Indispensable or unworkable? The IMF's new approach to conditionality

by Vivien Collingwood
for the Bretton Woods Project

About the author

Vivien Collingwood *is at Nuffield College, Oxford University, and is writing her doctoral thesis on governance conditionality. Her article on the ethics of conditionality, 'Assistance with strings attached', will be published in the Spring 2003 issue of* Ethics & International Affairs.

vivien.collingwood@nuffield.ox.ac.uk

About the Bretton Woods Project

The Bretton Woods Project monitors the World Bank and IMF in collaboration with NGOs and researchers. Established by a network of 30 UK-based NGOs in 1995, it circulates information, undertakes research, and advocates for change in the institutions. Issues it has addressed include structural adjustment programmes, conditionality, the World Bank/IMF growth model, and a number of controversial projects.
The Project produces a regular bulletin, the *Bretton Woods Update*, which is available in print, e-mail and web versions.
The Project receives core funding from the C.S. Mott and John D. and Catherine MacArthur Foundations.

Acknowledgments

Thanks to Tony Killick for his very useful comments on a draft version of this paper.

Further comments are welcome. We may post selected comments (with permission) on the Bretton Woods Project's website. Send to vivien.collingwood@nuffield.ox.ac.uk and flefrancois@brettonwoodsproject.org .

Contents

Acronyms

CAS	Country Assistance Strategy
CDF	Comprehensive Development Framework
ESAF	Enhanced Structural Adjustment Facility
IMF	International Monetary Fund
ICFTU	International Confederation of Free Trade Unions
PRGF	Poverty Reduction and Growth Facility
PRSC	Poverty Reduction Support Credit
PRSP	Poverty Reduction Strategy Paper
SAF	Structural Adjustment Facility
UNDP	United Nations Development Programme

Executive Summary

In September 2002 the IMF's Executive Board finally approved a new set of guidelines on conditionality.[1] These set out how its structural conditionality can be made more effective, with provisions on improving the clarity and focus of conditions, increasing recipient-country 'ownership' of reforms, and coordinating IMF conditionality with that of other organisations.

While any review of IMF conditionality is welcome, the new guidelines fail to address the deeper problems and flawed assumptions plaguing conditionality. Questions of legitimacy have been sidelined in the drive for efficiency. Effectiveness and legitimacy cannot be separated, however, and if IMF conditionality continues to be perceived by recipient-country governments and citizens to be illegitimate, it will not be successful, even on its own terms.

By May 2000, when the streamlining process was first announced, IMF conditionality had expanded significantly, and had become a target of criticism from external analysts and staff members. IMF conditionality was accused of being intrusive, confusing, and occasionally inappropriate. The IMF's 2001 Annual Report stated that streamlining aimed to make 'conditionality more efficient, effective, and focused.' The new guidelines focus on three core areas:

- *Simplifying conditionality.* Conditionality should only be applied to those policy areas deemed to be critical to achieving the goals of Fund-supported programmes. This means fiscal, financial, and exchange rate policies, and in some cases privatisation, governance, and public sector reform. Conditionality attached to non-critical policies should be avoided. The IMF intends to achieve greater clarity and consistency by explaining the different types of conditionality, and their purposes, in loan agreements.

- *Increasing recipient-country ownership*. IMF conditions must be used in ways that enhance, rather than undermine, ownership. Recipient countries must initiate reforms and IMF staff should be flexible in its approach and tailor reforms to suit local conditions and capacities.

- *IMF-World Bank relations.* The IMF should coordinate its conditionality with that of other organisations. In Bank-IMF relations, the organisation with expertise in a particular area should take the lead (the 'lead agency' principle), and its assessments should be included in the other organisation's reports. In addition, conditionality should be devised within a 'common framework', such as the PRSP, so as to avoid policy conflict and increase country ownership.

It is difficult to judge the initial impact of the new guidelines, particularly given that the evidence varies significantly from case to case. Despite this, the IMF has claimed a number of positive changes:

- The average number of conditions has been reduced overall, and the IMF claims there is better differentiation between 'critical' and 'non-critical' conditions.

- There has been better prioritisation and a decrease in the number of conditions on low-income country loans. The average number of conditions on 27 new PRGF programmes has been reduced by one-third, and two-thirds of all PRGF conditions focus on core areas.

- There is a clearer division of labour with the Bank, with the IMF withdrawing in some areas to let the Bank take the lead.

However there is plenty to question in the IMF's current approach:

- *No alternative model of conditionality.* Despite the new rhetoric of 'clarity' and 'parsimony', changes brought in by the guidelines are extremely limited. Whether conditionality should be abandoned was never in question—the IMF considers conditionality to be 'indispensable'—but that said, this was a missed opportunity to explore alternative kinds of conditionality. The review merely clarifies the status quo while reiterating the IMF's commitment to the principle of ownership. Conditionality on general goals of IMF programmes rather than the means to achieve them would have deserved better consideration for a start.

- *Few limits on conditionality.* The guidelines are imprecise and give the IMF considerable scope in interpreting what 'critical' means. There are no limits on the number of conditions that can be attached to loans, and nothing prevents the IMF from using large numbers of structural conditions outside its 'core' areas. Given that the IMF is cautious about granting recipient countries a 'long leash', it is likely that the IMF will find additional ways to try to control recipient-country actions, such as increased monitoring and surveillance.

