

Structural Conditionality in IMF-supported Programs

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Open Conference on IMF Conditionality
Oslo January 2008



Main Findings

- Fund programs continue to include too many conditions – 17 on average, the same number as before the Streamlining Initiative.
- Most of these conditions would only have a limited impact, even if implemented.
- But in fact, only half are met as agreed.
- One third of conditions are still in areas where the IMF has little or no expertise.

In view of these findings...

- The report calls for significant changes in the framework for setting structural conditionality
- Much fewer conditions, capped at less than a third of the current average number.
- These should be clearly part of the authorities reform program and critical to the achievement of its objectives.
- These conditions should be set in areas where the IMF has expertise.

Structure of the Presentation

- 1. Motivation and Background
- 2. Key Questions and Methodology
- 3. Findings and Conclusions
- 4. Recommendations

Motivation and Background

- Evolution of Conditionality
- Enabling Legal Framework
- Typologies of Structural Conditionality
 - Legal standing (PA, PC, SB)
 - Structural Depth
 - Difficulty of implementation
 - Source of demand

Evolution of Conditionality

- In 1970s gradual expansion of scope to issues of composition and general government
- 1979 Conditionality Guidelines
- Mid-1980s: programs increasingly included structural conditions: trade and financial sector
- 1990's: Transition and Growth Agenda – Privatization; SOE restructuring, and Safety Nets
- 2000's: Fiduciary Agenda and Governance
- 2002 Guidelines on Conditionality

Enabling Legal Framework

- Articles of Agreement provide the legal basis for the use of conditionality:
 - *Safeguarding the revolving nature of Fund Resources.*
 - *Provide members with predictability regarding the availability of Fund resources*
- Board Decisions: Conditionality Guidelines of 1968, 1979, and 2002.

Structural Conditionality differs

- by legal standing
- by structural depth
- by the expected “difficulty” in their implementation
- by “source of demand”

Legal Typology of SC:

- [1] Prior actions (PA): Measures that a borrowing country is expected to adopt prior to the Fund's approval of the arrangement, completion of a review or the granting of a waiver with respect to a PC.
- [2] Performance criteria (PC): A variable or measure (objectively monitorable) whose observance is a condition for the making of purchases or disbursements under a Fund arrangement.
- [3] Structural benchmarks (SB): To be used when a measure cannot be specified in terms that may be objectively monitorable or where its non-implementation would not by itself warrant an interruption of the program.

Prior Actions: Examples

- [1] Replenish in 2001:Q1 the special privatization account by the full amount borrowed from it in late 2000. **[Met].**
- [2] Submission to parliament of a revised law authorizing the Chamber of Accounts to audit all government bodies. **[Met].***
- [3] Adopt action plan for the recovery of tax arrears of national oil distribution company. **[Met].**
- [4] Preparation of a detailed loan recovery strategy for intervened commercial bank BA. **[Met].**
- [5] Council of Ministers to adopt in April 2002 a privatization plan for the national telecom company. **[Not met].****

Performance Criteria: Examples

- [1]. Transfer ownership of asset packages of state-owned mining company **[Not met, waived].***
- [2]. Completion of the privatization state-owned commercial bank Y **[Not met, waived].****
- [3]. Grant legal protection to staff of the Superintendency of Banks (submission of a draft law to the assembly) **[Met].**
- [4]. Complete civil service census **[Met].**
- [5]. Implement new customs tariff. **[Not met, waived].**

