IMF and World Bank Structural Adjustment Programs and Poverty

Tihut Getabicha
tgetabic@conncoll.edu

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IMF and World Bank Structural Adjustment Programs and Poverty

An independent study submitted to the Economics Department.

A look into why international organizations such as World Bank and International Monetary Fund have failed developing countries.

Written By: Tihut Getabicha

05/04/2022
Introduction

Poverty reduction is in the news for both the International Monetary Fund (IMF) and the World Bank. The IMF website says:

“In September 1999, the objectives of the IMF’s concessional lending were broadened to include an explicit focus on poverty reduction in the context of a growth-oriented strategy. The IMF will support, along with the World Bank, strategies elaborated by the borrowing country in a Poverty Reduction Strategy Paper (PRSP)” (IMF 2001,2).

For its part, the World Bank headquarters has built into its lobby wall the slogan “our dream is a world free of poverty.”

In a joint statement issued by the President of the World Bank and the Managing Director of the International Monetary Fund in April 2001, they declared poverty “the greatest challenge facing the international community” and an issue concerning which “the Bank and Fund have an important role to play” (WB and IMF 2001,2).

At the same time, there has been a long-standing criticism from the left of World Bank and IMF structural adjustment programs as disproportionately hurting the poor: when the International Monetary Fund (IMF) and World Bank arrive in southern countries, corporate profits go up, but so do poverty and suffering. Decades of promises that just a little more “short-term” pain will bring long-term gain have exposed the IMF and World Bank as false prophets whose mission is to protect those who already control too much wealth and power.
IMF and World Bank adjustment programs typically force the government to make adjustments in a few highly visible macroeconomic indicators, which affect mainly the formal sector. On the other hand, a home-grown reform program (for example, that of China over the last two decades, with only three adjustment loans in the 1980s and none in the 1990s) would generally include a more sweeping transformation of incentives that affect the formal and informal sectors alike (WB, 2001,3).

A structural adjustment is a set of economic reforms that a country must adhere to in order to secure a loan from the International Monetary Fund and/or the World Bank. Structural adjustments are often a set of economic policies, including reducing government spending, opening to free trade, and so on (Hickel, 2018).

This paper examines the effect of IMF and World Bank adjustment lending on poverty reduction. I briefly examine the effect of IMF and World Bank adjustment lending on growth and find no effect (suitably instrumenting for adjustment lending). My main result is that IMF and World Bank adjustment lending lowers the growth elasticity of poverty, that is, the amount of change in poverty rates for a given amount of growth. This means that economic expansions benefit the poor less under structural adjustment, but at the same time, economic contractions hurt the poor less. What could be the mechanisms for such a result?
There could be several explanations for this:

A) IMF and World Bank conditionality may itself cause an expansion or contraction in aggregate output—depending on the composition of the structural adjustment package—but not affect the poor very much. This view would see the poor as mainly deriving their income from the informal sector and subsistence activities, which are not affected much by fiscal policy changes or adjustments in macro policies.

B) The net effect may be overall contraction or expansion, depending on the initial sizes of the declining and expanding sectors and the specific policy measures in the structural adjustment package. However, if the poor are not tightly linked to either the expanding or the contracting formal sector, then the amount of poverty change for a given amount of output change may not be very high under structural adjustment.

**Literature Review**

Most of the studies reviewed are not quantitative and often have not applied rigorous statistical methods. Opschoor et al (1996) point out that the various evaluation methods are hampered due to differences in context, sector focus, and stage of the adjustment process. The results of the inquiry on the effects of adjustment policies are strongly influenced by what is examined, at which sectoral level, and at what stage of the adjustment process. Adjustment programs are considered to have negative as well as positive effects – depending on the focus of the analysis.
There are also issues in differentiating the effects of SAPs from underlying economic and social developments.

