals*. 2nd ed. London: Routledge.

² As part of an ongoing initiative by the IMF toward greater openness with respect to its operations and activities, the IMF is expanding public access to documentary materials in the IMF's archives, including Executive Board documents that are more than five years old, and other materials that are more than 20 years old. The IMF moved first in 1996 to declassify all materials in its archives that were more than 30 years old, but LOIs were excluded because they contained highly confidential information. LOIs started to be publicized from 1997 only with agreement of the involved governments. For the currently available ones, visit <http://www.imf.org/external/np/loi/mempub.htm>.

press releases and their publicly available original LOIs, was attempted. The conclusion from this is that, with some risk of extrapolation, there exists a satisfactorily high association between them: in the basic area of agreement—such as type of arrangement, amount, and program length—the sample press releases showed the same content with the original LOIs.³ More importantly, press releases are judged as faithful to LOIs in delivering core conditions or themes of adjustment programs. The major difference of press releases from LOIs lies with the degree of detail: that is, while the sample LOIs described conditions to be implemented in detail—mentioning policy measures, target or in-charge government agencies, and sequencing—the press releases dropped many specific instruments and time-lines for implementation. The other merit of the *IMF Survey* is its coverage. The press releases deliver all agreements in a disinterested manner, no matter what country may be the other party of contract, and no matter what type of arrangements it may be. Hence, they enable us to see a complete universe of conditionality agreements, whilst country reports and staff working papers do not. Finally, press releases were written to an implicitly fixed format so that information is delivered in a systematic and consistent manner rather than desultory, which makes data coding less arbitrary. On the other hand, country reports are more research-oriented, focusing on issues of interest. Therefore, medium to long-term effects of policy implementation preceded by conditionality agreements are viewed from fairly theoretical perspectives. This type of text makes it more difficult for readers to discern conditions under one arrangement from another. Therefore, for these merits, despite the availability

³ This conclusion was drawn from the comparisons of 1997 LOI of South Korea; 1998 LOIs of the Philippines, Brazil, and Bulgaria; and 1997 Policy Framework Paper of Uganda.

of original LOIs in limited number and other sources, conditions were solely counted from the press releases in *IMF Survey*.

Now turning to type of arrangements and data collecting point, this research used 398 cases of Stand-By Agreement (SBA), Extended Fund Facility (EFF), Structural Adjustment Facility (SAF), and Enhanced Structural Adjustment Facility (ESAF). SBA has been in operation since 1953, EFF since mid-1970, and SAF and ESAF since mid to late 1980s, accounting for 916 in total. Including other financial operations of the IMF—such as Buffer Stock Financing Facility (BSFF), Compensatory and Contingency Financing Facility (CCFF) and Systemic Transformation Facility (STF)—the total will easily go over 1000. However, these facilities were excluded from the counting targets due to their unconditional or temporary nature. In the case of BSFF and CCFF, member countries can borrow money from the IMF without the requirement of changing their economic policies if their economic difficulties were caused by detrimental developments in international economy that were largely beyond the control of the member. Loan repayment is the only condition attached to these facilities. And STF, while requiring policy change, was established in 1992 to help economies in transition in Eastern Europe and Russia and terminated in 1995.

The 398 cases are almost a complete universe of conditionality arrangements in relatively recent history over the past fifteen-year period, 1983-97.⁴ The rationale behind the selection of this time period is that the year of 1983 marked the watershed of IMF's

⁴ The actual number of SBA, EFF, SAF and ESAF since 1983 is slightly more than 400. Missing cases, fewer than ten, occurred simply because their press releases could not be found, although they were mentioned in the list of arrangements.

involvement in development finance.⁵ Although the IMF had been supporting member countries in restoring their macroeconomic balances since its founding, it was not until debt crisis broke out in August 1982 when it contracted a series of agreements with Latin American members, starting with Mexico in January 1983, that the IMF got systematically involved in policy-based lending in the name of structural adjustment. Moreover, although IMF Stand-by Agreements had long linked specific policy measures to financial support, the policy-based lending since the 1980s has been directed to a much broader range of policies than traditional IMF Stand-bys, been considerably more directive, and affected more countries than before (Nelson, 1990). Aside from changes in theoretical underpinnings of programs, simple statistics also evidence changes in Fund financial activities: the number of four types of arrangements for 30 years up to 1982 was 518 out of 925 and total amount of commitments was 55,389 million SDRs. On the other hand, for the past 15 years, the IMF contracted 407 agreements worth 110,758 million SDRs. Compared to the first 30 years, the average number of arrangements per year increased by more than 50% and the total amount of commitments by almost 200%.

Once the source of data was identified, discussion of the range and scope for condition counting seems to be in order.⁶ Briefly speaking, the conditions to be counted from the press releases are policy instruments at a medium level of specificity. Adjustment decisions vary along three dimensions: timing, scope and content. The focus

⁵ Margaret G. de Vries, IMF historian, also confirmed that since August 1982, the IMF's main preoccupation had been with the external debt problems of the developing countries. Her full article is "Selected Topics: Historian Traces Origins and Development of Fund Involvement in World Debt Problem." *IMF Survey* (January 7 and 21, 1985).

⁶ There were some cases that the IMF calls "augmentation" under which initial programs are extended with increased amount and additional conditions in the middle of or near the end of the program. Such changes were excluded from counting with a view to maintaining consistency in collecting data and capturing bargaining strength intact.

of variance in this dissertation is content. Each episode of conditionality agreement has two main components, macroeconomic and structural, under which eight to ten common policy areas are identified.⁷ What is meant by a policy instrument at medium specificity is a policy instrument designed to achieve projected policy goals. For instance, if a policy goal set in the agreement is reducing overall government budget deficit, the recipient country can attain it through either cutting government expenditures or increasing revenues or through a combination of both. These two measures can be even further specified to limiting increases in government payrolls and increasing income taxes by a certain rate, respectively. From such a cascade of specificity, policy instruments to be counted at medium specificity in the first place are limited to reducing government payrolls and increasing income tax rates. If conditions at the targeted level are not available in the press releases, however, counting goes one level up. Although policy instruments of one level down (i.e., staged implementation of a policy with timeline) were released in some cases, those specific policies were excluded from counting in order to maintain consistency in counting.⁸

Another counting item from the press releases concerns various numeric macroeconomic targets. Strictly speaking, numeric targets are not conditions. However,

⁷ The components of adjustment programs can be categorized into three: macroeconomic, structural, and mesoeconomic. While macroeconomic and structural components relate to the generation of wealth, mesoeconomic components mainly relate to transfers and distribution of resources through expenditure policies in a given macro-context. However, some meso-policies can affect generation of wealth directly and, thus, two-categorization of policies by inserting meso-policies into either macro or structural as appropriate was adopted for simplicity's sake. For the role of meso-policies in generating wealth, see Stewart, Frances. 1987. "Alternative Macro Policies, Meso Policies, and Vulnerable Group." in *Adjustment with a Human Face, Volume I Protecting the Vulnerable and Promoting Growth*, eds. Giovanni A. Cornia, Richard Jolly, and Frances Stewart. Oxford: Clarendon Press; and Stewart, Frances. 1995. *Adjustment and Poverty: Options and Choices*. London: Routledge.

⁸ Condition-counting scheme, which is broken down into policy components, is attached at the end of the dissertation as Appendix 1.

conditions for structural adjustment are policy measures to achieve those targets and, accordingly, they delineate policy options as conditions. In essence, such targets are the ones that tell us the degree and extent to which recipient's economy should be contracted in order to undertake structural adjustment; thus, they are a true indicator of qualitative toughness of conditionality agreements. Delicate adjustment of macroeconomic targets is as much an item for serious bargaining as is including and excluding certain policy instruments (Such importance of numeric targets will be well shown later in the chapter concerning the Korean case). Therefore, a rationale for counting them as conditions is that they confirm whether or not those targets were explicitly agreed, although their qualitative nature is completely lost while being counted. The following is descriptive information on the frequency of arrangement types (ARRGTTYP) and the dependent variable, TITNESS.

Table 4. 1 Descriptive Statistic of Type of Arrangement

ARRGTTYP	Freq.	%	Valid %	Cumul. %
SBA	258	64.82	64.82	64.82
EFF	34	8.54	8.54	73.37
SAF	37	9.30	9.30	82.67
ESAF	69	17.34	17.34	100

Table 4. 2 Descriptive Static of Tightness of Conditionality

	N	Min.	Max.	Mean	Std.Dev.
TITNESS	395	3	33	12.89	5.03

Retrieving the press releases of conditionality agreements had an additional merit that it provided a clear-cut answer to the question of where the variance in conditionality agreements is located. All the conditionality agreements are similar in that they are structured to cover up to ten macroeconomic and structural areas of economy.⁹ The conventional argument for the inflexibility of conditionality agreements seems to be the result of looking only at the general structure of conditionality agreements or monetarist assumptions.¹⁰ The real flexibility of conditionality agreements, however, seems to lie with policy instruments at the medium and lower level of specificity, which could not be properly observed without reviewing the original LOIs or similar documents, such as press releases. The only problem with this simple counting of conditions is that it is likely to lose sensitivity of recipient countries to particular conditions. Even if all the recipient countries agree upon the supposedly same set of conditions, it will have different impact on individual members due to the difference in their economic context where those conditions will be implemented. It is not impossible to measure the sensitivity of specific conditions with recipient countries, but it does not appear appropriate to use a relatively

⁹ A similar content-analysis was conducted by Stewart (1995). He suggests that the content of IMF adjustment programs have three elements: demand restraint, switching policies emphasizing exchange rate reform, and long-term supply policies. Demand restraint policies have dominated IMF programs, being a universal feature, while over half the programs include exchange policies and somewhat lower proportion long-term reforms. However, this conclusion appears relatively indecisive and less informative in that he used only 93 cases between 1980-84 (Table 1.5, p. 9).

¹⁰ The variance in conditionality cannot be identified with fundamental changes in Fund programs. This variance is more or less related to relative flexibility, given the fixed frame for program design. Seen from the perspective of program design, or basic philosophy of economics, flexibility in the content of IMF conditionality has not incorporated any fundamental movements on the provisions that have traditionally formed the bedrock of Fund programs (Killick, 1995). Thus, the inflexibility of Fund-supported programs seems to have to do with the level of perception, fundamental assumptions vs. specific content interactive with individual economies. As long as Fund-supported programs are based on monetarist assumptions and structured that way, they would not look changing. However, if the focus is on specific conditions and their impact in a particular economic context, the IMF has been differentiating its approach to developing countries.

large number of cases, since this requires a match between each condition and each characteristic of an economy, or the cause of economic crisis in each recipient country. Such in-depth examination better fits small-N studies.

4.1.2 Expected Utility Components

The expected utility functions for the conditionality bargaining game were explained in Chapter 3. I, therefore, move directly into how to measure components of these equations.

- Subjective Probability: DSUBPROB, RSUBPROB

The most daunting job in testing the conditionality bargaining model is to form formulae for subjective probabilities for each player. Subjective probability is fundamentally private information known only to individual players who supposedly calculate it under bargaining situation and can be based on anything, as the adjective 'subjective' indicates. It is still more for researchers who work with conjecture.

As the lender of last resort, the IMF's subjective probability with respect to conditionality bargaining is formulated here to represent its possible liability or liquidity position in relation to member countries from the developing world. The IMF has institutional arrangements that allow it to borrow from a particular group of member countries in order to meet extraordinary needs for fund, which indicates that not every unit of SDR in the pool of fund from member quotas can be used to support members or

are immediately available.¹¹ Thus, the IMF's financial capacity in relation to members from the developing world during any fiscal year is likely to be determined by two considerations: legitimate borrowing requests from all of them within pre-set access limits¹² and undisbursed loan carried over from the previous fiscal year. The undisbursed loan cannot be ignored in the consideration of liability since disbursement, as a due course of periodic installments or sudden request for resumption of installments, could take place any time during the fiscal year. Against this need for funds, the size of immediately usable funds without external borrowing will determine the IMF's subjective probability. Even though the IMF is a basket of currencies, not all of the participating currencies are internationally recognized and used as an effective medium of international transaction. Most countries maintain around 80% of their foreign reserves with gold and major five currencies, which are those of five Executive Board member countries (see IMF Annual Report, 1998). Therefore, considering the worldwide acceptance of their currencies, the size of immediately disposable fund will be

¹¹ Under Article VII of the Articles of Agreement, the IMF is authorized to borrow currencies for the GRA when the IMF's liquidity (its stock of SDRs and usable currencies) is low relative to the demand for its resources. Under General Arrangements to Borrow (GAB) since 1962, the IMF may borrow, in certain circumstances, specified amounts of currencies, for four- or five-year each, from 11 industrial countries or their central banks: the United States, Germany, Japan, the United Kingdom, France, Italy, Canada, the Netherlands, Belgium, Sweden, and Switzerland. Following the Mexican financial crisis in 1994-95, concern that substantially more resources might be needed to respond to future financial crises prompted a call on the Group of Ten and other financially strong countries to develop financing arrangements that would double the amount available under the GAB, namely New Arrangements to Borrow (NAB). Representatives of 25 countries reached agreement in principle in 1996 on the features of NAB, which was subsequently adopted by the Executive Board in 1997. The amount of resources potentially available to the IMF under the GAB and the NAB combined will be up to 34 billion SDRs. Source: Treasurer's Department. 1998. *Financial Organization and Operations of the IMF*. Pamphlet Series, no. 45, Washington, DC: International Monetary Fund.

¹² The pre-set access limits do not include enlarged access to IMF resources to a multiple of quota or without limits in relation to quota under the Supplemental Reserve Facility (SRF) approved in late 1997.

determined by the portion of quotas that the five Executive Board member pay in their currencies and securities denoted in their currencies and retained SDRs.¹³ Thus, a formula for the IMF's subjective probability is as follows:

$$\frac{(\text{Currencies and Securities from 5 Major Donors} + \text{SDRs}) \text{ within GRA}}{(\text{Access Limits} \times \text{Total of Member Quotas except for 5 Major Donors}) + \text{Undisbursed Loans}}$$

The above formula is used only for SBA and EFF, which are run with resources from General Resource Account (GRA). SAF and ESAF, on the other hand, are disbursed from an account appropriated to them (Special Loan Account within GRA) and different lending principles from those of SBA and EFF are applied. Another reason that SAF and ESAF have to have a separate subjective probability formula is that while all the members—regardless of their economic size and level of development—can access SBA and EFF, SAF and ESAF are available only to member countries within lowest income group designated by the IMF.¹⁴ Therefore, applying one formula to all types of agreement is misleading. The IMF's subjective probability for SAF and ESAF is computed from

$$\frac{\text{Special Loan Account within GRA} + \text{Accrued Interest from Investment}}{\text{Access Limits} \times \text{Total of Eligible Member Quotas} + \text{Undisbursed Loan of SAF/ESAF}}$$

The structure of the above formula is fairly the same with that for SBA and EFF except for Accrued Interest from Investment. The reason for its inclusion in the formula

¹³ Each member can pay up to 75% of its quota in its own currencies and 25% in SDRs.

¹⁴ SAF started with 61 lowest income countries in 1986, although China and India indicated that they did not intend to draw on the resources, and the number of eligible countries fluctuates with inclusion of new members and graduation of some of them.

is because the unused portion of SAF and ESAF fund is invested in global financial markets until it is needed and both the amount invested and interest gains from it are substantial. While GRA resources not in use are also invested, the amount invested and accrued interest gains are almost negligible, compared with those of SAF/EASF fund.

One thing to keep in mind about these subjective probabilities for the IMF is that they are annual subjective probabilities, not one-on-one bargaining partner-specific. Under the circumstances, formulating such a formula is not feasible, although it is more desirable. To understand it better, imagine that the Fund's annual subjective probability imitates the notion of reserve requirements (capital adequacy ratio) in the banking sector.

For the recipient, its subjective probability is determined by its ability to mobilize fund internationally against its domestic capital needs, indicated by balance-of-payments current account deficit. Turning to the concept of balance of payments, deficit in current account should be offset by surplus in capital account, and vice versa, which keeps the country's economy in balance. Faced with severe balance-of-payments gap, however, developing countries have two financing options: running down reserves or borrowing from foreign sources, either commercial banks or official financial agencies. However, since reserve inadequacy has already become a serious problem to many developing countries, depleting reserves to correct maladjustment in their economies can hardly be considered as an option for them, and mobilizing funds abroad looks more practical (Bird, 1995). Mobilizing funds internationally includes borrowing from multilateral lender—such as the IMF, the World Bank, and regional development banks, bilateral aid agencies in the developed countries and some oil-producing Arab countries, and

syndicated banks by issuing national bonds. Therefore, the recipient's subjective probability of contracting a preferred conditionality agreement with the IMF is a function of fund externally raised, especially net fund-raising from private lenders, which is enough to enable it to bypass the IMF virtually leaving the IMF as the lender of *last* resort.¹⁵ Besides excluding credits from the IMF, borrowing from other official lenders should also be left out since the five Executive Board members are taking part in other multilateral lenders in a similar manner.¹⁶ Thus, from the relationship between debt-creating capital inflows from private creditors—usually bonds issued to syndicated banks (DEBTINFL), and the size of capital need to be replenished, a formula for the subjective probability a recipient country could apply to its bargaining with the IMF is derived:

$$\frac{\text{Net Debt Creating Capital Inflow}}{\text{Balance of Payments Current Account Deficit}}$$

- Discount Rate: DDISCOUT, RDISCOUT

In this research the IMF is portrayed to discount negotiation outcomes with the interest rate it pays to members who hold SDRs more than required from member obligations. This SDR interest rate is set weekly in accordance with fluctuation in the

¹⁵ Even in case that developing countries have no financial windows but the IMF, they can have differing abilities to withstand lack of access to international financial markets without resorting to the IMF, and this ability is private knowledge. Although this ability is eligible to be subjective probability, this research sticks to international fund-raising capability as the subjective probability.

¹⁶ This does not eliminate a possibility of borrowing from other official lenders. Intricate cross-currents of support and rivalry among various international institutions involved in development finance exist (Nelson, 1990), and this could leave financial windows open for the recipient. However, at least formal or informal cross-conditionality among creditors and donors was pronounced, and commercial banks have been less spontaneous in lending to developing countries for a considerable period since the debt crisis in 1982. Thus, capital flows from private lenders could be a sheer indicator of financial ability of the recipient.

exchange rates of the five major donors' currencies and annual average of them was used as the Fund's discount factor.

The recipient country, which is in economic crisis, might discount bargaining outcomes with the rate at which its foreign reserve assets are depleted. Since the level of foreign reserves affect imports, the ratio of non-gold reserves to imports expressed in terms of the number of weeks covered by the stock of non-gold reserves is a proxy rate of depletion. This data was collected from *International Financial Statistics Yearbook* published by the IMF.

- Recipient's Domestic Political Cost: RPOLCOST

The political structure of decision making constrains policy choices, and such institutional constraints are different across institutional setting—namely, regime type. Usually a democratic regime is known as imposing more institutional constraints than authoritarian does; a democratic regime has a separate body retaining the right to ratify conditionality agreements, and citizens of that regime have freedom to express their dissatisfaction through protesting and vote casting at next election. Whether it is demonstrations or losing elections, it is a form of domestic political cost resulting from conditionality agreements, and the magnitude of such cost will be differentiated by regime type. Therefore, recipient's regime type or degree of democratization are used as a proxy measure of domestic political cost. This variable is based on the score of [democracy – autocracy] within POLITY IIId data set modified from POLITY III by McLaughlin et al (1998), which ranges from negative 10 to positive 10. The more a recipient country is democratized, the less likely it is to agree upon tough conditions.

- **Opportunity Cost: DOPPOCST, ROPPOCST**

The opportunity cost that the IMF has to pay if it concludes an agreement with the recipient country is lost opportunity to contract agreements with other recipients, which equally means that certain amount of fund and proceeds from it are withheld. Thus, the opportunity cost for the IMF is operationalized by fund apportioned for an agreement and interest accruing from it. The sum of agreed amount of loan and periodic financial charge for that loan was taken to measure the magnitude of opportunity cost for the IMF. For convenience's sake, financial charge was calculated only for the first year. For the IMF, the opportunity cost has a direct relationship to the number of conditions.

On the other hand, opportunity cost for a recipient means forgone chances for loans with easier terms from other lenders if it has alternative financial windows. Capital flows from bilateral lenders and private financial institutions are indicators of the existence of such opportunity. Therefore, the sum of net loans from bilateral agencies in the developed countries and private banks will measure this variable, and this variable is likely to have a negative relationship to the number of conditions.

- **Donor's Reputation Costs: DREPUCST**

Conditionality is a means for the IMF to ensure debt service by the recipient. Any arrears in repayment can hurt the IMF's reputation in international financial matter, since arrears suggest that Fund-supported programs could not deal with economic problems in developing countries properly. Whether it is real cause or not, such situation would raise a question as to the IMF's performance. Actually, arrears have become a serious problem to the IMF during the 1980s, particularly towards the end of the '80s, and the IMF

emphasized internally and externally timely debt service by recipients. Thus, using arrears in repayments would be a nice operationalization of reputation cost that the IMF has to pay. Data of arrears started to be methodically reported in *Annual Report* from 1986 and so does this variable. In addition, although only handful of developing countries had arrears to the IMF, annual total amount of arrears to the IMF rather than one-on-one country specific was put in the data. This variable is likely to have a positive relationship to the toughness of conditionality by having the IMF's tighten conditions so as to ensure repayments.

- Previous Engagement: PREENGAG

Structural adjustment is characterized by recidivism. Many developing countries contracted conditionality agreements with the IMF over and over and program after program. This long-term dependency between the IMF and recipient countries is expected to reveal information about the other player's type and strategies, and it is likely to influence the outcomes of future bargaining. Hence, the outcomes of their interaction may be on the learning curve, based on the evaluation of past transactions and performance rather than independent of the past. Although this aspect of interaction between the IMF and developing countries is not properly captured in the bargaining game model by iteration, the effect of repeated encounter on the conditionality agreement can be statistically measured. In other words, transaction records, regardless of the types of arrangement prior to current negotiation, can measure the iteration. As it will be coded binary, not the number of previous encounters, this variable does not measure the degree

of iteration, however. If the two players have been engaged in multiple financial transactions, the toughness of conditionality will increase.

Table 4. 3 Descriptive Statistic of Expected Utility Components

EU Comp.	N	Min.	Max.	Mean	Std.Dev.
DSUBPROB	398	0.14	1	0.43	0.19
DDISCOUT	398	3.85	9.78	6.38	1.84
DOPPOCST	398	1.50	16182	354.24	1255.15
DREPUCST	331	182.7	3496	2324.16	1034.57
RSUBPROB	220	0	1	0.27	0.33
RDISCOUT	348	0	71.7	12.36	11.83
ROPPOCST	388	0	10461.53	563.55	1109.28
RPOLCOST	296	-9	10	-0.83	7.16

PREENGAG	Freq.	%	Valid %	Cumul. %
No Previous ENGAG	28	7.04	7.31	7.31
Previous ENGAG	355	89.20	92.69	100
Missing	15	3.77		

4.1.3 Independent Variable: Leverage

Operationalization of leverage is done only with economic indicators that are considered to be as relevant to conditionality bargaining, and this is partly a reflection of characteristics of the contemporary world economy, which is highly interdependent.

4.1.3.1 Operationalization and Measurement of Leverage for the IMF

- Size of Lendable Funds: FUNDSIZE

This variable measures financial capacity of the IMF, namely how well the IMF is prepared to lend. If the IMF is concerned about its liquidity position¹⁷ vis-à-vis its members, as mentioned earlier, the size of fund the IMF can dispose of will be a factor that determines the tightness of conditionality. Having said this, a problem with this operationalization is determining how much money the IMF can apportion for lending, given the fixed pool of fund based on members' quota subscriptions. The IMF might have principles for allocating its budget, although not shared with the rest of the world, and such principles could determine the whole size of fund lendable to member countries during fiscal year.¹⁸ What is more critical for operationalization, however, is how to divide the big pie into pieces for separate lendings. Simple amount of annual budget for lending does not suffice to tell us about how much the IMF can afford individual members' requests. Thus, FUNDSIZE enables us to capture a more bargainer-specific picture of IMF lending practice than the subjective probability of the IMF does.

Assuming that the annual lending budget is equals to the size of immediately usable fund without resorting to external borrowing, the IMF's preparedness for each lending can be measured as the ratio of the size of disposable fund (the sum of currencies

¹⁷ The Fund's liquidity position vis-à-vis developing countries is different from its overall liquidity position, which is calculated by the relationship between its immediately usable assets, comprising SDRs and usable currencies in the GRA, and its liquid liabilities consisting of members' liquid claims on the Fund (reserve positions, undrawn balances of ordinary resources and lenders' claims on the Fund). The Fund's holdings of gold are not included in the category of immediately usable resources.

¹⁸ According to Williamson (1983b), about one-half of the sum total of Fund quota, as a rule of thumb, is available for lending at any one time. Though in a slightly different context, namely raising quotas, Williamson's calculation of supply of and demand for IMF funds is worth referring to (pp. 657-659).

and securities from the five major donors and SDRs in GRA) less undisbursed loans, to the maximum amount of loan that a recipient can request within the pre-set access limits. As with the subjective probability for the IMF, the ratio is obtained from two formulae in accordance with the type of arrangement. The following is for SBA and EFF:

$$\frac{(\text{Currencies and Securities from 5 Major Donors} + \text{SDRs}) \text{ within GRA} - \text{Undisbursed Loans}}{\text{Access Limit by Arrangement Type} \times \text{Member's Quota}}$$

For SAF and ESAF, it follows as:

$$\frac{(\text{SLA} + \text{Accrued Interest from Investment}) - \text{Undisbursed Loan}}{\text{Access Limit by Arrangement Type} \times \text{Member's Quota}}$$

As the size of fund increases within which the IMF can comfortably approve loan requests, the tightness of conditionality will decrease. In other words, as the ratio gets larger, the IMF is likely to be more liberal and the number of conditions will decline.

- IMF's Exposure to Recipients: IMFEXPOS

This variable measures the size of transactions that the IMF has had with recipients thus far. It is measured by the cumulative amount of credits in SDR from the IMF to the recipient up to the time of current arrangement. This is the sum of all credits regardless of the type of arrangements through which credits were transferred, even including BSF, CFF, and STF. And it is likely to be in a positive relationship with the dependent variable.

- Degree of Exposure: DEGEXPOS

While the IMFEXPOS measures the total amount of transactions between the two players in absolute terms, it needs to be re-viewed from a relative perspective, namely, as a portion out of total. This variable will eventually be a test statistic of weight the IMF has put on individual recipients. The conversion of IMFEXPOS into ratio will be done by dividing it by total outstanding credits to all the developing countries arranged by the IMF. As the ratio goes up, the number of conditions is likely to decline.

- Five Major Donors' Quotas: 5MQUOTAS

The fund that the IMF manages depends on members' quota subscriptions, which is determined by their size of economy at their admission. Quota is a direct indicator of members' economic capacity and financial contribution to the IMF. Thus, the degree to which the interest of the five Executive Board member countries, as a collective actor, is represented in conditionality or the influence that they exert on conditionality decision can be partly measured by their quotas. This variable is the arithmetic sum of quotas in SDR from the five Executive Board members. The greater the contribution they make to the IMF is, the more conditions are likely to be issued.

- Votes Cast by Five Major Donors: VOTECAST

The IMF elected for a weighted voting system as its decision making rule, which is based on member's quota subscription to the IMF. This means that their economic power within the IMF is directly converted into political one, with which members can maneuver lending policies toward developing countries in their favor. The percentage of

votes cast by the five Executive Board members out of total votes of the year, was taken to measure their political power within the IMF. Traditionally the votes cast by the five major donor countries took up over 40% of the total, but this is now on the gradual decline. The more political power they have, the more conditions they are likely to impose.

- Amount of Official Development Aid: ODAAMNT

Although it has been traditionally project-oriented, official development assistance took substantial part of GNP, around 30% at minimum and 80% at maximum, in many developing countries. Aware of that, the major donors may capitalize on it, linking tomorrow's bilateral aid to today's conditionality bargaining as an attempt to achieve their preferred conditions. Thus, official development assistance from the five Executive Board members to LDCs claims a legitimate entry into the data set. In measuring the official aid flow to LDCs, it should be noted that total official aid from 20 Development Aid Committee (DAC) countries within Organization for Economic Cooperation and Development (OECD) and certain Arab countries was used altogether, not only from the five major donors. Statistics of official aid published by the DAC breaks down the flow of aid by origins and destinations. Nonetheless, DAC data based on creditor reporting system (CRS) concentrate on major recipients and many small countries were omitted from the list. On the other hand, World Bank data based on debtor reporting system (DRS) cover all the recipients, but ignores the origin of aid. This research used World Bank data in order to increase the number of available cases. It is obvious that using such data will inflate the amount of ODA from the five Executive

Board members. However, the official aid from the five Executive Board members still makes up more than 70% of total ODA (IMF, 1998a) and, thus, the amount may not be outrageously inflated. The official development assistance is likely to have a positive relationship with the number of conditions.

- Amount of Commercial Investment from Five Major Donors: COMINVET

Capital flows from the developed world to the developing do not consist only of aid. Commercial investments, a broader term for pursuit of profits from commodity production and financial activities, are the other form of capital flow to developing countries. They can choose one among foreign direct investments, portfolio investment in equity and bond, and syndicated bank lending. As with the official aid, for capital-stricken developing countries, hosting commercial investments from the capital-abundant donor countries could be an important survival strategy. Thus, the donor countries may take advantage of this as bargaining leverage. The sum of net private capital inflows to LDCs was used to measure this variable. Again, this data was not broken down by the origin of the capital, but the numbers do not appear to be unduly exaggerated. The number of conditions is likely to increase as the size of commercial capital influx to a recipient gets larger.

- Allowing Access to Five Major Donors' Market: EXPOACCS

A characteristic of the trade system of developing countries is lack of diversity in trading partners. Their imports and exports are directed to small number of countries, mostly former colonizer countries, and this could be a potential problem to them in

bargaining process. That is, if country “A” is relatively more dependent on access to markets in country “B” than “B” is on “A,” then “B” can be in a position to use its relatively lower dependence to exact concessions from “A” in trade negotiations or to link it to other negotiations, since “B” would suffer relatively lower cost from reducing or cutting off trade with “A.”¹⁹ This can happen during conditionality bargaining, if the major donors attempt to increase the toughness of conditionality by changing the degree of market openness to exports from the recipient. Thus, the degree of market openness to foreign trade, especially to exports, constitutes one form of leverage. It is measured by the percentage of exports directed to the five Board member countries out of the total exports from the recipient, which was extracted from *Direction of Trade Statistics Yearbook* published by the IMF. The more the five Board members open their market to the recipient, the more conditions will be agreed upon.

¹⁹ This argument should be balanced with the opposite situation that trade dependence helps the debtor. In a debt rescheduling agreement, a conflict of interest among different groups in the creditor country, pitting investors who want to enforce maximum repayments against consumers and exporters who want to maintain normal trade relations, can increase the relative bargaining power of the debtor. In punishing a debtor who repudiates, lenders may be inflicting damage on creditor-country citizens who benefit from trade with the debtor. Debtor countries have some leverage because foreign lenders do not directly benefit by cutting them off from world markets. See Bulow, Jeremy and Kenneth Rogoff. 1989. “Multilateral Negotiations for Rescheduling Developing Country Debt.” in *Analytical Issues in Debt*, eds. Jacob A. Frankel, Michael P. Dooley, and Peter Wickham. Washington, DC: International Monetary Fund.

