International Journal of Advanced Social Studies
ISSN: 3006-1776 (Print), 3006-1784 (Online)

Research Article

Impact of IMF Policies on Economic Growth of Developing Countries

Article History
Received: January 26, 2025
Revised: April 13, 2025
Accepted: April 27, 2025
Published: April 30, 2025

*Corresponding Email:
kinzaiqbal269@gmail.com

https://doi.org/10.70843/ijass.2025.05106

Khalid Mahmood Mughal, Kinza Iqbal *
Department of Economics, Preston University Kohat, Islamabad Campus, Pakistan

Abstract

IMF was created in the light of the Bretton Woods agreement in nineteen hundred and forty-six. The initial mandate of the fund was to manage international trading through the correction of the balance of payment problems of member countries. Later on, the fund diversified its mandate and included economic growth also as one of its targets. Recently the fund has been actively engaged in developing countries through its programmes of structural enhancement and enhanced structural adjustment programmes. It was realized that funds policies had failed most of developing countries. In order to highlight this issue, we have used data from nine developing economies and checked the effect of IMF policies on the growth of their economies. OLS results showed that trade openness, interest rate, and education affected positively the growth of these economies during this time period. The study suggested more free trade among economies for having high economic growth. IMF should avoid making rigid tax policies for recipient countries Finally, funds' allocation and proper utilization should be ensured among these countries.

Keywords: IMF, Economic growth, Trade openness, Interest rate, Developing countries.

Introduction

IMF was formed in 1946 concluding Bretton Woods's agreement. At that time the world had witnessed major economic upheaval in the form of World War two. The economic systems of nations were in shambles and a need was felt to create an economic institution that could help the faltering economies. IMF had initially the task of streamlining the international financial system by correcting the balance of payment problems through exchange rates (Joyce, 2009). Later on IMF passed through stage by stage different phases of its evolution gaining authority over the international arena and reaching its current status. It is a huge capital lending facility with the leverage to interfere with the domestic financial and economic policies of a country. Through implementing its agenda (Joyce, 2009). IMF now performs several functions as its role including BOP, exchange rate, inflation, fiscal policy, trade, and growth as its targeted indicators. It advances loans to target countries and imposes conditionality on its economic system. These are termed as structural adjustment programmes. These programmes are meant to alleviate the suffering of the country through mechanisms as stated above, however, the record has shown that IMF programmes mostly have adverse effects on the economy of a country instead of alleviating country problems (Bradlow, 2008). Most developing countries have implemented IMF programmes but have aggravated their own economic problems in the process. With macroeconomic indicators responding negatively. On the other hand, countries that seek loans from the IMF are caught in a debt trap and are mired more and more into a situation where they have to seek more loans in order to pay the principal amount Easterly (2001).

IMF debt scheduling mechanism has its own flaws including donor country's influence on IMF programmes and inherent bureaucratic discrepancies. The study signifies what effect IMF policies have on developing countries do they bear a positive influence on a country's economy or otherwise. Most developing countries are now IMF beneficiaries and are deeply involved with IMF loan programmes. The outcome of their economic policies is dependent on IMF structural adjustment programmes. It shapes the economic outcomes of these countries. To study the aspect of IMF involvement and its influence on developing countries we would assume that a country has sought a structural adjustment loan and in which way this programmes affects the country's economy. Whether the country was better off with the programme or without it?

The study encompasses major macroeconomic indicators and the outcome of their analysis is interrelated. For example, if we regress trade, taxes, interest rate, and education with GDP of countries during an IMF-related programme and without it we should be able to get a fair picture of what performance the economies have shown during that period. The study signifies the relationship between different macroeconomic variables to prove whether economies are better with or without IMF programme.

Limitations of the study

IMF programmes do affect microeconomic variables significantly however for the purpose of endogeniety and exogenous problems we sidestep this effect and concentrate on macro variables to analyze the overall effect of IMF policies in developing countries.

Hypotheses of the Study

The major hypothesis is given as follows

1. H 1: There is a positive relationship between trade openness and economic growth.
2. H2: The higher the interest rate, the lower the economic growth.
3. H3: Education and economic growth seem positively associated.
4. H4: Tax revenues and economic growth are positively related.

