INTERNATIONAL MONETARY FUND

Guidance on the Design and Implementation of IMF Conditionality: Preliminary Considerations

Prepared by the Policy Development and Review Department

(In consultation with other Departments)

Approved by Timothy Geithner

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I. BACKGROUND

1. Conditionality on the IMF's support for members' economic programs is specified and implemented in accordance with guidelines approved by the Executive Board. The first set of explicit guidelines was approved in 1968, and a replacement set was approved in 1979. The 1979 guidelines have been supplemented from time to time by Board decisions on specific issues, including instructions governing specific facilities such as the EFF, the PRGF, and the SRF. In addition, management issued an Interim Guidance Note (IGN) on structural conditionality in September 2000.[1] Conditionality today is therefore guided by multiple instructions issued over more than two decades. Moreover, some guidance—particularly on limitations on structural conditions, prior actions, and the granting of waivers—has become interpreted so loosely as to have lost much of its force. Beginning with the issuance of the IGN, the Fund has embarked on a full review of conditionality. The final step in this review is to develop comprehensive guidance that is clearly linked to the goals toward which the Fund's assistance is directed and that reflects the enhanced collaboration that now prevails with other agencies, notably the World Bank.

2. The aim of the current review of conditionality is to enhance the implementation and effectiveness of Fund-supported programs. The review has reaffirmed that conditionality is indispensable to ensure that IMF financing goes hand in hand with appropriate policy action by the country receiving that financing. In the course of the review, Directors have agreed that it is essential that Fund-supported programs be founded on strong country ownership and that they take adequate account of national preferences and decision-making processes and of members' capacity to implement reforms in the necessary time frame. The review therefore has emphasized two specific goals: to streamline, focus, and clarify conditionality so as to make it more efficient and effective, and to ensure that programs are designed so as to enable members receiving financial support from the Fund to be firmly committed to implementing them.

3. The IMFC, at its April 2002 meeting, welcomed the progress that had been made in this review and urged the Fund to continue the process, including through consideration of new guidelines (communiqué, paragraph 14). Accordingly, this paper presents an encapsulation of the agreements that have been reached so far, which could serve as the basis for a draft of new guidelines on conditionality. Where appropriate, the draft incorporates language from the 1979 guidelines, from the IGN, and from the conclusions of the Board discussions during the review.[2] The staff's intention is that the new guidelines would be more

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[1] The 1979 Guidelines and selected subsequent decisions are reproduced in the Annex. For the 1968 Guidelines, see Margaret Garritsen de Vries (Editor), *The International Monetary Fund 1966-1971: The System Under Stress, Volume II: Documents* (IMF, 1976), p. 197.

[2] See "Conditionality in Fund-Supported Programs—Overview," (SM/01/60, February 20, 2001), "Conditionality in Fund-Supported Programs—Policy Issues," (SM/01/60, Sup. 1, February 20, 2001), "Structural Conditionality in

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comprehensive than the 1979 version and would replace both that document and the IGN. In general, other existing Executive Board Decisions on specific aspects of conditionality would remain in effect,[3] and the new guidelines would refer to them as appropriate. Although the substance of the new guidance does not differ greatly from the 1979 guidelines, it is specified in more detail so as to provide tighter interpretations of a number of terms and concepts. This review also provides an opportunity to define more clearly the relationships between conditionality and the various forms of the Fund's financial assistance.

4. The Executive Board's review of conditionality in 1978-79 focused primarily on the goal of establishing an adequate and consistent level of conditionality, while taking account of the different circumstances facing each member country. The strategy for achieving that goal was summarized by the staff in the following terms (SM/78/230, 8/29/78, p. 1):

> When purchases in the upper credit tranches are involved, it is expected that they will be made in support of policies which give substantial assurance that a viable balance of payments position will be achieved within a reasonable period. The basic purpose of corrective programs in these cases is to restore a sustainable balance between aggregate demand and supply, mainly through fiscal, credit, and other policies. These policies should bring inflationary pressures under control and establish conditions for steady and sound

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Fund-Supported Programs," (SM/01/60, Sup.2, February 16, 2001), "Trade Policy Conditionality in Fund-Supported Programs," (SM/01/60, Sup. 3, February 16, 2001, discussed at EBM/01/23 (March 7, 2001) with "Concluding Remarks by the Chairman on Conditionality in Fund-Supported Programs," (BUFF/01/36, March 15, 2001); "Streamlining Structural Conditionality—Review of Initial Experience," (SM/01/219, July 12, 2001), "Strengthening IMF-World Bank Collaboration—Revised Board Paper Experience," (SM/01/219, Sup. 1, Rev. 1, August 23, 2001), "Conditionality in Fund-Supported Programs—External Consultations," (SM/01/219, Sup. 2, July 17, 2001), discussed at EBM/01/79, July 25 and 27 , 2001); "Strengthening Country Ownership of Fund-Supported Program," (SM/01/340, Rev. 1, December 6, 2001), discussed at EBM/01/121 (November 28, 2001); "The Modalities of Conditionality—Further Considerations," (SM/02/13, January 8, 2002), discussed at EBM/02/9 (January 28, 2002), with "Concluding Remarks by the Chairman – The Modalities of Conditionality—Further Considerations," (BUFF/02/13, February 1, 2002); and "Lessons from the Real-Time Assessments of Structural Conditionality," (SM/02/90, March 21, 2002), "Streamlining and Focusing Conditionality and Enhancing Ownership of Fund-Supported Programs—Managing Director's Report to the International Monetary and Financial Committee," (SM/02/91, Rev. 1, April 10, 2002), discussed at EBM/02/26 (April 3, 2002), with "Summing Up by the Acting Chair – Lessons from the Real-Time Assessments of Structural Conditionality," (BUFF/02/59, April 9, 2002).

[3] The principal decisions are reproduced in the Annex.

> development of the economy. Where distortions in the structure of relative prices exist, a correction of the distortions by means of exchange rate changes and other adjustments may be necessary in order to improve the allocation of resources in the economy and to strengthen the external sector. An important element of the programs in all cases is to avoid or reduce the reliance upon restrictions on current payments and transfers and on foreign trade.

5. That strategy remains appropriate today, but the context has changed in ways that may require a broader interpretation than was appropriate in the late 1970s, though rather less broad than the prevailing interpretation in the 1990s. First, because of a heightened recognition that the problems that induce members to request the use of Fund resources are often deep-seated and long-lasting, programs now frequently last longer than one year and may not fully resolve these problems within the program period. The 1979 guidelines were drafted on the understanding that most programs would last no more than 12 months. The lengthening and additional complexity of programs has entailed a more comprehensive approach to conditionality in many cases. Second, it is now generally accepted that although the alleviation of excess aggregate demand and price distortions are necessary conditions for achieving medium-term external viability together with strong and sustainable economic growth, they are unlikely to be sufficient. Additional structural reforms may be required. In the light of more than two decades of experience, it should now be possible to define and circumscribe the scope of structural conditionality more clearly, while still recognizing that some flexibility in interpretation and implementation is both inevitable and desirable.

