Hard work, and foreign help:
how to successfully conduct adjustment with official assistance

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Outline

1. Introduction
2. Features of adjustment spells - and how to measure their success
3. Regression results, robustness checks, extensions
4. Concluding remarks

1. INTRODUCTION AND MAIN CONCLUSIONS

How to successfully adjust after a crisis?

- History vs economics:
  - An appropriate adjustment strategy should be tailored to the country's characteristics and environment,
  - Behind many idiosyncrasies, what are the lessons to be drawn from past experience and across countries?

How to measure success?

- Accounting vs performance
  - **Many possible ways to judge whether adjustment is successful:**
    - Accounting approach: compliance with policy conditions
    - Market-based approach: access to market financing regained
    - Macroeconomic approach: performance after end of programme
  - **Macroeconomic approach:**
    - Least common denominator: growth resumed and debt declining significantly

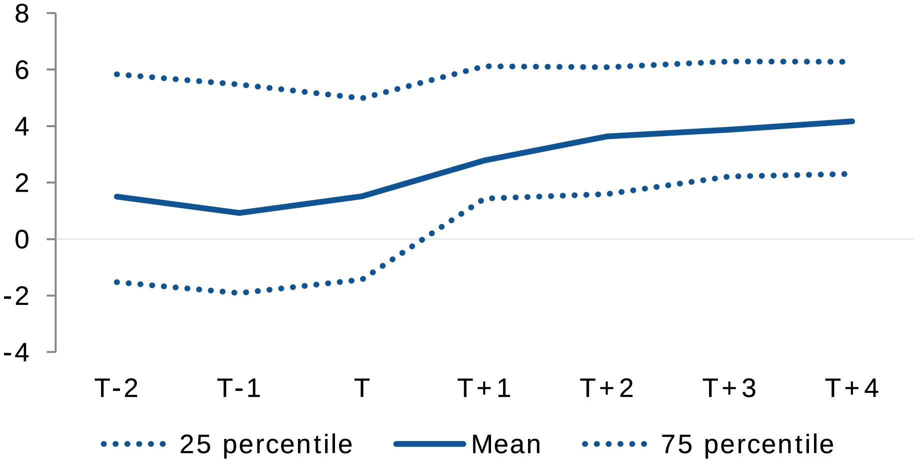
Results and Lessons Learned

- Hard Work: Faster fiscal adjustment, lower initial debt, more exchange rate flexibility, functioning banking sector, structural reforms.
- Good Luck: Strong global growth and risk appetite.
- Market definition of adjustment stricter.
- Out-of-sample evaluation of framework suggests ongoing/recently completed European programmes as or more likely to adjust successfully than average