Literature Review

Edwards (1989) focused on IMF programmes since 1982. The author found that IMF programmes appeared to be going astray and not achieving their goal of poverty alleviation, correcting balance of payment problem. The funds hardly allowed a technical policy course rather it had a vague and falsified approach toward its lending mechanism. The funds lending was based on the polak model which is now not practical. Ul Haque (1998) found that IMF programmes as argued balanced the economy and had moderate effects on the debtor country. Several approaches to study the effect of programme were used namely. It was found that a country could be best judged if it was evaluated on the basis of programmes policies with and without. It was also valuable to gather data from grouped countries than otherwise. Easterly (2001) had the opinion that the benefits accrued to the poor from IMF adjustment loans were more prone to growth reduction and effect on poverty. The effect on lateral adjustment was more pronounced than structural adjustment programmes without lateral adjustment. This was due to the reason that adjustment in structural adjustment programmes acted countercyclically and put most of the poor in an unadvantage situation. It was the smoothing function of poverty in adjustment programmes that effects growth and thus affected macroeconomic indicators indirectly. Fiscal measures resulted in disturbed output such as the effect on subsidies.

Babu (2001) stated that IMF fund had progressed stage by stage to a more power-wielding authoritative international financial institution, its guidelines for disbursement of loan although clear yet lack foresight and clearly destabilize an already eroding economy. It interfered in the government functions of debtor countries and its aid was a facilitator to creditor countries. Removal of trade barriers, privatization of state institutions, banking system deregulation, and subsidy abolishment adversely affected the growth of the debtor country. Evrensel (2005) also emphasized on IMF programmes in Indonesia. It was found that due to the high liquidity in Indonesian markets after the announcement of IMF programme excessive risks were taken in above markets which resulted in negative fallout.

Usman (2008) propounds that the effect on trade openness, financial stability, tax generation, export versus GDP, exchange rate and current account balance, and the compliance of Pakistan with IMF was realized through regression. The findings were that once the government complied with IMF programme and conditionalities aid was increased. Once IMF programmes are being structurally adjusted macroeconomic factors vis a vis IMF policies are probed for adjustment and aid is discontinued if these conditions are not met. It is concluded that aid increases with micro-economic stability. Drehrer (2004)) finds the moral hazard in IMF policies. In Pakistan's case in 1999 enhanced structural adjustment programme was in place, as a corollary spread on bonds was reduced. As the chances for bail-out were exhausted funds resources in Pakistan were devalued which decreased moral hazard. Similarly in case of Russia fund's response to the crisis was negative and also reduced moral hazard. It was noticed that moral hazard was positive in the short term with funds loan and negative in the long term. It was a significant risk that induced excessive risk in any country's financial and equity markets. Drehrer (2005) focused on economic growth in IMF debtor countries. It was noted that due to endogeniety problem, IMF programmes showed negative growth. IMF had been tasked to stabilize the economic conditions of debtor countries but instead, it weakened debtor country's economies, fully sixty percent of IMF debtor countries did not finish their IMF-related programmes. A strong economy may exude debtor countries to take their programme to the finish. Political stability, strong bureaucracies, and political weakness affected programme. IMF conditionalities were main course of discourse and resulted in interruption and noncompliance. To stay in the programme government bad economic policies further deteriorated their economic condition.

Joyce (2009) has the view that IMF was structured to restore the external balance of payment problem but in the nineteen eighties due to IMF concentration on third world countries and developing economies growth also became one of its objectives. IMF programmes offered structural adjustment programmes for low-income concessionary programmes and nonconcessionary programmes were initiated. It was pointed out that IMF forced a country to follow structural adjustment programmes through fiscal measures which had adverse negative consequences for the debtor country. Yanikkaya (2003) used panel data from developing countries to find out the effect of trade liberalization on economic growth. The results showed that trade barriers led to enhanced growth of the developing economies. The study results were according to the growth theories. Bibi et al. (2014) emphasized the role of trade openness, inflation, imports, exports, real exchange rate, and foreign direct investment in enhancing economic growth in Pakistan. The authors used data from 1980 to 2011. Co-integration results showed an association of variables. However, the study suggested that the negative impact of trade openness could be overcome by producing import substitutes and creating conditions for trade surplus. Finally, foreign direct investment and trade were very important for the economic growth.

Sofilda et al. (2016) also used a panel model from 2004 to 2013. They used regression techniques for the analysis. Trade openness led to decreased investment and growth. However, global competitiveness enhanced economic growth in the economy. Finally, taxes, inflation, and investment also increased economic growth. By using data from 2015 to 2000, Oo et al. (2019), used an Autoregressive Distributed Lag (ARDL) panel method. It was found that the export performance of ASEAN countries had an important relationship with determinants of export performance, like exchange rate, inflation, gross domestic product, and foreign direct investment. These factors affected positively the growth. Vieira and da Silva (2021) used ARDL model to check the determinants of economic growth. They used data from 2000 to 2017. The results showed that in the short term, the error correction model showed that unlike Brazil the BRICS countries had a very low error adjustment, which meant that the long-term equilibrium link of factors in Brazil returned to a steady state faster than all other countries.