- *The review is isolated.* The IMF failed to link the review sufficiently to other issues, such as PRSPs or the IMF's use of governance conditionality. This risks limiting the positive effects of streamlining.

- *Effectiveness takes precedence over ownership.* The IMF is more concerned with questions of effectiveness of conditionality and the preservation of its resources (that is, loan repayment—though in practice additional factors determine the decision to lend and the level of flexibility in case of non-compliance to conditions) than with improving genuine ownership and participation. For this reason, the Fund is likely to err on the side of caution and opt for more conditionality when doubtful about a government's commitment to reform. The Fund assumes that its current policies are appropriate: the review does not cover macroeconomic policy content, despite widespread failure to promote growth and reduce poverty in recipient countries. It aims at making recipients internalise and accept IMF policies, rather than giving them flexibility to design their own. This is particularly the case with the continuing use of prior actions, which must be implemented before a country receives assistance.

- *Need for more capacity building and empowerment.* Ownership does not just mean recipient-government accordance with Fund objectives; it also means having the capacity to engage a range of actors, governmental and non-governmental, in forming and implementing policies. Many recipient countries cannot compete with the Fund's knowledge base and resources, and lack the technical knowledge to propose alternative policies. Until capacity-related issues are addressed, recipient-countries will find it difficult to assume the initiative for reform.

- *Thinner Fund, fatter Bank?* There is a danger that IMF conditions will simply be moved to Bank agreements (which have not been streamlined). If this happens, the overall impact of conditionality is likely to stay the same. Increased Bank-Fund cooperation could result in less policy leverage for recipient-countries. The 'lead agency' and 'common framework' principles bind Bank and Fund prescriptions closer together. While this might reduce confusion, it also increases the pressure on developing countries to comply and reduces scope for policy choice.

The IMF is unlikely to achieve its objectives unless deeper problems concerning the content of IMF policies and the nature of the IMF's relations with recipient countries—whether these are relations of domination or empowerment—are addressed. The long-term aim must be for conditionality to be replaced with a form of financing that gives priority to local needs and greater emphasis on democratic decision-making. The challenge is to establish how orthodox IFI conditionality might be minimised, and with regard to this, the new IMF guidelines do not go far enough.

1. Introduction

The International Monetary Fund (IMF) has been using conditionality—that is, attaching policy conditions to loans—since the 1950s. In order to be eligible for a loan or to receive further credit from the IMF, a borrowing country must meet specific macroeconomic targets and implement structural reforms. The IMF's Executive Board has finally approved a new set of guidelines on conditionality, the first in over twenty years. These outline the IMF's vision of how its structural conditionality can be made more effective in the future, with provisions on improving the clarity and focus of conditions, increasing recipient-country 'ownership' of reforms, and on coordinating IMF conditionality with that of other organisations, particularly the World Bank.

While any attempt to reform conditionality is welcome, the new guidelines fail to address many of the deeper problems surrounding conditionality and the sometimes flawed assumptions behind IMF policies. The IMF remains firmly wedded to the *status quo*, and despite the rhetoric of ownership, questions of political responsibility, accountability and legitimacy have been sidelined in the drive for effectiveness. This approach has failed to work in the past and is unlikely to work in the long term, a conclusion reinforced by a number of studies suggesting that in the absence of real ownership, conditionality is ineffective in inducing sustainable, country-driven reforms.[2] Issues that remain to be addressed include:

- There is, as of yet, no alternative model of conditionality. Despite the new rhetoric of 'clarity' and 'parsimony', changes brought in by the guidelines are extremely limited.
- There are few restraints on IMF conditionality, and no actual limits on the number of conditions that can be attached to loans. Nothing prevents the IMF from using large numbers of structural conditions outside its 'core' areas.
- The review only applies to structural conditionality, and does not address the highly contentious issue of macroeconomic policy content.
- Short-term effectiveness takes precedence over ownership. The IMF is more concerned with questions of macroeconomic stability, the promotion of 'sound' policies in borrowing countries and the preservation of Fund resources (that is, loan repayment) than with improving genuine ownership and participation
- Is this a case of thinner Fund, fatter Bank? There is a danger that IMF conditions will simply be moved to Bank agreements, which have not been 'streamlined'.

