THE “PERESTROIKA OF AID”?
NEW PERSPECTIVES ON CONDITIONALITY

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Executive summary

Donors have applied conditionality to their adjustment lending in order to induce governments to make reforms in their economies. However, implementation has been poor because it has been hard to induce unwilling governments to change, especially if they regard proposed reforms to be inappropriate or perceive that they are likely to be ineffective.

To overcome these implementation problems the World Bank and IMF have resorted to applying progressively more detailed and tightly defined preconditions and conditions, whilst policing their implementation more carefully and designing stronger incentives. Although these measures have helped to persuade governments to implement those conditions necessary to access the money, reforms have often been reversed once the programme has ended and other, non-core conditions have still not been implemented. This could be called financially-driven tactical compliance.

The conclusion of many studies is that these efforts have not been sufficient to overcome poor implementation, which is caused by a lack of ownership (ie, governments and civil society have not fully engaged in designing their reform programmes, so they are not committed to implementing them). Therefore, in addition to improving the conditionality tool it is also necessary to encourage ownership of the reform process. The World Bank has accepted that it needs to build ownership into the adjustment process and is developing new mechanisms for doing so (although it still perceives that conditionality can be useful in some circumstances). The IMF has more grudgingly accepted ownership in its rhetoric but is doing relatively little to institutionalise it as an objective.

James Wolfensohn's Comprehensive Development Framework, which incorporates the Partnerships Initiative, is the vehicle through which the Bank aims to achieve ownership and partnership. The framework is a positive step forward. However, to be effective it will require a radical change in donor and government practices. A potentially limiting aspect of the framework is that it incorporates selectivity. The Bank's reassessment of aid's effectiveness identified selectivity, on the basis of good economic policy, as a vital element for ensuring that aid achieves maximum growth and poverty reduction. However, unless the Bank, and other donors, are able to take a more eclectic view of what constitutes a good economic environment, rather than withdrawing from conditionality, selectivity could in reality imply more up-front conditionality.

Other analysts have also been examining how to both improve conditionality as a tool and develop alternatives based on ownership. Their proposals can almost all be placed on a continuum between pure selectivity at one end and recipient-led dialogue at the other.

NGOs' engagement in the conditionality debate has largely focused on concerns about donors' policy prescriptions and advocating alternatives. It is important that they now engage in the debate about alternatives to conditionality. We suggest that three basic principles should underlie an NGO approach to the conditionality debate:

1. Poverty focus - what should happen is what works for the poor.

2. Participation/democracy - this suggests that the aid relationship on both the donor and the recipient side should be opened up to a much wider public examination and debate about the use of aid and the associated policy reforms.

3. Partnership rather than coercion.

These principles lead us to argue that NGOs should reject the idea of pure selectivity. This is important, since there is a strong drift in this direction by official creditors. The approach to selectivity being taken by the donors will not cause them to question the validity of their own priorities. It will de-emphasise greater engagement with the difficult cases where potential recipients have different priorities. It will not, by itself, strengthen democracy and civil society involvement in the aid In our view, the only selectivity which should apply is that asked for in cases of repressive dictatorships, by legitimate opposition movements (a current example being Burma). In all other cases, we support the notion of dialogue and partnership, inclusive enough to involve civil society. But to make this any different from traditional conditionality - to make the engagement relationship.

honest - donors have to be prepared to genuinely listen to and understand recipient priorities and constraints. They cannot engage in dialogue from a starting position that they are right about all policy advice. In this situation, there is no point in dialogue.

Introduction

During a consultation meeting last July, the World Bank's newly unveiled Partnership's Initiative was hailed as the "perestroika of development assistance". Indeed, a fundamental shift does appear to be occurring in the World Bank's approach to designing and implementing conditionality and managing the development process. This change reflects two trends in the Bank:

- a reassessment of the effectiveness, and the role, of aid in response to declining aid budgets; and
- a realisation that conditionality has not been effective for inducing reform and that instead governments and civil society must "own" the reform process.

While the USSR's transformation was led by President Gorbachev, aid's perestroika is being led by World Bank President, James Wolfensohn. In January this year, he unveiled his "Comprehensive Development Framework", which is based on the concepts of *partnership* - between governments, civil society and donors to build ownership of the reform process - and the need to be more *selective* about which countries donors lend to - to generate more growth and poverty reduction from a diminishing pot of aid.

This apparent shift by the Bank raises some fundamental questions:

- Is the paradigm changing or is the World Bank simply repackaging itself?
- How is the IMF's approach changing?
- What is ownership?
- Can selectivity and ownership be reconciled?
- What is partnership?
- Can donors cooperate and coordinate themselves?
- Is this the end of conditionality?

It is important that we outside the official aid community re-examine our preconceptions about conditionality, ownership and partnership with a view to widening and contributing to this growing debate. A simplistic divide characterises much of our thinking on the use of conditionality: on the one hand there are those who recognise the need for ownership and sovereignty but regard some governments as unresponsive to the wider needs of their populations and therefore support some form of "poverty-focused" or "social" conditionality, which if done rightly could strengthen civil society; and on the other, there are those who regard all conditionality imposed from outside as undermining the democratic system and abusing the sovereignty of the borrower country. The latter emphasise the need to support the democratic process regardless of the outcome for the poor.

This paper looks at how conditionality is being redesigned to make it a more effective tool and asks whether new initiatives for programme design and implementation will diminish the need for it, or whether these simply repackage conditionality whilst strengthening the hand of donors. The first part of this paper provides an overview of the recent experience with conditionality; part 2 looks at new donor approaches to conditionality, efforts to nurture ownership of reform programmes and develop partnerships with donors, and selectivity; part 3 outlines several of the new approaches to conditionality being developed by analysts outside the Bretton Woods Institutions (BWIs); and finally, in part 4 the implications of this apparent paradigm shift are examined in terms of the priorities for NGOs.

Part 1

THE RISE AND FALL OF CONDITIONALITY

1 *The growing emphasis on conditionality*

Conditions are the terms under which a borrower accepts a loan. Intrinsically conditions are not bad, provided they are negotiated between all parties to the loan contract and mutual agreement is reached. Indeed, it is unlikely that we would encourage the Bretton Woods Institutions (the collective name for the World Bank and IMF) or bilateral donors to provide money without some sort of agreement about how the money should be used. The question is, how is agreement reached and how are conditions formulated and applied.

The Bank has always attached conditions to its project aid, in the past they were specific to the project and not what might be described as "economy wide". Similarly, the IMF has also always required governments to make changes in macroeconomic policy in return for balance of payments support. However, the importance of conditionality, particularly in terms of the degree to which the Bank and Fund actually enforce their conditions, came to prominence in the 1980s after the emergence of the debt crisis, after which the significance of programme conditionality rose in importance to assume the function that it has today as an "instrument of discipline." (Singer, 1994)

"Since the mid-eighties, lending has often been justified in terms of the benefits of the policies adopted as the result of conditionality clauses. The policies have become the projects, with investment in economic infrastructure replacing investment in physical infrastructure. Loans are justified by the policy changes instead of vice versa." (Hopkins et al, 1997, p512)

The BWIs use conditionality to try to induce policy reform[1] (Collier et al, 1997). They justify this on the grounds that it ensures that aid operates within an environment in which it can work effectively, and hence over the longer-term, as the quality of policies in developing countries improves, the less need there will be for aid in the future. Whilst it is accepted that aid does not operate in a policy vacuum, there has been much debate and controversy surrounding the efficacy of the set of policies advocated by the BWIs and whether or not they are appropriate for achieving poverty eradication. There has also been growing criticism of the process by which adjustment programmes are designed and the reform process is managed.

2 *The proliferation*

Debates about conditionality have tended to focus on what sort of conditions should be applied. Non-governmental organisations (NGOs) and academic analysts have been particularly concerned with identifying areas, such as poverty, the environment, education and gender, which the BWIs have neglected to consider when designing their programmes and which have directly or indirectly caused unnecessary hardship and suffering as a result. Academic and NGO critics have been reasonably successful in championing their causes, forcing the BWIs to change their rhetoric and, to a lesser extent, their programme content. Whilst these changes have helped to improve the design of adjustment programmes, ameliorating their most negative consequences and to some extent reducing negative political pressures, conditionality has in fact proliferated as more conditions have been placed on more areas of government policy whilst the central focus of reform programmes has remained unchanged.

Bilateral donor governments have also been persuasive in lengthening the list of conditions and extending the influence of the BWIs as new philosophies and political and ideological changes have led to changing values and emphasis on reforms. For example, with the demise of the cold war, donors' interest in forging democratic governance systems in borrower countries has become a higher priority. In recent years, they have also been keen to see action taken to improve human rights records, reduce corruption and develop social capital.

"Donors pressed the International Financial Institutions toward greater concern with issues of governance." (OED, 1998 p78)

This trend has been intensified by the BWIs themselves. In response to poor programme outcomes, the BWIs have argued that the policy prescription is correct but expected improvements have not materialised because reforms have not been deep or wide enough or programmes have not been properly implemented. Thus, they have resolved to impose even more conditions and preconditions[2] in more areas of government policy, and have placed more stress on monitoring the reform process. For example, admitting that its previous policy prescriptions have failed to produce their expected results, the IMF has unveiled its "Second Generation" of reforms. These focus on good governance, deeper structural reform, banking sector reforms and capital account liberalisation, and reorienting the allocation of government spending to social sectors and away from unproductive sectors, ie, military spending[3]. They are intended to build on the Fund's more traditional reform programme.

"We have learned that this "first generation" of reform is not, by itself, enough - either to accelerate social progress sufficiently, or to allow countries to compete more successfully in global markets."(Michel Camdessus, 1997 p2)

The BWIs have also used crisis situations to expand their reach into more areas of government policy. For example, in the light of the crisis in South East Asia the World Bank's Operations Evaluation Department is now advocating that the Bank should pay more attention to institutions and social welfare systems in addition to economic reforms (OED 1999). The assumption being, that it was not the growth process or the economic system that was at fault, therefore it is not necessary to revaluate the reforms advocated by the BWIs, but the impact of the crisis could have been lessened if the appropriate private sector and welfare institutions existed.

What effect this proliferation of conditions has had on programme outcomes is hard to tell, although there is some evidence that would suggest that it has not improved them. Indeed, the reverse would seem to be the case, for example, Killick (1995) found that programmes financed through the IMF's Enhanced Structural Adjustment Facility (ESAF) contained more conditions and benchmarks than programmes financed through the Structural Adjustment Facility (SAF) but the ESAF programmes performed less well.

"Academic writers on the subject [of ownership] also find, predictably in our view, that high conditionality programs do not generally do well." (IMF, 1998a p20)

3 *The growing disillusionment*

The growing perception that using conditionality to induce policy change is extremely difficult is reflected in the frequent breakdown of adjustment programmes.

