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IMF LENDING AND POVERTY IN LATIN AMERICA

RESEARCH PROJECT FOR THE COURSE OF UNDERGRADUATE RESEARCH IN INTERNATIONAL RELATIONS

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ABSTRACT

While the IMF presents the intention of aiding poverty reduction by promoting economic growth, research shows that its presence might cause more harm than good due to the conditionality it sets for countries. However, due to a lack of regionalized studies, this research intended to cover the gap by determining the effects of entering an IMF lending program for the countries of Latin America, as well as determining if the creation of the Poverty Reduction and Growth Facility (PRGF) in 2000 had any positive effects in decreasing poverty. The hypothesis was that borrowing from the IMF causes an increase in the levels of poverty of Latin American countries. The method applied was a multiple regression analysis of a panel data set of 17 Latin American countries over the years 2001-2021, using the poverty line of $3 a day and its poverty gap as the measurements of poverty. With the application of an instrumental variable, the study was able to address endogeneity bias and calculate the causal effects of IMF lending. The study found that IMF presence increases the poverty line by 23.53% and the poverty gap by 11.02 % in the year the program started, with such effects lasting for up to two years, and by the third year, there was no effect on poverty. This means that the PRGF didn't accomplish its intended purpose in Latin America, and it rather increased levels of poverty for two years. These results can have certain implications on how countries in the region will address their current debt, as well as serve to analyze considerations of future borrowing from the IMF.

Keywords: IMF, inequality, poverty, Latin America

RESUMEN

Si bien el FMI presenta la intención de ayudar a reducir la pobreza mediante la promoción del crecimiento económico, las investigaciones demuestran que su presencia podría causar más daño que beneficio debido a las condiciones que impone a los países. Sin embargo, debido a la falta de estudios regionalizados, esta investigación pretendía cubrir esa laguna determinando los efectos de la adhesión a un programa de préstamos del FMI para los países de América Latina, así como determinando si la creación del Servicio para el Crecimiento y la Lucha contra la Pobreza (SCLP) en 2000 tuvo algún efecto positivo en la reducción de la pobreza. La hipótesis era que los préstamos del FMI provocan un aumento de los niveles de pobreza de los países latinoamericanos. El método aplicado fue un análisis de regresión múltiple de un conjunto de datos de panel de 17 países latinoamericanos durante los años 2001-2021, utilizando el umbral de pobreza de 3 dólares al día y su brecha de pobreza como medidas de la pobreza. Mediante la aplicación de una variable instrumental, el estudio pudo abordar el sesgo de endogeneidad y calcular los efectos causales de los préstamos del FMI. El estudio reveló que la presencia del FMI aumenta el umbral de pobreza en un 23,53 % y la brecha de pobreza en un 11,02 % en el año en que se inició el programa, con efectos que se prolongan hasta dos años, y que al tercer año no se observaba ningún efecto sobre la pobreza. Esto significa que el PRGF no logró su objetivo previsto en América Latina, sino que aumentó los niveles de pobreza durante dos años. Estos resultados pueden tener ciertas implicaciones en la forma en que los países de la región abordarán su deuda actual, así como servir para analizar consideraciones sobre futuros préstamos del FMI.

Introduction

The International Monetary Fund (IMF) is an institution that lends money to countries in moments of financial crisis. When signing an IMF agreement, the borrowing country agrees to implement a series of policies that the IMF tailors for them in order to stabilize its macroeconomic indicators. However, historically, the IMF has been accused of doing more harm than good (Garuda, 2000; Vreeland, 2002; Forster et al., 2019; Oberdabernig, 2013). To address this problem, in 2000, the International Monetary Fund (IMF) renamed its concessionary lending program to "Poverty Reduction and Growth Facility", presenting its clear intentions on reducing poverty and promoting economic growth (Hajro & Joyce, 2009; Biglaiser & McGauvran, 2022). Although economic growth is generally associated with poverty reduction, such an outcome is not always achieved. Albeit appearing counterintuitive, many of the policies implemented by the IMF, such as fiscal austerity, have been proven to increase levels of poverty and inequality (Stubbs, 2021; Tamale, 2021).

