SUM Report No. 13

The World Bank's and the IMF's use of Conditionality to Encourage Privatization and Liberalization:

Current Issues and Practices

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CONTENTS

Abbreviations and acronyms

ADB	Asian Development Bank
CAS	Country Assistance Strategy
CPIA	Country Policy and Institutional Assessment
DDCI	Debt and Development Coalition of Ireland
DSC	Development Support Credit
DTIS	Diagnostic Trade Information Studies
EdM	Electricidade de Moçambique
ERAP	Energy Reform and Access Project
ERC	Energy Regulatory Commission
ESAF	Enhanced Structural Adjustment Facility
FNDP	Fifth National Development Plan
FY	Fiscal Year
GoU	Government of Uganda
GPP	Good Practice Principles
GRA	General Resources Account
HIPC	Heavily Indebted Poor Country
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IEO	Independent Evaluation Office
IF	Integrated Framework for Trade Related Technical Assistance
IFC	International Finance Cooperation
IFI	International Financial Institution
IMF	International Monetary Fund
MTEF	Medium Term Expenditure Framework
NCB	National Commercial Bank
NGO	Non-Governmental Organization
PAD	Project Appraisal Document
PARPA	Poverty Reduction Action Plan
PEAP	Poverty Eradication Action Plan
PPA	Power Purchasing Agreement
PRGF	Poverty Reduction and Growth Facility
PRS	Poverty Reduction Strategy
PRSP	Poverty Reduction Strategy Paper
PSIA	Poverty and Social Impact Analysis
PSP	Private Sector Participation
RTA	Regional Trade Agreements
SBA	Stand-by Agreements
SOE	State Owned Enterprise
UNDP	United Nations Development Fund
UNECA	United Nations Economic Commission for Africa
UNICEF	United Nations International Children’s Fund
WB	World Bank
WHO	World Health Organization
WSS	Water and Sanitation Sector
WTO	World Trade Organization
ZCCM	Zambia Consolidated Copper Mines Ltd.
ZESCO	Zambia Energy Supply Company
ZNCB	Zambia National Commercial Bank

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Summary

This report is prepared in the light of the statement of the current Norwegian Government Declaration (the Soria Moria Declaration) that Norwegian aid shall not support programs that are made conditional on liberalization and privatization. The main purpose is to evaluate to what extent the World Bank and the International Monetary Fund (IMF) still support such programs, to what extent they have put undue pressure on governments to privatize or liberalize, and to what extent they follow their own recently published guidelines. The report makes no attempt to assess the soundness of privatization and liberalization policies, or the consequences of privatization and liberalization policies.

The report was prepared by a team of three consultants in Norway, and one in each of the following countries: Bangladesh, Mozambique, Uganda and Zambia, with support from Norway's embassies in the respective countries.

The report has three main parts. The first is dedicated to conceptual clarification. We define conditionality as the application of *specific, pre-determined requirements that directly or indirectly enter into a donor's decision to approve or continue to finance a loan or grant*. We note the different use of the concept by the International Financial Institutions (IFIs) and Non Governmental Organizations (NGOs) and conclude that their disagreement about current conditionality practices is partly attributable to their different understandings of the concept.

The second part consists of a review of recent studies on the above mentioned issues, including those conducted by the IFIs themselves, and those undertaken by NGOs, other international organizations and independent academics. We discuss points of consensus as well as divergence, and point to strengths and weaknesses in their methods for data collection and their basis for drawing conclusions.

The third part consists of material collected specifically for this report. This includes a sectoral review of current IFI strategies in the areas of utilities, social sectors (health and education) and trade. It furthermore presents a brief quantitative review of recent PRGFs. However, the main part of the findings consists of case studies of recent IFI programs that to varying degrees support privatization and liberalization in Bangladesh, Mozambique, Uganda and Zambia.

The main findings may be divided into two groups. The first relate to the extent to which the IFIs still convey strong policy preferences in favor of privatization and liberalization and whether they still use conditionalities to promote these preferences in borrowing member countries. A main finding from the sector reviews as well as the cases is that a narrow focus on privatization and liberalization has been replaced by a broader view regarding institutional reform and complementary policies. However, the agenda has changed more with regards to social policies and utility reform than trade, where the basic thrust is still towards liberalization. There also seems to be less of a change in the policies promoted by the IMF than those promoted by the World Bank.

Do the IFIs still use conditionalities to promote privatization and liberalization?

- Privatization and liberalization are still included as conditionalities in World Bank and IMF loans, but are less common than before.
- The policy advice given by the IMF and the World Bank on privatization and liberalization has changed. There is a clear trend towards greater pragmatism and focus on complementary policies, but changes are not uniform across cases and sectors.
- The IFIs exert considerable influence through providing policy advice, and have not generally elaborated alternative policies to those involving privatization and liberalization.

Furthermore, privatization and liberalization conditionalities are far less common in current IFI programs than they used to be. This is in accordance with the IFIs own reviews. However, they still figure in a significant number of programs. The quantitative review of 40 PRGFs shows that privatization is a condition in over half the reviewed PRGFs. It is also included in three of the four loan programs studied in the case studies.

The case studies also show that where privatization has been included as conditionality, this has not been a very efficient way of influencing policy choice and implementation. Giving policy advice and assisting in the preparation and elaboration of policy have generally had more impact on the final choice of policies. This assistance has generally been geared towards privatization and liberalization, and little effort has been made to elaborate policy alternatives.

A second group of findings relate to broader changes in conditionality practices and the extent of adherence to recently published IFI guidelines. Among the main conclusions in this regard are the following:

Do the IFIs adhere to their own new guidelines?

- There is a stronger sense of national "ownership" of the programs, but this is reduced by:
    - weaknesses in participatory processes;
    - extensive dependence on IFIs and foreign consultants in elaboration of policies, and lack of local input;
    - lack of "policy space" and analysis of policy alternatives; and
    - lack of unified view within the government, frequently used by IFIs to promote their own cause.
- The IFIs are more flexible in their enforcement of conditionalities. Sometimes bilateral donors and civil society have demanded less flexibility.
- Donor coordination is strengthened, but this may reduce policy space and weaken borrowing member countries' bargaining power.
- Local IFI representatives show little in-depth knowledge of the World Bank's GPPs.

Regarding ownership, we understand this to include the question of whether the programs adequately reflect government priorities set out in national development plans; whether the processes of elaborating these development plans have been inclusive, and, finally whether the countries have been given sufficient “policy space” and assistance in developing alternative policies.

The case studies show that there is a stronger sense of national ownership of the programs today than before the guidelines on conditionality were reviewed. All the programs studied are based on government plans. However, this sense of ownership is weakened by three factors. First, the quality of the participatory processes varies significantly across the countries. Second, policies have been elaborated with significant input from the IFIs and foreign consultants, and there has been a lack of local input. Third, there is a perceived lack of “policy space” stemming in part from lack of analysis of policy alternatives. A fourth factor that has been brought up in the case studies is that when government institutions have had differing views (as is often the case), IFI representatives have used these differences strategically to promote their own view.

A further general finding from the case studies is that the IFIs have become more flexible in the implementation of conditionalities. However, this is often opposed by other donors or civil society when the conditionalities in question concern governance.

Donor coordination is also found to be improved, but this may be a double-edged sword for borrowing countries. The case studies show that there is a concern that the donors may “gang up” against the government and allow them even less policy space.

Finally, the case studies show that the new Good Practice Principles (GPP) and the World Bank’s Conditionality Review are not well known among the local IFI representatives.

PART 1: INTRODUCTION

1. Background, purpose and research questions

The background for this study is the declaration that forms the political platform of the current Norwegian Government (the Soria Moria Declaration). This states that Norwegian aid shall not support programs that are made conditional on liberalization and privatization (p.10). This refers to the long standing practice of financial and development institutions (e.g., the World Bank and the IMF) to condition their aid on the introduction of such reforms.

However, the multilateral institutions have recently reviewed their own use of conditionality. The most recent review by the World Bank[1] highlights the following changes and principles for action:

a) Overall Bank lending conditions have shifted from privatization/restructuring to strengthening public sector governance and institutions.
b) Privatization remains an element of the toolkit available to governments looking to improve economic performance.
c) The Bank may support privatization within the context of a government-owned reform program – but no imposition or coercion, no policy prescriptions.
d) Bank lending design has evolved (programmatic single-tranche operations) to allow significant flexibility in accompanying evolving medium-term reform processes without threat of significant funding interruption.
e) If privatization is used as performance indicator (trigger/prior action), process should follow good practice principles.

The IMF uses guidelines dating from 2002 for their use of conditionality. These were reviewed in 2005 and are currently under a new revision.[2] The main elements of the guidelines are:

a) Ownership: Policies should be nationally owned.
b) Parsimony: Conditions should be applied only to measures *critical* to the success of the program;
c) Clarity: Program related conditions must be clearly spelt out and guidelines should lay out the expected frequency of reviews;
d) Conditions should be coordinated with other multilateral institutions;
e) Conditions should be tailored to national circumstances.

Nevertheless, NGOs and other stakeholders still question the current World Bank and IMF practices on the grounds that they place undue pressure on governments to liberalize and/or privatize their economies. Also other bilateral donors are concerned about the use of conditionalities by the World Bank and the IFIs, particularly in sensitive policy areas such as privatization, liberalization and user fees.

