

Conditionality

Concept: Conditionality

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Description Conditionality is an international financial practice through which a government or other borrower makes specific commitments in return for a loan or grant. In other words, it refers to creditor or donor governments or international agencies making financing contingent on certain actions or policy changes. Formally associated with the lending programs of the International Monetary Fund (IMF), the World Bank, and major creditor or donor states — the United States, Britain, France, Germany, and Japan — conditionality is not an end in itself, but a means to achieve economic and political development. It involves pressure by donors or lenders to encourage certain actions. Although used extensively by major lending and donor institutions, conditionality is a controversial tool, particularly from the perspective of developing countries.

Agreements between donors and recipients often involve three types of conditions. Preconditions are actions to be taken by recipient countries before donors or lenders approve grants or loans, for example, adjusting exchange rates or eliminating price controls. Performance criteria are conditions recipients must meet to avoid a suspension of further funding. Also called "trigger actions," they may involve quantitative goals of macroeconomic policy or structural changes to the economic system. Policy understandings, or structural benchmarks, are actions agreed to by recipients to further goals of economic and political restructuring; failing to meet benchmarks rarely carries an explicit sanction.

Following the creation of the IMF and the World Bank, conditionality evolved as a mechanism to encourage policies that would make it more likely for member countries to solve balance of payments problems, and thus repay loans. This type of conditionality was employed by the IMF and the Bank until the mid-1970s. Viewing excess demand as the root cause of inflation and exchange-rate disequilibrium, the IMF in particular sought to rapidly alleviate inflationary pressures that distorted exchange rates through changes in monetary and fiscal policies.

In response to the growing economic crisis of many developing countries during the 1970s, conditionality began to involve long-term structural policies. Termed "first-generation conditionality," this change reflected a growing recognition that achieving a balance between the internal and external economies of developing countries required restructuring economic policy over the long rather than short term. International financial institutions believed that without tackling "structural distortions" such as rigidly programmed government spending and artificially low domestic

interest rates, external disequilibria could not be resolved. The Fund and the Bank therefore became associated with Structural Adjustment Programs (SAPs), which promoted sustainable economic growth, addressed structural impediments to healthy growth and trade liberalization, took measures to strengthen financial systems, and put more emphasis on the need for supply-side measures to reinforce economic growth.

With the end of the Cold War, "second-generation conditionality" or "political conditionality" became more prominent. Dramatic changes in Eastern and Central Europe made immediate the need for both economic and political restructuring, with a growing consensus that there was a direct relationship between the two. Unlike previous conditionality policies, second-generation schemes added necessary political reforms to SAPs, specifically in the areas of good governance, human rights, and democratization.

Conditionality has always been the subject of controversy. Those who favour conditionality maintain that assurances that loans will be used effectively are necessary both to encourage lenders to lend and safeguard against the irresponsible use of funds. Critics argue that conditionality poses major threats to state autonomy and democratic processes. Some developing countries have come to view conditionality as one of the first instruments used by the economically advanced countries to impose the process of globalization upon them. These countries also fear that with more extensive conditionality, they are increasingly unable to make independent policy decisions congruent with local interests, and are unable to maintain the social policy instruments that can adequately protect citizens from the negative effects of globalization. And, although international institutions and donor states attempt to work with recipients to create policy change, it remains uncertain whether change imposed upon a country without the necessary support from its people will be long-lasting. Defenders of conditionality respond to these criticisms by pointing out that rarely are conditions strictly imposed upon countries; policy dialogue between donors and recipient governments to reach mutually agreed loan conditions is key.

With respect to the concept of autonomy under globalizing conditions, conditionality is Janus-faced. Intensive market integration between countries because of globalization has given the IMF and World Bank a new role in helping economies adversely affected, particularly by financial crises. Supporters of conditionality hold that it can help such economies restore their autonomy. At the same time, the IMF and World Bank are criticized for promoting market-driven globalization through conditionality and compromising the autonomy of recipient countries by encouraging conformity to neo-liberal economic strategies.

Suggested
Reading:

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