To the knowledge of the author, the most recent study of the IMF and inequality was done by Lang (2021). In his research, Lang introduces a new instrumental variable (IV) to address the problem of endogeneity that concerned previous authors. Nonrandom selection (concerns of endogeneity bias) has been approached by authors in two ways: By doing a propensity score estimation (Garuda, 2000; Oberdabernig, 2008; Bird et al., 2020), in which they compare a country with IMF presence with a country without IMF presence but with similar macroeconomic conditions to determine the counterfactual outcome of not lending to the IMF. The second approach is a more straightforward solution, which is the implementation of an instrumental variable (Lang, 2021). Previous authors (Barro and Lee 2005; Dreher and Walter 2010) have used a common standard instrument, which is the voting similarity with the United States in the UN General Assembly

(UNGA). However, research shows that this variable is not suitable to be implemented as an instrumental variable because similarity of voting with the United States in the UN General Assembly is correlated with both poverty and inequality (Lang, 2021; Forster et al., 2019). Thus, applying the recent contribution of Lang (2021) with a suitable instrument, this research can implement the updated method to contribute to the research gap of regional studies, since to the knowledge of the author, there is yet no research studying the effects of the IMF on poverty in the region of Latin America.

While having vast research studying all the countries that have ever borrowed from the IMF provides a great background and contribution to this field, some authors also recognize the limited scope of such research (Oberdabernig, 2008). This is because only with a region-focused approach can a researcher take into consideration certain economic and political variables that are distinct to a specific region and not present in other parts of the world. By having results that are specific to a region, policymakers can make informed decisions about borrowing from the IMF. This research intends to contribute by focusing on the region of Latin America. Hence, the research question is as follows: Does lending from the IMF increase poverty levels in Latin America?

Because the author theorizes that when a country in Latin America lends from the IMF, it experiences an increase in poverty, the null hypothesis would be the contrary: lending from the IMF does not increase poverty levels in Latin America.

Thus, applying the methods of Lang (2021), this research is divided as follows: Section 2 is the literature review; Section 3 explains in detail the methods applied; Section 4 offers the results; Section 5 is a discussion of such results; and finally, Section 6 offers the concluding comments.

Literature Review

As the International Monetary Fund (IMF) renamed its concessionary lending program to "Poverty Reduction and Growth Facility", it presents its clear intentions on reducing poverty and promoting economic growth (Hajro & Joyce, 2009; Biglaiser & McGauvran, 2022). Then, in response to the global financial crisis, the IMF replaced the PRCF with the Extended Credit Facility (ECF). Albeit the changes in these programs' duration, size, and conditionality, the main vision and goals are still focused on poverty reduction (Oberdabernig, 2013). There is great debate, however, on whether the Fund has achieved its goals in the countries it is aiming to aid, or if their presence has led to a rather adverse outcome.

When a country requests a loan from the IMF, it is set under a series of conditionalities that the country has to comply with in order to get the loan disbursement (Biglaiser & McGauvran, 2022). These conditionalities are tailored to a country's specific needs and situation, with the intention to improve the macro-economic indicators and thus promote economic growth, which is generally associated with poverty reduction. This link is logical under the assumptions of modern economic theory, that economic growth translates to higher wages, which would eventually reach the poor. In order to have economic growth, but not poverty reduction, unequal income distribution must increase as well (Roemer & Gugerty, 1997). It is important, however, to challenge such assumptions to determine whether: a) Does the IMF promote economic growth? B) If yes, does that economic growth translate to poverty reduction?

Although many authors have been concerned about the effects of the IMF on economic growth, there is little consensus in the field. While some studies found that the participation under an IMF program reduced economic growth, others concluded the opposite result (Oberdabernig, 2013). A recent study by Evrensel & Yanıkkaya (2023), which focuses on conditionality compliance, finds

that while concessional lending does not have a significant impact on growth, non-concessional lending has a negative effect. They also conclude that compliance with some stabilization conditions contributes to growth.

Other authors, such as Biglaiser & McGauvran (2022), study the type of conditionalities imposed by the IMF, disaggregating them into structural and stabilization reforms. They conclude that structural reforms increase poverty, but stabilization conditions don't have an impact. While Berg & Krueger (2003) previously pointed out that poorer populations benefit from stabilization measures of a subsequent rise in GDP and decrease in inflation, it is important to question if such growth will translate to the poor. Generally, many stabilization reforms include austerity measures, which studies have shown that it has a significant impact on increasing inequality (Stubbs, 2021; Tamale, 2021). In a study exploring the effects of the IMF pushing for austerity to its members in the developing world, Tamale (2021) states that research shows that "austerity increases the income of the wealthiest 10% at the expense of the bottom 80%" (p.8).