- The OED's 1997 report examining Sub-Saharan African governments' compliance with conditionality found that only 10 countries had "good" compliance with conditionality and 25 countries had "poor" or "weak" compliance.
- The World Bank's Quality Assurance Group, in a review of the financial years' 93-95 adjustment portfolio found that about 45% of the programmes were in difficulty. In Africa this figure reached 60%.
- The IMF review (1997) of the effectiveness of its ESAF-funded adjustment programmes found that three-quarters of programmes broke down or experienced lengthy interruptions, two-thirds of which were caused by delays in implementing IMF policy prescriptions.
- An evaluation of the Special Programme for Africa found that only 8 of the 28 reform programmes between 1992-96 remained on track, and concluded that "programme implementation has been less than desired, raising a host of issues relating, among others, to conditionality and ownership." (OED,

1998 p99)

There are several reasons why governments

- governments do not have the capacity or expertise to implement technical reforms;
- external or political shocks divert governments' attention away from the reform process;
- governments are not willing to implement reforms because they do not agree with or understand the Bank and Fund's policy prescriptions;
- governments are not willing to implement reforms because its is politically difficult for them to do so since they are regarded as biased, or inappropriate by their electorates or harmful by significant elites;
- past experience with IMF/Bank reform programmes has not been positive;
- programmes contain too many conditions;
- they have insufficient finance to do so properly.

Part of the problem is that the IMF and World Bank, both unelected bodies, have the power to insist on policy reforms, and do so without consulting widely with the government or its people. This power arises from their centrality in the aid process, but this power is not absolute - they cannot actually force governments to implement them. Governments have been told to accept the BWI's adjustment programmes or do without much-needed balance of payments support. On the whole, they have accepted the conditions to access the money, but they have tended not to implement programmes in full and many have broken down.

Secondly, programmes tend to be devised according to a "blueprint" based on best practice, theoretical fixes without investigating their actual economic effectiveness or the merits of alternative policies on an objective basis. Whilst borrower governments have had some scope for negotiating details about the timing and the degree of reform, they have had little opportunity to propose alternative policy formulations. The BWIs have also failed to take into consideration various political, social, cultural and environmental limitations or characteristics. are not able, or do not want, to implement conditionality:

Thus, the conditions they impose are often seen to be inappropriate.

There are also intrinsic problems with conditionality as a tool:

- it is extremely difficult to monitor - whether or not a condition has been met often requires a subjective judgement;
- often donors have incentives to judge implementation favourably in order to continue disbursing funds;
- conditionality has force only during the life-time of an adjustment programme, after which, the government can change policy without reprisals from donors.

The incentives for donors to continue disbursing funds even if countries are off-track are strong. This diminishes the usefulness of conditionality as an instrument of discipline because recipients do not perceive that threats to withhold aid will be acted upon.

"The picture is blurred by the fact that the Bank repeatedly asked the SPA [Special Programme of Assistance for Africa] donors to continue providing QDA [Quick Disbursing Assistance] in off-track situations, in order to finance shadow programmes and not jeopardize already achieved results in the reform process." (OED, 1998 p48)

Collier et al (1997) have termed this lack of credibility the "nuclear deterrent" effect, because the resulting action of suspending all aid would cause such huge problems for the borrower country's economy that the threat to withhold it is not credible. This "nuclear deterrent effect" has been reinforced by creditors who have encouraged borrowers to use new aid money to repay previous loans, ie for "defensive lending". Because until now there has been no mechanism for rescheduling or reducing debts owed to the BWIs, they have been particularly reliant on defensive lending to ensure that indebted countries could continue to repay them. Their need to be repaid has led them to continue to provide loans to countries that have persistently failed to implement reforms,

undermining conditionality as an instrument of discipline.
Also, donors have an incentive to continue disbursing funds in order to maintain their budgets and jobs, and to ensure they have a continued role in particular countries. For example, although ESAF programmes have not been particularly successful and implementation has been extremely poor, the IMF has been pushing hard to secure more funding for the ESAF in order to make it permanent.

Observing these problems, the BWIs have tried various measures over the last two decades to strengthen the conditionality tool. These can broadly be grouped into two areas:

- better targeting and monitoring of reforms; and
- providing stronger incentives to induce policy reform.

In terms of improving the specification of conditions and reducing the number of them, the OED concluded that, *"The quality of conditionality has improved in several ways: it is more precise than in the past, and it incorporates more targets and benchmarks to record progress attained towards achievement of objectives... at the same time, however, there are still too many, highly detailed conditions (eg , in FY95 FSAC to Guinea). Similarly, performance indicators are often related to inputs rather [than] to outputs or impacts (eg , in the FY95 Mali EDSAAC) or not clearly lined to the objectives (eg , the FY96 Mauritania PRMC)."* (OED, 1997 p35)

To improve their capacity to monitor implementation, the BWIs have put more emphasis on benchmarks and targets with more review missions. For example, the IMF staff's review of ESAF programmes recommended that review missions for some countries should be increased from every 6 months to every 3 months (IMF, 1997).

To improve the incentive to reform, the BWIs tried using:

- short-leash finance;
- back-loading reforms; and
- trigger conditions.

The ability of the BWIs to influence policy reform once the money has been disbursed is greatly diminished, so they have tried to force governments to implement reforms before disbursements are made. This is known as short-leash financing, ie money is only released once specific policy reforms, have been successfully implemented. Money is also provided in installments (known as tranches), this allows the BWIs to withhold later installments if conditions are not met, ie, by tying in tranches of aid to a specific sequence of policy reforms the failure to implement any part of this sequence, in principle, triggers a suspension of the whole programme. The BWIs have tended to heap conditions on to intial installments and to hold back the bulk of loans to later tranches (ie back loading). However, short-leash financing has not improved the credibility of lenders, or their threats to withhold aid when part of a programme has not been implemented, often because it has not been credible to suspend a whole programme on the grounds that the recipient government failed to implement one policy reform.

"Trigger" conditions (known as benchmark criteria by the Bank and performance criteria by the Fund), are conditions that, when implemented, qualify the country for the next loan installment. In the case of the Bank they also determine how much overall funding (out of a base case, low case and high case lending scenario) a country is eligible for.

Whilst these measures increase the incentives for governments to implement particular reforms there is no incentive to maintain them or to implement other elements of reform programmes to which no incentives are attached. Thus, they have not significantly improved the credibitity of conditionality and other alternatives have been sought. Several new initiatives now being piloted are paying more attention to:

- more flexible approaches to applying conditionality;
- issues of ownership;
- encouraging civil society participation; and
- being more selective about which countries to lend to.

Part 2

THE BWI'S CHANGING APPROACH

Recent efforts to improve the current system have focused on two aspects of the conditionality problem:

- how to improve conditionality as a tool; and
- how to develop and sustain government and civil society commitment to the reform process to improve implementation.

1 *New donor approaches to conditionality*

Efforts to improve the effectiveness of conditionality as a tool have focused on:

- overcoming the problems associated with "defensive lending" and the "nuclear deterrent effect" to make inducement more effective. For example, developing more flexible approaches to "short-leash" lending;

- repackaging resources to increase the certainty of resource flows whilst giving donors more flexibility to withhold them;
- ways to reduce the number of conditions.

a) Higher impact adjustment lending

As the name suggests, Higher Impact Adjustment Lending (HIAL) aims to achieve a higher impact from structural adjustment programmes. The approach, developed by the World Bank, assumes that it has promoted good policies but the results have been poor, as such it merely augments the Bank's basic approach to conditionality. Key features are:

- more rigorous selection;
- allowing governments more flexibility in deciding the timing of reforms;
- more flexible and quick disbursing loans (single and floating tranches) to provide greater certainty and smoother resource flows;
- improving conditionality through front-loading conditions, reducing the number of conditions and focusing them better, with stricter consequences in the case of non-compliance;
- use of performance indicators for defining expected results and monitoring impact.

Effectiveness is improved by being more selective about which governments receive adjustment lending (see below). In this case, selectivity is determined according to a government's track-record with reform, or in the case of a new government, its willingness to indicate its commitment to the reform effort.

Floating tranche operations are favoured for those countries which have a good track-record. Floating tranches are discreet bundles of resources to which a limited number of key objectives are attached. For example, resources for macroeconomic reforms are separate from resources for social sector reforms. To access a bundle of resources the government must simply comply with the specified conditions attached to it. Failure to implement any particular reform does not lead to the suspension of the whole programme, only that part regarded as commensurate with the policy, ie aid agreements become "priced menus of policy changes" from which the government effectively chooses.

Where commitment to reform is thought to be strong but a track-record has not been established, a single-tranche disbursement is made once the government has carried out a number of prior actions and has therefore demonstrated its commitment to the reform process (compared to multi-tranche operations for non-HIAL programmes with large proportions of the resources tied to second and third tranches).

In the past, non-compliance with certain conditions has caused donors to withhold finance whilst the government gets back on-track with the reforms. This has led to a harmful process of "stop-go" financing which causes problems in the adjustment process. Or the "nuclear deterrent effect" has prevented donors from withholding aid thereby limiting the effectiveness of conditions. Floating tranches are designed to overcome these problems by allowing donors to halt resources to certain reform areas where compliance is poor but continue financing other reform efforts where these are being made. Thus, the threat of aid withdrawal is made more credible.

Whilst non-compliance in one area does not jeopardize the entire assistance package, a country can still go "off-track", and once it does it faces immediate suspension of its adjustment loans and lending is not restarted until earlier reforms have been implemented in full and a further track record of independent policy action has been established.

HIAL addresses some of the weaknesses of the conditionality tool from the donors' perspective but it does little to address the problems recipient governments associate with it. Whilst the approach claims to encourage more ownership, it simply gives the government more flexibility in deciding when to implement the reforms advocated by the Bank. Although not intrinsic to HIAL, this approach still does not allow for a plurality of approaches to reform. This may explain why assessments of progress with implementation showed a deterioration over the life-time of the programmes (see below).

Success so far?

A recent review of the HIAL approach found that governments' compliance with programmes has improved but problems remain and delays persist (World Bank, 1998).

- A higher proportion of good compliers had HIAL programmes compared to standard adjustment operations, although compliance in 3 out of the 13 HIAL programmes was not good and one of these eventually went off-track.
- In 9 out of 14 HIAL operations governments consulted with stakeholders (generally the private sector), but in 3 of these consultations task managers had reservations about the quality of the process.
- Floating tranches have reduced the pressure on the Bank to disburse and has increased its leverage to get conditionalities implemented.
- Compared to adjustment operations completed between FY93 and FY95 Bank-wide, the average number of post-effectiveness conditions appeared to have increased, while the average number of conditions per tranche has gone down. Generally, conditionality has become significantly more front-loaded.
- 6 out of 13 programmes contained no indicators to judge programme performance. Where indicators were specified, they were used in an inconsistent manner.
- For 8 operations for which at least two implementation progress reports were completed, the ratings fell in half the cases compared to the previous year, and in none of the cases did they improve. Indicating a deterioration over the life-time of the operation.

b) Donor coordination and results-oriented conditionality

The Special Programme of Assistance for Africa (SPA) is a grouping of multilateral and bilateral government donors providing programme support to Sub-Saharan African nations. The SPA has recently embarked on a trial three-year programme in Burkina Faso led by the European Commission which resembles an enhanced HIAL approach based on assessing programme outcomes rather than policy reforms.

To foster ownership, the SPA approach proposes that governments formulate and draft their own programmes and identify performance targets; with donors acting as advisors, providing feedback and advice to governments on the design and likely effectiveness of the proposed reforms. The borrower government is given greater control with regard to the sequencing and timing of reforms (although this only applies to structural not macroeconomic reforms), as long as overall progress is adequate and performance criteria are met.

