Progress on IMF conditionality?

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November 2012

A first reading of the press statements and overview paper from the IMF’s review of conditionality, completed in September 2012 might give the impression that the IMF has made a 180 degree turn in its conditionality policy, one of the most controversial aspects of the Fund’s role. However, the transformation doesn’t seem as complete as the IMF argues. Harmful conditions are still being imposed not only to developing countries, but also in Europe, and the IMF claim to have increased its focus on poverty reduction and social protection seems uneven, both throughout countries and time. Furthermore, as the review of conditionality reveals, the most relevant positive trends in low income countries, may not be thanks to the IMF policy conditions, but despite these policies and mainly due to debt relief.

The IMF review of conditionality, too positive?

The IMF claims that it has “largely learned lessons from previous crisis to improve the way it lends to countries in trouble and be better targeted and flexible”. Some of the positive findings of the review argue that conditionality has been “better tailored to country needs and circumstances” and that it has “become increasingly parsimonious and well-focused on macro-critical areas of core Fund responsibility”. The review also concludes that “implementation rates of programme conditionality have also improved” and that “social spending has been largely protected and, in the case of Low Income Countries, has increased”.

This apparent turn in the way the Fund is defining and implementing conditionality policy is the result of a series of assessments, evaluations and reforms that have been taken place since 2007. The review, although analysing the lending from 2002 to September 2011, focuses mainly in reviewing the impact of such reforms, thus concentrating on programmes approved after 2007.

According to the review, it appears that the IMF has been doing a good job in implementing the reforms and, as a consequence, the “macroeconomic and social effects of programs appear to have been generally positive”. The conclusion of the review points out space for improvement, in the areas such as country ownership and transparency or further consideration of macrosocial issues in IMF supported programs, including “employment issues and inclusive growth strategies”. Keeping conditionality focused, enhancing risk diagnostics, leveraging surveillance and improving partnerships with other institutions are also among the recommendations. But in general the IMF conclusion is that the institution “has done a lot to improve its conditionality and lending programmes”.

Relevant to 10% of IMF lending

The review of conditionality was aimed to cover the period from 2002 to September 2011, however, “since the Euro Area programmes were initiated toward the end of the period, the coverage of these programs is limited in several ways”. The Greece programme, for instance, was not formally part of the sample covered in the review. According to Peter Bakvis, head of the ITUC/Global Unions Washington Office, this is one of the main problems in the review, since it only “applies to less than 10% of the Fund's current outstanding credit”. The review’s overall conclusions are not relevant, admits the report, for crisis loans paid out since 2008 in Europe, which have become the Fund’s core business and more than 90% of total current lending volume”. Surprisingly, the euro area programmes and the Greece case are specifically mentioned in several parts of the review, with concrete analysis on the definition of conditionality in the case of the Euro area programmes, and on the equity considerations of programme conditionality in the case of Greece. With recurrent mentioning of the European programmes, it becomes almost impossible to discern to what extent the Euro area programmes were considered in the review or not, and it leaves the suspicion that they were just left out of the general conclusions, to ensure a positive outcome for the review.
The overview paper recognises that the Greece programme is a “leading example” of how conditionality in crisis programs “has required cuts in expenditures, including social sectors and real wages”. When analysing the outcomes of this programme within the review, the Fund recognises - to a certain extent - the failure of these measures. “Some recent programmes, notably those in the euro area, comprise ambitious fiscal consolidation (...). Fiscal consolidation paired with growth-enhancing structural reforms aimed at reversing unfavourable debt dynamics. However, in at least one case [Greece], growth fell more than expected and debt ratios evolved less favourably than hoped”. This failure was reaffirmed during the Annual Meetings in Tokyo as the IMF recognised that it has “dramatically underestimated the impacts of austerity policies”.

**Austerity is dead, long live austerity**

The IMF claims that its programmes since 2002 have internalized lessons from the past, specifically mentioning the lessons learned from the Asian crisis. In fact there has been a slow but important trend towards less conditionality in the IMF lending. But, as we have seen, the Fund seems to have been unable to apply those lessons and this trend in the Euro area programs. The question remains whether the Fund has really left behind the austerity mantra also outside Europe. As Simon Wren-Lewis professor of economics at Oxford University says, “the IMF's attitude to austerity remains nuanced and country specific”3, and its message now for Europe - that too much austerity can be counterproductive - might not apply to the global South, even in similar circumstances.