Mallick (2024) examined how aggregate government expenditure and its two broader components like revenue expenditure and capital expenditure affected the growth rate of output in India. By using SVAR technique, it was found that aggregate expenditure and capital expenditure hardly affected growth. However, taxes, openness measures, and private investment affected the growth of India. Nazari and Imanian (2023) used a panel data from 1997 to 2014, to check how did government budget deficit affect the economic growth of 12 OPEC member countries. They used ARDL model for the analysis. Results showed that both government budget and tax revenue affected growth negatively. But, savings and exports boosted economic growth. Hidayat et al. (2024) focused on how did exchange rate, inflation, foreign direct investment, government expenditure, and economic openness affected export and import growth by using data from 1980 to 2021. The results showed that foreign direct investment and government spending increased the rate of exports and imports. Moreover, foreign direct investment, government spending, and economic openness contributed positively to economic growth. Faouzi (2024) investigated how export competitiveness, exchange rates, inflation, and government budget affected the economic growth of BRICS+ countries by using data from 2011 to 2021. ARDL result indicated that exchange rates and exports increased economic growth both in the short and long term. However, inflation has decreased growth. Finally, government budget also increased economic growth.

Methodology

By using data from 2012 to 2022 to find out the influences of IMF policies on the economic growth of developing countries Dependent variables were used GDP per capita. Trade openness, interest rate, tax rate, and education were used as independent variables. We have used data from countries such as Bangladesh, India, Indonesia, Iran, Jordan, Malaysia, Pakistan, Philippines and China. All data have been collected from WDI. We have used the dependent variable as GDP per capita. The Data have been sourced through the Pakistan Bureau of Statistics, the economic survey of Pakistan, the State Bank of Pakistan, internet statistical sites, and World Bank data.

Model Specifications

$$LGDPC = \beta 0 + \beta 1\ TRADOit + \beta\ 2RINRTit + \beta\ 3\ TAXRit + \beta\ 4\ SSEROit + uit \tag{1}$$

The econometric model is presented here

The equation is:

LGDPPC= Log Economic growth (GDP per capita)

TRADO= Exports of goods and services (% of GDP) and Imports of goods and services (% of GDP)

INRT= Real interest rate

SSENRL= Secondary school enrolment (% gross)

it = (time trend)

uit= (error term)

Results and Discussion

Table 1. Summary statistics of the factors influencing GDP.

Variables	Observations	Mean	Standard deviation	Minimum	Maximum
GDPC	198	3330.291	2138.249	641.2889	11555.93
TRADO	198	65.08653	34.86085	25.30623	144.8809
RINRT	198	3.313879	4.427829	-18.84519	13.98545
TAXR	198	11.63731	3.833422	4.994378	24.68985
SSERO	198	72.83998	21.0767	19.91184	126.036

As shown in Table 1, it is found that on average, GDPPC is 3330.291 percent. However, range of real interest rate has been noted from -18.84519 to 13.98545 percent in developing countries. On average, TRADO across selected developing countries is 65.08583 percent from 2001 - 2022. Likewise, variations have been noted in TAXR from 4.994378 to 24.68985 percent along with variables. On average, SSERO is 72.83998 percent in developing countries. Overall result showed the stability in the data.

Empirical Estimates

Table 2 points out the OLS regression technique.

Table 2. OLS Regression results and dependent variable is GDP per capita.

Variables	Coefficients, Standard Errors and t-values
TRADO	0.0025 *
	0.0009
	(2.82)
RINRT	-0.0177*
	0.0039
	(-4.53)
TAXR	0.0021*
	0.0077
	(0.28)
SSERO	0.0077 *
	0.0010
	(7.92)
C	0.1125
	0.0382
	(3.50)
f-Statistics	73.75
Probability	0.0000
R2-Squared	0.74
Adjusted R-Squared	0.73

Table 2 reveals the results of the analysis. Trade openness can be seen as affecting positively the economic growth of developing countries during IMF structural adjustment programmes. The findings showed that one percent increased trade openness resulted in increased economic growth by 0.0025 percent in developing countries. The reason may be that trade openness provides chances for more investment, production, and growth. The finding is favored by Oo et al. (2019).

Real interest rate also affected the economic growth of developing countries during IM structural adjustment programme. The study results indicated that one unit increased interest rate caused for less growth in developing countries. Tax rate also affected the growth path of developing economies. The impact of more tax revenue on economic growth seemed positive but insignificant. Increased collected revenue was less used for more investments and consumption purposes by the government. Corruption can also be the reason for this. Our result is in inconsistent witth Nazari and Imanian (2023). Results pointed out that education would cause high growth in developing economies. Highly educated human capital is an asset of the countries. Education enhances the growth of countries. It increases invetments, job chances and production of countries.

