INTERNATIONAL MONETARY FUND

Application of Structural Conditionality—2008 Annual Report

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In consultation with other Departments

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I. INTRODUCTION

1.   **This report provides an update, based on objective indicators, of the application of structural conditionality in Fund-supported programs**. Such annual reports on structural conditionality are one element of the management implementation plan (MIP) prepared in response to the Board-endorsed recommendations made in the IEO evaluation of Structural Conditionality in IMF-Supported Programs.[1] This annual report covers Fund arrangements approved during the period 1995–2007 (and their reviews through April 30, 2008), extending therefore the dataset contained in the recent IEO report by about three years (from 2005 to 2007).[2] In addition, this report examines experience with Policy Support Instruments (PSIs), which were introduced in October 2005, and thus not covered in the IEO evaluation.

2.   **The key findings of the IEO report remain valid for the period of the extended data, although it is also too early for the data to reflect the impact of the IEO evaluation on the design of conditionality in Fund arrangements.** First, the average number of structural conditions in Fund-supported programs remained unchanged at about 17 per program year. Second, sectoral coverage of structural conditionality points to further progress in focusing on core and shared areas of Fund expertise as well as on fewer sectors. Overall program implementation has improved as reflected by the decline in the waiver rate and the increase in the implementation index. Structural conditionality in PSIs has maintained a similar pattern as PRGF arrangements during the same period.

3.   **As indicated in the MIP, this and future annual reports provide updates on the use of structural conditionality based on objective indicators (e.g. number, type, sectoral coverage).** These reports do not analyze qualitative dimensions of structural conditionality, such as criticality or parsimony; the next scheduled review of Fund conditionality will examine such dimensions. The next review will also allow a preliminary assessment of the impact of forthcoming revisions to the Operational Guidance Note on Conditionality, which also are in response to the IEO evaluation.

4.   **Before delving into these updated statistics, a few "health warnings" are warranted.** In particular:

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[1] See "Evaluation of Structural Conditionality in IMF-Supported Programs," Independent Evaluation Office, and "The Chairman's Summing Up—IEO Evaluation of Structural Conditionality in IMF-Supported Programs" (http://www.ieo-imf.org/eval/complete/eval_01032008.html) and "Implementation Plan in Response to Board-Endorsed Recommendations Arising from the IEO Evaluation of Structural Conditionality in IMF-Supported Programs" (Public Information Notice (PIN) No. 08/52).

[2] The "2005 Review of the 2002 Conditionality Guidelines" covered IMF arrangements approved through end-2003 and reviews through September 2004; the IEO's evaluation "Structural Conditionality in IMF-Supported Programs" covered arrangements approved through end-2004.

- The normalized number of structural conditions for the entire program length is reported against the year of program *approval.*[3] Thus, for a three-year Fund-supported program approved in early 2005, structural conditions set in 2007 are counted in the number of program year conditions for 2005 and would not be included in the data for structural conditionality in 2007. Likewise, the data for 2007 would only include conditions related to programs approved in that year. Consequently, annual tracking using the MONA database is subject to limitations.[4]

- For ongoing programs (e.g., those approved in 2005–07) with reviews yet to be completed, the number of structural conditions set at the early stages of the program may overstate the average number of conditions per program year. For example, if a number of conditions (say, prior actions) are required upfront for an ongoing program, then the normalized number of conditions per program year may be initially exaggerated. As more reviews are concluded the average numbers are likely to provide a more complete picture of conditionality under the program.

- As provided under the 2002 Conditionality Guidelines, structural conditionality must be either critical for achieving the program goals, critical for monitoring program implementation, or necessary for implementing specific provisions under the Articles of Agreement. The aggregate numbers, however, do not distinguish between these different criteria for conditionality.

- In addition, the decline in the number of new Fund arrangements in recent years biases the average number of conditions for that period. The relative weight of an individual country may exaggerate the average for a particular year, thereby constraining comparisons over time. For instance, the existence of only one new GRA arrangement with fewer conditions in 2006 reduces the average number of conditions recorded that year. However, of the three GRA arrangements approved in 2007, one program had a significantly larger number of conditions, which biases that year's average upward.[5, 6] Likewise, among PRGF arrangements, only four PRGF

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[3] As was the case in the 2005 Conditionality Review and the 2007 IEO Report, the number of conditions per program year is normalized by program duration, including any extensions. For ongoing programs, the end-date is assumed to be the last completed review (or the approval date if no review was completed) plus nine months.

[4] The Monitoring of Fund Arrangements (MONA) database is an electronic database on program design, compliance, and economic targets and developments of Fund-supported programs. It provides what amounts to a cumulative history of Fund-supported programs from Executive Board approval through its termination

[5] Iraq, with 28 conditions per program year, raised the average for 2007 to 19 conditions; without Iraq, the average would have been 14 conditions per program year.

