Conditionality and Ownership

Remarks made at the Seminar on Conditionality and Ownership organized by IMF, World Bank and Commonwealth Secretariat at London on July 23-24, 2001.

I will divide my comments in five parts. First, I will focus on the nature of relationship between an individual country and the IMF. Unless this context is properly analyzed the subsequent discussion on conditionality and ownership will remain incomplete. Second, I will offer a few suggestions about the division of labor between the IMF and the World Bank. The next three sections will be focused on the contents, process and results of conditionality.

1. Relationship between borrowing country and the IMF.

Before we delve into the issue of conditionality and ownership, let us recognize that there is a strongly asymmetric power relationship between an individual borrowing country and the IMF. The latter enjoys excessive concentration of power and has a virtual monopoly of knowledge and ideas in prescribing as to what are the right policies a country ought to follow. It has also disproportionately large influence on financing provided by other players – Development banks, fund managers, Debt relief by Paris and London Clubs, Syndicate lending by commercial banks. A negative assessment by the IMF or even a failure to complete review on time places the reputational capital of the borrowing country to great risk, erodes its credibility in the financial markets and reduces financial flows to the country. There are instances where this created a snowball effect amplifying the disequilibria in macroeconomic balances as the IMF and other external financers collectively withheld their assistance.

Monopoly of any kind is undesirable and therefore the monopoly of prescribed policies and economic ideas by the IMF combined with the helplessness of the borrowing country is harmful and inimical to a sustained and mutually beneficial relationship.

2. Product differentiation between the World Bank and IMF

There is a need to divide the responsibilities and accountabilities and thus differentiate the products offered by the two Bretton Woods Institutions. Structural reforms and institutional development should be the primacy of the World Bank as it has accumulated vast experience over time, has knowledgeable staff in a large number of sectors such as privatization, governance, civil service, financial sector and human development, has intensive country specific knowledge and continuous presence in the country. The Bank possesses a tool box of appropriate instruments which can be adapted and applied in the particular circumstances of a country. World Bank's approach in insisting on prior actions and outcomes before the adjustment loan is disbursed is preferable as it is based on result based conditionality rather than promises to be delivered in the future.

IMF has a much better focus and is well equipped to handle macroeconomic issues. It has competent and experienced cadre of economists, a wealth of cross-country and country specific knowledge acquired over time and research capability to advise on macroeconomic policies. Macroeconomic policies should, therefore, remain within the domain of the I.M.F.

3. Contents of Conditionalities

First it is not obvious if the relationship between policy actions prescribed and policy objectives to be achieved is linear, stable and invariant to specific country conditions. Thus the robustness of assumptions on which conditionalities are based is questionable.

Second, the IMF missions endeavor to specify as broad a coverage of conditionalities as possible in order to remain well targeted and reach a critical mass necessary to bring about the intended outcomes. Imposing large number of conditionalities or extending their scope to be as comprehensive as possible is no substitute for hedging on uncertainty. The more constraints are placed on the degrees of freedom and action of the authorities and the more their hands are tied the higher is the probability of failure, deviations and slippages.

For example, Pakistan had to take a dozen prior actions, fulfill 30 performance criteria and structural benchmarks over a 15-month period. The performance criteria had five pages of footnotes on adjusters, qualifiers and precise numbers to be achieved. The distortions created by such acute micro management by the IMF are quite severe and paradoxically they retard the progress in meeting the performance criteria.

4. Process of Conditionality design and specification

The process usually starts on the premise that the country has no commitment to reform and only the IMF specified conditionalities can force the authorities to take the required actions. This mistrust therefore results in a coercive relationship. For ensuring ownership, this kind of relationship has to give way to a continuous and collaborative relationship in which policy dialogue guides the process.

There are at present three areas of disconnect which need to be fixed – first between the MD and the staff within the IMF. While the MD wishes to reduce the burden of conditionalities the staff are wedded to the old ways of doing things and thus operate on a quite different tangent. Second, there is a disconnect between the MD and the Board particularly, the G-7 Executive Directors who want to show toughness by insisting on as many conditionalities as they can squeeze out. Finally, there is a disconnect between country knowledge and decision making authority. The staff which has intensive country knowledge has least powers to take decisions while the Central Department Staff with least country knowledge possess almost a veto power. Graph 1 shows an irreverse relationship between the intensity of country knowledge and the decision making authority.

5. Results of Conditionalities

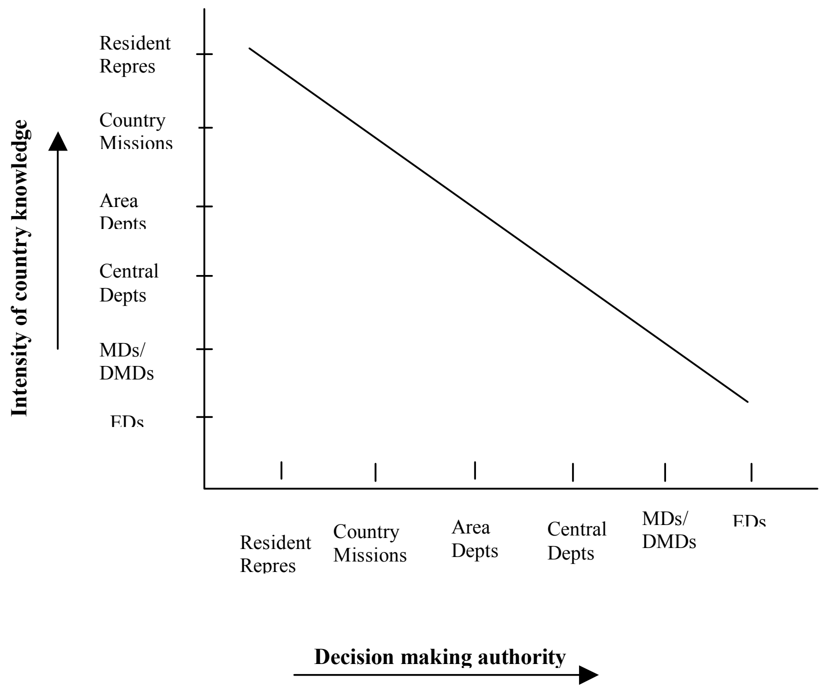
Although the inputs into the conditionalities are precisely defined the measurement of the outcomes is quite difficult. The measurement should use the outcome indicators which are susceptible to policy changes rather than those variables which are outside the policy leverage. But this raises another problem.

The attribution of conditionality to the actual outcomes is itself quite problematic. How do the exogenous variables affect the actual outcome? While the precise quantitative criteria which are used to judge the compliance of the borrowing countries are laid out clearly ex-ante the review does not systematically test the strength and magnitude of underlying assumptions and the behavorial relationships on which these performance criteria were built.

Concluding Remarks

There is a serious trade-off between ownership and conditionality only if the asymmetric power relationship between the IMF and the borrowing country persists. But if a more collaborative and consensual relationship model is pursued then it is possible to integrate ownership and conditionality in an agreed framework.

Relationship between Country Knowledge and Decision making


Intensity of country knowledge
Resident Repres
Country Missions
Area Depts
Central Depts
MDs/ DMDs
EDs
Resident Repres
Country Missions
Area Depts
Central Depts
MDs/ DMDs
EDs
Decision making authority

GRAPH 1