INTERNATIONAL MONETARY FUND

Structural Conditionality in Fund-Supported Programs

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(In consultation with other departments)

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I. Introduction

1. In the five decades of the Fund's existence, views on its involvement in structural policies in general—and on structural conditionality in Fund-supported programs in particular—have evolved. When the Fund was established at the end of World War II, it was understood that its role was to promote macroeconomic stabilization and an open exchange system. Structural reform "…insofar as the concept existed at the time, was not seen as a legitimate matter of international concern."[1] Access to the Fund's financial resources was to be temporary and subject to adequate safeguards; its purpose was to give members the opportunity "… to correct maladjustments in their balance of payments without resorting to measures destructive to national or international prosperity."[2] Conditionality as it evolved in the 1950s and 1960s—Fund lending based on a set of policies a member intends to follow to address its balance of payments problems—focused primarily on macroeconomic policies and program monitoring was typically confined to key macroeconomic indicators.[3]

2. By the mid 1970s, however, it had become apparent that in some cases, maladjustments in the balance of payments could be quite protracted and rooted in structural rigidities and distortions. Thus, when the Extended Fund Facility (EFF) was established in 1974, the Executive Board agreed that financing under the facility would be provided "… in support of comprehensive programs that include policies of the scope and character required to correct structural imbalances in production, trade and prices … ."[4] Although it was now recognized that in *some* Fund-supported programs structural policies had a role to play, the extent of Fund involvement in this area remained controversial. Regarding stand-by arrangements, the Conditionality Guidelines of 1979 stipulate that performance criteria should relate to other (non-macroeconomic) variables only in "exceptional cases."[5] And when

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[1] Allen (1994), p.10.

[2] Article I(v) of the Articles of Agreement.

[3] See Polak (1991) for a discussion of the concept of conditionality and the evolution of the practice.

[4] Executive Board Decision No. 4377–(74/114), September 13, 1974.

[5] More specifically, the Guidelines require that 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." Executive Board Decision No. 6056–(79/38), March 2, 1979. In principle, the Conditionality Guidelines cover also extended arrangements, which are subject to the Fund's decisions and policies on stand-by arrangements, *except* as otherwise provided in the decision on extended arrangements and subsequent related decisions (Executive Board Decision No. 4377-(74/114), December 13, 1974). This exception applies, inter alia, to the limitation on non-macroeconomic

(continued…)

the Board discussed the potential role of structural ("supply-oriented") policies in adjustment programs in 1981, most Executive Directors from developing countries strongly disagreed with the staff's analysis and opposed greater Fund involvement. Against this background, formal conditionality related to structural measures remained relatively limited until the mid 1980s, although the staff generally encouraged structural reforms in its discussions with member countries.[6]

3. More recently, following a shift in the Executive Board's attitude toward structural policies in Fund-supported programs in the late 1980s and a marked expansion of structural conditionality in the 1990s, the Fund's role in this area has again come under criticism. Motivated by the debate on the merits and demerits of the extensive structural reform agenda of recent Fund-supported programs in the Asian crisis countries, outside critics have argued that the Fund has moved too far beyond its original mandate and needs to refocus.[7] These concerns have been echoed inside the Fund and have prompted efforts to begin streamlining structural conditionality in Fund-supported programs.[8]

4. This paper seeks to provide a comprehensive overview of the extent, focus, and features of structural reforms in stand-by, EFF and SAF/ESAF/PRGF-supported arrangements since the late 1980s. It is intended as background for the Board's discussion on the appropriate scope of structural conditionality and on ways of streamlining it. Specifically, four sets of questions are addressed. First, how much did structural conditionality in Fund-supported programs increase and what factors accounted for this increase? Second, how broad was the scope of structural conditionality? How were structural measures related to the programs' macroeconomic objectives; and how did the Fund deal with structural policies outside its areas of expertise? Third, how was the implementation of structural reforms monitored? How detailed was the monitoring and how were different monitoring techniques—such as performance criteria and reviews—used? Fourth, what was the record on implementation and how was implementation related to the extent of conditionality? These questions are discussed in chapters II through V; chapter VI summarizes the main findings and conclusions.

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performance criteria in the Guidelines, which does not affect extended arrangements, because the Board decision establishing the EFF explicitly recognizes the need to address balance of payments problems related to *structural imbalances* as a purpose of the facility.

[6] See Boughton (2000), Chapter 13, pp.32–33.

[7] See, for example, Feldstein (1998), Council on Foreign Relations (1999), and Goldstein (2000).

[8] See interim report of the Reform Task Force on "The Future Role of the Fund," (July 2000) circulated for the July 2000 Board retreat, and "Streamlining Structural Conditionality in Fund-Supported Programs—Interim Guidance Note," (September 18, 2000). The paper has benefited from the discussions of the interdepartmental working group that prepared this interim guidance note.

5. The paper focuses on broad trends in structural conditionality—its breadth and depth (level of detail)—and does *not* address issues of program design, i.e., whether the structural content of the programs was appropriate, whether policies were optimally sequenced, and how structural (as well as macroeconomic) policies contributed to the achievement of program objectives. These are important issues. They are, however, best examined in the context of detailed case studies, which are beyond the scope of the paper.[9] An alternative approach would be a general cross section or panel study of program effectiveness. Such studies have generally been quite successful in examining the achievement of certain broad macroeconomic program objectives, such as current account adjustment, inflation, and growth. However, efforts to establish a link between specific policies and the achievement of certain program objectives have yielded less promising results.[10]

6. "Structural conditionality" is not a well-defined concept and attempting to quantify it requires some clarification. The purpose of conditionality is to ensure that the Fund's resources are used "… in accordance with the purposes and provisions of the Articles [of Agreement]."[11] Specifically, conditionality is intended to safeguard the revolving character of the Fund's resources and promote the achievement of program objectives that are consistent with these "purposes and provisions"—notably, but not exclusively, a viable external position. At the same time, conditionality provides assurances to members by specifying the conditions under which they have access to Fund financing.

7. Any attempt to quantify structural conditionality needs to refer to specific tools—performance criteria, prior actions, benchmarks and reviews—that are used to monitor policy implementation in Fund-supported programs (Box 1). Using these tools as a measure of structural conditionality is, however, not without problems. Focusing exclusively on one type of condition, such as performance criteria, clearly does not capture the full extent of conditionality; on the other hand, focusing on a broader aggregate requires adding up structural measures that differ considerably in the way they are monitored and hence in their importance for the approval of a program or the continuation of purchases.

[9] For examples of such cases studies, see "External Evaluation of the Enhanced Structural Adjustment Facility," (EBAP/98/8, January 22, 1998).

[10] For a review of the literature on the effectiveness of Fund-supported programs, see Annex I of the paper on "Conditionality in Fund-Supported Programs–Preliminary Considerations." Fischer and Sahay (2000) examine the growth performance of the transition economies and conclude that anti-inflation policies and structural reforms had a positive impact on growth. However, their analysis focuses on various indicators of structural reform rather than indicators of structural conditionality. Mercer-Blackman and Unigovskaya (2000) examine the relationship between indicators of Fund conditionality—performance criteria and structural benchmarks—and growth in the transition economies. They find that compliance with performance criteria is positively related to growth, but they find no significant impact of structural benchmarks.

[11] Gold (1979), p.2.

Box 1. Monitoring Techniques

Conditionality entails a body of practices and procedures, generally known as program monitoring techniques. These have been adapted to monitor structural reforms. Four forms of program monitoring have been employed in upper credit tranche stand-by and extended arrangements and the Fund's concessional lending: prior actions (PAs), performance criteria (PCs), structural benchmarks (SBs) and program reviews (PRs).

Prior actions are measures taken at the outset of an adjustment program or prior to the completion of a review to improve the capacity of the program to meet its objectives. Their implementation constitutes a precondition for program approval or completion of a review. PAs are particularly important in cases of severe imbalances or a weak record of policy implementation. Prior actions for the completion of reviews are frequently applied to structural benchmarks whose implementation has repeatedly been delayed.

Performance criteria are intended for structural measures that are critical to the success of the adjustment program and whose implementation in a specific timeframe is important. They need to be defined in precise, objectively verifiable terms. Their implementation constitutes a condition for purchases under an arrangement Non-implementation by the deadline requires a request for a waiver, which the staff can support if the delay or non-implementation is not seen as overly detrimental to the attainment of the program's objectives, or if adequate compensatory measures are taken.

Benchmarks were first introduced in the context of the Structural Adjustment Facility (SAF) but are now used across Fund arrangements to monitor structural policies. They are typically used to monitor the implementation of reforms that are important but not as critical as are PCs, critical measures where the timing is less important, or critical measures that cannot be defined sufficiently precisely to constitute a structural PC. They are monitored in the context of reviews rather than directly linked to purchases. Delays in the implementation of specific SBs does not necessarily hold up the completion of a review, but a delay in a substantial number of SBs can signal a setback in meeting a program's objectives and will figure importantly in deliberations to complete a review.

Program reviews provide a framework for assessing structural reforms against established benchmarks, or progress in implementing reforms that are difficult to define ex ante with a high degree of precision, or reforms characterized by a series of smaller steps, which may be of only moderate significance individually but can make an important contribution to meeting a program's objective when a critical mass is implemented. The completion of a review is linked to a purchase. Ideally, the focus of forthcoming program reviews should be defined in letters of intent, particularly if the content of the letter of intent goes beyond the policies that are important for the achievement of a program's macroeconomic objectives.

When designing a program, four considerations are taken into account to determine the appropriate monitoring tool:

- *Level of priority:* PAs and PCs signal the highest level of priority; with SBs generally signaling a lower priority.
- *Timing:* the completion of PAs should be important at the outset of an arrangement or before the completion of a review, while that of PCs should be critical within a specific interval; the timing of SBs may be more flexible.
- *Definability:* PAs, PCs need to be very clearly defined,1/ SBs should ideally be clearly defined, but need not be, and review conditions may be specified in more general terms.
- *The presence or absence of perverse incentives*: PAs and PCs, and to a lesser extent SBs, being associated with specific dates, can put the authorities at a disadvantage in negotiations that may involve third parties.2/

However, the above considerations may sometimes conflict with each other, so that the structural conditionality instruments used in a program will not necessarily provide a clear signal of priorities. This problem arises in particular when the highest-priority measures fail the definability or the perverse incentive test.

1/ Precise definition of PAs has become especially important since the Board's decision in July 2000 to include PAs in the text of arrangements.

2/ For instance, a specific date for a privatization can weaken the authorities' bargaining power vis-à-vis a potential buyer.

8. Performance criteria, for example, are conditions for the continuation of a program and require a waiver in the case of non-observance. By contrast, structural benchmarks are generally not directly linked to the continuation of purchases.[12] They serve as markers for a broader assessment of progress under the program in the context of program reviews and, unlike performance criteria, are normally not referenced in arrangements.[13] In addition, letters of intent or the accompanying memoranda on economic and financial policies, which outline the authorities' overall policy agenda, frequently list numerous structural policy measures that are neither performance criteria nor benchmarks. Most of these policy measures are monitored in the context of program reviews and many of them may be important for the assessment of progress under the program. However, failing to implement one of these measures does not carry the same weight as failing to meet a structural benchmark, and neither has the same implication as failing to observe a performance criterion. Finally, countries may be required to fulfill certain prior actions for the approval of a program or the completion of a review. While until recently, these prior actions were sometimes not stated explicitly in letters of intent and were not referenced in the relevant Board decisions,[14] they clearly were conditions for the approval or continuation of a program.

9. The approach taken in this paper is to base the empirical analysis on the broadest available measures of structural conditionality and disaggregate these summary measures to gain an adequate understanding of the extent of conditionality. The measure of structural conditionality used for the historical comparison covers performance criteria, prior actions and benchmarks relating to structural policies (as opposed to quantitative, macroeconomic variables); data limitations prevent a broader coverage including structural policy measures that are listed in letters of intent—frequently in the form of detailed policy matrices—but are

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[12] Benchmarks were introduced with the SAF in 1986. Under SAF-supported arrangements, resources were committed for three years to be disbursed under three successive annual arrangements. With annual disbursement schedules, SAF-supported programs could not use performance criteria to assess policy implementation in the course of each annual arrangement, instead, benchmarks were applied to structural measures as well as financial variables to "…facilitate the evaluation of progress under an arrangement…prior to the approval of the next annual arrangement" (See "Enhancement of the Structural Adjustment Facility—Considerations Relating to Access and Monitoring procedures,"EBS/87/230, p. 6). Unlike performance criteria, benchmarks do not require waivers to avoid program interruption in cases of non-compliance. Following their introduction in the context of the SAF, benchmarks came to be used increasingly in other Fund-supported programs, including stand-bys.

[13] Structural benchmarks in annual arrangements of ESAF-supported programs are the exception. They are referred to in the arrangement as the basis for the assessment of progress under the program prior to the approval of the next annual arrangement.

[14] In July 2000, the Executive Board decided to strengthen the application of the Fund's Misreporting Guidelines, extending them to prior actions, which henceforth had to be stated explicitly in Board decisions concerning program approval on the completion of a review.

neither performance criteria, nor prior actions or benchmarks.[15] However, the paper *does* examine a broader set of structural policy measures in 24 recent Fund-supported programs based on a survey among area department staff.[16]

10. Analyzing structural conditionality on the basis of such broad measures is not uncontroversial. The measures of conditionality employed in this paper are neither based on a legal definition of conditionality, nor do they cover only structural policies that matter directly for the approval or continuation of a program. Indeed, it is debatable whether structural measures that are merely listed in a letter of intent and even structural benchmarks are part of Fund conditionality. However, with the growing reliance on reviews for program monitoring, ambiguities about the status of structural benchmarks and other structural policy measures in the context of program reviews have led to a blurring of the boundaries of conditionality. In light of this development, it seems expedient to take the broadest available measure of structural conditionality to examine its evolution; taking a narrower approach would sidestep the issues raised by the blurring of its boundaries.

II. Trends in Structural Conditionality in Fund-Supported Programs 1987–99

11. This chapter provides a broad overview of the evolution of structural conditionality in Fund-supported programs—stand-by arrangements, extended arrangements, and SAF/ESAF/PRGF-supported arrangements—since 1987. Structural conditionality is measured in terms of the number of performance criteria, prior actions and benchmarks related to structural policy measures. Three factors underlying the expansion of structural conditionality are discussed: the shift in the Executive Board's attitude towards structural reforms in Fund-supported programs; the introduction of new facilities to support structural adjustment in low-income countries; and the transition in former centrally planned economies.

12. Judging by aggregate measures such as the share of programs with structural conditions and the average number of conditions—structural performance criteria, prior actions and benchmarks—per program year, structural conditionality in Fund-supported programs has increased substantially since the mid 1980s. Of the upper credit tranche stand-by and extended arrangements approved in 1985 and 1986, fewer than one fifth had performance criteria relating to structural measures—most of them concerning the exchange system.[17] By the late 1980s, almost two thirds of Fund-supported programs[18] contained

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[15] The information on structural performance criteria, prior actions and benchmarks is derived from the MONA (Monitoring Fund Arrangements) database, which is briefly described in Appendix I.

[16] The survey of these 24 programs is described in Appendix II.

[17] See "Monitoring of Structural Adjustment in Fund-Supported Adjustment Programs," (EBS/87/240, November 20,1987).

structural conditionality—structural performance criteria, benchmarks or prior actions—and by the mid 1990s, nearly all arrangements included some structural conditions (Figure 1).

13. In addition to becoming nearly universal, structural conditions in Fund-supported programs appear to have become more numerous. In 1987, Fund-supported programs contained on average two structural conditions per program year; by 1994, this number had increased to 7, rising further to an average of 14 structural conditions per program year in 1997–99. Some of this increase appears to be attributable to outliers—a few programs with a very large number of structural conditions: in the second half of the 1990s, the median of total structural conditions, which is less affected by such outliers, was typically lower than the mean.

14. The number of structural conditions did not rise uniformly across different types of conditions. The increase in the aggregate reflects primarily a proliferation of structural benchmarks, the least stringent and least clearly defined type of condition (Figure 2). While the average number of prior actions per program year has also grown significantly, a substantial part of this increase appears to be due to a small number of programs with very large numbers of prior actions, with the median remaining below two, even in recent years. Finally, although the average number of structural performance criteria has increased since the late 1980s and early 1990s, it has stayed in a relatively moderate range at or below two. Thus, taking into account the differences between different types of conditions, the increase in structural conditionality over the past decade and a half appears less dramatic than simple aggregate indicators suggest. Nevertheless, even the more nuanced picture painted by this disaggregation indicates a clear expansion of structural conditionality.

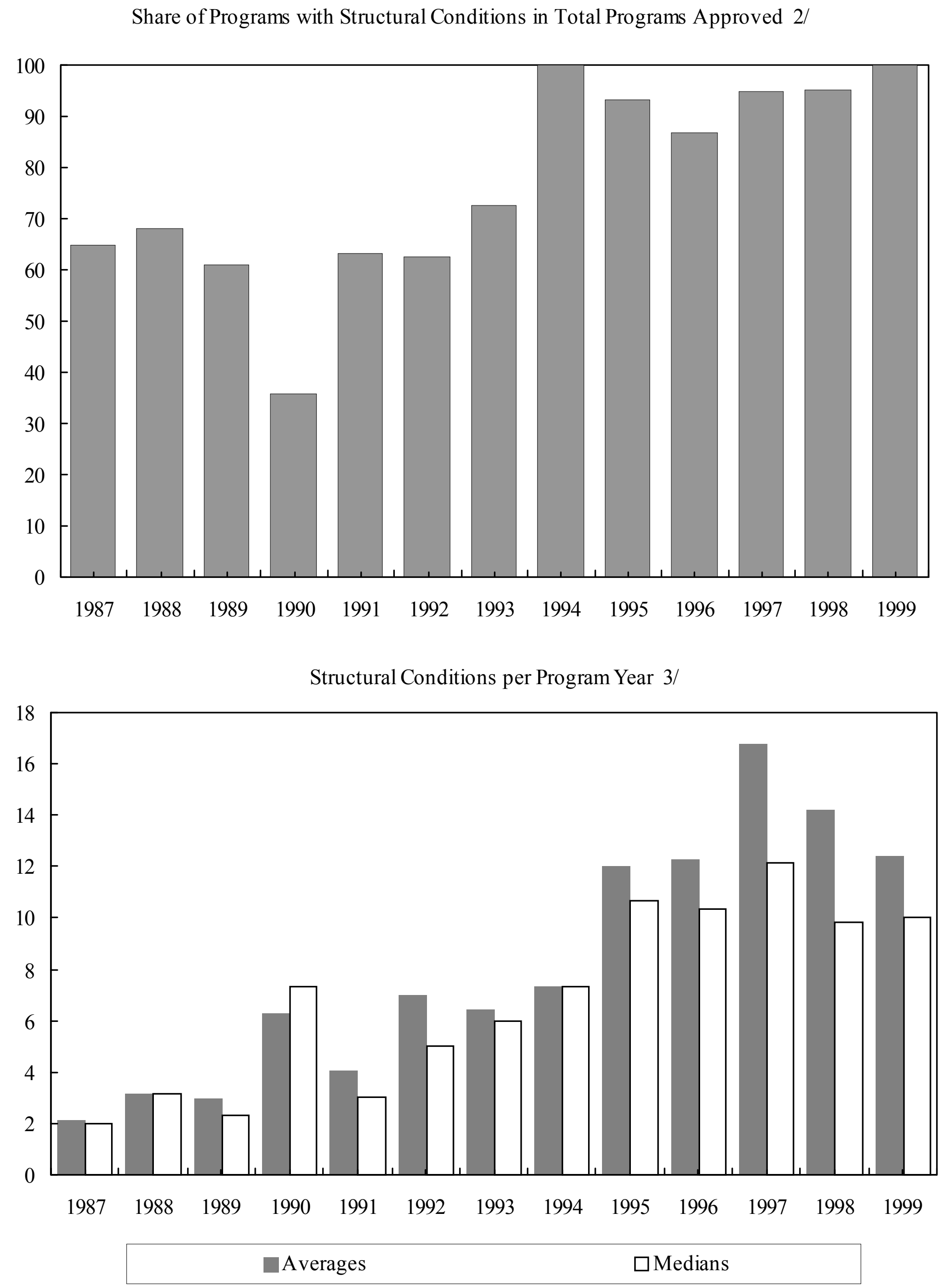
15. The expansion of structural conditionality in the 1990s was preceded by a gradual shift in the Fund's attitude toward structural reforms in adjustment programs. Even though the possibility of structural impediments to a sustainable external position and the role of structural adjustment policies were recognized when the EFF was established in 1974, a significant part of the Fund's Executive Board reacted with considerable reservation to a staff paper on "Supply-Oriented Adjustment Policies" in 1981.[19] However, seven years later, in late 1987, the summing up of the Board discussion on "Monitoring Structural Adjustment in Fund-Supported Adjustment Programs"[20] noted that Directors were in broad agreement "… that structural reform could play a critical role in external adjustment and in laying the

[18] Upper credit tranche stand-by and extended arrangements, as well as arrangements supported by the Structural Adjustment Facility (SAF) and the Enhanced Structural Adjustment Facility (ESAF), which were introduced in 1986 and 1988, respectively. Excluding programs supported by the Systemic Transformation Facility (STF), which are not covered in MONA.

[19] SM/81/78, April 6, 1981.

[20] EBS/87/240, November 20, 1987.

Figure 1. Structural Conditionality in Fund-Supported Programs, 1987-1999 1/

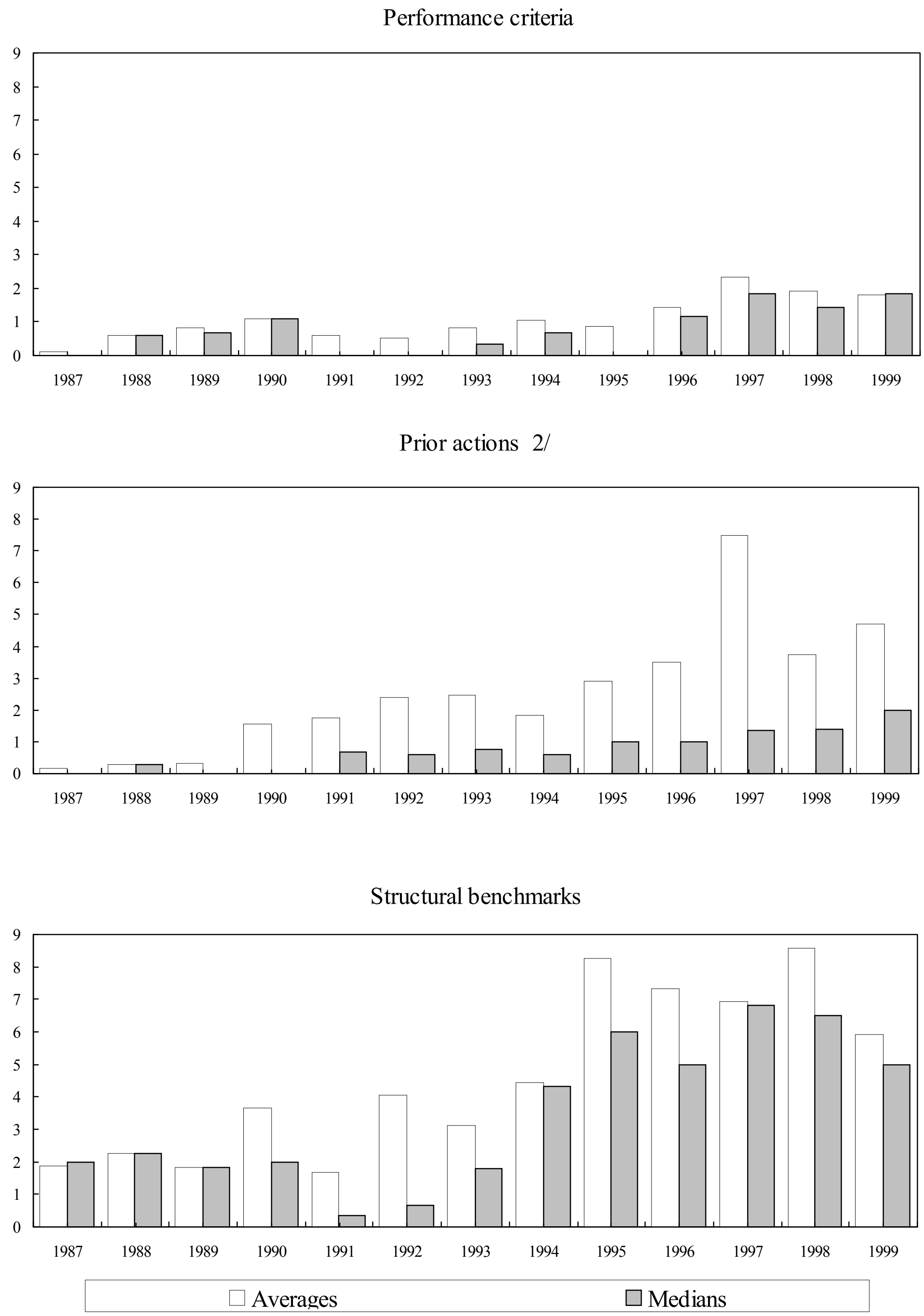


Source: International Monetary Fund, MONA database; and country papers.

1/ Stand-by, EFF, and SAF/ ESAF/ PRGF- supported programs.
2/ Programs with at least one of the following structural conditions: performance criteria, prior actions, conditions for completion of review, structural benchmarks.
3/ Total number of conditions per program as defined in footnote 2, adjusted for differences in program length.

Figure 2. Structural Conditionality by Type of Condition, 1987-1999 1/

(Average number per program year)



Source: International Monetary Fund, MONA database; and country papers.

1/ Stand-by, EFF, and SAF/ ESAF/ PRGF- supported programs.

2/ Including conditions for completion of review.

basis for the durable growth that was needed for adjustment to be sustained."[21] Although there was no clear consensus on the extent to which structural reforms should be subject to Fund conditionality, most Executive Directors "… supported the principle that conditionality should be attached to structural reform when the latter was seen as essential for the achievement of external viability—often but by no means always the case—and hence for safeguarding the revolving character of the Fund's resources."[22]

16. In the intervening years, the Fund had been involved in an extensive debate on program design, structural policies, and the importance of growth as an objective of Fund-supported programs (Box 2).[23] This debate took place against the background of increasing criticism that Fund-supported programs focused too narrowly on reducing demand, thereby jeopardizing growth.[24] At the same time, there was a growing realization that the heavily indebted countries were not merely experiencing liquidity problems and could hope to regain market access only if they were able to return to sustainable growth.[25] These developments, together with an increased focus on structural reforms in the industrial countries, led the Fund to place greater emphasis on growth and structural adjustment in Fund-supported programs. Subsequently, as structural conditionality became more common and the thinking about the links between structural reforms and macroeconomic performance evolved, a growing variety of structural reforms ranging from financial sector restructuring to governance issues, came to be seen as potentially relevant for the macroeconomic objectives of Fund-supported programs.

[21] The Chairman's Summing Up of the Discussion on Monitoring Structural Adjustment in Fund-Supported Adjustment Programs. Executive Board Meeting 87/176—December 8,1987.

[22] Ibid.

[23] See, for example, "External Adjustment, Financing and Growth—Issues in Conditionality" (EBS/87/40, February 25, 1987), as well as Boughton (2000), Chapter 13, pp 54–61, and Corbo, Goldstein and Khan (1987).

[24] Allen (1994), p.8.

[25] Mohammed (1991).

Box 2. The Role of Structural Policies and Growth in Fund-Supported Programs—The Discussion in the 1980s

Attitudes towards structural policies in Fund-supported programs changed considerably during the 1980s. At the beginning of the decade, when the growing interest in supply side policies in the industrial countries began to influence the policy debate in the Fund, the reaction of many Executive Directors from developing countries was decidedly negative. Commenting on a staff paper on "Supply-Oriented Adjustment Policies"1/ at a Board meeting in 1981, the Executive Director for Mexico strongly criticized the assumptions underlying the discussed policies and noted that his authorities did not expect Fund guidance on this matter.2/ A number of other Directors expressed similar views. In light of these reactions, further studies were proposed at the conclusion of the discussion and the staff decided to proceed cautiously. Structural policies were discussed with authorities but they did not play a significant role in Fund conditionality—with the exception of reforms of the exchange and trade system, which had always been a concern for the Fund. In conditionality reviews in the first half of the decade, "supply-side" or "institutional" policies, as they were termed at the time, received relatively short shrift, and so did the issue of growth in countries undergoing Fund-supported adjustment programs.