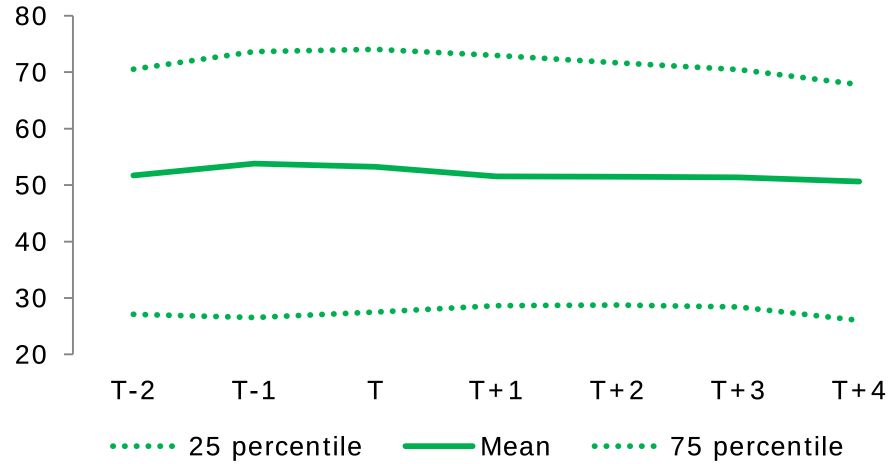
2. FEATURES OF SUCCESSFUL ADJUSTMENT EPISODES, AND HOW TO MEASURE THEM

Macro situation I

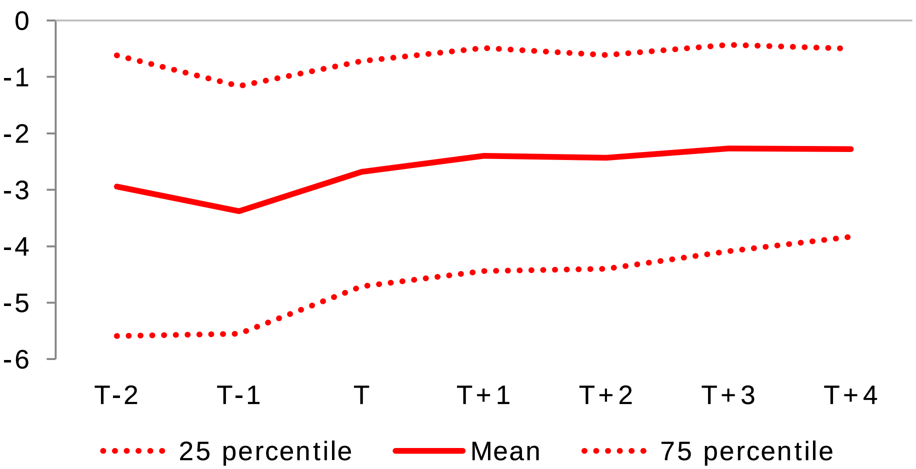
Real GDP Growth in %



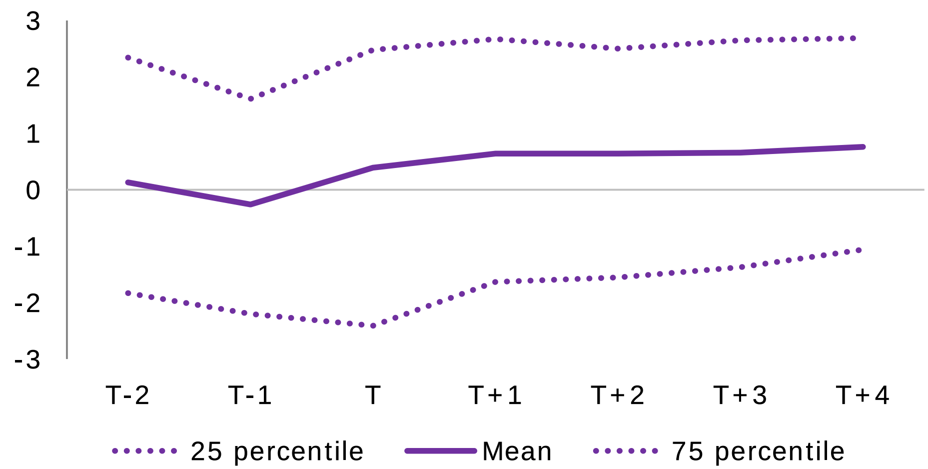
General Government Debt to GDP



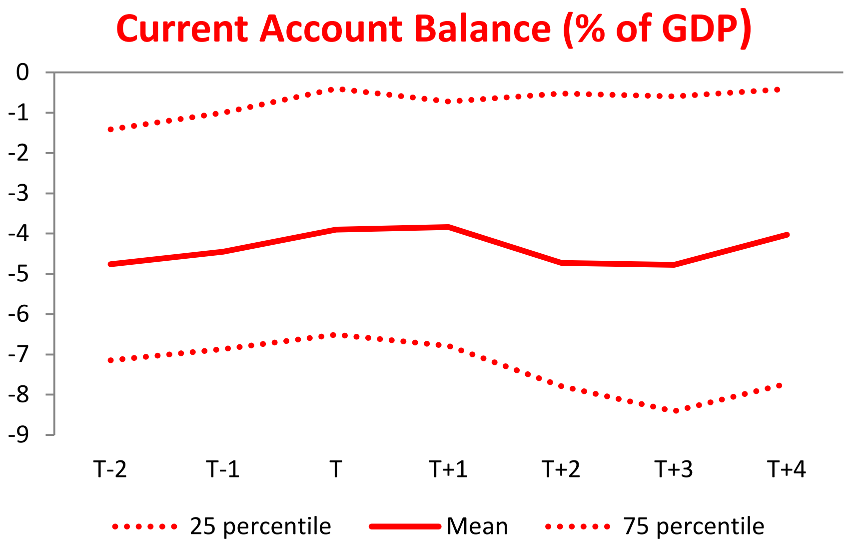
