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Assessing the Effectiveness of IMF Structural Conditionality

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I. Introduction

This paper[(1)] assesses the effectiveness of structural conditionality in bringing about reforms in structural policies in countries undertaking a program financed by the International Monetary Fund (IMF). To this end, it tries to respond to the following three questions: how significant would policy changes be if program conditions were met; how often are these conditions met; and to what extent do these conditions serve as a catalyst or at least as a stepping-stone to promote reform in the sectors on which they are imposed.

IMF lending has always been made contingent on conditions that would provide assurance to borrowing member countries that committed resources would be available to them upon compliance with agreed policies and to give the IMF confidence that the country will be able to repay (Guitián, 1981). Through the 1970s, conditionality was almost solely set on variables that reduced demand, as a means to improve the balance of payments with the expectation that lower inflation and better fiscal balances would mitigate adverse effects on growth over the longer term (Goldstein and Montiel, 1986). Beginning in the mid-1980s, lending was increasingly made conditional on structural reforms.

(1) This paper draws on a report from the Independent Evaluation Office of the IMF (IEO), “Structural Conditionality in IMF-Supported Programs”, prepared by a team headed by Ruben Lamdany and Javier Hamann. I am grateful to Alisa Abrams for her comments and assistance. The views expressed in this paper are solely mine and do not necessarily represent those of the IEO, the IMF or IMF policy.

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These structural conditions are set on variables affecting the supply side of the economy, and are aimed at strengthening the sustainability of macroeconomic adjustment while relaxing the need for contractionary demand-side measures. However, use of structural conditionality evoked growing criticism as its scope and volume widened over time. Critics were concerned about the legitimacy of the IMF setting conditions outside the areas of its core mandate and competence, and they saw structural conditionality as intrusive and taxing local capacity (e.g., Action Aid, 2004; Eurodad, 2006; Oxfam, 2006).

There is a considerable body of literature on the purpose, design, effectiveness and impact of structural conditionality. Drazen (2002) sees structural conditions as a useful tool for governments to demonstrate their commitment to sustainable macroeconomic stability. James (1998) and Mussa and Savastano (1999) study the use of conditionality by donors to further their goals and aid agendas, while Martin (2006) focuses on conditionality as an accountability tool for donors. Goldstein (2000) shows that conditionality can assist authorities in setting and sustaining domestic priorities.

On the other hand, Killick (1997, 1998) argues that conditionality fails to achieve compliance and its intended outcomes. Kanbur (2000), Dollar (2001), and Villanger (2004) offer various arguments as to why conditionality is not always a good enforcement tool for donor programs. Giustiniani and Kronenberg (2005) argue that by the mid-1990s it was increasingly recognized that excessive structural conditionality "could undermine national ownership of a policy program, strain administrative capacity, and weaken implementation of policies that are truly essential." These latter two issues, the extent of compliance and the ability of conditionality to bring about lasting policy changes, are the focus of this paper.

The remainder of this paper is organized as follows. Section II provides a description of structural conditionality in Fund-supported programs approved between 1995–2004, including how conditions were distributed across categories of structural depth. Section III discusses compliance with structural conditions; and Section IV presents an assessment of the extent to which structural conditionality was followed by additional reforms in the corresponding sector. Section V presents the main conclusions of the study.

II. Structural Conditions: How much change would they bring about?

This section provides a description of structural conditionality in Fund-supported programs, including the sectoral distribution of those conditions and the degree of structural change that they would bring about if implemented. In this paper, structural conditions are defined as those conditions included in IMF programs that are not specific quantitative targets related to the financial programming. Structural conditionality was pervasive during the period studied (1995–2004). There were over 7,000 structural conditions in the 216 programs approved during this period for 94 countries, with an average of 17 conditions per year of program.

These conditions spanned across most sectors in the economy and they covered changes in legislation, policies, and the structure of economic incentives, as well as institutional reform. About two-thirds of all structural conditions were concentrated in sectors that constitute the core areas of IMF mandate and expertise (the “core”), including taxation, public expenditure management, financial sector reform, and issues related to exchange rate and monetary policy. The other one-third of the conditions focused on areas over which the IMF has much less expertise (“non-core”), primarily state-owned enterprise reform, privatization, social policies, and civil service reform. Table 1 shows the sectoral distribution of conditionality over the period.