In the mid 1980s, the issue of growth in Fund-supported programs began to move to center stage. For some time, the Fund had been facing criticism for failing to encourage economic growth. Fund-supported programs were seen as "austerity" programs promoting excessive demand restraint.3/ The Fund had responded to this criticism by presenting a more nuanced picture of the policies and growth record of Fund-supported programs.4/ However, the experience of the heavily indebted countries in the first half of the 1980s suggested that lack of growth was indeed a serious issue. By 1985, the limitations of the initial strategy to deal with the debt crisis had become apparent. A consensus was emerging that a revival of growth was needed for the heavily indebted countries to grow out of their debt problems and regain market access. This was the conclusion that prompted the announcement of the Baker Plan in 1985. The Executive Board's initial reaction was cautious,5/ but by 1987, the issue of growth was clearly on the agenda. The 1987 conditionality review argued that "… a powerful argument for conditionality to include growth as a direct objective is that without such an approach medium-term viability (and the revolving character of Fund resources) may be elusive."6/ Most Directors supported this view and the chairman concluded, in a personal comment, that "[g]rowth goes hand in hand with sustained adjustment."7/

With the new focus on growth, the discussion on the role of structural policies in Fund-supported programs gained momentum. Discussing the1987 conditionality review, Directors stressed "… that a growth-oriented strategy called for greater emphasis on stronger and more specific structural measures …"8/ Shortly after, the staff prepared a paper on "Monitoring of Structural Adjustment in Fund-Supported Adjustment Programs."9/ Structural reforms as part of the adjustment strategy of Fund-supported programs had now become generally accepted, but the Board hesitated to go a step further and link structural conditionality explicitly to growth. However, it did so implicitly, as growth was now seen to be closely linked to external viability and most Directors agreed that conditionality should apply to structural policies where they were critical for a program's external objective.10/ Nevertheless, rather than changing the Conditionality Guidelines, the Board agreed that a strict interpretation of the Guidelines would be too narrow and suggested that the staff and management continue to experiment with placing greater emphasis on structural reforms.11/

1/ SM/81/78, April 6, 1981.
2/ Statement of Mr. Buira on Supply-Oriented Adjustment Policies, Executive Board Meeting 81/62, April 20, 1981.
3/ See Bahram Nowzad, "The IMF and its Critics," Essays in International Finance No. 146 (Princeton, New Jersey: Princeton University, 1981).
4/ See Mohsin S. Khan and Malcolm D. Knight, "Fund-Supported Adjustment Programs and Economic Growth," Occasional Paper No. 41 (International Monetary Fund, Washington DC, November 1985).
5/ See Chairman's Concluding Remarks at the Discussion on the Review of Conditionality, Including Issues Relating to Program Design and Prolonged Use of Fund Resources, Executive Board Meeting 86/13, January 27, 1986.
6/ "External Adjustment, Financing, and Growth—Issues in Conditionality," (EBS/87/40, February 25, 1987), p.19.
7/ EBM/87/72–5/8/87, p. 69.
8/ Ibid, p.67.
9/ EBS/87/240, November 20, 1987.
10/ The Chairman's Summing Up of the Discussion on Monitoring Structural Adjustment in Fund-Supported Programs. Executive Board Meeting 87/176—December 18, 1987.
11/ See Boughton (2000), Chapter 13, p. 34.

17. Parallel to the discussion on objectives and design of Fund-supported programs, the Fund was exploring ways of providing financial assistance tailored to the special needs of low income countries after an earlier attempt to do so through low-conditionality,[26] concessional loans from the Trust Fund had lapsed in the early 1980s (Box 3). These efforts led to the establishment of the Structural Adjustment Facility (SAF) in 1986 and the Enhanced Structural Adjustment Facility (ESAF) in 1988. Structural reforms were expected to figure prominently in—and indeed were an important justification for—arrangements supported by these facilities.

18. Lending under the SAF and ESAF picked up quickly in the late 1980s, accounting for over half of all Fund-supported programs approved in 1987–88. From the beginning, practically all SAF- and ESAF-supported arrangements included structural conditionality, even though the average number of structural conditions was initially relatively small (Table 1). While the share of ESAF-supported arrangements in total Fund arrangements declined in the first half of the 1990s, the average number of structural conditions in these programs increased substantially and by the late 1990s, it was well into double digits. Structural conditionality in extended arrangements has also expanded significantly, but the role of these arrangements in total Fund lending has generally been relatively modest and the average number of structural conditions has varied considerably over the years.

[26] These loans were subject to first credit tranche conditionality.

Box 3. Types of Fund Arrangements

The IMF provides financing to its member countries under different types of credit arrangements ("facilities"). These include regular facilities (stand-by and extended arrangements) at market-related interest rates, and a concessional facility for low-income countries (PRGF) at below market interest rates, as well as range of special facilities.1/

Stand-By Arrangements (SBAs) were established in 1952. Originally conceived as precautionary arrangements, they quickly came to be used to meet immediate financing needs, although precautionary arrangements have continued to play a role. The duration of stand-by arrangements can vary from six months to (a legal maximum of) three years, but most SBAs cover periods of one to two years; they are to be repaid within 3¼ to 5 years after the date of purchase. Policies on stand-by arrangements—phasing of purchases (typically quarterly)and conditionality—evolved in the 1950s and 1960s and were eventually codified in guidelines on conditionality, approved in 1968 and revised in 1979. Purchases beyond the first 25 percent of a member's quota are subject to upper credit tranche conditionality, which has traditionally focused on macroeconomic policies—fiscal, monetary, and exchange rate policies—aimed at overcoming balance of payments difficulties. Since the mid 1980s an increasing number of stand-by arrangements have also included structural reforms; in a few recent SBAs in countries experiencing a capital account crisis, structural policies addressing financial sector problems were at the very core of the programs.

The Extended Fund Facility (EFF) was established in 1974 to provide medium-term assistance to member countries experiencing chronic or acute balance of payments problems due to structural distortions and weak growth. Duration (typically 3 years with a possible extension to 4) and repayment periods (4½ to 10 years) under EFF arrangements are longer than under SBAs, but phasing and conditionality are similar. However, given the nature of the balance of payments problems the facility was designed to address, structural policies have typically played a more important role than under stand-by arrangements.

T**he Poverty Reduction and Growth Facility (PRGF)** was established in 1999, and replaced the ESAF as the Fund's concessional lending facility for low-income countries. For programs supported by the PRGF, poverty reduction is a key element of a renewed growth-oriented strategy. PRGF arrangements (and IDA lending from the World Bank) are based on a comprehensive policy strategy set out in a the poverty reduction strategy paper (PRSP), which is prepared by the country in an open, participatory process. PRGF arrangements cover a three-year period, with repayments over 5½-10 years at an interest rate of 0.5 percent. Performance criteria and reviews are normally semiannual, although quarterly test dates can be used in selected cases where closer monitoring is needed.2/

The predecessors of the PRGF were **the Structural Adjustment Facility (SAF) and the Enhanced Structural Adjustment Facility (ESAF),** set up in March 1986 and December 1987, respectively. They were financed from special resources—a trust fund—and offered highly concessional loans to support macroeconomic adjustment and structural reform in low-income countries. The expected duration of programs supported by the SAF and ESAF was 3 years, and the repayment period was 5½ to 10 years. Members were expected to lay out their policy strategy in a rolling three-year policy framework paper (PFP), which formed the basis for annual policy programs supported by SAF/ESAF arrangements. Conditionality under ESAF arrangements, which effectively superseded SAF arrangements starting in 1988, was stronger than under the SAF, with semi-annual (rather than annual) disbursements and macroeconomic as well as structural performance criteria (rather than policy benchmarks only).

1/ Special facilities have been created to meet member countries' special financing needs.
2/ This structure with a single, three-year arrangement and the possibility of quarterly monitoring also applied to later ESAF arrangements begun after early 1999.

Table 1. Structural Conditionality by Type of Program, 1987–1999

	Number of Programs Approved 1/	Distribution by Type of Program (In percent)			Share of Programs with Structural Conditionality 2/ (In percent)			Average Number of Structural Conditions 3/		
		SBAs	EFFs	SAF/ESAF/ PRGF	SBAs	EFFs	SAF/ESAF/ PRGF	SBAs	EFFs	SAF/ESAF/ PRGF
1987	20	35.0	0.0	65.0	14.3	...	92.3	3.3	…	2.0
1988	25	44.0	4.0	52.0	36.4	0.0	100.0	1.9	…	3.5
1989	23	52.2	13.0	34.8	33.3	66.7	100.0	1.5	0.7	4.3
1990	14	78.6	0.0	21.4	18.2	...	100.0	1.9	…	9.2
1991	30	66.7	6.7	26.7	45.0	100.0	100.0	3.5	3.7	4.8
1992	24	62.5	12.5	25.0	40.0	100.0	100.0	5.3	1.4	11.5
1993	22	59.1	9.1	31.8	53.8	100.0	100.0	5.3	2.3	8.8
1994	33	51.5	9.1	39.4	100.0	100.0	100.0	6.5	4.5	8.9
1995	29	72.4	6.9	20.7	90.5	100.0	100.0	13.4	8.3	8.9
1996	30	40.0	16.7	43.3	75.0	80.0	100.0	10.5	16.3	12.4
1997	19	52.6	10.5	36.8	90.0	100.0	100.0	19.4	4.7	16.9
1998	21	28.6	19.0	52.4	83.3	100.0	100.0	9.6	24.1	12.7
1999	20	35.0	20.0	45.0	100.0	100.0	100.0	12.7	7.8	14.3

Source: International Monetary Fund, MONA database; and country papers.

1/ In cases where stand-by or extended arrangements and SAF/ESAF/PRGF-supported arrangements were approved simultaneously, only the the latter were counted.

2/ Share of programs with at least one structural condition (performance criteria, structural benchmarks, prior actions, or conditions for completion of review) in total programs approved in each category.

3/ Average number of total structural conditions as defined in footnote 2, per program year, excluding programs with no structural conditions.

19. Accession to the Fund of a large number of countries with hitherto centrally planned economies was another factor accounting for the Fund's growing involvement in structural reforms in the 1990s. Prior to 1990, only four European countries with centrally planned economies[27] were members of the Fund. While all of these countries (with the exception of Poland) had several stand-by arrangements in the 1980s, a comprehensive structural transformation of their economies was, at the time, not on the agenda. The situation changed with the political transformation in Eastern Europe in 1989 and the break-up of the Soviet Union in 1991. In the aftermath, 22 countries with centrally planned economies became Fund members, and the goal for nearly all of them was transition to a market-based economy.

20. Nearly all of the countries that embarked on the transition to a market-based economy had one or more Fund arrangement in the 1990s (see Box 4).[28] Initially, not all of these programs involved structural conditionality,[29] but by 1994, structural conditions had become virtually universal and the average number of conditions had risen to 8; by the late 1990s, Fund-supported programs in the transition economies contained, on average, close to 20 structural conditions per program year (Table 2).

21. With the Fund's growing involvement in low income countries and transition economies, other, more traditional types of programs came to play a less important role in its overall lending activities—at least in terms of numbers of programs approved, if not in terms of amounts committed. In the first half of the 1990s, these programs accounted on average for close to one half of total programs approved; in the second half, their share was less than one third. Structural conditionality in these programs—typically stand-by or extended arrangements in non-transition economies—has also increased substantially in the 1990s. However, with the exception of two years, it has not been universal, and the average number of structural conditions per program year, albeit now much higher than in the late 1980s and early 1990s, has been lower than in the transition economies and the low income countries

[27] Hungary, Poland, Romania, and Yugoslavia; in addition, several Fund members in Asia (China, Cambodia, Lao PDR, and Viet Nam) had more or less centrally planned economies.

[28] The definition of "transition economies" used in this paper is based on the country classification of the World Economic Outlook and covers all former centrally planned economies in Central and Eastern Europe and the Former Soviet Union, as well as Mongolia. This definition is relatively narrow and does not include countries with more or less strong elements of central planning in Asia and Africa; these countries too embarked on a process of liberalization and structural transformation in the 1990s.

[29] See chapter III for a brief discussion of the differences between "first generation" programs in the transition economies, which focused primarily on stabilizing the economy after initial price liberalizations, and "second generation" programs, in which structural transformation played a crucial role.

Box 4. Fund-Supported Programs in the Transition Economies—An Overview

With the accession of a number of countries embarking on the transition from central planning to a market-based economy, the composition of the Fund's membership changed significantly in the early 1990s. The group that became soon known as the "transition economies" comprised 10 countries in Central and Eastern European (CEE), 15 countries emerging from the former Soviet Union (FSU), as well as Mongolia.1/ Of these only four CEE countries had been Fund members prior to 1989;2/ all others joined between 1990 and 1993. With the exception of two countries, Slovenia and Turkmenistan, all transition economies have had at least one Fund program during the transition period; most had a series of arrangements, beginning with stand-by or STF arrangements 3/ in the early phase of the transition, which were frequently followed by extended or ESAF/PRGF-supported arrangements.

In the early 1990s, the number of Fund programs with transition economies was limited and confined to CEE countries. Many of these countries had Fund arrangements only in the initial phase of the transition when stabilization was the main challenge. The inflationary impact of the initial price liberalization and exchange rate depreciation had to be brought under control by fiscal and monetary discipline and, in several countries, by adopting relatively fixed exchange rate regimes. Less than one half of these early "first generation" programs contained any formal structural conditions and those that did had relatively few, primarily in the areas of exchange and trade reform, price liberalization and financial system development. After 1992-93, attention in the CEE economies began to shift from stabilization to more comprehensive structural reforms, but few of the early reformers needed Fund-supported arrangements (the two exceptions being Bulgaria and Romania). Structural reforms in these countries were mostly guided by European Union accession requirements or OECD peer reviews.

In the first two years after the break-up of the Soviet Union, relatively few FSU countries requested financial assistance from the Fund, but by 1995 nearly all had Fund arrangements. As in the CEE countries, the early programs in the Baltics and Russia in 1992 and in Moldova and Kyrgyz Republic in 1993 focused primarily on price liberalization and stabilization; subsequent arrangements increasingly sought to address the structural transformation of these economies. In many of these countries, initial macroeconomic disequilibria and structural problems were more serious than in many of the CEE economies, leading to deeper Fund and Bank involvement from the start. At the same time, political resistance and limited implementation capacity complicated the adjustment and reform process. These "second generation" transition programs focused much more on the transformation of the whole structure of the economy and contained extensive structural conditionality.

1/ In addition, several member countries with more or less centrally planned economies in Asia (China, Cambodia, Lao PDR, and Viet Nam) and Africa have undertaken extensive market-oriented reforms in the 1990s.
2/ Yugoslavia as a founding member, Romania in 1972, Hungary in 1982, and Poland 1986. With the exception of Poland, all countries had three or more stand-by arrangements prior to 1989.
3/ The Systemic Transformation Facility (STF) was created in April 1993 and allowed to lapse two years later. It was designed to provide support for the early stages of transition from centrally planned to market economies. The amounts disbursed were relatively small and conditionality was low.

Table 2. Structural Conditionality by Type of Country, 1987-1999

	Distribution of programs by type of country (In percent)			Share of programs with structural conditionality 1/ (In percent)			Average number of structural conditions 2/			
	Transition economies 3/	SAF/ESAF/PRGF countries 4/	Other countries 5/	Transition economies 3/	SAF/ESAF/PRGF countries 4/	Other countries 5/	Transition economies 3/	SAF/ESAF/PRGF countries 4/	Asian crisis countries 6/	Other countries 7/
1987	0.0	65.0	35.0	…	92.3	14.3	…	2.0	…	3.3
1988	8.0	52.0	40.0	100.0	100.0	20.0	3.0	3.5	…	0.8
1989	0.0	34.8	65.2	…	100.0	40.0	…	4.3	…	1.2
1990	21.4	21.4	57.1	33.3	100.0	12.5	2.7	9.2	…	1.1
1991	16.7	26.7	56.7	80.0	100.0	41.2	6.9	4.8	…	2.0
1992	29.2	25.0	45.8	71.4	100.0	36.4	6.2	11.5	…	1.2
1993	45.5	22.7	31.8	60.0	100.0	71.4	7.1	8.1	…	4.0
1994	21.2	36.4	42.4	100.0	100.0	100.0	8.2	8.6	…	5.7
1995	41.4	20.7	37.9	100.0	100.0	81.8	15.7	8.9	…	9.1
1996	40.0	33.3	26.7	91.7	100.0	62.5	17.9	8.1	…	9.6
1997	42.1	26.3	31.6	100.0	100.0	83.3	20.7	17.4	13.2	5.0
1998	28.6	38.1	33.3	100.0	100.0	85.7	21.6	11.6	22.2	7.9
1999	20.0	45.0	35.0	100.0	100.0	100.0	16.2	14.3	…	7.9

Source: International Monetary Fund, MONA database; and country papers.

1/ Share of programs with at least one structural condition (performance criteria, structural benchmarks, prior actions, or conditions for completion of review) in total programs approved in each category.

2/ Average number of total structural conditions as defined in footnote 1, per program year, excluding programs with no structural conditions.

3/ As defined in the World Economic Outlook, covering former centrally planned economies in Eastern Europe, FSU countries, and Mongolia.

4/ Countries with SAF/ESAF/PRGF-supported programs, excluding transition economies.

5/ Including Asian crisis countries

6/ Indonesia, Korea and Thailand.

7/ Excluding Asian crisis countries.

with ESAF/PRGF arrangements. This is also true for the stand-by arrangements with the Asian crisis countries—albeit not for the extended arrangement with Indonesia that replaced the initial stand-by (Figure 3)—although structural reforms clearly were the centerpiece of these programs. As for the role of structural conditionality in stand-by and extended arrangements more generally, the distinction between the two types of arrangements has become increasingly blurred as stand-by arrangements with extensive structural content were approved in the transition economies and in other countries.

22. The expansion of structural conditionality since the late 1980s has prompted calls for streamlining. This, in turn, has raised questions about the pattern of structural conditionality. In particular, does the increase in structural conditions per program year primarily reflect the Fund's involvement in a growing range of structural issues, i.e., a broadening of the scope of structural conditionality? Or is it largely attributable to a trend towards greater detail in monitoring structural reforms? These questions are addressed in the next two chapters.

III. The Scope of Structural Reforms in Fund-Supported Programs

23. This chapter examines whether a broadening of the scope of structural conditionality in Fund-supported programs—i.e., a widening of the range of structural issues covered—was a key factor in its expansion. It traces developments in the distribution of structural conditions across economic sectors, discusses prioritization based on the importance of specific reforms for a program's macroeconomic objectives, and examines whether collaboration with other institutions, notably the World Bank, helped limit the scope of Fund conditionality in the structural area.

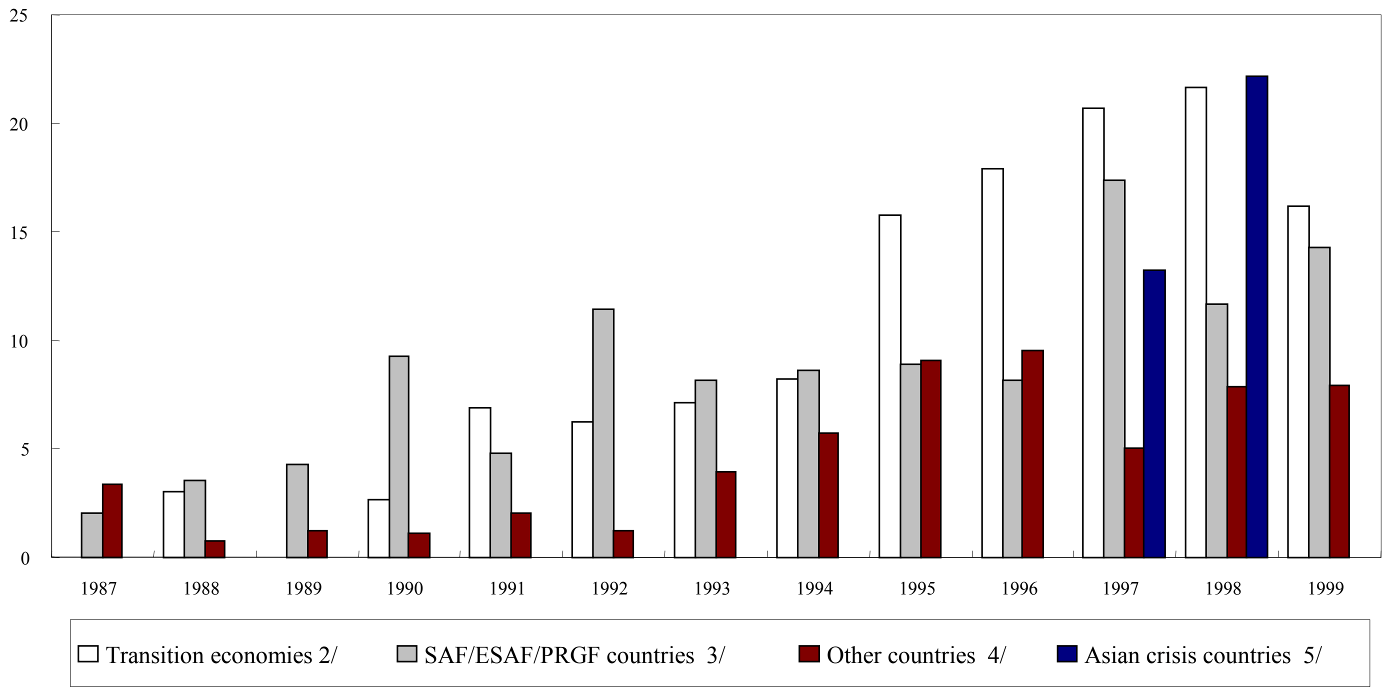
A. Sectoral Distribution of Structural Conditions

24. Judging by the distribution of structural conditions in Fund-supported programs based on a 14 sector classification scheme,[30] the breadth of structural conditionality appears to have increased somewhat in the past decade. In 1987–93, half of all programs with structural conditionality had conditions—performance criteria, prior actions and structural benchmarks—in four or fewer sectors, and close to one fifth had conditions in only one sector (Figure 4). In 1994–99, structural conditionality covered six or fewer sectors in half of the programs, and programs with conditions in one or two sectors accounted for less than 10 percent of the programs approved. However, a simple count of the sectors with structural conditions provides an inadequate picture of the breadth of structural conditionality because it does not allow for differences in the distribution across these sectors.[31] More informative is a comparison of the sectoral distribution of structural conditions in individual programs with

[30] See Appendix II for a description of the sector classification.

[31] According to this measure, the breadth of structural conditionality is the same for a country with 90 percent of all conditions in one sector and 10 percent in a second sector, and for a country with the same number of conditions uniformly distributed across the two sectors.

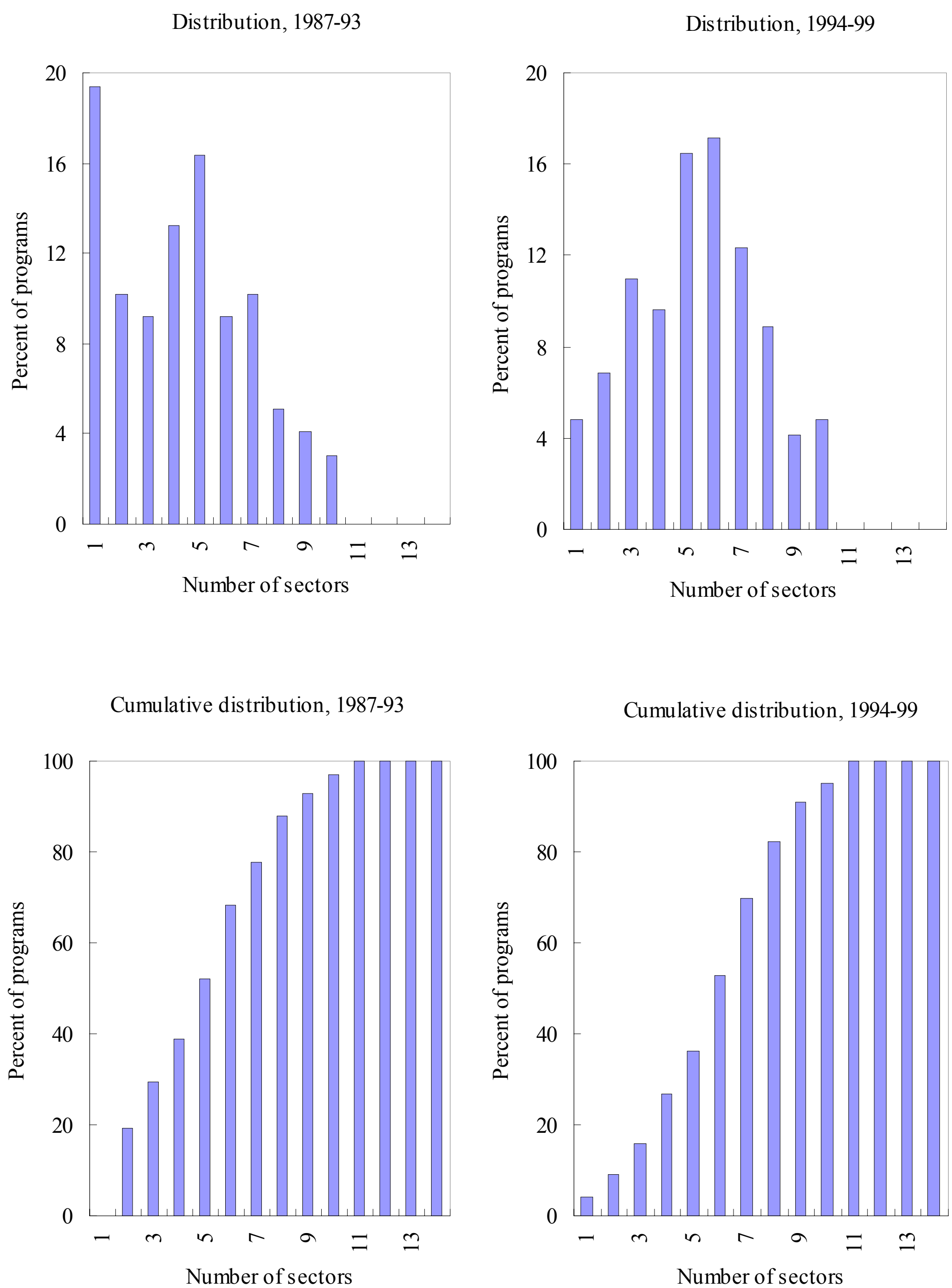
Figure 3. Structural Conditionality by Type of Country, 1987-1999
(Average number of structural conditions per program year 1/)



Source: International Monetary Fund, MONA database; and country papers .

1/ Total number of performance criteria, prior actions, conditions for completion of review, and structural benchmarks per program, adjusted for differences in program length.
2/ As defined in the World Economic Outlook, covering former centrally planned economies in Eastern Europe, FSU countries, and Mongolia.
3/ Countries with SAF/ESAF/PRGF-supported arrangements, excluding transition economies.
4/ Residual group, encompassing programs in countries that do not fall into any of the other categories.
5/ Indonesia, Korea, and Thailand.

Figure 4. Frequency Distribution of Programs by Number of Structural Sectors Covered 1/



Source: International Monetary Fund, MONA database; and country papers.

1/ Structural conditions (performance criteria, prior actions, conditions for completion of review, structural benchmarks) in Stand-by, EFF, and SAF/ ESAF/ PRGF- supported programs, classified according to a 14-sector classification scheme.

a hypothetical uniform distribution.[32] This measure also suggests some increase in the breadth of structural conditionality. However, in most programs the majority of conditions has remained concentrated in a relatively small number of sectors.

