

# Streamlining Conditionality in Bank and Fund Supported Programs

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A recent paper produced jointly by the staffs of the Bank and the Fund and discussed by the Executive Boards of both institutions has led to a number of comments on how the effort to streamline conditionality has had a tangible effect in Fund programs, but not so in Bank loans.<sup>2</sup> These comments are based on a chart that showed how conditionality in programs with low-income countries had evolved from the period 1998-2000 to the period 2001-2002 (Figure 1). While a broad definition of Bank conditionality may give support to that conclusion, *a narrower definition actually shows that the streamlining effort is producing noticeable results in low income countries in all areas except for that of fiscal management*. A slight increase in conditionality in this area has followed the greater emphasis on improving development effectiveness in all public expenditures, and the move towards a more aggressive stance on debt with the Heavily Indebted Poor Countries (HIPC) initiative and the development of Poverty Reductions Strategy Papers (PRSP). Moreover, *when middle income countries are brought into the picture, overall conditionality has declined in recent years, including in the area of fiscal management*.

## The Streamlining Effort

In the late 1990s, the Bank and the Fund decided to streamline conditionality, following the perceived surge at the time of the debt crisis as well as a growing discomfort with the effectiveness of the support provided by both institutions. The streamlining effort entailed a reduction of the amount of conditions in programs, while sharpening their focus. On the part of the Bank and the Fund that meant being flexible and responsive in discussing alternatives with the client countries, so that the smaller conditionality set could produce better development outcomes. The expectation was that streamlined conditionality would lead to greater ownership of the reform programs, which would in turn lead to less policy reversals and a more sustained implementation. The move also addressed the need for a better tailored approach in the design and follow-up of second generation reforms, and in bringing about lasting institutional development.

The Executive Boards and Managements of both institutions provided clear signals in this regard, by stressing ownership in each case, while following closely the number and content of conditions. Thus, the concept of conditionality gradually shifted, moving the due diligence of the institutions to ensure the effectiveness of their support toward greater emphasis on the quality and appropriateness of policy actions, and away from the sheer number of those actions. Within this framework, both the Bank and the Fund sought to focus more intensely in their respective areas of expertise, reducing conditionality

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<sup>1</sup> The views expressed are exclusively those of the authors, and in no way represent the official views of the World Bank.

<sup>2</sup> *Strengthening IMF-World Bank Collaboration in Programs and Conditionality—Progress Report* (IMF document SM/04/57 and World Bank document SecM2004-0070, February 25, 2004).

overlap.<sup>3</sup> The idea was to adopt a coherent approach based on an efficient division of labor, with each institution focusing its conditionality on measures critical to their respective programs' success.

### **From Broad to Narrow Conditionality in Low Income Countries**

Focusing on low income countries and with a broad concept of Bank conditionality, Figure 1 shows how the streamlining effort led in the Fund to a sharp decrease in the average number of structural policy conditions under PRGF arrangements, with a heavier load remaining in the institution's core areas of responsibility—economic management, tax policy, exchange rate policy, monetary policy, and capital account. In parallel, the Bank expanded structural conditionality in its core areas—poverty reduction strategies, governance and regulatory reforms, while remaining strong in other social and economic sectors—agriculture, infrastructure, etc.. In the two areas where both institutions share a strong mandate—financial sector and fiscal management, both institutions reduced their emphasis on the former, while increasing the average number of conditions on fiscal management issues.

