

INTERNATIONAL MONETARY FUND and WORLD BANK

**Strengthening IMF-World Bank Collaboration on Country Programs and Conditionality**

Prepared by PDR (IMF)  
and OPCS and PREM (World Bank)

In consultation with other Departments

Approved by Jack Boorman (PDR) and Joanne Salop (OPCS)

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## ACRONYMS

CAS	Country Assistance Strategy
CCL	Contingent Credit Line
DC	Development Committee
EFF	Extended Fund Facility
ESAF	Extended Structural Adjustment Facility
FSAP	Financial Sector Assessment Program
FSLC	Financial Sector Liaison Committee
HIPC	Heavily Indebted Poor Country
IDA	International Development Association
IMF	International Monetary Fund
IMFC	International Monetary and Financial Committee
JIC	Joint Implementation Committee
JSA	Joint Staff Assessment
MIC	Middle-Income Country
PFP	Policy Framework Paper
PID	Project Information Document
PRGF	Poverty Reduction and Growth Facility
PRSC	Poverty Reduction Support Credit
PRSP	Poverty Reduction Strategy Paper
ROSC	Report on the Observance of Standards and Codes
SBA	Stand-By Arrangement
SRF	Strategic Reserve Facility

## EXECUTIVE SUMMARY

1. The Bank and the Fund have worked together since their creation in the 1940s. Over the years, as their missions converged in some areas, it became important to define the rules of engagement and the division of labor between the two institutions. These have been articulated in a series of statements by the Managing Director of the Fund and the President of the World Bank, with the emphasis reflecting the particular priorities of the time. Last year in a joint statement in Prague, the two heads of institution set out their vision of cooperation, reflecting recent developments in the work of the two institutions and the priorities for the future. Since then, both Boards have held discussions about related issues. In the Fund, these discussions have taken place in the context of focusing the work of the Fund and streamlining its conditionality; in the Bank, they have taken place in the context of discussions about strategic selectivity, the country business model, and the appropriate design and use of lending and other instruments.
2. ***Framework for Collaboration.*** These discussions have given renewed momentum to the strengthening of collaboration between the two institutions. A 1998 joint management statement set out the agreed principles for this collaboration. First, in country operations, those involved should have a clear understanding about each institution's responsibility and the relationships between the two. Second, consultations between the staffs must begin at an early stage and continue throughout the operational cycle to ensure a coherent approach and reduce redundancy. Third, each institution must be separately accountable for its own operations. Operationalization of these principles in light of the vision for cooperation endorsed in Prague and the subsequent discussions of streamlined conditionality needs to take account of the wide range of circumstances under which countries request assistance from the Fund and the Bank and which result in the different types of engagement of the two institutions. Progress on collaboration has been greater with respect to low-income countries than middle-income countries. However, both country groups would benefit, in terms of improved quality and cost-effectiveness of Bank- and Fund-supported programs, from strengthened procedures for establishing institutional views and resolving differences as needed, for systematic and early sharing of information on the country diagnosis and proposed program support, and for streamlining and focusing conditionality on actions that are critical to the success of the program. Indeed, the ultimate goal is a more effective Bank-Fund partnership in support of country programs.
3. ***Low-Income Countries.*** The progress on Bank-Fund collaboration in low-income countries builds on successful collaboration under the Heavily Indebted Poor Country Initiative and the Poverty Reduction Strategy Paper (PRSP) approach. Reflecting mounting evidence on how to make aid more effective in reducing poverty, the PRSP approach provides a country-owned basis for more effective staff collaboration. The IMF's Poverty Reduction and Growth Facility (PRGF), the Bank's Country Assistance Strategy (CAS) and Poverty Reduction Support Credit (PRSC), and the Joint Staff Assessment (JSA) provide the instruments by which PRSPs are translated into Bank and Fund operations. That said, challenges remain, especially with respect to working through the implications of streamlining conditionality. In particular, work is needed to ensure a more systematic approach on the part of Bank and Fund staff in (a) assisting countries in identifying priorities and sequencing reforms to be set out in PRSPs; (b) clarifying

specific Bank and Fund responsibilities for lending and other support; and (c) formulating mutually supportive and harmonized conditionality (but not cross-conditionality) in PRGFs and PRSCs (and other IDA lending instruments). This work will entail a period of learning in which best-practice approaches are identified as a basis for delineating an agreed operational framework.

4. ***Middle-Income Countries.*** For middle-income countries, solutions are more varied, reflecting the greater diversity in assistance needs and, in some cases, the absence of a country-led framework for Bank-Fund support and joint Bank-Fund assessments. However, the same broad principles of increased specialization, enhanced collaboration, and focus on critical conditionality apply. For countries where the Bank and the Fund are both providing support over the medium term, staff collaboration arrangements should be similar to those for low-income countries, though without a formal country document like the PRSP to guide them. However, there are other countries where either the Bank or the Fund is involved more than the other, or support is on very different time schedules. The collaborative mechanism in these cases must allow for rapid response while ensuring that structural conditionality deemed critical for the Fund-supported program is consistent with the medium-term reforms supported by the Bank. Finally, the Fund may be called to respond to a crisis situation in a country where the Bank does not have a strong policy dialogue on the structural issues that are deemed crucial for the macro program at the time. The Bank's effort to strengthen its diagnostic economic and sector work (ESW) should make such cases increasingly rare. However, they cannot be ruled out, given the wide array of structural issues; in such circumstances, the above framework will need to be applied flexibly, building on the lessons learned from past and ongoing programs.

5. ***Conclusions.*** The key message of this paper is that enhanced collaboration on conditionality will strengthen program design, but only if there is enhanced staff cooperation throughout the country program cycle. Recent reviews and discussions in both the Fund and the Bank have emphasized the need to anchor their respective conditionalities in a coherent and satisfactory country-owned program, and within that to seek to streamline and focus conditionality on the key actions crucial to success. Bank-Fund collaboration on conditionality must be seen in this context of greater selectivity and country ownership. But it also must be seen in the context of the country program cycle: broad agreement on the substantive issues between Bank and Fund staff is essential to ensure that the in-depth work needed to support the policy dialogue gets done, thereby providing the basis for inclusion in program design and conditionality in a timely manner as and when needed.

6. Progress has been made in this direction in recent months, and the stage is set for further advances, especially in low-income countries. These advances reflect ongoing efforts at the Bank to rebuild its analytic ESW program and to promote more systematic use of policy-based lending, at the IMF to better focus conditionality, and in both to support the PRSP approach. To make further progress, the following steps are recommended:

- Explicit introduction of the “lead agency” concept for dealing with specific policy issues to ensure clarity of roles, improve accountability, and increase transparency. Board

documents would explicitly cover the work of the respective institution and the responsibilities of the lead agency. The lead agency's staff views would be reported transparently in the Board documents of the other institution.

- Systematic information sharing and monitoring would occur in the context both of lending operations and in CAS and Article IV consultations in countries with ongoing or prospective Bank and Fund lending operations, with Board documents appropriately summarizing the information.
  - Each institution would retain ultimate responsibility for its own lending decisions. Conditions critical for the success of an institution's program would continue to be specified in that institution's own arrangements, with lead agency staff advising both institutions on the substantive content. Conditionality would be duplicated only when a policy measure was considered critical for the success of the programs supported by both institutions. In such cases, conditionality would be harmonized, using identical dates and benchmarks to the extent possible.
7. Implementing these proposals will be a continuing process and will present significant challenges to both institutions, requiring engagement at all levels. First, staff will need additional guidance on specific modalities of collaboration with each other and with member countries, operationalizing the approach set out in this paper. Second, central monitoring and Senior Management overview of progress on collaboration on supporting country program design and conditionality in both PRSP and middle-income countries will be important for ensuring proactive and responsive follow-through. Third, to ensure Board engagement and guidance, periodic reports will be provided to the two Boards on progress on implementation; it has been proposed that the first report would be in about one year's time.