25. Until the mid 1980s, structural reforms in Fund-supported programs were typically confined to the exchange and trade system. In addition, programs occasionally addressed selected fiscal and financial sector issues, or general pricing policies. While in the late 1980s, programs began to cover an increasing variety of structural measures, close to two thirds of the structural conditions have been, and continue to be, related to reforms in the fiscal and financial sectors, the exchange and trade system, and economic statistics—areas that are considered to be at the very core of the Fund's involvement in member countries (Figure 5).[33] Structural conditions related to the restructuring of public enterprises, privatization, and the reform of the social security system together have accounted for another 20 percent of total conditions. While these reforms were outside the Fund's core areas of expertise, they were motivated not only by efficiency considerations and the need to scale back extensive quasi-fiscal operations, but also by budgetary considerations more directly. They were thus often linked to fiscal adjustment, which plays a critical role in nearly all Fund-supported programs.

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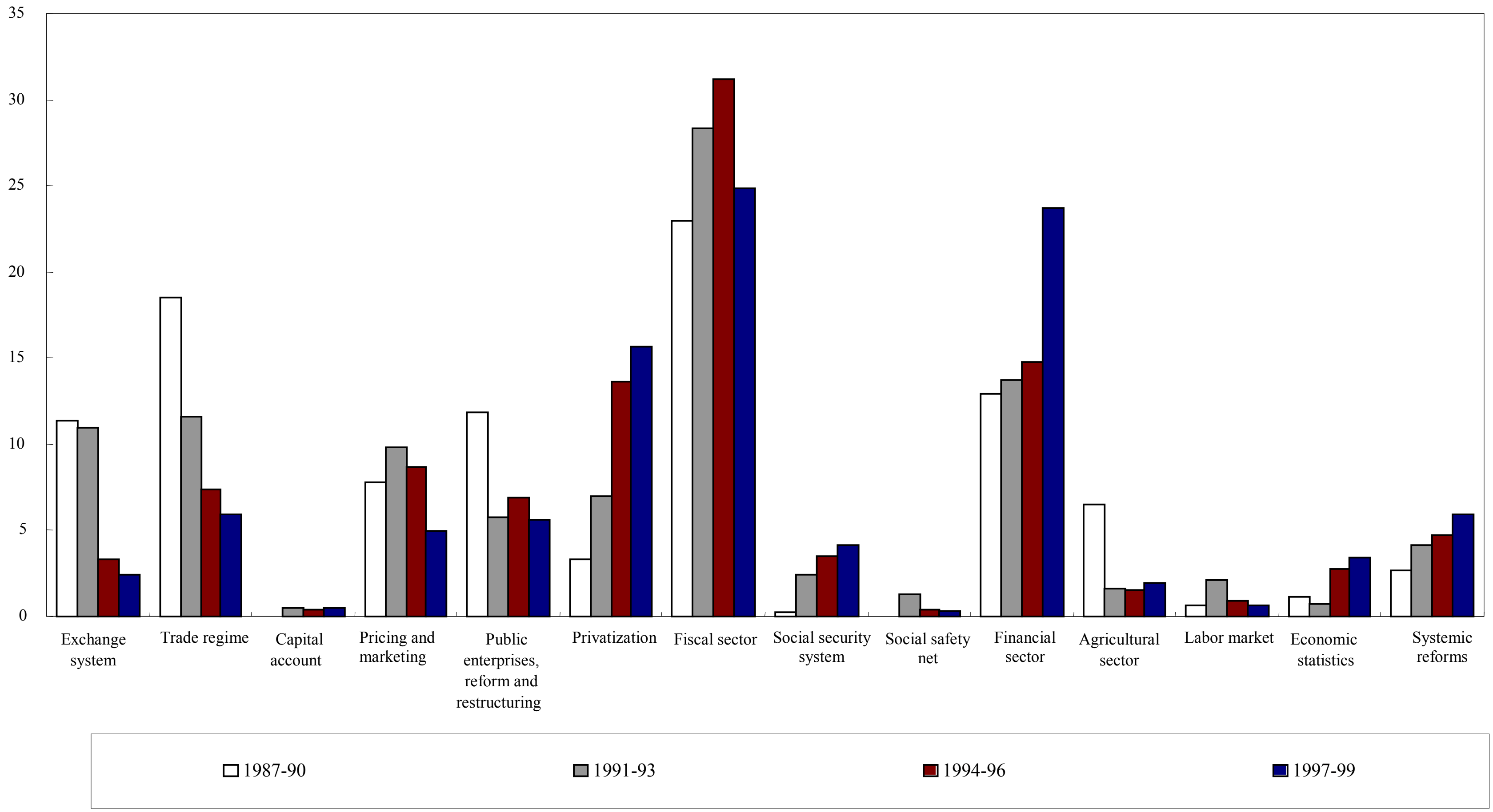
[32] An index of concentration was derived by calculating for each program the sum of the squared differences between each of the 14 sectors' actual shares in the program's total structural measures and their hypothetical (constant) shares for a uniform distribution. The result was expressed in relation to the result obtained for the case of extreme concentration (all measures in one sector), yielding an index that has the value one when all measures are concentrated in one sector and zero when they are uniformly distributed across all 14 sectors. The average for all programs of this index of concentration declined from 0.61 in 1987–90 to 0.45 in 1997–99, reflecting primarily a decline (broadening of the reform agenda) in the transition economies and some decline (from a very high degree of concentration) in other, more traditional types of Fund-supported programs. In non-transition countries with ESAF/PRGF-supported arrangements, the breadth of structural conditionality appears to have been quite stable over the past decade and a half.

[33] The Fund's core areas of responsibility are identified in the Interim Report of the Reform Task Force on "The Future Role of the Fund," (July 2000). They are: 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.

Figure 5. Structural Conditions by Economic Sector, 1987-1999
(In percent of total structural conditions 1/)



Source: International Monetary Fund, MONA database; and country papers.

1/ Averages of the sectoral distributions of total structural conditions (performance criteria, structural benchmarks, prior actions, and conditions for completion of review) for each program. For a more detailed description of the sector classification see Appendix I.

26. Even though some of the more marginal areas of structural reform in Fund-supported programs, notably “systemic” reforms relating to the institutional, legal, and regulatory framework, have become more important over the past decade, the total share of the core areas (exchange and trade systems, and fiscal and financial sectors), and areas that are partly linked to fiscal adjustment (public enterprise restructuring, privatization, and social security reform) has been quite stable over time. However, the relative importance of the sectors in these two groups has shifted. For example, whereas the number of structural conditions in the exchange and trade systems has remained broadly unchanged,[34] the relative weight of these sectors has declined substantially, while fiscal and, in particular, financial sector issues have gained importance. Greater focus on the sustainability and quality of fiscal adjustment has led to a considerable expansion of structural reforms in the fiscal area, while concerns about the soundness of financial systems have been a driving force in the proliferation of structural reforms in the financial sector. In the area of public enterprise reform, the emphasis appears to have shifted from restructuring to privatization, reflecting in part the lack of success of earlier efforts to make these enterprises more efficient without changing ownership structures.

27. Finally, whereas in the late 1980s and early 1990s, the sectoral distribution of structural conditions differed considerably between transition economies, low income countries with SAF/ESAF/PRGF-supported arrangements and other countries with stand-by or extended arrangements, it has become more homogeneous in recent years (Table 3). In all country groups, reforms in the fiscal and financial sectors now play a dominant role, followed by privatization.

28. Among the structural reforms in the fiscal area, reforms of the tax system and tax administration have dominated, accounting for over 40 percent of all structural conditions in this area. Measures have ranged from organizational changes in tax administration to changes in the tax system to broaden its base, for example though the introduction of a VAT. Close to 30 percent of the structural conditions in the fiscal sector have been related to expenditure and public sector management, including steps to introduce or strengthen systems of expenditure control. Civil service reform has been another important, and often controversial, target of structural conditionality, frequently requiring substantial cuts in public sector employment[35]

[34] For a discussion of progress in trade reform see the accompanying background paper on trade reform in Fund-supported programs.

[35] In some programs, these “cuts” involved the elimination of “ghost workers,” employees that were only nominally employed and did not perform any functions.

Table 3. Structural Conditions by Economic Sector and Type of Country, 1987-1999
(In percent 1/)

	Exchange System	Trade Regime	Capital Account	Pricing and Marketing	Public Enterprises, Reform and Restructuring	Privatization	Fiscal Sector	Social Security System	Social Safety Net	Financial Sector	Agricultural Sector	Labor Market	Economic Statistics	Systemic Reforms
Transition economies 2/														
1987-90	5.0	17.5	0.0	30.0	12.5	0.0	12.5	0.0	0.0	17.5	0.0	5.0	0.0	0.0
1991-93	10.0	15.7	0.2	18.2	1.6	4.5	9.5	2.9	4.0	19.6	1.0	5.4	0.9	6.5
1994-96	2.6	5.8	0.6	9.6	6.4	12.6	23.1	5.8	0.7	20.7	1.4	0.4	1.5	8.7
1997-99	2.3	7.1	0.4	4.6	3.9	16.7	25.2	3.3	1.0	21.9	3.1	0.7	2.2	7.7
SAF/ESAF/PRGF countries 3/														
1987-90	5.7	12.4	0.0	8.2	11.3	4.7	26.0	0.4	0.0	16.3	8.7	0.5	2.0	3.8
1991-93	7.4	10.3	0.1	5.6	8.2	9.7	28.2	0.9	0.7	19.4	2.8	1.4	1.4	3.9
1994-96	3.1	9.2	0.1	7.2	5.8	15.5	32.6	1.8	0.0	15.5	0.8	0.4	4.9	3.1
1997-99	1.4	7.8	0.2	5.6	9.4	16.5	29.9	4.8	0.3	16.2	1.0	0.5	2.0	4.4
Asian crisis countries 4/														
1987-90	.	.	.	.	.	.	.	.	.	.	.	.	.	.
1991-93	.	.	.	.	.	.	.	.	.	.	.	.	.	.
1994-96	.	.	.	.	.	.	.	.	.	.	.	.	.	.
1997-99	0.0	3.5	1.4	5.9	3.2	11.9	0.6	0.0	0.0	64.1	0.6	0.0	2.0	6.8
Other 5/														
1987-90	42.1	27.1	0.0	5.0	14.6	0.0	6.3	0.0	0.0	5.0	0.0	0.0	0.0	0.0
1991-93	17.8	7.4	1.0	5.8	5.3	4.7	47.6	4.6	0.0	3.1	0.5	0.5	0.0	1.7
1994-96	4.9	6.5	0.3	8.9	8.1	13.7	35.9	2.8	0.4	9.7	2.1	1.8	1.9	3.1
1997-99	4.5	2.7	0.3	3.5	4.8	14.7	26.9	5.4	0.0	21.2	1.8	0.5	5.5	8.3

Source: International Monetary Fund, MONA database; and country papers.

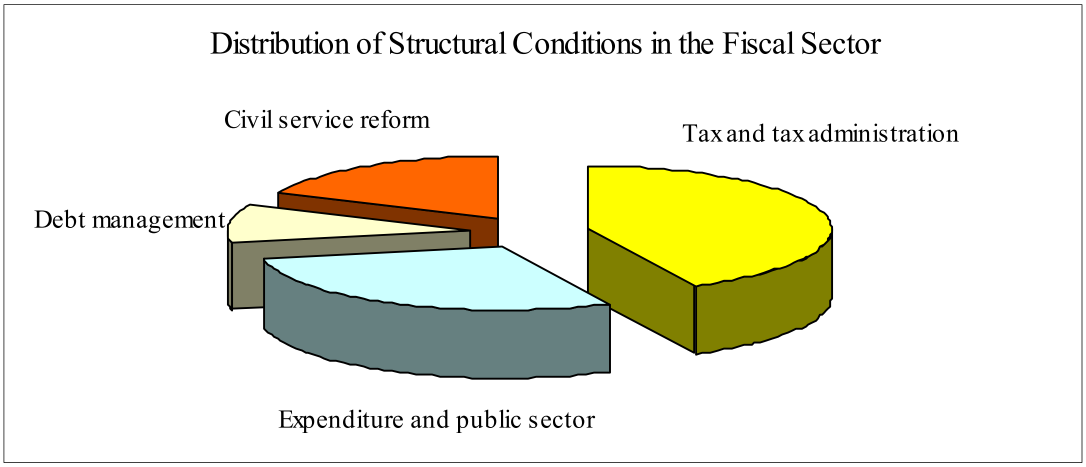
1/ Averages of the sectoral distributions of total structural conditions (performance criteria, structural benchmarks, prior actions, and conditions for completion of review) for each per program. For a more detailed description of the sector classification see Appendix I.

2/ As defined in the World Economic Outlook, covering former centrally planned economies in Eastern Europe, FSU countries, and Mongolia.

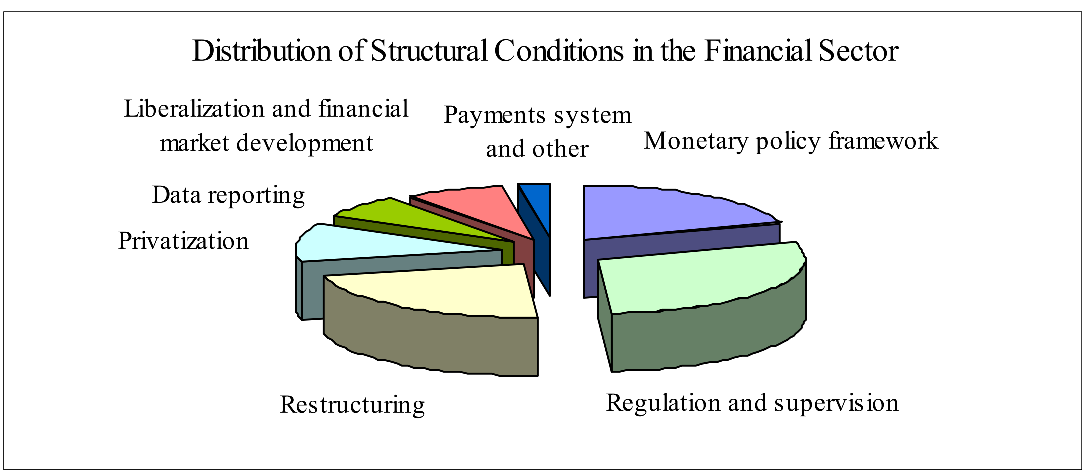
3/ Countries with SAF/ESAF/PRGF-supported arrangements, excluding transition economies.

4/ Indonesia, Korea, and Thailand.

5/ Residual group, stand-by and extended arrangements in non-transition countries.



29. In the financial sector—the second most important area of structural conditionality in Fund-supported programs—one fifth of the measures have focused on improvements in the monetary policy framework, ranging from changes in the system of reserve requirements to the introduction or modification of central bank laws to give the central bank greater autonomy. Even more important has been the restructuring of financial institutions and the strengthening of regulation and supervision; these areas have accounted for more than half of all structural conditions in the financial sector. By contrast, less than 10 percent of the conditions have been related to financial liberalization, such as the liberalization of interest rates, and efforts to promote the development of financial markets.



30. The preceding overview suggests that although the breadth of structural conditions in Fund-supported programs has increased during the past decade, this may not have been the only, or even the main, factor driving the expansion of structural conditionality. Most of the

structural conditions have been, and still are, concentrated in a relatively small number of sectors, notably the fiscal and financial sectors, the exchange and trade system, and in sectors where reforms are at least partly related to fiscal considerations, such as public enterprise restructuring and privatization. The link between these reforms and programs' macroeconomic objectives seems self-evident. However, this does not mean that structural measures in these sectors are always critical, nor does it imply that reforms in other sectors are always less important.

B. Structural Reforms and Macroeconomic Program Objectives

31. Structural reforms in Fund-supported programs are frequently divided into two broad groups. One group covers policies designed to underpin macroeconomic stabilization by enhancing the functioning of macroeconomic policy instruments. Such policies include measures to improve the tax structure, tax administration, or public expenditure management to make fiscal adjustment more durable; changes in the operational framework of monetary policy to enhance its efficacy; and reforms in the foreign exchange and trade system to facilitate exchange rate policy. The other group of structural reforms covers policies aiming more generally at improvements in the economy's underlying structure—its efficiency and flexibility—to foster growth and facilitate adjustment to exogenous shocks. Such reforms may include trade liberalization, pricing policies in certain sectors such as energy or agriculture, as well as institutional and regulatory changes in the financial and corporate sectors and the labor market.

32. The delineation between these two groups of structural reforms is, however, not clear cut. Measures aiming primarily at the efficacy of macroeconomic policy instruments, such as reforms of the tax system or the operation of the money market, may have wider implications for economic efficiency. Conversely, policies designed primarily to strengthen growth and reduce poverty by enhancing incentives in the private sector, such as reforms in agricultural marketing arrangements, may have an important impact on the fiscal position and the effects of exchange rate policy.

33. In many instances, structural policies are motivated by a variety of considerations relating to stabilization efforts as well as broader growth objectives. As noted above, privatization of public enterprises has frequently been driven by the dual objectives of increasing efficiency in the enterprise sector more generally and stopping the drain on the budget resulting from their losses (Box 5). And if a country adopts a currency board arrangement to bring down inflation, structural measures ranging from labor market reform to financial sector regulation and restructuring may be needed to ensure that the arrangement, and hence the stabilization effort, is sustainable (Box 6). In this case, the immediate objective of the reforms may be to make the currency board work, but their wider implications for economic performance are likely to be considered as well. These examples suggest that it is not possible to establish a simple mapping from specific structural reforms to specific program objectives. Hence, the distribution of structural reforms across economic sectors may say little about their importance for these objectives.

Box 5. Privatization in Fund-Supported Programs

During the last decade, privatization has emerged as an important element of structural reforms in Fund-supported programs. The goals were twofold. First, privatizations sought to achieve efficiency gains and eliminate fiscal subsidies in light of the poor performance of public enterprises in many countries and an unsuccessful record of restructuring attempts.1/ Second, liquidity-constrained governments sometimes privatized with a view to financing fiscal deficits with the proceeds. 2/ The available evidence suggest that private firms are more profitable, and their output grows faster than in those that remain in the hands of the state. It also indicates that the short-term fiscal situation improves in countries that privatize: transfers decline markedly, revenue improves somewhat, and domestic borrowing requirements decline. However, there appears to be no clear link between the number of firms privatized and aggregate privatization revenues, owing to the variations in the size and financial situation of the firms privatized, and the privatization techniques used. On the negative side, privatization often leads to job losses, the social impact of which may need to be mitigated through retraining and job creation programs, and income support within a well-defined social safety net.

The primary goal of privatization and the techniques chosen have varied across countries. Most transition economies felt that some form of rapid privatization was the best way of separating enterprises from the state; fiscal considerations were often secondary. In the early 1990s, the speed and breadth of privatization was viewed as a measure of the country's seriousness about its transformation. The magnitude of the task and the lack of firm-level data practically excluded a detailed case-by-case approach (such as was used in Great Britain in the 1980s).3/ Rapid privatization was also seen as a preferable alternative to "spontaneous privatization," in which the existing managers stripped assets from public enterprises and transferred them to their own, private firms. Hence, several transition countries made use of privatization by restitution to their pre-communist owners, some form of privatization vouchers, or non-traditional techniques, such as Russia's loans-for-shares privatization, all of which have yielded negligible fiscal gains in spite of large book-value transactions.

In most countries, the privatization process involved a mix of techniques, with the relative importance of each driven by domestic political considerations. In general, Fund conditionality accommodated these differences, with conditions ranging from the issuance of coupons for mass privatization to the sale of specific, large state-owned companies. In non-transition countries, the process was much more gradual and selective, with the case-by-case sale being the predominant technique, usually with substantial fiscal impact and firm-level efficiency gains. These economies generally had an established private sector, even though in many cases it lacked financial resources to buy firms offered for sale. This implied that only foreign firms could participate in the bidding, complicating the politics of privatization. In many non-transition countries, fiscal considerations were an important motive for privatization. Fund conditionality typically focused on specific groups or numbers of enterprises that were to be privatized and sought to ensure the transparency of the process.

Privatization has not been without problems. When the rule of law is weak, well-organized interest groups may exploit the privatization process to their advantage. This has occurred in some transition economies, for example in Russia. Also, contrary to arguments made by the proponents of mass privatization, market-based reallocation to more efficient owners has been hampered by the lack of capital market development. Moreover, privatization needs to be accompanied by adequate regulation: a private monopoly can be as damaging as a public one. Lack of regulation in the financial sector has proven particularly damaging. These problems are not necessarily confined to transitions economies. Thus, even though privatization may yield short-term fiscal benefits, the hoped for efficiency gains may be slow to come if it is done in an environment where adequate regulation and standards of governance are lacking. In recent years, programs have therefore begun to place greater emphasis on reforms in the institutional, legal, and regulatory framework to ensure that the conditions for the development of a vibrant private sector are in place.

1/ The growing frustration with state-owned enterprises in the ESAF countries was highlighted in the collection of studies edited by Hugh Bredenkamp and Susan Schadler, *Economic Adjustment and Reform in Low-Income Countries*, (Washington: International Monetary Fund), 1999, pp.52-54.
2/ In some countries, the privatization proceeds were used to finance the cost of a transition from a pay-as-you-go pension scheme to a funded one. See, for example, *Fiscal and Macroeconomic Impact of Privatization*, Occasional Paper No.194 (Washington: International Monetary Fund), 2000.
3/ In the former Czechoslovakia, for example, the 1990-95 privatization program included settling more than 100,000 property-restitution claims, auctions of more than 20,000 small firms and large-scale privatization of almost 4,000 firms. See Michal Mejstřík, "Large Privatization: Theory and Practice," in *The Privatization Process in East-Central Europe*, edited by M. Mejstřík (Dordrecht: Kluwer Academic Publishers), 1997.

Box 6. Structural Measures Supporting a Currency Board Arrangement

In the past decade, a number of countries have adopted currency board arrangements (CBAs) prior to, or in the context of, a Fund-supported program to bring inflation under control. To make a currency board arrangement work, a number of structural features typically have to be in place, or have to be put in place. The introduction of the CBA itself will require changes in the legal and operational framework for conducting monetary policy, such as amendments to the central bank law, or the adoption of a new currency board law, together with supporting legislation (e.g., to cover existing contracts), as well as purely technical changes in monetary policy operations. The currency board may also entail the introduction of a new currency. Beyond these measures, the adoption a currency board has important implications for the conduct of economic policy more generally. In particular, (i) the lender of last resort (LOLR) role of the central bank is either eliminated or limited; (ii) the nominal exchange rate is no longer available as an adjustment tool; (iii) money financing of the budget is eliminated or at least severely curtailed. Each of these implications may, in turn, necessitate structural reforms. 1/

No, or limited, lender of last resort function

Currency boards are often adopted during financial crises. Thus, there will likely be a number of problem banks which need to be resolved either prior to, or simultaneous with, the adoption of the CBA. This may require that they be taken over by the government (and the deposit insurance fund may need to be replenished), followed by their closure or recapitalization and re-privatization.

Even if there are no problem banks (or once they have been dealt with), the limited LOLR function and the need to cope with the interest rate fluctuations typically associated with CBAs means that the banking sector may require strengthening. In particular, liquidity management of banks may need to be improved (e.g., by allowing averaging of reserve requirements), and enhanced supervision and enforcement of prudential norms and regulations may be required.

No exchange rate variability

Since, by definition, a currency board does not allow changes in the nominal parity, other relative prices (such as wages) need to be able to adjust to correct external imbalances. This requires labor market flexibility (if unemployment is to be avoided) and, particularly in the early stages of disinflation, may require economy-wide incomes policy to avoid a real appreciation of the exchange rate. Measures to enhance labor market flexibility may be narrowly focused—such as changes in the labor code or unemployment insurance—or may require more wide ranging supporting measures, such as changes in, or development of, the housing market, depending on the obstacles to labor mobility.

No, or limited, monetary finance of the budget

Since the currency board typically requires net domestic assets (NDA) of the central bank to be zero or constant, direct and indirect money financing of the budget are severely limited under a CBA. The credibility of the CBA, therefore, depends on enhanced budgetary discipline. This may require both revenue and expenditure measures. Weaknesses in the tax system and structural drains on the budget from loss-making state enterprises, the social security system, or subsidies may need to be addressed. In addition, technical changes in the government bond and treasury bill market may be required to augment the government's capacity for non-monetary financing of its deficits.

The need for structural measures in these areas clearly depends on the starting conditions, which may vary considerably across countries.

1/ To be sure, these reforms are also important in other economies; however, they become particularly important in countries with CBAs, in view of the specific constraints of the CBA.

34. The case of cotton sector reform in Mali illustrates how structural measures in an area that, at first sight, may seem rather marginal can become critical for a program's macroeconomic objectives and the goal of poverty reduction, which is central to PRGF-supported arrangements. Providing a livelihood for one fifth of the population and accounting for half of Mali's foreign exchange receipts and 10 percent of government revenue, developments and prospects in the cotton sector had to be reckoned with when the PRGF-supported program was designed. Existing marketing arrangements, which kept producer prices well below international prices, were a source of serious concern and changes in these arrangements figured prominently in the program. Failure to make progress with the reform and the resulting consequences for production, exports, government revenue and, ultimately, the risks to macroeconomic stability only underscored the importance of the matter (Box 7).

35. While a wide range of structural reforms may be potentially important for a program's macroeconomic objectives, a broad structural reform agenda raises questions about implementation capacity and prioritization. Selecting among structural reforms according to their importance for the achievement of a program's macroeconomic objectives is no doubt a difficult task. It is ultimately a matter of judgment; there are no simple, generally accepted rules to guide prioritization. While the ultimate objectives of Fund-supported programs may not vary all that much within broad groups of countries,[36] the policy adjustments needed to achieve these objectives may differ considerably: what may be critical in one country may not be an issue in another.[37]

[36] Low income countries and most other program countries aim to achieve external viability and sustainable growth; the transition economies seek to complete the transformation into a market economy while maintaining macroeconomic stability and restoring growth; and countries experiencing a capital account crisis have aimed to restore market confidence and ensure orderly adjustment in the current account, while limiting the shot-term contraction of output.

[37] This was clearly recognized when the role of structural reforms in Fund-supported programs was discussed in the late 1980s. The Board paper on "Monitoring of Structural Adjustment in Fund-Supported Adjustment Programs," concluded that "… there is no a priori basis for general exclusion of particular areas of reform. Rather, the specific areas to be addressed will need to be determined on a case by case basis in light of the country's circumstances, taking account of both the magnitude of the distortions involved and the extent to which they bear on external viability, as well as other considerations such as whether the World Bank is playing a complementary role in assisting the country in its structural reforms…" (EBS/87/240, November 20, 1987, p.5).

Box 7. Mali: Does Cotton Sector Reform Matter for Stabilization and Growth?

Cotton has been the main sources of economic growth in Mali, doubling in output between 1989/90 and 1997/98 and contributing some 7 percent to GDP. In the late 1990s, cotton exports accounted, on average, for one half of foreign exchange revenues, one-tenth of fiscal revenue, and the sector provided livelihood for 1.5 million people (out of a total population of more than 9 million). While the 30-year expansion of the Malian cotton sector was strong—owing, in large part, to high international cotton prices—the centralized, monopsonic marketing system left little of the benefit to cotton farmers and became a constraint on further growth.

Cotton is produced primarily under the supervision of the Compagnie Malienne pour le Développement des Textiles (CMDT), which is 60-percent owned by the government of Mali.1/ The CMDT accounts for 95 percent of total cotton production and provides a full range of production-related services to farmers, including the sale of inputs, extension services, domestic marketing, and ginning of seed cotton. In addition, the company provides many public services, such as feeder road maintenance, technical education of farmers, or even general health and education functions. As the exclusive marketing entity of Malian cotton, the CMDT is obliged to purchase all cotton output at the fixed price up to, but not beyond, the aggregate production target CMDT agrees with the government and the farmers' unions for the year (the targets are detailed up to the village level). The responsibilities of the CMDT have been spelled out in five-year performance contracts between the government, the CMDT, and cotton producers represented by their unions.

The existing arrangement gives the CMDT large powers over the producers. As a classic monopsony, the CMDT maximizes its rent by driving a wedge between the export and producer prices and sets production targets at a lower level than would have resulted from a market equilibrium. For example, in 1995-97 Malian producer prices averaged 41 percent of the fob export price, as opposed to 83 percent and 86 percent in Zimbabwe and India, respectively. 2/ Although the Malian producer prices were more stable than in those countries, the cost of smoothing price fluctuations was high. Regarding the area under cultivation, the World Bank estimated that the ecologically sustainable area is, at least, 20 percent larger than the one currently cultivated.

