

2011 Review of Conditionality and the Design of Fund-Supported Programs Concept Note

I. INTRODUCTION

1. The Fund regularly assesses conditionality in IMF-supported programs, with the next formal review planned for 2011. This paper summarizes previous assessments of conditionality, outlines staff's proposed approach to the forthcoming review, and seeks Directors' early views on the approach.

2. Since the previous review was completed in 2004-05, a number of key changes and developments have affected conditionality in IMF-supported programs.

Conditionality has been streamlined, focused, and better tailored to countries' policy performance. This process culminated with the discontinuation of structural performance criteria (SPCs) in March 2009 and a shift towards a review-based monitoring of performance in structural areas.¹ Facilities and instruments have been introduced or revamped for programs under both the General Resource Account (GRA) and the Poverty Reduction and Growth Trust (PRGT), and a more systematic use of *ex-ante* conditionality has been introduced.² The global financial crisis has led to an increase in arrangements in a context where unexpected shocks and spillover effects from major advanced countries have made program design and implementation potentially more difficult.

3. Staff proposes that the forthcoming review focuses on assessing the impact of these changes and developments. The review would take a broad approach, examining not only the explicit conditionality embedded in Fund-supported programs but also overall program design. The review would cover all forms of Fund-supported programs meeting the standards of upper credit tranche conditionality, thereby matching the scope of earlier reviews.³ Compared with the 2004-05 review, this one will study more systematically a broader set of programs indicators (e.g., prior actions and indicative targets—notably related to social protection—in addition to quantitative performance criteria, structural benchmarks and performance criteria). It would also allow for an early evaluation of the shift towards review-based assessments of program performance and of how recent changes to IMF policies (including access to IMF financing) have affected the balance between adjustment

¹ Decision No. 14280 - (09/29), March 24, 2009.

² Since 2005, new facilities and instruments include the Flexible Credit Line (FCL) and the Precautionary Credit Line (PCL) for all IMF member countries; and the Policy Support Instrument (PSI), the Rapid Credit Facility (RCF), the Stand-by Credit Facility (SCF), and the Extended Credit Facility (ECF), along with the Exogenous Shocks Facility (which was discontinued with the introduction of the SCF), for low-income countries.

³ Thus, the review would exclude assessment of conditionality or program design under the Emergency Natural Disaster (ENDA) facility, the Emergency Post-Conflict Assistance (EPCA) facility, the rapid access component of the ESF (ESF-RAC), and the RCF. Staff-monitored programs will also be excluded.

and financing. Moreover, staff will proactively engage external stakeholders on views on the application of conditionality.

II. EARLIER ASSESSMENTS OF CONDITIONALITY

4. The 2004-05 review covered both program design and issues in the application of conditionality. The review examined key features of Fund-supported programs approved during 1995-2000 (with data through 2003), including their design and objectives, and the extent to which these objectives were achieved.⁴ Separate papers also examined the application of the Conditionality Guidelines in arrangements approved from 2001 through mid-2004 (with data through mid-2004).⁵

5. The main conclusions of the 2004-05 review were:

- **On program design:** (i) Fund-supported programs were tailored with macroeconomic and structural policies generally formulated in line with program objectives and country circumstances; (ii) in middle-income countries, external adjustment was generally geared towards achieving medium-term debt sustainability, but was sharper and more abrupt than indicated by circumstances in a number of cases; and (iii) in low-income countries, program objectives were often to place the economy on a more sustainable long-term path for growth and the balance of payments, rather than an immediate improvement in the current account balance.
- **On formal aspects of program conditionality:** (i) coverage of structural conditionality had shifted towards critical measures, and program-related conditions had become clearer, but the number of structural conditions had not decreased much; (ii) Fund-supported programs experienced fewer permanent interruptions; (iii) waiver rates had not declined, but implementation, measured as the number of waived PCs that were eventually met, had improved; and (iv) conditionality could not substitute for program ownership in order to achieve program objectives.

⁴ “Design of Fund-Supported Programs—Overview” (www.imf.org/external/np/pdr/2004/eng/design.htm). The review included three background papers: “Fund-supported Programs: Objectives and Outcomes” (www.imf.org/external/np/pdr/2004/eng/object.htm); “Policy Formulation, Analytical Frameworks and Program Design” (www.imf.org/external/np/pdr/2004/eng/policy.htm); and “Macroeconomic and Structural Policies in Fund-Supported Programs: Review of Experience” (www.imf.org/external/np/pdr/2004/eng/macro.htm).