Structural Benchmarks: Examples

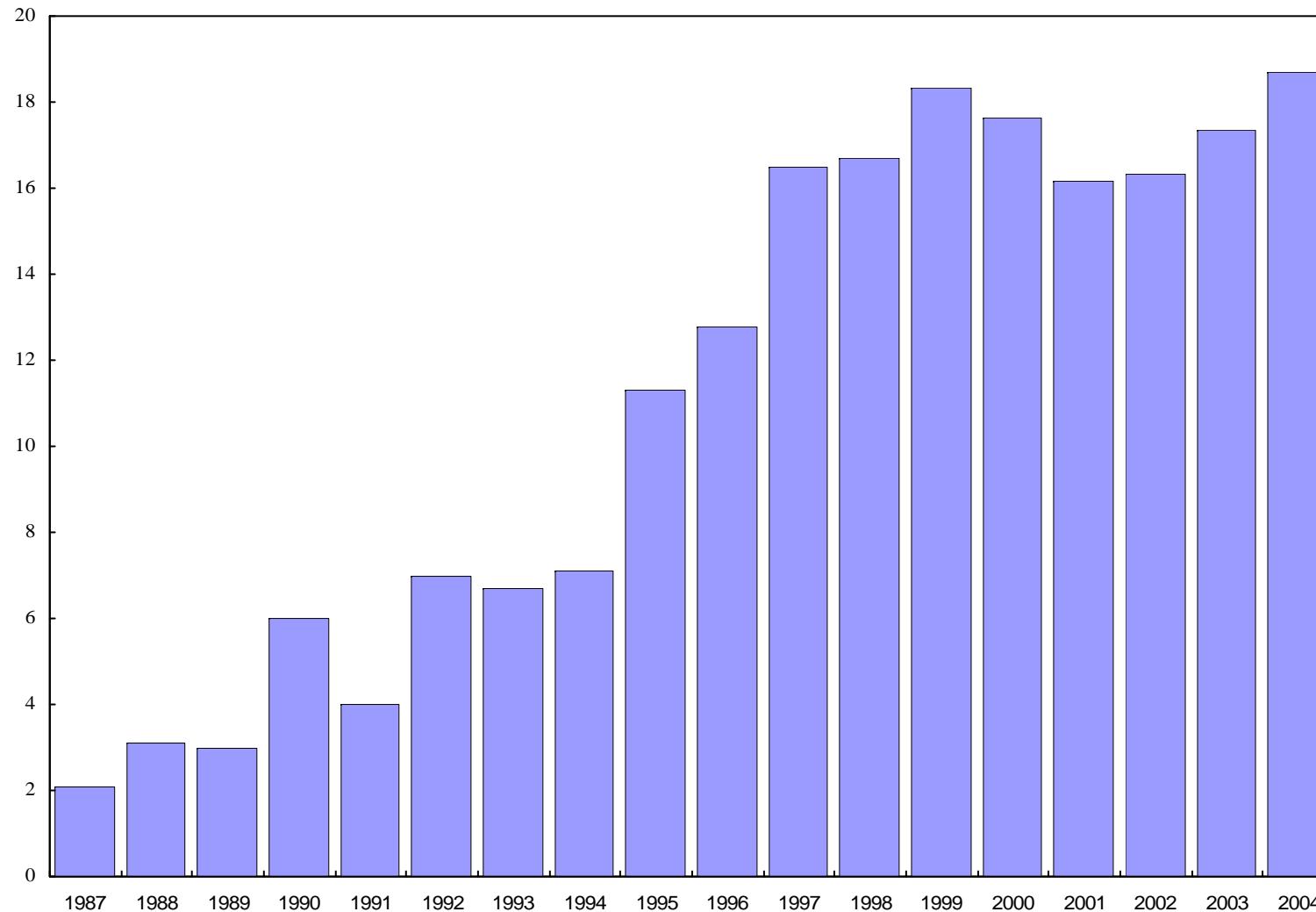
- [1]. Approve legislation on permanent, limited deposit insurance **[Met with delay]**.
- [2]. Contract new professional management for the Agricultural Bank **[Met with delay]**.
- [3]. Adopt an action plan for the computerized budget management system, providing for the integration of external debt service and externally financed projects into the system **[Met]**.
- [4]. Submit to Congress new draft labor legislation **[Not met].***
- [5]. Resubmission of the Forestry Code to Parliament **[Met]**.

Who introduced **this** condition in the program?

Different sources of “demand”

- Authorities
 - Economic Team
 - Line Ministries
 - Central Bank
- Private Sector and Civil Society
- Donors and IFIs
- Foreign private creditors
- IMF Board, Management and Staff

Figure 1. Average Number of Structural Conditions per Program Year 1/



Source: International Monetary Fund, MONA database and IEO staff estimations.

'1/ Total number of conditions (prior actions, structural benchmarks and performance criteria) adjusted for program length.

Widespread criticism

- Criticism mounted over time:
 - Spread from CSOs to academia
 - Spread from developing to advanced economies
- Nature of criticism
 - Legitimacy
 - Conditionality does not work without ownership; and with ownership it is not needed.
 - Lack of proper consultation
 - Overwhelms limited domestic capacities.