## I. INTRODUCTION

1. Collaboration between IMF and World Bank staff on country program design and conditionality is one element in an evolving approach to cooperation between the two institutions. This approach reflects a long history of working together to assist member countries to achieve sustainable growth and poverty reduction, and of strengthening the means of collaboration and adapting them to changing circumstances. It aims to align the work of the two Bretton Woods institutions, with their respective mandates and expertise, so as to promote effectively the interests of their member countries while minimizing overlap and conflict. The ultimate goal is a more effective Bank-Fund partnership in support of country programs. In September 1998, the Managing Director of the IMF and the President of the World Bank reaffirmed the principles of earlier accords, and agreed on changes in procedures and practices aimed at assuring more effective coordination in operations. More recently, in September 2000, the two heads of institution set out a “shared vision” of close cooperation. Each of these Management initiatives has received support from the Executive Boards, and the latest joint statement was welcomed by the IMFC and the Development Committee at their September 2000 meetings in Prague.<sup>1</sup>

2. ***Focus on Conditionality.*** These discussions have gained renewed momentum in the context of efforts by both institutions to make their conditionality more effective and focused so as to strengthen country ownership of adjustment and reform programs, and to clarify institutional roles. The Executive Board of the IMF discussed conditionality in Fund-supported programs on March 7, 2001. Directors agreed on the need to streamline and focus the Fund’s conditionality and acknowledged that a clear division of labor and enhanced cooperation with the World Bank and other agencies was an important element of streamlining. At the Bank, Executive Directors have discussed related issues in the context of the new Poverty Reduction Strategy Paper (PRSP)-based framework of support for low-income countries, the report of the Task Force on the World Bank Group and the Middle-Income Countries, and the Adjustment Lending Retrospective, which drew on previous reviews and research on the experience and lessons relating to conditionality in Bank-supported adjustment lending. Together with developments on the country business model, this approach complements the Fund’s. These developments raise a number of operational issues for Bank-Fund collaboration that would require a higher degree of cooperation than in the past.

3. ***Coverage of Paper.*** The focus throughout this paper is on collaboration on conditionality, and on making both Bank and Fund conditionality more selective, focused, and effective. But this has to be seen in the wider context of Bank-Fund cooperation in supporting country

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<sup>1</sup> See *Report of the Managing Director and the President on Bank-Fund Collaboration* (World Bank document SecM98-733 and IMF document SM/98/226), September 4, 1998. This document is referred to as the joint guidelines. For the history leading up to the adoption of these guidelines, see the annex to this paper. Also see *The IMF and the World Bank Group: An Enhanced Partnership for Sustainable Growth and Poverty Reduction*, Joint Statement by Horst Köhler, Managing Director, and James Wolfensohn, President (SecM2000-536), September 5, 2000.

development. The paper therefore reviews the lessons of experience with this cooperation and sets out principles for improved coordination. It examines how these principles are being implemented in the context of support for low-income and middle-income countries. It concludes with issues for discussion by Executive Directors.

## **II. EVOLVING FRAMEWORK FOR COORDINATION**

4. Bank-Fund collaboration has long reflected the fact that both institutions rightly see the areas covered by the other as essential for macroeconomic stability and sustainable development. (The annex to this paper reviews the history of Bank-Fund collaboration.) Building on case-by-case cooperation at the country level, attention now has turned to reducing duplication and overlap, developing more systematic procedures, and promoting synergies. Though it is still early in the process, the stage is set for further advances, especially in low-income countries, where both institutions are committed to working within the PRSP approach. These advances reflect ongoing reforms at the Bank to rebuild its analytic work and promote the country business model, and at the IMF to focus conditionality.

### **A. Background**

5. Throughout the 1980s and 1990s, both institutions increasingly recognized that successful development requires both sound macroeconomic policies and good structural and social policies and institutions. In the 1980s, the Bank began to stress the importance of sound macroeconomic policies for the success of its lending operations, particularly with the growth of adjustment lending. In the 1990s, a renewed emphasis on growth and increasing involvement in medium-term reform programs in low-income and transition economies led the Fund to incorporate significant elements of structural policy reform into its programs and conditionality.

6. The 1989 “Concordat” represented a major turning point in the relationship between the Fund and the Bank. It broke new ground by setting out more clearly the understanding of Senior Management on the mandates and roles of the two Bretton Woods institutions. In brief, as summarized in the September 2000 joint statement:

- The Fund’s “core mandate is to promote international financial stability and the macroeconomic stability and growth of member countries. To that end, the Fund must focus on its core responsibilities: monetary, fiscal, and exchange rate policies, and their associated institutional and structural aspects.”
- “The core mandate of the World Bank Group is to help countries reduce poverty, particularly by focusing on the institutional, structural and social dimensions of development—thus complementing the Fund’s macroeconomic focus.”

7. Since the late 1990s, a strengthened spirit of cooperation has emerged. This reflects acceptance, in both institutions and among shareholders, of the emerging paradigm for successful

poverty reduction and development: the importance of country ownership; a comprehensive approach encompassing macroeconomic, structural, and social policies; selectivity and focus on the key priorities for reform; and more effective coordination among development partners in providing external assistance. This spirit, encapsulated in the 1998 joint guidelines and the September 2000 joint statement, has led to a number of important initiatives: the strengthening of the Bank's program approach to supporting country development, stronger de facto collaboration at the country level, the Fund's streamlining of conditionality, the linking of Bank and Fund operations in low-income countries to PRSPs, joint work on debt relief under the Heavily Indebted Poor Country (HIPC) Initiative, and the joint Bank-Fund Financial Sector Assessment Program (FSAP) and Reports on the Observance of Standards and Codes (ROSCs). In two areas cooperation has been buttressed with new institutional coordination mechanisms: the Joint Implementation Committee (JIC) for cooperation on HIPC/PRSP countries, and the Financial Sector Liaison Committee (FSLC) for cooperation in financial sector work.

8. ***Principles Guiding Collaboration.*** The 1998 joint guidelines reaffirmed the Concordat and singled out three central principles for collaboration between the Fund and the Bank: clarity for members about the primary responsibilities of each institution, full consultation between the institutions, and distinct accountability in lending decisions. The guidelines noted that the delineation of responsibilities leaves several areas of overlap—including elements of financial and public sector reform—in which collaboration is required. They also noted that Fund- and Bank-supported programs “should be complementary and part of an overall reform agenda owned by the member country. The Executive Board of each institution will be made aware of the total package and of how the components covered by one institution complement the parts covered by the other.” The importance of working within an overall reform agenda was reinforced in the September 2000 joint statement, which asserted that the Fund and the Bank are guided by the principle that “a comprehensive approach is required to address the multidimensional nature of sustainable growth and poverty reduction.”

9. ***Cooperation in Country Work.*** At the country level, cooperation and coordination have been strengthened in many areas. It has become more common for Bank staff to join Fund missions and vice versa, or for country programs to be negotiated in joint missions. The collaborative framework has been enhanced significantly for low-income countries under the HIPC and PRSP initiatives. The Fund's Poverty Reduction and Growth Facility (PRGF) lending, the Bank's IDA and Poverty Reduction Support Credit (PRSC) lending, and access to debt relief under the HIPC Initiative are all linked operationally to the PRSP framework. That framework provides substantial scope for reducing overlap, delineating responsibilities, and rationalizing structural conditionality. To ensure the effective implementation of the new framework, the JIC was established to monitor the progress and implementation of the PRSP approach, and also to resolve differences in view between Bank and Fund. These developments are discussed further in Section III.

10. ***Adaptation of Bank Program Approach.*** A key contributing factor has been the efforts—endorsed at Development Committee meetings in Prague and Washington—to strengthen the Bank's program approach to supporting country development. Building on a

country's development agenda and on a comprehensive and systematic diagnosis, the Bank's Country Assistance Strategies (CASs) set out the lending and other activities with which it will support that agenda, and the understandings reached about performance, deliverables, and accountabilities. As part of this approach, the Bank is systematizing its country-based diagnostic economic and sector work (ESW), with a view to strengthening the CAS and the policy dialogue with the authorities across the structural, social, and sectoral agenda. In addition, for countries with appropriate fiduciary<sup>2</sup> and other policies, the Bank has introduced programmatic lending, which provides medium-term support for the country's reform program; individual operations under this umbrella are timed, to the extent possible, according to the country's budget and policy cycles. In such countries, Bank support should be able to proceed on a timeframe similar to the Fund's.

