

INTERNATIONAL MONETARY FUND

**Review of the 2002 Conditionality Guidelines**

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In consultation with other Departments

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March 3, 2005

Contents	Page
Executive Summary .....	3
I. Introduction .....	6
II. The 2002 Guidelines on Conditionality .....	8
III. Review of Experience .....	12
A. Parsimony and Criticality .....	12
B. Clarity .....	25
C. Process .....	26
D. Program Implementation .....	26
IV. Assessment .....	31
A. The Extent of Streamlining .....	31
B. The Risks of Streamlining .....	35
C. Waivers of Structural Performance Criteria .....	36
D. Ownership and Selectivity .....	40
V. Issues for Discussion .....	42
Figures	
1. Institutional and Economic Classification of Structural Conditionality .....	13
2. Structural Conditions in Fund-Supported Programs .....	16
3. Types of Structural Conditions in Fund-Supported Programs .....	17
4. Total Structural Conditionality in GRA-Supported Arrangements .....	19
5. Number of Structural Conditions in GRA-Supported Arrangements with Members with Relatively Weak Track Records .....	20
6. Prior Actions in Countries with Relatively Weak Track Records .....	21
7. Bank and Fund Structural Conditionality .....	22
8. Ownership and Policy Space .....	27

9. Permanent and Temporary Interruptions and Delays, 1995-2003 .....	28
10. Implementation of Conditionality, 1995-2003 .....	29
11. Composition of Structural PC Waiver Rates: Delayed Measures, Alternative Measures, and Lapsed Rates in Fund-Supported Programs .....	30
 Annex	
Some Key Extracts from the Guidelines and Supporting Documents .....	44

## EXECUTIVE SUMMARY

The 2002 Guidelines on Conditionality are built on the principles of national ownership, parsimony and clarity in the application of conditions, tailoring to country circumstances, and coordination with other multilateral institutions. These principles are intended to reinforce each other in securing more effective program design and implementation, and thus in enhancing support to members and better safeguarding Fund resources.

### *The record*

Since the Fund revised its conditionality guidelines in 2002 (and starting with the “streamlining” initiative of 2000), substantial changes appear to have been made in pursuit of national ownership, parsimony, and clarity:

- **The coverage of structural conditionality has shown major shifts, consistent with a greater focus on critical measures.** Conditionality has shifted out of noncore areas, and toward economic management in programs supported by the Poverty Reduction and Growth Facility (PRGF) and vulnerabilities in programs supported under the General Resources Account (GRA). Conditionality is also now less dispersed across sectors, and shows stronger links to initial economic conditions. Conditions whose criticality is neither obvious nor convincingly explained still exist, but seemingly not in large numbers.
- **Numbers of structural conditions have not shown much of a decline.** Numbers have declined somewhat in PRGF-supported programs, but not in GRA-supported programs. Numbers are, however, a crude metric, and need to be seen in the context of the increased focus noted above. Specification of conditions at high levels of detail contributes to holding up numbers of conditions, as does a tendency—in GRA-supported programs—to set more conditions in programs with members with relatively weak track records.
- **Conditions have become much clearer.** Program-related conditions are now almost always transparently distinguished from the rest of the authorities’ program. Vaguely-specified program review clauses are rare, and reviews are rarely used to introduce entirely new conditionality.

Although it is too soon to gauge whether, since the advent of the guidelines, Fund support has contributed to better economic outcomes, some improvement is also evident in program implementation:

- **Fund-supported programs experience fewer permanent interruptions,** although temporary interruptions and average review delays have not declined.
- **Waiver rates for structural performance criteria (PCs) have not declined (and have even risen in GRA-supported programs), but implementation of waived PCs has**

**improved.** The latter is consistent with a greater focus on critical conditions, although waivers continue to be used to provide policy space *ex post*, in particular with respect to the timing of implementation.

### ***Streamlining structural conditionality***

**There is some scope for further progress in streamlining the coverage of structural conditionality.** In particular, greater care could be taken to set structural benchmarks only in critical areas, and to set out program strategies more clearly in staff reports.

**The shift in coverage of conditionality away from growth- and efficiency-related reforms is not without risks.** Whether this shift represents early evidence of “reform gaps” will have to be assessed when program outcomes are known.

**There may be a case for setting fewer structural conditions at a high level of detail.** While detailed specification may be perceived as micromanagement, it is also conducive to clarity, and thus not necessarily to be resisted. But renewed scrutiny—including by the Executive Board—of the numbers and detail of conditions would be helpful.

**The tendency to provide policy space—including flexibility on timing—*ex post* suggests that there may be scope for improving the *ex ante* formulation of structural conditions.** This would give the member stronger assurances of the availability of Fund financing in defined conditions, and reduce the waiver rate and thereby strengthen credibility. Specifically:

- **Care should be taken not to set overambitious timetables** for implementation. In cases of particular uncertainty, the Fund could experiment with foreshadowing conditions, leaving precise dates to be specified at a later stage.
- **Floating tranches could be used in a limited set of cases.** Clarifying the criteria for their use would help ensure that this possibility is considered when the criteria are met.
- **More conditions could be formulated to provide policy space *ex ante*.**

### ***Process, ownership, and conditionality***

**Process is a difficult area.** The staff appears to be making serious efforts to follow good processes of program development, but it is clear that good processes do not guarantee strong implementation, and that some aspects of good processes are idiosyncratic. In very few cases have the authorities expressed an interest in writing the first draft of the letter of intent, but this does not at all mean that they are not actively involved in program design. More scope for process improvements probably exists in the proactive development of policy options by the staff.

**It will remain difficult to gauge ownership, but substituting conditionality for ownership is not the answer.** Assessing risks when ownership is divided presents special challenges. In the face of these difficulties, there is a tendency to set many conditions—especially prior actions and PCs—in cases of ownership doubts. In some of these cases, greater selectivity and judicious use of staff-monitored programs might be preferable.

## I. INTRODUCTION

1. **The Fund reviews its conditionality at regular intervals.** These reviews may encompass issues related to the design of Fund-supported programs or to the formal aspects of conditionality. Both sets of issues are fundamental to the effectiveness of the Fund's financial support, which requires that program design reflect the best possible analysis in its formulation of both objectives and policy content, and that the formulation and application of conditionality be supportive of good program design and of program implementation.
2. **The 2004–05 conditionality review has already included discussions of program design.**<sup>1</sup> These discussions ranged widely, across programs supported by both the General Resources Account (GRA) and the Poverty Reduction and Growth Facility (PRGF), and covered their objectives and outcomes, analytical frameworks, and macroeconomic and structural policies. Directors commended the staff study's comprehensive analytical treatment of various aspects of program design. At the same time, Directors considered that the study raises new issues and questions which merit further inquiry. Directors stressed that national ownership of policies and the role of alternative policy options should be further reviewed. Several Directors pointed to the frequent granting of waivers of structural conditions as symptomatic of possible systemic flaws in program design. How best to strike a balance between the principle of streamlining and the need for reforms to ensure medium-term growth and viability was also placed on the agenda for the continuation of the conditionality review.
3. **With the present paper, the 2004–05 conditionality review expands to include a review of the application of the new Guidelines on Conditionality, adopted in 2002.**<sup>2</sup> These guidelines were the culmination of a comprehensive and far-reaching review of conditionality that aimed to enhance the effectiveness of Fund-supported programs. They represented the first revision of the Fund's conditionality guidelines since 1979, and were developed by the Fund after seeking input from civil society and public forums held in several countries. The Executive Board discussed a series of staff papers on conditionality during 2000–02 before finalizing the guidelines.
4. **The main focus of the 2000–02 conditionality review was structural conditionality, with the aim of focusing and streamlining it and of enhancing national ownership of policy programs.** Thus the new guidelines departed from previous practice

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<sup>1</sup> *IMF Executive Board Discusses Program Design* (PIN No. 05/16, 2/8/05, <http://www.imf.org/external/np/sec/pn/2005/pn0516.htm>) and *Design of Fund-Supported Programs—Overview, Fund-Supported Programs—Objectives and Outcomes, Policy Formulation, Analytical Frameworks, and Program Design, and Macroeconomic and Structural Policies in Fund-Supported Programs—Review of Experience* (11/24/04). Further work on program design in PRGF cases is ongoing, and will be brought to the Board by mid-2005.

<sup>2</sup> *Guidelines on Conditionality*, Decision No. 12864-(02/102), 9/25/02, (<http://www.imf.org/External/np/pdr/cond/2002/eng/guid/092302.htm>).

primarily in the area of structural conditionality and in emphasizing good processes of program development. Accordingly, and as foreshadowed in the issues paper for the present review (which was discussed at an informal Executive Board seminar in June 2004), these are the prime focus of this paper. The paper complements and draws on both the recent review of program design and the review of IMF-World Bank collaboration held in March 2004.<sup>3</sup> It is accompanied by a paper setting out some of the analysis in more detail.<sup>4</sup>

5. **In the main, this paper reviews arrangements approved between 2001 and 2004,** and contrasts them with arrangements approved through 2000. End-2000 was chosen as the cutoff date because the key changes in the 2002 conditionality guidelines, relative to previous practice, had been foreshadowed in an “Interim Guidance Note on Streamlining Structural Conditionality” of September 2000.<sup>5</sup> In what follows, the shorthand “pre-” and “post-guidelines” refers to this cutoff date of end-2000.

6. **This review comes at an early stage of experience with the new guidelines, and further evidence will be needed before definite conclusions can be drawn.** The ultimate test of conditionality is whether it contributes to better economic outcomes, including over the medium term, and these cannot yet be gauged. Moreover, although this review draws in part on case studies, no substitute exists for cross-country analysis for identifying broad trends, and at this stage such analysis is hampered by small sample sizes. Because of the preliminary nature of this review, it was based largely on information already available to the staff. The views of the authorities were sought on the case studies of the process of program development, and the review also uses the authorities’ responses to the survey carried out for the review of Bank-Fund collaboration. A future review, at a time when information is available on economic outcomes, will be able to make a more fundamental assessment, and broader consultation with both authorities and civil society would also seem appropriate at that time.

7. **This review should thus be seen, not as a definitive assessment, but rather as an interim checkpoint, focusing primarily on ensuring that the broad thrust of the guidelines is being implemented.** At this early stage and absent outcomes data, it would be surprising if the review uncovered clear evidence warranting changes to the thrust of the guidelines, and indeed it does not. The staff, therefore, does not recommend any changes to the guidelines at this time. While the guidelines were framed at a relatively high level of

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<sup>3</sup> *IMF Discusses Strengthening IMF-World Bank Collaboration on Country Programs and Conditionality—Progress Report* (PIN 04/36, 4/7/04, <http://www.imf.org/external/np/sec/pn/2004/pn0436.htm>).

<sup>4</sup> *Review of the 2002 Conditionality Guidelines—Selected Issues*, <http://www.imf.org/External/np/pp/2005/eng/030405.pdf>

<sup>5</sup> *Streamlining Structural Conditionality* (9/18/00, <http://www.imf.org/external/np/cond/2001/eng/091800.pdf>). The PRGF, which replaced the Enhanced Structural Adjustment Facility (ESAF) in September 1999, shares some of the objectives of the new conditionality guidelines, and the cutoff date thus probably represents an artificially sharp distinction for the PRGF.

generality, more specific guidance to staff, consistent with the guidelines, is provided by a staff statement and an operational guidance note, which were intended to be more amenable to revision as experience accumulated.<sup>6</sup> The staff will revisit these supporting documents in light of the Board discussion of the present review.

8. **This paper is structured as follows.** Chapter II recapitulates the key elements of the guidelines. Chapter III reviews recent experience with conditionality, with a focus on the coverage and numbers of conditions, the clarity with which conditionality is specified, the process by which it is formulated, and finally the record on program implementation. Chapter IV provides an assessment, focusing on four main questions that emerge from the review of experience: Has conditionality been adequately streamlined and focused on critical measures? Have any risks materialized in the process? How should the waiver rate for structural performance criteria be viewed? And has national ownership of policies been fostered, and selectivity been shown in cases where ownership is lacking? Issues for discussion are presented in Chapter V.

## II. THE 2002 GUIDELINES ON CONDITIONALITY

9. **The key purpose of conditionality is to ensure that Fund resources are used to assist a member in solving its balance of payments problem, thus providing adequate safeguards for the temporary use of these resources, and to provide assurances to the member of access to Fund resources.** To provide its resources to a member, the Fund must be confident that policies are such that these resources will be used in accordance with its purposes, and that they will be repurchased or repaid. At the same time, in order to embark on a course of action that may hold together only in the presence of Fund support, the member needs to be assured that it will have access to Fund resources in defined circumstances.

10. **The 2002 guidelines emphasize national ownership of policies, parsimony in conditions, tailoring policies to circumstances, coordination with other multilateral institutions, and clarity in the specification of conditions.**<sup>7</sup> These principles are intended to reinforce each other in securing more effective program design and implementation, thus benefiting members and better safeguarding Fund resources. As foreshadowed in the issues paper, the present review focuses on ownership, parsimony, and clarity. Coordination with the World Bank was recently reviewed, as noted above; and tailoring of programs to circumstances cannot be addressed without knowledge of program outcomes.

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<sup>6</sup> *Staff Statement—Principles Underlying the Guidelines on Conditionality* (9/25/02, <http://www.imf.org/External/np/pdr/cond/2002/eng/guid/092302.htm>) and *Operational Guidance on the New Conditionality Guidelines* (5/8/03, <http://www.imf.org/External/np/pdr/cond/2003/eng/050803.htm>).

<sup>7</sup> These principles are set out in the staff statement. Ownership, tailoring, and coordination are also drivers of the Poverty Reduction Strategy Paper (PRSP) approach that underlies the PRGF.

11. **This section briefly reviews key elements of the guidelines.** In implementing the guidelines, the staff is guided also by the staff statement and the operational guidance note, and therefore the paper draws also on these documents.<sup>8</sup> References are to the guidelines unless otherwise stated. An annex provides the relevant excerpts from all three documents.

12. **National ownership of Fund-supported programs is a basic principle underlying the guidelines.** Absent ownership, a program is less likely to be implemented. Moreover, it is impossible in practice to write conditions in a way that guards entirely against the risk of purely nominal implementation (e.g., laws being passed, but not enforced), and without ownership, implementation is less likely to be genuine and consistent and may also later be reversed, putting gains made under the Fund-supported program at risk.<sup>9</sup> The guidelines note that the need for ownership implies selectivity: use of Fund resources can be approved only if the Fund is satisfied that the member is sufficiently committed to implement the program. Thus the Fund *must* make judgments on ownership; but the staff statement also recognizes that such judgments are difficult.

13. **The guidelines state that conditionality should be used parsimoniously; in general, conditions should be applied only to measures critical to the success of the program, but they should also be applied to all such measures.**<sup>10</sup> As explained in the staff statement (¶6), “parsimony means that program-related conditions should be limited to the minimum necessary to achieve the goals of the Fund-supported program or to monitor its implementation ... .” The criticality criterion was a key innovation of the 2002 guidelines: the interim guidance note of 2000 permitted conditions to be placed on measures in the Fund’s core areas that were merely *macro-relevant*. The narrowing of this criterion from relevance to criticality was a major topic of discussion in the Executive Board’s review of conditionality during 2000–02.