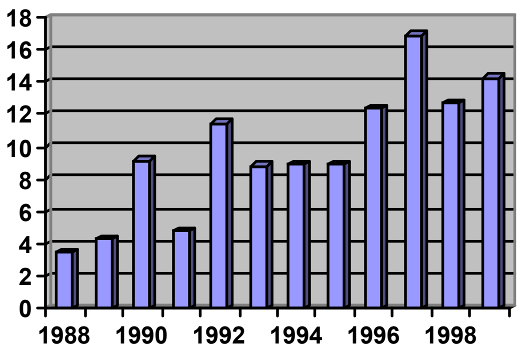
2. Context

In the IMF's view, conditionality is an 'indispensable' tool: conditions are designed to solve borrowing countries' immediate balance-of-payments difficulties and lay the foundations for sustainable economic growth over the longer term. Conditionality is also considered to be an essential means of preserving the Fund's resources for future borrowers, by ensuring that recipient countries follow prudent policies and are thus eventually able to repay the Fund. In practice however, repeated IMF lending to many countries despite low compliance with conditions, creating continuous dependence, suggests that other factors can determine the decision to lend.[3]

The IMF's use of structural conditionality expanded significantly during the 1980s and 1990s (see graph below). This expansion can be put down to two main factors. First, increasing numbers of structural conditions were intended to address the problem of how to restore growth in developing countries while simultaneously dealing with balance of payments crises, following criticism that inadequate attention had been paid to growth in the medium-term. Second, as a result of the debt crisis, the IMF became increasingly involved in providing financing for low-income countries with what it calls 'severe structural problems' as well as macroeconomic imbalances.[4]

A review of conditionality—the first since 1979—was long overdue by May 2000, when the streamlining process was first announced. By then, IMF conditionality had become a target of frequent criticism from all sides of the political spectrum, from both inside and outside the Fund and from external analysts and staff members alike. The extent of public outrage was also revealed by the incidence of angry riots and demonstrations by those citizens whose lives had been directly and adversely affected by IMF conditionality.[5]

Average no. of structural conditions on IMF SAF/ESAF/PRGF programmes.[6]



Expanding structural conditionality failed to produce the intended results. Compliance rates were poor and in most developing countries, economic growth remained elusive. Despite this, the Bank and the Fund continued to lend to developing countries with bad compliance records. This created confusion in the IFIs and in recipient and donor countries. Spiralling levels of conditionality made it harder, rather than easier, to identify and prioritise critical reforms. When would failure to meet conditions result in 'waivers', and when would it result in the suspension of funds? The problem was compounded by the fact that the content of World Bank and IMF conditionality had converged over time, creating areas of overlap and ambiguity.

In addition, expanding conditionality clearly undermined recipient-country 'ownership'. By May 2000, the Bank and the Fund had acknowledged that unless recipient-country governments agree that reforms are necessary, and are in accordance with IMF policies, the reforms are unlikely to be sustainable. A model of conditionality that entails policies being imposed on unwilling governments in times of financial crisis, short-circuiting domestic structures of decision-making, clearly conflicts with the idea of country ownership.

A further problem was that the IMF extended its conditionality into areas where the organisation lacked a clear mandate and expertise, thus intensifying its crisis of legitimacy.[7] In the wake of the 1997-8 East Asian Crisis, for instance, critics argued that by imposing badly-judged policy measures on crisis-hit countries with insufficient regard for local circumstances, the IMF made a bad situation worse. High-profile economists have since argued that the Fund's decision to cut government spending and raise interest rates in East Asian countries had the effect of plunging them into recession. The Fund also faced criticism for letting political factors, particularly the interests of its most powerful members, influence its conditionality during the East Asia crisis; for example, the controversial decision to forcibly break up nationally-owned industries and reduce tariff reductions in a time of crisis, thus allowing western banks and other competitors to move in.[8]

3. The new guidelines

The IMF's 2001 Annual Report states that the main goal of streamlining is to make "conditionality more efficient, effective, and focused". The new guidelines focus on three areas: simplifying conditionality, improving recipient-country ownership, and clarifying the IMF's relationship with other organisations.

Simplifying conditionality

Three words sum up the IMF's promised new approach to conditionality: parsimony, clarity, and consistency. Conditionality must be better focused in order to avoid the type of excessive, 'cookie-cutter' conditionality that has provoked much internal and external criticism. It should only be applied in areas that are 'critical' to achieving the goals of Fund-supported programmes. By this the Fund means fiscal, financial, and exchange rate policies, and in some cases, policies relating to privatisation, governance, and public sector reform. Non-critical policy conditionality should be avoided.

The IMF also intends to achieve greater clarity and consistency by explaining the different types of conditionality, and their purposes, in loan agreements. Each different kind of conditionality (such as prior actions, performance criteria, structural benchmarks, and so forth) has a particular function, and the Fund aims to "ensure consistency in the application of policies."[9]

Increasing recipient-country ownership

In line with existing mechanisms, such as Poverty Reduction Strategy Papers (PRSPs) and the Bank's Comprehensive Development Framework (CDF), the new guidelines argue that IMF conditionality must be used in ways that enhance ownership. The IMF holds that conditionality *can* strengthen ownership: "ownership and conditionality can be complementary and mutually supportive." For this to be the case, though, it is imperative that developing countries initiate reforms and that IMF staff respond to their particular needs: "the Fund will be guided by the principle that the member has primary responsibility for the selection, design, and implementation of its economic and financial policies." The IMF should be flexible in its approach to recipient-countries, and tailor reforms to suit local conditions and capacities: "the Fund will pay due regard to the domestic social and political objectives, the economic priorities, and the circumstances of members …"

IMF-Bank coordination

The guidelines state that the IMF "should strive to be consistent with that of other institutions and, whenever possible, should be integrated within a coherent country-led framework". Two key principles are put forward, those of 'lead agency' and 'common framework'. The lead agency principle states that that when both the Bank and the Fund are involved in a particular area, the organisation with expertise in that particular area should take the lead, and its assessment of policy implementation should then be included in the other's reports. The intention is to ensure a better division of labour between the IMF and the Bank, and improve accountability and transparency in both organisations.

