

CONFERENCE ON CONDITIONALITY
Norway
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Conditionality in Fund-supported programs has always served two key purposes...

It provides **assurances to the member** on what is required to access Fund resources while at the same time serving to **safeguard these resources**. More generally, conditionality alerts national authorities and the Fund when program objectives are unlikely to be fulfilled—and corrective actions are necessary if program goals are to be met.

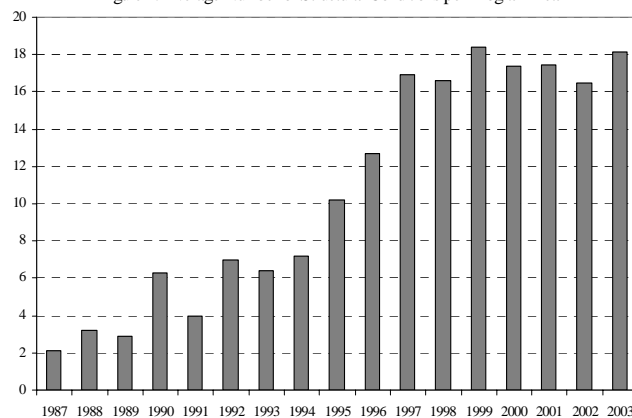
But the application of structural conditionality has evolved over time in the light of evolving goals of Fund-supported programs and program design.

Inclusion of structural measures—and conditionality—in Fund-supported programs began because of criticisms that adjustment programs focused exclusively on stemming aggregate demand rather than on policy measures that would serve to increase aggregate supply. In fact, the need for structural reforms was first recognized during the oil shocks of the late 1970s and the debt crisis of the early 1980s, as these events highlighted the need to address structural weaknesses in order to sustainably address macroeconomic imbalances.

A simple, crude metric to assess the use of conditionality is the number of conditions per program year. Based on this metric, there were only 2 or 3 conditions per year in the early 1990s, but this average increased as the goals of Fund arrangements multiplied. In particular, three factors are behind the increased use of structural conditionality:

- the **challenges faced by transition economies**, which required simultaneous action in many sectors and the development of new institutions and organizational arrangements;
- the **expanded role of Fund lending operations in low income countries**, which highlighted the importance of measures that improve economic efficiency to foster growth and poverty reduction; and
- the **importance of addressing financial sector and other balance sheet vulnerabilities**, which was brought to light with the Asian crises and is of particular importance in emerging market economies.

Figure 1. Average Number of Structural Conditions per Program Year



Empirical evidence suggests that structural measures that are subject to conditionality in Fund-supported programs have important beneficial effects. In particular, there is a close association between program goals and the nature of structural measures included in Fund-supported programs. Moreover, economic efficiency-enhancing measures included in programs are associated with economically and statistically significant better growth

performance, and revenue-enhancing structural measures are associated with better fiscal performance (The Design of IMF-Supported Programs; OP 241).

Nevertheless, the increase in the number of conditions raised questions about the focus of Fund-supported programs and the use and effectiveness of Fund conditionality...

Many academics and stakeholders argued that conditionality was intrusive and was not adequately tailored to country circumstances, both in terms of what the country needs to do as well as in terms of the socio-political factors of economic reform.

Against this background, the Board approved new Conditionality Guidelines in September 2002—the first revision since the late 1970s. These guidelines have five pillars...

- country ownership;
- parsimony and criticality;
- coordination with other institutions;
- tailoring conditionality to country circumstances; and
- clarity in the specification of conditionality.

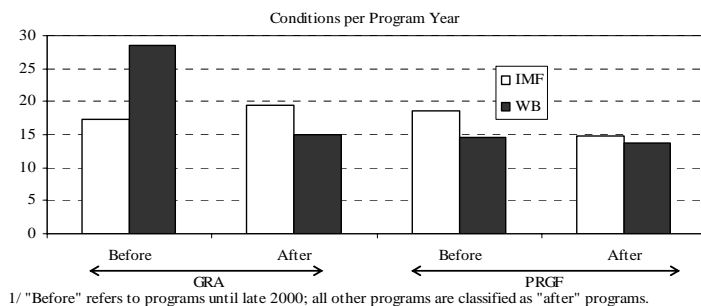
But the guidelines emphasize in particular the importance of country ownership and the concepts of parsimony and criticality that should apply to conditionality...

On ownership: The guidelines highlight that it is the member country that has primary responsibility for the selection, design, and implementation of a Fund-supported program and related conditionality. Fund staff should aid in the identification of policy options, but it is the authorities that must come up with a program that can achieve their goals.

On parsimony and criticality: The guidelines state that conditionality should be applied only to measures that are **critical** to achieve the goals of the Fund-supported program. There are two guiding principles. First, conditionality should be applied to **all such critical measures**. Second, conditions need to be set at the **minimum necessary level**.

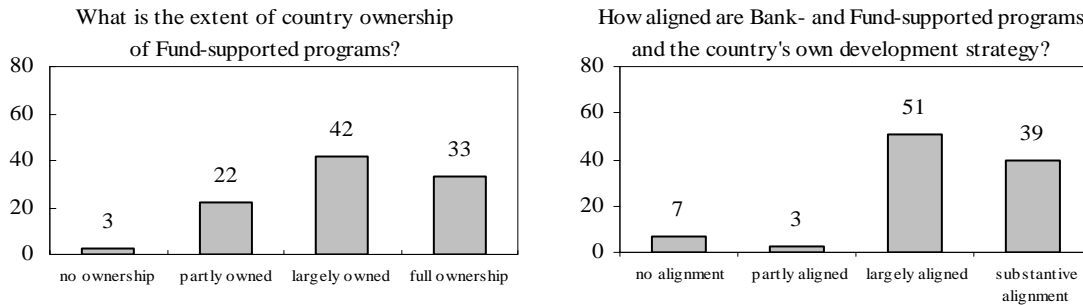
In general, we have already seen a number of positive developments. The Review of the new Conditionality Guidelines undertaken in 2005 found...