14. **The criticality criterion applies to all measures—whether they are in the Fund’s core areas or outside, or whether they are or are not covered by another agency’s (e.g., the World Bank’s) conditionality.** Measures critical to the success of the Fund-supported program should be included as conditions because the Fund needs to be able to interrupt its own lending if a critical element of the program goes off track. Of course, the independence of Fund conditionality from Bank conditionality in no way reduces the importance of

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<sup>8</sup> Guidance quoted is drawn preferentially from the guidelines, and from the staff statement and the operational guidance in that order, reflecting the fact that the staff statement was effectively endorsed by the Board.

<sup>9</sup> For a general review of the importance of ownership for policy change, see Killick, T., R. Gunatilaka, and A. Marr, 1998, *Aid and the Political Economy of Policy Change* (London, UK: Routledge). Ivanova, A., W. Mayer, A. Mourmouras, and G. Anayiotos (2003), *What Determines the Implementation of IMF-Supported Programs?*, IMF Working Paper 03/8, find that program implementation depends primarily on borrowing countries’ domestic political economy, with little effect from the extent and structure of conditionality.

<sup>10</sup> Conditions can also be established to implement specific provisions of the Articles or policies adopted under them. All measures should be reasonably within the member’s direct or indirect control.

effective collaboration between the two institutions or of the “lead agency” concept: the Fund looks to the Bank’s analytical work in formulating any conditionality that may be required in those areas where the Bank is the lead agency. Recognizing that conditions that are critical to the success of Fund-supported programs are more likely to be in the Fund’s core areas than outside, the guidelines suggest that conditions outside these areas may require more detailed explanation of their critical importance.<sup>11</sup>

15. **Program goals are key to the guidelines’ definition of criticality.** Targeting conditions to relatively narrow goals leaves greater scope for the authorities to design related, but broader, goals and policies, thereby fostering overall ownership. The guidelines state that Fund-supported programs will target external stability, in both the short and medium term, and that external sustainability should be pursued while fostering sustainable growth. In addition, the policy on the PRGF makes poverty-reducing growth an explicit goal of PRGF arrangements. In GRA-supported programs, growth can of course be a key aid to sustainability; but measures that would be aimed solely at increasing growth but would have no impact on external sustainability, while laudable, should not be made conditions of GRA-supported programs.

16. **Although conditionality should not be *substituted* for national ownership, it need not be completely independent of it.** The staff statement explains that conditionality can promote and strengthen ownership, in particular by demonstrating the authorities’ commitment to a course of action—although conditions that are less than fully owned by the authorities should be the exception rather than the rule.<sup>12</sup> The guidelines themselves state that the member’s past performance in implementing conditionality shall be taken into account as one factor affecting conditionality. To be sure, there is a tension here with the principle of criticality; but in cases where the Fund has greater confidence in implementation, fewer conditions may suffice to secure adequate safeguards for Fund resources.

17. **The guidelines specify rules for the use of performance criteria and structural benchmarks that are intended to support the principles of parsimony and clarity.** Both structural performance criteria (PCs) and structural benchmarks (SBs) are monitoring tools for reforms that are critical to the success of the program. PCs are to be chosen when the measures to be monitored are objectively monitorable and are so critical that purchases or disbursements should be interrupted in case of nonobservance. SBs are more appropriate when judgment must be exercised in deciding if the measures have been taken, or where nonimplementation would not, by itself, warrant an interruption of purchases or disbursements. In the latter case, SBs serve as clear markers in the assessment of progress in

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<sup>11</sup> The statement in ¶7(b) of the guidelines that conditions will “normally” be within the Fund’s core areas should be interpreted in the context of the following sentence, which requires greater justification for conditions in noncore areas.

<sup>12</sup> See Drazen, Allan (2002), *Conditionality and Ownership in IMF Lending: A Political Economy Approach*, ” IMF Staff Papers, Vol. 49 (special issue), pp.36-67 on relations between conditionality and ownership.

the implementation of critical reforms. Like other conditions, SBs are to be used parsimoniously.

18. **Waivers for nonobservance of performance criteria may be granted for a number of reasons.**<sup>13</sup> Waivers may be granted if the deviation is minor, temporary, or corrective actions have been taken, as long as the Fund is satisfied that the program will be successfully implemented. While the waiver policy in the guidelines does not explicitly allow for cases where the Fund considers that a measure is no longer critical (whether because circumstances have changed or because it judges that it previously erred), these could be cases where the Fund remains satisfied that the program will be successfully implemented, and the deviation in such cases can be considered “minor” in its impact on program objectives.

19. **The guidelines allow critical upfront measures to be made prior actions, although these too should be used parsimoniously.** The operational guidance clarifies that prior actions may be used either when a measure needs to be implemented immediately in order to achieve program goals, or when there are significant doubts that the measure would be implemented later. In the latter case, the likelihood that the relevant measures will be implemented absent prior actions may be judged to be too low for the program to proceed: indeed, the authorities should be given the chance to demonstrate their commitment to these measures through early implementation. The operational guidance also reminds staff that implementing prior actions has not been shown to increase the likelihood that subsequent measures under the program will be successfully implemented, and notes that prior actions must be justified in terms of their criticality to program objectives; in other words, they must not be arbitrary “litmus tests,” introduced solely for the purpose of testing ownership.

20. **As emphasized in the staff statement, clarity is another major principle underlying the guidelines.** Indeed, as noted above, it is a basic principle of Fund arrangements that members should know the conditions under which they will have access to Fund resources. Program-related conditions must therefore be clearly specified and transparently distinguished from other measures in the authorities’ program. Similarly, the guidelines circumscribe the scope and lay out the expected frequency of reviews, under which the Fund assesses whether the program is broadly on track and whether modifications are necessary. Reviews inevitably entail an exercise of judgment by the Fund, thereby creating uncertainty for members as to the continued availability of Fund resources.

21. **Finally, the staff statement emphasizes that programs should be formulated through a mutually acceptable process led by the member.** It makes clear that, in response to a member’s request for use of Fund resources, the staff will ascertain how the authorities intend to adjust policies, and, particularly in cases where the member’s

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<sup>13</sup> In addition, the Fund may grant waivers of applicability in cases where the data necessary to monitor observance are not yet available. These are not considered further in this review, and the term “waiver” is henceforth to be read as “waiver for nonobservance.”

administrative capacity is weak, stand ready to advise the authorities on a range of available policy options. It is expected that program documents will be prepared by the authorities, with the cooperation and assistance of Fund staff, although the staff statement clarifies that there is no requirement to this effect. The operational guidance further emphasizes the importance of assessing potential implementation difficulties—including when implementation hinges on legislative approval, actions by lower levels of government, or cooperation by several ministries—as well as technical capacity. More generally, the guidelines state that the Fund will encourage members to seek to broaden and deepen the base of support for sound policies in order to enhance the likelihood of implementation.<sup>14</sup>

### III. REVIEW OF EXPERIENCE

22. **Since little time has elapsed since the introduction of the guidelines, any review of experience must be treated with caution.** The present chapter *describes* this experience. It does not attempt to ascertain whether changes are statistically significant, and indeed, given the small sample sizes (generally some 20 arrangements a year, divided roughly equally between GRA and PRGF), any attempts to establish significance would likely fail. To be sure, changes in the characteristics of members that seek Fund support or in their circumstances could influence some of the developments described below. But the hope was that the guidelines would make a visible difference, and this review seeks pointers as to whether this difference has yet materialized.

#### A. Parsimony and Criticality

##### *Coverage of conditions*

23. **Streamlining was expected to focus conditionality on areas critical to the goals of the Fund-supported program.** Substantial changes are evident in this area.

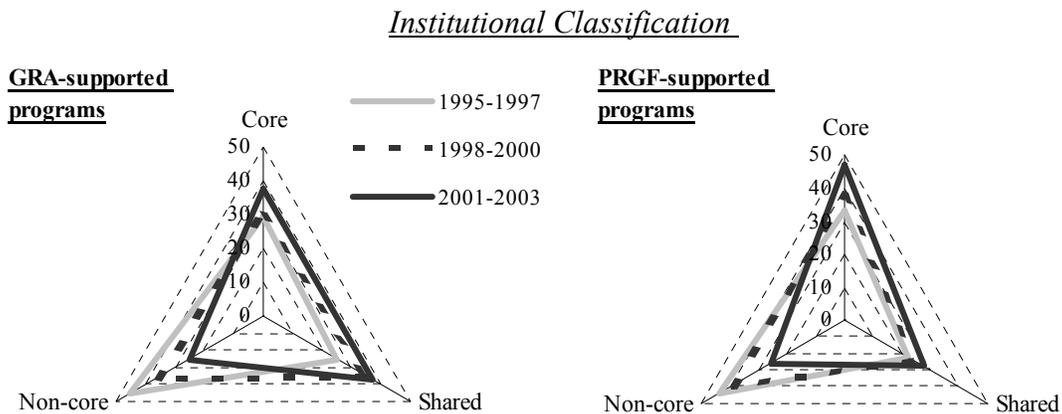
24. **Major shifts have occurred in the coverage of structural conditionality, suggesting a greater focus on criticality** (Figure 1). Consistent with the notion that conditions in noncore areas are less likely to be critical to the goals of Fund-supported programs, conditionality in both GRA- and PRGF-supported programs has shifted out of noncore areas, toward areas where the Fund shares expertise with the World Bank in the former case, and toward core areas in the latter case. Between 1995–97 and 2001–03, the share of structural conditions in noncore areas fell by 17–18 percentage points in both GRA-

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<sup>14</sup> This point involves complex elements of external communication and relations with civil society that are beyond the scope of the present review. The PRS approach is of course a prime example of a process aimed at broadening ownership, and has been examined in the annual PRSP implementation reports and the Independent Evaluation Office's evaluation of the PRGF/PRSP (7/6/04, <http://www.imf.org/External/NP/ieo/2004/prspgrgf/eng/index.htm>). For a discussion of external communication in support of Fund-supported programs, see *IMF Executive Board Discusses Integrating IMF Communications and Operations* (PIN No. 05/34, 3/18/05, <http://www.imf.org/external/np/sec/pn/2005/pn0534.htm>).

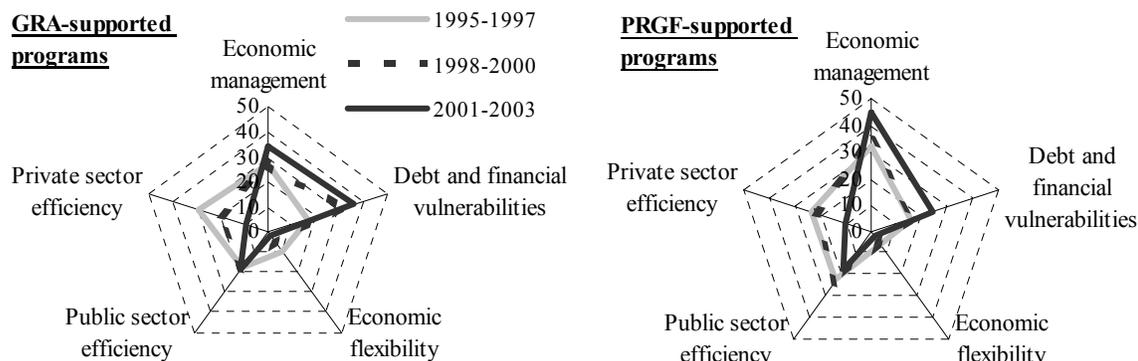
and PRGF-supported programs. Structural conditionality has also shifted out of measures related to economic flexibility and private sector efficiency, in arrangements under the GRA toward debt and financial vulnerabilities (which now account for almost 40 percent of all conditions), and in PRGF arrangements toward economic management (which now represents almost 45 percent of all conditions).<sup>15</sup>

Figure 1. Institutional and Economic Classification of Structural Conditionality  
(As a share of total structural conditionality per program year)



<sup>15</sup> The vulnerabilities category includes primarily financial sector reforms, with some public debt management; the economic management category comprises mainly reforms in the fiscal and monetary areas. For further discussion of the sectoral coverage of conditionality, see *Selected Issues*, Chapter III.

Economic Classification



25. **Conditionality is now also focused on fewer areas.** In both GRA- and PRGF-supported programs conditionality is now less scattered among fourteen different sectoral categories than it was pre-guidelines. Between 1998–2000 and 2001–03, in GRA-supported programs, the average coverage fell by about three quarters of a sector to a little under six sectors, and in PRGF-supported programs by almost two sectors to a little over six sectors. A similar trend is evident among supply-side categories. This greater focusing seems consistent with a greater emphasis on those few key areas where action is critical to the success of the program.

26. **In addition, greater focus is evidenced by a stronger relation of structural conditions to the economic situation at the start of the program in recent years.**<sup>16</sup> The number of conditions in economic management declines with stronger pre-program fiscal performance, and the number of conditions in private sector efficiency drops with stronger pre-program growth performance. These links have appeared or strengthened in the post-guidelines period.<sup>17</sup> Similarly, conditions aimed at addressing vulnerabilities are more numerous where initial external debt levels are high—a link that was not present in pre-guidelines programs and is consistent with a sharper focus on priorities, but which may also capture the growing understanding of the importance of such vulnerabilities.

**Numbers of conditions**

27. **The guidelines were also expected, broadly speaking, to lead to reduced numbers of structural conditions.** Of course, the number of conditions is a crude metric. First, it weights equally conditions of quite different import. Moreover, a focus on numbers takes no account of the possible *tension between* parsimony and criticality (when problems are complex and require a multi-pronged approach), nor of that between parsimony and clarity

<sup>16</sup> *Selected Issues*, Chapter III.

<sup>17</sup> Of course, the link of growth-related conditionality to (possibly temporarily) higher growth is not without dangers, see Section IV.B.

(most noticeable when vaguely specified program review clauses are replaced by a number of precisely defined conditions). Indeed, in the 2000–02 conditionality review, Directors stressed that the number of conditions is only one, imperfect, indicator of the extent of progress with streamlining.

28. **Overall, numbers of conditions in Fund-supported programs have been broadly stable since the introduction of the guidelines** (Figure 2).<sup>18</sup> This development, however, masks differences between PRGF- and GRA-supported programs.

