

**FOR
AGENDA**

SM/01/279

September 13, 2001

To: Members of the Executive Board

From: The Secretary

Subject: **Streamlining Conditionality and Enhancing Ownership—Report of the Managing Director to the International Monetary and Financial Committee**

Attached for consideration by the Executive Directors, on a date to be announced, is the report of the Managing Director to the International Monetary and Financial Committee (IMFC) on streamlining conditionality and enhancing ownership. This report, together with the Chairman's summing up of the July 25 discussion on conditionality, will be among the documentation circulated to the IMFC for its meeting on September 29.

Questions may be referred to Mr. T. Lane (ext. 37668).

Att: (1)

Other Distribution:
Department Heads

INTERNATIONAL MONETARY FUND

Managing Director's Report to the International Monetary and Financial Committee—Streamlining Conditionality and Enhancing Ownership

September 12, 2001

1. Since the Spring 2001 meetings of the International Monetary and Financial Committee, we have continued to make progress with our effort to streamline and focus the conditions attached to the Fund's financing. As the IMFC noted in its last Communiqué, the overarching objective is to make conditionality more efficient, effective, and focused, without weakening it. The Committee noted that it is essential that Fund-supported programs take adequate account of national decision-making processes and the administrative capacity to implement reforms and be founded on strong country ownership.¹

2. In refocusing conditionality, a key principle is that policy reforms that are critical for a program to achieve its macroeconomic objectives should continue to be covered under conditionality; however, conditionality should be applied more sparingly to structural measures that are relevant but not critical, particularly when they are not clearly within the Fund's core areas of responsibility and expertise. Finding an appropriate balance between streamlining conditionality and ensuring that key areas of policy are covered requires careful judgment, taking account of different countries' circumstances. Accordingly, we are proceeding in refocusing conditionality on a case-by-case basis.

3. Given this case-by-case approach to implementing changes in conditionality, an ongoing assessment of conditionality is an essential element of the process, as each program brought to the Executive Board's consideration provides an opportunity to assess the coverage of conditionality, its effects on ownership and the prospects for successful implementation, and the division of responsibilities with the World Bank. Program documents are now systematically presenting the rationale for including or excluding specific policy areas. This presentation has helped generate substantive discussions of the appropriate

¹ *Communiqué of the International Monetary and Financial Committee of the Board of Governors of the International Monetary Fund*, April 29, 2001, paragraph 15.

coverage of conditionality, which in turn informs the staff's approach in designing conditionality in subsequent cases.

4. This approach is already bringing about some changes in the way the Fund applies conditionality. In particular, a review of initial experience with streamlining structural conditionality, examining the first six months after the issuance of the *Interim Guidance Note on Streamlining Structural Conditionality*, indicates an increased concentration of conditions in the Fund's core areas of responsibility and expertise; in the case of programs supported by the Poverty Reduction and Growth Facility, there has also been a significant reduction in the total number of conditions, while for stand-by arrangements the number of new programs is too small to permit meaningful identification of trends.² The continued diversity in the number and focus of conditions across countries suggests that conditionality has continued to be adapted to the circumstances of each country.

5. An essential requirement for meaningful progress in refocusing our conditionality is to achieve a clearer division of labor and a more systematic working relationship with the World Bank.³ Over the past several years, both the IMF and the World Bank's operations have evolved in ways that have led to an increased need for collaboration both in the design of their support for country programs and in establishing and monitoring the conditions attached. Here, the goal of cooperation is that, to the extent possible, the staffs of the IMF and World Bank should work within a common country-led policy framework. Another element in cooperation is the application of the concept of "lead agency" in program design and monitoring: for each area of policy, one institution would be identified as the agency to lead the policy dialogue with the country, and that institution's assessment of policy implementation should be reported transparently in the other institution's reports as an input to an overall assessment. Communication is, of course, critical to successful collaboration: it is essential that the two institutions discuss at an early stage each country's policy priorities and the division of responsibilities. To this end, upstream reviews of conditionality are being undertaken in which these issues can be resolved between the Fund's area departments and their counterparts at the Bank. This work in the Fund is being complemented by initiatives at the World Bank to consider its experience with adjustment lending and conditionality as part of its periodic review of operational policies and lending instruments in support of countries' own strategies and programs.

² These results and the factors that have influenced the focusing and prioritization of conditionality in various country cases are discussed in a staff paper, *Streamlining Structural Conditionality—Review of Initial Experience* (SM/01/219, July 12, 2001).

³ A paper addressing these issues, *Strengthening IMF-World Bank Collaboration on Country Programs and Conditionality* (SM/01/219, Supplement 1, Revision 1, August 23, 2001) was prepared jointly by the staffs of the two institutions and discussed by both Executive Boards.

6. Another key element in our review of conditionality is two-way public communication and discussion. The papers prepared by the staff on conditionality have been made public over the internet and we have invited public comments on them. Comments received on the first round of papers have been conveyed to the Executive Board and posted on the IMF website and they are being taken into account by staff in further work. We are also working with several other organizations to hold a series of seminars on ownership and conditionality. During the summer, seminars were held in Berlin, Tokyo, and London, with wide participation from both borrowing and creditor countries.⁴

7. On July 25, 2001, the Fund's Executive Board discussed conditionality focusing on these issues: the review of initial experience with streamlining, IMF-World Bank collaboration, and the comments and contributions from outside the institution. The Executive Board broadly endorsed the path that is being taken in this review; its detailed assessment is presented as an attachment.

8. We will be continuing our review of conditionality in the period ahead. The Board will return in the Fall to focus on issues related to ownership and conditionality. Among the specific issues to be considered are the role the Fund could play in enhancing national ownership of economic programs, which goes beyond the design of conditionality. The Board will also consider various issues related to the modalities by which Fund financing is linked to policies, including the use of prior actions, waivers, program reviews, the scope for results-based conditionality, and the role of financing assurances.

9. Early in 2002, the Board will take stock of the lessons emerging from the 18-month-long review of conditionality, including the issues raised in previous Board discussions and the comments and contributions from outside the institution. It will also distill lessons from the real-time assessments of conditionality, with regard to the factors to be taken into account in assessing which policy measures are critical to program objectives; the application of conditionality to measures that are relevant but not critical, and to measures outside the Fund's core areas of responsibility and expertise; and the experience with strengthened Fund-Bank collaboration. At the same time, we will continue to work to implement those changes that have already been decided upon. To help guide implementation, we are holding a series of internal seminars dealing with the application of conditionality, and the division of responsibility with the World Bank, on specific areas of policy; seminars on privatization and civil service reforms have already been held, and others are planned for the coming months.

10. This work points the way toward a revision of the Fund's guidelines on conditionality. I believe that this effort will contribute to creating a Fund that is more focused and more responsive to the needs of its member countries.

⁴ *Conditionality in Fund-Supported Programs—External Consultations* (SM/01/219, Supplement 2) summarizes the proceedings of the external seminars and reviews the main themes of comments received from outside the IMF on the staff papers.