The Response to this criticism: The Streamlining Initiative

- Management: 2000 Interim Guidance Note on Structural Conditionality.
- Executive Board: The 2002 Conditionality Guidelines.

The 2000 Interim Guidance Note

- Management initiative called for “streamlined” Structural Conditionality.
- “Macro-relevance” as a test to be met by formal structural conditions.

The 2002 Conditionality Guidelines

- The Guidelines focus on:
 - Parsimonious use of SC
 - Criticality for achievement of goals.
 - Preferably, but not only, in core Macro Areas.
- Importance of “national ownership” for program implementation
 - Government ownership.

Key Questions and Methods

Two key evaluation issues

- The Effectiveness of Structural Conditionality
- The impact of the Streamlining Initiative

Main questions on effectiveness

- Structural depth of conditions
- Compliance with structural conditions
- Effectiveness at promoting sectoral reform
- Country circumstances and design characteristics that strengthen compliance and effectiveness

Questions on the Streamlining Initiative

- Has SC been used more parsimoniously? How has the number of SC changed since 2000?
- Impact of “criticality”? Has the sectoral distribution of SC changed?

Methodology

Data from 3 overlapping sources

MONA database - 216 programs approved between 1995-2004

- 7,139 conditions
- Analysis of sectoral distribution of SC
- Analysis of compliance by sector

Desk Studies of 43 programs approved between 1999-2003

1,567 conditions

- Analysis of structural depth by sector
- Analysis of effectiveness by sector

In depth studies of 13 programs approved between 1999-2003

630 conditions

Analysis of progress in structural reform

Impact in the overall economic framework

Other Sources of information

- Staff Survey
- Interviews with authorities and other stakeholders (WB, CSOs)
- Board documents
- Other Internal documentation
- Data on key economic/political features of countries

Evaluation Methods

- Regression analysis to explain:
 - Determinants of volume of SC in programs
 - Relationship between number of conditions and degree of distortion in specific sectors
 - Relationship between number and type of conditions and compliance.
- Review of documentation:
 - Greys and Minutes → Board signals on streamlining
 - Program Requests 2003-04 → Are program objectives better explained, criticality assessed better in more recent years?

Evaluation Methods (continued)

- Case studies:
 - To understand negotiation, program design, compliance and effectiveness of SC.
- Interviews with authorities, CSOs:
 - Gather their views on role and effectiveness of conditionality; their suggestions for improvements in use of SC.
- Meetings with staff of IMF and WB:
 - To understand process of program negotiation and design.
 - To understand the role of the internal review process.
 - Modalities of cooperation between IMF-WB.
- Staff survey
 - Staff's views of streamlining initiative, program design and IMF-WB cooperation