29. **In PRGF-supported programs, the number of structural conditions is on the decline.** From 17–18 in the late 1990s, the average number of structural conditions per program year has fallen to 13–14 (Figure 2). The reduction in the number of prior actions has been especially marked, but numbers of structural benchmarks are also down somewhat from the late 1990s (Figure 3).<sup>19</sup> An examination of the scope of individual structural conditions in the PRGF cases with the largest numerical declines suggests that the decline in conditions is genuine, and not the result of a broadening of the scope of conditions.<sup>20</sup>

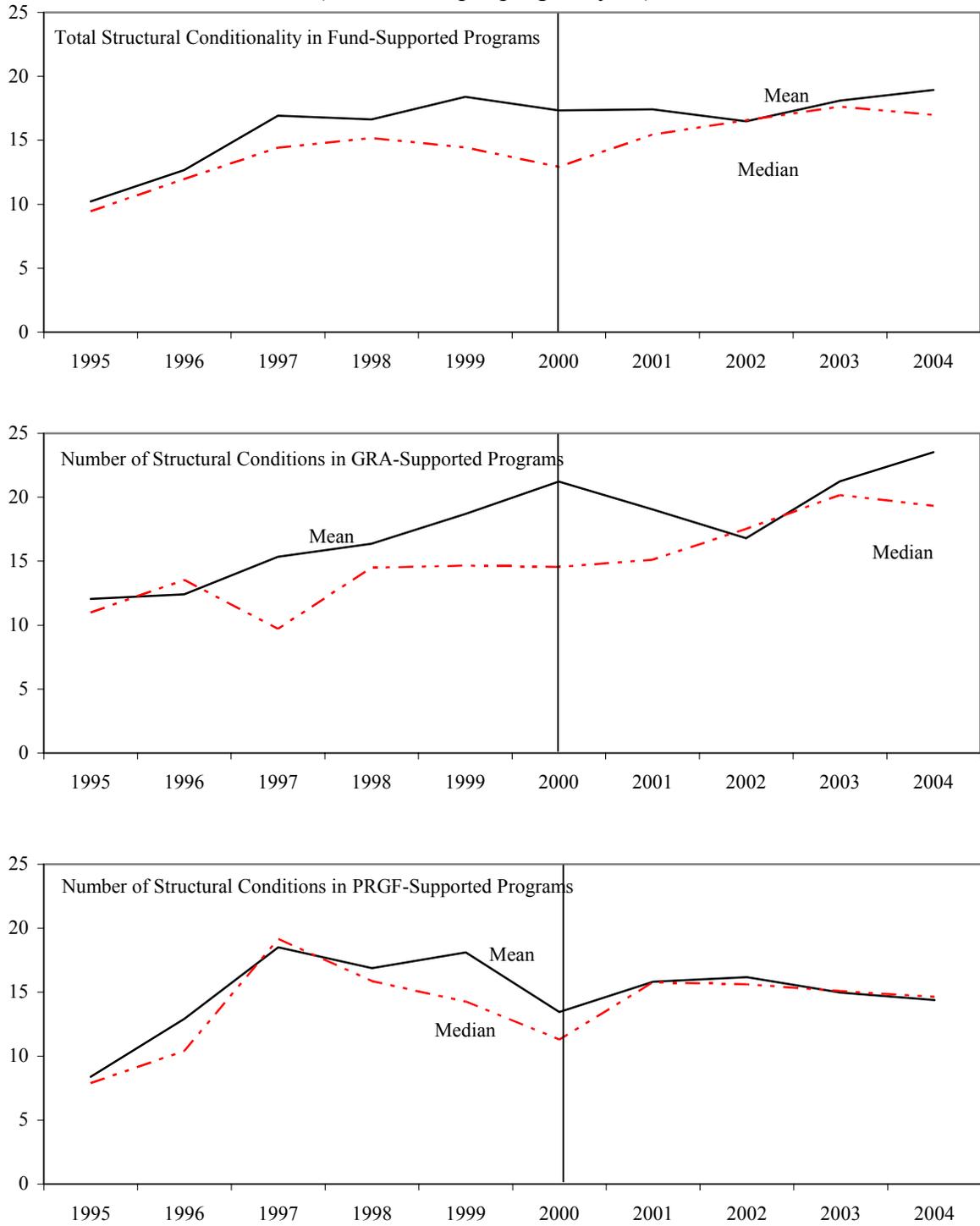
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<sup>18</sup> Numbers of conditions are normalized using the length of the arrangement, including any extensions, except for permanently interrupted and ongoing programs, which assume an end-date equal to the last completed review (or the approval date if no review was completed) plus nine months. The number of conditions per year is reported against the year in which the arrangement was approved, even though the arrangement may stretch into later years. Averaging is done across arrangements *approved* in a given year, which gives equal weight to short and long arrangements. (If averaging were done across arrangements *outstanding*, PRGF arrangements would have a higher weight in the Fundwide averages, and Fundwide numbers of conditions would likely show a small post-guidelines decline.)

<sup>19</sup> Numbers of prior actions are subject to measurement error in view of the policy change in 2000, whereby prior actions became subject to the misreporting policy and thus had to be accurately listed in texts of arrangements. However, any resulting bias is likely to take the form of more consistent recording of prior actions in the more recent period, and thus the observed decline may even be underestimated.

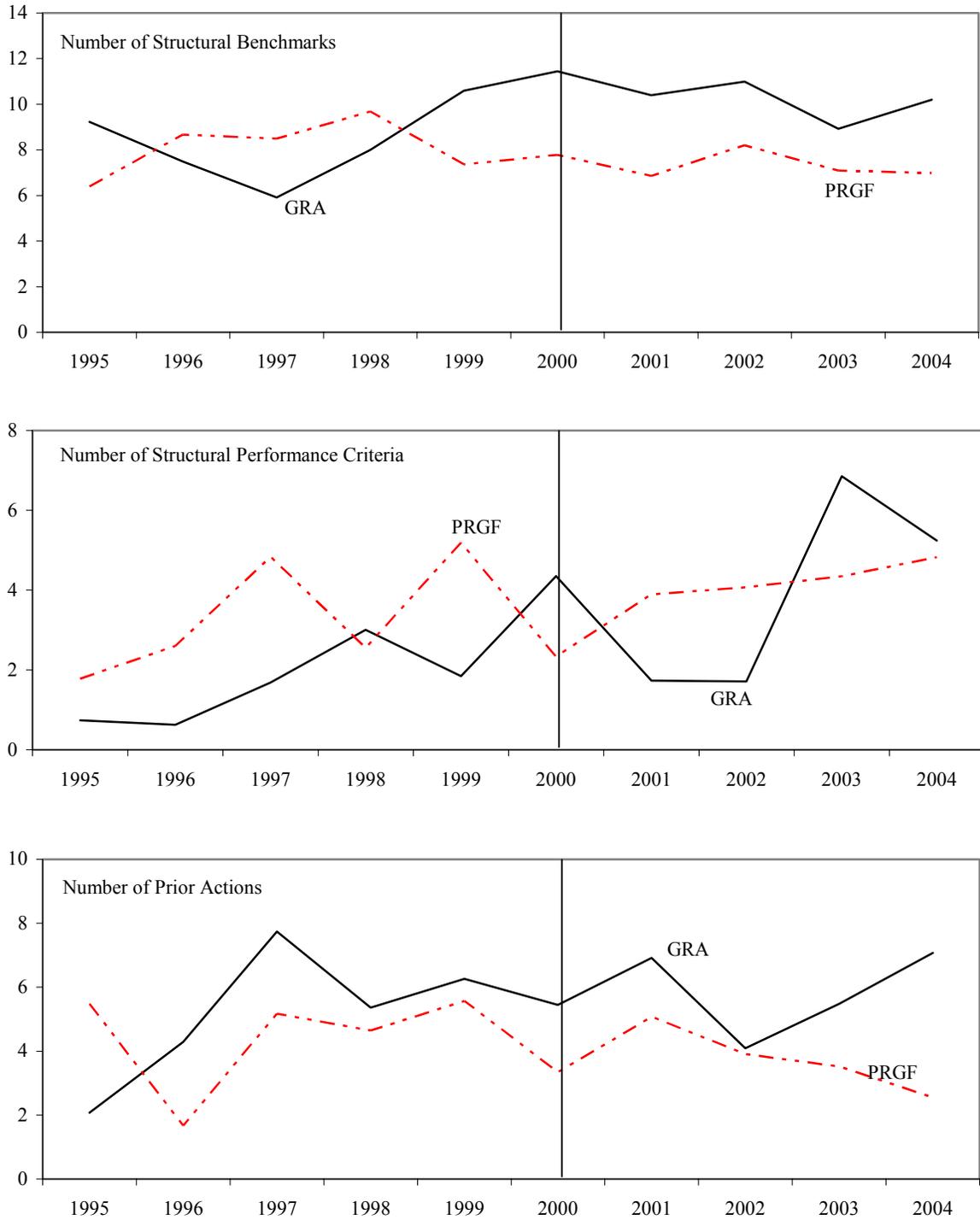
<sup>20</sup> The cases examined were Azerbaijan, Guinea, Mauritania, Mongolia, and Tajikistan. An example of a condition judged to be broadly based would be the approval by Parliament of a privatization program, including the list of large-scale enterprises to be privatized; an example of a condition judged to be narrowly based would be the completion of a study of foreign exchange auctions. Conditions were judged to be comparable in their scope in the pre- and post-guidelines periods, except in Guinea where conditions were more narrowly based in the later period.

Figure 2. Structural Conditions in Fund-Supported Programs  
(Normalized per program year)



Source: MONA database and staff estimates (for 2004).

Figure 3. Types of Structural Conditions in Fund-Supported Programs  
(Averages normalized per program year)



Source: MONA database and staff estimates (for 2004).

30. **In GRA-supported programs, the number of structural conditions has shown no decline, and has even recently increased.** In 2001–02, the average number of conditions a year stayed around its late 1990s level of some 16–20 conditions a year, but in 2003–04 this number rose to 21–23. Sample sizes, however, are small—about ten arrangements a year, and only six in 2004—and subject to large compositional changes. In more homogeneous subgroups of GRA-supported programs, a small decline in numbers of conditions is evident among the same members pre- and post-guidelines, but a rise in arrangements that were treated as precautionary on approval (Figure 4). One factor that is driving up the number of conditions in GRA-supported programs is the disappearance, in line with the guidelines, of vaguely-specified program review clauses in favor of specific conditions (see Section III.B): abstracting from programs in which structural measures were monitored entirely through review clauses, the average number of conditions in 1995–98 would have been some two conditions higher. The number of prior actions and structural benchmarks in GRA-supported programs has been variable but broadly flat, and the number of structural PCs was sharply higher in 2003–04 than in previous years.<sup>21</sup>

31. **The growing understanding of the importance of vulnerabilities—especially in the financial sector—has clearly played a large role in conditionality in GRA-supported programs.**<sup>22</sup> Between 1998–2000 and 2001–03, conditions in the area of debt and financial sector vulnerabilities increased by one and a half conditions a year per program, even as the average number of conditions across programs remained unchanged. The increase in vulnerability-related conditionality has been across the board, affecting programs with both relatively high and relatively low emphasis on vulnerability. Moreover, programs with above-average vulnerability-related conditionality were also the sole source of increase in the number of conditions *outside* the vulnerability category, and most of this increase was related to economic management, much of it serving most likely to help rein in public debt.

32. **Also striking is the influence of weak track records on the number of conditions in GRA-supported programs.**<sup>23</sup> GRA-supported programs with members with relatively weak track records have recently shown a tendency to higher numbers of conditions (Figure 5). Such members have also recently become more prominently represented among

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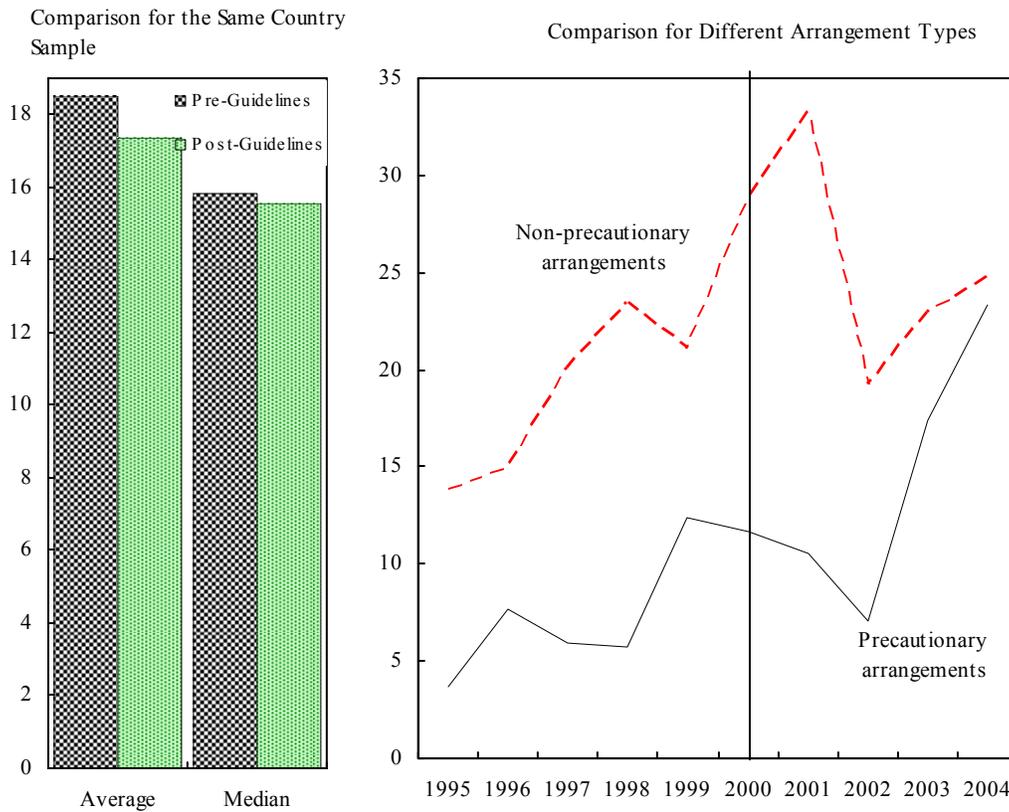
<sup>21</sup> Programs in capital account crisis cases have had higher-than-average numbers of conditions, without a systematic link to the level of access and without particular reliance on prior actions, see *Selected Issues*, Chapter VI.

<sup>22</sup> *Selected Issues*, Chapter III.

<sup>23</sup> Track records are characterized by reference to an implementation index for structural conditionality calculated by assigning a value 0 to conditions that were not met at all, 2 to conditions that were met on time, and 1 to conditions that were met with delay, partially, or in another form than originally stipulated. A member is identified as having a relatively weak track record if its implementation index in its previous Fund-supported programs was below 1.42, the median implementation index of all Fund-supported programs over the last decade.