Similarly to the HIAL approach, to smooth resource flows it is proposed that the reform programme should be differentiated into 3 groups of coherent policy objectives - macroeconomic fundamentals, budget management and equitable growth - to which separate bundles of funds are attached. Donors must provide part of their financial support for macroeconomic reforms but they are free to link the remainder to either one or both of the other policy areas if they so wish.

For macro economic reforms, the usual conditionality and performance criteria are applied through the standard Policy Framework Paper process, however, a new form of conditionality is applied to budget management and structural reforms. In these cases, although policy content is monitored, the release of funds is linked to outcomes, ie performance rather than specific reforms (for a discussion of outcome indicators see Collier et al, 1997, in Part 3 below). Performance targets relate to specific short-term and long-term objectives and results are regularly monitored according to a unique set of indicators for each country (by which all donors abide to avoid unnecessary proliferation).

Performance in all three areas of reform is evaluated jointly by all donors (linked into the IMF's assessment of its ESAF programme or Article 4 consultations),

- if macro reforms are only slightly delayed then the associated resources are also delayed, but resources for budget management and equitable growth could be released;
- If macro reforms are on track then all 3 bundles of resources are released.

A joint donor assessment is intended to encourage greater cooperation between donors and economise on the resources and staff time devoted to carrying out programme supervision, as well as minimising the negative consequences of multiple donor missions that tie up scarce recipient government resources.

The importance of this proposal is its shift in emphasis away from achieving individual conditionalities towards judging performance in terms of the results achieved, *"the purpose of external support would not be to enforce any particular reform, but to foster the good management of a coherent set of economic policy instruments and objectives over the longer term."* (EC, 1997). It is envisaged that implementation indicators would be used to determine whether policies are being implemented effectively and whether policies are appropriate, and impact indicators would be used to ascertain whether policies actually have the intended impact.

A step in the right direction?

Whilst HIAL is very much reflected in this approach, the SPA has gone further than the World Bank in terms of emphasising performance outcomes rather than inputs, taking into account external factors that might affect outcomes. Depending on the performance assessment, all donors agree on a common position as to whether or not to continue providing adjustment finance to the country concerned. Crucially, the decision to release resources remains dependent on whether or not the macroeconomic conditions are fulfilled:

- no resources are released for any of the reform areas if the macroeconomic reforms are seriously off-track;

reducing the number of conditions and pursuing better donor co-ordination and therefore smoother resource flows. Concern with outcomes rather than policy prescriptions should allow governments to decide for themselves how to achieve the agreed targets. However, the degree to which ownership can be achieved is limited by the fact that macroeconomic reforms and the aid linked to them continue to be subject to "traditional" IMF conditionality, with the emphasis on meeting "traditional" performance targets for particular reforms. Thus IMF stabilisation requirements remain central to the reform process.

Also, if structural or budget-related conditions are anticipated to affect macroeconomic stabilisation, then these reforms will also be made subject to standard IMF conditionality. This limits government ownership because the IMF still has significant control of the reform process. Thus, although the approach intends that short-term goals should reflect long-term objectives, macroeconomic stabilisation is still the priority of these programmes rather than poverty reduction.

Whilst governments are expected to develop their own reform strategies and identify a matrix of indicators to enable donors to monitor implementation and outcomes, real ownership will not be achieved if donors do not demonstrate willingness to be flexible about what a reform programme should look like. It is likely that governments will feel implicitly constrained from proposing policies that do not adhere to the standard IMF approach because they assume they will be unacceptable to the donor community.

Moreover, governments may need substantial assistance to identify a suitable matrix of indicators.

This process is crrently being tried in Burkina Faso (European Commission, 1998). An initial evaluation was disappointing, it found that:

- progress has been slow because of *"a lack of involvement by civil society and even by the government of Burkina Faso in the process."*
- when the government did eventually provide the donors with a matrix of indicators, they had simply been taken from the country's PFP and HIPC documents and there was too many of them; and
- World Bank and IMF co-ordination with the SPA donor mission was poor.

"Both reviews [of ESAF] brought home the important fact that programmes need not only to be well-designed, but also resolutely and consistently implemented, if they are to have their intended effect on economic performance." (Summing Up, IMF Executive Board, July 1998)

In addition to making conditionality a more wieldy tool, efforts have been underway to encourage greater commitment on the part of governments to reform. Two approaches are being pursued:

- improving government ownership of the reform programme and stakeholder participation in the reform process; and
- selectivity to identify those countries most able and willing to reform.

2 Improving commitment to reform

a) Ownership and participation

Many reviews of policy-based lending have concluded that successful adjustment outcomes are best achieved when there is strong domestic support for reform, both within the government and amongst civil society, and consensus as to what reforms should be made and when. This willingness to reform is referred to as "ownership".

"There is abundant evidence linking country ownership to the successful implementation of the development agenda, and the ability to sustain its benefits...reforms that are donor-driven and dependent on conditionality for their implementation compromise the success of programmes, producing reluctant acceptance by recipients of what donors want and undermining country ownership." (OED 1997, p9)

"There is one common theme that runs through all the foregoing country perceptions. At the bottom of all the concerns they reflect, is a feeling of a loss of control over the setting of the policy agenda in reform programmes, as well as the pace of implementation of these policies. They therefore go to the very heart of the ownership problem. All the available evidence suggests that conditionality intensive programmes seldom succeed in achieving their objectives. Moreover, all the parties in the development debate are agreed that ownership is the key to successful programme implementation" (IMF, 1998a, p36)

"To nurture sustained ownership, reform requires a clear understanding of borrower interests in the light of political economy considerations. Where the seeds of borrower ownership are in place, lending can be a useful instrument of reform." (OED 1999, p53)

Despite this strong evidence, in practice the BWIs have done little, until recently, to systematically encourage stronger ownership. Whilst some effort has been made to broaden discussions on Policy Framework Papers and Country Assistance Strategies to include more government departments, the perception remains that it is standard practice to develop programmes in Washington; only allowing governments to negotiate the timing of reforms once the Bank and Fund missions have arrived in their countries to finalise the programmes.

Participation from civil society has been even more *ad hoc*. The BWI's have tended to regarded outreach to civil society as a public relations exercise, where ownership relates to persuading the public that reforms are necessary and good in order to minimise political opposition to them.

Tentative steps have been taken by the Bank to consult with civil society about the content of Country Assistance Strategies However, the Bank's perception of civil society as stakeholders in the reform process may be changing. A review of experience with civil society participation in the Country Assistance Strategy process revealed that, *"participatory or consultative processes are now used more frequently in preparing CASs than two or three years ago",* and that *"for two-thirds of all surveyed CASs, survey respondents indicated that the benefits of participation, although often intangible, significantly outweighed the costs."* (World Bank, 1998e p3)

This finding was reaffirmed publicly by World Bank president, James Wolfensohn, *"Our experience is that by engaging with civil society in projects and programmes, better results are achieved both with design and implementation and usually greater effectiveness, including more local ownership."* (Wolfensohn, 1999 p26)

(CASs) but no formal mechanism has been established and the process has been left to the discretion of country staff and resident representatives. Consequently, many NGOs and civil society groups have had uneven and conflicting experiences with participation. In some cases, the Bank has made reasonable efforts to reach civil society and ascertain their needs and priorities in a systematic manner but there are many more examples of only cursory attention being paid to participation with minimal effort being made to contact and listen to civil society.

CONDITIONALITY VERSUS OWNERSHIP

Johnson and Wasty (1993) tested the relationship between successful reform outcomes and the degree of government ownership and found a positive relationship between the two, such that good/poor ownership explained good/poor programme outcomes in 73% of cases studies.The remaining outcomes were attributed to external factors. The study classified ownership according to four factors: locus of the initiative; level of intellectual conviction among key policy-makers; expression of political will by the leadership; and efforts toward consensus building among various constituencies. Political factors, particularly political stability, the synchronisation of reforms with the planning horizons of politicians and the pressure for election success, proved very important in terms of a government's commitment and ownership of the reform process.

Ana Marr (1996), examining the use of conditionality in the successfully reforming South East Asian economies, noted that in South Korea, Thailand, and Indonesia political will for reform (demonstrated often by voluntary commitment to policy reforms) was high, as was administrative capacity and the ability of governments to impose reforms (especially where the electoral system created a virtual dictatorship or secure leadership position), therefore conditionality was largely unnecessary. In the case of the Philippines, despite pro-reform governments, reform progressed slowly and was limited by domestic political factors, particularly anti-reform pressures from important political groups, and external shocks. Marr concludes that few conditions were imposed on these successfully reforming governments but *"compliance with these few conditions has been high only when the government itself regarded them as beneficial. Where the recipient government has remained unconvinced of the need for policy change, IFI [International Financial Institutions] conditionality has been violated, invariably without impunity, as in South Korea's unwavering support for its automotive industry and Thailand's reluctance to restructure petroleum product pricing."* Thus, whilst the BWIs have been important for influencing the direction of policy reform, conditionality was largely irrelevant for bringing about the actual reforms. Marr also notes that *"the most apparent IFI impact on policy reform lies in the easing of external resource constraints through financial assistance. This has provided committed governments with the financial resources needed for carrying out policy reform."* Questioning why these countries chose to reform when they did, Marr suggests that *"domestic politics, culture, and history are the major factors contributing to these decisions."*

Eboe Hutchful (1995) examined the case of another star reformer - Ghana. He found that there were limits to reform which were determined by the interests of the Rawlings government. Whilst the government was happy to implement reforms which suited its needs and political agenda, once these reforms had been successfully implemented it was much more difficult to persuade the government to reform further. It was political liberalisation which subsequently pushed the government a little further along the reform path. The loosening of political controls destabilised the government forcing it deeper into reliance on the "policy rent" (loans) provided by the BWIs to sustain it in power. Hutchful concludes that *"political liberalisation has thus fuelled economic liberalisation (rather than the other way round)."* There was little ownership on the part of the government which desperately needed money and accepted the reforms as a consequence but did not fully understand them or support them. Whilst the Bank talked of "an unambiguous sense of ownership" among Ghanaian officials, Finance Minister Kwesi Botchwey was calling for the BWIs to give the government the opportunity to develop and implement its own reforms as a way of broadening the government's capacity. Thus the Bank's perception that it was working with the government and building ownership is contrasted with the government's perception that it accepted the conditions out of necessity, not because it agreed with the Bank's analysis of the need for reform.

Building ownership and partnerships

"It is also clear to all of us that ownership is essential. Countries must be in the driver's seat and set the course. They must determine goals and the phasing, timing and sequencing of programs. Where there is not adequate capacity in the government to do

this, we must support and help them to establish, own, and implement the strategy." (Wolfensohn, 1999 p9)

"Partnership" and "ownership" are central pillars of the Comprehensive Development Framework, advocated by Wolfensohn. The "Partnership Initiative" is the first attempt by the Bank to develop a systematic framework that encourages government ownership in the reform process. The main features of the initiative are:

- encouraging government design and ownership of the reform programme;
- building public consensus for reform through government consultation with civil society and the private sector to assess the problems, develop strategies to solve them and to help implement these strategies;
- developing partnerships between donors to improve aid coordination and to focus all aid on the one, coherent strategy, instead of individual donors each funding their individual programmes;
- encouraging better aid effectiveness by selectively choosing those governments that implement an appropriate set of economic policies.

