2011

IMF Conditionality, Fiscal Policy, and Income Inequality in Latin America

Nicholas Egger-Bovet
Claremont McKenna College

CLAREMONT McKENNA COLLEGE

IMF CONDITIONALITY, FISCAL POLICY, AND INCOME INEQUALITY IN LATIN AMERICA

SUBMITTED TO

PROFESSOR RODERIC CAMP

AND

DEAN GREGORY HESS

BY

NICHOLAS EGGER-BOVET

FOR

SENIOR THESIS

FALL 2011
NOVEMBER 28, 2011

TABLE OF CONTENTS

CHAPTER 1: INTRODUCTION

As the global economy suffers through the 2011 Eurozone crisis, the International Monetary Fund, also known as the Fund or the IMF, has once again been brought to the forefront of the international stage in their attempts to fix the ever worrisome debt problems facing Greece, Italy, Spain, and others. In the not-so-distant-past it would have been inconceivable for a *developed* European economy to require assistance from the IMF. While the IMF has, and continues to, adapt to fit the needs of countries facing balance of payments crises, the institution's impacts range far beyond macroeconomic indicators. The IMF has typically spent its time fixing crises in middle and low income countries across the globe, and in doing so has influenced their political, social and economic elements with mixed results. Given the level of involvement with these lower and middle income countries, it is imperative to look at how the IMF has impacted their income inequality and poverty levels to fully determine the outcomes that their programs and conditions have had. This paper will focus specifically on this relationship between IMF fiscal policy conditions and income inequality in Latin America.

A Brief History of the IMF

The International Monetary Fund was originally created in 1944 during the Bretton Woods Conference and formally established in December of 1945.[1] Under the IMF's Articles of Agreement, the role of the IMF was to "promote international monetary cooperation" and to "correct maladjustments in [countries'] balance of payments."[2] These

---

[1] "About the IMF: History: Cooperation and Reconstruction (1944–71)," IMF -- International Monetary Fund Home Page. Accessed November 26, 2011. http://www.imf.org/external/about/histcoop.htm.
[2] *International Monetary Fund Handbook - Its Functions, Policies, and Operations*, edited by Bernhand Fritz-Krockow and Parmeshwar Ramlogan, Washington D.C.: International Monetary Fund, 2007. Accessed November 26, 2011. 1.

statements, while still applicable today, were referring to the IMF's role of overseeing the operations of the newly created Bretton Woods system. Under the Bretton Woods system, countries agreed to peg their currencies to the United States dollar, which was tied to the value of gold. By only allowing the pegged exchange rate to be adjusted during fundamental disequilibrium, the global monetary system would be able to avoid the beggar-thy-neighbor policies adopted after the Great Depression, while still allowing countries to adjust their exchange rates to avoid major balance of payments crises.[3] During the 1950s and 1960s, the global economy continued to grow, and has been called the "golden age" for the IMF, as they were credited with the success of this period. Whether this credit was deserved is a debated topic.[4] The Bretton-Woods system continued to work well until 1971 when the United States ended the dollar's ability to be converted into gold. This led to the demise of the Bretton Woods System, and the emergence of global floating exchange rates in 1973.[5] After the 1973-1974 oil shock, private banks received huge deposits from rich, oil-exporting countries, and therefore were able to provide a significantly higher amount of private sector lending.[6] Without the Bretton Woods system to manage, and countries being able to easily borrow from private banks, the IMF did not have a significant global role until the beginning of the 1980s and the Third World Debt Crisis.

The Third World Debt Crisis, also referred to as the Latin America debt crisis, was the result of a huge increase in private sector lending from the 1970s to 1982 to less

[3] Graham Bird. "The IMF: A Bird's Eye View Of Its Role And Operations." *Journal of Economic Surveys* 21, no. 4 (2007), 686.
[4] Ibid. 686.
[5] "About the IMF: History: The End of the Bretton Woods System (1972–81)." IMF -- International Monetary Fund Home Page. Accessed November 26, 2011. http://www.imf.org/external/about/histend.htm.
[6] Bird, IMF: A Bird's Eye View, 687.

developed countries (LDCs). This increase in lending was promoted by the increase in global integration, the influx of petro dollars into the financial system, and the increased demand for loans from developing countries.[7] The total amount of debt in developing countries increased from $180 billion in 1975 to $406 billion in 1979.[8] In 1981, international banks had already halted their flow of money into a number of countries including Hungary, Morocco, Poland and Yugoslavia,[9] However, it was not until 1982, when Mexico "announced that its central bank had run out of foreign reserves and that it could no longer meets payments on its foreign debt" that the situation turned into a crisis. This was because foreign banks recognized that a number of other Latin American countries, such as Argentina, Brazil, and Chile were in similar situations to Mexico and therefore cut all lending to those countries and demanded repayment of previous loans.[10] Due to the halt in capital flows to Latin American countries and others around the world, the crisis continued to spread until "more than 40 countries had encountered severe external financing problems" by 1986.[11] This crisis was pivotal for the role of the IMF, as it officially became the "international crisis manager" from that point on.[12]

The Third World Debt crisis was followed by a series of crises throughout the 1990s and into the early 2000s. The most severe crises during this time period were the 1997 Asian Financial Crises, which this paper is outside of the scope of this papre and the

---

[7] Manuel Pastor, and Gary A. Dymski. "Debt Crisis and Class Conflict in Latin America." *Capital & Class* 15, no. 1 (1991), 203-31.
[8] Michael P. Todaro, and Stephen C. Smith. *Economic Development*. Boston: Pearson Addison Wesley, 2006, 676-677.
[9] James Boughton. "The IMF and the Force of History: Ten Events and Ten Ideas That Have Shaped the Institution." IDEAS: Economics and Finance Research. Accessed November 26, 2011. http://ideas.repec.org/p/imf/imfwpa/04-75.html., 12.
[10] Paul R Krugman, Maurice Obstfeld, and Marc J. Melitz. *International Economics: Theory & Policy*. Boston: Pearson Addison-Wesley, 2012, 632.
[11] Ibid. 632
[12] Boughton, IMF and the Force of History, 12.

Mexican Peso Crisis in Latin America in 1994-1995. The Peso Crisis began when Mexico devalued its peso by 15 percent in 1994, leading to a panic by investors, which further decreased the value of the peso to 50 percent of its previous value. It wasn't until the IMF stepped in and provided a $17.8 billion emergency loan that the country started to recover.[13] The crises throughout Latin America during the 1980s will be further analyzed later in this paper in the context of IMF fiscal conditions, and their consequences for income inequality.

IMF Conditionality and Structural Adjustment Programs

The 1980s and 1990s were crucial decades for the IMF as the institution changed to address the crises during this period. One of the most important ways in which they changed was their usage of conditionality attached to their loans. The IMF significantly increased the number and scope of conditions as well as started to implement structural adjustment programs during these two decades, but have since started to reduce the number of conditions though a streamlining process.[14] Before further addressing these new changes and structural adjustments, it is important to understand the purpose behind conditionality.

Conditions were not originally a part of the IMF's Articles of Agreement, but were instead added in 1952. The rationale behind their existence stems from Article 1 of the Agreements, which states that the IMF will "give confidence to members by making the Fund's resource temporarily available to them under adequate safeguards."

[13] Riordan Roett. *The Mexican Peso Crisis: International Perspectives*. Boulder, CO: Lynne Rienner Publishers, 1996, 2 & 24.
[14] Graham Bird. "Reforming IMF Conditionality - From 'streamlining' to 'major Overhaul'" *World Economics* 10, no. 3 (September 2009), Accessed November 26, 2011. http://www.relooney.info/0_New_5922.pdf., 81.

Essentially conditions are the safeguards that will ensure every country that receives an IMF loan will have the economic ability to repay it.[15] It has also been argued that IMF conditionality is used as a way of reducing moral hazard by increasing the costs associated with borrowing from the IMF.[16]

In addition to getting repaid and reducing moral hazard, the IMF's goal for conditionality is to fix the problems that caused the balance of payments disequilibrium in the first place. The IMF will only become involved with a country if there is a demonstrated balance of payments need. This need occurs "whenever the sum total of demands for resources in an economy exceeds the amount of those resources that can be generated internally plus those that can be attracted from abroad."[17] If the country demonstrates this need and approaches the IMF, it must then accept the IMF conditions, which are defined as the "policies a member must adopt to secure access to Fund resources."[18] There are three components to conditionality. The least demanding of these components is the government must sign a letter of intent to receive the funds. The second component requires the completion of prior actions before receiving the loans. The third component is "quantified 'performance criteria' which are used to provide an objective indication of whether the agreed upon programme of economy policy reform is on track."[19] These performance criteria must be met in order for other tranches, or additional amounts of the loan, to be given to the country.

---

[15] Ariel Buira,.*An Analysis of IMF Conditionality.* University of Oxford, Economics Department, 2002, 3.
[16] Bird, Reforming IMF Conditionality, 84.
[17] Ibid. 798.
[18] Buira, An Analysis of IMF Conditionality, 3.
[19] Bird, IMF: A Bird's Eye View, 705.

In most cases, countries receiving loans from the IMF have pursued expansionary fiscal and monetary policies to stimulate the economy during a downturn. This creates an increase in aggregate demand, and this leads to a balance of payments deficit.[20] Based on the objectives for conditionality, IMF conditions have tended to focus on reducing fiscal imbalances and restraints on monetary expansion in order to reduce aggregate demand.[21] These conditions result in policies that attempt to increase public sector revenues through increased taxation, and limit pubic expenditures associated with wages/salaries, government employment, subsidies, capital expenditures and state enterprises.[22] According to a 1986 review by the IMF of 94 programs from 1980-1984, the totals showed "91 percent containing measures to restrain government expenditure, and 96 percent measures to increase revenues."[23] These types of conditions were the main form of conditionality until the structural adjustments programs were initiated in the mid-1980s.

The implementation of IMF structural adjustment programs came during a period with significant increases in the number of conditions being attached to IMF loans.[24] This increase in conditions occurred for a number of reasons including: an increase in confidence about the correctness of economic policy recommendations, the positive signal given to private capital markets due to a strong commitment to policy reform, and to further decrease the potential problem of moral hazard as mentioned previously.[25]

---

[20] Buira, An Analysis of IMF Conditionality, 13.
[21] Bird, IMF: A Bird's Eye View, 706.
[22] Buira, An Analysis of IMF Conditionality, 13.
[23] Charles Sisson. "Fund-supported Programs and Income Distribution in LDCs." *Finance and Development*, March 1986, 2.
[24] Buira, An Analysis of IMF Conditionality, 16.
[25] Bird, IMF: A Bird's Eye View, 709.

With the IMF determining that higher numbers of conditions was the best way of ensuring the structural reform of countries' economies, the IMF structural adjustment programs were a natural fit.

These IMF structural adjustment programs were designed to "permit adjustment to occur without there being an adverse effect on economic growth." By allowing for lending over a longer period of time, adjustments could be implemented gradually and therefore still fix balance of payments problems, but without the negative impact on growth.[26] This rationale fit well with the overwhelming and complex problems in developing countries' economies, as well as the newly formed countries-in-transition after the fall of the Soviet Union.[27] Structural adjustment programs were also the perfect way of incorporating the "neo-liberal economic stance and increasingly favored policies aimed at reducing the role of the state: the reduction or elimination of subsidies, market liberalization and privatization of public enterprises" that had been adopted by the United States and the United Kingdom during this period.[28] Therefore structural adjustment allowed for the combination of "supply-side measures with more conventional components of conditionality" such as reducing fiscal deficits and monetary expansion.[29] This paper will later examine the effects of IMF structural adjustment programs and the rise of conditionality on income inequality in Latin America.