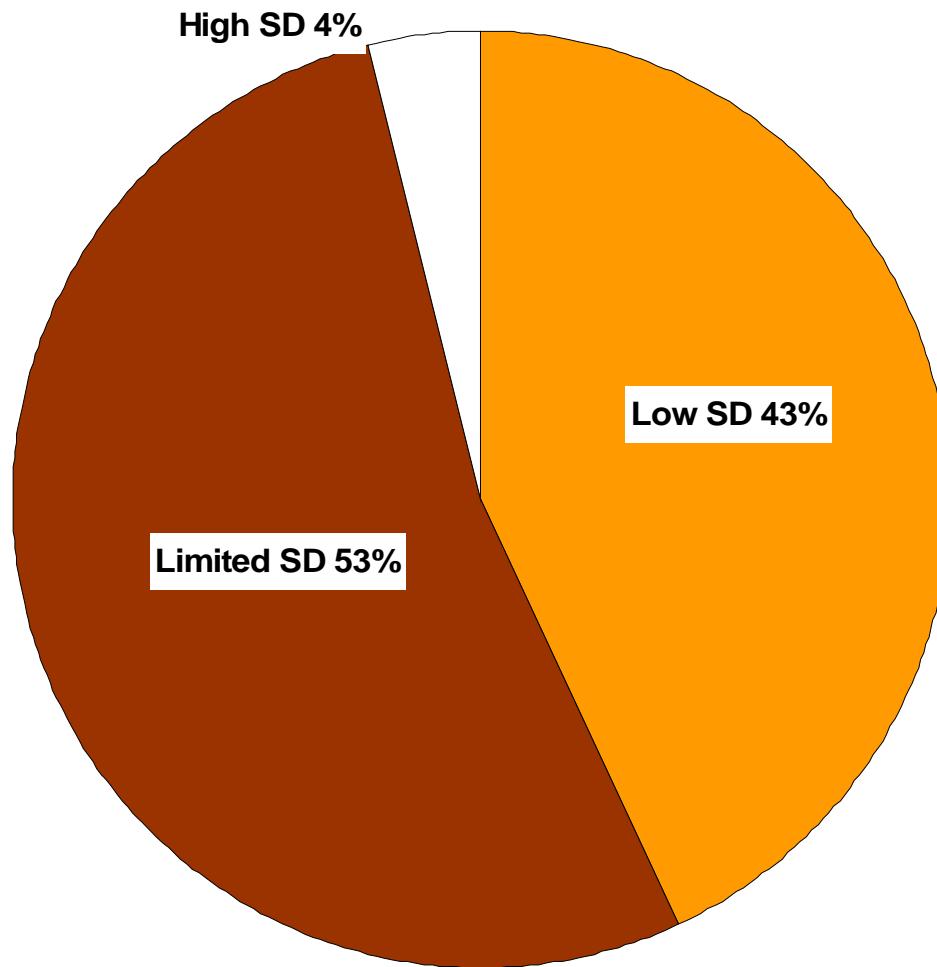
Main Findings on Effectiveness

- Structural Depth
- Compliance
- Conditionality and Sectoral Reforms
- Conditionality and the overall economic framework

Categories of Structural Depth

- **Little or No SD.** Conditions that would not, by themselves, bring about any meaningful economic changes.
- **Limited SD.** Conditions calling for one-off measures that can be a significant impact but would need to be followed up by other measures for the effect to be lasting.
- **High SD.** Conditions that by themselves would bring about lasting changes in the institutional environment.

Structural Depth



Structural Depth and Sustainability

- Little or no SD: More than 40 percent of conditions (e.g., preparing plans or drafting legislation)
- Limited SD: About half the conditions (one-off change in prices; passage of budget)
- High SD: Less than 5 percent of conditions required durable institutional changes.

Compliance

- Only 54% of the structural conditions were met on time.
 - Another 25% was complied late or partially.
 - 56% of PC and 51% of SBs.
 - higher in core sectors: 60% vs. 37% in non-core.
 - Less than 1/3 of conditions with High SD were complied with (10% of which were reversed).
 - Country-level averages ranged from about 80% (Brazil, Guinea, Mozambique) to about 30% (Croatia, Ecuador, Tajikistan).

Conditionality and Reform

- There was only a weak link between compliance with structural conditionality and subsequent additional reforms in the corresponding sector.
- Reform was pursued equally in sectors where conditionality was met, met with delay or not met at all.

Effectiveness: other findings

- Determinants of Compliance and Effectiveness
- Conditionality as a monitoring tool for donor initiatives
- Program Documentation
- Monitoring and Evaluation
- Conditionality in PRGF

Are there country circumstances
and design characteristics that
increase the odds that Structural
Conditionalities may help reform?

Determinants of compliance and effectiveness: design features

- Compliance was higher in core sectors (PEM and tax administration)
- Structural depth was “more intense” in core sectors
- Compliance was lowest in privatization and SOE reform
- Effectiveness was also higher in core sectors, i.e., the link between compliance with conditionality and reform seemed stronger.

Determinants of compliance and effectiveness: country conditions

- Ownership of the reform program by a strong economic policymaking team is critical for the implementation of conditionality.
- Broader government ownership seems to be a precondition for sustainability of reform at the country and sector levels.
- Ownership of the specific conditionality by the corresponding implementing bodies is a necessary condition for effectiveness

Monitoring other Initiatives

- Conditionality was an effective tool to monitor
 - HIPC and other donor led initiatives
 - EU accession process
- Less clear for Capital Market operations
- This use of conditionality may reduce its effectiveness in supporting reform.

Program Documents

- The rationale for an IMF arrangement was not always explained clearly.
- Important program objectives were sometimes unclear and often unexplained.
- Often, documents do not explain the link between specific structural conditions and the objectives.