- Fewer program interruptions have taken place since the introduction of the new conditionality guidelines.
- Conditionality is less scattered across different reform areas, suggesting that there is greater focus in Fund-supported programs.



- Aggregate World Bank and Fund conditionality (number of conditions per program year) is declining, both among PRGF and GRA member countries.

In terms of ownership, surveys of national authorities' perceptions in countries with Fund-supported programs—carried out before and after the new guidelines (the latest in late 2003; charts)—show that country ownership has improved and a close alignment with the country's own development program (though of course there is room for improvement)...



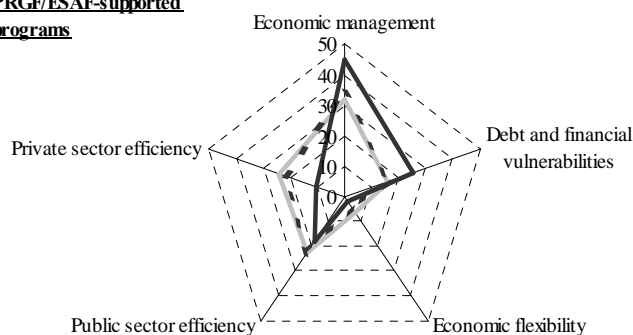
And, for low-income countries in particular, regular reviews of the PRSP process—which provides the crucial link between country ownership and conditionality—emphasize areas related to ownership where scope for improvement exists...

The most recent PRSP assessment (late 2005) finds that there is a good alignment between the goals of PRGF arrangements and PRSPs and that, to further improve operations and respond to countries' needs, the Fund's near-term priorities are to: (i) help countries design realistic, yet flexible, macroeconomic frameworks linked to national strategies and budgets; (ii) increase focus on the sources of (and obstacles to) growth; (iii) examine the distributional impact of economic policies; (iv) strengthen public expenditure management and poverty and social impact analysis of policy choices; and (v) work with other donors for better-coordinated assistance that will enhance aid effectiveness.

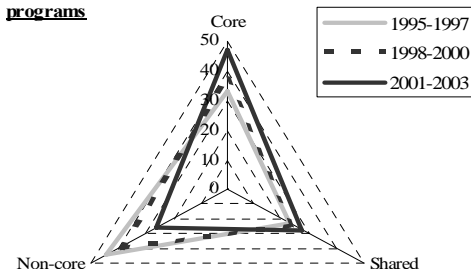
In terms of criticality and parsimony, in the case of low income members specifically (though not exclusively), the application of conditionality is changing...

- PRGF conditions have fallen in number and become more focused. Nevertheless, care has been taken to ensure that *all* areas that require conditionality—i.e., that are critical to the success of the program—are covered. Parsimony is not an objective in and of itself.
- A few points are worth noting on how conditionality is changing. First, there has been a shift toward conditionality focused on economic management. Second, there has been a shift away from supply-side conditionality. Finally, as many low-income countries have completed first-generation structural reforms and have realized a measure of macroeconomic stability, second-generation reforms such as those to improve absorptive capacity and reduce poverty have become more important.

PRGF/ESAF-supported programs



PRGF/ESAF-supported programs



- Also, there is close coordination with the World Bank and other development partners. Toward this end, the Managing Director and World Bank President have established an external committee on Fund-Bank collaboration, which is expected to report by end-2006.

But more needs to be done in the design of Fund-supported programs and corresponding conditionality, in particular to ensure that...

- Conditionality is set using realistic timetables and takes into account a country's implementation capacity—and hence that 'waiver' rates decline further.
- Sufficient ex ante policy space is provided; conditions should not only be critical, but should also be set at the minimum necessary to achieve the program's goals.
- Structural benchmarks are not used loosely; i.e. do not cover non-critical reforms.

Moreover, while the design of conditionality is applied consistently across all members, program design does vary depending on the type of facility being used and what we have learned as we use these facilities...

- The new **Exogenous Shock Facility**, which provides financial assistance to low-income countries that are facing sudden and exogenous shocks and do not have a PRGF arrangement in place, has conditionality that is comparable to that of a PRGF but is limited to measures that address the external imbalances arising from the exogenous shock.
- **Emergency Natural Disaster Assistance (ENDA)** and **Emergency Post Conflict Assistance (EPCA)**, which provide emergency assistance for low-income countries, are designed to be disbursed rapidly and do not involve adherence to performance criteria. EPCA's were originally designed as a one-off operation, but are now possible over a three year period because we learned that rebuilding institutions in post-conflict cases takes time.
- The IMFC recently supported the development of a **Reserve Augmentation Line** for EMEs, a key component of the MD's Medium-Term Strategy. The approach to conditionality in this facility draws on what has been learned through our experience with the CCL.

In sum, lessons have been learned regarding how best to approach conditionality and program design...

Successful implementation of structural reform requires structural conditionality to be: strongly owned by countries, well-coordinated with other development partners, and targeted toward the achievement and maintenance of macroeconomic stability and growth.

...and another opportunity to draw lessons will take place with the review of structural conditionality being prepared by the IMF's Independent Evaluation Office (IEO), which will be discussed by the Board in early 2007.

To conclude, conditionality is a fundamental element of the Fund's financial operations to support its members. But our approach has evolved over time, and will continue to do so.

We are always open to learning lessons from the past and to new ways on how to improve the design of Fund-supported programs and, in particular, to hearing your views today.