---

[26] Graham Bird, and Paul Mosley. "Should the IMF Discontinue Its Long-term Lending Role in Developing Countries?" In *Globalization and the Nation State: the Impact of the IMF and the World Bank*, edited by Gustav Ranis, James Raymond Vreeland, and Stephen Kosack. London: Routledge, 2006. Accessed November 26, 2011. 381.
[27] Bird, Reforming IMF Conditionality, 89.
[28] Buira, Analysis of IMF Conditionality, 16.
[29] Bird, IMF: A Bird's Eye View, 706.

While the rationale behind the structural adjustment programs and the rise in conditions may have been sound, there was a lack of ownership by the countries' governments of the programs, which led to poor results and a general lack of compliance. With higher numbers of conditions attached to IMF loans, countries felt less compelled to achieve them and the end result led to a 20 percent decline in compliance from the 1970s to the 1990s.[30] Both the issues of ownership and compliance are crucial when examining what impacts IMF fiscal conditions have on income inequality.

Latin America and the Importance of Income Inequality

This paper aims to analyze the link between IMF fiscal policy conditions and its impacts on income inequality, but first it is essential to understand why income inequality is an important issue, and how it affects both the IMF's goals and the overall development of the borrowing country. According to an article in the September 2011 issue of Finance and Development, higher levels of income inequality lead to higher levels of domestic and foreign indebtedness. This occurs because governments tend to "prop up the living standards of the bottom group" by making it cheaper to borrow, rather than confronting the underlying causes of the inequality.[31] Increasing debt levels are exactly what the IMF is trying to avoid, and therefore this is a compelling reason for the IMF to address the inequality issue. Additionally, Alberto Alesina and Roberto Perotti find that income inequality leads to increases in socio-political instability. This instability decreases the levels of investment in the country, thus lowering its growth.[32] These

[30] Buira, Analysis of IMF Conditionality, 19.
[31] Laurence Ball, Daniel Leigh, and Prakash Loungani. "Finance & Development, September 2011 - Painful Medicine." IMF -- International Monetary Fund Home Page. September 2011. Accessed November 27, 2011. http://www.imf.org/external/pubs/ft/fandd/2011/09/Ball.htm. 26.
[32] Alberto Alesina, and Roberto Perotti. "Income Distribution, Political Instability, and Investment."

findings are easily supported with current events around the globe, from the education strikes in Chile to the Occupy Wall Street movement to the Arab Spring Revolutions.

Inequality is an especially important topic in Latin America. It was ranked second in regional inequality, behind only sub-Saharan Africa in 2006 and inequality permeates every aspect of daily life.[33] Income distribution resembles a reverse pyramid, and "the allocation of goods, services, and basic opportunities is equally unbalanced."[34] With inequality playing major role in all economic, political and social factors in Latin American society, it is impossible to ignore, especially given the potential consequences this inequality may have in the future. Given the large income inequality this region has, it is worthwhile to focus on Latin America for this paper. By analyzing the effects that IMF fiscal conditions have had on Latin America as a region and individual countries, it may be possible to draw conclusions about what has gone wrong, and to provide recommendations for how the situation can be improved in the future.

This paper will analyze the effects of IMF fiscal policy conditions on income inequality and poverty in Latin America. It will first draw upon the general literature to provide context and insight into the relationship between IMF conditions and inequality. The following sections will present a more in-depth analysis of Latin America and look specifically at the case of Mexico during the 1982 Third World Debt Crisis. The final section will address recent developments by the IMF towards improving their conditionality to better income inequality and to provide policy recommendations.

European Economic Review 40, no. 6 (1996), 1204.

[33] Edwin J. Goñi, Humberto López, and Luis Servén. "Fiscal Redistribution and Income Inequality in Latin America." *World Development* 39, no. 9 (2011), 1558.

[34] Kelly Hoffman, and Miguel Centeno. "The Lopsided Continent: Inequality in Latin America." *Annual Review of Sociology* 29 (2003), Accessed November 26, 2011. www.jstor.org/stable/30036972. 363.

CHAPTER 2: GENERAL REVIEW OF THE LITERATURE

While the role of the International Monetary Fund has always been to help fix balance of payment disequilibria, its impacts beyond these macroeconomic indicators have not gone unexamined. The IMF has never been or claimed to be a development agency, unlike the World Bank, yet the "stark reality is that there is no sharp dividing line" between fixing a country's balance of payments problems and helping the country develop.[35] This lack of clear distinction has prompted many to scrutinize the Fund's programs, especially their conditionality, and their effects on income distribution and poverty.

This section will focus on the general literature regarding two main issues of IMF conditionality and income inequality. The first is examining the relationship that exists between IMF fiscal policy conditions and their impacts on income inequality and poverty. A number of scholars working for and independently of the Fund have attempted to empirically determine if there is an adverse effect on income distribution and the poor. This paper will use the general literature to examine whether or not IMF fiscal conditions have indeed hurt income inequality. While there are numerous factors (explained later in this section) that make the analysis of this relationship extremely difficult and impossible to measure with 100 percent accuracy, it is still valuable to examine and understand the arguments presented. This analysis, despite its imperfections, brings crucial awareness of issues regarding income inequality and the IMF, and provides a basis for bettering the Fund's conditions in the future.

[35] Bird and Mosley, Should the IMF Discontinue its Long-Term Lending, 394.

The second issue is the role of internal politics within the borrowing countries in the development and implementation of IMF fiscal policy conditions. Countries are given a large degree of control over the implementation of IMF conditions and those receiving loans from the IMF have varying degrees of negotiating power based on their size and ability to access international capital markets.[36] This gives the government significant influence over who receives the benefits of the reforms, and ultimately what redistribution of income occurs. Therefore, it is essential to try and better understand the role that internal politics play in the resulting changes in income inequality. This paper will use the general literature to examine whether or not internal politics of borrowing countries have played a significant role in adversely affecting income inequality.

By examining the general literature regarding IMF conditionality and income inequality, there will be a greater context in which to analyze the specific cases within Latin America. This will be especially useful when examining the role of internal politics on income inequality, as the factors involved cannot be empirically evaluated unlike the broad relationship between IMF fiscal conditions and income inequality. Both elements will be reviewed more extensively in the following chapters.

IMF Fiscal Policy Conditions and Income Inequality

This section will review the general literature regarding IMF conditions and their impact on income inequality. Through this review, it will be possible to view the major arguments that have been presented, and draw broad conclusions about whether or not

[36] Buira, Analysis of IMF Conditionality, 4.

IMF fiscal policy conditions have indeed adversely impacted income inequality. It will also touch on the scale of these consequences.

Before diving into the literature, it is important to understand the limitations that are present when trying to evaluate the relationship between IMF fiscal conditions and income inequality. Since this paper will not be examining the specific empirical methodologies used in the literature, it is valuable to look at some of the challenges these experts are trying to overcome during their analyses. There are two main challenges present: 1) the problem of the counterfactual and 2) determining changes in income inequality within a country during and after an IMF program and then attributing those changes to IMF conditionality.

The biggest problem facing researchers is the counterfactual, or determining what would have happened if the IMF had not given the country a loan or imposed certain conditions.[37] Essentially, there is no way of determining the exact impact of the IMF conditions because it is impossible to know what would have happened if the IMF had not become involved.[38] That being said, it is still possible for researchers to conduct empirical analyses on the topic, and determine meaningful results. All results must simply be qualified by stating that due to the counterfactual issue, it is impossible to determine if these results are 100 percent accurate.

The second challenge results from a lack of the appropriate data and imperfect methodologies. According to Omotunde Johnson and Joanne Salop in their article

---

[37] Graham Bird. "Growth, Poverty and the IMF." *Journal of International Development* 16, no. 4 (2004), 628.
[38] Bird and Mosley, Should the IMF Discontinue its Long-Term Lending, 381.

"Distributional Aspects of Stabilization Programs in Developing Countries" the ideal data set would "provide the distribution of income both prior to and at some time after the implementation of a program." Unfortunately this data does not exist and therefore the use of proxy variables is required.[39] Additionally, the lack of available and reliable data in most developing countries makes it is extremely difficult to create accurate results.[40] Fortunately, data collection continues to improve and therefore future results are likely to be more accurate than the ones examined in this paper.

Determining the appropriate methodology to attribute changes in income inequality to the IMF conditions is also an extremely difficult task. The most intuitive method would simply be to look at income inequality before and after the IMF program, but this leaves the very large problem of trying to determine exactly what affect the IMF fiscal policy conditions had rather than other factors involved. Another issue is the timeframe used to determine the effect. Ideally the timeframe would be long enough for a new equilibrium to be reached in the economy, thus allowing the full effects to be present. Unfortunately this does not make practical sense and therefore imperfect timeframes, often determined by the availability of reliable data, are used.[41] Selection bias has also posed a problem for researchers. In an ideal experiment, the subjects are chosen at random, whereas the countries that seek IMF assistance do so because they all have severe balance of payments disequilibria. This presents the challenge of determining whether or not changes in income inequality are the result of the underlying factors of

[39]Omotunde Johnson, and Joanne Salop. "Distributional Aspects of Stabilization Programs in Developing Countries." *Palgrave Macmillan* 27, no. 1 (March 1980), Accessed November 26, 2011. http://www.jstor.org/stable/3866860. 9.
[40] Sisson, 34.
[41] *Fund-Supported Programs, Fiscal Policy, and Income Distribution*. Vol. 46. Occasional Paper. Washington D.C.: International Monetary Fund, 1986. 2.

these countries, or the IMF fiscal policy conditions.[42] Despite these challenges, there are a number of studies that attempt to empirically determine the link between IMF fiscal conditions and income inequality. While none are perfect, they still provide a valuable insight into the effects that IMF conditions have on income inequality.

Although the topic of IMF consequences on income distribution had been debated in the past, the first significant analysis was conducted and published by the Fund in 1986. This review, *Fund-Supported Programs, Fiscal Policy and Income Distribution,* concludes that "Fund-supported programs have improved rather than worsened income distribution."[43] The report does acknowledge that their structural adjustment programs have been controversial in regards to income inequality and poverty, but defends the IMF policies by stating "the income distribution has not necessarily been made more regressive as higher income groups may be affected more" and without those programs the income disparity could have become "even more drastic."[44] The IMF also addresses specific conditions regarding taxation, public expenditures, debt financing, subsidies and state enterprises and finds that there is "little reason to believe that these programs lead to any increase in income inequality… [or] any significant decrease in living standards of the poorest quartile."[45] While these conclusions support the actions of the IMF, it is also difficult to imagine that they would produce anything that shed a negative light on their fairly new structural adjustment programs.

[42] James Vreeland, "The Effect of IMF Programs on Labor." *World Development* 30, no. 1 (2002), Accessed November 26, 2011. http://citeseerx.ist.psu.edu/viewdoc/summary?doi=10.1.1.29.3746. 124.
[43] Fund-Supported Programs, Fiscal Policy, and Income Distribution, 3.
[44] Ibid. 4.
[45] Ibid 37.