The common framework principle states that conditionality should be devised within a single framework, such as the PRSP, in order to avoid conflicts between policies and increase country ownership. IMF Poverty Reduction and Growth Facilities (PRGFs) should be based on PRSPs that have been devised and written by recipient countries. This was recently the case for the Mozambique PRGF, which was modified as a result of the country's PRSP, although—as the Fund has admitted—the opposite is more common (see critique below).[10] More generally, the Bank and Fund should aim to communicate more effectively with each other by holding frequent consultations and sharing information.

4. Initial Impact

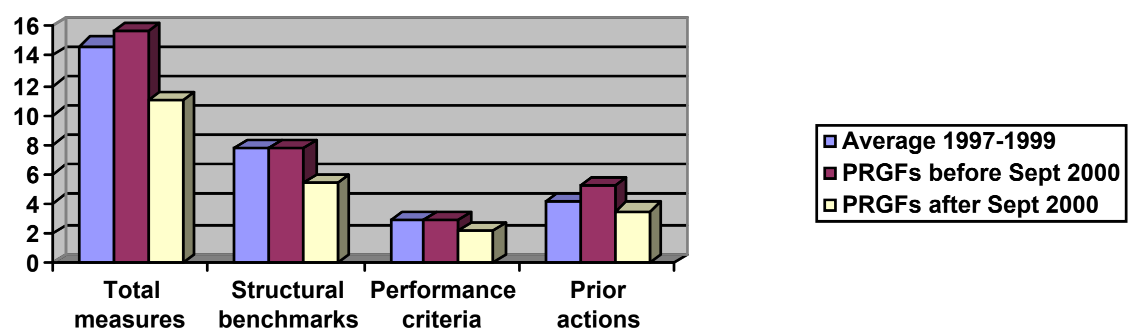
While we should be cautious about drawing firm conclusions about the guidelines' impact, it is possible to compare 'new' programmes implemented after an interim guidance note on streamlining was circulated in September 2000, and 'old' programmes implemented prior to that date.[11] From the IMF's point of view, the evidence suggests three initial positive changes:

- The IMF study suggests that overall, conditionality has been simplified: the average number of conditions has been reduced, and there is clearer differentiation between 'critical' and 'non-critical' conditions. Structural benchmarks, previously a source of much confusion, are being applied more sparingly.

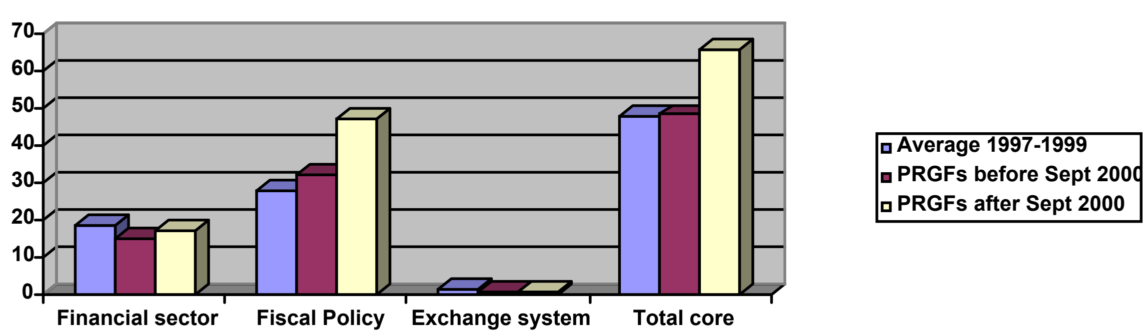
- There has been better prioritisation and a marked decrease in the number of conditions on low-income country loans. Overall, the average number of conditions on 27 new PRGF programmes has been reduced by one-third, and two-thirds of all conditions focus on core IMF areas (see graphs)—although these figures should be treated with caution, since they represent averages over highly divergent cases.

- The IMF claims that there is a clearer division of labour with the Bank, allowing the IMF to withdraw from some areas—such as privatisation, health reform, and public enterprise restructuring—to leave the Bank to set and monitor conditions.

Structural measures in PRGFs (number of conditions)[12]



Distribution of core (i.e. financial sector, fiscal policy and exchange system) structural conditions in PRGF programmes, in per cent[13]



5. Remaining issues

Despite the fact that the IMF has claimed some positive changes, there is still plenty to question in the organisation's approach. Potential problems lie in three main areas: the extent to which the guidelines introduce real change in the level and type of conditionality; the ongoing tension between ownership and conditionality; and the Fund's relations with other organisations.

No real change in the use or content of conditionality

Despite the new rhetoric of 'ownership', 'clarity', and 'parsimony', the content of the new guidelines is extremely limited and has the effect of endorsing the status quo. Of course, given that it considers conditionality to be 'indispensable', abandoning conditionality was never an option for the IMF. That said, however, the review did present an opportunity to explore alternative forms of conditionality that give more emphasis to recipient-country ownership, such as an outcomes-based model. In that sense, the streamlining process is a disappointment, as the guidelines merely affirm the existing model and fail to explain why alternatives were rejected.