By the late 1990s, the Fund staff became convinced that continuation of the existing structure of the cotton sector would stifle economic growth and undermine efforts to reduce poverty. Although the CMDT guaranteed stability of producer prices and provision of some public services, the cotton sector was operating below its potential, the farmers' share of the export price was extremely low, and the operating costs of the CMDT were excessive, as revealed by audits and several technical studies. Consequently, in the context of a new ESAF arrangement approved in mid-1999, the World Bank and IMF argued in favor of liberalizing the sector.

The proposed reform package (EBS/99/129), based on the 1998 technical audit of the CMDT, 3/ addressed the three key problems of the Malian cotton sector: suboptimal production, weak pass-through of international prices into producer prices, and inefficiencies in the CMDT operations. The package called for open, competitive entry and freely negotiated prices at all levels of cotton production, marketing, and export. The CMDT was to be audited, restructured, and brought under transparent, public control through regular external audits. A new performance contract with the CMDT was to be signed in late 1999 that would revisit the profit sharing arrangement. Farmers' organizations were to be given right to underwrite the capital of the CMDT (up to 20 percent initially), giving them some direct control over the company. The role of the private sector in transportation, credit and input provision was to be increased, effectively eroding the CMDT's monopsony powers. As far as formal conditionality is concerned, the first-year ESAF arrangement contained one prior action (adoption of a cotton sector action plan) and one performance criterion (signing of a new CMDT performance contract).

Introduction of these reforms was, however, delayed and the CMDT continued expanding along its traditional, all-encompassing path. Against the background of a sharp decline in international cotton prices in 1998/99, financial discipline loosened, and the CMDT incurred losses to the tune of 2 percent of GDP. Efforts to regain financial stability by cutting producer prices led to widespread farmers' strikes and delayed planting, endangering cotton output for 2000 and beyond. The cumulative losses of cotton export proceeds for 1999-2000 amount to more than one-fourth of the values programmed under the ESAF arrangement.

1/ The rest is owned by Compagnie Française pour le Développement des Fibres Textiles (CFDT), a French company. This company holds various stakes in most of the cotton marketing companies in the Francophone Africa.
2/ In addition to cash distributions, the CMDT provides the above mentioned services, the cost of which was estimated at about 4 percent of cotton export earnings in 1997/98. Hence, the value of these services does not make up for the difference in prices received by the farmers.
3/ The audit was a structural performance criterion under the third-year annual arrangement under the previous ESAF.

36. Ex-post assessments by area department staff of the importance of specific structural measures for a program's macroeconomic objectives are available from the survey of 24 recent Fund-supported programs discussed in the introduction.[38] The sample of programs in transition, low income, and other countries covered by the survey appears to be fairly representative of the whole set of programs approved in the past 3 years. The distribution across economic sectors of "formal" conditions (structural performance criteria, prior actions

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[38] See Appendix II for a brief description of the survey.

and benchmarks) is similar to that of the larger set of programs in the MONA database, and the distribution of total structural measures resembles that of formal structural conditions (Figure 6).

37. The survey results indicate that close to 30 percent of all the structural measures covered in letters of intent or the accompanying memoranda on economic and financial policies (including those subject to specific types of conditions) were considered critical for the programs' macroeconomic objectives, with another 40 percent seen as important (Table 4). Among the structural measures subject to specific conditions—performance criteria, prior actions and benchmarks—the share of measures judged critical is somewhat higher—about 40 percent—with another third classified as important.

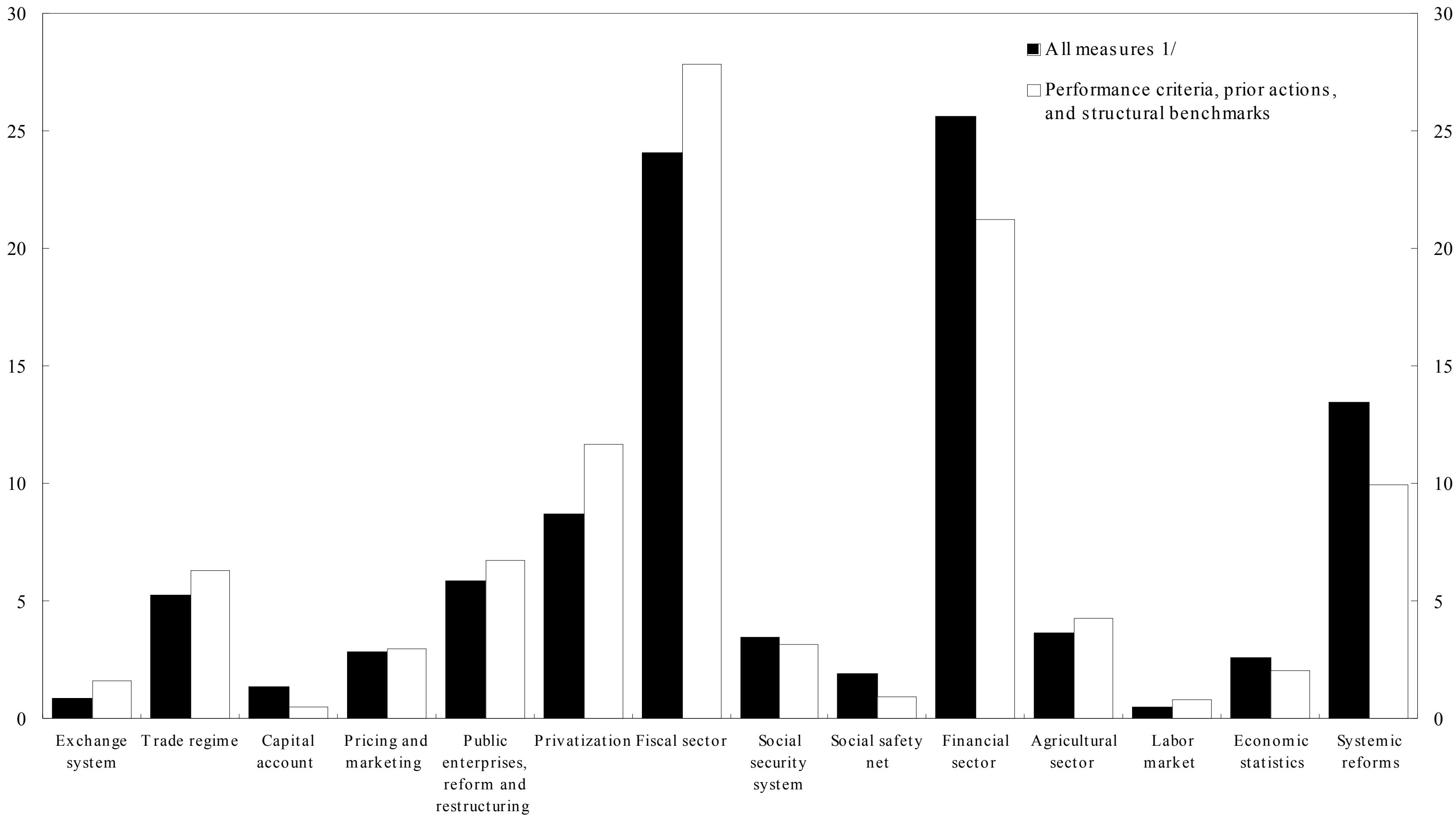
38. Assessments of the macroeconomic relevance of structural measures vary, however, considerably across countries. This variation may reflect differences in the interpretation of the three categories of macroeconomic relevance used in the survey,[39] as well as difficulties in drawing a line between measures that are critical, important, or merely useful, particularly when a program identifies a number of individual steps that are part of a larger sequence of measures and may not seem all that critical in and of themselves.[40] In addition, assessments may vary depending on whether they were done by the teams that negotiated the programs or by successor teams. The survey results thus need to be interpreted with caution. Rather than providing a clear indication of the macroeconomic importance of the structural measures included in the survey programs, they may primarily indicate the difficulties of classifying structural measures according to their macroeconomic relevance.

39. Assessing the relevance of specific structural reforms for a program's macroeconomic objectives may frequently be easier ex post than ex ante. The programs in the Asian crisis countries—Indonesia, Korea, and Thailand—are a case in point. In all three countries, severe problems in the financial system were widely perceived to be at the core of the crisis and it was understood that these problems needed to be addressed to restore market confidence, overcome the crisis, and lessen vulnerability to future crises. This assessment was reflected in the programs' structural agendas, which focused primarily on the financial sector and on issues related to financial sector restructuring.

[39] The survey distinguished between measures that are critical, important and useful for the achievement of a program's macroeconomic objectives. Structural reforms were to be considered "critical" if without them the program objectives could not have been achieved; they were to be considered "important" if the achievement of program objectives would have been difficult but not impossible.

[40] This may explain why general, qualitative assessments of the importance of structural reforms for program objectives provided by area departments generally suggest a somewhat higher share of critical measures.

Figure 6. Distribution of Structural Measures Across Economic Sectors - Survey Sample
(In percent of total structural measures)



Source: Survey of 24 Fund-supported programs; see Appendix II for a brief description of the survey, and Appendix I for definition of the sector classification.

1/ Covering all structural measures listed in letters of intent, and the accompanying memoranda on economic and financial policies or policy matrices for the countries covered by the survey. Averages of sectoral distributions for each program.

Table 4. Macro-Relevance of Structural Measures by Economic Sector—Survey Sample

(In percent)

Economic Sector 1/	Share of Measures in Each Sector in Total Measures 1/	Share of Measures in Each Sector Considered 1/		
		Critical	Important	Useful
Exchange system	0.8	42.9	38.1	19.0
Trade regime	5.2	24.6	35.4	40.0
Capital account	1.3	12.1	63.6	24.2
Pricing and marketing	2.8	24.3	30.0	45.7
Public enterprises, reform and restructuring	5.8	33.1	34.5	32.4
Privatization	8.7	18.5	48.1	33.3
Fiscal sector	24.1	26.4	51.6	22.0
Social security system	3.5	29.1	37.2	33.7
Social safety net	1.9	25.5	38.3	36.2
Financial sector	25.6	29.4	57.2	13.4
Agricultural sector	3.7	34.1	38.5	27.5
Labor market	0.5	66.7	16.7	16.7
Economic statistics	2.6	18.8	57.8	23.4
Systemic reforms	13.5	19.1	50.4	30.4
Total/average for all sectors	100.0	28.9	42.7	28.4

Economic Sector 1/	Share of Conditions in Each Sector in Total Conditions 2/	Share of Conditions in Each Sector Considered 2/		
		Critical	Important	Useful
Exchange System	1.6	56.3	37.5	6.3
Trade regime	6.3	33.9	41.9	24.2
Capital account	0.5	40.0	0.0	60.0
Pricing and marketing	2.9	31.0	34.5	34.5
Public enterprises, reform and restructuring	6.7	37.9	24.2	37.9
Privatization	11.7	32.2	41.7	26.1
Fiscal sector	27.8	38.7	43.8	17.5
Social security system	3.2	48.4	29.0	22.6
Social safety net	0.9	44.4	22.2	33.3
Financial sector	21.2	42.6	42.6	14.8
Agricultural sector	4.3	52.4	28.6	19.0
Labor market	0.8	75.0	25.0	0.0
Economic statistics	2.0	5.0	60.0	35.0
Systemic reforms	10.0	32.7	35.7	31.6
Total/average for all sectors	100.0	40.7	33.3	25.9

Source: Survey of 24 Fund-supported programs; see Appendix II for a brief description of the survey, and see Appendix I for details on the sector classification.

1/ Covering all structural measures listed in letters of intent, and the accompanying memoranda on economic and financial policies or policy matrices for the countries covered by the survey.
2/ Performance criteria, structural benchmarks, prior actions, and conditions for completion of review.

40. Structural measures in a number of other areas were also included, ranging from the privatization of public enterprises in Thailand to trade and financial services liberalization in Korea. However, these measures were generally not subject to performance criteria or even benchmarks and accounted for a relatively small share of the structural measures listed in the extensive policy matrices representing these programs' letters of intent (Figure 7).[41] These reforms were part of the government's broader policy agenda and were expected to support the restoration of market confidence by demonstrating the authorities' resolve to enhance the flexibility and growth potential of the economy.

41. The range of structural measures in the letter of intent was particularly broad in Indonesia, where reforms to enhance efficiency and transparency were seen as equally important to restoring market confidence as financial sector restructuring. Unlike the programs in Korea and Thailand, the stand-by arrangement and the subsequent extended arrangement with Indonesia did include performance criteria, prior actions and benchmarks in areas other than those related to financial and corporate restructuring (Box 8).

42. In all three countries, the programs' structural content expanded substantially as the crisis evolved.[42] Much of this was accounted for by the increasing complexity of financial sector reform. Moreover, it soon became apparent that efforts to restructure the financial sector were unlikely to succeed if problems in the corporate sector were left unattended and corporate sector restructuring, as well as supporting reforms in bankruptcy and other relevant legislation, emerged as a vital counterpart to the measures addressing the weaknesses in the financial sector (Box 9). In retrospect, area department staff have concluded that only the measures related to financial and corporate sector restructuring, supporting reforms in the legal and regulatory framework as well as measures to enhance transparency and monitoring, and, in Indonesia, measures to deal with the disruption of the economy at the height of the political crisis, were indeed critical for the achievement of the programs' objectives. Many other structural reforms were no doubt useful, but it is debatable whether they were important for the restoration of confidence and needed to be dealt with at the height of a crisis.

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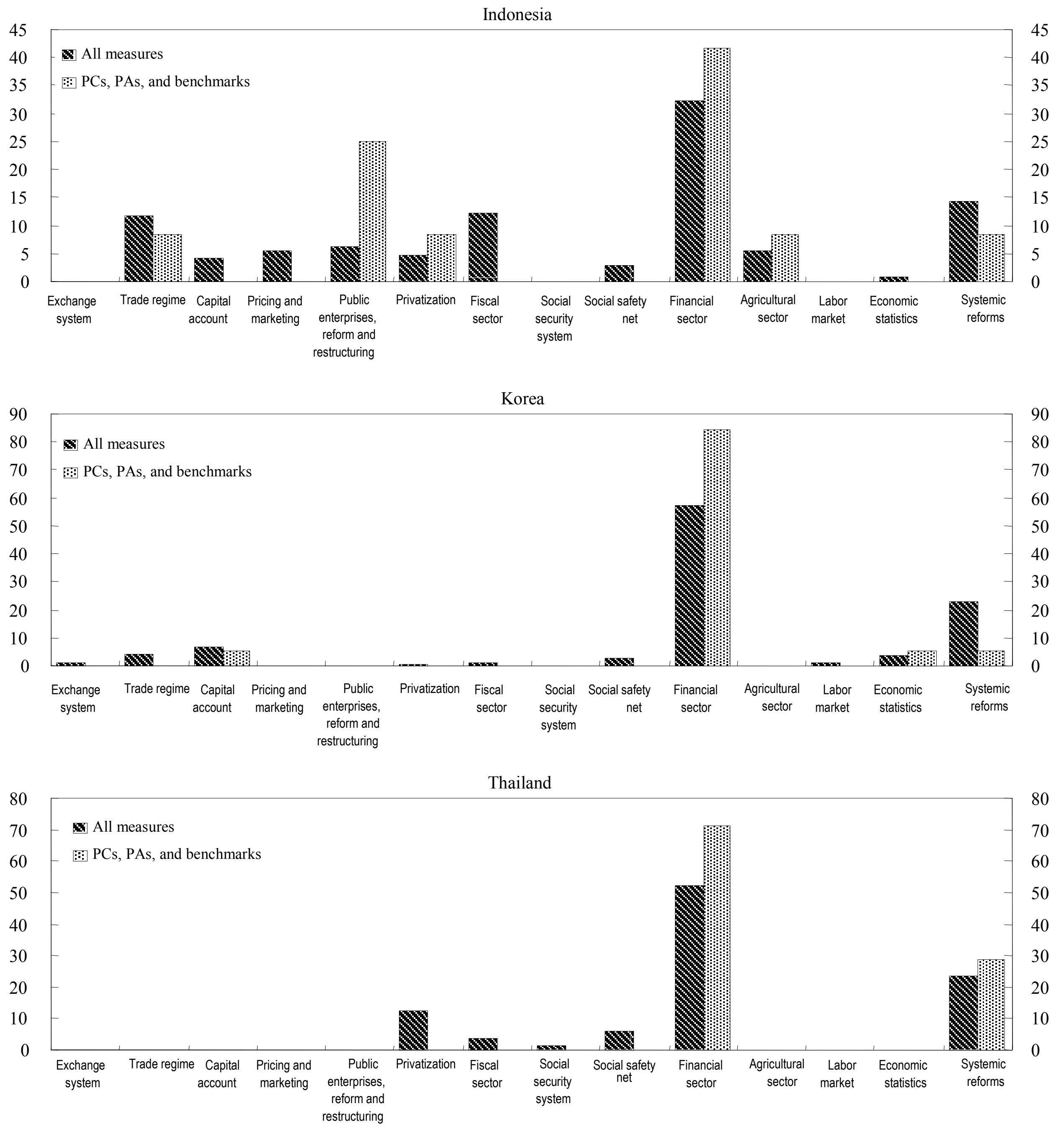
[41] Given the ambiguity of the status of these policy matrices, it is perhaps not surprising that all measures listed in them came to be understood as part of these programs' structural conditionality. See, for example, the discussion of structural conditionality in the Indonesia programs in Goldstein (2000b).

[42] Frequent reviews provided an opportunity to adapt the structural reform agenda. While this generally meant expanding it in response to new emerging problems, it also allowed some refocusing, with some reforms that were no longer seen as important being dropped from the agenda.

Figure 7. Distribution of Structural Measures by Economic Sector - Asian Crisis

(In percent of total structural measures)



Source: Survey of 24 recent Fund-supported programs; see Appendix II for a brief description of the survey, and Appendix I for definition of the sector classification.

1/ Covering all measures listed in letters of intent and the accompanying policy matrices for the 1997 stand-by arrangements with Korea and Thailand and the 1998 extended arrangement with Indonesia. Averages of sectoral distributions for each program.

Box 8. Indonesia: The Structural Reform Agenda

The first Indonesia program, a three-year stand-by arrangement, was approved on November 5, 1997 against the background of intense pressures on the rupiah, which had been floated in August as contagion from the financial crisis in Thailand was spreading. In contrast to Thailand and later Korea, which had virtually run out of usable reserves when their programs were negotiated, the Indonesian authorities at the time still controlled useable reserves of some US$24 billion, almost six months of imports. The main objectives of the program were to restore market confidence, achieve an orderly adjustment in the current account, limit the unavoidable decline in growth, and contain the inflationary impact of exchange rate devaluation. Adjustments in fiscal and monetary policy as well as structural measures were deemed necessary to achieve these objectives.1/

The structural agenda of the Indonesia program covered, from the start, a broader range of measures than in Korea and Thailand. Bank restructuring played a key role, but trade and other structural reforms to enhance efficiency and transparency were seen as equally important to restoring market confidence. Of the nine structural performance criteria and benchmarks set in the original letter of intent for the next two quarters, four were related to the financial sector—including the closure of banks under intensified supervision and without approved rehabilitation plans—and five to adjustments in regulated prices, tariffs, government expenditures and procurement procedures.

In early 1998, with the crisis deepening amid political uncertainty, slippages in monetary policy, and uneven implementation of important structural measures, the program was strengthened and the coverage of structural measures was widened. Building on the policy package agreed in January, the April 1998 letter of intent contained a policy matrix listing 117 specific structural measures in a variety of areas: fiscal policy (17); monetary and banking issues (18); bank restructuring (24); investment and deregulation (15); privatization and public enterprises (13); social safety net measures (2), foreign trade (15); environment (6) and other areas (7). Five of the 17 prior actions for the April review, and seven of the 19 structural performance criteria and benchmarks set for the coming year were related to bank and corporate restructuring; the others covered a variety of areas, including the removal of restrictions on the transferability of forestry concessions. The review indicated that close to 40 percent of the listed measures had already been implemented during the program period; however, continued systematic monitoring was complicated by the political crisis.

Measures added to the program's structural agenda in mid 1998 were more narrowly focused on financial and corporate sector restructuring. At the second review in June, 15 additional structural measures were incorporated, ten of which addressed monetary and banking issues, including bank restructuring. The third review at the end of July added another 16 structural measures, with all but two related to bank and corporate sector restructuring.

1/ Fiscal adjustment was also seen as necessary to cover the carrying cost of financial sector restructuring.

Box 9. Financial and Corporate Sector Restructuring

A salient feature of the Fund-supported programs in the three Asian crisis countries was their extensive structural reform agenda. These reforms aimed at the core of these countries' external difficulties: severe problems in the financial sector, which had undermined investor confidence and triggered massive capital outflows. Although the programs covered a range of structural issues—reflecting partly the authorities' broader reform plans—dealing with the crisis in the financial sector was clearly seen as the top priority.

While many previous Fund-supported programs had included measures to restructure and reform financial systems, the sheer scope of issues that had to be addressed in Indonesia, Korea, and Thailand was unprecedented. Moreover, even though closures of financial institutions in Thailand prior to the program signaled serious problems in the financial sector, the magnitude of the problem was not fully anticipated at the outset because the full extent of the vulnerabilities in the financial system became only apparent as the crisis evolved and the depreciation of the exchange rate and the depth of the recession became evident. In these circumstances, the programs' structural content expanded rapidly. A growing number of financial institutions got into trouble or showed clear signs of weakness; they had to be closed, restructured, or, if they were viable, recapitalized. Institutional and legal frameworks, such as agencies overseeing the restructuring and bankruptcy laws, proved inadequate to deal with the crisis and needed to be improved. Finally, the regulatory and supervisory framework required strengthening to ensure that financial institutions would start operating on a sound basis.

One area barely mentioned at the beginning eventually emerged as a critical counterpart to financial sector reform and restructuring: corporate sector restructuring. Of the three original programs, only the letter of intent from Korea addressed corporate sector issues. It focused on transparency and corporate governance—audits, disclosures rules, and mutual credit guarantees of large conglomerates—but did not yet include a detailed set of measures, notwithstanding the bankruptcy of several major conglomerates in the year before the arrangement. However, as the recession deepened and problems in the financial sector spread, it became increasingly evident that the issue of corporate restructuring required attention. In the course of successive program reviews, measures to facilitate corporate restructuring, including supporting changes in tax and legal codes, thus moved to center stage and became a critical part of the programs.

By mid 1998, the importance of corporate sector restructuring for financial sector reform, and hence for the programs' success, was widely recognized. However, the Fund was not well equipped to deal with these issues, which were clearly beyond its areas of expertise. Close cooperation with the World Bank was thus critical for the design of an important element of the adjustment strategies in the Asian crisis countries. These adjustment strategies were laid down in extensive, detailed policy matrices outlining several hundred specific steps in various areas of structural reform. These matrices came to be widely identified with the programs' structural conditionality, even though only a small fraction of the measures they included were subject to performance criteria, prior actions or structural benchmarks.

43. In the transition economies, prioritizing the structural reform agenda was complicated by the sheer magnitude of the structural issues these countries were facing at the outset. Exchange and trade systems were tightly regulated and had essentially become defunct with the disintegration of the COMECON; prices were controlled and played a minor, if any, role in resource allocation; the delineation between private and public sector activity was non-existent, and the most basic legal and institutional framework of a market economy was lacking. Structural conditionality in the initial programs was relatively limited and focused primarily on exchange, trade and price liberalization. In addition, to support efforts to bring the initial rise in inflation under control, central and commercial banking functions had to be separated and the drain on the budget from public enterprises had to be stopped. In a number of cases, incomes policies were put in place to prevent large wage increases from constituting a drain on the budget in an environment of soft budget constraints (Figure 8).

44. In the second generation programs that followed the initial liberalization and stabilization phase, the separation of private and public sector activities moved to center stage. Structural conditionality now focused more on privatization, strengthening of government finances, and financial sector reform.[43] "Systemic" reforms—changes in the legal and institutional framework—became more important too, but they accounted for less than 10 percent of the structural conditions in transition economies in the second half of the 1990s (Box 10). Inadequate progress in this area is increasingly being seen as an important shortcoming of the reform process in many transition economies because it has hampered the development of a vibrant, competitive private enterprise sector.[44]

45. The main elements of the transition process—liberalization, stabilization, restructuring and privatization, and legal and institutional reforms—and the broad outlines of their phasing were agreed upon fairly early.[45] This provided some general guidance on setting priorities for structural reforms. However, there was less consensus on the details of sequencing after the initial liberalization and stabilization phase, and on the specifics of some of the measures, such as large-scale privatizations or the form of financial sector regulation and competition policy. Moreover, given the wide range of structural issues demanding attention, ignoring the linkages between structural reforms in different sectors was likely to have even more serious consequences than in many other countries. In these circumstances, identifying clear priorities of structural reform was an onerous task and it is not surprising that structural conditionality in these programs has generally been broader and more diverse than in other programs.

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[43] In some sectors that were seen as important for the transformation process, such as agriculture, the Fund refrained from greater involvement due to lack of expertise, even though these sectors were not covered by the World Bank.

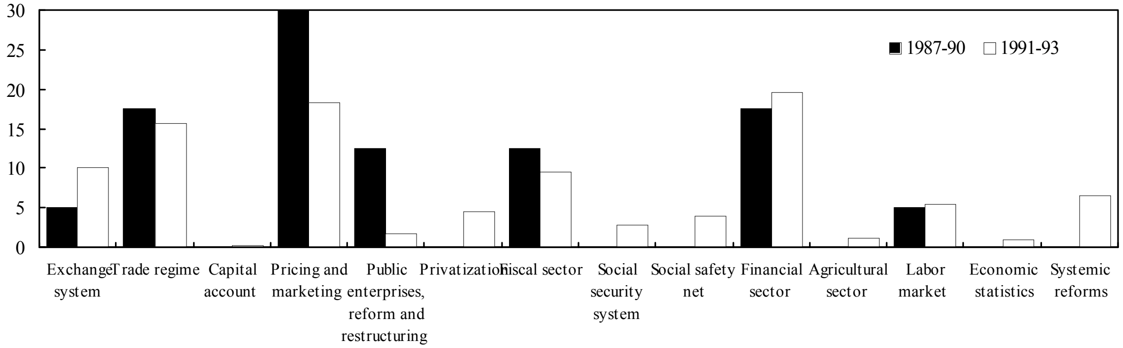
[44] See, for example, Christiansen and Richter (1999), p. 10.

[45] See, for example, Fischer and Gelb (1991).

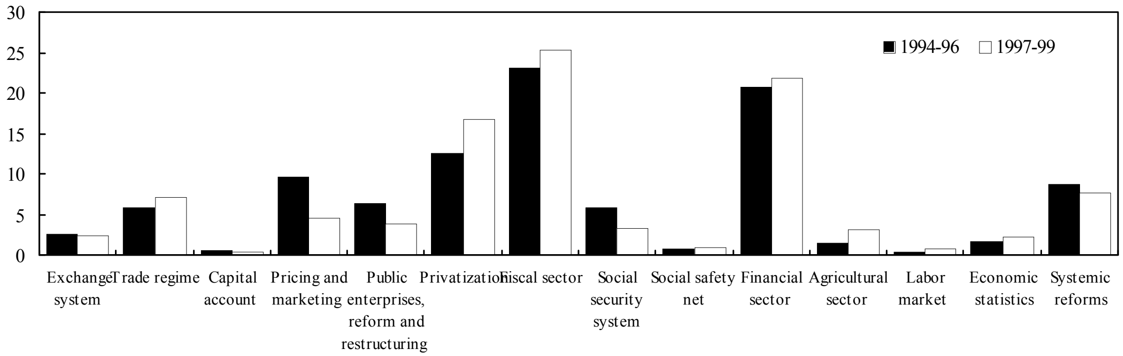
Figure 8. Distribution of Structural Conditions by Economic Sector : Transition Economies, 1987-1999

(In percent of total structural conditions 1/)

1987-93



1994-99



Source: International Monetary Fund, MONA database; and country papers.

