When do governments implement financial sector reforms? IMF Financial Sector Conditionality and Domestic Interests

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Abstract

Having and maintaining a well-functioning, sound and transparent financial sector is critical for economic growth. Yet, more often than not, governments are faced with strong opposition from financial sector interests and fail to take corrective actions. Indeed, scholarly work has shown that governments often rely on external intervention to implement politically difficult reforms. The IMF has been one of the significant and active promoters of financial sector reforms in developing countries. However, we still lack a systematic analysis of the conditions under which IMF programs include financial sector conditions, more importantly the conditions under which these reforms are implemented. Utilizing a unique new dataset and analyzing the design and implementation of IMF financial sector conditionality between 1992 and 2014, I show that when the share of the financial/business interests in the GDP increases, it is more likely that the program will include financial sector conditionality. This confirms the expectation that the IMF maximizes conditionality when the financial sector is strong. Moreover, the programs that are signed by the left wing governments are more likely to have financial sector conditions than the programs signed by the right wing governments. The effect of the financial sector is not necessarily mediated by the partisan politics and democratic institutions in the implementation stage due to lack of broader electoral appeal and mobilization capacity. The implementation of financial sector conditionality significantly goes down in the presence of strong financial interests, irrespective of the regime type and partisan ideology. In summary, the findings in the empirical chapters highlight the interaction between partisan preferences and organized interests in the borrowing country. We can only predict the successful implementation of specific policy-related conditions when we know and account for the role of strong organized interest groups and stakeholders and their relationship to governments.

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Introduction

The recent financial crisis has once again signified the need for having and maintaining a well-functioning, sound and transparent financial sector. These generally require laws and regulations to tightly regulate financial sector activities, to establish supervision mechanisms and corrective actions in insolvent banks. The IMF has been one of the most significant and active promoters of financial sector reforms in developing countries to address these needs. Financial sector conditionality has become more salient since early 1990s, as a response to increasing critique of IMF programs that led to massive capital outflows and severe banking crisis. Especially during the Asian Financial Crisis, in which weak financial sector regulations were to blame, the Fund oriented its lending activity to preserve financial sector stability. In the light of studies that link financial sector development to economic growth (Levine 1997) and the IMF reforms to prevention of banking crises (Papi, Presbitero et al. 2015), understanding the determinants and implementation of IMF financial sector conditionality is critical.

We still lack a systematic analysis of the conditions under which IMF programs include financial sector conditions, more importantly the conditions under which these reforms are implemented. There is a significant variation in the implementation of financial sector conditionality. For instance, when the Asian Financial Crisis hit in 1997, while Korea had easier time to implement financial sector reforms, countries like Thailand, Malaysia and Indonesia faced difficulties (Haggard and Kaufman 1995, Haggard 2000). Why do governments respond so differently to the IMF programs? What are the political conditions for successful implementation of financial sector reforms? How do the financial interests matter?

This paper highlights the role of domestic financial interests in the design and implementation of the IMF programs. Scholarly work has shown that the domestic financial interests either play a minimal role or support financial sector reforms (Woo 2010). However, this study shows that the implementation of financial sector reforms is driven by idiosyncratic domestic institutional and/or political factors, such as the strength of the financial interests. Unlike the labor market conditionality and the effect of the unions, the financial interests' effect is not filtered through partisan differences and electoral concerns in the implementation stage but partisan politics matter only for the design of financial sector conditionality.

This study contributes to the research on the financial sector reforms and the IMF in several ways. It introduces a unique dataset that disaggregates all the policy conditions according to their

targeted economic sector and provides a focused analysis on the implementation of financial sector reforms. Accordingly, this study enables a dynamic and issue-specific analysis of IMF programs, improving on the common approach of looking at the initial letter of intent and using aggregate measures of implementation (Ivanova, Mayer et al. 2003, Joyce 2003, Nsouli, Atoian et al. 2004, Pop-Eleches 2008).

Secondly, a disaggregated approach is critical in showing how political processes derive cross-national policy variation in implementation and the effect of organized interests. There is significant variation in the implementation of different policies under IMF (Dreher 2003, Vreeland 2006). For instance, between 1992 and 2014, the overall implementation of IMF conditionality remains around 61%. While only 51% of the pension reforms were implemented, 64% of financial sector reforms were implemented respectively. What accounts for these differences in implementation across countries and across policy areas? Are domestic groups successful in preventing implementation? Although the research on the IMF has focused on organized interest groups (Grossman and Helpman 2001, Ivanova, Mayer et al. 2001, Drazen 2002, Mayer and Mourmouras 2002, Ivanova, Mayer et al. 2003, Dreher 2006), the partisan politics and the sensitivity of (especially) left-wing governments to distributional consequences of economic reforms (Stone 2002, Pop-Eleches 2008, Beazer and Woo 2015), and the timing of elections (Dreher 2003, Arpac, Bird et al. 2008, Rickard and Caraway 2014), our understanding of their effect on the implementation of the Fund's structural conditionality remains incomplete. An issue-specific focus allows this study to shed new light on the linkages between organized interests and their policy makers in the IMF borrowing countries.

Financial Sector Conditionality

Healthy and effective financial sector is critical for macroeconomic stability and economic growth (Levine 1997). Financial sector and its intermediaries play a crucial role in economic activities such as saving decisions, efficient allocation of resources, supporting sustainable public finances and sound macroeconomic policies (Giustiniani and Kronenberg 2005). As recent examples from the Asian Financial Crisis and the Global Financial Crisis show, unsound financial systems create or become the channel through which macroeconomic shocks are transmitted and lead to full-blown economic crisis. Consequently, the IMF has become increasingly focused its lending activities to diagnose and correct problems in the banking sector such as strengthening the financial

soundness, enhancing the institutional and legal framework and putting the right incentives in place (IMF 2011).

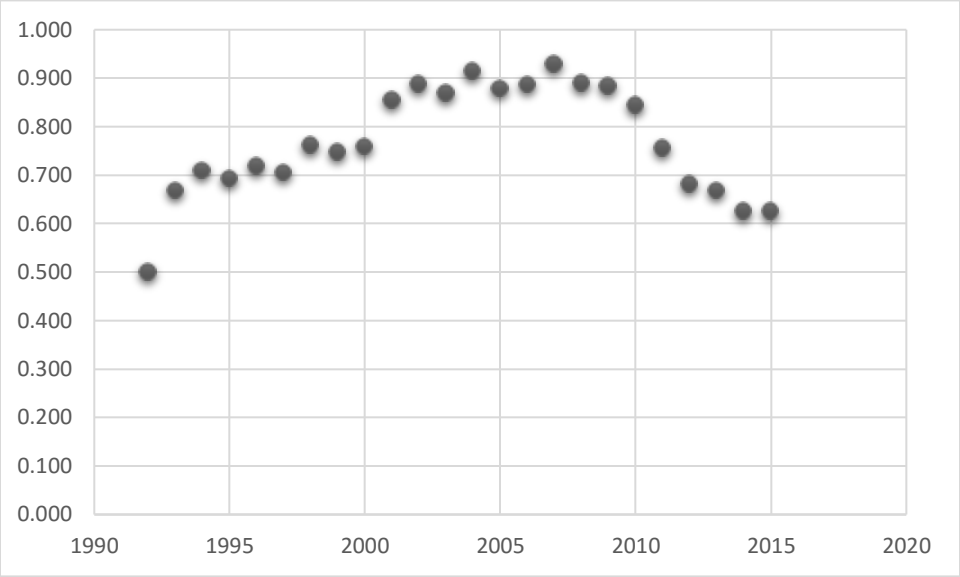

Figure 1. Percentage of Financial Sector Conditionality in the IMF Programs Between 1992-2015

Following the Asian Financial Crisis, financial sector conditionality has become common in the IMF programs and are the second most important area of structural reforms (IMF 2011). Figure 1 provides percentage of IMF programs that include at least one financial sector condition since 1992. The focus on the financial sector peaks especially at the onset of the financial crisis. Today, typical IMF programs include on average two financial sector conditions. Figure 2 provides a summary of the evolution of the number of financial sector conditions since 1992. During its peak around mid-2000s, a typical IMF program included nearly 5 financial sector conditions.