Table 4. 4 Descriptive Statistic of Donor's Leverage

DLeverage	N	Min.	Max.	Mean	Std.Dev.
5MQUOTAS	398	25596	57839	44511.88	11228.50
VOTECAST	398	38.8	41.28	40.06	1.01
FUNDSIZE	398	-17.88	3640.41	177.37	376.13
IMFEXPOS	392	0	6430.67	329.65	630.62
DEGEXPOS	392	0	17.46	1.09	2.04
ODAAMNT	392	-243.95	5438.5	336.17	435.58
COMINVET	387	-467.8	20719	479.98	1899.28
EXPOACCS	328	3.70	93.45	41.95	18.45

- **Adjacency: ADJCNCY**

Geographical proximity has been regarded as a factor that provokes conflicts or facilitates cooperation in international relations. Economic disaster in one country easily spreads over others in the region and a leader country of the region would be willing to minimize contagion, containing the crisis at the epicenter, in order to maintain regional stability. Thus, the five major donor countries are likely to consider developing countries in the same region more favorably than those which are not. Following the World Bank's classifications of countries by geographical location, recipients are coded binary if they are located in the same region with any of the five major donor countries.

- **Colonial Ties: COLOTIE**

It is a well-known fact that many developing countries peg the exchange rate of their currencies to those of their former colonizers and their trade is highly concentrated with them. Their former colonizers are now dominant powers within the Executive Board

and this history-laden bilateral relationship between them could affect the interaction within the boundary of the IMF and work favorably toward the recipients.²⁰ Thus, colonial relationship in the past, which is coded binary, is included in the data set as political context variable.

- **Military Alliance: ALLIANCE**

An indicator of the strength of political relationship between two countries is whether they are bound by a defense pact. If a recipient country is integrated into an alliance system led by one of the major donor countries, economic policies are likely to be influenced by political considerations. Thus, whether a recipient country is allied to any of the major donors, especially to the United States, during the year of agreement will be coded binary and its effect on the number of conditions will be observed. The source of data is COW alliance data updated by D. Scott Bennett.

- **Military Aid from Five Major Donors to Recipient: MILITAID**

Another way of operationalizing political ties between the five major donors and recipients is military aid. Military aid can be offered to developing countries within or outside alliance systems in the form of arms trade, technology licensing and transfer, and military training. The only problem with operationalizing this variable is the lack of hard data on military aid. Data on military expenditure as a whole have been plagued with secrecy and accordingly inaccuracy, and data on military aid as part of them share the same problem. As a way of getting around this problem, a dummy variable of arms trade

²⁰ For examples of the influence of colonial ties combined with that of geographical proximity, recall Footnote 20 of Chapter 1.

between developing countries and the five Executive Board members was created. This assumes that transfer of conventional arms from the five major donors to LDCs is partly subsidized by the suppliers, and that subsidy is taken as military aid. Lists of arms trade during the period of 1983 through 1997 were obtained from *SIPRI Yearbook on Disarmament and Arms Control*, and arms trade between the five Executive Board members and recipients in the year previous to conditionality agreements was coded binary.

- International Context: INTCONXT

Other than bilateral political relationship, the general international context within which agreements for structural adjustment take place is also important.²¹ The most dramatic change in the contemporary international relations may be the end of Cold War. The demise of communism in Eastern Europe and Russia not only has changed the landscape of international relations; it has also resulted in world leaders altering their national interest and the scheme for calculating it from those during the Cold War period. This effect could be extended to conditionality bargaining. Thus, to trace back up the impact of the changes in international context on conditionality, a dummy variable of Cold War distinguished from the year of 1990 was created.²² It is likely that the major donors were less harsh with recipients during the Cold War period than Post-Cold War period.

²¹ The effect of context on international relations is well examined in Goertz, Gary. 1994. *Context of International Politics*. Cambridge, MA: Cambridge Univ. Press. He classifies contextual effect in three types, i.e., as barrier, cause, and changing meaning. Applying his theory to conditionality bargaining, context functions as a cause since it would change states' interest in Fund lending and conditionality.

²² The breakdown of the Berlin Wall in 1989 is considered as the beginning of post-Cold War period in this dissertation. However, this breakdown might have effected in international relations from 1990.

Table 4. 5 Frequencies of Donor's Leverage in Binary Form

	Freq.	%	Valid %	Cumul. %
ADJCNCY				
Not Same Region	285	71.61	71.61	71.61
Same Region	113	28.34	28.34	100
COLOTIE				
No Colonial Ties	184	46.23	46.23	46.23
Colonial Ties	214	53.77	53.77	100
ALLIANCE				
Not Allied	314	78.90	78.90	78.90
Allied	84	21.11	21.11	100
MILITAID				
No Military Aid	305	76.63	76.63	76.63
Military Aid	93	23.37	23.37	100
INTCONXT				
Cold War	188	47.24	47.24	100
Post Cold War	210	52.76	52.76	52.76

4.1.3.2 Operationalization and Measurement of Leverage for the Recipient

- Total External Debt: TOTDEBT

One of the ways that the recipient countries can handle the situation in their favor is capitalizing on their financial and economic relations with the major donors by threatening total moratorium. This is a situation that can be succinctly illustrated by Keynes's oft-quoted dictum "if you owe the bank a thousand dollars, you have a

problem; if you owe the bank a million dollars, the bank has a problem.” With sufficiently large debt cumulated, developing countries can threaten default of debt service, and this can drag creditors into economic mishaps. Any breakdown in bank-debtor country relations would necessarily have repercussions elsewhere and debt crisis becomes a public affair with creditor governments and international organizations (Aggarwal, 1987; Chan, 1993). Thus, the total external debt the recipient has accumulated is eligible to be bargaining leverage. Total external debt, regardless of its origins and even including credits from the IMF, will be used. This variable is likely to be in an inverse relationship with the number of dependent variable.

- **Severity of Economic Crisis**

- Balance-of-Payments Current Account Deficit: BOPCUADF;
- Inflation Rate: INFLAT;
- Unemployment Rate: UNEMPLO;
- Overall Government Budget Deficit to GDP: BUDGDEF

Many, but not all, adjustment talks with the IMF are preceded by economic crisis in a prospective recipient country.²³ Thus, many aspects of bargaining with the IMF, such as outcomes and length of negotiation, are likely to be affected by the severity of its economic crisis. Although economic crisis can be diagnosed with many other symptoms, this research uses balance-of-payment current account deficit, inflation rate of consumer

²³ Some recipient countries go into adjustment agreements with the IMF as a precautionary step, even though their economies do not show obvious signs of economic crisis. Stand-by Agreement for the Philippines in 1998 was such case, where the Filipino government initiated a talk with the IMF, since it expected an abrupt depreciation of its currency in the wake of currency crisis in the region summer of 1997. This was also to cope with balance-of-payments problems in the foreseeable future, which would be caused by foreign exchange crisis.

price index, unemployment rate, and ratio of consolidated budget deficit to GDP as indicators of economic crisis. Actually these are the problems that the IMF wants to tackle through structural adjustment in developing countries and, thus, it will be of our interest to observe their relationship to the toughness of conditionality. The more severe the economic crisis is, the more conditions a recipient is likely to agree upon.

- **Use of IMF Credit: IMFCRDTS**

This variable uses the same data with the variable of IMFEXPOS for the IMF. However, the meaning it has to the recipient will not be the same as to the IMF. Who will be benefited from this shared part by both sides in conditionality bargaining will be determined by other interacting variables.

- **Foreign Direct Investment Inflows: FDIINFLO**

Moving production facilities to foreign countries of low cost or investing in them to acquire a lasting management interest (10% or more of voting stock) became common moves for developed countries, and these multilateral economic activities are the main driving force behind globalization. While foreign direct investment must be a lucrative opportunity for both investors and host countries, it is also true that there are associated risks—the risk of nationalization, as seen in the movement of New International Economic Order (NIEO) in the late 1970s, or when hosting countries become entangled in domestic political upheavals, or when the relationship between home and host countries turns sour. Therefore, being a popular target for foreign direct investments or hosting many foreign direct investments is an asset to that country, which can be taken

advantage of through nationalization in case. Thus, foreign direct investment as leverage in conditionality bargaining will be measured by the size of net foreign direct investment inflows from the major donor countries since they are home countries of the MNCs most active in foreign direct investment. The more a recipient hosts foreign direct investment, the less likely it will agree upon tough conditions.

- **Portfolio Equity Investment: EQIINVET**

Unlike foreign direct investment, portfolio equity investment does not involve participation in management. Equity flows are the sum of country funds, depository receipts, and direct purchases of shares by foreign investors. They reflect the internationally perceived value of the stock market of the country and accessibility. The global accessibility looms more important than ever as international investors turn their eyes to the so-called emerging markets with expectation of fast and high returns. Thus, a recipient country which has provided good investment opportunities may use its accessibility and profitability as leverage in conditionality bargaining. The amount of the net portfolio equity investment will be used for this variable, which is likely to be in an inverse relationship with the number of conditions.

- **Ratio of Trade to Gross Domestic Production: TRADEGDP**

A country's economic structure is also likely to affect its bargaining position vis-à-vis the IMF, especially if the economy is structured to be self-sufficient or dependent on other states for food and material resources. Autarky, as state of economy or a national policy of restricting economic exchanges across borders, is often deliberately pursued

with a view to maximizing the state's independence of influence from other countries and to making a country more easily governable. While autarkic economies are likely to insulate them from vicissitudes in international economy, interdependent economies are more likely to be subject to external changes and lose their leeway in managing economy. Thus, the import of economic structure will stand out at juncture rather than in times of peace, and conditionality bargaining preceded by economic crisis will be one of those cases. In examining the influence of structure of economy on conditionality bargaining, the weight of trade in gross domestic production will be a proxy measure of the degree of self-sufficiency. Recipients that have a high ratio of trade to GDP are more likely to receive more conditions than the ones who have a low ratio.

- State-Owned Enterprise to GDP: SOEGDP

One common policy for structural adjustment is reducing the range and scope of public sector in economic activities and expanding those of private sector. What is usually done to achieve this goal is restructuring and privatizing state-owned enterprises (SOEs), accompanied by massive lay-off. This sudden increase in unemployment puts political pressure on the government under adjustment and can even lead to political instability. These expected political consequences of structural adjustment may be used to excuse recipients from tough conditions. Thus, possible domestic rent-seeking behavior or politics of special interests will be surrogated by the economic activity of SOEs in the economy (GDP). Here economic activity of SOEs is value added as the sum of their operating surplus (balance) and wage payments. The magnitude of SOEs' economic activity is likely to be in an inverse relationship with the number of conditions.

- **Ratio of Imports to Gross Domestic Production: IMPOGDP**

Theoretical reason for this variable is the same with TRADEGDP but from the opposite direction—that is, how much an economy is domestic oriented and how large domestic market is. However, looking at the structure of economy from the angle of imports is intended to catch not only the economic, but also the political meaning in relation to politics of special interest. In many developing countries import-substitution-industrialization has political rationality to protect particular social segments and constituencies through economic policy, which will affect conditionality bargaining in one way or another. Thus, the ratio of imports to GDP is another proxy measure of rent-seeking behavior in developing economy. Recipients that have a higher ratio of imports to GDP are less likely to receive a higher number of conditions than others who have a lower ratio.

- **Size of Urban Population: URBANPOP**

Implementing structural adjustment is known to have a different influence on social segments. Especially if adjustment accompanies drastic government spending cuts in terms of subsidies and payrolls, and price increase of imported foodstuff through devaluation, the social segment that is hit hardest is urban labor class, who was once beneficiary of urban bias. Overurbanization in developing countries sets the principal conditions for the occurrence and severity of protests against structural adjustment involving international agencies such as the IMF (Walton and Ragin, 1990), and the urban labor class is easily mobilized to represent its interest through mass movements. This urban resistance to adjustment affecting their interest is one of the obstacles to

overcome in order for the recipient government to implement externally required economic reform. Thus, the urban population is used as an indicator of the presence of a politically charged urban labor class in the recipient country.²⁴ This variable is likely to reduce the tightness of conditionality as its size increases.

Table 4. 6 Descriptive Statistic of Recipient's Leverage

RLeverage	N	Min.	Max.	Mean	Std.Dev.
BOPCUADF	367	-29660	10723	-731.00	2751.08
INFLAT	304	-100	11750	140.49	1051.35
UNEMPLO	154	0.1	56.3	10.55	10.68
BUDGDEF	208	-35.56	6.38	-4.27	4.93
TOTDEBT	392	3.7	140010	11468.89	21769.28
IMFCRDTS	392	0	6430.67	329.65	630.62
FDIINFLO	391	-217.7	10972	223.03	839.20
EQIINVET	391	0	5528.8	83.36	485.95
DEBTINFL	388	-2484.2	9629.5	201.12	1024.55
TRADEGDP	387	6.32	227.93	67.33	36.11
IMPOGDP	387	2.982	131.74	37.69	21.35
SOEGDP	120	0.4	50.1	9.32	8.24
URBANPOP	398	5.2	90.5	42.24	20.26

- **Significance to International Finance: INFINSIG**

While the INTCONXT measures the impact of a broader international context, more narrowly defined international context, which is relevant to issues at hand, should

²⁴ Another way to test the impact of urban population on structural adjustment is using the degree of urbanization measured by residuals from the regression of level of urbanization on GNP per capita, as Walton and Ragin did in their work.

also be considered. The Fund's activities reflect its founding purpose of stabilizing international economy through monitoring balance of payments and foreign exchange adjustment in member countries. With the advent of a highly mobile and integrated international financial system in the early 1990s, however, the IMF has paid keen attention to developments in international capital markets, which is also of interest to the major Executive Board member countries. Furthermore, in conjunction with their overseas investment activities, the five Board members are likely to give special attention to conditionality agreements with the so-called emerging market economy countries. The significance in international finance of a developing country seems to be hinged on two things: their investment potentials and the seriousness of its economic problems to draw attention from international investors. Once a developing country is designated as an emerging market economy, its investment potentials are quasi officially recognized. Thus, the financial significance of a developing country is coded binary if it has been listed as an emerging market economy in *The Economist* since 1993 and arranged loans with the IMF, which were equivalent to 100% or more of its quota subscription as the indicator of seriousness of its economic problems.

- Resource Endowment: RESOENDW

Two times' oil embargo in the 1970s had crippled the world economy and made Western industrialized countries, which were dependent on imported oil, vulnerable to external forces. Since then, endowment with natural resources, especially oil, has been given a special position in international political economy. Even though the power of oil and the influence that oil exporting countries exert on the world economy has faded, their

status, even if they are in an economic crisis, will have a bearing on lenders' perception of the situation, and this will be the case as long as oil remains the vital fuel source for industrial activities. Thus, incorporating the power of oil into the model will illustrate the effectiveness of natural endowments as leverage in external financial relations. Coding fuel-exporting countries follows the World Bank's country classification: a recipient is a fuel-exporting country if oil exports take at least 50% of the total export of goods and services. If a recipient is endowed with oil, it is less likely to receive tough conditions.

- Economic System: ECONSUS

The demise of communism in Eastern Europe and Russia meant not only political democratization, but also transformation of economy into capitalist system. With the admission of former communist countries and spin-off countries from the Russian Federation into the IMF, the IMF undertook a mission to march market economy to those countries, and the transition process in these countries is likely to affect their position in conditionality bargaining vis-à-vis the IMF. Thus, the economic system that recipient countries have, whether they are economies in transition or long-standing capitalists, will be treated as a dummy variable. And being an economy in transition is likely to increase the number of conditions, rather than reduce it.

Table 4. 7 Frequencies of Recipient's Leverage in Binary Form

	Freq.	%	Valid %	Cumul. %
INFINSIG				
Not Significant	392	98.49	98.49	98.49
Significant	6	1.51	1.51	100
RESOENDW				
Non Oil Endowed	363	91.21	91.21	91.21
Oil Endowed	35	8.79	8.79	100
ECONSYS				
Capitalist	316	79.40	81.65	81.65
Former Communist	71	17.84	18.35	100
Missing	11	2.76		

There are two more independent variables, which will be used for statistical analysis: member quota subscriptions (QUOTA) and the ratio of amount of agreed loan to quota (AMNTQOTA). The descriptions of these variables are omitted from this section since they do not require any operationalization and measurement. They use information as given by the IMF in *Annual Reports* and the press releases in *IMF Survey*. For reference purposes, their descriptive statistics are provided below.

Table 4. 8 Descriptive Statistic of IMF-Recipient Financial Transactions

TRANSACT	N	Min.	Max.	Mean	Std.Dev.
QUOTA	398	4	4313.1	290.42	501.51
AMNTQOTA	398	15	1939	89.96	117.50

4.2 STATISTICAL METHOD: POISSON MODEL FOR COUNT DATA

The number of agreed conditions was chosen to be the dependent variable for statistical analysis. Those numbers are discrete, not continuous, and can be said to be counts of events that occur in a particular way: events that an underlying social system produces randomly during a fixed time period and, at the end of the period, only the total of these events is observed. Although it remains unobserved, the underlying process that drives the observed counts is of considerable substantive importance, which statistical analysis ultimately seeks for, and an event count is the aggregation of this underlying process (King, 1989). Event counts that results from a process are distributed according to the Poisson distribution. The Poisson distribution is

$$Y_t \sim f_P(y_t | \lambda_t) = \frac{[\exp(-\lambda_t)](\lambda_t)^{y_t}}{y_t!},$$

where Y_t is the dependent variable, t refers to time, y_t is a particular realization of Y_t , and λ_t is the rate of event occurrence. This distribution is appropriate for event count analysis because it can take only on the values of non-negative integers and does not have upper bound, which theoretically enables us to count an infinite number of events in each episode. Applying the event count approach to conditionality, component conditions of an adjustment package are events and the total number of conditions is the count of them. It could be assumed that there are certain unobservable underlying continuous effects on the number of conditions. This assumption can also be expanded into that the rate at which recipient countries agree upon conditions with the IMF can take a probability

distribution. That is, the rate at which countries agree upon conditions is the probability of leverage that each player mobilizes to the bargaining. Thus, the observed number of conditions is used to estimate the underlying variable. Plugging components of conditionality data into the distribution formula, Y_t is the number of agreed conditions, t refers to particular episodes of agreement, y_t is a particular item of condition of Y_t , and λ_t is the rate of condition occurrence or probability of leverage. Since count of conditions takes only positive values and no specific restriction to the number of negotiable conditions has been identified, the Poisson distribution fits the nature of data.

There are two things noteworthy in applying the Poisson distribution to the data of conditionality. First, the Poisson regression model in this analysis uses data implicitly truncated at zero. That is, since the dependent variable is the number of conditions agreed upon, zero might represent qualitatively a situation that the recipient country did not contact the IMF at all, let alone reach an agreement on conditionality. On the other hand, values greater than zero represent the number of conditions that a recipient country consented to implement in addition to indication of preceding contact with the IMF. In such a setting, it might make sense to confine our attention to the non-zero observations, thereby the distribution of dependent variable is truncated at zero. And, deriving the Poisson distribution requires two key substantive assumptions that events accumulating during observation period i are independent and they have a constant rate of occurrence, λ . This directs to the principle of complete randomness, where ideally the variance is equal to the mean, but it is not very natural or practical for all situations (Consul, 1989).

In practice this means that the rate of agreeing upon conditions is the same across individual agreements, which might not be the case.²⁵

The Poisson distribution is one of special probability distributions formed through experimental situations and used as models of observed phenomena. That is, by listing expected probability of a random variable, those distributions only allow us to confirm whether the underlying process approximates a specific distribution. Those distributions in themselves are not to measure the effects of particular independent variables, which is of interest to the majority of cases in econometrics. To obtain the results we intend to with probability distributions, the Poisson model should be transformed into one that combines regression concepts so that we can estimate the unobserved rate from independent variables (Martin, 1992). Thus, from the Poisson distribution, a Poisson regression model to find the unobserved continuous process is specified as a function of these explanatory variables,

$$E(Y_i) = \lambda_i = \exp(\chi_i, \beta),$$

where χ_i is a vector of explanatory variables and β is a parameter vector, indicating the effect of each explanatory variable as the underlying rate of leverage, λ .

²⁵ If either of the assumptions is not met, a different distribution for total count, Y_i , will be produced. That is, by assuming that λ varies within an observation—or that a particular form of “contagion” which affect one another negatively or positively—occurs among individual events making up Y_i , negative binomial distribution is formed. In the negative binomial distribution, λ is still the expected rate of events. Whereas $\text{Var}(Y_i) = \lambda_i$ in the Poisson distribution, then negative binomial distribution sets it as $\text{Var}(Y_i) = \lambda_i \exp(\gamma)$, where γ registers contagion. The more events within observation i that either have heterogeneous λ or are positively correlated, the larger the parameter σ^2 will be. Although σ^2 cannot equal one in this distribution, the smaller σ^2 is, the closer the negative binomial distribution is to the Poisson. For a full explanation, see King, Gary. 1989a. “Event Count Models for International Relations: Generalizations and Applications.” *International Studies Quarterly* 33:23-147; and 1989b. *Unifying Political Methodology: The Likelihood Theory of Statistical Inference*. New York: Cambridge Univ. Press. Additional analysis results using negative binomial distribution are given in Appendix 2.

The Poisson model will be estimated using maximum-likelihood techniques with both systematic and stochastic components, rather than least squares. Conventional least squares estimation is characterized, among others, by the assumption of linearity of a parameter or parameters and normality of disturbances and, thereby, dependent variable is also normally distributed. In addition, least squares method treats negative and positive observations symmetrically, and involves sums of observations that weight all observations equally. While only continuous variable can be normally distributed, the Poisson model is based on discrete dependent variable and, in principle, a nonlinear regression. The discrete nature of the number of conditions and the preponderance of small finite or countable infinite values in the Poisson model suggest that the conventional least squares technique is not appropriate. On the other hand, maximum likelihood estimation is a statistical method that makes more explicit use of information about the presumed shape of the disturbance distribution and the logic of which is best illustrated in the setting of a discrete distribution (Greene, 1993). Thus, it will be easier to estimate the parameters of nonlinear equations of Poisson model with maximum likelihood techniques than with ordinary least squares. The likelihood function of the Poisson regression is:

$$L(\beta|y) = \sum_i [y_i \beta' x_i - \exp(\beta' x_i) - \ln y_i!].$$

For the last, it is important to note that the numerical value of maximum likelihood estimate is interpreted as the probability at maximum of observing a particular sample, assuming that a hypothetical model with unknown parameter, β , generated the

data. Therefore, the likelihood parameters of the model are not necessarily the marginal effects as the coefficients in the linear regression model are read.

The interpretation of the theoretical findings in the previous chapter will be limited if they are not statistically tested. Thus, this chapter represented a preparation en route to empirical tests of them in the following chapter. Dependent and independent variables and a matching statistical method were specified, which would be used to test the underlying process of leverage in the conditionality agreement. The key criterion for selecting these variables was whether or not they were relevant as leverage in the issue area of conditionality bargaining, and it also took into account the broader contextuality of conditionality bargaining so that characteristics of international system could be listed as eligible leverage. Now we move onto testing the specified hypotheses by grouping and/or combining the listed variables.

CHAPTER 5

EMPIRICAL TESTS OF CONDITIONALITY BARGAINING MODEL

Having the hypotheses and the statistical method specified, I shall now proceed to empirical tests of the conditionality bargaining model, using the variables described in Section 4.1.1 through 4.1.3. The focus of analysis is on identifying the unobserved rate of recipient's agreeing upon conditions with the IMF (i.e. the impact of leverage on the bargaining outcomes). In other words, how does the existence or nonexistence of leverage affect the toughness of conditionality agreement indicated by its number? Since both parties of the bargaining can influence the number of conditions, TITNESS, statistical analyses will be conducted in separation for each player with groups of independent variables of similar nature. First, it levels ground by testing conflicting views on IMF conditional lending.

5.1 CONTROVERSIES ON CONDITIONAL LENDING PRACTICE

As a reply to criticisms of its inflexibility in conditionality, the IMF claims that it treats member countries fair by strictly applying rules based on quota and credit tranche. The Fund's external relations documents (IMF, 1998a) say that conditionality is basically dependent on whether or not their borrowing is exceeding their first credit tranche (25% of quota), and that high conditionality is automatically followed if a recipient requests loan of upper tranche or exceeding its quota subscription. Thus, a model specification to verify

IMF's claim is formed below, using the members' quota subscriptions (QUOTA) and the proportion of agreed amount to their quotas (AMNTQOTA).

Remarking on the tables of statistical results hereafter, robust standard errors are added to regular estimates of coefficients, normal standard errors, and p-values. The robust standard errors are White's heteroscedasticity-corrected variances,¹ which test heteroscedasticity common in cross-sectional data. Although tests designed to detect heteroscedasticity are usually applied to ordinary least squares residuals, the White test of heteroscedasticity is general and does not rely on the normality assumption of classical linear regression model (Gujarati, 1995), and thus it is applicable to this dissertation. White's heteroscedasticity-corrected standard errors can be larger or smaller than uncorrected standard errors, and the statistical significance of regressors can accordingly change. The statistical significance in the following analyses, however, are judged by normal standard errors, and p-values that lost or gained statistical significance with the White standard errors at 0.05 level are marked with an asterisk (*).

Table 5. 1 Quota Proportionality and Conditionality

Log likelihood = -1191.7903				Number of obs =	395
				LR chi2(2) =	101.46
				Prob > chi2 =	0.0000
				Pseudo R2 =	0.0408
TITNESS	Coef.	Std. Err.	R.Std.Err.	z	P> z
QUOTA	.0001871	.0000223	.0000408	8.382	0.000
AMNTQOTA	.0004954	.0000816	.000086	6.070	0.000
_CONS	2.449968	.0176228	.0221846	139.023	0.000

¹ For White's standard errors, refer to White, Halbert. 1980. "A Heteroscedasticity-Consistent Covariance Matrix Estimator and a Direct Test for Heteroscedasticity." *Econometrica* 48, no. 4:817-838.

The above result indicates that the IMF abides by its proclaimed policy. The number of conditions increases as the percentage of the agreed loan to member's quota increases. What appears to be rather perplexing in this result, however, is the sign of coefficient and the significance of QUOTA. Theoretically, the quota *per se* in absolute terms is not likely to have a direct bearing on high conditionality until it is transformed into relative terms as the ratio to the amount of arranged loan, which means there should be no systematic relationship to conditionality. Or, alternatively, it will sound more logical if it shows a negative coefficient sign, since the quota subscription is a measure of members' economic capacity in the world economy and financial contribution to the IMF. Thus, a fair expectation is that the more quota a member country subscribes, the less tough conditions it will receive. However, my research did not support this contention.

The IMF's defense would be strengthened if it can refute an opposite conventional allegation against conditionality. Structural adjustment is known to have produced more or less disappointing results and this record was worse in the poorest countries. A putative blame mounted against the Fund is that it is tougher with the poorest members and usually puts more conditions on arrangements of concessional nature, such as SAF and ESAF (Killick, 1995). This is an irony to many, since those arrangements were established to support special needs of heavily indebted poorest countries. Thus, it is put on a test whether facilities of concessional nature added extra toughness on conditionality besides the rule of proportionality above. The Fund's unequal treatment for poor countries can be easily operationalized with types of arrangement. If types of arrangement have a different effect on the number of conditions, the allegation will be verified. A model for this test has two dummy variables for arrangement types, EFF and SAF/ESAF, of which SBA is the

base or omitted category. By doing so, arbitrarily ranking those types is avoided and statistical results will reveal their relative inequality. During data collection, it was observed that some recipient countries contracted more than one agreement with the IMF at the same time, and this is interpreted as an effort on the recipient side to get around access limits in order to fill up the balance-of-payments gap. Hence, another dummy variable for multiple arrangements (JNTARRGT)² is added to the model.

Table 5.2 indicates that the conventional allegation was not groundless. Since the variables are dummies, the difference in coefficients does not mean difference in slope, but difference in intercepts. The facilities with concessional elements turned out to start at a higher intercept than SBA's, which means the base number of conditions is higher. And EFF, although not concessional, requires additional efforts on the IMF side to arrange external borrowing on behalf of recipient countries, and is also associated with a higher conditionality than SBA. On the other hand, contracting multiple arrangement at one time did not show a theoretically expected coefficient sign, nor did it have significant influence on the toughness of conditionality.

Interestingly enough, the results from the two models support both sides of the debate on conditionality. The IMF has advocated for its fair practice in conditionality, invoking the rule of proportionality of quota and conditions, and this defense is upheld. On the opposite side, a criticism in the field that the IMF was not only arrogantly inflexible in designing adjustment programs but also biased against poor countries (which are more likely to be unleveraged than not), was sustained, too. What is inferred from this result is

² In my data set 48 (12.06 %) cases out of 398 were identified to be joint arrangement. They were usually combination of SBA and one of SAF and ESAF.

Table 5. 2 Type of Arrangement and Conditionality

Log likelihood = -1211.3519						Number of obs = 395
						LR chi2(3) = 62.33
						Prob > chi2 = 0.0000
						Pseudo R2 = 0.0251
TITNESS	Coef.	Std. Err.	R.Std.Err.	z	P> z	
EFFD	.2817696	.0472401	.0634486	5.965	0.000	
SAFESAFD	.2103832	.0320927	.0385329	6.555	0.000	
JNTARRGT	-.075636	.0439919	.0555368	-1.719	0.086	
_CONS	2.479571	.0183646	.0265961	135.019	0.000	

that each side of the debate has chosen one aspect of the phenomenon for its convenience and unduly emphasized it. Viewed in a more objective manner, this statistical result, while confirming both sides' grounds, indicates that IMF lending practice has been basically standing in the middle ground and that it is the applied method in formulating conditionality that distinguished results. Conditionality agreements have not been contracted invariably through one process; in some cases, the IMF fairly abided by the rule of proportionality, and in others, it did not. This is nothing but a statistical evidence for the presence of bargaining process in conditionality agreements. That is, whether a recipient will contract a conditionality agreement following the rule of proportionality or imprudent treatment is not predetermined but dependent on its bargaining with the IMF. Now the question is what factor determines the final choice of conditionality formula between the rule of proportionality and harsh treatment? The answer seems to lie with leverage.

5.2 THE IMF AND LEVERAGE

If the maintained proportionality is the only factor that affects the toughness of conditionality, difference in agreements should have a fixed number of conditions in proportion to the ratio of agreed loan to quota. Apparently, that is not the case, and the following is an analysis of the IMF's leveraged behavior to purposely increase or decrease the number of conditions beyond the proportionality:

- Expected Utility Components and Conditionality

The components of expected utilities of conditionality bargaining are neither directly related to leverage, nor do they function like leverage. However, those ingredients still affect the total value of bargaining outcomes as seen in the propositions, and accordingly, players' preferences over them.³ Thus, the relationship between the changes in the magnitude of components and the number of conditions is examined with the following specification. The double entry of opportunity and reputation costs (simple and quadratic terms) is due to their curvilinear relationship to the dependent variable. This is a combined specification that directly tests the four hypotheses regarding utility ingredients (Hypotheses 1b, 2a, 4, 5b and 7k derived from Propositions 1, 2, 4, 5 and 7) at the end of Chapter 3.

³ In a sense, the outcomes of the bargaining model in Chapter 3, especially Agreement ① through ⑥, can be differentiated by the number of agreed conditions, if qualitative comparison of contents is not feasible.

opportunity cost and tightness of conditionality may be related to fear for default in the future. That is, the opportunity cost is in exact proportion to the size of presumed loan. If the size of loan is large enough, the IMF may not reflect the face value of opportunity cost for fear of default by the recipient in the future and, thus, the number of conditions will not increase continuously.

The different coefficient signs of reputation cost indicates that the number of conditions will increase as the reputation cost increase, but it will start to decline after the reputation cost goes beyond a certain point. In this analysis, the reputation cost was measured by arrears to the IMF, and this trend reveals an interesting behavior of the IMF in conditional lending. That is, there could be many reasons why recipients fall behind its debt service to the IMF. A possible cause that some scholars suggest is that structural adjustment was too defected to generate resources to recipients for debt service, but the IMF has not realized it (Sachs, 1989; Bird, 1995). The fact that the number of conditions increases as the reputation costs increases reflects this argument. The Fund remains desensitized to this problem until the arrears become a burden on its financial capacity, and starts to correct program defect from that point as indicated by its quadratic term. The variable of PREENGAG was included to measure the effect of the repeated encounter between the IMF and recipients, and the learning effect as an alternative to modeling an iterated game. The result says that the Fund's previous financial relationship with the recipient influences positively the number of conditions but not significantly. This means that the five major donor's interest and decision in conditionality is more likely to be based on other issues and circumstances at the moment than the evaluation of the past performance of the recipient. This explains the recidivism in conditionality agreements.