Against this background this independent study was commissioned with the main purpose to:

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[1] World Bank,, *Review of World Bank Conditionality*, Operations Policy and Country Services, World Bank, September 2005.
[2] IMF, *Review of the 2002 Conditionality Guidelines*, March 3, 2005. The new revision is scheduled to be finished by late 2006.

(i) conclude as to the extent to which the World Bank and the IMF in recent years have put pressure on governments to introduce policies of privatization and liberalization through the use of conditionalities;

(ii) conclude about the extent to which the World Bank and the IMF have followed the principles set for themselves in their most recent guidelines.

2. Mandate, method and limitations

The mandate of the study is set out in the Terms of Reference for the coordinating team. The study was lead by a coordinating team based in Norway. Its mandate has been to provide a clarification of concepts, review recent studies on the practices of the World Bank and the IMF and to coordinate the case studies. The case studies were undertaken by local consultants with assistance from the respective Norwegian embassies.[3]

Four countries were chosen for the case studies: Bangladesh, Mozambique, Uganda and Zambia. In the countries, the following programs and projects were chosen:

- Bangladesh: The main program in focus is the Third Development Support Credit (DSC III) issued by the World Bank. This covers a range of different sectors. The case study focuses primarily on the energy sector, but looks also at trade liberalization.
- Mozambique: The main programs in focus are the Energy Reform and Access Project and Energy Reform and Access Program, both supported by the World Bank. The main focus of these programs is reforms of the EdM (Electricidade de Mozambique).
- Uganda: The main program in focus is the Poverty Reduction Strategy Credit 5 of the World Bank.
- Zambia: The main program in focus is the Poverty Reduction and Growth Facility. It focuses particularly on the reforms of the financial sector, but looks also at energy.

Several criteria have been important in the choice of case studies:

(i) Current interest: The most significant changes in World Bank/IMF policies have been quite recent. In order to make the study as relevant as possible, we have therefore limited the focus to ongoing or very recently concluded programs and processes.

(ii) Sector diversification. The cases should ideally be chosen from different sectors. Due to other considerations, this was only partly achieved, but sectors not covered in the case studies were attempted covered in sector reviews (see below).

(iii) Inclusion of both the World Bank and the IMF. The practices of these institutions are different, but according to both institutions' guidelines are to be closely coordinated. It was therefore important to cover both.

(iv) Practical considerations. Finally, for practical purposes the cases had to be from countries in which Norway has an embassy. The embassies' recommendations regarding programs of interest were followed to the extent possible.

Because we were not able to cover as broad a spectrum of sectors in the case studies as we had hoped, we chose to include a "desk-review" of current practices in three additional

[3] The exception is the case from Uganda which given practical considerations and time constraints was undertaken by the embassy itself.

sectors: social sectors (focusing on user fees in health and education), utilities (focusing on transport/physical infrastructure) and trade.

The team was working within significant time constraints. The Norway based team was identified between June and July 2006 and was operative from mid august. It has had a total of 13 work-weeks divided between the three team members available. The consultants responsible for the case studies were operative from early September and had approximately one month each for conducting the study.

3. Key concepts

3.1. Defining privatization and liberalization

- *Privatization:* The partial or total transfer of property or responsibility from the public sector (government) to the private sector (business) or private persons
- *Liberalization:* Any relaxation of previous government restrictions, in areas of social or economic policy or political organization

The term privatization may involve a number of different practices: a) transfers of public assets to private ownership, through sale or lease of public land, infrastructure, and enterprises, b) public financing of private services through for example contracting out governmental services, or c) the cessation of public programs and disengagement of government from specific kinds of responsibilities that may lead to a shift by consumers toward privately produced and purchased substitutes.[4]

Contrary to some authors, we do not consider general efforts to "improve the business climate" or "encourage private sector development" to be privatization, unless these efforts include the transfer of property or responsibility from the public to the private sector. We include the formation of public-private partnerships to the extent that these involve such transfer of property or responsibility. The introduction of user fees may be considered a transfer of responsibility for financing public services from the public sector to private persons.

Liberalization is a broader concept than privatization. In this report we will focus only on liberalization in areas of economic policy. This may include: (i) trade liberalization: the lifting of tariff and non-tariff barriers against foreign trade, (ii) price liberalization: the reduction/removal of regulations on prices and reduction/removal of subsidies, and (iii) the lifting of monopolies and opening for private sector participation in production of goods and services.

[4] Paul Starr, 'The meaning of Privatization', *Yale Law and Policy Review*, 6 (1988), pp. 6-41.

3.2. Defining conditionality

- *Conditionality*: The application of specific, pre-determined requirements that directly or indirectly enter into a donor's decision to approve or continue to finance a loan or grant

One may distinguish between the following different forms of conditionality:

- *Fiduciary conditionality*: This relates to the financial management of funds and to public accountability in relation to those funds. The purpose of this form of conditionality is to ensure that the funds are used for the purpose intended and that the funds are used in the most efficient manner. Hence, this is an element of regular financial accountability.
- *Policy conditionality/economic policy conditionality*: This includes conditions about the implementation of policies believed to be of importance in reaching general development goals. Funding is not necessarily directed towards the areas of policy conditionality.
- *Process conditionality*: This focuses on the process of planning, adopting and/or implementing policies rather than their content or the management of funds. Generally it involves that certain institutions are in place or certain principles for participation are followed to enhance transparency and representativeness of governance.
- *Outcome conditionality*: This focuses on measurable outcomes (e.g., GDP growth, poverty reduction) rather than what kinds of policies are implemented to reach those goals. This form of conditionality is central to the concepts of results orientation in aid and output-based aid.

As our focus is on conditionality that requires the adoption of privatization and/or liberalization, our main concern will be policy conditionality.

The IFIs tend to apply a specific and restricted definition of conditionality using technical terms, such as: "the specific conditions attached to [the] disbursement of policy-based lending or budget support"[5], or more narrowly and specifically formulated for the Conditionality Review, as "the set of conditions that, in line with the Bank's Operational Policy (OP) 8.60, para. 13, must be satisfied for the Bank to make disbursement in a development policy operation."[6]

There is also a certain discrepancy between the World Bank and the IMF in their use of the term conditionality. The World Bank includes only legally binding conditions as conditionality. This includes:

- *Prior actions*: policy actions that the country agrees to take before the Bank's/Fund's Executive Boards approves a loan, and
- *Tranche release conditions* (floating or regular): policy actions that the country agrees to undertake for the disbursement of loan tranches from the World Bank.[7]

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[5] Stefan Koeberle, Harold Bedoya, Peter Silarsky, and Giro Verheyen (eds), *Conditionality Revisited: Concepts, Experiences, and Lessons* (Washington, D.C.: The World Bank, 2005), p. 5.
[6] World Bank, *Review of World Bank Conditionality* , p. 3.
[7] World Bank, *Review of World Bank Conditionality*, p. 3-4.

Unlike the World Bank, the IMF generally also includes benchmarks and program reviews that are not in the same way legally binding in the term conditionality:

- *Prior actions*: measures that a country is expected to adopt before the approval of an arrangement or completion of a review.
- *Performance criteria*: conditions that have to be met for the agreed amount of credit to be disbursed (from the IMF). These may be: quantitative (referring to macroeconomic policy variables, e.g. credit aggregates, fiscal balances, or external borrowing); or structural (e.g. financial sector operations, reform of social security systems, or restructuring of key sectors such as energy).
- *Structural benchmarks*: a monitoring mechanism to be applied to measures that may not be objectively monitored or where non-implementation would not, by itself, warrant an interruption of IMF financing.
- *Program reviews:* These are conducted by the IMF and are meant to serve as an opportunity for a broad-based assessment by the Executive Board of progress with the program (http://www.imf.org/external/np/exr/facts/conditio.htm).

In popular use, the term conditionality is often given a much broader definition and has become closely associated with the alleged attempt of the IFIs to impose policies, e.g. of privatization and liberalization, on poor countries. Many of the critics of the IFIs include a broad set of monitoring and review mechanisms in the term conditionality, although not all of these formally or automatically impact on the decision to approve or disburse a grant or a loan or part of a loan. Several of the NGOs include a wider array of monitoring mechanisms in the term conditionality, including:

- *Country Policy and Institutional Assessments (CPIAs)*: These are reviews that the World Bank conducts of policies and institutions before a decision to enter into negotiations over loans/grants. This is argued by critics to be a form of "indirect conditionality".[8] The World Bank too has admitted that this may be understood as a form of "ex-ante" conditionality: Instead of trying to induce governments to reform or create reformers, donors select genuine reformers and provide them with financing.[9]
- *Trigger actions*: These are not formally legally binding conditions, but as they are expected prior actions of the next operation in programmatic loans, there is significant likelihood that they may become so.
- *Benchmarks:* Benchmarks describe the contents and results of the government's program in areas monitored by the World Bank, or small steps in a critical reform process, that would not individually warrant an interruption of funding. Whereas the World Bank argues that these are only indicators of the direction of performance, NGOs argue that they are in effect conditions since they may enter into a general evaluation of country performance.

We have decided to adopt a broad definition of conditionality, as stated above, that includes the full spectrum of requirements, from legally binding conditions to criteria for screening potential borrowers – so-called ex-ante conditionality. In adopting such a broad definition, it is important to emphasize that we have no preconceived views about whether "few" or "many" conditionalities are good or bad, or whether the inclusion of a conditionality in a policy matrix or a loan document means that it is "imposed" by the IFIs. The advantage of our

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[8] Jeff Powell, "The World Bank policy scorecard: The new conditionality?", An Issue, Update 43 (The Bretton Woods Project 2004), available online at: Hhttp://www.brettonwoodsproject.org/art.shtml?x=84455H.