II. Basis for New Guidelines

6. This section describes and organizes the various aspects of conditionality that have been discussed in the course of this review or that are already embodied in the existing guidelines. If Directors agree, this text could serve as the basis for a draft of new guidelines that would be presented to Directors for review.

A. Principles

7. *Nature and purpose of conditionality*. The IMF provides financing to a member country with a balance of payments need, provided that the country is implementing an adequate program of policy adjustments in response to its external imbalances. IMF conditionality specifies, through the instruments described below, how the Fund's financing will be linked to the implementation of the program. Conditionality is governed by the Fund's Articles of Agreement and decisions of the Executive Board (including guidelines approved by the Board).[4] It is intended to give the country confidence that it will continue to

[4] Article V, Section 3 requires the Fund to adopt general policies on the use of its general resources and authorizes the Fund to adopt special policies that will assist members to solve their balance of payments problems in a manner consistent with the Articles under adequate

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receive IMF financing as long as it implements the policies envisaged under the program, and to provide safeguards for the Fund's resources by ensuring that the financing is provided only if needed policy adjustments are under way.[5]

8. *Early warning and prevention*. Through formal and informal consultations and the provision of technical assistance, the Fund encourages members to adopt corrective measures as a precaution against the emergence of balance of payments difficulties or at an early stage of the development of difficulties.[6]

9. *Ownership.* National ownership of economic policies is important for successful implementation of Fund-supported programs. Conditionality, if well designed and agreed upon through a mutually acceptable and collaborative process, can promote and strengthen ownership and enhance the likelihood of success.[7] Therefore, in responding to members' requests to use Fund resources, the Fund shall be guided by the principle that the member is responsible for the design and implementation of its economic policies. The initial response by the staff shall be to ascertain, through dialogue, how the authorities intend to adjust policies. If the Managing Director considers those intentions to be insufficient to meet the goals of the program, he shall authorize the staff to try to reach understandings with the authorities on a mutually acceptable means of achieving the program goals, while paying due regard to the domestic social and political objectives, the economic priorities, and the circumstances of the member, including the causes of the balance of payments problem and the member's capacity to implement reforms in the necessary time frame.[8]

10. *Focus on program goals.* Discussions with the authorities regarding a program of policies shall be directed at the following macroeconomic goals:

(a) solving the member's balance of payments problem without recourse to measures destructive of national or international prosperity; and

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safeguards. Country-specific conditions have to be consistent with the rules on conditionality.

[5] From "IMF Executive Board Discusses Conditionality" (PIN/01/28, March 21, 2001).

[6] This principle is adapted from 1979 Guideline No. 1, updated to include the role of technical assistance and informal consultations.

[7] See "IMF Reviews Strengthening Country Ownership of Fund-Supported Programs" (PIN/01/125, December 14, 2001).

[8] Most of the latter part of this sentence ("while paying due regard …causes of the balance of payments problem") is from 1979 Guideline 4.

(b) achieving medium-term external viability together with strong and sustainable economic growth.[9]

Conditions attached to the provision of resources will be applied parsimoniously and will be focused on those that are critical for achieving these goals and for safeguarding the Fund's resources.[10] Because accurate, reliable, comprehensive, and timely data are essential for monitoring implementation and economic performance, and because serious data deficiencies may constrain program design and the choice of conditions, conditionality may appropriately cover the correction of such deficiencies and other improvements in the member's statistical practices.

11. *Macroeconomic and structural conditions.* Conditionality will apply primarily to macroeconomic variables. Structural conditionality may also be included in Fund-supported programs, provided that it is adopted with due regard to the following principles:

(a) Except as provided by the Decisions governing the use of specific facilities, structural conditionality will be limited to measures that are necessary to achieve the macroeconomic objectives of the program, or are necessary to implement specific provisions in the Articles or policies adopted under them.[11] Conditionality on policies that are not clearly within the Fund's core areas of responsibility requires particular justification, based upon the country's situation and a judgment that such conditionality is critical for achieving the macroeconomic goals of the program.[12] Conditionality on

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[9] Adapted from paragraph 6 of the IGN. For PRGF-supported programs, as noted below in paragraph 20, the growth objective is for "durable growth, leading to higher living standards and a reduction of poverty.

[10] Article I(v) of the IMF *Articles of Agreement* specifies that one purpose of the IMF is to "give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity." Safeguards include macroeconomic adjustment, provision of accurate information, and internal controls and procedures in a member's central bank or designated fiscal agent.

[11] The first part of this sentence is adapted from paragraph 2 of the IGN. The last phrase ("or are necessary …") is from 1979 Guideline 9.

[12] As formulated by the Reform Task Force and quoted in the IGN, the Fund's core areas of responsibility in this context comprise "macroeconomic stabilization; monetary, fiscal, and exchange rate policy, including the underlying institutional arrangements and closely related structural measures; and financial sector issues, including the functioning of both domestic and international financial markets."

governance issues is subject to the guidance note in EBS/97/125 (July 2, 1997) and Sup. 1 (July 11, 1997) and is limited to economic aspects of governance that are critical for achieving the macroeconomic goals of the program and safeguarding the Fund's resources.[13] Conditionality on external debt management policies is subject to the guidelines specified in Executive Board Decision No. 6230-(79/140) (August 3, 1979), as amended.[14]

(b) Conditionality on policies that are not clearly within the Fund's core areas of responsibility but that are critical to the success of the program will, to the extent possible, be based on the advice of, and will be monitored directly by, the institution with primary responsibility for the policy area (most often the World Bank). The application of this "lead agency" framework should be implemented flexibly to take account of country circumstances and the substantial areas of joint work between institutions.[15] Notwithstanding the choice of lead agency, the Fund retains full responsibility and accountability for all conditionality in Fund-supported programs.

(c) The policy advice, program design, and conditionality supported by the IMF, the World Bank, and other international financial institutions need to be consistent and, whenever possible, integrated within a coherent country-led framework.[16] The roles and inputs of each institution should be stated clearly in program documents.

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[13] See "Executive Board Reviews IMF's Experience in Governance Issues" (PIN/01/20, March 8, 2001).

[14] The governance and external debt Decisions are reproduced in the Annex.

[15] Ibid. Operational guidance for implementing this framework is specified in a paper prepared jointly by the staffs of the IMF and the World Bank; see "Guidance Note on Fund-Bank Collaboration," (FO/DIS/02/176, May 17, 2002). For guidance on the division of responsibility between the Fund and the World Bank and for details on the areas of shared responsibility, see "Bank-Fund Collaboration in Assisting Member Countries" (SM/89/54, Rev. 1, March 31, 1989), "Report of the Managing Director and the President on Bank-Fund Collaboration" (SM/98/226, Rev. 1, September 25, 1998), and "Guidelines on Collaboration Between the Bank and the Fund in Financial Sector Work" (SM/99/158, July 2, 1999). As discussed in the 1998 report, areas of overlap in which both institutions have a mutual interest include elements of financial sector work, some elements of public sector reforms, and issues of transparency, governance, corruption and legislative reform, trade policy, and debt.

