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Conditionally yours

An analysis of the policy conditions attached to IMF loans

By Jesse Griffiths and Konstantinos Todoulos

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Contents

Acronyms

CEPR	Center for Economic and Policy Research
CG	Conditionality guidelines
COLA	Cost of living adjustments
CSO	Civil society organisation
DFI	Development Finance International
ECF	Extended Credit Facility
EFF	Extended Fund Facility
Eurodad	European Network on Debt and Development
FCL	Flexible Credit Line
GDP	Gross Domestic Product
GRA	General Resource Account
IEO	Independent Evaluation Office
IMF	International Monetary Fund
LIC	Low-income country
MEFP	Memorandum of Economic and Financial Policies
MIC	Middle-income country
MONA	Monitoring of Fund Arrangements
PLL	Precautionary and Liquidity Line
PRGF	Poverty Reduction and Growth Facility
PRGT	Poverty Reduction and Growth Trust
PSI	Policy Support Instrument
QPC	Quantitative Performance Criteria
RCF	Rapid Credit Facility
RFI	Rapid Financing Instrument
SBA	Standby Arrangement
SCF	Standby Credit Facility
VAT	Value Added Tax

Executive summary

Loans from the International Monetary Fund (IMF) largely come with policy change conditions attached – conditions that the IMF has played a significant role in developing. Criticisms of the excessive burden and politically sensitive nature of these conditions led to significant reviews at the IMF and the introduction of some conditionality-free facilities, although these are limited in scope. The IMF claims to have limited its conditions to critical reforms agreed by recipient governments. However, the worrying findings of this research suggest that the IMF is going backwards – increasing the number of structural conditions that mandate policy changes per loan, and remaining heavily engaged in highly sensitive and political policy areas.

Eurodad's research found that:

The number of policy conditions per loan has risen in recent years, despite IMF efforts to 'streamline' their conditionality. Eurodad counted an average of 19.5 conditions per programme. This is a sharp increase compared to previous Eurodad research, which found an average of 13.7 structural conditions per programme in 2005-07 and 14 per programme in 2003-04.

The biggest IMF facilities in terms of loan totals have the heaviest conditionality. This rise is driven by exceptionally high numbers of conditions in Cyprus, Greece and Jamaica, which together accounted for 87% of the total value of loans, with an average of 35 structural conditions per programme.

Almost all the countries were repeat borrowers from the IMF, suggesting that the IMF is propping up governments with unsustainable debt levels, not lending for temporary balance of payments problems – its true mandate.

Widespread and increasing use of controversial conditions in politically sensitive economic policy areas, particularly tax and spending, including increases in VAT and other taxes, freezes or reductions in public sector wages, and cutbacks in welfare programmes including pensions. Use of these types of conditions tends to be lower in low-income countries, but is very high in some of the largest programmes. Other sensitive topics include requirements to reduce trade union rights, restructure and privatise public enterprises, and reduce minimum wage levels.

> “ If countries are genuinely facing protracted and serious debt problems, then IMF lending only makes the situation worse.

This analysis confirms the findings of other research, which shows that the IMF uses its significant influence to promote controversial austerity and liberalisation measures, with potentially severe impacts on the poorest people around the globe:

- A report published by Development Finance International (DFI) on IMF programmes in low-income countries[1] found that “*the IMF … returned to a path of fiscal conservatism and reduced spending levels from 2010 onwards*”.
- A Center for Economic and Policy Research (CEPR) study of IMF advice in Europe found “*a focus on other policy issues that would tend to reduce social protections for broad sectors of the population (including public pensions, health care, and employment protections), reduce labour’s share of national income, and possibly increase poverty, social exclusion, and economic and social inequality as a result.*”[2]

This is particularly worrying for borrowers from developing countries, who have a limited voice and a minority vote at the IMF. Agreements made in 2010 to increase – by a small amount – the votes of emerging market economies have been blocked by the failure of the US to ratify them. The US has such a large share of IMF votes that it can unilaterally veto these kinds of decisions, while European governments cling on to eight of the 24 seats* on the IMF’s executive board.

It is clear that the IMF’s role and governance needs a major overhaul. We make three recommendations:

- First, the IMF should focus on its true mandate as a lender of last resort to countries that are facing temporary balance of payments crises. Such countries need rapid support to shore up their public finances, not lengthy programmes that require major policy changes. A far more sensible approach would be to extend the example of the IMF’s new but little used Flexible Credit Line to all IMF facilities – requiring no conditionality other than the repayment of the loans on the terms agreed.
- Second, if countries are genuinely facing protracted and serious debt problems, then IMF lending only makes the situation worse. The development of fair and transparent debt work-out procedures should be prioritised by the international community, and at regional and national levels, to assess and cancel unpayable and illegitimate debt. However, the IMF should not be the venue for such debt work-out mechanisms: as a major creditor, they would face an impossible conflict of interest.
- Finally, the IMF must urgently address its crisis of legitimacy, and radically overhaul its governance structure to give developing countries a fair voice and vote, and to radically improve transparency and accountability. A vital first step would be to introduce double majority voting, so that approval is needed from a majority of IMF member countries, in addition to a majority of IMF voting shares.

*The European countries with seats on the IMF’s board are: Austria, France, Germany, Italy, the Netherlands, Norway, Switzerland and the UK.

1 What is conditionality?

IMF loans, provided through a variety of facilities, largely come with policy change conditions attached – conditions that the IMF has had a significant role in developing. Criticisms of the excessive burden and politically sensitive nature of these conditions led to significant reviews at the IMF and the introduction of some conditionality-free facilities, although these are limited in scope. The latest IMF review was undertaken in 2011, and the IMF claims to have made its conditions limited in scope to critical reforms agreed by recipient governments. This study by Eurodad aims to put this claim to the test.