Since the beginning of the 1980s the World Bank and the International Monetary Fund have introduced structural adjustment loans and stabilization programs to correct balance-of-payments distortions and to realize the conditions necessary for economic growth in developing countries (Opschoor et al. 1996). Structural adjustment programs (SAPs) are designed to reform economies to a more export-oriented and liberalized market economy while downsizing governments that have become inefficient bureaucracies. They consist of combinations of exchange-rate policies, monetary and interest, fiscal, trade, public-sector, and institutional policies. The main instruments are price reforms, trade political measures such as liberalization and devaluation, reduced government expenditures as well as the removal of institutional obstructions to flexible responses of the private sector (Sebastian and Alicbusan 1989).

Due to the diversity of impacts on the environment from SAPs, most authors are unable to draw firm conclusions on their overall success or failure, but instead, pinpoint the more common impacts and the most likely scenarios. However, the net result of the available studies and reviews is that the negative environmental impacts resulting from SAPs exceed positive impacts (Kessler et al. 1998).
Data and Concepts

I have data for 1980–98 on all types of IMF lending and on World Bank adjustment lending. International Monetary Fund lending includes standbys, extended arrangements, Structural Adjustment Facilities, and Enhanced Structural Adjustment Facilities (recently renamed Poverty Reduction and Growth Facilities) (IMF, WB, 01). World Bank adjustment lending includes structural adjustment loans, sectoral structural adjustment loans, IMF and World Bank Structural Adjustment Programs and structural adjustment credits (the latter is concessional for low-income countries). The data are reported in the year that the loans are approved.

For data on poverty, I use an updated version of Ravallion and Chen’s (1997) database on poverty spells. These authors were careful to choose spells and countries for which the definition of poverty was constant and comparable over time and across countries. The source of the data is household surveys. They report the proportion of the population that is poor at the poverty line of $2 per day at the beginning of and the end of the spell (they also report the poverty rates for a poverty line of $1 per day, but Chen’s regression chooses to use the former because many countries have a zero initial value at $1 per day). They also report the Gini coefficients at the beginning and the end and the mean income in the household survey at the beginning and the end.
### Table 1.1 Descriptive Statistics

<table>
<thead>
<tr>
<th>Change in Poverty</th>
<th>Mean Consumption Growth</th>
<th>Initial Gini</th>
<th>Initial Poverty Rate</th>
<th>Adjustment Loans Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mean</td>
<td>6.0%</td>
<td>–1.1%</td>
<td>39.5</td>
<td>41.2</td>
</tr>
<tr>
<td>Median</td>
<td>–0.1%</td>
<td>0.0%</td>
<td>39.5</td>
<td>36.3</td>
</tr>
<tr>
<td>Std. dev.</td>
<td>31.5%</td>
<td>11.1%</td>
<td>11.1</td>
<td>29.6</td>
</tr>
<tr>
<td>N</td>
<td>14</td>
<td>155</td>
<td>15</td>
<td>15</td>
</tr>
</tbody>
</table>

### Table 1.2 Regression analysis

<table>
<thead>
<tr>
<th>Variable</th>
<th>Ordinary Least Squares: Regression 1</th>
<th>Ordinary Least Squares: Regression 2</th>
<th>Two-Stage Least Squares: Regression 3</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Coefficient</td>
<td>t-statistic</td>
<td>Coefficient</td>
</tr>
<tr>
<td>C</td>
<td>0.039</td>
<td>1.8</td>
<td>0.319</td>
</tr>
<tr>
<td>GINI1</td>
<td>–0.006</td>
<td>–3.06</td>
<td>–0.006</td>
</tr>
<tr>
<td>PROGRAM</td>
<td>–0.019</td>
<td>–0.62</td>
<td>–0.114</td>
</tr>
<tr>
<td>GROWTH*GINI1</td>
<td>0.058</td>
<td>3.27</td>
<td>0.057</td>
</tr>
<tr>
<td>GROWTH*PROGRAM</td>
<td>1.790</td>
<td>7.37</td>
<td>2.027</td>
</tr>
<tr>
<td>N</td>
<td>149</td>
<td>144</td>
<td>126</td>
</tr>
</tbody>
</table>