[9] World Bank, *Review of World Bank Conditionality*, p. ii

case-study methodology, as opposed to more quantitative approaches, is that it allows us to critically investigate these issues, and we will therefore leave the questions open for now.

4. Introduction to the debates

4.1. The "old" conditionality debate

- Critique of the policy content of structural adjustment lending
- Lack of compliance and low impact of reforms
- The issue of sovereignty and national ownership of reforms
- Failure of the IFIs to enforce
- Conditionality overload

With the term "the 'old' conditionality debate" we refer to the debate arising in relation to the World Bank's policy based structural adjustment lending and the IMF's broadening of conditionality from the mid 1980s.[10] As the rise of policy based lending coincided with the increasing influence of neo-liberal ideas in the IFIs, conditionality was from the start associated with the privatization and liberalization agenda.

The first and by far the most discussed item in the "old" conditionality debate relates to the *policy content* of conditionality. The lion's share of this literature focuses on the premises of or the effects of the market oriented policies often associated with what John Williamson in 1990 termed "the Washington consensus", in which privatization and liberalization figured among the most hotly debated elements.[11] The critical literature is voluminous, varied and rather well-known, focusing on the distributional aspects of the reforms, the failure of reforms to take social and environmental issues into account, and their failure to ensure sustained growth.

The second major focus of the debate was on the practice of conditionality. One point of critique coming both from within and from outside the IFIs focused on *the lack of efficacy of conditionality*. Already in the late 1980s, some evidence was collected showing that in fact very few structural adjustment programs were implemented as planned.[12] Furthermore,

[10] Conditionality as we know it today originated with the IMF, and had initially a relatively specific macroeconomic focus. It was intended to substitute for collateral, normally pledged by commercial banks in terms of an asset (a house or a piece of land) to be handed over if the borrower failed to pay back a loan. In the IFIs, conditionalities had a different purpose. They were originally related to project lending and they were meant to ensure that the funds were used as intended. With the introduction of policy based lending in the 1980s, the purpose changed to enable the borrower to remove what the lender regarded as fundamental policy-induced obstacles to economic growth and development.

[11] This was originally formulated by John Williamson and included ten measures involved in neo-liberal reform programs, where the first five regard stabilization by orthodox fiscal and monetary policies, and the remaining five reforms constitute different ways of saying that the size and role of the state should be severely reduced: (5) the exchange rate should be market-determined, (6) trade should be liberalized and outward oriented, (7) direct investment should suffer no restrictions, (8) state-owned enterprises should be privatized, (9) economic activities should be deregulated, and (10) property rights should be made more secure. See John Williamson, *Latin American Adjustment: How Much Has Happened?* (Washington D.C.: Institute for International Economics, 1990).

12 See Stephan Haggard, "The Politics of Adjustment: Lessons from the IMF's Extended Fund Facility", in Miles Kahler (ed.), *The Politics of International Debt* (Itacha, New York: Cornell University Press, 1986), pp. 157-86, Paul Mosley, Jane Harrigan and John Toye, *Aid and Power: The World Bank and Policy-Based Lending*,

studies showed that not only was implementation of IMF and World Bank programs slow, there was also no higher probability of introduction of market oriented policies in the countries where an IMF program was in place than where this was not the case.[13] In the late 1990s, a series of new studies confirmed these conclusions[14]. They found "no evidence that any of the variables under the World Bank's control affect the probability of success of an adjustment loan."[15] Moreover, in many cases loading on new conditionalities was used as a means to remedy failure of compliance, with very little success. Easterly concluded that: "Putting external conditions on governments' behavior through structural adjustment loans has not proven to be very effective in achieving widespread policy improvements or in raising growth potential. If the original objective was "adjustment with growth", there is not much evidence that structural adjustment lending generated either adjustment or growth."[16]

A second point of critique was that conditionality *impinged upon the sovereignty of borrowers*. Thus, there were not only economic repercussions of conditionalities, but also democratic, as the public will – expressed through the government or elected national assemblies – was set aside in the attempt to satisfy conditionalities set by the IFIs.

A third and related critique was *the lack of enforcement of conditionality* by the IFIs. One study of the top twenty adjustment recipients over a period of 20 years, found that countries continued to get new adjustment loans in spite of their failure to implement policies upon which prior loans were conditioned. Such inconsistency and mixed message to the borrowers was found to result from the pressure within the IFIs for high levels of disbursement and creation of new loans. It was viewed as a major factor in explaining the lack of results.[17]

A final point of critique, coming rather from inside the Bank and the Fund and from governments attempting to implement programs, was that they contained too many conditionalities. This often resulted from the failure of the IFIs to coordinate among themselves, and a tendency for the IMF to "step in" and take on the traditional role of the World Bank in cases where the Bank was not engaged in lending and policy advice. As many conditionalities were highly demanding and dependent on legal changes, the *conditionality overload* led often to a totally unmanageable task for borrowing governments.[18]

These points are crucial as a background for the understanding of recent IFI reviews. In the following, we will discuss the main reviews conducted and their conclusions.

Volume 1 (London: Routledge, 1990), Joan Nelson, *Economic Crisis and Policy Choice: The Politics of Adjustment in Developing Countries* (Princeton, New Jersey: Princeton University Press, 1990), and World Bank, "Effective Implementation: Key to Development Impact ("The Wapenhans Report"): Report of the World Bank's Portfolio Management Task Force" (Washington, D.C.: World Bank, 1992).

[13] Tony Killick, "Principals, agents and the limitations of BWI conditionality", *World Economy*, 19 (1996: 2): 211-229, Paul Collier, "The Failure of Conditionality", in C. Gwin and Joan Nelson (eds) *Perspectives on Aid and Development* (Washington, DC: Overseas Development Council, 1997), pp. 51-77.

[14] Tony Killick, *Aid and the Political Economy of Policy Change* (London: Routledge, 1998), David Dollar and Jakob Svensson (2002), "What explains the success or failure of structural adjustment programmes", *The Economic Journal*, 110 (October 2002): 894-917.

[15] David Dollar and Jakob Svensson, *What explains the success or failure*,, p. 895.

[16] William Easterly, "What did structural adjustment adjust? The association of policies and growth with repeated IMF and World Bank adjustment loans", *Journal of Development Economics*, 76 (2005): 1-22, p. 20.

[17] William Easterly, "What did structural adjustment adjust?".

[18] Benedicte Bull, *Aid, Power and Privatization: The Politics of Telecommunication Reform in Central America,* (Cheltenham, UK/Northampton, US: Edward Elgar, 2005).

4.2. The World Bank and the IMF's response to critique

The IMF response

- IMF:
  - Adopting the "new aid architecture": PRSP-alignment and donor coordination
  - Reaffirming of IMF's role to address balance of payment problems
  - 2002 Guidelines on Conditionality

- World Bank:
  - Adopting the "new aid architecture": PRSP-alignment and donor coordination
  - Devising a selectivity approach to aid allocation
  - 2005 Conditionality Review

IMF's replacement of the Enhanced Structural Adjustment Facility (ESAF) with the PRGF in 1999 may in itself be viewed as a response to much of the critique above, as the PRGF was intended to be based more on participation and country ownership, be more selective in the use of conditionalities and include stronger analyses of social issues.[19] A further response to the critique was the review of the Guidelines on Conditionality dating from 1979, resulting in the 2002 Guidelines on Conditionality.[20] These new guidelines state that the key purpose of conditionality is to ensure that Fund resources are used to assist a member in solving its balance of payments problem. The main purpose is in other words in line with the original intent of conditionality: to provide adequate safeguards for the use of IMF's resources. However, the new Guidelines emphasize five specific principles to be taken into account in official practice:

1. *Ownership*: This refers to the willing assumption of responsibility for a program of policies by country officials. The guidelines aim to promote ownership by ensuring that conditionality is well designed and is formulated through a mutually acceptable process led by the country concerned. The staff should endeavor to reach understandings with the authorities on a mutually acceptable means of achieving the program goals, while paying due regard to the domestic social and political objectives, the economic priorities and the circumstances of the member. Programs supported by the Poverty Reduction and Growth Facility (PRGF) will normally be based on a Poverty Reduction Strategy Paper (PRSP). The guidelines also note that the need for ownership implies selectivity: use of Fund resources depends in particular on the Fund's assessment that the member is sufficiently committed to implement the program.
2. *Parsimony*: This means that program-related conditions should be limited to the minimum necessary to achieve the goals of the Fund-supported programs. The macroeconomic goals of Fund-supported programs are to solve the member's balance

[19] http://www.imf.org/external/np/prgf/2000/eng/key.htm
[20] IMF, "Guidelines on Conditionality", September 2002.

of payments problem without recourse to measures destructive of national or international prosperity; and to achieve medium-term external viability while fostering sustainable economic growth. Conditions that are not of critical importance for achieving the macroeconomic goals of the program or for monitoring its implementation, or that are not necessary for safeguarding the Fund's resources or for the implementation of other specific provisions of the Articles or Agreement or policies adopted under them, are to be avoided.
3. *Tailoring* policies to circumstances: This implies a recognition that the causes of macro-economic concerns, for example balance of payments difficulties, may vary, and the emphasis to be given to various program goals may differ among members.
4. *Coordination*: The Fund's policy advice, work on program design, and conditionality should strive to be consistent with that of other institutions, and, whenever possible, should be integrated within a coherent country-led framework.
5. *Clarity:* This means that program-related conditions must be clearly spelt out and guidelines should lay out the expected frequency of reviews.