Although the guidelines do put rhetorical emphasis on the need to increase ownership and IMF flexibility in using conditionality, there are no formal limits on how many or what type of conditions the IMF may use. The guidelines are extremely imprecise as to what a 'critical' condition is, leaving the IMF considerable room for interpretation. There is nothing to prevent the IMF from continuing to use large numbers of structural conditions outside its 'core' areas.

This reflects the fact that in the end, the IMF is more concerned with issues of compliance and the preservation of its financial resources (despite complicating factors mentioned on page 7) than with improving recipient-country ownership and participation. For this reason, the Fund is likely to err on the side of caution and opt for more conditionality in cases when the IMF is doubtful about a government's commitment to reform. The guidelines clearly state that "a member's request to use Fund resources will be approved only if the Fund is satisfied that the member's program is consistent with the Fund's provisions and policies…" Given that the IMF is reluctant to grant recipient countries much flexibility, it is likely that it will continue to explore additional ways of controlling recipient-country actions, such as increased monitoring and surveillance. One contentious aspect of this is the IMF's move towards taking compliance with financial 'standards and codes' into account when making lending decisions. There is concern that not only are the policies and regulations identified inappropriate to many developing countries, but the IMF's adoption of standards and codes as an additional form of conditionality would further deepen power asymmetries between developed countries, the IMF and recipient countries.[14]

Initial evidence confirms that there have been few significant shifts in the way that the IMF uses conditionality. A recent study by Tony Killick suggests that the rhetoric of streamlining has made little difference to the Fund's negotiation style or the content of PRGF programmes. There is only limited evidence to suggest that the addition of 'poverty reduction' to the programme title has had any effect.[15] Numbers of conditions attached to loans remain high in non-PRSP countries; as many as thirty-two structural conditions were attached to a recent loan to Pakistan, for example. The ICFTU has pointed out that numerous non-core structural conditions continue to be applied in IMF programmes. It draws attention to an April 2002 PRGF Review for Pakistan which specifies that requirements to privatise state-owned power companies and banks are being maintained as IMF structural conditionalities.[16] Likewise, the IMF has made c.$1 billion of debt relief for Zambia conditional upon the privatisation of the Zambia National Commercial Bank.[17]

Crucially, there are a number of highly contentious issues that the review has not begun to contemplate. Macroeconomic policy *content* has gone unquestioned. Even if the average number of conditions is reduced, IMF policies remain the same, despite widespread failure to promote growth and reduce poverty in recipient countries. In spite of IMF efforts, 89 developing countries were worse off in per capita income in the mid-1990s than they had been ten years previously, and 70 of these had an income per capita level lower than in the 1960s and 1970s.[18] A number of high-profile economists, including some within the World Bank, have challenged the free-trade mantra that lies behind much conditionality, pointing to strong evidence that suggests that trade liberalisation can only promote growth and reduce poverty under certain conditions.[19]

Lastly, the streamlining process was too isolated from other evaluation mechanisms. The IMF failed to link the review sufficiently to other issues, such as standards and codes, PRSPs or the IMF's use of governance conditionality. This risks limiting the positive effects of streamlining; 'streamlining' structural conditionality will have little impact if non-core issues such as privatisation and social security reform continue to be addressed via the debt-relief process, or if the IMF continues to take a broad approach to governance conditionality. There is as yet no mechanism to oversee or evaluate the consistency of conditionality across these different areas, let alone evaluate consistency across the IFIs and private creditors.

Ownership remains elusive

The IMF claims that conditionality and ownership are compatible: if used correctly, conditionality can provide reform-minded governments with a framework for action. Tony Killick writes, however, that "it is by no means clear that streamlining will bring any net encouragement to ownership".[20] The IMF's drive for effectiveness has taken precedence over the need for greater democracy and participation in the reform process. While the new guidelines stipulate that recipient-countries should be in the driving seat and initiate their reforms, they do not deal with the fundamental problem of what happens when governments and staff disagree about reforms.

The new guidelines define 'ownership' as 'a willing assumption of responsibility for a program of policies, based on an understanding that the program is achievable and is in the country's best interest.' The IMF only allows 'ownership' within a strict set of boundaries, namely, when policies conform to the preferred IMF model; and the IMF still expects to draft Letters of Intent for borrowing countries. Real ownership would entail giving the recipient-country government enough freedom to take the measures it deemed fit to reach agreed goals, and such an interpretation is distinctly absent from the new guidelines.