IMF loans are provided through a variety of concessional and non-concessional facilities that have changed over time. The current available facilities are summarised in Table 1. These include a number of new facilities introduced after the tripling of IMF funds from $250 billion to $750 billion in 2009,[3] sanctioned by the G20 (although not yet formally approved) to enable the Fund to come to terms with the increased demand in the number and size of new loans to countries affected by the global economic crisis. For years, the main IMF funding instrument for low-income countries (LICs) was the Poverty Reduction and Growth Facility (PRGF),[4] successor to the Enhanced Structural Adjustment Facility. Now, the IMF has three different lending facilities for LICs, which are listed below.

The rationale behind IMF conditionality is that countries in fiscal crisis should only receive loans from the IMF if they reform their policies – the precise agreed reforms and macroeconomic targets are set out in the conditions attached to the loans. The IMF argues that these reforms are necessary for the borrowing country to restore macroeconomic stability and growth. In practice, the precise conditions have often been controversial, and cover a wide range of policy areas that are not always linked to the IMF's core competencies, as previous conditionality reviews have noted.[5] In most cases, an IMF loan deal is sealed with the presentation of a letter of intent, which is usually accompanied by a Memorandum of Economic and Financial Policies (MEFP). The initiative for drafting and sending this lies, in theory, with the government of the borrowing country.[6]

In practice, the IMF is heavily involved in drafting programme documents and the design of the conditions attached. The IMF claims it stresses the issue of programme ownership by borrowing governments. However, the IMF's own Independent Evaluation Office (IEO) review in 2007 found that 84% of Fund staff surveyed recognise

Table 1: IMF Facilities

Programme / Concessionality	Type of country	Description	Programme used during study period?	Included in this research?
The Extended Credit Facility (ECF)[7] *Concessional*	LIC	Main tool for providing medium-term lending to LICs. Currently zero interest rate through 2014, 5½ year grace period, maturity of 10 years.	Afghanistan, Bangladesh, Burundi, Central African Republic, Côte D'Ivoire, Gambia, Guinea, Liberia, Malawi, Mali, Niger, São Tomé and Príncipe, Solomon Islands	Yes
The Standby Credit Facility (SCF)[8] *Concessional*	LIC	For short-term lending to LICs. Can be used on a precautionary basis. Currently zero interest rate through 2014, grace period of 4 years, and a final maturity of 8 years.	Georgia (also SBA), Solomon Islands, Tanzania	Yes (2)
Rapid Credit Facility (RCF)[9] *Concessional*	LIC	Emergency lending. Currently zero interest rate through 2014, grace period of 5½ years, final maturity of 10 years. No programme-based conditionality.	No	No – not used during study period
Stand-By Arrangements (SBA)[10] *Not Concessional*	All	For short-term lending. Length typically 12–24 months, and repayment within 3¼-5 years of disbursement. May be provided on a precautionary basis.	Bosnia and Herzegovina, Georgia (also SCF), Jordan, Kosovo, Tunisia	Yes
Extended Fund Facility (EFF)[11] *Not Concessional*	All	For medium- and longer-term lending. Use has increased substantially in the recent crisis period. Typically longer than SBAs—up to a maximum four years. Repayment due within 4½–10 years.	Cyprus, Greece, Jamaica	Yes
Policy Support Instrument (PSI)[12]	LIC	Fund programme without a borrowing arrangement.	Mozambique, Uganda	No – no lending
Flexible Credit Line (FCL)[13] *Not concessional*	All	For countries meeting pre-set qualification criteria. Not subject to the normal access limits. Single up-front disbursement rather than phased. Same terms as SBA.	Poland, Colombia, Mexico	No – no conditionality
Precautionary and Liquidity Line (PLL)[14] *Not concessional*	All	For countries with "sound fundamentals and policies". 6 months or 1-2 years. Same terms as SBA. Limited conditionality.	Morocco	No – limited conditionality
Rapid Financing Instrument (RFI)[15] *Not concessional*	All	Emergency lending. Repayment within 3.5 – 5 years. Same terms as SBA.	No	No – not used

Source: Based on description by IMF[16]

> IMF loans....largely come with policy change conditions attached – conditions that the IMF has had a significant role in developing.

that the first draft of the MEFP was prepared by IMF staff, and there is no evidence that this has changed significantly since 2008. As we have argued before, real democratic ownership should come from more than the acceptance by a government facing dire economic circumstances of a set of economic reforms: it should be the result of a process that involves parliaments and civil society organisations (CSOs). However, the reality of the situation was pithily expressed by the Ukrainian Prime Minister, Arseniy Yatseniuk, who recently said he "*will meet all IMF conditions… for a simple reason… we don't have any other options.*"[17]

The IMF attaches two different types of conditions to its loans – quantitative conditions and structural conditions. We will focus on structural conditions, as they are the ones that set out specific policy changes required under the IMF programme.

- *Quantitative conditions*, known as Quantitative Performance Criteria (QPC), are a set of macroeconomic targets that governments must meet, including, for example, the level of fiscal deficit a government is allowed. In this research, we do not examine QPCs as they do not directly prescribe policy changes. However, we look at the outcomes of those policies, although these will also be important and are likely to be highly political.
- *Structural conditions,* which tie IMF lending to the achievement of institutional and legislative policy reforms within countries, come in two different forms:

  Prior actions – binding conditions, which have to be fulfilled before the loan is granted.