The World Bank response

An early proposal from some of the main critics of conditionality was to replace it with a more careful selection of countries to support. In this way one would respond both to critiques of efficacy and of sovereignty. Based on the conclusion from a 1998 World Bank report that aid was considerably more effective in countries with "sound" economic policies than where these were not in place, there were proposals for replacing conditionality with greater selectivity in choosing recipients.[21] Although the econometric cross-county analyses supporting this conclusion have been criticized on several grounds, they have influenced World Bank practice, for example through the introduction of CPIAs.

However, in addition to including such an "ex-ante" mechanism, the World Bank has thoroughly reviewed its principles for the use of conditionality. The 2005 Conditionality Review suggests the following "good practice principles" (GPPs) which to a great extent overlaps with the IMF 2002 Guidelines[22]:

1. *Ownership:* The critique of the IFIs on the one hand that they place undue pressure on governments to adopt policies they otherwise would not have adopted and on the other, that this pressure in either case was not efficient – provoked one and the same response: an emphasis on ownership. There is a significant consensus that only policies for which the country itself has "ownership" are to be included in lending programs as conditionalities. The Conditionality Review states as a "good practice principle" to actively reinforce country ownership by relying on clear evidence of ownership informed by analytic work.
2. *Coordination:* In order to make the financial flows more predictable, and to reduce the complexity of conditionality, the Review recommends to agree up-front with the government and other financial partners on a coordinated accountability framework which includes both policy actions and outcome indicators.

[21] David Dollar and Lant Prichett (eds.), *Assessing Aid. What Works, What Doesn't and Why?* (Washington, D.C.: World Bank, 1998).
[22] World Bank, *Review of World Bank Conditionality*.

3. *Tailoring to circumstances:* Customize the accountability framework used to evaluate country performance under the program and modalities of the Bank support to country circumstances.
4. *Criticality:* As a "good practice principle" the World Bank states that it will choose only actions critical for achieving results as conditions for disbursement. Apart from a general attempt to reduce the number of conditions attached to specific loans, new lending mechanisms were introduced to simplify the policy process.
5. *Transparency:* Conduct transparent progress reviews conducive to predictable and performance-based financial support.

4.3. The "new" conditionality debate

- Have conditionality *practices* changed?
  - Has the use of conditionality declined?
- Has the *content* of conditionality changed?
- Is there real *ownership* of the programs?
  - Do they reflect national development plans?
  - Are these developed in an inclusive manner?
  - Have the governments been given sufficient "policy space"?

In spite of changes, there are still a number of disputed issues. The "new" conditionality debate includes both empirical disagreements about what is the actual "state of affairs", and disagreements on more normative issues. This report will, however, concentrate on the empirical questions in order to contribute to clarifying what is the current state of affairs. The report will focus on three main questions in the current debate:

(1) Have IMF/World Bank *practices* really changed in line with the recent guidelines? A main issue of debate is the degree to which the number of conditionalities has declined, and the degree to which the World Bank and the IMF still are engaged in "micro management" of economic policy in borrowing member countries.

(2) Is the policy *content* changing with a move away from privatization, liberalization and user fees? This question also relates to the question of whether borrowing member countries have been assisted in developing alternative options.

(3) Finally, to what extent are policies still "imposed" by the IMF and the World Bank or is undue pressure being exerted? Do the programs adequately reflect government *ownership* and priorities set out in national development plans? Have national governments been given sufficient "policy space" in choosing between policy alternatives. Has the process of elaborating these development plans been inclusive?

These questions are addressed in a number of recent studies, some of which will be discussed below.

PART II: REVIEW OF EXISTING STUDIES

5. Recent studies on the World Bank and the IMF's use of conditionality

- World Bank: 2005 Conditionality Review; 2006 Development Policy Retrospective; evaluations of PRSCs.
- IMF: 2005 Staff Review; evaluations of PRGFs.
- NGO studies: Eurodad; Action Aid; Christian Aid; Debt and Development Coalition of Ireland

The IFI themselves have recently paid significant attention to the issue of conditionality. The *Review of World Bank Conditionality* (the Conditionality review) is the most comprehensive of the reviews conducted by the World Bank so far.[23] This was followed up by the *Development Policy Lending Retrospective* (the Retrospective)[24] that responded to a request by IDA Deputies and the Board for a systematic review of experience with the implementation of the new policy by the time of the IDA 14 Mid-Term Review. It confirms most of the conclusions from the Conditionality Review but is somewhat broader.

The IMF has conducted several reviews of the 2002 guidelines. The March 2005 staff review (the Staff Review) is among the most comprehensive.[25] A second review is currently being conducted by the Independent Evaluation Office (IEO). It will focus on first, what forces influence program design? What was the rationale for structural conditionality on the part of the IMF, and how did the nature of the interaction between IMF staff and country authorities affect program design? Second, was structural conditionality effective, and if so, what factors seem to be influencing its impact?[26] At the time of writing this review is not concluded.

Another important source of information about the current practices of the IMF and the World Bank are their own evaluations of the PRSCs and PRGFs. These generally have a broader scope than a focus only on conditionalities. However, they discuss important aspects of both the practice and content of conditionality as well as the issue of ownership of relevance for this report. In 2004, the Independent Evaluation Office of the IMF published the *Evaluation of the IMF's Role in Poverty Reduction Strategy Papers and the Poverty Reduction and Growth Facility* (the 2004 IEO Evaluation) based on six in-depth country studies, cross-country analysis of 23 countries with "full" PRSPs and a survey of a broad range of stakeholders as well as IMF staff.[27]

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[23] World Bank, *Review of World Bank Conditionality*.

[24] World Bank, *Development Policy Lending Retrospective*, Operations Policy and Country Services, World Bank, July 7, 2006.

[25] IMF, *Review of the 2002 Conditionality Guidelines*, Prepared by the Policy Development and Review Department, March 3, 2005.

[26] IMF, *Evaluation of Structural Conditionality in IMF-Supported Programs*, Issues Paper for an Evaluation by the Independent Evaluation Offices (IEO), May 17, 2005.

[27] Independent Evaluation Office (IEO), *Evaluation of the IMF's Role in Poverty Reduction Strategy Papers and the Poverty Reduction and Growth Facility*, prepared by a team headed by David Goldsbroug (Washington, D.C.: International Monetary Fund, 2004).

A further review of interest is published in a joint report from the World Bank Operations Evaluation Department (OED) and the IMF IEO from 2005. In this report, the Poverty Reduction Strategy Initiative is studied through 10 country case studies of IMF and World Bank supported programs.[28] This focuses particularly on the policy process, including the degree of policy ownership, participation in the process and coordination between the two institutions.[29]

In addition to these IFI reports, in the following, we will discuss recent literature produced by NGOs, independent academics and other international donors and institutions. In terms of NGO literature we will focus particularly on four recent reports published by Eurodad, Action Aid, Christian Aid and the Debt and Development Coalition of Ireland (DDCI) respectively. The European NGO Eurodad has conducted a review of conditionalities faced by 20 low-income countries selected according to given criteria.[30] The report studies the number of conditionalities faced by the countries, the extent to which they touch sensitive areas (i.e. privatization and liberalization) and the extent to which the World Bank follows its own recommendations for conditionality practice.[31] The Action Aid report takes a different and more qualitative approach to assessing the degree to which the World Bank has changed its practices as a result of the conditionality review, and how likely it is that the GPPs will be implemented. The report is a mix of critique of the GPPs and a critique of their implementation in Pakistan and Uganda.[32] Christian Aid's report focuses on trade liberalization and the extent to which the World Bank and IMF policies have changed regarding this issue. It examines eight low-income countries in Africa: Mozambique, Mali, Malawi, Kenya, Tanzania, Senegal, Ethiopia and Ghana.[33] Finally, a report by the DDCI examines 13 PRSC programs focusing on conditionalities related to privatization.[34]

While there is an immense amount of studies on specific countries, or on the more general topics of privatization, liberalization and IFI involvement, the above mentioned reports are those that explicitly and comprehensively study the recent use of conditionalities of the IFIs with a specific focus on privatization/liberalization conditionality.

[28] OED/IEO, *The Poverty Reduction Strategy Initiative: Findings from 10 Country Case Studies of World Bank and IMF Support* (Washington, D.C.: The World Bank, 2005).

[29] The study includes the following countries: Albania, Cambodia, Ethiopia, Guinea, Mauritania, Mozambique, Nicaragua, Tajikistan, Tanzania, and Vietnam. Data collection for the study finished in 2003.

[30] These are that the country had (i) more than one World Bank development policy loan and more than one IMF PRGF or equivalent in the last five years, (ii) that the country had produced at least one national poverty reduction strategy paper in the last five years; and (iii) that the country was classified as a post-stabilization country. In addition, there were used criteria to ensure geographical diversity, and priority was given to HIPC countries.

[31] Eurodad, *World Bank and IMF conditionality: a development injustice* (2006).

[32] Action Aid, *What Progress? A Shadow Review of World Bank Conditionality* (2006).

[33] Christian Aid, *Business as usual: The World Bank, the IMF and the liberalisation agenda* (September 2005).

[34] Debt and Development Coalition of Ireland, *World Bank's Poverty Reduction Support Credit Continuity or Change?*, 2005.