11. **Financial Sector.** A particular area where Bank-Fund cooperation has increased significantly is the financial sector, with the establishment of the FSLC in 1998. The roles and responsibilities of the Bank and the Fund in financial sector work were set out in guidelines issued by the FSLC in 1999.<sup>3</sup> These guidelines outline procedures by which staff exchange information, coordinate work programs, undertake joint missions, provide consistent policy advice to country authorities, and negotiate financial sector conditions in Letters of Intent and Letters of Development Policy. The FSAP, which was launched in May 1999 to strengthen the monitoring of financial systems in the context of the Fund's bilateral surveillance and the Bank's financial sector development work, emerged from this enhanced collaboration. The assessments of observance of relevant financial sector standards that are undertaken under the FSAP are presented, together with assessments of other international codes and standards, in summary form as ROSCs, which have also become an important collaborative exercise.

## B. Lessons of Experience

12. In aiming for greater selectivity and streamlining of conditionality, the Fund and the Bank must be informed by the lessons of recent experience on collaboration. These lessons suggest the importance of strong support from the two Executive Boards, ongoing Management involvement, mutual respect of institutional work styles and cultures by staff, and recognition that practice needs to be tailored to country circumstances.

13. **Importance of Board Support.** Several examples from the past illustrate the critical importance of Management and Board support and guidance on collaboration. First, following the Concordat, the Bank relied heavily on advice from the Fund in interpreting the macroeconomic situation as a basis for adjustment operations; variations from this approach consistently received strong adverse reactions from the Bank Board, and as a result they have

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<sup>2</sup> Refers to public expenditure, procurement, and financial management systems.

<sup>3</sup> See *Guideline for Bank-Fund Collaboration in Financial Sector Work* (SM/99/158), July 2, 1999.

been few and far between.<sup>4</sup> Second, as the Fund expanded its coverage of structural issues in the 1990s, often but not always in collaboration with the Bank, the Fund Board supported the practice on a case-by-case basis. Third, the PRSP framework was established by decisions of the two Boards. Fourth, the respective lending instruments (PRGF and PRSC) were designed within this joint framework, with the PRGF receiving the full support of the Fund's Board and the PRSC receiving more cautious support from the Bank's, with important implications for program development. Finally, the establishment of the JIC and the FSLC and the collaboration on the FSAP and on the ROSC have enjoyed strong and helpful Board support.

14. ***Cultures and Work Styles.*** Another lesson concerns working relationships between the staffs. Cultures and work styles of the two institutions differ, for good reasons deriving from their core mandates. First, support for country development—the focus of the Bank—normally requires long-term support for structural, social, and institutional changes that are often complex and likely to take time to implement, whereas balance of payments support—the focus of the Fund—typically requires quick action (especially in crisis situations) and shorter-term lending. Second, for many countries, Bank and Fund lending instruments envisage different time horizons for policy adjustments. Fund programs normally have a timeframe of 12-36 months, while Bank lending typically has a longer horizon. Third, because the Bank has historically aimed at more varied objectives than the Fund, it has also used a more varied set of instruments, including lending for specific investment projects. To some extent, these issues will become more manageable as the Bank's country business model and program approach evolve. Even so, institutional differences will remain and will need to be carefully managed, with each institution respecting the other's style and working needs and drawing on the other's strengths.

15. ***Country Differences.*** The scope and design of Bank and Fund coordination vary across country programs, and there is a need for flexibility and customization of collaborative arrangements to the circumstances of individual countries. For most low-income and some middle-income countries, both the Bank and the Fund are engaged in supporting a medium-term program. For other countries, Bank and Fund engagement may be less sustained and also less parallel, and there is often no formal country-led framework for Bank-Fund support and joint Bank-Fund assessments. The Fund might be engaged in countries where the Bank has no dialogue or recent work, and the Bank might have lending operations where there is no Fund program. Any framework developed for staff cooperation must allow for different approaches in different countries.

## C. Future Directions

16. These differences notwithstanding, it is important to build on institutional strengths and comparative advantage to develop a stronger operational framework for an effective division of

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<sup>4</sup> See *Adjustment Lending: Bank Policy and Practice in Consulting/Coordinating with the IMF* (SecM99-789), December 15, 1999.

labor in designing and monitoring conditionality. The principles outlined in the 1998 joint memorandum can provide the basis for implementing a strengthened framework of collaboration.

- Explicit introduction of the “lead agency” concept for dealing with specific policy issues to ensure clarity of roles, improve accountability, and increase transparency. Board documents would explicitly cover the work of the respective institution and the responsibilities of the lead agency. The lead agency’s staff views would be reported transparently in the Board documents of the other institution.
- Systematic information sharing and monitoring would occur in the context both of lending operations and in CAS and Article IV consultations in countries with ongoing or prospective Bank and Fund lending operations, with Board documents appropriately summarizing the information.
- Each institution would retain ultimate responsibility for its own lending decisions, and conditions critical for the success of the respective institution’s program would continue to be specified in that institution’s own arrangements, with lead agency staff advising both institutions on the substantive content. Conditionality would be duplicated only when a policy measure was considered critical for the success of the programs supported by both institutions. In such cases, conditionality would be harmonized, using identical dates and benchmarks to the extent possible.

17. Although the above approach is embodied in the 1998 agreement, implementing it is a continuing process that will present challenges to both institutions at all levels. First, for staff and unit managers, work practices and attitudes will need to change, and there will be implications for the deployment of resources in both institutions and for the skills mix. Second, systematic monitoring and continued attention by Senior Management is essential to ensure continued progress and timely resolution of emerging issues. Third, periodic reports to the two Boards on progress in implementation would be helpful, to ensure the continued support and guidance of the Boards. Finally, reflecting the country perspective, Letters of Intent and Letters of Development Policy would need to be adapted both to better reflect country responsibility for the overall reform program, and to provide for similar transparency about respective institutional responsibilities for supporting the design and monitoring of program conditions.

### III. COLLABORATION ON LOW-INCOME COUNTRIES

18. Before the introduction of PRSPs in 1999, the Bank and the Fund coordinated their support to low-income countries primarily through Policy Framework Papers (PFPs), which were in principle jointly prepared by Bank and Fund staff in conjunction with country authorities.<sup>5</sup> These documents presented a three-year plan that highlighted the country’s main macroeconomic, structural, and social policies. Conditionality for Fund-supported programs—

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<sup>5</sup> See *Policy Framework Papers: A First Review of Experience in the World Bank* (R88-68), March 1988.

Structural Adjustment Facility (SAF) and Extended Structural Adjustment Facility (ESAF) loans—including a wide range of structural conditionality, was generally taken from the measures presented in the PFP, drawing case by case on the expertise of Bank staff in fields outside of the Fund’s core competence. Where Bank adjustment operations were in place, they also generally drew on the structural reform priorities set out in the PFP. However, although presentation of the PFP to the Executive Board was a prerequisite for Fund approval of an ESAF arrangement, the PFP was not a prerequisite for specific operational activities in the Bank. Thus the staffs placed different levels of emphasis on the preparation of the PFP and sometimes gave mixed signals to the authorities as to its importance. Moreover, the PFPs did not always encourage domestic ownership of policy reforms, as they were often drafted by Bank and Fund staff, albeit in consultation with country authorities.

19. Mounting evidence on aid effectiveness in the second half of the 1990s suggested that the support of the two institutions and other donors should be linked more closely to countries’ own development agendas. At the same time, the experience of working together on implementing the joint HIPC Initiative demonstrated to both institutions the need for, and the possibility of, much closer collaboration. These developments gave rise to the PRSPs and to changes in Bank and Fund lending instruments to support them.<sup>6</sup> Since the introduction of the PRSP process, the Bank and Fund have made considerable progress in collaborating in assistance to low-income countries.