Conclusions

We have tried to check the impact of IMF policies on the economic growth of developing economies. The OLS regression results indicated that high interest rates, and trade openness, affected positively the growth of developing countries. The role of education cannot be ignored. It also seems to be affecting growth positively. So we can say that regarding the overall significance of trade on GDP in developing countries, IMF programmes have not shown a positive correlation throughout the tenure of the programme. IMF policies affected countries in their growth. We therefore conclude that economic growth does not happen as an effective measure as a result of IMF policies in developing countries. The study reinforces the trend that IMF structural enhancement and enhanced structural enhancement programmes have not brought out the desired results in developing economies. On the basis of the study results, it is found that there should be more free trade among economies. This will enhance the economic growth of nations. Rigid rigid tax policies should not be made for recipient countries. Incidence taxes and even flows on returns should be channelized in line with loan requirements of recipient countries, justice in countries' taxation systems should be emphasized, year on year-on-year calculation at the federal level should be sought not to enhance tax load but to work out a manageable to amalgamate tax base for higher returns and better efficiency. Funds should support educational and development of the taxation system in the recipient country through building the infrastructure of the federal taxation system and revenue collection and generating mechanism, institution of tax-related structuring rules regulations and implementation should be made for the government of the recipient country.

References

Babu, R. (2001). IMF Conditionality: A Perspective. Cochin University Law Review, Silver Jubilee Issue, 25, 296.

Bibi, S., Ahmad, S. T., & Rashid, H. (2014). Impact of trade openness, FDI, exchange rate and inflation on economic growth: A case study of Pakistan. International Journal of Accounting and Financial Reporting, 4(2), 236.

Bradlow, D. (2008). Developing Countries Debt Crises, International Financial Institutions, and International Law: Some Preliminary Thoughts. German YB Int'l L., 51, 111.

Dreher, A. (2004). Does the IMF cause Moral Hazard? A critical review of the Evidence. A Critical Review of the Evience. https://core.ac.uk/download/pdf/9311371.pdf.

Drehrer A.(2005)IMF and economic growth. The effects of programmes, loans and compliance with conditionality. Department of management, technology and economics, Swiss Federal Institute Of Technology, Zurich.http://papers.ssrn.com/paper.id =558401

Easterly, W. (2001). The effect of International Monetary Fund and World Bank programs on poverty (Vol. 2517). World Bank Publications.

Edwards, Se. (1989b). The IMF and the Developing Countries: A Critical Evaluation', Carnegie—Rochester Conference Series on Public Policy No. 31. Washington, DC: North-Holland.

Evrensel, A. Y. (2005). IMF programmes in emerging countries. Comparative Economic Studies, 47, 4-22.

Faouzi, T. C. (2024). Competitiveness and its beyond: examining the impact of exports, exchange rates, Inflation, and Government Budget on Economic Growth. Journal of Contemporary Business and Economic Studies, 7, 02.

Hidayat, A. M., Purwanda, E., Hadijah, H. S., & Sodik, G. (2024). Impact of exchange rates, Inflation, foreign direct investment, government spending, and economic openness on exports, imports, and economic growth in Indonesia. Journal of Infrastructure, Policy and Development, 8(6), 3270-3270.

Joyce, J. P. (2009). A true test: do IMF programs hurt the poor?. Applied Eonomics, 41(3), 295-306.

Mallick, H. (2024). Does onslaught of globalization induce pro-efficient government expenditures in a large transitioning economy? Empirical evidence from India. Economic Change and Restructuring, 57(2), 89.

Nazari, M., Asadi, E., & Imanian, M. (2023). Uncertainty, budget deficit and economic growth in OPEC member countries. Energy Sources, Part A: Recovery, Utilization, and Environmental Effects, 45(2), 3519-3529.

Oo, T., Kueh, J., & Hla, D. T. (2019). Determinants of export performance in ASEAN region: panel data analysis. International Business Research, 12(8), 1-14.

Sofilda, E., Hariyanti, D., & Ismawaty, T. (2016). The Effect of global competitiveness and trade openness through the investment, tax, and inflation towards economic growth. OIDA International Journal of Sustainable Development, 9(02), 71-88.

Ul Haque, N., & Khan, M. S. (1998). Do IMF-supported programs work? A survey of the cross-country empirical evidence.

Vieira, F., & da Silva, C. (2021). What drives export performance in the BRICS countries? An ARDL investigation. Economics Bulletin, 41(2), 686-695.

Yanikkaya, H. (2003). Trade openness and economic growth: a cross-country empirical investigation. Journal of Development economics, 72(1), 57-89.