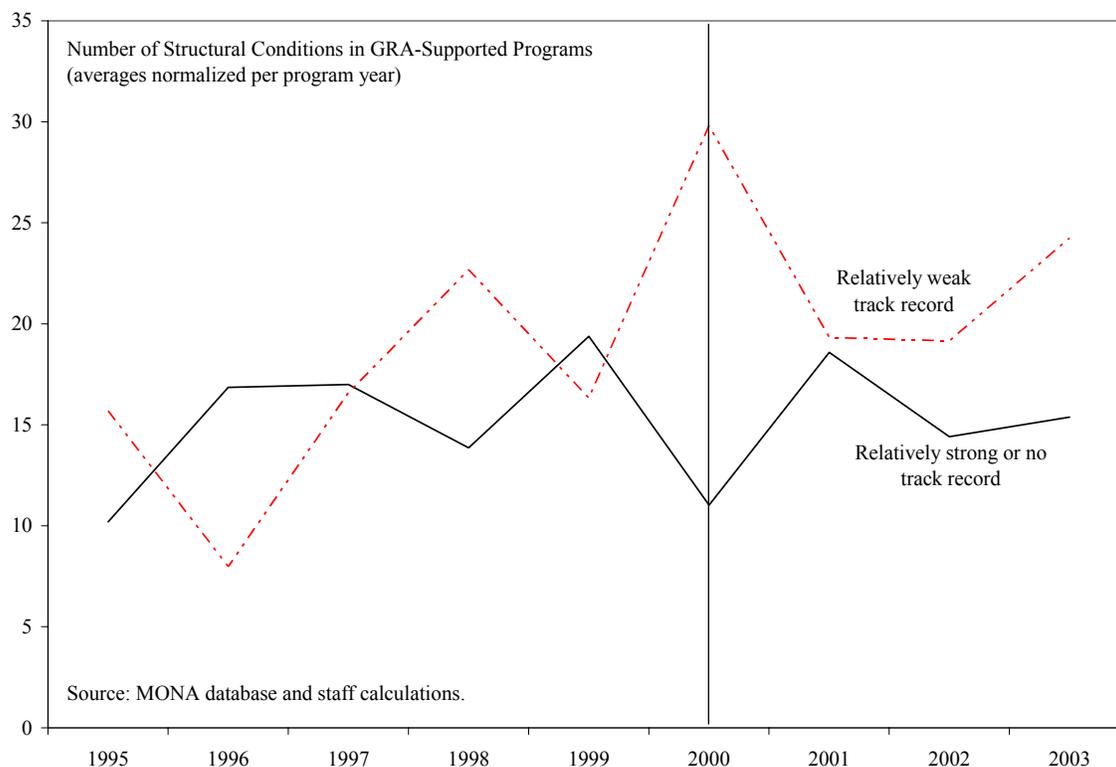
members using GRA resources, with their share more than doubling from 25–30 percent in 2001–02 to almost 65 percent in 2003-04.

Figure 4. Total Structural Conditionality in GRA-Supported Arrangements (Normalized per program year)



Source: MONA database and staff estimates.

Figure 5. Number of Structural Conditions in GRA-Supported Arrangements with Members with Relatively Weak Track Records



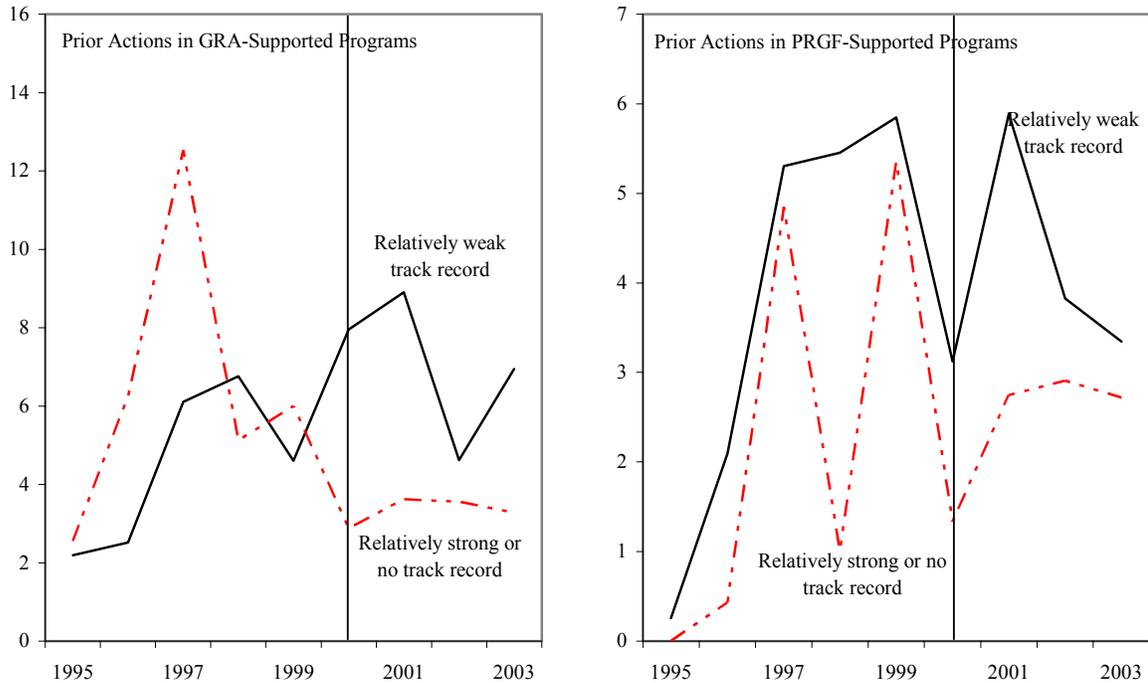
33. **In both GRA- and PRGF-supported programs, prior actions are used as a screening device.** Prior actions have continued to be used more in countries with relatively weak track records (Figure 6)—a link that is corroborated by empirical analysis.<sup>24</sup>

#### *Relations between Fund and World Bank conditionality*

34. **“Aggregate” Fund-Bank conditionality appears to be on the decline** (Figure 7, panel 1). As noted in Section II, developments in “aggregate” conditionality do not speak to whether the Fund is implementing properly its own guidelines, but aggregate conditionality is important to borrowers and to aid donors. In a set of 30 members with overlapping Fund arrangements and Bank policy-based operations both pre- and post-guidelines, “aggregate” conditionality from these two kinds of operations has declined—in GRA cases, because Bank conditions have become fewer, and in PRGF cases, on account of reductions in numbers of conditions at both institutions.<sup>25</sup>

<sup>24</sup> *Selected Issues*, Chapter V.

Figure 6. Prior Actions in Countries with Relatively Weak Track Records  
(Averages normalized per program year)



Source: MONA database and staff calculations.

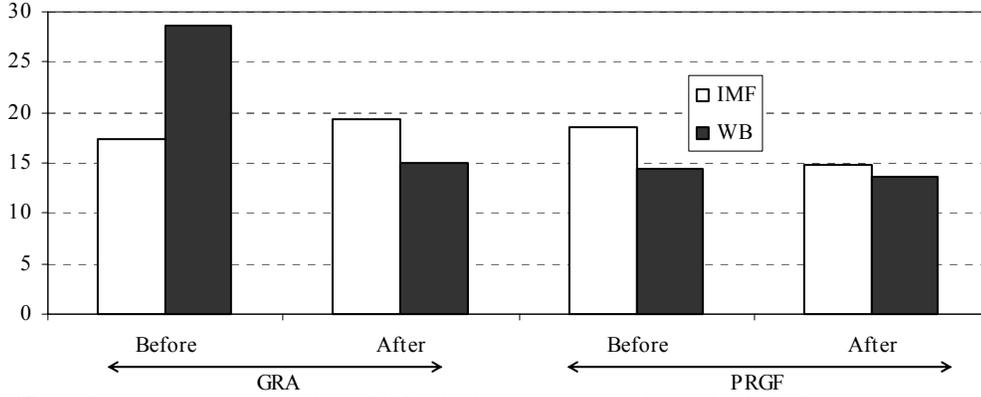
35. **Consistent with the guidelines, and unlike in the past, the Fund now shows little tendency to make its conditionality depend on the Bank's** (Figure 7, panel 2). In the late 1990s, the Fund tended to set more conditions in the Bank's core areas when the Bank did not have a concurrent operation—seemingly “taking over” relevant, but not critical, conditions when the Bank was not present. This tendency has almost disappeared in the post-guidelines period, consistent with a focus by the Fund on measures critical to the success of the program it supports.<sup>26</sup>

<sup>25</sup> Bank conditions in this analysis do not include conditions associated with investment lending or technical assistance loans, because the relevant data are not available.

<sup>26</sup> Of course, there are still cases of overlapping conditionality, where reforms are critical to the programs supported by both institutions. Whether conditions are appropriately harmonized in these cases is beyond the scope of this review.

Figure 7. Bank and Fund Structural Conditionality

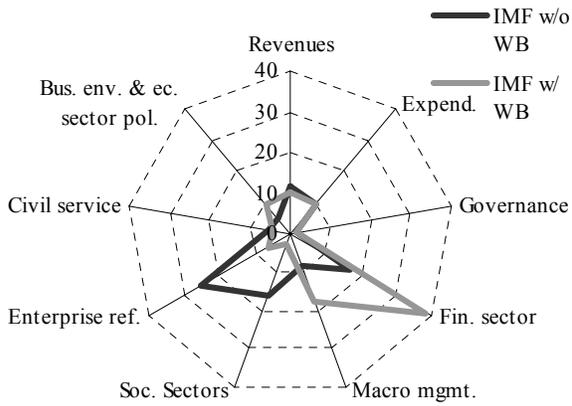
*Panel 1: Has "Aggregate" Bank-Fund Conditionality Decreased?  
(Number of conditions normalized per program year) 1/*



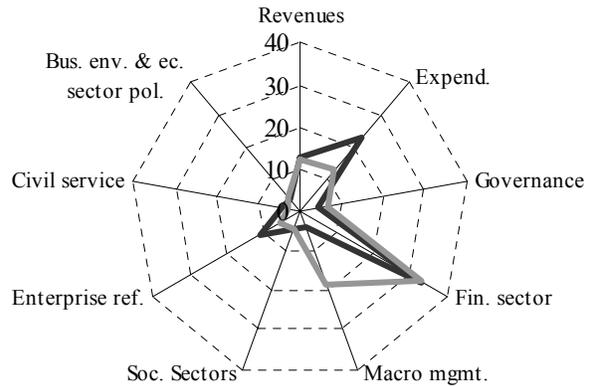
1/ "Before" refers to programs until late 2000; all other programs are classified as "after" programs.

*Panel 2: Does the Distribution of Fund Conditionality Depend on the Presence or Absence of a Bank-Supported Program? (Sector classification of conditionality in percent of total Fund conditionality)*

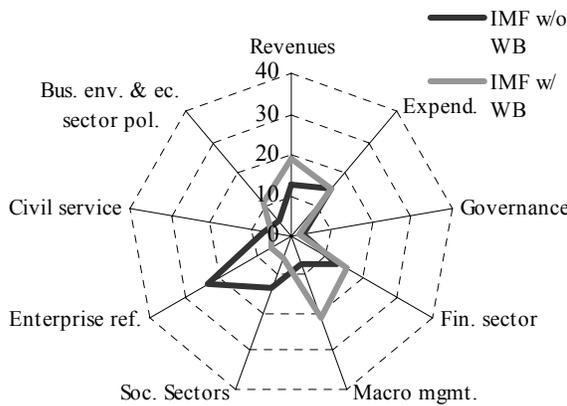
GRA-supported programs; 1995-2000



GRA-supported programs; 2001-2003



PRGF-supported programs; 1995-2000



PRGF-supported programs; 2001-2003

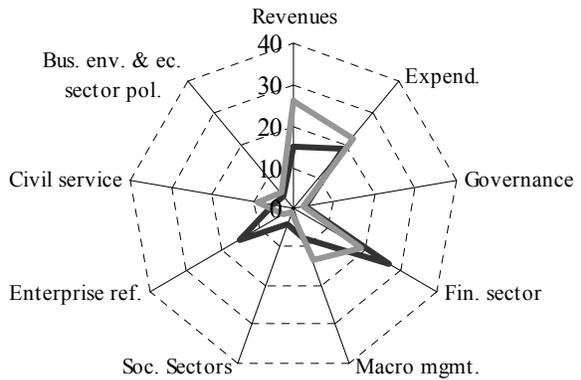
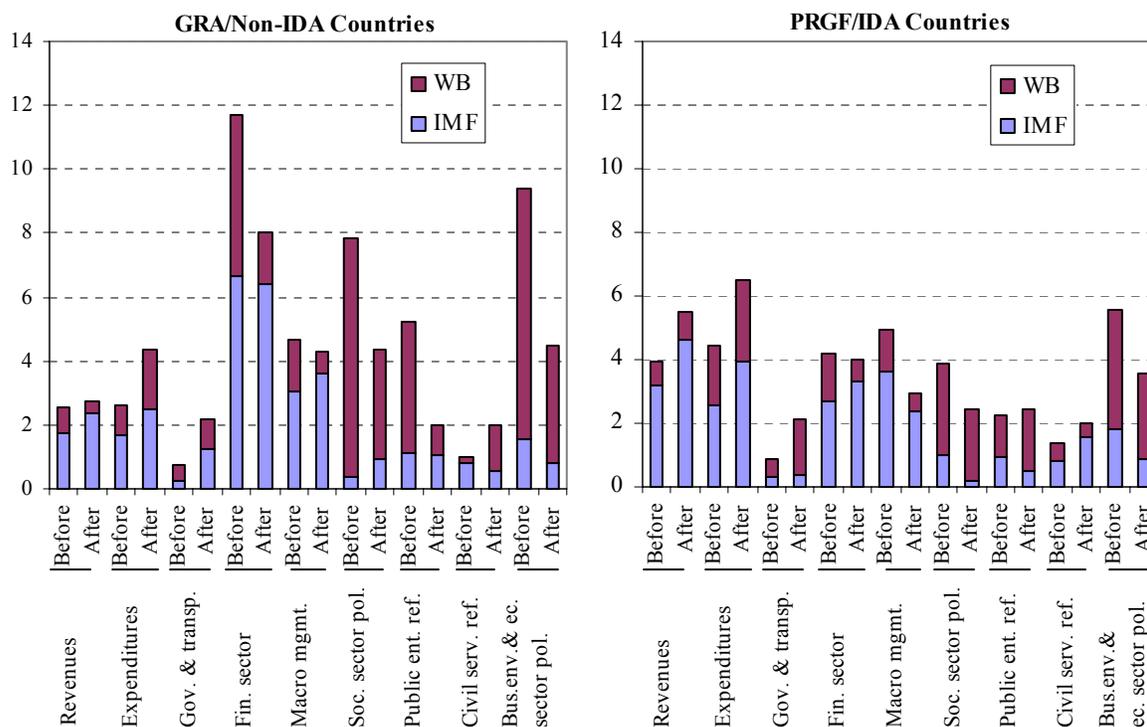


Figure 7. Bank and Fund Structural Conditionality (continued)

*Panel 3: Are there “Gaps” in Bank-Fund Conditionality?  
(Number of conditions normalized per program year)*



36. **As the Fund has focused its conditionality, the Bank does not seem to have increased its conditionality in the areas from which the Fund has withdrawn** (Figure 7, panel 3). Social sectors, public enterprise reforms, and business environment—sectors with reduced Fund conditionality—have not generally been areas of increased Bank conditionality, and indeed, for members using Fund resources under the GRA, these have been areas where the Bank has also reduced its conditions. This result should, however, be interpreted with caution given the sample size (12 GRA- and 18 PRGF-supported programs). Moreover, these comparisons do not take into account the many other means through which Fund and Bank support members’ reform efforts, including through technical assistance and the policy dialogue more generally.