In those cases where the IMF is unsure about recipient-country commitment to reforms, it is 'business as usual'. The guidelines state that "the member's past performance in implementing economic and financial polices will be taken into account as one factor affecting conditionality …". If countries have bad implementation records, then conditionality will continue to be stringent. The IMF claims that in such cases, conditionality can sometimes play a useful 'scapegoating' role by providing governments with a convenient excuse for implementing unpopular reforms. This is hardly compatible with a broad understanding of ownership, however, as such reforms would only be 'owned' by government elites. By-passing the democratic process may provide fast, limited results in the short term, but in the long term is likely to backfire in the form of social and political unrest, and undermines attempts to build lasting democratic institutions.[21]

One area in which conditionality and ownership clearly conflict is that of prior actions (that is, actions that must be undertaken before money is released). Although the use of prior actions has been reduced overall, the IMF is making greater use of prior actions in some agreements with countries that have poor implementation records. For example, prior actions constituted half of all conditions in recent agreements with Rwanda, the Central African Republic, and Ethiopia. This directly conflicts with the IMF's emphasis on ownership, as prior actions are the most coercive form of conditionality; they are "IMF-owned measures *par excellence*."[22] A similar objection can be made to IMF conditionality that is imposed in times of financial crisis, giving countries little option but to agree to the proposed reforms; again, this strongly contradicts the principle of ownership. The IMF wields significant power both as the guardian of concessionary funds and as 'gatekeeper' to the market, power that should not be used to substitute for domestic decision-making processes.

The new guidelines under-emphasise some essential aspects of ownership, namely, empowerment and capacity building. Ownership does not just mean government accordance with Fund objectives; it means having the capacity to engage a range of actors, governmental and non-governmental, in forming and implementing policies. "Genuine ownership can only be derived if the countries themselves participate in the making of the policies...”[23] The problem remains, however, that recipient governments cannot compete with the Fund’s knowledge base and resources; many are lacking in technical knowledge and skills. Until capacity-related issues are resolved, recipient-countries will find it difficult to assume the initiative for reform.

Current attempts to improve recipient-country ownership of and participation in reforms appear to be failing in some cases. Killick notes that PRSPs are not challenging established practices, but are instead badly defined and lack domestic political commitment. Rather than taking the initiative and committing to ‘home-grown’ reforms, many recipient-countries, like diligent exam candidates, are producing the reform programmes that they think the IMF would like to see. Even when PRSPs are produced, IMF programmes are not always designed in accordance with them; while some PRGFs have built on PRSPs, the tendency is for the process to work *vice versa.* This was the case in recent PRGFs for Ghana, Kenya, and Albania.[24]

Thinner Fund, fatter Bank?

The new guidelines leave a number of question marks hanging over the relationship between Bank and Fund conditionality. Despite the ‘lead agency’ and ‘common framework’ principles, the Fund has considerable leeway to use conditionality outside its core areas of fiscal, financial and exchange rate reform. If it considers additional structural measures to be critical to achieving its objectives it may continue to use them. Moreover, while there are coordinating mechanisms for conditionality in some areas—in PRSPs, PRGFs, and CASs for low-income countries, for example—there is no comparable mechanism for middle-income countries.

Beyond this, there is a real danger that IMF conditions will merely be shifted into Bank agreements (which have not been streamlined) meaning that the overall impact of conditionality will stay the same regardless of the IMF’s streamlining process. Ironically, increased Bank-Fund cooperation might result in less—rather than more—policy leverage for recipient-countries. Despite the fact that the guidelines state that there will be no cross conditionality, the ‘lead agency’ and ‘common framework’ principles bind Bank and Fund prescriptions closer together. While this might reduce confusion, it also increases the pressure on developing countries to comply with conditionality and reduces scope for choice, which directly conflicts with the goal of increasing ownership.

A more complex challenge is that of coordinating IMF conditionality with organisations other than the Bank. In recent years, a large number of international organisations have adopted or increased their use of conditionality. In areas such as the Balkans and the Soviet Union, for example, the European Union pre-accession and development conditionality sits alongside Bank and Fund conditionality.[25] It is unlikely that streamlining IMF conditionality will offer a net benefit to recipient countries unless coordination with other organisations is addressed; the IFIs should be prepared to apply the ‘lead agency’ principle to other organisations, such as the EU and the UNDP, and other bilateral donors, as well as themselves. As with Bank-Fund cooperation, though, coordination might also mean a difficult trade-off with policy choice and ownership.

6. Towards a workable conditionality

Some NGO attitudes towards conditionality are paradoxical. While fiercely critical of IMF prescriptions, these NGOs have been eager to encourage or add their own conditions on environment-, governance-, and poverty-related issues. This risks incoherence. Rather than try to formulate a universally acceptable definition of conditionality, it is more productive to clarify who determines policy objectives and instruments.

Criticisms of conditionality fall into two main camps: first, those that disagree with IMF policies while reserving the right to use conditionality in the appropriate circumstances, when attached to acceptable policies; and second, those that condemn conditionality outright because of its intrusive nature and impact on ownership.

This paper has implied throughout that there is a problem both with the *content* of IMF policies and with the *scope* and *type* of conditionality used by the IMF – and this criticism also applies to World Bank conditionality. The challenge is to establish how orthodox IFI conditionality might be minimised, and in this respect, the new IMF guidelines clearly do not go far enough.