Structural conditions vary in the degree and durability of the structural change that they would bring about if implemented. Some conditions may entail little or no structural change (i.e., one-off, easily reversible measures such as raising the price of gasoline) while others may have a profound and lasting effect (i.e., a comprehensive reform of the labor market). In order to get a sense of their degree of structural depth (SD), we classified all the conditions into three categories[2]:

- Little or No SD (0). This category includes conditions that would not, by themselves, bring about any economic changes, neither structural nor macro. Some of these conditions may serve as stepping stones to significant reforms, but this would require follow-up action.[3] Examples of little or no SD include the preparation or announcement of plans, strategies, or legislation; the definition of rules, drafting or submission of legislation to Congress, and the hiring of consultants to perform agreed upon tasks.
- Limited SD (1). This category includes conditions calling for one-off measures that could be expected to have an immediate and possibly significant effect, but that would need to be followed by other measures in order for this effect to be lasting. It encompasses conditions of two main types: those requiring one-off fiduciary measures, and quasi-macro quantitative conditionality. Examples of the former include the publication, by a given date, of the federal budget or the accounts of public enterprises, or the preparation of specific audits. Examples of quasi-macro quantitative conditionality include changes in controlled prices, limits on the growth of a wage bill, or the reduction of arrears of certain public enterprises. Other examples in this intermediate category include conditions leading to the establishment of a pilot system or project and the implementation of existing legislation or regulations. One particularly important condition included in this category is the approval of a specific budget law. This is a legislative action, but it is a "one-off" event in that it must be undertaken yearly.
- High SD (2). This category includes conditions that, by themselves, would bring about long-lasting changes in the institutional environment. Most of the conditions in this category entail legislative changes (e.g., approval,

(2) Each category was assigned a numerical rating which was used to calculate the average structural depth of different types of conditions, as reported in Table 1.

(3) The analysis in Section IV links program conditions and follow-up actions.

adoption, or enactment of legislation by a parliament). This category also includes conditions requiring that certain fiduciary measures be taken on a regular and/or permanent basis, even when legislation is not needed (often these measures are implemented through regulation). Examples of such measures are similar in substance to conditions with limited SD, but are expected to have effects that are more lasting. This category also includes conditions with long-lasting structural impact that may be grounded in pre-existing legislation but that probably could not be undone without new legislation, e.g., implementing civil service reform or privatization.

Data from a sample of 43 programs approved between 1999 and 2003 were used to analyze the structural depth of conditions based on the classification outlined above.(4) Each of the approximately 1500 conditions in these programs was assessed twice by two different economists, with a third economist reviewing those cases that had received different SD ratings. The classification was done with a bias towards ascribing to each condition the highest possible SD rating. There was sufficient information for about 1,300 conditions (87%) to be able to rate them. The results are presented in Table 1 and in Figure 1. Only 4 percent of conditions were rated as having High SD, and more than 40% as having little or no SD. The overall distributional pattern is broadly similar for conditions in core and non-core areas, but the average SD appears to be higher for the core sectors, indicating that the Fund was supporting more ambitious sectoral reforms in the sectors of its core competence.

(4) The period was truncated at 2003 to avoid selecting programs that could still have been ongoing at the time of the study. These programs accounted for 1,567 of the 3,652 conditions in the 103 programs that were approved during that period, and the analysis was based on the 1,306 conditions for which there was information on relevant variables used for assessment. The sectoral distribution of conditions in this sample is not significantly different from that for the universe of programs approved during 1995-2004. Thirty of the 43 programs were chosen randomly and the remaining 13 were selected from a stratified sample used to create a representative set of countries used for in-depth case studies, which focus on issues not discussed in this paper.

III. Are structural conditions being complied with?

This section analyzes compliance with structural conditionality in IMF-supported programs. It also examines the extent to which compliance varies across sectors and whether it is related to the structural depth of conditions. The documentation for IMF arrangements (i.e., IMF loans) specifies the actions that the authorities need to take and the dates by which these actions need to be taken for the funds in the corresponding tranche to be made available. If all conditions are complied with, i.e. met as agreed, the borrower can draw the corresponding tranche on the agreed date. Otherwise, the borrower may seek waivers from the IMF Board of Directors. Waivers are sought for late or partial compliance, and sometimes to altogether avoid having to make the agreed upon changes. The Board of Directors reviews the state of the program based on recommendations from IMF management, and decides how to proceed in regard to each condition that has not been complied with. Also during these reviews, modifications are made to conditions for future tranches, allowing programs to adapt to changing circumstances. Often the need for waivers leads to delays in tranche disbursement, but the program eventually goes back on-track. Sometimes, however, waivers are not granted and the program goes permanently off-track and is terminated. In this case, the authorities would need to request and negotiate a new arrangement or loan.