- Institutional Arrangement within the IMF and Conditionality

The institutional arrangements within the IMF that allow the five Executive Board members to exert influence on the decision making process in general are likely to affect the number of conditions, too. In this respect, the most important institutional arrangement of the IMF appears to be the scheme for fund formation: member quota subscription. About 40% of annually required funds are provided by the five Board member countries, and the other 60% comes from the other 177 members. Another institutional setting of the IMF to be considered is the decision making process using a weighted voting system, which is in turn based on members' quota subscription. Within the IMF, economic power and voting power are two sides of one coin. The overwhelming financial contribution to the IMF enables the five major donors to collectively enjoy up to 40% of total votes cast. The five Board members can influence the number of conditions in proportion to their financial contribution to the IMF through their voting power at program approval stage. With this specification, Hypothesis 7a of Proposition 7 will be tested.

Table 5. 4 IMF Institutional Setting and Conditionality

Log likelihood = -1109.7953				Number of obs =	395
				LR chi2(2) =	260.88
				Prob > chi2 =	0.0000
				Pseudo R2 =	0.1052
TITNESS	Coef.	Std. Err.	R.Std.Err.	z	P> z
5MQUOTAS	4.45e-06	2.85e-06	3.58e-06	1.559	0.119
VOTECAST	-.1781124	.0321259	.0397333	-5.544	0.000
_CONS	9.467126	1.401448	1.738459	6.755	0.000

According to the above table, the number of agreed conditions would be on the rise, as expected, when the five major donors put more money into the pool of fund, but it does not have a significant impact on the toughness of conditionality. On the other hand, their voting power converted from their financial contribution to the IMF has a significant inverse relationship with the intensity of conditionality. That is, as the portion of votes cast by the five donors goes up, the number of conditions to be issued to recipient countries will decline. The insignificance of 5MQUOTAS and crossing curves of 5MQUOTAS and VOTECAS is seemingly odd, but is a correct reflection of trend in fund formation and voting power by the major donors. That is, since 1992, the five Executive Board members have donated money in absolute amount more than ever, but still their portion in total fund formation has declined below 40%, and so has their voting power. Compared with the situation before 1992, the five major donors used to enjoy more voting power while providing less resource. The plummeted conversion rate of 1 SDR of quota into votes indicates that their privilege has been edged off for the past five years. Nonetheless, the inverse relationship of voting power to the toughness of conditionality in the 1990s demonstrates that changes in internal and external environments surrounding the IMF, which will be seen later, filled in the major donors' weakened institutional capabilities and provided them with opportunities to tighten conditionality.⁴

⁴ This discrepancy is similar to what Leech calls "voting paradoxes" at collective level—where a member's share of the votes has increased but its share of power fallen or vice versa. For the detailed description of weighted voting and actual voting power in the context of the IMF, see Leech, Dennis. 1998. *Power Relations in the International Monetary Fund: A Study of the Political Economy of a priori Voting Power using the Theory of Simple Games*. University of Warwick CSGR Working Paper 06/98.

- **Financial Relations and Conditionality**

As the lender of last resort, two types of financial relations will affect the number of conditions that the IMF likes to issue: first, the IMF's financial capacity (i.e., the degree of preparedness to accommodate recipient' request at the onset of bargaining, which will be a private information); and its financial involvement with recipients (i.e., the degree of exposure to the recipient). The degree of exposure receives special attention since, in case that negotiation should rupture, fear for default will be a function of outstanding credits that the IMF has provided for the recipient so far. Thus, modeling with variables for present and past financial relations of the IMF to the recipient will be appropriate in examining the operation of leverage. This specification includes the IMF's subjective probability, since it is formulated with the notion of the IMF's liquidity position vis-à-vis recipient countries. This specification tests Hypothesis 7b of Proposition 7.

Table 5. 5 Financial Relations and Conditionality

				Number of obs	=	388
				LR chi2(6)	=	56.97
				Prob > chi2	=	0.0000
				Pseudo R2	=	0.0235
Log likelihood = -1184.4156						
TITNESS		Coef.	Std. Err.	R.Std.Err.	z	P> z
DSUBPROB		.289684	.0719904	.0924084	4.024	0.000
FUND SIZE		-.000083	.0000414	.0000635	-2.006	0.045*
IMFEXPOS		.0006141	.0002035	.0002684	3.018	0.003
IMFEXPO2		-5.92e-08	2.90e-08	3.85e-08	-2.040	0.041*
DEGEXPOS		-.2057179	.0658543	.0857881	-3.124	0.002
DEGEXPO2		.0096807	.0035157	.0048862	2.754	0.006
_CONS		2.434571	.0391532	.0547982	62.181	0.000

In adjusting the degree of the tightness of conditionality with financial leverage, the IMF's subjective probability plays a significant role, unlike in the specification only with utility components. As an indicator of confidence level in liquidity position vis-à-vis developing countries, the higher subjective probability the Fund has, the more conditions was requested. Its significance says that it has impact on trimming the number of conditions. The IMF also appears to put more conditions to its loans in order to increase the probability of debt service by recipient countries when its liquidity position is squeezing, which is measured by the ratio of lendable fund to possible maximum request from the recipient (FUNDSIZE). On the other hand, the IMF becomes liberal and generous with conditionality, if it manages relatively abundant funds.⁵ Especially the inverse relationship between the size of lendable funds and the number of conditions agreed should be regarded as a realization of the assumption about the IMF's utility in ensuring loan repayment. That is, the IMF, as the lender of last resort, is concerned about maintaining usable fund at a certain level, and thereby, tries to increase the probability of debt service by recipient countries through high conditionality (Bird, 1995).

The direct relationship between the size of outstanding credits to the recipient and the number of conditions is apparently correct, taking into account Fund utility in loan repayment. Its quadratic term, IMFEXPO2, on the other hand, indicates that the

⁵ This result is in line with a general cyclicity in IMF conditionality noted by Williamson (1983), Cooper (1983), and Cornelius (1988): IMF conditionality is stricter when the world is in a recession than when there is a boom. Large fund, which is made possible from a worldwide economic boom, enables members to pay their quotas on time and clear arrears and/or enough private lending to bypass the IMF. Less demand for IMF credits, or the IMF's reaction to the declining use of its credit potential, leads to easier conditionality. The IMF is likely to make itself attractive as a lender by relaxing conditionality. On the other hand, when the world economy is in recession, the IMF tightens conditionality to reduce the demand for IMF credits.

toughness of conditionality will be mollified if the IMF has lent beyond a certain level, and this is interpreted as related to potential threat for default. The only problem with examining the relationship between the accumulated credits in absolute amount and the number of conditions is that it is likely to fail to capture a bigger picture of the dynamics between the IMF and the recipient. Rather the dynamics between the IMF and the recipient is likely to be better portrayed with the relative size of credits against the total credits. Thus, the variable measuring this relativity, DEGEXPOS, turns out to have an inverse relationship with the number of conditions with significance. The more portions of total credits were lent to a particular recipient, the fewer conditions were imposed on that country for fear of default. Given the curve-linear relationship of DEGEXPOS to the dependent variable, the quadratic term of DEGEXPOS indicates that the number of conditions will decrease only until it reaches a certain point of degree of exposure. After passing that point, the number of conditions will eventually go up again.

- **Bilateral Political Relations and Conditionality**

Special bilateral relationship between the donor and the recipient, which is exogenous to the IMF's financial activities, could be transmitted to the interaction within the boundary of the IMF and work favorably toward the recipient. Gathering variables that measure bilateral political relationship based on history, geography and military, a model is specified, as shown below. This specification is a collection of dummy variables for whether or not they had such relationship with the major donors in order to test Hypothesis 7c of Proposition 7.

Table 5. 6 Bilateral Political Relations and Conditionality

Log likelihood = -1125.4455						Number of obs = 395
						LR chi2(5) = 229.58
						Prob > chi2 = 0.0000
						Pseudo R2 = 0.0926
TITNESS	Coef.	Std. Err.	R.Std.Err.	z	P> z	
ADJCNCY	-.0386721	.0554701	.083053	-0.697	0.486	
COLOTIE	-.063427	.0308537	.0372842	-2.056	0.040*	
ALLIANCE	-.0113362	.0641274	.0955718	-0.177	0.860	
MILITAID	.0257644	.0353666	.0480312	0.728	0.466	
INTCONXT	-.4140473	.0308306	.0370782	-13.430	0.000	
_CONS	2.770656	.0247148	.0294001	112.105	0.000	

The above results show that the number of conditions is also affected by factors exogenous to what the IMF is legitimately expected to deal with. Except for military aid, having geographical proximity, colonial affiliation, and alliance bond with one or more of the five major donors is better than not, although only colonial relationship among them has statistical significance. And the international political context characterized by the Cold War up to 1990 functioned to significantly reduce the number of conditions, as expected. Confrontation with communism seemed to procreate pro-stability bias within the IMF due to the major donors' interest in maintaining pro-West regimes in recipient countries and hence help recipients receive fewer conditions, compared with the post-Cold War period when the base number for agreed conditions moved upward.⁶ In any event,

⁶ Public choicests such as Vaubel (1991) ascribe the increase in the number of agreed conditions to organizational politics within the IMF. Stiles (1991) also emphasizes bureaucratic politics among departments, while building a bargaining model between the IMF and developing countries. Seen from this point of view, the influence of international political context on the toughness of conditionality can be

the five major donors seemed to play favoritism toward recipients connected to them in one way or another. This indicates that, although conditionality is a highly economic topic, political consideration is always working as the background condition.

These results, however, should be read carefully. Although overall political context does matter to conditionality bargaining, neither concept of issue specific power nor leverage, which this research supports, is disrupted. The two military related variables, ALLIANCE and MILITAID, are usually regarded as important assets of national power. However, their statistical insignificance connotes that they are not effective leverage to influence the other, at least in conditionality bargaining, which means that even issue linkage between economic and military hardly takes place. This is especially true when the five major donors organizationally support programs contradictory to their business in military, such as cutting excessive military budget in developing countries. In these cases, military related leverage is likely to work negatively rather than positively.⁷

- **Bilateral Economic Relations and Conditionality**

Just as bilateral political relationship affects the outcome of conditionality bargaining, bilateral economic relationship can do the same thing. This is especially the case with asymmetric dependence of one actor on the other for trade and finance, whereby

spurious, and a learning effect weighs more. However, the influence of the Cold War on IMF conditionality appears to be real, when considering the different slopes for increase in the number of agreed conditions before and after 1990. The chart in Appendix 3 shows this graphically. Thus, a fair eclectic solution from these two different evaluations of the Cold War effect on IMF conditionality may be that the increased toughness of conditionality is an outcome of synergy between the learning effect from bureaucratic politics and the changes in international context. The internal activism of IMF technocrats would be spurred on by permissible contextual changes.

⁷ Recall that cutting military budget was newly added to structural adjustment as a secondary objective (Polak, 1991).

each party of the relationship will suffer a different cost of loss when their economic relationship is disrupted. Naturally, the party who will lose less is likely to take advantage of it to draw yield from the party who will lose more. The asymmetric dependence between the five Executive Board member countries and recipients is easily noticed in the unidirectional flow of aid and commercial investment from the former to the latter, and the needed access to the five Board member countries' markets for exports. Thus, a model of leverage for conditionality bargaining manifested by asymmetric economic dependence is explored below. This specification corresponds to testing Hypothesis 7d of Proposition 7.

Table 5. 7 Bilateral Economic Relations and Conditionality

Log likelihood = -945.08062				Number of obs = 317		
				LR chi2(4) = 121.72		
				Prob > chi2 = 0.0000		
				Pseudo R2 = 0.0605		
TITNESS		Coef.	Std. Err.	R.Std.Err.	z	P> z
ODAAMNT		.000283	.0000389	.0000613	7.285	0.000
COMINVET		.0000341	6.10e-06	5.52e-06	5.602	0.000
EXPOACCS		-.0057731	.0033715	.0040674	-1.712	0.087
EXPOACC2		.000014	.0000376	.0000431	0.371	0.710
_CONS		2.622162	.0710782	.0866744	36.891	0.000

According to Table 5.7, the five Board member countries tended to link their bilateral aids to conditionality bargaining so as to get the recipients to agree on more conditions. As the five countries increase the amount of bilateral aid to developing countries, the number of conditions increase in the same manner. At a profound level, this

is also a manifestation of the so-called cross-conditionality. Cross-conditionality is defined as where acceptance by the borrowing country of the conditionality of one financial agency is made a pre-condition for financial support by the others (Griffith-Jones, 1992). In this case the five major Board member countries make IMF lending an almost obligatory part of bilateral debt-rescheduling/new money packages, and loans granted by the IMF are stringed with tighter conditions in proportion to the size of bilateral loans. Thus, a multilateral relationship of the recipient with the IMF is in fact transformed into a bilateral one with bilateral donors through cross-conditionality.

Like official assistance, commercial investments in developing countries from the major donors also work favorably for the donor to increase the number of conditions significantly. This will be an effective leverage, particularly against recipient countries if foreign capital influx takes a substantial portion in their balance of payments or GNP. Furthermore, this leverage can be used as a tool for the donors with which to punish stubborn recipients when the bargaining comes to rupture or to sanction them in other cases.

Allowing recipients to access to their markets is also an important leverage. In simple terms, EXPOACCS says that it has an inverse relationship with the number of conditions, but comes slightly short of statistical significance. However, the positive direction of the coefficient sign for the quadratic term, despite no statistical significance, indicates that more conditions will be requested as the five Board member countries grant more market access to recipient countries. As in trade argued by Blair (1991), asymmetric dependence becomes leverage in conditionality bargaining as well.

5.3 THE RECIPIENT AND LEVERAGE

On the recipient side, leverage that recipients can mobilize in order to elevate their bargaining position vis-à-vis the IMF is somewhat different than that for the donors. Basically, recipients countries do not possess institutional tools to effectively deal with the donors within or outside the IMF, in part because economic crisis hits different countries at different times with varying intensity, and more importantly, because large developing countries have more to gain by negotiating singly than jointly (Aggarwal, 1987; Chan, 1993). Despite creditors' early fears, debtors' cartel has never been formed, and their fate in conditionality bargaining seems to be dependent on their individual ability, rather than as a collective actor. This section is laid out in the similar manner to that for the IMF.

- **Expected Utility Components and Conditionality**

As with the IMF, the recipient will see conditionality bargaining from an economic perspective—that is, whether or not the negotiation will bring it more benefit than cost. To find a way that the recipient chooses the final landing point in conditionality bargaining with cost efficiency, a specification only with utility components is formed below, which intends to test Hypotheses 1a, 2b, 3, 5a and 7k of Propositions 1, 2, 3, 5 and 7.

The subjective probability, which is based on the recipient's ability to replenish its financial needs abroad, has not only an inverse relationship with the number of conditions, but also has significance. While the subjective probability for the IMF has a direct relationship with the toughness of conditionality, the recipient's subjective probability has

Table 5. 8 Recipient's Expected Utility Components and Conditionality

Log likelihood = -390.32497				Number of obs = 142	
				LR chi2(7) = 51.63	
				Prob > chi2 = 0.0000	
				Pseudo R2 = 0.0620	
TITNESS	Coef.	Std. Err.	R.Std.Err.	z	P> z
RSUBPROB	-.3032604	.0877815	.103158	-3.455	0.001
RDISCOUT	.0039871	.002429	.0029911	1.641	0.101
RPOLCOST	.0109071	.0037613	.0042106	2.900	0.004
RPOLCOS2	-.0009615	.0010107	.0011028	-0.951	0.341
ROPPOCST	.0003112	.0000576	.0000585	5.400	0.000
ROPPOCS2	-3.16e-08	8.67e-09	8.223-09	-3.646	0.000
PREENGAG	-.106602	.1244539	.1804403	-0.857	0.392
_CONS	2.456332	.13847	.1970486	17.739	0.000

a negative relationship, the crossing curves of which seems to be a theoretically and practically inevitable aspect of conditionality bargaining. In any event, this result indicates that a recipient country which can raise enough funds abroad will receive a smaller number of conditions than one which cannot, and even is less likely to rush to the IMF for financial help. In the previous chapters, recipients' desire to bypass the IMF and its actual threat to the IMF's *raison d'être* was mentioned many places. With this result at hand, we can tell under what conditions it will be feasible: abundance in world liquidity at system level and value of individual countries for investment and credibility to draw capital in.

Domestic political cost (measured by regime type) is in a curve-linear relationship with the toughness of conditionality, hence its quadratic term was added. The first term of regime type shows significance, but retains a wrong sign of coefficient. Theoretically, the

number of conditions should go down as the domestic political cost rises. On the other hand, the second order of regime type has a correct coefficient sign but not significant. As long as it is insignificant, it is not worth discussing the variable further. However, the parabolic curve of regime type indicates that recipient countries on the brink of democratization or in the process of consolidation right after democratization (which are located around zero on the scale of autocracy and democracy), receive the highest number of conditions. Both absolute authoritarian and absolute democratic regimes enjoy low conditionality, but the former occurs because it has zero domestic political cost, while the latter has a narrow win-set for bargaining—as constrained by domestic political process (Haggard and Kaufman, 1989; Putnam, 1988). The revealed curve-linear relationship between conditionality and regime type could be a case that rekindles the debates on the causal direction between structural adjustment and political instability in developing countries (see Bienen and Gersovitz, 1985; Sidell, 1988).

A recipient's opportunity cost with quadratic term, in addition to its first order, has a direct relationship with the number of conditions upon initial inspection. However, the theoretical reasoning contained in opportunity cost is very similar to that of subjective probability, and thus, it should be in a negative relationship with the number of conditions. This expectation is well captured by the quadratic term of the variable; that is, the increase in number of conditions will be reversed at a certain point and eventually decrease as the recipient's opportunity cost keeps increasing. This appears to indicate that there is a minimum opportunity cost, or that there is a minimum amount of foreign fund raising in order for a recipient to reduce the number of conditions.

Although it does not have statistical significance, the coefficient sign of the recipient's discount rate is odd. Since it was operationalized with the number of weeks that the recipient's foreign reserves can cover imports, the more weeks of imports the recipient's foreign reserves cover, the better it can endure lengthy bargaining with the IMF, which will eventually reduce the toughness of conditionality. Considering this, rather than pure theoretical concept of discount rate, the coefficient sign of RDISCOUT should be directed to negative, not positive, as the recipient's discount rate increase. Previous loan agreements indicate long-term dependency of the recipient on the IMF for external financing and, thereby, reveal to the IMF the recipient's performance record and strategic preferences, which can be taken advantage of by the IMF. However, contrary to the hypothesis, the history of previous transactions with the IMF is associated with decreasing the toughness of conditionality (i.e., lower intercept) though insignificant. Therefore, this variable needs a new measurement in the future with the actual number of previous engagement rather than a binary coding.

- Economic Crisis and Conditionality

Conditionality bargaining takes place first with internally and externally sensed economic crises in a recipient country. Thus, it is appropriate to check out the impact of economic crisis in individual countries on the bargaining process that drove them to the IMF for financial bailout. The severity of economic crisis will have certain function to conditionality bargaining in the respect that it influences the utility ingredients, such as subjective probability and discounting, and eventually determines the contents of economic

reform package. What follows is a model with indicators of economic crisis. This specification tests Hypothesis 7e derived from Proposition 7.

Table 5. 9 Economic Crisis and Conditionality

Log likelihood = -214.84502				Number of obs =	76
				LR chi2(4) =	17.72
				Prob > chi2 =	0.0014
				Pseudo R2 =	0.0396
TITNESS	Coef.	Std. Err.	R.Std.Err.	z	P> z
BOPCUADF	-.0000473	.0000121	8.75e-06	-3.911	0.000
INFLAT	.0000415	.0000458	.0000356	0.905	0.365
UNEMPLO	-.0059683	.0060896	.0068607	-0.980	0.327
BUDGDEF	.0074728	.0074973	.0082706	0.997	0.319
_CONS	2.571146	.0686321	.0769482	37.463	0.000

The founding purpose of the IMF is to provide temporary financial help for member countries experiencing imbalances in their balance of payments. As its organizational purpose directs, the size of the balance-of-payment current account deficit was the single most significant factor, among other indicators of economic crisis, that weakens the bargaining position of recipient countries. The wider the gap of balance of payments is (which is to be filled with financing from the IMF), the more conditions recipient countries have to endure to receive loans from the IMF. Surprisingly, hyperinflation, unemployment, and chronic central government budget deficit in developing countries have neither expected coefficient signs nor statistical significance. This result could be ascribed in part to the insufficient number of cases for analysis. The

effective number of cases used in this specification is only 76 out of 398, which is the lowest of the whole specifications in this research. This dramatic reduction of observations might come mainly from the unemployment data, which has only 154 cases available, and eliminating missing cases by list-wise would decrease usable cases further.

- **Politics of Debt and Conditionality**

Foreign debt itself is part of economic crisis in developing countries. Nonetheless, developing countries can convert their problem into a useful leverage by threatening default, through which the ball is hit into the creditors' court from debtors. Facing the possibility of moratoria and the ripple effect on their financial system, creditors are likely to roll over the debt or initiate talks for debt rescheduling. A model using variables of accumulated debt can show how recipient countries can draw out yields from the five Board members who strive to prevent possible economic damages. Even in using debt as leverage, recipients' strategy can be two-tiered by distinguishing debts by origin (i.e., debt owed solely to the IMF and total debt stock from all types of creditor, multilateral, bilateral, and private sources). This specification also utilizes quadratic terms of the variables, since they are in a curve-linear relationship with the dependent variable. And INFINSIG was included to examine the impact of recipients' status in the world economy and recognition of their debt problems in conditionality bargaining. This specification tests Hypotheses 7f, 7g, and partly 7i of Proposition 7 together.

The following table reveals an intriguing fact: the effect of leverage played out with external debt on the number of conditions is circumstantially determined by the origin of debt. As a recipient accumulates debt, regardless of types of creditors, it coincidentally

increases the number of conditions. However, if that country's debt is large enough, this effect will be reversed so as to reduce the number of conditions—as the coefficient sign of quadratic term of total debt, TOTDEBT2, indicates with significance.

Table 5. 10 External Debt and Conditionality

				Number of obs	=	388
				LR chi2(5)	=	99.09
				Prob > chi2	=	0.0000
Log likelihood = -1163.352				Pseudo R2	=	0.0408
TITNESS		Coef.	Std. Err.	R.Std.Err.	z	P> z
TOTDEBT		8.88e-06	2.00e-06	2.54e-06	4.447	0.000
TOTDEBT2		-5.52e-11	2.03e-11	2.18e-11	-2.724	0.006
IMFCRDTS		-.0001054	.0000509	.0000663	-2.069	0.039*
IMFCRDS2		1.74e-08	9.98e-09	1.07e-08	1.748	0.081
INFINSIG		.6790757	.1534382	.162366	4.426	0.000
_CONS		2.493964	.0194144	.0247107	128.459	0.000

On the other hand, debt owed to the IMF have a completely opposite effect: a heavy use of IMF credits, which indicates limited overseas fund-raising ability of the recipient, does not help strengthen its bargaining position vis-à-vis the IMF. Departing from the initial pattern, IMF credits appear to increase the number of conditions after passing a point that can be regarded as a threshold. This result is especially fascinating, recalling that, as a shared variable with the IMF, which measures its vulnerability as a creditor (IMFEXPOS, IMFEXPO2), their coefficient showed opposite signs with significance (Table 5.5). Taking into account the opposite direction of the curves of IMFEXPO2 and IMFCRDS2, usage of IMF credits or exposure beyond a certain point

appears to make both sides concerned about their positions in the financial relationship with each other and, thus, more compromising than before the threshold point.

In passing, more results are reported about the relationship between the toughness of conditionality and total external debt. The variable of TOTDEBT was not normally distributed⁸ and, thereby, the unbiasedness and efficiency of the estimate was suspected. To correct this problem, additional functional forms for TOTDEBT such as logging the variable were attempted in order to fit the normal curve better. Nonetheless, the functional form did not give satisfactory results in terms of the direction of coefficients and statistical significance. This disappointing result from the transformed variables is interpreted as that as long as total external debt is concerned with conditionality, its sheer size matters, and not anything else. This interpretation is agreeable admitting that total external debt is not only debtor's problem, but creditor's as well. The amount of debt accumulated by the debtor is the exact amount that the creditor should collect and, hence, as the size of debt gets bigger, the creditor becomes vulnerable. This simple number tells the creditor the severity of financial damage it should swallow if the recipient defaults, which is why a threat of default from a recipient country can be an effective weapon. Therefore, total external debt as leverage should be seen from the creditor's viewpoint rather than the debtor's.

The direction of coefficient and the statistical significance of INFINSIG is rather surprising. Theoretically, the emerging market economies are likely to receive a milder

⁸ Among 392 valid cases out of 398, the smallest total external debt is \$ 3.70 million and the largest is \$ 140,010.00 million. The frequencies of external debt below the mean of \$ 11468.90 million counts 78% of the total, which means that the mean was boosted by a few cases of extremely large debt making up the remaining 22%. Graphically the distribution is highly skewed to the right.

treat from the IMF than those who are not. Apparently, however, the recipients' rising economic status in the world economy did not help them with the toughness of conditionality: those countries agreed on more conditions for economic policy change. A possible interpretation of this result may be that those emerging market economies, instead, received large loans from the IMF, which far exceeded pre-set access limits. That is, the amount of agreed loan could be tremendously large for their quotas and hence sufficiently compensate for the toughness of conditionality. If such was the case, in reality the conditionality agreements for emerging market economies could still be softer than those for developing countries that have not yet reached that status. In a sense, (temporarily) troubled emerging market economies are baptized with a mixed blessing of tough conditions and enormous funds poured into them, which seems to come from the idea that emerging market economies, not only quickly normalized but complying with the IMF's rule of game, are important to prosperity of world economy. However, it remains to be seen whether this implicitly discriminatory lending practice of the IMF can be upheld, especially depending on how rapidly Southeast Asian countries will bounce back.

The recipient's debt leverage means, in one sense, that conditionality was bent over for the major donor countries whose private interest weighs more against official. For recipients who mainly depend on the IMF for their external financing, the size of accumulated debt may not be an effective tool to reduce the number of conditions, and the five Executive Board members' interest in conditionality bargaining corresponds to protecting the IMF's financial turf. However, if recipients have accumulated commercial credits substantially more than credits from the IMF in their total debt stock, the five Board member countries' priority is switched to avoiding wrinkles on their domestic

economy, and recipient countries can take advantage of this to reduce the toughness of conditionality. This outcome is also a byproduct of complex interdependence where direct interstate relations are affected by the presence of important transnational actors (Keohane and Nye, 1989). More specifically, in face of debt crisis, banks' priorities are simply to avoid default while limiting the extent of any new loan exposure, and their presence looming large not only affects the general foreign policy environment but also substantially alters the issues of salience for policy or the nature and scope of policy options available to the governments (Cohen, 1985). As a result, the goals and contents of Fund programs are compromised to some extent.

These results substantiate two arguments regarding debtors' behavior introduced earlier. First, what Sachs (1989) called double-edged behavior of debtor countries seems to be well evidenced with these results: debtor countries are aware that the IMF is an ongoing institution and will not default to the IMF for fear that it will rupture its relationship with this institution, which leads to tougher conditions. On the other hand, recipients will dare to default debt service to private syndicate lenders, since it might not forestall further borrowing from new lenders elsewhere due to their fundamental competition for profit-generation from lending, and this is why recipients can mollify the toughness of conditionality.

The second argument this result substantiates is moral hazard problems in recipient countries. The necessity for strong structural adjustment has been coupled with rooting up brinkmanship in those countries, but it was not easy to pinpoint the conditions under which it becomes plausible and feasible. As the Fund argues (Fischer, 1998c; Kapur, 1998), the notion that the availability of IMF programs encourages reckless behavior by

debtor countries may be far-fetched, considering the fact that the economic, financial, social, and political pain is simply too great—and that no country shows any great desire to enter IMF programs unless they absolutely have to. Thus, it does not make much sense to argue that countries would deliberately court such a crisis, knowing that international assistance would be forthcoming. However, given the reaction from the creditors in terms of the number of conditions, recipient countries whose debt approaches the highest point of parabolic debt curve (approximately 80 billion in U.S. dollars), may have incentives at least to neglect their economic problems in order to threaten a debt crisis with the hope for debt roll-over.⁹

- Economic System and Conditionality

Haggard and Kaufman (1989) and Chan (1993) argued that economic characteristics of a recipient country are regarded as important to resisting to pressure from the IMF to accept particular conditions. While staying stubborn and persistent, recipients can prolong the bargaining process to next rounds, and it will eventually work to reduce the number of conditions. Thus, a model composed of variables that capture characteristics of an economy will reveal to us what effect they have on conditionality bargaining. Unlike the others, this model includes a recipient's subjective probability. Its inclusion is more or less decided by the nature of the other variables; they are a fixed nature of economy rather than flexible and, as such, are hard to change pending

⁹ Kapur (1998) says that moral hazard is in both borrowing countries and creditors and that perhaps the greater moral hazard is among creditors who believes that the IMF offers implicit insurance of bailouts. His argument is not groundless considering that the flow of capital was reversed from the developing world to the developed due to increased repayments during 1980s.

negotiation with the IMF.¹⁰ The subjective probability can deteriorate prior to negotiation with the IMF, but is not likely to improve dramatically. Thus, the subjective probability from financing capability can also be treated as a fixed characteristic of an economy. This specification will be successfully testing Hypothesis 7h of Proposition 7.

Table 5. 11 Economic Characteristics and Conditionality

Log likelihood = -635.71567				Number of obs =	215
				LR chi2(4) =	37.27
				Prob > chi2 =	0.0000
				Pseudo R2 =	0.0285
TITNESS	Coef.	Std. Err.	R.Std.Err.	z	P> z
RSUBPROB	-.0438199	.0601914	.0719006	-0.728	0.467
RESOENDW	-.1368356	.0799052	.0927954	-1.712	0.087
TRADEGDP	-.0013185	.0005337	.0006279	-2.470	0.013
ECONSYS	.2515626	.0465242	.0484485	5.407	0.000
_CONS	2.590707	.0422086	.0517985	61.379	0.000

Above, the subjective probability keeps the theoretically expected coefficient sign, but it is not significant. RESOENDW, which mainly deals with oil endowments, also has the expected sign, but comes short of conventionally accepted significance level (P=0.05). TRADEGDP, which indicates whether or not a recipient country is self-sufficient, is

¹⁰ Low elasticity in factor allocation and mobility of resources characterizes developing economies, which would hinder them from appropriately responding to short-term unexpected external changes. Adjustment policies in face of balance-of-payments difficulties require the relative transfer of resources out of nontradables into tradables, to boost exports and reduce import requirements. The ability to do this with reasonable ease is therefore an important attribute. This difference in economic characteristics would affect the recipient's bargaining ability to avoid conditions ensuing adverse effects. See for more discussion, Killick, Tony. 1993. *The Adaptive Economy: Adjustment Policies in Small, Low-Income Countries*. EDI Development Studies. Washington, DC: World Bank.

significant, but the coefficient sign is opposite to the theoretical expectation. That is, a high ratio of trade to GDP indicates low self-sufficiency and less ability to resist to the Fund's pressure to change economic policy, and thus, the number of conditions will increase as the ratio does. A possible explanation of the opposite direction of the coefficient sign with significance is that theoretical benefits that make autarky an attractive policy for a state are nothing but an illusion, damaging nations more than it helps them (McCarthy, 1996). In our own century, there were many examples of semi- and complete autarkic practices being adopted by nations, only to be undermined by information flows and the mobility of people—and they are not sustained for long. Furthermore, as indicated by the fact that a state's economic significance in the world economy is often measured by its share in the world trade—which is quite contrary to the concept of autarky—an open economic system that contributes to generating global wealth through a large volume of trade in specialized and value added products has more leverage than a closed system today. With the variable of ECONOSYS, Eastern European countries, under systemic transformation from a centrally planned economy to a market-oriented capitalist, are shown to have received more conditions than other long-standing capitalist economies. This is interpreted as necessary to create market economies from scratch in these countries and concomitant desire of the IMF to integrate them into the mainstream of global economy as fast as possible through institutionalization of market economy.