Variable definitions:

- **GROWTH**: Log rate of growth per annum in mean of household survey
- **GINI1**: Initial Gini coefficient
- **PROGRAM**: Number of IMF/World Bank adjustment loans initiated per annum
- **CENTAM**: Dummy for Central America
- **FRZ**: Dummy for Franc Zone
- **EGYPT**: Dummy for Egypt and Israel
- **SSA**: Dummy for Sub-Saharan Africa
Ten percentage points higher Gini will lower the growth elasticity of poverty by 0.6 percentage points. A not-often-noticed implication of this result is that the poor will be hurt less by output contraction in a highly unequal economy than in a relatively equal one, simply because the poor have a low share of output to begin with. The initial Gini also has a direct negative effect on the change in poverty, suggesting a reversion to greater equality if a country begins highly unequal. Another result is that, although adjustment lending has no direct effect on poverty reduction, it has a strong interaction effect with economic growth. The absolute value of the growth elasticity of poverty declines by about two points for every additional IMF or World Bank adjustment loan per year.

This means that the poor benefit less from expansions during a structural adjustment program than in expansions without an adjustment program, while they are at the same time hurt less by contractions. Expansion under adjustment lending is less pro-poor, whereas contraction under adjustment lending is less anti-poor. The welfare of the poor may have increased from the income-smoothing effect of adjustment lending. On the other hand, it is disappointing that the poor do not share fully in growth in those cases in which there are recoveries that accompany adjustment lending. Because the World Bank and the IMF ultimately wish to restore
growth in the economies to which they make adjustment loans, it is worrisome that positive growth has less of a poverty-reducing impact with high World Bank and IMF involvement.

**Analysis: How the WB and IMF have failed the poor**

In 2000, UN staff buckled down to the work of formulating the aspirations of the Millennium Declaration into a series of eight concrete, measurable targets called the Millennium Development Goals (Hickel, 2018). Goal 1 was to cut poverty and hunger in half, but there were a number of others: to achieve universal primary education, to eliminate gender disparity in education, to reduce child mortality by two-thirds, to reduce maternal mortality by three-quarters, and to reverse the spread of AIDS and malaria (Gartner, 2016). And only twelve years in, with their deadline still three years away, they claimed success on Goal 1. They announced that poverty rates had already been cut in half and that the goal of halving hunger was close to being achieved. Soon after the UN’s report, *The Economist* ran a widely shared article with the headline: ‘A Fall to Cheer: for the first time ever, the number of poor people is declining everywhere’ (Economist, 2012). Gates published a public letter in 2014, opening with the words: ‘By almost any measure, the world is better than it has ever been’ (Gates, 2014). Yes, the MDGs witnessed success, the number of deaths among children under five declined from 12.7 million in 1990 to 6 million in 2015 (WHO, 2015). Maternal mortality, declined by an impressive 45 percent during the Millennium Development Goals. HIV and malaria infection rates have declined markedly. While the UN technically fell short of reaching its targets on these fronts, the numbers are nonetheless evidence of substantial progress (WHO, 2015).
Shortly after the Millennium Declaration was adopted, the UN rendered it into the Millennium Development Goals that we know so well today. According to Hickel, I found that during this process, the poverty goal (MDG-1) was actually refurbished—this time behind closed doors, without any media commentary at all (Hickel, 2013). First, they changed it from halving the proportion of impoverished people in the whole world to halving the proportion in developing countries only. Because the population of the developing world is growing at a faster rate than the world as a whole, this shift in the methodology allowed the poverty accountants to take advantage of an even faster-growing denominator. On top of this, there was a second significant change: they moved the starting point of analysis from 2000 back to 1990 (Hickel, 2018). This gave them much more time to accomplish the goal, extended the period of denominator growth, and allowed them to retroactively claim gains in poverty reduction that were achieved long before the campaign actually began. All of this brings us to question why are international organizations so eager to claim victories they have not achieved? Why would they want to make it seem as though poverty and hunger and inequality are being reduced when in fact they are not?