[6] It is also noteworthy that the small sample has implications for the calculations of the mean and the median. For instance, in the case of GRA-supported programs in 2007, the mean and median are both 19 conditions per program year because Iraq's 28 conditions per program year raised the average; but with only three GRA

(continued)

arrangements were approved in 2007, of which Guinea had an average of 32 structural conditions per program year, which raises the average for that year. While the larger number of conditions in a particular Fund arrangement may be linked to country-specific circumstances, the average numbers across all programs might be affected by the small sample.

II. EXPERIENCE WITH CONDITIONALITY IN GRA AND PRGF ARRANGEMENTS

A. Numbers of Conditions

5. **The number of GRA- and PRGF-supported programs approved in 2005–07 declined relative to the previous three-year period—from 53 to 32 arrangements (Figure 1)**.[7] This decline stems primarily from a steep fall in the number of GRA arrangements in place (from 26 during 2002–04 to only 10 during 2005–07; e.g., only one GRA arrangement was approved in 2006 and three such arrangements were approved in 2007).

6. **The average number of structural conditions in Fund-supported programs has remained unchanged.** For all GRA- and PRGF-supported programs, the average number of conditions (normalized by program duration) has remained at about 17 per program year during 2005–07 (Figure 2). Among GRA-supported programs, the number of structural conditions has averaged about 20 per program year since the start of the streamlining initiative in 2000. For PRGF arrangements, there has been a small increase in 2005–07 relative to the previous three-year period—from 13½ to 15 conditions per program year—although it declined from about 19 conditions per program year during the three-year period that preceded the start of the streamlining initiative.

7. **Developments in the use of different types of structural conditionality show mixed evidence.** The use of prior actions and performance criteria has either declined or remained broadly the same during 2005–07; structural benchmarks, on the other hand, show a steady increase since 2003 (Figure 3). Specifically:

- The use of prior actions dropped to about three per program year during 2005–07 from about 4½ conditions per program year in the previous three-year period; the decline is registered in both GRA- and PRGF-supported programs.

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approvals that year, the median is the middle number of the conditions across the three arrangements, which is also 19 conditions per program year.

[7] Structural conditionality associated with PSIs have been excluded from the most updated data to maintain a consistent time series and assure consistency with the definitions used by the IEO evaluation and previous staff papers on this topic. Section III reports on structural conditionality in PSIs.

- The number of structural performance criteria (SPC) across GRA and PRGF arrangements for the same time periods has been roughly constant at about four conditions per program year. In PRGF arrangements, however, the average has risen from just over three per program year in 2002–04 to about 4 in 2005–07. Two arrangements in 2007 with about 11 SPCs (namely, The Gambia and Guinea) appear to have driven the increase in the latter period.

- The use of structural benchmarks, however, has increased on average from about eight per program year in 2002–04 to 10 in 2005–07; this increase is evident across all Fund arrangements. Applying the principles of parsimony and criticality equally to benchmarks is an area of particular emphasis in the 2008 revisions to the Operational Guidance Note on Conditionality.

B. Coverage and Implementation of Structural Conditionality

8. **Coverage of structural conditionality points to continuous progress in focusing on core and shared areas of Fund expertise as well as on fewer sectors.**[8] Following the 2005 Conditionality Review, this report provides an institutional classification and an economic classification of structural conditionality.[9] Specifically:

- **Institutional Classification:** Focus of structural conditionality in both GRA- and PRGF-supported programs is increasingly on core areas of Fund expertise since the 2002 Guidelines took effect (Figure 4). Specifically, for GRA arrangements approved in 2005–07, core reform areas comprised 43 percent of total structural conditions per program year, compared with 37 percent in 2002–04 and 30 percent prior to the 2002 Guidelines. PRGF arrangements have recorded an even larger shift, with conditionality in core areas comprising about 57 percent of total conditionality in 2005–07—about 11 percentage points higher than in the previous three-year period and 20 percentage points higher than in the period 1995–2001. Reform areas shared with the World Bank have been about 35 percent in GRA arrangements since the 2002 Guidelines took effect compared with about 30 percent in the pre-Guidelines

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[8] As was found in the 2005 Conditionality Review, an increase in the number of conditions may be associated with the shift into some of these areas, such as financial vulnerabilities. For instance, addressing the financial difficulties of problem banks frequently result in more conditions as the reform measures distinguish between individual banks facing financial trouble.

[9] The institutional classification maps conditionality to the Fund's core areas of expertise (fiscal, monetary, exchange rate, and external sector policies), reform areas shared with the World Bank (reforms to the financial and private sector development), and non-core reform areas (poverty-related measures, civil service reform, and public enterprise reform). The economic classification maps conditions to those relevant for economic management, policies to address external and financial sector vulnerabilities, measures to strengthen economic flexibility (which might help enhance growth prospects, such as trade reform), policies to enhance public sector efficiency, and policies to strengthen private sector efficiency.

period. Among PRGF arrangements, the share declined by seven percentage points in 2005–07 compared with the previous three-year period—from 28 to 21 percent.