[16] This point is adapted from the Summing Up of the Executive Board discussion of IMF-World Bank Collaboration on July 27, 2001 (PIN/01/92, September 4, 2001).

12. *Policy Instruments and Outcomes.* Conditionality may apply to indicators of economic policies (instruments-based conditionality) or to indicators of economic performance objectives (outcomes-based conditionality), or both. In general, the use of outcomes-based conditionality gives the member more scope to implement its own policy choices and adjust its policy instruments in response to changing circumstances, but it could weaken the assurances provided to the member if the outcomes are not reasonably within the authorities' ability to control. Outcomes-based conditionality may be chosen over policy indicators if the staff and the authorities agree that it would be beneficial and if the performance objectives are reasonably within the authorities' direct or indirect control and can be evaluated and verified within the required time frame.

13. *Tailored programs and uniformity of treatment.* Conditionality and program design shall reflect the member's circumstances and the provisions of the facility under which the Fund's financing is being provided. The Fund recognizes that the causes of balance of payments difficulties differ among members, and that the appropriate financing, policy adjustments, and time required to correct the problem will reflect those and other circumstantial differences.[17] In addition, economic policy understandings should be consistent with the member's capacity to implement policies. Nonetheless, conditionality must be appropriate to ensure that the program goals will be met. The Managing Director will recommend that the Executive Board approve a member's request for the use of Fund resources when it is his judgment that the program is consistent with the Fund's provisions and policies and that it will be carried out.[18] In doing so, he will ensure consistency in the application of policies relating to the use of the Fund's resources with a view to maintaining the nondiscriminatory treatment of members.[19] The member's past performance in

[17] For example, in some financial crises, the overriding goal of Fund-supported programs has been to restore market confidence, ensure orderly external adjustment, address the weaknesses that had made these countries vulnerable to a crisis, and create the conditions for a resumption of growth. In transition economies, completing the transformation into a competitive market economy while restoring or maintaining stable macroeconomic conditions has been the key challenge. PRGF arrangements seek to promote poverty reduction by removing impediments to strong, sustainable growth and a viable external position. [From paragraph 6 of the IGN.]

[18] This sentence is from 1979 Guideline No. 7.

[19] This sentence is adapted from 1979 Guideline No. 8, with the phrase "adequate coordination" replaced by "consistency" to clarify the meaning. When Executive Directors discussed this sentence in 1979, they agreed to replace the language from the 1968 guidelines, "uniform and equitable treatment," with the simpler phrase, "nondiscriminatory treatment." That revision was adopted on the understanding that "nondiscriminatory" had the same legal sense as "uniform" but would be more readily comprehensible to a general reader. "Equitable" was deemed redundant. The General Counsel explained that "uniform" described "treatment involving the capacity of the Fund to make proper distinctions" and was in

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implementing successful policies may be taken into account as one factor affecting conditionality.

14. *Transparency and clarity*. Conditionality in Fund-supported programs shall be specified clearly so as to distinguish between the conditions on which the Fund's financial support depends and other elements of the authorities' program. Although program documents may set out the authorities' broad policy agenda for national or international audiences, they should clearly specify the parts of the agenda that constitute understandings on which continued access to Fund resources depends.

B. Facilities

15. The Fund provides financial assistance to its members through a variety of facilities or policies. This section summarizes the features of those facilities that pertain to conditionality, with references to the pertinent Executive Board Decisions. Except as otherwise indicated, the guidelines on conditionality would apply regardless of the facility.

16. *Credit tranche policies*. Except for requests relating to special facilities, drawings in the credit tranches are normally through stand-by arrangements,[20] for which the following principles apply:

(a) The normal period for a stand-by arrangement will range from 12 to 18 months. If a longer period is requested by a member and is considered necessary by the Fund to enable the member to implement its adjustment program successfully, the stand-by arrangement may extend beyond this range, up to a maximum of three years.[21]

(b) Phasing and performance criteria will be omitted in stand-by arrangements that do not go beyond the first credit tranche.[22] They will be included in all

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contrast to "same," which implied "treatment that would be undeviating for all members." See minutes of EBM/79/36 (February 28, 1979).

[20] As defined in Article XXX(b) a stand-by arrangement is "a decision of the Fund by which a member is assured that it will be able to make purchases from the General Resources Account in accordance with the terms of the decision during a specified period and up to a specified amount."

[21] Adapted from 1979 Guideline No. 2, which specified "one year" as the normal period.

[22] A member may be required to describe the general policies it plans to pursue, including its intention to avoid introducing or intensifying exchange and trade restrictions.

other stand-by arrangements but will apply only to purchases beyond the first credit tranche.[23]

17. *Extended Fund Facility (EFF)*. Extended arrangements are subject to the decisions and policies on stand-by arrangements, except as otherwise provided in the decision on the Extended Fund Facility (EFF) (Decision No. 4377-(74/114), September 13, 1974) and subsequent related decisions. Given the purpose of extended arrangements, which are intended to support "comprehensive programs that include policies of the scope and character required to correct structural imbalances in production, trade and prices," the use of structural conditionality is expected to be broader and more extensive than in stand-by arrangements.

18. *Supplemental Reserve Facility (SRF)*. Financing under the SRF is available under a stand-by or extended arrangement in addition to resources in the credit tranches or under the EFF. Such financing is available for one year to members "experiencing exceptional balance of payments difficulties due to a large short-term financing need resulting from a sudden and disruptive loss of market confidence ... if there is a reasonable expectation that the implementation of strong adjustment policies and adequate financing will result, within a short period of time, in an early correction of such difficulties." Purchases after the initial purchase, which will normally coincide with the approval of the corresponding arrangement, are subject to the conditions of the corresponding arrangement.[24]

19. *Contingent Credit Lines (CCL).* Financing under the CCL is committed to members meeting a number of criteria for eligibility.[25] Under the CCL, an initial amount is available upon approval. The amount to be released upon completion of the activation review (which would verify that the member's own policies did not contribute to the development of the crisis) would be determined at the time of commitment of the CCL resources, with the remainder subject to phasing and conditionality as determined appropriate by the Fund during a post-activation review (Summing Up by the Acting Chairman of the Executive Board, Contingent Credit Lines, November 17, 2000). Other modalities are specified in the CCL Decision.

20. *Poverty Reduction and Growth Facility* (*PRGF*). The use of conditionality in arrangements approved under the PRGF is guided by the decision on the establishment of the Enhanced Structural Adjustment Facility (ESAF) Trust (Decision No. 8759-(87/176), December 18, 1987) as amended. According to the 1999 amendment that transformed the

[23] From 1979 guideline No. 6. The relationship between performance criteria and phasing of purchases under stand-by and extended arrangements is covered by Decision No. 7925-(85/38) March 8, 1985, as amended (see Annex).