The following principles should be taken into account when examining the role of conditionality in the international lending regime:

- Funds should be committed on the basis of democratically endorsed country plans. The process should be carried out in the open and led by elected representatives, incorporating the views of groups outside the narrow circles of policy elites. There should be no interference by outside agencies in the setting of policies.
- Governments should make explicit their long-term 'ends'—such as macroeconomic stability and poverty alleviation— but the 'means' (i.e. how these long-term goals are reached) should be left open, even if this occasionally means that mistakes are made.
- Keeping conditionality to a minimum should apply to all conditionality—social, environmental and political conditionality as well as orthodox macroeconomic conditionality.
- Borrowing countries should be given greater opportunity to obtain funding from institutions with a more balanced representation of borrowers and creditors. This implies major changes in the governance of the IMF and World Bank or the establishment or enhancement of other organisations, such as regional monetary funds.

The IMF should engage in deeper questioning of its stance on conditionality, and the Bank should engage in a parallel exercise. Civil society groups, meanwhile, should:

- Focus on empowerment, capacity-building, partnership, and raising public awareness, rather than encouraging the proliferation of new types of conditionality;
- Challenge the IMF and the World Bank on their own terms by putting forward alternative strategies for growth and poverty reduction, and pointing to the flaws in existing policies. They need to take the IMF up on its claim that it will be 'guided by the principle that the member has primary responsibility for the selection, design, and implementation of its economic and financial policies.'[26] Potential opportunities for putting pressure on the Bank and the Fund include general and periodic internal reviews of conditionality, as well as possible evaluations by the Bank's Operations Evaluation Department and the IMF's Independent Evaluation Office of any related aspect of Fund operations (PRSPs being an obvious example).

The IMF is unlikely to achieve its objectives unless deeper problems concerning the content of IMF policies and the nature of the IMF's relations with recipient countries—whether these are relations of domination or empowerment—are addressed. As the concept of ownership suggests, issues of effectiveness and legitimacy cannot be separated. If IMF conditionality continues to be perceived by recipient-country governments and citizens to be illegitimate, it will not be successful, even on its own terms. The long-term aim must be for conditionality to be replaced with a form of financing that gives priority to local needs and greater emphasis on democratic decision-making. With respect to this, the recent IMF guidelines do not go far enough.

Glossary of terms used

Conditionality: the practice of attaching policy conditions to loans and aid, adopted by the IMF in the 1950s. Structural conditions are designed to underpin the Fund's macroeconomic policies, and most are concerned with fiscal policy, the financial sector and the exchange and trade system. They also extend to areas such as public enterprise reform, privatisation, and social security reform.

Standards and codes: financial and regulatory benchmarks established by the Financial Stability Forum. The aim of the standards and codes initiative is to coordinate states' domestic policies and institutions in the core areas of macroeconomic policy transparency and information dissemination, institutional market infrastructure, and financial regulation and supervision.

Letter of Intent: statement of an intended programme of policy reforms that is attached to a country's request for IMF funds.

Prior actions: measures that a country agrees to undertake before the Fund approves a loan, and before the first disbursement takes place.

Performance criteria: specific conditions that have to be undertaken before the agreed amount of credit is disbursed by the Fund.

Structural benchmarks: these are similar to performance criteria, but are not considered critical to achieving the Fund's objectives, and thus failure to achieve them does not necessarily mean an interruption in Fund financing.

Ownership: the idea that borrowing countries should be 'in the driving seat' of reform by taking an active part in proposing, designing and implementing policies. Although the word is often employed by the IFIs, it is seldom defined or elaborated.

Moral hazard: a term used by economists to describe the inadvertent encouragement of risk-prone behaviour by risk-adverse institutions. Loan bail-outs are a classic case of moral hazard: the theory goes that the borrower will be encouraged to act irresponsibly in the future, in the expectation that further bail-outs will follow.

Waiver: a suspension from certain performance criteria, granted for example when a country has already taken corrective measures.

Bibliography and further reading

IFIs

Ahmed, Lane and Schulze-Ghattas, 'Refocusing IMF conditionality', *Finance and Development* (IMF, December 2001) at http://www/imf/org/external/pubs/ft/fandd/2001/12/ahmed.htm.

IMF conditionality page, http://www.imf.org/external/np/exr/facts/conditio.htm.

IMF, *Guidelines on conditionality* (IMF, September 25 2002), at http://www.imf.org/External/np/pdr/cond/2002/eng/guid/092302.htm.

IMF, *Streamlining structural conditionality: review of initial experience* (IMF, July 2001) at http://www.imf.org/external/np/pdr/cond/2001/eng/collab/review.htm.

IMF, *Conditionality in Fund-supported programs: policy issues* (IMF, February 16 2001), at http://www.imf.org/external/np/pdr/cond/2001/eng/policy.

IMF and World Bank, *Strengthening IMF-World Bank Collaboration on Country Programs and Conditionality* (IMF/World Bank, August 2001), at http://www.imf.org/external/np/pdr/cond/2001/eng/collab/coll.htm.

IMF Independent Evaluation Office, *Evaluation of prolonged use of IMF resources* (IMF, September 2002) at http://www.imf.org/External/NP/ieo/2002/pu/092502.pdf

World Bank, *From adjustment lending to development policy support lending: key issues in the update of World Bank policy* (World Bank, June 2002), at http://www1.worldbank.org/operations/OP860Consultations/EnglishVersion/1OPBP8.60public06-06-02pc.pdf.