Even when fewer policies are imposed in IMF programmes (quantitatively speaking) in the global South, damaging IMF conditionality remains a concern for many CSOs and countries. The present negotiations on a $4.8 billion IMF loan to Egypt have set off alarms on which conditionality policies will be attached. Recent cases show how other countries have been obliged to apply damaging policies to access IMF lending and debt relief. For instance, conditions for Guinea to qualify for debt relief have included reducing agricultural subsidies and bringing in new laws to facilitate public-private partnerships5.

According to a Development Finance International (DFI) report published last April, on IMF focus on growth and poverty reduction in low-income countries5, “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”. So it seems to be back and forth with austerity, depending on when and to whom it applies.

For instance, the review also admits that policies such as tariffs and price increases have been maintained in many cases, even when they are seen by the Fund itself as “expenditure policy measures potentially affecting the poor”. For example, between 2006 and 2010, nine of the 18 countries in the case study sample for the review were subject to programme conditionality affecting prices of products consumed by the poor. The Fund argues that “technical assistance (TA) explicitly considered adverse impacts of such measures on the poor and how these could be mitigated.” However, as the review recognises, this mitigation measures were only suggested in 5 of the cases.

The review claims that, in general, there has been an increase in IMF flexibility and an enhanced focus on growth and poverty reduction in its Poverty Reduction and Growth Trust (PRGT) programmes. But, as the DFI report showed, “there is no evidence in programme documents that this [enhanced focus on poverty reduction and growth] is occurring”, and there seems to be a trend of cutting social spending in 2010 to 2012 programmes.

In this sense, there is a need for active monitoring of IMF conditionality not only in Europe, but also in the global South, to see if the mea-culpa on pushing too far with austerity measures in Europe has practical consequences in the form of further changes in conditionality elsewhere.

**Is the IMF protecting the poor?**

One of the most relevant conclusions of the IMF review of conditionality is that “social spending has been largely safeguarded under most Fund-supported programmes and has even tended to increase in PRGT programmes”. The review points out that there has been increased attention to social aspects in IMF programmes due to “concerns about a lack of employment opportunities and rising inequalities”. Protecting social spending is not only seen as a pro-poor policy, but as an investment. “Social stability has a large impact on macroeconomic stability and growth, and thereby on a member's balance of payments and external viability. This focus also aims to help build the foundations for growth through investment in human capital (education and health)”.


The IMF claims to have internalized the objective of poverty reduction, but outcomes seem uneven. They recognise that there's a need for a better and more systematic analysis of social impact of policy measures in programmes. For example, “social impact analysis was conducted only in half of the programmes involving increases in fuel or electricity price increases” [of the case studies in background Paper 2]. Also, the establishment of indicative targets for social spending is present in a majority of PRGT programmes, but not in all of them. No further information is given on why and which programmes don't include floors for anti-poverty spending.

The previously mentioned DFI report concluded in relation to this that it "does look as though the IMF is making greater efforts to safeguard social spending", but that anti-poverty spending floors “are only having limited overall success”, and there’s a danger of backward steps due to cuts in health expenditure after 2010. These cuts “reflect a view that any counter-crisis stimulus should be temporary” as well as a “hardening attitude of some major Board member countries, which since 2009 have become sceptical about anti-crisis stimulus”. It's difficult to discern if the increase in social spending that the Fund is claiming to create is due to a new focus towards a poverty reduction, or it is just the result of the counter-crisis stimulus trend in 2009 (which, it seems, is being reversed now).

Beyond conditionality, the review credits the efforts of the Fund technical assistance in looking at “the equity dimension of tax policy, fuel pricing and utility tariff reforms”, but also recognises that this analysis is rarely included in the programmes’ policy measures.

Assessing equity impacts of tax policy

Regarding tax, the review states that “although technical assistance often provides advice on the equity dimension of tax policy reforms, equity considerations appeared to be less prominent in programme conditionality on tax policy”, and that “the equity implications of tax policy structural benchmarks were not explicitly addressed in the design of tax measures”. The review 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” - , which has been mainly focused on introducing or strengthening VAT and other indirect taxes, and streamlining tax expenditures related to incentives and exemptions for business. The review also argues, contentiously, that “the assumption that VAT is a regressive revenue raiser is subject to controversy” and questions whether an efficient tax policy, in terms of focusing on revenue collection, “inevitably involves compromising equity objectives”.

With such skirting around the issue of the equity impacts of tax policies, it is not surprising that the tax policy conditions do not address equity issues. However, there seems to be space for change in this area, calling for further and more direct analysis of “the impact of tax policy measures on low-income households or the progressivity of revenue collection”.