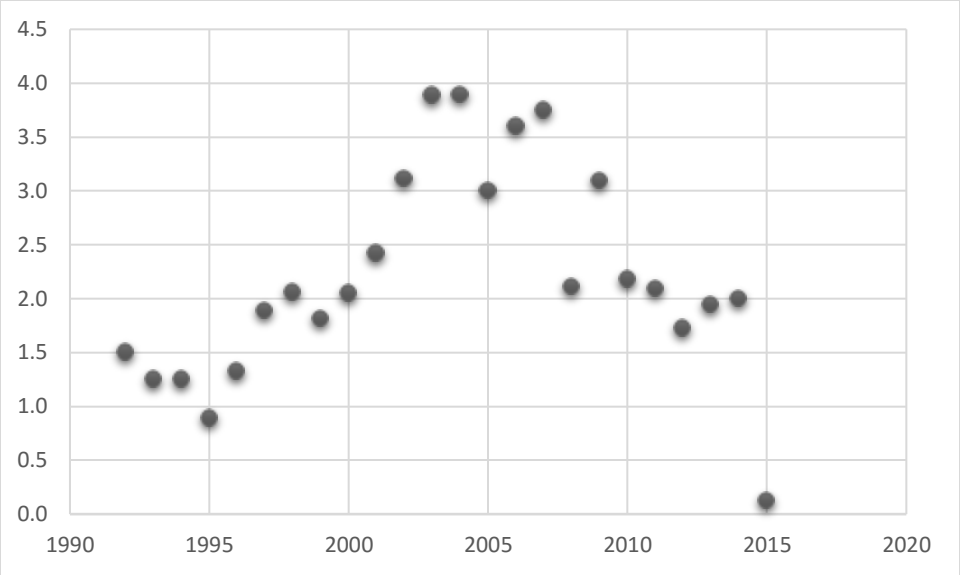

Figure 2. Average Number of Financial Sector Conditions in IMF Programs

Financial sector reforms involve regulations regarding financial transactions, riskier behavior in the financial sector, liberalization and/or privatization of the financial institutions. For instance, Korea Program in 1997 included the following measures: "Call special session of Nat Assembly to pass: (i) bill on central bank independence with price stability as main mandate; (ii) bill to consolidate bank supervision; (iii) bill on corporate financial statement transparency (by 2nd biweekly review, 1/8/98)". Moreover, the program included measures to allow foreign bank participation in the market such as, "Allow foreign banks & brokerage houses to establish subsidiaries (3/31/98". Similarly, from 2010 to 2013, the Irish government and the Irish Central Bank have implemented a series of reforms that reduce the vulnerabilities of the financial sector.[2] For instance, given the extent of the problems in the financial sector, the Irish IMF program included measures to diagnose and correct problems such as: "Complete stress tests, diagnostic evaluation of banks' assets and (…) a full assessment of credit unions' loan portfolios". Moreover, the program aimed to restructure financially troubled banks with measures such as "Submit to Oireachtas the Supervision and Enforcement Bill" and "The merger of Irish Nationwide Building Society and Anglo-Irish bank". Moreover, the financial sector conditionality required regulatory standards on practice of lending, corporate governance code and capital requirements as well as a new risk-based supervisory authority.

[2] For detailed information on the IMF program in Ireland, please see: http://www.imf.org/external/country/IRL/.

The IMF programs are signed around economic downturns such as currency, sovereign debt and banking crisis. In many cases such as the Asian Financial Crisis and the Eurozone crisis, the financial sector is at the center of the structural problems in the borrowing country (Haggard 2000, IEO 2016). Thus the IMF tries to diagnose and correct the structural problems in the borrowing country through policies. For instance, certain prudential regulations increase the bank's reserve requirements to maintain systemic stability in case of sudden capital flows or bank runs (Rosenbluth and Schaap 2003) (Rosenbluth and Schaap 2003). The Fund also invests in the financial oversight mechanisms such as creation of independent financial regulation authorities or increasing the role and independence of the central bank. These institutions detect and prevent risky behavior in the financial sector. Lastly, the Fund also imposes conditions that require downsizing, restructuring or privatization of the financial institutions in the borrowing country.

Moreover, the IMF conditionality requires liberalization of foreign ownership restrictions. While benefiting from the cheaper access to foreign capital through capital account liberalization, the domestic financial interests favor restrictions on the inflow of foreign capital and foreign ownership rights (Pepinsky 2013). They especially prefer restrictions on the ability of foreign firms to own and operate in their home country to maintain their control as primary lenders. Especially in developing countries, the domestic financial institutions are weaker relative to their foreign counterparts from the developed economies. Thus, when the financial markets are liberalized, they would face severe competition from their foreign counterparts (Claessens, Demirgüç-Kunt et al. 2001, Pepinsky 2013). Foreign financial institutions have comparative advantage due to their ability to offer lower interest rates, mobilize greater funds and maintain higher profit margins than the domestic banks in the borrowing country (Claessens, Demirgüç-Kunt et al. 2001)

These regulations affect financial actors by increasing the costs of doing business, leading to profit losses, increasing competition or scrutiny. As a result, the financial actors are adversely affected by these changes either through direct changes in their organizational structures or through the changes in their regulatory environment. That is why the financial actors such as banks are the main interest groups in understanding the financial sector reforms in the borrowing countries. Banks and firms experiencing stress have strong interests in delaying reforms since timing of these decisions affect their survival. For instance, they would claim that they are viable. There is anecdotal evidence that documents the effect of business and financial actors on policy outcomes. For instance, Haggard (2000) argues that close ties between business and government had long

been a distinctive feature of many of the rapidly growing Asian economies prior to the Asian Financial Crisis. Thus, when the crisis hit in 1997, while Korea had easier time to implement financial reforms due to its control over the banks and the financial sector, countries like Thailand, Malaysia and Indonesia, where the business support was a crucial element of the political formula, faced difficulties (Haggard 2000).

IMF and Financial Sector Conditionality

Scholars have shown that non-compliance with structural conditionality is common (Stone 2002, Nsouli, Atoian et al. 2004, Edwards and Martin 2010). Compliance is contingent upon a variety of factors, such as worsening macroeconomic conditions such as fiscal deficits, current account imbalances and slow GDP growth (Nsouli, Atoian et al. 2004, Edwards and Martin 2010), geopolitical interests such as strategic ties to the US (Stone 2002, Stone 2008), the type of crisis, partisan politics and institutional capacity(Pop-Eleches 2008). However, we still know very little about which policies are eventually adopted and how the IMF interacts with struggling countries in specific policy areas.

This is critical since there is significant variation in the implementation of different policies under the IMF (Dreher 2003, Vreeland 2006). For instance, between 1992 and 2014, the overall implementation of IMF conditionality remains around 61%. While only 51% of the pension reforms were implemented, 64% of financial sector reforms were implemented respectively.[3] The implementation remains especially low in areas such as the privatization of public institutions and pension and civil service reform. Closer look at implementation records of these countries highlight further differences. While Greece was able to implement 70% of all the financial sector reforms and 80% of the labor market reforms pertaining to private sector; it had difficulties in especially passing legislations regarding civil service and pension reforms. While Irish government had difficulties in implementing reforms pertaining to financial sector privatization and restructuring (60%), it was more effective in pushing for financial sector regulations (91%).

These observations raise important questions: What accounts for the differences in implementation across countries and across policy areas? Why do some countries are more effective in implementing IMF reforms than others, and in some policy areas than others? In this project, I argue that one of the most important sources of this heterogeneity in implementation lies

[3] These are based on the authors' own coding of the IMF conditionality from the MONA database.

in the strength of organized interests who are adversely affected by specific policies and their interaction with their governments. Specifically, I examine how partisan differences in the borrowing country governments mediate the effect of organized interests in the implementation of IMF reforms.