5.1. Have conditionality practices changed?

- World Bank/IMF: the number of legally binding conditions is reduced.
- World Bank: the number of indicative benchmarks has increased due to more complex loans (PRSC).
- NGOs in agreement on these overall trends, but criticize the increase in the use of benchmarks.
- NGOs criticise indirect conditionality (screening of borrowers).
- Questions raised by IMF on process conditionality.

The main conclusion from the IFI literature is that there are significant changes in the practice of conditionality. First, the number of legally binding conditions per loan is found to have been reduced, but primarily in World Bank loans. The Conditionality Review finds that the average number of conditions per World Bank policy based operation has declined from above 35 in the late 1980s and early 1990s to about 12 in fiscal year 2005 (FY05). This trend can be found in all regions, and in all types of borrowing countries, whether IBRD or IDA borrowers.[35] The Retrospective confirms this conclusion as it finds that the average number of conditions per policy-based operation has remained at the level of FY05 in FY06.[36]

The IMF Staff Evaluation from 2005 also finds that the overall number of conditions in the PRGFs has declined, but as it has increased in the programs supported by the General Resources Account (GRA) (from an average of 16-20 in the 1990s to 21-23 in 2003-2004), the overall number of conditionalities in Fund supported programs has been stable.[37] In GRA supported programs there is also a tendency that weak track records have led to a higher number of conditionalities, one of the practices that was criticized in the "old" conditionality debate and that the emphasis on streamlining and criticality was set out to avoid. The report also shows that "aggregate" Fund-Bank conditionality is on the decline because Bank conditions have become fewer in GRA countries, and both have been reduced in PRGF countries. Moreover, the Fund shows little tendency now to "step into" areas that are in fact of Bank responsibility but where the Bank was not present.[38]

Second, there is a change in the type of conditionalities used. The World Bank reports find that whereas the number of binding conditionalities has dropped, the number of indicative benchmarks has increased. The Conditionality Review finds that the number of indicative benchmarks has increased from an average of about 15 in the early 1990s to around 23 in FY05. Thus, the average policy matrix – which includes prior actions, triggers and indicative benchmarks – has grown in length, even through the number of prior actions has fallen.[39] According to the Retrospective, the average number of benchmarks rose further from 30 in FY05 and 32 in FY06. This trend is argued to be closely associated with the emergence of large policy matrices under PRSC-supported multisectoral programs. In line with this explanation, it finds a significant difference between IBRD operations and IDA operations in terms of benchmarks: In contrast to IDA operations IBRD operations use few benchmarks and the declining trend that begun in FY04 has continued into FY06. The IBRD loans use

[35] World Bank, *Review of World Bank Conditionality.*
[36] World Bank, *Development Policy Lending Retrospective.*
[37] IMF, *Review of the 2002 Conditionality Guidelines.*
[38] IMF, *Review of the 2002 Conditionality Guidelines*.
[39] World Bank, *Review of World Bank Conditionality*

small policy matrices that are focused on prior actions and triggers, leaving the description of the broader program to government documents or analytic underpinnings.[40]

For the IMF – that does not distinguish as clearly between binding conditionalities and benchmarks – the picture is slightly different. The IMF's 2004 IEO Evaluation shows that there has been a significant decline in performance criteria (4.0/2.7) and structural benchmarks (8.4/4.9), but no decline in prior actions (4.8/4.5) from the ESAF to PRGF programs.[41] The IEO 2004 also criticizes the "process conditionality" involved in the PRS processes. It emphasizes that there are great difficulties in attempting from the outside to encourage political systems to move in the direction of greater openness, accountability, and participatory policymaking. Due to these difficulties, there has been extensive emphasis on improving these processes. According to the report, there is a risk that the focus on participatory processes distracts attention from the task of making improvements in existing domestic procedures for policy formulation and implementation.[42]

Also a number of NGOs have focused on the number of conditionalities faced by borrowing countries. The main finding of the Eurodad report is that 14 out of the 20 low income countries studied have more than fifty conditions attached to each of their current World Bank grants, and 3 out of the 20 have more than 100 conditions. Contrary to the World Bank's own conditionality review, Eurodad furthermore finds that the number of conditions in loans issued by the World Bank is rising not falling. However, this conclusion rests on their counting of benchmarks as conditionalities and it is the number of benchmarks that has registered a strong increase.[43] The DDCI report is more in line with the World Bank's own evaluation. It shows that the number of binding conditions has indeed decreased. However, the number of non-binding conditions, including benchmarks has increased.[44] On a more qualitative basis, the Action Aid report argues that the number of conditions attached to World Bank loans remains too high and very often inappropriate or non-critical conditions are used.[45]

In sum, there is not really a great deal of discrepancy between the IFIs and the NGOs in terms of the view of whether the number of conditionalities has declined. The apparent disagreement stems in good part from differences in their definition of conditionality, more specifically to the issue of whether to include benchmarks in the term conditionalities. The Eurodad report defines conditionality broadly as "commitments contained within a donor's loan or grant contract that developing countries must adhere to if they are to receive all or part of the funding" (p.4). In this definition they include "prior actions" (named binding conditions) and "benchmarks" (named non-binding conditions). When the distinction is made between binding and non-binding conditionality (such as in the DDCI report), the disagreement regarding numbers tend to disappear.

However, the difference in their definition goes in some cases further than that. The Conditionality Review and the Retrospective of the World Bank do not consider CPIAs or other forms of assessments not included in the loan documents as conditionalities, whereas several of the NGOs are concerned with various broader forms of conditionality. The

[40] World Bank, *Development Policy Lending Retrospective*
[41] IEO, *Evaluation of the IMF's Role*.
[42] IEO *Evaluation of the IMF's Role*.
[43] Eurodad, *World Bank and IMF conditionality: a development injustice*
[44] Debt and Development Coalition of Ireland, *World Bank's Poverty Reduction Support Credit.*
[45] Action Aid, *What Progress?*

Christian Aid Report focuses on a series of alternative methods to ensure compliance rather than formal conditionality. These include the conduction of CPIAs and the elaboration of Country Assistance Strategies (CAS). Also the IMF's Article IV consultations, and in the area of trade specifically, the Diagnostic Trade Information Studies (DTIS) conducted by the World Bank are viewed as a form of conditionality.[46] Also Eurodad criticizes the World Bank's use of the CPIAs and points out that, ironically, it is the countries with the highest CPIA score that have the highest number of conditions.[47]

Underlying this disagreement are also differences with regards to the view on ownership and the participatory nature of loan negotiation processes. Underlying the NGO's definition of benchmarks as conditionalities is a view of the processes of formulating the benchmarks as basically run by the IFIs and all monitoring advices included in the loan documents and policy matrices as "imposed". In this case, it is clearly negative that the number of benchmarks has increased.

We find that the combination of a broad definition of conditionality and an assumption of imposition is problematic. The problem is for example illustrated in the Eurodad report's use of the Uganda example. The Eurodad report finds that Uganda faces the highest number of conditionalities of all countries included in the study. In the PRSC5, they sum up to 197 including benchmarks. However, they fail to notice that the policy matrix of PRSC5 is a direct copy of Uganda's poverty reduction strategy and that the benchmarks are developed through the process of formulating this strategy. Providing no evidence of imposition, it is difficult to assess the extent to which the high number of conditions represents the alleged "micro-management" by the Bank or simply a complex poverty reduction strategy.

5.2. Has the content of conditionality changed?

- World Bank: The emphasis on privatization has declined and there is increased emphasis on institutional issues/governance
- IMF: Conditionality is more narrowly focusing on economic management.
- NGOs: Privatisation/liberalisation remains an issue in most World Bank/IMF loans. Although some change is observed, there is no real change in policy emphasis.

The second question of importance to us is whether the content of conditionality has changed. This is also a relatively broad question, but we will focus primarily on the "negative" side: whether there has been a decline and change in the conditionalities that include privatization and/or liberalization.

With regards to content, the Conditionality review finds that the emphasis on privatization has strongly declined since the 1990s. Reforms in the financial sector and private sector development continue to be important areas of Bank engagement, but with a focus on improving business environments rather than on privatization. Conditionality on user fees is found to be extremely limited; it exists in the power sector (eastern Europe and Latin America), but there are virtually no such conditions in basic health, education, and water, and

[46] Christian Aid, *Business as usual.*
[47] Eurodad, *World Bank and IMF conditionality.*

when such conditions are used they may actually call for the removal of user fees. Furthermore, conditionality on trade liberalization has declined significantly since the mid-1980s. The focus of remaining conditions is on institutional issues, such as the performance of customs agencies, etc.[48]

The Retrospective further emphasizes that the content of conditionality is found to have become strongly focused on public governance. The most important sectors for conditionality are law and public administration, making up 50 percent in the IDA countries, followed by education, health, finance, energy, transport and agriculture that each have been almost equally important sectors. In IBRD countries, financial sector issues play a larger role. The number of conditions related to privatization and liberalization has continued to drop in FY06, and these conditions now play a relatively small role according to the report.[49]

The IMF Staff Review also finds a major shift in the coverage of structural conditionality, suggesting a greater focus on criticality. In practice that has meant that the IMF conditionalities have focused more narrowly on debt and financial vulnerabilities and economic management and less on growth and efficiency related reforms. Nevertheless, whereas the guidelines stipulate that structural benchmarks (like the performance criteria) can only be used for critical measures, the report finds that they are still used in some cases to monitor less critical reforms.[50]

The IEO 2004 Evaluation finds that both the Bank and the Fund have reduced the shares of their conditionality on reforms of state owned enterprises (SOEs) and trade.[51] Yet the main focus is on the content of PRSPs not on conditionalities per se. It finds that almost two-thirds of PRSPs envisage some form of privatization, and a little under half give some emphasis to financial sector liberalization and decentralization (p.33). However, trade liberalization and state enterprise reform is generally not treated in detail.[52] This is in turn reflected in the PRGFs.