About half of the 7,000 structural conditions during the period being studied were complied with on time. This compares with over 80 percent compliance for quantitative macro conditions (IMF, 2005). Another 25 percent of structural conditions were complied with etiher late, only in part or with modifications.(5) The data do not allow for distinguishing the extent of late compliance nor whether conditions were eventually met as agreed or modified. These figures are drawn from a database that only includes the conditions in programs that were

(5) As part of a waiver request, borrowers sometimes substitute a particular measure with a different one that would have similar macroeconomic impact, even if the structural impact would be very different. For example, the sale of a state-owned enterprise might be substituted by an increase in the value-added tax that is projected to bring a similar impact on revenues.

eventually completed. The compliance rate would be much lower if it included programs that went off-track.(6) Compliance rates were significantly higher for conditions in the core sectors (60 percent compliance in core sectors versus 39 percent in non-core). One possible explanation is that monetary and fiscal authorities, the IMF's main counterparts, were better able to oversee and track compliance with conditions in areas under their responsibility but found it more difficult to manage this process in other, non-core areas.

The analysis on the interaction between compliance and structural depth was conducted based on data from the sample of 43 programs discussed above, since this information is only available for these programs (Table 2). As noted above, this is a representative sample, and total and sectoral compliance rates for these 43 programs are similar to the rates for the whole universe of 216 programs. Compliance rates were much lower (at less than one-third) for conditions with high SD—probably because these conditions are in general more difficult to implement. About one-quarter of all structural conditions had significant or limited SD and were complied with. Again, this proportion was greater in core sectors. This compliance rate rises only to about 40 percent when allowing for conditions that were only partially met or met after a delay. It is surprising that compliance rates were so low, especially because almost half the conditions did not require policy or institutional changes.

IV. Structural Conditionality: A weak catalyst for reform

This section examines whether structural conditionality was effective in bringing about follow-up structural reforms, as well as whether reforms were sustained over time. It assesses whether there was a link between compliance with conditionality and its effectiveness at securing durable reform, and whether the relationship between compliance and effectiveness varies according to the degree of structural depth of the measures. To avoid intractable causality

(6) On the other hand, the data do not include prior actions, which in this sample are met by definition. Including them would raise compliance to over 60 percent.

problems, the analysis asked whether structural conditions had been a step within a broader sectoral reform—i.e., whether compliance with a particular condition was followed by additional reforms in the corresponding sector—but it did not try to establish a direct causal link. Admittedly, this criterion is a very low threshold for establishing effectiveness, since it links specific conditions to sectoral reforms that may be only marginally (if at all) connected to the corresponding condition, and with reforms that may have taken place without conditionality.

The analysis, which was based on data from the 43 sample programs described in previous sections, was conducted by assessing whether further reforms took place to advance the explicit or implicit objectives in sectors covered by structural conditionality. For each condition we asked whether it was complied with, and what was the average compliance for conditions in the corresponding sector. We then looked at the information available for the period after the program and asked whether additional reforms took place in this sector, or whether the reform had stalled or backtracked. An individual condition was deemed effective if reform continued in the corresponding sector following compliance with that condition. For conditions whose compliance completed a reform, mostly conditions with high SD, the effectiveness test was whether reversals had taken place.

To conduct this analysis it is necessary to have information on what were the explicit or implicit goals were of the sectoral reforms in which the conditionality was embedded (to assess whether there was further progress), and on what happened after the program was concluded. For each of the 43 programs, sectoral objectives were identified for each sector covered by structural conditionality. Sometimes this information could be found in the Staff Report, i.e., the loan document. In other cases, a sectoral strategy had to be gleaned from the description of the overall program. The assessment of the impact of structural conditionality beyond compliance was based on information provided in different IMF reports, mainly the staff report for the first Article IV consultation after expiration of programs, Ex-Post Assessments of the corresponding program, and in follow-up program documents when relevant. The information, therefore, covered a period of between one and one and one half years after the completion of the program. For some conditions and the corresponding sectors, the assessment of follow-up reforms was based on very limited information, especially for conditions linked to late tranches in programs approved in 2003. For others, e.g., for conditions from the start of the early programs, there was information on sectoral reforms that took place over four years after their implementation.