Devarajan, Shantayanan et al, *Aid and reform in Africa: Lessons from ten case studies* (Washington: World Bank, 2001), at http://www.worldbank.org/research/aid/africa/release/aid.htm.

Other

Bretton Woods Project: comments on IMF conditionality review, http://www.brettonwoodsproject.org/topic/adjustment/22imfcondreview-comments.html.

Bretton Woods Project, 'Bank researcher rejects trade openness orthodoxy', *Bretton Woods Project Update* 30 (Sept-Oct 2002), at http://www.brettonwoodsproject.org/topic/knowledgebank/k3007milanovic.html.

Buira, Ariel, 'An analysis of IMF conditionality' at http://ksghome.harvard.edu/~.drodrik.academic.ksg/g24buira.pdf

Collier, Paul et al, 'Redesigning conditionality', *World Development* 25/9 (1997).

Feldstein, Martin, 'Refocusing the IMF', *Foreign Affairs* 77/2 (1998).

ICTFU, *Changing the model: IFI policies and the failures of corporate-driven globalization* (September 2002), at http://www.globalpolicy.org/globaliz/econ/2002/0926icftu.htm.

Khor, Martin, 'A critique of the IMF's role & policy conditionality', *Third World Network Global Economy Series No.4* at http://www.twnside.org.sg/title/geseries4.htm.

Killick, Tony, *The 'streamlining' of IMF conditionality: aspirations, reality, and repercussions* (London: ODI, 2002) at http://www.brettonwoodsproject.org/topic/adjustment/condikillick.pdf

Killick, Tony, *Aid and the political economy of policy change* (London: Routledge/ODI, 1998).

Malido, Webster, 'Not privatising will cost Zambia $1bn under HIPC, warns Ellyne', at http://allafrica.com/stories/200212080126.html.

Schneider, Benu and Sacha Silva, *Conference report on international standards and codes: the developing country perspective* (London: ODI, 2002) at http://www.odi.org/speeches/codes_and_standards/report.pdf.

Thacker, Strom C., 'The high politics of IMF lending', *World Politics* 52 (1999), at http://muse.jhu.edu/journals/world_politics/v052/52.1thacker.html

Vianna, Aurélio, 'Fund threatens Brazilian democracy', *Bretton Woods Project Update* 31 (Nov-Dec 2002), at http://www.brettonwoodsproject.org/topic/reform/r3103brazil.html.

Wood, Angela, *Carrots and Sticks: A quick fix for IMF conditionality* at www.brettonwoodsproject.org/topic/adjustment.
Wood, Angela, *For richer, for poorer? G8 proposals for IMF reform*, (Bretton Woods Project, April 2001).
Wood, Angela, and Matthew Lockwood, *The perestroika of aid? New perspectives on conditionality* (Bretton Woods Project, March 1999), at http://www.brettonwoodsproject.org/topic/governance/poa.html.
World Development Movement, *States of Unrest II* (April 2002), at http://www.wdm.org.uk/cambriefs/Debt/Unrest2.pdf.

Endnotes

[1] The term 'conditionality' is used by lenders and aid donors to refer to the attaching of conditions to loans and aid. The IMF has been using macroeconomic conditionality since the 1950s, extending this to structural and governance issues in the 1980s and 1990s.
[2] See, for example: Killick, *Aid and the political economy of policy change*; Collier et al, 'Redesigning conditionality'; and Devarajan et al, *Aid and reform in Africa.*
[3] Thacker, 'The high politics of IMF lending'; IEO, *Evaluation of prolonged use of IMF resources*.
[4] Ahmed et al, 'Refocusing IMF conditionality'.
[5] World Development Movement, *States of Unrest II*.
[6] Source: IMF, *Conditionality in Fund-supported programs: policy issues*, p.25.
[7] Khor, 'A critique of the IMF's role & policy conditionality'.
[8] Feldstein, 'Refocusing the IMF'.
[9] For this and the quotes below, see IMF, *Guidelines on Conditionality*.
[10] Killick, *The Streamlining of Conditionality*, p.13.
[11] See IMF, *Streamlining structural conditionality: review of initial experience.*
[12] Source: IMF, *Streamlining structural conditionality*, p.7.
[13] Source: IMF, *Streamlining structural conditionality*, p.10.
[14] Schneider and Silva, *Conference Report on International Standards and Codes*.
[15] Killick, *The Streamlining of Conditionality*.
[16] ICTFU, 'Changing the model', p.6.
[17] See Malido, 'Not privatising will cost Zambia $1bn under HIPC'.
[18] See Khor, 'A critique of the IMF's role & policy conditionality'.
[19] See Bretton Woods Project, 'Bank researcher rejects trade openness orthodoxy'.
[20] Killick, *The 'Streamlining' of IMF Conditionality*.
[21] See Vianna, 'Fund threatens Brazilian democracy'.
[22] Killick, *The 'Streamlining' of IMF Conditionality*.
[23] Khor, 'A critique of the IMF's role & policy conditionality'.
[24] Killick, *The 'Streamlining' of IMF Conditionality*, p.13.
[25] See Killick, *The 'Streamlining' of IMF Conditionality*, pp.14-15.
[26] IMF, *Guidelines on conditionality*, p.1