Following the IMF's review, an influential study was conducted by Manuel Pastor in 1987, which reviewed 18 Latin American countries from 1965 – 1981.[46] It was the first large scale empirical analyses that attempted to determine a link between IMF conditionality and income distribution. Pastor argues that the strongest and most significant effects of the Fund programs were associated with the decline in wages and the labor share of income.[47] The article states that IMF programs have led to nominal wage restraints on government workers, which have reduced the labor share of income and furthered the redistribution away from workers.[48] The article also makes the claims that IMF conditions that force the decrease in government expenditures hurt the non-elite the most, and this exacerbation in class conflict and income distribution can lead to extreme social tensions and political conflict.[49] While these particular claims are largely unsubstantiated in his article, they pose the interesting question of the role that the elites and internal politics play in redistribution. This topic will be covered in further depth later in this chapter.

In 2000, Gopal Garuda conducted another, more empirically sound, study focusing on 58 IMF programs from 1975-1991.[50] The paper examines the effects of "currency devaluation, reductions in the budget deficit, changes in growth rates and changes in inflation rates" on income inequality through analyzing countries' GINI

---

[46] Manuel Pastor. "The Effects of IMF Programs in the Third World: Debate and Evidence from Latin America." IDEAS: Economics and Finance Research. 1987. Accessed November 27, 2011. http://ideas.repec.org/a/eee/wdevel/v15y1987i2p249-262.html. 249.
[47] Ibid. 249.
[48] Ibid 258.
[49] Ibid 259.
[50] Gopal Garuda. "The Distributional Effects of IMF Programs: A Cross-Country Analysis." *World Development* 28, no. 6 (2000), 1031.

coefficients.[51] The results show that countries with severe balance of payments problems that receive IMF loans "show 10-20 percentage point declines in distribution measures relative to control group countries."[52] This increase in income inequality often results from aggregate demand reducing policies, which include "cuts in government expenditure, increases in levels of taxation, reductions in real wages, and credit restraints." These policies prompt nominal wage cuts and reductions in public sector employment, which tend to "increase poverty and worsen the skew of income."[53] This paper further emphasizes the role that fiscal policy changes determined by IMF loan conditions play in income inequality and poverty.

James Vreeland's 2001 paper, "The Effect of IMF Programs on Labor", uses 2,095 observations of 110 countries from 1961-1993 to analyze the role of IMF programs on labor's share of income in the manufacturing sector.[54] Vreeland finds that "when countries enter IMF programs, labor share plummets and as participation continues it seems to trend downward."[55] This decrease in labor share in due to IMF conditions for a reduction in public expenditure. This occurs though "wage freezes, limits on employment, and reduced benefits for public employees."[56] Vreeland's findings reinforce the previous findings of Garuda and Pastor but then delve further into why this income inequality occurs. The paper demonstrates that not only does labor's share of income decrease but capital's share of income increases.[57] This is significant because the owners

---

[51] Ibid. 1033.
[52] Ibid. 1047.
[53] Ibid. 1033-1034.
[54] Vreeland, The Effect of IMF Programs on Labor, 121.
[55] Ibid. 127.
[56] Vreeland, the Effect of IMF Programs on Labor, 122.
[57] Ibid. 133.

of capital (who tend to be better off in the first place) are therefore hurt less by IMF conditions than their labor force thus widening the income gap in both directions. Vreeland definitively concludes by stating "IMF programs have negative distributional consequences"[58], and "the negative effects of IMF programs on economic growth are paid for by the least well-off in a country."[59]

While there has been significant evidence demonstrating that IMF fiscal policy conditions have indeed had negative income distribution effects, these consequences are still debated, and their entirety is not fully known or understood. In Graham Bird's article "Growth, Poverty and the IMF," he claims that countries that have pursued IMF structural adjustment programs have a "more 'pro-poor' mix of stabilization polices... [and] government expenditure on health and education seems to be more protected and regressive tax policies less likely." These factors result in a moderation of income inequality.[60] William Easterly has concluded that the main result from IMF conditions is that they lower the "growth elasticity of poverty." This means the poor will benefit less from economic growth under structural adjustment, but they will not be hurt as badly during a period of recession.[61] Omotunde Johnson and Joanne Salop conclude that "the brunt of any downward adjustment of government expenditure to GDP is most commonly borne by public sector employees engaged in projects that come to be postponed."[62]

---

[58] Ibid. 133.
[59] James Raymond Vreeland. *The IMF and Economic Development*. New York: Cambridge University Press, 2003. 151.
[60] Graham Bird. "Growth, Poverty and the IMF." *Journal of International Development* 16, no. 4 (2004), 629.
[61] William Easterly. "The Effect of IMF and World Bank Programs on Poverty." October 31, 2000. Accessed November 26, 2011. http://www.imf.org/external/pubs/ft/staffp/2000/00-00/e.pdf. 2.
[62] Johnson and Salop, 12.

These mix of views and findings fuel the debate over the actual consequences that IMF conditions may have on income inequality. With the methodological and data problems associated with such large scale analyses presented above, it is extremely difficult to draw any firm general conclusions. Additionally, Heller et al. observe that without a more disaggregated analysis, it is almost impossible to truly understand the consequences on income inequality. They use the example of cutting funding in the education sector. If the cuts are at the university level or for primary education, the distributional impacts will be very different. Similarly, it is important to not only view the amount of cuts, but to "assess the impact on the quality and quantity of services delivered."[63] Therefore, in order to gain a better understanding of the IMF fiscal policy conditions it is necessary to take a more specific approach and analyze the specific outcomes at a regional and country specific level. The following chapters will attempt to do this for Latin America, and then Mexico specifically.

Internal Politics and Fiscal Policy Implementation

While a conclusive answer has yet to be provided over the consequences of IMF fiscal policy conditions on income inequality, it is essential to analyze and understand the role that the government of the borrowing country plays when determining how the fiscal policy is actually implemented. The IMF imposes fiscal policy conditions on the borrowing country, but these conditions rarely have specific actions that countries must take. In fact, only 3 of 94 programs from 1980-1984 have an "explicit reference to a government functional expenditure and less than one third of the programs refers to

[63] Heller, Peter, et al. *The Implications of Fund-Supported Adjustment Programs for Poverty; Experiences in Selected Countries*. Vol. 58. Occasional Paper. Washington D.C.: International Monetary Fund, 1988. 23.

government functional expenditure policies at all."[64] The IMF is able to encourage fiscal reform without specifically referring to fiscal policies by "placing limitations on credit to the government and the acquisition of new foreign debt."[65] This forces the government to fix their fiscal deficit in order to maintain financial viability. The IMF also allows the government to determine how it is going to fix its fiscal deficit because it is extremely difficult for them to determine how much spending is too much in any given sector.[66] The borrowing government therefore has to cut spending or raise revenues, but is allowed to determine how this takes place. It is critical to analyze what role internal politics and the favoritism of the elite plays in the government's decisions, and whether those decisions adversely affect income inequality and the poor.

The general literature demonstrates that the government's decisions do play a very important role in determining the consequences on the country's income inequality. Sidney Dell points out that the "causes of distributional outcomes 'lie more in the realm of politics than economics.'"[67] Domestic political decisions "largely determine who bears the burden of reducing and restructuring aggregate demand."[68] The government has the ability to determine the "composition of the budget cuts," and the resulting income inequality will depend on that composition.[69] The most direct manner in which this composition could significantly hurt the poor and increase income inequality is by cutting social programs that target the poor.[70] This allocation also plays a significant role when

64 Fund-Supported Programs, Fiscal Policy, and Income Distribution, 3.
65 Garuda, 1033.
66 Fund-Supported Programs, Fiscal Policy, and Income Distribution, 22.
67 Vreeland, The IMF and Economic Development, 136.
68 Johnson and Salop, 23.
69 Garuda, 1033.
70 Pastor, Effects of IMF Programs, 258.

determining which public sector jobs are going to be cut. Income distribution will become more equal if high paid upper level government employees are cut, whereas if only low level government jobs are cut income inequality will become worse.[71] Therefore, the government plays a crucial role in determining who is affected by the fiscal changes prompted by IMF conditions.

Given this link between government decisions and income inequality outcomes, it is important to understand how and why governments make the decisions that they do regarding their changes in fiscal policy. The main argument posed by numerous scholars is that governments make their decisions based on ensuring the continued support of the local elite. One reason for this is that in order for a country to reach an agreement with the IMF, it must get the support of these elite and this is often achieved by promising them they will not bear the costs of the adjustments.[72] Due to the IMF's desire to "secure the cooperation of local elites [it] may lead them to design programs which place the burden of adjustment on workers and other 'popular classes.'"[73] Therefore, the governmental authorities do not have complete control over the fiscal policies they ultimately implement. Instead, "the choice of policy instruments will be influenced by the political power of various income groups."[74] The likely result will be that the government will cut basic social services and the "'social wage' will decline further and distributional consequences will be worse."[75] While the government does also take into account the "causes of the balance of payments problem and of the effects of different policy

[71] Johnson and Salop, 12.
[72] Pastor, The IMF and Latin America, 57.
[73] Pastor, Effects of IMF Programs, 258.
[74] Garuda, 1033.
[75] Pastor, Effects of IMF Programs, 258.

instruments" into its decisions, the influences of the elite often ensure that they remain relatively unhurt by the policy outcomes.[76]

Although the IMF officially maintains that income distribution outcomes are an "internal political concern," they have always been indirectly concerned with how their programs affect income inequality and resource allocation issues. This is partly due to the fact that the complexity of the topic makes it challenging for the IMF to address.[77] It is extremely difficult to empirically evaluate the true effect of IMF conditions on income inequality due to poor access to information, and the problem of the counterfactual. However, the general literature has generally found that the impacts of IMF conditions on the fiscal policies of borrowing countries can have direct negative consequences on income inequality and poverty within the country involved. While IMF conditionality is often blamed for these adverse effects, the governments of borrowing countries also play a significant role in determining the changes in income inequality. This often occurs when the government implements IMF programs to protect certain groups of constituencies, which have "disproportionately served the interests of the middle- and upper-income groups rather than the poor."[78][79] The general literature provides a basic understanding of the problems associated with the IMF, internal politics and income equality, but does not fully explain the intricacies of these relationships. The following chapters will attempt to accomplish this in the context of Latin America.

[76] Johnson and Salop, 12.
[77] Fund-Supported Programs, Fiscal Policy, and Income Distribution, 1.
[78] Vreeland, IMF and Economic Development, 136.
[79] Heller, et al., Implications of Fund-Supported Programs, 23.

CHAPTER 3: THE IMF, LATIN AMERICA, AND INCOME INEQUALITY

The IMF has been actively lending across the globe since its founding, but its involvement in Latin America was vastly increased after the 1982 Latin America Debt Crisis. To illustrate this point, in 1983 almost three quarters of Latin American countries were under IMF programs, compared with less than one-third in the 1970s.[80] This was not only a momentous change between the IMF and the region, but for the IMF itself. Before the crisis, the IMF had mainly only lent to small low-income countries in Africa and East Asia. The 1982 crisis not only allowed the Fund to diversify its portfolio of countries, but solidify its role in the international community as a crisis managing institution.[81] Given the significance of the Latin American crisis, for both the continent and the IMF, it is valuable to examine the causes leading to the crisis, the response by the IMF, and the resulting outcomes on income inequality and poverty in the region. This section will also analyze the role of national politics and various interest groups in determining the successes and failures of the implementation of IMF fiscal conditionality.