The sectoral follow up was rated based on the identified sectoral goals and using the post-program information. The ratings were 1 when the sectoral goals were achieved in a durable manner or when further reform took place in the intended direction, -1 when the outcome of a condition that had been met was eventually reversed, and 0 when sectoral reform efforts stalled. There were 229 sectors(7) with at least one structural condition for which an effectiveness rating could be given. Additional reforms took place beyond the program in about half of the sectors (53 percent) with at least one condition. In the other half, the reform efforts either stalled (37 percent) or were reversed (10 percent). The about 50 percent follow-up figure has an upward bias since in many cases the specific conditions were not connected with the sectoral reforms that took place subsequently. This bias is not present in regard to reversals, where the figure refers to the specific measures that were taken. Conditionality in core sectors was more likely to be followed up by additional reforms than in non-core sectors. Effectiveness was also measured at the level of individual conditions. In other words, each of the 1,300 assessed conditions was awarded an effectiveness score based on the overall score for its sector. Again, positive effectiveness scores were more common in core sectors.

Is high compliance a good predictor of meaningful, durable reform? Does this depend on the structural depth of the measures subject to conditionality?

(7) Potentially, there could have been up to 387 sectors, if there would have been at least one condition in each of the nine possible sectors in each of the 43 countries. The number 229 means that on average there were about 5 sectors covered in each program.

The analysis showed only a weak link between compliance with structural conditionality and effectiveness at bringing about reform and ensuring its durability. In fact, the probability of further reform in a sector covered by conditionality was not affected by whether conditions had been met as agreed, met partially or after a delay or not met at all. Two sets of correlations were estimated to measure the link between compliance and effectiveness. The first was at the sectoral level using compliance rates and effectiveness scores for 229 sectoral observations. The second set measured the same relationship at the individual condition level assigning each of them the effectiveness measure awarded to its respective sector. Neither set of tests revealed a significant correlation between compliance and the indicator of effectiveness. Similarly, no significant correlation was found between structural depth of conditions and their effectiveness, in terms to leading to further reforms in the sector.[8]

V. Main Conclusions

This study explored the effectiveness of IMF structural conditionality at bringing about durable policy reforms. There was extensive use of structural conditionality in IMF-supported programs during the 1995–2004 period, with an average of 17 conditions per program/year. These conditions covered most sectors in the economy and required borrowing countries to undertake certain actions before they could receive financial support. These actions ranged from institutional reforms and changes in legislation, to setting up teams or making announcements. Two-thirds of conditions were set in the core areas of IMF expertise and responsibility, such as public expenditure management and tax-related issues.

The study found that fewer than 5 percent of the structural conditions

(8) In fact, structural conditionality with high SD had a higher than average rate of policy reversals (more than 10 percent as compared to 6 percent for the whole sample). This may be due to a selectivity bias, i.e., the IMF may be more inclined to ask for conditions with high SD when the authorities' ownership of the reforms is low or when the underlying situation is particularly difficult.

called for lasting structural reforms, and only one-third of these were complied with. More than 40 percent of conditions only called for preparing plans or drafting legislation. In view of these figures, it is surprising that only about half of all conditions were met as agreed. Moreover, there was only a weak link between compliance with structural conditionality and subsequent reforms in the corresponding sector—a weak measure of the effectiveness of conditions in bringing about reform. Compliance and effectiveness were higher in the areas of IMF core competency, but even there compliance was only 60 percent.

The findings of this study raise questions about the usefulness of structural conditionality. The low compliance rate with conditions and the low degree of change that they would bring about if implemented suggest that structural conditionality did not play a critical role in providing borrowers with assurances on the availability of resources. It is also unclear how low structural depth conditionality could play a role in safeguarding Fund resources. The low correlation of compliance with continued policy changes beyond the program calls into question the usefulness of structural conditionality in fostering medium-term external viability and sustainable growth. At the same time, the large number of conditions was widely criticized as intruding in the policymaking process and detracting from society's sense of ownership of programs. These are perhaps some of the reasons why there have been recurrent calls both within and outside the IMF for a drastic reduction in the volume and scope of structural conditionality.