Moving on, when we study structural reforms, these are generally intended towards market-oriented changes that are designed to transform the economic sector. The IMF has historically promoted the liberalization of previously protected markets (Forster et al., 2019). Although modern economic theory agrees that market liberalization promotes economic development, many authors note that in the short term, liberalization reforms create a system of winners and losers where the poor are disadvantaged (Apeti & Gomado, 2025).

In order to prove or disprove such theories, empirical work is essential. While some authors find that the participation in IMF programs increases poverty and inequality (Garuda, 2000; Vreeland, 2002; Forster et al., 2019; Oberdabernig, 2013), others conclude that it does not have a significant impact (Hajro and Joyce, 2009; Lang, 2021).

In order to deduce whether IMF participation has a causal effect on poverty and inequality, a multiple regression analysis is required. This is a statistical technique that determines the relationship between a dependent variable and two or more independent variables. However, the main issue with these studies is the inability to assess the counterfactual outcome. Although it is possible to determine the effects of the IMF in a country, it is not possible to know what would've happened without the program (Garuda, 2000). To address this issue, certain authors implemented "propensity score estimation" (Garuda, 2000; Oberdabernig, 2013), a statistical tool that can be used to match countries that entered a program with countries that didn't enter a program but were under a similar pre-program economic state.

Garuda (2002) determines that in cases of countries that were already facing economic disequilibria, entering a program caused an increase in income inequality. Oberdabernig (2013), later on, also determines that entering a program is associated with an increase in poverty and inequality; however, such effects last around two years. While Forster et al. (2019) also find an increase in income inequality, they determine that the problem persists in the medium term.

Although, as described previously, research in this field proves to be extensive, there are still gaps and room for future research that can be addressed. First, the majority of authors studied focused their research on the years before the creation of the PRGF, generally due to data constraints. Hence, it makes us unable to determine if this new facility has achieved its goal. Second, a lack of resources hinders the researchers' ability to do focused studies on different regions of the world. Thus, the majority of research in the field is based on big panel data of multiple countries around the world. Albeit these studies are extremely useful to have a deeper understanding of the effects of IMF conditionality on a global scale, they lack a specific regional focus. Focused regional studies can be beneficial as they will provide information that can be used to create and promote

region-specific policies. Hence, the contributions of this study are twofold: To shed light on how the IMF has specifically affected the region of Latin America and to determine if, after shifting its focus to helping the poor, the IMF achieved its goal or yet again caused more harm than good.

Methodology

Because the purpose of the research is to determine if IMF lending causes poverty and inequality levels to increase, a multiple regression analysis, which is a method of quantitative research, was applied. Regression analysis is popularly used by researchers when they are striving to find causal relationships between variables. Regression analysis can be simple (one DV and one IV) or multiple (one DV and two or more IV). Because poverty is a complex social and economic problem, we cannot have only one independent variable to explain such phenomena. It is thus necessary to implement more explanatory variables, and for such reason, the analysis is multiple and not a simple regression.

It is important to note that when we study the effects of the IMF, it introduces the problem of endogeneity. Endogeneity is caused when the independent variable we're using to explain our DV is correlated with the problem as well, or by some other unobservable factor. That is to say, countries don't randomly choose to request an IMF loan, but rather, they are generally already facing several economic conditions or are influenced by unobservable factors (Oberdabernig, 2013).

Instrumental variables can help prevent endogeneity bias. The instrumental variable —from now on referred to as IV— is a third variable that is associated with the explanatory variable but does not correlate with the dependent variable. Hence, it is a variable that influences IMF lending decisions, but is not associated with poverty. This study takes the example of Lang (2021), which proposes that IMF liquidity influences how the IMF allocates its loans depending on its history of lending to countries.

The author finds that in the years when the Fund's liquidity is low, the loans tend to go to countries that have a history of lending with them, and when their liquidity is higher, there is a greater probability of the IMF granting loans to more countries (Lang, 2021).

This study also controls for economic and political variables that are associated with both IMF lending decisions and poverty and inequality. They are divided into two groups:

Controls for Inequality: variables that are known to affect income inequality and poverty.

Controls for IMF participation: variables that influence the probability of getting into an IMF program.

All these control variables are lagged by one year (t-1) to avoid simultaneity bias[1].

Table 1: List of explanatory and control variables.