International organizations particularly WB and IMF are complex constituencies, they strongly depend on the demands of who funds those organizations, and whether or not they pursue their goals depends on the individuals who run them. Also known as the Bretton Woods Institutions (BWIs), they were initially created with the intention of rebuilding the international economic system following World War II. The IMF and World Bank show not just the failure of
central planning and managed development, but also how easily multilateral institutions are diverted from the original good purpose of helping poor nations to serve the political and financial interests of Washington and Wall Street. Following, I will discuss three major characteristics of these two international organizations and why they won’t alleviate poverty.

Firstly is the structural underrepresentation of the developing world in both of these organizations. One of the central criticisms of the World Bank and IMF relates to the political power imbalances in their governance structures. Voting shares are based principally on the size and ‘openness’ of countries’ economies, poorer countries are structurally under-represented in the decision-making processes. Despite the 2016 voting reforms at the IMF, which shifted voting powers, the distribution of voting power remains severely imbalanced in favor of the US, European countries, and Japan, in particular, but the shifting also advantaged China (BWI, 2020). Importantly, the US still has veto power over an array of major decisions. The under-representation of low- and middle-income countries on the BWIs’ Executive Boards is worsened by the historic ‘gentleman’s agreement’ between the United States and European countries, which has seen the Fund and Bank led by European and US national, respectively, since their inception (BWI, 2019). Civil society has long called for this opaque system to be replaced with a merit-based, transparent process. Although seemingly neutral institutions, in practice, the IMF and World Bank end up serving the powerful interests of western countries. At both institutions, the voting power of a given country is not measured by, for example, population, but by how much capital that country contributes to the institutions and by other political factors reflecting the power the country wields in the world. It doesn’t sound as neutral
as they pose these organizations to be (Carotheres, 2014). The G7 plays a dominant role in determining policy, with the US, France, Germany, Japan, and Great Britain each having their own director on the institution’s executive board while 19 other directors are elected by the rest of the approximately 150 member countries—the numbers speak for themselves (BBC, 2019). Not to mention the majority of countries are in the global south, yet don’t have enough representation in BWIs. The president of the World Bank is traditionally an American citizen and is chosen with US congressional involvement (Hickel, 2018). The managing director of the IMF is traditionally European. On the IMF board of governors, composed of treasury secretaries, the G7 has a combined voting power of 46%—that is almost half of the entire voting power (Hickel, 2018). So, when these powerful western countries come together in their secluded what has now come to be known as the “Green Room” to discuss policies and programs—they don’t have representatives from the global south to criticize, disagree, and rebuttal the policies of their new design. Therefore, BWIs are now tools to perpetuate neoliberalism (Wolff, 2020).

The second reason for their failure is that these organizations continue to impose neoliberalism in the global south and this is deep-rooted in the history of the emergence of the free market in the developing world. To provide a little bit of history, from the Great Depression until the end of World War II, Keynesian economics had its primary influence on economic policies. Keynesian economics lost popularity in the mid-1970s due to stagflation and the associated new program launched by the Chicago School (MIT, 2020). Unlike Keynes' idealization of government regulations, economists from the Chicago School such as Milton Friedman perceived most government expenditures as excessive. Hence, government
intervention was viewed as inefficient and not likely to achieve projected goals. In fact, Friedman claimed the stagflation of the 1970s is the failure of the Keynesian theory. But it is not really Keynesian economics failure that caused stagflation, in fact, it was in 1973 when the Organization of Petreloum Exporting Countries (OPEC) decided to drive up the price of oil, the price of other goods went up too because the energy required to produce and transport them was expensive, production became more expensive which slowed down economic growth hence unemployment rose (MIT, 2020). With the help of Friedman, the Chicago School derived a formula for creating the perfect free-market economy. The formula included government deregulation, privatization of government enterprises, and cutbacks on government spending. They trained a group of economists using this formula, and the economists were known as “Chicago boys”. In the late twentieth century, the Chicago School began to have a profound influence on South American Governments such as Chile (Hickel, 2018). President Allende was lifted to power in Chile on his promise of a fairer society: better wages, public education, healthcare, housing and fairer rents. His victory was an impressive achievement, given that the CIA and US corporations had attempted to manipulate the outcome of the election in favor of Allende’s right-wing opponent (Hickel, 2018). Despite his strong progress, he was then later on overthrown by a military offense led by Augusto Pinochet with the intervention of the U.S.