- **Economic Classification:** In both GRA- and PRGF-supported programs, there has been a substantial shift in conditionality into policies that address economic and financial vulnerabilities since the 2002 Guidelines took effect. Reforms in economic management constituted the largest share of total conditionality in 2005–07—some 38 percent and 52 percent in GRA and PRGF arrangements, respectively (Figure 5). Among the GRA arrangements, the combined increase in the shares of conditionality associated with economic management and flexibility from 2002–04 to 2005–07 offset the nine percentage point decline in conditionality related to private sector efficiency. The share of vulnerability-related conditions was broadly unchanged during the two periods, at about a third of the total conditionality. In PRGF-supported programs, the decline in conditionality (excluding reforms in economic management) has been fairly even across sectors during the post-2002 Guidelines period.

9. **Program Implementation:** Developments in the implementation index and the waiver rate point to substantial progress in the implementation of structural conditionality across Fund-supported programs.[10] The average implementation rate has increased from 1.3 in 2004–06 to 1.6 in 2005–07 across both GRA and PRGF arrangements (Figure 6).[11] In addition, the waiver rate for structural performance criteria has declined (from 40 percent in 2002–04 to seven percent in 2005–07), although the fewer number of programs in the latter period and fewer reviews for recently approved programs might temporarily bias the waiver rate downward.[12]

III. EXPERIENCE WITH CONDITIONALITY IN POLICY SUPPORT INSTRUMENTS

10. **The Policy Support Instrument (PSI) was introduced in October 2005, and has since been used by six members for a total of seven cases.**[13] By design, PSIs are to follow

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[10] In principle, measuring program success requires assessments of economic outcomes. However, as noted in the 2005 Conditionality Review, a preliminary indicator is the extent to which program implementation is on schedule. The underlying assumption is that on time implementation of a well-designed program should be more successful. Recent analytical work on program design and the economic outcomes of Fund-supported programs is in "The Design of IMF-Supported Programs" (IMF Occasional Paper 241).

[11] Construction of the implementation index excludes prior actions, which are completed on time by definition. The index is constructed for SPCs and SBs by assigning a value of 0 for unmet conditions, a value of 1 for conditions partially met or met with delay, and a value of 2 for conditions fully met on time.

[12] The waiver rate for SPCs is constructed by assigning a value of 0 or 1, converted to percent, if the SPC is met on time or not, respectively; it is computed only for completed reviews. The waiver rate should be treated as an upper bound since MONA does not permit precise identification of missed SPCs that became prior actions, or SPCs that were met with alternative measures.

[13] The Executive Board approved PSIs for Nigeria (2005), Cape Verde (2006), Uganda (two PSIs in 2006), Mozambique (2007), Senegal (2007), and Tanzania (2007). Nigeria's PSI (2005) was approved for two years.

the same guidelines for structural conditionality as PRGF arrangements, consistent with the need for parsimony and criticality as well as a focus generally, but not exclusively, on areas of Fund expertise.[14]

11.   **Structural conditionality in PSIs have maintained a similar pattern as PRGF arrangements.** In particular:

- **Number of Structural Conditions:** The PSIs have averaged about 12 structural conditions per program year, compared with about 15 in PRGF arrangements for the comparable period (Figure 7). However, as noted before, the average numbers provide only a partial picture since several of these programs are still ongoing with outstanding program reviews under both PSI and PRGF arrangements.

- **Types of Conditionality:** As in PRGF arrangements, PSIs were dominated by structural benchmarks—about 7 to 8 out of the total of 12 structural conditions per program year were benchmarks—and prior actions were used infrequently. The use of structural assessment criteria (analogous to structural performance criteria in PRGF arrangements) were about the same in both arrangements.

- **Economic and Institutional Classification:** The primary focus of conditionality in PSIs was on economic management, albeit less so than in the case of PRGF arrangements (which may reflect the generally more stable economic conditions of the members subscribing to the PSI). Among the remaining categories, PSI arrangements focused broadly equally on economic vulnerabilities, and public and private sector efficiency. As for institutional classification, core and shared areas of reform constituted about 70 percent of total structural conditionality.

- **Program Implementation:** Program implementation has been strong among the PSIs. The implementation index was 1.8 in 2005–07 along with a zero waiver rate.

Uganda's first PSI was approved for 16 months (January 2006); it was replaced in December 2006 with a three-year PSI.