*A look at individual conditions and justifications*

37. **At the most disaggregated level, two questions can be asked of the formulation of conditions.** First, to what extent are conditions applied to *reforms* that are not likely to have a critical impact on program goals? And second, are conditions specified at a *level of detail* that may be perceived as micromanagement (whether their link to a critical reform area is clear or not)?

38. **A review of arrangements approved in 2001–03 suggests that relatively few conditions are now set in what seem, *a priori*, “odd” areas—although there still exist conditions (typically structural benchmarks) whose criticality is neither obvious nor convincingly explained.** Examples of conditions whose impact on program goals appears minor and for which the staff report does not provide a clear explanation of criticality (although the problem to be addressed by the measure is typically discussed) include: formulating an action plan to establish a Constitutional Council (Cameroon, SB, 2002), reducing employment in the education sector by 5 percent (Tajikistan, SB, 2004), or announcing criteria to increase borrowing limits for state and local governments that propose qualifying revenue-yielding projects of a self-sustaining nature in water and sanitation, with a view to modernizing the sector (Brazil, SB, 2003). Cases also exist where a condition is set on preparation of a measure, but no follow-up on effectiveness of the measure was found, raising questions why the initial step was considered critical and the subsequent ones were not—for instance, submission to Parliament of a tobacco law and a lottery law (Serbia and Montenegro, SB, 2002).<sup>27</sup>

39. **At the same time, tension remains between clear specification of conditions and micromanagement.** It remains relatively easy to find examples of conditions that are specified in considerable detail. Examples include providing resources in the budget to increase the number of auditors by 400 (Turkey, SB, 2002), sending letters of redundancy to 340 health sector employees (Macedonia, SB, 2003), and issuing guidelines requiring double signatures in operating school bank accounts, including of a member of the community-based school management committee (Sierra Leone, PC, 2004).<sup>28</sup> Further examples can be found in the many conditions relating to the introduction or upgrading of ASYCUDA (Automated System for Customs Data) software, often only in certain offices (Albania, Armenia, Bosnia, Gambia, Madagascar, Uganda). An example of highly detailed specification of conditions in the financial sector—the source of many conditions in GRA-supported programs—is given in *Selected Issues*, Box 2 (Brazil, 2002). Section IV.A will return to the level of detail at which conditions are set.

40. **The rationale for structural conditionality is generally explained in staff reports, although room for improvement remains.** About three quarters of staff reports for new arrangements include a separate box with explicit rationales for conditions in specific areas, the status of structural conditionality from earlier arrangements, and the areas of reform

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<sup>27</sup> Of the conditions cited in this paragraph, only one raised any concerns among Executive Directors at the Board meeting on the occasion when it was introduced into the program: one Director questioned whether the benchmark on reducing employment in the education sector in Tajikistan was necessary, while another thought that this condition was useful in providing a clear focus for the authorities.

<sup>28</sup> Directors did not comment on the level of detail of these conditions at the Board meeting on the occasion when they were introduced into the program, although the benchmark on health sector employment in Macedonia elicited comments from two Directors to the effect that retrenching staff was only a cure for a symptom and that the health sector problem had to be addressed more fundamentally.

covered in World Bank operations.<sup>29</sup> These boxes are particularly helpful in providing explanations of the criticality of conditions in noncore areas, as required under the guidelines. Most of the remaining staff reports address these issues elsewhere, but boxes seem especially useful as a presentational device to ensure that the relevant questions are dealt with prominently and in an integrated manner.

## B. Clarity

41. **Major progress has been made in clarity on program-related conditions since the introduction of the new guidelines.** All quantitative and structural conditions are now almost always included in a separate table in the letter of intent or staff report, as suggested in the operational guidance note (¶19). Moreover, letters of intent now almost never feature detailed policy matrices covering the authorities' broader agenda—a practice discouraged in the guidelines (¶10).

42. **Recent practice has also largely conformed to the guidelines' stipulations on the scope and frequency of program reviews:**

- The backward-looking component of reviews is generally slated to consider the implementation of explicit program-related conditions; only rarely is the scope of a review defined to include ill-specified “progress in [a given sector].”
- As allowed for in the guidelines, flexibility to introduce new conditions appears to be used primarily to respond to changes in circumstances—if the latter are understood to include situations in which it is determined, during the course of the program, that the program's intermediate objectives are unlikely to be met unless specific actions or conditions are formulated (e.g., revenue targets without tax policy changes, or state-owned enterprise reform without specific plans and conditions). The introduction of entirely new conditionality during the course of the program, without reference to changed circumstances, is rare.<sup>30</sup>
- The scheduled frequency of reviews in PRGF arrangements is semiannual, with few exceptions. Countries experiencing or emerging from capital account crises, understandably given their rapidly changing situations, mostly have scheduled quarterly reviews. For other countries, average review frequency has varied widely, with no tendency to decline since the guidelines went into effect. In 2003–04 arrangements for noncrisis cases typically had semiannual reviews, the exceptions

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<sup>29</sup> These boxes were introduced in mid-2001—see *Streamlining Structural Conditionality—Review of Initial Experience* (<http://www.imf.org/external/np/pdr/cond/2001/eng/collab/071001.pdf>).

<sup>30</sup> *Selected Issues*, Box 5.

being Ecuador, Gabon, Paraguay, and Romania, which had quarterly reviews (and all of which also had above-average numbers of structural conditions and PCs).

### C. Process

43. **Broadly consistent with the findings of an earlier survey of country authorities and staff, case studies of ten recent Fund-supported programs suggest that the staff has made serious efforts to follow good processes—although this does not mean there is no room for improvement.** The case studies—of Brazil, Bulgaria, Burkina Faso, Ecuador, Guinea, Guyana, Georgia, Romania, Sri Lanka, and Tanzania—are presented in *Selected Issues*, Chapter VII. In all cases, the staff has attempted to incorporate almost all key ingredients of an effective process suggested in the guidelines and their supporting documents. This generally positive assessment is consistent with the results of a survey carried out as part of the recent review of IMF-World Bank collaboration.<sup>31</sup> Majorities of both country authorities and staff in these surveys gave broadly positive assessments of country ownership and of the Fund's flexibility in program design, although the staff was generally more positive than the authorities (with positive responses of the order of 90 percent, compared with 65-75 percent on the authorities' part) (Figure 8). While some perception gap may be inevitable, the results of the staff's efforts clearly still leave room for improvement in the authorities' eyes. Section IV.D will return to the question of further scope for improvement in process.

### D. Program Implementation

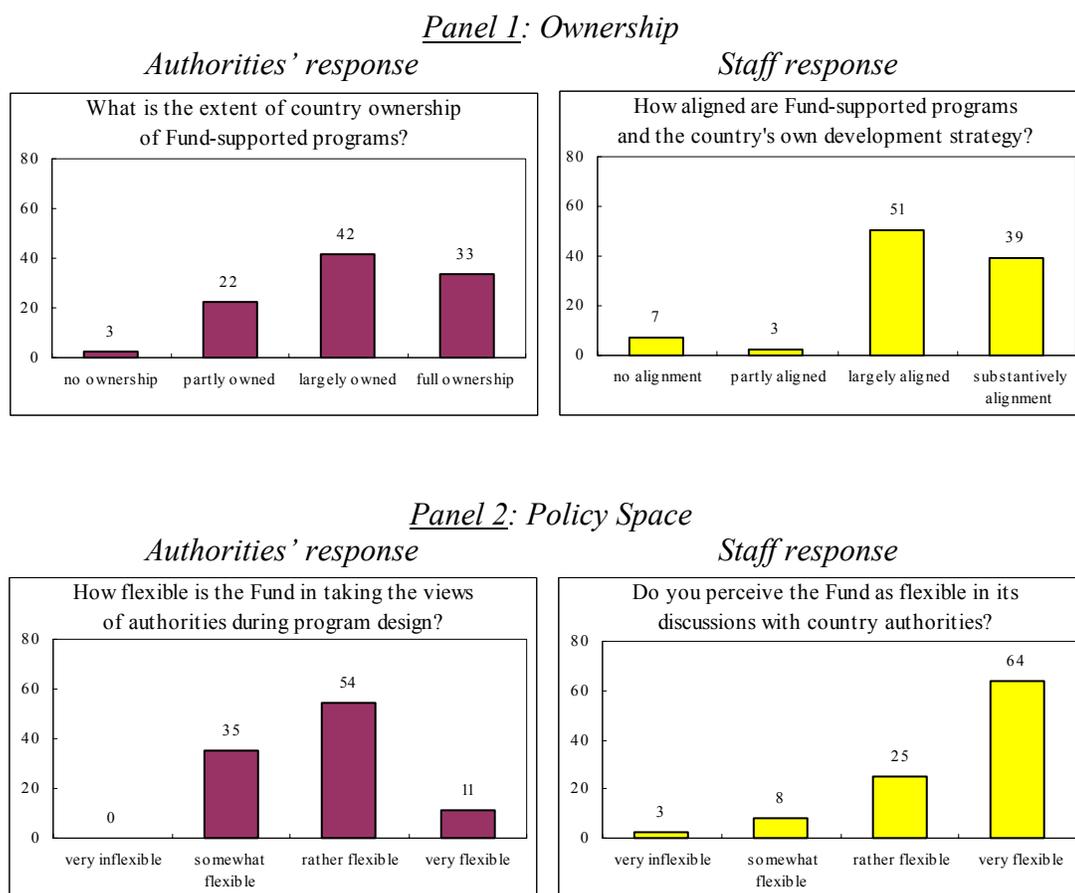
44. **Of course, the ultimate objective of the new guidelines was to help improve economic outcomes—but their effectiveness in this regard cannot yet be determined.** Because Fund resources are provided to members to permit a sustainable adjustment without destruction of prosperity and must be repaid, outcomes cannot be judged only relative to immediate program targets, but need to encompass issues of medium-term sustainability and growth. The question of program outcomes must therefore be left to a subsequent review.

45. **By contrast, program implementation can be observed, and it too was expected to improve.** First, with the emphasis on ownership and implementation capacity, policy programs were expected to be implemented more consistently. Moreover, with conditions limited to measures critical to the success of the program, it was expected to become a less frequent occurrence that programs would be judged to remain on track even as conditions were not met. Observed program implementation—the degree to which programs remain on track, and waiver rates—was expected to improve on both counts.

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<sup>31</sup> The results of this survey should be interpreted with caution, as there were only 38 respondents (a 40 percent response rate) among authorities. Moreover, the survey referred to Fund-supported programs approved during mid-2001-mid-2003.

Figure 8. Ownership and Policy Space  
(As a percent of total responses)

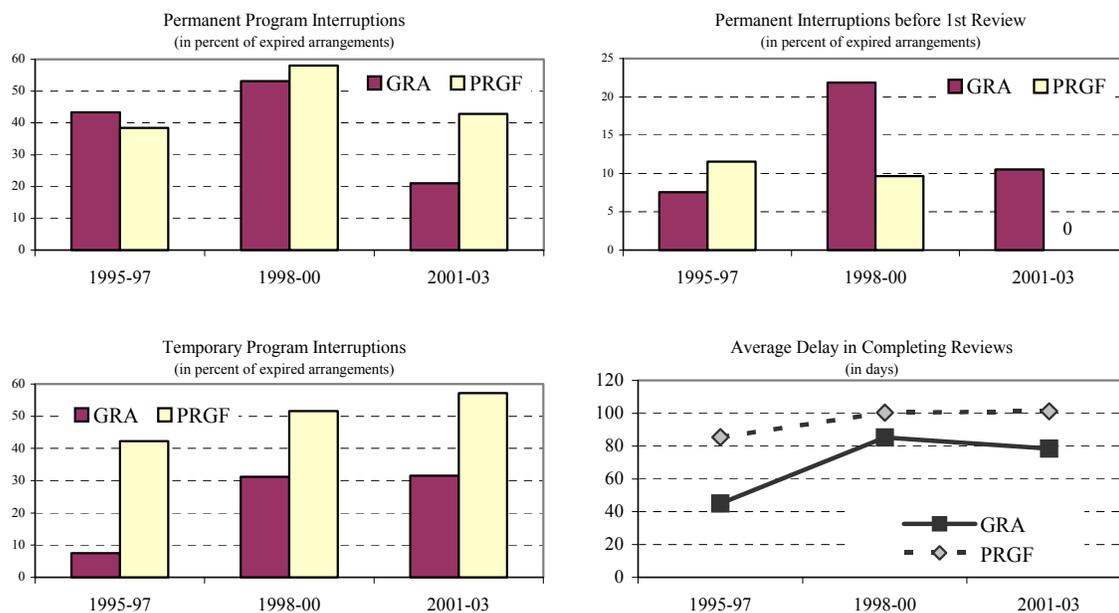


Source: Surveys conducted for the review of Bank-Fund collaboration, September 2003.

46. **In line with expectations, a substantial decline occurred in programs with permanent interruptions** (Figure 9, top panel). Cases in which programs went off track and were not brought back on track prior to expiration have declined significantly among GRA-supported programs. An improvement is also visible among PRGF arrangements, at least relative to 1998–2000, although the recent sample includes only seven expired arrangements. The share of programs that went irretrievably off track even before the first review has also declined, although for GRA-supported programs not below the level of 1995–97. The decline in permanent program interruptions suggests that Fund resources provided early in the arrangement are placed at less risk and, more generally, that members' adjustment efforts have been sustained.

47. **Developments in program interruptions and review delays have not been as positive** (Figure 9, bottom panel). The frequency of interruptions of at least six months has been stable or rising, and review delays remain broadly at their late 1990s levels of 80–100 days.