Overall Fiscal Balance

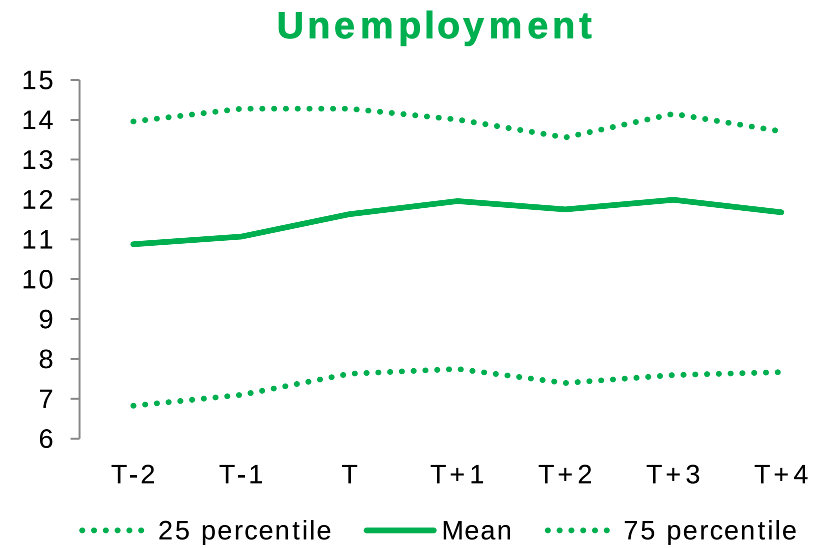


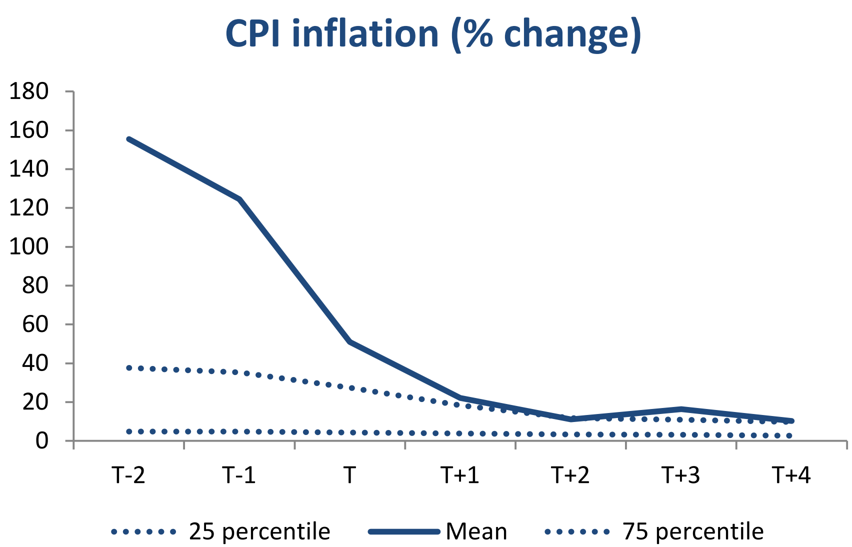
Primary Balance

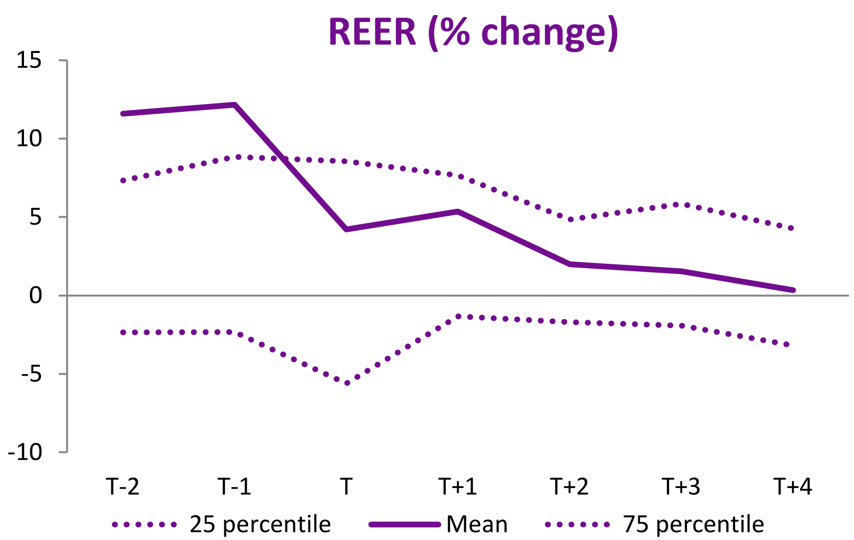


Macro situation II









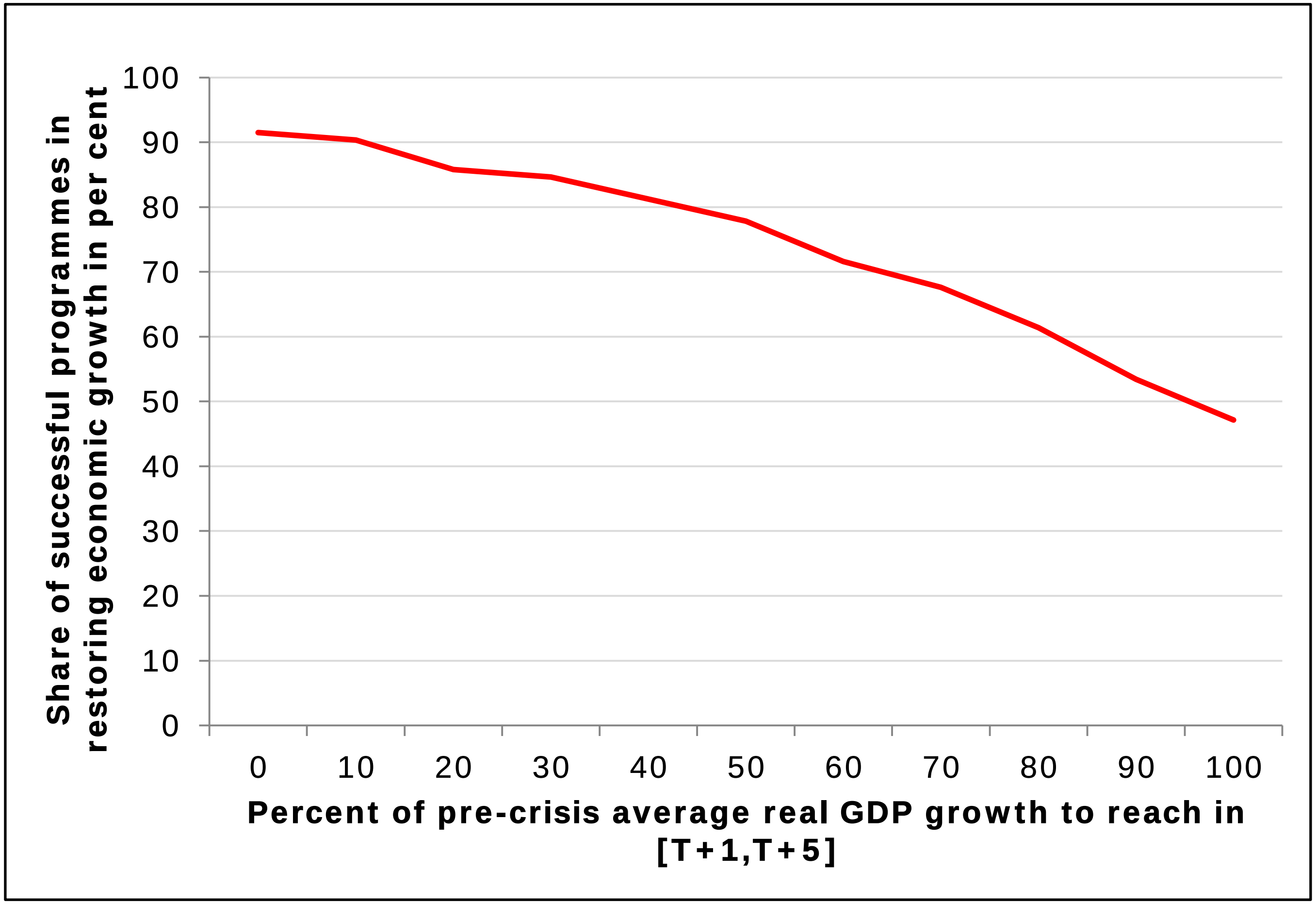
Successful adjustment 1: Post-adjustment real GDP growth rate to reach ¾ of pre-crisis one

- If av. real GDP growth in [T-5,T-1] <= 3% then av. growth above 2.25% [T+1,T+5]
- If av. real GDP growth in [T-5,T-1] between 3% and 6% then av. growth in [T+1,T+5] at least 3/4 of the growth in [T-5,T-1]
- If av. real GDP growth in [T-5,T-1] higher than 6%, then above 4.5% average growth in [T+1,T+5].