[14] See "Implementation of the Policy Support Instrument" (http://www.imf.org/external/np/pp/eng/2005/090205.pdf).
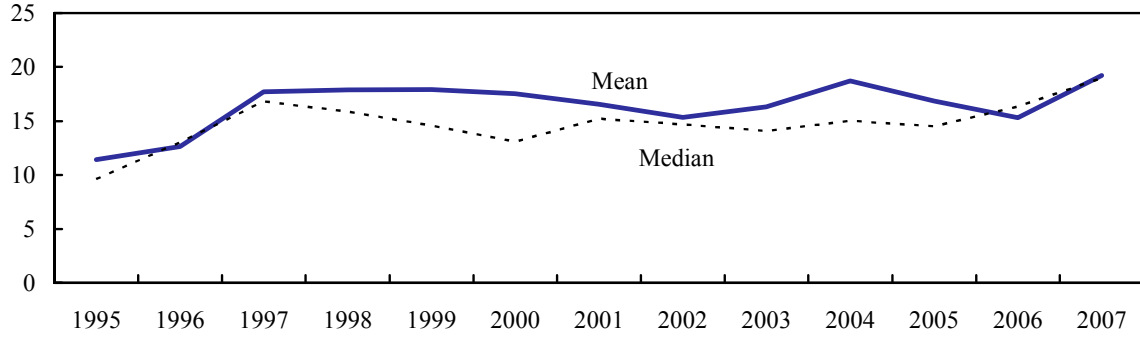
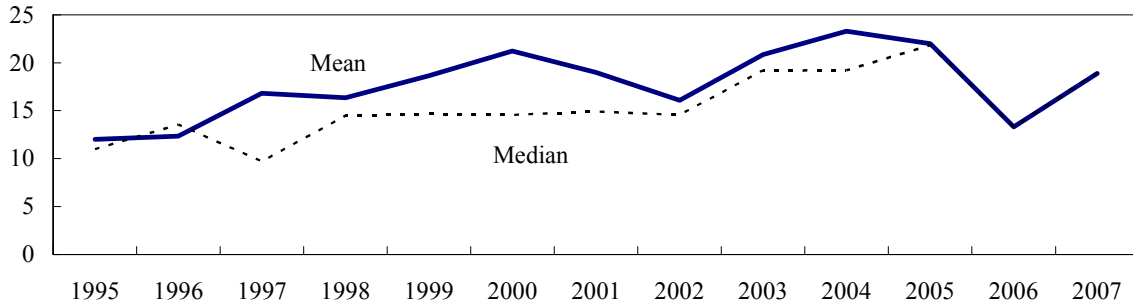Figure 1. Number of Approvals of GRA and PRGF Arrangements, 1995-2007
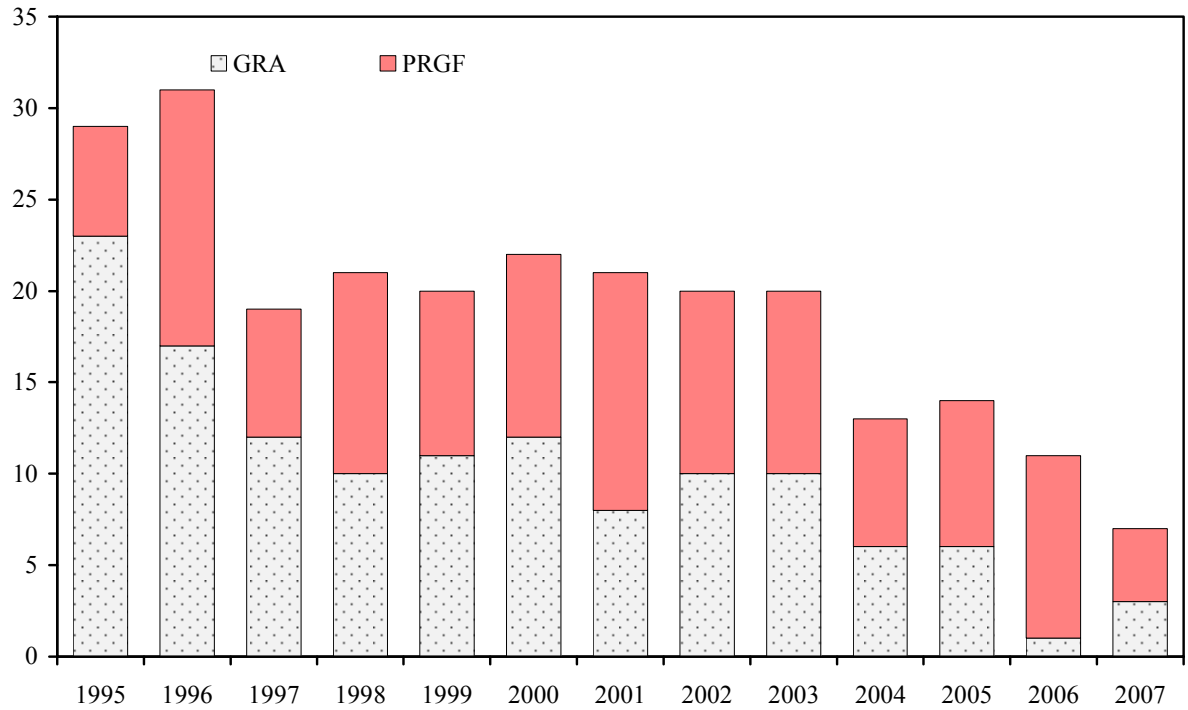
Source: MONA database.