This study argues that the implementation of IMF reforms should be analyzed at a disaggregated level by analyzing specific policy areas in which different organized interests have distinct effects. The IMF structural conditionality spans many dimensions and the distributional consequences of each specific reform vary with these policy dimensions (Vreeland 2006). Thus the implementation of IMF reforms are politically contentions and governments, more often than not, are faced with strong opposition from interest groups and voters. Indeed, scholarly work has shown that governments often rely on external intervention to implement politically difficult reforms (Vreeland 2003). However, the research on the implementation of IMF conditionality requirements in general fails to capture the particular contentions and dynamics surrounding specific policy conditions. For instance, while labor unions may be relevant for understanding the implementation of labor market reforms, the interests of the banking sector are more relevant in the reforms pertaining to the financial sector. Although previous literature assumes that different organized interests may have different preferences, they fail to directly model these differences (Caraway, Rickard et al. 2012). Accordingly, each organized interest group is not necessarily interested in every reform in the program but is most likely to focus on the reforms that directly affect their welfare. Thus, the borrowing countries' domestic political characteristics such as the ideology of the government, strength of different interest groups, their access to political apparatus and institutional structure would influence implementation in different areas. There is, thus, a remaining need to systematically investigate when and how governments take on strong interest groups[4] that oppose particular IMF reforms.

This study focuses on specific groups, their preferences, and their effect on implementation. Specifically, one important link that provides access to the decision makers for the organized interests is studied: partisan orientation of the decision makers. How does the nature of the interaction between the domestic stakeholders and the government partisanship matter for

[4] I use special interests, organized interests, organized interest groups terms interchangeably throughout the text.

the implementation of IMF conditionality in policy specific areas? That is why this study focuses on financial sector reforms, that include financial sector regulations/supervision and privatization.

The research on the IMF financial sector requirements in general fails to capture the particular contentions and dynamics surrounding such as the effect of financial interests. Why are some governments more likely to receive financial sector conditions than others and more effective in implementing these conditions than other? This study shows that implementation of financial sector reforms is driven by idiosyncratic domestic institutional and/or political factors, such as the strength of financial interest.

Relying on new datasets created through the study of official documents and databases such as MONA, several studies indicate substantial heterogeneity in the conditionality targets, policy areas, depth and stringency (Dreher and Vaubel 2004, Dreher 2004, Dreher 2009, Woo 2010, Caraway, Rickard et al. 2012, Dreher, Sturm et al. 2013, Rickard and Caraway 2014, Beazer and Woo 2015). The scholarly work on the IMF-financial sector relationship has focused mainly on the determinants of capital account liberalization. Three sets of factors are relevant for understanding financial sector reform. First, learning among competitors in the global markets and diffusion mechanisms are important drivers of adopting new economic policies (Simmons and Elkins 2004). Second, scholarly work has focused on the domestic political institutions. For instance, Mukherjee and Singer (2010) point out the interactive effect of welfare spending and the IMF loans. They show that large loans from the IMF provide an opportunity for borrowing governments to initiate capital account liberalization since the IMF loans help governments to compensate the adversely affected groups (Mukherjee and Singer 2010). When welfare spending is adequate to compensate losers from financial sector reform in a borrowing country, the large IMF loans shield the governments from the possible costs. Perhaps surprisingly, in one of the most comprehensive studies of financial sector reforms, Mody and Abiad (2003) find that the ideology of the government does not matter. Third, discrete event such as formation of new governments and changes in macroeconomic circumstances are important drivers of the financial sector reforms. Among these factors, the role of the IMF has been emphasized. Simmons and Elkins (2004) show that the use of IMF credits are associated with more restrictive capital controls. On the other hand, Chwieroth shows that participation in the IMF programs is associated with capital account liberalization (Chwieroth 2009).

Similar to the research on the labor market conditionality, scholarly work mainly focused on the analysis of certain financial outcomes, rather than the determinants of the design and implementation of the financial sector conditionality. The only exception to this is a study by

Gould (2003), who shows how the conditionality is influenced by private financiers such as the commercial banks who supplement the Fund's loans to borrowers. By focusing primarily on "bank friendly conditions" which requires the borrowing country to pay back commercial bank creditor as a condition of its loan, Gould (2003) shows that these supplementary financiers influence the terms of the Fund conditionality. Thus, the research on the IMF financial sector requirements fails to capture the particular contentions such as the effect of financial interests. Why are some governments more likely to accept and implement financial sector conditions than others? This study shows that the implementation of financial sector reforms is driven by idiosyncratic domestic institutional and/or political factors, such as the strength of the financial interests. The effect of financial interests is not filtered through partisan differences and electoral concerns in the implementation stage but partisan politics matter for the design of financial sector conditionality.

Theory of Financial Sector Conditionality

The design and implementation of IMF conditionality is a process of interaction between the IMF, the borrowing country government and the relevant domestic stakeholders with heterogeneous preferences. The Fund is concerned with various objectives such as maintaining the international financial stability, its interests as a bureaucratic organization or might be constrained by the interests of its major shareholders. Similarly, the borrowing country governments are motivated by multiple objectives including enhancing public welfare, holding the office and satisfying the interests of their constituents. Lastly, the domestic stakeholders are concerned with the welfare of their constituents.

The borrowing country government not only needs to contend with active domestic interest groups such as labor unions, but also with the pressures coming from the Fund and its donors. Thus, successful implementation of the IMF conditionality depends on the government's ability to strike a difficult balance between its own economic and ideological agenda, the demands of the IMF and the political pressures from domestic interest groups vying for policy reforms. In other words, building a pro-reform coalition whose consent is required for the reforms to be implemented is necessary for the successful implementation of IMF conditionality.

Existing research already documents how adversely affected groups stall reform initiatives (Przeworski 1991, Haggard and Kaufman 1995). The more powerful these groups are, the less likely that the reforms are implemented. However, since the IMF conditionality spans many dimensions and the distributional consequences of each specific reform vary, we need to directly

link the organized interests to the policy areas that are in their interests and study idiosyncratic domestic institutional and/or political factors in each policy area (Vreeland 2006). Thus, analyzing politics of design and implementation requires understanding relevant stakeholders in each country who are adversely affected by specific policies and how they relate to decision makers in enabling or preventing formation of pro-reform groups. Since financial sector reforms involve regulations regarding financial transactions, riskier behavior in the financial sector, liberalization and/or privatization of the financial institutions, they directly affect financial sector interest.

Who would be more successful in forming the pro-reform coalitions with respect to financial sector reforms under the IMF conditionality? The IMF targets these important sectors of the economy, especially when they seem dysfunctional. The most vulnerable countries and economic sectors with more structural problems receive the largest number of conditions since the Fund maximizes conditionality in the neediest countries to stabilize the economy (Pop-Eleches 2008). Moreover, the design of conditionality is driven by the changes in the knowledge expertise and dominant ideology of IMF staff (Barnett and Finnemore 2004). When the financial sector is strong, the IMF maximizes conditionality to ensure the stability and transparency of the sector, enable access for the foreign institutions, especially the ones from the major stakeholders. In summary, when financial interests are strong, IMF increases conditionality to address structural problems in these markets and achieve long-term sustainable economic growth and development. However, whether the borrowing country government responds to the IMF pressures in the presence of strong organized interests is function of partisan interests and electoral process.