The joint IEO-OED 2005 evaluation of PRSCs and PRGFs finds that the total number of structural conditions under PRSC and PRGF programs has fallen, in particular conditions for enterprise restructuring and privatization. They do, however, remain important elements in sectoral programs.[53]

Also several of the NGOs have focused on the issue of the content of conditionalities. The Eurodad report finds that 20 percent of all conditions in the World Bank loans are economic policy conditions, and over half of these (11 percent) include privatization or trade liberalization.[54] Similarly, the DDCI report finds that there are conditionalities related to privatization in all but two of the examined PRSCs. Most of the PRSPs upon which these PRSCs are based do indeed talk about privatization, but there are also examples of PRSCs with privatization conditionality that are based on PRSPs which do not include privatization (this includes Burkina Faso, Ghana, Mozambique and Senegal). Moreover, the general thrust of the conditions is similar to previous World Bank approaches: encouraging private sector

[48] World Bank, *Review of World Bank Conditionality.*
[49] World Bank, *Development Policy Lending Retrospective.*
[50] IMF, *Review of the 2002 Conditionality Guidelines.*
[51] IEO, Evaluation of the IMF's Role.
[52] IEO, Evaluation of the IMF's Role.
[53] OED/IEO, *The Poverty Reduction Strategy Initiative.*
[54] Eurodad, *World Bank and IMF conditionality.*

investment, decentralizing public service provision, private sector provision of basic services, etc.[55]

Contrary to many of the other reports that focus exclusively on the World Bank and on a broader set of conditions, the Christian Aid report, which is mostly concerned with the IMF and trade liberalization, finds that the number of formal trade conditions appears to be declining. Yet, this does not mean that the Bank and the Fund have abandoned trade conditions. The report argues that the fall in number is less relevant due to several factors. First, it says little about how significant and encompassing conditions really are. It gives the example from Kenya where one single condition includes "the implementation of comprehensive trade reforms", implying a complex process of policy change. Second, in many cases the number of conditionalities has fallen because the liberalization is already completed. African countries are already considerably more liberalized than they were in the late 1990s, and focus can be on complementary policies that do not fall so clearly under the category of trade policy conditions.[56]

In sum, there is general agreement that the number of privatization and liberalization conditionalities has declined, but that these still play a part in some programs. However, there is no general agreement on the emphasis placed on this kind of policy by the World Bank and the IMF. Whereas the IFIs themselves argue that the main policy focus is currently on governance and economic management, the NGOs claim that the basic orientation has not changed, and privatization and liberalization are still priorities for the IFIs.

5.3. Is there real ownership of the programs?

- World Bank: reports that key government officers generally confirm a sense of country ownership; rejects that pressure is exerted.
- IMF: critical about its own role in PRSP-related processes, points to insufficient participation on macro-economic questions.
- NGOs: assert lack of public involvement in policy reform processes
- IFIs have not been good enough in assisting borrowers elaborating policy alternatives

As mentioned above, an issue of particular interest for us is the issue of ownership, as this has direct relevance for the issue of use of pressure by the IFIs. We understand ownership to include the question of whether the programs adequately reflect government priorities set out in national development plans. Moreover, it includes whether the process of elaborating these development plans has been inclusive, and, finally whether the countries have been given sufficient "policy space" and assistance in development of policy alternatives.

The Conditionality Review includes a conditionality survey in which 105 governmental officials with experience with World Bank policy based operations have participated. A main focus of this survey is the issue of ownership. It reveals that 70% of the respondents felt that there is a sense of ownership to the program, 74% felt it had sufficient political support and

[55] Debt and Development Coalition of Ireland, *World Bank's Poverty Reduction Support Credit.*
[56] Christian Aid, *Business as usual.*

84% felt it was well aligned with the country's medium and long-term development strategy. However, it also reports that 50% felt that the Bank introduced elements that were not part of the country's program, and that 38% felt that the government's original policy program was significantly modified in negotiations with the World Bank.[57]

The Retrospective argues that the limited number of privatization and trade reforms supported under the set of operations approved in the second half of FY06 respect government preferences and take into account government constraints. The examples given here are programs from Mali, Egypt, Vietnam and Guyana.[58]

The IMF reports have a somewhat more self-critical tone. The IMF's 2005 Staff Review points to the great difficulty of gauging ownership, and hint at the possibility that the staff sometimes unduly discounts issues of divided ownership. It further finds little evidence that staff advise the authorities on a range of available policy options and implementation plans during the process of program development. The process of program design tends to be driven by an interplay between the staff and the authorities' preferences rather than proactively developing policy options. Rarely does staff consider the possibility that the authorities' administrative capacity is too weak for this interplay to ensure that the range of appropriate policy options is covered.[59]

The IEO 2004 Evaluation is even more critical of the IMF's own work on ownership. At a positive note it highlights that there are signs that the "policy space" in the macroeconomic area has widened – in the sense that there is greater openness on the part of the IMF for considering alternative country-driven policies. PRGF supported programs generally target a smaller and more gradual fiscal adjustment than under the ESAF and give more weight to revenue increases than expenditure contraction.

However, the report also finds that the PRSP processes have had limited impact on generating meaningful discussions outside the narrow official circle of alternative policy options with respect to macro-economic framework and macro-relevant structural reforms.[60] The report also points out the tension between the principle that PRSPs should be country driven, and the externally imposed requirement for "broad-based participation," which must be associated with an underlying – but unexpressed – judgment that existing political processes in the recipient countries are inadequate. Furthermore, it points to the tension between the emphasis on country ownership of policies and the role of IFI policy assessment. While the PRS initiative is meant to encourage the exploration of alternative country driven policy options, there is still the basic requirement that the IMF (and the World Bank) must advice on "sound" policies and the implicit assumption that they can help improve outcomes by influencing policy choices through policy advice and conditionality.

Results in terms of ownership are therefore found to be mixed. In most of the country case studies the drafting of the PRSP was done by nationals of the country, although they in three cases were donor funded consultants. The role of parliaments was uneven: of the 29 PRSPs produced up to July 2003, the final draft of the document was formally sent to parliaments in only 13 cases. In all country case studies, the authorities confirmed that the key initial driver

[57] World Bank, "2005 Conditionality Survey: Executive Summary and Detailed Survey Results", *Review of World Bank Conditionality*, Background Paper 6, 2005.
[58] World Bank, *Development Policy Lending Retrospective.*
[59] IMF, *Review of the 2002 Conditionality Guidelines*
[60] IEO, *Evaluation of the IMF's Role*.

for embarking on a PRSP process was the fact that it was a necessary condition for getting access to debt relief under Heavily Indebted Poor Country (HIPC) initiative and/or to concessional lending from the IMF and the World Bank. Regarding participation the report concludes that the impact of the participatory process on final strategies was generally not large, at least in areas of primary concern to the IMF, namely macro economic areas. Indeed, the macroeconomic framework of the PRS was generally not developed in a participatory manner. Furthermore, in most PRGFs, key strategic priorities and policy choices in both macroeconomic and structural areas in program design are still not guided by the PRSP. The perception that the approach is overly influenced by procedural requirements of the IFIs is found to be widespread.

The report also goes far in identifying the cause of the failure to implement the ambitions of the PRS approach. The approach implies a very different way of organizing IMF inputs, operating within a "partnership framework that recognizes explicitly that IMF contributions are only one part of a broader picture. This means that the IMF program and surveillance roles in PRSP countries will be qualitatively different from those in other countries. However, the consequences have largely not been spelled out, resulting in an attempt to address a very different set of challenges with an essentially unchanged institutional approach.[61]

Also the joint OED-IEO report focuses significant attention on the issue of ownership.[62] At the general level it is argued that the "policy space" has widened for each individual country and that the IFIs no longer bring rigid policy preferences. In the case studies the report raises the question directly of whether there has been pressure from the IMF or the World Bank to adopt controversial policies of privatization and liberalization. The report does not find any degree of pressure from the World Bank to implement policies of privatization and liberalization in any of the case studies. However, in one case (Nicaragua) it was widely believed that the emphasis – not on privatization and liberalization, but on social-sector spending – had been imposed by the Bank. In another case (Tanzania) civil society members criticized the Bank for *not* exerting more influence on the government in order to make it strengthen the participatory elements during the formulation of the PRSP.

A general conclusion from this report is that there is much less public discussion about the macroeconomic issues of concern to the IMF, than the more micro-oriented issues of concern to the World Bank – in spite of the fact that they may have equally important developmental consequences. This confirms the conclusion in the IEO 2004 evaluation.[63]

In sum, there is significant discrepancy between the World Bank and the IMF evaluations regarding ownership. In general, the World Bank evaluates the ownership of its own programs more positively than the IMF does. Moreover, the World Bank rejects that there are any forms of "pressure" on the government to adopt specific policies and evaluates as positively the way in which their lending programs reflect the priorities in the PRSPs. The IMF admits that there is insufficient participation in macro-economic areas of concern to them, and that the PRGFs do not always reflect the PRSPs in macro-economic areas. The differences may of course partly be explained by different approaches used by the respective evaluation departments.