The Latin American debt crisis emerged from the huge boom in international lending that occurred during the period of 1974-1979. With the recycling of OPEC petrol dollars following a price spike in 1973, Latin American countries continued to use cheap capital to fund their growth, becoming further indebted, and eventually leading to the crisis in August 1982 when Mexico announced it could no longer pay its debts.[82] While this is the broad story behind the crisis, there are a number of other factors that spurred this increase in borrowing in addition to the fact that the money was easily available.

[80] Pastor, IMF and Latin America, 151.
[81] Bird, IMF: A Bird's Eye View, 687.
[82] Todaro and Smith, 676-677.

Pastor and Dyrnski state that financial internationalization and the slow growth of advanced economies were substantial contributing factors.[83] As the growth in developed countries started to decline, this reduced the amount of imports they were willing to purchase, and Latin America suffered the most as a consequence of these changes.[84] Additionally, Krugman et al. point to the U.S. dollar's significant appreciation after 1981, which "raised the real value of the dollar debt burden substantially."[85] This only exacerbated the already high levels of debt the Latin American countries had been obtaining.

These numerous external factors clearly influenced the excessive borrowing in Latin America, but it does not fully explain the rationale for the Latin American countries themselves. Berg and Sachs argue that the large amount of borrowing was the not the result of strategic economic calculations but "the political needs of the incumbent government" as a way to "satisfy intense social demands for higher government spending without having to suffer (in the short-term) the political consequences of higher tax" rates.[86] This rationale makes logical sense, and is consistent with almost every other large fiscal deficit in the world. The government wants to gain social favor by providing additional services, but does not want to pay for them. However, Berg and Sachs delve further into why Latin American countries specifically had such high debt levels. They suggest that the prevalence of extreme income inequality in Latin America lead to "little commonality of interests" and a conflict between higher pressure for redistributive

---

[83] Pastor and Dymski, Debt Crisis and Class Conflict in Latin America, 155.
[84] Pastor, IMF and Latin America, 156.
[85] Krugman, et al., International Economics, 632.
[86] Berg, Andrew, and Jeffrey Sachs. *The Debt Crisis: Structural Explanations of Country Performance*. Vol. 2607. Working Paper. National Bureau of Economic Reserach, 1988. 2-3.

policies and the wealthy class' ability to resist these pressures given their more influential position in society.[87] Therefore, the internal demand for government spending caused by income inequality coupled with the large prevalence of international funding and the harmful economic shifts from the United States and other developed countries all contributed to the 1982 Latin American Debt Crisis. Now that the underlying factors behind the crisis have been addressed, it is possible to examine the policy responses by the IMF and the Latin American countries, and the outcomes of those decisions on income inequality and poverty.

IMF Conditionality and Latin American Structural Adjustments

In the years following the Latin American Debt Crisis, the IMF increased the number of conditions attached to their Standby arrangements and Extended Fund Facility (EFF) loans from approximately "six in the 1970s to 10 in the 1980s."[88] While these IMF loans were designed to fix balance of payments problems, they did not address growth. The term "stabilization" or "stabilization program" is often used for these short term policy changes to fix a balance of payments deficit.[89] This eventually led to the implementation of the Structural Adjustment Facility (SAF) and Enhanced Structural Adjustment Facility (ESAF) in 1986 and 1987 respectively. The SAF and ESAF were designed to promote growth through three year longer term structural adjustments in addition to fixing the immediate balance of payments problems faced by the countries.[90] In the case of Latin America, poorer countries such as Bolivia, Honduras and Nicaragua

---

[87] Ibid. 3.
[88] Buira, Analysis of Conditionality, 16.
[89] M Hutchison and Ilan Noi. "Macroeconomic Effects of IMF-sponsored Programs in Latin America: Output Costs, Program Recidivism and the Vicious Cycle of Failed Stabilizations." *Journal of International Money and Finance* 22, no. 7 (2003), 994.
[90] Ibid. 18.

utilized the SAF/ESAF loans, whereas the middle income countries such as Argentina, Brazil, Chile and Mexico only used the Standby and EFF loans. With the IMF doing its best to adapt to the needs of its member countries, there were still a number of problems that faced Latin American countries during this period.

One of the biggest problems that countries in Latin America were facing when approaching the IMF for assistance was their huge fiscal deficits caused by the excessive debt built up during the 1970s. Therefore, one of the main focuses of IMF conditions was on fixing these fiscal deficits. Critics, such as Pastor, disagree with the "excessive attention to fiscal measures" stating that "a deliberate attempt to reduce fiscal deficits in the midst of [a] global slowdown is a reckless pro-cyclical policy."[91] While the criticism may be valid, there are limited alternative options for countries to take to fully address their growing debt levels and fiscal deficits.

There are two ways to fix a fiscal deficit: increase government revenues through increased taxation, or decrease government expenditures. Ideally the government would be able to increase tax revenues by increasing rates of existing taxes and/or widening the base of existing taxes. However, in most countries tax rates were already quite high and broadening existing taxes was not a viable option. A more viable option was to introduce a new and broadly based tax, often in the form of a value-added tax (VAT).[92] Bolivia introduced a successful VAT tax during its 1985 restructuring, and it "quickly became the

[91] Pastor, IMF and Latin America, 160.
[92] Mackenzie, G.A., David Orsmond, and Philip Gerson. *The Composition of Fiscal Adjustment and Growth: Lessons from Fiscal Reforms in Eight Economies*. Vol. 149. Occasional Paper. Washington D.C.: International Monetary Fund, 1997. 14-25.

centerpiece of the new tax system."[93] Chile was also able to successfully implement a VAT tax, which increased its tax revenue by five percent of GDP.[94]

Unfortunately successful taxation is not always the case. Increasing revenue in developing countries is extremely difficult due to the inadequacy of the necessary enforcement agencies to enact these changes. Heymann described the Argentine tax system as "that of a system without clear design, with complicated legislation that is not enforced, which cannot collect broad-based taxes and has to rely on a diversity of rather primitive taxes."[95] This is why the simplification of the tax code was so essential to the success of countries like Bolivia. By replacing the old and ineffective tax system and replacing it with more streamlined taxes, Bolivia was actually able to succeed at increasing its revenues.[96] This results in the majority of changes occurring on the expenditure side.

Given the difficulties associated with collecting government revenues, the majority of fiscal reforms took place by decreasing government expenditures. The IMF Conditionality Guidelines implies that the IMF should "interfere as little as possible with the preferences of the borrower."[97] This has generally allowed the borrowing governments to determine how to specifically implement these budget cuts, leaving the IMF to only provide external advice. Cuts in fiscal spending tend to fall under four main

---

[93] Ter-Minassian, Teresa, and Gerd Schwartz. *The Role of Fiscal Policy in Sustainable Stabilization: Evidence from Latin America.* August 1997. Accessed November 26, 2011. http://www.imf.org/external/pubs/ft/wp/wp9794.pdf. 25.
[94] Mackenzie, Composition of Fiscal Adjustment and Growth, 15.
[95] Ter-Minassian and Schwartz, Role of Fiscal Policy in Sustainable Stabilization. 13.
[96] Ibid. 13.
[97] J. J. Polak, *The Changing Nature of IMF Conditionality*. Princeton, NJ: International Finance Section, Dept. of Economics, Princeton University, 1991. 53.

categories: government wage/employment levels, subsidies, state enterprises and capital expenditures.[98] All four of these options provide the government with viable and effective means of cutting costs in the short run and for the long term benefit of the country if they are used appropriately.

The most used type of fiscal reductions involved reducing minimum wages, government employee salaries, and/or decreasing the number of government employees. This sector is an easy target for spending reductions given that on average more than 40 percent of non-agricultural workers are employed by the government, and the government is the one that determines those salaries.[99] For example, in 1990 Argentina announced that there would be a freeze on new hiring, anyone above the retirement age would be forced to leave, and they would eliminate 56 secretary of state positions.[100] These types of cuts, in addition to temporary wage and hiring freezes were common but were often ineffective. This was partly because they made government jobs unappealing, and therefore made it difficult to hire the talented senior level officials necessary for the positions.[101] Additionally, repeated attempts at wage freezes that occurred in Brazil and Argentina "encouraged private sector firms to increase prices preemptively" so as to mitigate the effects.[102] Wage and hiring freezes were also largely unsuccessful due to the obvious political implications involved. In Bolivia, "politically powerful groups, such as the armed forces and workers in the education and health sectors" influenced government

[98] Fund-Supported Programs, Fiscal Policy, and Income Distribution, 21.
[99] Fund-Supported Programs, Fiscal Policy, and Income Distribution, 23.
[100] Ter-Minassian and Schwartz, Role of Fiscal Policy in Sustainable Stabilization, 24.
[101] Mackenzie, Composition of Fiscal Adjustment and Growth, 19.
[102] Ter-Minassian and Schwartz, Role of Fiscal Policy in Sustainable Stabilization, 11.

decisions resulting in a negligible reduction in government employment.[103] Therefore, while temporary wage and hiring freezes were common in Latin America, they did not have significant long term impacts on the fiscal budgets.

The reduction or elimination of government subsidies was another tool that governments used to try to fix their fiscal deficits. Subsidies, usually on food, petroleum or fertilizers, were used to keep prices low for the people, and were often touted as protecting the lower class.[104] Under Fujimori, Peru eliminated a number of its subsidies in 1990 in an attempt to balance its budget.[105] Brazil also reduced its subsidies of food and oil during this time. Historically, there has been a large debate about whether or not the reduction and elimination of subsidies disproportionately hurt the poor. While Sisson argues that the majority of subsidy benefits ultimately help the rich instead of the poor, subsidies still do have some benefit for the poor even if it is not as much as it should be.[106]

A third category of budget cuts regards government capital expenditures. Capital expenditures, also referred to as public investment, are normally spent on bigger projects like infrastructure, hospitals, etc. and therefore take a longer time to complete and are more expensive. Government capital expenditures also include "repair, maintenance, and other recurrent costs in order to attain greater efficiency in utilizing the existing capital stock, rather than creating new capital."[107] While some programs, such as those in Chile,

[103] Abed, George. *Fiscal Reforms in Low-Income Countries; Experience Under IMF-Supported Programs*. Vol. 160. Occasional Paper. Washington D.C.: International Monetary Fund, 1998. 33.
[104] Fund-Supported Programs, Fiscal Policy, and Income Distribution, 27.
[105] Fiscal Policy and Sustainable Stabilization, 31.
[106] Sisson, 3.
[107] Heller, et al., 25.

managed to increase the amount of public investment, the majority of countries in Latin America used capital expenditures as a short term means of cutting costs.[108] For example in 1985, Bolivia enacted a one year halt on public investment, and Argentina during its IMF program in 1989 "announced a suspension of all state-funded public works."[109] Cutting capital expenditure generally has low political costs, especially when governments reduce maintenance funding. Short term cuts on capital expenditures can also be the most damaging in the long-run for both the growth of the country, and the impacts on income inequality.