Partisan models of policy-making suggest that different parties have divergent policy preferences and respond to different constituencies (Alt 1985, Hibbs 1987). The right represents upscale groups such as employers, the upper middle class, the business and the financial community (Rueda 2007). These groups, as capital owners and high-income earners, are more inflation-averse and are against generous unemployment insurance. Thus they prefer stable and market friendly orthodox economic policies that lower spending and inflation as well as favor labor market flexibility (Rueda 2007). The left, which is more sensitive to preferences of low-skilled workers, organize their platforms around their preferences, reward them by targeting unemployment and increasing social spending (Rueda 2007). These partisan differences have been supported by many studies that documented the variations in macroeconomic priorities (Hibbs 1987, Garrett 1998), the interaction between partisanship and various domestic institutions such

as labor organizational structure (Alvarez 2001), labor market organizations (Boix 2000), central bank independence as well international constraints (Garrett 1998, Boix 2000).[5]

Partisan Politics and Financial Sector Reform

Left wing governments use IMF reforms to weaken owners of the capital politically, the core constituency of the political right. The left would find it difficult to reform the financial markets during normal times due to heightened political costs. During crisis, the left would have greater incentives to target strong financial interests by increasing their leverage against the financial sector and push through reforms that would not be otherwise approved by tying their hands with the conditionality (Vreeland 2002). Moreover, the core constituency of the political left, low-income groups and workers, benefit from financial sector reforms since it would provide cheaper credit for these groups. Since the implementation of IMF financial sector conditionality is critical for receiving IMF loans and long-term economic growth, the left wing governments use IMF reforms to weaken owners of the capital politically, the core constituency of the political right. Since the right is politically dependent on owners of the capital and high-wage earners. When the right wing governments are able to influence the design and implementation process they will delay and/or block reforms to shield the financial sector from the costs of reform.

H1: Left (right) governments will be more (less) likely to accept and implement financial sector reforms when financial sector interests are strong (during economic crisis)

Electoral Politics and Financial Sector Reform

Both the left and right governments benefit from a properly functioning labor market and financial sector in the long term. Under IMF programs, the short and long-term interests of political parties and partisan governments can diverge. Despite the long-term benefits of structural reforms, these reforms also result in significant short-term costs to the welfare of organized interests and partisan constituencies. Scholars argue that politicians are not blind ideologues who only pursue partisan

[5] For instance, Garrett (1998) shows that policy reform is most likely where partisanship and labor institutions are congruent. This could be left government and strong organized labor or right government and weak/decentralized labor. Although some argued the decreasing relevance of partisan politics in the face of globalization, others show that it is still relevant. Garrett (2001) shows that the international market exposure actually induces greater government spending on redistribution programs that compensate for market-generated inequalities. Garrett's analysis highlights the ability of labor-market institutions to effectively negotiate between government and labor. Thus left-labor movements, and, consequently, cross-national partisan differences are still relevant.

agendas. Instead, given political parties have both ideological and electoral concerns, they act pragmatically in response to the political environment they face (Garrett 1998, Rueda 2007). They should respond to their core constituencies as long as their prospects of re-election are not threatened. If there is a clash between their ideological and electoral concerns, politicians are better off pursuing strategies that improve their prospects of re-election rather than their partisan preferred strategies.[6]

The politics of financial sector reform are different than other reforms such as the labor market due to the nature and the extent of opposition. Even when domestic financial interests are strong, they do not create significant electoral pressure on their respective governments. When the financial sector is strong, the IMF maximizes conditionality to ensure the stability and transparency of the sector, enable access for the foreign institutions, especially the ones from the major stakeholders. Moreover, restoring stability to the financial sector is crucial and requires rapid process of reform for economic recovery (Calomiris and Mason 2003). Labor unions can politicize the labor market reforms and mobilize workers to vote for certain parties. They increase the visibility of the reforms in the public space and the political costs of reforms for the policy-makers. However, financial sector interests do not collectively organize and mobilize electoral groups. The financial sector resists to these reforms through their discretionary control over the economic interactions in the borrowing country and through the use and allocation of their funds (Calomiris and Mason 2003). Rather than public demonstrations and electoral mobilization, financial interests exert their influence through negotiations behind closed doors and their access to policymakers. For instance, prior to the crisis, Irish banks had privileged access to the Central Bank officials and members of Fianna Fail. Relying on these ties and their control over economic activities, the Irish Banks were able to affect policies that would target their business practices (Honohan 2016).[7]

Lacking significant electoral effects, scholarly work has also suggested that the effect of financial interests do not vary across different regime types (Haggard and Maxfield 1996).

[6] The literature on the IMF, which focuses on the effect of electoral concerns and timing of elections, show ambiguous results. As an example, Dreher (2003) argues that program suspensions are more likely to occur prior to elections. Surprisingly, this effect is smaller in democratic countries than in autocracies. By contrast, Arpac, O., et al. (2008) do not find any systematic significance of the electoral cycle.

[7] Personal interview with Patrick Honohan, former Governor of the Irish Central Bank (2009-2015). Washington D.C., October 2016.

Governments in both democratic and non-democratic regimes benefit from financial sector reforms such as capital account liberalization, which increases their credibility in the international markets and help them solve short and long term exchange rate problems (Haggard and Maxfield 1996). However, the borrowing country governments, especially in the developing world, also benefits from certain restrictions in the financial sector. Autocratic leader can use their control over the financial sector to advance their political interests such as allocating credit to their inner circle and providing cheaper financing for their clientele (Rosenbluth and Schaap 2003). This is easier when the financial sector is not liberalized and does not face competition from the foreign banks (Haggard and Maxfield 1993). Moreover, autocratic regimes are more likely to respond to the interests of narrower factions within the society (Bueno De Mesquita 2005). Contrary to the democratic regimes in which large and populous groups such as farmers and labor who benefit from financial liberalization and cheaper access to capital, the autocratic regimes are more open to the influence of narrower interests such as the financial sector. Autocracies would be less willing to reform the financial sector and open their markets to foreign competition. However, similar incentives also exist in democratic countries in which the governments can benefit from shielding their markets from foreign competition and having political benefits (Hutchcroft 1998). Thus, unlike the study of labor market conditionality in which the interest of the unions are mediated through electoral politics in democracies, similar effects do not exist in democratic borrowers in the case of the financial sector conditionality.

In summary, both the left and right governments benefit from a properly functioning financial sector in the long term. Despite the long-term benefits of structural reforms, these reforms also result in significant short-term costs to financial sector interests. The short-run costs of financial sector reform are borne by a numerically small but economically important and politically influential group. Left governments will use the political leverage of the IMF to implement reforms that impose short-run costs on large and dysfunctional financial sectors. Right governments, because they are more sensitive to political pressure from capital, will be less likely to implement reforms when they face opposition from a large financial sector. Due to lack of electoral effects, these expectations should be true irrespective of regime type.

Summary of the Theoretical Expectations

Due to their importance, the IMF targets these important sectors of the economy, especially when they seem dysfunctional. When the financial sector is strong, the IMF maximizes conditionality to

ensure the stability and transparency of the sector, enable access for the foreign institutions, especially the ones from the major stakeholders. Countries with large and dysfunctional capital markets are more likely to have financial sector reforms as a part of their loan package. However, whether the borrowing country government responds to the IMF pressures in the presence of strong organized interests is function of partisan interests. Left governments respond to low-income groups and trade unions, and the right governments protect the owners of the capital such as businesses as their respective constituencies. The short-run costs of financial sector reform are borne by a numerically small but economically important and politically influential group. Financial sector interests do not collectively organize and mobilize electoral groups. The financial sector resists to these reforms through their discretionary control over the economic interactions in the borrowing country and through the use and allocation of their funds (Calomiris and Mason 2003). This group exerts political pressure by lobbying governments not by mobilizing voters at election time. Left governments will use the political leverage of the IMF to accept and implement reforms that impose short-run costs on large and dysfunctional financial sectors. Right governments, because they are more sensitive to political pressure from capital, will be less likely to accept and implement reforms when they face opposition from a large financial sector.