In general, the IMF finds it difficult to analyse the social impacts of its policy conditionality. For instance they recognise that “the link between social spending and outcomes is complex. Fund staff studies show that social spending remains pro-rich in many developing countries, and World Bank studies point to a pervasive lack of proper incentives for social services providers”. More generally, the review states that “determining the macroeconomic and social effects of Fund-supported programs is challenging, and despite substantial research, there is as yet no consensus.”

In any case, it is a welcome step for the Fund to be looking into the implications of its policy on the most vulnerable and recommending further consideration in a broader context of the social aspects of policy measures, including better analysis, surveillance and inclusion in programme design “of policy measures to mitigate adverse short term impacts on the most vulnerable”. However, as some Eurodad members have called for, a much more “qualitative analysis assessment of the social impacts of IMF conditionality, such as distributional and employment impacts of the Fund’s lending programs” would be better.

Is the IMF to be praised for the positive developments in low-income countries?

A detailed analysis reveals an interesting conclusion, which seems to have slipped out of the overview paper: the only observable macroeconomic positive effects of PRGT programs are improvements in debt ratios. “With the exception of a decline in debt levels, key variables do not show clear trends in PRGT-supported programmes during and immediately after programmes”.

The IMF also recognizes that this achievement, together with positive changes in fiscal balances as well as increased social spending, might not be thanks to the impact of fiscal austerity or other policy measures, but mostly due to the gains of debt relief under Heavily Indebted Poor Countries (HIPC) initiative and Multilateral Debt Relief Initiative (MDRI).
“The very large change in fiscal balances in high debt PRGT countries is driven to a large extent by significant debt relief operations.”

This idea is repeated in several parts of the review. The IMF thus recognises the positive impacts of debt relief on debt levels, fiscal balances, as well as social spending, but nothing is mentioned on plans for the post-HIPC era, when no debt relief or debt workout mechanism will be in place for those countries facing debt distress. Furthermore, other macroeconomic positive effects (such as growth, low inflation or positive fiscal balances) are not observable in those countries following the policy conditions under PRGT programmes. However, the review claims that “despite these challenges, previous studies found that low-income countries do benefit from longer-term programme engagement”. So, when it comes to LICs, the review finds – rather astonishingly – that we should rely on previous studies rather than on the conditionality review itself.

Underestimating risks of debt distress?

While the review highlights the “improvements in debt sustainability level in PRGT eligible countries”, little is mentioned on measures adopted to address the risk of new debt distress for such countries. In fact, the review recognises that “a substantial number of PRGT-supported programmes initiated during 2002-2011 did not call on countries to reduce their external and public debt in the medium term through fiscal and/or external adjustment”, since, thanks to debt relief, there was no risk of over-indebtedness.

This might be seen as an underestimation of risks of over-indebtedness, especially for low-income countries. As a recent report by the UK NGO Jubilee Debt Campaign (JDC) report highlights, according to the IMF and World Bank's own predictions, average debt payments as a percentage of government revenue for countries that have completed HIPC will rise by one third between 2010 and 2014. For low and lower middle income countries which have not had debts cancelled through HIPC, but for which there are IMF and World Bank predictions, average debt payments are predicted to rise by one-third between 2008 and 2014. The JDC report also warns that these predictions are a baseline, based on the assumption of strong economic and export growth, “so far [the IMF and World Bank predictions] have tended to underestimate future debt burdens”. Contrary to this analysis, the review of conditionality argues that “in programme LICs, even after stripping out the impact of debt relief, debt ratios increased only little and have since stabilized”.

But in fact, data shows that there has been an increase in borrowing in low-income countries, due to reduced economic growth and falling revenues since the outburst of the financial and economic crisis. According to World Bank data, analysed in the JDC report, “new foreign loans to low income countries increased from $5.2 billion in 2007 to $6.8 billion in 2008 and $9 billion in 2009”. The IMF itself is planning to contribute to this new inflow of finance support in low-income countries, as it has committed to increase its “concessional lending to LICs by $17 billion through 2014, including up to $8 billion over the next two years”. The IMF is already responsible for 15 per cent of all loans to low income countries, with the World Bank accounting for a further 30 per cent.

The IMF commitment to ensuring resources for lending to low-income countries has been reinforced by the recent decision to spend a $2.7 billion windfall from selling gold to subsidise lower interest rates on loans to low-income countries from 2014 onwards. Several CSOs were hoping that this money would go to cancel debts, rather than “helping to create new ones”.