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[61] IEO, *Evaluation of the IMF's Role*
[62] OED/IEO, *The Poverty Reduction Strategy Initiative.*
[63] OED/IEO, *The Poverty Reduction Strategy Initiative.*

The NGOs are highly critical of the Bank's and the Fund's ability to ensure ownership, and criticize the PRSP processes for being prepared under the sway of the World Bank. Moreover, they argue that the Bank continues to impose controversial economic policy reforms on poor countries, also where they are not expressed in country's own national poverty strategies.[64]

The Action Aid report focuses particularly on the question of whether the IFIs follow their own guidelines. It argues that ownership should mean that policies are adopted through democratic means involving a wide range of stakeholders in society. The report finds that resulting from the narrower definition of "ownership" applied by the World Bank, civil society groups in Uganda feel that most of the agenda on economic management and the direction of public sector reforms are driven by the World Bank and the IMF. In Pakistan it is found that water privatization policies are agreed between the Bank and the government with scarce civil society involvement.[65]

Also some other international organizations and independent studies have focused on the issue of ownership and the nature of the process of elaborating development plans. The United Nations Economic Commission for Africa (UNECA) together with the United Nations Development Program (UNDP) commissioned in the early 2000 a study on the elaboration of PRSPs in 12 African countries as an input to the UNECA initiative, the PRSP Learning Group.[66] These found that the African governments encountered serious difficulties in the formulation and implementation of credible national poverty reduction plans. Although great progress was reported to have been made in linking budgeting with planning, through e.g. the Medium Term Expenditure Framework (MTEF), there are major difficulties in the estimation of costs. Consequently, the financing gap is in many instances so wide that the PRSPs are considered a wish list. Furthermore, the institutionalization of the participatory process of elaboration of the PRSP remains weak. It is pointed out that the private sector (business) is virtually excluded from participation in many cases, and that national parliaments as well as regional and local elected bodies have been excluded from the process.

The institutional weaknesses are confirmed in a recent independent study focuses on the case of the elaboration of the Poverty Reduction Strategy Paper in Ghana and focuses on the extent to which the new foreign aid regime places constraints on democratic governance. This study finds that the parliament and other constitutionally established bodies are generally by-passed in the elaboration of the PRSP. Much of this is accounted for by the zeal of donors to involve 'civil society' in policy discussions.[67]

In summary, the studies find several weaknesses in the way ownership is practiced. With regards to loan programs' reflection of government priorities, the World Bank reports evaluate the Bank's own progress on this account more positively than the similar IMF studies do of the IMF's progress. The IMF observes a dilemma between the requirement of respecting national policy priorities and encouraging adoption of "sound" economic policies.

Regarding inclusiveness, the World Bank evaluates this as satisfactory, whereas NGOs and others find major flaws, including the lack of respect for existing democratic institutions,

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[64] Eurodad, *World Bank and IMF conditionality.*
[65] Action Aid, *What Progress?*
[66] Fantu Cheru, 'Building and Supporting PRSPs in Africa: what has worked well so far? What needs changing?', *Third World Quarterly*, Vol. 27, 2006 (2):,355-376.
[67] Lindsay Withfield, Trustees of development from conditionality to governance: poverty reduction strategy papers in Ghana, J. of Modern African Studies, 43,4 (2005): 641-664.

including parliaments. The IMF also admits that in the area of macro-economic policy there has been limited public debate and the PRGFs are not consistently based on the PRSPs when it comes to macroeconomic issues.

And finally, regarding "policy space" and assistance in development of policy alternatives, the conclusion from the Fund and the Bank is that the borrowing countries have significantly more "policy space" today than before due to more flexible fiscal targets and less fixed policy solutions. At the same time, it is admitted that the IFIs have not been good enough at elaborating policy alternatives or assisting the borrowing member countries in doing so.

5.4. Evaluation of main studies

- IFI reports tend to adopt quite narrow methodological and disciplinary approaches.
- NGO reports often present weak and selective evidence for strong claims.

The main emphasis above has been on IFI and NGO reports as these generally are of sufficiently recent date to be relevant for our purpose. However, both IFI reports and NGO reports have significant biases and flaws. The main problem of the NGO reports are the weak evidence that they often present for their strong claims. For example, it is frequently argued that the IFIs continue to "impose" policy conditions, without presenting any evidence that the conditions referred to are indeed imposed. Moreover, to the extent that the reports refer to studies, they say little about the methods that are used. A further problem is that many reports tend to consciously misrepresent the findings of IFI reports, and present only evidence that support their cause.[68] This reduces the credibility of otherwise useful and interesting reports.

The IFI reports also have significant flaws. Although having had quite different human and financial resources available than the NGOs, there are questionable methods employed in several of the individual reports. For example, the much quoted Conditionality Survey has committed the error of asking the respondents to react to a series of almost exclusively positive statements about World Bank policy and practice. It is a well known problem in survey method that people have a tendency to answer affirmatively. In order to reveal the "real" attitude of respondents one should therefore vary the "direction" of statements. [69]

Yet, the most serious weakness of the IFI reports is their quite narrow methodological and disciplinary starting points. To the extent that the reports refer to literature produced outside of the IFIs themselves, they refer almost exclusively to economic literature, written by economists and published in economic journals.[70] They employ almost exclusively either a quantitative method or simply deduce conclusions from modeling. This goes both for the studies of conditionality as such and for the studies of the economic reforms that conditionality is supposed to encourage. In conclusion, there is a need for further independent studies.

[68] For example, the Eurodad report mentions that 50% of the representatives of recipient countries interviewed in the World Bank Conditionality Survey felt that the "World Bank introduced elements that were not part of the country's program". The report takes this as an evidence of lack of ownership, but fail to mention that 70% agrees that there is a strong sense of ownership of World Bank-supported policy programs in my country".

[69] Howard Schuman and Stanley Presser, *Questions and Answers in Attitude Surveys. Experiments on Question Forms, Wording and Context* (New York: Academic Press Inc., 1981).

[70] See, e.g., "The Theory and Practice of Conditionality: a Literature Review", *Reveiw of World Bank Conditionality*, Background Paper 5, Development Economics, World Bank, 2005.

PART III: STUDIES UNDERTAKEN FOR THIS REPORT

6. A quantitative study of IMF's recent PRGFs

- Privatization is still an important element in the 40 PRGF supported programs reviewed, but often not included as conditionalities.
- Liberalization is less pronounced.
- There is great variation in the number of conditionalities.
- There is no indication of a changing trend.

The review above shows that there is more focus on the World Bank's use of conditionality in the areas of privatization and liberalization than the IMF's, both from NGOs and independent academics. The World Bank is also the focus of a DFID lead review of the recent use of conditionality.[71] This imbalance was the motivation for the inclusion of a "desk"-review of the IMF's use of conditionality to encourage privatization and liberalization in recent programs.

A review of 40 PRGF supported programs was undertaken. Selection criteria were simply that the PRGFs had to be operative in 2006 and been approved in 2002 or later. The main purpose of this exercise was to conduct a brief review of whether privatization and liberalization still were important features of these programs, and the extent to which they were included in the policy conditionalities. Conditionalities were operationalized as defined above, in line with the IMF's use of the term, to include all structural conditionality including prior actions, performance criteria and structural benchmarks. Quantitative criteria were not included.

The findings show that privatization and liberalization indeed still figure as important elements in the PRGFs. In 26 of 40 cases there were conditions that demanded either privatization or liberalization. Privatization, included in 23 of the cases, was by far the most common. In addition, 10 of the programs described in detail the privatization plans of the government, but these were not included in the policy conditionalities. That means that in only 7 of the 40 cases privatization did not figure as an important element of the PRGF.

There may be several reasons why detailed privatization plans in 10 cases did not figure among conditionalities. It may not have been deemed "critical" for the success of the program by the IMF or it may be solely a governmental initiative with little IMF input. However, individual countries may also have included a strong emphasis on privatization due to an understanding that this is a policy which is still looked upon favorably by the IMF board.

Liberalization was not an equally important element of the PRGFs. In 11 of the 40 cases, liberalization was a part of the conditionalities. Liberalization was divided into two categories: trade liberalization and price liberalization; the latter category including removal of subsidies. Trade liberalization figured as a conditionality in only three cases, whereas there were 9 cases of conditionalities demanding price liberalization.

[71] DFID, CIDA, BMZ and Norway: Joint Monitoring of World Bank Conditionality, to be finalized by the end of 2006.

With regards to the total number of conditionalities we have counted structural benchmarks on the one hand, and prior actions and performance criteria jointly on the other. We found there to be an average of 5,3 “hard conditions” (prior actions and performance criteria) in the PRGFs and an average of 6,8 benchmarks. However, the most notable is perhaps the great variation in the number of benchmarks and “hard conditions”. One extreme case had 16 hard conditions and 13 benchmarks (the Dominican Republic), whereas one case had only 1 hard condition attached (Afghanistan) and many had between 2 and 6 of each type. Again there are many interpretations of this. There is no ground for drawing the conclusion that those countries where policy is most out of line with IMF’s preferences have the most conditionalities. A more plausible explanation is that the government itself has played an important role in spelling out the desired prior actions, performance criteria and benchmarks and thus limited the attempts at streamlining the process on the part of the IMF.