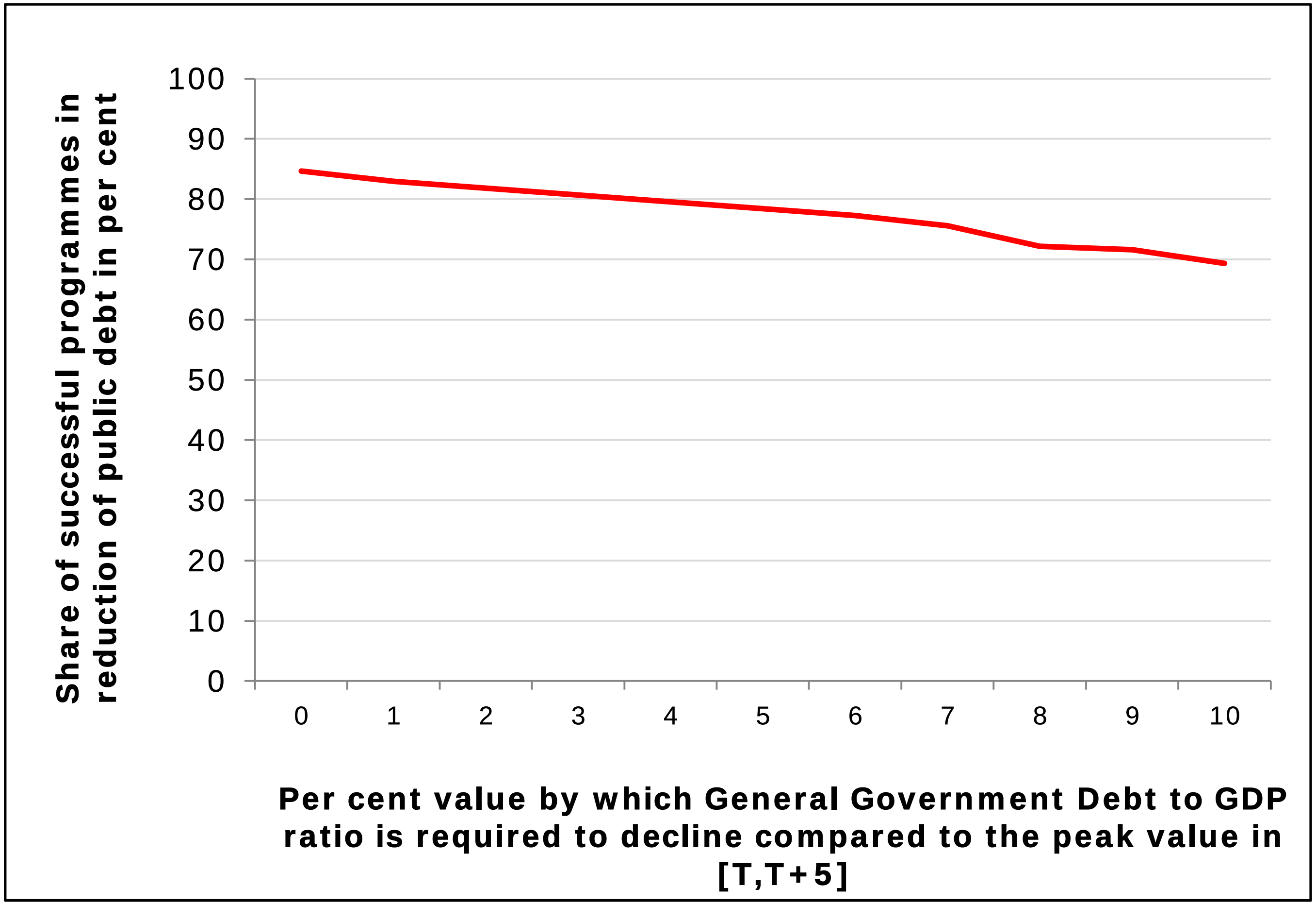
Successful adjustment 2: General Government Debt to decline by 5%

- If average general government debt to GDP in [T+1,T+5] below 25%, trends in public debt irrelevant from outcome perspective.
- If average general government debt to GDP in [T+1,T+5] above 25%, then if general government debt peaked between T and T+5 and declined by at least 5% compared to the peak value.
- The country does not default on its debt in [T+1,T+3].

Share of successful programmes in restoring growth



Share of successful programmes in debt reduction



Success rate

	General Government Debt to decline by 5% until T+5 and no default in [T+1,T+3]	General Government Debt to decline by 5% until T+4 and no default in [T+1,T+4]
Post-adjustment real GDP growth rate to reach 3/4 of pre-crisis one	58.5%	58.0%
Post-adjustment real GDP growth rate to reach 2/3 of pre-crisis one	60.8%	60.2%

3. RESULTS

Hard Work and foreign help – factors conducive to adjustment success

Increases prob. of successful adjustment	Lowers prob. of successful adjustment
Lower initial fiscal vulnerabilities (overall or primary balance in percent of GDP at programme start)	Higher global risk aversion
Larger improvement in overall and primary balance over programme horizon	Weaker global growth
	Credit crunch
Real GDP growth at programme start	High initial debt levels (depending on specification)
Openness	Lack of exchange rate flexibility
Structural reforms	Depreciation (through debt servicing burden)
More and more stringent conditionality	