[24] Decision No. 11627-(97/123) SRF, December, 17, 1997, as amended.

[25] Ibid.

ESAF into the PRGF, the purpose of the PRGF is to provide “loans on concessional terms ... to low-income developing members ... in order to support programs to strengthen substantially and in a sustainable manner their balance of payments position and to foster durable growth, leading to higher living standards and a reduction of poverty.”[26]

21. *Compensatory Financing Facility (CFF)*. Financing under the CFF is available to eligible members that are temporarily experiencing a decrease in export earnings or an excess in cereal import costs. Members must have either an upper credit tranche arrangement in place or a balance of payments position that is satisfactory apart from the effects of the CFF-related shocks. In the former case, purchases will normally be tranched in line with the phasing provisions of the upper credit tranche arrangement, the conditionality of which would thereby also apply to purchases under the CFF. In the latter case, CFF financing would normally be provided in a single purchase and would not be linked to upper credit tranche conditionality.[27]

22. *Emergency Assistance*. Emergency assistance is provided under a special policy, normally as an outright purchase without the requirements of phasing or performance criteria in cases of natural disaster or in post-conflict countries. (Decision No. 12341-(00/117), November 28, 2000) In a request for emergency assistance, a member country is required to describe the general policies it plans to pursue, including its intention to avoid introducing or intensifying exchange and trade restrictions. Also, the Fund should be satisfied that the member will cooperate with the Fund in an effort to find a sustainable solution to its balance of payments needs. Countries usually express their intention to formulate a Fund-supported program.

C. Modalities

23. *Nature of arrangements*. Fund arrangements are not international agreements and therefore language having a contractual connotation will be avoided in arrangements and in program documents.[28] The authorities’ policy intentions are described in a Letter of Intent (LOI) or a Memorandum on Economic and Financial Policies (MEFP). LOIs and MEFPs should be drafted by the authorities, with the assistance of the Fund staff if they wish, and should reflect their policy goals and strategies. Policies and performance goals that are subject to Fund conditionality should be clearly demarcated from other aspects of the

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[26] In general, the operational guidelines for the staff that were specified for the ESAF in 1988 also apply to the PRGF. See “Enhanced Structural Adjustment Facility (ESAF) – Operational Guidelines for the Staff” (SM/88/148), July 12, 1988.

[27] See Decision No. 8955-(88/126), August 23, 1988, as amended; and “Amendment of the Compensatory Financing Facility,” (EBS/00/215, November 3, 2000).

[28] Adapted from 1979 guideline No. 3.

program in these documents, and detailed policy matrices covering the broader agenda should be avoided unless they are considered necessary by the authorities to express their policy intentions or by the staff to monitor policy implementation. Implementation of these understandings is monitored through prior actions or performance criteria, or through indicative targets or structural benchmarks in the context of program reviews.[29] Each of these instruments is to be used sparingly and should be focused on those measures that are necessary for the achievement of the macroeconomic goals of the program and to safeguard Fund resources.

24. *Side letters.* In addition to conditionality specified in LOIs and MEFPs, members requesting the use of Fund resources may communicate confidential policy understandings to Fund management or staff in a side letter. The use of side letters to keep certain understandings confidential is subject to the guidelines specified in Executive Board Decision No. 12067-(99/108) (September 22, 1999).[30]

25. *Prior actions.* A member may be required to adopt corrective measures prior to the Fund's approval of an arrangement or completion of a review, when management judges such prior actions to be necessary for the successful implementation of the program. In these cases the Managing Director will keep Executive Directors informed in an appropriate manner of the progress of discussions with the member.[31]

26. *Performance criteria.* Performance criteria are conditions that apply to specific variables or actions that can be clearly and unambiguously measured, that are reasonably within the authorities' direct or indirect control, and that can be evaluated and verified within the required time frame. Applying performance criteria requires that these measures in and of themselves are sufficiently important to warrant holding up purchases under the arrangement in cases of non-compliance. The number and content of performance criteria may vary because of the diversity of circumstances and institutional arrangements of members, subject to the principles enunciated above.[32] To ensure that the Fund-supported program is appropriate to resolve the member's balance of payments problem in a timely manner and to provide appropriate financing assurances to the member, performance criteria normally will

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[29] The last three sentences are adapted from paras. 4 and 12 of the IGN.

[30] This Decision is reproduced in the Annex.

[31] These two sentences are adapted from 1979 Guideline No. 7. The phrase "to be necessary for the successful implementation of the program" replaces the earlier phrasing, "to enable the member to adopt and carry out a program consistent with the Fund's provisions and policies."

[32] This paragraph is adapted from 1979 Guideline No. 9. The second sentence is from paragraph 4 of the IGN.

apply to specified dates or continuously. However, when the achievement of a policy adjustment or a performance objective is not required by a predetermined date, and when flexibility in timing would promote national ownership, the disbursement of Fund resources may be linked to achievement during the program period rather than on a specific date. These "floating tranches" are expected to apply primarily to performance criteria that are included because of their importance for medium-term external sustainability and growth.

27. *Indicative targets*. Indicative targets serve two purposes. First, they may be specified in lieu of performance criteria for the latter part of an arrangement, when there is substantial uncertainty about economic trends. Every effort should be made to include performance criteria initially for as much of the period of an arrangement as possible, and in all cases for at least the first six months. When indicative targets are specified beyond that period, the expectation is that they will be respecified as performance criteria as uncertainty is reduced.[33] Second, indicative targets may be specified in addition to performance criteria as a quantitative benchmark on the member's progress in meeting the macroeconomic goals of the program.[34] The use of indicative targets is subject to the operational guidelines in Executive Board Decision No. 7925-(85/38) (March 8, 1985), as amended.[35]

28. *Structural benchmarks*. Structural benchmarks, like performance criteria and indicative targets, apply to specific and measurable actions or outcomes. Benchmarks are either less critical or characterized by a series of smaller steps, which may be of moderate significance individually and have to reach a critical mass to signify progress.[36] Structural benchmarks are intended to serve as markers in the assessment of progress in the implementation of structural reforms.

29. *Program reviews.* Program reviews provide a framework for an assessment of whether the program is broadly on track toward successful completion, informed by progress against established conditions including indicative targets and structural benchmarks. Achievement of indicative targets and structural benchmarks is neither a necessary nor a sufficient condition for a member to be permitted to make a scheduled purchase. Their use should be aimed at specifying the basis on which program reviews will be assessed. Since

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[33] In some circumstances, uncertainty can also be handled by permitting conditions to be adjusted in a pre-specified way in response to particular eventualities.

[34] For example, an arrangement might include a ceiling on the overall fiscal deficit as a performance criterion and a floor on fiscal revenue as an indicative target, where revenue performance is preferred over expenditure measures as a means of meeting the performance criterion.

[35] This Decision is reproduced in the Annex.