Figure 9. Permanent and Temporary Interruptions and Delays, 1995–2003

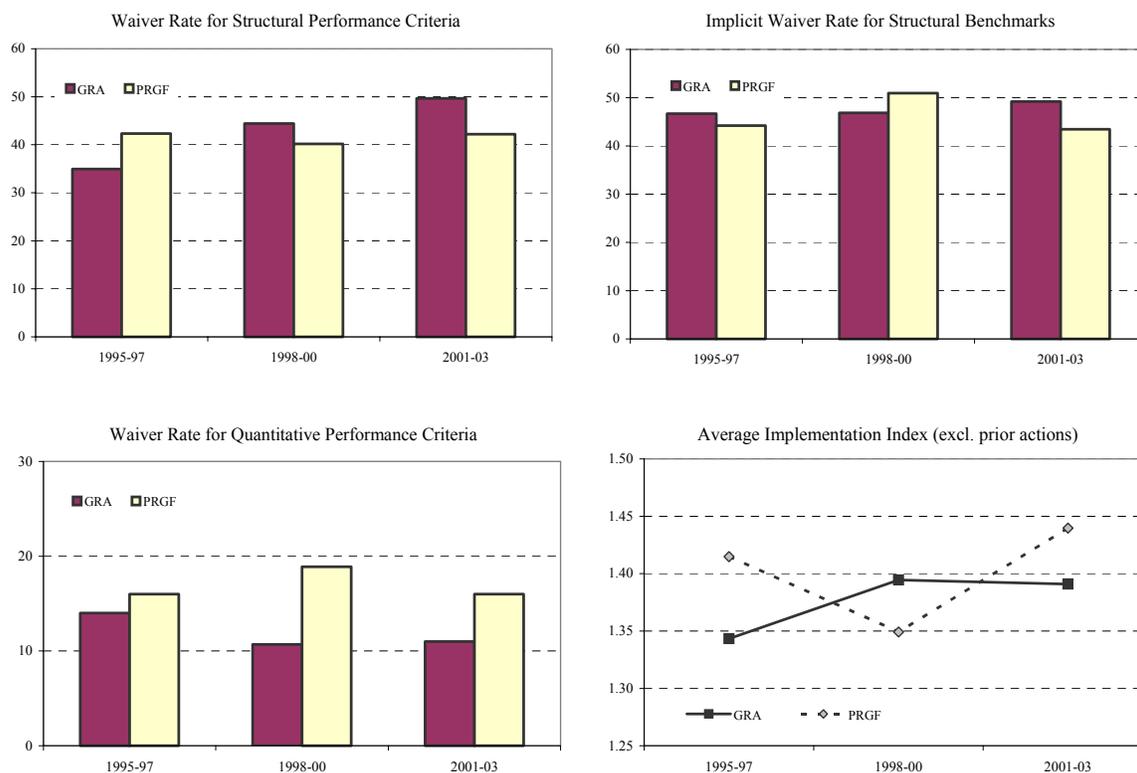


48. **The implementation of conditionality has shown a minor improvement in PRGF arrangements, but no improvement in GRA-supported programs** (Figure 10). In the latter, waivers for structural PCs and (implicitly) structural benchmarks have actually risen, and the overall measured implementation of structural conditionality in on-track programs has been stable.<sup>32</sup> In PRGF-supported programs, the trend in implementation has been somewhat better, with overall implementation rising (though from a low in the immediate pre-guidelines period), mostly on account of improved observance of SBs.<sup>33</sup> In PRGF arrangements too the waiver rate for structural PCs has failed to decline as had been expected. Waiver rates for quantitative PCs (at 10–20 percent) remain much lower than those for structural PCs (at 40–50 percent), and show little evidence of a trend in either GRA- or PRGF-supported programs.

<sup>32</sup> An “implicit waiver rate” can be calculated for structural benchmarks that—like PCs that need to be waived—were not met on time. The implementation index is calculated as described in footnote 23.

<sup>33</sup> The implementation index for PRGF arrangements is likely to be slightly biased downward in the most recent period, as there is still time in many of these arrangements for delayed implementation of missed measures.

Figure 10. Implementation of Conditionality, 1995–2003

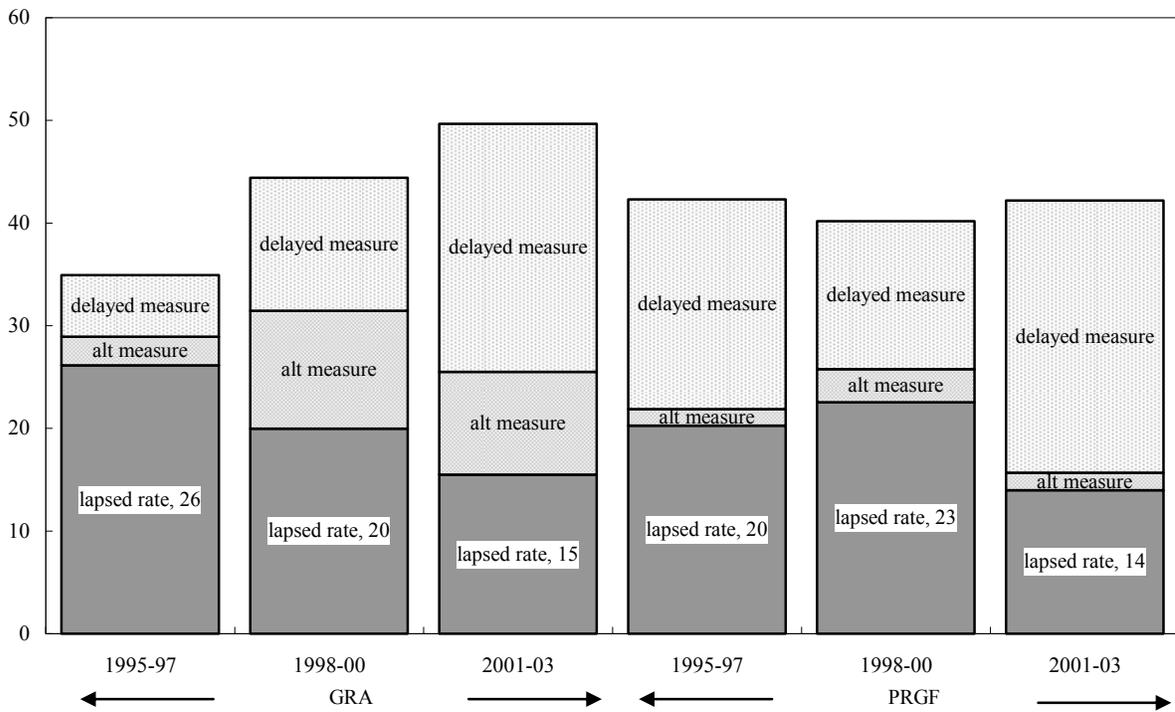


49. **Expectations had been that waivers for structural conditions would become less common.** In the 2000–02 conditionality review, Directors expressed concern over the high and rising incidence of waivers, and “believed that waivers should become less frequent as conditionality is focused on measures that are critical to program objectives, and ownership is strengthened.”<sup>34</sup> They were concerned not only that “waivers [were] often an indication of poor program implementation and/or a lack of realism in program design,” but also that the Fund needed “to adhere more closely to the existing policy that, in cases of significant policy slippages, waivers should be granted only if appropriate corrective action has been taken to achieve the objectives of the program.” Recent developments raise the question whether these concerns remain valid.

<sup>34</sup> *IMF Board Discusses Modalities of Conditionality* (PIN No. 02/26, 3/8/02, <http://www.imf.org/external/np/sec/pn/2002/pn0226.htm>).

50. **Despite the high or rising waiver rate, the Fund does not appear to be taking PCs less seriously than in the past; in fact, there is evidence of the opposite, as the share of conditions that are implemented has risen.** The incidence of waivers granted for conditions that never get implemented, even as the arrangement continues—and that can thus be identified in hindsight as conditions the arrangement could have done without—is relatively low (Figure 11). Moreover, this incidence (termed the “lapsed rate”) appears to have declined in both GRA- and PRGF-supported programs, with a somewhat greater decline in the latter.<sup>35</sup>

Figure 11. Composition of Structural PC Waiver Rates: Delayed Measures, Alternative Measures, and Lapsed Rates in Fund-Supported Programs (In percent of all structural PCs)



<sup>35</sup> The lapsed rate shown in Figure 11 includes programs that later experienced permanent interruptions (perhaps on account of PCs that were waived and later still failed to be observed) and, in the more recent period, programs that may yet experience a permanent interruption. The “true” lapsed rate—i.e., the incidence of PCs the program could have done without—would exclude both these categories. The true lapsed rate in GRA-supported programs has declined in the post-guidelines period, going from 31 percent in 1995–97 to 22 percent in 1998–2000 and 17 percent in 2001–03. The true lapsed rate in PRGF-supported programs cannot yet be calculated for the post-guidelines period, since very few post-guidelines PRGF arrangements have yet expired. But the true lapsed rate in PRGF arrangements has probably declined alongside, or even more than, the unadjusted lapsed rate, since the inclusion of ongoing programs in the post-guidelines period imparts an upward bias to the lapsed rate. For further discussion, see *Selected Issues*, Chapter I.

51. **Many measures subject to structural PCs that are waived are implemented with a delay, often and increasingly as prior actions for the granting of the required waivers.** As shown in Figure 11, delays in implementation are both the most important and the fastest growing reason for the high waiver rate, and rough estimates suggest that most of this growth may be accounted for by missed conditions that become prior actions for waivers (see *Selected Issues*, Chapter I). Alternative (or slimmed down) actions account for a smaller share of waivers.

52. **All in all, the picture that emerges suggests a focus on criticality in formulating structural conditionality and monitoring its implementation, but also persistence of difficulties in formulating the precise timing and modalities of measures.** Consistent with the guidelines' emphasis on criticality, the Fund seems to be making serious efforts to formulate as program-related conditions only measures on which it is willing to insist, and this insistence may be contributing to the absence of a decline in program interruptions and review delays. At the same time, many structural conditions are still waived when the actions are taken on a different timeframe or with different modalities. Difficulties in precise formulation of conditions may be especially important in noncore areas, where implementation is weakest.<sup>36</sup>

#### IV. ASSESSMENT

53. **Thus, insofar as conclusions can be drawn from brief experience, the guidelines appear to have brought important changes.** Conditions have become more focused and more concentrated in the Fund's core areas, although they have not become significantly fewer in number; and they are specified more clearly. The eventual implementation of conditions also seems to have improved, albeit often with delayed timing or in modified form. Importantly, more programs are successfully implemented, with fewer suffering permanent interruptions. And the staff appears to be making serious efforts to use effective processes in the course of program negotiation.

54. **Four questions nonetheless emerge.** First, has streamlining been sufficient? Second, should the sharp shifts in the sectoral composition of conditionality be viewed entirely positively, or are there risks? Third, how should the high structural PC waiver rate be viewed? And fourth, has the Fund found the proper balance between national ownership and selectivity? This section will consider each of these questions in turn.

##### A. The Extent of Streamlining

55. **While the coverage of conditionality has been considerably streamlined, there has been, overall, no parallel decline in numbers of conditions.** Section IV.D will examine the extent to which numbers of conditions and PCs are affected by a desire to apply

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<sup>36</sup> *Selected Issues*, Chapter III.

extensive conditionality where ownership is in doubt. Overall, however, given the uncertainties and judgment surrounding the concept of criticality, it is extremely difficult to identify individual cases where too many conditions may have been specified. Reasonable rationales have typically been given in program documents, and indeed the Executive Board has generally expressed few reservations about these (see ¶38, and *Selected Issues*, Boxes 3 and 6, which describe the Board's support for the number and range of structural conditions in the recent arrangements for Bolivia, the Dominican Republic, Ecuador, Paraguay, and Romania). The present section therefore asks whether the tools of conditionality are used, or program goals specified, in ways that may compromise parsimony.

### *Use of structural benchmarks*

56. **Numbers of benchmarks have not significantly declined.** In assessing this development, it is important to distinguish between the *breadth of coverage* of reforms monitored by benchmarks and the *level of detail* at which these reforms are monitored.

57. **The guidelines stipulate that structural benchmarks, like PCs, can only be used for critical measures, but it seems likely that they are still used, in some cases, to monitor “less critical” reforms** (along the lines of the possible examples cited in ¶38). There is considerable anecdotal evidence that the guidelines' statement that the “non-implementation [of SBs] would not, by itself, warrant an interruption of purchases or disbursements under an arrangement” is often misread to imply that the reform at issue need not be critical. The high prevalence of SBs that are not part of clusters of conditions (some of which are also objectively definable, raising the question why they were not set as structural PCs) points in the same direction.<sup>37</sup>

58. **The use of structural benchmarks in this way is consistent with the persistence, to some degree, of the “relevance” model of conditionality.** According to this model—that of the interim guidance note of 2000—there is a role for conditionality on measures that are macro-*relevant*, rather than critical.<sup>38</sup> This model avoids the considerable difficulties involved in a criticality test for measures that will bear fruit only some way into the future. Such measures are “critical” in the sense that their implementation is viewed as necessary to achieve longer-term objectives, but it may be difficult to establish that they *must* be taken *during the period* of the Fund-supported program. The guidelines take the view that measures that are not unambiguously critical to the achievement of program goals should not be part of conditionality, but could be part of the policy dialogue more generally—although the relevance model would argue that a focus on program-related conditions tends to overshadow the broader policy dialogue.

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<sup>37</sup> *Selected Issues*, Chapter IV.

<sup>38</sup> In the interim guidance note, the presumption was that reforms that were macro-relevant, but not critical, would be subject to structural benchmarks rather than PCs (¶10).

59. **It is also striking that benchmarks often continue to be detailed.** The guidelines specify that SBs should be “clear markers in the assessment of progress” in implementation, and in the 2000–02 conditionality review, the Executive Board noted that “[s]tructural benchmarks were extensively used to map out steps in the implementation of particular structural policies,” and “saw a need for structural benchmarks to be used more sparingly, by limiting each benchmark to an important and representative step toward a policy outcome[, which] would also help avoid the impression of micromanagement.”<sup>39</sup> As noted above (¶39), however, some arrangements still include SBs on very narrowly circumscribed actions.

60. **Detailed specification of benchmarks is not necessarily to be resisted.** Whether there is a tradeoff between detail and the guidelines’ principle of parsimony is a difficult question. Detail tends to increase the number of structural conditions—which to some extent illustrates the difficulties involved in using numbers as a metric. Members may nonetheless consider that detailed Fund involvement constitutes micromanagement and thus represents a failure to limit conditionality to the “minimum necessary” (as required by parsimony, see ¶13). At the same time, detailed specification certainly supports another key principle underlying the guidelines, that of clarity. It can provide the authorities with welcome transparency as to how the Fund will assess progress at the time of a program review; indeed, the guidelines themselves call for the program elements to be taken into account for the completion of a review to be specified as fully and transparently as possible in the arrangement, thus encouraging the setting of numerous specific SBs rather than a single, more vaguely specified condition or review clause. Discussion of detailed steps also helps give the Fund confidence that specific action will be taken (although it does not necessarily follow that conditionality needs to be specified at the same level of detail).

61. **All in all, the establishment of structural benchmarks in noncritical areas would be more obviously a contradiction of the guidelines than highly detailed specification—but the latter is likely to be a more important issue in practice.** Although conditionality has become more focused, nonetheless SBs should not be applied to noncritical reforms. To counteract the tension within the guidelines whereby nonobservance of structural PCs, but not SBs, interrupts purchases or disbursements under the arrangement, it could be clarified that the difference between these conditions is a difference in the nature of the *steps to be monitored* (i.e., small steps in a larger process), not in the reform itself. At the same time, the level of detail at which SBs are specified probably contributes more significantly to the still relatively high numbers of conditions. It is less obvious that detailed specifications should be avoided, but it might be clarified that SBs should be applied to “important and representative steps.”

### ***Program goals and strategies***

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<sup>39</sup> *IMF Executive Board Discusses Conditionality* (PIN No. 01/28, 3/21/01, <http://www.imf.org/external/np/sec/pn/2001/pn0128.htm>).