Although this initiative offers the most systematic approach to ownership yet developed by the Bank, there are a lot of practical details regarding its implementation that need to be worked out (see World Bank, 1998d), such as:

- how to resolve differences between government and donors about the design of the programme;
- how to ensure fair representation and accountability;
- how to change incentives so that aid donors do not try to "cherry pick" the best projects or work within the most fashionable sectors;
- how to change donor's reward systems so that they are not based on quantity of lending;
- how to ensure access to information.

But perhaps the most fundamental problem with it is that it is based on selectivity (see below). If donors are unable to widen their perception of what incorporates a good programme (the basis of selectivity), then it is likely that governments will simply design development strategies according to what they understand to be acceptable to the donor community ie, governments will feel constrained to prepare strategies which fit donors' preconceptions about selectivity. If true ownership and partnership is to be achieved then donors will have to accept a pluralistic approach that allows for country-specific development strategies.

Building in flexibility

The external review of ESAF (IMF, 1998a) found that *"in spite of the general consensus [about the desirability of ownership], it has not been possible to move matters beyond mere theory."* To rectify this, they recommend that:

- the country itself should take steps to define its medium- to long-term development strategy and build national consensus for it;
- that the Fund management engage in intensive and informal policy dialogue with the country's political leadership in order to understand the country's political constraints and possibilities;
- the timing and duration of IMF missions should be improved so that the government has adequate time to prepare itself;
- flexibility should be introduced into the conditionality regime by allowing governments to choose between different reform strategies;
- new forms of conditionality should be developed for countries which have stabilised their economies;
- resident missions be established in all ESAF countries and more power devolved to them;
- the Fund should be more selective about which countries it lends to.

Whilst still lacking a systematic framework, if implemented, these recommendations would be an important step towards improving the policy dialogue and management of the reform process. However, it seems unlikely that the IMF will implement many of them. Whilst acknowledging that government ownership is a prior condition for national consensus, the Executive Board has simply proposed that:

- greater flexibility should be afforded to missions to agree with the authorities on alternative policy mixes that would be consistent with an appropriate set of programme objectives, although "the scope for such flexibility would need to be defined reasonably clearly *ex ante*", ie in Washington; and
- although Fund missions will continue to negotiate with the heads of the authorities' economic team, they should encourage the authorities to include other relevant ministries in the discussion of structural or sectoral policies, and to discuss with all affected ministries the impact of measures taken in other areas.

This is not ownership as most proponents would describe it. The IMF is simply offering to provide a menu of reforms from which governments may choose rather than introducing flexibility into negotiations. The lack of commitment to the principle of ownership is clear: whilst acknowledging that the Fund has a role to play in efforts to strengthen ownership, the Board cautions that *"it [is] important to strike the right balance between fostering ownership and securing a strong arrangement."* (IMF, 1998b p4). It also accepts no responsibility for consulting with civil society or for assisting the government to do so. The IMF's failure to appreciate the importance of ownership, casts doubt on the effectiveness of other donor's initiatives, in particular the Bank's Comprehensive Development Framework, which relies on all donors to co-ordinate their aid, giving in support of a comprehensive strategy.

Instead, the IMF has chosen to fall back on standard measures such as prescribing more detailed policy reforms and more intensive monitoring of certain countries to aid consistent policy implementation, and a more selective approach in its financing decisions:

"...while greater selectivity may help build countries' resolve to implement programs as agreed, establishing the criteria for greater selectivity would be far from straightforward. Without greater selectivity, however, interruptions are likely to remain a feature of the ESAF experience, as the IMF continues to assist members at the margins of commitment and in the midst of difficult political transitions to start the adjustment process or push ahead with reforms already begun." (IMF, 1997 p45)

b) Selectivitiy - spurring growth in a good policy environment

"When countries desire reform foreign aid can provide critical support - in ideas, training and finance. Efforts to "buy" policy improvements in countries where there is not movement for reform, by contrast have usually failed." (World Bank, 1998a, p2)

Selectivity refers to the rationing of finance according to certain criteria. Given a limited amount of aid resources, donors have always selected which countries should receive aid. There has been a tendency, particularly amongst bilateral donors, to select countries according to political or colonial alliances and perceived need. In many cases, need has been viewed in terms of the need to reform, ie donors have given money to those countries with the poorest economic environments in order to try to induce reform. However, recent work by the World Bank (Dollar and Burnside, 1997a), suggests that donor's failure to select countries according to objective economic criteria has contributed to aid's ineffectiveness, ie the failure to achieve growth and poverty reduction objectives.

"The main answer to the question of why so many sub-Saharan African countries received adjustment lending but failed to adjust is the lack of selectivity in Bank adjustment lending, particularly in the second half of the 1980s." (OED, 1997 p25)
"Providing adjustment loans to governments not serious about reform has been a major recent problem of foreign aid." (World Bank, 1998a)

Motivated by the decline in aid spending and the apparent ineffectiveness of aid to bring about policy reform, Dollar and Burnside examined the relationship between aid, policy reform and growth. They found that aid works in countries with "good economic management", which is defined in terms of "good" economic policies and sound institutions. In these environments aid helps to crowd in private investment by boosting investor confidence that policies are correct and will be sustained. But aid does not support policy reform, and may even allow governments to put off making necessary reforms, in poor economic environments.

The implications of their findings are that countries whose economic fundamentals are sound will grow with or without aid but growth and poverty reduction will be quickened if aid is given. Therefore, to get the maximum benefit from aid it should be targeted towards those countries with good policies. Countries with poor policies should be encouraged to reform and should be helped via advice and technical assistance but should not receive programme support.

They surmise that policy reform is *"largely driven by domestic social and political forces"*, and that *"the impetus for reform has to come from countries themselves and there is no point in doing adjustment lending in an unreceptive environment...Thus more weight should be placed on demonstrated reform and less on conditionality to be fulfilled later."* (Dollar and Burnside, 1997b p10)

Just another form of conditionality?

There are many problems with Dollar and Burnside's analysis, not least that the methodology and data they employ are very poor (see Wood 1999). However, a more fundamental problem is how to reconcile selectivity with ownership.

Rather than inducing policy reform, this approach rewards governments for maintaining appropriate policies. The underlying basis of this approach is that aid cannot induce unwilling governments to reform but it can support reform efforts, ie where there is already government ownership of the reform process.

Whilst selectivity would at first appear to support ownership, if selection is made on the basis of a narrow definition of a "good policy environment", then it amounts to little more than another means of imposing "up-front", short-leash conditionality, ie only those governments who are already implementing Bank-supported reforms would be eligible for
A mechanism which locks in donors and

policy-based lending.

"An important corollary, then, of withdrawing from hard core conditionality and reliance instead on overall judgements about governments' intentions is that donor agencies, specifically the IMF and World Bank, must be willing to take a more eclectic view of what constitutes an acceptable programme." (Killick, 1998 p180)

Given the tight policy formulation identified by Dollar and Burnside, ownership and selectivity can only be complementary when a recipient government's programme reflects what the Bank considers to be good policy. The implication is that governments wishing to take an alternative economic approach must expect to forego policy-based lending. Alternatively, if finance needs are pressing they may feel compelled to design programmes which reflect the Bank's view point even if they are not committed to them. This raises concerns about how the selectivity approach can be reconciled with the Bank's desire to move towards a "partnership approach" to developing and funding programmes.

Not only does the Bank define a "good" policy environment very narrowly, the consensus on what defines "good" policies is subject to change. What may have been regarded as a good policy yesterday may not be today. For example, in the 1970s the Bank supported statist-type policies, in the 1980s it promoted free-market based reforms, and now Joseph Stiglitz, World Bank Chief Economist, has acknowledged problems with the current "Washington Consensus" and is propounding a "Post-Washington Consensus".

Moreover, whether or not a government is regarded as committed to the reform process is largely a matter of subjective judgement. It is possible that donors will view certain countries more favourably than others because of historical ties, limiting the effectiveness of selectivity. The effectiveness of selectivity may also be reduced if donors perceive that they are locked into relationships with particular countries, especially if these countries are particularly poor.

recipients is defensive lending, ie when a donor carries on providing aid to a recipient so that they can repay previous loans made to them. The IMF and World Bank have been particularly engaged in this activity. Without substantial debt relief it is likely that the pressure to provide new aid for defensive lending will continue whether a country has a good economic environment or not.

It is also likely that donors have a tendency to be overly optimistic about governments' commitment to the reform process. For example, the Bank identified Kenya as a worthy recipient of its Higher Impact Adjustment Lending, even though it considered Kenya to be a "poor-complier", on the grounds that the government had signalled that it was now committed to reform. However, the government did not comply with its HIAL programme and it broke down.

Nor does selectivity do away with the need for conditionality, even though selectivity should achieve the same ends as conditionality, ie aid effectiveness. Drawing on the work of Collier et al, 1997, the World Bank (1998a) suggests that conditionality remains important for:

- binding- or locking-in committed governments to an economic policy to protect them from internal interests which oppose the reform;

- signalling to the private sector that the government is serious about reform and the new policy regime will persist.

3 *Summary*

The World Bank is taking innovative steps to improve conditionality and lessening its reliance upon it. However, unless the Bank, and other donors, are prepared to accept that governments may wish to implement programmes that do not fit the standard IMF-WB policy prescription, then it is unclear how these different innovations can be reconciled.

In contrast, the IMF appears unable to innovate or accept that governments will not be forced to implement reforms which they regard as politically, economically, or socially damaging to them or the country. Thus, its answer to the shocking finding that three-quarters of its ESAF programmes were interrupted and two-thirds of these interruptions were due to policy slippage, is to rely on standard techniques, such as more vigorous monitoring of implementation and more reliance on up-front conditionality by being more selective about which countries it lends to.

Part 3

ALTERNATIVE APPROACHES AND PERSPECTIVES

It is not just donors who are questioning the role of conditionality; a wide range of academics and others have been assessing conditionality and exploring alternatives. Most of these alternatives emphasise the importance of ownership with different mechanisms for achieving this, ranging from selective approaches to recipient-led dialogue.

1 *Identifying objectives not specifying policies*

Collier and his colleagues (1997) argue that using conditionality to induce policy reform has failed because the threat to withdraw aid, should policies not be reformed, is, like the nuclear deterrent, not likely to be implemented. Also, by withholding aid money donors would in effect hurt themselves because they are engaged in defensive lending, ie, rather than providing debt relief they choose to provide new loans in order that recipient governments can repay previous loans. Thus donors have an incentive to carry on providing aid funds to ensure they continue to receive their debt repayments. Moreover, because the recipient government does not "own" the reforms which are "bought" by the lenders, the private sector does not perceive that reforms are credible and permanent. The solution to these problems is to foster government ownership of reforms, through an approach in which lenders monitor policy outcomes rather than the implementation of particular policy measures, ie, donors specify what they regard as desirable outcomes rather than desirable policies.

According to Collier et al, in order to signal ownership of programmes and to indicate to the private sector that reforms are permanent governments must be responsible for formulating policies as well as for implementing them, ie, governments should be allowed to choose a policy package for themselves, based on objectives identified by the lenders. Aid is then allocated on the basis of periodic overall assessments of government achievements such as improved growth or poverty reduction rather than on the implementation of particular policy measures. This requires a "longer-leash" approach whereby performance would be assessed over a longer period than the current tranche-based system.