1/ Covering performance criteria, prior actions and structural benchmarks. Transition economies as defined in the World Economic Outlook, covering former centrally planned economies in Eastern Europe, FSU countries, and Mongolia. Averages of the sectoral distributions of total structural conditions (performance criteria, structural benchmarks, prior actions, and conditions for completion of review) for each program. For a more detailed description of the sector classification see Appendix I.

Box 10. First and Second Generation Programs in Transition Economies—Estonia

Two stand-by arrangements with Estonia, one approved in 1992 and the other in 1996, show the difference between the "first generation," stabilization programs and "second generation," transformation programs in the transition economies. Focus as well as extent of structural conditionality shifted. While the first program had only five prior actions, the other had 22 structural benchmarks.

The 12–month stand-by arrangement approved in September 1992 included the following 5 prior actions: 1/

- Introduce tax-based incomes policy;
- Convert all foreign exchange holdings of the government in the Bank of Estonia to domestic deposits;
- Appoint inter-ministerial commission to monitor implementation of the stabilization program;
- Separate commercial and central bank functions of the Bank of Estonia;
- Restructure tax code i) increasing the VAT from 10 to 18 percent, ii) increasing the effective corporate tax rate from 27 to 35 percent, iii) adopt a new top tax rate of 50 percent of personal income.

The 13-month stand-by arrangement approved in July 1996 contained 22 structural benchmarks: 2/

Budgetary policies and pension system

- Issue decree clarifying that the government does not extend explicit guarantees to local authority borrowing;
- Introduce in parliament legislation tightening requirements for local government borrowing;
- Submit to parliament new state pension and social tax laws;
- Develop national audit plan and strengthen audit procedures;
- Introduce legislation requiring proper VAT bookkeeping;
- Strengthen collaboration between national tax board and customs administration;
- Request World Bank assistance in conducting a public expenditure review;
- Initiate study of long-term finances of social insurance fund.

Financial sector

- Submit to parliament amendments to the credit institutions act to allow exchange of information between supervisory authorities and external auditors;
- Increase minimum capital requirement of commercial banks to EEK 60 million;
- Approve law defining modalities for the operations of investment funds.

Pricing and regulatory policy

- Submit to parliament law establishing a monopoly regulatory board;
- Start operations of monopoly regulatory board;
- Increase electricity prices to cover increasing share of long-run operation costs;
- Submit to parliament amendment to competition law strengthening the competition board.

Trade Policy

- Complete equalization of excises on all domestic and imported goods;
- Eliminate reference prices for all imports.

Land reform/enterprise restructuring

- Pass amendments to land reform law;
- Issue government decree requiring municipalities to follow accelerated procedures for privatization of land linked to enterprise sales;
- Issue government decree defining procedures to speed up sales of undeveloped land;
- Complete restructuring of balance sheets of Eesti Energia and Eesti Polevkivi.

Statistics

- Submit to parliament law on statistics.

1/ EBS/92/132.
2/ EBS/97/52.

46. Given the broad range of structural reforms that may be relevant for a program's macroeconomic objectives and the absence of general rules for discriminating among them according to their relative importance, prioritization is beset with difficulties. These difficulties may have contributed to the expansion of structural conditions. When structural measures cannot be differentiated clearly, including several measures that appear more or less equally relevant may seem safer than selecting one or two arbitrarily, in particular when the choice is limited by political constraints in the program country and the reform measures are in sectors where the link to macroeconomic stabilization and external adjustment seems largely self- evident. However, it is also possible that prioritization was not always seen as imperative. Given the general trend towards a greater focus on structural issues in Fund-supported programs in the 1990s, program design may at times have been guided by comprehensiveness rather than selectivity. This may also have contributed to the expansion of structural conditionality.

C. Collaboration with the World Bank and Other Institutions

47. Beyond prioritization, collaboration with other institutions, notably the World Bank, provided a possible mechanism for limiting the scope of structural conditionality in Fund-supported programs. However, while collaboration with the World Bank appears to have been quite extensive, it did not necessarily help limit the scope of the Fund's structural conditionality. As noted above, conditions related to public enterprise restructuring and privatization—areas belonging to the World Bank's core areas of expertise—have accounted for a substantial share of structural conditions in Fund-supported programs.

48. According to the assessments provided by area department staff in the context of the survey of 24 recent Fund-supported programs, the World Bank has frequently provided input in designing programs' structural reform agenda and identifying specific measures. In addition, it has assisted in monitoring implementation, and has supported implementation through technical advice (Figure 9 and Table 5). In some instances, other institutions—such as regional development banks—have also provided input but their contribution has typically been much more limited.

49. The involvement of the World Bank and other institutions has varied considerably across economic sectors. It has been the most extensive in the areas of agriculture, systemic reforms (covering legal and institutional reforms, as well as corporate governance and restructuring), reform and restructuring of public enterprises, social security systems, and strengthening social safety nets. In these areas, two thirds to 80 percent of the reforms covered in the programs' letters of intent involved input from the World Bank and other institutions. These institutions have also played an important role in the area of labor market reform, reforms in pricing and marketing arrangements, and privatization. By contrast, their contribution has been more limited in the financial sector, and in trade and capital account liberalization (including liberalization of foreign direct investment)—areas that are generally considered as part of the Fund's areas of responsibility and expertise or joint responsibilities of the Fund and the World Bank. Finally, the World Bank and other institutions provided little input in the fiscal area, economic statistics, and exchange system reform. In these latter areas, Fund technical assistance was important in identifying the structural measures included in the programs.

50. Thus, judging by the experience of the sample programs, the involvement of the World Bank and other institutions in the design and monitoring of structural reforms has been quite extensive, even though collaboration has not been without problems.[46] Why then did

[46] How well collaboration works seems to depend on specific circumstances. One third of the survey respondents indicated that cooperation was good or satisfactory, half of these involving ESAF/PRGF-supported programs, which accounted for some 40 percent of the sample. In the other cases, difficulties arising from differences in the other institution's timetable, differences regarding policy priorities, and administrative obstacles were cited as factors complicating collaboration.

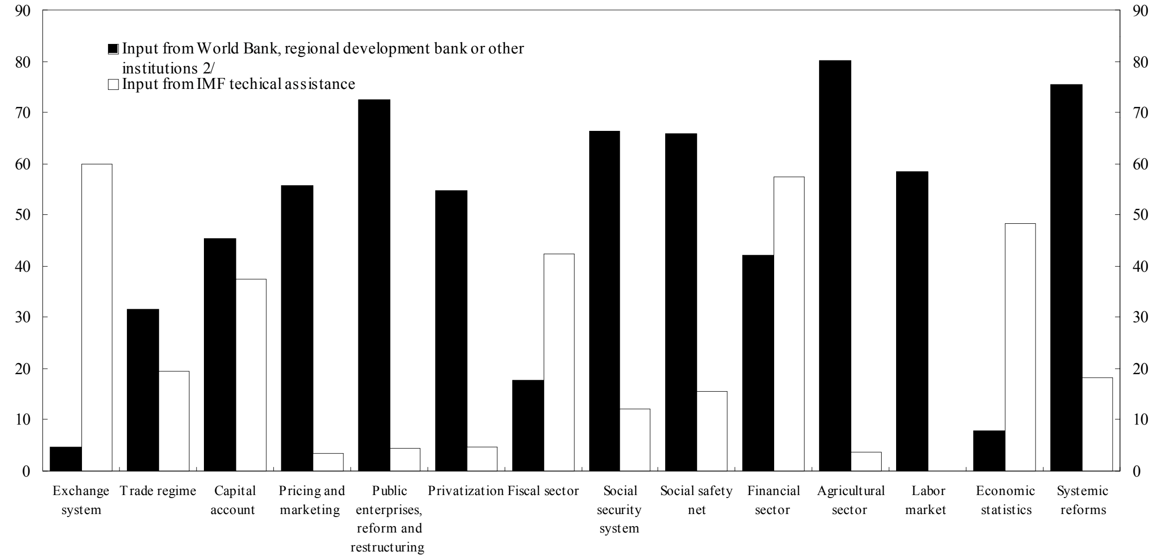
the Fund see a need to apply conditionality in spite of this close collaboration at the operational level? The remainder of this section addresses this question.

51. Given the complementary roles of the Fund and the World Bank in their developing member countries, there has been a continuous search in both institutions for forms of collaboration that would best serve their members' needs. Guidelines on collaboration have been around since the 1960s, but in the 1980s, the growing involvement of both institutions in structural adjustment[47] and the increasing overlap of their activities called for a renewed

[47] In 1980, the World Bank introduced Structural Adjustment Loans (SALs) to support economy-wide structural adjustment; subsequently, Sector Adjustment Loans (SECALs), which focused on structural adjustment in specific sectors, were added.

Figure 9. The Role of Other Institutions and IMF Technical Assistance in Program Design - Survey Sample

(In percent of total structural measures in each sector) 1/



Source: Survey of 24 Fund-supported programs; see Appendix II for a brief description of the survey, and Appendix I for definitions of the sector classification.

1/ Covering all structural measures listed in letters of intent, and the accompanying memoranda on economic and financial policies or policy matrices for the countries covered by the survey.

2/ Input from any of these institutions alone or combined in the identification of structural measures. (See Table 5 for details on input by type of institution and their role in providing advice on implementation as well as monitoring.)

Table 5. Input from Other Institutions in Program Design and Monitoring - Survey Sample
(In percent of total structural measures in each sector) 1/

Economic Sector	Input provided by: World Bank	Regional Development Bank and/or Other Institution	World Bank and Regional Development Bank and/or Other Institution	Total
		Identification of measures		
Exchange system	4.8	0.0	0.0	4.8
Trade regime	23.1	6.2	2.3	31.5
Capital account	30.3	0.0	15.2	45.5
Pricing and marketing	55.7	0.0	0.0	55.7
Public enterprises, reform and restructuring	72.4	0.0	0.0	72.4
Privatization	53.2	0.5	0.9	54.6
Fiscal sector	14.5	1.7	1.5	17.7
Social security system	61.6	0.0	4.7	66.3
Social safety net	66.0	0.0	0.0	66.0
Financial sector	42.0	0.2	0.0	42.1
Agricultural sector	73.6	6.6	0.0	80.2
Labor market	58.3	0.0	0.0	58.3
Economic statistics	4.7	3.1	0.0	7.8
Systemic reforms	66.0	2.1	7.5	75.5
All sectors	41.7	1.4	1.9	45.0
		Advice on implementation		
Exchange system	4.8	0.0	0.0	4.8
Trade regime	18.5	5.4	2.3	26.2
Capital account	27.3	0.0	15.2	42.4
Pricing and marketing	52.9	0.0	0.0	52.9
Public enterprises, reform and restructuring	58.6	4.1	0.0	62.8
Privatization	51.9	5.6	0.9	58.3
Fiscal sector	13.5	4.0	1.7	19.2
Social security system	53.5	0.0	4.7	58.1
Social safety net	63.8	0.0	0.0	63.8
Financial sector	42.3	1.7	0.2	44.2
Agricultural sector	46.2	22.0	0.0	68.1
Labor market	50.0	0.0	0.0	50.0
Economic statistics	4.7	3.1	0.0	7.8
Systemic reforms	60.9	3.9	7.2	71.9
All sectors	50.0	0.0	0.0	50.0
		Monitoring of implementation		
Exchange System	0.0	0.0	0.0	0.0
Trade Regime	18.5	5.4	0.0	23.8
Capital account	27.3	0.0	15.2	42.4
Pricing and marketing	47.1	0.0	0.0	47.1
Public enterprises, reform and restructuring	60.0	4.1	0.0	64.1
Privatization	45.4	3.7	0.9	50.0
Fiscal sector	12.7	4.0	1.5	18.2
Social security system	52.3	0.0	4.7	57.0
Social safety net	63.8	0.0	0.0	63.8
Financial sector	39.5	1.4	0.2	41.0
Agricultural sector	45.1	22.0	0.0	67.0
Labor market	25.0	0.0	0.0	25.0
Economic statistics	4.7	0.0	0.0	4.7
Systemic reforms	58.8	3.6	6.6	69.0
All sectors	36.1	3.5	1.7	41.3

Source: Survey of 24 Fund-supported programs; see Appendix II for a brief description of the survey, and Appendix I for definitions of the sector classification.

1/ Covering all structural measures listed in letters of intent, and the accompanying memoranda on economic and financial policies or policy matrices for the countries covered by the survey.

clarification of their respective responsibilities and the modalities of their cooperation. The results of this discussion were summarized in a joint memorandum from the Managing Director of the Fund and the President of the World Bank on "Bank-Fund Collaboration in Assisting Member Countries."[48] The "Concordat" of 1989 was subsequently elaborated and updated in light of developments in the lending activities of both institutions in the 1990s, which had led to further overlap in their activities (Box 11).[49]

52. Close collaboration between both institutions was particularly important in countries with Fund arrangements under the SAF and ESAF, which included structural reforms as a defining element. The Policy Framework Papers outlining the broader policy strategy underlying these arrangements were to be formulated with assistance from both institutions. Bank and Fund staff were expected to identify jointly the critical structural problems, and the Fund arrangement would cover structural policies in the Fund's area of expertise.[50]

53. These efforts to clarify the respective areas of responsibility of the Fund and the World Bank and strengthen the modalities of cooperation between the two institutions helped foster Bank-Fund collaboration at the operational level. However, they left open the question of how the issue of conditionality should be handled in cases where certain structural measures outside the Fund's areas of expertise were deemed critical for the objectives of a Fund-supported arrangement. There was no framework ensuring that such measures would be covered by Bank conditionality, and even when they were covered by conditionality under a Bank lending operation, the need to avoid cross conditionality prevented the Fund from linking its disbursements directly to Bank conditions.[51] In these circumstances, the Fund often saw a need to apply conditionality to measures outside its areas of expertise that were critical for a program's macroeconomic objectives, either because there was no Bank conditionality at all or because timing and form of the Bank's conditionality did not provide

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[48] Memorandum to the Executive Board of the International Monetary Fund and the Board of Executive Directors of the World Bank, March 30, 1989.

[49] See, "Report of the Managing Director and the President on Bank-Fund Collaboration," (SM/98/226, Revision 1, September 25, 1998).

[50] "Enhanced Structural Adjustment Facility (ESAF)–Operational Guidelines for the Staff," (SM/88/148, July 12, 1988).

[51] The prohibition against cross conditionality arises from the Fund's responsibility to determine the conditions under which members have access to its resources, which cannot be delegated to another institution. Thus, the Interim Committee underscored the need to avoid cross conditionality when the ESAF was established. See Boughton (2000), Chapter 14, p.15.

Box 11. Principles of Bank-Fund Collaboration

Given the complementary roles of the World Bank and the Fund in many developing member countries, collaboration between the two institutions has a long tradition. Formal guidelines on Bank-Fund collaboration have been in place since 1966, with several amendments in the 1970s and 1980s.

The 1989 "Concordat," formulated in response to a growing overlap in the activities of both institutions, outlined their respective responsibilities and the principles of collaboration. Reaffirming the general principles underlying the earlier guidelines, the Concordat defined each institution's mandate, primary responsibilities, and areas of expertise as follows:

- "… the Fund has focused on the aggregate aspects of macroeconomic policies and their related instruments—including public sector spending and revenues, aggregate wage and price policies, money and credit, interest rates and the exchange rate."1/

- "… the Bank has focused on development strategies; project investments; structural adjustment programs; policies which deal with the efficient allocation of resources in both public and private sectors; priorities in government expenditures; reforms of administrative systems, production, trade and financial sectors; the restructuring of state enterprises and sector policies." 2/

The Concordat recognized, however, that a range of matters would be of interest to both institutions. Close collaboration was thus seen as essential to avoid differing policy advice.

The principles for collaboration outlined in the 1989 Concordat were reaffirmed in 1998 in the "Report of the Managing Director and the President on Bank-Fund Collaboration." 3/ The report underscored the need for a clear understanding in member countries as to which institution has primary responsibility in any given area of policy advice and reform; full consultation between both institutions on their positions regarding key elements of a country's policies and reform agenda; and separate accountability for each institution's lending decision, while seeking complementarity and integration of their respective programs into the country's overall reform agenda. To facilitate collaboration on financial sector reform—an important area of interest to both institutions—a Bank-Fund Financial Sector Liaison Committee was set up in 1998, which produced "Guidelines on Collaboration Between the Bank and the Fund in Financial Sector Work." 4/Subsequently, in 2000, a Joint Implementation Committee was established to coordinate collaboration in the context of PRSPs and the HIPC Initiative.

1/ Memorandum from the Managing Director and the President on "Bank-Fund Collaboration in Assisting Member Countries," March 30, 1989. p.3.
2/ Ibid.
3/ SM/98/226, Revision 1, September 25, 1998.
4/ SM/99/158, July 2, 1999.

the necessary safeguards for the Fund.[52] This led to a considerable amount of overlapping conditionality, measures that were covered by both Fund and Bank conditionality.

54. The Poverty Reduction and Growth Facility (PRGF), which replaced the ESAF in 1999, seeks to overcome the problem of overlapping conditionality by specifying a detailed framework for the coordination of Fund and Bank activities under the umbrella of the Poverty Reduction Strategy Paper (PRSP).[53] The PRSP defines the authorities' overall policy strategy for poverty reduction and identifies each institution's responsibility for specific policy areas, broadly in line with earlier understandings on their respective mandates and areas of expertise. A formal framework for consultation between the two institutions is expected to ensure that progress in all policy areas covered by the PRSP is taken into account when decisions on each institution's lending operations—the PRGF in the case of the Fund, and the Poverty Reduction Support Credit (PRSC) and other IDA lending in the case of the Bank—are taken.[54]

55. Outside the evolving framework for PRGF-supported arrangements, the lack of a well defined framework for complementary conditionality by the Fund and the World Bank continues to constrain efforts to limit the scope of Fund conditionality. While it is possible to rely on Bank conditionality on a case-by-case basis in situations where such conditionality is in place, a general move towards truncating Fund conditionality to its core areas of expertise when policies outside these areas are critical for a program's macroeconomic objectives would risk failing to establish the safeguards conditionality is supposed to provide.

IV. Monitoring Structural Reforms

56. The increased focus on structural policies in Fund-supported programs raised special issues for program monitoring. This chapter discusses the considerations affecting the application of different monitoring techniques in the structural area and reviews monitoring practices. It takes a closer look at developments in the use of different monitoring tools and discusses their implications for the expansion of structural conditionality. Finally, the chapter examines whether the increase in the number of structural conditions reflects a trend towards greater detail in program monitoring.

[52] There is considerable anecdotal evidence suggesting that World Bank staff often encouraged the application of Fund conditionality in these cases as substitute for, or a strengthening of, Bank conditionality.

[53] See, "The Poverty Reduction and Growth Facility—Operational Issues," (SM/99/293, December 13, 1999).

[54] The PRSC was approved by the World Bank's Board of Executive Directors in 2000 and is not yet fully operational.

A. General Considerations

57. When the Executive Board discussed the role of structural reforms in Fund-supported programs in the late 1980s, it was recognized that monitoring these reforms raised different issues than monitoring macroeconomic policies.[55] In order to fulfill the dual function of conditionality to provide safeguards to the Fund and assurances to the member, program monitoring needed to be "… both precise and objective, and to relate as far as possible to policy instruments or intermediate targets that are subject to a member's control, rather than to variables whose link to policy variables is uncertain."[56] However, whereas in the macroeconomic area, well defined and readily observable intermediate targets, such as monetary aggregates or fiscal balances, were typically available, comparable intermediate targets were difficult to find in the structural area. Ultimate and intermediate objectives of structural reforms could frequently not be defined in precise, objectively verifiable terms and when such a definition was feasible, the resulting indicator was often not readily observable or sufficiently directly linked to policy actions to be used as a performance criterion.[57] Thus, if structural reforms were to be subject to performance criteria or prior actions, conditions would likely have to focus on the policy actions themselves.

58. The main drawback of focusing on individual policy actions was that it could lead to considerable detail in program monitoring, leaving little room for the government to modify the reform process after the program had been agreed. The reform was synonymous with the agreed steps. Moreover, to meet the criterion of specificity, individual steps might have to be defined in such a way that each one of them alone was not necessarily all that critical, with its importance deriving mainly from the fact that it was a link in a chain of steps, which together defined a reform that was critical for program objectives. Finally, focusing on individual, well defined steps could give rise to a proliferation of structural conditions if selective coverage of specific steps was deemed insufficient to monitor progress in implementation. Monitoring structural reforms in the context of program reviews was less liable to involve these drawbacks because it did not require the same degree of precision in defining what was being monitored. However, it also meant less clearly defined assurances regarding the conditions under which purchases could continue.

59. Many of these issues were recognized—at least in principle, if not in detail—when the Board discussed the monitoring of structural policies in Fund-supported programs in

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[55] See "Monitoring Structural Adjustment in Fund-Supported Adjustment Programs," (EBS/87/240, November 20, 1987).

[56] Ibid, p.10.

[57] For a discussion of possible structural indicators—such as the spread between the official and the parallel market rate as an indicator of exchange market distortions—see "Monitoring Structural Adjustment in Fund-Supported Adjustment Programs," Appendix I (EBS/87/240, November 20, 1987).

1987. In general, this discussion sought to strike a balance between the advantages and disadvantages of structural performance criteria and prior actions on the one hand and reliance on reviews on the other. There was, however, a clear understanding that it would not be possible to define hard and fast rules, given the different circumstances in individual countries.[58]

60. Prior actions were seen as an important tool, defining a critical first step in a reform program, particularly in situations where a strong indication of policy commitment was deemed essential, given the extent of existing imbalances or the past record of implementation. Performance criteria were considered useful for monitoring important, well defined measures that could not be implemented at the outset. However, making structural reforms subject to performance criteria required that a precise timetable could be attached to their implementation. It was recognized that this was frequently not the case, in particular when legal or institutional changes were involved.[59]

61. Program reviews, which allowed for greater flexibility regarding timing came to be seen as an important tool for monitoring structural reforms. In addition, they seemed well suited to assess progress in areas where individual steps could not be defined with an adequate degree of precision.[60] However, the Board recognized that reviews provided considerable flexibility at the expense of clear assurances to members and recommended that the coverage of reviews should be specified "… in some detail at the outset of the program."[61]

62. The role of structural benchmarks was not addressed in this discussion. Benchmarks had only recently been introduced in the context of SAF-supported arrangements, which relied on less frequent disbursements than other Fund-supported programs and required monitoring tools that were not directly linked to disbursements. However, the initial experience with benchmarks as the main monitoring tool cast doubt on their effectiveness. Consequently, with the introduction of the ESAF two years later, disbursements became more frequent (semi-annual) and performance criteria, including in the structural area, became part

[58] See "Monitoring of Structural Adjustment in Fund-Supported Adjustment Programs," (EBS/87/240, November 20, 1987), p.11.

[59] In view of these considerations, performance criteria were expected to play a limited role in monitoring structural reforms. Consequently, the Board saw no need to revise the Conditionality Guidelines of 1979, which stipulate that performance criteria should normally be confined to macroeconomic variables and may relate to other variables only in exceptional cases.

[60] See "Program Design and Performance Criteria,"(EBS/86/211, September 8,1986), p. 34.

[61] "Monitoring of Structural Adjustment in Fund-Supported Adjustment Programs," (EBS/87/240, November 20, 1987), p. 11.

of the conditionality of concessional arrangements. Structural benchmarks continued to play an important role in concessional arrangements and came to be used increasingly also in stand-by and extended arrangements. However, while it was clear that benchmarks differed from prior actions and performance criteria in that they were not directly linked to the approval or continuation of a program, their status in program monitoring has never been clearly defined.

B. Monitoring Practices

63. The broad principles that emerged from the discussion on monitoring structural reforms in Fund-supported programs in the late 1980s provided considerable flexibility for tailoring monitoring practices to country-specific circumstances. As a result, monitoring practices have differed significantly, not only across different groups of programs and countries (Tables 6 and 7) but also within each group (Figures 10 to 13).

64. Performance criteria have rarely been used to monitor structural reforms in the transition economies and in countries with more traditional types of Fund-supported programs.[62] In these two groups of countries, more than half of the programs approved during 1997–99 had no structural performance criteria. By contrast, structural performance criteria have been more common in ESAF/PRGF-supported arrangements. While the number of performance criteria in these programs has generally been relatively small—fewer than two per program year in over half of the programs approved during 1997–99—a few programs have had quite a large number of structural performance criteria ranging from 4 to more than 9. Performance criteria have also played an important role in monitoring structural reforms in the Asian crisis countries, with considerable variation in the number of performance criteria across programs.

65. Practices regarding the use of prior actions have been even more diverse. One third of the programs in transition and ESAF/PRGF countries, and half of the other programs approved during 1997–99 had no prior actions. In general, prior actions have been more common and more numerous in the transition economies than in other programs, with over one fifth of the programs approved in 1997–99 containing 5–10 prior actions per program year, and another fifth more than 15.

66. The preponderance of prior actions in a significant number of programs in the transition economies may reflect the sheer magnitude of the structural reform agenda in these countries and the need to make a credible start at the outset in several key areas, in particular in countries with a weak track record. Furthermore, to the extent that prior actions relate to the completion of reviews rather than the approval of the program, their frequency typically reflects repeated delays in the implementation of measures that were initially specified as structural benchmarks (rather than performance criteria) to allow for a degree of flexibility in

[62] Non-transition countries with stand-by or extended arrangements.

implementation. Such "delayed" structural benchmarks are frequently transformed into prior actions, both in the transition economies and in other programs.

Table 6. Structural Conditions by Type of Country and Type of Condition, 1987-1999

(Conditions per program year 1/)

	Transition Economies 2/				SAF/ESAF/PRGF Countries 3/				Asian Crisis Countries 4/				Other Countries 5/			
	Total conditions	Structural benchmarks	Performance criteria	Prior actions 6/	Total conditions	Structural benchmarks	Performance criteria	Prior actions 6/	Total conditions	Structural benchmarks	Performance criteria	Prior actions 6/	Total conditions	Structural benchmarks	Performance criteria	Prior actions 6/
	Averages															
1987	…	…	…	…	2.0	2.0	0.0	0.0	…	…	…	…	3.3	0.0	1.3	2.0
1988	3.0	0.0	0.5	2.5	3.5	2.9	0.6	0.0	…	…	…	…	0.8	0.0	0.8	0.0
1989	…	…	…	…	4.3	3.2	0.9	0.2	…	…	…	…	1.2	0.0	0.8	0.4
1990	2.7	0.0	0.7	2.0	9.2	6.1	1.2	1.9	…	…	…	…	1.1	0.0	1.1	0.0
1991	6.9	1.2	0.0	5.7	4.8	2.8	0.9	1.1	…	…	…	…	2.0	0.6	0.6	0.9
1992	6.2	0.0	0.0	6.2	11.5	9.6	1.2	0.7	…	…	…	…	1.2	0.9	0.2	0.2
1993	7.1	2.3	0.7	4.1	8.1	6.3	1.7	0.1	…	…	…	…	4.0	0.9	0.2	2.8
1994	8.2	4.7	0.5	3.0	8.6	5.9	1.8	0.9	…	…	…	…	5.7	3.1	0.7	2.0
1995	15.7	12.1	0.0	3.6	8.9	6.1	2.0	0.8	…	…	…	…	9.1	4.5	1.2	3.3
1996	17.9	11.6	0.8	5.4	8.1	5.2	2.3	0.6	…	…	…	…	9.6	3.4	0.9	5.2
1997	20.7	8.3	1.0	11.3	17.4	8.7	4.0	4.7	13.2	3.3	4.6	5.2	5.0	2.4	0.0	2.7
1998	21.6	10.1	2.3	9.3	11.6	8.6	1.7	1.4	22.2	19.3	2.9	0.0	7.9	4.5	1.7	1.6
1999	16.2	8.1	0.0	8.1	14.3	6.1	3.1	5.2	…	…	…	…	7.9	4.5	1.2	2.2
	Medians															
1987	…	…	…	…	2.0	2.0	0.0	0.0	…	…	…	…	3.3	0.0	1.3	2.0
1988	3.0	0.0	0.5	2.5	2.3	2.0	0.0	0.0	…	…	…	…	0.8	0.0	0.8	0.0
1989	…	…	…	…	5.0	3.0	0.5	0.0	…	…	…	…	0.7	0.0	0.7	0.0
1990	2.7	0.0	0.7	2.0	9.0	5.0	1.3	0.0	…	…	…	…	1.1	0.0	1.1	0.0
1991	7.0	0.0	0.0	7.0	3.5	2.9	0.7	0.7	…	…	…	…	1.7	0.0	0.7	0.0
1992	5.0	0.0	0.0	5.0	8.8	6.5	0.6	0.3	…	…	…	…	0.7	0.3	0.0	0.0
1993	7.3	0.0	0.0	2.9	10.0	8.0	1.7	0.0	…	…	…	…	3.0	1.0	0.0	1.0
1994	8.1	4.7	0.0	1.3	8.0	4.7	1.7	0.5	…	…	…	…	5.8	2.7	0.0	0.3
1995	13.5	11.1	0.0	1.3	9.3	5.8	2.0	0.2	…	…	…	…	9.0	6.0	0.0	1.3
1996	16.3	11.0	0.0	2.6	7.3	4.7	2.7	0.3	…	…	…	…	10.5	2.8	0.0	2.8
1997	15.5	7.0	0.0	1.8	17.3	9.3	2.7	2.0	7.3	2.3	5.0	0.7	5.0	2.4	0.0	2.7
1998	20.4	9.3	1.2	7.5	8.7	5.0	1.6	0.7	22.2	19.3	2.9	0.0	8.3	4.2	0.0	1.8
1999	17.5	8.6	0.0	7.6	11.0	5.0	2.5	5.0	…	…	…	…	8.0	3.7	0.0	0.8

Source: International Monetary Fund, MONA database; and country papers.