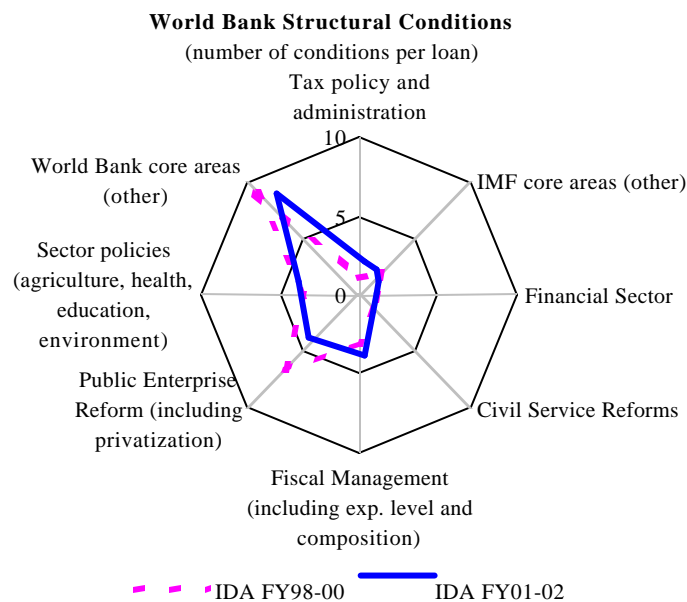
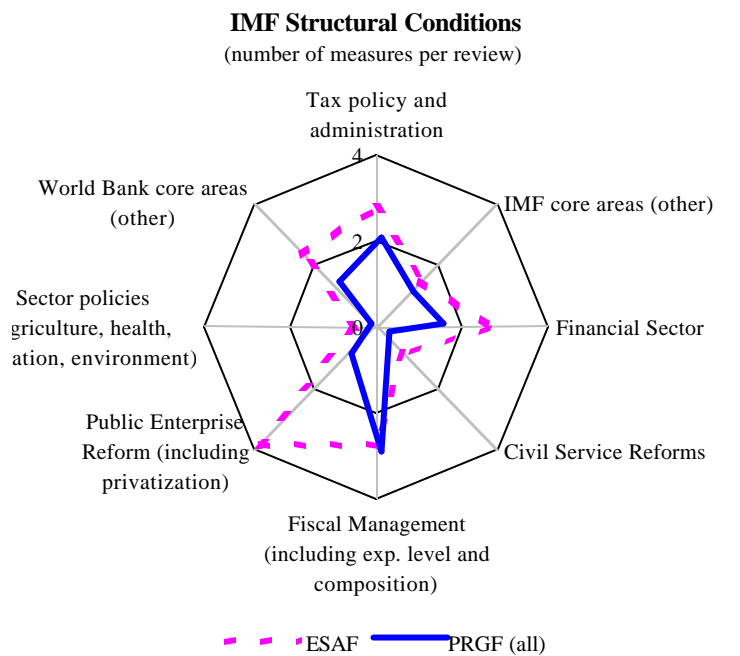
The picture on the Bank side changes significantly when only binding conditions are taken into account. While the broad concept includes policy actions that borrowing countries intend to implement, the stricter concept of binding conditions only includes those policy actions that need to be taken in order to allow the borrower to draw on the loan. With the advent of the PRSPs and the ensuing Poverty Reduction Support Credits (PRSC), the policy matrix associated with these credits and grants included actions that were central to the overall strategy, but that were not elevated to the level of program conditions. The attribute of being a binding condition is typically reserved for those policy actions that are judged as necessary for the success of the overall strategy.

As Figure 2 shows, streamlining has also had a significant impact on the average number of binding conditions in Bank programs with low income countries. Conditions have declined in all areas, except in fiscal management. The decline has been more noticeable in the core areas of the Fund, including tax policy and administration, and economic management—exchange rate policy and monetary policy, as well as on public enterprise reform. The Bank remains focused on poverty reduction and other social policies, as well as on sectoral policies—agriculture, infrastructure, etc..