M&E framework

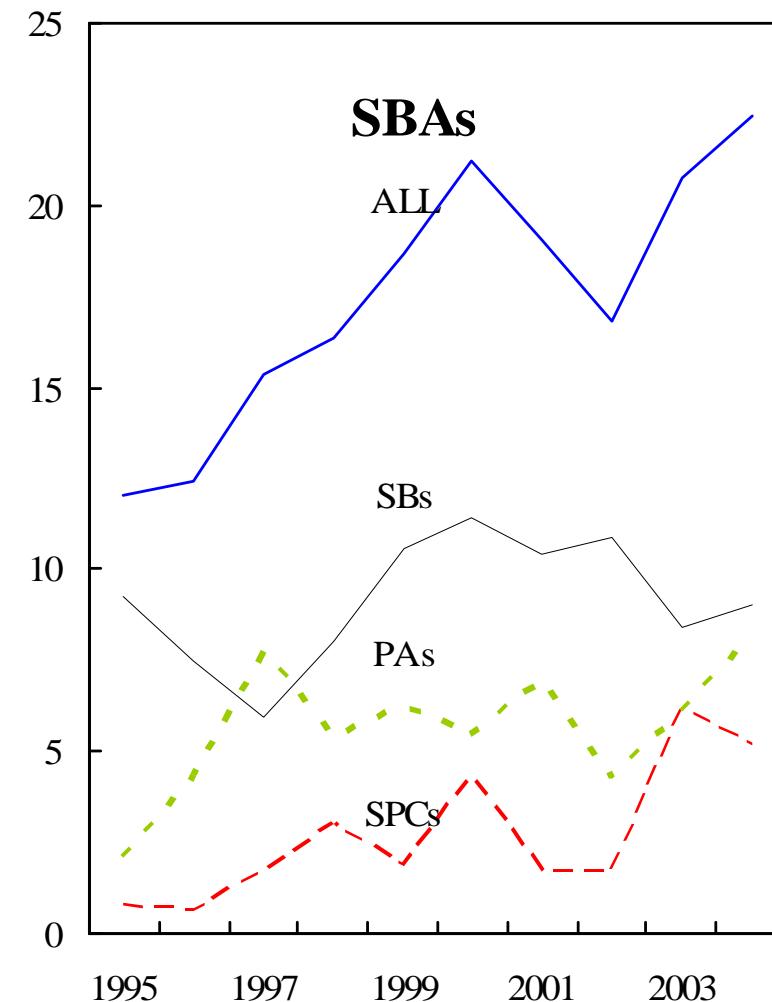
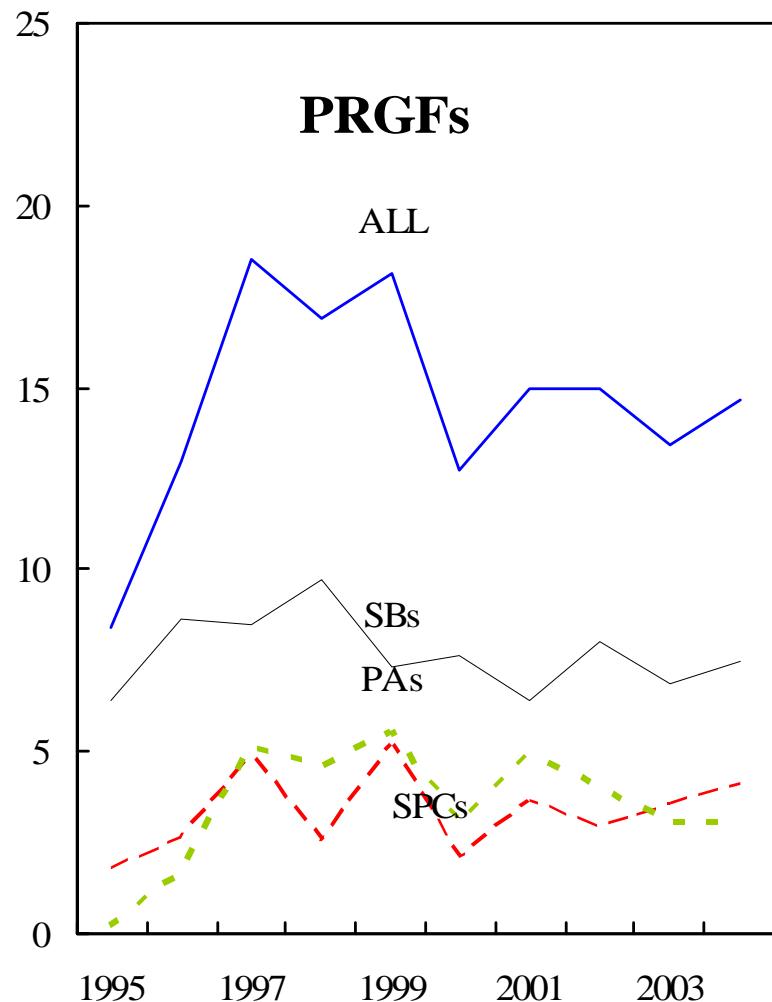
- The evaluation was complicated by the lack of an agreed framework to assess results and accountability
- An M&E framework would facilitate learning what works and what does not.
- M&E framework would identify define what data needs to be collected before, during, and after a program.