[36] Adapted from paragraph 4 of the IGN.

reviews inherently involve judgment and flexibility, it is important that the basis for successful completion of reviews be specified as clearly as possible in advance, so as to provide adequate assurances to the member regarding the conditions under which disbursement of Fund resources will continue. In programs extending beyond one year, or in circumstances where substantial uncertainties concerning major economic trends make it impractical to establish in advance one or more conditions for all or part of the program period, provision will be made for a review in order to reach the necessary understandings with the member for the remaining period. The normal interval between reviews will be six months, but reviews may be held at shorter intervals when particularly close monitoring is required, including in cases where volatile capital flows or rapidly changing economic circumstances may require new understandings.

30. *Consultation*. Appropriate consultation clauses will be incorporated in all arrangements. In accordance with Fund policies, provision will be made in stand-by arrangements for consultation from time to time during the whole period in which the member has outstanding purchases in the upper credit tranches. Extended arrangements will provide for consultation during the period in which the member has outstanding purchases under the relevant arrangement.[37]

31. *Waivers.* If a performance criterion is not met, the Executive Board may decide to grant a waiver so as to allow the member to make a scheduled purchase. Although a missed performance criterion may result from weak implementation of policy measures, it may also reflect a minor or temporary deviation, changes in circumstances, or misspecification of the original program. A decision by the Executive Board to grant a waiver for this purpose implies that the objectives of the program are expected to be met and that the program is substantially on track or that corrective measures are expected to bring it on track in a timely manner. Waivers are not to be granted to allow purchases in spite of major uncorrected policy slippages. When a review is delayed beyond a test date, a waiver of applicability may be granted for a performance criterion for which data are not yet available, provided that the program is judged to be on track. Efforts should be made to avoid such delays, and consequently waivers of applicability should be exceptional.

D. Evaluation and Review

32. *Program evaluation.* The staff will prepare an analysis and assessment of the performance under programs supported by use of the Fund's general resources in connection

[37] Adapted from 1979 guideline No. 5. See "Stand-by and Extended Arrangements—Standard Forms," Decision No. 10464-(93/130), September 13, 1993. For guidance on post-program monitoring, see "Review of Fund Facilities - Proposed Decisions and Implementation Guidelines" (EBS/00/216, November 2, 2000), Annex III.

with Article IV consultations and as appropriate in connection with further requests for use of the Fund's resources.[38]

33. *Periodic review*. The staff will prepare, for review by the Executive Board, periodic studies of Fund-supported programs in order to evaluate and compare the appropriateness of the programs, the consistency of conditionality with these guidelines, the effectiveness of the policy instruments, the observance of the programs, and the results achieved.

III. Issues for Discussion

34. Directors may wish to address both the general issue of whether the guidance described above is an appropriate basis for new conditionality guidelines and the more specific issues regarding individual guidelines. If agreed, the staff would then prepare a draft text for further discussion and approval.

- Do Directors agree that the adoption of new guidelines would help consolidate and ensure continuation of the progress that has been made toward streamlining and focusing conditionality?
- Are the principles set out in Section II.A an accurate reflection of the Board's views on the purposes and goals of conditionality?
- Does the description in Section II.B provide an adequate basis for clarifying the relationship between conditionality in stand-by arrangements and in other Fund facilities?
- Does Section II.C appropriately characterize the intended modalities of conditionality?

[38] This paragraph is adapted from 1979 Guideline No. 11.

Existing Guidance on Conditionality: Selected Documents

GUIDELINES ON CONDITIONALITY

The Executive Board agrees to the text of the guidelines on conditionality for the use of the Fund's resources and for stand-by arrangements as set forth [below].

Decision No. 6056-(79/38)
March 2, 1979

Use of Fund's General Resources and Stand-By Arrangements

1. Members should be encouraged to adopt corrective measures, which could be supported by use of the Fund's general resources in accordance with the Fund's policies, at an early stage of their balance of payments difficulties or as a precaution against the emergence of such difficulties. The Article IV consultations are among the occasions on which the Fund would be able to discuss with members adjustment programs, including corrective measures, that would enable the Fund to approve a stand-by arrangement.

2. The normal period for a stand-by arrangement will be one year. If, however, a longer period is requested by a member and considered necessary by the Fund to enable the member to implement its adjustment program successfully, the stand-by arrangement may extend beyond the period of one year. This period in appropriate cases may extend up to but not beyond three years.

3. Stand-by arrangements are not international agreements and therefore language having a contractual connotation will be avoided in stand-by arrangements and letters of intent.

4. In helping members to devise adjustment programs, the Fund will pay due regard to the domestic social and political objectives, the economic priorities, and the circumstances of members, including the causes of their balance of payments problems.

5. Appropriate consultation clauses will be incorporated in all stand-by arrangements. Such clauses will include provision for consultation from time to time during the whole period in which the member has outstanding purchases in the upper credit tranches. This provision will apply whether the outstanding purchases were made under a stand-by arrangement or in other transactions in the upper credit tranches.

6. Phasing and performance clauses will be omitted in stand-by arrangements that do not go beyond the first credit tranche. They will be included in all other stand-by arrangements but these clauses will be applicable only to purchases beyond the first credit tranche.

7. The Managing Director will recommend that the Executive Board approve a member's request for the use of the Fund's general resources in the credit tranches when it is his judgment that the program is consistent with the Fund's provisions and policies and that it will be carried out. A member may be expected to adopt some corrective measures before a stand-by arrangement is approved by the Fund, but only if necessary to enable the member to adopt and carry out a program consistent with the Fund's provisions and policies. In these cases the Managing Director will keep Executive Directors informed in an appropriate manner of the progress of discussions with the member.

8. The Managing Director will ensure adequate coordination in the application of policies relating to the use of the Fund's general resources with a view to maintaining the nondiscriminatory treatment of members.

9. The number and content of performance criteria may vary because of the diversity of problems and institutional arrangements of members. Performance criteria will be limited to those that are necessary to evaluate implementation of the program with a view to ensuring the achievement of its objectives. Performance criteria will normally be confined to (i) macroeconomic variables, and (ii) those necessary to implement specific provisions of the Articles or policies adopted under them. Performance criteria may relate to other variables only in exceptional cases when they are essential for the effectiveness of the member's program because of their macroeconomic impact.

10. In programs extending beyond one year, or in circumstances where a member is unable to establish in advance one or more performance criteria for all or part of the program period, provision will be made for a review in order to reach the necessary understandings with the member for the remaining period. In addition, in those exceptional cases in which an essential feature of a program cannot be formulated as a performance criterion at the beginning of a program year because of substantial uncertainties concerning major economic trends, provision will be made for a review by the Fund to evaluate the current macroeconomic policies of the member, and to reach new understandings if necessary. In these exceptional cases the Managing Director will inform Executive Directors in an appropriate manner of the subject matter of a review.

11. The staff will prepare an analysis and assessment of the performance under programs supported by use of the Fund's general resources in the credit tranches in connection with Article IV consultations and as appropriate in connection with further requests for use of the Fund's resources.