- Global Economic Opportunities and Conditionality

The international economy in the late twentieth century is characterized by intensification of globalization. Multinational corporations in the developed countries have

looked for economic opportunities in promising emerging market economies, with or without the intention to participate in management. Developing countries which can provide such opportunities for the major donor countries may use that asset as leverage in conditionality bargaining. The five Board member countries which do not want their economic privileges in those countries forfeited will properly respond to recipients' requests. Thus, a model with variables measuring economic or investment opportunities is built below. All the variables in this specification have a curve-linear relationship with the dependent variable, and hence, their quadratic terms were used together. With these variables, Hypothesis 7i, and thereby, the validity of Proposition 7, will be empirically verified.

Table 5. 12 Global Economic Opportunities and Conditionality

Log likelihood = -1155.8875				Number of obs =	384
				LR chi2(7) =	92.46
				Prob > chi2 =	0.0000
				Pseudo R2 =	0.0385
TITNESS	Coef.	Std. Err.	R.Std.Err.	z	P> z
FDIINFLO	.0000821	.0000449	.0000447	1.831	0.067
FDIINFL2	-1.37e-08	4.86e-09	4.18e-09	-2.825	0.005
EQIINVET	.0002807	.0001046	.0001177	2.683	0.007
EQIINVE2	-4.91e-08	2.23e-08	2.32e-08	-2.197	0.028
DEBTINFL	.0000257	.0000355	.0000365	0.725	0.468
DEBTINF2	-6.71e-09	4.87e-09	4.43e-09	-1.377	0.169
INFINSIG	.8356056	.1283103	.0624643	6.512	0.000
_CONS	2.518689	.0156671	.0203565	160.763	0.000

The above results reflect new characteristics of international economy in which finance is emphasized more than trade. Thanks to telecommunication technology and capital account liberalization in the developed countries, the total amount of financial transaction outnumbers that of commodity trade these days. Seen from this perspective, if a recipient hosts large foreign direct investments, it can be used to reduce the number of conditions, but with no efficiency. On the other hand, if the recipient is a host of large equity investments, it can lessen the harshness of conditionality agreement with efficiency. Any artificial barrier intended to block access to lucrative emerging markets must hurt international investors' interests (Chan, 1993), especially from countries where domestic markets are saturated, and this is well reflected on the parabolic curve of $EQINVE2$ with significance. $DEBTINFL$, the pure measure of net private bank and trade-related lending and portfolio bond investments, has a coefficient sign in line with theoretical expectation, but is not significant. Its quadratic term says that the number of conditions will eventually be on the rise, but with no significance. As a matter of fact, debt-creating capital inflows are part of total debt stock, and hence, the same theoretical expectation is projected on this variable as on total debt stock. Let alone the insignificance, however, the signs of coefficients of two $DEBTINFL$'s are opposite to those of total debt stock. It needs further study of developing countries' debt structure and attitude towards creditors by type. Again, the variable $INFINSIG$ functions to directly increase the base number of conditions with significance, as it did in the other specification.

- Politics of Special Interest and Conditionality

A new emphasis in international bargaining theory is the concept of a two-level game developed by Putnam (1988). National bargainers are supposed to build consensus on two fronts to have negotiation succeed: first, he or she has to reach an agreement with the foreign negotiator on issues at hand; second, he or she has to achieve domestic consensus on the agreement. In so doing, domestic institutional setting determines the size of win-set within which the national negotiator can maneuver the bargaining outcomes and even draw a preferred outcome from bargaining using (private) information of the given win-set.

The focus of domestic political process in the context of structural adjustment is politics of special interests, or rent seeking behavior, which is blamed for a low degree of implementation in conjunction with overambiguous and overambitious targets. To test this argument, a model is built with variables that could be regarded as a proxy of special interests and other political and economic system, which are intertwined with one another to determine the size of win-set. In developing countries, public sector is one of the most conspicuous sources of special interest, which usually becomes a target for restructuring and streamlining in the wake of adjustment. The contribution made by state-owned enterprises to GDP will give us a clue as to how much opposition will be entailed to implementing conditions. And as related to this, the size of urban population—which consists mostly of public sector employees and labor workers in manufacturing sector who are also potential political protesters—will give us a broader picture of the political dynamics in developing countries.

In the above model, the impact of regime type on the number of conditions remains the same with in the model of utility ingredients, but the impact of quadratic term on reducing the toughness of conditionality has a clear significance. Thus, democratic regime helps reduce the number of conditions by narrowing the size of win-set. Also, if a recipient's economy is based on ISI, it effectively reduces the number of conditions to be consented upon, since the size of special interest that hinders structural adjustment appears large. The size of public sector in economy turns out to be significant, but has a coefficient sign opposite to the theoretical expectation. On the other hand, URBANPOP shows a theoretically expected coefficient sign, but not significant. If a recipient country is less urbanized and most of its population dwell in rural area, the government is limited in setting the win-set for negotiation in its favor and seems to sign an adjustment agreement with more conditions than not. However, the reliability of this specification cannot be fully verified due to the small number of observations. This is mainly from the data of SOEGDP, which was one of the poorest in the data set, together with unemployment.

5.4 COMPREHENSIVE SPECIFICATION FOR CONDITIONALITY BARGAINING

So far, the statistical models have been focused on exploring possible forms of national and organizational leverage from as many different angles as possible. Those tests suffice to open eyes to a world of variety in leverage to be deployed for conditionality bargaining, depending on issues in question, but not enough to give us a comprehensive picture of the relationship between leverage and conditionality bargaining. Thus, a model that can illuminate conditionality bargaining with a bird's-eye-view is necessary.

Exploring a comprehensive model for conditionality bargaining should be based on the theoretical considerations discussed above. However, it should not be an anthology from each specification, which consists of variables that showed correct directions of coefficients and statistical significance. A major concern of the comprehensive specification is parsimony, which can still capture most of the characteristics of conditionality bargaining with as few variables as possible. And while individual specifications examine the effectiveness of leverage in one direction—as if not checked and balanced by that of the other player—this hardly takes place during negotiation, and any outcome of bargaining is produced through clash of leverage. By putting leverage (mobilized by each player) together in one model, the effectiveness of its leverage will be weighed one against another.

In a sense, the comprehensive specification should be a condensed narrative of conditionality bargaining of how it starts, what is at stake, and how it ends—and choosing variables for the specification follows suit. Hence, the story goes that the entire process of conditionality bargaining unfolds with economic crisis in developing countries; a basic rule of the game is that a prospective recipient can draw rescue fund from the IMF within the pre-set limits and the number of conditions will increase as it approached the limits. Agreed conditions for structural adjustment are also a means to build consensus between debtors and creditors on handling snow-balling debt problems in developing countries with a view to preventing mischievous consequences at the system level. The five Executive Board member countries try to influence conditionality in proportion to their financial contribution to the IMF; the IMF's lending policy is influenced by its fundamental imperative as the lender of last resort, or provider of global liquidity. And the leading

powers within the IMF adjust the level of conditionality in accordance with their vision for world management, constrained by the context within which conditionality bargaining takes place. Thus, variables corresponding to each story line are balance-of-payments current account deficit, the ratio of agreed loan to quota, five major donors' quota subscription, the size of lendable fund, international context, and accumulated external debt.

Table 5. 14 Comprehensive Specification for Leverage and Conditionality

Log likelihood = -975.56741						Number of obs = 361
						LR chi2(7) = 290.86
						Prob > chi2 = 0.0000
						Pseudo R2 = 0.1297
TITNESS	Coef.	Std. Err.	R.Std.Err.	z	P> z	
BOPCUADF	.0000149	6.00e-06	8.73e-06	2.480	0.013*	
AMNTQOTA	.0010166	.0002605	.0003093	3.903	0.000	
TOTDEBT	6.80e-06	1.83e-06	2.15e-06	3.710	0.000	
TOTDEBT2	-3.46e-11	1.71e-11	1.94e-11	-2.031	0.042*	
5MQOTAS	.0000137	2.08e-06	2.27e-06	6.561	0.000	
FUNDSIZE	-.0000441	.0000433	.0000444	-1.020	0.308	
INTCONXT	-.1752262	.0474759	.0524387	-3.691	0.000	
_CONS	1.875059	.1193949	.1298989	15.705	0.000	

The above results are roughly in line with those of individual specifications: AMNTQOTA, INTCONXT, TOTDEBT, and TOTDEBT2 retained the theoretically expected direction of coefficients and more or less the statistical significance as they did in individual models. On the other hand, 5MQOTAS not only kept the correct sign of

coefficient, but also its significance jumped to significant level. FUNDSIZE kept the correct sign, but lost significance; and BOPCUADF obtained a wrong coefficient sign, but remains significant, which is atheoretical.

To test the robustness of this comprehensive specification, another specification is built with more variables. This mission is also to overcome a potential weakness of the comprehensive specification—disconnection from the components of expected utilities—by including appropriate ones. Among the various utility components, the most vital part is players' subjective probabilities. Player's subjective probabilities are a succinct expression of players' tangible and intangible capabilities to be transformed into leverage. Although the formulae for each player's subjective probability were formed only with tangible assets, due to problems with operationalization and measurement, the idea at the bottom is that the effect of the intangible on the subjective probability cannot be ignored in reality, and thus, it pretends to have incorporated them into the formulae.

The results from the specification (Table 5.15) with players' subjective probabilities included are that the presence of subjective probabilities does not change the results much from the one without subjective probabilities. The only difference is that the quadratic term of accumulated external debt gained a clear-cut significance, and the indicator of economic crisis exchanged the correct direction of coefficient for statistical insignificance. Above all, the subjective probabilities themselves failed to show statistical significance, despite their theoretically correct coefficient signs. Thus, the robustness of the comprehensive model without subjective probabilities appears to be sustained with these results.

Table 5. 15 Comprehensive Specification with Subjective Probabilities

Log likelihood = -571.21333				Number of obs =	214
				LR chi2(9) =	156.14
				Prob > chi2 =	0.0000
				Pseudo R2 =	0.1202
TITNESS	Coef.	Std. Err.	R.Std.Err.	z	P> z
DSUBPROB	.115779	.108549	.1043283	1.067	0.286
RSUBPROB	-.0659206	.0653784	.070381	-1.008	0.313
BOPCUADF	-8.20e-06	.0000121	.0000182	-0.675	0.500
AMNTQOTA	.0011201	.0003472	.000409	3.227	0.001
TOTDEBT	9.86e-06	2.40e-06	2.54e-06	4.100	0.000
TOTDEBT2	-9.82e-11	2.68e-11	3.54e-11	-3.664	0.000
5MQUOTAS	.0000114	2.79e-06	2.92e-06	4.081	0.000
FUND SIZE	-.0000379	.0000581	.0000747	-0.652	0.514
INTCONXT	-.1868513	.0639664	.0666755	-2.921	0.003
_CONS	1.910639	.155501	.1683266	12.287	0.000

The main theme of this dissertation is to identify bargaining leverage as the source of variance in conditionality agreements (i.e., the degree of tightness in conditionality), and thus, all the statistical analyses used the number of agreed conditions as the dependent variable. One of the assumptions of the game model says that the desirability of a conditionality agreement is determined by the toughness of conditionality and the amount of agreed loan, which can be traded off. If the model is established with such an assumption, the amount of agreed loan must be another measure of bargaining leverage, and conducting an additional analysis with that variable seems to be worth while in that it will demonstrate the explanatory power and versatility of the model, overcoming the restrictive nature of the original dependent variable. Moreover, if the statistical model

were well specified, switching the dependent variable from the number of conditions to the amount of agreed loan, while keeping the independent variables, will have the coefficient signs switched as necessary, since the two dependent variables are theoretically in a trade-off relationship.

Using the amount of agreed loan as the dependent variable, however, is poised with a problem. The amount of agreed loan is already reflected on the variable of AMNTQOTA in the comprehensive model, which causes endogeneity to the model. In looking for a substitute, the role of Fund lending in relation to the size of balance-of-payments gap is good enough, but this has the problem of endogeneity, too, since the balance-of-payments current account deficit is used as an independent variable. To solve this problem, the ratio of the amount of agreed loan to GDP (AMNTGDP, %) will be used. This new variable transforms the absolute amount of agreed loan into relative term, namely the IMF's contribution to recipients' economies. At a superficial level, there should be normality in the size and distribution of Fund lending in relation to the level of development of borrowing countries, which is measured by GDP. If there exists any different relationship between Fund lending and the level of economic development, however, we can also suspect that bargaining leverage affected the extraordinary distribution of IMF funds. Unlike the number of agreed conditions, AMNTGDP, the alternative dependent variable, is continuous, and thus, the statistical method is switched to ordinary least squares regression from Poisson.

Table 5. 16 Descriptive Statistic of the Alternative Dependent Variable

	N	Min.	Max.	Mean	Std.Dev
AMNTGDP	387	0.16	33.13	2.88	3.40

Table 5. 17 Comprehensive Specification with the Alternative Dependent Variable

Number of obs = 359
 F(7, 351) = 22.51
 Prob > F = 0.0000
 R-squared = 0.3098
 Adj R-squared = 0.2960
 Root MSE = 2.2236

AMNTGDP	Coef.	Std. Err.	R.Std.Err.	t	P> t
BOPCUADF	.0002251	.0000559	.0000505	4.029	0.000
AMNTQOTA	.0204927	.0020843	.0029429	9.832	0.000
TOTDEBT	-.0000701	.0000159	.0000129	-4.400	0.000
TOTDEBT2	3.05e-10	1.54e-10	1.17e-10	1.986	0.048
5MQOTAS	.0000407	.0000165	.0000141	2.470	0.014
FUNDSIZE	-.0010097	.0003292	.0003474	-3.067	0.002
INTCONXT	.2241728	.3636633	.2928286	0.616	0.538
_CONS	.0333385	.9312187	.7339856	0.036	0.971

In Table 5.17 above, the variable AMNTQOTA is the ratio of agreed loan to recipient member's quota subscription; thus, the higher the ratio, the more the actual amount of arranged loan is and the more contribution is made to the recipient's economy. The coefficient sign of the AMNTQOTA is so naturally positive and significant, as indicated by high *t*-ratio (9.832). Quotas from the five Executive Board member countries

are a significant base for fund formation within the IMF. Theoretically, increased quota allocations to them means that overall liquidity position of the IMF is improved and the usable resources are affluent, which has more or less a positive impact on recipient economies. The variable of 5MQUOTAS testifies this reasoning behind with a positive coefficient sign and statistical significance.

The most interesting part of the results above is the coefficient signs of TOTDEBT. When TITNESS was used as the dependent variable, the coefficient signs of first and second order of TOTDEBT were positive and negative, respectively. Now, the dependent variable is switched to the ratio of arranged loan to GDP and the coefficient signs of two TOTDEBT's are negative and positive, respectively. This means that as the size of total external debt gets larger, the IMF's contribution to recipients' economies gets smaller. However, the positive coefficient of the quadratic term indicates that the IMF's contribution to the recipients' economies will be on the rise again, after passing a certain point in the size of total external debt. The logic behind this is the same with that for the number of conditions; that is, as the size of accumulated external debt increases, the IMF fears for moratorium by the debtor country and makes more contribution to the debtor country's economy to help it continue debt service to the creditors.

With the number of conditions on the left-hand side of the equation, the severity of economic crisis indicated by the balance-of-payments current account deficits (BOPCUADF) did not give us the theoretically expected result. However, with the ratio of arranged loan to GDP, the result is satisfactory in terms of the direction of the coefficient sign and its significance. This indicates that a slight imbalance in economy is easy to have a loan arranged with the IMF and the size of arranged loan is likely to be

larger than necessary. However, when the imbalance is severe, the recipient has to go through an uphill battle with the IMF for a meager contribution from the IMF. The IMF has been criticized for discriminating against heavily indebted poor countries whose balance of payments problem is chronic and structural (Bird, 1995), and this criticism is empirically supported by this result.

Although it turned out to be insignificant, the meaning of the coefficient sign of INTCONXT should be noted. The variable of INTCONXT indicates that IMF lending has made a greater contribution to recipients' economies during the Cold War than the post-Cold War. This result is in contrast with its coefficient sign, when the dependent variable was the number of conditions. In the previous analysis, the IMF was read to request fewer conditions (negative sign) during the Cold War period than during the post-Cold War. This contrast means that the curves of the two regression lines cross each other, rather than go in parallel, and thereby substantiates the trade-off relationship between the number of conditions and the amount of agreed loan. The only utterly odd result is the coefficient sign of FUNDSIZE. The variable FUNDSIZE measures the preparedness of the IMF to lend. Theoretically, this means that the more the IMF is ready to lend, the more contribution it makes to recipients' economies. The expected coefficient sign is positive, but it turned out to be negative with a high significance.

As with the specification with the number of agreed conditions as the dependent variable, the comprehensive specification using the ratio of agreement loan to GDP is also slightly modified with the addition of subjective probabilities. The result (Table 5.18) is quite similar to the original specification without the subjective probabilities. As expected, no further interpretation is necessary; simply, interpreting what the coefficients of the two

Table 5. 18 Comprehensive Specification with the Alternative Dependent Variable
and Subjective Probabilities

Number of obs = 213
F(9, 203) = 10.86
Prob > F = 0.0000
R-squared = 0.3249
Adj R-squared = 0.2950
Root MSE = 2.5506

AMNTGDP	Coef.	Std.Err.	R.Std.Err.	t	P> t
DSUBPROB	-.8507406	.9971009	.9261574	-0.853	0.395
RSUBPROB	-2.092324	.5881145	.4249873	-3.558	0.000
BOPCUADF	.0003741	.0001108	.0000952	3.377	0.001
AMNTQOTA	.0207657	.0031413	.0039302	6.611	0.000
TOTDEBT	-.0000547	.0000238	.0000164	-2.294	0.023
TOTDEBT2	3.56e-10	2.50e-10	1.63e-10	1.424	0.156*
FUND SIZE	-.00127	.0004952	.0005226	-2.564	0.011
5MQUOTAS	.0000413	.0000249	.0000219	1.660	0.098
INTCONXT	.1408132	.5574756	.4664202	0.253	0.801
_CONS	1.056218	1.370929	1.031344	0.770	0.442

subjective probabilities mean is enough. The recipient's subjective probability has a negative coefficient in this specification and this is a correct reflection of the nature of the recipient's subjective probability. That is, the recipient's subjective probability is equal to its ability to raise funds abroad so as to replenish balance-of-payment current account deficit; a higher subjective probability means that it would borrow most fund from international capital markets and loan arrangement with the IMF would be only a back-up plan in case of shortage. Thus, as the recipient's subjective probability increases, the economic contribution from the IMF will decrease (i.e., the negative sign of the coefficient

is theoretically correct). On the other hand, the donor's subjective probability makes another odd case along with the size of lendable fund (FUNDSIZE) in the specification. The donor's subjective probability is formulated to be the Fund's annual liquidity position vis-à-vis member countries from the developing world, which means that as the IMF's fund position gets more liquid, the more economic contribution to developing countries is feasible. Considering this, a theoretically correct coefficient sign of the donor's subjective probability is positive, but it came out negative though insignificant. Overall, the addition of the subjective probabilities did not affect the model enough to reveal specification error. With or without the subjective probabilities, the two different comprehensive specifications are judged to illuminate well the relationship between the IMF and developing countries, which is determined by mobilized leverage.

5.5 THEORETICAL IMPLICATIONS OF FINDINGS

The main purpose of the statistical analyses was to verify the external validity of the theoretic model of conditionality bargaining. The beginning of this research was a question of whether the existing conditionality agreements are arguably all alike, and what could explain such difference if they are not. To answer the question, a conditionality bargaining model was built using the concept of leverage. The subsequent quest was empirically testing the relationship between leverage and variance in agreements represented by the number of agreed conditions with all the risk of oversimplification of the contents. On average, the correspondence between the outcomes predicted by the model and real world experience was satisfactory. There were a total of 39 independent

variables as operationalization and measurement of leverage in 11 small and 2 comprehensive specifications,¹¹ 23 (58.97%) of which showed theoretically expected coefficient signs and statistical significance. And the number of specifications within which more than half of the used independent variables showed significant explanatory power was 11 out of 13. This indicates that the models were properly specified to test the hypotheses. Through a variety of operationalization, it was revealed that the difference in conditionality agreements was a direct outcome of leverage that each party of the bargaining brings to the negotiation table.

In passing, there were 8 cases of independent variables that changed statistical significance with robust standard errors obtained through the White test. This phenomenon was not ubiquitous but sparsely scattered over the specifications that it is safe to say that the asymptotic unbiasedness and consistency properties of maximum likelihood estimators in large samples was not destroyed. Nonetheless, they are no longer efficient and the lack of efficiency makes the usual hypothesis-testing procedure of dubious value (Gujarati, 1995). Therefore, correcting those errors would be desired in the future.

A possible remedial measure to correct the inefficiency of some estimates identified by the White test is to transform those variables in functional forms such as square rooting or logging to reflect suspected types of heteroscedasticity and thereby make their variances homoscedastic. The target variables for functional transformation will even include the dependent variable, especially the number of agreed conditions. This variable

¹¹ The statistical analyses that confirm partial grounds of both sides of the debate (Table 5.1 and 5.2) and the comprehensive specifications with the subjective probabilities (Table 5.15 and 5.18) are not counted.

was obtained through content analysis and was first-cut in the field. Therefore, re-counting the number of agreed conditions, first, is suggested in order to enhance its objectivity and accuracy, and then functional transformations should be attempted as a remedial measure. Another remedy to this problem is increasing the size of samples so as to cover conditionality agreements during the entire presence of the IMF. If this is done, this will not only correct the efficiency problem of estimates haunted by heteroscedasticity and enhance their asymptotic unbiasedness as they approach their true values, but also expect to end the controversy especially over the variable of INTCONXT since the analysis will include more conditionality agreements during the Cold war period.

This research was built against a conventional skepticism of the relationship between developed and developing countries in general, or possibilities of negotiation between them from the perspective of aggregate power structure in international relations. Rather, the model was narrowly focused on issue-specific bargaining structure, with the concept of leverage and the statistical results supported this notion given issue area of conditionality. Most of the variables used for the analyses were monetary and financial, such as the total external debt and bond/equity portfolio investment, which are more volatile and vulnerable to domestic and international disruptions than commodity economy; and derivatives from an economic “relationship” between the two parties, such as market accessibility and financial dependency, rather than hard data on usable resources, human and natural, or production capacity. Such second-tier economic data neither have direct bearings on aggregate power in international relations, such as GNP and population, nor can be transformed into military capabilities if needed. Nonetheless, analyses based on those variables, without resorting to power parity, showed that both

sides not only considered the other as qualified negotiation partner, but also drew out conclusions on interaction through bargaining, given the issues to be settled.

Another fact—conditionality bargaining was better explained with the concept of leverage within a specific issue area—is evidenced in that the variables of alliance and military aid did not have significant explanatory power. These variables are highly regarded components of aggregate-power-based theory of international relations, and within that theoretical tradition, the outcomes of interaction among states are pretty much predictable due to power fungibility, regardless of the nature of the issue at hand. Hence, if the aggregate structural power were the correct conceptualization underlying the conditionality bargaining, those variables should show significance with theoretically correct coefficient signs, which did not happen. In the similar vein, this unsubstantiated conceptualization of aggregate structural power may indicate that conditionality bargaining is even selective in issue-linkage, or has a limited scope of issues to be linked to. The other economic variables, although originally presented as operationalization of leverage, are in a sense a manifestation of issue linkage taking place successfully. This selectivity in issue linkage may be related to the fact that one party of the bargaining is an international organization. That is, although the five major Executive Board members are portrayed as having tremendous sway in decision making within the IMF and insert their interests into its operation, their action is, in any event, under the umbrella of an international organization, which will delineate the scope and range of feasible issue linkage for them more than in bilateral relations.

Third, at a substantive level, IMF conditionality has been entangled in debates over many aspects. The bottom line of the debates was that IMF conditionality could not

achieve intended goals; its feet were only dragged into muddy global debt problems deeper and deeper. Many attempts to chase this problem to the origins closed their research with a hasty conclusion that the IMF dominated the entire process of structural adjustment with one design. Against this single-minded conclusion of coercive conditionality, a game-theoretic bargaining model showed theoretically that there could be many different outcomes on the continuum of absolute coercion to absolute compromise, and statistical analyses in this chapter showed empirically that this could not take place, unless it was intervened with a necessary condition of leverage. Furthermore, the statistical results supported or reputed conventional arguments in conditionality literature published by the IMF and those critical scholars who have been accepted without systematic delve. For example, both arguments for fair application of conditionality in line with credit tranche (Gold 1979; Guitián, 1981) and discriminative treatment by the Fund of the poorest countries (Killick, 1995), especially eligible for SAF/ESAF, which is conflicting with the former, were given a firm ground by the analysis. External debt (Sachs, 1989) and moral hazard problems in developing countries (Cornelius, 1988 and Vaubel, 1991 vs. Bird, 1995 and Fischer, 1998), along with bittersweet backlash of colonialism (Haggard and Kaufman, 1989), were also evidenced to be real by the statistical analysis. Those statistical analyses were based on almost complete universe of conditionality agreements, which immunizes them from selection bias. Therefore, their results vindicated the veracity of conventional wisdom and enhanced the level of generalization. In addition, they could also capture the overlooked functional mechanism of that wisdom.

Fourth, the statistical results of this chapter testify the close connection between the game model and empirical expectation. Although driven by abstract in the first place,

various ingredients of the model, such as cost terms and discount rate, showed surprisingly high explanatory power to the research question. This does not necessarily mean that the Fund and recipient countries calculate their utilities in the exactly same way in reality. However, at least the results assure us of two things: players in conditionality bargaining are highly likely to consider such components seriously; and the difference in those components plays a certain role in conditionality outcomes.

Lastly, the statistical results vindicate the external validity of the model in terms of expected bargaining outcomes. As profiled in Table 3.1, conditionality bargaining game produced three different results and leverage was identified as the underlying necessary function for those results. On the other hand, it was shown at the beginning of this chapter that contentions from both the IMF and critical scholars have credible empirical records. The verification of those contentions is not contradictory to the outcomes from the model, but are securely nested in the model. That is, the two contentions can be regarded as two extremes on the continuum of coercion to compromise, and it is leverage that moves conditionality agreements from middle ground to either direction. Compared with game theoretic outcomes, they are equivalent to maximum imposition by the IMF, Agreement ④, and maximum technical application of conditionality, Agreement ①, respectively. And Agreement ③ comes to exist between these two extremes by the function of leverage. The subsequent statistical analyses aimed at materializing the existence of leverage, playing in the middle ground and its effectiveness. Many independent variables that are congruent with theoretical expectations plainly say that there exist more sources of leverage to give players flexibility in conditionality bargaining than we have thought, from institutional settings of the IMF and recipient countries to various opportunities in international politics

and economy. A windfall from the established validity of the conditionality bargaining model based on leverage is that conditionality is prospective rather than retrospective. IMF conditionality will change its face, continuously interacting with newly emerging trends in international political economy, and both sides' bargaining style and appropriate leverage will adapt themselves to them.

CHAPTER 6

LEVERAGE, CAPITAL MOBILITY AND CONDITIONALITY: INTERNATIONAL BAILOUT OF KOREA, 1997

On December 3, 1997, Michel Camdessus, Managing Director of the IMF, announced that Korea and the IMF concluded a Stand-by Agreement. Through this agreement, Korea would receive a loan worth around \$55 billion. The IMF would provide \$21 billion in Stand-by credits over three years, the World Bank would provide up to \$10 billion, and the Asian Development Bank would provide up to \$4 billion. Some countries, including the United States, Britain, Japan, Germany, France, Canada, Australia and Italy would pitch in a total of up to \$20 billion. This aid package could be the largest one in IMF loan history. In the summer of 1997, Indonesia and Thailand received assistance from the IMF which totaled about \$60 billion combined, and Mexico negotiated a package of \$50 billion to ease out its financial crisis in 1995, which had been the biggest IMF loan up to that date. Agreed policy measures for structural adjustment comprised disciplined fiscal and monetary operation, far-reaching financial sector reforms, and radical liberalization of trade and capital accounts, as well as improvements in the structure and governance of Korean corporations.

At a glance, this recent international bailout of Korea is one of the ordinary Stand-by Agreements that have been contracted between the IMF and developing countries since the debt crisis broke out in 1982. However, the Korean case is distinct from previous ones in many respects: the international economic context of the bargaining was considerably changed from that of the debt crisis, the origins of the problem were located within the

private sector rather than the public sector, and the final terms of agreement contained unusual items. The entire process of bargaining took only two weeks from the request for bailout to approval by the Executive Board of the IMF. What is more important is that such distinctiveness does not work to segregate it from other conditionality agreements. To the contrary, it appears to be the culmination of factors shared across the conditionality agreements, which form the very core of the conditionality bargaining with the IMF. Therefore, this chapter delves into Korea's recent experience with the IMF.

A case study at this point, after all the efforts to generalize conditionality bargaining, is intended to put a concrete look on the theoretical model. So far, discussions of conditionality bargaining have been abstract and general. While theorizing and generalizing conditionality bargaining was attempted, many details of individual conditionality bargaining—which might be sometimes more relevant to explaining its outcomes and, thereby, differentiate it from others—were inevitably sacrificed. The case study in this chapter calls those details back into the picture and brings down the discussion from general to particular level. Through a detailed study of a specific case, we will be able to get practical sense of many components of the conditionality bargaining game. That is, what form each ingredient of the game can take in reality, and how well each part of the model fits a specific case. This comparison between theory and reality is indispensable for establishing validity of the theory, and a good generalization should remain valid even after idiosyncrasy of each case is taken into account. Also, the distinctiveness of individual cases will be better understood when they are viewed against the common pattern piercing through them all, rather than staying aloof. Now, we start with a chronicle of what unfolded in Korea late 1997.

6.1 SUMMARY OF EVENTS

January through October 1997: Korea's macroeconomic performance in 1997 was broadly favorable, notwithstanding a widening current account deficit, mainly as a result of deteriorating terms of trade. However, since the beginning of the year, an unprecedented number of large business conglomerates had moved into bankruptcy. This reflected a number of factors, including excessive equipment investment in certain sectors—such as steel and autos, which was furnished by domestic banks borrowing capital from international financial markets for short-term (due in a year or less)—and a weakening in the profitability associated with the cyclical downturn. Those bankruptcies undermined the financial system, and non-performing loans rose sharply to the equivalent to 7.5% of GDP. Preceded by crisis in Thailand and Indonesia, foreign banks began to refuse to roll over the country's short-term debt. The won, Korean currency, plunged precipitously as banks and corporations scrambled to buy dollars to repay loans suddenly called in.

November 18: The Korean government, and more specifically, the Ministry of Finance and Economy (MOFE), adamantly denied a spreading rumor that a request for help from the IMF was under review. The MOFE assured that any bailout by the IMF was not being considered, saying that Korea's foreign currency reserves were not at a worrying level yet, which required emergent IMF loans.

November 19: The Korean government announced financial market stabilization measures as a self-help attempt, which comprised restructuring of the financial system through inter-

bank mergers and acquisitions (M&As), as well as disposing of bad debts at banks and merchant banks specializing in short-term lending.