IMF program dummy	=1 if a country signed or was under and IMF program in that year. =0 otherwise.
IMF probability	Own calculations based on Lang, 2021.
IMF liquidity	Dataset from Lang, 2021.
IV	IV = IMF_probability x IMF_liquidity. Own calculations based on Lang, 2021.
GDP per capita (ln)	Gross domestic product, PPP. World Bank, 2024.

[1] For example, this year's GDP cannot cause this year's poverty levels, because these types of variables are measured at the end of the year; hence, we use the previous year's GDP to control for the current year's poverty levels.

Education	Mean Years of Schooling (years) from the HDI.
Trade	Trade (%GDP) (World Bank, 2024).
Life Expectancy	Life expectancy at birth in years (World Bank, 2024).
Liberal	(Moser & Sturm, 2011) Data from Freedom House Index.
Account Balance	Current account balance on % GDP
Investment	Gross capital formation (% of GDP) (World Bank, 2024).
GDP growth	GDP growth (annual %) (World Bank, 2014).
Banking Crisis dummy	=1 if *i* country was going through a banking crisis in *t* year. =0 Otherwise. Data from Laeven & Valencia (2020).
Executive Elections	=1 if *i* country was going through presidential elections in *t* year. =0 otherwise. Vreeland (2020) argues that countries are more likely to enter an arrangement after an election.
Legislative Elections	=1 if *i* country was going through legislative elections in *t* year. =0 otherwise. Vreeland (2020) argues that countries are more likely to enter an arrangement after an election.

Source: own work

The data is input in a panel data set of 17 Latin American countries over the years 2001-2021. It is an unbalanced panel because some countries lacked observations in some years. The countries included are: Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Uruguay, and Venezuela. Due to data constraints, Belize and Guyana were automatically removed from the panel as they didn't have any observations in any of the poverty indicators that are considered in this study.

This regression is divided into two parts. The first stage is to predict the IMF participation using the instrument (IMF liquidity x IMF probability) and the control variables. The output from this regression is the exogenous value, i.e., the value that is left after we remove the other factors that influence IMF decisions on lending.

Output → Predicted IMF value.

In the second stage, we use the output and the control variables to predict the causal effects of IMF lending. Using the software tool R allows us to upload the data and automatically run the regression using this formula:

$$Inequality_{it} = \beta_0 + \beta_1 \widehat{IMF}_{it} + \beta_2 X_{i,t-1} + \mu_i + \lambda_t + u_{it}$$

The regression is run twice, each using a different poverty indicator as the DV: The poverty headcount ratio, which measures the number of people living below the poverty line of $3 per day, as recently updated by the World Bank, and their income shortfall from this poverty line, i.e., the poverty gap that measures how poor the poor are.

The results of each regression will be discussed below.

Results

First-Stage Results

The results of the first-stage regression confirmed that the instrument (IMF_liquidity x IMF_participation) has a significant predictive value for IMF program participation. We confirm that because the coefficient is positive and statistically significant ($\beta = 0.0171$, $p < 0.001$). The F-statistic results are 20.58, which exceeds the threshold of 10 (Staiger & Stock, 1997). When the F-value is greater than 10, it demonstrates that the instrument is strong and relevant to use for the second stage.