However, inflation doubled in the first eight or nine months of Pinochet’s military regime. When rates of inflation continued to rise, Pinochet consulted with economists to stabilize the failed economy. These economists were the "Chicago Boys". We are not surprised to see the global south be the laboratory to test out new ideas, this has more often been the case. I mention
the Chile experiment because Chile was one of the first countries to implement and you can say it was the testing lab for the neo-liberal model. The Chicago Boys assured Pinochet that if he withdrew government involvement from all private sectors at once that the natural laws of economics would push the domestic economic variables, such as inflation and unemployment, back to equilibrium. Pinochet followed the Chicago School's recommendations; he privatized a majority of state-owned companies including several banks, permitted speculative financing of projects, opened borders to foreign imports exposed Chilean manufacturers to competition, and cut all government funding by ten percent. In 1974, Pinochet's adaptations backfired and inflation escalated above 700 percent. Scholars of the Chicago School then insisted that the inflation was attributable to Pinochet's incorrect implementation of free-market ideals (Carey, 2011).

The point to take from the Chilean story is that neoliberal economic policies were so obviously destructive to people's lives that it was very difficult to get them implemented in a democratic government. In most cases, the only way to bring them in was through military dictatorship and a state terror program that would quash resistance wherever it emerged. In order to aggressively deregulate the economy, you first have to aggressively regulate the political sphere (Hickel, 2013).
The third characteristic of their failure is that the economic policies of those in charge of running the IMF and World Bank have generally been imposed through conditions placed on loans and other benefits of membership. The IMF's embrace of loan conditionality was declared the "biggest divergence from the Bretton Woods objectives". The majority of conditions imposed on poor countries wanting loans from the IMF and World Bank include privatization-related conditions. For example, when Bangladesh received a large credit from the World Bank in 2005, of the fifty-three conditions added to the loan, eighteen required that Bangladesh, where over 50% of the population lives below the poverty line, privatize its banks, electricity, and telecommunications sectors (Davis, 2017). Despite the fact that these conditions have ultimately made matters worse within poorer countries, the average amount of conditions imposed on low-income countries rose from 48 per loan to 67 per loan between 2002 and 2005 (Davis, 2017).

The World Bank has also been known to impose conditions involving trade liberalization on poor countries. Rwanda was conditioned to join the East African Trade Agreement, practically stripping its right to freely contract for its exports. Bangladesh was required to remove any quantitative restrictions it had imposed on sugar imports (Beck, 2013). In essence, the purpose of the World Bank and IMF in giving loans to poorer countries is to assist those countries in raising their economy while helping to end the perpetuating cycle of poverty. However, the World Bank has been known to impose "Micro-Management" type conditions, which ultimately prevent much-needed aid from reaching those actually in need of help (Beck, 2013). Uganda, where 37.7% of the country lives in poverty, was required to "review and
approve its school sports policy for tertiary schools," before it could access its World Bank financing in 2005 (Beck, 2013). As a condition for receiving their financing, The Republic of Mali, where 10% of children die as infants, was forced to move its government offices to a new location. So where is the sovereignty of these states?