1/ Covering programs with at least one of the following structural conditions: performance criteria, structural benchmarks, prior actions, or conditions for completion of review; adjusted for differences in program length.
2/ As defined in the World Economic Outlook, covering former centrally planned economies in Eastern Europe, FSU countries, and Mongolia.
3/ Countries with SAF/ESAF/PRGF-supported programs, excluding transition economies.
4/ Indonesia, Korea and Thailand.
5/ Residual group, stand-by and extended arrangements in non-transition countries.
6/ Including conditions for completion of review.

Table 7. Structural Conditions by Type of Program and Type of Condition, 1987–1999

(Conditions per program year 1/)

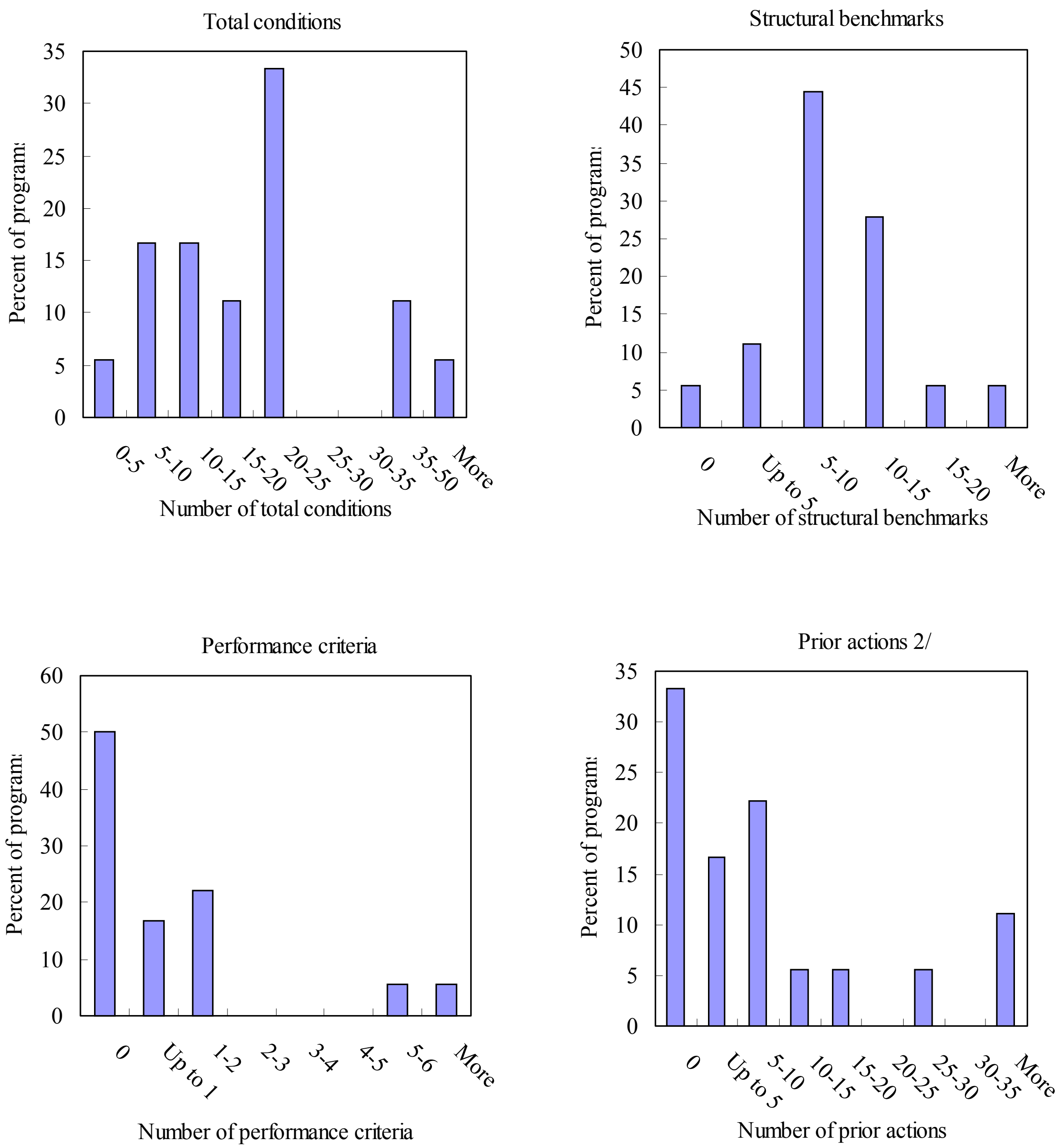
	Stand-by Arrangements				Extended Arrangements				SAF/ESAF/PRGF-Supported Arrangements			
	Total conditions	Structural benchmarks	Performance criteria	Prior actions 2/	Total conditions	Structural benchmarks	Performance criteria	Prior actions 2/	Total conditions	Structural benchmarks	Performance criteria	Prior actions 2/
							Averages					
1987	3.3	0.0	1.3	2.0	…	…	…	…	2.0	2.0	0.0	0.0
1988	1.9	0.0	0.6	1.3	…	…	…	…	3.5	2.9	0.6	0.0
1989	1.5	0.0	0.8	0.7	0.7	0.0	0.7	0.0	4.3	3.2	0.9	0.2
1990	1.9	0.0	0.9	1.0	…	…	…	…	9.2	6.1	1.2	1.9
1991	3.5	0.5	0.5	2.6	3.7	3.7	0.0	0.0	4.8	2.8	0.9	1.1
1992	5.3	0.0	0.1	5.2	1.4	1.2	0.0	0.2	11.5	9.6	1.2	0.7
1993	5.3	0.3	0.1	4.8	2.3	1.2	0.0	1.2	8.8	6.5	1.8	0.5
1994	6.5	3.8	0.6	2.1	4.5	0.0	0.2	4.3	8.9	6.3	1.8	0.8
1995	13.4	9.4	0.4	3.5	8.3	3.8	1.5	3.0	8.9	6.1	2.0	0.8
1996	10.5	6.6	0.6	3.3	16.3	7.3	0.0	9.1	12.4	7.9	2.4	2.0
1997	19.4	7.0	1.7	10.7	4.7	2.0	0.0	2.7	16.9	8.2	3.9	4.8
1998	9.6	5.4	1.8	2.3	24.1	12.1	2.9	9.1	12.7	8.7	1.6	2.5
1999	12.7	5.4	1.0	6.4	7.8	6.5	0.5	0.7	14.3	6.1	3.1	5.2
							Medians					
1987	3.3	0.0	1.3	2.0	…	…	…	…	2.0	2.0	0.0	0.0
1988	0.9	0.0	0.8	0.0	…	…	…	…	2.3	2.0	0.0	0.0
1989	1.3	0.0	0.7	0.0	0.7	0.0	0.7	0.0	5.0	3.0	0.5	0.0
1990	1.9	0.0	0.9	1.0	…	…	…	…	9.0	5.0	1.3	0.0
1991	2.0	0.0	0.0	1.3	3.7	3.7	0.0	0.0	3.5	2.9	0.7	0.7
1992	5.0	0.0	0.0	5.0	0.7	0.7	0.0	0.0	8.8	6.5	0.6	0.3
1993	3.0	0.0	0.0	2.7	2.3	1.2	0.0	1.2	10.0	8.0	1.7	0.0
1994	7.3	4.0	0.0	0.0	3.7	0.0	0.0	3.0	8.7	5.0	1.7	0.3
1995	12.0	6.7	0.0	1.3	8.3	3.8	1.5	3.0	9.3	5.8	2.0	0.2
1996	12.3	3.2	0.0	1.1	15.5	8.0	0.0	5.0	8.7	5.0	2.8	0.7
1997	10.8	6.7	0.0	0.0	4.7	2.0	0.0	2.7	17.3	7.0	2.7	3.7
1998	8.3	4.2	0.5	2.0	23.3	10.5	1.9	3.8	9.3	6.0	1.5	1.0
1999	9.3	5.0	0.0	3.0	8.2	5.7	0.0	0.5	11.0	5.0	2.5	5.0

Source: International Monetary Fund, MONA database; and country papers.

1/ Covering programs with at least one of the following structural conditions: performance criteria, structural benchmarks, prior actions, or conditions for completion of review; adjusted for differences in program length.

2/ Including conditions for completion of review.

Figure 10. Distribution of Structural Conditions by Type of Condition : Transition Economies 1/
(1997-1999)

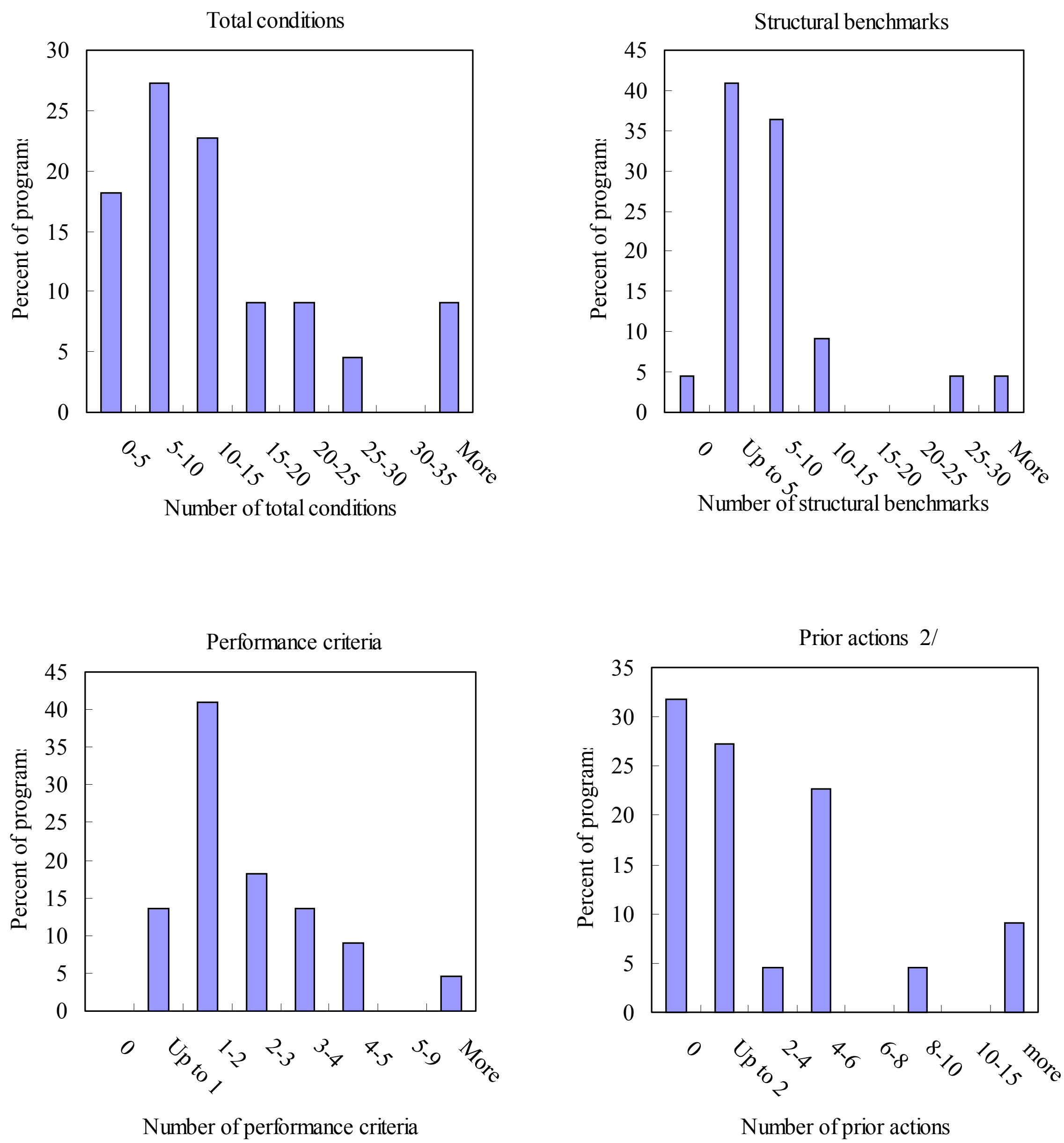


Source: International Monetary Fund, MONA database; and country papers.

1/ As defined in the World Economic Outlook, covering former centrally planned economies in Eastern Europe, FSU countries, a

2/ Including conditions for completion of review.

Figure 11. Distribution of Structural Conditions by Type of Condition : ESAF/PRGF Countries 1/
(1997-1999)

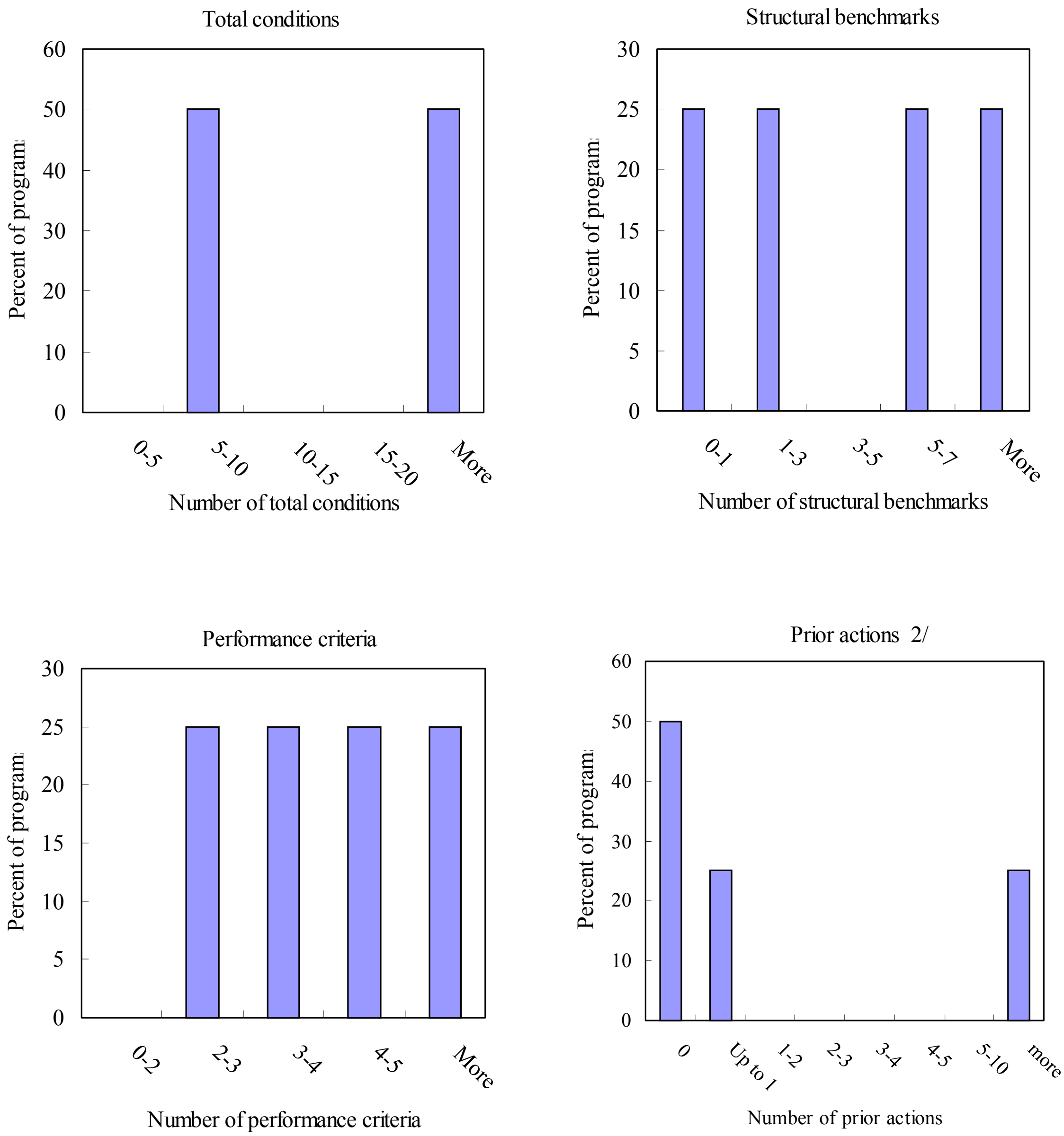


Source: International Monetary Fund, MONA database; and country papers.

1/ Countries with ESAF/PRGF-supported programs, excluding transition economies.

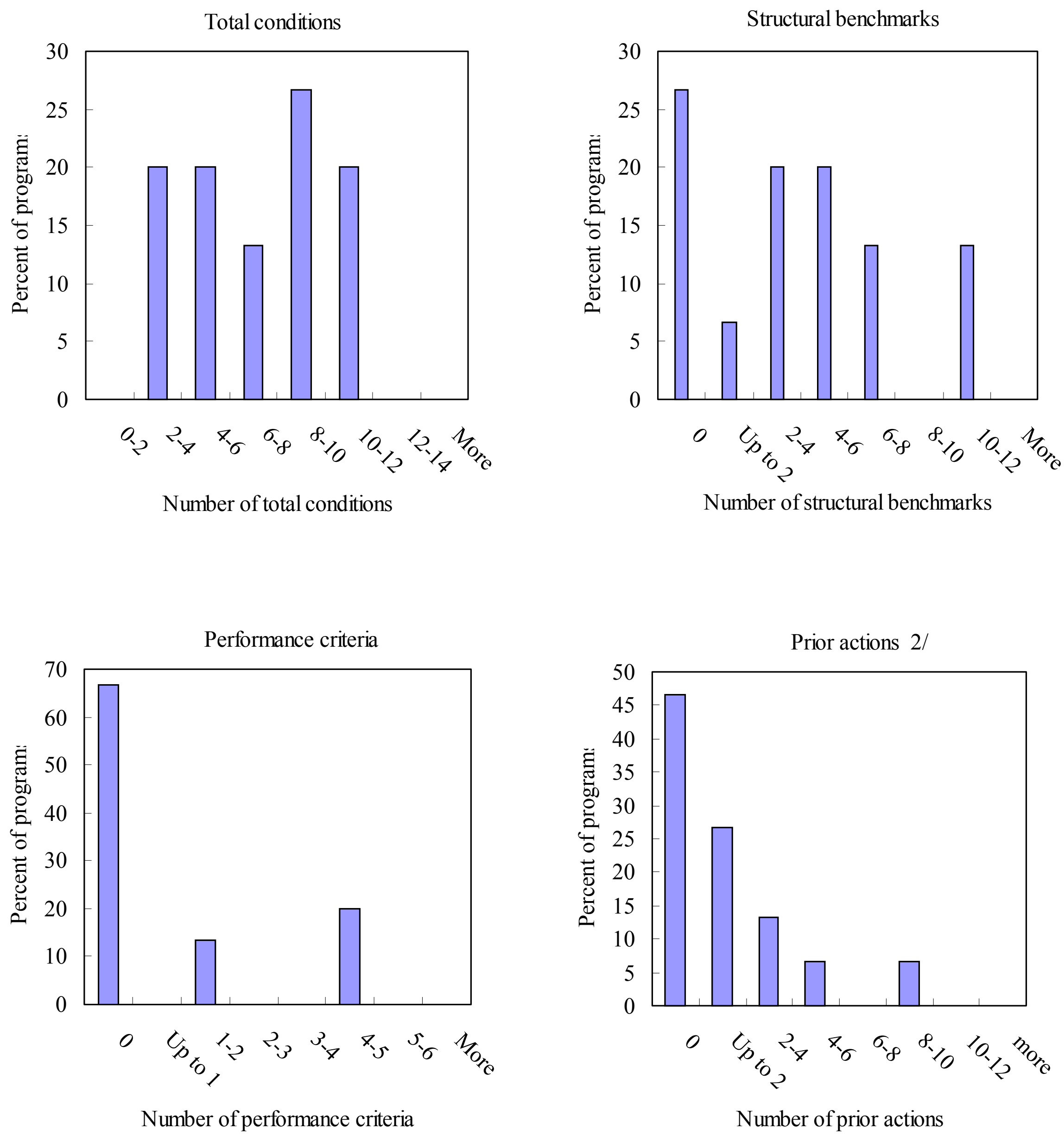
2/ Including conditions for completion of review.

Figure 12. Distribution of Structural Conditions by Type of Condition : Asian Crises Countries 1/
(1997-1999)



Source: International Monetary Fund, MONA database; and country papers.
1/ Covering the three stand-by arrangements with Indonesia, Korea and Thailand approved in 1997 and the extended arrangemen
with Indonesia approved in August 1998.
2/ Including conditions for completion of review.

Figure 13. Distribution of Structural Conditions by Type of Condition : Other Countries 1/
(1997-1999)



Source: International Monetary Fund, MONA database; and country papers.
1/ Residual group, stand-by and extended arrangements in non-transition countries.
2/ Including conditions for completion of review.

67. As noted in chapter II, among the different types of structural conditions, the increase in structural benchmarks has by far been the most pronounced. Moreover, in most country groups, the distribution of structural benchmarks appears to be somewhat more concentrated than the distributions of performance criteria and, in particular, prior actions, suggesting that the increase in the average number of structural benchmarks per program year may more closely reflect developments in average programs rather than developments in a few outliers. Judging by their numbers, benchmarks thus appear to have played a dominant role in monitoring structural reforms in many Fund-supported programs in recent years.

68. How does this expansion of structural benchmarks affect the extent of structural conditionality? Does the quadrupling of the average number of structural benchmarks per program year imply a larger increase in structural conditionality than the doubling of structural performance criteria? These questions are difficult to answer due to the ambiguous status of structural benchmarks. Since structural benchmarks are not directly linked to the continuation of disbursements but only indirectly through program reviews, their status depends on their role in these reviews. More specifically, it depends on how much they matter for the completion of reviews. Do all of them matter and how do they differ from other structural measures listed in letters of intent? Does the fact that failure to implement structural benchmarks quite often results in conversion into performance criteria or prior actions for the completion of a review affect their status? In order to assess the extent of structural conditionality and examine how it can be streamlined, these issues need to be clarified.

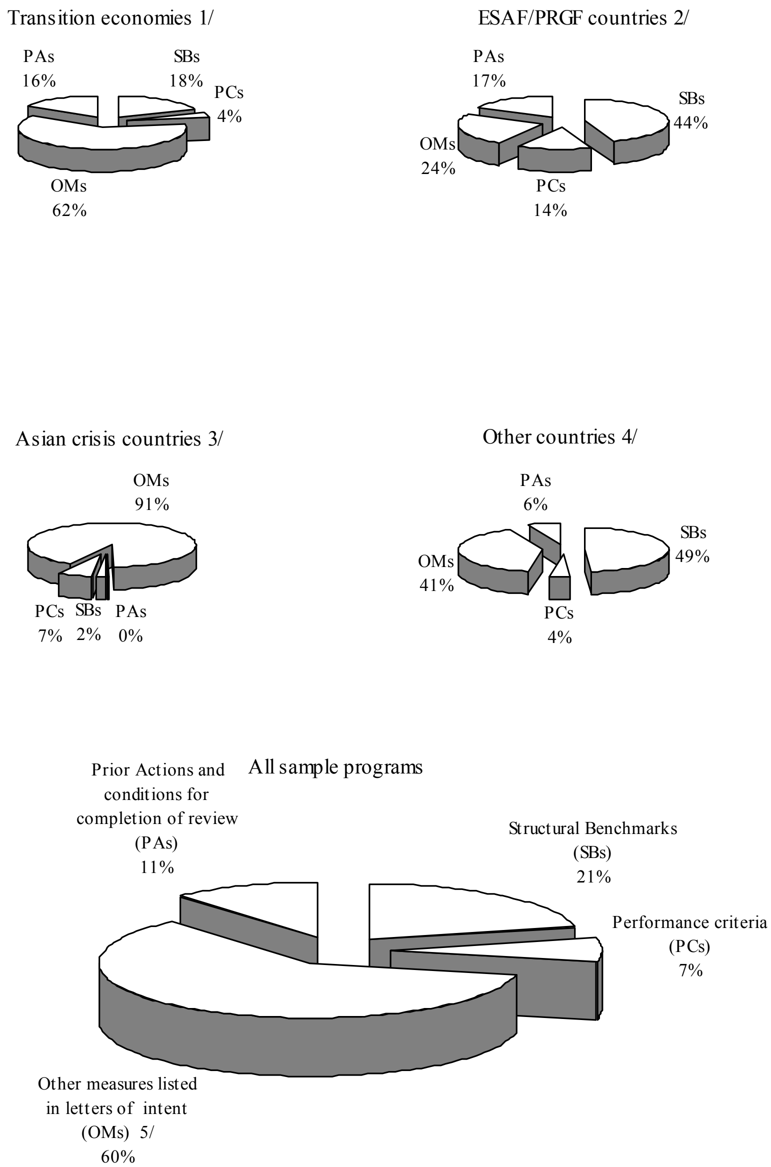
69. In addition to structural benchmarks, prior actions, and performance criteria, many programs have include more or less extensive lists of structural measures in their letters of intent. In a significant number of cases, notably in the Asian crisis countries and in the transition economies, these measures have been presented in the form of detailed policy matrices, frequently with specific implementation schedules.[63] In terms of presentation, if not in terms of formal status, these lists or matrices of structural measures have become quite similar to structural benchmarks and are frequently viewed—both inside and outside the Fund—as part of Fund conditionality, reinforcing the perception of a massive increase in structural conditionality.[64] Moreover, there appears to be a degree of substitutability between these matrices and structural benchmarks in practice: some programs, particularly in the Asian crisis countries, have included extensive policy matrices but relatively few explicit benchmarks while others, particularly ESAF/PRGF-supported arrangements, have tended to include more extensive lists of structural benchmarks covering most of the program's

[63] In more than half of the 13 stand-by and extended arrangements covered by the survey, detailed policy matrices were used to present the programs' structural reform agenda; in ESAF/PRGF-supported arrangements the broader policy agenda has traditionally been presented in the form of policy matrices.

[64] Goldstein (2000b), for example, discusses these matrices as part of Fund conditionality.

structural reform agenda, with fewer additional measures listed in the letter of intent (Figure 14).

Figure 14. Structural Measures by Type of Condition and Type of Country - Survey Sampl
(In percent of total structural measures)



Source: Survey of 24 Fund-supported programs; see Appendix II for a brief description of the survey, including a list of the sample countries.

1/ As defined in the World Economic Outlook, covering former centrally planned economies in Eastern Europe, FSU countries, and Mongolia.
2/ Countries with SAF/ESAF/PRGF-supported arrangement, excluding transition economies.
3/ Indonesia, Korea, and Thailand.
4/ Stand-by and EFF arrangments in non-transition economies.
5/ Covering all other structural measures listed in letters of intent, and the accompanying memoranda on economic and financial policies or policy matrices.