Challenges to Fiscal Policy Reform

Fiscal policy reforms face a significant variety of challenges, and are often never fully accomplished. Vito Tanzi elaborates on the extent of fiscal policy challenges by stating "tax evasion, inflation, and the proliferation of exonerations have reduced the government's control of tax revenues, while political pressures, fragmentation of the public sector, and inadequate monitoring systems have undermined its ability to keep public expenditure in check."[110] Additionally, the fiscal policies changes that are ultimately implemented are not always the most economically beneficial, and thus do not always accomplish their goals of fixing the balance of payments problems and spurring growth in the country. This section will focus on the challenges that have faced fiscal policy reform in Latin America. It will also emphasize the political factors that can and have influenced these policy decisions.

---

108 Ibid. 26.
109 Fiscal Policy and Sustainable Stabilization, 22 & 25.
110 Fiscal Policy, Stabilization and Growth in Developing Countries, 14.

Fiscal policy reforms have not had the success that IMF programs would suggest they should. This is often due to the fact that the specific allocation of fiscal policy cuts is not done in the most economically beneficial manner. This refers specifically to the rate of return on various government expenditures, and their effects on growth. If the government cuts programs that are beneficial to long-term and sustainable growth, such as capital expenditure, then it can hurt the economy in the medium and long term despite the initial decrease in the fiscal deficit.[111] Interestingly, the IMF's Independent Evaluation Office (IEO) has shown that the implementation of an "IMF-supported program does not reduce public spending in either health or education—measured as a share of total public spending, GDP, or in per capita real terms."[112] This is one example of governments choosing the right programs to keep. The ideal composition of budget cuts would be to eliminate the wasteful and inefficient programs of the public sector, and leave the efficient and beneficial programs untouched.

While this composition would be ideal, it is highly unlikely that this will actually occur due to national politics and the vested interested of various groups that would be adversely affected in some way. All IMF programs, especially those referring to fiscal reform in Latin America, "do in fact serve the interest of the ruling groups" and other interest groups.[113] A main factor behind the implemented fiscal policies that makes them different from the most economically sound options is the government's general preference for short-sighted thinking rather than long-term planning. Governments have

---

[111] Mackenzie, Composition of Fiscal Adjustment and Growth, 19.
[112] Independent Evaluation Office (IEO). *Fiscal Adjustment in IMF-Supported Programs*. Washington D.C.: International Monetary Fund, 2003. 17.
[113] Pastor, IMF and Latin America, 169.

short time horizons and short sighted thinking for a number of reasons, but especially because of their desire to maintain power. This occurred in Venezuela during the 1980s as their policy reforms reflected no strategy for redirecting spending other than making cuts in areas that were the easiest to achieve.[114] One cost of pursuing stabilization policies is that the "short-run political costs [begin] to loom larger than the longer-run economic benefits" and political support for the program therefore declines.[115] The austerity measures associated with fiscal policy reform can often be painful politically, and therefore the government generally chooses to pursue the reforms that have the most support from various interest groups. This ultimately leads to reforms that are not beneficial in the long run, but rather politically feasible in the short run.

Internal politics also plays a large role in determining whether or not a country will comply with adjustment benchmarks set by the IMF, regardless of the fact that these benchmarks are often requirements for the country to continue receiving its loan. Hutchinson and Noi find that Latin America had significantly higher rates of recidivism, or repeated loans with the IMF, than other regions.[116] Buira also notes that IMF conditionality compliance declines in a parallel manner with the increase in the number of loan conditions.[117] The intuitive argument that with more conditions there will likely be more instances of incompliance stands true in this case. This high recidivism rate is also partially explained by the fact that as soon as an arrangement starts to "break down, the Fund immediately starts to negotiate a new program" and this previous lack of

---

[114] Ter-Minassian and Schwartz, Role of Fiscal Policy in Sustainable Stabilization, 15.
[115] Mario I. Bléjer, and Ke-young Chu. *Fiscal Policy, Stabilization, and Growth in Developing Countries*. Washington, D.C.: International Monetary Fund, 1989. 14.
[116] Hutchison and I Noi, 996.
[117] Buira, An Analysis of IMF Conditionality, 19.

compliance does not affect receiving new loans in the future.[118] Given the lack of incentives for countries to meet the fiscal policy conditionality they agreed upon in order to receive the loan, governments choose to do what is in their best interests and often times it is the policymaker's optimal policy choice to not push for the completion of these fiscal reforms.[119] Without consequences in place, governments in Latin America have chosen to ignore their initial agreements with the IMF, and thus benefit politically from the softened fiscal policy impacts on the country.

Income Inequality and Latin America

During stabilization policies and structural adjustments, countries in Latin America have neglected to address the effects that fiscal policies have on income inequality and the poor. As long as politicians maintain their support base, and the IMF is satisfied with their progress addressing their balance of payments problems, there is no reason to examine if the policy decisions may be ignoring the underlying expansion of "income distribution [and] exacerbated social tension."[120] In fact, governments are more than happy to enact policies that "create 'rents' for groups whose support the government need in order to stay in power" and completely ignore the future consequences on both the economy and income inequality in the future.[121] It is important to note however that not all effects on income inequality should be attributed to IMF conditions and government implementation. Given the level of debt, and the severity of the crisis during the 1980s, Killick argues that "declines in real wages and consumption standards, and

---

[118] Axel Dreher. "Does the IMF Influence Fiscal and Monetary Policy?" *The Journal of Policy Reform* 8, no. 3 (2005), 12.
[119] Hutchinson and Noi, 1011.
[120] Pastor, Effects of IMF Programs in the Third World, 259.
[121] Fiscal Policy, Stabilization and Growth in Developing Countries, 31.

increased proportions living in poverty…became *inevitable*."[122] While this may certainly be the case, it is highly likely that government policies exacerbated income inequality in Latin America.

Latin America suffered in the 1980s especially, with regional decline of 6.6 percent in GDP per capita and a 16 percent decline in income per capita.[123] While this decline impacted everyone, the poor were affected more than the wealthy. From 1980-1985, the consumption per capita of the owners of capital rose by 16 percent whereas the consumption of labor declined by 25 percent.[124] This demonstrates how despite the overall decline in growth in Latin America, the brunt of this decline was felt by the poor. An example of the rising inequality is Brazil, where the "ratio of the top 10 percent to the bottom 40 percent rose from 5.1 in 1980 to 6.7 in 1990, with a similar increase based on per-capita household income."[125] This rise in income inequality was mirrored throughout the region.

After the Latin American Debt Crisis, the IMF tried to help countries fix their massive debts by imposing conditions that would force them to reduce their fiscal deficits. These conditions generally gave countries the freedom to determine how they were actually going to implement these policies. Fiscal reform typically took place by increasing tax revenue through new broadly based taxes, and decreasing expenditures by reducing government salaries and employment, reducing subsidies, and cutting capital

---

[122] Tony Killick. "Structural Adjustment and Poverty Alleviation: An Interpretative Survey." *Development and Change* 26, no. 2 (1995), 312.
[123] Dharam P. Ghai, *The IMF and the South: the Social Impact of Crisis and Adjustment*. London: Zed Books on Behalf of UNRISD, Geneva [and] ISER/UWI, Kingston, 1991, 20.
[124] Ibid. 21.
[125] Clements, Benedict. *Income Distribution and Social Expenditure in Brazil*. IMF Working Paper. Washington D.C.: International Monetary Fund, 1997, 7.

expenditures. While fiscal adjustments were absolutely necessary for the countries to fix their high levels of foreign debt, the policy choices made were often short sighted and were determined based on their effects on political support, rather than long-term economic stability and growth. These decisions often resulted in countries not meeting the benchmarks set by the IMF, which should have resulted in the termination of the loan. However, this would ultimately never occur since the IMF would always renegotiate with those countries. This furthered the political motivations to avoid politically costly actions during stabilization reforms and policies. By avoiding the most economically and socially beneficial fiscal reforms, Latin American governments ultimately hurt income inequality and the poor.

CHAPTER 4: THE IMF AND MEXICO: 1980-1989

While analyzing Latin America as a whole brings the major issues regarding the IMF and income inequality to light, it is impossible to delve into the complexities and important details that occur during the process of negotiating loan conditions and the decisions behind how the borrowing country determines which fiscal policies to adapt after finally receiving the IMF loan. By focusing on the specific case of Mexico before, during, and after the 1982 crisis, it will be easier to understand these intricacies and gain a better insight into the rationale behind IMF and the Mexican governmental decisions, and how they ultimately impacted income inequality and the poor.

The 1982 crisis was a pivotal moment for the IMF and the global financial community in general. With Mexico's announcement that it would not be able to pay its debts, the world faced its first serious threat of a global financial collapse. The IMF stepped in to help manage the crisis but this was essentially new territory for them as they had to balance the internal politics of Mexico, the interests of the United States, and foreign bank demands for repayment, all while trying to implement a loan package that would satisfy all parties involved before Mexico defaulted on its loans. This was an incredibly complicated task, and one that will be examined further in this chapter.

The implementation of the IMF's conditions regarding fiscal reductions was also a complicated process. Internal politics, especially with the election of a new president, and an uncooperative private sector led to a lack of political will to fully implement painful fiscal cuts necessary to get the country out of the crisis. Instead, a large fiscal reduction occurred, but not large enough to actually make the country's economy grow again. This ultimately led to an increase in income inequality and poverty in the country.

Mexico is an interesting case study to examine the relationship between IMF conditions and income inequality due to the fact that the program negotiated was "one of the most severe austerity packages launched in Latin America during that period."[126] Given that the 1982 crisis was the first real crisis to "threaten the stability of the [entire] international financial system" it was also one of the most urgent programs the IMF had ever undertaken.[127] With high stakes and little time, the IMF loan to Mexico "introduced important innovations in the speed of negotiations, the role of structural elements in the policy adjustment program, the assembling of official financing packages, and…relations between the Fund and private creditors."[128] Mexico provides an excellent example of how the urgency in the face of a crisis and role of internal politics are highly influential in determining the number and depth of conditions attached to IMF loans. This example demonstrates how these factors determine whether or not the country ultimately follows through to meet those conditions, and what consequences they have on income inequality and poverty.