Second-Stage Results

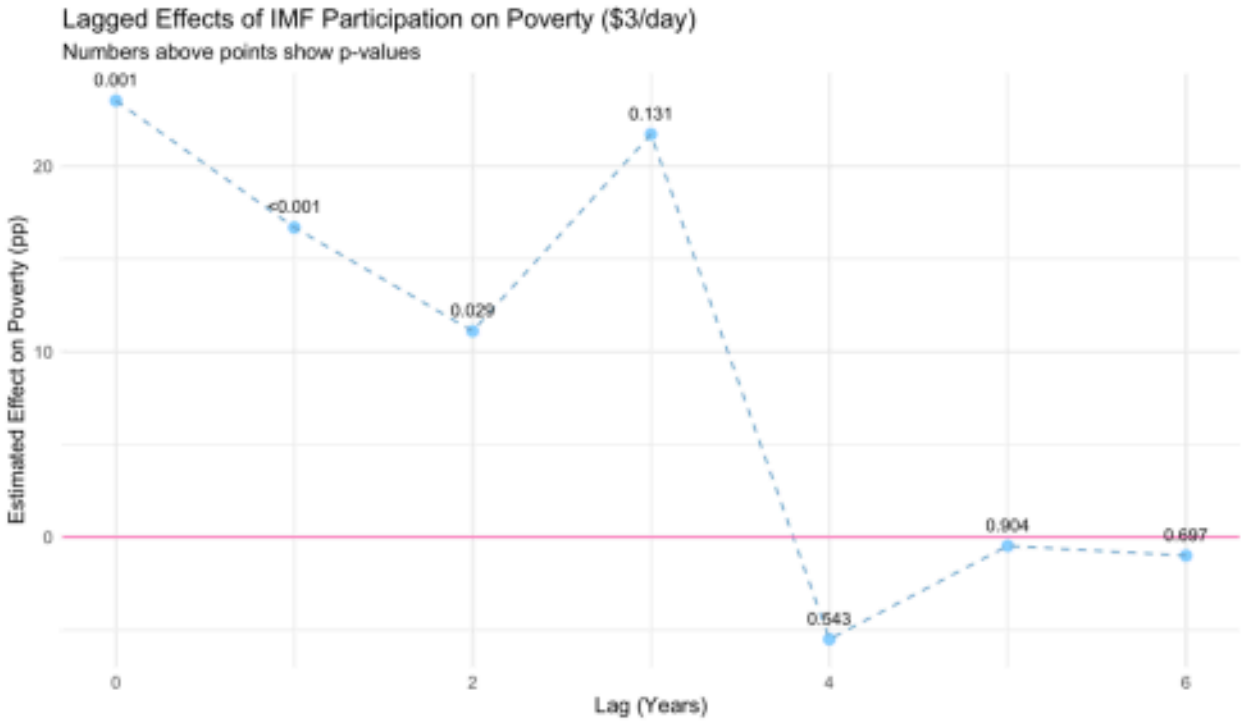
Using the Poverty line of $3 a day as the dependent variable (DV) results in a positive coefficient of 23.53, with a strong statistical significance (p=0.001), and a multiple R-squared of 0.7541, which suggests that 75% of the variation in the poverty line can be explained with this model. Having a positive and statistically significant coefficient shows a positive relation between IMF participation and poverty. Because the null hypothesis theorized a negative relation, we can thus reject the null hypothesis.

Furthermore, these results are valid for the year in which the country is under an IMF agreement. However, it is important to determine if that effect is still present in the subsequent years. For such a reason, a lag of six years was applied to determine the effects after each specific year has passed. The table below summarizes the results:

Lag (years)	Estimate	P-value	Significance	Sign	R squared	Interpretation
0 (no lag)	**+23.53**	**0.001**	***	+	0.741	IMF increases poverty, immediate effect.

1	**+16.69**	**<0.001**	***	+	0.746	Effect reduced, but still present and significant after a year
2	**+11.11**	**0.029**	*	+	0.736	Effect reduced, but still significant.
3	**+21.72**	0.131		+ (ns)	0.739	No longer significant
4	**–5.50**	0.543		- (ns)	0.739	Effect no longer present, and statistically insignificant.
5	**–0.47**	0.904		- (ns)	0.749	Not significant
6	**–0.99**	0.697		- (ns)	0.767	Not significant

The results of the second stage suggest that IMF participation has an immediate effect on poverty, increasing 23.5 percentage points with no lag, i.e., in the year the country was under a program. This effect remains positive and significant for up to two years after being part of an IMF program. By the third year, the effect is still present but is reduced, and afterwards, the effect is no longer statistically significant; thus, there is no effect in poverty.