Research Design

This study uses a new dataset extracted from the IMF's MONA database, which covers the IMF arrangements concluded with borrowing countries between 1992 and 2014 to test these expectations. There is a total of 473 IMF programs in the dataset, with more than 13,000 policy conditions for nearly 100 different countries across the globe. The focus of this analysis is on the programs with labor market policy reforms. The financial sector reforms include changes in the financial sector regulations/supervision and restructuring and privatization of the financial institutions.

As part of the arrangements, IMF reviews and records implementation of each condition in the MONA database. I first code the number of policy conditions in the financial sector. Then I code whether the borrowing country meets these conditions or not. If the condition is met (meaning that the actual reform is undertaken), it is coded as 1 and if it is not met (meaning that the reform is not undertaken), it is coded as 0. If the condition is not met or half-met, I consider it as not implemented and consider 0. The unit of analysis for this paper is program/year to capture the dynamic nature of IMF programs. Thus I calculate total number of policy conditions under review

for each year and then create a corresponding measure for the implementation record for each program/year as a percentage of total conditions implemented. This variable, which measures the percentage of financial sector conditions implemented in a program/year observation, is the dependent variable in this study. There is a total of 1495 program years between 1993 and 2012. 1134 of these program/years include at least one financial sector condition.

Empirical Approach

The quantitative analysis includes a global sample of all the borrowers since 1992. Secondly, the sample also includes both concessional and non-concessional programs. There is no significant difference in the case of the financial sector conditionality between concessional and non-concessional programs. The Fund aims to increase the stability of the financial sector through policies that reduce the vulnerabilities by building capacity for crisis contingency and investing in the soundness of the financial sector and that enable development of the market and the financial infrastructure. Although concessional programs rely less on bank restructuring due to relatively weaker financial sectors in the low income countries, the overall program goals are quite similar and negatively affect financial interests.

One of the main concerns for the empirical analysis of implementation is selection into IMF conditionality is not random. There are both theoretical and empirical reasons to expect that the factors that affect labor market conditionality might also affect its implementation. For instance, Caraway, Rickard et al. (2012) and Beazer and Woo (2015) argue that labor market and public sector conditionality are affected by certain domestic factors and strategic concerns. Thus, if political factors that condition the negotiations on the IMF loan agreements and lead to fewer conditions, we cannot distinguish whether the compliant behavior with these conditions is attributable to an independent set of factors or the factors that determine them in the first place. It is possible to correct for this selection bias by controlling for the observable determinants of nonrandom selection of the countries under the IMF programs through implicit assumptions regarding the drivers of the selection process. Are countries under the IMF programs that receive financial sector conditionality are systematically different than countries that do not receive these conditions? By accounting for the observable factors such as domestic political factors, economic conditions and geopolitical factors that are discussed in the literature review, one can account for selection mechanism. However, some of the factors that are critical in understanding conditionality and compliance are not readily observable. They might have a systematically significant effect on

determining the countries that receive labor market conditions and the rate of implementation. Previous studies have cited the willingness of the government or societal trust to the government as some unobservable political characteristics in the borrowing country (Vreeland 2003).

When we take into account the observables in the analysis, we predict the outcomes on the basis of the variation in these variables, which might be different than the actual observed outcomes (Vreeland, 2003). The difference between the two is the error term which actually accounts for the unexplained or the unobserved. If these error terms are randomly distributed across countries that receive social conditions and that do not, there should not a correlation between the error terms of the selection (conditionality) and outcome (implementation) equations. However, a correlation between the two would indicate non-random distribution of unobserved factors across the countries with and without labor market conditions attached to their IMF programs (Vreeland, 2003). This necessitates the use of selection-corrected estimates of implementation.

To correct for these problems, I first run Heckman selection models. The first stage of the model predicts selection into sample, receiving financial sector conditionality. The second stage predicts the implementation of financial sector conditionality. Since the first stage requires an instrument, I use the total number of IMF programs with financial sector conditions in the previous year as an instrument.[8] The logic behind this instrument is that it proxies the technocratic nature of the IMF in the program design stage in assigning labor conditionality to borrowers. Any political and economic factor that determines the design of IMF programs would also be likely to affect implementation as well. Thus, to satisfy exclusion restriction criteria, I choose this variable that is necessarily driven by the IMF's own technocratic considerations and assessments of the global economy rather than political/economic characteristics of the borrowing country. Since this variable is coded annually, it also accounts for shifts in the ideological orientations of the IMF. This instrument is driven by the IMF's technocratic considerations, which is independent of the domestic political processes that drive implementation. The IMF's effect on the design stage should be larger due to vulnerabilities of the borrowing country government and their expertise advantage vis a via the government. Thus, its technocratic judgement and assessment on assigning conditionality should apply to different countries under similar economic/political

[8] I also use percentage of program rather than total number of program both in the global and regional level. The results are robust to these specifications as well.

conditions, within the same year. However, the implementation process is driven more by domestic characteristics, which is (relatively) more independent of the IMF's technocratic preferences.

The error term that accounts for the unexplained or the unobserved is significant in the financial sector analysis. There is a significant and negative correlation between the error terms of the selection (conditionality) and outcome (implementation) equations. This means that distribution of unobserved factors across the countries with and without financial sector conditions attached to their IMF programs are not non-randomly distributed (Vreeland, 2003). This necessitates the use of selection-corrected estimates of implementation. Thus, I present the Heckman models for both design and implementation stages.

For some of the critical control variables, the data sources contain a high proportion of missing values. List-wise deletion techniques are the common approach to deal with missing data. This approach necessarily omits observations with missing values on any variable. Accordingly, nearly 2/3 of the observations are lost when list-wise deletion is employed. This technique is criticized to be inefficient and biased, creating higher standard errors, and wider confidence intervals, and leading to the loss of statistical power (Rubin 1996, Rubin 2004). I use multiple imputation techniques to address these problems. Multiple imputation technique replaces missing values with multiple sets of simulated values based on information contained in observed data (Rubin 2004). By utilizing all observed values, preserving their important characteristics and keeping incomplete observations within the sample, it addresses the limitations of list-wise deletion in real world settings. Thus, multiple imputation does not aim to 'predict missing values as close as possible to the true ones but to handle missing data in a way resulting in valid statistical inference' (Rubin 1996).

The unit of analysis is program/year. All the models are estimated using multiple imputation and Heckman selection models. I also include cubic polynomial time trends to account for the dynamic nature of IMF programs and lag all the independent variables, except the ideology variable, one year. Thus, the models presented show the likelihood of receiving IMF conditionality and implementation by borrowing country government at time t in response to the financial sector strength, the economic and political conditions at t-1.

Explanatory Variables

To proxy for the strength of the financial sector, I use a measure of "capital stocks", which comes from the Penn World Table (Feenstra, Inklaar et al. 2015). This variable captures the strength of capital owners in the borrowing country and proxies for the financial/business interests within a given economy. I use capital stocks variable as a percentage of the GDP, to account for the share and importance of the financial sector for the economy of the borrowing country. Higher values of the capital stock mean that financial interests contribute to a higher percentage of the economy and are stronger in the borrowing country. The capital stock variables ranges from 0.15 to 9.5, which means that the share of the capital stock in GDP has a maximum value of 0.15, very small contribution, and a maximum value of nearly 10 percent, significant portion of the economic activity. Its mean is 2.88 percent of the GDP.

Ideology variables come from various sources. For the countries in the Central and Eastern Europe, I rely on Frye (2010) that classifies executives in these countries as belonging to left, center or right according to their economic policy orientations. For the Latin American countries, I rely on Coppedge (1995) and Pop-Eleches (2009) to identify government/executive ideology along the same lines. For the remaining countries in the dataset, I rely on World Bank Database on Political Institution's (WDI) 'executive partisanship' variable. I then create a dummy variable, which takes the value of 1 for the left-wing governments and 0 for the others. Since I rely on conditional hypothesis regarding the interaction between the interest groups and partisanship, I also create interaction terms equal to the product of the right-wing dummy and capital stocks variable. All models that include the interaction term also include both constitutive terms.