Negotiating IMF Program Conditionality

Nobody in either the IMF or the Mexican government had predicted that there was an imminent crisis in the early 1980s. IMF economists had expressed concerns about the rising levels of debt but the country's booming oil industry mitigated these

---

[126] Ghai, IMF and the South, 124.
[127] James M. Boughton, "7. The Mexican Crisis: No Mountain Too High?" In *Silent Revolution: the International Monetary Fund, 1979-1989*, Washington, D.C.: International Monetary Fund, 2001. 281.
[128] Ibid. 281.

concerns.[129] Once the possibility of economic troubles became more apparent towards the middle of 1981, Mexico's external public debt was already at a record high of $52.2 billion USD, almost double its $26.4 billion debt in 1978.[130] The initially high level of debt stemmed from the rise of populism in the country during the 1970s, which "accelerated public investment [and] increased social spending" and continued due to a lack of political will to increase taxes or reduce government spending.[131] An additional $20 billion dollars in debt was added in the second half of 1981 and the first half of 1982 in order to pay off the interest on its high level of debt.[132] While the rapid rise in borrowing was concerning, the more important problem was the borrowing was only short term, and therefore a significant amount of the principal debt had to be paid back by 1983. During this same 1978-1991 period, the operational deficit had also risen from 5.7 percent of GDP to 9.8 percent.[133]

The situation became even more concerning due to the fact that there was an upcoming presidential election in July 1982, and it would be extremely difficult to pass any tough changes until the new president was in office.[134] Unfortunately the winner of this presidential election, Miguel de la Madrid, was not able to take office until December, despite the financial worries of the country.[135] The IMF believed that the country would be able to avoid default until that time, but in mid-August "new money

---

[129] Boughton, Silent Revolution, 283.
[130] Lance Taylor. *The Rocky Road to Reform: Adjustment, Income Distribution, and Growth in the Developing World*. Cambridge, MA: MIT Press, 1993. 272.
[131] Robert R. Kaufman, "The Politics of Economic Adjustment Policy in Argentina, Brazil, and Mexico: Experiences in the 1980s and Challenges for the Future." *Policy Sciences* 22, no. 3-4 (1989), 404.
[132] Taylor, Rocky Road to Reform, 272.
[133] Ibid. 272
[134] Boughton, Silent Revolution, 284.
[135] Ibid. 286.

dried up, and Mexico faced a crisis that could be resolved only through international coordination."[136]

Mexico desperately needed external funding to avoid a default, which would have been a catastrophe to their economy, the economy of the United States, and the entire global financial structure. Therefore, the IMF took the lead in trying to work out a loan program for Mexico with the utmost urgency. After some initial negotiations, the IMF's Managing Director told the Mexican representatives that the "program would have to be designed by the Mexican authorities themselves and would have to meet their own political as well as economic requirements." This was going to be particularly difficult because the program "would have to be endorsed by both the outgoing and the incoming administrations" in addition to the other parties involved.[137] The private banks that had been lending to Mexico were one of these important parties. The IMF determined that without their support and an additional flow of capital, Mexico would surely default, hurting everyone. It was therefore in the bank's best interests to increase their lending to Mexico.[138]

After months of negotiations, the IMF and Mexico eventually reached an agreement on December 23, 1982 for $3.75 billion USD under the EFF extended arrangement facility. In addition to this, commercial banks had committed $4.3 billion in additional capital.[139] The most pressing condition of the program was Mexico's reduction in its fiscal deficit. The Mexican government agreed to reduce the fiscal deficit to 8.5

---

[136] James Boughton. "From Suez to Tequila: The IMF as a Crisis Manager." *The Economic Journal* 11-, no. 460 (January 2000), Accessed November 26, 2011. http://www.jstor.org/stable/2565658. 285.
[137] Boughton, Silent Revolution, 291.
[138] Boughton, Suez to Tequila, 286.
[139] Boughton, Silent Revolution, 314-315.

percent of GDP in 1983, from 16.5 percent in 1982.[140] This was a huge reduction, and absolutely necessary in order to begin fixing the country's debt crisis and regain growth after a negative 0.5 percent decline in GDP in 1982.[141] After taking office Miguel De la Madrid also promoted "trade liberalization and privatization" as additional government objectives to improve the economy.[142] These actions shifted the country away from the previous conflict between the populist governments and the domestic business elite and the "orthodox technical specialists in the Central Bank and Treasury."[143] De la Madrid's background as one of these technical specialists allowed him to surround himself with people who "shared his views of fiscal conservatism" and therefore reduce the power of public enterprises and "reduce the allocation of subsidies to public firms."[144] While these were more long term strategies, the biggest and most energy consuming emphasis right after the crisis was on the reduction of the huge fiscal deficit in order to satisfy the IMF and help return growth to the country.

Mexico's Fiscal Reductions and Income Inequality

The extremely large decrease in the Mexican government's fiscal deficit was inevitably going to hurt the poor and increase income inequality. Given that the IMF loan negotiations required only the support of the Mexican political and economic elite, and not the popular vote, it was highly likely that fiscal deficit reductions would increase income inequality in the following years. It is also worthwhile to note that Mexico was not a very wealthy country before this crisis hit. Despite its long period of economic

---

140 Ibid. 306.
141 Taylor, Rocky Road to Reform, 272.
142 Judith Teichman. "Mexico and Argentina: Economic Reform and Technocratic Decision Making." *Studies in Comparative International Development* 32, no. 1 (1997), 37.
143 Kaufman, 404.
144 Tecihman, Mexico and Argentina, 37.

growth, “between 35 and 40% of household earned a total income below the prevailing minimum wage, approximately 19 million people suffered from malnutrition; the infant mortality rate was equal to 50 per 1,000 live births; and around 15% of the population was illiterate.[145] Therefore, the effects of the 1982 crisis on poverty and inequality only heightened the existing levels that were present. This section will review the different elements of Mexico’s fiscal reduction and their consequences on income inequality and poverty.

In order to decrease the fiscal deficit, the IMF had imposed conditions including “a new devaluation, increase in public revenues – via increase in indirect taxes as well as in the prices of public services – and highly restrictive credit and wage policies.”[146] This led to a decline of 6.3 percent in GDP per capita in 1983, but did manage to reduce the public fiscal deficit by half.[147] Over the period of 1982 – 1985, “GDP grew at an average of zero %; real wages were reduced by 30%; the wage share contracted by 10%; and social expenditures fell on average by 19%.”[148] With a lack of new lending, “declining reserves, a plunge in oil prices, and a major new surge in inflation,” Mexico’s economy had not improved but had instead plunged back into recession by 1985.[149] Therefore, while the austerity measures may have reduced the fiscal deficit, they did not fix the problem, but rather made income inequality worse in the country instead.

---

[145] Nora Lustig. "Economic Crisis, Adjustment and Living Standards in Mexico, 1982-85." *World Development* 18, no. 10 (1990), Accessed November 26, 2011. http://ideas.repec.org/a/eee/wdevel/v18y1990i10p1325-1342.html. 1325.
[146] Ghai, IMF and the South, 124.
[147] Taylor, Rocky Road to Reform, 274.
[148] Lustig, 1336.
[149] Kaufman, 405.

In an attempt to increase government revenues, the Mexican government introduced a number of new taxes after the IMF loan. While these efforts were beneficial, especially those regarding the implementation a reformed VAT tax, they did not create a sizeable change for the government.[150] This was most likely due to a significant amount of tax fraud and a narrow a tax base.[151] While continuing to improve the tax system, especially in the enforcement and collection areas, would have been extremely beneficial, it was not politically feasible. Often times "Mexican private sector groups…used the threat of capital flight to veto government tax reform initiatives," forcing the country to have "one of the lightest tax loads in the region."[152] Instead, the country focused more on revenue collection through higher prices for public goods and reductions in government expenditures. By increasing the prices for public goods and services, Mexico was able to increase its revenues to offset the decline in revenue from their lagging oil industry.[153]

The most important components behind the fiscal reductions were the employment levels and the changes in wage income within Mexico. Real average wages decrease by 26.5 percent in 1983 and real minimum wages declined by 25.2 percent.[154] These decreases were the most severe of the three year IMF program. That being said, by 1985 real wages had contracted by approximately 30 percent overall.[155] This "contraction of personal income…virtually wiped out the gains in employment and

[150] Mackenzie, Composition of Fiscal Adjustment, 27.
[151] Rudiger Dornbusch, Jose Vinals, and Richard Portes. "Mexico: Stabilization, Debt and Growth." *Economic Policy* 3, no. 7 (October 1988), Accessed November 26, 2011. http://www.jstor.org/stable/1344488 . 275.
[152] Kaufman, 408.
[153] Ghai, IMF and the South, 127.
[154] Taylor, Rocky Road to Reform, 275.
[155] Lustig, 1327-1328.

income that were made during the year of Mexico's oil boom."[156] The Mexican government was able to decrease nominal minimum wages by pegging them to expected inflation, which was lower than actual inflation for that year. This meant that minimum wages were much lower than they had been in the past, which hurt the lower classes that would be working minimum wage jobs the most.

Employment also declined significantly in the manufacturing and construction activities "which together comprise about 20% of total employment and 27% of nonagricultural employment."[157] Due to government cuts in capital expenditures, a decrease in construction employment and wages was the natural consequences as nothing new was being built. These reductions could have also been supplemented by a more aggressive strategy towards eliminating excess government positions.[158] However, this did not occur because it would potentially threaten influential political leaders. While the overall unemployment rate did not plunge as drastically as it could have during such a large recession, the lower income population was still substantially hurt by the reductions in employment and the decreasing wage levels across every sector.

The reduction of social expenditures was another of the main components of the stabilization plan that had significant consequences for income inequality. With a decline in revenues due to lower oil prices, and 40 percent of public expenditure going to debt servicing (15 percent increase from 1980-1981 levels), it was inevitable that the government would have to cut its expenditures on services such as health, education,

[156] Wayne A. Cornelius, "The Political Economy of Mexico under De La Madrid: Austerity, Routinized Crisis, and Nascent Recovery." *Mexican Studies/Estudios Mexicanos* 1, no. 1 (1985), 97.
[157] Lustig, 1332.
[158] Mackenzie, Composition of Fiscal Adjustment, 27.

social security, and others.[159] From 1980-1981, Mexico spent a total of 17 percent of public expenditures on social expenditures, which then dropped to 12.7 percent from 1983-1985. This amounted to a decrease in per capita outlays of 24 percent for education, 22 percent for health, and 37 percent for social security in comparison with the 1982 levels.[160]

While the quantity of services did not decline during this period, it is highly likely that teachers and doctors received significantly lower salaries. This could lead to lower human capital in these areas, and thus eventually a lower quality of service. Additionally, a decrease in capital expenditures "means not only that new capacity was not generated, but also that existing capacity was not properly maintained."[161] Therefore, while the level of services did not decline during this period, the social expenditure cuts most likely led to worse quality public services in the following years. It is possible that the reduction of capital expenditures associated with social programs was simply cutting programs with low social rates of return, but given the extent of the decreases, this is unlikely to have occurred for all of the reductions.[162]

Mexico also greatly reduced its subsidies in order to decrease its expenditures to help fix the fiscal deficit. Subsidies for basic foodstuffs and public transportation declined from 6.5 percent in 1982 to 2.1 in 1987 as a percent of GNP.[163] This occurred as the result of the push for the privatization of many state industries as a way of reducing governmental expenditures. By reducing subsidized prices and transfers to state

---

[159] Lustig, 1334.
[160] Lustig, 1334-1335.
[161] Ibid. 1335.
[162] Mackenzie, Composition of Fiscal Adjustment, 27.
[163] Ghai, IMF and the South, 127.

enterprises, they would make more revenue, cost less, and would be more prepared to be taken over by the private sector.[164] In addition to the push for privatization, the government also used a reduction in subsidies as a way of cutting costs. The Mexican government decided to implement more targeted subsidies rather than having a general food subsidy. This mainly resulted in the elimination of the general subsidies for corn tortillas, "the staple of the popular diet." Instead, a two tiered pricing system was set up. Additional subsidies on "cooking oil, bread, and eggs were also gradually eliminated.[165] While the leakage associated with these subsidies is not known, it is reasonable to assume that the majority of the people helped by these food subsidies are lower income. By eliminating these food subsidies, "the cost of the basic food basket [as a percentage of their minimum wage] rose from 30% in 1982 to over 50% in 1985".[166] This is an extremely large increase for basic food necessities, and therefore the reductions of the subsidies, while most likely necessary to reduce the fiscal deficit, had significant consequences on the income and health of the poor. These factors clearly contributed to the increase in income inequality in Mexico.