November 20: Stanley Fischer, First Deputy Managing Director of the IMF, arrived in Seoul and delivered the IMF's concern about the Korean economy. This assured the Korean authorities of the IMF's full support to Korea's request for rescue if it occurred. Also, Lawrence Summers, Deputy Secretary of Treasury of the United States, said at a meeting with Chang-Yeul Lim, Minister of MOFE, that the United States believed that financial support to countries with problems should only be provided in the context of an IMF program.

November 21: In an overnight reversal of policy stance, the Korean government announced that it decided to seek a rescue loan from the IMF to lift itself out of an ongoing financial crisis, and that Korea and the IMF were already engaged in unofficial negotiations over the amount and terms of the emergency loan. Following the Korean authorities' announcement, the IMF management welcomed Korea's decision and pledged a full support. Anxiety about Korea spread to other markets in Asia and other regions to contribute to a 129.80-point drop in Dow Jones Industrial Average in the United States.

November 26: Hubert Neiss, Director of Asia-Pacific Region of the IMF, arrived in Korea with other seventeen IMF delegates and started conducting research on the Korean economy.

December 1: The Minister of MOFE announced that the Korean government and the IMF delegation team reached a provisional agreement on a bailout program, including the general outlines of amount and terms.

December 2: The Managing Director of the IMF denied the Korean assertion on a package settlement in Malaysia, where he was attending a meeting of Asia-Pacific finance ministers and central bank officials. He said that Seoul's announcement of reaching an agreement was considered to be part of Seoul's negotiating tactics. In the following telephone talk with the Minister of MOFE, Camdessus expressed negative views about parts of the tentative accord worked out by the working-group officials of the two sides, and he demanded that the Korean government delay the announcement until every last detail was settled. The same day, the Korean authorities suddenly suspended operations of nine badly ailing merchant banks until the end of the year. Those banks would be closed for good unless they devised a plan to right themselves by March 31, 1998.

December 3: Arriving in Seoul, Michel Camdessus had a direct talk with the Minister of MOFE. In the last-minute negotiation, Minister Lim accepted demands by the IMF for immediate liquidation of seriously ailing banks and merchant banks. He also agreed to allow foreign banks and security companies to establish subsidiaries in Korea by mid-1998, and to extend upper limits for foreigners acquiring per item shares.

December 4: The Executive Board of the IMF approved Korea's request for a three-year Stand-by credit equivalent to 15.5 billion SDRs (1,939% of Korea's quota of 799.6

million SDRs), using the accelerated procedures established under the Emergency Financing Mechanism (EFM).¹ At the announcement of the package deal, major stock markets around the world buoyed as it soothed investors' fear.

In the Letter of Intent,² the Korean government pledged to implement the following conditions: macroeconomic objectives were to be set to narrow the external current account deficit to below 1% of GDP in 1998 and 1999, inflation was to be contained at or below 5%, and the real GDP growth was to be decelerated to about 3% in 1998 and following recovery in 1999. Monetary policy was to be tightened immediately with call rate raised up to 21%, and fiscal policy was also to be maintained tightly in line with monetary policy in order to achieve budget balance through both revenue and expenditure measures.

The structural components of the program included a wide-range of financial sector restructuring: the Bank of Korea Act was to be revised to provide for central bank independence, and commercial banks failing to meet the Bank for International Settlements' (BIS) net worth ratio of 8% were to be immediately liquidated through third-party takeovers or M&As. Also, capital accounts were to be liberalized to accelerate

¹ The EFM was adopted in September 1995. It strengthens the IMF's ability to respond swiftly in support of a member country facing an external financial crisis and seeking financial assistance from the IMF in support of a strong economic adjustment program. The policy favors larger loans from the IMF in a shorter time during periods of market crisis, but those loans would carry higher interest rates and shorter repayment periods than traditional IMF assistance. Source: IMF. 1998. "Financial Facilities and Policies: IMF Financing Helps Members Pursue Sound Policies." *IMF Survey Supplement on the Fund* (September) or visit <http://www.imf.org/external/pubs/ft/survey/sup0998/08.htm>.

² Its full text is available on the IMF's website: <http://www.imf.org/external/np/loi/120397.htm>.

foreign investment in the Korean equity market by allowing the establishment of subsidiaries of foreign banks and security companies by mid-1998, and by extending the upper limit for foreigners acquiring per item shares from 26% to 50% and to 56% in 1998. Timetables for trade liberalization were also to be set in compliance with the World Trade Organization (WTO) commitments. In addition, reforming corporate structure and its governance was required: the Korean government was not to intervene in bank management and lending decisions except policy lending (agriculture, small business, etc.); and a timetable was set to improve the transparency of corporate balance sheets. Finally, labor market was to be reformed to facilitate the redeployment of labor, in parallel with further steps to improve labor market flexibility.

6.2 RECONSTRUCTING THE CASE TO THE CONDITIONALITY BARGAINING

To demonstrate that the Korean case conforms to the conditionality bargaining model, the contents of the above chronology should be reorganized by the game component. Blurring timelines, components of the events will be organically reassembled by their shared theoretical aspects, which will make it easier to link causes to the outcomes.

As already seen, despite the imminent crisis, the MOFE representing Korean government dismissed speculations that Korea would seek assistance from the IMF. While the MOFE admitted that the domestic financial market was unstable, particularly in the aftermath of serial corporate bankruptcies throughout 1997, it did not hesitate to show confidence in the nation's economic capability, saying “it is strong enough to overcome the

ongoing financial sector turmoil” (Yoo, 1997a). The financial stabilization package announced in November was a last-ditch measure in order to avoid the IMF, but it failed to prevent the country from sliding further into financial turmoil. Such reluctance to open a talk with the IMF was a sheer reflection of the cost that the Korean government expected to pay when it occurred. The Korean government was concerned that an IMF rescue fund would create many short-term economic problems, such as a rise in unemployment, bankruptcies of financial institutions, mounting tax burdens, and negative GDP growth. Furthermore, “[t]he infusion of IMF emergency bailout money into Korea, if implemented as planned, would surely result in a loss of economic sovereignty and seismic upheavals of the national economy” (Yoo, 1997b). However, a bigger concern behind it was that it would not stay isolated as economic cost, but turn into political cost easily.

The bailout by the IMF and ensuing economic cost came at a critical time for the country's political leadership. In two weeks, Korea was supposed to hold a presidential election. Politicization of economic cost entailed to an IMF bailout would undoubtedly affect the election. Knowing that various side-effects would follow a rescue plan by the IMF, it was not a readily acceptable option for the incumbent government and party, in the midst of presidential campaign, to pursue such a controversial aid package publicly. This would unquestionably divert votes from their candidate to competitors. If bypassing the IMF had not been unavailable and the political costs linked to the bailout had not loomed so large, possibly the best course for the Korean government to follow would have been to ask for a \$55 billion loan from the IMF after December's presidential polls, as the chairman of the U.S. Institute of International Economics suggested (Yoo, 1997a). Unfortunately, however, the situation was too urgent to wait until the presidential election

was over in order to reduce the political cost. It is hard to tell whether the financial crisis was an offspring of a concealed political-business cycle in Korea. However, there was, at least, evidence that the authorities in charge neglected warnings from the society and procrastinated in taking appropriate actions, although the government and party in power did not blatantly manipulate macroeconomic policy to maximize their electoral chances. In any event, the outgoing regime's behavior before the crisis was broadly in line with an argument that when a country already had economic problems, the government was less likely to initiate a stabilization program in the year before or during an election (Haggard, Kaufman and Webb, 1992). And it appears to be mainly due to the domestic political cost that it identified with the expected result of the presidential election.

The above concern was well grounded, considering the presence of highly mobilized labor organizations in Korean politics and economy. Korea had been rocked by a month of worker unrest earlier in 1997 when the congress passed a controversial labor law that would have made layoffs easier. Aggressive and persistent labor movements forced the Korean government to postpone its taking effect until 1999. When the bailout program was announced, as expected, the militant Korea Confederation of Trade Unions promised to wage "all-out strikes" if companies pushed for layoffs as a result of bailout by the IMF. And, imaginably, opposition political parties were eager to exploit voters' feelings of anger and shame ahead of presidential election. President-elect Tae-Jung Kim, who was a long-time opponent of the regime and linked his policy platform to the interest of labor class, was one of the candidates who advocated re-negotiation with the IMF for

his presidential bid.³ His victory may have been, in one sense, benefited from political damage inflicted on the candidate from the incumbent party.

Aware of collateral side-effects of an IMF bailout, the Korean government secretly approached its allies for a bilateral aid package so that it could bypass the IMF. The Minister of MOFE suggested that Korea would prefer an aid package negotiated with major trading partners, such as Japan and the United States, rather than submission to a multilateral IMF bailout. However, Korea's efforts to secure loans from the central banks of the United States and Japan failed because they said that it was politically impossible for them to loan tens of billions of dollars required to patch up the world's 11th largest economy, and that they would extend loans only if Korea first accepted an IMF aid package (Chon, 1997).

The United States was known to have firmly rejected Korea's bid for bilateral aid. From the start, the Clinton administration said that it would not do in Asia what it did in Mexico: taking the lead with a bailout plan that puts American taxpayer dollars at risk. Instead, it insisted that Korea implement reforms that were needed to get it back on the right path (Sanger, 1997). At the APEC summit, where Korea's financial crisis became a hot potato, Japanese Prime Minister Hashimoto expressed the same view of the measures the Korean government had to take to overcome its financial troubles. He said, "our government will provide the best possible support to Korea within the framework of the

³ The IMF was so keenly aware of the risk in bailing out the outgoing Young-Sam Kim's regime that it asked three leading presidential candidates to officially pledge a full respect for the agreement with the IMF when one of them took office. Nonetheless, President Kim promised re-negotiation with the IMF during his campaign, even for a short time, which caused the Korean stock market to plummet further and added difficulty to subsequent debt rescheduling talks in December. Later, he was known to change his policy, following advice from Jong-Keun You, his top economic adviser.

IMF assistance” (Chon, 1997). This was not a good sign to Korea in that it made the IMF bailout not a matter of choice from necessity, but inevitability. This meant that all other possible opportunities for financing abroad were already consumed. Even before the negotiation with IMF started, the Korean government was freed from opportunity cost that might be incurred if it accepted the bailout program by the IMF without consulting other donors. It might be this total loss of opportunities that drove Korea to the IMF, which would subsequently reduced Korea’s confidence.

Initially, many expected that \$20 billion would be enough to help Korea out of its financial crisis, which was mainly caused by a slew of corporate failures and their impact on its banking system. However, when the government announced its plan for requesting a bailout by the IMF, it suggested that the amount of bailout would be more than expected. By the time the IMF delegation team finished research on the Korean economy, it was revealed that the debt accumulated by the banks reached up to \$120 billion, which far exceeded expectations; thus, more assistance became necessary. Aside from burdening the economy, such a sizable debt was poised as an immediate problem to the bargaining with the IMF in terms of confidence or subjective probability of winning the negotiation. With other financial windows closed, the IMF was the only source that the Korean government should depend on for the needed capital. Furthermore, considering the amount of loan, the conditions which would be traded off with the loan would not be easy ones. As statistically tested in the previous chapter, the subjective probability of winning negotiation with a preferred policy package is boosted by capital inflows from abroad that meet financial needs of the recipient. If such is the case, Korea’s subjective probability of winning its preferred deal was very low. On the other hand, expectations that Korea

would receive tough conditions for the loan would be naturally high.

To make things worse, Korea also had to act quickly. While its foreign reserves had dwindled below \$10 billion during crisis, which the IMF judged as a perilous level, Korea had to find a financial source to defray \$20 billion short-term debt that was due at the end of December. Korea was desperate for assistance because of this ticking time bomb; therefore, once a bailout by the IMF became official, the Korean government wanted an early conclusion of the talk with the IMF by accepting most of IMF's demands in return for rescue money. The Minister of MOFE pledged to exercise maximum flexibility in accepting the IMF's possible calls for adjustments of the nation's major economic indices, except for the IMF's direct intervention in domestic industrial restructuring (Yoo, 1997c). Thus, it is hardly imaginable that the Korean government would have valued future bargaining outcome as much as the present one with a hope for a better deal. For the Korean government, prompt loan disbursement, followed by a quick deal, must have looked more attractive than prolonged bargaining over minor changes in conditions. As if vindicating this situation, the negotiation was over in a week. "Sensing the seriousness of the Korean currency crisis, including its shallower-than-expected foreign exchange reserves, the two sides reached the agreement on the early introduction of IMF funds," commented Hubert Neiss (Kang, 1997). And the Korean government stated that it had decided to accept most of the conditions presented by the IMF, based on the judgement that the IMF-set terms would not give much burden to Korea's economic policy operation (Ibid).

As easily inferred from its attempt to bypass the IMF, the Korean government's first priority was getting loans from allies without strings attached. However, when it

turned out to be unavailable, the Korean government, like many others, tried to maximize its utility in negotiation with the Fund by securing a loan matching its financial needs, while minimizing harmful conditions, which would partly compensate for the poised costs. Unfortunately, however, this never happened, and the bargaining results tell us that the Korean government was forced to make a choice between two equally undesirable trade-offs, “larger loans but at harsher terms and small loans but at more favorable terms” (Chan, 1993), and its choice went for the former.

On the IMF side, the actor who played the most conspicuous role throughout the process was unarguably the Executive Board represented by the United States and the Managing Director. As the largest shareholder within the IMF, the United States holds tremendous power over Fund decisions.⁴ While rejecting Korea's call for direct financial help, the United States still directed how to quell a financial crisis with the toughest elements of the economic prescription, especially financial reform (Passell, 1997). Furthermore, the Managing Director who has considerable latitude in the application of Fund principles could, and did, intervene in the bargaining process to deliver the intention of the Executive Board as witnessed in the chronology. While the negotiation in Korea was proceeded by the mission delegates who interpreted the financial information in a disinterested manner, their self-proclaimed technical decisions were blocked and permeated by political factors from the Executive Board, and the Managing Director supportive to it, as Assetto (1988) analyzed ten years ago.

In discussing the role of the Executive Board in conditionality bargaining

⁴ The United States' voting rights as the largest shareholder is over 18% of total shares. Many key issues require an 85% majority, so that the United States effectively has a veto over major Fund decisions.

particularly in East Asian countries' cases, it is noteworthy that Japan had been, until then, the biggest creditor to Asia, and it would be posed under the direst damage by any default in the region. According to Moody's, about half of all external debt in Southeast Asia was held by the Japanese banks, with a much smaller portion, between 10% and 20%, held by lenders in the United States (O'Brien, 1997). Unlike the Latin American debt crisis of the 1980s, big American banks, with the exception of Citicorp, had a limited lending presence in Asia. The Asian debt crisis involved lenders from a number of countries, with European and Japanese banks facing much larger potential losses than American banks, although it would still be troublesome for some American banks if those loans were defaulted.

Nevertheless, Japanese banks exposed to the troubled region were not properly protected by any substantial leadership from the Japanese authorities to present solutions to the problem.⁵ Japan's role in the Asian crisis was largely as banker and follower, taking the roles assigned by the United States, despite its economic size and location. As financial crises were sweeping through Asia, provoking fears of a global recession, Japan was too mired in its own problems to be of much help. Rather, Japan had prolonged its own economic torment and contributed to the Asian financial crisis by denying its problems (WuDunn, 1997). Japan was unwilling to help Korea independently, nor would it push ahead with its own plan, if any, without Washington's approval. Japan put up \$10 billion for the Korean rescue package, which was twice as much as the United States' contribution, but the rescue plan was orchestrated from Washington. In a sense, this may

⁵ The relationship between the degree of debt concentration and bargaining power in debt negotiation was empirically tested. Taking this into account, Japan should have taken the leadership to assemble a bailout plan for Korea in its favor. For the empirical test, see Fernández, Raquel and Şule Özler. 1999. "Debt Concentration and Bargaining Power: Large Banks, Small Banks and Secondary Market Prices." *International Economic Review* 40, no. 2 (May):333-355.

indicate the degree of unity achieved among the five Executive Board member countries. Although there were potentials for conflict among them due to different degree of exposure to economic damage caused by the crisis in the region, a rift among them was hardly disclosed, at least to outside world.⁶

Meanwhile, the United States was making its second-line contribution more politically palatable to itself. What the United States, or the IMF in general, was pursuing in bailing out the sinking boat of Korea was solving a two-way moral hazard problem, which is broadly in line with guaranteeing loan repayment. Rubin, Secretary of Treasury of the United States stated the following:

the availability of IMF resources made debtor countries less willing to pursue adjustment programs needed to enable them to meet their outstanding debt-service obligations. This would effectively reduce the risks faced by investors in poorly run economies and then investors would not demand that national leaders enforce economic discipline, if they become convinced that the IMF always stands ready to forestall default. (quoted from Passell, 1997)

From this, the IMF appeared to discipline prospective borrowers through tough conditions on behalf of unruly investors in advance, on one hand, and to secure debt service to the IMF by them on the other.

Before the field research was launched, the actual size of short-term debt that Korean banks had accumulated was kept almost in secret. When its number was finally

⁶ This contrasts with *inter-country* differences during debt crisis in the 1980s argued by Chan (1993). He says that the US with a comparatively large exposure to Latin American countries generally took a harder line than European counterparts in negotiating with the debtor government, insisting on drastic adjustment efforts by the debtor government as a condition for extending new loans. Instead, the first official disagreement among the five Board member countries came out at the annual meetings of the World Bank and International Monetary Fund (IMF) in October, 1998 over world economic plan aftermath of Asian crisis. Online articles on their conflicting plans are available at <http://cnn.com>.

figured out, the IMF also learned the size of loan it would have to provide. Financing Korea's imminent \$20 billion short-term debt meant that a huge portion of the IMF's usable funds would have to be appropriated for one loan; thereby, not only would the Fund's overall liquidity position be significantly influenced, but also the level of lending to other members would have to be adjusted downward.⁷ Facing such enormous opportunity cost from bailing out Korea, the IMF automatically might want certain compensation for the deprived opportunities through tough conditions.

In addition to the opportunity cost, the IMF should be concerned about criticism of it if Korea fails in economic restoration only to cause additional debt arrears to the IMF. However, the IMF might not be unduly concerned about it, compared with the opportunity cost, since Korea had a track record of success in economic adjustment with Fund support in the 1980's⁸, and general debt arrears to the IMF have been declining since 1992. Rather, the reputation cost the IMF suffered was *post hoc*. As soon as the conditionality agreement was announced, the IMF came under severe attack for the wrong treatment for the country that had enjoyed high economic growth until then; furthermore, it became entangled into debates on abolishing the IMF. From then on, the IMF had to

⁷ The impact of financial crisis in Southeast Asia on the Fund's financial position is shown in graphs in 1998 Annual Report. The Fund's annual lending reached the highest in 1997 (Figure 7, p. 88) and liquidity position fell from the previous year by more than 100%. Related to this, during its 11th quota review, the Board of Governors requested quota increase by 45% in January 1998 and, as of March of 1999, 153 members consented to it.

⁸ Korea implemented adjustment programs in 1981, 1983 and 1985. It should be noted, however, that putting Fund-supported adjustment programs forefront as the factor for success is controversial in the sense that the economic development model that Korea was following in the 1980's depended more on government intervention in economy than efficient market function, which is opposite to Fund's structural adjustment.

devote substantial energy to justifying its existence and function without a systemic role.⁹

Taking its prompt reaction to Korean situation in account, quick conclusion of the bargaining might be important to the IMF, too. As an isolated case, the IMF might not have serious reasons to hurry up in order to bail out Korea. However, the Fund was vastly concerned about the systemic impact of the Korean crisis, namely, contagion of crisis to other emerging markets in Latin America and Russia, and a global recession aftermath. The Asian economy was buoyant for the past decade and led world economic growth. In the wake of crisis, the IMF adjusted its forecast for world output rates from 4.4% (both for 1998 and 1999, which were published before the crisis) to a negative 1.1% for 1998 and negative 1.2% for 1999 (IMF World Economic Outlook, 1997 and 1998).¹⁰ Thus, prioritizing containment of crisis and stability in the world financial market, the IMF shared interest with Korea in the fast resolution of the negotiation.

With those costs in mind, the two parties negotiated hard on a few issues, which would be vital to maximizing utility, if they were won as preferred. And each party's standing place appears to have had a significant impact on the final outcome of the negotiation. The first issue for haggling was annual growth target. The IMF called for Korea to adjust the nation's GDP growth target for 1998 drastically from the initially set 6% to less than 2.5%, whereas Korea offered 4.8% or a minimum expansion of 3%. The Korean authorities feared that a GDP growth of 2.5%, and the resulting belt-tightening,

⁹ This is well indicated by the number of files on IMF website that sells the IMF. Since the end of 1997, the IMF's website has been inundated by documents that explain the Fund's role in Asian crisis and its new mission for capital market stability.

¹⁰ This was a forecast in May report. It was upgraded to 2.0% and 2.5% respectively in the October report.

would sharply raise the nation's jobless rate leading to overall social unrest. However, it was settled for 2.5%, as the IMF wanted.

The other issue that the two sides failed to narrow their differing perceptions on was in relation to liquidating troubled financial institutions. It was inevitably expected that financial sector restructuring would be a troublesome point of the negotiation, taking into account the IMF's great interest in the financial sector during its field research, as well as the Korean government's circumventive announcement earlier. Thus, negotiations focused on policy options to shake off Korea's financial system through M&As, capital increases, and third-party takeover. As concrete measures for restructuring financial industry, the IMF proposed that Korea sharply expand its fiscal spending and mobilize more taxpayers money, which it said would help reduce non-performing loans at banks and merchant banks. This automatically meant the revision of the domestic tax system, too. The IMF also strongly demanded that some insolvent banks, as well as several ailing merchant banks, be liquidated or merged with foreign banks. Other banks must tidy their portfolios, exchanging short-term liabilities for long-term debt that is less subject to speculative meltdown. Most of all, the IMF presented that more rapid capital account liberalization would be required to provide momentum for the overall reform process by weakening entrenched vested interests and the bureaucratic control on private sector activities.

The IMF also challenged the economic methods that fueled the nation's growth by asking for the restructuring of business groups, so-called *chaebol*. As a prerequisite for assistance, the IMF insisted that the Korean government discard policies favoring *chaebol* in financing and taxation, while ending the policy of forcing unsound businesses to merge into solid ones. The conglomerates needed restructuring to leave them with less debt, and

to change to a management style which measures success in profits rather than market share (Passell, 1997). Linked to corporate governance, the IMF demanded from the financial institutions greater accountability, more responsible lending and investment practices, and a move away from the back-room deals that had brought great wealth to politicians and favored businessmen.

The Korean government was reluctant to accept the IMF's demand for an immediate shutdown of heavily-indebted banks and merchant banks. Korea wanted a softer measure on those issues, citing enormous negative impact of banks' liquidation on the overall Korean economy. Regarding the banking sector restructuring, Korea asked the IMF to give three to six months to resolve the ailing banks' problems in accordance with its own program, unveiled in November. The Korean authorities worried about rising unemployment, labor unrest and the possibility of runs on banks by frightened depositors; therefore, they argued for allowing the ailing institutions to be revamped or merged with healthier ones. This request was understandable considering Korean banks' long-standing role in the economy. The Korea government's perception on the potential closing of the merchant banks was well pointed out by a researcher at a securities company:

It is being taken very seriously in Korea because, for their scale, they have provided very sizable credits to Korean business and industry. In particular, the merchant banks are important sources of loans for smaller and midsize businesses. The effects of any merchant bank closings on employment would be small because the average merchant bank employs 100 to 300 people. But the government is more worried about setting a precedent for the liquidation of commercial banks, which are far larger than merchant banks and employ thousands of people. (quoted from Pollack, 1997)

The effort to find a formula for liquidating troubled banks was frustrated because the two parties had quite different conceptions of what would constitute such a formula. And it was in this matter that Camdessus perceived Korea as “coming round to the IMF’s stand on the most sensitive point, what should be done with the country's merchant banks” (Yoo, 1997d). Nonetheless, the MOFE had no other choice but to suddenly halt the operation of nine merchant banks in the middle of bargaining in the hope of facilitating negotiations, as well as easing the terms. However, even such a desperate action could not reverse the course of event. The Korean government accepted the most risky conditions set by the IMF, of which implementation is certain to expose all local industrial and financial enterprises to indiscriminate foreign mergers and acquisitions, simultaneously opening capital markets to foreign speculators (Yoo, 1997e).

A legitimate question at this point is how the theory of leverage can explain this negotiation result, and what would have been done differently given the underlying power relationship between the IMF and Korea. To begin with, the Korean crisis attracted immediate attention from the IMF, and the procedures gained momentum quickly once it was set in motion. This seemed mainly due to Korea’s status in the world economy. There was a presumption that immediately following the debt crisis in late 1982, the IMF would be anxious to avoid a general international banking and financial collapse (Bird, 1995). By the same token, when Korea’s crisis was divulged to the rest of the world, both the IMF and the United States underscored the risks of much broader trouble for the world economy if they failed to act. The United States, which views relative stability in international financial markets as an important foreign economic policy goal because the alternative is still seen as a source of potential political instability at both domestic and the

international level, feared that Korea's failure could resonate in Japan and around the globe (Altbach, 1998). An economically strong Asia that imports as well as exports, and thereby supports global growth, was also good for global interest. Thus, the economic cost was expected to be enormous if the IMF failed to rescue Korea. This was leverage that Korea had at a systemic level.

At a particular level, on the other hand, Korea has a significant factor to concern the lenders, which might be called leverage. "We are convinced that economic stability is important to our national security concerns especially in Korea, one of the last surviving arenas of cold war conflict," Rubin argued (Sanger, 1997). At that time, four-party talks (North and South Korea, China, and the United States) were coincidentally scheduled in Geneva over a peace treaty that would finally end Korean War. The United States had a lot riding on a stable and prosperous Korea on the corner of northeast Asia. If Korea's financial health continued to deteriorate, the diplomatic pressure on Washington to step in could become excruciating.

Other than the security concerns, there were some other palpable economic interests at stake in Korean financial crisis, too. Rubin confessed in an interview with the *New York Times* (12/18/97) that "you have to remember that the crux of our concern is America's interests. Our economy can certainly be affected if a sufficient number of emerging nations head into a prolonged crisis." This statement pertains to economic (inter)dependence as leverage. Asian products account for 11% of all imports to the United States, and Japan alone accounts for an additional 17%. The Asian financial crisis helped drive down the price of imports to the United States—with goods from Korea, Taiwan, Hong Kong and Singapore dropping an unprecedented 1.2% in November of

1997, reflecting the steep decline in the values of their currencies relative to the dollar (Stevenson and Sanger, 1997). Tumbling price of imports from Asian countries was a boon to consumers and a big help in holding down inflation. However, the profits of multinational corporations were already under pressure by the downturn in Asia. In Korea, US goods got nearly twice as expensive with the country's suddenly devalued currency, which was squeezing many U.S. exporters—from auto parts manufacturers to farmers—and could imperil the jobs those exports support. With inflation already down to about 2%, the Federal Reserve Board avoided raising interest rates despite the tight labor market because the turmoil in Asia would lower U.S. exports to Asia, and thereby would cut economic growth in 1998 by half a percentage point or more. Higher interest rates would not only aggravate the Asian distress by further weakening their currencies, but would risk slowing the U.S. economy too much. Under the circumstances, the near-certainty was that the U.S. trade deficit would be driven sharply higher by the economic crisis sweeping through Asia and have profound economic and political implications (Ibid.). This would have an effect to drive the trade deficit back to, or above, the records set in the late 1980's, although it would still be a smaller share of economic output than in the '80s. After years in which the strong economy has dampened confrontations over international trade, the issue would be poised to flare again against a backdrop of turmoil in Asia as imports surge and exporters find it more difficult to sell their goods abroad (Ibid.). Just as Korea needed the United States as an export market, the United States also needed Korea and other Southeast Asian countries as an export market. Both sides appeared to have equal footing in terms of leverage indicated by economic interdependence.

This was the leverage that both sides of the bargaining table commonly recognized. Before and during the bargaining, the Korean government wanted to maximize its utility in the loan it needed and easy terms, and such expectation was reasonably coming from the self-perceived significance in the world economy and security significance in the Northeast Asia. It was fairly contextual leverage. Unfortunately, however, that was all. Korea's attempt to chase two rabbits at the same time did not bear fruit. It turned out to be so, since Korea failed to transform its positional significance into bargaining power to bring substantial change to outcomes (i.e., softening conditions while maintaining the level of loan due to the lack of relevant leverage to back it up). The circumstantial weakness—the need for immediate rescue with a huge loan—was so overwhelming that it limited the range of options it could choose and let its economic status be preyed upon through drastic financial market opening.

The lack of effective leverage on the Korean side cannot be better shown than in abandoning its plan for financial market opening, which was formed in accordance with the United States' request a few years ago. Moreover, the conditions that the Korean government agreed upon appear to be more than corrective measures for restoring macroeconomic balance (The Economist, 1997). It is even dubious whether such a full opening of financial market was indispensable to reestablishing macroeconomic equilibrium.¹¹ For fairness' sake, the causes of the crisis, as will be seen later, were pertinent to governance and transparency of the financial system, which was recently

¹¹ The inclusion of structural components in the conditions caused debates later on between the IMF and critical scholars. For instance, Feldstein (1998) argued that such measures endangered the IMF's effectiveness in dealing with the problems. As a response to this, Fischer (1998d) argued that such measures were absolutely necessary, since the causes of the financial crisis were structural ones rather than balance-of-payments problems.

added to the menu for Fund-supported structural adjustment. Although many of the objectives underlying the program were laudable, capital account liberalization might be neither a necessary nor a sufficient condition to establish such transparency, which reflects a troubling lack of institutional self-restraint under pressures from major shareholders (Kapur, 1998). Let alone the weak theoretical grounds that it was holding toward financial market opening, it was a quasi tradition within the Korean government to protect its financial market, and it could not be overcautious about opening its markets. The lack of leverage, however, not only brought an end to what the Korean government had protected in the most defensive manner, but also deprived it of opportunities to take its pace with autonomy. Throughout the negotiation between the IMF and the Korean government, the financial sector restructuring was the most hostile issue, where the power relationship between the two players was ultimately tested.

The overall process of the negotiation between the IMF and Korea and its outcome fit Agreement ② of Figure 1. At first, it appeared to be an encounter of two strong proposer with high propensity for agreement, which might yield Agreement ③ as in Table 3.1. Various attempts by the Korean government to circumvent the IMF's demands at the beginning hardly make it a weak bargainer. It is also unreasonable to call Korea a strong proposer with low propensity for agreement, since the imminent short-term debt did not allow the Korean government to be intransigent at all, although it wanted to avoid particular conditions such as financial market opening. If it could be a hard bargainer, Korea might have walked away from the negotiation by declaring veto at node 4. Unlike the beginning of the talk, the circumstances were rather unfavorable to Korea, and were even getting worse as time went by. Having low subjective probability, high domestic

political cost, and no luxury to discount future bargaining outcome already counted, the intervention by the Managing Director in the middle had an effect of almost vetoing the proposal made by the Korean government. Confronting the donor who was much stronger than it expected at the first round, the Korean government settled for Agreement ② at node 4 by accepting a proposal by the IMF. Such turnaround in the final outcome of the negotiation signifies the role of leverage in conditionality bargaining.

6.3 IMPLICATIONS TO DEBATES ON CONDITIONALITY

Theoretical reconstruction in the previous section confirmed that there exists conformity between the conditionality bargaining model and the Korean case. The effectiveness of leverage that each player mobilized to the negotiation was ruthlessly contested with the utilities, which were maximized in terms of toughness of conditionality. Speaking of the toughness of conditionality, radical capital account liberalization appears to be its nucleus, and the saliency of issues in financial market opening (a policy extrinsic to returning an economy to equilibrium) leaves us perplexed about the nature of IMF conditionality. Searching for the meaning of such characteristics in the Korean bailout to the general debates regarding conditionality requires examination of the origins of the crisis. As will be seen, they are not merely causes to a particular crisis, but they reflect the context of the bargaining and set the course for what would be pursued through conditionality.