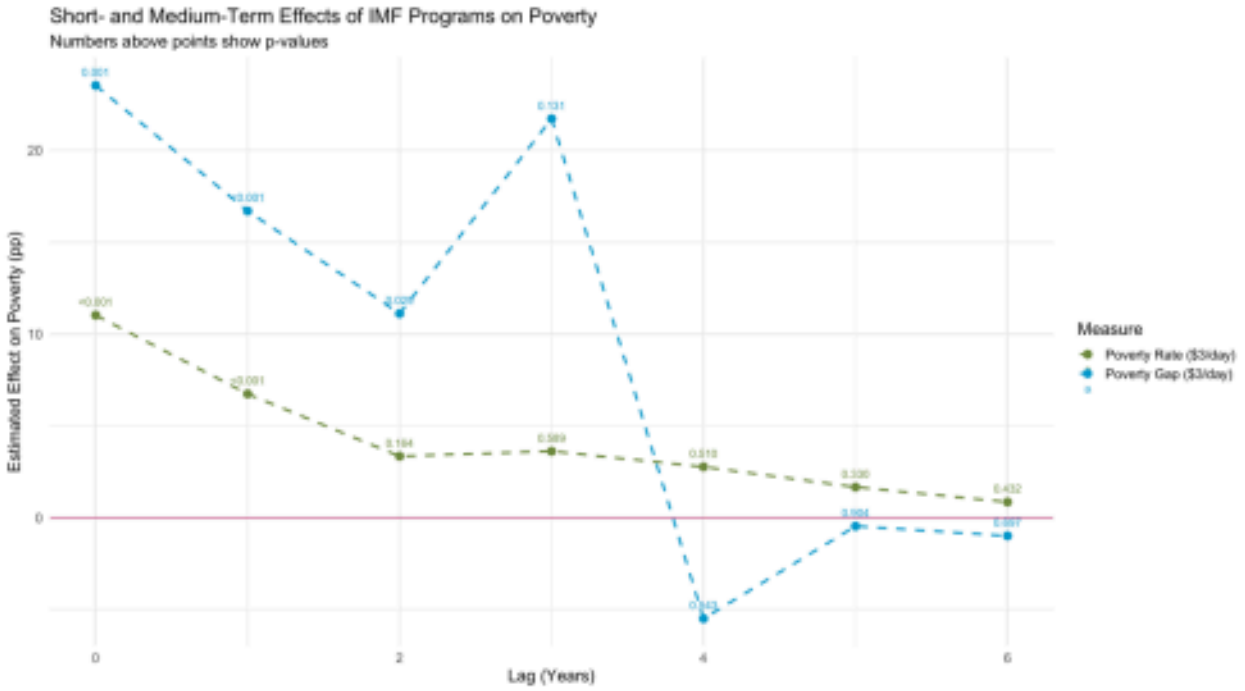


The second regression was run using the poverty gap index at $3 a day as the DV, ceteris paribus. This is another measurement of poverty used to determine the intensity of poverty below the poverty line. In this case, without any lag, the results show a positive coefficient of 11.02 with a statistical significance of $p < 0.001$. The regression was lagged again by up to six years. The results are shown below:

Lag (years)	Estimate	P-value	Significance	Sign	R squared	Interpretation
0 (no lag)	+11.02	2.22e-06	***	+	0.696	IMF increases poverty the poverty gap immediately
1	+6.73	0.000106	***	+	0.696	The effect remains positive and

						significant, but reduced
2	+3.34	0.164		+ (ns)	0.679	No longer significant
3	+3.61	0.589		+ (ns)	0.684	No longer significant
4	+2.77	0.510		+ (ns)	0.682	No longer significant
5	+1.66	0.330		+ (ns)	0.705	Not significant
6	+0.85	0.432		+ (ns)	0.726	Not significant

Using the poverty gap at $3, the effects on the intensity of poverty are positive by up to two years after being under an IMF agreement, and no longer significant after the third year.



The graph shows the difference in results using both the poverty line and the poverty gap. The interpretation of such differences will be discussed in the next section.

Discussion

The purpose of this study was to determine if lending from the IMF increases poverty in Latin American countries, measured by the poverty line of $3 a day and the poverty gap. The findings suggest that when a country borrows from the IMF, it experiences an increase in both poverty indicators after one year, and by the second and third years, the effect decreases and fades away. These findings similarly align with Oberdabernig (2013), who concluded that poverty and inequality increased in the first year. However, while this author found that after a two-year lag, the effect is no longer significant, this research determines that by the second year, there is still a strong increase in the poverty line, albeit of less intensity.

On the other hand, Lang (2021) also determined an increase in inequality (determined by the Gini index), which lasts for up to five years. Because Lang's study focuses on the global scale, it cannot be used to compare with the region of Latin America, and further study would be needed to determine if in Latin America the increase in inequality also increases for as long as five years.

After confirming from the first-stage results that the instrument is a strong predictor, we analyzed the results of the second stage. With the first DV of the poverty line at $3 a day, we determined that a country that is under an IMF program faces an increase in poverty of 23.53 percentage points in the year of the arrangement. For two years, the increase in poverty is still present, although the percentage consistently decreases. This implies that within this sample, the short-term effects of IMF lending are an increase in the number of people falling below the poverty line of $3 a day. There are more poor people. This could be either caused by the austerity policies or structural adjustments that the Fund demands from its borrowing countries. This study is not able to determine which specific conditions cause poverty. The instrument allows to determine that the increase is not due to reverse causality (meaning that the countries go to the IMF because they are

already poor). With the first stage, we cleaned that factor and calculated the effects that are due to IMF lending. Finally, by the third, fourth, fifth, and sixth years of lag, these effects are no longer visible. IMF lending no longer causes poverty increase after the second year, but it doesn't decrease poverty either. Thus, in this sample, there is no evidence that the PRGF's goals of reducing poverty have been met.