#### **A. Cooperation under PRSPs**

20. The PRSP is a comprehensive statement of the country’s strategy for generating sustainable growth and reducing poverty, prepared by the government in consultation with the private sector, civil society, and external development partners, including the Bank and the Fund. The lending operations of both institutions, and access to debt relief under the Enhanced HIPC initiative, are all linked to the PRSP.<sup>7</sup> Bank and Fund staffs provide a Joint Staff Assessment (JSA) of the country’s poverty reduction strategy and of the adequacy of the PRSP as a basis for concessional lending by the two institutions.<sup>8</sup> The principle of country ownership embodied in the PRSP does not eliminate the need for the Bank and Fund to place conditions on the use of their resources. It does, however, imply that conditionalities in such operations principally draw

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<sup>6</sup> The core IMF-World Bank document underlying the PRSP approach is *Poverty Reduction Strategy Papers—Operational Issues*, Joint IMF-World Bank paper (SM/99/290 and R99-241), December 10, 1999, available at <http://www.worldbank.org/poverty> or <http://www.imf.org>. Also see *Heavily Indebted Poor Countries (HIPC) Initiative and Poverty Reduction Strategy Papers (PRSP)—Progress in Implementation* (IDA/SecM2000-487), August 14, 2000.

<sup>7</sup> Recognizing that this process would take time, the Boards of the Bank and the Fund have agreed that governments seeking concessional assistance and HIPC debt relief during the early implementation of the program could prepare a less comprehensive paper, known as an interim PRSP or I-PRSP. See *Interim Poverty Reduction Strategy Papers (I-PRSPs): Guidance on I-PRSPs and Joint Staff Assessment of I-PRSPs*, Joint Note to World Bank and IMF Staff, September 7, 2000.

<sup>8</sup> See “Guidelines for Joint Staff Assessment of a Poverty Reduction Strategy Paper,” available on the World Bank’s external website at <http://poverty.worldbank.org/files/jsa%20guidelines.pdf>.

from or elaborate on policies and actions contained in the PRSP. Generally, each institution limits conditionality to its core areas of responsibility and competence. Looking ahead, there is a need to adapt these coordination mechanisms in post-conflict countries, with programs reflecting the specific challenges in such countries of economic and social stabilization and of the rebuilding of economic institutions and physical and human capital.

21. **PRGF.** To support the PRSP approach, the Fund replaced the ESAF with the PRGF. As the PRGF guidelines state, the PRGF recognizes that growth-oriented policies should be implemented in a framework in which the pressing need to reduce poverty is also a central objective.<sup>9</sup> Thus, specific measures supported by a PRGF arrangement should derive from the country's poverty reduction strategy, as outlined in the PRSP, and should focus on policies within the Fund's core areas of expertise: monetary, fiscal, and exchange rate policies; the institutional arrangements underlying these policies; and structural aspects closely related to them, including those in areas of overlapping responsibilities, such as the financial sector, tax administration, and governance. In general, conditionality should not extend beyond these areas except for measures deemed critical for maintaining macroeconomic stability. Rather, conditionality on policies outside the Fund's core areas of expertise should normally be covered under IDA lending operations.

22. **CAS.** The Bank also is aligning its support to low-income countries to the PRSP. The specific measures supported by the Country Assistance Strategy (CAS) derive from the country's poverty reduction strategy, as set out in the PRSP<sup>10</sup> and as appropriate to the Bank's comparative advantage vis-à-vis other development partners. In addition, the Bank has introduced the poverty reduction support credit (PRSC), as a flexible CAS-based development assistance instrument for providing phased medium-term support for well-performing countries to the social, structural, and sectoral reform agenda outlined in the PRSP and for complementing the PRGF.<sup>11</sup> To date the Board has approved three PRSCs—to Uganda, Vietnam and Burkina Faso<sup>12</sup>—and several others are under preparation. PRSC conditionality principally draws from and elaborates on policies and public actions contained in the PRSP, and is limited to the Bank's areas of primary responsibility and competence. To this end, the PRSC builds on the Bank's analytical advice to the country during the country's preparation of its PRSP, including the Bank's assessment of the country's social, structural, and sectoral policies, and of its public expenditure, financial

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<sup>9</sup> See *Poverty Reduction and Growth Facility—Operational Issues* (SM/99/293), December 13, 1999.

<sup>10</sup> After July 1, 2002, it is expected that IDA CASs presented to the Bank's Board would normally be based on a PRSP, which would provide the context for all IDA lending and nonlending activities.

<sup>11</sup> For further details, see the Operational Memorandum *Interim Guidelines for Poverty Reduction Support Credits (PRSC)*, May 31, 2001. These guidelines will be kept under review and revised, as necessary, in light of the early experience with PRSCs.

<sup>12</sup> See Uganda PRSC (IDA-R2001-45), 2001; Vietnam PRSC (IDA-R2001-60), 2001; and Burkina Faso PRSC (IDA-R2001-140), 2001; available on the Bank's external website at <http://www.worldbank.org>.

management, and procurement systems.<sup>13</sup> Like all adjustment operations, individual PRSC operations are conditioned on satisfactory macroeconomic performance, with Bank staff's assessment drawing on Fund staff's advice.

23. ***Joint Implementation Committee.*** To ensure the effective implementation of the PRSP approach, Bank and Fund Managements established the JIC, effective May 1, 2000. The mandate of the JIC is to monitor the progress and implementation of the PRSP approach and the Enhanced HIPC Initiative, including the progress of country cases and their financing. The JIC seeks to ensure consistency in application across countries and to resolve differences in view between Bank and Fund staff that cannot be resolved at the Regional and Area department level. If the JIC is unable to resolve disagreements, issues are to be reported jointly, in consultation with relevant Regional/Area and functional departments, to Senior Management in both institutions. No issues have arisen to date in which differences of views have not been resolved through this process.

## **B. Coordination on Conditionality**

24. Under the PRSP approach, consistency among the macroeconomic, structural, and social components of the reform program will be provided through a coherent strategy set out in the PRSP and assessed in the JSA. Complementarity of Bank and Fund support, an efficient division of labor, and overall coherence and focus of conditionality will be enhanced to the extent that each institution concentrates on and limits conditionality to its core areas of responsibility and expertise. Putting this approach into operation requires specific collaborative mechanisms to ensure that the strategy outlined by the PRSP is coherent and sufficiently specific in terms of priorities and the timing and sequencing of reform steps to allow definition of programs to be supported by the PRGF and the PRSC (and other IDA lending instruments). Clarity is also needed on which structural measures are deemed critical for macroeconomic stability in a particular country and how responsibilities will be divided on such measures.

25. ***Coherence and Specificity of Programs.*** The Bank and the Fund are important sources of advice to governments in the preparation of a PRSP, and they jointly assess the adequacy of the PRSP as the basis for their support. Going forward, to ensure that their advice is coherent and specific, Bank and Fund country teams will meet early during the PRSP process to discuss the key macroeconomic, structural, and social issues facing the country and the options for and sequencing of policy reforms that they will encourage the country to consider. In their dialogue with the country authorities, civil society, and other development partners, Bank and Fund country teams will be guided by this shared view, which also will provide the basis for the JSA.

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<sup>13</sup> References to PRSP indicate that normally a full PRSP considered adequate in the Joint Staff Assessment provides the basis for the medium-term program supported by a PRSC series. However, during the transition period of initial build-up in the pipeline of PRSPs and PRSCs, an Interim Poverty Reduction Strategy Paper (I-PRSP) may provide the basis for a PRSC program in exceptional cases—if the I-PRSP describes an adequately developed and broadly framed country-owned poverty reduction strategy and this is set out in the Joint Staff Assessment. In this case, the medium-term program may be updated or revised in the full PRSP, and the design of the series of PRSCs will also be reviewed and adjusted as appropriate.