⁵ “Review of the 2002 Conditionality Guidelines” (www.imf.org/external/np/pp/eng/2005/030305.htm). The analysis was limited for programs approved later in the period and also included comparisons to programs approved during 1995-2000.

6. Following the 2004-05 review, the operational guidance note on conditionality was revised (Figure 1).⁶ The revisions highlighted the importance of country ownership and provided updated guidance on the design of conditionality as well as on the presentational requirements for Board papers.

7. The Fund’s policy on conditionality was reformed again more recently, taking account of the Independent Evaluation Office (IEO) review of structural conditionality in 2007.⁷ The IEO evaluation found that while the streamlining initiative had shifted the composition of conditionality toward core traditional areas of the Fund’s responsibility (especially macroeconomic stabilization) and new areas of focus (e.g., the financial sector), it had not reduced the volume of conditionality. Moreover, some remaining conditionality was deemed not critical for the achievement of program goals. Following the Board discussions on the IEO report, the operational guidance on conditionality was further revised. While reaffirming the five interrelated principles in the 2002 Conditionality Guidelines on national ownership of programs, parsimony in program-related conditions, tailoring to country circumstances, effective coordination of multilateral institutions, and clarity in the specification of conditions, this revision focused on parsimony and criticality of program conditions.⁸ In 2009, the Board discontinued SPCs in all Fund-supported programs, relying on a review-based approach to monitor structural reforms in IMF-supported programs.⁹ The aim of this revision was to enhance the flexibility of the conditionality framework, to tailor conditionality to countries' policy performance, and to reduce the stigma associated with SPCs and associated waivers, while preserving adequate safeguards for the use of the Fund’s resources.

8. Recent Fund papers have reviewed early program experiences during the global crisis and provided updates on trends in structural conditionality. For low-income countries, analysis highlighted that structural conditionality has become more streamlined and that program design had shown increased flexibility (accommodating larger fiscal and

⁶“Statement of the IMF Staff – Principles Underlying the Guidelines on Conditionality, Revised Jan. 9, 2006” (www.imf.org/external/np/pp/eng/2006/010906.pdf) and “Operational Guidance to IMF Staff on the 2002 Conditionality Guidelines” revised January 9, 2006 (www.imf.org/external/np/pp/eng/2006/010906g.pdf).

⁷ “Independent Evaluation Office - Structural Conditionality in IMF-Supported Programs” (http://www.ieso-imf.org/eval/complete/pdf/01032008/SC_main_report.pdf) and “Implementation Plan in Response to Board-Endorsed Recommendations Arising from the IEO Evaluation of Structural Conditionality in IMF-Supported Programs (www.imf.org/external/np/pp/eng/2008/040808.pdf). See also Public Information Notice (PIN) No. 08/52.

⁸ “Operational Guidance to IMF Staff on the 2002 Conditionality Guidelines”, revised July 10, 2008 (<http://www.imf.org/external/np/pp/eng/2008/071008.pdf>).

⁹ This change was reflected in the “Operational Guidance to IMF Staff on the 2002 Conditionality Guidelines” revised January 25, 2010 (www.imf.org/external/np/pp/eng/2010/012510a.pdf). See also “Conditionality in Fund-Supported Programs—Purposes, Modalities, and Options for Reform” (www.imf.org/external/np/pp/eng/2009/012909.pdf) and Public Information Notice (PIN) No. 09/41.

current account deficits) while placing emphasis on strengthening social protection.¹⁰ For emerging market countries, analysis showed that macroeconomic policies had been supportive, particularly with accommodative fiscal policy stances that were adapted to evolving conditions. Moreover, larger and more frontloaded financing packages helped create room for policy accommodation in GRA-supported programs. In addition, initial program conditionality had been more focused than in the past and observance better, suggesting improved country ownership.¹¹ Analysis also indicated that the number of structural conditions had declined in recent years, while conditionality has become more focused on core IMF areas.

III. KEY ISSUES FOR THE FORTHCOMING REVIEW

A. Content and Application of Program Conditionality

9. Staff proposes to undertake a quantitative and qualitative assessment of conditionality in Fund-supported programs approved during 2002-10, with an emphasis on the recent years.¹² This would comprise examining the content, evolution, and breakdown of conditionality (e.g., by fiscal, monetary, exchange rate, financial, and other structural policies; by country-income groups; by instrument/facility type; and by level of access). The analysis would also assess whether conditionality was consistent with program goals and objectives as well as in line with the five principles of ownership, parsimony, tailoring, coordination, and clarity from the 2002 Guidelines (as described above).