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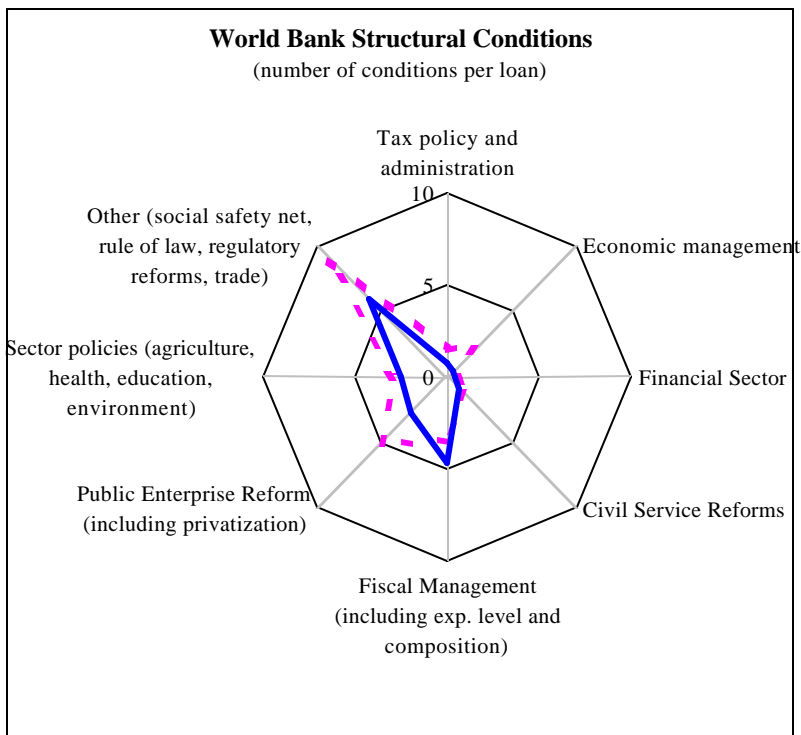
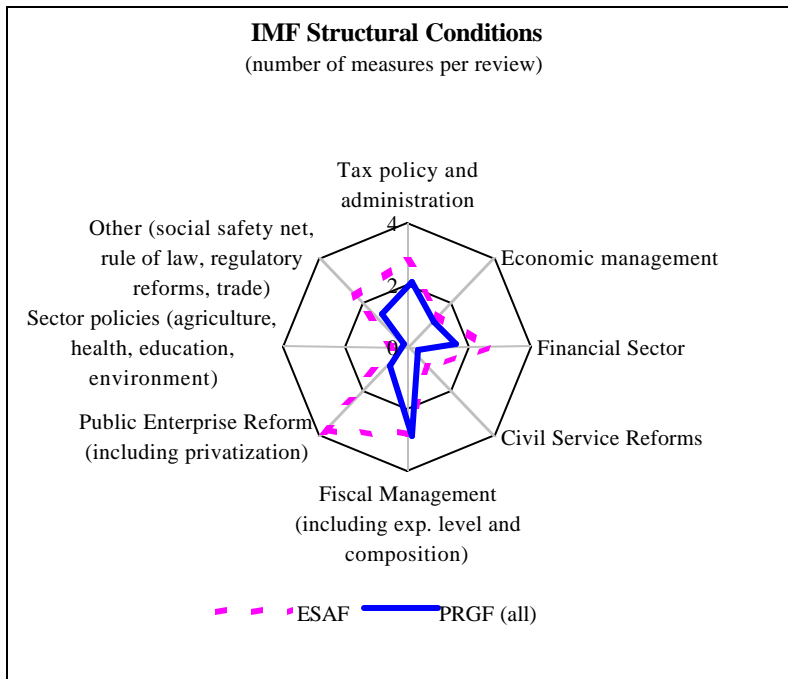
<sup>3</sup> See *The IMF and the World Bank Group: An Enhanced Partnership for Sustainable Growth and Poverty Reduction*, Joint Statement by Horst Köhler, Managing Director, and James Wolfensohn, President (SecM2000-536), September 5, 2000. See also *Report of the Managing Director and the President on Bank-Fund Collaboration* (IMF document SM/98/226 and World Bank document SecM98-733, September 4, 1998). See also *Strengthening IMF-World Bank Collaboration on Country Programs and Conditionality* (IMF document SM/01/219 and World Bank document SecM2001-0461/1, August 23, 2001), and *Strengthening IMF-World Bank Collaboration on Country Programs and Conditionality—Progress Report* (IMF document SM/02/271 and World Bank document SecM2002-443, August 19, 2002).

**Figure 1: A view with “broad” Bank Conditionality<sup>4</sup>**



<sup>4</sup> As presented in *Strengthening IMF-World Bank Collaboration in Programs and Conditionality—Progress Report* (SM/04/57 and SecM2004-0070). Broad Bank conditionality refers to legally binding policy actions, as well as other policy commitments that have no direct bearing on the borrower’s ability to draw on a loan.