Hard Work and foreign help – factors conducive to adjustment success

- How to reconcile

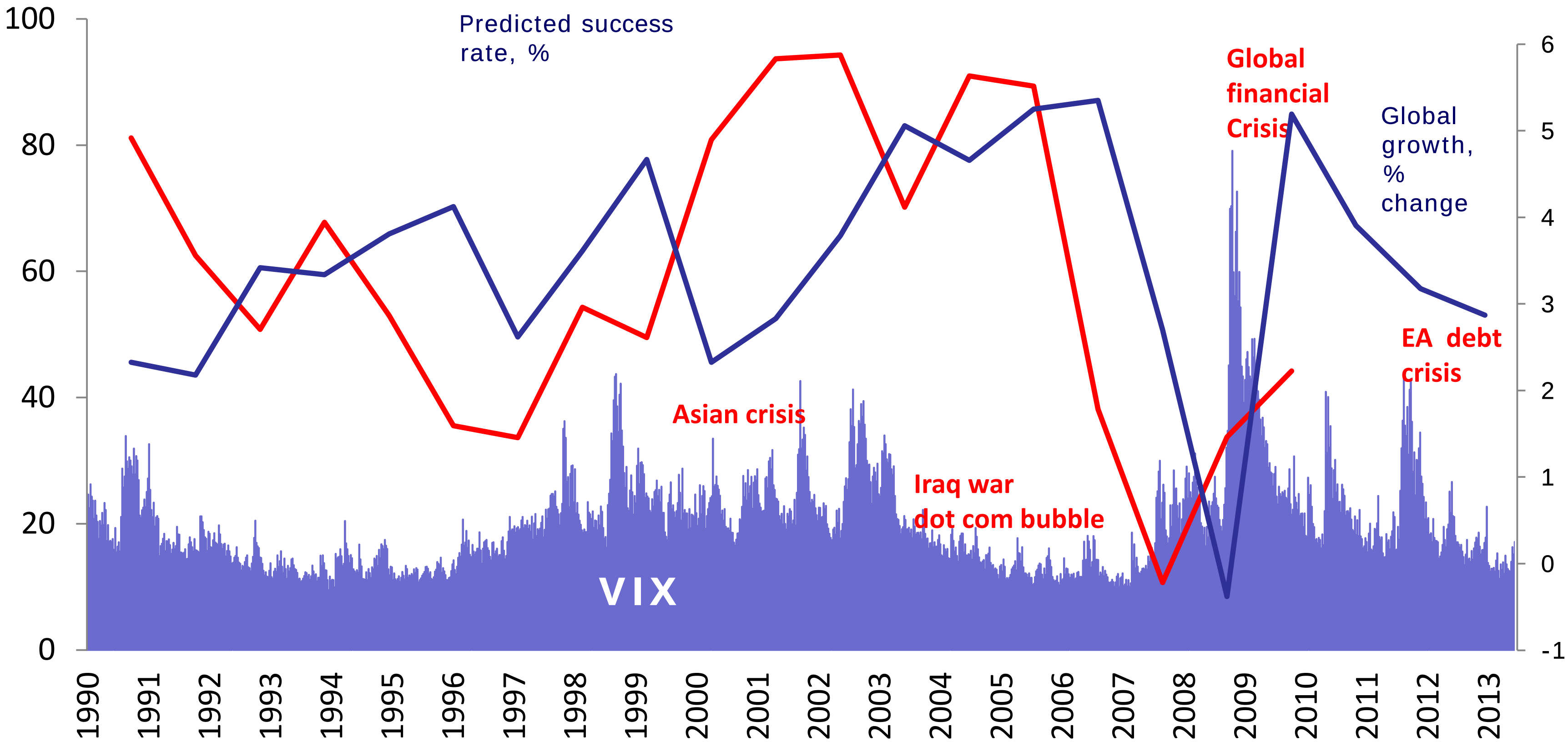
  - fiscal multiplier debate with
  - positive effect of fiscal adjustment on success?

- Medium-term supply (labour market) effects of fiscal consolidation.

Robustness check

- Definition of success (2/3 growth threshold, only growth criterion)
- Thresholds for income level
- Excluding regions: Asia, Africa, Latin America, Caribbian
- Successor programme
- Reference year T-1 instead of T