  Structural benchmarks – not binding, but influential in the reviews of government performance carried out by the IMF at least every six months, which give clearance for the release of a subsequent loan tranche.

Increases in structural conditionality during the 1990s and criticisms from civil society groups and borrowing governments[18] over the years about the amount and intrusiveness of conditionality led to a series of reviews of IMF conditionality, aiming to 'streamline' practices. Based on these reviews, the IMF initiated lending reforms and changes in conditionality in its programmes (see Table 2, overleaf). The first conditionality guidelines[19] were laid out in 2002 and set the template for future reviews by attempting to:

- streamline processes;
- focus on areas of core competence and expertise.

However, previous Eurodad research, published in 2008, found that change in IMF conditionality was slow and it even backtracked on some issues.[20] Our research found that:

- The number of conditions per loan had actually increased after the Fund's 2005 review of its conditionality.
- A third of all conditions were in sensitive economic areas, including privatisation and liberalisation.

Conditionality has become a hot topic again, after a boom in IMF lending following the global financial crisis. IMF lending had dwindled to very low levels by 2007, but the latest international crisis – beginning in 2007-08 – gave the Fund the opportunity to expand to new countries and to lend to old recipients.[21] This was to be expected as IMF lending has historically been linked to periods of debt distress during or after acute international crises – for example the 1970s oil crisis, 1980s debt crisis, 1990s Eastern European crisis, and the 1997 East Asian crisis.[22] During the sovereign debt crises after 2008, there was a sharp increase in demand for credit, and the IMF responded by doubling quotas and access limits,[23] allowing bigger loans.

The IMF has introduced a new facility without conditionality for countries judged to be good performers, showing that it can lend without requiring changes in government policies in return. Unfortunately, the Flexible Credit Line (FCL – see Table 1) is only for countries the IMF considers to have "*very strong economic fundamentals and policy track records*".[24] The Precautionary and Liquidity Line (PLL) is for countries with "*sound fundamentals and policy frameworks*."[25] This means that it is really used as a form of pre-conditionality – only countries with 'policy track records' or 'frameworks' that the IMF considers 'strong' can be admitted. A recent IMF review confirmed the subjective nature of this exercise, noting that "a membership survey points to countries' desire for more transparency and predictability in qualification" for the FCL and PLL.[26] So far the FCL has only been used by Poland, Mexico and Colombia and the PLL has only been used by Morocco. This means that the overwhelming majority of countries borrow from the IMF with conditions attached.

> The IMF has introduced a new facility without conditionality for countries judged to be good performers, showing that it can lend without requiring changes in government policies in return

> The IMF's latest review of conditionality, published in 2011, recognised that work still needed to be done, calling for conditionality that is more appropriate to the needs of each country.

The Fund claims it has learned lessons from previous crises and programmes, and that there has been real change in how it designs and implements conditionality. According to the IMF, the changes were made to make the conditions 'macro-critical' – meaning that they either have to be deemed important for reaching the goals of the programme or necessary for the provision of funds.[27] In addition, the Fund claimed to gear conditionality towards core areas of IMF expertise. Finally, in recent years the IMF has claimed it is moving away from strict conditionality based assessments for the disbursement of loans to the countries, to review-based assessments. These are conducted more regularly and include both assessments against conditionality and also a broader analysis of the overall performance of the economy.

The IMF's latest review of conditionality, published in 2011, recognised that work still needed to be done, calling for conditionality that is more appropriate to the needs of each country, increasing ownership of the country, and better clarity of and parsimony in conditions.[28] At the time, Eurodad produced a briefing that analysed this review.[29]

In this paper, Eurodad assesses whether there really has been any change in IMF conditionality by focusing on two critical issues: the overall numbers of conditions; and whether the IMF is including less conditionality in the most politically controversial areas: economic policy reform on sensitive topics.

Table 2: Important milestones in IMF Reviews of Conditionality

2000	Recognition for need for clarity on the boundaries of conditionality
2002	Guidelines for conditionality revised
2005	Review of Guidelines[30]
2009	Review of guidance note for Guidelines
2007	IEO Evaluation of Structural Conditionality
2012	Review of Guidelines published

Source: IMF Factsheet[31]

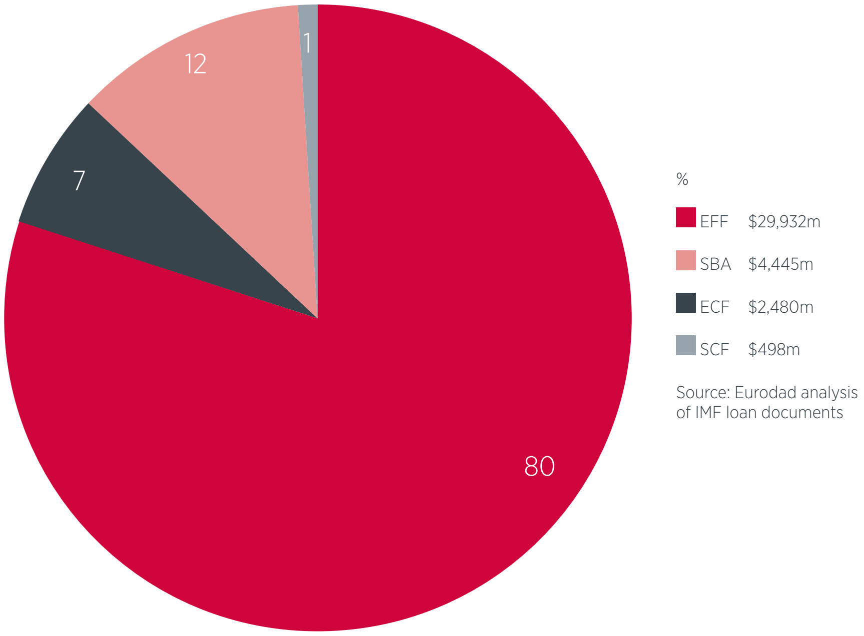
2 Study parameters

We assessed all loans with structural conditionality approved since the last IMF review, up to 31 August 2013. We examined the documents that were agreed at the time of approval, and counted all conditions – separating those that were several conditions wrapped into one. Finally we identified all conditions that were in two key examples of highly sensitive and controversial economic policy – those affecting fiscal policies and the role of the state in the economy.