**Figure 2: A view with binding Bank Conditionality only<sup>5</sup>**

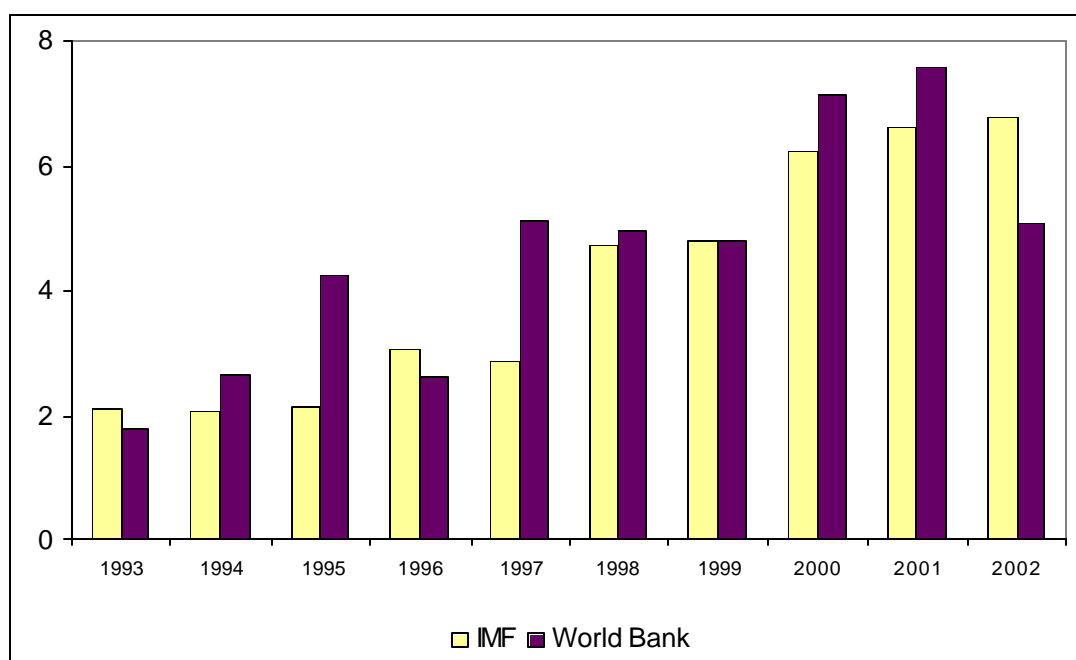


<sup>5</sup> Legally binding conditions in Bank loans are those that need to be fulfilled in order for the borrower to be able to draw on the loan.

## The Shared Emphasis on Fiscal Management

Fiscal management is the only area where the streamlining effort resulted in an increase in the average number of conditions for low income countries, when comparing the 1998-2000 with 2001-2002. Nevertheless, and *in line with the overall trend*, when middle income countries are brought into the picture, the average number of conditions has begun to taper off (Figure 3).

**Figure 3: Fiscal Management Conditionality in the Bank and the Fund  
(Average number of conditions per loan or arrangement)**



The emphasis on fiscal management reflects the decision to improve the effectiveness of all development expenditures, and not just those financed with the support from the Fund and the Bank. This improvement is the element that brings comfort regarding a judicious resource use, thus facilitating the streamlining of conditionality. Fiscal management covers four basic topics: fiduciary issues (financial management, procurement and transparency), public expenditure management (structure, efficiency and medium term framework), debt management (debt and debt service workouts and development and management of domestic debt markets), and decentralization and local governments (transfers of revenue and expenditure, administrative independence, local delivery of services).

The Bank's interventions in support of fiscal management programs in low and middle income countries gained momentum in the second half of the 1990s, with the heightened interest in fiduciary issues and the change in the paradigm for debt management (Figure 4). These leaps topped the increasing awareness of the relevance of public expenditure management that had already started to pick up in the early 1990s.<sup>6</sup> Beginning in 1997, more attention was provided to increasing transparency in public resource management initially, and improving financial management and procurement later. At the same time, the approach for solving the problems faced by debt ridden countries began to change significantly with the introduction of HIPC in the Fall of 1996.