12. The staff will from time to time prepare, for review by the Executive Board, studies of programs supported by stand-by arrangements in order to evaluate and compare the appropriateness of the programs, the effectiveness of the policy instruments, the observance of the programs, and the results achieved. Such reviews will enable the Executive Board to determine when it may be appropriate to have the next comprehensive review of conditionality.

GUIDELINES ON PERFORMANCE CRITERIA WITH RESPECT TO EXTERNAL DEBT IN FUND ARRANGEMENTS

The Executive Board approves the Chairman's summing up on external debt management policies as set forth [below].

Decision No. 6230-(79/140)
August 3, 1979,
as amended by Decision Nos. 11096(95/l00), October 25, 1995,
and 12274-00/85), August 24, 2000

The Chairman `s Summing Up on External Debt Management Policies

In the context of a general discussion of the issues relating to external debt management policies, the Executive Board considered the following guideline on the performance criteria with respect to foreign debt:

> When the size and the rate of growth of external indebtedness is a relevant factor in the design of an adjustment program, a performance criterion relating to official and officially guaranteed foreign debt will be included in upper credit tranche arrangements. The criterion will include all forms of debt, including loans, suppliers' credits and leases, that constitute current, i.e., not contingent, liabilities, which are created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which require the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments discharge the principal and/or interest liabilities incurred under the contract. The criterion will include foreign debts with maturities of over one year, and, in appropriate cases and where specifically provided, other financial instruments that have the potential to create substantial external liabilities for governments. The criterion will usually be formulated in terms of debts contracted or authorized. However, in appropriate cases, it may be formulated in terms of net disbursements or net changes in the stock of external official and officially guaranteed debt. Flexibility will be exercised to ensure that the use of the performance criterion will not discourage capital flows of a concessional nature by excluding from the coverage of performance criteria debts defined as concessional on the basis of currency-specific discount rates based on the OECD commercial interest reference rates, and including a grant element of at least 35 percent, provided that a higher grant element may be required in exceptional cases. Normally, the performance criterion will include a subceiling on foreign debt with maturities of over one year and up to five years. Additional subceilings may also be included on debt

> with specified maturities beyond five years or with a specified grant element lower than 35 percent.

Adoption of this guideline will be subject to the understanding that the staff will be guided also by the following points:

10. The above guideline will be applied with a reasonable degree of flexibility while safeguarding the principle of uniformity of treatment among members. The external debt guideline should be interpreted in the light of the general guidelines on conditionality (Decision No. 6056-(79/38)), especially guideline No. 4, which states:

> In helping members to devise adjustment programs, the Fund will pay due regard to the domestic social and political objectives, the economic priorities, and the circumstances of members, including the causes of their balance of payments problems.

Also, guideline No. 9 includes the following:

> The number and content of performance criteria may vary because of the diversity of problems and institutional arrangements of members. Performance criteria will be limited to those that are necessary to evaluate implementation of the program with a view to ensuring the achievement of its objectives.

Furthermore, guideline No. 8 states:

> The Managing Director will ensure adequate coordination in the application of policies relating to the use of the Fund's general resources with a view to maintaining the nondiscriminatory treatment of members.

11. In analyzing the amount and terms of new debt that would be appropriate-in the member's circumstances-over the medium term, the staff will take into account prospective developments in the member's external payments situation and the profile of its external indebtedness.

12. In formulating external debt criteria, the staff will be mindful of the need to ensure consistency between external debt management policies and domestic financial policies. Where external debt per se is not a matter for concern, but adjustment programs have as a main objective to reduce excess demand pressures and restore overall balance to the public sector finances, the credit ceiling for the public sector would cover both domestic and foreign financing of the overall public sector deficit.

13. Normally the performance criterion will relate to official and officially guaranteed foreign debt. The coverage will include official entities for which the government is

financially responsible as well as private debt for which official guarantees have been extended and which, therefore, constitute a contingent liability of the government.

14. In cases where the member's external debt management policy covers private sector debt without official guarantee and there is an established regulatory machinery to control such debt, it will be proposed that the performance criterion on foreign debt should be adapted accordingly.

15. The staff is encouraged to include short-term debt of a maturity of less than one year in the performance criteria relating to foreign debt, while allowing some flexibility in light of the different institutional reporting procedures employed by members and the statistical difficulties of recording that category.

16. The guideline provides for excluding from the coverage of performance criteria those debts defined as concessional on the basis of currency-specific discount rates based on the OECD commercial interest reference rates and including a specified grant element. In some cases, member countries utilize credits associated with concessional debts. The staff will take this into account in discussing the appropriate amount of debt.

17. In principle, a performance criterion on foreign debt will incorporate by reference the definition of debt set forth in point No. 9 below. Financial instruments that are not covered under the definition but have the potential to create substantial external liabilities for governments will be included in the performance criterion where appropriate, in which case they would be explicitly specified.

18. (a) For the purpose of this guideline, the term "debt" will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows:

(i) loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);

(ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and

(iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair, or maintenance of the property.

(b) Under the definition of debt set out in point 9 (a) above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

THE ROLE OF THE FUND IN GOVERNANCE ISSUES-GUIDANCE NOTE
[*EBS/97/125, July 2, 1997*]

…

Use of Fund resources

14. While the policy advice indicated above in relation to Article IV consultations is also relevant in the case of Fund-supported programs, the need to safeguard the Fund's resources must also be taken into account.

15. The use of conditionality related to governance issues emanates from the Fund's concern with macroeconomic policy design and implementation as the main means to safeguard the use of Fund resources. Thus, conditionality, in the form of prior actions, performance criteria, benchmarks, and conditions for completion of a review, should be attached to policy measures including those relating to economic aspects of governance that are required to meet the objectives of the program. This would include policy measures which may have important implications for improving governance, but are covered by the Fund's conditionality primarily because of their direct macroeconomic impact (e.g., the elimination of tax exemptions or recovery of nonperforming loans). While the Fund staff

should rely on other institutions' expertise in areas of their purview (e.g., public enterprise reform by the World Bank), it could nevertheless recommend conditionality in these areas if it considers that measures are critical to the successful implementation of the program.

16. Weak governance should be addressed early in the reform effort. Financial assistance from the Fund in the context of completion of a review under a program or approval of a new Fund arrangement could be suspended or delayed on account of poor governance, if there is reason to believe it could have significant macroeconomic implications that threaten the successful implementation of the program, or if it puts in doubt the purpose of the use of Fund resources. Corrective measures that at least begin to address the governance issue should be prior actions for resumption of Fund support and, if necessary, certain key measures could be structural benchmarks or performance criteria. Examples of such measures include recuperation of foregone revenue and changes in tax or customs administration. The staff would need to exercise judgment in assessing whether the actions adopted by the authorities were adequate to address the governance concerns; as in the case of other policies in which the track record is weak and the commitment of the authorities is in doubt, it may be appropriate in some circumstances to call for a period of monitoring prior to a resumption of financial support. The authorities' policy response could also entail changes in management in public institutions and, as appropriate, the removal of individuals from involvement in particular operations where corruption had occurred, and efforts to recover government funds that have been misappropriated. The staff must, of course, be mindful of the need to avoid action prejudicial to any related domestic legal processes in a particular case.