On the basis of the PRSP, the JSA, and consultation with the authorities, Bank and Fund staff will set out the key reforms and public actions to be supported by the two institutions in a joint staff program perspective, indicating the likely sequencing, division of responsibilities for the policy dialogue and lending, and use of lending and other instruments. To the extent possible, at this stage staff would also indicate the areas of conditionality likely to be negotiated with the country authorities.<sup>14</sup> The joint staff program perspective will be reported to both Managements, in the context of a Fund mission brief or the Bank's PRSC (or other IDA lending instrument) concept document. Updated as appropriate, the joint program perspective will also be submitted to each Board in the form of an appendix to the document accompanying the presentation of the PRGF and PRSC (or other IDA lending instrument).<sup>15</sup>

26. ***Distinct Accountability for Lending Decisions.*** Each institution remains separately accountable for its lending decisions, and any conditionality that is critical for the success of one institution's program would continue to be specified in that institution's own arrangement. That said, the Bank would normally regard the presence of an on-track PRGF as adequate evidence that the macroeconomic framework is appropriate, and the Fund would normally regard the presence of an on-track PRSC as adequate evidence that the social and structural program is appropriate. When a PRSC is under consideration or performance under a PRSC is being reviewed without a companion PRGF in place, Bank staff will ascertain, before formulating their own assessment, whether Fund staff have any major outstanding concerns about the adequacy of the country's macroeconomic policies. Fund staff will communicate any such concerns to the Bank in time to be reflected in Bank reporting to its Board. Similarly, when a PRGF is under consideration or performance under a PRGF is under review without a companion PRSC, Fund staff, before formulating their own assessment, will consult with Bank staff to ascertain whether the Bank has major outstanding concerns about the adequacy of the country's poverty reduction strategy, the social impacts of the macroeconomic policies supported by the PRGF, or the country's performance in meeting structural and social conditions in the areas of competence of the Bank.<sup>16</sup> Bank staff will communicate any such concerns to the Fund in time to be reflected in Fund reporting to its Board. Conditionality in macroeconomic and closely related structural

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<sup>14</sup> In some instances, the PRSP will not fully guide the selection and sequencing of conditionality (for example if the PRSP does not fully prioritize measures in certain areas or there are unforeseen constraints on taking some policy actions). In these cases, the joint staff program perspective should indicate a possible division of responsibilities and note that further discussion with the country authorities is necessary.

<sup>15</sup> For Fund programs, this information would replace the appendix on relations with the World Bank Group, which provides information on loan execution that is available elsewhere and not used for operational purposes. Similarly, it would typically replace the discussion on Bank relations with the IMF in PRSC President's Reports.

<sup>16</sup> See IMF, *The Poverty Reduction and Growth Facility (PRGF)—Operational Issues* (SM/99/293), December 13, 1999. That paper states: "For social policies, most poverty-reducing measures, and other structural policies within the Bank's primary mandate, the Fund staff should ascertain whether the Bank staff has any major outstanding concerns about the adequacy of implementation before the Fund staff and management make their own assessment of whether to recommend Board approval of a PRGF arrangement or completion of a review. It is expected that the views of the Bank staff would be given heavy weight in the assessment of progress in these areas. Furthermore, the views of the Bank staff regarding the implementation of the elements of the PRSP within their mandate would be included in each PRGF staff report."

areas within the Fund's domain will be applied under the PRGF arrangement; conditionality in structural and social policy areas within the Bank's domain will be applied under the PRSC (and other IDA lending instruments). Exceptions should be considered only when a structural measure falling within the Bank's domain has a direct impact on macroeconomic stability. To the extent possible, such measures should be identified early through consultations between the staffs. These measures would be supported by both the PRGF and PRSC (and other IDA lending instruments), but responsibility for helping the government design the measures, and for monitoring and evaluating performance, would rest with the Bank, with Fund staff basing their assessment on Bank staff advice.

#### **IV. COLLABORATION ON MIDDLE-INCOME COUNTRIES**

27. The operational framework for collaboration is less developed in middle-income countries (MICs) than in low-income countries. The 1998 joint guidelines set out extensive guidance on the process of coordination, providing clear direction on establishing a framework for collaboration. However, the wide variety of assistance needs among MICs leads to differences across countries in the focus and timing of Bank and Fund support and in the content and scope of conditionality, and makes the implementation of collaboration especially challenging. To date, progress in collaboration in MICs reflects the application of the joint guidelines on a case-by-case basis. This section explores the challenges of following through on these guidelines and the Prague statement to build stronger and more systematic collaboration in MICs.

##### **A. Framework for Collaboration**

28. In MICs, as in all countries, the key principles of collaboration would be (a) explicit introduction of the “lead agency” concept, with Board documents transparently reporting lead agency views on the handling of policy issues, (b) early consultation on individual programs to develop a common view and agreement on a rational division of labor, and (c) retention by each institution of ultimate responsibility for its own lending decisions. These principles also mean that conditionality should be limited to the critical actions needed for program success and that for all conditions, each institution should look to the lead agency. Conditionality that is critical for the success of the program supported by an institution would continue to be specified in that institution's own arrangement. If this means duplicating conditionality, there should be harmonization.

29. To ensure consistent implementation, it will be important to issue guidance to staff on the approach, including any reporting requirements to the two Managements and Executive Boards. Improving staff collaboration in the work on MICs will involve addressing several generic issues that have inhibited greater Bank-Fund collaboration to date. These include the absence of a PRSP-like country document providing a common country-led framework for the operations of the two institutions; the absence of a comprehensive analysis of policy priorities across the two

institutions' areas of responsibility; and in many cases the lack of synchronization of the degree and nature of involvement and of decisions on lending and conditionality.

- **Documentation.** MIC governments do not normally present to the Bank and the Fund an overall program for adjustment, development, or poverty reduction in a formal document like the PRSP.<sup>17</sup> Nonetheless, in many cases countries will have set out their development strategies in public documents. At the outset of a program, countries will also articulate their views in a Letter of Intent to the Fund and/or the Letter of Development Policy to the Bank. To a large extent, therefore, the staff of the two institutions have the basic materials on which to arrive at a common understanding of the country's overall program.
- **Comprehensive Analysis.** Agreement on a coherent program of support needs to be based on a comprehensive analysis of the country's development challenges. Even in countries without a Fund arrangement, Fund staff regularly analyze country macroeconomic policies and related structural and institutional issues in staff reports in the context of Article IV consultations.<sup>18</sup> As part of the systematic approach to supporting development in MICs, the Bank is increasingly basing its CASs on integrative analyses of priorities across the country's social, structural, and sector policies and across its fiduciary systems<sup>19</sup>—although further investments in country analytic work will be needed in the Bank, in line with its program to rebuild its diagnostic ESW.
- **Lending Instruments.** One of the practical issues that led to the expansion of Fund coverage of structural issues in the 1990s was the asynchronous timing of Bank and Fund lending instruments. As the Fund streamlines its conditionality and focuses on policies that are critical to its program objectives, early and ongoing collaboration with Bank staff should help to assure appropriate coverage of structural issues. At the same time, the Bank's program approach through the CAS should help to bridge any timing gaps on the Bank's instruments; and for some countries with appropriate fiduciary and other policies,<sup>20</sup> the use of programmatic adjustment lending by the Bank will also provide a vehicle for closer alignment of the timing of Bank-supported and Fund-supported country programs.

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<sup>17</sup> MIC governments present their strategies in the Letter of Intent to the Fund's Executive Board and, where there is an adjustment loan, in a Letter of Development Policy to the Bank's Board. However, in contrast to the PRSP, these documents do not present a common framework for all development partners.

<sup>18</sup> Following the Asian financial crisis, surveillance was strengthened in areas critical to preventing financial crises, including by drawing on available Bank economic and sector work in such areas. Further, Bank and Fund conduct joint assessments through the Financial Sector Assessment Program (FSAP) and the periodic Reports on the Observance of Standards and Codes (ROSC) for countries requesting such assessments.

<sup>19</sup> See *Supporting Country Development: Strengthening the World Bank Group's Support for Middle-Income Countries* (DC2001-0005), April 10, 2001.

<sup>20</sup> Similar to the PRSC in low-income countries, such lending would involve a series of operations phased, to the extent practicable and feasible, to coincide with the country's budget and policy cycle.

The discussion below sets out how the framework could operate in different country circumstances.

## **B. Coordination under Diverse Country Circumstances**

30. MICs have highly diverse needs for Bank and Fund support, reflecting the underlying diversity of such country characteristics as the level of income, poverty incidence, vulnerability to external financial pressures, access to capital markets, and progress already made in policy reform and institution building. Some MICs face pervasive poverty, lack access to commercial sources of finance, and still have a broad agenda of basic macroeconomic, structural, and social reforms for which they require sustained support. Others have greatly advanced in establishing vibrant market economies and are attractive to foreign and domestic investors, but remain vulnerable to financial contagion or other external shocks that may temporarily reverse private flows, reduce national income, and increase the incidence of poverty. In between, there is a wide range of countries with uncertain access to capital markets and poverty of a less pervasive but more concentrated nature, which have often moved beyond basic macroeconomic and market-opening reforms to implementing second-generation reforms needed for establishing strong market economies and modern social systems. This diversity inevitably means that the approach to collaboration on conditionality in these countries will be varied, reflecting different country circumstances.