An obvious difficulty with such an approach is that monitoring policy outcomes is more problematic than measuring changes in policies since policies tend to be more observable than outcomes. Firstly, some of the outcomes in which donors are most interested are slow changing, making monitoring problematic for certain objectives, such as, poverty reduction. Outcomes could, therefore, be evaluated with reference to some norms which are seen to be legitimate. Legitimate norms could be defined in terms of average performance of a peer group, for example, African governments could be assessed relative to the African average. Assuming that performance improves, the mean of the indicator would change, becoming more demanding over time.

Secondly, even where outcomes are fully observable, they can be attributed to factors beyond government control, for example, movements in a country's terms of trade are likely to affect its growth rate. To ensure governments are not rewarded or punished in such circumstances, effective evaluation would need to allow for these factors. The extent to which this is possible will differ depending on the set of objectives to be achieved. Some element of quantitative analysis will help correct against outside factors but some degree of subjective judgement will also be inevitable.

Helleiner (1997), is principally concerned with the issue of ownership and the gulf between donors' (principally the BWIs) rhetoric and their actual practices, which limit the possibility of ownership in favour of speedy implementation of reforms and quick disbursement of money. He argues that conditionality has actually reduced recipient governments' responsibility for and ownership of reform programmes. Moreover, in some cases the bluntness and pacing of required policy reforms may have, in some instances, been harmful to development prospects.

He concludes that long-term development can only come through recipient government ownership of reforms and an effective state which has the capacity to make reforms work, *"as far as national-level developmental programmes and policies are concerned, there is no substitute for an effective state"*.

Helleiner proposes that a way forward may be to rework how conditionality is applied. He stresses that the current "short-leash" approach is not effective because: 1) donors do not reduce funding when certain targets are missed because the targets are multi-dimensional and there is little clarity as to which should be given priority; and 2) there is rigid adherence to the targets which leads to undesirable "stop-go" financing patterns. Thus, short-leash financing leads to *"irritation surrounding the negotiation and subsequent interpretation of the targets; incentives to "fudge" numbers and facts; uncertainty about funding prospects; and hence unduly short-term perspectives on the part of both private and public investors and decision makers."*

As an alternative he advocates a "longer leash" approach, *"in which donors would undertake to make steadier and long-term commitments after a donor-recipient dialogue had established agreement as to the general nature of the requirements for development and the government's credibility with respect to their pursuit. Conditionality could thus take more the form of an ex post reward for appropriate approaches rather than an ex ante lever against future change."* To

2 *The long leash approach*

minimise the impact of foreseeable adverse events leaving reforming governments with insufficient resources, donors could include pre-agreed financial supplements and/or waivers into the agreement.

Of course the problem arises as to what "appropriate" policies should be and how much commitment there should be to them.Donors continue to assume that there is agreement on what the required policies are, thus the problem is essentially to raise the degree of commitment of the recipient governments to these policies. However, beyond the basics of fiscal and exchange rate management there is not a general consensus and the donors should not assume that their views are more correct than the borrower's own views. Thus, there are bound to be differences of opinion, and commitment to particular reforms will inevitably vary between recipient governments, and not simply in terms of the timing or sequencing of reforms.

Lengthening the leash of funding and conditionality will inevitably lead to some failures and disappointments, but where there is government ownership there is at least consolation in the knowledge that these governments will learn from their mistakes and in so doing will raise their capacity.

Such an approach would require a significant shift in the current approach of donors towards longer time horizons, an emphasis on capacity building and institutional strengthening in the recipient country, minimal intrusion in domestic policy making, efforts to encourage genuine dialogue, and a move away from a substitutive role towards a supportive role.

3 *Principals, agents and the failings of conditionality*

Killick (1997) hypothesizes that conditionality is not an effective means of improving economic policies in recipient countries because donors (specifically the BWIs) are

unable to put in place a system of rewards and punishments sufficient to overcome the frequently perceived conflicts of interest between themselves and recipient governments. Therefore, in the event of a serious breakdown in the donor-recipient
Killick uses a principal-agent approach to analyse the usefulness of "hard core" conditionality, where the donor ("principal") is trying to get the recipient ("agent") to follow the former's agenda. Hard core conditionality is coercive, whereby recipient governments agree to actions they would not otherwise have taken at the insistence of the lender in return for financial assistance. In this case, Killick assumes that borrowers do not own the reforms, ie they would not willingly undertake them themselves. This is distinguished from policy dialogue in which donors reward governments who choose to follow policies of which they approve[4]. The central problem with coercion is the ability of principals (donors) to design incentive systems that induce agents (recipient governments) to implement policy changes they would not otherwise have made or that would have been undertaken more gradually.

Killick identifies a "participation constraint" ie, the recipient governments' aversion to the measures stipulated by the donor agency. The participation constraint is the minimum level of inducements necessary to bring the government to the negotiating table. Aversion will be highest when a programme does not marry with the recipient's own objectives, and it is reduced when recipients own the adjustment programme. The adequacy and structure of the incentives offered are relative to the participation constraint, ie, how much money the donor can offer directly plus the additional aid and private capital that this money generates through its catalytic effect, is therefore very important. In this respect, the threat to withhold aid should the recipient fail to implement the programme is significant. If the threat is not regarded as credible by the

recipient then the inducement nature of conditionality is severely diminished.

Based on a sample of 21 developing country case studies, Killick concludes that, in general, conditionality is not an effective
Killick suggests that the conditionality

relationship the recipient government will prioritise domestic concerns rather than pursuing the relationship with the donor. Conditionality is therefore not a substitute for weak domestic institutions or political will.

means of improving economic policies in recipient countries. Whether or not a recipient implements World Bank programme measures depends upon the extent to which the government and its officials perceive them to be in their own interests. Because differing objectives are common between donor and recipient, recipient ownership of programmes becomes an important factor in ensuring programme implementation.

Whilst ownership has been poor, donors' incentive systems have not been adequate to ensure implementation. Programmes have been underfunded and have not catalysed funding from other sources, in particular, private sector investment has not been forthcoming. Moreover, threats of withdrawal of aid, for example the IMF threatening programme cancellation and the World Bank withholding tranches of aid, have not been effective in practice, usually because the costs to a government are not great and new credits can generally be negotiated (Killick, 1998). Therefore conditionality has not improved the effectiveness of aid and *"over-reliance on conditionality has led to major misallocations of resources and large-scale waste of public money."* Over-reliance on conditionality has resulted in the provision of finance to governments that were not serious about reform or were unable to deliver it. Indeed, Killick argues that aid has been mis-allocated in favour of poor-performing governments at the expense of better performing ones ie, bad performance is rewarded. Collier also makes this argument. He suggests that because aid is used to buy policy reforms donors have tended to focus on those countries with the worst economies because they perceive that they can "buy" more reforms for their money. In the light of Dollar and Burnside's analysis, donors have been putting their money into those economies where it was least likely to be effective.

mechanism could be improved by reducing

the recipient's participation constraint and strengthening the structure of rewards and punishments. However, differences in donor-recipient interests have intensified with the proliferation of conditions. Unfortunately, the BWIs appear unable or unwilling to reverse this process. The likelihood of securing more finance for adjustment programmes is also unlikely in the present climate of diminishing aid flows. Fundamental improvement in the ability of the BWIs to credibly threaten withdrawal of finance is also unlikely, due to political considerations. These include the difficulty for the BWIs of acting against governments which are among its shareholders and the destabilising economic impact that withdrawal of support creates (Collier's 'nuclear deterrent' effect). As improvements in the mechanism of hard core conditionality are not likely to be easily achieved Killick advocates that this form of conditionality should not be used except in rare circumstances, such as when measures can be incorporated as preconditions, or where there are specific grounds for believing that levying policy conditions will tip the domestic political balance in favour of change.

He has proposed an alternative model of conditionality based on four principles:

- *ownership* - conditionality should be non-coercive. Ideally, local ownership should result in consensus in favour of the policy changes so that they become built into the political fabric. Where there is not a culture of participation and consensus building this will be difficult to achieve. Ownership indicators will be necessary for judging the degree of local ownership. Commitment or future performance could be assessed according to past performance, although this would not be a suitable indicator in all cases, especially where there has been a history of political instability. An alternative indicator could be a government's willingness to prepare its own policy document. Indicators of ownership should also provide evidence on the extent to which stakeholders have been consulted, and the extent to which the changes have broad-based support.
- *selectivity* - donors should be more discriminating about the governments they are willing to support. By limiting programme support to those countries which have adopted for themselves a good policy environment, selectivity should raise the effectiveness of the assistance provided, diminish the moral hazard problem and act as a rationing device which discriminates efficiently in favour of governments that will employ the resources within a supportive policy environment. By withdrawing from imposing hard core conditionality and relying instead on overall judgements about governments' intentions, the BWIs must be willing to take a more eclectic view of what constitutes an acceptable programme.
- *support* - sufficient finance is essential to ensure that reforms are not undermined. Conventional financial support for adjustment programmes should be supplemented by easy access contingency financing to overcome problems caused by unforeseeable shocks, and debt relief for reforming governments. Conditionality-free technical assistance should be available to governments to raise their policy capabilities. Sustainable technical assistance is necessary to ensure that those governments with weak public administrations, little expertise and, therefore, limited capabilities for preparing and executing convincing policy programmes are not disadvantaged.
- *dialogue* - donors should reorient themselves to concentrate on the exercise of influence, and to maximise the number of entry points through which that might be exerted.

Donor practices also need to be reformed. Firstly, they should decentralise responsibilities within agencies to allow cultivation of personal contacts in recipient countries, and to foster greater understanding of local goals and constraints. This should ensure conditions are better designed.

The tasks of consensus building and greater selectivity will also require greater decentralisation of responsibilities within agencies by, for example, establishing effective field offices.This would avoid the imposition of inappropriate headquarters-designed conditions. Although efforts to decentralise activities should beware of the possibility of field staff “going native”, becoming advocates of “their” countries, making selectivity and objectively-based Mosley (1995) starts from the empirical observation of a negative relationship between aid flows and growth in Africa. He notes that some analysts (such as Boone) have therefore concluded that aid does not work to support growth through adjustment and investment, but rather replaces them and perpetuates balance of payments difficulties and therefore the need for more aid. In contrast, he argues that a closer look reveals a more complicated truth. Using a simple game-theoretic model of donor-recipient interaction, he demonstrates that the credibility of policy advice is a crucial element.

Firstly, conditionality, by definition, needs to be imposed: *"if any part of the donor's conditionality were welcomed by the recipient there would be no need for it to be imposed as a condition."* In Mosley’s model, the recipient desires aid but not reform (at least not as much reform as the donor): the tighter the conditionality the unhappier the recipient. The donor wants to maximise reform, but also has an interest in spending the aid budget. For a higher interest lender (including IBRD) the motivation is to maintain the ability to repay. For a low interest lender (IDA and aid donors) the motivation may be partly defensive lending but also to avoid budget cuts. In both cases, both geo-political factors may also be relevant. A simple rule (followed in practice in "balance of payment support") is to link aid disbursements to balance of payments deficits.

In this simple model, the most likely outcome is for the recipient to breach conditionality (‘slippage’) but for the donor to refinance anyway. Why?

On the recipient side, slippage is always better politically, whether or not it gets refinancing, because otherwise the recipient would have made the reforms anyway. It is

decisions harder rather than easier.

Secondly, incentive systems need to be reexamined to discourage unselective, pro-lending biases.

4 *Conditionality and the effectiveness of aid*

better for the donor because it is better to disburse (slippage or not) than not.