The poor and middle classes as well as small and private entrepreneurs "bore the brunt of both stabilization and structural adjustment. The 50 percent drop in real wages from 1982-1988, rising unemployment and a 70 percent cut on popular consumption subsidies during the first three years led to a very socially discontent country.[167] However, despite these changes the Mexican people did not violently demonstrate against

---

[164] Mackenzie, Composition of Fiscal Adjustment, 27.
[165] Lustig, 1335.
[166] Ibid. 1335.
[167] Ghai, IMF and the South, 126.

the government. Instead, the majority of the people dedicated more hours to working and creating more diversified sources of income. Rather than lashing out against the government in frustration, there was a general "'retreat to the household'" and a focus on finding ways to cope with the economic downturn.[168] This was not the case in the Dominican Republic, where riots after IMF imposed price increases "left 60 dead, 200 wounded, and 4,300 arrested."[169] Therefore, these opposing reactions show how volatile economic reforms can potentially be, and events could have gotten a lot worse in Mexico if there had also been as significant a civil unrest. This attitude definitely maintained the stability of the country, but most likely hurt income inequality by allowing the government and interest groups to determine their fate without standing up for their rights and wages.

While the country managed to decrease its fiscal deficit leading after receiving the IMF loan, these fiscal reductions inevitably led to an increase in income inequality and poverty in the country. Essentially Mexico conducted a meaningful reform right after the 1982 crisis, but after 1983 "fiscal and monetary policies were eased significantly" due to the upcoming midterm presidential elections in 1985.[170] Without the political commitment to structural change, there was a lack of economic growth and a large increase in inflation, which lead to additional economic problems in 1985. At this point, the government was unable to meet the IMF's performance criteria, which resulted in the suspension of further loan credits.[171] The government then "had no choice but to take the

[168] Lustig, 1337.
[169] Pastor, Effects of IMF Programs, 259.
[170] Kaufman, 408.
[171] Tecihman, 38.

medicine and to suffer the political consequences' of additional reform. This resulted in another round of "state divestitures, the replacement of import licenses by tariffs, the elimination of quantitative controls on imports, and the withdrawal of many subsidies."[172] While Mexico eventually recovered in 1989, it was not a great decade overall, especially for inequality, which rose from 46.3 in 1984 to 55.1 in 1989 based on the GINI coefficient.[173] The case of Mexico in the 1980s demonstrated how negotiations between the IMF and the borrowing country and internal politics play an incredibly large role in the conditions and implementation of IMF loans. These decisions help those in power, while hurting the poor and middle classes and increasing income inequality.

[172] Tecihman, Mexico and Argentina, 38.
[173] World Bank Development Research Group. Mexico GINI Coefficient Data. 2011. Raw data. Washington D.C.

CHAPTER 5: CONCLUDING REMARKS AND POLICY RECOMMENDATIONS

Following the Third World Debt Crisis in 1982, the number of IMF conditions attached to its loans vastly increased, yet Latin America still suffered a series of further crisis throughout the 1990s and into the early 2000s. These countries were hurt by unsustainable government policies, increased openness to global trade and capital flows and a low rate of compliance with IMF conditions. This low rate of compliance and the clear failures of increased conditionality led to a push for streamlining conditionality in the beginning of the 2000s. By reducing the number of conditions, the IMF felt that it would allow countries to increase the ownership of addressing their balance of payments problems, thus increasing the level of compliance with the conditions that were deemed essential to the success of the program.[174]

The high amount of conditions were also criticized because they imposed external pressure to force a country to implement changes, and therefore, infringing upon the country's sovereignty. However, this hypothesis seems questionable when only the elites and politicians determine how the country will implement these changes. These decisions made in the realm of internal politics often focus on maintaining the current level of power, and thus the brunt of the reforms falls on the poor, and less politically influential groups. It would therefore be more appropriate to deem conditionality as a restriction on the elites to decide whether or not to benefit themselves or the country as a whole.

While this may not always be the case, it is important to understand that conditions do not necessarily have to be a negative action. If politicians and elites are

[174] Bird, Reforming IMF Conditionality, 91.

able to enact the necessary reforms and ensure a fair distribution of burden to fix the economy, then there is no need for IMF conditions.[175] However, if the government determines that staying in power is more important than these other factors, conditions are required to force them to comply. This provides an interesting complexity to IMF lending and conditionality, especially regarding the buy-in of the governments for certain reforms, because the entire point of conditions is to force the governments to do something that they would not do on their own without the condition. Therefore, the underlying problem was not that there were too many conditions (assuming that the IMF had determined conditions that would have been beneficial to the country), but that the governments were simply not choosing to follow through with the conditions they had originally agreed to. This low rate of compliance was for two reasons: a lack of incentives from the IMF, and internal politics.

Streamlining conditionality was a clear indicator that the IMF recognized the high levels of conditionality had not helped to fix the problem, and was trying to encourage more countries to lend from them under less restricted terms. This demonstrates that while the IMF wants to ensure that financial crises are solved in the most efficient manner possible, the institution as a whole wants to give out loans. Otherwise, the institution would have no purpose whatsoever. While it seems intuitive that the IMF should want to give loans, it is actually an underlying problem that affects the success of their programs. By caring about giving out a loan for the sake of distributing money - whether or not this motivation is in addition to a demonstrated need – the IMF undermines its bargaining power with the countries it is negotiating with. Conditionality

[175] Bird, Reforming IMF Conditionality, 85.

is the way that the IMF tries to ensure that the government implements beneficial economic policies, but without strict consequences for failing to meet conditionality benchmarks, the governments of borrowing countries have very little incentive to actually follow through with their agreements. Governments of borrowing countries are very calculating and they understand that the IMF will simply renegotiate their loans if they fail to meet set criteria. This allows them to implement policies that are most beneficial to themselves, and their political support base, regardless of whether or not it is in line with IMF conditions, or is beneficial for the country as a whole. Therefore, it is important to understand that these governments are not helpless, but rather have significant leverage and power when working with the IMF and determining the implementation of their policies.[176]

Governments of borrowing countries have a significant amount of power over determining how IMF loan conditions will be implemented, and therefore the role of internal politics is extremely important as well. After accepting an IMF loan, the government then has to determine how it is going to implement reforms while attempting to navigate through all of the various interest groups, political opposition, and the citizens of the country. The most probable scenario is that political "elites are reluctant to make policy alternations that threaten their constituencies" and could harm their chances of staying in power. For this same reason, "politicians prefer to proceed incrementally because they fear that they will have to take on many groups at once."[177] Given the

---

[176] Irfan Nooruddin, and Joel W. Simmons. "The Politics of Hard Choices: IMF Programs and Government Spending." *International Organization* 60, no. 04 (2006), 1027.
[177] Henry Bienen, and Mark Gersovitz. "Economic Stabilization, Conditionality, and Political Stability." *International Organization* 39, no. 4 (Fall 1985), Accessed November 27, 2011. http://www.jstor.org/stable/2706721. 754.

intense pressures that these governments face because of the fact that they are in an economic crisis and are losing some sovereignty to an external organization, it makes perfect sense that these decisions are based around political support more than economic benefits. This also illustrates why governments so often do not implement, or only partially implement adjusts required by IMF loan conditions.[178] By delaying implementation, the government gets to benefit in the short run by continuing providing services for the people, but at the expense of the long term growth and equality in the long run. However, if the government does have to implement reforms, they will make sure that they protect the powerful elites to ensure political support. While there is such a strong fear of losing power, interestingly enough, regime collapses and "large-scale and persistent instability" are rarely ever caused by "the acceptance and implementation of IMF policies."[179] While these factors are highly influential, it is very difficult to "understand fully how such political factors might alter the effects of the IMF" and its programs on income inequality and poverty.[180]

As the IMF has implemented the more streamlined conditionality, they have attempted to increase the borrowing country's ownership of the reforms, and therefore make the changes necessary to fix their balance of payments disequilibria and foster growth. However, there are still other underlying factors that must still be addressed in order to improve the IMF conditionality outcomes on income inequality. Two important factors are the lack of time to produce the most efficient programs in crisis situations, and the concreteness of the IMF's role as a financial only institution.

[178] Bienen and Gersovitz, Economic Stabilization, 753.
[179] Ibid. 753.
[180] Nooruddin, Politics of Hard Choices, 1028.

During, or right before, an economic crisis of any magnitude, there is an obvious sense of urgency to fix the problem as soon as possible. With such a high degree of urgency it is impossible to fully think through the problem, and come up with the most appropriate solution for the country's economic wellbeing, let alone ensuring that income inequality does not rise significantly and the poor are not disproportionately hurt during this process. This sense of urgency occurred in the 1982 Mexican case, and the ultimate product was a hastily put together program that did not address many crucial elements to the reform of the Mexican economy Income inequality rose, and the poor were hurt because of it. One might argue that the IMF learns from every past crisis, and is therefore better equipped to make faster decisions, but in reality every crisis has its own unique set of circumstances that make it different from previous crises.

Given that the IMF is a "'monetary not a development institution'" the priority will always remain in fixing the country's balance of payment problems.[181] Ensuring that that income inequality and poverty do not significantly rise in the country will be a very difficult challenge during these crisis situations, unless the IMF takes a stronger stance on ensuring these factors become a part of their policy packages. This is remains highly unlikely despite the potential impacts that the IMF could have by focusing on a combined effort to fix balance of payments problems, and ensure that inequality and poverty do not disproportionately rise during this time.

Despite these challenges, the IMF has viable options that can not only improve the success rate of its loans, but also ensure that inequality and poverty are not severely

[181] Bird, Growth, Poverty and Inequality, 1.

hurt in the process. One of these ways is by adding conditions to loans that restrict the reductions in certain sectors that would disproportionately hurt the poor. While the IMF would surely have an incredibly difficult time trying to force governments to place a higher level of burden on the elites, they may be successful in at least ensuring the poorest are still provided for. The IMF has recently implemented a number of loan facilities aimed at reducing poverty, including the Poverty Reduction and Growth Facility (PRGF). There have also been studies that have shown countries under the ESAF programs "have a more 'pro-poor' mix of stabilization policies and greater 'social capacity.'" Additionally, "government expenditure on health and education seems to be more protected and regressive tax policies less likely."[182] Despite not being a development agency, the IMF does have the ability to create positive impacts during its programs.

The IMF would also benefit from taking a longer term view on growth and income inequality, despite the immediate and daunting tasks they face during periods of crisis. Similarly to capital expenditures, income inequality and poverty may be easy to put aside and ignore and in the short run, but will have huge long term impacts on the country and its economic growth. Governments understand the value of these longer term investments, but they also tend to be the most politically appealing areas to reduce due to the fact that the majority of the consequences will not be apparent until later in the future when they are out of office. While addressing poverty and inequality in the short run may

[182] Bird, Growth, Poverty, and the IMF, 629.

be costly, the costs could be much higher for the country in the forms of reduced growth and distribution social tension.[183]

There are two ways in which the IMF could help improve income inequality and poverty during its programs: 1) strict conditions that force governments to address these issues and 2) utilizing foreign aid and the World Bank to cover short term budget cuts to social services. Throughout this paper the inadequacies of conditionality have been expressed, and therefore it is unlikely that conditions regarding income inequality and poverty will be any more effective than the governments would do themselves. The second option is more intriguing. The argument, posed by Bird, is that income inequality and poverty increase during IMF programs due to the fact that governments[184] cater to the elite and thus disproportionately hurt the poor during the implementation of reforms. Given that governments will be highly unlikely to change this self-serving manner of business, the IMF could attract foreign aid, from the World Bank or other development agencies, to supplement its loan with aid. This would "fill budgetary gaps" and cushion "living standards against a decline in output" and thus ensure the poor do not become worse off during this period of time. While this would require the approval of the borrowing country, this seems to be the most viable option for taking a holistic approach to fixing a country's balance of payments problems, and ensuring the wellbeing of the people.