To monitor the evolution and trends in IMF conditionality, Eurodad assessed all loans with structural conditionality approved by the IMF since the period assessed by the IMF's last conditionality review. We examined the following:

- Loans approved from 1 October 2011 until 31 August 2013.
- A total of 23 operations in 22 countries (see Table 3, overleaf).
- Only the structural benchmarks, as these are the conditions that mandate policy change.
- Seven non-concessional loans and 16 concessional loans. The last Eurodad review examined only concessional loans, but after the financial crisis, the size and conditionality of non-concessional loans has been highly significant in changing the balance and the landscape of IMF lending. As Graph 1 shows, for the loans studied in this paper, non-concessional loans (EFF

Graph 1: Loan share by facility



Source: Eurodad analysis of IMF loan documents

" After the financial crisis, the size and conditionality of non-concessional loans has been highly significant in changing the balance and the landscape of IMF lending.

Box 1 : Counting conditions

The practice of 'bundling' several actions under one condition makes it difficult to make direct comparisons between CSO assessments of conditionality and IMF reviews. This issue has been identified as the problem of 'specificity'.[32] Certain conditions may be developed into more concrete actions that need to be undertaken so a reform can take place. Also, many reforms are included in the narrative report that could be considered conditions. In many cases, only a generic reference is listed under structural benchmarks in the Memoranda, while it can refer to a whole series of actions across many sectors. This practice may obscure the nature of the requested reforms and conceal sensitive elements, which artificially brings down the number of conditions.

In addition, many structural conditions already listed as one point in the MEFP had more than one action, which were developed further in the body of the text. The unbundling process increases total structural conditions by 17% (from 380 to 446) and sensitive conditions by 33% (from 129 to 172), which shows that the way conditions are formulated on many occasions hides the real number of actions taken.

Some examples:

Guinea: "*Adopt a 2012 budget law that is consistent with the discussions of the November 2011 mission*"[33] (refers to other documents for unbundling).

Côte d'Ivoire: "*Prepare a financial sector reform and development strategy. Prepare and adopt, in the Council of Ministers, a new investment code*"[34] (unbundles in further actions).

Gambia: "*Submit to the National Assembly amendments to the Banking Act 2009*"[35] (unbundles in five actions in text).

Table 3: Loan sizes in countries studied

Country name	Approval type	Arrangement type	Loan size (in million $)
Afghanistan,Islamic Republic of	11/14/2011	ECF	134
Bangladesh	04/11/2012	ECF	987
Bosnia and Herzegovina	09/26/2012	SBA	405
Burundi	01/27/2012	ECF	47
Central African Republic	06/25/2012	ECF	63
Côte D'Ivoire	11/04/2011	ECF	616
Cyprus	05/15/2013	EFF	1,000
Gambia, The	05/25/2012	ECF	28
Georgia	011/04/2012	SBA-SCF	386
Greece	03/15/2012	EFF	28,000
Guinea	02/24/2012	ECF	199
Jamaica	01/01/2013	EFF	933
Jordan	08/03/2012	SBA	2,000
Kosovo, Republic of	04/27/2012	SBA	107
Liberia	11/19/2012	ECF	79
Malawi	07/23/2012	ECF	156
Mali	12/27/2011	ECF	46
Niger	03/16/2012	ECF	121
São Tomé and Príncipe	07/20/2012	ECF	4
Solomon Islands	12/07/2012	ECF	0.3
Solomon Islands	12/06/2011	SCF	8
Tanzania	07/06/2012	SCF	225
Tunisia	06/07/2013	SBA	1,740

Source: IMF[36]

and SBA) totalled $34 billion – 92% of the total – dwarfing concessional loans (ECF, RCF and SCF), which are more numerous but generally smaller in size.

We examined all IMF lending programmes that have structural conditionality. This means we have excluded those with no lending attached (PSI) and those that do not contain structural conditionality (FCL, RFI and PLL). We also excluded countries that already had ongoing programmes on 1 October 2011, including those that had programme reviews during our study period, as these would not give us such a clear test of the impact of the last conditionality review.

The research is based on the analysis of data from all of the relevant IMF documents agreed at the time of programme inception. We decided not to use the IMF's conditionality database, the Monitoring of Fund Arrangements (MONA), as this is updated as programme conditions evolve, and so provides a less stable evidence base than looking at the conditions agreed at the start of the programme.

We have focused on two key issues: the number of structural conditions per loan, and the degree to which IMF conditionality interferes in highly sensitive political issues. We count both binding structural conditions and non-binding structural conditions. Although failing to meet non-binding conditions does not imply suspension of finance, they influence recipient countries' decisions and are used as a guide to assess the performance of a loan. We have also 'unbundled' conditions that are really several conditions wrapped into one. The IMF often counts several policy actions 'bundled' together as a single condition. In some cases there was insufficient supporting information to do this properly so we did not unbundle, meaning in reality there are likely to be a higher number of conditions than we counted. See Box 1 for more details.