SIDE LETTERS AND THE USE OF FUND RESOURCES

Confidentiality

1. The existence and content of side letters will be treated with the utmost confidentiality by management, Fund staff, and Executive Directors.

Definition of side letters

2. A side letter is a letter or other written communication from a member's authorities to Fund management or staff containing confidential policy understandings complementary to or elaborating upon those in new or currently applicable letters of intent supporting a request for the use of Fund resources.

3. Understandings contained in side letters will not contradict or detract from those contained in the applicable letters of intent.

Use of side letters

4. Members requesting the use of Fund resources are encouraged to include all policy undertakings in letters of intent. Side letters will be used sparingly and only in those circumstances which the authorities consider, and management agrees, require such exceptional communication.

5. The use of side letters to keep certain understandings confidential can be justified only if their publication would directly undermine the authorities' ability to implement the program or render implementation more costly. Accordingly, their use will normally be limited to cases in which the premature release of the information would cause adverse market reaction or undermine the authorities' efforts to prepare the domestic groundwork for a measure.

6. While there is no presumption that particular kinds of measures would be conveyed in a side letter rather than a letter of intent, some matters that could in some cases be considered for inclusion in side letters would be: (i) exchange market intervention rules; (ii) bank closures; (iii) contingent fiscal measures; and (iv) measures affecting key prices.

Communication of side letters to the Executive Board

7. Fund staff will advise members' authorities of this decision pertaining to the communication of side letters to the Executive Board before the authorities send side letters.

8. The Executive Board will consider any side letter in a restricted session soon after the relevant letter of intent is issued to the Board. At this session, each Executive Director's constituency will be represented by only one person. A numbered copy of the side letter will be made available to each such representative and, at the end of the meeting, each copy will be returned. Staff will be present to answer any questions, including questions about the circumstances that justified the use of the side letter.

9. In principle, the full text of a side letter will be communicated to the Executive Board. However, at the request of the authorities, the Managing Director may delete from the copies to be communicated to the Board information of such specificity that:

(i) it is substantially immaterial to Executive Directors' consideration of the request for the use of Fund resources; and

(ii) disclosure would: (a) seriously hamper the authorities' capacity to conduct economic policy; or (b) confer an unfair market advantage upon persons not authorized to have knowledge of the information.

10. Information that might in specific cases be deleted under paragraph 9 above includes: figures regarding foreign exchange markets (e.g., exchange rate intervention triggers or

amounts of intervention), names of specific banks or companies, or specific dates for the introduction of certain policy measures.

Communications about side letters by Executive Directors to members' authorities

11. Executive Directors who decide to communicate information about a side letter to their respective authorities should: (i) limit the recipients to those who have a strict need to know; (ii) inform the recipients of the need to treat the information as highly confidential; and (iii) inform the recipients about the procedures that apply to the communication of side letters to the Executive Board under this decision.

12. Executive Directors that communicate information about a side letter to their respective authorities will inform promptly the Managing Director and the Executive Director for the member that sent the side letter of such communication.

Review

13. This decision will be reviewed by the Executive Board within one year, provided, however, that it will be reviewed promptly before that time if the confidentiality of any side letter has not been observed.

Decision No. 12067-(99/108)
September 22, 1999

RELATIONSHIP BETWEEN PERFORMANCE CRITERIA AND PHASING OF PURCHASES UNDER FUND ARRANGEMENTS-OPERATIONAL GUIDELINES

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6. Every effort should be made to include performance criteria initially for as much of the 12-month period of the Fund arrangement as possible. However, it may not be possible always to establish in advance one or more performance criteria for part of the period of the arrangement because of substantial uncertainties about major economic trends and normal time lags between the completion of negotiations on the arrangement and Board discussion of the arrangement. Taking into account both sets of factors, as well as the actual experience in recent years, it would be reasonable to expect that, as a normal rule, performance criteria would be included initially which would govern purchases over a period of at least six months of the arrangement. This would normally involve at least two sets of performance criteria. Where this minimum period is not met, the staff report would include a full explanation of the underlying reasons.

7. As a general rule, indicative targets would be included at the outset for that part of the 12-month arrangement for which performance criteria are yet to be established. Provision will also be made for a review in order to replace these indicative targets later with performance criteria. Indicative targets will also be included for the last month of the arrangement period.

8. In the case of segments within the framework of a multiyear arrangement, normally performance criteria would be set up to the end of each underlying annual program period. The purchase after the end of the underlying annual program (which may be the last purchase under the preceding segment of the arrangement or the first purchase under the subsequent segment) would be contingent both on understandings being reached with the Fund on the next year's underlying program and on observance of performance criteria for the end of the preceding program period or established in the context of the member's new program, or on a waiver being approved by the Board in the case of nonobservance of these performance criteria.

9. Notwithstanding the foregoing, in the case of extended arrangements, performance criteria and purchases could be phased at semiannual intervals, provided that appropriate monitoring of macro- economic developments would be ensured, normally in the form of quarterly benchmarks.

Decision No. 7925-(85/38)
March 8, 1985,
as amended by Decision No. 8887-(88/89), June 6, 1988

STREAMLINING STRUCTURAL CONDITIONALITY IN FUND-SUPPORTED PROGRAMS: INTERIM GUIDANCE NOTE

1. This note has been prepared by an Inter-Departmental Working Group[1] on streamlining structural conditionality in Fund-supported programs. The general principles set out below are preliminary and will be reviewed in early 2001 in light of the initial experience and the Board's discussion of the forthcoming papers on *The Experience with Structural Conditionality in Fund-Supported Programs* and *Ownership, Conditionality, and Policy Implementation*.

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[1] The Working Group comprised Messrs. Ahmed (PDR, Chair), Artus (EU1), Cardemil (WHD), Collyns/Moghadam (APD), Davis/Mahler (FAD), Fajgenbaum (AFR), Havrylyshyn/Saavalainen (EU2), Nashashibi (MED), Mr. Sundararajan/Ms. Gulde-Wolf (MAE), and Ms. Schulze-Ghattas (PDR, Secretary of the Group).

2. The Reform Task Force in its interim report on “The Future Role of the Fund“ recommends that Fund programs should henceforth be formulated on the “… presumption that structural conditionality will be limited to a core set of essential measures that are macro-relevant and in the Fund’s core area of responsibility, with a broader approach requiring justification based upon the specific country situation.”[2] The report further notes that “…the Fund may continue to advise on a broader range of structural reforms in some cases, but they would not generally be part of conditionality.”(paragraph 51)

3. This note outlines some principles to assist staff in determining the appropriate scope of structural conditionality in Fund arrangements in the general resources account, as well as in PRGF arrangements. These principles are inevitably fairly general and will need to be applied judiciously on a case by case basis. However, they should be seen as establishing a general presumption that structural conditionality in Fund-supported programs should be selective and justified by the program’s overall macroeconomic objectives. This should not weaken the quality of Fund-supported programs; rather, it should help strengthen conditionality and ownership in those areas that are critical for the program’s success.