A long view of how conditionality on fiscal management has evolved suggests that the average number of conditions stepped up to a new level in 1997, but has remained rather constant since (Figures 4 and 5). Indeed, the peaks observed for the universe of countries in 2000 and 2001 (Figure 4) correspond to specific programs intended primarily to boost fiscal management, which happened to bunch in those two years. While in 2000 fiscal management conditionality increased mostly because of programs in middle income and blend countries, in 2001 the increase was due to low income countries (Figure 5).<sup>7</sup>

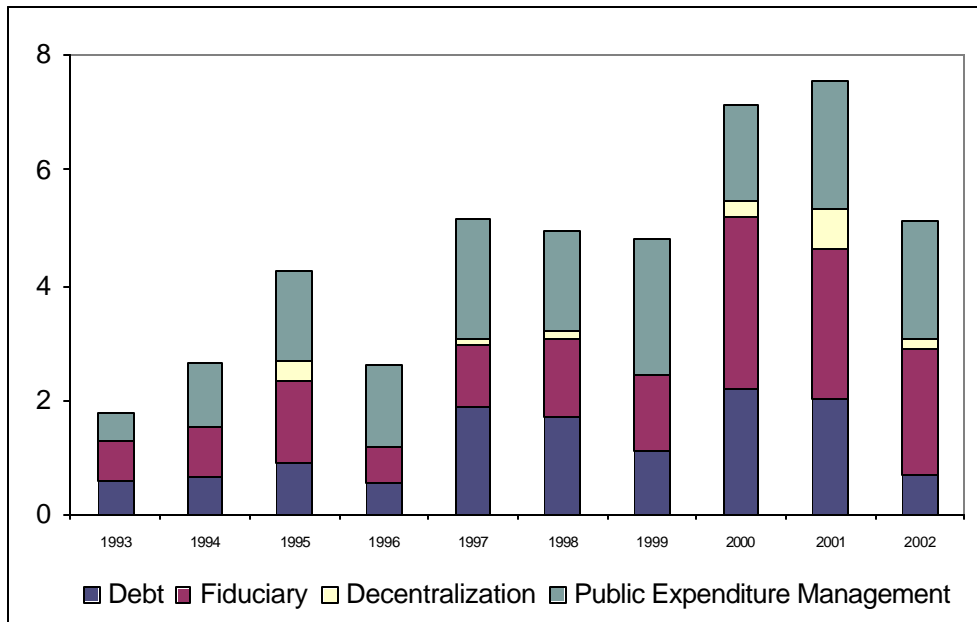
#### **Analytical Work and Fiduciary Conditionality**

The emphasis on fiduciary conditionality has gained structure from the Country Financial and Accountability Assessments (CFAA) and from the Country Procurement Assessment Review (CPAR). Using these two pieces of analytical work prepared jointly with the country and with other external partners, the Bank and the Fund are now approaching the necessary institutional strengthening in these areas in a more systematic and coordinated way. A major actor in bringing together this kind of analytical work has been the Public Expenditure and Financial Accountability (PEFA) partners. The PEFA program is a partnership of the World Bank, European Commission, the Fund, UK Department for International Development, Swiss State Secretariat for Economic Affairs, French Ministry of Foreign Affairs, Norwegian Ministry of Foreign Affairs, and Strategic Partnership with Africa. The PEFA program is managed by a Steering Committee consisting of headquarters representatives of the member agencies.

<sup>6</sup> The observed blimp in 1995 corresponds to two operations: Argentina's Provincial Reform Structural Adjustment Loan, and Ecuador's Structural Adjustment Loan.

<sup>7</sup> The 2000 programs that account for the increase in the bar were Brazil's Administrative and Fiscal Reform Structural Adjustment Loan, India's Uttar Pradesh Fiscal Reform and Public Sector Restructuring Credit, and Papua New Guinea Governance Promotion Adjustment Loan. The 2001 programs that contributed most to the blimp were Benin's Public Expenditure Adjustment Credit, Kenya's Economic and Public Sector Reform Adjustment Credit, and Uganda's and Vietnam's Poverty Reduction Support Credits.

**Figure 4: World Bank Conditionality on Fiscal Management**  
 (Average number of conditions per operation in low [IDA] and middle [IBRD] income countries)



**Figure 5: World Bank Conditionality on Fiscal Management in Low Income Countries**  
 (Average number of conditions per operation in IDA countries)