To reduce the worries of omitted variables bias, I control for number of variables that are likely confounders. The design and implementation of the IMF programs are determined in response to the borrowing country's financial problems, domestic characteristic and geopolitical factors. The higher number of veto players make it less likely to implement policies (Tsebelis 2002). Thus, I control for the political constraints index (Henisz 2004). This measure estimates the feasibility of policy change by taking into account veto players and the heterogeneity within the legislative branch among different parties and within different branches of government (Henisz 2004). The higher values of this index indicate higher political constraints, and thus higher policy predictability. I expect countries with higher political constraints to have more conditions included in the programs since the government would use the IMF conditionality to overcome domestic

oppositions such as the veto points. However, the higher the political constraints, the more difficult it should be to implement financial sector reforms.

The research on the conditionality suggests that the US favors its strategic allies (Stone 2008). Dreher and Jensen (2007) argue that temporary membership to the UNSC better proxies the donor influences on the IMF decisions than other measures such as bilateral aid from the United States and United Nations General Assembly voting similarities. The UNSC temporary membership information comes from Dreher and Jensen (2007) and indicates whether the borrowing country has been a temporary member of the UNSC when signing or implementing the IMF program. Since this dataset only covers members until 2012, I code the missing variables from the UNSC website. We expect the UNSC temporary members to have a lower likelihood of receiving financial sector conditions and implementing these reforms since they are less likely to be punished by the IMF for non-compliance. I define democracies by relying on the Polity2 scores. The countries with scores of 6 and higher are defined as democracies. As summarized in the theory section, the expectation regarding the effect of democracies is ambiguous.

I also control for some standard correlates of financial liberalization and financial sector reforms such as the bank non-performing loans to gross loans (%). Conditionality in the financial sector will be more important when there are larger problems, with higher non-performing loans. I also control for capital account openness which comes from Chinn and Ito (2006). To account for some structural features of the financial sector, I control for Bank concentration (%), percentage of foreign bank assets among total bank assets (%) and credit to government and state-owned enterprises to GDP (%). The Bank concentration variable measures the ratio of the assets of the country's three largest banks to total banking assets. Especially in the developing countries, a small group of lenders might control the market and profit from their dominant access (Pepinsky 2013). Highly concentrated banking sector would lead the IMF to open the market to competition and increase the likelihood of financial conditionality. However, these actors, by using their market power, would also try to maintain their dominance and attempt to block the implementation of reforms. Moreover, when the government controls the financial institutions, they allocate credit to themselves and connected firms. I control for the amount of credit to government and state enterprises to measure the extent of the government control over the financial sector. The government might not be willing to give up their control over financial authority and thus the implementation should go down. Lastly, I control for the influence of foreign banks in the domestic

market. Foreign financial institutions seek policies that provide cheaper access to capital and better regulatory environment. Thus if they control the domestic market, they would seek financial conditionality and its implementation. These variables come from the Global Financial Development Data (GFDD) (Čihák, Demirgüç-Kunt et al. 2012).

I use a number of commonly consulted economic controls such as GDP Growth, GDP Per Capita, Inflation, Trade as a percentage of GDP, and the Total Debt Service as a percentage of Exports to control for the macroeconomic environment in the borrowing country. These economic controls come from the World Bank's World Development Indicators. The GDP Growth and the GDP Per Capita measures proxy the country's level of economic development. Wealthier countries may find it easier to resist pressures for financial protectionism due to more diversified economic bases. Moreover, in terms of institutional structure, several scholars highlight the capacity of the borrowing country governments to implement reforms. The richer economies and the countries with better bureaucracies are found to have better program implementation records (Pop-Eleches, 2008b). Thus, I also control for bureaucratic capacity, which comes from the International Country Risk Guide (ICRG) Dataset. This variable proxy the institutional strength and quality of the bureaucracy. Higher points in this variable means that the bureaucracy is strong and has expertise to govern without drastic changes in policy or interruptions in government services and autonomous from political pressure. I expect a better bureaucratic apparatus to negotiate harder, which leads to fewer conditions and then make it easier for government to implement complex rules and regulations.

Other macroeconomic indicators (inflation, debt and exports) relate to the overall economic conditions in the borrowing country. The negative economic conditions increase the need for IMF loans, which in turn increases the implementation. Lastly, I control for the size of the IMF Loan by including the total access variable, which is coded from the IMF official website with respect to each program. Total access to the IMF Funds is the amount of Fund loans as a ratio of the country's quota. The ratio increases with larger loans. As total access increases, it is easier for the the borrowing country government to compensate for the loss to the domestic interests, thus the implementation increases (Mukherjee and Singer 2010). The choice of control variables for the financial sector models is guided by the analysis of Mody and Abiad (2003). I provide the summary statistics for all the independent variables included in the analysis in the appendix.

Results and Discussion

I present the results from the Heckman selection models. I briefly focus on the selection equation (the design of conditionality) and then on the outcome equation, the implementation of financial sector reforms. This is necessary to account for selection and effect of unobservables. Table 1, models 1-2, reports the unconditional effect of capital stocks. Model 3 reports the interactive effects capital stocks and right wing government. Finally, models 4 and 5 report the full models without and with interaction effects. The results provide strong support to the idea that the countries with stronger financial sectors are more likely to receive financial sector conditionality.

Table 1. Financial Sector Conditionality Models (Heckman Model Selection Equation)

	1)	2)	3)	4)	5)
Capital Stocks	0.099***	0.091***	0.083***	0.043*	0.012
	-0.025	-0.026	-0.03	-0.032	-0.037
Left Government		0.181**	-0.042	0.208**	-0.246
		-0.081	-0.203	-0.096	-0.223
CapitalStocks*Left			0.076		0.161**
			-0.062		-0.069
Democracy				-0.049	-0.051
				-0.096	-0.103
Political Constraints				0.165	0.128
				-0.233	-0.241
Bureaucracy				0.06	0.071
				-0.07	-0.078
GDP Growth				0.012	0.012
				-0.007	-0.008
GDP Per Capita				0.000	0.000
				0.000	0.000
Inflation				0.002***	0.002***
				0.000	0.000
Capital Account				0.065**	0.064**
				-0.032	-0.032
Trade % of GDP				0.002*	0.003*
				-0.001	-0.001
Debt				-0.002	-0.005
				-0.008	-0.008
UNSC				-0.207	-0.184

				-0.177	-0.177
Non-Performing Loans				0.011*	0.010*
				-0.005	-0.006
Bank Concentration				-0.006**	-0.006**
				-0.002	-0.002
% of Foreign Banks				-0.002**	-0.002**
				-0.001	-0.001
Credit to State Insti.				0.010**	0.008
				-0.006	-0.006
Total Access				0.000***	0.000***
				0.000	0.000
Instrument	3.370***	3.334***	3.610***	2.120**	2.307**
	-0.414	-0.415	-0.431	-0.849	-0.877
period	-0.004	-0.001	-0.043	-0.069	-0.106
	-0.49	-0.491	-0.506	-0.514	-0.531
period 2	-0.023	-0.025	-0.022	0.017	0.021
	-0.194	-0.193	-0.198	-0.202	-0.207
period 3	-0.003	-0.002	-0.001	-0.008	-0.008
	-0.023	-0.023	-0.023	-0.024	-0.024
Constant	-1.834	-1.836	-1.96	-0.721	-0.731
	-0.47	-0.47	-0.487	-0.865	-0.898
# of Observations	1495	1495	1495	1495	1495

Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

In all the models, the capital stocks variable is positive and significant (except the full model with interactions, Model 5, unconditionally and conditionally with the inclusion of control variables. When the share of the financial/business interests in the GDP increases, it is more likely that the program will include financial sector conditionality. Figure 3 provides the marginal effect of capital stocks on the likelihood of receiving financial sector conditionality. When the share of the capital stocks in GDP rises from a minimum of 1 to a maximum of 9 percent, the predicted probability of receiving financial sector conditionality increases by 25 percent.