62. **Another important question is whether parsimony has been compromised by overly broad program goals or inadequately specified strategies.** Since measures critical to the achievement of program goals must be included in conditionality, vague program goals risk wide-ranging conditionality, defeating the guidelines' drive toward parsimony and focus. And identification of strategies can only help to focus conditions on measures critical to program success.

63. **An examination of staff reports suggests that overly broad inclusion of goals is not an important factor in the formulation of conditionality.**<sup>40</sup> The majority of goals presented in staff reports are within the scope of the guidelines—external stability, macroeconomic stability (which is a means to external stability), and growth in the case of the PRGF.<sup>41</sup> Many arrangements in the GRA—as many as in the PRGF—cite growth as a goal, seemingly independently of its implications for sustainability; and some cite poverty reduction. But in both these cases these goals do not appear to impact the formulation of conditionality; instead, they seem to function as a statement of broad support by the Fund for the authorities' objectives.

64. **By contrast, some room for improvement exists at least in the presentation, and possibly also in the formulation, of strategies.** Deficiencies in the presentation in staff reports do not necessarily reflect deficiencies in the staff's thinking, but they do suggest—as has previously been argued by the Independent Evaluation Office (IEO)—that some program documents should be clearer in presenting the “story line” or “big picture” that underlies the program, and thus that the Board is not always given the best possible information on which to base its decisions.<sup>42</sup> Several such deficiencies can be identified:<sup>43</sup>

- Although two thirds of requests for arrangements emphasize a few key strategies—priority areas for action, such as the financial sector, public expenditure management, or governance—one third do not cite explicit strategies.
- Moreover, even when strategies are cited, program documents do not generally explain why they were selected. The case of Lesotho (2001 PRGF, see *Selected Issues*, Box 1) can be considered best practice in this regard. Of course, in some cases the cause of external imbalance may be clear, and no explicit discussion of strategies

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<sup>40</sup> See *Selected Issues*, Chapter II, for further discussion.

<sup>41</sup> PRGF-supported programs also often cite poverty reduction as a goal, in line with the strategic orientation of the facility and its link to Poverty Reduction Strategy Papers.

<sup>42</sup> *IEO Evaluation of Fiscal Adjustment in Fund-Supported Programs* (9/9/03, <http://www.imf.org/External/NP/ieo/2003/fis/index.htm>).

<sup>43</sup> See *Selected Issues*, Chapter II, for a full discussion.

is necessary. But in many cases, particularly in the PRGF, the problems are complex and explanations of the choice of strategies would provide insights.

- Although the correlation between strategies and conditionality is generally good, some strategies do not translate into significant conditionality, and programs quite commonly have extensive conditionality in areas not cited in their strategies. In either case, one may wonder whether it is the conditionality or the strategy that is better thought out, and hence whether conditionality could have been better tailored or strategy better explained.

## B. The Risks of Streamlining

65. **As was recognized at the time of the 2000–02 conditionality review, streamlining brings a risk that reforms that could make a substantive difference to a country’s prospects will receive insufficient attention.** While it is too early to pass judgment on the guidelines’ impact, some pointers are worth noting.

66. **Potentially worrisome is the sharp shift in conditionality away from growth- and efficiency-related reforms.** As noted above, both PRGF arrangements (despite having growth as a program goal) and GRA-supported arrangements (despite the links between growth and external sustainability) now place much less emphasis on these reforms than they did in the 1990s.<sup>44</sup> Indeed, econometric tests do not suggest that GRA-supported programs place more emphasis on growth-related measures when external debt is high.<sup>45</sup> Relatedly, programs that cite pro-growth reforms as a strategy do not generally include more conditionality in these areas than do other programs.<sup>46</sup>

67. **It is not possible to discriminate, at this early stage, between benign and less benign interpretations of these developments.** As noted above, the decline in supply-side conditionality is consistent with the guidelines’ emphasis on criticality, and, as long as country ownership is present, does not necessarily indicate that less action is being taken. The decline may also reflect changes in the challenges faced by members who turn to the Fund, or the weak state of knowledge as to measures to sustain growth once “low-hanging fruit” have been picked: for instance, while there is broad agreement that institutions are crucial for growth, the measures that countries could take to strengthen their institutional

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<sup>44</sup> A similar tendency is evident in trade-related conditionality, see *IMF Executive Board Reviews Fund’s Work on International Trade* (PIN No. 05/49, 4/11/05, <http://www.imf.org/external/np/sec/pn/2005/pn0549.htm>). Although the recent study on program design confirmed the importance of macroeconomic stability for growth, it also suggested that supply-side measures are positively and significantly related to better growth performance.

<sup>45</sup> *Selected Issues*, Chapter III.

<sup>46</sup> *Selected Issues*, Chapter II.

framework are less clear, especially once country-specific circumstances are taken into account. An additional explanation could be that the improved growth performance of low-income countries in recent years has resulted in a sense of lesser urgency for additional growth-related reforms. But the new guidelines may also have led to lesser emphasis on reform agendas that require a longer period to mature, or on politically difficult measures. The relative lack of conditionality in these areas could potentially compromise the attainment of medium-term objectives (a point on which judgment must await the availability of outcomes data), signaling “reform gaps” with longer-term consequences. While at this early stage it is not possible to conclude whether the guidelines are having untoward consequences, risks exist that will need to be kept under review.

68. **The risk that some areas will not receive sufficient attention in reform plans is highlighted by trends in “aggregate” Bank-Fund conditionality, but this too could be an entirely benign development.** As noted in Section III.A, the World Bank does not seem to have increased its conditionality in the areas from which the Fund has withdrawn. It was a concern of Directors during the 2000–02 conditionality review that “strengthened collaboration [with the Bank would be] needed to ensure that important measures are adequately covered as the Fund applies conditionality more sparingly outside its core areas.”<sup>47</sup> Of course, with the growing recognition that it is ownership rather than conditionality that ultimately drives forward reform agendas, it is not obvious that gaps in Bank-Fund *conditionality* (nor indeed in aggregate conditionality once other agents, such as regional development banks and bilateral donors, are taken into account) need to be viewed with concern. Much more worrisome would be gaps in analytical work, policy advice, or technical assistance. In these areas the recent review of Bank-Fund collaboration provides comfort that coordination is improving, although it also stressed that there was need for sustained commitment and steady implementation.<sup>48</sup>

### C. Waivers of Structural Performance Criteria

69. **As noted above, the guidelines have not, as had been expected, led (so far) to a decline in the waiver rate.** What has declined is the rate at which measures fail to be implemented at all. At the same time, many waivers continue to be required in cases where measures are either significantly delayed or modified. This flexibility is consistent with the waiver policy and can be interpreted as *ex post* provision of policy space. Indeed, in the surveys conducted for the review of Bank-Fund collaboration, 83 percent of authorities agreed (or strongly agreed) that the Fund’s waiver policy was flexible in taking into account the adoption of corrective measures. The case studies of processes (*Selected Issues*,

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<sup>47</sup> *IMF Reviews Progress on Strengthening IMF-World Bank Collaboration on Country Program and Conditionality* (PIN No. 02/117, 10/9/02, <http://www.imf.org/external/np/sec/pn/2002/pn02117.htm>).

<sup>48</sup> The “IMF-Bank Relations” annexes in staff reports, and the analogous “Fund Relations” note at the Bank, provide a vehicle for transparent communication to the two Boards on all of each institution’s involvement.

Chapter VII) also suggest that policy space has often been provided in successfully implemented programs not just up front, but also during the course of implementation.

70. **The provision of *ex post* policy space is not inconsistent with the guidelines' emphasis on criticality.** While, according to the staff statement (¶7), “a judgment that a condition is of critical importance... means that if it were not implemented, it is expected that the goals will not be achieved,” this should not be read to suggest that, if delayed or alternative actions are substituted for those initially slated, the latter were not truly “critical.” In accordance with the principle of ownership, the Fund’s conditions are drawn directly from the member’s program, as elements that the Fund considers critical to the achievement of program goals. It may indeed be the case that there is little scope for delay or modification of these elements, but a condition may also be more demanding than the minimum that would be required to reach program goals, leaving some room for maneuver, and hence for waivers. The guidelines’ supporting documents could clarify this point, to avoid an overly narrow reading of the definition of criticality.

71. **This said, there are disadvantages to setting demanding conditions and then providing policy space *ex post* via waivers:**

- First and foremost, the lower the likelihood that conditions will be met, the greater will be the role of the Fund’s discretion in granting or withholding waivers, and hence the less the assurance to the member that it will be able to maintain timely access to Fund resources.
- Moreover, high waiver rates risk encouraging overambitious program targets in the belief that waivers would be granted in case of nonobservance (even in cases where there is actually little scope for delay or modification), and thereby also risk undermining the ability of Fund arrangements to signal members’ commitment to sound policies.<sup>49</sup>

72. **The prevalence of waivers could be reduced by setting structural conditions in less demanding ways.** In some cases, the authorities may prefer conditions to be set following an ambitious timetable or modalities—because it will help them focus their efforts, overcome vested interests, or signal their commitment—and the Fund should follow the authorities’ preferences, as long as it is satisfied that the condition will in all likelihood be met. However, if the authorities do not find such conditions helpful, the staff could explore with them the scope for conditions that permit more room for maneuver in meeting program goals. The following paragraphs discuss several possibilities in this regard.

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<sup>49</sup> Interestingly, in some arrangements—e.g., Romania—“prior actions” have been set in advance for subsequent reviews (despite the proscription on this terminology in the operational guidance, ¶12), perhaps because the high waiver rate for PCs has called forth another instrument with perceived lower “waivability.”

73. **As noted above, delays in implementation are by far the most common reason for waivers, suggesting that timetables for conditions are often overambitious.** Indeed, structural measures can be such that what is critical is that they be taken at all—not so much that they be taken in a given quarter, or sometimes even a given year. To be sure, a tension exists between realism and ambition, and the authorities themselves may have a preference for ambitious conditions, if they consider these helpful in driving their agenda forward. However, in the surveys conducted for the review of Bank-Fund collaboration, 40 percent of authorities disagreed (or strongly disagreed) that the timetable for implementation of structural measures in Fund-supported programs was realistic—suggesting that there are many cases where the staff presses for faster implementation, and the authorities reluctantly agree. Moreover, the appropriate balance between realism and ambition requires a thorough assessment of both technical and political implementation capacity. While the case studies in *Selected Issues* (Chapter VII) suggest that the staff already seeks to be careful in taking implementation capacity properly into account, and while technical assistance often helps in this regard, the staff clearly faces serious constraints—in terms of skills, time, and access to information—in forming a judgment on capacity. Because the staff must rely to an important extent on the authorities’ assessment of capacity, it is especially important that it not press for overambitious timetables.

74. **One possibility that has recently been used in the face of timing uncertainties is to specify that a condition *will* be set, leaving its precise timing to be set at a subsequent review.** In Turkey, it was foreshadowed at the time of the seventh review under the Stand-By Arrangement in April 2004 that presentation of a social security reform to Parliament and adoption of a new banking act would be set as PCs at the time of the eighth review.<sup>50</sup> In cases of particular uncertainty, and experimentally, the Fund could make further use of this approach. It would be crucial that the measures in question are ultimately established as actual conditions, to avoid their potential misuse to signal commitments that do not materialize in reality.

75. **As a solution—in a few cases—to the difficulty of determining the “critical” timing of a measure, there may also be some scope to make use of floating tranches.** The possibility of floating tranches—“purchase(s) or disbursement(s) ... made available whenever the measure is implemented”—was introduced in the 2002 guidelines (§13), although it was recognized that the potential for using them would remain limited.<sup>51</sup> Floating tranches have not yet been employed, perhaps in part because the staff has not been clear on the circumstances in which they should be considered. The internal logic of floating tranches requires that two criteria be met: the measure must *strengthen the external position over the medium term*, so as to warrant the release of additional Fund resources; but it must also *create an additional balance of payments need in the short term*—otherwise, the program

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<sup>50</sup> Turkey—*Letter of Intent* (<http://www.imf.org/external/np/loi/2004/tur/01/index.htm>).

<sup>51</sup> PIN No. 02/26, op. cit.

will be either underfinanced without the measure, or overfinanced with it. (Indeed, overfinancing would suggest that the Fund is “buying” implementation of the measure, creating a difficult tension with the principle of ownership.) These restrictive criteria suggest that floating tranches would be appropriate only for a small set of measures in Fund-supported programs, probably concentrated in the areas of trade liberalization and civil service reform. Clarifying these criteria would be conducive to consideration of floating tranches in those cases where they are met.<sup>52</sup>

76. **Additional room may also exist to provide policy space within conditions.** The guidelines explicitly provide for outcomes-based conditionality (including in the structural area), as a way of providing the authorities with policy space *within* conditions, although as with floating tranches it was recognized that the scope for moving in this direction was likely to be limited. The outcomes sought by structural change are often not sufficiently within the member’s control, nor observable with a short enough lag, to be stipulated as conditions.<sup>53</sup> However, on the spectrum from specific actions to outcomes, the potential for structural conditions providing policy space is likely to be concentrated in the intermediate range. Although definitional problems make it difficult to gauge whether conditions providing policy space are used more than previously, such conditions have been used in a number of cases in recent years. Examples include revoking a bank’s license if it is not sold by a specified date (Turkey, SB, 2002); revision of the value-added tax (VAT) threshold to reduce the number of VAT taxpayers substantially, and revision of the threshold for the presumptive tax accordingly (Tanzania, SB, 2003); and conditions preserving the authorities’ ability to choose between expenditure and tax measures to achieve a certain budget target (e.g. Bolivia (2003), Colombia (2003)).<sup>54</sup> With conditions of this type, there may be a risk that they would be met in unacceptable or suboptimal ways. But if greater care were taken to distinguish between the risk of unacceptable action (which must be avoided) and the risk of merely suboptimal action (which the Fund should accept in the name of national ownership), it might be possible to formulate more conditions providing policy space. Indeed, the scope for setting conditions on outcomes should itself be explored further.

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<sup>52</sup> The experience with floating completion points under the Heavily Indebted Poor Countries Initiative also suggests that floating tranches may not capture some benefits associated with more traditional conditionality, when the latter helps the authorities focus their efforts; see *Selected Issues*, Chapter IV.

<sup>53</sup> As noted in *The Modalities of Conditionality—Further Considerations* (<http://www.imf.org/External/np/pdr/cond/2002/eng/modal/010802.htm>), however, many quantitative conditions—including fiscal deficit and net international reserves targets—are outcomes-based.

<sup>54</sup> In addition, many conditions are set on preparation of action plans and the like, leaving substantial policy space as to what is included in the plan—e.g., preparation of a privatization program for the postal bank (Croatia, SB, 2003), or development of an action plan and timetable for introducing a commitment control system (Kenya, SB, 2003).