As Mosley comments: "*The moral hazards implicit in such an equilibrium need no underlining: recipients lack an incentive to engage in a serious adjustment effort because to do so will, especially if it is successful, put future aid flows and thus short-term economic welfare at risk; and donors have an incentive to underwrite the avoidance of adjustment because it is the payments deficit resulting from such adjustment which rationalises future aid flows.*"

In real life, of course, some breaches of conditionality are punished, although most are not. Two modifications of the model are introduced to deal with this: the possibility that recipients can be pushed to reform further, which does actually bring about higher growth; and treating slippage and refinancing sequentially rather than simultaneously.

The donor works backwards by evaluating the costs and benefits of enforcing punishment; the recipient calculates optimal slippage in light of the expectation that the donor will maximise pay-off, and the donor calculates optimal tightness assuming optimal slippage by the recipient. Mosley’s most important result is that the more credible the reforms (ie, the reforms are linked to growth), the more likely they are to be implemented: *‘recipients can only be expected to carry out policy conditions if they perceive a pay-off from them.’*

Mosley then examines this idea by looking at country-specific experience, comparing countries which experienced improvement in incomes or deterioration moving from the 1970s and the 1980s. In fact only three countries showed a net improvement. Ghana, Uganda and Mauritius, are the only countries in which aid had a significant and positive impact. For these countries, aid was credibly linked to growth.

However, Mosley differentiates between a link between aid and growth versus adjustment and growth. Adjustment bunches together a lot of heterogeneous instruments, making the relationship harder to pin down.

His next point is to look at the combination of initial conditions and policy actions in successful adjusters, as opposed to failures. Between Ghana, Uganda and Mauritius, initial conditions varied hugely. Despite this, there was a lot of similarity in terms of what policy measures were initially recommended. However, there was a difference in what was implemented and what was effective. Some things helped spur growth (public investment, real exchange rate change and policy stability), but others didn't (public enterprise reform, changes in effective protection rate and in agricultural subsidies or the real interest rate).

Fundamentals seem to be: protect (public) investment and devalue. But this then raises the question: if it is so simple, why did not more African countries do this? To understand this, it is necessary to look at the process of successful adjustment over time.

Looking at the first three years after receiving Structural Adjustment Lending (SAL), not all reforms are introduced in response to conditionality. Some are and others are not. But what is crucial is that a growth spurt happens early on, so that growth is seen (by the finance minister) as being caused by reform, even if it is not (eg, in the case of Ghana by recovery from drought, or Uganda by a coffee boom).

The perceived linkages between aid, adjustment and growth gave supply-side reform advice credibility, and at the same time, growth gave resources for public investment, which in turn was crucial for maintaining growth. So: *‘first impressions were vital.’*

‘During the initial adjustment period, aid-effectiveness was created in the three 'success' countries by a combination of increases in public investment and aggressive depreciation of the real exchange rate: the success of these policies then enabled aid-effectiveness to sustain itself by its own bootstraps, since it created credibility for the advice of donors, new investible resources and an incentive to keep the thrust of policy stable, all of which fed back into growth in the period following adjustment. In other adjusting countries, the spiral worked in the opposite direction: lack of initial success bred doubt in the validity of the structural adjustment experiment, lack of investible resources nd lack of stability in policy, all of which undermined growth performance.’

In Ghana and Uganda, a second wave of reforms has focused on trade and financial liberalisation. Crucially, these followed the liberalisation of the exchange rate and rehabilitation of the capital stock, thereby preventing the common problem of a fall in import duty revenue and the industrial base just as price-based incentives were trying to stimulate local production. Also, it was highly selective (against the advice of Washington) about which tariffs it lowered. For example, it lowered tariffs on raw materials while keeping them high on finished goods. The message is that growth is not sensitive to the overall level of protection, but rather to the structure of protection. Finally, successful reform included incentives for export performance, still rare in Africa (as opposed to its common use in East Asia).

Relationships between the BWIs and the governments were not perfect, but did maintain trust. *‘Much of that trust can be ascribed to the credibility created by the apparently high rate of return on the initial adjustment effort.’*
Aid and adjustment are offered as joint products. Mosley's analysis suggests that *‘if the recipient's policy actions cannot be effectively monitored before aid money is handed over, the outlook for conditionality is bleak and that even if they can, its success will depend on the ability of donors to buy off powerful losers and the credibility of recommended policies. Other factors, including the recipient's debt position, may also come into play.’*

He recommends:

- Linking conditionality to variables directly related to growth (investment, productivity) rather than policy levers with uncertain leverage
- Timely compensation of those who lose from adjustment (ie, to reduce the subjective dislike of adjustment). However, in the success cases of

White and Morrissey (1997) provide a framework for analysing conditionality which incorporates the possibilities not only that recipient governments resist implementing reforms, but also that they might want to but face constraints to doing so, either political or financial. It places some other approaches (eg, Mosley and Killick) within this framework, seeing them as particular cases reflecting assumptions about the intentions of donors and recipients. Their conclusions are that the effect of conditionality depends on which case prevails, but that 'generally it is either impotent, unnecessary or counter-productive in terms of supporting more effective reform.'

Two basic assumptions are made: that recipient governments always want aid finance, and that donor governments always want some sort of reform. There are then four possibilities:

Case 1 - Donors want reform and to disburse aid finance (see Mosley on why) and recipients want not only aid finance but also reform. Here the issues are over how much reform and what kinds of reform. There may be difficulties in that a government may be unsure how much reform it can attempt because of administrative or political constraints.

Case 2 - Both recipient and donor want to spend the aid budget but the recipient does not want reform. This is the case analysed by Mosley as a game: donor and recipient bargain over how much reform will be agreed for a given level of aid finance.

Case 3 - Both recipient and donor agree on reform, but the donor does not want to lend more, perhaps because aid budgets have been reduced (a case of increasing interest). Here the bargaining is over how much finance will be disbursed for an agreed amount of reform.

Case 4 - Opposed interests: the recipient

Ghana and Uganda, these safety nets came in only after the initial credibility of adjustment had been established.

5 *Tailoring conditionality to donor-recipient relationships*

wants aid but not reform; the donor wants reform but does not want to lend more. While in Case 1 there is an incentive for co-operation and in cases 2 and 3 there is scope for bargaining, here there is open conflict over both policy reform and aid. White and Morrissey argue that this is similar to Killick's principal-agent approach: the donors are principals because they have specific policy reform objectives they want the recipients to implement, while the recipients are agents who will implement them to some extent in return for aid finance.

White and Morrissey then go on to introduce conditionality - i.e. the linking of aid disbursement to the extent of policy reform. They ask: what is the purpose of conditionality. They take four objectives from Collier et al, and go on to add two more:

1. paternalism - donor knows best/better than recipient
2. bribery - persuading recipient to something they don't want to do and wouldn't otherwise do
3. restraint - to prevent reversal, eg, if change of government
4. signalling - to other donors and private sector that reform is sincere
5. monitoring - to ensure aid is going to the right economies
6. supportive - linking financing to reform to allow the latter to take place.

One of their crucial points is that *'the need for and nature of conditionality will differ substantially from case to case....conditionality designed under one scenario will not be effective under another.'* An important instance is: conditionality designed for Case 4 (to discourage slippage as a strategy) will have undesirable effects in Case 1 (where a country may be punished for unintentional slippage, rather than being assisted in implementation). But in all cases, conditionality as practised is ineffective in increasing the amount of reform undertaken.

Case 1 - Although there is a shared desire for reforms, there can still be a role for conditionality, as restraint, signalling, monitoring and support. But there is also a problem, as conditionality may make things worse if it undermines the bases for co-operation. The danger is that the donor is less likely than the recipient to know the feasible amount of reform, and so set conditionality too tight. If the recipient knows
Case 2 - A common case of disagreement over reform. The recipient may often be willing to agree to an increased amount of reform to get the agreed level of aid, but then slip back. The donor could retaliate by cutting off funding, but as in the Mosley case does not want to do this, and will disburse funds in the face of slippage because their desire to disburse outweighs their problem with slippage. They then face a credibility problem, and conditionality is ineffective.

Case 3: Conditionality is not effective in promoting more reform than the recipient would in any case desire, but can be used as an excuse to withhold aid.

Case 4: Here the danger with conditionality is that it drives a spiral of slippage and punishment. Recipients have an incentive to slip on reform, and donors do not worry about disbursing finance, so they are happy to punish by reducing aid. If this reduction undermines the supportive role, then further slippage will occur, and so on. This will happen as long as initial reform conditionality exceeds the amount of reform the recipient is willing to implement.

As White and Morrissey comment in conclusion: *'From a policy viewpoint, the analysis has rather worrying conclusions for donors as conditionality is shown to have undesirable consequences in nearly every case (unless the donor wants an excuse to reduce its spending).'*

Finally, they consider the option of *ex post* conditionality, or selectivity based on performance measures. But there are problems here:

- arbitrariness about what is sufficient;
- missing targets because of external shocks or unavoidable implementation problems;

this it may slip intentionally; if it does not know how much reform is possible it may slip unintentionally. In both cases the conditionality is ineffective and the recipient is punished. The danger of conditionality here is that it makes intentional backsliders indistinguishable from those who are in fact committed. The conclusion is that if recipients want to implement reform, the best donor response is simply to offer support.

- uncertainty for the recipient about aid receipts, which can undermine sustainability of reform.
- Also some aid will have to be 'front-loaded *'and in practice ex post conditionality could look very much like existing ex ante conditionality'*.

Their suggestion is that donors should put effort into identifying the recipients' preferences and capacity for reform, and then offer support, both in implementation and in 'building preferences'. Once feasible reform is identified then unconditional funding should be offered. The only constructive roles for conditionality are monitoring and supportive. Stepping back from this model a bit, the category a particular country ends up in may depend on geo-politics. Zambia and Zimbabwe at various points seem to fit category 4, with the IMF and the World Bank being willing to walk away from balance of payments support. They did not ultimately care enough about disbursing to these countries. But in the case of Kenya and Zaire in the past, they did, and this puts them in category 2.

6 *Selectivity, poverty reduction and good governance*

Montes proposes an alternative form of selectivity, which, unlike the World Bank's proposal, is not based on a good policy environment but which is based on good governance and commitment to poverty reduction. In this case 'good governance' is related to a government's bureaucratic and administrative capability.

Montes links the limited success of adjustment programmes to a lack of ownership, as well as a lack of focus on the private sector and poverty reduction. He observes that development aid can only be effective if recipient governments are fully in control of their public expenditure management decisions and they have strong bureaucratic institutions. Thus rather than trying to induce policy change by providing funds for economy-wide programmes, he proposes that donors should focus on providing resources that directly support civil service capacity building, particularly in the area of public expenditure management. Such a shift in focus would be consistent with the BWIs thinking since they have now come to understand the importance of strong Current practices inhibit the development of effective bureaucratic systems:

- Structural adjustment programmes have required cuts in government expenditure, which, in many cases, has led to a steady deterioration in the quality of civil services. Particularly, as expenditure cuts in the civil service have led to lower wages rather than a reduction in the number of staff.
- Technical assistance has had a patchy record.
- Donors have not been concerned with ensuring that their aid projects fit with recipient countries' expenditure management systems and have insisted on setting up parallel management and accounting systems.
- Donors have not co-ordinated their projects and consequently there have been many competing demands placed on the most able civil servants. As a consequence donor actions have seriously hindered the development of efficient public expenditure management systems in recipient countries.