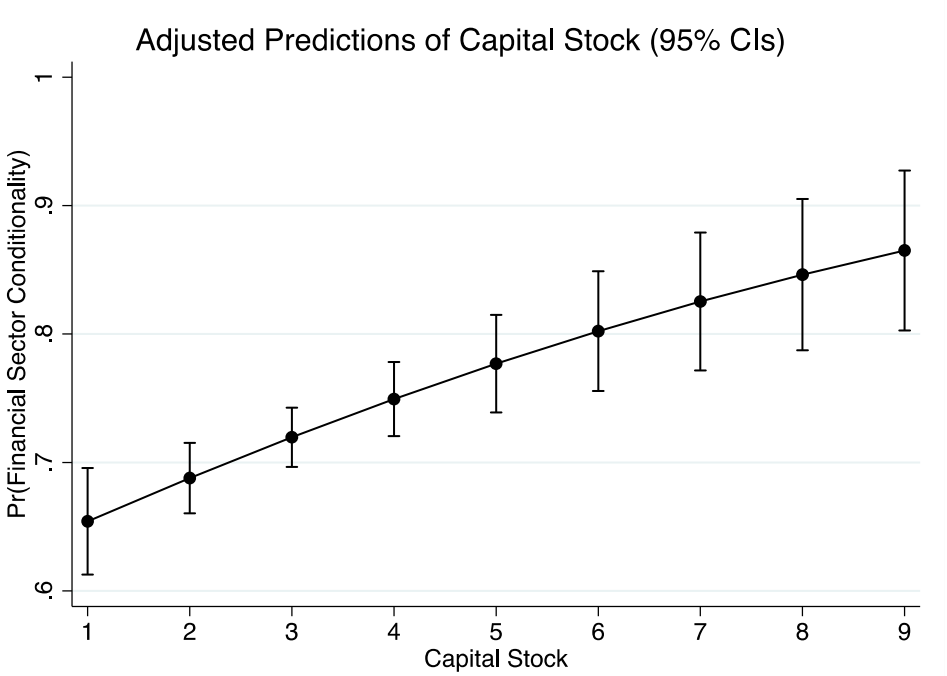

Figure 3. Marginal Effects of Capital Stocks on Financial Sector Conditionality

It is also interesting to note that the coefficient of the left wing dummy is also positive and significant (Models 2-4). This also supports the partisan expectations. The programs that are signed by the left wing governments are more likely to have financial sector conditions. Moreover, as it is seen in Model 5, this is especially true when strong financial interests and left wing governments are both present. Figure 4 shows the effect of ideology in response to increasing financial sector importance for the economy. Both left wing and right wing governments are more likely to receive financial sector conditionality when we move from an economy where the financial sector has minimal importance to where they have maximum importance. However, the left wing governments on average more likely than the right wing governments to receive the financial sector reforms and this difference increases when the financial sector gets stronger. This supports the idea that the left wing governments might use the IMF conditionality to weaken financial sector interests.

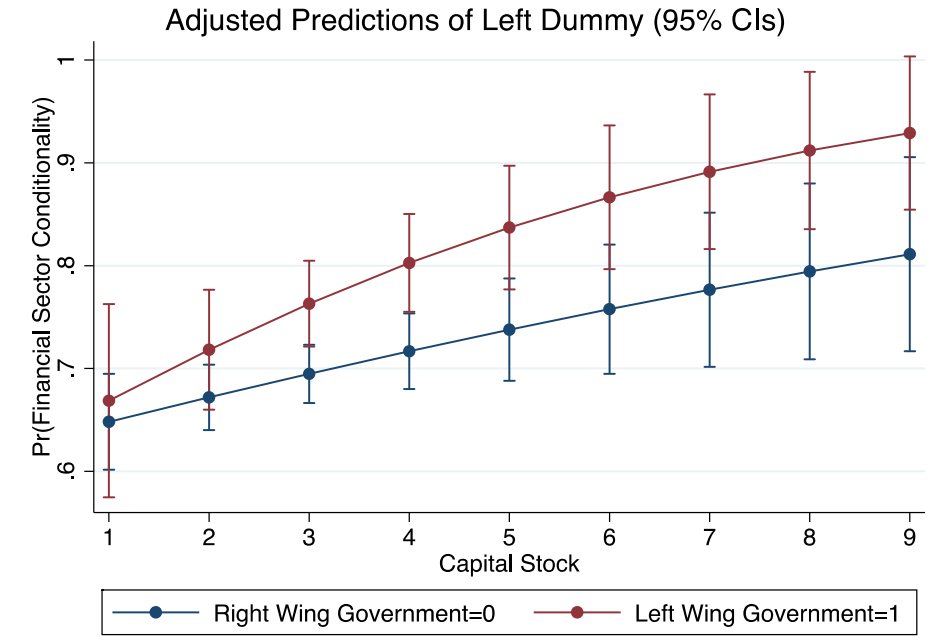

Figure 4. Marginal Effect of Ideology on Financial Sector Conditionality

Models 4 and 5 also show that the financial sector conditionality is designed in response to underlying economic and structural conditions in the borrowing country. The likelihood of receiving financial sector conditions increase with higher inflation and more open economies (trade as a percentage of GDP and capital account openness). The IMF also responds to structural features of the financial sector since credit to state enterprises and higher non-performing loans are significantly associated with higher financial sector conditionality. However, when major banks control the market, the likelihood of receiving conditionality significantly goes down. As expected, larger IMF programs in terms of the size of the loans include more financial sector conditions. Lastly, political factor does not seem to matter in the design of conditionality since democracy, bureaucratic quality and political controls do not have a significant effect. Although the UNSC temporary membership has a negative effect as expected, it is not significant. In summary, the design of IMF conditionality is driven by the strength of the financial interests and partisan preferences and the underlying economic conditions in the borrowing country.

Why might be the case? Despite the importance of the financial sector and their control over the economy, why do these programs with strong financial sector interests receive more conditionality? When the financial sector is strong, the IMF maximizes conditionality to ensure the stability and transparency of the sector, enable access for the foreign institutions, especially

the ones from the major stakeholders. Moreover, restoring stability to the financial sector is crucial and requires rapid action during the design stage by the IMF (Calomiris and Mason 2003). Thus, the economic importance of the financial sector makes them an obvious target for reform by IMF. The IMF has long been one of the main drivers of financial sector liberalization.

Implementation of Financial Sector Conditionality

I focus on the second stage of the Heckman model, the determinants of the implementation of the financial sector conditionality. Firstly, the disturbances are significantly and negatively correlated between the selection and outcome equations. Unobservable characteristics increase the likelihood of receiving financial sector conditionality and decrease the likelihood that these reforms will be implemented.