Even though the review of conditionality doesn’t evaluate the lack of measures to prevent debt distress in LICs in the near future, other IMF papers alert that this risk is to be taken into account. “A recent prediction by the IMF is that if there is a downturn on the global economy in 2012, there could be $27 billion of net debt created in just one year for low-income country governments”.

The review of conditionality does address however the risk in countries “facing weak growth and challenging public debt dynamics”, specifically mentioning programmes in the Euro area and in some Caribbean countries. However, most of the analysis within this review regarding the risks of public debt dynamics refers to Euro area cases, especially Greece - which is surprising if we take into account that Greece was supposed to be left out of the review. Nothing specific is mentioned on why Caribbean countries are facing “challenging public debt dynamics” and what measures the IMF has implemented to prevent or predict this problem.

In any case, the review recognises the “need for more robust risk diagnostics in programme design” in order to face “the challenges in some high-debt programmes”, as well as emphasises “the challenges
Concerning debt sustainability assessments encountered in some recent crisis programmes. Unfortunately, by “high-debt and crisis programmes”, the IMF seems to refer mostly to Euro area programmes.

**Debt limits and Debt sustainability**

The debate on whether the IMF is giving enough attention to the risk of an invigorated debt crisis in impoverished countries is not new. In fact, the IMF recently reviewed its debt sustainability framework (DSF) for LICs, but the new framework doesn’t seem to have faced the issue in its whole complexity.

As a coalition of Norwegian CSOs state, in a recent joint letter to the Nordic-Baltic Executive Directors prior to the IMF and World Bank Annual Meetings in Tokyo, “there is clearly a need for a better framework to prevent unsustainable debt burdens from building up again”. This coalition demands more cautiousness in the Debt Sustainability Analysis (DSA), including quantified indicators to monitor the risk of external private debt, contingent liabilities and domestic debt. Also during the Annual Meetings, the IMF constituency formed by Canada, Ireland and a group of twelve Caribbean countries, released a statement where they called on the IMF to adapt its lending toolkit to the needs of “small, vulnerable, middle-income countries”, such as small island states, facing “high debt overhangs”.

This recent review of the DSF introduced lower thresholds for debt distress, as well as an examination of public sector domestic debt and private sector foreign debt within the debt sustainability analyses. These new characteristics were mostly welcomed by many CSOs but also considered insufficient. Fundación Jubileo Bolivia expressed their worries that the new indicators still focused on repayment capacity only, and did not take into account social goals or MDGs. The same was pointed out by a coalition of Norwegian NGOs during the IMF consultation on debt limits. “DSF should not solely look at a country’s ability to pay when judging a country’s indebtedness. The analysis should also consider the impact debt repayments are having on a country’s ability to cut poverty and protect basic human rights, such as the right to education and health care.” For the UK NGO JDC, the DFS review also fails by not looking at the source nor destiny or the terms of the loans, as this could “enable lenders to be held to more account for their actions and allow debate on the quality as well as quantity of lending”. Conducting or allowing debt audits or implementing the Principles on Promoting Responsible Sovereign Lending and Borrowing developed at UNCTAD, or in Eurodad’s Responsible Finance Charter could be a way to go to prevent irresponsible lending and further debt distress in LICs.

Furthermore, regarding the underestimation of debt distress risks, the coalition of Norwegian NGOs denounced that the Fund itself does not always adhere to its own debt limit framework, as “half of HIPC-lending in 2008 and 2009 went to countries that were either already in debt distress, or at a high risk of experiencing debt distress”.

Increased lending to low and middle income countries might be endangering the gains from debt relief (that, according to the IMF conditionality review, are responsible for the only observable macroeconomic effect of PRGT-supported programmes), pushing debt levels up and risking a new debt crisis in the global South. As JDC alerts, “debt cancellation has led to falling debt burdens, and increased government spending in areas such as education. But too little has been done to prevent debts increasing again, and financial deregulation has left countries vulnerable to the knock-on effects of debt crisis in the rich world”.

The review of conditionality argues that most “projections in Fund-supported programmes were largely unbiased in 2006-11, but their accuracy suffered from the shocks of the global financial crisis”. The danger remains of the implications for low and lower-middle income countries of a more than probable deterioration of the crisis, especially in Europe, and whether this may also break the projections of debt distress in those countries.