31. ***Countries with Ongoing Programs of Financial Support from both the Bank and the Fund.*** For countries receiving medium-term support from both institutions for a broad reform agenda, the task of coordinating conditionality is essentially similar to the one discussed above for PRSP/PRGF/PRSC countries. In the Bank, such assistance is provided typically through a package of adjustment and investment loans and ESW supporting specific areas of reform or public spending, set out in the CAS. In the Fund, such assistance would typically be provided under the Extended Fund Facility (EFF).<sup>21</sup> Coordination in countries where both institutions provide medium-term support could be similar to that in low-income countries, except that in the absence of a PRSP-like statement of the country's program, Bank and Fund staff will need to base their shared view of the government's program on the government's public statements and their own analysis. Conditionality normally will be applied under the operations of the institution having primary responsibility in the particular policy area. Exceptions would occur when a structural measure is critical for macroeconomic stability, in which case it could be included in both institutions' operations with the specific conditionality harmonized to facilitate implementation and monitoring and developed with the staff expertise of the lead agency.

32. ***Countries without Ongoing Support from the Bank and/or the Fund.*** In several different MIC situations, either the Bank or the Fund is involved more than the other or support

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<sup>21</sup> The Executive Board has directed that the EFF should normally be limited to such cases. See Summing Up by the Acting Chairman, *Review of Fund Facilities—Proposed Decision and Implementation Guidelines*, Executive Board Meeting 00/113, November 17, 2000, Buff/00/175.

is on very different time schedules. The collaborative mechanism in these cases must allow for rapid response while ensuring that the structural conditionality critical for a Fund-supported program is consistent with the medium-term reforms supported by the Bank and that the macro conditionality for a Bank-supported program is consistent with the assessment of the Fund.

33. In many MICs, Fund support is intended to help countries address temporary balance of payment difficulties. In other cases, a Fund arrangement is intended to catalyze resources from capital markets or provide a framework for a policy dialogue; normally this involves a Stand-By Arrangement (SBA), which may involve structural conditions as critical to program success. While the Fund is responsible to its members for its own assessment of the adequacy of the structural framework for its lending, before formulating that assessment Fund staff ascertain whether Bank staff have any major concerns. Bank staff also would systematically be given the opportunity to design and monitor the conditionality on policies within the Bank's domain, as an input into Fund Management's recommendations. This could take place through a parallel Bank lending operation or through specific inputs to Fund staff. Early communication between countries and Bank and Fund staff on structural reforms needed for the objectives of the Fund arrangement, and on the division of responsibilities for policy dialogue, lending support, and scope of conditionality, would be key to effective collaboration. These arrangements should also be transparently set out in appropriate documentation to the two Boards.

34. In other cases, during periods when the overall macroeconomic framework is satisfactory, the Bank may provide adjustment lending where no Fund arrangement is in place. For coordination in such cases, the Concordat established a mechanism that has been applied successfully in practice. While the Bank is responsible to its members for its own assessment of the adequacy of the macroeconomic framework for adjustment lending, before formulating that assessment Bank staff ascertain whether Fund staff have any major concerns. Fund staff provide advice on the basis of the most recent Article IV consultation and the World Economic Outlook. If specific macroeconomic conditionality is needed to safeguard Bank resources, Fund staff would be given the opportunity to design and monitor it, as an input into Bank Management's recommendations.

35. A third category of MICs are countries that have ample access to capital markets and do not borrow from either institution to finance ongoing reforms. Such countries may welcome continued nonlending support and arrangements that ensure rapid access to Bank and Fund resources in times of crisis. Bank assistance to inactive borrowers in normal times tends to be limited to analytic and advisory support, including ESW and technical assistance. The Bank may provide selected investment lending, and in the future may also offer adjustment loans with a deferred drawdown option, a proposed precautionary instrument based on a continuing program of structural and social reform and policy dialogue. Fund assistance to these countries can be in the form of a precautionary arrangement or a Contingent Credit Line (CCL) for countries with strong policies and limited external vulnerability. The CCL is subject to stringent eligibility criteria that include adequacy of structural policies. The Fund will base its assessment of the

adequacy of these policies, *inter alia*,<sup>22</sup> on the Bank's analysis and on the joint assessments provided in the context of the FSAP and the ROSC. Similarly, in the case of the proposed deferred drawdown option, the Bank would look to the Fund to take the lead in the dialogue and advice on macroeconomic issues.

36. ***Capital Account Crises.*** In cases of financial market crises, speed of response is essential. While the Fund must therefore take the lead and focus on designing a stabilization program, other supporting reforms, including financial sector restructuring and improvement of social impact programs, may be needed to restore market confidence and ensure broad support for the arrangement. The appropriate coordination mechanism would be similar to that used in non-crisis cases, albeit with a particular premium on speed. To that end, the Fund will give the Bank the opportunity to be involved in structural aspects of program formulation from the start. The Bank will adjust its work program to the tight schedule necessitated by the required speed of response, including in helping countries with program formulation, policy dialogue, and monitoring. In the immediate crisis any early understanding of both institutions on the program (including coverage of conditionality in operations) could still be documented in the Fund's mission brief and in subsequent lending documents to the two Boards. Fund financial support in such cases may be under an SBA or the Supplemental Reserve Facility (SRF).

## V. ISSUES FOR DISCUSSION

37. The proposals in this paper imply progressive changes in the way the two institutions work together in supporting member countries. They build on the 1998 agreement on collaboration and the September 2000 joint statement by the President and Managing Director on enhanced cooperation. They also build on a number of changes already under way: ongoing reforms at the World Bank in the way it supports country development; initiatives at the IMF to streamline its conditionality; and changes in the operations of both institutions to support stronger country ownership of reform programs and the broad approach articulated for low-income countries in the PRSP process.

38. ***Implications for Cooperation in Supporting Member Countries.*** The 1998 agreement set out three principles for collaboration: clarity about responsibilities, early and effective consultation, and separate accountability. Drawing on developments and experience since 1998, this paper proposes a number of steps for better implementation of these principles in practice.

- Explicit introduction of the "lead agency" concept for responsibility for supporting countries on specific policy issues, with Board documents transparently and

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<sup>22</sup> The CCL is envisaged to support the country's own economic agenda and as such involves no formal conditionality. Its only requirement for activation is that the capital account crisis be the result of contagion and not the country's own actions, thereby requiring verification that macroeconomic policies have been broadly on track. Moreover, while a member is expected to elaborate on a structural reform agenda, the Fund does not check on its implementation before activating the CCL.

systematically setting out the staff views of the lead agency on the various issues and conditionalities as an input into Board discussions.

- Systematic information sharing by country teams and monitoring by Bank and Fund Senior Management. This would occur both upstream in the context of CAS and Article IV consultations and downstream in the context of lending operations, with Board documents appropriately summarizing the information.
- Each institution would retain ultimate responsibility for its own lending decisions, and conditions critical for the success of the respective institution's program would continue to be specified in that institution's own arrangements, with lead agency staff advising both institutions on the substantive content. Conditionality would be duplicated only when a policy measure was considered critical for the success of the programs supported by both institutions. In such cases, conditionality would be harmonized, using identical dates and benchmarks to the extent possible.

**Do Executive Directors agree with the proposed approach? What do Executive Directors see as the key risks, and how can they be managed?**

39. *Collaboration in Support of Low-Income Countries.* The framework for collaboration now in place has advanced considerably since 1998. With both institutions supporting country programs set out in PRSPs, there is an increasingly clear division of labor, with macroeconomic and closely related structural conditionality covered by the PRGF, and other structural and social issues covered by the PRSC or other Bank lending operations. But there is more to be done, with a more systematic operational framework and early consultations to better set out priorities and sequencing for reforms, specify Bank and Fund staff program perspectives for lending and other support, and ensure mutually supportive conditionality in PRGFs and PRSCs.