SC design in PRGFs

- PRGFs have a three year duration, aimed at addressing growth and poverty reduction.
- However, conditionality is similar to that of SBA
 - average horizon of conditions 4-5 months
 - Higher average structural depth (sectoral distribution).
- Compliance rates are similar to SBA.
- PRGFs are not built around a roadmap providing an operational medium term framework.
- Conditionality are designed opportunistically in each tranche

Main Findings: Streamlining

No Change in the Number of Conditions



Streamlining Initiative: Numbers

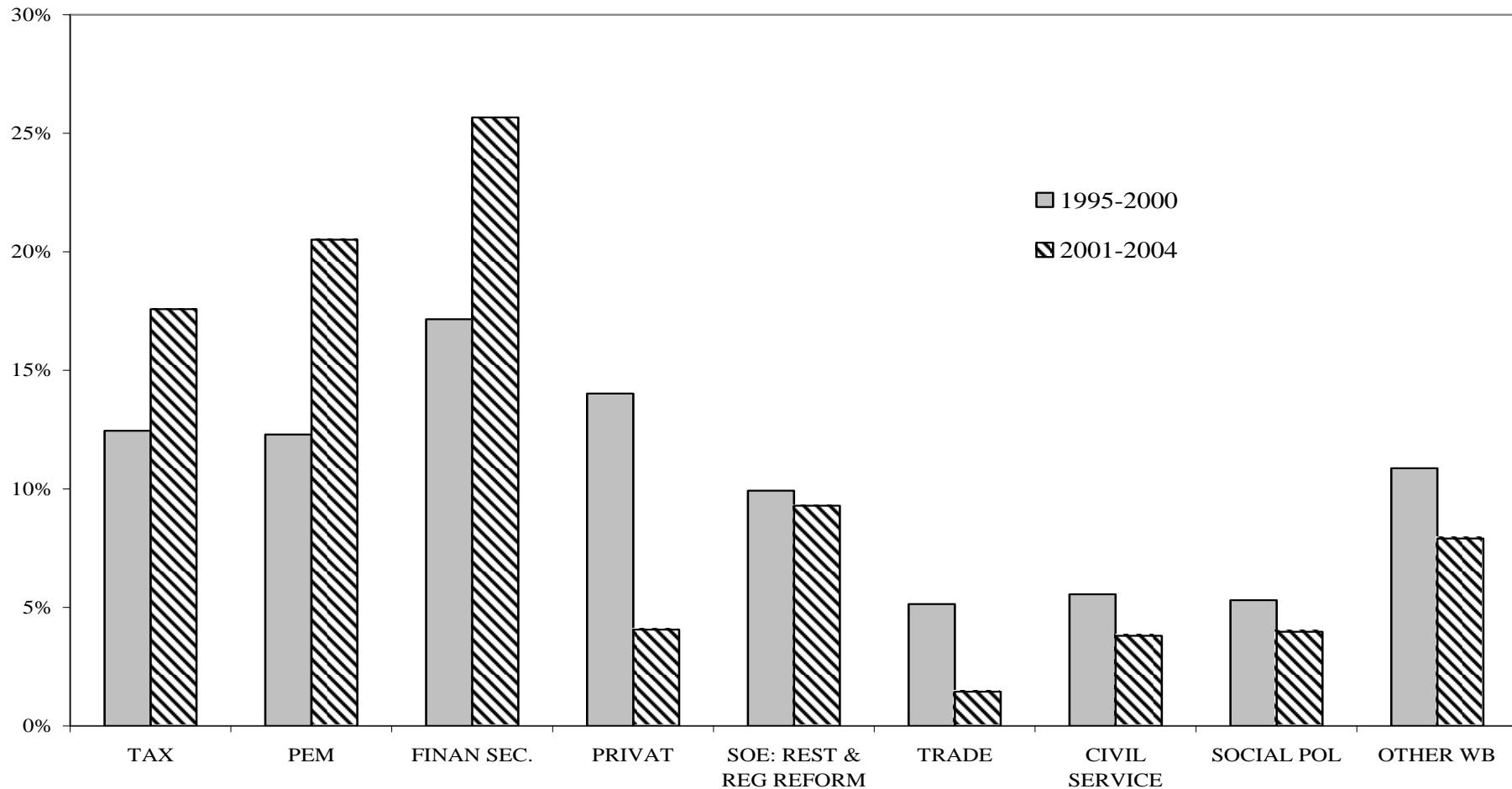
- Number of structural conditions remained stable at about 17 per program/year
- Higher for PRGF and lower for SBAs