> “ The IMF often counts several policy actions 'bundled' together as a single condition.

To assess politically sensitive conditions, we selected two key areas – fiscal policy and reducing the role of the state in the economy through liberalisation and privatisation. These issues are politically sensitive within all countries, meaning their inclusion inevitably implies that the IMF is interfering in the domestic politics of the country. Recently leaked documents relating to the Greek loan have shown that these kinds of conditions caused controversy not just in the country, but also at the IMF board level.[37] This is not to suggest that conditions in other areas are not potentially extremely controversial, but we selected two areas that are unquestionably linked to major political choices about which different groups within society have widely differing viewpoints:

Fiscal policy space:

We identified conditions that heavily interfere with the making of taxation and expenditure decisions, normally by imposing restrictions on public spending and borrowing. This also includes austerity measures such as reducing wage bills, restrictions on social spending, increased contributions by taxpayers and removal of exemptions. We identified a key subcategory of regressive taxation, typically linked to VAT tax increases, which can potentially impose a higher burden, relative to resources, on the poorest.

Liberalisation and privatisation:

Here we identified three critical subcategories:

Liberalisation – based on the World Bank's 2006 definition of sensitive conditions,[38] including price, trade and exchange rate liberalisation, with the addition of the items included in a 2006 report commissioned by the Norwegian government,[39] including the lifting of monopolies and opening up private sector participation in production of goods and services.

Privatisation – drawing on the definition of privatisation used in the report commissioned by the Norwegian government. We did not consider general efforts to improve the business climate or to encourage private sector development as privatisation unless these efforts included the transfer of property or responsibility from the public to the private sector.

Public enterprise restructuring – conditions that call for the exploration of restructuring a sector or call for a study to be undertaken to look at the profitability of a certain sector, or call for a management review and change to the regulatory environment.

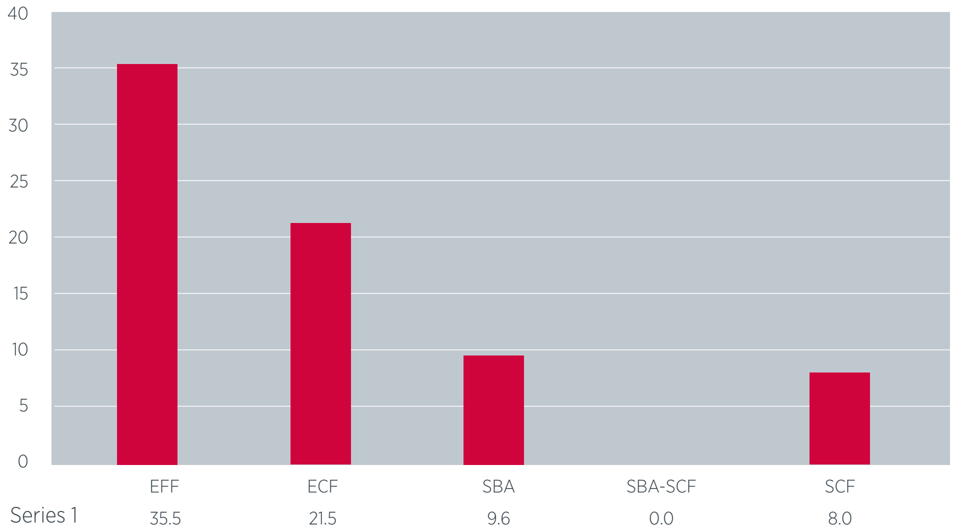
“ We identified conditions that heavily interfere with the making of taxation and expenditure decisions, normally by imposing restrictions on public spending and borrowing.

3 Number of conditions

The number of structural conditions per IMF loan is an important indicator of the extent of IMF influence over a country's economic policies. This research finds that the number of conditions per loan has risen in recent years, despite IMF's efforts to 'streamline' its conditionality. This rise is driven by exceptionally high numbers of conditions in a few countries, and much higher than average numbers in the IMF's main lending facilities. We also find that almost all the countries were repeat borrowers from the IMF, showing the need for proper debt work-out mechanisms to deal with unsustainable debt levels.

Eurodad's analysis shows that the average number of conditions per loan has actually risen since the last conditionality review. After unbundling, Eurodad counted 448 structural conditions – the focus of this research – an average of 19.5 per programme. This is a sharp increase compared to previous Eurodad research, which found an average of 13.7 structural conditions per programme in 2005-07 and 14 per programme in 2003-04. It is higher than the 17 structural conditions per programme that the IMF's Independent Evaluation Office found between 1997 and 2004,[40] which included programmes before attempts were made to 'streamline' conditionality. However, the IEO only counted bundled conditions, so the true average may have been higher. Our numbers may be an underestimate of the current situation, because we only examined the original programme document. We did not look at any changes made in subsequent programme reviews, which may have increased the total conditions.

Graph 2: Average structural conditions per programme



Source: Eurodad analysis of IMF documents

The biggest IMF facilities in terms of loan totals have the heaviest conditionality. As Graph 2 shows, two facilities come with particularly heavy structural conditionality attached: the ECF (21.5 conditions per programme on average) and the EFF (35.5 conditions per programme). Given that these account for 87% of the volume of loans examined in this study (see Graph 1), this suggests that overall IMF conditionality is becoming less parsimonious rather than more. However, it is worth noting that some facilities have far less conditionality than others, even though these account for a small amount of IMF lending during the period studied.