When using poverty gap as the DV, we face similar results. An IMF program increases the poverty gap by around 11 percent, and by 6.7 percent with a one-year lag. However, by the second year, the effect drops and is no longer significant. Hence, although being under an IMF agreement increases the poverty gap (how far below the poverty line the people fall), the effect lasts for only one year.

By comparing both results, we notice that while the increase in the number of people falling below the poverty line of $3 a day lingers for two years, the effect in the poverty gap only lasts one year. This might suggest that some households show signs of recovery (decreasing the poverty gap), but not enough to get out of poverty. That is to say, an IMF program causes more people to become poor, and also, the ones who are poor become even poorer.

With the results of the control variables, we can also determine a few expected statistical relationships. All of these results are without lag. For example, countries with higher GDPs face lower levels of poverty. As for education, the effect was not statistically significant to conclude. Countries with higher trade openness have lower poverty levels. For investment, controlling for other factors, higher investment increases poverty. Because this was studied without lag, it can be suspected that the benefits brought by investment are not received by the poor immediately. Whether investment affects poverty in the long term is outside the scope of this research. For the rest of the variables, the results were not significant enough to draw a conclusion.

Comparing these results with Oberdabernig (2013), who also ran a regression to determine the effects after the implementation of PGRF (in their case, 2000-2009), we find both similar and conflicting results. Oberdabernig (2013) finds that during the year of program participation, there is a decrease in poverty indicators (reduction of poverty), but after lagging for 1 and 2 years, both the headcount ratio and poverty gap at $2 increase. Although this research doesn't allow for pinpointing precisely the cause of such differences, Oberdabernig also mentions that their results cannot be universally applicable due to the large cross-country comparison that does not allow for detailed analysis. Considering such, this research that focuses on a specific region can be more detailed and appropriate if we want to determine how the IMF affects the region of Latin America specifically.

As with any research, the limitations are multiple; however, the most crucial are twofold: First, it only considers if a country has borrowed from the IMF, but it is unable to study the borrowing country's compliance with conditionality. Although countries agree to implement such conditions to receive the funds, in practice, not all countries comply with the IMF's conditions. Second, this study does not segregate each type of conditionality to determine which type of conditions have the greater effect on poverty. That is to say, while we conclude that lending from the IMF increases poverty, from this study, we cannot determine exactly why that happens. Room for future research lies in determining two things: Does complying with the IMF has an effect on the poverty increase? Which type of conditionalities have the greater effect on increasing poverty? By addressing these questions, countries in Latin America can address their current debts with the IMF and determine whether they are willing to implement the IMF's conditions, depending on their specific effects on poverty.

Conclusions

According to the results in this study, borrowing from the IMF increases poverty in the Latin American region, measured by the number of people falling below the new poverty line of $3 a day, and also how far people fall below this line. The effect lasts for two years, and by the third year, there is no effect on poverty. Thus, between the years 2000-2021, when a country in Latin America borrowed money from the IMF, it experienced an increase in poverty for two years. This answers our research question to conclude that borrowing from the IMF increases poverty and that the PGRF has not reached its intended purpose in the region of Latin America. Beyond the presented results, this study also offers certain contributions to the field. It adds to the current literature by applying a new method to study a specific dataset of countries and years that have not been exclusively studied before. It addresses the lack of regional research by providing a thorough study of the Latin American region, using distinct variables proposed by multiple authors, which have been proven to be the most influential economic and political factors for IMF lending and poverty. On a greater scope, these results suggest the necessity for the IMF to reassess the design of conditionality, as it is clear that the policies that work for developed economies will not necessarily have the same results in fragile economies of developing nations. Finally, this research is just one more drop into the sea of real-life experience on how politics attempts to maneuver the principle of trade-offs. Often, policymakers must decide if implementing certain policies that have the potential to improve the lives of a greater number of citizens in the long run, at the cost of significantly and immediately damaging the lives of the most vulnerable part of the population, is a risk worth taking.

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