**Do Executive Directors agree that these are priorities for the future, that this collaboration is proceeding on the right track, and that the plans for reflecting it in Board documents are appropriate?**

40. *Application of the Principles in Middle-Income Countries.* Progress on collaboration has been more mixed in middle-income than in low-income countries, reflecting their more diverse circumstances and the absence of a Bank-Fund coordinated policy framework. For countries where both institutions are providing medium-term support, collaboration arrangements can be developed similar to those for low-income countries, though typically without a formal country document like a PRSP. For countries in which one institution is engaged more than the other or both are engaged on very different time schedules, it will still be important to seek to implement the same principles, albeit with flexibility. In some circumstances the collaborative mechanism must allow for rapid response, and in all cases it must ensure that structural conditionality judged critical to success in Fund-supported programs is consistent with the medium-term reforms covered in the country's dialogue with the Bank; equally, the macro conditionality judged critical to success in Bank-supported programs must be consistent with the

reforms covered in the country's dialogue with the Fund. In every case, the three broad principles elaborated above should be respected.

**Do Executive Directors agree that strong efforts should be made to apply these principles of collaboration more systematically in middle-income countries where possible, drawing on the experience being gained in collaboration on low-income countries?**

41. *Arrangements for Review.* The paper stresses the importance of Board support and guidance for effective implementation.

**Do Executive Directors agree that there should be a report on progress to the two Boards, focusing on implementation issues and providing a further opportunity for guidance? Should this be in a year's time?**

## **HISTORY OF BANK-FUND COOPERATION ON CONDITIONALITY**

1. Over the years, Bank-Fund cooperation on program conditionality has aimed to ensure that the two institutions provide advice that is consistent and that fully exploits the expertise and financial resources of each institution. In the first three decades of operations, the clear differences in focus between the two institutions made collaboration a low-priority issue. As long as Bank lending was concentrated on public sector investment projects, the interest of one organization in the work of the other tended to be asymmetrical: the Bank was more interested in the macroeconomic performance of a country in which it was lending than the Fund was in projects financed by the Bank.<sup>1</sup> In more recent years, as the two institutions moved to overlapping fields of economic activity, collaboration intensified and produced positive results. However, at times collaboration between the two institutions ran into problems, prompting further periodic reviews of existing practices.

2. This annex briefly reviews the history of collaborative frameworks addressing the issue of conditionality in Fund- and Bank-supported programs, prior to or expanding on the 1998 joint guidelines discussed in the text. These frameworks have aimed to delineate areas of primary responsibility, define areas of overlap, and clarify the mandates of the two institutions.

### **Informal Developments before the Mid-1980s**

3. Until the mid-1960s, cooperation between the two institutions on program conditionality was informal and diversified across Regions, but as the institutions expanded that approach became impractical.<sup>2</sup> In 1966, the two institutions reached a basic understanding on their respective areas of “primary responsibility” in situations where functions overlapped:

"As between the two institutions, the Bank is recognized as having primary responsibility for the composition and appropriateness of development programs and project evaluation, including development priorities ... [T]he Fund is recognized as having prime responsibility for exchange rates and

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<sup>1</sup> For a detailed account of the relations between the two institutions since their establishment, see Jacques Polak, “The World Bank and the IMF: A Changing Relationship,” in Devesh Kapur, John P. Lewis, and Richard Webb, *The World Bank: Its First Half Century*, Vol. II (Washington, D.C.: Brookings Institution, 1997), pp. 473-521. Also see James M. Boughton, *Silent Revolution: The International Monetary Fund 1979-1989*, (Washington, D.C.: International Monetary Fund, forthcoming), Chapter 20. This annex is based in part on the latter account.

<sup>2</sup> In the absence of any institutional arrangements, the extent to which staffs in the two institutions worked together on macroeconomic policy advice in individual countries depended a great deal on the inclinations of Regional managers. Concern with macroeconomic policies was most prominent in the Bank’s Latin America Region, particularly by the mid-1960s, when a prior arrangement with the Fund became a condition for Bank lending. See Edward Mason and Robert Asher, *The World Bank since Bretton Woods* (Washington, D.C.: Brookings Institution, 1973), pp. 453-55. Also see Margaret G. De Vries, *The International Monetary Fund, 1966-1971: The System under Stress*, Vol.1 (Washington, D.C.: IMF, 1976), p. 611.

restrictive systems, for adjustment of temporary balance of payments disequilibria and for evaluating and assisting members to work out stabilization programs as a sound basis for economic advance... [T]he range of matters which are of interest to both institutions ... includes ... the structure and functioning of financial institutions, the adequacy of capital markets, the actual and potential capacity of a member country to generate domestic savings, the financial implications of economic development programs both for the internal financial position of a country and for its external situation, foreign debt problems, and so on.”<sup>3</sup>

4. All subsequent understandings between the two institutions have built upon this basic 1966 document. Its principles were reaffirmed in 1970 and on several occasions in the 1980s, and the procedures for collaboration and avoidance of inconsistent advice were gradually made more specific.<sup>4</sup> Despite this broad institutional arrangement, the staffs of the Fund and the Bank had very different conceptions of their respective roles through the 1970s. Institutional arrangements involved where to demarcate boundaries: the crucial dimension for the Bank was stabilization versus development and short run versus long run, while for the Fund the proper demarcation was between macro- and microeconomics, between aggregate performance and the structure of the economy. On occasion, each institution strayed into the other’s roles as defined by these arrangements.<sup>5</sup>

5. When the Bank began making structural adjustment loans (SALs) for medium-term balance of payments financing in 1980, it had to reconcile that activity with the Fund’s “primary responsibility” for the balance of payments. The Fund insisted that it would continue to take the lead in advising countries on medium-term balance of payment issues,<sup>6</sup> and the Bank did not challenge that understanding. The Management of both institutions issued instructions to staff on specific procedures for collaborating in countries where both were concerned with medium-term policies. While most disputes were resolved before they disrupted the provision of assistance to

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<sup>3</sup> See “Fund-Bank Collaboration,” memorandum to the Members of the Executive Board from the Secretary and to Department Heads from the Managing Director December 13, 1966.

<sup>4</sup> See *Fund/Bank Collaboration* (EBD/70/38), February 19, 1970; *Progress Report on Fund Collaboration with the Bank in Assisting Member Countries* (SM/81/62), March 19, 1981, and Minutes of EBM/81/62, April 20, 1981; and *Fund-Bank Collaboration—A Further Progress Report* (SM/84/210), August 27, 1984 and Minutes of the EBM/84/171, November 28, 1984. See also *Bank-Fund Collaboration* (R85-30), February 4, 1985; and *Progress Report on Bank-Fund Collaboration* (RD86-112), May 29, 1986. The 1966 statement is attached to the 1970 document as an appendix.

<sup>5</sup> One of the main disagreements in the 1970s and 1980s centered on the evaluation of a country’s balance of payments prospects over the medium-term. The Fund and the Bank both felt that resolution of whether a balance of payments problem was temporary or a more permanent external disequilibrium problem was their primary responsibility: the Fund, because the cause was inappropriate macroeconomic policies; the Bank, because it was a longer-term problem of structural imbalance. Other disagreements centered on fiscal priorities and on exchange rate objectives. For a discussion of these institutionally determined differences of view, see *Progress Report on Bank-Fund Collaboration*, op. cit, and Polak, op. cit.

<sup>6</sup> See Minutes of IMF Executive Board meeting EBM/80/83, May 28, 1980, p. 24.

countries, the willingness of staff in the field to defer to each other in assessing countries' balance of payments or development requirements was not uniformly high.<sup>7</sup>

### **Impetus from the SAF and the PFP Process**

6. The creation of the SAF in 1986 and the ESAF in 1987 required borrowers to negotiate medium-term structural reform programs with the IMF. While conditionality was similar in many respects to that of the EFF, these facilities called for a more formal coordination with the Bank than in the past and required explicit procedures to avoid cross-conditionality.<sup>8</sup> The principal innovation was the introduction of the Policy Framework Paper (PFP), a document to be negotiated by the borrowing country with the staffs of both the Fund and the Bank and approved by the Executive Directors of both institutions. The Bank's Executive Board (sitting as a Committee of the Whole) would discuss each PFP first and would focus on the developmental and structural aspects of the paper.<sup>9</sup> The Fund's Board would have the Bank's assessment at hand along with the PFP for its own discussion of the PFP. It would normally defer to the Bank's judgment on those issues, but it would retain its independence to act in accordance with its own Articles.