Figure 2. Structural Conditions in Fund-Supported Programs
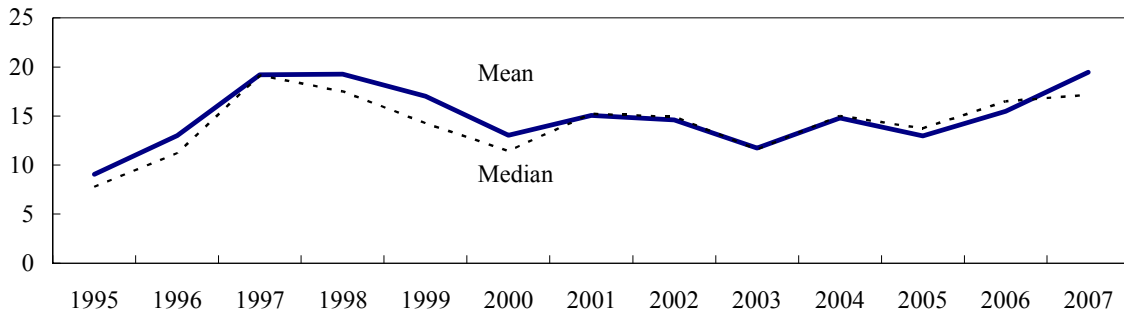(Normalized per program year)

Total Structural Conditions in Fund-Supported Programs

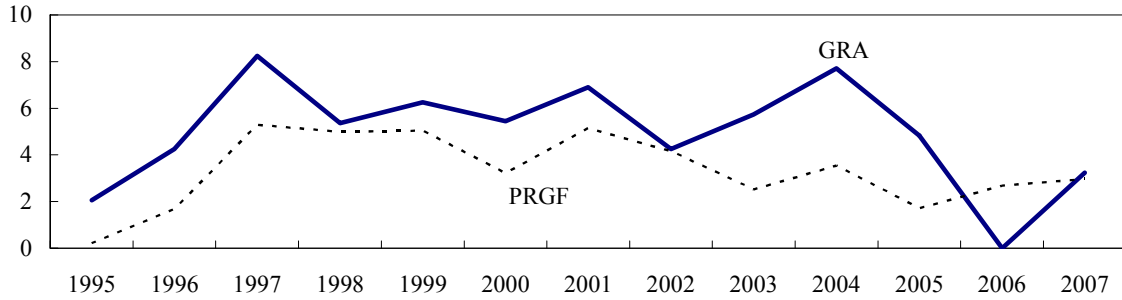**Number of Structural Conditions in GRA-Supported Programs**

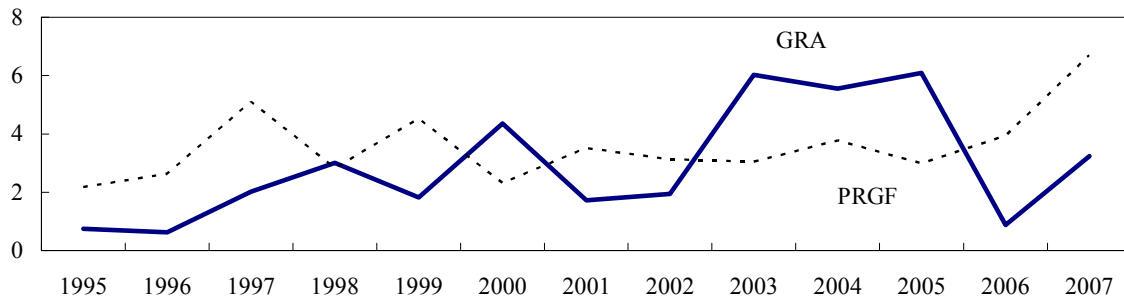**Number of Structural Conditions in PRGF-Supported Programs**

Source: MONA database.

Figure 3. Types of Structural Conditions in Fund-Supported Programs
(Average; normalized per program year)

Number of Prior Actions

Number of Structural Performance Criteria

Number of Structural Benchmarks
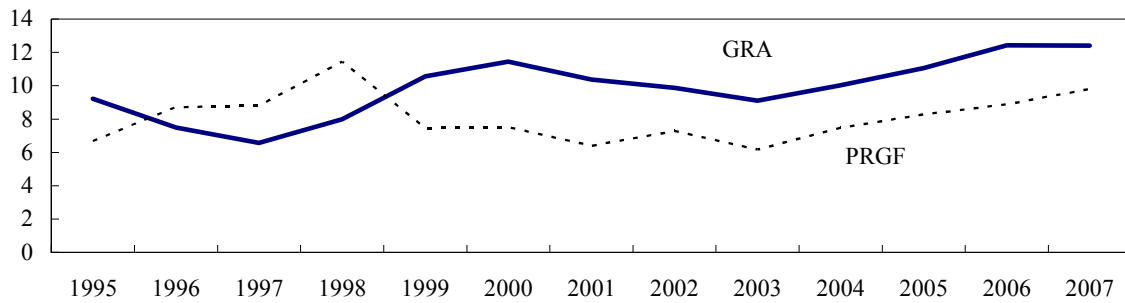
Source: MONA database.