Risk appetite and global growth key for successful adjustment

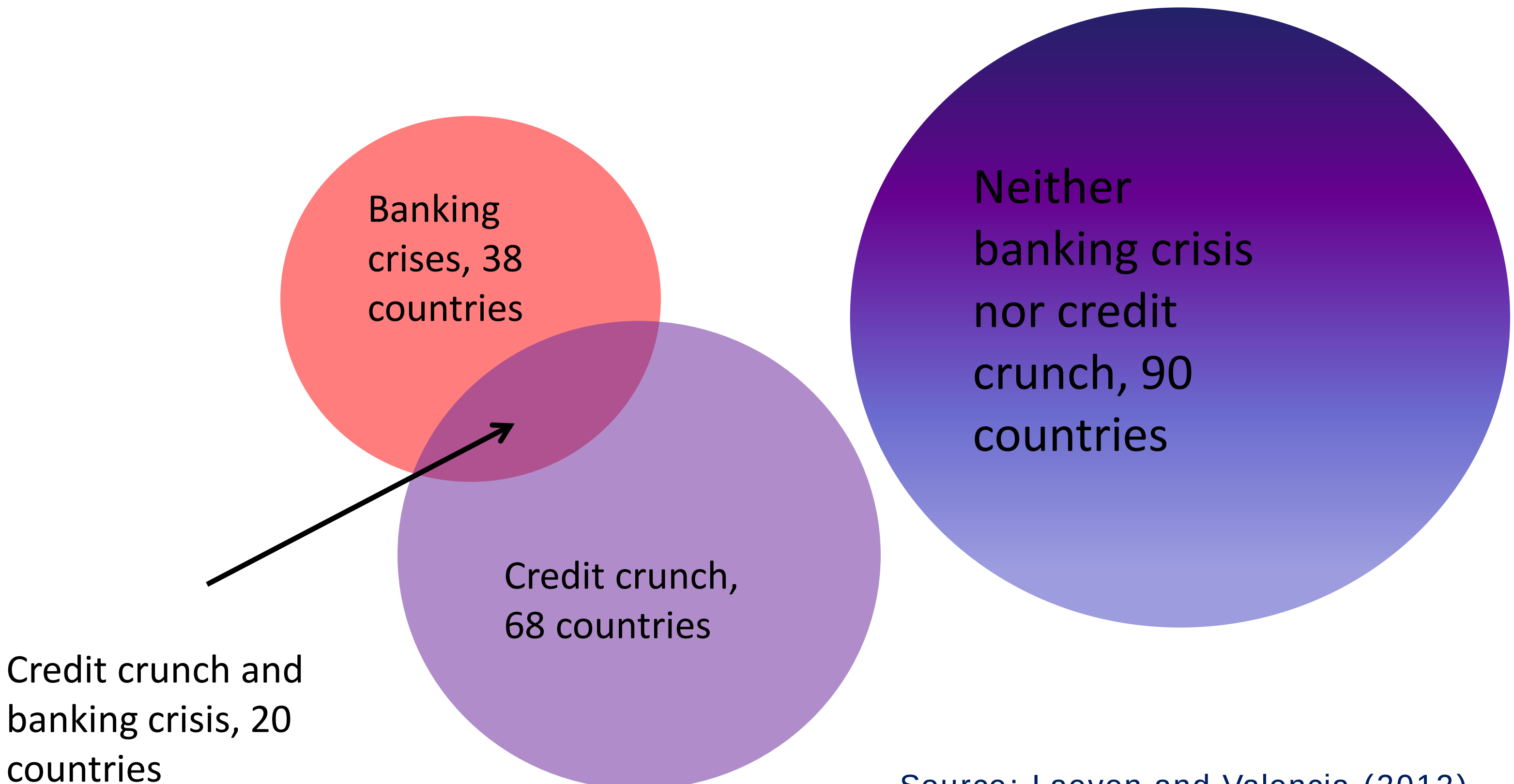


Source: Bloomberg, authors' calculations.

...but some factors we thought might matter didn't seem to

- Banking crises
- Size of initial current account deficit
- Whether a follow-on programme was requested
- Amount of official financing rel. to country size

Credit crunches rather than banking crises impediments to successful adjustment; affects about half of the sample