Needless to say, the current international economic system is characterized by high interdependence and capital mobility. International barriers to the flow of capital have

been disappearing rapidly, and investors and financial institutions move money around wherever they wish. This increased financial integration holds government hostage to foreign exchange and capital markets, forcing greater fiscal and monetary discipline than they might otherwise choose. National systems intended to supervise banks in their home countries have proven unable to keep pace with the rapid development of a global financial marketplace that pays little attention to borders. The United States and other big countries also attempted to bring changes to governments and banks outside their borders by encouraging greater disclosure of financial data.¹² Unfortunately, however, those efforts to bolster the soundness of financial systems around the world have so far yielded little, if any, success.

In addition to this, there is no international body able to play the role of global regulator. While the IMF, other multinational bodies, and national governments are willing to come to the rescue at crises,¹³ they lack the crucial power that usually goes hand-in-

¹² Most standards, guidelines, principles and practices have been developed by Basel Committee on Banking Supervision within Bank for International Settlements (BIS) since 1974. The Basel Committee, which consists of 12 industrialized countries, continuously revises and adapts them to market developments. Although focusing on banking system, its jurisdiction extends to non-bank financial intermediaries, such as securities, insurance, and pension funds, in order to harmonize rules, regulations, and practices in individual countries, as well as internationally. The BIS held a conference on how to measure aggregate market risk and regulate excessive market exposures in the spring of 1997, just when the East Asian crisis began to unfold, and concluded that not many regulatory schemes were feasible. For more information on international capital rules, visit <http://www.bis.org>.

¹³ The IMF's regulatory role in international capital markets is represented by the establishment of the Interim Committee of the Board of Governors on the International Monetary System in 1974, the Fund's ministerial oversight body on the management and adaptation of the international monetary system, as well as dealing with disturbances that might threaten the system. It decided in April 1997 to seek to amend the Articles of Agreement of the Fund so as to bring capital movements formally under its jurisdiction, and make the liberalization of international capital movements a central purpose of the Fund. For details, visit: <http://www.imf.org/external/np/cm/1997/CM970428A.htm>. Related to that, the IMF's efforts to enhance the soundness of the financial system has focused on the banking system, the framework of which is well discussed in IMF, 1998b, *Toward a Framework for Financial Stability*. Washington, DC: International Monetary Fund. The IMF also established Special Data Dissemination

hand with status as the lender of last resort (i.e., the ability to demand changes in a bank's management before crisis hits).¹⁴ A result from this is that, to a remarkable extent, individual nations are suddenly more at risk because of the ineffectiveness of obscure banking regulators in far-off countries. Thus, one nation's trouble in international payments system might have serious implications everywhere, too. What is different from the past is that the stakes are now too high that collapse of an important country's banking system could produce a domino effect (Norris, 1997).

The recent crises in East Asia were nothing but the manifestation of such a risky, but irreversible, trend in the international financial system. Korea, Thailand and Indonesia were among the countries paying a steep price for the problems with their banks. These countries failed in common to dampen overheating pressures that were manifested in large external deficits and property and stock market bubbles, and their lax prudential rules and financial oversight led to a sharp deterioration in the quality of banks' loan portfolios (Fischer, 1998b). As the crises unfolded, political uncertainties and doubts about the authorities' commitment and ability to implement the necessary adjustment and reform exacerbated downward pressures on currencies and stock markets. However, it should be admitted that large private capital flows to these markets—in an imprudent search for high yields by international investors without due regard to potential risks—contributed, to an

Standard (SDDS) in 1996, which guides data disclosure on economic, banking, and other financial statistics to the public.

14 One of IMF's functions is *surveillance* on developments and problems in the international economy and in individual economies. Once a year, the Fund's staff prepares an *Article IV report* for each country, an in-depth analysis of the country's economic policies and performance. The IMF also issues warnings of impending problems. However, heeding such warnings is member countries' discretion. Fischer (1998b) suggested later that the Fund warned Thailand of an impending crisis, but that actions were not taken.

important degree, to the buildup of the imbalances that eventually led to the crises.¹⁵

Market participants were aware that macroeconomic conditions and export performance in the region were not so positive as in the past, and that speculative activities and short-term capital flows into the region were becoming more pronounced. Nonetheless, they chose to *ignore* all of these considerations and to focus instead on the region's high growth, comparatively low inflation rates, lack of significant budget deficits, openness of the region's markets, and high rates of return that their past investments in the region had yielded (UN, 1998).

Korea's capital market was also vulnerable to the currency turmoil that swept other Asian countries in the second half of 1997. After the crash in the Hong Kong stock market in late October of that year, Korea's economy was attacked by the same forces that raided other South Asian countries, primarily unmanageable overseas debt loads. Short-term debt grew fast in 1995.¹⁶ Partly reflecting a jump in trade credit associated with the expansion of trade and the liberalizing steps. In 1997, about \$66 billion of Korea's estimated \$120 billion in overseas debt was short-term, of which, about \$20 billion was due at the end of the year. Such debt loads had dragged down the value of the won and forced many companies into bankruptcy. Seeing its currency plummeting unchecked,

15 Up to the current crisis, Asia attracted almost half of total capital inflows to developing countries, nearly \$100 billion in 1996. Capital movements in both matured and emerging markets before and after the crisis are extensively analyzed in Adams, Charles, Donald J. Mathieson, Garry Schinasi, and Bankim Chadha. 1998. *International Capital Markets: Developments, Prospects, and Key Policy Issues* (September). Washington, DC: International Monetary Fund.

16 Looking at debt to GDP ratio, Korea's external debt increased from 14.7% of GDP at the end of 1994 to 17.2% at the end of 1995, and by a further \$ 6.5 billion (1.3% of GDP) in the first quarter of 1996. Accordingly, interest on short-term debt increased sharply in 1995, but at 5½% of exports, although the overall debt-service ratio remained moderate. Source: Adams, C., J. G. M. Schulze-Ghattas, V. Arora, J. Zhou, and A. Bakastov. 1996. *Korea, Selected Issues*. IMF Staff Country Report 1996/136.

foreign banks began refusing to roll over Korea's burgeoning short-term debt after back-to-back corporate bankruptcies, which shook up the fragile banking system.

One thing noteworthy in that debt problem is that almost all of the debt was owed by the private sector. Unlike elsewhere, the Korean government itself was relatively free of debt, which made the situation dramatically different from the crisis that afflicted Mexico in 1994-95, or the Latin American countries in the 1980's. The IMF evaluated in its country report that the fiscal situation in Korea was sound as a result of a long tradition of fiscal conservatism: over the years, fiscal expenditure, which was relatively low by international standards, has been broadly in line with revenue, resulting in relatively low levels of government debt and high government saving (Adams et al, 1996).

Korea's immediate problem lay in the crushing debts of its banks and *chaebol*. Nonetheless, the origin of the crisis was rather deep-seated: state-manipulated financial systems, long a key formula the Korean government prescribed for a decade of extraordinary growth (Alexander, 1998). In Korea, backed by a seemingly limitless supply of cheap loans from government-controlled banks, a few dozen politically connected conglomerates had long grown at an incredible pace along with the economy and dominated the industrial landscape (Choi, 1993).¹⁷ Corporate bonds, as a way of mobilizing capital, was hardly used until a system of bank guarantees for corporate bond issues was introduced. In 1988, about 97 per cent of corporate bonds were guaranteed by banks, which meant effectively that they were converted into a means of indirect bank borrowing (Mahler, 1990). As a result, the conglomerates' equity stretched paper-thin, and the banks

¹⁷ His article methodically reviews economic development through financial support for business groups from the Korean government.

went deeply into debt. The risk in holding corporate bonds was not the bankruptcy of the company, but the bankruptcy of the guaranteeing bank.

Under the circumstances, any default of debt service obviously didn't mean that the Korean government failed to honor the nation's sovereign debt, but that some of the nation's banks and corporations were unable to pay back loans. However, even when such private default takes place, it signifies a far more serious disaster for the Korean government. Until then, banks in Korea had close ties to the government, and default by them would, by any means, would do harm to the nation's reputation and complicate the prospects for a recovery (Kristof, 1997). For this reason, the Bank of Korea was forced to pay \$10 billion in short-term foreign debt on behalf of Korean commercial banks just before the outbreak of crisis, which turned out to be beyond its ability with far low foreign reserves.

It is undeniable that an excessive unhedged foreign borrowing by the domestic private sector—and a lack of transparency about the ties between government, business, and banks—both contributed to the Korean crisis and complicated efforts to defuse it. The resulting financial sector weakness accelerated the currency crisis to a certain extent, since such weakness was seen as limiting the scope or willingness of authorities to use interest rates to defend the currency, or cast doubts on the prospects of the economy more generally, or cast doubts on the political autonomy and integrity/governance of financial institutions (Fischer, 1998c). And this formed a natural environment under which capital flight was encouraged, regardless of the capital control framework. The Korean government was once praised by scholars as the prototype of developmental state for its ability to penetrate into and transform the society for development purposes (Evans,

1992). Now it has become the nation's nightmare.

Seen from this perspective, the nature of the Korean crisis was a temporary illiquidity, not fundamental insolvency (Feldstein, 1998). And the crisis broke out because of bad governance, not because of insufficient financial market opening. If that was the case, the matching conditions to cure this illness do not intuitively need wide financial market opening. Nonetheless, the IMF insisted on addressing domestic issues with external treatments, and the interface between the two foreign domains should be found in international capital mobility and opportunity for investment: the remarkable performance of foreign portfolio investment in Korea that had yielded high returns with every type of investment.

Considering this performance, it is not surprising that considerable excess demand by foreigners for participation in the Korean capital market has emerged. The magnitude of this demand is clearly reflected on the extent to which the stock in the Korea Fund has traded at high premiums over its net asset value. When they were initially issued in 1984, Korea Fund shares traded at a premium in the 10-20% range, which increased gradually to reach a remarkable 157% at the end of August 1987, before the stock market crash in New York in October 1987. Even after that incident, such a strong foreign interest in investing in the Korean stock market continued, combined with the desire to further diversify their portfolios in emerging market economies. From a long-term perspective on performance of the Korean economy, it was reasonable to expect the Korean stock market to have a superior performance in the future, too. Although the prices of Korean stocks and Korean corporations' price-earnings ratios increased sharply in the past seven years, they did not appear to be unreasonably high in light of the superior performance of most

Korean corporations (Mahler, 1990). The hefty premium in the price of Korean Fund shares indicated such international viewpoint, and suggested that Korean stocks were still significantly underpriced.

Although the balance of payments was switched from surplus to deficit in the early 1990's, it was comfortably financed by the positive response of capital inflows to a slight relaxation of controls, which could be interpreted as materialization of the above expectation. The net private capital account strengthened sharply in 1991, reflecting an increase in foreign bond issues by Korean corporations, and in 1992, net portfolio inflows nearly doubled, reflecting the partial opening of the stock market to foreign investors. Net portfolio investment inflows continued to strengthen over the years, with net private capital inflows reaching \$16 billion in 1995. Korea continued to be a net exporter of direct investment, but increasingly became a major net recipient of portfolio investment inflows.

In contrast to such seemingly abundant potential for investment, financial policy of Korea that frames investment environment had exhibited a surprisingly low level of openness, particularly given the country's strong export orientation. Throughout its rapid economic development, the Korean economy was characterized by significant government intervention and a financial sector which lagged the industrialization of the economy. Given the profitability of the Korean market, therefore, it appears natural that the pent-up demand for financial services in protected markets increased the interest of foreign financial institutions in lowering the barriers to entry. As the so-called emerging markets have grown, the opportunity costs of being closed out of them have grown correspondingly, and foreign firms have become active lobbyists for liberalization (Haggard and Maxfield, 1996). U.S. based financial firms have been particularly

aggressive in securing diplomatic support for their interests. These political pressures have played out at a number of different levels, from the formulation of the services at GATT (now WTO) to regional negotiations (such as the North American Free Trade Agreement) to bilateral consultations.

A common cause of financial market opening across a large number of developing countries was more frequently balance-of-payments crises, which was more typically made manifest in speculative attacks of exchange rate, rapid capital flight, and a sudden collapse in the availability of external lending. From the government's perspective, even under acute international pressures, capital account liberalization helps resolve both short and long-term foreign exchange problems by increasing the credibility of the government's economic policy stance in the eyes of creditors and earners of foreign exchange (Haggard and Maxfield, 1993). However, compared with other middle-income developing countries, Korea had been relatively immune to balance-of-payments trouble. In fact, from 1985 through 1988, Korea experienced large current account surpluses, peaking at over 8% of GNP in 1987. These surpluses generated pressures that were exactly the opposite of those experienced in the crisis cases. In the absence of pressing balance-of-payments constraints, the Korean government was under little pressure to liberalize. Thus, its policy shift did not come as a response to balance-of-payments difficulties.

Instead, the main sources of pressure on Korea came from the US government. Under the 1988 trade bill, the US Treasury Department was authorized to determine whether countries manipulated their exchange rates to prevent effective adjustment, or to gain competitive advantage. The department found that Korea was manipulating its exchange rate, and in February 1990, Financial Policy Talks between the two countries

were launched. These talks coincided with an array of complaints from American banks that they experienced discrimination in their Korean operations, and from American securities firms that began to develop an interest in gaining access to the lucrative Korean market (Haggard and Maxfield, 1996). In that talk, the MOFE presented a blueprint for the “comprehensive” liberalization of the financial sector, which was tailored to American requests. The United States, acting at the behest of American banks, pressed Korea to open its financial markets, which was how the capital account liberalization started in Korea.

Historically, financial-sector reform in Korea was an ongoing effort, with the full effects of some of the already-implemented measures still to take hold, and with further measures on the agenda. Since it started in the early 1980’s, it accelerated in the late 1980’s with pressures from the United States. Over the years, a range of reforms aimed at the development of domestic money, security, and foreign exchange markets developed. These measures paved the way for a broader opening of capital account for portfolio capital flows in the 1990’s. Moreover, as long as Korea was to join the Organization for Economic Cooperation and Development (OECD) in the near future, the liberalization of the domestic capital market was considered to be a necessary condition.¹⁸ Eventually, complete liberalization measures that place limits on access to trade, credit, and quantitative ceilings on the amount of foreign borrowing were going to be abolished by 2000, provided that stable macroeconomic conditions can be maintained throughout and the interest differential has narrowed to 2% points. Following this schedule, even in the

¹⁸ Originally Korea was expected to join OECD in the late 1980’s. However, its actual join was delayed until 1996.

first half of 1997, several measures were taken to ease investment inflows.¹⁹

The progress in capital market internationalization shows two major concerns for the Korean authorities: to first ensure that domestic firms not be taken over by foreigners, and then to ensure that the scope of potential inward or outward capital flows not be so large as to seriously disrupt the stability of the domestic capital market or the won exchange rate. In light of these concerns, it was considered desirable to proceed gradually with internationalization of the capital market, which was also confirmed by the IMF in a research paper (see Mahler, 1990). The reasons that the Korean government was likely to open the stock market only gradually are: first, there was a strong demand by foreigners to invest in Korea, and this, if granted, would put pressure on the won to appreciate. Second, there is a desire to avoid foreign purchase and control of Korean firms. Third, there was a concern that foreign investors would have a speculative, short-term focus, which might lead to destabilizing movements in and out of the Korean market, particularly during and any periods of serious domestic unrest. Lastly, it was believed that Korean securities companies need more time to develop before they were in a position to compete with foreign securities firms. It is obvious that if liberalization of flows was accompanied by liberalization of entry, these gains might accrue to foreign financial intermediaries, which have access to large pools of foreign funds, superior technology, and a sophisticated knowledge of foreign market opportunities. Although they were the rationale for gradual liberalization of capital account, such policy brought the opposite

¹⁹ For example, a capital increase of about \$200 million was authorized for the Korea Fund; the limit on foreign ownership of Korean equities was raised from 20% to 23%; foreign investors were allowed to purchase non-guaranteed bonds of small and medium-sized companies with maturities of 3 years and above and up to 50% of the issue; and restriction of the usage of long-term loans with maturities of over 5 years brought into the country by foreign manufacturers were abolished.

result, losing transparency in the relationship between the state and the market.

Also, the approach to the liberalization of capital inflows and outflows depended on the priorities adopted by the country. In the case of Korea, management of balance-of-payments current account appeared initially to be the overriding consideration, and Korea sought to manage current account surpluses and deficits through regulatory and other changes which influenced capital inflows and outflows (Johnston et al, 1997). The authorities' gradual approach to capital account liberalization aimed to balance the long-run benefits of a more open capital account with the potential adjustment costs associated with a more rapid opening.

Even before the actual negotiations for bailout began, pressure for market opening was quite expected in Korea. Major trading partners of Korea, particularly the United States, may raise their calls for further opening of domestic markets, especially liberalization of those sectors in which they enjoy advantages by using the forthcoming rescue package of the IMF as a leverage, which turned out to be the financial market (Chun, 1997). Targeting financial market was not groundless, taking into account that just recently the WTO, after long negotiations, concluded a financial services pact that further opens up the banking, securities, and insurance industries in scores of nations. Therefore, such radical financial market opening was introduced at the expense of the previously established plan under the pressure from the IMF, more correctly, the Executive Board, and it was not surprising that Rubin expressed his content, saying that "the United States welcomes the program, which includes significant financial restructuring measures to open Korea's financial markets to foreign participation and improve corporate governance as well as important macroeconomic policy changes" (CNN, 1997).

The fact that the condition of financial market opening was driven by the Executive Board can be indirectly proved by the different views held by IMF experts on capital account liberalization. As well known, capital account liberalization can have significant benefits for economic growth and welfare. At the same time, however, the opening of capital account entails certain risks if not accompanied by the necessary structural reforms and macroeconomic policies. Therefore, there exist three different views with regard to the liberalization of capital account: one view says that capital account liberalization should follow liberalization of current account and the domestic financial system (Edwards, 1984); another view argues for simultaneous liberalization of current and capital accounts (Krueger, 1984); and Hanson (1994) suggests that a stable macroeconomy and domestic financial liberalization to a significant degree are preconditions to international financial liberalization. Against these theoretical backdrops, IMF experts (Johnston et al, 1997) hold a stance that attention needs to be paid to sequencing capital account liberalization with structural measures, especially in the monetary and financial sector, and to pacing liberalization in conjunction with the development of appropriate macroeconomic policies. The liberalization of capital account and other aspects of economic and financial sector reform are a good deal more complex and not readily open to stylized presentation on sequencing. Different components and aspects of capital account should be liberalized at various stages, along with aspects of current account and domestic financial sector in line with countries' overall macroeconomic objectives (Bhattacharya, 1997). Lack of coordination between the domestic financial sector and capital account reforms can create distortions and regulatory

incentives for capital movements that are unrelated to the underlying economic conditions, thus risking greater instability in capital movements.²⁰

IMF economists (Johnston et al, 1997) predicted that capital account liberalization would continue in a number of developing countries. It follows that they assume that the Korean authorities will continue to implement their program to gradually liberalize capital account and domestic financial sectors. Moreover, given Korea's strong fundamentals and profitable investment opportunities, the deficits in overall balance of payments will be comfortably financed by a mix of debt and non-debt-creating capital flows. However, somewhat faster liberalization would imply somewhat larger current account deficits, together with higher growth and investment in the near term. Larger current account deficits would be comfortably financed, but could reduce the ability of the economy to respond to unfavorable external developments, such as unexpected deterioration of terms of trade (Adams et al, 1996). Most importantly, however, a much faster pace of external liberalization would risk complicating short-run macroeconomic management and could place significant upward pressure on the exchange rate.

Through the conditions attached to the Korean bailout, the politicized Executive Board revealed its deep commitment to mobilizing international capital, reducing risk for investors, and pressing countries to open markets at virtually any cost. A growing number

²⁰ Stanley Fischer also said at an IMF seminar that capital account liberalization had to be phased appropriately so as to retain some capital controls in transition. He favored market based controls, such as were maintained by Chile, over quantitative limitations on flows. This stance was reconfirmed in an IMF seminar this year. Distinguished economists had one voice in advocating orderly liberalization of capital account. See Fischer, Stanley. "Capital Account Liberalization and the Role of the IMF." speech delivered at IMF seminar "Asia and the IMF," Hong Kong. [Online] Available <http://www.imf.org/external/np/apd/asia/fischer.htm>, September 19, 1997; and IMF Economic Forum. "Capital Account Liberalization: What's the Best Stance." IMF, Washington, DC. [Online] Available <http://www.imf.org/external/np/tr/1998/TR981002A.htm>, October 2, 1998.

of critics in the United States and across Asia argue that the IMF is not only acting at Washington's bidding, but that it is protecting foreign investors, including many American banks and businesses that made foolish investments in Asia (Sanger, 1997). There was an evidence that large Japanese, European and American banks institutions missed warnings signs in Korea, but became, in some ways, the beneficiaries of Korea's \$55 billion bailout package. While the United States would only put American taxpayer dollars at risk as part of a "second line of defense," backing up the IMF and other international institutions, it was exerting considerable effort to get Korea to open up their financial markets to the Merrill Lynches of the world. Although the events of 1997 have highlighted the risk of investing in emerging markets, the process of global portfolio diversification is likely to resume over the longer term (Knight, 1998). And this means that the IMF's conditionality will continue to reflect pressure from world financial centers on developing countries to liberalize their capital accounts prematurely.

The Korean bailout brought in the old criticisms revolving around IMF conditionality. The IMF called for high interest rates and fiscal austerity to bring back foreign capital and reverse the depreciation of the Korean won. A related concern was that the prescriptions the IMF is enforcing in Korea and other Asian countries will squeeze the growth out of those countries, touch off unemployment, and risk social unrest.²¹ Thus, Jeffrey Sachs has critically proclaimed that the IMF's seal of approval is a seal of doom; with such deep uneasiness, austerity will push Asia into recession and political instability

²¹ Again, this was defended by the IMF on the ground of stemming the outflow of capital, while making a decisive start on the longer-term tasks of restructuring the financial sector, bringing financial sector regulation and supervision up to international standards, and increasing domestic competition and transparency (Fischer, 1998c).

(Passell, 1997). It was also folly to call for policies that reduce consumption and investment in a country like Korea with high savings rate and a high-technology industrial sector. Alternatively, Sachs suggested that the United States and Japan should have moved quietly months ago to stem panic in the Korean currency market, in essence acting as the lender of last resort to an illiquid, but basically solvent, economy (Ibid).²² The heavily leveraged IMF laid out detailed conditions on Korea that it would have a rather self constraining effect and may not leave room for flexible and prompt adjustment to future contingencies in the international economy.

Supportive to Sachs, Asia's economic crisis deepened as Moody's and Standard & Poor's, the world's largest credit-rating agencies, downgraded the sovereign debt of Korea with Indonesia and Thailand together to "junk" status, and sent its financial market into another violent plunge. The declaration of a bailout by the IMF was aimed at persuading private investors around the world to keep investing in Korea, and that they could continue to loan Korea the cash it needs to avoid default. However, the country's credit rating dropped precipitously, and the "junk bond" status of the nation's credit made it far more difficult and expensive for the country to obtain loans just at the moment it needs them the most. The IMF involvement is not only an indicator of past economic difficulties, but also a lead indicator of future problems, particularly given the recidivist tendencies of some of the Fund's clients. Here, the involvement of the Funds stands as a proxy for declining creditworthiness, and in this case, a negative catalytic effect is the expected and rational outcome (Bird, 1995).

²² Feldstein (1998) shares many of Sachs' views on the nature of the Korean crisis, wrong adjustment program, and concerted efforts by Japan and the United States rather than publicized bailout by the IMF for financial provision.

Overall, the Korean bailout is a recent case showing that the IMF conditionality is not a simple technical fix. Rather, it subtly adapts itself not only to a rapidly changing context in international economy, but also to the power relationship between the two players, which is revealed through mobilized leverage. Although some of the conditions Korea agreed to implement were typical technical application, the negotiation was disproportionately focused on financial market opening that may have a considerable domestic and international influence on the economy. Even the Fund perceives that the programs for East Asian countries mark departure from the kind of programs the IMF has traditionally supported in the past. This is because the centerpiece of each program is not a set of austerity measures to restore macroeconomic balance, but rather a set of forceful, far-reaching structural reforms to strengthen financial systems, increase transparency, open markets, and restore market confidence (Camdessus, 1998). The saliency of financial issues in the Korean bailout undeniably had to do with the high tide of international capital mobility and played a key role in setting the direction of conditions and toughness.²³ However, consenting or not, on that condition was the outcome of battle of leverage; thus, this drives the nature of IMF conditionality to “political.”

²³ The East Asian crisis revived debates on capital account liberalization, and strengthening the architecture of international monetary system has become a new mission for the IMF. This is easily understood if we visit the IMF's website, which is inundated with speeches and reports of reforming international financial system.

CHAPTER 7

FINALE: CONCLUDING REMARKS AND FUTURE RESEARCH

FINDINGS AND IMPLICATIONS

This dissertation aimed at obtaining a better understanding of structural adjustment by tracking down the process of conditionality agreement between the IMF and developing countries. Departing from conventional wisdom in IMF conditionality, the process of agreement was portrayed as a dynamic bargaining where both parties involved rely on their visible and invisible assets, so-called leverage, in order to produce their preferred outcomes. While the possibility of bargaining between the IMF and developing countries as recipients of loans has been grossly ignored in the field or even a burgeoning curiosity of it has not been sufficiently supported by refined analytical tools, this dissertation succeeded in developing a game-theoretic model and testing it empirically at both general and particular levels.

The most important finding from this research was that leverage is a necessary condition that sets the course of the relationship between the IMF and developing countries and it plays the key role in producing difference in conditionality agreements. Corresponding to the three different theoretical results of Table 3.1, there exists variance in conditionality agreements in a practical sense, and such variance is quite related to the dynamics in interaction between the two actors, largely determined by leverage. Leverage as a direct cause or intervening variable functions like a prism refracting invisible solar ray

into seven different colors. The ray of conditionality invariably hits the prism of leverage, and the specific color of a conditionality agreement that results depends on the size and strength of the leverage. The enumerated propositions generalize such conditions across conditionality agreements.

The statistical analysis of the conditionality bargaining model was taken as a necessary step to build a palpable body that enables us to feel it empirically. Testing the hypotheses, directly derived from the propositions, served as a link between the theory and the reality. With the number of agreed conditions, the empirical analyses supported the theory that leverage is an important aspect of the conditionality bargaining process, which effects the difference in conditionality agreements. More specifically, financial capacity; structure of financial (inter)dependence; domestic and organizational institutional arrangements; the use, or threat, of financial retaliation; severity of economic crisis; domestic economic structure; and historical and international political context were all significant and important variables to determine the degree of toughness in conditionality. In addition to the individual specifications of leverage for each player, the two comprehensive specifications explored a big picture of leverage and conditionality, and they were in culmination of presenting the explanatory power of the model, retaining the theoretically expected coefficient signs and statistical significance. With respect to the parameters of the bargaining model, it appeared that the utility ingredients also play a significant role in determining the bargaining outcomes as much as leverage does. Thus, it will be safe to say that it is the combination of leverage and utility parameters that better represents the nature of a conditionality agreement. Indeed, such powerful results of the statistical analyses not only indicate that the statistical model itself and the variables

specify the bargaining model properly, but also vindicate, among other things, the external validity of the propositions. Thus, conditionality agreements are a complex product of factors that players consider as important, and, among those factors, leverage is the essential component in molding the product in their preferred way in terms of toughness or softness.

The above findings have considerable academic and practical implications. First, while the whole research design of this dissertation was developed to mainly serve a narrow and limited topic of IMF conditionality, it is located in the broad theoretical context of international relations. Although power has been a concept that is most widely used in international relations, it was reduced and refined to the concept of leverage in this research in order to account for the bargaining intrinsic to IMF conditionality, which is highly interactive and has a circumscribed agenda. The concept of leverage is certainly similar to the traditional concept of power, but it is distinguished from power for its relevance to and effectiveness in the specific context of bargaining. This characteristic of leverage is deemed to be the main factor that enhances the explanatory power of bargaining models and thereby improves their predictive ability.

Second, the results of this research provide an answer to the controversies regarding structural adjustment, for which there has been no clear consensus in regard to the fundamental causes of failure and their remedy. By unlocking its bargaining process, which had been put aside as a black box thus far, it disclosed that the seed of failure might be planted at the very beginning of the program. Conditionality agreements are produced under the influence of various factors, both domestic and international, and they can be plagued by political compromise more than what is necessary. Having said this, it is

indispensable to think ahead and consider what factors are likely to have what influence on conditionality bargaining. This means that studies of structural adjustment, especially those of implementation, should be reoriented so as to incorporate this prior intervening process of leverage. That is, when the economic problems in developing countries are double tallied with actual solutions obtained through compromise, and theoretical solutions found without compromise, the issue of the effectiveness of Fund-supported adjustment will come into our grips, and search for appropriate solutions to the identified problems will start from there.

Third, if conditionality agreements are the compromised outcome from clash of political rationality, it is possible that the agreed upon conditions may not properly fit the problems. While bargaining is proceeding, conditions vital to restoring balances in the economy could be dropped for political reasons and replaced with irrelevant ones. What is worse in this situation is that even if the parties involved in conditionality bargaining admit that political rationality does more harm than good to solving problems in hand, it is hardly plausible to remove the digressing effect of political rationality from conditionality agreements. Therefore, a realistic and achievable policy alternative is a better usage of political rationality in order to reduce overambitious and overambiguous conditions in agreements, and to attain targeted results slowly, but surely. This does not mean to overlook political rationality played through leverage, but to change the tactics to play it with. As this research indicates, the nature of conditionality bargaining is not predetermined to be zero-sum or non-zero-sum, and players' fundamental interests converge at circulating funds without leaks. With this interest shared, political rationality in conditionality bargaining should be used to have their reform proposals gradually closer

to shared preference under the shadow of the future so that it can grind a way to successful adjustment through iterated interactions.

For a wiser use of political rationality, conditionality agreements need to include a condition of building a permanent communication channel between the IMF and recipient countries, which is staffed by indigenous experts rather than expatriates transplanted by the IMF. This concomitantly requires that conditionality agreement put more emphasis on building state capacity to generate informed and indigenous analysis of economic problems and options, which obviously affect the speed and coherence of adjustment responses. To some extent, this capacity is determined by a very basic feature—the number of well-trained and experienced staff in economic agencies within recipients' governments. Maintaining balance in economy is as important as restoring it through adjustment programs, which requires a high level of management skill. Of course, management is at a human dimension, not at a favorable external environment. Thus, enhancing intellectual capacity in recipient countries should be a part of the reform program beyond emphasizing elementary education within social safety net. This policy alternative comes down to the ownership of program, as the IMF likes to call. Ownership of a reform program is created, not given, through involvement.

Fourth, statistical analysis for this research had difficulty in obtaining reliable data on agreed conditions. Although this problem was resolved to count conditions from the press releases contained in *IMF Survey*, it did not fail to turn our attention to related practical issues in conditionality—transparency and implementation of conditionality. Recently, the IMF has started to tackle transparency of its own. Low transparency in Fund lending can be partly indicated by the secrecy of Letters of Intent. Disclosure of

LOIs does not trace back farther than late 1997. Nonetheless, the IMF alone should not be blamed for the secrecy of LOIs, or low transparency, considering that the counterpart of conditionality agreement shares the same interest. An easy justification for sealing LOIs off is to minimize negative reactions in recipient countries before introducing adjustment programs, and to facilitate implementation. To the contrary, however, this practice appears to have exacerbated the problem rather than helped it. Undisclosed LOIs are more likely to nurture an environment favorable to slippage, succumbing to domestic political rationality. Even if it does not become an international public good, as Vaubel (1991) thinks, policy conditions are more likely to be implemented if they are made public. It will also make it easier for the IMF to monitor the implementation of conditionality and eventually enhance the degree of compliance. In addition, sharing information among many different groups outside the IMF is a way to make evaluation of program design and its effectiveness more reliable.