Table 2. Financial Sector Implementation Models (Heckman Model Outcome Equation)

	1)	**2)**	**3)**	**4)**	**5)**
Capital Stock	-0.033***	-0.031***	-0.023*	-0.016*	-0.013
	-0.016	-0.017	-0.012	-0.009	-0.009
Left Government		-0.049	0.022	-0.029	0.027
		-0.038	-0.075	-0.027	-0.057
CapitalStock*Left			-0.019		-0.014
			-0.021		-0.016
Democracy				-0.036	-0.011
				-0.028	-0.029
Political Constraints				0.148**	0.147**
				-0.069	-0.07
Bureucratic Quality				-0.039**	-0.033*
				-0.018	-0.019
GDP Growth				0.000	0.000
				-0.002	-0.002
GDP Per Capita				0.000*	0.000
				0.000	0.000
Inflation				0.000	0.000
				0.000	0.000
Capital Account				0.003	0.005
				-0.009	-0.008
Trade % of GDP				0.001***	0.001***

				0.000	0.000
Debt				-0.002	-0.001
				-0.001	-0.001
UNSC				0.093*	0.090*
				-0.052	-0.052
Non-Performing Loans				0.000	0.000
				-0.001	-0.001
Bank Concentration				0.000	0.000
				0.000	0.000
% of Foreign Banks				0.000***	0.000***
				0.000	0.000
Credit to State Insti.				0.001	0.001
				-0.001	-0.001
Total Access				0.000	0.000
				0.000	0.000
period	-0.046	-0.047	-0.077	-0.06	-0.105
	-0.24	-0.243	-0.224	-0.169	-0.172
period 2	0.003	0.003	0.014	0.006	0.021
	-0.097	-0.098	-0.09	-0.069	-0.07
period 3	0.001	0.001	0.000	0.000	-0.001
	-0.011	-0.012	-0.011	-0.008	-0.008
Constant	0.761	0.771	0.743	0.491	0.493
	-0.182	-0.186	-0.17	-0.141	-0.146
Mills	-0.589***	-0.595***	-0.530***	-0.112*	-0.093
	-0.117	-0.119	-0.101	-0.08	-0.074
# of Observations	1134	1134	1134	1134	1134

Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

The results provide strong support to the idea that, once the agreement is signed, the financial sector pressures their governments to not to implement conditionality. Table 2, Model 1 reports the unconditional effect of capital stocks on the implementation of financial sector conditionality. This effect is consistently shown in models 2, 3 and 4 as well. As the financial interests get stronger, the implementation of financial sector conditionality goes down. When we move from an economy where financial/business sector does not contribute significantly to the

economy (capital stocks is 1) to an economy where they contribute significantly (capital stocks I 10), the implementation of financial sector conditionality goes down nearly by 27 percent (model 1), 22 percent (model 3) and 15 percent (model 4) respectively. Figure 12 provides the effect of the capital stocks in the implementation of financial sector reforms (based on model 4). The average implementation rate for the financial sector conditionality is around 40 percent. As shown in the figure, the implementation goes down by nearly 15 percent when we compare an economy with no financial sector to an economy with a significant financial sector. This is a substantively significant effect.

It is also interesting to note that, the effect of the financial sector does not depend on the ideology of the government since neither the unconditional effects of the left wing dummy nor the interactive effects are significant. Unlike the labor market reforms, the effect of the financial interests is mediated neither by the partisan politics nor by the democratic institutions such as electoral process during the implementation process.[9] In summary, countries with large financial sectors are more likely to have financial sector reforms than countries that do not have large financial sectors due to incentives to correct structural problems in the economy. However, when the financial sector is large, their economic importance and influence over the economy also increases. Thus, the implementation of financial sector conditionality is more difficult in countries with large financial sectors.

[9] I run similar models to labor market models by splitting the sample for democracies and non-democracies and during and outside the election years. However, the capital stocks variable is not significant in these models. Moreover, I also run fixed and random effect models. The main results are robust to these specifications as well.

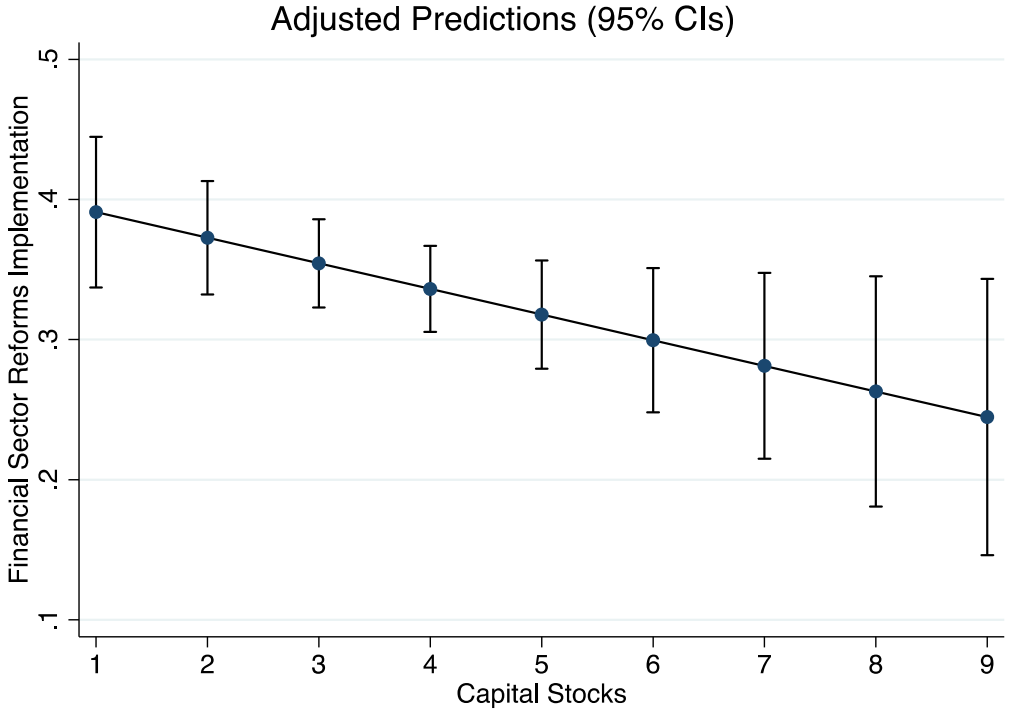

Figure 5. Marginal Effect of Capital Stocks on Financial Sector Implementation

In terms of the controls, some of the economic controls have the expected signs. The countries that have more open economies are more likely to implement financial sector conditionality. This is probably because they want to send more positive signals to the international markets. However, neither the macroeconomic conditions and nor the level of economic development have a significant effect on the implementation of the financial sector conditionality. As expected, the number of foreign banks operating in the borrowing country increases implementation since these actors would benefit from a more stable and sound financial system. They would also benefit from the reforms associated with the financial sector conditionality such as increasing openness. Interestingly, other structural characteristics such as the concentration in the financial sector and state's control over the industry do not have a significant effect. Similarly, larger IMF loans are not significantly associated with better implementation of conditionality. Lastly, the geopolitics play an unexpected role. The temporary members of the UNSC are significantly more likely to implement the financial sector reforms by nearly 1 percent. Although unexpected, this is not a substantially significant effect.

The political controls, that do not have a significant effect during the design stage, are important drivers of the implementation. Countries with higher political constraints are more likely to implement the IMF reforms. This supports the idea that the government might use the IMF conditionality to implement reforms that might be otherwise costly. Unexpectedly, better bureaucracies are associated with lower implementation rates. When bureaucracy is strong, it has professional expertise to govern and independent of the political pressure, the implementation of the financial reforms goes down.

To sum up, we can conclude that the implementation of financial sector conditionality is driven the preferences of strong organized interests and some structural features in the financial sector. Overall, the findings point to the incentives of the financial interests in the implementation stage rather than underlying political conditions such as ideology of the government and democratic institutions. Moreover, some international factors such as the openness of the economy and the presence of foreign banks have significant effect on implementation.

Conclusion

One of the main arguments in this paper is that implementation should be analyzed at a disaggregated level by analyzing specific policy areas in which different organized interests have distinct effects. This paper shows the effect of strong financial interests on the design and implementation of financial sector conditionality. IMF borrowers with stronger financial sectors are more likely to receive financial sector conditionality. IMF maximizes conditionality to ensure the stability and transparency of the sector, enable access for the foreign institutions, especially the ones from the major stakeholders. Moreover, left wing governments on average more likely than the right wing governments to receive the financial sector reforms, especially when financial sector is stronger. Left wing governments use the IMF conditionality to weaken financial sector interests in the design stage. Due to lack of broader electoral appeal and organizing capacity, the effect of the financial interests is not necessarily mediated by the partisan politics and electoral concerns during the implementation stage. Their effect operates through their importance and control over the economy irrespective of regime type and government ideology. As the financial interests get stronger, the implementation of financial sector conditionality goes down.

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