Certain countries with large numbers of conditions significantly push up the average. Although a number of programmes have cautiously chosen and limited conditionality, we noted that some countries' programmes – especially those under the ECF and EFF – receive a disproportionate number of conditions. Examples include: Côte d'Ivoire with a stunning 82 structural conditions; Greece with 41; and Cyprus with 37. Previous Eurodad studies identified the phenomenon of 'good' performers (according to the IMF) having fewer conditions in comparison with countries that deviated from the economic orthodoxy championed by the IMF.

> “ The number of structural conditions per IMF loan is an important indicator of the extent of IMF influence over a country's economic policies.

The IMF claims that countries turn to it for funding in times when they face 'unusual difficulties'. However, these claims do not match the fact that the overwhelming majority of programme countries were no strangers to IMF programmes.[41] Twenty of the 22 countries studied had previous arrangements within the last ten years, and the majority within the last three years. The repeated need to provide IMF loans suggests that the IMF often lends into situations of actual sovereign insolvency, rather than limiting its assistance to situations of temporary sovereign illiquidity, as its mandate would suggest. The consequence is that unavoidable sovereign debt restructurings are being delayed due to the availability of IMF loans.

An IMF staff paper released in spring 2013 confirmed that this happens and triggered a process to reform the IMF's sovereign debt restructuring framework.[42] A far better approach, supported by Eurodad, would be to establish fair, independent and transparent debt work-out mechanisms that could decide on the sustainability and legitimacy of countries' debts in a timely and orderly fashion. Eurodad suggested the principles these mechanisms should follow in our paper, *A fair and transparent debt work-out procedure*.[43]

Number of structural conditions:

Côte d'Ivoire
82

Greece
41

Cyprus
37

4 Politically sensitive conditions

This research found widespread and increasing use of controversial conditions in politically sensitive economic policy areas, particularly those that affect tax and spending policies. Use of these types of conditions tends to be lower in low-income countries, but is very high in some of the largest programmes. Sensitive topics include requirements to increase VAT and other taxes, freeze or cut public sector wages, cut welfare programmes including pensions, increase the price of basic products, reduce trade union rights, restructure and privatise public enterprises, and reduce minimum wage levels.

Our research found widespread and increasing use of controversial conditions in politically sensitive economic policy areas, particularly those that affect tax and spending policies. Eurodad identified 174 structural conditions in sensitive areas, in 20 of 22 countries studied. This is an average of 7.6 per programme, a significant increase from previous Eurodad research undertaken before the economic crisis, which found an average of 4.4 sensitive conditions per loan. This reflects the increasing scope of the programmes approved during the crisis years. The majority of these were related to limiting the fiscal space of governments to make tax and spending decisions (see Table 4).

The burden of sensitive conditions is much heavier in the three countries under EFF programmes: Cyprus, Greece and Jamaica. This is also the facility with the largest loans, suggesting that the IMF's re-emergence as a major lender to crisis-stricken countries has been accompanied by increased IMF involvement in highly sensitive economic policy areas. Although Eurodad believes the IMF should stay out of economically sensitive policy areas, we note that the average number of sensitive conditions per loan was lower in facilities directed at low-income countries (the ECF and SCF).

Fiscal space

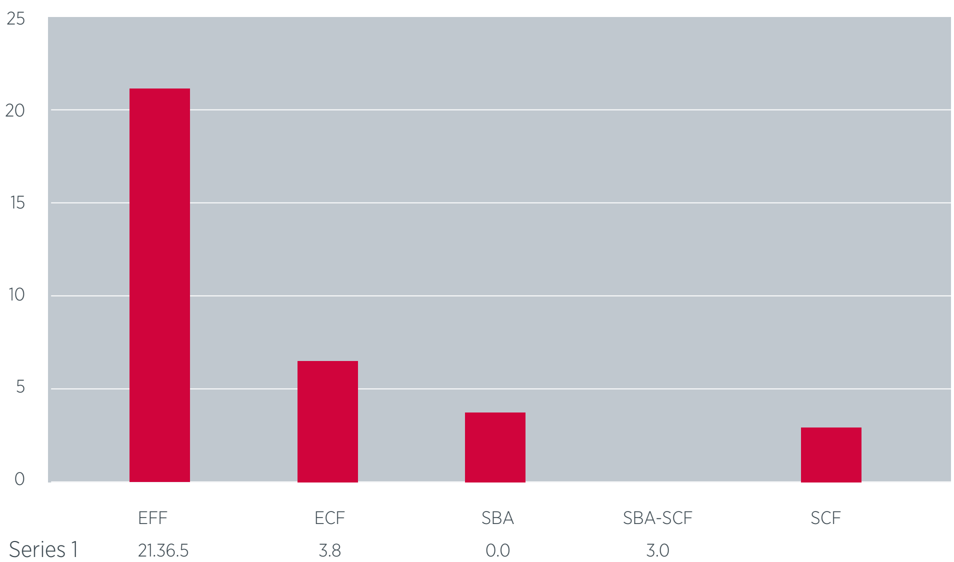
The most common types of sensitive economic policy conditions are those related to limiting fiscal space, which account for over 60% of all sensitive conditions. These conditions limit the fiscal space available for governments to take tax and spending decisions. They routinely include ceilings for public expenditure:

Table 4: Numbers of sensitive structural conditions

Sensitive issue	Number of conditions	% of total sensitive conditions
Fiscal space – general	94	54.0
Fiscal space – regressive taxation	11	6.3
TOTAL Fiscal space	105	60.3
State role – liberalisation	44	25.3
State role – privatisation	12	6.9
State role – public enterprise restructuring	13	7.5
TOTAL – State role in the economy	69	39.7

> This research found widespread and increasing use of controversial conditions in politically sensitive economic policy areas, particularly those that affect tax and spending policies.