Furthermore, disclosing LOIs is important in that it will fill in the missing link between successful structural adjustment and politics. Nowadays, the IMF emphasizes transparency, governance, and democracy side-by-side with structural adjustment in recipient countries. What is overlooked in this discourse is that democracy, as a necessary condition to putting derailed economies back on track, requires forming a broad consensus on reform process, and without disclosing the content of LOIs, such a democratic process will not take place. Transparency about the details of Fund-supported adjustment programs, and dialogues among concerned groups, are integral parts of both enhancing public support and developing informed programs in the future. This will also be a way to establish ownership of a reform program.

FUTURE RESEARCH AGENDA

This dissertation has opened the door for other related research. First, correlation between the types of conditionality agreements and the degree of implementation should be examined. Bargaining theory argues that a criterion of successful negotiation is the degree of compliance by the signatories with negotiated agreements. Agreements that are essentially one-sided cannot endure indefinitely, due to the fact that the party that has been coerced into accepting an agreement against its interest will resent that agreement and the party who imposed it. This is also applied to conditionality agreement. Thus, the relationship between imposition or compromise and the degree of compliance should be examined, which is possible by classifying the existing conditionality agreements to the six bargaining outcomes within the model developed in this dissertation. This research will be expedited if the meaning of Agreement ①, ②, ③, ④, ⑤, and ⑥ is explored; that is, practically what constitutes them and how different they are from one another. A method to classify conditionality agreements in realistic terms would use the duration of bargaining, correspondence between the causes of economic crisis in the involved developing country and prescribed policies, usage of leverage, agreed amount of loan, and so on. This information can be extracted from other detailed case studies. With this, an array of studies of structural adjustment becomes complete, from conditionality agreement to implementation and its effectiveness.

Second, so far the bargaining game is solely based on complete information. However, the state of the world is hardly known to us with certainty, and this gives us a reason to further refine the model with incomplete information to reflect reality better. In

the conditionality bargaining game, a key factor that makes players' knowledge of their payoffs incomplete will be uncertainty about the type of players determined by their leverage. In other words, a key factor is whether players are leveraged or not. Thus, an expected modification of the model to capture this feature is having two sets of the same game trees side-by-side, and beginning the game with a chance move that determines whether or not the recipient is leveraged. By distributing probabilities to the types of recipient on each side, equilibrium of the game will be sought in a Perfect Bayesian manner. This Bayesian update is expected to provide valuable information about the role of leverage in repeated relationship between the IMF and recipients. The Bayesian update will enable us to explain why remarkably different or consistent outcomes are produced with particular recipient countries over time. This will check on learning effect in conditionality, as well.

Third, as another way of examining the impact of leverage, it is possible to look at the toughness of conditionality agreements from a perspective of their internal and external orientation.* Comparing the number of conditions that covers each sector, we could classify conditionality agreements to their orientation and run regression with maximum likelihood technique. The classification of agreements could be simple binary or ordered scale on the continuum of most internal to most external oriented, and statistical methods will be selectively applied from probit and ordered probit in accordance with the type of dependent variable. This research is expected to reveal two aspects of conditionality agreement. First, the orientation of conditionality agreements reflects the

* This research idea is based on Prof. Beth Simmons's comments on my paper presented at Midwest Political Science Conference (April, 1999). I appreciate her inputs.

degree of sudden exposure of an economy under adjustment to external economic forces or integration into global system. Killick (1993) suggests that choice between relatively open or closed economic policies is a “big” one that would have many ramifications for the economy’s structure. Thus, internally oriented conditionality is likely to give a recipient country more time to concentrate national energy on rebuilding their economic system and laying inroads to gradual opening later, minimizing external disturbances. Considering the low adaptability and resiliency of developing economies, internally oriented agreement is likely to be preferred to externally oriented, and again, the degree of agreed orientation would be a litmus test of bargaining strength. Second, in terms of frequency, the 1990’s is likely to witness more externally oriented conditionality agreements than internally oriented due to more globalized economic activities. Thus, this will reveal the interaction of conditionality with the changing context of international political economy, in which the major Executive Board member countries’ interest is sitting tight. Significant results of this test will reconfirm the validity of the theory that this dissertation advocates.

Fourth, with a view to corroborating further the generality of the developed bargaining model, it should be applied to other bargaining relationship with international financial institutes. Since the 1980’s the World Bank has been involved in policy lending, in addition to its traditional project lending. Debt rescheduling with syndicated banks and the Paris Club is also a good candidate for application. The Paris Club represents official lenders in the industrialized countries; thus, the elements of collective political rationality will not be diluted in forming a unified front among them toward recipient countries. Examining bargaining with individual bilateral aid agencies in the five major donor

countries is worth pursuit for their extensive involvement in aid-giving and international relations as a whole. Subsequent statistical analysis just requires adapting the dependent variable to key issues within each bargaining relationship.

In the wake of economic crisis in Southeast Asian countries, voice for the abolition of the IMF has become louder than ever. Even if it is true that the existence of an organization to bail them out only exacerbates moral hazardous behavior in financial matters by developing countries, it is dubious as to whether the global economic shape, especially since 1982, would have been dramatically different without the IMF. This is easily understood when seen against the findings of this dissertation so far. The process through which a new role of financing development was assigned to the IMF indicates that by and large it serves a high interest of developed countries as a collective actor in the changing water of international monetary affairs, and that conditionality is a safeguard against delinquency by developing countries in financial transactions with them. The application and implementation of conditionality, however, has been equally tampered and hampered by political calculations from developing countries using leverage. It is obvious that such compromise would have occurred at a bilateral level between individual developed countries and developing countries anyway, reflecting a complicated nature of international relations, if it had not been for the IMF. The only difference is that the presence of the IMF has provided a multilateral forum where political bargaining over conditionality takes place in a systematic and collective manner. Thus, bringing order to international development finance by abolishing the IMF, or replacing it with something

else, is not only a wishful thinking, but also a passing vogue that can hardly be incarnated into actions.

Having said this, what makes discussions about the IMF more productive may be admitting the existence of the IMF here now, and trying to provide a viable mechanism for sharing responsibility for a better management of the international monetary system, but not such counterfactual discussions. The IMF's effectiveness derives from the fact that it, as an international institution, can carry on a policy dialogue with member countries and make policy recommendations. Fund programs should be effective in improving economic performance and reducing the demand for its lending to finance balance-of-payments gaps in developing countries. The effectiveness of Fund-supported programs has a strategic connection to its organizational longevity. The long-living IMF is of interest to developing countries as well; therefore, developing countries are equally responsible for the effectiveness of the IMF. Their equal responsibility in the effectiveness of the IMF means that they should capitalize on conditionality as a means to achieving long-term development, and that they should bargain hard to lay out achievable goals for structural adjustment, rather than create another troubled cycle of austere structural adjustment from recklessness. All in all, sharing responsibility for the effective IMF and stable international development finance requires both parties involved in conditionality bargaining to use their leveraged political rationality prudently from a long term perspective, not from anything else.

APPENDICES

APPENDIX 1

METHOD OF DATA COLLECTING: COUNTING THE NUMBER OF AGREED CONDITIONS

- **COUNTING RULES**

1. General objectives of the program are not counted.
2. Principal economic and financial objectives (targets) of 8 policy areas are counted as conditions.
3. Specific policy instruments of medium range under each policy area receive priority as conditions. If this is not possible, count the number of 8 policy areas instead.
4. Narrow steps or timetables under each policy instrument are not counted.
5. For arrangements with annual installment and performance review such as SAF and ESAF, conditions are counted only from the initial arrangement. Also, augmentation and/or extension of the arrangement are excluded from counting.

- **COUNTING FORMAT**

Country Name

- I. Type of Agreement, Arrangement Date - Expiration Date (Duration by Months)
- II. Total Amount Agreed (SDR Millions), Quota Percentage
- III. Total Number of Agreed Conditions
- IV. Macroeconomic Components
 1. Fiscal Policy
 2. Monetary Policy
 3. Exchange Rate Policy
- V. Structural Components
 4. Trade Account
 5. Capital Account

6. Privatization of PSE
7. Labor Market/Income/Wage Policy
8. Sectoral Reform/Liberalization
9. Governance
10. Data Dissemination

• **TWO EXAMPLES OF CONDITION COUNTING**

Mexico

- I. EFF 010183-123185 (36 months)
- II. SDR 3,410.63 M 450 % of Quota
- III. 19
- VI. Macroeconomic Components
 1. Fiscal Policy
 - ① reduction of the PS deficit from 16.5 % of GDP in 82 to 8.5% in 83, 5.5% in 84, and 3.5 % in 85
 - ② increasing productivity of PS
 - ③ holding down current expenditure
 - eliminating subsidies to public and private sectors
 - cutting back the growth of wage bill
 - review of public investment projects
 - ④ increasing public sector revenues
 - adjustments in PSE pricing policies and administrative fees
 - ⑤ tax reform
 - widening tax base, elimination of special exemption, adjusting tax rates
 - ⑥ current account deficit reduction to US \$ 4.25 billion in 83
 2. Monetary Policy
 - ① Bank of Mexico subject to limits in line with the anti-inflation and BOP aims

- ② private sector receives an appropriate share of domestic financial savings.
 - ③ inflation reduction from 100% to 87% in 55% in 83
 - ④ flexible management of interest rate to allocate credit
- 3. Exchange Rate Policy
 - ① flexible exchange rate policy
- V. Structural Component
- 4. Trade: Not Identified
- 5. Capital Account
 - ① reducing the scope and weight of the restriction on external transactions
 - ② lowering reliance on external financing
 - ③ debt rescheduling
- 6. Privatization of PSE
 - ① rationalizing PS by consolidating agencies
- 7. Labor Market/Income/Wage Policy
 - ① forward looking wage policy consistent with declining inflation and protection of employment
- 8. Sectoral Reform/Liberalization:
 - ① decontrol of consumer goods price
- 9. Governance: Not Identified
- 10. Information Dissemination: Not Identified

Korea

- I. SBA 120497-120300 (36 months)
- II. SDR 15,500 M 1939% of Quota
- III. 30
- VI. Macroeconomic Component
 - 1. Fiscal Policy
 - ① limiting the slowdown of GDP growth in 98 and recovering in 99
 - ② orderly reduction in the external current account deficit
 - ③ fiscal stance shifting to deficit

- ④ additional fiscal measures covering 1-1.5% of GDP for balance or a small surplus
 - increasing mineral oil taxes
 - broadening VAT base and selective increase in income and corporate taxes
 - cuts in current expenditures in infrastructure and other capital expenditures

2. Monetary Policy

- ① containing inflation at 5% or below
- ② building international reserves to more than 2 months of imports by end-98
- ③ tight monetary stance
 - reversing large liquidity injection
 - raising money market rates sharply and maintained at a high level
 - day-to-day conduct of monetary policy guided by movements in the exchange rate and short-term interest rates

3. Exchange rate Policy

- ① maintaining flexible exchange rate regime, with limited intervention to smoothing operations

V. Structural Component

4. Trade: Not Identified

- ① time table for trade liberalization in line with WTO commitments
- ② streamlining import certification procedures

5. Capital Account

- ① increasing the ceiling on aggregate foreign ownership of listed Korean shares from 26% to 50% by end-97 and to 55% by end-98
- ② increasing the ceiling on foreign ownership from 7% to 50% by end-97
- ③ liberalizing foreigners' access to Korean money markets
- ④ further reduction in restriction on foreign direct investment by simplifying approval procedures
- ⑤ setting a time table to eliminate restrictions on foreign borrowing by

corporations

6. Privatization of PSE: Not Identified

7. Labor Market/Income/Wage Policy

- ① enhancing the flexibility of labor market by easing dismissal restrictions under mergers and acquisitions and corporate restructuring
- ② strengthening employment insurance system and private job placement operations

8. Sectoral Reform/Liberalization

- ① strengthening financial system
 - rapid resolution of troubled financial institutions in compliance with Basel Committee capital standards
 - mergers and acquisition by domestic or foreign institutions
 - deposit guarantee by 2000 and replacement with regular deposit insurance system for small depositors
 - auditing financial statements by international standards
 - legislation to set up an agency to consolidate supervisory functions and independence of the Bank of Korea
 - promoting competition through allowing foreigners to establish bank subsidiaries and brokerage houses by mid-98

9. Governance

- ① measures to reduce reliance of corporations and financial institutions on short-term debt and allow a better diversification of risk in the economy

10. Information Dissemination

- ① financial data disclosure

APPENDIX 2

STATISTICAL RESULTS OF NEGATIVE BINOMIAL REGRESSION

1. CONTROVERSIES ON CONDITIONALITY LENDING PRACTICE

- Table A2. 1 Quota Proportionality and Conditionality

Log likelihood = -1159.2646					Number of obs = 395
					LR chi2(2) = 52.08
					Prob > chi2 = 0.0000
					Pseudo R2 = 0.0220
TITNESS	Coef.	Std. Err.	z	P> z	
QUOTA	.0001905	.0000334	5.697	0.000	
AMNTQUOTA	.0005249	.0001367	3.839	0.000	
_CONS	2.445897	.0239314	102.204	0.000	
/LNALPHA	-2.934642	.180416	-16.266	0.000	
ALPHA	.0531498	.0095891			
Likelihood ratio test of alpha=0:					chi2(1) = 60.72 Prob > chi2 = 0.0000

- Table A2. 2 Type of Arrangement and Conditionality

Log likelihood = -1169.2183					Number of obs = 395
					LR chi2(3) = 32.17
					Prob > chi2 = 0.0000
					Pseudo R2 = 0.0136
TITNESS	Coef.	Std. Err.	z	P> z	
EFFD	.2762633	.0657496	4.202	0.000	
SAFESAFD	.2093691	.0434371	4.820	0.000	
JNTARRGT	-.0707466	.0588498	-1.202	0.229	
_CONS	2.479655	.0242032	102.452	0.000	
/LNALPHA	-2.78741	.1634643	-17.052	0.000	
ALPHA	.0615805	.0100662			
Likelihood ratio test of alpha=0:					chi2(1) = 81.09 Prob > chi2 = 0.0000

2. THE IMF AND LEVERAGE

- Table A2. 3 Donor's Expected Utility Components and Conditionality

Log likelihood = -855.93361					Number of obs = 316
					LR chi2(7) = 181.53
					Prob > chi2 = 0.0000
					Pseudo R2 = 0.0959
TITNESS	Coef.	Std. Err.	z	P> z	
DSUBPROB	.030367	.0858011	0.354	0.723	
DDISCOUNT	-.0828879	.0108291	-7.654	0.000	
DOPPOCST	.0001744	.0000239	7.299	0.000	
DOPPOCS2	-9.41e-09	1.85e-09	-5.074	0.000	
DREPUCST	.0003125	.0000785	3.980	0.000	
DREPUCS2	-5.15e-08	1.96e-08	-2.624	0.009	
PREENGAG	.0149354	.0566655	0.264	0.792	
_CONS	2.601688	.1322197	19.677	0.000	
/LNALPHA	-13.58643	241.3616	-0.056	0.955	
ALPHA	1.26e-06	.0003035			
Likelihood ratio test of alpha=0:					chi2(1) = 0.00 Prob > chi2 = 1.0000

- Table A2. 4 IMF Institutional Setting and Conditionality

Log likelihood = -1103.1367					Number of obs = 395
					LR chi2(2) = 164.34
					Prob > chi2 = 0.0000
					Pseudo R2 = 0.0693
TITNESS	Coef.	Std. Err.	z	P> z	
5MQUOTAS	4.49e-06	3.22e-06	1.394	0.163	
VOTECAST	-.1783848	.0361717	-4.932	0.000	
_CONS	9.475981	1.578376	6.004	0.000	
/LNALPHA	-3.83732	.3276949	-11.710	0.000	
ALPHA	.0215513	.0070622			
Likelihood ratio test of alpha=0:					chi2(1) = 13.32 Prob > chi2 = 0.0003

- Table A2. 5 Financial Relations and Conditionality

Log likelihood = -1146.5659

Number of obs = 388
 LR chi2(6) = 29.62
 Prob > chi2 = 0.0000
 Pseudo R2 = 0.0128

TITNESS	Coef.	Std. Err.	z	P> z
DSUBPROB	.2967343	.0991421	2.993	0.003
FUNDSize	-.0000829	.0000528	-1.569	0.117
IMFEXPOS	.0006417	.0002719	2.360	0.018
IMFEXPO2	-6.70e-08	4.20e-08	-1.594	0.111
DEGEXPOS	-.2155992	.0877231	-2.458	0.014
DEGEXPO2	.0106466	.0051093	2.084	0.037
_CONS	2.431847	.0525519	46.275	0.000
/LNALPHA	-2.802075	.1674655	-16.732	0.000
ALPHA	.060684	.0101625		

Likelihood ratio test of alpha=0: chi2(1) = 75.70 Prob > chi2 = 0.0000

- Table A2. 6 Bilateral Political Relations and Conditionality

Log likelihood = -1114.7781

Number of obs = 395
 LR chi2(5) = 141.05
 Prob > chi2 = 0.0000
 Pseudo R2 = 0.0595

TITNESS	Coef.	Std. Err.	z	P> z
ADJCNCY	-.0418189	.0645883	-0.647	0.517
COLOTIE	-.0641433	.0361835	-1.773	0.076
ALLIANCE	-.0034904	.0746122	-0.047	0.963
MILITAIID	.0231609	.0412816	0.561	0.575
INTCONXT	-.413717	.0356464	-11.606	0.000
_CONS	2.77074	.0294293	94.149	0.000
/LNALPHA	-3.577371	.2698067	-13.259	0.000
ALPHA	.0279491	.0075408		

Likelihood ratio test of alpha=0: chi2(1) = 21.33 Prob > chi2 = 0.0000

- Table A2. 7 Bilateral Economic Relations and Conditionality

Log likelihood = -922.57856

Number of obs = 317
 LR chi2(4) = 64.14
 Prob > chi2 = 0.0000
 Pseudo R2 = 0.0336

TITNESS	Coef.	Std. Err.	z	P> z
ODAAMNT	.0002857	.0000528	5.411	0.000
COMINVET	.000034	8.77e-06	3.884	0.000
EXPOACCS	-.0064279	.0043993	-1.461	0.144
EXPOACC2	.0000211	.0000487	0.434	0.664
_CONS	2.633649	.0930376	28.307	0.000
/LNALPHA	-2.979918	.2077722	-14.342	0.000
ALPHA	.050797	.0105542		

Likelihood ratio test of alpha=0: chi2(1) = 45.00 Prob > chi2 = 0.0000

3. THE RECIPIENT AND LEVERAGE

- Table A2. 8 Recipient's Expected Utility Components and Conditionality

Log likelihood = -388.15214		Number of obs = 142 LR chi2(7) = 34.86 Prob > chi2 = 0.0000 Pseudo R2 = 0.0430		
TITNESS	Coef.	Std. Err.	z	P> z
RSUBPROB	-.301033	.098572	-3.054	0.002
RDISCOUT	.0039904	.0027373	1.458	0.145
RPOLCOST	.010692	.0042479	2.517	0.012
RPOLCOS2	-.0009522	.0011443	-0.832	0.405
ROPPOCST	.000312	.000067	4.658	0.000
ROPPOCS2	-3.18e-08	1.01e-08	-3.142	0.002
PREENGAG	-.1132061	.1409647	-0.803	0.422
_CONS	2.460957	.1560336	15.772	0.000
/LNALPHA	-3.737273	.5651836	-6.612	0.000
ALPHA	.023819	.0134621		
Likelihood ratio test of alpha=0:		chi2(1) = 4.35	Prob > chi2 = 0.0371	

- Table A2. 9 Economic Crisis and Conditionality

Log likelihood = -213.62777					Number of obs = 76
					LR chi2(4) = 11.88
					Prob > chi2 = 0.0183
					Pseudo R2 = 0.0271
TITNESS	Coef.	Std. Err.	z	P> z	
BOPCUADF	-.0000466	.0000145	-3.217	0.001	
INFLAT	.000043	.0000521	0.826	0.409	
UNEMPLO	-.0061386	.0068856	-0.892	0.373	
BUDGDEF	.0078921	.0085113	0.927	0.354	
_CONS	2.57476	.078008	33.006	0.000	
/LNALPHA	-3.817794	.7545288	-5.060	0.000	
ALPHA	.0219762	.0165817			
Likelihood ratio test of alpha=0:					chi2(1) = 2.43 Prob > chi2 = 0.1187

- Table A2. 10 External Debt and Conditionality

Log likelihood = -1136.2183					Number of obs = 388
					LR chi2(5) = 50.32
					Prob > chi2 = 0.0000
					Pseudo R2 = 0.0217
TITNESS	Coef.	Std. Err.	z	P> z	
TOTDEBT	9.51e-06	2.73e-06	3.488	0.000	
TOTDEBT2	-6.07e-11	2.79e-11	-2.174	0.030	
IMFCRDTS	-.0001195	.0000687	-1.739	0.082	
IMFCRDS2	1.92e-08	1.45e-08	1.328	0.184	
INFINSIG	.7027564	.2292394	3.066	0.002	
_CONS	2.493314	.0249551	99.912	0.000	
/LNALPHA	-2.966685	.1877219	-15.804	0.000	
ALPHA	.0514737	.0096627			
Likelihood ratio test of alpha=0:					chi2(1) = 54.27 Prob > chi2 = 0.0000

- Table A2. 11 Economic Characteristics and Conditionality

Log likelihood = -623.43099

Number of obs = 215
 LR chi2(4) = 22.19
 Prob > chi2 = 0.0002
 Pseudo R2 = 0.0175

TITNESS	Coef.	Std. Err.	z	P> z
RSUBPROB	-.0419593	.0756342	-0.555	0.579
RESOENDW	-.1365599	.0975041	-1.401	0.161
TRADEGDP	-.001316	.0006605	-1.992	0.046
ECONSYS	.2524292	.0597833	4.222	0.000
_CONS	2.589819	.0526914	49.151	0.000
/LNALPHA	-3.089796	.271673	-11.373	0.000
ALPHA	.0455112	.0123642		

Likelihood ratio test of alpha=0: chi2(1) = 24.57 Prob > chi2 = 0.0000

- Table A2. 12 Global Economic Opportunities and Conditionality

Log likelihood = -1127.8826

Number of obs = 384
 LR chi2(7) = 45.63
 Prob > chi2 = 0.0000
 Pseudo R2 = 0.0198

TITNESS	Coef.	Std. Err.	z	P> z
FDIINFLO	.0000832	.000061	1.362	0.173
FDIINFL2	-1.39e-08	6.67e-09	-2.088	0.037
EQIINVET	.0002939	.000143	2.055	0.040
EQIINVE2	-5.16e-08	3.02e-08	-1.707	0.088
DEBTINFL	.0000233	.0000465	0.501	0.617
DEBTINF2	-5.90e-09	6.82e-09	-0.866	0.387
INFINSIG	.8154012	.1993105	4.091	0.000
_CONS	2.517888	.0203053	124.001	0.000
/LNALPHA	-2.936915	.1856367	-15.821	0.000
ALPHA	.0530291	.0098441		

Likelihood ratio test of alpha=0: chi2(1) = 56.01 Prob > chi2 = 0.0000

- Table A2. 13 Politics of Special Interest and Conditionality

Log likelihood = -303.39154

Number of obs = 111
 LR chi2(5) = 11.59
 Prob > chi2 = 0.0409
 Pseudo R2 = 0.0187

TITNESS	Coef.	Std. Err.	z	P> z
RPOLCOST	.0115667	.0062371	1.854	0.064
RPOLCOS2	-.0034072	.0014194	-2.400	0.016
IMPOGDP	-.0053107	.0025	-2.124	0.034
SOEGDP	.0093389	.0045748	2.041	0.041
URBANPOP	-.0002679	.0019719	-0.136	0.892
_CONS	2.649875	.1511199	17.535	0.000
/LNALPHA	-3.359159	.4883161	-6.879	0.000
ALPHA	.0347645	.0169761		

Likelihood ratio test of alpha=0: chi2(1) = 6.51 Prob > chi2 = 0.0107

4. COMPREHENSIVE SPECIFICATION FOR CONDITIONALITY BARGAINING

- Table A2. 14 Comprehensive Specification for Leverage and Conditionality

Log likelihood = -975.37494

Number of obs = 361
 LR chi2(7) = 201.93
 Prob > chi2 = 0.0000
 Pseudo R2 = 0.0938

TITNESS	Coef.	Std. Err.	z	P> z
BOPCUADF	.0000144	6.25e-06	2.303	0.021
AMNTQOTA	.0010103	.0002676	3.775	0.000
TOTDEBT	6.82e-06	1.89e-06	3.610	0.000
TOTDEBT2	-3.50e-11	1.76e-11	-1.984	0.047
5MQUOTAS	.0000137	2.13e-06	6.412	0.000
FUNDSIZE	-.0000446	.0000442	-1.009	0.313
INTCONXT	-.1752791	.0485099	-3.613	0.000
_CONS	1.874869	.1221796	15.345	0.000
/LNALPHA	-5.594907	1.666612	-3.357	0.001
ALPHA	.0037167	.0061944		

Likelihood ratio test of alpha=0: chi2(1) = 0.38 Prob > chi2 = 0.5350

• Table A2. 15 Comprehensive Specification with Subjective Probability

Log likelihood = -571.21334					Number of obs = 214
					LR chi2(9) = 117.80
					Prob > chi2 = 0.0000
					Pseudo R2 = 0.0935
TITNESS	Coef.	Std. Err.	z	P> z	
DSUBPROB	.1158501	.1085484	1.067	0.286	
RSUBPROB	-.0658933	.0653782	-1.008	0.314	
BOPCUADF	-8.21e-06	.0000121	-0.676	0.499	
AMNTQOTA	.0011201	.0003471	3.226	0.001	
TOTDEBT	9.86e-06	2.40e-06	4.101	0.000	
TOTDEBT2	-9.83e-11	2.68e-11	-3.664	0.000	
5MQUOTAS	.0000114	2.79e-06	4.082	0.000	
FUNDSIZE	-.0000379	.0000581	-0.653	0.514	
INTCONXT	-.18683	.0639676	-2.921	0.003	
_CONS	1.910441	.1555035	12.286	0.000	
/LNALPHA	-14.88023	306.4768	-0.049	0.961	
ALPHA	3.45e-07	.0001057			
Likelihood ratio test of alpha=0:					chi2(1) = 0.00 Prob > chi2 = 1.0000

APPENDIX 3

TREND IN TIGHTNESS OF CONDITIONALITY

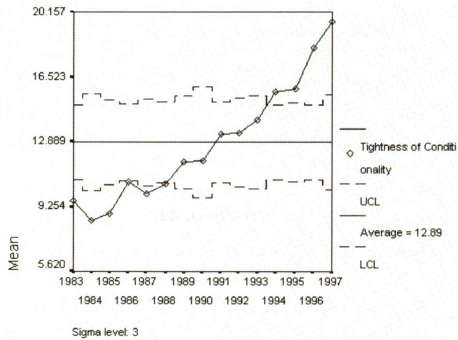


Figure A3. 1 International Context and Trend in Tightness of Conditionality

BIBLIOGRAPHY

REFERENCES

- Adams, C., J. G. M. Schulze-Ghattas, V. Arora, J. Zhou, and A. Bakastov. 1996. *Korea, Selected Issues*. IMF Staff Country Report 1996/136.
- Adams, Charles, Donald J. Mathieson, Garry Schinasi, and Bankim Chadha. 1998. *International Capital Markets: Developments, Prospects, and Key Policy Issues* (September). Washington, DC; International Monetary Fund.
- Aggarwal, Vinod K. 1987. *International Debt Threat: Bargaining among Creditors and Debtors in the 1980s*. Berkeley, CA: Institute of International Studies.
- , 1996. *Debt Games: Strategic Interaction in International Debt Rescheduling*. Cambridge: Cambridge Univ. Press.
- Alexander, Arthur J. 1998. "Asia's Financial Crisis: Linked to Its Economic Miracle?" *Japan Economic Institute Report*, no. 19A (May 15):1-13.
- Altbach, Eric. 1998. "The Asian Crisis and the IMF: After the Deluge, the Debate." *Japan Economic Institute Report*, no. 17A (May 1):1-13.
- Anunobi, Fredoline O. 1992. *The Implications of Conditionality: The International Monetary Fund and Africa*. Lanham: University Press of America, Inc.
- Assetto, Valerie J. 1988. *The Soviet Bloc in the IMF and the IBRD*. Boulder, CO: Westview Press.
- Aylward, Lynn and Rupert Thorne. 1998. "Countries' Repayment Performance vis-à-vis the IMF." *IMF Staff Paper* 45, no. 4:595-617.
- Baldwin, David. 1979. "Power Analysis and World Politics: New Trends versus Old Tendencies." *World Politics* 31, no. 2 (January):161-194.
- , 1980. "Interdependence and Power: A Conceptual Analysis." *International Organization* 34, no. 4 (Autumn):471-506.
- , 1985. *Economic Statecraft*. Princeton, NJ: Princeton Univ. Press.
- Barston, Roland P. 1971. "The External Relations of Small States." in *Small States in International Relations*, eds. August Schou and Arne O. Brundtland. Stockholm: Almqvist & Wiskell.
- Bartos, Otomar J. 1977. "Simple Model of Negotiation: A Sociological Point of View."

Journal of Conflict Resolution 21 (December):565-579.

Bennett, D. Scott. 1997. "Testing Alternative Models of Alliance Duration, 1816-1984." *American Journal of Political Science* 41, no. 3. (July):846-878.

Bergsten, C. Fred. 1990. "From Cold War to Trade War." *International Economic Insights* (July/August).

Bhattacharya, Rina. 1997. "Pace, Sequencing and Credibility of Structural Reforms." *World Development* 25, no. 7:1045-1061.

Bienen, Henry S. and Mark Gersovitz. 1985. "Economic Stabilization, Conditionality, and Political Stability." *International Organization* 39, no. 4 (Autumn):729-754.

Biersteker, Thomas J. 1993. "International Financial Negotiations and Adjustment Bargaining: An Overview." in *Dealing With Debt: International Financial Negotiations and Adjustment Bargaining*, ed. Thomas Biersteker. Boulder, CO: Westview Press.

Birch, Melissa H. 1993. "The International Monetary Fund." in *Dealing with Debt: International Financial Negotiations and Adjustment Bargaining*, ed. Thomas Biersteker. Boulder, CO: Westview Press.

Bird, Graham. 1995. *IMF Lending to Developing Countries: Issues and Evidence*. London: Routledge.

Bjøl, Erlin. 1971. "The Small State in International Relations." in *Small States in International Relations*, eds. August Schou and Arne O. Brundtland. Stockholm: Almqvist & Wiskell.

Blair, David. 1993. *Trade, Negotiations in the OECD: Structures, Institutions, and States*. London: Kegan Paul International.

Brady, Linda P. 1991. *The Politics of Negotiation: America's Dealings with Allies, Adversaries, and Friends*. Chapel Hill, NC: The Univ. of North Carolina Press.

Bueno de Mesquita, Bruce and David Lalman. 1992. *War and Reason: Domestic and International Imperatives*. New Haven: Yale Univ. Press.

Buira, Ariel. 1983. "IMF Financial Programs and Conditionality." *Journal of Development Economics* 12:111-136.

Bulow, Jeremy and Kenneth Rogoff. 1989. "Multilateral Negotiations for Rescheduling Developing Country Debt." in *Analytical Issues in Debt*, eds. Jacob A. Frankel, Michael P. Dooley, and Peter Wickham. Washington, DC: International Monetary Fund.