#### D. Ownership and Selectivity

77. **While on the whole the evidence—particularly the decline in permanent program interruptions—is consistent with improved national ownership since the advent of the guidelines, some cases of very poor implementation remain.** The question thus arises whether the Fund could do better at reaching agreement on modified but still acceptable policy programs that would garner greater national ownership—or, failing this, at exercising selectivity. Only by supporting policy programs that are consistent with achievement of external sustainability and that are implemented does the Fund fulfill the purposes of its financial assistance and safeguard its resources.

78. **Process is important in securing ownership, but the relevant case studies prepared for this review confirm that good processes do not guarantee ownership, and indeed that some aspects of “good processes” are idiosyncratic.**<sup>55</sup> There are several examples where no missing process element can obviously be identified, yet implementation fell short.<sup>56</sup> And there are cases where the process deviated from the one envisaged in the guidelines, yet good implementation followed. The provision of policy space, for instance, is not a *sine qua non* for good implementation: sometimes agreement is reached readily (as in Burkina Faso), and sometimes the authorities eventually come to agree largely with a firm position taken by staff (as in Romania). Similarly, there are cases of successful implementation where large numbers of conditions were used in the presence of divided or otherwise less than perfect ownership (as in Bulgaria and Romania).

79. **Further improvements in process are of course desirable, and the case studies point to two areas where these might particularly be sought:**

- **The authorities generally do not write the first draft of the LOI, but it is not clear that this should be a source of significant concern.** In only a very few cases (one among the case studies) have the authorities expressed any interest in drafting the LOI, although this does not at all mean that they have not been active in designing the program reflected in that first draft or indeed in providing portions of the draft (through the intermediary of existing official documents or specially produced strategy notes), or in contributing to substantive revisions of the draft. It does not seem likely that the authorities will in many cases wish to take on the task of drafting the LOI, but it is clear that the task of document production is less important than the central work of program design.

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<sup>55</sup> *Selected Issues*, Chapter VII.

<sup>56</sup> Of course, this finding is likely to hold only for the limited range of relatively good processes examined: processes that transgressed all benchmarks would very likely yield poor results.

- **There is little evidence that the staff advises the authorities on a range of available policy options and implementation plans during the process of program development.** The staff statement emphasizes that staff should stand ready to do so, particularly in cases where administrative capacity is weak. The process of program design, however, tends to be driven more by an interplay between the staff and the authorities' initial views, with the staff exploring the room to accommodate the authorities' preferences rather than proactively developing policy options. Rarely does the staff seem to take the view that the authorities' administrative capacity is too weak for this interplay to ensure that the range of appropriate policy options is covered. It may be worth encouraging staff to be more proactive in developing a range of policy options, even when the authorities themselves have put forward clearly formulated plans.

80. **The case studies point strongly to the great difficulty of *gauging* ownership, and hint at the possibility that the staff sometimes unduly discounts issues of divided ownership.** It is difficult for the staff to come to a definite conclusion that ownership is lacking at the outset of a program (or that ownership may be present now, but liable to change), and difficult also to raise ownership issues with the authorities, given the need to build and maintain a relationship of trust and confidence. Judgments on ownership become especially difficult when some responsible officials are committed to the program, but others are not. While the case studies include examples where calculated risks paid off (notably with regard to parliamentary support in Brazil, Bulgaria, and Tanzania), there are also cases where differences in the degree of commitment or even involvement by government officials, including in key implementing line ministries, became a source of weak implementation.

81. **Faced with the difficulty of reliably gauging ownership, the Fund continues to employ prior actions as a screening device, but it is important not to interpret implementation of prior actions as an unambiguous sign of commitment.** As noted in Section III.A, arrangements with members with weak track records generally feature more prior actions than others. But while previous analysis already suggested that program implementation (subsequent to the prior actions) for members with large numbers of prior actions was no better than the Fundwide average, updated research suggests that such implementation is actually *worse* than the Fundwide average.<sup>57</sup> Prior actions may still be successful in a limited sense: they may bring programs up to a minimum implementation standard, albeit at the lower end of Fundwide experience. They may also serve to strengthen ownership of the actions in question.<sup>58</sup> But prior actions are not a panacea, and due attention must thus be paid to the risk of nonimplementation, or, by extension, of purely nominal or temporary implementation of subsequent conditionality, which will not permit sustained progress toward program goals.

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<sup>57</sup> *Selected Issues*, Chapter V.

<sup>58</sup> See the discussion of Romania in *Selected Issues*, Box 6.

82. **There also appears to be a tendency, in cases of weak track records, to raise the number of structural conditions, performance criteria, and program reviews.** This tendency is clearly evident in the GRA (see Section III.A), where the number of conditions in weak track record cases is one factor that has compromised parsimony in recent years. PCs are frequently favored in these cases, and indeed account for the bulk of the recent increase in conditions in the GRA. Quarterly program reviews also remain another frequently used instrument in these cases, compromising clarity to some extent.

83. **Recent developments in conditionality—particularly in the GRA—thus raise the question whether the Fund has been sufficiently selective in approving arrangements, or whether it has attempted to substitute conditionality for ownership.**<sup>59</sup> A clear answer to this question must await the availability of outcomes data, but there is certainly a case for renewed scrutiny of proposed Fund-supported programs on this score, to ensure “that the member’s program will be carried out” (guidelines, ¶5) and thus to provide adequate safeguards for Fund resources.

84. **While it will inevitably remain difficult to screen out cases with weak ownership, more use could perhaps be made of staff-monitored programs.** During the 2000–02 conditionality review, Directors already considered that “greater selectivity, including some period of successful implementation before committing Fund financing, would, in some cases, be the preferred course of action to address instances of past poor performance.”<sup>60</sup> Staff-monitored programs (SMPs) appear to have fulfilled their screening function well, on average leading to implementation of subsequent Fund-supported programs at least on a par with implementation elsewhere.<sup>61</sup> Of course, SMPs are not appropriate instruments in the presence of acute balance of payments needs; and prolonged use of SMPs, without financial support, risks resulting in adjustment fatigue. Nonetheless, while prior actions can sometimes be met in a “hit and run” way, sustained implementation of sound policies over the period of a SMP makes demands on administrative and political capacity that are comparable to those of an upper credit tranche Fund-endorsed program.

## V. ISSUES FOR DISCUSSION

Directors may wish to focus their interventions on the following general issues:

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<sup>59</sup> See *Selected Issues*, Box 3, for a description of the mixed implementation record of GRA-supported arrangements with many PCs approved in 2003. In several of these cases, Executive Directors expressed concerns about the implementation risks to the program, and emphasized that conditionality provided important safeguards and that prior actions provided a necessary demonstration of the authorities’ commitment.

<sup>60</sup> PIN No. 02/26, op. cit.

<sup>61</sup> See *Selected Issues*, Box 7.

- How do Directors view the nature and extent of recent changes in the way conditionality is formulated and programs are designed?
- Do Directors view these changes as unambiguously positive, or do they see risks?
- In what areas do Directors see scope for further changes?
- As an aside, would Directors consider it reasonable to return to these issues in more depth in 2008 (instead of 2007 as currently mandated), in order to allow for sufficient experience to accumulate for better judgments to be made as to the appropriateness of the guidelines?

## Some Key Extracts from the Guidelines and Supporting Documents<sup>62</sup>

### On ownership

- The Fund will be guided by the principle that the member has primary responsibility for the selection, design, and implementation of its economic and financial policies (¶3);
- A member's request to use Fund resources will be approved only if the Fund is satisfied that ... [the program] will be carried out, and in particular that the member is sufficiently committed to implement the program (¶5);
- National ownership refers to a willing assumption of responsibility for a program of policies, by country officials who have the responsibility to formulate and carry out those policies, based on an understanding that the program is achievable and is in the country's best interest (staff statement, ¶3);
- Judgments on the depth and breadth of national ownership...are inherently subjective and difficult, and ownership itself is likely to change and develop over time" (staff statement, ¶3).

### On parsimony and criticality

- Program-related conditions ... will be applied parsimoniously (¶7);
- Conditions will be established only on the basis of those variables or measures that are reasonably within the member's direct or indirect control and that are, generally, either (i) of critical importance for achieving the goals of the member's program, or (ii) necessary for the implementation of specific provisions of the Articles or policies adopted under them (¶7(a));
- In general, all variables or measures that meet these criteria will be established as conditions (¶7(a));
- Parsimony means that program-related conditions should be limited to the minimum necessary to achieve the goals of the Fund-supported program or to monitor its implementation and that the choice of conditions should be clearly focused on those goals (staff statement, ¶6);
- A judgment that a condition is of critical importance...means that if it were not implemented, it is expected that the goals will not be achieved (staff statement, ¶7);

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<sup>62</sup> Paragraph references are to the guidelines unless otherwise noted.

- Conditions will normally consist of macroeconomic variables and structural measures that are within the Fund's core areas of responsibility. Variables and measures that are outside the Fund's core areas of responsibility may also be established as conditions but may require more detailed explanation of their critical importance (¶7(b)).

### **On program goals**

- Fund-supported programs should be directed primarily toward the following macroeconomic goals: (a) solving the member's balance of payments problem without recourse to measures destructive of national or international prosperity; (b) achieving medium-term external viability while fostering sustainable economic growth" (¶6).<sup>63</sup>
- (An additional goal of the PRGF is "fostering durable growth, leading to higher living standards and a reduction in poverty" (Annex to Decision No. 8759-(87/176) ESAF, as amended).)

### **On the relation between conditionality and ownership**

- The member's past performance in implementing economic and financial policies will be taken into account as one factor affecting conditionality (¶4).
- Conditionality, if well-designed and established through a mutually acceptable collaborative process, can promote and strengthen ownership, in particular by demonstrating the authorities' commitment to a course of action (staff statement, ¶3);

### **On structural performance criteria and benchmarks**

- Performance criteria will apply to clearly-specified variables or measures that can be objectively monitored by the staff and are so critical...that purchases or disbursements under the arrangement should be interrupted in cases of nonobservance (¶11(b));
- A measure may be established as a structural benchmark where it cannot be specified in terms that may be objectively monitored or where its non-implementation would not, by itself, warrant an interruption of purchases or disbursements under an arrangement. Structural benchmarks are intended to serve as clear markers in the assessment of progress in the implementation of critical structural reforms in the context of a program review (¶11(d)(ii)). Structural benchmarks may be included if they are on key components of a broader reform program that is judged to be critical (e.g., steps in a tax reform or

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<sup>63</sup> Consistent with this, the Extended Fund Facility is intended to support "comprehensive programs that include policies of the scope and character required to correct structural imbalances in production, trade, and prices when it is expected that the needed improvement in the member's balance of payments can be achieved without policies inconsistent with the purposes of the Fund only over an extended period" (Decision No. 5706-(78/39), 3/22/78).

privatization program), as long as they are applied as parsimoniously as possible (operational guidance, ¶11).

### **On waivers**

- The Fund will grant a waiver...if it is satisfied that the program will be successfully implemented, either because of the minor or temporary nature of the nonobservance or because of corrective actions taken by the authorities (¶12).

### **On prior actions**

- [Prior actions may be used] when it is critical for the successful implementation of the program that such actions be taken to underpin the upfront implementation of important measures,... tak[ing] into account the strain that excessive reliance upon such actions can place on members' implementation capacity (¶11(a));
- Prior actions may be used...when a critical measure needs to be implemented immediately in order to achieve program goals, or when there are significant doubts that the measure would be implemented later if specified as a performance criterion (operational guidance, ¶12);
- Conditions set for the completion of future reviews are not prior actions and should not be referred to as such; rather, they are either performance criteria or benchmarks (operational guidance, ¶12);
- Prior actions...must be justified in terms of their criticality to program objectives (operational guidance, ¶12);
- In assessing the use of prior actions, staff should be guided by the experience that implementing prior actions has not been shown to increase the likelihood that other subsequent measures under the program will be successfully implemented (operational guidance, ¶12).

### **On clarity of program-related conditions**

- In all their program documents, the authorities should clearly distinguish between the conditions on which the Fund's financial support depends and other elements of the program (¶10); an effective means of [distinguishing] is to include tables listing all quantitative and structural performance criteria, indicative targets, prior actions and structural benchmarks (operational guidance, ¶19);
- Detailed policy matrices covering the broader agenda should be avoided in program documents such as [letters of intent] and [memoranda of economic and financial policies] unless they are considered necessary by the authorities to express their policy intentions (¶10).

### **On program reviews**

- The elements of a member's program that will be taken into account for the completion of a review will be specified as fully and transparently as possible in the arrangement (¶11(c)(i)), and the policy areas on which the backward-looking component of the review is to focus should be specified, to the extent possible, in the form of performance criteria, indicative targets and structural benchmarks (operational guidance, ¶13);
- [An objective is] to limit the possibility that reviews will be used to add conditionality unless clearly justified by changes in circumstances... Adding new conditionality during a review in areas previously without any conditionality would require a clear justification as to why the related measures had become critical to program objectives (operational guidance, ¶13);
- Reviews are expected to be held every six months, but substantial uncertainties concerning major economic trends or policy implementation may warrant more frequent monitoring (¶11(c)(i)).

### **On process**

- National ownership of sound economic and financial policies and an adequate administrative capacity are crucial for successful implementation of Fund-supported programs (¶3);
- The Fund will encourage members to broaden and deepen the base of support for sound policies in order to enhance the likelihood of successful implementation (¶3);
- [t]he guidelines aim to promote ownership by ensuring that conditionality is well designed and is formulated through a mutually acceptable process led by the member (staff statement, ¶3); promotion of ownership depends in part on effective and inclusive processes of program development in which the authorities and the staff are both fully engaged (staff statement, ¶4);
- [I]n responding to a member's request for access to Fund resources, it is expected that the initial response by the staff will be to ascertain, through dialogue, how the authorities intend to adjust policies (staff statement, ¶4); particularly in cases where the member's administrative capacity is weak, the staff will stand ready to advise the authorities on a range of available policy options and implementation plans, and to provide technical assistance, so as to enable them to make informed choices (staff statement, ¶4);
- [T]he staff [will] pay due regard to the domestic social and political objectives, the economic priorities, and the circumstances of the member, including the causes of the balance of payments problem and the member's capacity to implement reforms in the necessary time frame (staff statement, ¶4);

- staff should...be flexible in program design when possible to meet the authorities' preferences (operational guidance, ¶6);
- [Program] documents will be prepared by the authorities, with the cooperation and assistance of Fund staff (¶10); [i]t is...expected that program documents...will be prepared by the authorities, with the cooperation and assistance of Fund staff (staff statement, ¶5); there is no requirement that country authorities draft [program documents], but staff should be responsive when authorities desire a greater role in the drafting of these documents (operational guidance, ¶5);
- Assessments [of potential implementation difficulties] should reflect ... country-specific issues such as constitutional and political structures. Such assessments take on particular importance when implementation of key measures hinges on legislative approval or on actions by lower levels of government... In some instances, where implementation requires cooperation by several ministries, the positions of these ministries are relevant to the assessments (operational guidance, ¶8);
- [Program design] should include an assessment of technical capacity, including capacity building in the program (operational guidance, ¶9).