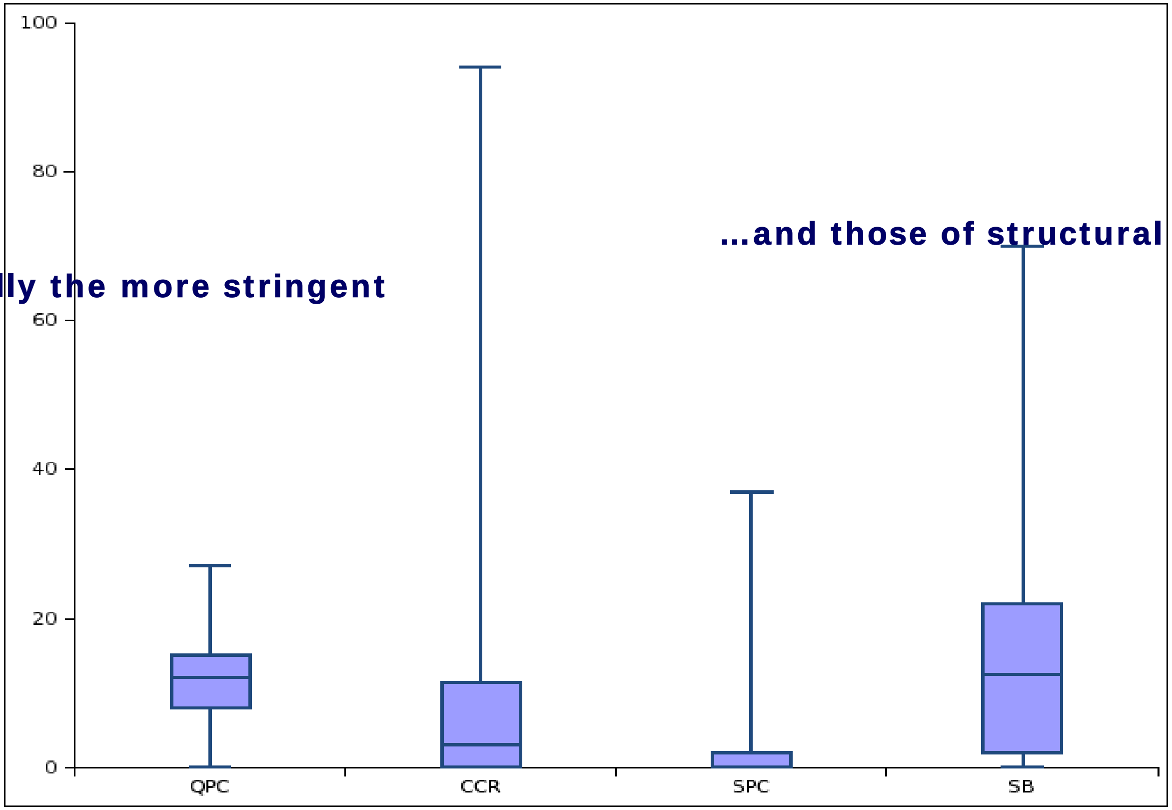
Source: Laeven and Valencia (2012), Authors' calculations.

Structural reforms and strength of conditionality

Probability of success increases with number of reform commitments

…especially the more stringent ones…

…and those of structural nature.



QPC=Quantittive performance criteria; CCR=Conditions for completion of review (prior action); SPC=structural performance criteria; SB=structural benchmark

Source: IMF, Authors' calculations.

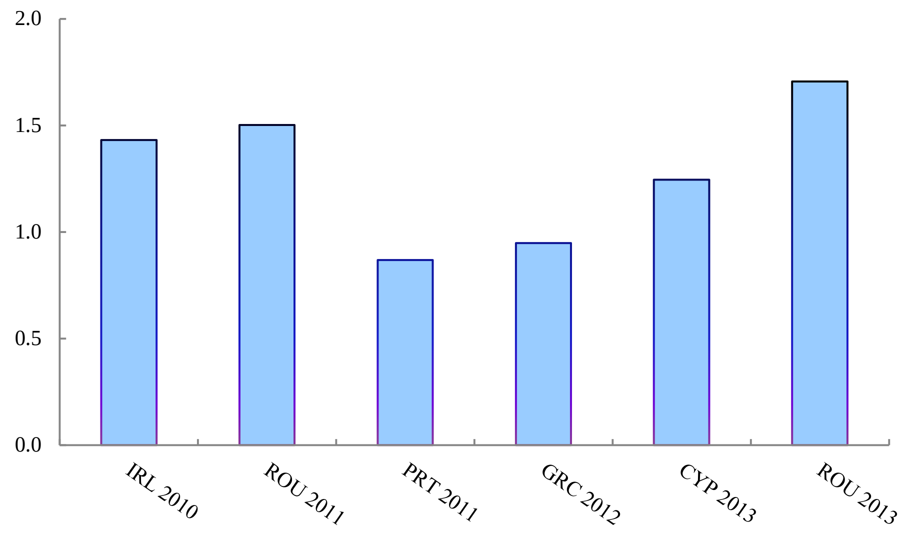
What can be learnt for the ongoing programmes in Europe?

- Framework likely to miss important country-specific aspects or adjustment objectives but could provide valuable cross-check

- Outliers in terms of pre-crisis debt and fiscal challenges, GDP per capita, institutional quality, financial debt, strength of other currency union members, size of ECB balance sheet...

- Reliance on projections additional challenge, especially for programme in early stages

European programmes have similar or higher probability of success than sample average



Note: Conditional probability over unconditional probability. Authors' calculations.

3. CONCLUDING REMARKS

Concluding remarks

- Decisive policy action and a benign external environment conducive for successful adjustment
- Fiscal and structural action key.....
- .... external vulnerabilities less so
- Progress under adverse external conditions should be acknowledged

THANK YOU!