The high levels of inequality in Latin America, the ever increasing global financial integration, and the current economic volatility in Europe, pose serious threats

[183] Goni, Fiscal Redistribution and Income Inequality, 1558.
[184] Bird, Growth, Poverty and IMF, 631.

for Latin America as a region despite its recent successes. The past decades and numerous IMF loan programs have failed to address income inequality and poverty, but have finally managed to get their economies on track. It is essential for the future prosperity of the region that the IMF make these crucial reforms before the next crisis emerges in Latin America. By addressing income inequality and poverty, in addition to the balance of payments problems, the IMF will be able to not only fix the crisis, but invest in the future growth of the country, and the region.

REFERENCES

Abed, George. *Fiscal Reforms in Low-Income Countries; Experience Under IMF-Supported Programs*. Vol. 160. Occasional Paper. Washington D.C.: International Monetary Fund, 1998.

"About the IMF: History: Cooperation and Reconstruction (1944–71)." IMF -- International Monetary Fund Home Page. Accessed November 26, 2011. http://www.imf.org/external/about/histcoop.htm.

"About the IMF: History: The End of the Bretton Woods System (1972–81)." IMF -- International Monetary Fund Home Page. Accessed November 26, 2011. http://www.imf.org/external/about/histend.htm.

Alesina, Alberto, and Roberto Perotti. "Income Distribution, Political Instability, and Investment." *European Economic Review* 40, no. 6 (1996): 1203-228. doi:10.1016/0014-2921(95)00030-5.

Ball, Laurence, Daniel Leigh, and Prakash Loungani. "Finance & Development, September 2011 - Painful Medicine." IMF -- International Monetary Fund Home Page. September 2011. Accessed November 27, 2011. http://www.imf.org/external/pubs/ft/fandd/2011/09/Ball.htm.

Berg, Andrew, and Jeffrey Sachs. *The Debt Crisis: Structural Explanations of Country Performance*. Vol. 2607. Working Paper. National Bureau of Economic Reserach, 1988.

Bienen, Henry, and Mark Gersovitz. "Economic Stabilization, Conditionality, and Political Stability." *International Organization* 39, no. 4 (Fall 1985): 729-54. Accessed November 27, 2011. http://www.jstor.org/stable/2706721.

Bird, Graham, and Paul Mosley. "Should the IMF Discontinue Its Long-term Lending Role in Developing Countries?" In *Globalization and the Nation State: the Impact of the IMF and the World Bank*, edited by Gustav Ranis, James Raymond Vreeland, and Stephen Kosack. London: Routledge, 2006. Accessed November 26, 2011.

Bird, Graham. "Growth, Poverty and the IMF." *Journal of International Development* 16, no. 4 (2004): 621-36. doi:10.1002/jid.1111.

Bird, Graham. "Reforming IMF Conditionality - From 'streamlining' to 'major Overhaul'" *World Economics* 10, no. 3 (September 2009): 81-104. Accessed November 26, 2011. http://www.relooney.info/0_New_5922.pdf.

Bird, Graham. "The IMF: A Bird's Eye View Of Its Role And Operations." *Journal of*

Economic Surveys 21, no. 4 (2007): 683-745.

Bléjer, Mario I., and Ke-young Chu. *Fiscal Policy, Stabilization, and Growth in Developing Countries*. Washington, D.C.: International Monetary Fund, 1989.

Boughton, James. "From Suez to Tequila: The IMF as a Crisis Manager." *The Economic Journal* 11-, no. 460 (January 2000): 273-91. Accessed November 26, 2011. http://www.jstor.org/stable/2565658.

Boughton, James M. "7. The Mexican Crisis: No Mountain Too High?" In *Silent Revolution: the International Monetary Fund, 1979-1989*, 281-318. Washington, D.C.: International Monetary Fund, 2001.

Boughton, James. "The IMF and the Force of History: Ten Events and Ten Ideas That Have Shaped the Institution." IDEAS: Economics and Finance Research. Accessed November 26, 2011. http://ideas.repec.org/p/imf/imfwpa/04-75.html.

Buira, Ariel. *An Analysis of IMF Conditionality.* University of Oxford, Department of Economics, 2002.

Clements, Benedict. *Income Distribution and Social Expenditure in Brazil*. IMF Working Paper. Washington D.C.: International Monetary Fund, 1997.

Cornelius, Wayne A. "The Political Economy of Mexico under De La Madrid: Austerity, Routinized Crisis, and Nascent Recovery." *Mexican Studies/Estudios Mexicanos* 1, no. 1 (1985): 83-124. doi:10.1525/msem.1985.1.1.03a00040.

Dornbusch, Rudiger, Jose Vinals, and Richard Portes. "Mexico: Stabilization, Debt and Growth." *Economic Policy* 3, no. 7 (October 1988): 231-83. Accessed November 26, 2011. http://www.jstor.org/stable/1344488 .

Dreher, Axel. "Does the IMF Influence Fiscal and Monetary Policy?" *The Journal of Policy Reform* 8, no. 3 (2005): 225-38. doi:10.1080/13841280500181726.

Easterly, William. "The Effect of IMF and World Bank Programs on Poverty." October 31, 2000. Accessed November 26, 2011. http://www.imf.org/external/pubs/ft/staffp/2000/00-00/e.pdf.

Fund-Supported Programs, Fiscal Policy, and Income Distribution. Vol. 46. Occasional Paper. Washington D.C.: International Monetary Fund, 1986.

Garuda, Gopal. "The Distributional Effects of IMF Programs: A Cross-Country Analysis." *World Development* 28, no. 6 (2000): 1031-051.

Ghai, Dharam P. *The IMF and the South: the Social Impact of Crisis and Adjustment*.

London: Zed Books on Behalf of UNRISD, Geneva [and] ISER/UWI, Kingston, 1991.

Goñi, Edwin, J. Humberto López, and Luis Servén. "Fiscal Redistribution and Income Inequality in Latin America." *World Development* 39, no. 9 (2011): 1558-569.

Heller, Peter, et al. *The Implications of Fund-Supported Adjustment Programs for Poverty; Experiences in Selected Countries*. Vol. 58. Occasional Paper. Washington D.C.: International Monetary Fund, 1988.

Hoffman, Kelly, and Miguel Centeno. "The Lopsided Continent: Inequality in Latin America." *Annual Review of Sociology* 29 (2003): 363-90. Accessed November 26, 2011. www.jstor.org/stable/30036972.

Hutchison, M. "Macroeconomic Effects of IMF-sponsored Programs in Latin America: Output Costs, Program Recidivism and the Vicious Cycle of Failed Stabilizations." *Journal of International Money and Finance* 22, no. 7 (2003): 991-1014.

Independent Evaluation Office (IEO). *Fiscal Adjustment in IMF-Supported Programs*. Washington D.C.: International Monetary Fund, 2003.

International Monetary Fund Handbook - Its Functions, Policies, and Operations. Edited by Bernhand Fritz-Krockow and Parmeshwar Ramlogan. Washington D.C.: International Monetary Fund, 2007. Accessed November 26, 2011. http://www.imf.org/external/pubs/ft/imfhb/eng/handbook.pdf.

Johnson, Omotunde, and Joanne Salop. "Distributional Aspects of Stabilization Programs in Developing Countries." *Palgrave Macmillan* 27, no. 1 (March 1980): 1-23. Accessed November 26, 2011. http://www.jstor.org/stable/3866860.

Kaufman, Robert R. "The Politics of Economic Adjustment Policy in Argentina, Brazil, and Mexico: Experiences in the 1980s and Challenges for the Future." *Policy Sciences* 22, no. 3-4 (1989): 395-413. doi:10.1007/BF00136325.

Killick, Tony. "Structural Adjustment and Poverty Alleviation: An Interpretative Survey." *Development and Change* 26, no. 2 (1995): 305-30. doi:10.1111/j.1467-7660.1995.tb00554.x.

Krugman, Paul R., Maurice Obstfeld, and Marc J. Melitz. *International Economics: Theory & Policy*. Boston: Pearson Addison-Wesley, 2012.

Lustig, Nora. "Economic Crisis, Adjustment and Living Standards in Mexico, 1982-85." *World Development* 18, no. 10 (1990): 1325-342. Accessed November 26, 2011. http://ideas.repec.org/a/eee/wdevel/v18y1990i10p1325-1342.html.

Mackenzie, G.A., David Orsmond, and Philip Gerson. *The Composition of Fiscal Adjustment and Growth: Lessons from Fiscal Reforms in Eight Economies*. Vol. 149. Occasional Paper. Washington D.C.: International Monetary Fund, 1997.

Nooruddin, Irfan, and Joel W. Simmons. "The Politics of Hard Choices: IMF Programs and Government Spending." *International Organization* 60, no. 04 (2006).

Pastor, Manuel, and Gary A. Dymski. "Debt Crisis and Class Conflict in Latin America." *Capital & Class* 15, no. 1 (1991): 203-31.

Pastor, Manuel. "The Effects of IMF Programs in the Third World: Debate and Evidence from Latin America." IDEAS: Economics and Finance Research. 1987. Accessed November 27, 2011. http://ideas.repec.org/a/eee/wdevel/v15y1987i2p249-262.html.

Pastor, Manuel. *The International Monetary Fund and Latin America: Economic Stabilization and Class Conflict*. Boulder, CO: Westview Press, 1987.

Polak, J. J. *The Changing Nature of IMF Conditionality*. Princeton, NJ: International Finance Section, Dept. of Economics, Princeton University, 1991.

Roett, Riordan. *The Mexican Peso Crisis: International Perspectives*. Boulder, CO: Lynne Rienner Publishers, 1996.

Sisson, Charles. "Fund-supported Programs and Income Distribution in LDCs." *Finance and Development*, March 1986, 33-36.

Taylor, Lance. *The Rocky Road to Reform: Adjustment, Income Distribution, and Growth in the Developing World*. Cambridge, MA: MIT Press, 1993.

Teichman, Judith. "Mexico and Argentina: Economic Reform and Technocratic Decision Making." *Studies in Comparative International Development* 32, no. 1 (1997): 31-55. doi:10.1007/BF02696305.

Ter-Minassian, Teresa, and Gerd Schwartz. *The Role of Fiscal Policy in Sustainable Stabilization: Evidence from Latin America.* August 1997. Accessed November 26, 2011. http://www.imf.org/external/pubs/ft/wp/wp9794.pdf.

Todaro, Michael P., and Stephen C. Smith. *Economic Development*. Boston: Pearson Addison Wesley, 2006.

Vreeland, James Raymond. *The IMF and Economic Development*. New York: Cambridge University Press, 2003.

Vreeland, James. "The Effect of IMF Programs on Labor." *World Development* 30, no. 1 (2002): 121-39. Accessed November 26, 2011. http://citeseerx.ist.psu.edu/viewdoc/summary?doi=10.1.1.29.3746.

World Bank Development Research Group. Mexico GINI Coefficient Data. 2011. Raw data. Washington D.C.