While donors have recognised the need for greater co-ordination between themselves, for example through the development of Sectoral Investment Programmes, their objective for doing so has been to implement their projects more efficiently rather than to support recipient governments' efforts to develop budgetary processes. Little is being done to support and build minimum standard public expenditure systems for planning, budgeting, monitoring and evaluation in developing countries. While donors are

institutions, which the Bank describes as the 'missing link' in the development process. Witness the World Bank's 'Partnerships for Capacity building in Africa' initiative and the IMF's 'Second Generation' reform packages which prioritise structural reform and governance issues. However, Montes warns that *'institutional development is a complex process that can only be driven by local commitment'.* Lists of *ex ante* conditions or benchmarks and annual updates of policy framework papers do little to contribute to capacity building because they overwhelm the limited capacity of civil servants.

constrained by their internal rules and administrative systems and while they continue to face pressures to disburse funds and implement projects quickly, aid will continue to neglect and even hinder the development of institutional capacity in borrower countries and the effectiveness of aid will be hindered too.

To improve aid effectiveness requires that donors shift their focus towards:

- increased selectivity - focusing on governments with 'good governance policies' and a commitment to poverty reduction. Where governments do not follow good governance principles, aid could be channelled directly to the private sector or NGOs;
- programmes and projects that directly support sustainable civil service capacity building.

7 *A counter concept of conditionality*

Schuftan argues for an alternative form of selectivity. He suggests that there may be a case for withholding aid to certain governments which act irresponsibly or repress or exploit their populations. Therefore, unless a government fulfills a basic set of conditions they should not receive aid. The broad package of conditions for making such a judgement should be set by representatives from the South, possibly based upon international human, economic and political rights, as well as environmental principles.

Although aid would be withheld from those governments which are not deemed creditworthy, aid should not be withheld from the country completely, instead, it should be directly channelled to NGOs. National 'clearing houses' for NGO funding might need to be established to allow this. This would send a clear message to governments that irresponsible practices are not acceptable.

Schuftan also argues that the negotiation process between Southern Countries and Northern donors needs to be more balanced. *'A counter-concept will help the South to negotiate from a position of strength, taking the offensive in the fight for its own version of what in its eyes are 'fair' conditionalities (that to begin with, do not take at face value the orthodox monetary/neo-liberal model of the economy that underlies Fund/Bank programmes). A new conditionality will thus consolidate the position of the developing countries as a whole and will strengthen their negotiating position vis a vis the developed countries.'*

The package of conditions would therefore focus less on macroeconomic policy reform and more on increasing the efficiency, transparency and accountability of government. Whilst the menu of reforms is collectively identified, a central concept should be customisation, so that all policy packages are customised to the actual circumstances of each country.

Existing national bodies in the development business, governmental and non-governmental, would be called upon to apply the criteria in each specific country context. Governments negotiating for loans would use commitments they are willing to make as regards these counter-conditionalities as bargaining chips when negotiating with donors. A national NGO coalition could vouch for or counter government claims that it has already fulfilled certain counter-conditionalities. Involvement of the NGOs would also have the advantage that:

- NGO coalitions can open channels of communication between governments and donors in case an impasse is reached between them; and
- formal dialogue between governments and NGOs will help to foster dialogue at a national level to ensure government compliance with counter-conditionalities.

Southern countries need to engage more actively in negotiations. Rather than accepting conditions identified by the lenders, collectively they should develop an alternative package of conditions, based on the same international human, economic and political rights, and social and environmental principles, which would lend them credibility and bargaining power when negotiating with lenders and encourage a more equal-footed partnership.

8 *Reverse conditionality*

Taylor (1997) advocates a proposal for ownership which he terms 'reverse conditionality'. Borrower governments would propose economic programmes to the BWIs. A reversal of the current system would be likely to lead to better designed programmes as well as better ownership because developing country economists are often much better qualified than the junior Bank and Fund staff to whom missions are entrusted, and they should be given the opportunity to apply their knowledge. Assuming that there will be occasions when disagreements between BWI staff and the government arise, these could be resolved either directly or via arbitration by BWI management or a third party, for example, a team of independent economists with experience in developing countries.

As well as reversing the programme formulation process the scope of macroeconomic conditionality should be restricted, for example just to a balance of payments target, allowing the country to pursue its own agenda for inflation, growth and income distribution.

Taylor advocates that the BWI's resources are redeployed toward their original intent of supporting countries in difficulty with their external account. He suggests that long-term and cheap (in terms of both the interest rate and the amount of conditionality) finance should be made available to countries who are reliant upon exporting raw materials and primary agricultural products. The BWIs should focus on providing financial and technical opportunities for export diversification to help developing countries out of their dependence on one or two primary product exports by developing a wider range of products which require more processing and therefore earn more income and are less susceptible to price fluctuations.

He suggests that the BWI's staff would be more committed and pay more attention to the needs of countries if the institutions were decentralised. Currently staff interact with each other rather than with the economists of the country they happen to be visiting, but if they were required to work at the country level they would be more likely to benefit from intellectual stimulation and cross-fertilisation of ideas rather than being self-absorbed in Washington.

9 *The Marshall Plan and self-monitoring*

Raffer and Singer (1996), propose that a system of 'self-monitoring', similar to that which was employed under the Marshall Plan, could be adopted. Under the Marshall Plan, the US government encouraged European governments to assess one another as part of the European Recovery Programme following World War II. The Plan also encouraged joint assessments of needs and joint requests for aid to foster regional co-operation between recipients.

A self-monitoring system could be based on country groupings. Countries could be grouped according to geographical or economic criteria. Regions grouped on a geographical basis need not hold to continental borders, for example, one continent might contain two or more regions or regions might contain countries from two continents. These regional groupings would then evaluate each others' performance, focusing on the specific needs and problems of each region. This mechanism could be improved by integrating NGOs into the process. The process could be made more 'people-centred' and transparent by ensuring that there is opportunity for public discussions including affected people and open information policies.

This system would promote a more open, transparent and democratic structure of development cooperation and provide a counterbalance to donor influence. The pursuit of narrow donor self-interests would be diminished because of its broad and inclusive approach. This mechanism would also fulfil donor's demands for good governance, democracy and transparency in a democratic and transparent way, whilst overcoming the problem of lack of ownership.

10 *Social benchmarks not conditions*

Hanlon (1997) argues that conditions can only work if they are global and are genuinely agreed to and accepted by those who must carry them out. He has identified four basic requirements for establishing useful conditions and benchmarks. They must be:

- transparent - the drawing up of conditions should be an open, public process in which there is adequate public discussion;
- acceptable and plausible - conditions must be realistic and possible to achieve so that they won't simply be ignored by the borrowing government.They must also be acceptable to donors;
- short and simple - current programmes impose too many conditions for a government to effectively implement. Instead a short list of conditions should be specified that are clear and simple; and
- measurable - it must be possible to test whether conditions have been met or not, and the means of making the test must be public.

At present a hierarchy of benchmarks and conditions operates. The most important are the fiscal benchmarks identified by the IMF, which must be fulfilled, after these come a small list of 'necessary' conditions, followed by a long list of other conditions which can often be quite vague and may be breached. Hanlon proposes that rather than impose both benchmarks and conditions, it would be preferable for donors simply to establish a few monitorable benchmarks instead. Benchmarks have 3 advantages over conditions:

- they are simple numbers;
- results can be measured; and
- there can be more than one way of achieving a specified benchmark, giving governments greater flexibility.

To be useful, benchmarks need to be realistic and testable and measure genuine improvements in, for example, living standards or poverty reduction, in ways which are acceptable to both donors and borrowers.

It is likely that the BWIs would insist on retaining key fiscal benchmarks but to these might be added some additional social benchmarks. For example, the UNDP's Human Development and Poverty Indicators or the OECD Development Assistance Committee's 1996 targets could be adopted as benchmarks. A third alternative which Hanlon terms the 'Measurable Goals Index' (MGI) could be composed of seven factors, all but the last of which should be easy to measure:

- % of the population in extreme poverty;
- % of primary school age children actually in school;
- difference between proportions of boys and girls in school;
- under 5 mortality;
- maternal mortality;
- % of adults with access to reproductive health services;
- rate of loss of environmental resources.

Rather than adopting one or other of these indicators, it would be possible to identify a composite index or to perhaps select five individual indices common to all these composite indices.

The two sets of benchmarks (fiscal and social) would need to be agreed together to avoid inconsistency between them. Public debates, involving civil society, could provide a forum for choosing between the conflicting demands. Once a set of long-term goals (maybe for 5 or 10 years) have been established another forum could establish a set of benchmarks. This forum could be comprised of four parties: the IFIs (perhaps represented by the IMF); the international social actors (perhaps represented by the UNDP or UNICEF); government; and civil society (represented by a coalition which includes churches, trade unions, and other NGOs). Donors, domestic business and parliaments may also be included in the forum if necessary. The parties of this forum could meet twice-annually or annually, to measure progress towards achieving the benchmarks and would be permitted to review and revise the benchmarks as deemed necessary.

11 *New procedures, new conditionalities*

Horesh (1994) has outlined a similar proposal for developing effective government ownership to that which is currently being developed by the World Bank. He proposes that the borrower government should be allowed to prepare its own programme in the light of its own development aspirations and cultural preferences. In so doing, it should be at liberty to contract the services of consultants, including field specialists from NGOs. The grass roots level experience that NGO field-workers have may be particularly useful for governments examining the potential impacts of reforms.

The merits of the programme would then be assessed by the donor community, perhaps by a representative body such as the UNDP or OECD, before giving it a seal of approval. The programme would be judged against broad objectives such as the likelihood of success, alleviation of poverty and social justice, as well as examining the individual elements designed to achieve these objectives. A checklist of elements might include:

- Does the government have a development strategy for which the Structural Adjustment Programme (SAP) is a preparation?
- Is there an early 'stabilisation phase' in the programme designed to correct the balance of payments - how soon is balance likely to be achieved? What are the social costs likely to be and what measures can be taken by donors to minimise them?

- What is the attitude to foreign investment?
- What (dynamic) comparative advantages can be exploited?
- Are there incentives for industrial entrepreneurs?
- Any role for minimum wage legislation?
- Will it need to undertake extensive agrarian reform?
- What encouragement is there for small-scale cultivation?
- Are formal credit institutions and voluntary co-operatives encouraged?
- Are gender issues considered?
- What infrastructure expenditures are being considered?
- How was the SAP formulated - what degree of participation, consultation?
- Has the government the capability to implement the reforms?
- To what extent is decision-making decentralised so that local stakeholders can participate in execution as well as programme formulation?

Donors should then decide whether a structural adjustment programme is worth supporting either individually or collectively via a chosen agency (eg the UNDP).

Part 4

IMPLICATIONS FOR NGOs

Donors have been unhappy with the conditionality relationship for some time, and have been experimenting with innovations. Many academic and other commentators have provided analyses and recommendations for alternative approaches. This paper has reviewed these developments. In this final section, we summarise the recommendations of the different approaches, and try to draw out the general dilemmas and common approaches. These dilemmas and approaches require responses from NGOs, so we finish by suggesting a position for NGOs to take, in the spirit of stimulating further debate on this increasingly important issue.