In a Syracuse University study, the BWIs have been the cause of the most numerous set of policies Sub-Saharan African countries have ever faced. Either directly, or as a consequence, the World Bank and IMF are responsible for policies that make significant changes in African economies. Even with the implementation of these policies, Sub-Saharan Africa is still the poorest region of the world and the least likely to meet the Millennium Development Goals by the established date (Teunissen, 2005). Both the World Bank and the IMF still subject African countries to dozens of conditions in order to receive loans. The conditions are mainly focused on lowering government expenses on social issues and diverting them towards market liberalization in order to cover forgone government revenues from lowering export barriers. The results of these conditions are lower salaries, impoverishment for Africans, and cheaper raw materials for multinational companies (Teunissen, 2005).
Conclusion

The power of the IMF becomes clear when a country gets into financial trouble and needs funds to make payments on private loans. As I discussed in the introduction, before the IMF grants a loan, it imposes conditions on that country, requiring it to make structural changes in its economy. These conditions, SAPs, are designed to increase money flow into the country by promoting exports so that the country can pay off its debts. Not surprisingly, in view of the dominance of the G7 in IMF policymaking, the SAPs are highly neoliberal. The effective power of the IMF is often larger than that associated with the size of its loans because private lenders often deem a country credit-worthy based on the actions of the IMF. The World Bank plays a qualitatively different role than the IMF, but works tightly within the SAP framework imposed by the IMF (Davis, 2017). It focuses on development loans for specific projects, such as the
building of dams, roads, harbors, etc that are considered necessary for ‘economic growth in a developing country.

I often wonder what happens in the closed meetings of the WB and the IMF with all those professional and experienced economists, isn’t there one person in the room who believes the SAPs have had a significant impact in the underdevelopment of the global south? I don’t believe so. I have read about people like William Easterly, who worked as a senior adviser to the Bank’s Macroeconomics and Growth Division before resigning and has since become a strong critique of structural adjustment (Hickel, 2018). Davison Budhoo, the IMF senior economist whose job was to implement structural adjustment programs in Latin America and Africa during the 1980s. In 1988, he resigned with a lengthy letter addressed to his former employer, IMF managing director Michel Camdessus (Davis, 2017). He wrote, “Today I resigned from the staff of the International Monetary Fund after over twelve years, and after 1,000 days of official Fund work in the field, hawking your medicine and your bag of tricks to governments and to people in Latin America and the Caribbean and Africa. To me, resignation is a priceless liberation, for with it I have taken the first big step to that place where I may hope to wash my hands of what in my mind’s eye is the blood of millions of poor and starving people.” I include all these professionals to convey that the meeting rooms within the World Bank and the IMF are not without critique—it’s the dominant influence of the developed world and the strong underrepresentation of the global south that has silenced these critics. However, there is others in the meeting rooms like chief economist Lawrence Summers (who has also served as US Secretary of the Treasury) 1991 wrote in an internal memo that was leaked: “Just between you and me, shouldn’t the World Bank
be encouraging more migration of the dirty industries to the LDCs [less developed countries]?” (Hickel, 2018). Therefore, one can only imagine how the meetings behind the closed doors of the IMF and the WB unfold.

In conclusion, the IMF and World Bank structural reforms have proven to be inefficient and detrimental to the people in Sub-Saharan Africa for three reasons- SAPs, neoliberalist policies, and failure of representation of the global south in the BWIs. After adhering to the IMF and World Bank's policies and mandated structural adjustment programs (SAPs), residents of Sub-Saharan African countries have not experienced any long-term improvement in their living conditions. However, as I said early on since the voting power in the IMF of all Sub-Saharan African countries together is only about a fourth of that allocated to the United States alone, their voice is not likely to bring about any major reform. In addition, these policies are ripping away the sovereignty of some of the poorest nations to instead impose neoliberalism in programs like the Chile experiment. Therefore, we need to reassess the BWIs and restructure how their programs are implemented in the global south.
Reference