Possible Reasons

- Donors' demand conditionality as a monitoring tool for their own initiatives:
 - HIPC
 - Large number of conditions in EU Accession
- Dynamics between staff, Management and Board:
 - Staff survey finds mixed signals from Board
 - Review process requires comprehensiveness

Significant Changes in the Sectoral Distribution of Conditionality

All Programs



Changes in Composition of SC since 2000

- The composition of SC shifted significantly toward IMF core areas and to basic fiduciary reforms and away from controversial areas such as privatization
 - PEM (↑), Financial sector (↑)
 - Privatization (↓), Trade (↓)
- These developments reflect changes in program design and not changes in distortions in these sectors.
- WB conditionality underwent similar sectoral changes.

Has Criticality been implemented?

- Changes indicate move to “core macro”
 - But 1/3 of conditions still in non-core
- A large share of conditions appears non-critical (50% had limited SD)
 - And at the same time it is unclear how to handle critical reforms in non-core sectors.

A few thoughts on the
findings

A few thoughts on the findings

- Low depth and compliance rates suggest that:
 - Conditions did not provide borrowers with predictability on the availability of resources,
 - did not they play a role in safeguarding IMF resources.
 - difficult to see how they could have been critical to meeting objectives.

A few thoughts on the findings

- Criticality has not been a sufficiently strong filter to bring a reduction in the number of conditions.
- Collective action problem impedes parsimony
- Need a M&E framework to assess whether conditions are critical and whether program is successful.

A few thoughts on the findings

- There are trade-offs in the use of conditionality to monitoring donor initiatives. Is this an appropriate and legitimate use of conditionality in Fund arrangements?
- Large number of conditions seen as intruding in the policymaking process and detracting from society's ownership of programs.
- Conditions, even with limited structural depth, tax implementation capacity.
- Legitimacy undermined by public's lack of understanding about the sources of conditions.

Main Recommendations

Policy review

- Board should clarify what it expects in terms of numbers and focus of structural conditions.
- Notional cap on the number of structural conditions per program/year.
- Board should clarify whether SC should continue to be used as a monitoring tool for donor-led initiatives. Non-lending instruments?

Program and conditionality design

- Staff should structural conditions that contribute significantly to program goals identified by the authorities.
- Fewer prior actions and performance criteria
- Conditions should be set only in core areas of IMF staff in-depth knowledge, e.g., fiscal and monetary policy, and aspects of finance.
- Discontinued the use of structural benchmarks and of conditions with low structural content.

Cooperation with the World Bank

(and other partners)

- The IMF should play a subsidiary role to that of the World Bank and other partners in setting conditions in areas where they have greater expertise.
- Explicit Board guidance would be needed when policy changes in non-core areas are deemed critical but effective cooperation with the Bank is unlikely to crystallize in time.

Development of a monitoring and evaluation framework

- The Fund should develop a monitoring and evaluation framework linking conditions in each program to reforms and specified goals.
- In the interim, it should improve and disclose its current monitoring data base, MONA.

Information in Board documents

- Program documentation needs to be more explicit about the objectives being supported by the IMF arrangement and how the proposed conditionality would help achieve these objectives.
- For PRGFs, in particular, program requests should be accompanied by an operational roadmap covering the length of the program, elaborating on the modalities of the reforms and on their sequencing and expected impact.

IMF outreach

- The IMF needs an outreach effort aimed at clarifying misunderstandings about how structural conditions are set and by whom.
- To be effective, such an effort would need to be supported by the Executive Board and the member countries.