1 *A summary of positions*

The paper started by reviewing the experiments of donors in the face of problems with traditional conditionality. Higher impact adjustment lending relies more on selectivity. There has been improved compliance, but problems remain. The SPA donor group experimented with greater donor co-ordination in Burkina Faso, with a recipient defined programme and a smoother flow of disbursements. However, an initial evaluation was disappointing. The desire to incorporate greater selectivity has become very strong. Apart from the methodological issues of how 'good' and 'bad' policy are defined, the drawback of selectivity is that conditionality enters by the back door, and doesn't actually build ownership of reforms.

Collier[5] et al argue for the promotion of ownership through recipients choosing policies, lenders choosing objectives, and aid being disbursed according to performance.

Helleiner favours 'long leash' conditionality. This involves dialogue to establish the recipient's ownership of the reform agenda, and then steadier and longer-term commitments by donors. This is ex-post

Raffer and Singer promote the idea of self-monitoring, as under the Marshall Plan, in

reward for adopting 'appropriate approaches' and comes close to selectivity.

Killick argues for greater engagement, with ownership being built on a combination of domestic political consensus and selectivity, and with programmes sufficiently well-funded to support reforms. For Mosley, first impressions are vital; it is the credibility of reform which builds ownership, as in Uganda or Ghana. He argues that devaluation and public investment are the right policies, and that conditionality should be linked to variables directly associated with growth, not with uncertain policy levers. He also argues that proper safety nets are crucial for domestic political reasons. White and Morrissey's analysis brings out the importance of identifying the recipients' preferences and capacity. They emphasise the need in turn for dialogue to 'build preferences', and then proceeding with unconditional support.

Montes argues for selectivity based not on policy content, but on 'good governance' and commitment to reducing poverty and protecting public expenditure and civil service capacity. He also points to the importance of donor co-ordination. Schuftan argues for selectivity to be based on economic, political and human rights. He also proposes that southern governments should develop a counter-concept of conditionality to strengthen their position in negotiations with donors.

Taylor also supports reverse conditionality as the key to ownership. That is, recipients should propose programmes, with third-party arbitration where there are irreconcilable donor-recipient disagreements. He promotes the idea of simple macro-targets, and argues that the Bretton Woods institutions have strayed too far from their original and legitimate function of helping the long run balance of payments situations of countries, which requires help with diversifying trade.

regional or cross-regional groupings of countries. Hanlon's position is that conditionality should be replaced by both donor and recipient adopting a set of a few monitorable social benchmarks, both fiscal and social. He argues for a public debate to set overall goals, and then benchmarks being chosen by a forum bringing together donors, recipient government and civil society. Finally, Horesh argues simply that recipient governments must set the policy agenda to be assessed by the donor community possibly through a representative body such as the UNDP or OECD.

2 *Dilemmas and common approaches*

The dilemma facing donors can be seen as how to move from the traditional conditionality relationship, where the donor tries to impose policy reform on an unwilling recipient, to a situation where the recipient government owns the reforms itself. The positions outlined above can almost all be placed on a continuum between two extreme ways of trying to achieve this shift. At one end lies pure selectivity, and at the other lies recipient-led dialogue.

Thus for Taylor, Horesh and Hanlon the only way to get recipients' ownership is if donors accept that recipients must take the lead in designing reform programmes. At the other extreme there are those who argue for selecting countries and lending only (or mostly) to them, whether by criteria of economic policy (Collier et al), or of good governance and a commitment to capacity building (Montes). In between are those who argue for some sort of dialogue on goals and targets, combined with an element of selectivity (White and Morrissey, Killick, Helleiner, Schuftan). In this latter group could also be placed the World Bank's 'Partnership Initiative' and the 'Comprehensive Framework for Development'.

Mosley is rather harder to place, since his argument is also about the content of reform. His recommendation is that for policy reform to be owned it must be credible.

For each position there are difficult questions.

- For selectivity; how do donors know that potential recipients will simply say that they adopt the policy reform agenda, and demonstrate it just enough to get new loans, and then drift 'off-track' again? Who will judge how much must be done to signal commitment to a particular policy agenda?
- For macro-economic management; is 8% inflation enough? 6%? 4%?
- For the dialogue approach; there are real questions about how honest each side will be, and how effective it will be. The notion of 'building preferences' is very vague.

3 *What position should NGOs take?*

We suggest that three basic principles should underlie an NGO approach to the conditionality debate:

1. Poverty focus - what should happen is what works for the poor. This means that the aid relationship should be effective in bringing about poverty reduction. For the Bretton Woods institutions, taking up Taylor's point, there should also be a priority goal of helping to improve a country's balance of payments position by supporting the diversification of trade.
2. Democracy - this suggests that the aid relationship on both donor and recipient side should be opened up to a much wider public examination and debate about the use of aid and the associated policy reforms.

3. Partnership rather than coercion. In their own programmes, Northern NGOs themselves face very similar dilemmas to official donors, in their relationships with Southern NGOs which they fund. Partly because they are much smaller, funding NGOs use an inevitable degree of selectivity. But ideologically they favour partnership and dialogue over selection and dumping of recipient NGOs. They favour long-term engagement on how to improve projects and programmes, over 'giving up'. They also favour trying to identify recipient preferences and priorities over simply trying to impose their own.

These principles lead us to argue that NGOs should reject the idea of pure selectivity. The strong drift in this direction by official creditors will not lead donors to question the validity of their own priorities. It will de-emphasise greater engagement with the difficult cases where potential recipients have different priorities. It will not, by itself, strengthen democracy and civil society involvement in the aid relationship.

In our view, the only selectivity which should apply is that asked for in cases of repressive dictatorships, by legitimate opposition movements (the current example being Burma). This may be seen as a variant of what Montes argues for. In all other cases, we support the notion of dialogue and partnership, inclusive enough to involve civil society. But to make this any different from traditional conditionality - to make the engagement honest - donors have to be prepared to genuinely listen to and understand recipient priorities and constraints. They cannot engage in dialogue from a starting position that they are right about all policy advice. If they do not accept this, there is no point in dialogue.

Footnotes

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GLOSSARY[6]

Appreciation: an increase in the value of the local currency in terms of foreign currencies.

Arrears: payments (on debts or for receipt of goods and services) which should have been made, but have not.

Balance of payments: a country's recepits and expenditure in international trade and financial transactions.

Balance of payments support: foreign exchange, generally in the form of loans from official creditors intended to allow the recipient to run a larger current account deficit than would otherwise be possible.

Bilateral creditor/donor: government which provides loans/grants to another government.

Bond: a form of debt which is transferable between creditors. The issuer (debtor) agrees to repay the bond at a specified date usually at a fixed rate of interest. They are generally repaid in a single installment.

Budget support: finance from official creditors/donors to support government spending in particular sectors, such as education or health.

Capital account: the part of the balance of payments which details capital flows other than grants in and out of the country. All the items in the capital account give rise to foreign exchange liabilities and future foreign exchange outflows from the recipient country, in the form of interest to lenders and profit repayments to investors.

Capital flow: foreign exchange in the form of grants, loans or investment.

Capital investment: investment in machinery, equipment, a factory, inputs etc., used in the productive process.

Commerical creditors: creditors in the private sector.

Commercial interest rate: an interest rate corresponding to that charged on commercial transactions.

Commerical risk: the risk that a loan to a private sector company will not be serviced in full because of a deterioration in the borrower's financial position.

Commodities: unprocessed agricultural produce and minerals.

Concessional loan: loan on which the interest rate is below the commercial rate.

Contagion: the phenomenon whereby developments in one country's economy lead to similar developments in another country's economy.

Current account: part of the balance of payments which details the difference between receipts for exports of goods and services and expenditure on imports of goods and services, plus grants from official creditors and workers' remittances.

Debt overhang: the excess of a country's external debt over its long-term capacity to pay, which acts as a discouragement to adjustment and investment.

Depreciation: a reduction in the value of the local currency in terms of foreign currencies.
Disbursement: the payment to a borrower of all or part of the sum to be borrowed.

Domestic borrowing: money borrowed by government or private company/individual from residents in the same country. The loan is made in the local currency.

Foreign borrowing: money borrowed by government or private company/individual from a foreign source. The loans is made in a foreign currency.

Foreign Direct Investment (FDI): investment made by an company or individual resident in one country in productive capacity in another country.

Grace period: under a loan or rescheduling agreement, the period during which no principal payments are made.

Herd instinct: the tendency for investors to follow each other when making the decision whether or not to invest or disinvest in/from a country or sector.

International capital market: the international market for financial capital in the form of loans, deposits, financial investments, etc. the term relates essentially to commercial transactions.

Multilateral creditor: international agency providing loans.

Net transfer: the overall transfer of financial resources between a country and its investors/creditors.

Portfolio equity investment: investment in shares (also known as equity investment).

Present value: this is the amount of money the borrower would need to have in a bank account, earning interest at the market rate, when the loan is made, so that all the payments due on the loan could be made when they fall due from the account, and the final payment would reduce the balance of the account exactly to zero.

Price elasticity of demand/supply: the extent to which demand for/supply of a good or service changes in response to a change in its price.

Private sector: activities undertaken by individuals or commercial businesses.

Profit remittances: transfers to foreign investors of part or all of the profits on their investments.

Public sector: activities undertaken by the government.

Rate of return: the average annual income on an investment as a percentage of the amount invested.

Recurrent spending: the continuing operational costs of an investment, as opposed to its initial capital cost.

Reserves: a government's holdings of foreign exchange, usually held by the Central Bank.

Return: income earned from an investment.

Syndicated bank loans: a commercial bank loan in which a number of banks participate.

Terms of trade: the ratio between the average price of exports and the average price of imports, expressed as an index. The terms of trade show how much a country can buy abroad for each unit of exports it sells.

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1. Conditionality can also be used to signal to investors that a government is committed to policy reform, to reassure them that there will be policy consistency over the longer term; to help willing reformers by locking a country into reform over the medium term; to tip the balance in favour of reform within a government, when those for and against are evenly matched; and as an alternative to collateral. See Collier et al, 1997 and Killick et al ,1998.

2. Preconditions are actions that must be carried out before programmes are presented to the executive boards for approval, and therefore, before the government gets access to the loan.

3. For a more detailed discussion and critique of the IMF's second generation reforms see, *The IMF's Final Frontier? Assessing "Second Generation" Reforms*, Bretton Woods Project, London.

4. Hopkins et al (1997) challenge Killick's assumptions about conditionality on the basis that not all conditionality is coercive. They argue that the distinction between "constructive dialogue" and "imposed conditionality" is not as stark as Killick makes out. Instead, they argue that conditionality can be useful for persuading governments to adopt policies that they generally agree with but to which they do not attach a high priority. Thus IFI funding is additional in the sense that it induces governments to implement policies that they would choose to implement had they the resources or capacity to do so. Furthermore, they suggest that in the case where some members of the government are pro-reform but others wish to maintain the status quo, then IFI finance may help to tip the balance in favour of reform whilst not detrimentally affecting ownership. Alternatively, where governments are aware of the apparent merits of reform but are concerned about the political costs of implementing them, then additional IFI finance to implement them can help sway the government's decision.

5. Paul Collier has recently joined the World Bank as head of the research department. It is, therefore, likely that the ideas presented in this paper will have much influence in the World Bank.

6. Definitions are taken from Woodward 1992.