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G-24 Discussion Paper Series

An Analysis of IMF Conditionality

Ariel Buira

No. 22, August 2003

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

CENTER FOR INTERNATIONAL DEVELOPMENT HARVARD UNIVERSITY

G-24 Discussion Paper Series

Research papers for the Intergovernmental Group of Twenty-Four on International Monetary Affairs

UNITED NATIONS
New York and Geneva, August 2003

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UNITED NATIONS PUBLICATION

UNCTAD/GDS/MDPB/G24/2003/3

PREFACE

The *G-24 Discussion Paper Series* is a collection of research papers prepared under the UNCTAD Project of Technical Support to the Intergovernmental Group of Twenty-Four on International Monetary Affairs (G-24). The G-24 was established in 1971 with a view to increasing the analytical capacity and the negotiating strength of the developing countries in discussions and negotiations in the international financial institutions. The G-24 is the only formal developing-country grouping within the IMF and the World Bank. Its meetings are open to all developing countries.

The G-24 Project, which is administered by UNCTAD's Macroeconomic and Development Policies Branch, aims at enhancing the understanding of policy makers in developing countries of the complex issues in the international monetary and financial system, and at raising awareness outside developing countries of the need to introduce a development dimension into the discussion of international financial and institutional reform.

The research carried out under the project is coordinated by Professor Dani Rodrik, John F. Kennedy School of Government, Harvard University. The research papers are discussed among experts and policy makers at the meetings of the G-24 Technical Group, and provide inputs to the meetings of the G-24 Ministers and Deputies in their preparations for negotiations and discussions in the framework of the IMF's International Monetary and Financial Committee (formerly Interim Committee) and the Joint IMF/IBRD Development Committee, as well as in other forums. Previously, the research papers for the G-24 were published by UNCTAD in the collection *International Monetary and Financial Issues for the 1990s.* Between 1992 and 1999 more than 80 papers were published in 11 volumes of this collection, covering a wide range of monetary and financial issues of major interest to developing countries. Since the beginning of 2000 the studies are published jointly by UNCTAD and the Center for International Development at Harvard University in the *G-24 Discussion Paper Series.*

The Project of Technical Support to the G-24 receives generous financial support from the International Development Research Centre of Canada and the Government of Denmark, as well as contributions from the countries participating in the meetings of the G-24.

AN ANALYSIS OF IMF CONDITIONALITY

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G-24 Discussion Paper No. 22

August 2003

Abstract

IMF conditionality was introduced in the 1950s as a means to restore members' balance-of-payments viability, to ensure that Fund resources would not be wasted and to ensure that the institution would be able to recover the loans it extended to member countries. For several decades, until the early eighties, Fund Conditionality centred on the monetary, fiscal and exchange policies of members. Over the last 20 years, while the resources of the Fund declined as a proportion of world trade, the number of Fund programmes increased steadily, and conditionality underwent substantial changes, expanding the scope of conditionality into fields that previously had been largely outside its purview. As the number of conditions increased, the rate of member country's compliance with Fund supported programmes declined, and reviewing and streamlining conditionality became inevitable.

Experience and the Fund's own studies show that programme success is closely related to ownership, and that ownership cannot be externally imposed. It must result from internal analysis and discussion, leading to the conviction by domestic actors that compliance with the programme is conducive to the attainment of their own objectives. Conditionality can neither substitute nor offset a lack of ownership.

This paper reviews the origins and purpose of conditionality, as well as its nature and evolution over time. It looks into the reasons for increased conditionality during the 1980s and 1990s and reviews the recent IMF debate on conditionality and on the proposed changes in Fund practices. It distinguishes between short-term imbalances that result from excess demand and structural disequilibria and the new type of financial crises associated with short-term capital movements, asking whether different problems call for different conditionality. The paper also discusses how the economic and social costs of adjustment may be minimized and whether Fund resources are sufficient to enable it to comply with its mandate.

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Institutions are not … created to be socially efficient; rather they, or at least the formal rules, are created to serve the interests of those with the bargaining power to create new rules.
(Douglas C. North, Nobel Lecture, 1993)

I. Introduction

Conditionality is perhaps the most controversial aspect of IMF policies. Among the traditional criticisms of Fund conditionality are that it is too short-run oriented, too focused on demand management and does not pay adequate attention to its impact on growth and the effects of programmes on social spending and on income distribution. In particular, fiscal and monetary policies – the core

recent years and made such programmes unwieldy, highly conflictive, time consuming to negotiate, and often ineffectual."

Similarly, the Council on Foreign Relations Task Force Report (1999) finds that "Both the Fund and the Bank have tried to do too much in recent years, and they have lost sight of their respective strengths. Both need to return to basics … (The Fund) should focus on a leaner agenda of monetary, fiscal and exchange rate policies, and