Firgure 4. Institutional and Economic Classification of Structural Conditionality
(As a share of total structural conditionality per program year)
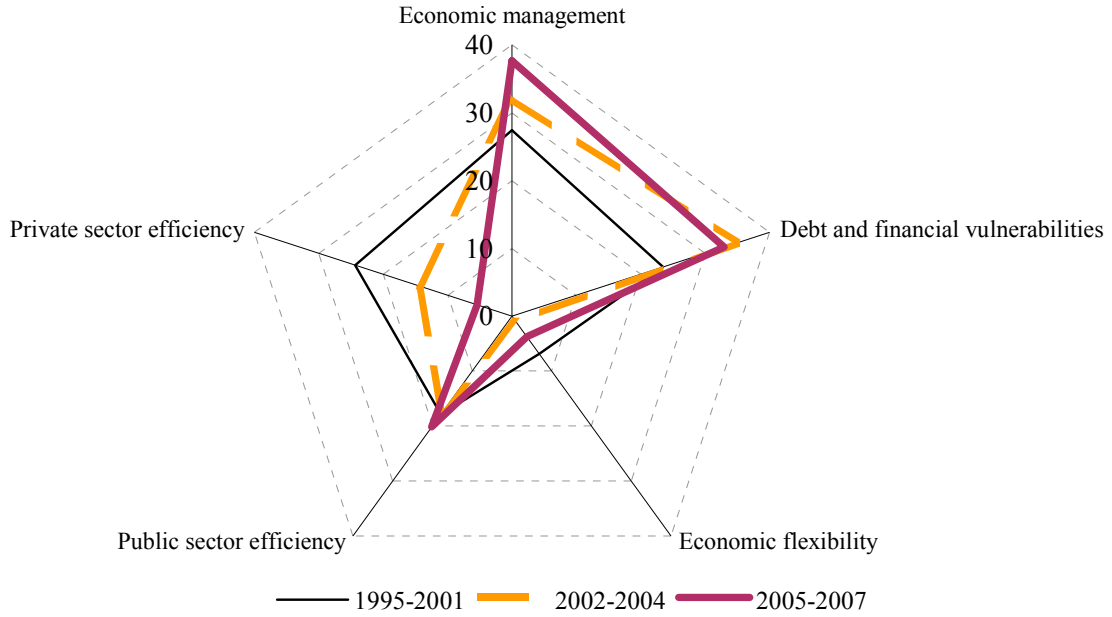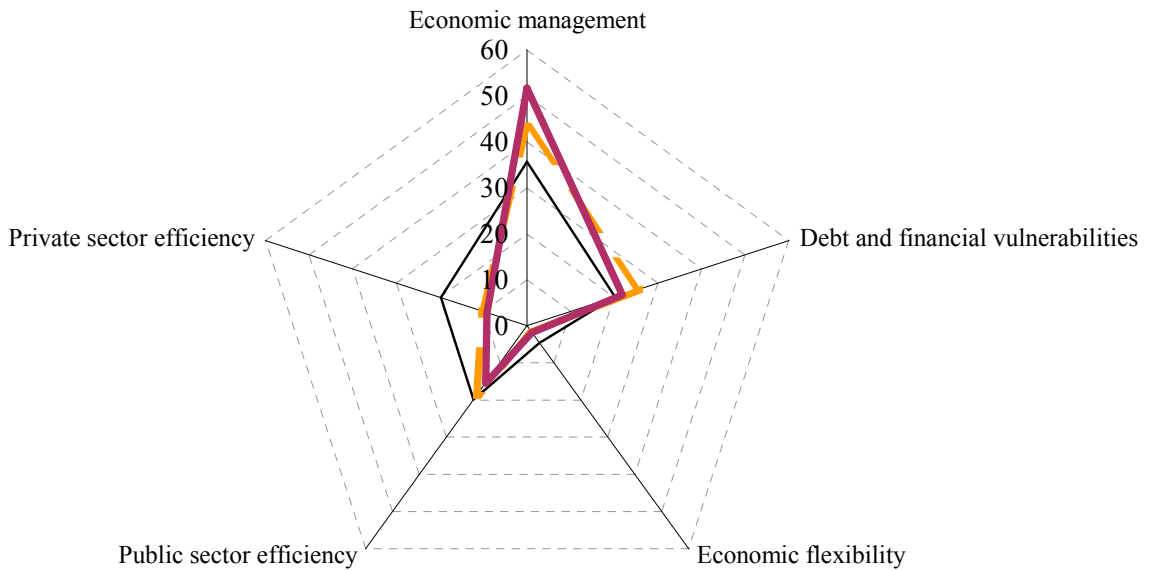
GRA-suported programs