70. However, while structural benchmarks are typically confined to measures that are relevant for a program's macroeconomic objectives, governments may, and frequently do, outline in letters of intent their broader policy agenda—including reforms agreed with other institutions such as the World Bank, regional development banks or bilateral donors—to reaffirm their commitment to this agenda before domestic and international audiences. Hence, some of the measures listed in letters of intent and the accompanying memoranda and policy matrices may not be relevant for a program's macroeconomic objectives and may have no bearing on the assessment of progress during program reviews. Questions about the status of specific measures in the context of program monitoring and the boundaries of conditionality thus apply, a fortiori, to these lists or matrices of structural measures included in letters of intent.

71. The variation in the number of structural conditions across programs—at the level of both total conditions and specific types of conditions—goes well beyond what can be explained by the variation in the breadth of these programs' structural reform agendas and suggests considerable differences in the detail of program monitoring. Moreover, simple bi-variate regressions of the number of structural conditions on the number of sectors with structural conditionality indicate that the share of the variation in structural conditions explained by variations in the breadth of structural conditionality has declined over time.[65] Monitoring practices appear to have become more diverse and, at least for a substantial number of programs, more detailed. Thus, the increase in the average number of structural conditions per program year may also reflect a trend towards greater detail in program monitoring.

72. The 1995-98 ESAF-supported program with Mauritania exemplifies this trend (Box 12). Under the three annual arrangements of this program, the process of introducing and operationalizing a value added tax was monitored through 19 structural conditions, mostly structural benchmarks and prior actions. In Mauritania, as in many other countries, such detail was introduced to enhance the specificity of program monitoring and help the authorities plan and execute implementation. However, detailed monitoring clearly involved considerable micro-management of the reform process and limited the flexibility of the authorities.

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[65] Whereas in 1987–93, close to two thirds of the variation in the total number of structural conditions per program year were explained by variations in the breadth of programs' structural agenda (number of sectors with structural conditions), in 1994–99 variations in the scope of structural conditionality accounted for just 40 percent of the variation in structural conditions. In the case of structural benchmarks, the corresponding share declined from 45 percent in 1987–93 to less than one fifth in 1994–99.

Box 12. Monitoring the Introduction of a VAT in Mauritania

In Mauritania the introduction of a value added tax (VAT) was one of the pillars of the 1995-98 ESAF-supported program.1/ The process of making the VAT operational was monitored through a series of detailed steps, most of which were prior actions or structural benchmarks. In addition, the letter of intent for the second annual arrangement contained a list of, and timetable for, 23 specific actions for strengthening the tax administration and the operation of VAT (EBS/96/60); the status of these measures was discussed in the subsequent letter of intent (EBS/96/171).

VAT-Related Structural Conditions During the 1995-98 ESAF Arrangement

Measure	Condition	Arrangement
1. Introduction of VAT	SB	First
2. Request IMF technical assistance to evaluate the implementation and administration of VAT	PA	First, midterm review
3. Provide information on VAT to the 50 largest taxpayers through individual visit	PA	Second
4. Start refunds of VAT credits and establish procedures and choose the forms needed for the refunds	PA	Second
5. Establish a monthly statement of VAT data (assessment, collection, arrears, and credits) and provide monthly to the IMF	PA	Second
6. Harmonize the taxpayer identification codes	SB	Second
7. Shorten the procedures for pursuit of delinquent taxpayers	SB	Second
8. Adopt an investment tax credit system	SB	Second
9. Communication of definitive VAT statements for January-August 1996	PA	Second, midterm review
10. Regular communication of monthly VAT data to the IMF	PA	Third
11. Appointment of the VAT audit team	PA	Third
12. Approval of an annual program of targeted VAT audits and specification of monthly audits	PA	Third
13. Establishment of a list of VAT arrears to be written off	PA	Third
14. Establishment of a monthly schedule for collection of recoverable VAT arrears	PA	Third
15. Initiate drafting of legislation on the transfer of collection function to the General Directorate of Taxation	SB	Third
16. Produce final version of legislation on the transfer of collection function to the General Directorate of Taxation for incorporation in the Budget Law	PC	Third
17. Collection of amounts from the first VAT audits	SB	Third
18. Strict implementation of the schedule for monthly collection of recoverable arrears	SB	Third
19. Regular reporting to the IMF of monthly VAT data, including the results of on-site audits and collections based on these results	SB	Third, midterm review

Notes: Structural benchmarks, prior actions, and performance criteria are abbreviated as SB, PA, and PC, respectively.

1/ Submitting the VAT legislation to the parliament was a prior action in 1993 under the previous ESAF arrangement.

73. An alternative to focusing on individual steps is to formulate structural reforms in terms of more broadly defined intermediate objectives. In the above example, the program could have stipulated: "introduce and operationalize a VAT." This approach leaves considerable room for the government to design and implement the steps of the reform process as it sees fit, but it provides little guidance if technical expertise is lacking. Moreover, it entails less clearly defined assurances if progress is being assessed in the context of program reviews or, if monitoring focuses entirely on the outcome rather than the process, it may imply considerable back-loading of conditionality and, possibly, financing.

74. Faced with the trade-off between specific guidance and assurances on the one hand and flexibility on the other, many programs appear to have opted for specificity and, as a result, considerable detail, particularly in countries with a weak implementation record. This raises the question whether some of the objectives of detailed program monitoring, notably the objective of providing guidance on implementation, cannot be achieved outside the framework of formal conditionality.

75. Detailed program monitoring also raises questions about the use of performance criteria and prior actions, because it may—and frequently does—imply applying such conditions to measures that may be clearly defined but not critical in and of themselves, constituting only one of many steps in the reform process.[66] This may be warranted when there is a clear sequencing of steps implying that failure to implement one of them within a given timeframe will delay or derail the remainder of the process, as, for example, in the case of the different stages of bank restructuring or the privatization of large enterprises. Applying performance criteria or prior actions to small steps may, however, be a different matter when these steps—say the sale of five specific state farms—are viewed as an indication of the government's resolve to tackle a broader issue—reform in the agricultural sector—which is not clearly defined and objectively verifiable. In this case, the sale of the farms may be held up for specific reasons, which may say little about the authorities' efforts to address the broader issue.

76. Finally, the variation in monitoring practices across programs raises questions about uniformity of treatment. To some extent, this variation clearly reflects differences in country-specific circumstances. Flexibility, the ability to adapt monitoring techniques to the particular conditions of a country, has always been regarded as a desirable feature of a monitoring framework; however, equally important has been the objective of ensuring uniform treatment among members.

[66] The survey of 24 recent programs discussed in the previous chapter suggests that this is an issue. According to the assessments provided by area department staff, only half of the performance criteria and prior actions in these programs related to structural measures that were both clearly defined and important in and of themselves.

V. Implementation of Structural Reforms

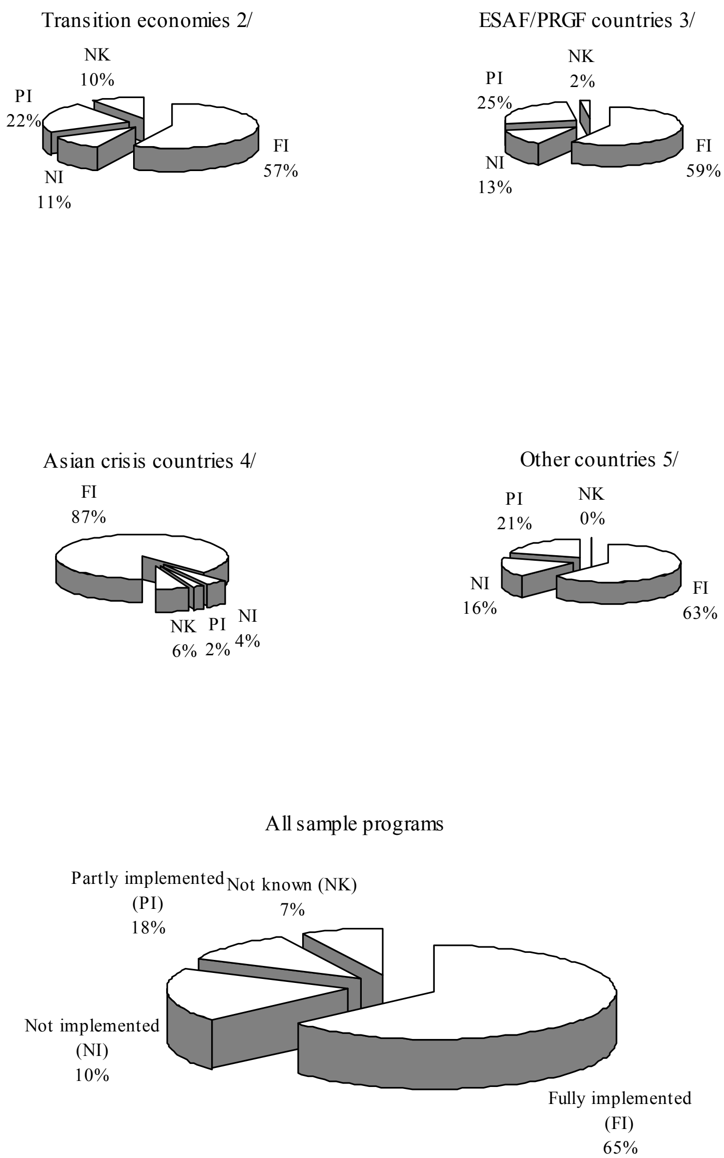
77. The increase in the extent of structural conditionality discussed in the preceding chapters raises questions about the record of implementation, which are addressed in this chapter. In addition to discussing implementation rates—their variation across types of conditions, groups of countries, and economic sectors—the chapter examines the relationship between the extent of conditionality and program implementation. Specifically, does more extensive structural conditionality create synergies and thus improve implementation *rates* or does it undermine implementation by stretching political and administrative implementation capacities? Or is the relationship between the extent of structural conditionality and the implementation of structural reforms more complex than either of these two extreme hypotheses suggest?

78. In general, judging by the assessments provided by area departments in the context of the survey, policy implementation in the structural area does not appear to be as good as in the macroeconomic area. Implementation in the structural area was viewed as equally good as, or better than, in the macroeconomic area in only one fifth of the programs. Using the broadest possible definition of structural measures under the programs—performance criteria, prior actions, benchmarks as well as other measures listed in letters of intent—some two thirds of the measures in the programs covered by the survey appear to have been fully implemented, with the remainder either not implemented at all (10 percent), or only partly (18 percent), or with unknown implementation status (7 percent). Of the measures classified as "fully implemented," a substantial number appears to have been implemented with considerable delay, with benchmarks carried over from one monitoring period to the next or changed into prior actions for the next review.

79. The average implementation rate is the lowest in the transition countries and in the non-transition countries with ESAF/PRGF-supported arrangements. By contrast, in the Asian crisis countries, nearly 90 percent of the structural measures included in these programs were reported as implemented, even though a number of them also with considerable delays (Figure 15).

80. Implementation rates in the survey countries vary across different types of conditions (Figure 16). They appear to be relatively high for prior actions, with over 80 percent of all measures fully implemented, but they are considerably lower for performance criteria (66 percent). Implementation rates are the lowest for structural benchmarks (57 percent fully implemented)—lower than for other measures listed in the letter of intent (63 percent). Average implementation rates are somewhat lower for the larger set of programs covered by the MONA database than for the programs covered by the survey, but the pattern of differences across types of conditions is similar, with 69 percent of the prior actions, 58 percent of the performance criteria, and 56 percent of the structural benchmarks fully implemented.

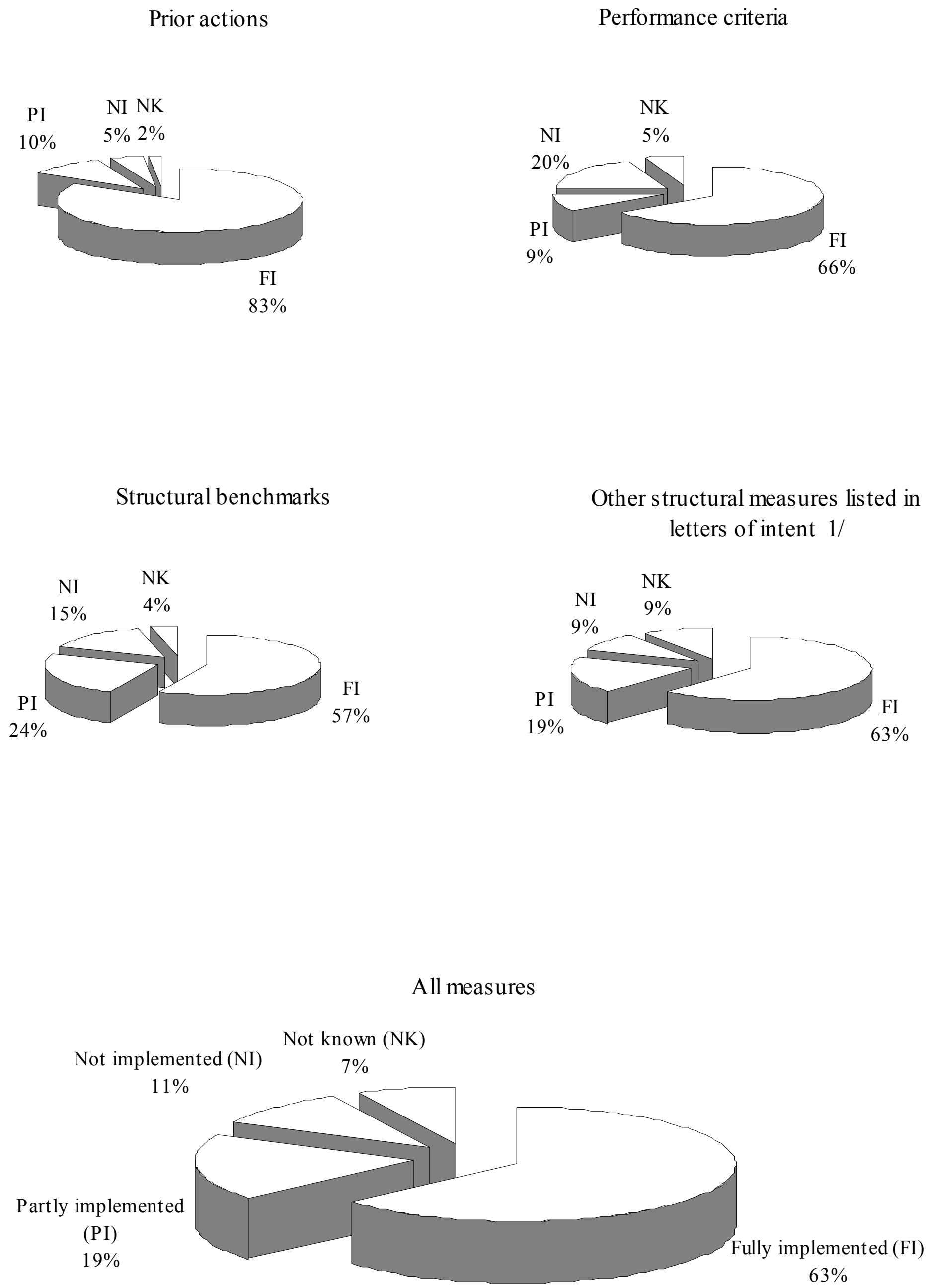
Figure 15. Implementation of Structural Measures by Type of Country - Survey Sample
(In percent of total structural measures) 1/



Source: Survey of 24 Fund-supported programs; see Appendix II for a brief description of the survey; including a list of the sample countries; and Appendix I for definition of the sector classification.

1/ Covering all structural measures listed in letters of intent, and the accompanying memoranda on economic and financial policies or policy matrices.
2/ As defined in the World Economic Outlook, covering former centrally planned economies in Eastern Europe, FSU countries, and Mongolia.
3/ Countries with SAF/ESAF/PRGF-supported arrangements, excluding transition economies.
4/ Indonesia, Korea, and Thailand.
5/ Stand-by and extended arrangements in non-transition economies.

Figure 16. Implementation of Structural Measures by Type of Condition - Survey Sample
(In percent of total structural measures)



Source: Survey of 24 recent Fund-supported programs; see Appendix II for a brief description of the survey and Appendix I for definition of the sector classification.

1/ Covering all other structural measures listed in letters of intent, and the accompanying memoranda on economic and financial policies or policy matrices.

81. Implementation rates differ also across economic sectors (Table 8). Implementation appears to have been particularly strong in the area of social safety net improvements, financial sector reform, trade and capital account liberalization, and “systemic” reforms (institutional and regulatory reforms as well as corporate restructuring); it has been quite low in the area of privatization and for reforms related to pricing and marketing arrangements. Among the main factors hampering implementation, limited implementation capacity and political or social opposition appear to have been almost equally significant, although their relative importance varies considerably across economic sectors.

82. In what way is policy implementation related to the extent of conditionality? According to one extreme view, the “synergy” view, extensive conditionality fosters implementation by creating a critical mass that facilitates progress in related areas and helps rally support for the reforms as they begin to show tangible effects. The opposite view holds that extensive conditionality hampers implementation by weakening ownership and stretching a country’s political and administrative implementation capacity. According to this view, extending conditionality beyond a certain point will create a backlash and lead to declining implementation rates. By contrast, the synergy view suggests that implementation rates will increase as conditionality is expanded.

83. The experience with structural conditionality in Fund-supported programs in the past decade appears to support neither of these two extreme views. Simple bi-variate regressions of the number of fully implemented conditions on the total number of conditions indicate a fairly linear relationship for total conditions as well as for different types of conditions (performance criteria, prior actions and benchmarks) (Figure 17).[67] The quadratic terms in these equations, which should be positive according to the synergy hypothesis and negative according to the backlash hypothesis, are positive, but very small and significant in only two cases. This implies that implementation *rates*, the shares of measures implemented, are essentially constant—albeit far from one—and do not increase (at least not perceptibly) or decrease as the number of conditions rises. The relationship between the number of measures implemented and the total number of conditions is, however, far from perfect; there is considerable residual variation, particularly for performance criteria. Implementation *rates* vary widely, but they are essentially uncorrelated with the extent of conditionality.[68]

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[67] For simplicity, the equations were estimated without a constant term rather than an explicit constraint forcing the constant term to be smaller than, or equal to, zero. Unconstrained estimations yielded positive (but insignificant) constant terms; the estimated coefficients for the other variables were broadly similar for the two sets of estimations.

[68] Correlation coefficients for the number of conditions (total conditions as well as specific types of conditions) and implementation *rates* (shares of measures implemented) are generally close to zero and statistically not significant.

Table 8. Implementation of Structural Measures by Economic Sector - Survey Sample
(In percent of total structural measures) 1/

	Implementation			
	Fully Implemented	Partly Implemented	Not Implemented	Not Known
Economic sector				
Exchange system	66.7	28.6	4.8	0.0
Trade regime	72.3	8.5	13.1	6.2
Capital account	78.8	9.1	0.0	12.1
Pricing and marketing	44.3	25.7	22.9	7.1
Public enterprises, reform and restructuring	56.6	19.3	6.9	17.2
Privatization	44.9	22.7	22.7	9.7
Fiscal sector	57.3	24.9	9.2	8.7
Social security system	55.8	25.6	16.3	2.3
Social safety net	83.0	14.9	2.1	0.0
Financial sector	79.7	9.9	7.7	2.7
Agricultural sector	64.8	22.0	9.9	3.3
Labor market	66.7	8.3	25.0	0.0
Economic statistics	60.9	21.9	10.9	6.3
Systemic reforms	71.3	13.4	6.3	9.0
All sectors	63.5	18.6	10.7	7.2

	Reason for Non-Implementation		
	Limited Implementation Capacity	Political and Social Opposition	Not Known
Economic sector			
Exchange system	0.0	100.0	0.0
Trade regime	17.9	75.0	7.1
Capital account	66.7	33.3	0.0
Pricing and marketing	14.7	76.5	8.8
Public enterprises, reform and restructuring	26.8	63.4	9.8
Privatization	50.5	44.6	5.0
Fiscal sector	59.4	32.9	7.7
Social security system	47.2	47.2	5.6
Social safety net	37.5	62.5	0.0
Financial sector	53.5	32.5	14.0
Agricultural sector	55.2	44.8	0.0
Labor market	0.0	100.0	0.0
Economic statistics	90.5	9.5	0.0
Systemic reforms	56.5	33.3	10.1
Weighted average of all sectors 2/	50.1	42.0	7.8

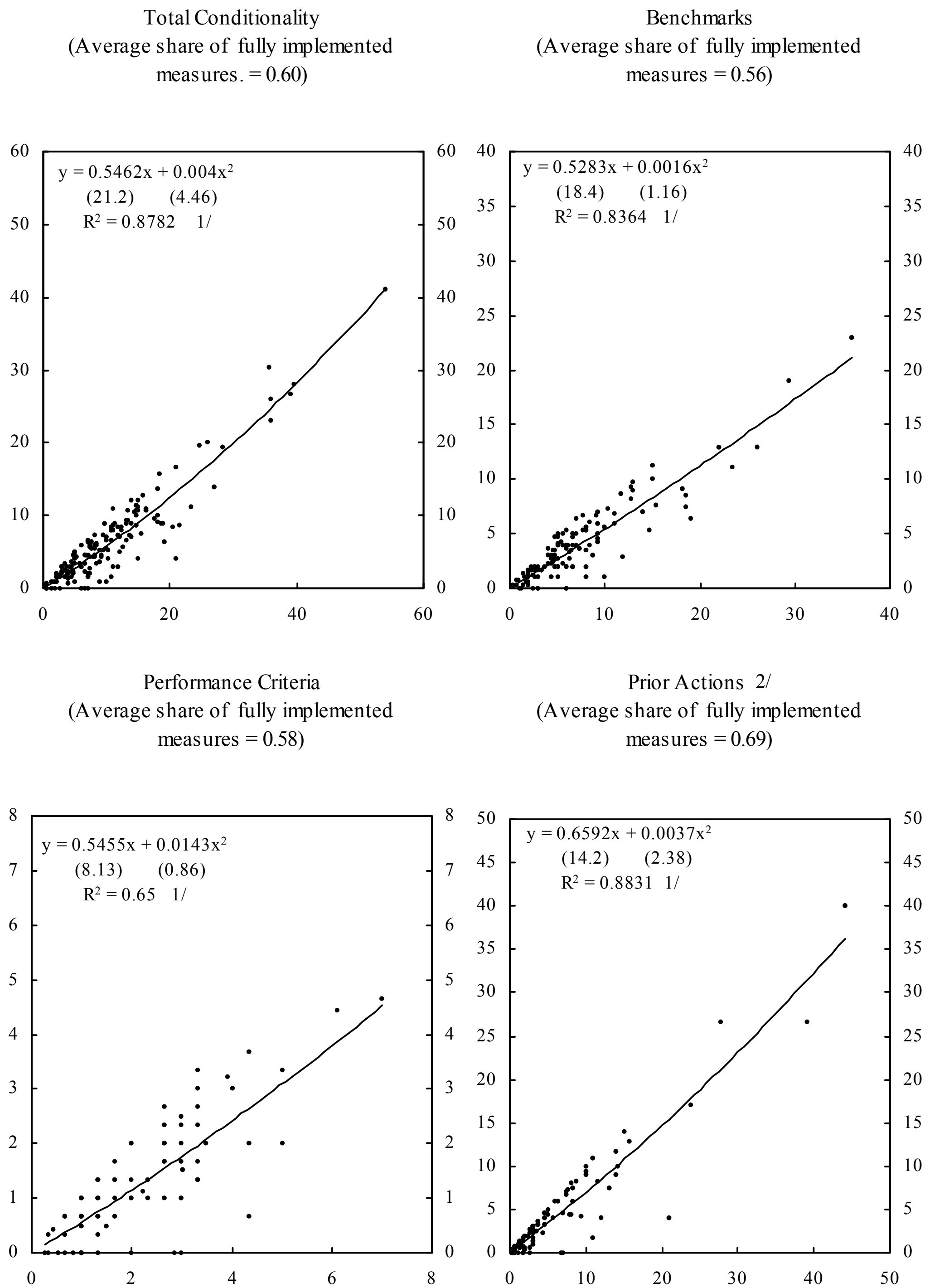
Source: Survey of 24 Fund-supported programs; see Appendix II for a brief description of the survey and Appendix I for definition of the sector classification.

1/ Covering all structural measures listed in letters of intent, and the accompanying memoranda on economic and financial policies or policy matrices for the countries covered by the survey

2/ Weighted by share of each sector in total structural measures.

Figure 17. Structural Conditionality and Implementation

(Number of fully implemented measures vs. total number of measures)



Source: International Monetary Fund, MONA database.

1/ Regression of number of fully implemented measures (y) on total number of measures (x) and total number of measures squared (x^2); t-statistics in parentheses.

2/ Including conditions for completion of review.

84. These results suggest that the relationship between structural conditionality and policy implementation is more complex than either the extreme synergy view or the extreme backlash hypothesis would suggest. This is not to say that the effects described by these two hypotheses do not exist in practice. In some countries, synergy effects may be at work while in others extensive conditionality may indeed create a backlash or at least involve some diminishing returns. In yet another group of countries, the implementation rate may be constant, and increasing the number of conditions may simply mean that a correspondingly larger number, albeit not all, get implemented. This would explain why it is difficult to detect a relationship between the *rate* of implementation and the extent of structural conditionality. On average, this rate is constant, with individual country experiences varying considerably around this average rate.

85. The four country examples described in Boxes 13 through 16 illustrate how the relationship between conditionality and policy implementation can vary substantially. Bulgaria's stand-by arrangement of 1997, and the extended arrangement that followed in 1998, are prime examples of programs with an extensive structural content (Box 13). The structural agenda for the three-year extended arrangement was outlined in a detailed policy matrix listing some 400 measures, including 40 structural benchmarks, 20 prior actions, and 31 performance criteria. The extensive scope of this policy program reflected Bulgaria's late start in the transition process and the government's intention to close aggressively the reform gap that had emerged as a result; EU accession requirements provided an additional incentive to press ahead with structural reforms. Given a strong core of commitment from the start, conditionality appears to have helped coordinate policies and monitor progress; in the process, it helped facilitate implementation and broaden ownership.

86. Structural conditionality has also been extensive in Ukraine, but the results have been very different (Box 14). Notwithstanding efforts to agree on the country's reform priorities in a broad, transparent process including the authorities, Bank and Fund staff, and foreign advisors to the government, commitment to reforms among the country's leadership—in parliament as well as government—was weak. In these circumstances, structural conditions, in particular prior actions, expanded significantly, in part to compensate for the lack of commitment but also to assist the authorities in implementing a broad-based reform program. The extended arrangement approved in 1998 contained 20 prior actions per program year, the largest number among all programs included in the survey. However, while reliance on numerous prior actions ensured that some measures got done, it did not ensure a high overall rate of implementation. Less than two thirds of the total number of performance criteria, prior actions and structural benchmarks and just over 40 percent of the other structural measures listed in the letter of intent have been implemented.

Box 13. Bulgaria

Following a clear break from past policies in mid-1997, Bulgaria has made major progress in macroeconomic stabilization and structural reform. The country's early transition was marked by weak and inconsistent stabilization policies and a slow pace of structural reform. Macroeconomic mismanagement and poor financial discipline culminated in a severe banking and foreign exchange crisis in 1996–97. Economic policy changed course in mid-1997 with a program based on a currency board regime, a prudent fiscal policy, and extensive structural reform. As a result, Bulgaria achieved a remarkable economic turnaround, as inflation stabilized in the low single-digit levels and positive output growth resumed. Sound economic policies helped the country to emerge relatively unscathed from the crises in emerging markets and the conflict in neighboring FR Yugoslavia. A solid rebound in activity has been underway since the second half of 1999, helped by improvements in the external environment.