- Camdessus, Michael. "The IMF and its Programs in Asia." speech delivered at the Council on Foreign Relations, New York. [Online] Available <http://www.imf.org/external/np/speeches/1998/020698.htm>, February 6, 1998.
- Chan, Steve. 1993. "Relative Bargaining Power in International Debt Negotiation: Collective Action, Sovereignty En Garde, or Mutual Partisan Adjustment?" *Conflict Management and Peace Science* 13, no. 1:29-60.
- Cheru, Fantu. 1992. "Structural Adjustment, Primary Resource Trade and Sustainable Development in Sub-Saharan Africa." *World Development* 20, no. 4: 497-512.
- Choi, Byung-Sun. 1993. "Financial Policy and Big Business in Korea: The Perils of Financial Regulation." in *The Politics of Finance in Developing Countries*, eds. Stephan Haggard, Sylvia Maxfield, and Chung H. Lee. Ithaca, NY: Cornell Univ. Press.
- Chon, Shi-Yong. "Hashimoto Pledges Support for IMF Bailout at Summit with Kim." [Online] Available <http://www.koreaherald.co.kr>, November 25, 1997.
- Chun, Sung-Woo. "Market Opening Pressure Likely to Increase after IMF Loan." [Online] Available <http://www.koreaherald.co.kr>, November 26, 1997.
- Cline, Ray. 1975. *World Power Assessment*. Washington, DC: Georgetown Center for Strategic and International Studies.
- CNN. "U.S., Allies Hagggle over World Economic Plan." [Online] Available <http://cnn.com>, October 4, 1998.
- CNNfn "IMF bails out South Korea: Seoul to Receive a Record \$55 Billion Financial Rescue Loan and Other Aid." [Online] Available <http://cnn.com>, December 3, 1997.
- Cohen, Benjamin J. 1982. "Balance-of-Payments Financing: Evolution of a Regime." *International Organization* 36, no. 2 (Spring):457-478.
- , 1985. "International Debt and Linkage Strategies: Some Foreign-Policy Implications for the United States." *International Organization* 39, no. 4 (Autumn):699-727.
- Collier, Paul. 1997. "The Failure of Conditionality." unpublished manuscript.
- Consul, P. C. 1989. *Generalized Poisson Distributions: Properties and Applications*. New York: Marcel Dekker, Inc.
- Cooper, Richard N. 1983. "Panel Discussion." in *IMF Conditionality*, ed. John Williamson. Washington, DC: Institute for International Economics.

- Cornia, Giovanni A., Richard Jolly and Frances Stewart, eds. 1987. *Adjustment with a Human Face, Volume 1 Protecting the Vulnerable and Promoting Growth*. Oxford: Clarendon Press.
- Cornelius, Peter. 1988. "Some Arguments against a Global Stabilization Policy by the IMF." *Economia Internazionale* 41:3-18.
- Cross, John G. 1969. *The Economics of Bargaining*. New York: Basic Books.
- Dell, Sidney. 1983. "Stabilization: The Political Economy of Overkill." in *IMF Conditionality*, ed. John Williamson. Washington, DC: Institute for International Economics.
- de Vries, Margaret G. 1985. "Selected Topics: Historian Traces Origins and Development of Fund Involvement in World Debt Problem." *IMF Survey* (January 7 and 21).
- Dooley, Michael P., Donald J. Mathieson, and Liliana Rojas-Suarez. 1996. *Capital Mobility and Exchange Market Intervention in Developing Countries*. IMF Working Paper 1996/31.
- Duchesne, Erick. 1997. "International Bilateral Trade and Investment Negotiations: Theory, Formal Model, and Empirical Evidences." Ph.D. dissertation, Michigan State University.
- Eckaus, R. S. 1986. "How the IMF lives with its conditionality." *Policy Science* 19: 237-252.
- Edwards, Sebastian. 1984. *The Order of Liberalization of the External Sector in Developing Countries*. Princeton Essays in International Finance, no. 156.
- Faruquee, Hamid. 1992. "Dynamic Capital Mobility in Pacific Basin Developing Countries." IMF Staff Paper 39, no. 3:706-717.
- Feldstein, Martin. 1998. "Refocusing the IMF." *Foreign Affairs* 77, no. 2 (March/April): 20-33.
- Fernández, Raquel and Şule Özler. 1999. "Debt Concentration and Bargaining Power: Large Banks, Small Banks and Secondary Market Prices." *International Economic Review* 40, no. 2 (May):333-355.
- Ferguson, Tyrone. 1988. *The Third World and Decision Making in the International Monetary Fund: The Quest for Full and Effective Participation*. New York: Pinter Publishers.
- Finch, David. 1988. "Let the IMF be the IMF." *International Economy*

(January/February).

-----, 1989. *The IMF: The Record and the Prospect*. Princeton Essays in International Finance, no. 175.

Fischer, Stanley. "Capital Account Liberalization and the Role of the IMF." speech delivered at IMF seminar "Asia and the IMF," Hong Kong. [Online] Available <http://www.imf.org/external/np/apd/asia/fischer.htm>, September 19, 1997.

-----, "The Asian Crisis: A View from the IMF." speech delivered at the Midwinter Conference of the Bankers' Association for Foreign Trade, Washington, DC. [Online] Available <http://www.imf.org/external/np/speeches/1998/012298.htm>, January 22, 1998a.

-----, "The IMF and the Asian Crisis." Forum Funds Lecture at UCLA, Los Angeles. [Online] Available <http://www.imf.org/external/np/speeches/1998/032098.htm>, March 20, 1998b.

-----, 1998c. "The Asian Crisis and the Changing Role of the IMF." *Finance and Development* 35, no. 2 (June):2-4.

-----, 1998d. "In Defense of the IMF: Specialized Tools for a Specialized Task." *Foreign Affairs* 77, no. 4 (July/August):103-106.

-----, "On the Need for an International Lender of Last Resort." paper delivered at the joint luncheon of the American Economic Association and the American Finance Association, New York. [Online] Available <http://www.imf.org/external/np/speeches/1999/010399.htm>, January 3, 1999.

Fisher, Roger 1987. "What is a 'Good' U.S.-Soviet Relationship – And How Do We Build One?" *Negotiation Journal* 3, no. 4 (October):319-327.

Fisher, Roger and William Ury. 1991. *Getting to Yes: Negotiating Agreement without Giving in*. New York: Penguin.

Friman, H. Richard. 1993. "Side-payments versus Security Cards: Domestic Bargaining Tactics in International Economic Negotiations." *International Organization* 47, no.34 (Summer):379-410.

Gates, Scott and Brian D. Hume. 1997. *Games, Information, and Politics: Applying Game Theoretic Models to Political Science*. Ann Arbor: The Univ. of Michigan Press.

Goertz, Gary. 1994. *Context of International Politics*. Cambridge: Cambridge Univ. Press.

- Gold, Joseph. 1979. *Conditionality*. Pamphlet Series, no. 31. Washington, DC: International Monetary Fund.
- Greene, William H. 1993. *Econometric Analysis*, 2nd ed. Englewood Cliffs, NJ: Prentice Hall.
- Grieco, Joseph M. 1988. "Anarchy and the Limits of Cooperation: A Realist Critique of the Newest Liberal Institutionalism." *International Organization* 42, no. 3 (Summer):485-507.
- , 1993. "Understanding the Problem of International Cooperation: The Limits of Neoliberal Institutionalism and the Future of Realist Theory." in *Neorealism and Neoliberalism*, ed. David Baldwin. New York: Columbia Univ. Press.
- Griffith-Jones, Stephany. 1992. "Cross-conditionality or the Spread of Obligatory Adjustment: A Review of the Issues and Questions for Research." in *Cross-Conditionality Banking Regulation and Third World Debt*, eds. Ennio Rodriguez and Stephany Griffith-Jones. London: MacMillan Press.
- Gutián, Manuel. 1981. *Fund Conditionality: Evolution of Principles and Practices*. Pamphlet Series, no. 38. Washington, DC: International Monetary Fund.
- , 1987. "Adjustment and Economic Growth: Their Fundamental Complementarity." in *Growth-Oriented Adjustment Programs*, eds. Vittorio Corbo, Morris Goldstein, and Mohsin Khan. Washington, DC: International Monetary Fund and World Bank.
- Gujarati, Damodar N. 1995. *Basic Econometrics*, 3rd ed. New York: McGraw Hill, Inc.
- Habeb, William M. 1988. *Power and Tactics in International Negotiation: How Weak Nations Bargain with Strong Nations*. Baltimore: The Johns Hopkins Univ. Press.
- Haggard, Stephan. 1985. "The Politics of Adjustment: Lessons from the IMF's Extended Fund Facility." *International Organization* 39, no. 3 (Summer):505-534.
- Haggard, Stephan and Chung H. Lee. 1993. "The Political Dimension of Finance in Economic Development." in *The Politics of Finance in Developing Countries*, eds. Stephan Haggard, Sylvia Maxfield, and Chung H. Lee. Ithaca, NY: Cornell Univ. Press.
- Haggard, Stephan and Robert Kaufman. 1989. "The Politics of Stabilization and Structural Adjustment." in *Developing Country Debt and Economic Performance: The International Financial System*, ed. Jeffrey D. Sachs. Chicago: Univ. of Chicago Press.

- , 1995. *The Political Economy of Democratic Transitions*. Princeton, NJ: Princeton Univ. Press.
- Haggard, Stephan, Robert Kaufman, and Steven Webb. 1992. *Democracy, Dictatorship, and Inflation in Middle-Income Countries*. Harvard Univ., Rutgers Univ. and World Bank, Washington, D.C. Processed.
- Haggard, Stephan and Steven Webb. 1994. *Voting for Reform: Democracy, Political Liberalization, and Economic Adjustment*. Washington, DC: World Bank.
- Haggard, Stephan and Sylvia Maxfield. 1993. "Political Explanation of Financial Policy in Developing Countries." in *The Politics of Finance in Developing Countries*, eds. Stephan Haggard, Sylvia Maxfield, and Chung H. Lee. Ithaca, NY: Cornell Univ. Press.
- , 1996. "The Political Economy of Financial Internationalization in the Developing World." *International Organization* 50, no. 1 (Winter):35-68.
- Hanson, James A. 1994. "An Open Capital Account: A Brief Survey of the Issues and the Results." in *Financial Reform: Theory and Experience*, eds. G. Caprio, Jr., I. Atiyas, and J. Hanson. Cambridge: Cambridge Univ. Press.
- Hardy, Chandra. 1987. "Debt Negotiations and the North-South Dialogue, 1974-1980." in *Positive Sum: Improving North-South Negotiations*, ed. I. William Zartman. New Brunswick, NJ: Transaction Books.
- Helleiner, Gerald K. 1987. "Stabilization, Adjustment, and the Poor." *World Development* 15, no. 12:1499-1513.
- Hopmann, P. Terrence. 1978. "Asymmetrical Bargaining in the Conference on Security and Cooperation in Europe." *International Organization* 32, no. 1 (Winter): 141-177.
- , 1995. "Two Paradigms of Negotiation: Bargaining and Problem Solving." *The Annals of the American Academy of Political and Social Science* 542 (November):24-47.
- , 1996. *The Negotiation Process and the Resolution of International Conflicts*. Columbia, SC: Univ. of South Carolina Press.
- Iklé, Fred C. 1964. *How Nations Negotiate*. New York: Harper & Row.
- ILO *Yearbook of Labor Statistics*. 1987-1994. Geneva: International Labor Organization.

IMF *Articles of Agreement of the International Monetary Fund*. [Online] Available
<http://www.imf.org/external/pubs/ft/aa/index.htm>.

---- *Annual Reports*. 1983-1998. Washington, DC: International Monetary Fund.

---- *Direction of Trade Statistics Yearbook*. 1982-1998. Washington, DC: International Monetary Fund.

---- *International Financial Statistics*. 1983-1998. Washington, DC: International Monetary Fund.

---- *Survey*. 1983-1998. Washington, DC: International Monetary Fund.

----- 1987. *Theoretical Aspects of the Design of Fund-Supported Adjustment Programs*. IMF Occasional Paper, no. 55.

----- 1995, 1998a. *Official Financing for Developing Countries*. Washington, DC: International Monetary Fund.

----- 1997. *The ESAF at Ten Years: Economic Adjustment and Reform in Low-Income Countries*. IMF Occasional Paper, no. 156.

----- 1997-1998. *Member Country Publication – by Country*. [Online] Available
<http://www.imf.org/external/np/loi/mempub.htm>.

----- 1998b. *Toward a Framework for Financial Stability*. Washington, DC: International Monetary Fund.

----- 1998c. *World Economic Outlook* (May and October). Washington, DC: International Monetary Fund.

----- 1998d. “Financial Facilities and Policies: IMF Financing Helps Members Pursue Sound Policies.” *IMF Survey Supplement on the Fund* (September).

IMF Economic Forum. “Capital Account Liberalization: What’s the Best Stance.” IMF, Washington, DC. [Online] Available
<http://www.imf.org/external/np/tr/1998/TR981002A.htm>, October 2, 1998.

Jain, Arvind and Douglas Nigh. 1989. “Politics and the International Lending Decision of Banks.” *Journal of International Business Studies* 20, no. 2 (Summer):349-359.

Johnston, R. Barry, Salim M. Darbar, and Claudia Echeverria. 1997. *Sequencing Capital Account Liberalization: Lessons from the Experiences in Chile, Indonesia, Korea, and Thailand*. IMF Working Paper 1997/157.

Jönsson, Christer. 1981. “Bargaining Power: Notes on an Elusive Concept.” *Cooperation*

and Conflict XVI:249-257.

Kahler, Miles. 1989. "International Financial Institutions and the Politics of Adjustment." in *Fragile Coalitions: The Politics of Economic Adjustment*, ed. Joan M. Nelson. New Brunswick: Transaction Books.

----- . 1990. "Orthodoxy and Its Alternative: Explaining Approaches to Stabilization and Adjustment." in *Economic Crisis and Policy Choice: The Politics of Adjustment in the Third World*, ed. Joan M. Nelson. Princeton, NJ: Princeton Univ. Press.

Kang, Seok-Jae. "IMF to Provide First Portion of Bailout Funds for Seoul This Week; Two Sides Fail to Narrow Gaps in Growth Range, Bank Liquidation." [Online] Available <http://www.koreaherald.co.kr>, December 1, 1997.

Kapur, Devesh. 1998. "The IMF: A Cure or a Curse?" *Foreign Policy* 111 (Summer): 114-126.

Keohane, Robert O. 1983. "The Demand for International Regime." in *International Regimes*, ed. Stephen D. Krasner. Ithaca, New York: Cornell University Press.

Keohane, Robert O. 1984. *After Hegemony: Cooperation and Discord in the World Political Economy*. Princeton, NJ: Princeton Univ. Press.

Keohane, Robert O. and Joseph S. Nye. 1989. *Power and Interdependence*, 2nd ed. Harper Collins Publishers.

Khan, Moshin. 1990. "The Macroeconomic Effects of Fund-supported Adjustment Programs." *IMF Staff Papers* 37, no. 2 (June):195-231.

Killick, Tony. 1984. *The IMF and Stabilization: Developing Country Experiences*. London: Gower.

----- . 1990. *Problems and Limitations of Adjustment Policies*. Working Paper 36. London: Overseas Development Institute.

----- . 1993. *The Adaptive Economy: Adjustment Policies in Small, Low-Income Countries*. EDI Development Studies. Washington, DC: World Bank.

----- . 1995. *IMF Programmes in Developing Countries: Design and Impact*. London: Routledge.

King, Gary. 1989a. "Event Count Models for International Relations: Generalizations and Applications." *International Studies Quarterly* 33:23-147.

- , 1989b. *Unifying Political Methodology: The Likelihood Theory of Statistical Inference*. New York: Cambridge Univ. Press.
- Knight, Malcolm. 1998. "Developing Countries and the Globalization of Financial Markets." *World Development* 26, no. 7:1185-1200.
- Knorr, Klaus. 1975. *The Power of Nations*. New York: Basic Books.
- Kristof, Nicholas D. 1997. "3 Seoul Candidates, Fearing Default, Bow to I.M.F. Plan." [Online] Available <http://www.nytimes.com>, December 14, 1997.
- Krueger, Anne. 1984. "Problems of Liberalization." in *World Economic Growth*, ed. A. Harberger. San Francisco: ICS Press.
- Lawler, Edward. 1992. "Power Processes in Bargaining." *The Sociological Quarterly* 33, no. 1:17-34.
- Leech, Dennis. 1998. *Power Relations in the International Monetary Fund: A Study of the Political Economy of A Priori Voting Power Using the Theory of Simple Games*. University of Warwick CSGR Working Paper 06/98.
- Lehman, Howard P. 1993. *Indebted Development: Strategic Bargaining and Economic Adjustment in the Third World*. New York: St. Martin's Press.
- Lensink, Robert. 1996. *Structural Adjustment in Sub-Saharan Africa*. London: Longman.
- Lister, Frederick K. 1984. *Decision Making Strategies for International Organizations: The IMF Model*. Monograph Series in World Affairs. Graduate School of International Studies, Univ. of Denver.
- Lockhart, Charles. 1979. *Bargaining in International Conflicts*. New York: Columbia Univ. Press.
- McCarthy, Thomas. "Molecular Nanotechnology and the World System." [Online] Available <http://mccarthy.cx>, October 12, 1996.
- McKeown, Timothy, Leona Pallansch, and Strom Thacker. 1999. "Political Conditionality in U.S. Bilateral and Multilateral Foreign Assistance." paper presented at the 40th Annual Convention of the International Studies Association, Washington, DC, February 16-20.
- McLaughlin, Sara, Scott Gates, and Havard Hegre. 1998. "Timing the Changes in Political Structures: A New Polity Databases." *The Journal of Conflict Resolution* 42, no. 2 (April):231-242.
- Mahler, Walter. 1990. *The Taxation of the Windfall from Internationalization of the*

Korean Capital Market. IMF Working Paper 1990/54.

Martin, Matthew. 1991. *The Crumbling Façade of African Debt Negotiations*. New York: MacMillan.

-----, 1994. "Negotiating External Finance for Adjustment." in *Negotiating Structural Adjustment in Africa*, ed. Willem van de Geest. New York: United Nations Publications.

Mayer, Frederick. 1992. "Managing Domestic Differences in International Negotiations: the Strategic Use of Internal Side-payments." *International Organization* 46, no. 4 (Autumn):793-818.

Morgan, T. Clifton. 1990. "Issue Linkages in International Crisis Bargaining." *American Journal of Political Science* 34, no. 2 (May):311-333.

Morgenthau, Hans. 1973. *Politics among Nations*, 5th ed. New York: Alfred A. Knopf.

Morrow, James D. 1994. *Game Theory for Political Scientists*. Princeton, NJ: Princeton Univ. Press.

Mosley, Paul. 1987. *Conditionality as Bargaining Process: Structural Adjustment Lending 1980-1986*. Princeton Essays in International Finance, no. 168.

-----, 1988. "On Persuading a Leopard to Change His Spots: Optimal Strategies for Donors and Recipients of Conditional Development Aid." in *Toward a Political Economy of Development: A Rational Choice Perspective*, ed. Roberts Bates. Berkeley, CA: Univ. of California Press.

Mosley, Paul and Jane Harrigan. 1989. *Evaluation of the Impact of 'Program Finance' for Development*. Institute of Development Policy and Management, Univ. of Manchester.

Mosley, Paul, Jane Harrigan, and John Toye. 1995. *Aid and Power: The World Bank and Policy-based Lending, Volume I Analysis and Policy Proposals*, 2nd ed. London: Routledge.

Most, Benjamin A. and Harvey Starr. 1989. *Inquiry, Logic and International Politics*. Columbia, SC: Univ. of South Carolina Press.

Nachmias, Nitza. 1988. *Transfer of Arms, Leverage, and Peace in the Middle East*. New York: Greenwood Press.

Nagel, Jack H. 1975. *The Descriptive Analysis of Power*. New Haven, CT: Yale Univ. Press.

- Nelson, Joan M. 1984. "The Politics of Stabilization." in *Adjustment Crisis in the Third World*, eds. R. E. Feinberg and V. Kallab. Washington, DC: Overseas Development Council.
- 1988. "The Political Economy of Stabilization: Commitment, Capacity and Public Response." in *Toward a Political Economy of Development: A Rational Choice Perspective*, ed. Robert Bates. Berkeley, CA: Univ. of California Press.
- 1990. "Introduction: The Politics of Economic Adjustment in Developing Nations." in *Economic Crisis and Policy Choice: The Politics of Adjustment in the Third World*, ed. Joan M. Nelson. Princeton, NJ: Princeton Univ. Press.
- 1996. "Promoting Policy Reforms: The Twilight of Conditionality?" *World Development* 24, no. 9:1551-1559.
- Norris, Floyd. "Korean Crisis: Blame the Lenders." [Online] Available <http://www.nytimes.com>, December 14, 1997.
- Nowzad, B. 1989. "The Debt Problem and the IMF's Perspective." in *Third World Debt: The Search for a Solution*, ed. Graham Bird. London: Edward Elga.
- O'Brien, Timothy L. "Sovereign Debt of Korea, Indonesia, Thailand Rated as 'Junk'." [Online] Available <http://www.nytimes.com>, December 23, 1997.
- Odell, John. 1980. "Latin American Trade Negotiations with the United States." *International Organization* 34, no. 2 (Spring):207-228.
- 1985. "The Outcome of International Trade Conflicts: The U.S. and South Korea, 1961-1981." *International Studies Quarterly* 29 (September):263-286.
- OECD. 1996. *International Capital Market Statistics: 1950-1995*. Paris: Organization for Economic Cooperation and Development.
- Organski, A.F.K and Jacek Kugler. 1980. *The War Ledger*. Chicago, The Univ. of Chicago Press.
- Oxfam Policy Department. 1995. *A Case for Reform: Fifty Years of the IMF and World Bank*. Oxford: Oxfam Publication.
- Passell, Peter. "Economic Scene: South Korea Facing Difficult Economic Choices." [Online] Available <http://www.nytimes.com>, December 18, 1997.
- Polak, Jacques J. 1991. *The Changing Nature of IMF's Conditionality*. OECD Development Centre Technical Papers, no. 41.

- Pollack, Andrew. "South Korea Suspends Operations of 9 Banks in Preparation for I.M.F. Bailout." [Online] Available <http://www.nytimes.com>, December 3, 1997.
- Powell, Robert. 1991. "Absolute and Relative Gains in International Relations Theory." *American Political Science Review* 85, no. 4 (December):1303-1320.
- Pruitt, Dean G. 1981. *Negotiation Behavior*. New York: Academic Press.
- Putnam, Robert. 1988. "Diplomacy and Domestic Politics: The Logic of Two-level Games." *International Organization* 42, no. 3 (Summer):427-460.
- Rapopoort, Anatol. 1960. *Fights, Games, and Debates*. Ann Arbor, MI: Univ. of Michigan Press.
- , 1969. *Two-person Game Theory*. Ann Arbor, MI: Univ. of Michigan Press.
- Rodrik, Daniel. 1990. "How Structural Adjustment Programs be Designed?" *World Development* 18, no.7:933-947.
- Rubinstein, Ariel. 1982. "Perfect Equilibrium in a Bargaining Model." *Econometrica* 50: 97-107.
- Sachs, Jeffrey D. 1987. "Trade and Exchange Rate Policies in Growth-Oriented Adjustment Programs." in *Growth-Oriented Adjustment programs*, eds. Vittorio Corbo, Morris Goldstein, and Mohsin Kahn. Washington, DC: International Monetary Fund and World Bank.
- , 1989. "Conditionality, Debt Relief, and the Developing Country Debt Crisis." in *Developing Country Debt and Economic Performance: The International Financial System*, ed. Jeffrey D. Sachs. Chicago: Univ. of Chicago Press.
- Sanger, David E. "Clinton's Personal Touch in Asia Rescue." [Online] Available <http://www.nytimes.com>, December 18, 1997.
- Schadler, Susan, et al. 1995. *IMF Conditionality: Experience under Stand-By and Extended Arrangements, Part I: Key Issues and Findings*. IMF Occasional Paper, no. 128.
- Schelling, Thomas. 1960. *The Strategy of Conflict*. Cambridge: Harvard Univ. Press.
- Sidell, Scott R. 1988. *The IMF and Third-World Political Instability: Is There a Connection?* New York: St. Martin Press.
- SIPRI *Yearbook of Arms Control and Disarmament*. 1982-1998. Stockholm, Sweden:

Stockholm International Peace Research Institute.

- Smith, Jr., Fred L. 1984. "The politics of IMF lending." *Cato Journal* 4, no. 1 (Spring/Summer):211-241.
- Snidal, Duncan. 1991. "Relative Gains and the Pattern of International Cooperation." *American Political Science Review* 85, no. 3 (September):701-726.
- Ståhl, Ingolf. 1994. "The Rubinstein and Ståhl Bargaining Models: A Comparison and an Attempt at a Synthesis." EFI Research Paper 6535. Stockholm School of Economics.
- Stein, Howard. 1992. "Deindustrialization, Adjustment, the World Bank and the IMF in Africa." *World Development* 20, no. 1:83-95.
- Stevenson, Richard W. and David E. Sanger. "Asian Crisis Could Wreak Havoc on Balance of Trade." [Online] Available <http://www.nytimes.com>, December 20, 1997.
- Stewart, Frances. 1987. "Alternative Macro Policies, Meso Policies, and Vulnerable Group." in *Adjustment with a Human Face, Volume 1 Protecting the Vulnerable and Promoting Growth*, eds. Giovanni A. Cornia, Richard Jolly, and Frances Stewart. Oxford: Clarendon Press.
- , 1995. *Adjustment and Poverty: Options and Choices*. London: Routledge.
- Stiles, Kendall W. 1990. "IMF Conditionality: Coercion or compromise?" *World Development* 18, no. 7:959-974.
- , 1991. *Negotiating Debt: The IMF Lending Process*. Boulder, CO: Westview Press.
- The Economist. 1997. "New Illness, Same Old Medicine." (Dec. 13):65-66.
- Taylor, Lance. 1987. *Varieties of Stabilization Experience: Toward Sensible Macroeconomics in the Third World*. New York: Oxford Univ. Press.
- Tollison, Robert D. and Thomas D. Willett. 1979. "An Economic Theory of Mutually Advantageous Issue Linkages in International Negotiations." *International Organization* 33, no. 4 (Autumn):425-449.
- Treasurer's Department. 1998. *Financial Organization and Operations of the IMF*. Pamphlet Series, no. 45. Washington, DC: International Monetary Fund.
- UN *Statistical Yearbook*. 1993, 1997. New York: United Nations.

- . 1998. *World Economic and Social Survey: Trends and Policies in the World Economy*. New York: United Nations.
- van de Geest, Willem. 1994. "The Bargaining Process of Policy-Based Lending." in *Negotiating Structural Adjustment in Africa*, ed. Willem van de Geest. New York: United Nations Publications.
- Vásquez, Ian. 1998. "The IMF's Dubious Purpose: Long on Bailouts, Short on Success." *The Freeman* 48, no. 10 (October):600-601.
- Vaubel, Roland. 1991. "The Political Economy of the International Monetary Fund: A Public Choice Analysis." in *The Political Economy of International Organizations*, eds. R. Vaubel and T. D. Willett. Boulder, CO: Westview Press.
- Vital, David. 1971. "The Analysis of Small Power Politics." in *Small States in International Relations*, eds. August Schou and Arne O. Brundtlan. Stockholm: Almqvist & Wiskell.
- Wagner, R. Harrison. 1988. "Economic Interdependence, Bargaining Power, and Political Influence." *International Organization* 42, no. 3 (Summer): 461-483.
- Walton, John and Charles Ragin. 1990. "Global and National Sources of Political Protest: Third World Responses to the Debt Crisis." *American Sociological Review* 55, no. 6:876-890.
- Walton, Richard E. and Robert B. McKersie. 1991. *A Behavioral Theory of Labor Negotiations: An Analysis of a Social Interaction System*, 2nd ed. Ithaca, NY: ILR Press.
- Waltz, Kenneth N. 1979. *The Theory of International Politics*. Reading, MA: Addison-Wesley.
- Wells, Robin. 1993. "Tolerance of Arrearages: How IMF Loan Policy Can Effect Debt Reduction." *The American Economic Review* 83, no. 3:621-633.
- Werner, Suzanne. 1998. "Negotiating the Terms of Settlement: War Aims and Bargaining Leverage." *Journal of Conflict Resolution* 42, no. 3 (June):321-343.
- White, Halbert. 1980. "A Heteroscedasticity-Consistent Covariance Matrix Estimator and a Direct Test for Heteroscedasticity." *Econometrica* 48, no. 4:817-838.
- Wiarda, Howard J. 1990. "The Politics of Third World Debt." *PS: Political Science & Politics* (September):411-418.
- Williamson, John. 1983a. "On Judging the Success of IMF Policy Advice." in *IMF*

Conditionality, ed. John Williamson. Washington, DC: Institute for International Economics.

-----, 1983b. "The Lending Policies of the International Monetary Fund." in *IMF Conditionality*, ed. John Williamson. Washington, DC: Institute for International Economics.

World Bank. 1988. *Adjustment Lending: An Evaluation of Ten Years of Experience*. Washington, DC: World Bank.

-----, 1990. *Adjustment Lending Policies for Sustainable Growth*. Washington, DC: World Bank.

-----, 1992. *Adjustment Lending and Mobilization of Private and Public Resources for Growth*. Washington, DC: World Bank.

-----, 1993a. *Adjustment Lending: Lessons of Experience*. Washington, DC: World Bank.

-----, 1993b. *Getting Results: The World Bank's Agenda for Improving Development Effectiveness*. Washington, DC: World Bank.

-----, 1994a. *Trends in Developing Economies*. Washington, DC: World Bank.

-----, 1994b. *World Development Reports*. Washington, DC: World Bank.

-----, 1994c. *World Debt Table: External Finance for Developing Countries 1994-95*. Washington, DC: World Bank.

-----, 1997a. *Global Development Finance* CD-ROM. Washington, DC: World Bank.

-----, 1997b. *World Development Indicators* CD-ROM. Washington, DC: World Bank.

WuDunn, Shery with Nicholas D. Kristof. "Japan Seems Paralyzed by Asian Crisis." [Online] Available <http://www.nytimes.com>, December 17, 1997.

Yoo, Cheong-Mo. "Seoul Strongly Denies Rumors on IMF Bailout Fund." [Online] Available <http://www.koreaherald.co.kr>, November 17, 1997a.

-----, "Seoul to Seek IMF Loans; Formal Announcement Due in 2 to 3 Days." [Online] Available <http://www.koreaherald.co.kr>, November 27, 1997b.

-----, "IMF Pressures Seoul to Revise Macroeconomic Targets." [Online] Available <http://www.koreaherald.co.kr>, November 28, 1997c.

- . "IMF Talks Stalled on Key Issues; Seoul Sticks to Own Growth, Restructuring Policies." [Online] Available <http://www.koreaherald.co.kr>, December 2, 1997d.
- . "Public Anger Mounting over Kim Government Economic Policy Failure." [Online] Available <http://www.koreaherald.co.kr>, December 6, 1997e.
- Young, Oran R. 1968. *The Politics of Force: Bargaining During International Crises*. Princeton, NJ: Princeton Univ. Press.
- Zartman, I. William. 1971. *The Politics of Trade Negotiation between Africa and the European Economic Community*. Princeton, NJ: Princeton Univ. Press.
- , ed. 1976. *The 50% Solution*. Garden City, NY: Doubleday Anchor.
- . 1977. "Negotiation as a Joint Decision-Making Process." in *The Negotiation Process*, ed. I. William Zartman. Beverly Hills, CA: Sage.
- . 1987a. "Introduction: Explaining North-South Negotiations." in *Positive Sum, Improving North South Neotiations*, ed. I. William Zartman. New York: Transaction Books.
- . 1987b. "Conclusion: Importance of North-South Negotiations." in *Positive Sum, Improving North South Neotiations*, ed. I. William Zartman. New York: Transaction Books.
- Zartman, I. William and Maureen Berman. 1982. *The Practical Negotiator*. New Haven: Yale Univ. Press.

MICHIGAN ST



31293