Legend: 1995-2001, 2002-2004, 2005-2007
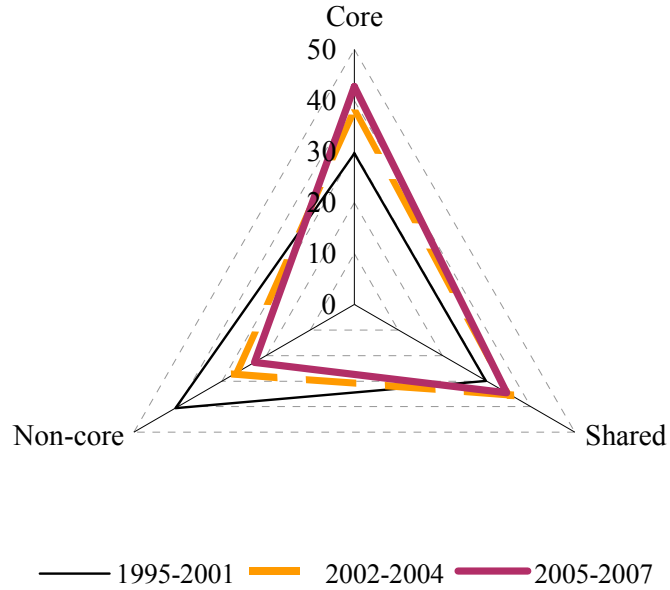
PRGF-supported programs
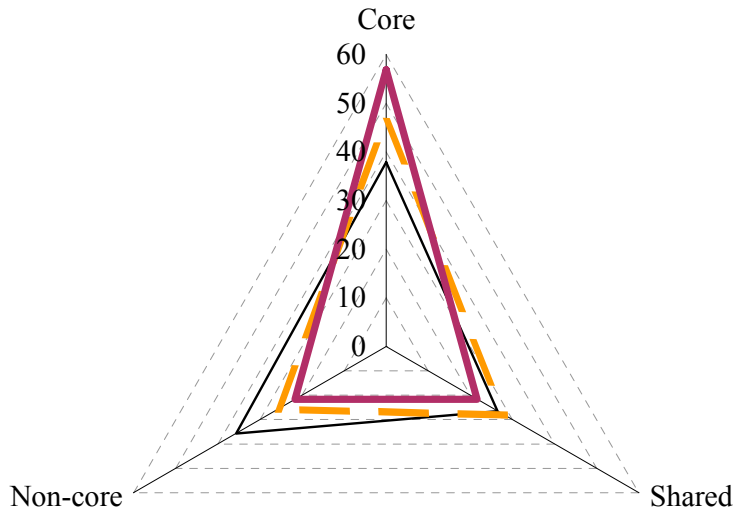
Source: MONA database.

Figure 5. Economic Classification
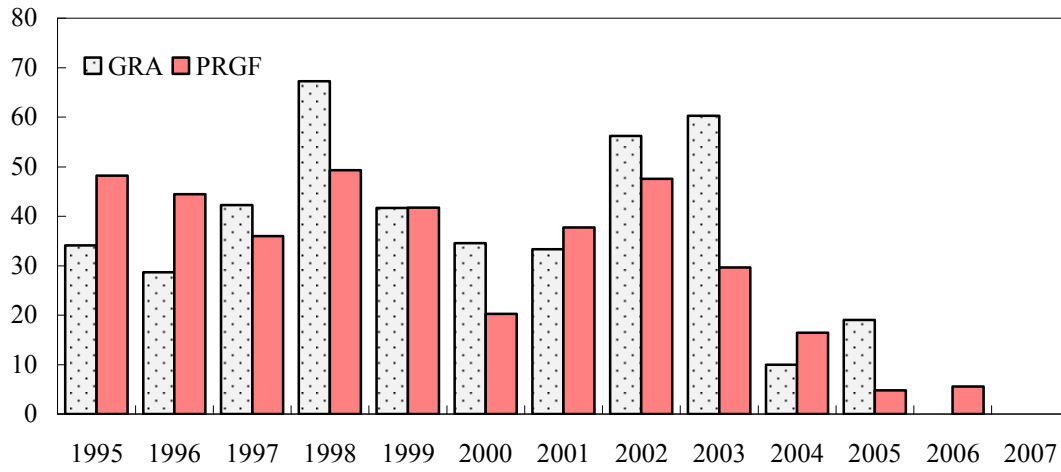(As a share of total structural conditionality per program year)

GRA-supported programs

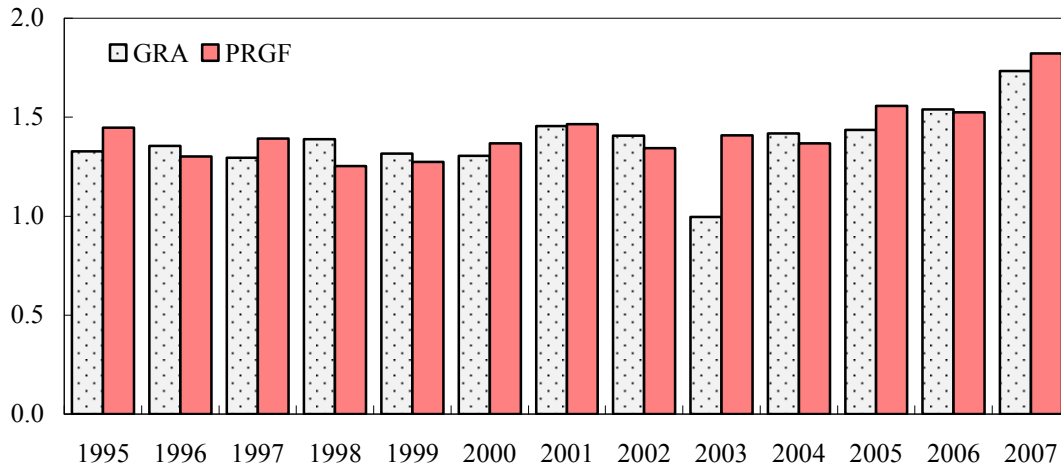**PRGF-supported programs**

Source: MONA database.