**IMF dependence and country ownership**

The review of conditionality also points out the long term relationship between some of the countries, specially LICs, and the Fund. “About 60 per cent of LICs had a Fund-supported programme during at least half of the period 2002-11, reflecting the fact that many LICs face longer-term balance of payments needs. LICs thus tend to have programmes not only when they are in unusual difficulties.” This fact raises concerns among some CSOs, as the tendency seems to be to keep countries IMF-dependant. Regarding this concern, Tim Jones, Policy Officer at JDC, said: “The IMF should be working out how to get low-income countries off its lending, not entrenching loans for another decade or more”.


Data analysed by JDC shows that 16 out of 26 countries on Extended Credit Facility (ECF) programme, were previously on a long term IMF programme. This means extending the IMF lending to 60 per cent of the countries on ECF programmes for at least six years, and therefore extending not only the dependence on IMF money, but also the policy conditions attached to it. This long term dependence on the IMF lending for LICs can transform the IMF role in LICs from temporary support to ongoing budget support and development lending, and “the IMF is not created to undertake such activity”.

This IMF long-term dependence that many LIC countries seem to have developed is not only a concern in terms of relying on IMF resources for too long and changing the IMF’s role towards these countries, but also in relation to undermining the capacity of the country to decide its own economic policies. As the Fund recognises “ownership has been critical to programme success”, but how conditionality can undermine ownership is still an issue of concern among many.

The review reveals that, according to a survey of Fund staff and Government authorities, 84% of Fund staff recognises that the first draft of the Memorandum of Economic and Financial Policies (MEFP) is not provided by the country authorities, but drafted by the IMF staff. When asked directly if the government had ownership of the programme conditionality, most staff answered positively, but 60% of Government authorities from General Resources Account (GRA) programme countries and 20% of PRGT programme countries disagreed. The review concludes that this suggests “room for further improvement towards ownership”.

This improvement also refers to the involvement of CSOs in discussion and implementation of fund supported programmes. As the review reveals, in most cases this involvement is non-existent. The review also concludes that “ownership can be supported by outreach and communication, programme flexibility, focused conditionality and increased clarity”. However, and also according to the surveys conducted within the review, most respondents “disagreed with the notion that more flexible structural conditionality had enhanced ownership or lessened the stigma”.

Two more concrete proposals are made on how to improve, by "more frequent and accessible analysis of programme design in a cross-country perspective", as well as by “transparency” that would allow stakeholders, such as academics, journalists, and market analysts in programme countries to express informed views on programme design and conditionality issues.” As UK NGO the Bretton Woods Project highlights, the Fund “gave no further details of how or when this would be done”.

One of the consequences of a soft ownership by country authorities is that the IMF programme is not always consistent with domestic priorities. A survey conducted in the review showed that country authorities and donors agreed less than mission chiefs and resident representatives on the consistence of the program objectives with domestic priorities.

**Is the IMF really changing its conditionality policies?**

As a thoughtful reading of the conditionality review papers shows, lending reforms and changes in conditionality have already had some impacts in the way the IMF deals with countries under different Fund programs, but much more can and must be done. One of the main challenges remaining is to monitor and evaluate, both quantitatively and qualitatively, the impacts of IMF policies in the most vulnerable people.

As the review concludes, debt relief is responsible for the only observable macroeconomic positive effects of IMF policies in low-income countries, including not only sustainable debt levels, but also an increase in social spending. In a time when, after HIPC and MDRI, there will not be a specific debt relief initiative in place for those countries in debt distress, and the chances for having a new debt crisis, not only in Europe but also in the global South, are growing, there’s an urgent need to evaluate what will happen when no further debt relief is a resource for impoverished and highly indebted countries.

Furthermore, and as the IMF recognises, more efforts in ownership and transparency are also vital for the programme success, and a better analysis on projections and evaluation would also help. The role of CSOs in monitoring and fostering these transformations is vital for assuring further change within the IMF. Some changes are certainly happening, mostly at a slower pace than what is needed, but the IMF has still a long way to go to be a fully democratic, transparent and efficient institution with no harmful conditions imposed on the countries.
Notes


4 Press Statement. Two-thirds of Guinea’s debt to be cancelled. Jubilee Debt Campaign UK. 27 September 2012 http://www.jubileedebtcampaign.org.uk/Twothirds3720of3720Guinea3727s3720debt3720to3720be3720cancelled+7834.twl

5 Martin, M. Watts, R., Enhancing the IMF's focus on growth and poverty reduction in Low-income countries. Development Finance International for Save the Children Norway, Norwegian Church Aid and the Norwegian Forum for Environment and Development. April 2012 http://www.reddbarna.no/?nid=154&hmfile=nzFU4ggm3vZwYSFOX_XgjQ%3d%3d


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