### **The 1989 Concordat**

7. As a result of coordination failure related to Bank lending to Argentina in 1988, the following year the Managing Director of the Fund and the President of the World Bank agreed to issue a document that came to be known as the Concordat, reaffirming the 1966 principles and attempting to clarify the separate responsibilities of each institution. In particular, the Concordat introduced the concept of "aggregative aspects of macroeconomic policy," which meant to limit the Fund's primary responsibility "to public sector spending and revenues, aggregate wage and price policies, money and credit, interest rates and the exchange rate." Correspondingly, the Bank's primary responsibilities included "development strategies; sector project investments, structural adjustment programs; policies which deal with the efficient allocation of resources in

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<sup>7</sup> See *Progress Report on Fund Collaboration with the World Bank in Assisting Member Countries*, op. cit., p. 10; *Fund-Bank Collaboration—A Further Progress Report*, op. cit., pp. 5-8; *Fund-Bank Collaboration—Developments in 1985* (SM/86/40), February 25, 1986, and (SecM86-910), May 29, 1986; *Progress Report on Bank-Fund Collaboration*, op. cit., pp. 4-5; and *Progress Report on Bank-Fund Collaboration* (EBS/90/131), July 12, 1990, pp. 2-3.

<sup>8</sup> As a matter of principle, the Fund and the Bank affirmed on several occasions that they should not impose cross-conditionality, defined as a requirement that a borrower meet the conditions of one institution in order to qualify for a loan or credit from the other. In the context of the Fund's Structural Adjustment Facility (SAF), the Policy Framework Paper (PFP) was expected to play a central role regarding the complexities of avoiding cross-conditionality. Reflecting differences of views among Directors, a compromise crafted at the IMF Board (see Chairman's summing up and minutes of EBM/86/24, February 11, 1986, p. 42) cautioned that the PFP "should not be overly precise," that the institutions' "respective mandates and expertise" should be preserved, and "some flexibility must be maintained in the specific working of these arrangements."

<sup>9</sup> On the complexities of avoiding cross-conditionality and the role of the PFP, and on the implications for Bank certification of investment plans as a condition for the EFF see Boughton, op. cit., Chapters 14 and 15.

both public and private sectors; priorities in government expenditures; reforms of administrative systems, production, trade and financial sectors; the restructuring of public sector enterprises and sector policies.”<sup>10</sup>

8. Both Executive Boards, especially the Bank’s, expressed reservations about the Concordat, and the Bank’s Board concluded that it did not regard the document as institutionally binding.<sup>11</sup> The Concordat thus took on a semiofficial status as a Management directive to staff but not as a declared institutional policy document. It did, however, gradually become an accepted basis for institutional policy and for promoting greater collaboration both at headquarters and in the field.

### Developments in the 1990s

9. While the Concordat remained as the general framework guiding collaboration between the two institutions in the 1990s, additional guidance notes were issued on specific aspects of collaboration to further elaborate and clarify the underlying principles.<sup>12</sup>

10. The 1992 Note on Bank-Fund Collaboration on the States of the Former Soviet Union (issued as an addendum to the Concordat) became necessary because of the unprecedented scale and complex interactions of reforms in the states of the FSU, requiring enhanced collaboration between the Bank and the Fund. In addition to the issues of mobilization of financial assistance and coordination with other institutions, the Note addressed the issues of collaboration between the Bank and the Fund in (a) assessing macroeconomic adjustment needs, priorities for structural reforms, and complementarities of policy requirements in each of these areas for success in the other; and (b) coordinating on the development of individual adjustment and reform programs, and on the critical interrepublic issues that transcended country-specific programs.

11. According to the 1995 Note for Bank-Fund collaboration in public expenditure work, primary responsibility in public enterprise reform, public expenditure (composition and efficiency), and administrative and civil service reform resides with the Bank. The Fund has primary responsibility for the aggregate aspects of public spending and revenues. The Note lay

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<sup>10</sup> See *Bank-Fund Collaboration in Assisting Member Countries* (SM/89/54), March 9, 1989, and (R89-35), March 10, 1989.

<sup>11</sup> See Polak, op. cit., p. 515.

<sup>12</sup> The following notes have been issued: *Bank-Fund Collaboration on the States of the Former Soviet Union* (EBD/92/97), April 29, 1992; *Guidance Note for Bank-Fund Collaboration on Public Expenditure Issues*, (EBD/95/123), September 7, 1995; *Bank-Fund Collaboration in Strengthening Financial Sectors* (SM/97/200), August 1, 1997; *Review of Bank-Fund Collaboration in Strengthening Financial Systems* (SM/98/224), September 2, 1998, and (SecM98-732), September 3, 1998; and *Guidelines for Bank-Fund Collaboration in the Financial Sector*, circulated in the Fund as SM/99/158, July 2, 1999, and in the Bank as attachment to a Memorandum from Mr. Sandström to Operational Vice Presidents and Financial Sector Staff, June 24, 1999.

down procedures for an annual review of public expenditure work of common interest to both institutions, and asked staff to report to management on how such collaboration is working.<sup>13</sup>

12. In 1998, the Bank and Fund responses to the Asian crises and the external evaluation of the ESAF indicated a need for improving collaboration. In response, a joint report of the Managing Director and the President on Bank-Fund collaboration and a joint review of Bank-Fund Collaboration in Strengthening Financial Systems were issued. The report reaffirmed the principles underlying the 1989 Concordat, including clarity for members on lead responsibility for policy advice and reform in any given area, early and full consultation between Bank and Fund staff, and separate accountability of each institution for its lending decisions, with the Executive Boards informed of the overall reform agenda and of how Bank support and Fund support complement each other. The report also delineated the institutions' responsibilities in the public sector and in new areas not covered by the 1989 Concordat.<sup>14</sup> In addition, the report clarified that in cases where one institution provides support in an area of the other institution's purview, the other retains responsibility for advising the authorities on the design of measures to be supported, and for monitoring and evaluating performance. In cases of crisis management, the report elaborates that while the Fund has responsibility for the overall stabilization program, the Bank is normally included in program formulation from the outset. Bank staff participation in Fund missions or parallel missions should help ensure that the early policy actions are consistent with the needs of the medium-term reform program, while follow-up missions should be led by Bank staff.

13. The roles and responsibilities of the Bank and the Fund in financial sector work are highlighted in the 1999 guidelines, which also set out the role of the Bank-Fund Financial Sector Liaison Committee to help guide collaboration. The guidelines highlight the essential features of good collaboration in those countries where both institutions have significant interest in the financial sector, especially in countries that face serious financial sector problems. The absence of full communication or information sharing has been identified in the guidelines as a major cause of coordination problems. The guidelines outline procedures for staff to establish contact lists, share information, coordinate work programs, undertake joint missions, provide consistent advice to country authorities, negotiate financial sector conditions in Letters of Intent (LOIs) and Letters of Development Policy for financial sector adjustment loans (FSALs), attribute the work of each institution in the policy documents of the other, handle confidential information, avoid

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<sup>13</sup> Also see *Note on Bank-Fund Collaboration in Public Expenditure Work*(SM/99/16), January 22, 1999, which describes several new mechanisms to strengthen coordination in public expenditure, building on existing procedures.

<sup>14</sup> As stated in the Report: "In the public sector, primary responsibility in public enterprise reform, public expenditure (composition and efficiency), administrative and civil service reform resides with the Bank. The Fund has primary responsibility for the aggregate aspects of public sector spending and revenues. Tax policy and administration is an area of overlap. There are overlapping responsibilities in issues of transparency, governance, corruption and legislative reform, trade policy and debt. New areas of work, whose importance has emerged more recently, include notably, corporate sector (restructuring, accounting, auditing and disclosure, and governance), judicial reforms, environment, and social protection and development where the Bank has primary responsibility."

possible conflicts of interest related to highly market sensitive information involved in financial sector work by staff, and collaborate on the preparation of financial sector policy work papers.