Figure 6. Implementation of Conditionality, 1995-2007

Waiver Rate for Structural Performance Criteria
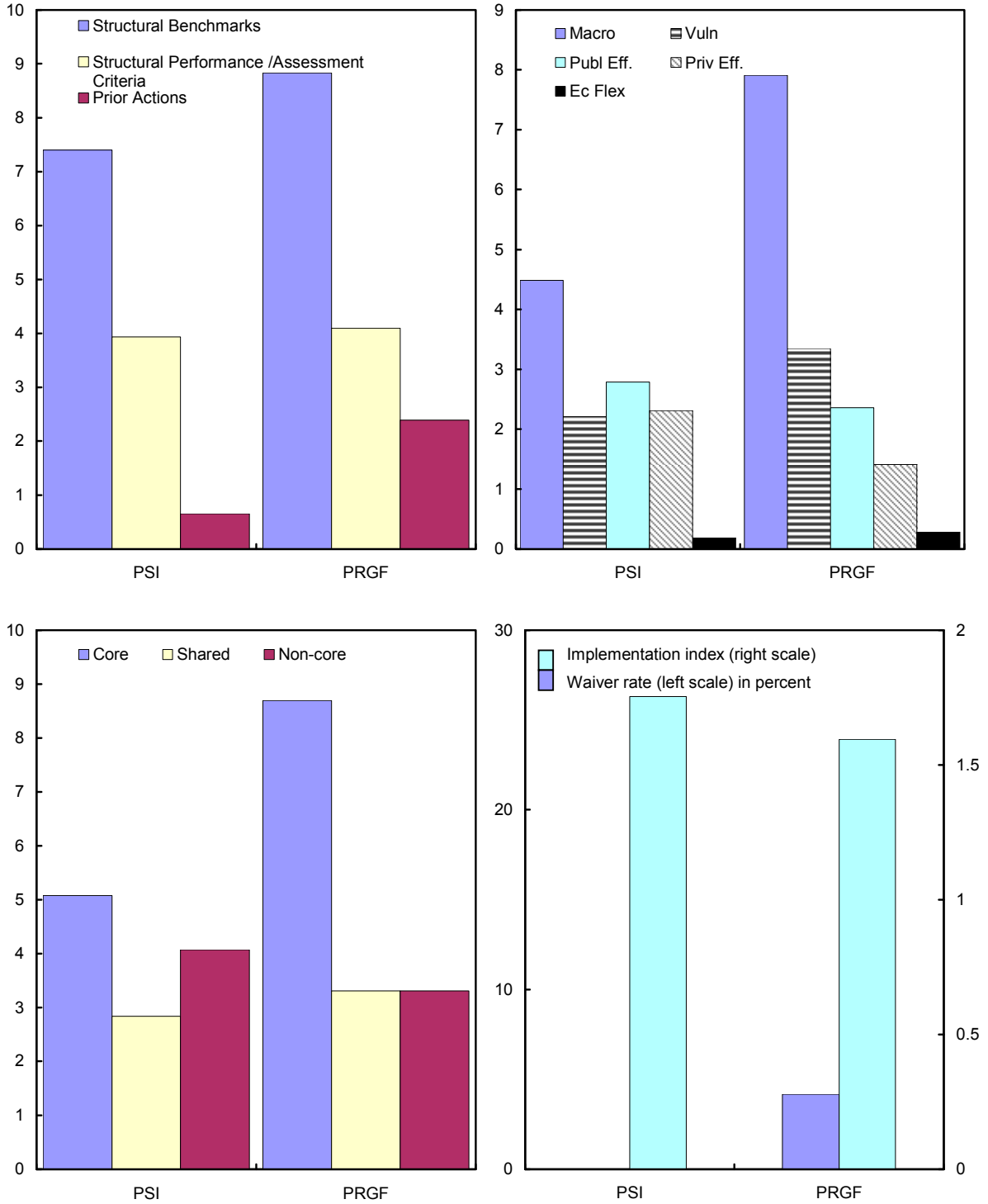

Note: No waivers were granted during 2007.

Average Implementation (excluding prior actions)

Source: MONA database.

Figure 7. Composition of Conditionality in PSI and PRGF Programs, 2005-2007
(Average Conditionality per Program-Year unless otherwise indicated)

Source: Source: MONA database.