10. The review would examine all dimensions of conditionality. In addition to an analysis of quantitative performance criteria (QPCs), structural performance criteria (SPCs), and structural benchmarks (SBs), the forthcoming review would examine the use of prior actions (PAs) and indicative targets (ITs), as well as the qualification criteria for the FCL. The inclusion of PAs and ITs is especially important given the March 2009 revisions to structural conditionality and the consequent questions as to how their use might have changed with the discontinuation of SPCs. ITs are an important element to inform Executive Board's reviews of program performance. They are also instrumental to assess the greater emphasis on social protection and the changes in IMF policy regarding public wage bill ceilings in Fund-supported programs.

11. The assessment would draw on statistical analysis based on the recently revamped Monitoring of Fund Arrangements (MONA) database. MONA tracks all formal conditions, staff macroeconomic forecasts, and program implementation. The overall

¹⁰ "Creating Policy Space – Responsive Design and Streamlined Conditionality in Recent Low-Income Country Programs" (www.imf.org/external/np/pp/eng/2009/091009A.pdf).

¹¹ "Review of Recent Crisis Programs" (www.imf.org/external/np/pp/eng/2009/091409.pdf).

¹² Consequently, as the first PCL was approved only in early 2011, the review will not cover conditionality or program design issues related to this instrument.

assessment would also benefit from country case studies, including recent Ex-Post Evaluations and Ex-Post Assessments.

12. Interactions with country authorities, the Executive Board, mission chiefs, donors, and other external stakeholders would offer additional insights on conditionality. These interactions would take the form of surveys and structured interviews. The results would provide views regarding conditionality in IMF-supported programs, including its consistency with the principles set in the guidelines, its application, and its overall perceived effectiveness. Staff proposes, in coordination with Executive Director's offices, to send a country authority survey to policymakers in previous and current program countries.

B. Program Design and Implementation

13. The review would explore how program design addressed country specific needs while remaining consistent with Fund policy. The recent Fund studies on the crisis programs (noted above) concluded that Fund-supported programs have been generally adapted to specific country needs and initial conditions, while remaining in line with Fund policy. The forthcoming review would examine how these issues have evolved more recently. It will therefore seek to explore whether the balance between adjustment and financing (including in exceptional access cases) has been supportive of sustainable economic recovery, including by promoting growth and reducing unemployment. It will also investigate whether programs have adapted to evolving country circumstances, while maintaining evenhandedness across the Fund membership. Another topic of interest will be how program design incorporated considerations linked to macro-financial linkages and international spillovers. The review would also examine a number of more specific, but nevertheless important, issues such as the composition of fiscal adjustment, how programs have taken account of the social impact of planned policy measures, and how the 2009 Special Drawing Rights (SDR) allocation has been taken into account in program design.

14. The review would assess evolving trends in program implementation. The recent changes in conditionality policies were geared towards improving implementation through increased streamlining, ownership, and flexibility. A goal of the current review would be to examine whether these policy changes achieved their stated aim. The relationship between initial program design, conditionality, and subsequent flexibility and implementation would also be explored.

C. Outcomes of Fund-Supported Programs

15. The review would examine macroeconomic outcomes of IMF-supported programs. Outcomes would be compared with relevant comparators (identified by income groups, instrument/facility type, level of access, or macro-economic conditions). Macroeconomic outcomes to be analyzed include GDP growth, inflation, the current account balance, the fiscal balance, reserves coverage, and money growth. While social outcomes are difficult to assess directly given long data lags, they could be explored through an analysis of appropriate intermediate indicators, such as public expenditure in priority areas. The review would include an analysis of the contribution of flexibility in program design during the recent crisis period to improving outcomes. The analysis would also provide a comparison of outcomes in programs with different objectives, such as adjustment to capital account crises, traditional current account crises, or protracted balance-of-payments needs of the kind often faced by low-income or transition countries.

IV. ISSUES FOR DISCUSSION

16. Staff seeks the views of Executive Directors on the following questions:

- Do Directors agree with the general approach presented in this note? Specifically, do Directors agree that the review should include issues related to the nature and content of IMF conditionality, program design, implementation, and macroeconomic outcomes? Are there any other general areas that the review should address?
- What other issues and questions would Directors like to see addressed concerning the application of IMF conditionality, program design and implementation, or macroeconomic outcomes?
- What are Director's views on the types of facilities and instruments that should be included in the review?
- Do Directors have views on outreach to external stakeholders, the Board, and staff, including related to the proposed surveys?
- Do Directors have other concerns about the review or other issues that the review should examine?

Figure 1. Conditionality in Fund-Supported Programs and IMF Facilities: A Selected Chronology