Table 1. Distribution of Structural Conditions by Sector and Structural Depth
(43 case studies from 1999-2003)[1/]

Sector Number	Sector Description / Depth	Number of Conditions: All	Low	Limited	High	Share of Total (In percent): All	Low	Limited	High	Average Depth [2/]
1	Tax Policy/Tax Administration	246	83	148	15	19	34	60	6	0.72
2	PEM	273	97	169	7	21	36	62	3	0.67
3	Financial Sector	293	154	128	11	22	53	44	4	0.51
4	SOE Reform	147	48	96	3	11	33	65	2	0.69
5	Privatization	83	53	21	9	6	64	25	11	0.47
6	Civil Service Reform	42	24	15	3	3	57	36	7	0.50
7	Social Policies	34	20	12	2	3	59	35	6	0.47
8	Other Fund Core	72	25	45	2	6	35	63	3	0.68
9	Other World Bank Core	116	54	56	6	9	47	48	5	0.59
Total	All Sectors	1306	558	690	58	100	43	53	4	0.62
Core vs.	Core	884	359	490	35	68	41	55	4	0.63
Non-Core	Non-Core	422	199	200	23	32	47	47	5	0.58

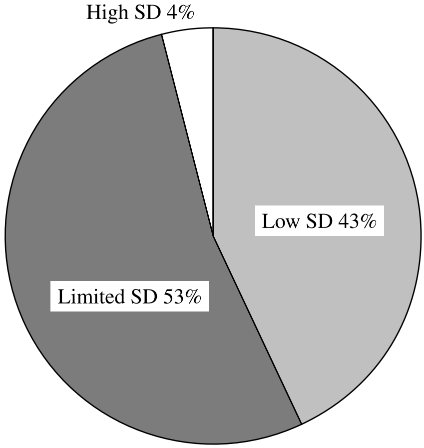
1/ Includes all 1306 fully assessed conditions in the 43 case studies from 1999–2003. Conditions not normalized to correct for program length.
2/ Calculated as follows: "Low"=0; "Limited"=1; and "High"=2.
Source: MONA, IMF staff reports and IEO staff calculations.

Table 2. Compliance with Structural Conditionality, by Depth and Type of Program (43 case studies from 1999-2003)[1/]

		All Programs											
	Structural Depth	All			0			1			2		
Sector Number	Sector Description	Number	Percent of Total	Compliance Rate	Number	Percent of Total	Compliance Rate	Number	Percent of Total	Compliance Rate	Number	Percent of Total	Compliance Rate
1	Tax Policy/ Tax Administration	189	21	64	70	17	59	109	24	69	10	23	50
2	PEM	174	19	53	67	16	58	101	22	51	6	14	33
3	Financial Sector	209	23	56	111	27	58	90	20	58	8	18	13
4	SOE Reform	77	8	43	24	6	42	52	11	44	1	2	0
5	Privatization	51	6	29	33	8	30	12	3	33	6	14	17
6	Civil Service Reform	32	4	31	18	4	22	11	2	45	3	7	33
7	Social Policies	28	3	43	18	4	44	8	2	50	2	5	0
8	Other Fund Core	53	6	64	20	5	70	31	7	61	2	5	50
9	Other World Bank Core	93	10	54	48	12	58	39	9	49	6	14	50
Total	All Sectors	906	100	54	409	100	53	453	100	56	44	100	32
	Core	625	69	58	268	66	59	331	73	60	26	59	35
	Non-Core	281	21	43	141	34	43	122	27	45	18	41	28

1/ Includes 906 fully assessed conditions in the 43 case study countries excluding prior actions.
Conditions not normalized to correct for program length
Source: MONA, IMF staff reports and IEO staff calculations.

Figure 1: Distribution of Structural Conditions by Structural Depth



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Assessing the Effectiveness of IMF Structural Conditionality

<Summary>

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This paper assesses the effectiveness of structural conditionality in bringing about changes in structural policies in countries undertaking IMF-financed programs during 1995–2004. Structural conditions were pervasive during this period, with an average of 17 conditions per program/year, and they elicited strong criticism as being intrusive and undermining government ownership of economic programs.

The study found that fewer than 5 percent of the structural conditions called for lasting structural reforms, and only one-third of these were complied with. Overall, only about half of the conditions were met on time, and there was only a weak link between compliance with structural conditionality and subsequent reforms in the corresponding sector—a weak measure of the effectiveness of conditions in bringing about reform. Compliance and effectiveness were higher in the areas of IMF core competency, such as public expenditure management and tax-related issues, and lower in areas such as privatization and reform of the wider public sector, but even there compliance was only 60 percent. These findings raise questions about the usefulness of structural conditionality in promoting reform, in providing borrowers with assurances on the availability of resources, as well as in safeguarding IMF resources.