Graph 3: Average sensitive conditions by programme type

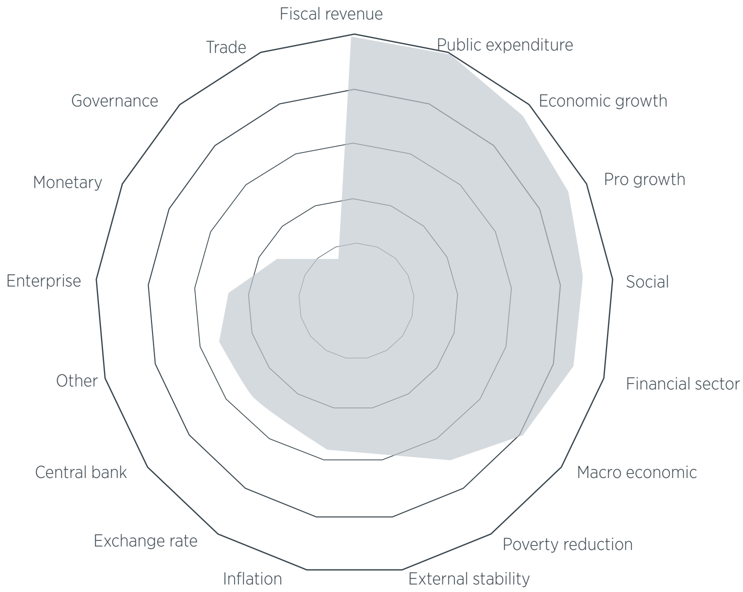


Source: Eurodad analysis of IMF documents limiting money for investment in vital public services including health, education and social security. Limits to government spending on salaries are also included, ranging from calls for regulation, to direct calls to reduce the wage bill by salary reductions for civil servants and state-employed professionals. This heavy IMF focus on tax and spending is confirmed by its own classification of conditions. Graph 4 shows that, according to IMF classifications, all the countries studied have conditions linked to fiscal revenue and public expenditure.

We found structural conditions linked to regressive taxes in 11 conditions in five countries. The conditionality review of 2011 admits that there has been an increase in tax policy conditionality – "*between 2006 and 2010, the number of tax policy conditions in Fund programmes increased tenfold*". This has been mainly focused on introducing or strengthening VAT and other indirect taxes, and streamlining tax expenditures related to incentives and exemptions for business.[44]

The controversial nature of IMF advice in this area was underlined by the IMF's admission in its 2012 World Economic Outlook that it had been consistently underestimating the "*negative short term effects of fiscal*

Graph 4 : IMF conditions by sector



Frequency of IMF conditionality by policy category, using IMF classification of 17 categories.[45]
The score ranges from 0 (none) to 1 (all of the 22 countries).

Source: IMF MONA database, chart by Eurodad

Box 2 : Examples of fiscal space conditions

These quoted conditions are intended to give typical examples of the types of reforms included in this category of sensitive conditions.

VAT increases:

- **Afghanistan:** "Submit VAT law – consistent with IMF advice – aimed at raising the revenue to GDP ratio".
- **Cyprus:** "Increased the standard VAT rate from 17% to 18% in 2013 and to 19% in 2014, and the reduced rate from 8% to 9% starting in 2014."

Other tax increases or major tax changes:

- **Bangladesh:** "Remove tax concessions and exemptions in the FY13 Finance Bill equivalent to at least 0.5% of GDP in FY13."
- **Burundi:** "Prepare a report aimed at … identifying all codes and other legal texts in which tax exemptions need to be removed in the context of passing the new income tax law".
- **Solomon Islands:** "Submit to Parliament draft amendment to income tax, customs and excise tax, and goods tax legislations related to the new mining tax regime in line with IMF technical assistance".

Public sector wage freezes or cuts:

- **Côte D'Ivoire:** "Update and implement a medium-term strategy for controlling the wage bill."
- **Cyprus:** "A reform of the COLA [cost of living adjustments] wage indexation mechanism in the public sector by extending its freeze to the end of the program and limiting its application to 50% of the price index thereafter."
- **Jamaica:** "Conclude a multi-year agreement with major unions … limiting nominal wage increases to zero for 2012/13 (and limiting merit increases to no more than 2.5%), and an annual average (including merit increases) of no more than 5% in the two subsequent years."

Cutbacks to welfare programmes and pensions:

- **Cyprus:** "Adopt measures to improve the targeting of social assistance, consolidate welfare programmes, and streamline administration costs."
- **Cyprus:** "Pension reform. Introduced reforms to the General Social Insurance Scheme, including freezing pensions under the Social Security Fund until end-2016 and raising employee and employer contributions in 2014."
- **Greece:** "Government to complete the reviews of social spending programmes to identify 1% of GDP in savings, while at the same time making proposals to strengthen core safety net programs."
- **Kosovo:** "Conclude a multi-year agreement with major unions (representing at least 70% of government workers) limiting nominal wage increases to zero for 2012/13 (and limiting merit increases to no more than 2.5%), and an annual average (including merit increases) of no more than 5% in the two subsequent years."

cutbacks" with "large, negative and significant" impacts. This was because the "*fiscal multipliers were underestimated*" – in other words they had significantly underestimated the impact on growth from changes in government spending and taxation.[46]

Liberalisation and privatisation

The majority of liberalisation conditions refer to lifting social protection measures or reducing government regulation of key markets. These include price liberalisation for sensitive products such as petroleum and electricity, and tariff adjustment programmes.