The pronounced improvement in Bulgaria's economic performance over the past three years owes much to the heavy emphasis on structural reform in the government's adjustment programs and to these programs' strong implementation record. Under a stand-by arrangement approved in April 1997, Bulgaria introduced a range of structural measures aimed at underpinning the post-crisis stabilization efforts and strengthening the credibility of the currency board arrangement. These measures covered four main areas: (i) banking sector reform through privatization and improvements in the legal and regulatory framework and supervision; (ii) restructuring of state-owned enterprises through privatization, liquidation, and isolation from bank credit; (iii) removal of price controls and adjustments toward market levels in prices that remained administered; and (iv) further trade and exchange system liberalization. Under a three-year extended arrangement approved in September 1998, the authorities widened and deepened the structural reform agenda, with the objective of laying the foundation for a competitive market economy and robust economic growth. In addition to the areas already covered by the 1997 program, fiscal reforms and actions to address inefficiencies in the energy and agriculture sectors were emphasized.

To support the implementation of the extensive structural reform agenda, the medium-term program spelled out the measures in great detail. Overall, the structural reform matrix attached to the medium-term program listed almost 400 measures over the course of the program. The majority of these measures were not subject to conditionality in the strict sense (prior actions, or structural performance criteria or benchmarks) but were slated to be monitored as part of general program reviews. In each area, the matrix highlighted not only the key objectives and strategies, but also included steps leading to the achievement of the objectives.

For several reasons, the strong structural content of Bulgaria's adjustment program and the detailed nature of the measures have proved beneficial. An emphasis on structural reform was warranted in view of the need to establish a market-based economy and the large reform gap that had emerged as a result of the limited and inconsistent reform efforts in the past.

Broad structural conditionality, and measures to strengthen financial discipline in the enterprise and banking sectors in particular, was also indispensable to ensure the credibility and sustainability of the new currency board arrangement. The need to meet structural requirements along the road to EU accession in many cases provided an additional rationale.

The extensive and detailed structural conditionality was also instrumental in achieving a strong implementation record. This conditionality helped the Bulgarian authorities to commit to the program and coordinate policies internally, and it established domestic ownership by an initially small, but growing group, of reformers. It also assisted IMF staff in monitoring progress under the program and verifying compliance in the context of formal reviews, and facilitated coordination with the World Bank. Reflecting the efforts by the Bulgarian authorities and the intensive monitoring, the program has remained on track and purchases made as scheduled. Structural performance criteria and benchmarks were met in most cases, and when waivers had to be requested, this often reflected the very ambitious goals and timetables rather than a lack of commitment or effort on behalf of the authorities. Measures other than performance criteria and benchmarks were also adopted broadly as envisaged, albeit with occasional delays. For all structural measures combined, three out of four have been implemented fully, and most other measures have either already been adopted in part or they are scheduled to be implemented during the remainder of the program.

Box 14. Ukraine

Background. In the early 1990s, with the breakdown of the central planning system and the disruption of crucial supply links within the USSR, Ukraine's economic output declined sharply. At the same time, fuelled by large, monetized fiscal deficits, inflation accelerated, reaching hyperinflationary levels by 1994. In addition, the move towards world market prices for energy within the former Soviet Union entailed a large terms of trade shock. With foreign exchange rationed and external arrears mounting, the country was facing a balance of payments crisis.

The 1994 Systemic Transformation Facility purchase and the 1995 and 1996 Stand-by arrangements. Against this backdrop, the initial programs focused primarily on macroeconomic stabilization; structural measures mainly sought to underpin stabilization efforts and regularize external arrears. They focused on trade and exchange market liberalization, price liberalization and dismantling of the system of state orders. Preliminary steps towards mass privatization, land reform, banking sector reform and the strengthening of bank regulation were also envisaged. Social benefits were to be rationalized, but social assistance for the most vulnerable groups was to be increased and better targeted. Nearly all structural measures under the STF were prior actions for the program, and most were implemented successfully.

The 1994 STF-supported arrangement did not include the removal of the export ban on grain. While the staff viewed this measures as critical to increasing agricultural incomes and weaning the agricultural sector from subsidized credits (which was a major source of monetary expansion), the authorities expressed concern about the reaction of the public. Recognizing the potential sensitivity of the matter, the staff agreed that this measure be postponed till the stand-by arrangement the following year.

The program supported by the 1995 stand-by arrangement sought to strengthen the areas of structural reform targeted under the STF. However, by the time of the second review, several of the structural measures were lagging. The 1996 stand-by was intended to consolidate the macroeconomic stabilization gains and to continue the structural reform agenda along the lines established in the earlier arrangements.

The 1996 Country Strategy Paper and the 1997 stand-by. The 1996 stand-by was partly a holding operation while a broader structural transformation agenda was being developed and articulated in a wider participatory process. A conference was held in Washington in July 1996 that brought together Ukrainian officials, Fund and Bank staff, representatives from bilateral and multilateral organizations, academics, and foreign advisors to the Ukrainian government. The process culminated in a comprehensive Country Strategy Paper (CSP).

The CSP identified four major pillars of Ukraine's medium term strategy: (i) a suitable framework for macroeconomic policy (including fiscal transparency, reforms of the budgetary process, and independence of the central bank); (ii) a social safety net to protect the most vulnerable groups of the population; (iii) private sector development; (iv) institution building and enhancement of the government's administrative capacity. The measures identified in the CSP were to form the basis for discussions on an extended arrangement to begin upon completion of the 1997 stand-by arrangement

Program discussions for the extended arrangement envisaged wide-ranging structural measures: some 100 in the first year, of which 20 would be prior actions. In the event, it proved impossible to come to agreement on an EFF-supported program at that time. While about half of the prior actions were met, there was considerable back-sliding on other structural reforms, especially in the energy and agriculture sectors. As an interim solution, an agreement on a one-year stand-by with relatively modest structural conditionality was reached.

The 1998 Extended Arrangement. The 1998 extended arrangement covered most of the structural agenda identified in the Country Strategy Paper. These included, inter alia, fiscal reforms and reform of the social welfare system, approval of a new central bank law and banking sector reforms, deregulation of the private sector, completion of the voucher privatization program and corporatization/privatization of state enterprises; changes in the legal code, particularly related to bankruptcy procedures, demonopolization of the economy (including bread distribution), liberalization of the agricultural sector, and restructuring of the coal mining sector. In total, the broad policy matrix contained 88 measures, of which 30 were prior actions and 10 were structural benchmarks.

Assessment. The Ukraine experience brings out a number of dilemmas and trade-offs in setting structural conditionality. Commitment to reform has often been mixed, with delays, slippages and reversals, and not infrequent opposition by Parliament. Moreover, on a number of occasions the letter of the policy understandings was adhered to, but not their spirit. Nevertheless, the Fund continued its engagement with Ukraine to signal its support for structural reforms, strengthen the hand of reformers, and push for reforms even when ownership was weak—assuming that ownership would follow once the benefits of the reforms became apparent—and, ultimately, to ensure that the structural reform agenda advance as comprehensively as possible under the circumstances, even if imperfectly.

87. When commitment to reform is lacking, extensive conditionality may do little to improve the general implementation record. But limiting conditionality to a few essential steps may not necessarily yield better results. In Zambia, following years of inadequate program implementation, the strategy was to focus conditionality on a selected number of critical structural reforms (Box 15). The ESAF arrangement approved in 1999 thus had a relatively limited structural reform agenda, centered on the privatization of a few key loss-making public enterprises. All measures were subject to formal conditions, mainly performance criteria and structural benchmarks. The initial results were, nevertheless, less than promising. The first review was delayed by one year, as all structural performance criteria (together with most quantitative performance criteria) were missed.

88. The three-year stand-by arrangement with Brazil (Box 16) approved in late 1998 also covered a relatively limited number of structural reforms, but it provides a clear contrast to the experience in Zambia. The program's structural agenda focused primarily on the fiscal area—the main source of Brazil's vulnerability. These reforms were considered essential to underpin fiscal adjustment and restore market confidence; their importance was underscored by adverse market reactions to events at the beginning of the program threatening to undermine fiscal adjustment. Against this background, ownership was based on a clear understanding of the importance of these reforms for the success of the program; despite some setbacks due to legal and political challenges, considerable progress was made with implementation. Conditionality mainly served to underscore the authorities' commitment.

Box 15. Zambia

Zambia is endowed with considerable natural resources, but these have failed to improve living standards because of price fluctuations in the world markets combined with poor macroeconomic management. In fact, in 1998, Zambia's per capita GDP of US$370 was lower than in 1961 when the country gained independence. Zambia has been implementing reform programs since the late 1970s, supported by six stand-by arrangements, one extended arrangement, one SAF, and two ESAF arrangements. In general, program implementation was inadequate—the last two stand-by arrangements as well as the extended arrangement were cancelled prior to the expiration date, and the first ESAF, approved in December 1995, completed only the first annual arrangement. In the late 1990s, it became evident that Zambia's debt servicing burden was unsustainable and a Fund program qualifying Zambia for assistance under the HIPC was essential.

Against this background, an ESAF arrangement was approved in March 1999. 1/ The policy agenda of the this program was decidedly minimalist in order to allow the authorities to focus on a few major structural issues and establish a track record in macroeconomic management. The structural component of the program was designed to address the key weaknesses in the economy, in particular the rot of the state-owned copper mines (ZCCM). 2/ At its peak in the mid 1970s, the ZCCM produced more than 700,000 metric tons of copper and contributed some 40 percent of government revenue. By the late 1990s, output had declined to 300,000 metric tons, physical capital was decayed after years of neglect, and the company had accumulated short-term debts and arrears that were then estimated at US$400 million 12 percent of GDP. In early 1999, after years of indecision and on-off negotiations with various foreign investors, the government reached an understanding with the Anglo-American Corporation of South Africa regarding the sale of 80 percent of a new company that was broken away from the ZCCM. In view of past delays in getting the matter resolved, the program sought to ensure the completion of the deal, with a performance criterion stipulating the transfer of ownership of the asset package.

The structural program also addressed inefficiencies in the operations of the state-owned telecommunication company (ZAMTEL), which seriously undermined the provision of telecommunication services, and the petroleum distribution company (ZNOC), which was incurring significant losses. ZAMTEL was to offer for sale a minority shareholding and management rights, while ZNOC was to be either offered for sale or closed. In addition, the program aimed at streamlining Treasury operations, establishing sound civil service pension system, and improving banking supervision. The original program contained three prior actions (two regarding privatization, one regarding civil service reform), four performance criteria (two focused on the privatization of the copper mines, one on the privatization of the telecommunications company, and one in the tax area), and one structural benchmark (linking the treasury bill rate to the consumer price index).

In the event, the first review of the ESAF arrangement was delayed by a year, owing to the nonobservance of all four structural performance criteria and most quantitative performance criteria. However, in mid-2000, the program was resumed and presently appears to be on track.

1/ The Board presentation of the arrangement, which began formally in January 1999, was repeatedly postponed because of delays in the implementation of prior actions.

2/ International copper prices declined steadily after 1981. Instead of initiating cost cutting measures, the ZCCM management engaged in asset stripping. Repeated bailouts of the company have derailed more than one decade of fiscal stabilization efforts. The external ESAF evaluation (EBAP/98/8) identified the delays in privatization of the ZCCM as a major error.

Box 16. Brazil

The 3-year stand-by arrangement with Brazil approved in December 1998 was adopted against the backdrop of strong capital outflows in the aftermath of the Russian crisis. The program aimed at quickly restoring market confidence, maintaining low inflation while achieving a gradual correction of the overvaluation of the currency, and supporting the resumption of economic growth to 3-4 percent a year. Following the floating of the currency in January 1999, the revised program replaced the exchange rate anchor with a firm monetary policy geared at keeping inflation to single digits (with the intention of moving to an inflation targeting framework later in 1999) and tightened fiscal targets.

Brazil's fiscal position was seen as the main source of external vulnerability and the program sought a substantial and durable fiscal adjustment—aimed at stabilizing the net-debt to GDP ratio by 2000 and allowing for reductions thereafter. While the program focused on turning around market confidence through fiscal adjustment, structural reforms in this and other areas were considered essential to underpin the fiscal adjustment effort over the medium term. The original program's structural agenda was, nevertheless, limited and focused on 11 structural benchmarks, six of which addressed fiscal issues.1/ Subsequent additions to this agenda were relatively marginal.2/

Measures to strengthen budget discipline at all levels of government were the centerpieces of the structural program. They sought to improve the tax system and tax administration, implement the administrative reform, and put the social security system on a sustainable path. This involved draft legislation for a fiscal responsibility act, as well as legislation for structural tax reform (requiring constitutional amendments) and social security reform. In addition, a multi-year budget plan was to be submitted to parliament.

The government also saw a need to press ahead with other structural reforms, including privatization, and took further steps to strengthen the financial system, such as completing the resolution and reform of the state banks; implementing regulation on the introduction of a capital charge related to market risk; introducing a forward looking loan classification system; and achieving full compliance with Basel Core Principles. Unlike in the Asian crisis countries, however, these reforms were not at the core of the program. In Brazil, a significant reform of the banking system (both public and private) had already taken place in the aftermath of the introduction of the Real Plan in 1994, which had led to a considerable downsizing in the banking industry and a marked reduction in the level of banking intermediation to the private sector. Moreover, bank credit has not been an important source of financing for domestic firms (due to the prevailing high real interest rates), and the private sector,3/ both corporates and banks, was well hedged against currency risk.4/

Despite some setbacks in the implementation of the government's structural reform agenda—due mainly to political obstacles and legal challenges—significant progress was made on various fronts, including the enactment of the Fiscal Responsibility Law in May 2000. Progress was also satisfactory in the areas of social security reform for private sector workers, administrative reform, financial system reform, and privatization. Fiscal and monetary policy targets were fully met. In terms of growth and inflation, the Brazilian experience contrasts sharply with that of the Asian crisis countries since GDP did not collapse while inflation was contained. Similarly, Brazil was not forced to restructure its public debt.

1/ EBS/98/189, Supplement 1, November 25, 1998.

2/ See, in particular, EBS/99/30, including Supplements 1 and 2.

3/ The disappearance of inflation and resulting high (real) rates of interest following the introduction of the Real Plan had led to a substantial rise in non-performing loans. In order to deal with the affected banks, between 1994 and 1997, the government liquidated, intervened in, or put under a temporary special administrative regime several financial institutions; opened the banking system to direct foreign participation; introduced programs aimed at promoting mergers and acquisitions; and privatized several public financial institutions. For a detailed analysis of this process, see Amann and Baer (2000), Baer and Nazmi, (2000), EBS/98/12 (Box 6), and SM/00/251 (Chapter VIII).

4/ SM/99/180, Chapter III.

89. These four country cases illustrate how implementation of structural reforms may vary significantly across programs and why it may be difficult to detect a pattern in implementation *rates* across countries. How conditionality works depends on country-specific circumstances, in particular the government's commitment to reform. If commitment is strong, conditionality can help underscore this commitment and can play a useful role in monitoring and coordinating implementation. In most instances, this may require only a limited number of conditions, but in some cases, even extensive conditionality may be helpful. By contrast, if commitment is very weak, neither extensive conditionality nor a more limited approach may do much to improve implementation. In intermediate cases, conditionality may, to some extent, help ensure the implementation of reforms that otherwise would not have been done, but there are clearly limits to substituting conditionality for the authorities' commitment.

VI. Summary and Conclusions

90. Judging by developments in aggregate indicators such as the share of programs with structural conditions and the average number of conditions (performance criteria, prior

actions, and structural benchmarks) per program year, structural conditionality in Fund-supported programs has increased substantially since the late 1980s. Three factors appear to have played a key role in this expansion. First, against the background of poor growth in the heavily indebted countries and mounting criticism that Fund program focused too much on short-term demand restraint, attention shifted towards the importance of growth and the role of structural reforms in Fund-supported programs. Second, the establishment of the SAF in 1986 and the ESAF in 1988, which reflected the increased focus on growth and structural reform, shifted the composition of Fund lending towards programs that, by definition, were expected to have a substantial structural component. Third, with the political transformation in Eastern Europe and the subsequent break-up of the Soviet Union, a large number of former centrally planned economies became Fund members; many of these countries, as well as more or less centrally planned economies in other parts of the world, required financial assistance in the context of a complete structural transformation of their economies.

91. Aggregate indicators of structural conditionality conceal large differences across types of countries. Not surprisingly, the total number of structural conditions per program year (performance criteria, prior actions and structural benchmarks) is the highest in the transition economies and in non-transition countries with ESAF/PRGF-supported arrangements. Many other, more traditional types of Fund-supported programs now tend to have a significant structural component too, but the number of structural conditions is typically considerably lower than in transition or ESAF/PRGF countries. With the exception of the extended arrangement with Indonesia, the programs in the Asian crisis countries, which have come to be seen as virtually synonymous with extensive structural conditionality, did not stand out in terms of the number of structural performance criteria, prior actions and benchmarks they included. For the most part, the structural reforms implemented under these programs were listed in detailed policy matrices, the status of which was not clearly defined.

92. Developments in the number of structural conditions have also varied across types of conditions. Structural performance criteria have become more common, but most programs tend to have relatively few—on average two or fewer per program year. Prior actions have increased much more, but a significant part of the increase in the average number per program year appears to be due to a sub-group of programs with very large numbers of prior actions, particularly in the transition economies, while a substantial share of the other programs contained no prior actions at all. Most of the increase in the total number of structural conditions appears to reflect an expansion of structural benchmarks, which were originally introduced in SAF-supported arrangements but came to be widely used in stand-by and extended arrangements.

93. While the range of sectors covered by the Fund's structural conditionality has broadened during the past decade, involvement in an increasing variety of reform areas was not the only, and perhaps not even the main, factor driving the expansion of structural conditionality. On average, close to two thirds of structural performance criteria, prior actions and benchmarks have been concentrated in a few key sectors that are closely linked to macroeconomic stabilization and external adjustment, notably the exchange and trade system and the fiscal and financial sectors. The relative weight of these sectors has shifted, however,

with reforms in the exchange and trade system now playing a much smaller role than in the late 1980s and early 1990s, and reforms in the fiscal and financial sectors gaining importance. In addition to these sectors, restructuring and privatization of public enterprises has played an important role, motivated in part by fiscal considerations.

94. The concentration of structural conditions in sectors that are closely linked to macroeconomic stabilization and external adjustment does not necessarily indicate that all these measures were critical for these programs' macroeconomic objectives and that measures in other sectors were less important. Prioritizing among different structural reforms is not a straightforward task and difficulties in deciding which measures matter most may have contributed to the proliferation of structural conditions. In addition, prioritization may not always have been seen as imperative, with program design being guided by comprehensiveness rather than selectivity.

95. While collaboration with other institutions, notably the World Bank, has been extensive, it did not necessarily help limit the scope of the Fund's structural conditionality, because it lacked a well defined framework for complementary conditionality. In these circumstances, the Fund has frequently seen a need to apply Fund conditionality to measures that were outside its areas of expertise but critical for a program's macroeconomic objectives—either because there was no Bank conditionality at all or because form and timing of the World Bank's conditions did not provide the required safeguards to the Fund. Hence, Fund conditionality has been quite extensive in some of the World Bank's areas of expertise, notably public enterprise restructuring and privatization, and overlapping conditionality has not been uncommon. While the evolving PRSP framework for PRGF-supported arrangements seeks to address these issues, the lack of a comparable framework for other countries remains serious constraint.

96. Coverage of a wider range of structural issues clearly contributed to the expansion of structural conditionality, but greater detail in monitoring structural reforms may have played an even more important role. This trend towards greater detail appears to reflect the inherent difficulties of monitoring structural reforms, which—unlike program monitoring in the macroeconomic area—can generally not rely on well defined, objectively verifiable intermediate targets and typically focuses on the policy actions themselves. While monitoring practices have varied widely in the application of performance criteria and prior actions, reliance on an increasing number of structural benchmarks appears to have been a common trend. In addition, letters of intent have frequently included detailed lists or matrices of structural measures, many of which were monitored in the context of program reviews.

97. Together with structural benchmarks, these lists or matrices appear to have been the main vehicle for detailed program monitoring, raising questions about their status and the boundaries of conditionality. Unlike performance criteria and prior actions, structural benchmarks and other measures listed in letters of intent are not directly linked to the approval of a program or the continuation of purchases; they matter only to the extent that they affect the completion of a review. And while structural benchmarks are confined to measures that are important for a program's macroeconomic objectives, letters of intent often

cover a broader range of measures that are part of the government's policy agenda but not necessarily important for these objectives.

98. The trend towards greater detail in program monitoring also raises questions about the application of performance criteria and prior actions in the structural area. Since these conditions need to be specified in precise, objectively verifiable terms, they have frequently been applied to relatively small steps that are not necessarily critical in and of themselves and matter only as part of a larger sequence of measures. Such steps may not always warrant the potential interruption of purchases associated with the non-observance of a performance criterion.

99. The record of policy implementation in the structural area appears to have been mixed and frequently not as good as in the macroeconomic area. However, there is no evidence that extensive conditionality either raises or lowers the implementation *rate*. Implementation rates (measured as the share of fully implemented conditions in total conditions) appear to have been highest for prior actions and considerably lower for performance criteria and structural benchmarks. The relationship between measures implemented and the number of conditions seems fairly linear but subject to considerable variation, supporting neither the extreme view that extensive conditionality creates synergies thus raising the implementation *rate*, nor the opposite view that it creates a backlash undermining implementation. This may be a reflection of the complex linkages between conditionality and policy implementation, which vary considerably across countries and do not lend themselves to broad generalizations.

100. While experiences regarding the extent of structural conditionality and policy implementation have varied widely across countries, there are indications that in a significant number of cases, structural conditionality has moved beyond what seems consistent with the principle of parsimony, underscoring the need for streamlining. The review of structural conditionality in Fund-supported programs holds several lessons for this task. First, it highlights the need to the clarify the boundaries of conditionality, in particular the status of structural benchmarks and other measures listed in letters of intent in the context of program reviews; streamlining is difficult without a clear understanding of the roles of different monitoring tools. Second it points to a need for greater prioritization based on the importance of specific structural reforms for a program's macroeconomic objectives. By contrast, limiting the scope of structural conditionality to certain core sectors may not yield the desired results: core areas accounted for a significant share of the expansion of structural conditions. Not all of these were critical, nor were reforms in non-core areas necessarily less critical. Moreover, limiting the Fund's structural conditionality to certain core sectors would require a well defined framework for complementary conditionality by the Fund and the World Bank to ensure adequate coverage of all measures that are critical for the macroeconomic objectives of a Fund-supported program. Finally, the trend towards greater detail in program monitoring suggests a need to reexamine the use of different tools—performance criteria and prior actions on the one hand and program reviews on the other—in monitoring structural reforms; it also raises the question of whether some of the objectives of detailed monitoring—for example, providing technical advice on implementation—cannot be achieved outside the framework of formal conditionality.

Appendix I

The MONA Database

The database for monitoring Fund arrangements (MONA) was established to collect, in a systematic way, information about Fund-supported programs, including information about conditionality. Country teams report at the time of program approval, and for each subsequent review.

The database in its present form covers stand-by, extended and ESAF/PRGF-supported arrangements since 1993. It does *not* contain information on purchases under special facilities, such as the Systemic Transformation Facility. In cases where countries had simultaneously stand-by or extended arrangements and SAF/ESAF-supported arrangements, only the latter were considered, because conditions in these programs were typically identical.

The information in MONA on conditionality refers to quantitative performance criteria, as well as structural performance criteria, structural benchmarks, and prior actions. For structural conditions, a brief description of the measure, type of condition, timing, and implementation status are being reported.

For the purpose of this study, the information on structural conditionality in the MONA database was expanded on the basis of country papers to cover programs approved during 1987-92. Including this addition, the database covered 308 programs with close to 4600 structural conditions (performance criteria, benchmarks, and prior actions (including prior actions for the completion of reviews). The conditions were classified according to 14 economic sectors (see Appendix Table).

Appendix II

The Survey

To complement the information in the MONA database, the staff conducted a survey of recent programs in 24 countries. The programs covered by the survey were selected by area departments and is, in terms of regional coverage, fairly representative of the total population of programs approved in recent years.

The survey sample included the following 24 countries:[69]

Albania (PRGF,1998); Brazil (SBA,1998); Bolivia (PRGF,1998); Bulgaria (EFF,1998), Cameroon (PRGF,1997); Cote d'Ivoire (PRGF, 1998); Indonesia (EFF,1998); Jordan (EFF, 1996); Korea (SBA,1997); Kyrgyz Republic (PRGF, 1997); Latvia (SBA,1999); Mali (PRGF,1996); Mauritania (PRGF,1995); Mexico (SBA,1999); Moldova (EFF,1996); Mongolia (PRGF,1999); Peru (EFF,1996); Russia (SBA,1999); Tanzania (PRGF,1996); Thailand (SBA,1997); Turkey (SBA,1999); Ukraine (EFF,1998); Yemen (EFF and PRGF, 1997); Zambia (PRGF,1999).[70]

The survey covered all structural measures included in the letter of intent—performance criteria, structural benchmarks, prior actions, and measures that were monitored only in the context of program reviews—close to 2500 measures in all.

The questions focused on the following issues:

- distribution of the measures by economic sectors (see Appendix Table);
- relevance of the measures for program objectives;
- involvement of other institutions in identifying and monitoring structural measures;
- record of implementation, and reasons for non-implementation.

In addition, country teams provided general, qualitative assessments of the importance of structural reforms for program objectives; the factors affecting the breadth of the structural agenda; the factors affecting implementation; and the factors affecting collaboration with other institutions.

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[69] Program type and approval year are indicated in parentheses.

[70] For some multi-year arrangements, only one program year was covered. In these cases, and for programs that were not yet completed, the effective program length was taken into account.

Appendix II Table. Sector Classification

Category code	Category	Coverage
1	Exchange System	Measures affecting the exchange regime (e.g., lifting of surrender requirements, unification of exchange rate) .
2	Trade Regime	Measures affecting the trade regime (e.g., reduction of tariffs and elimination of quotas).
3	Capital account	Measures affecting capital account regulations (e.g., easing or elimination of restrictions on certain types of capital account transactions), including direct investment.
4	Pricing and Marketing	Measures in all sectors except agriculture (including the energy sector) aimed at the adjustment of regulated prices, liberalization of price setting and the operation of marketing channels (e.g. liberalizing domestic prices, reducing or removing subsidies, and eliminating state monopolies on marketing channels)
5	Public enterprises, reform and restructuring	Measures to rationalize and restructure public enterprises, excluding privatization; governance issues relating to public enterprises.
6	Privatization	Measures to change the ownership of state-owned enterprises in all sectors, excluding agriculture; broad-based privatization schemes as well as privatization of selected enterprises; including measures to prepare enterprises for privatization.
7	General government tax and expenditure reform	Structural dimensions of the budget rather than macroeconomic aspects of fiscal policy, excluding public enterprises and reforms of the social security system. Revenues: tax rate changes, tax code changes, and measures to reduce tax arrears, tax administration issues. Expenditures: measures affecting expenditure structure and administration, measures to reduce expenditure arrears. Also: establishment of treasury systems, measures on public employment, the wage bill (if primarily done for fiscal reasons), and civil service reform, inter-governmental relations; governance issues related to resource management in the government sector.
8	Social security system	Modification of the system of social protection for fiscal reasons or to ensure long-term viability, e.g., pension reform (including reduction of pension arrears, changes in coverage and benefits), reform of public health care, rationalization of social welfare programs.
9	Social safety net	Measures to strengthen social protection, including temporary ones, to ease impact of economic crisis on the poor, e.g., temporary public employment measures, maintenance of subsidies, increases in benefits from existing systems of programs, temporary welfare programs.
10	Financial sector	Measures affecting financial institutions, including restructuring, privatization, closure; changes in the regulatory and supervisory system; central bank reform (including structural reforms affecting the operational framework of monetary policy); legal reforms pertaining to the operations of financial institutions and financial markets; provision of statistical information in financial institutions/markets.
11	Agricultural sector	All the measure related to this sector: land reform, subsidies to agriculture, liberalization of input or output prices, farm restructuring, etc.
12	Labor market	All the measures clearly oriented to modifying the functioning of the labor market
13	Economic statistics	All measures related to the provision of economic statistics

14	Institution building, legal and regulatory framework, transparency	Measures affecting the institutional, legal and regulatory framework, which are not included elsewhere, e.g., competition law, bankruptcy law, commercial code; corporate restructuring and governance; improvements in transparency more generally.

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