4. The authorities' policy commitments in the structural area are laid down in the letter of intent (LOI) or the memorandum on economic and financial policies (MEFP). Implementation of these policy commitments is monitored through performance criteria, structural benchmarks, prior actions, or in the context of program reviews. The form of monitoring depends on the importance of certain structural reforms for the program’s objectives as well as the nature of the measures involved. Applying performance criteria requires that specific measures can be clearly and unambiguously defined, and that these measures in and of themselves are sufficiently important to warrant holding up the arrangement in cases of non-compliance. Structural benchmarks too are applied to individual, well-defined measures, but they do not assign the same weight to these measures as do performance criteria; rather they serve as markers in the assessment of progress with the implementation of reforms in a given area. Finally, reviews provide a framework for an assessment of structural reforms against established benchmarks or of reforms that are either less critical or characterized by a series of smaller steps, which may be of moderate significance individually and have to reach a critical mass to signify progress. Reviews provide considerable scope for judgment and, hence, flexibility to the Fund, but they imply less clearly defined assurances for the borrowing country regarding the conditions under which purchases can continue.

5. Sometimes, the authorities and/or staff find the LOI a useful vehicle to set out the authorities’ broader policy agenda for either national or international audiences. In these

[2] Core areas of responsibility are defined in paragraph 2 of the report. They include “macroeconomic stabilization; monetary, fiscal and exchange rate policy, including the underlying institutional arrangements and closely related structural measures; and financial sector issues, including the functioning of both domestic and international financial markets.”

instances, only part of the LOI may constitute firm policy commitments under the program in the form of performance criteria or benchmarks. In such cases, review clauses need to indicate clearly the areas that will be covered by program reviews. The principles outlined in the following paragraphs (paras. 6–11) focus on structural reforms that constitute policy commitments in the sense that they are subject to some form of monitoring under the program. Issues related to the broader coverage of structural measures in LOIs or MEFPs are briefly discussed in paragraph 12.

6. *Fund conditionality should cover only structural reforms that are relevant for a program's macroeconomic objectives.* There are, however, no clear rules for classifying structural reforms according to their macro-relevance. While all Fund-supported programs ultimately seek to achieve medium-term external viability together with strong and sustainable growth, the conditions that determine what needs to be done to achieve these objectives vary considerably across programs. For example, in recent financial crises, the overriding goal of Fund-supported programs was to restore market confidence, ensure orderly external adjustment, address the weaknesses that had made these countries vulnerable to a crisis, and create the conditions for growth to be resumed. In the transition economies, completing the transformation into a competitive market economy while restoring or maintaining stable macroeconomic conditions has been the key challenge. PRGF arrangements seek to promote poverty reduction by removing impediments to strong, sustainable growth and a viable external position. While macro-relevance needs to be established on a case by case basis, it will be important to make this assessment explicit in program documents.

7. *Not all structural reforms that meet the macro-relevance test will typically be subject to program conditionality.* In order to determine which reforms should be covered, it is useful to distinguish between structural reforms that are essential or critical for the program's macroeconomic objectives and reforms that are macro-relevant but do not have the same degree of importance. Distinguishing between the two is obviously a matter a judgment. One way to do so is to ask the question: If the reforms in question were not carried out, would achievement of the program's macroeconomic objectives, including the restoration of sustainable growth, be seriously jeopardized, regardless of progress in other areas? If the answer is no, the reforms in question may be macro-relevant but are probably not critical.

8. *Structural reforms that are critical for the achievement of the program's macroeconomic objectives will generally have to be covered by Fund conditionality.* If measures can be identified that are specific, well-defined and monitorable, and mark important steps in the whole reform process, they would likely be subject to performance criteria or prior actions. For structural reforms that are critical for a program's macroeconomic objectives but are defined by a series of individual small steps that have to reach a critical mass, monitoring would typically rely on benchmarks and/or program reviews, with review clauses highlighting the relevant area.

9. *If certain structural reforms are critical for the program's success but outside the Fund's core areas of responsibility, the Fund will have to seek assistance from the World*

Bank or another institution to provide input in designing and monitoring the reform measures and, if necessary, give technical advice on implementation to the country. In these cases, the Fund would still bring these measures under its own conditionality and decide on the adequacy of implementation on the basis of assessments provided by the World Bank or other relevant institution.[3]

10. *Structural reforms that are relevant—but not critical—for the program's macroeconomic objectives and within the Fund's core areas of responsibility may be subject to conditionality.* Whether such reforms should be included and in what form they should be monitored is a matter of judgment and depends on their relative importance for the program's objectives and the nature of the measures involved. However, the presumption would be that structural performance criteria would not be used in these cases, and that prior actions or structural benchmarks would be used sparingly and would require justification. In most instances, structural policy commitments to the Fund that fall into this category would be monitored in the context of reviews as part of an overall assessment of progress under the program.

11. *If structural reforms meet the macro-relevance test but are neither critical nor in the Fund's core areas of responsibility, Fund conditionality would generally not apply.* If these measures are covered by the World Bank, the Fund may, and in many cases would, take note of the Bank's assessment of progress with implementation in forming a judgment on the country's adjustment effort.[4]

12. The general principles outlined above focus on structural conditionality, i.e., policy commitments to the Fund in the structural area that are subject to some form of monitoring under the program. As noted in ¶4, however, LOIs or MEFPs may include the authorities' broader policy agenda. In these cases, review clauses need to delineate the areas that are covered by Fund conditionality beyond those covered explicitly by performance criteria. The

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[3] In the case of PRGF-supported arrangements, it has been decided that the respective areas of responsibility of the Fund and the World Bank will be delineated in the PRSP. It is intended that the Fund would "…not apply conditionality in areas outside the Fund's mandate and expertise, with the possible exception of measures that are critical to the country's fiscal and/or external targets…" (see, *Key Features of PRGF-Supported Programs* (SM/00/193, 8/17/00, paragraph 18)). It is recognized, however, that changes at the World Bank—in particular, the development of the Poverty Reduction Support Credit—and the nature of the World Bank's current lending operations in specific countries will affect how quickly it will be possible to move in this direction. In the interim, PRGF conditionality may cover additional measures that are critical for the program's objectives.

[4] In the case of PRGF arrangements, it is envisaged that the Fund will take into account the World Bank's assessment in all areas for which the Bank has responsibility under the PRSP (or I-PRSP).

breadth as well as the level of detail of the measures covered by LOIs or MEFPs should continue to be determined by what is most useful in each country context. Nevertheless, in some cases, MEFPs containing large and detailed policy matrices have raised concerns about excessive intrusiveness of Fund conditionality. Such detailed matrices should be avoided unless they are considered necessary by the authorities to express their policy commitment or by the staff to monitor policy implementation.