Privatisation and public enterprise restructuring are the two categories of sensitive economic policy that have the fewest conditions. These are complementary categories that have shown some decline in the number of conditions compared to previous periods, but still continue to be on the agenda, often in conjunction with other types of sensitive policies. One of the possible reasons for the low number of conditions in these categories is that countries that have followed IMF programmes over a number of years are likely to have followed public sector restructuring and privatisation prescriptions during earlier years.

One final remark is that the IMF has a tradition of promoting policies in tandem with the World Bank and other development institutions,[47] and there continues to be evidence of this practice. For example, in the case of Burundi, the country officials were asked to turn to the Bank for "*assistance to undertake an assessment of debt management […] and develop an action plan to improve capacity.*"[48] In Guinea's MEFP, there is a more abstract call to "*Adopt a medium-term public investment programme, based on advice provided by the development partners (MEFP, Box 2).*"[49]

In recent loans to European countries, the IMF has, unusually, taken the junior role in the Troika, which includes the European Central Bank and the European Union.

Eurodad's research confirms the findings of other studies, which shows that the IMF promotes controversial austerity and liberalisation measures, with potentially severe impacts on the poorest people around the world:

- A report published by Development Finance International (DFI) on IMF programmes in low-income countries[50] found that "*the IMF to a limited degree adopted a policy of counter-cyclical measures to combat the global crisis in 2009, but then returned to a path of fiscal conservatism and reduced spending levels from 2010 onwards*".
- Examining the 'soft influence' of the IMF through their regular consultations with European Union member governments between 2008 and 2011, the Center for Economic and Policy Research (CEPR) found "*a consistent pattern of policy recommendations, which indicates a macroeconomic policy that focuses on reducing spending and shrinking the size of government*" and "*a focus on other policy issues that would tend to reduce social protections for broad sectors of the population (including public pensions, health care, and employment protections), reduce labour's share of national income, and possibly increase poverty, social exclusion, and economic and social inequality as a result.*"[51]

Box 3 : Examples of liberalisation and privatisation conditions

These quoted conditions are intended to give typical examples of the types of reforms included in this category of sensitive conditions.

Price increases for basic products:

- **Bangladesh:** "Adopt an automatic adjustment mechanism for retail petroleum prices to ensure full pass-through of international prices."
- **Côte D'Ivoire:** "Increase electricity rates by 10%".
- **Mali:** "Prepare formulas to adjust domestic oil and electricity prices to international oil prices."

Privatisation and restructuring public enterprises:

- **Bangladesh:** "Approval by the Securities and Exchange Commission of a demutualisation model and plan for the Dhaka and Chittagong stock exchanges."
- **Côte D'Ivoire:** "No new injection of public funds in the five public banks in difficulty outside a restructuring plan discussed with the IMF and the World Bank."

Reducing trade union rights:

- **Greece:** "Government to legislate measures to level the playing field in collective bargaining, including: (i) removal of the 'after effects' of contract expiration; (ii) removal of 'tenure' in all existing legacy contracts; (iii) a freeze of 'maturity' in all private contracts; (iv) elimination of compulsory arbitration."

Reductions in minimum wage levels:

- **Greece:** "Government to legislate a realignment of the minimum wage level determined by the national collective agreement by 22%, freeze it until the end of the programme period, and a further 10% decline for youth, which will apply generally without any restrictive conditions."

5 Conclusion and recommendations

This research confirms the findings of other studies, which shows that the IMF uses its significant influence in countries wracked by crisis to promote controversial austerity and liberalisation measures, with potentially severe impacts on the poor.

This is particularly worrying for developing country borrowers, who have a limited voice and a minority vote at the IMF. Agreements made in 2010 to increase – by a small amount – the votes of emerging market economies have been blocked by the failure of the US to ratify them.

A fundamental change in approach is needed from the IMF, based on three key proposals:

First, the IMF should focus on its true mandate as lender of last resort to countries that are facing temporary balance of payments crises. Such countries need rapid support to shore up their public finances, not lengthy programmes that require major policy changes.

- *A far more sensible approach would be to extend the example of the Flexible Credit Line to all IMF facilities – requiring no conditionality other than the repayment of the loans on the terms agreed.*

Second, if countries are genuinely facing protracted and serious debt problems, then IMF lending only makes the situation worse.

- *The development of fair and transparent debt work-out procedures should be prioritised by the international community, and at regional and national levels, to assess and cancel unpayable and illegitimate debt.*

It is clear that the IMF should not be the venue for such debt work-out mechanisms, as they are likely to be a major creditor, and so would face a severe conflict of interest.

Finally, the IMF must address its crisis of legitimacy as a matter of urgency, and radically overhaul its governance structure to give developing countries a fair voice and vote, and to radically improve its transparency and accountability.

- *A vital first step would be to introduce double majority voting, so that approval is needed from a majority of IMF member countries, in addition to a majority of IMF voting shares.*

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- research complex development finance policy issues
- synthesise and exchange NGO and official information and intelligence
- facilitate meetings and processes which improve concerted advocacy action by NGOs across Europe and in the South.

Eurodad pushes for policies that support pro-poor and democratically-defined sustainable development strategies. We support the empowerment of Southern people to chart their own path towards development and ending poverty. We seek appropriate development financing, a lasting and sustainable solution to the debt crisis and a stable international financial system conducive to development.

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