We have also looked at variations across regions and over time. With regard to regions, privatization and liberalization conditions figure less prominently in African PRGFs (13/20) than those of the other regions. The difference is more noticeable if we look at only privatization, which figures in 8 out of 20 PRGFs. Privatization and liberalization conditions figure in 7 out of 8 Asian PRGFs, 3 out of 4 PRGFs with Central European or East European countries, and 5 of 8 PRGFs with Latin American countries.

There is no significant variation across time. In other words, the PRGF supported programs entered into in 2006 have neither more nor less conditionalities related to privatization and liberalization than those entered into in 2002.

7. Sector reviews

Due to the significant bias towards utility reform, and particularly energy reform in the case studies, we found it useful to include also a brief review of changes and/or continuities in World Bank and IMF policy in other sectors sectors. We chose to focus on, social sectors (health and education) and trade, in addition to utilities (focusing on energy and water).

7.2. Utilities

- A change in World Bank policy has taken place:
  - less emphasis on shift of ownership;
  - more focus on regulatory frameworks;
  - a recognition of flaws in many utility sector reforms, especially in Africa.
- The poverty focus of utility sector reforms needs to be more strongly emphasized, by the World Bank as well as many borrowers.
- The critique of World Bank often has ideological overtones, but consensus on a more nuanced role for the private sector in the utility sector has emerged.

From state ownership to privatization

In the 1980s the World Bank lent money to a number of governments in the developing world for projects in water and electricity. Almost none at that time was for privatization, but most aimed at some form of institutional reform to improve services. Most of these projects were unsuccessful, often due to what has been described as limited political will to change existing power structures.[72] Substantial amounts of money were poured into state with blatant mismanagement practices. The results were meager. The typical public sector reform projects supported by donors appeared mostly impotent in face of the challenges.

At the end of the 1980s, the development paradigms in the World Bank changed decidedly towards economic liberalization. The opening of markets and reduction of state ownership were increasingly seen as solutions to exiting utility inefficiency and mismanagement. The private sector, it was believed, would be more independent of the political forces that were seen to hinder development.

Besides the aim of improving performance, one other important initial reason for privatization of utilities was to reduce the fiscal burden of governments. This was in many cases tied into structural adjustment packages that sought to balance the budgets and to reduce rampant inflation. In the 1990s privatization thus became a key part of conditionalities in the electricity sector,[73]and privatization and/or cost recovery policies were recurrent conditionalities in the water sector.[74]

In water, the typical privatization model consists of awarding a concession/management contract to a private firm for delivery of water for a specified period. There can also be service contracts for specialized services like billing. In energy, the typical privatization model is through what is called independent power producers (IPP) where a private firm operates a power generation plant of some type, and then has an agreement to sell the electricity to a government distributor. While there are few that have privatized the whole power chain – generation, transmission and distribution – unbundling has taken place in a number of countries with a view to later commercialize and/or privatize parts or the whole.

Critique and changes in the utility agenda

At the turn of the century, the privatization prescriptions came under severe criticism with several high profiled failures.[75] The critique was fourfold:

Flaws in the reforms. The first point of critique against early reforms was that without good regulations, private companies will try to realize monopolistic profits, and limit the functioning of markets to the detriment of consumers. One reason for flawed regulatory

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[72] Virginia Roaf, "*After Privatisation: What Next?*", Global Issue Papers, 28 (2006), Heinrich Böll Stiftung.
[73] Kate Bayliss,,"*Privatisation of Electricity Distribution: Some Economic, Social and Political Perspectives*" (PSIRU Report April 2001).
[74] Sarah Grusky, "IMF Forces Water Privatisation on Poor Countries" (Global Challenge Initiative, 2001).
[75] There are many sources, but one giving a good overview is for instance Afeikhena Jerome, " Infrastructure Privatisation and Liberalisation in Africa "The Quest for the Holy Grail or Coup de Grace?" (National institute for Economic Policy, Johannesburg, September 2004).

frameworks is that privatization receipts to the government increase with the profitability of the firm to be sold. Thus, many Governments offer exclusivity periods and price liberalization to increase the attractiveness of the utility, and financially strapped governments are more likely to offer extensive concessions than Government with better finances.[76]

Flaws in the process of reforms. One problem of the privatization processes is that there are rarely more than two bidders in auctions for major concession contracts in developing countries.[77] Many SOEs are thus sold at a discount,[78]and to terms that involve major market privileges. In Africa, there is a particular dearth of utility investors, and this reduces not only the competition, but indeed the whole credibility of the transaction. This problem is aggravated by the fact that private firms often have considerably more bargaining power, clout and expertise than their counterparts on the government side. A highly unfortunate situation is found when the World Bank takes an active role on the side of the private firm in such negotiations. Uganda is one country where this seems to have happened, both in the water and in the power sector. This has had nearly disastrous consequences for the power situation in Uganda. [79]

Disappointing benefits from privatization. The fiscal benefits to governments are not guaranteed, particularly if the public utility was making profits before the sale.[80] The proceeds from the sale plus new taxes from the private investors may not cover the shortfall in income from the enterprise. In the power sector, badly designed Power Purchasing Agreements (PPA) have left Governments with substantial liabilities, often in hard currency. Furthermore, privatization may have skewed distributional impact. While some literature support the notion that private firms are more efficient operators than public[81], these efficiency gains are not automatically passed on to consumers. The poor may have to pay higher prices for the same service, they may as low paying customers lose the service, and those that are informally attached to the network may be disconnected. Allowing customers to steal constitutes in some countries an important indirect subsidy to the poor. This means that poorer groups often have to bear a proportionally higher cost of reforms, than other groups. [82]

However, the poor may also benefit from privatization if services are extended, prices are made affordable, and services are made more reliable.[83]Of the infrastructure sectors, water supply has had the comparatively least successful experiments with private participation.[84]

[76] Emannuelle Auroil and Pierre Picard, ”Infrastructure and Public Utilities Privatisation in Developing Countries*”*, *World Bank Policy Research Paper,* June (2006).
[77] Trujillo, Quinet, Estache: “*Dealing with Demand Forecast Games in Transport Privatization*”, Transport Policy, 2002.
[78] Nancy Birdsall and Peter Nellis, “*Winners and Losers: Assessing the Distributional Impact of Privatisation*”, Center for Global Development, Working Paper no 6.
[79] Action Aid, *How Money Talks. How aid conditions continue to drive privatization in poor countries* (2004), p. 11; and Nordic Consulting Group, *Review Of The Norwegian Support to the Energy Sector In Uganda 1997 – 2005* (2005).
[80] Auroil and Picard, “Infrastructure and Utility Privatization”.
[81] Megginson and Netter: *”From State to Market: a Survey of Empirical studies on Privatisation*”, Journal of Economic Literature, 2001, no.39.
[82] Nancy Birdsall and John Nellis, *“Winners and Losers: Assessing the Distributional Impact of Privatisation”*. *World Development,*Vol 31, 10 (2003).
[83] Selim Jahan and Robert McCleery, *”Making Infrastructure Work for the Poor. Synthesis Report of four country studies Bangladesh, Senegal, Thailand and Zambia*” (UNDP, 2005).
[84] Colin Kirckpatrick, David Parker, and Yin-Fang Zhang, “An Empirical Analysis of State and Private Sector Provision of Water Services in Africa”, *World Bank Economic Review*, Vol 20, 1 (2006).

The role of the IFIs. Also the role of the IFIs has been criticized. In some cases privatization related conditions appear to have led to rushed privatizations, for governments to get access to aid funds. The time constraints inherent in conditionalities may cut the privatization processes short, for instance by bypassing the establishment of sound regulatory bodies. It needs to be emphasized that, not only the IFIs, but most donors have at some stage been involved in the sector, and most have in some way promoted increased private participation in infrastructure. Indeed, there are few - even today - that completely disregard any private involvement in the sector.

Changes in strategy

Regarding policies increasingly, the Bank accepts the conclusion that shift of ownership is not a panacea, but that the utility sector needs considerably more nuanced strategies. There is more emphasis on government regulation and on improving public sector capacity to deliver services, with or without the private sector. The goals are increasingly to get an economically efficient, financially viable and environmentally sustainable service provision, rather than a specific tariff policy or reform. Community based development alternatives are to be assessed. There is even acceptance of the necessity of subsidies.[85]

Regarding strategies, the World Bank Conditionality Review shows that in total numbers, conditionalities tied to privatization of utilities fell from the 1995-1999 to the 2000 – 2005 period. [86] However, in relative terms compared to other sectors, utilities constitute an increasing share of all World Bank conditions and benchmarks tied to privatization.

One recent study confirms that Bank policies on privatisation of water utilities have changed, and that conditionalities tied to these types of policies have been reduced. Of 16 World Bank supported Water and Sanitation projects (approved between 2003 and 2005), 5 include some form of Private Sector Participation (PSP) while 7 focus on public sector reform. In three countries, Brazil, Colombia and Rwanda, the project documents have strong pro-poor focus. However, the picture is mixed and India, Nigeria and Ghana are mentioned as examples where the World Bank continues to push its traditional privatisation policies without regard to poorer groups.[87]

However, the critics of the World Bank are not equally convinced of the changes that have occurred in the Bank. One highly critical voice of the World Bank, the Action Aid, cites a number of examples from 2000 – 2004 where "*donors continue to tie aid to utility privatisation*." The cases mentioned are Burkina Faso, Ghana, India, Kenya, Pakistan, Peru, Tanzania and Uganda. This does, however, not seem like a disproportionate number of countries, compared to all that either get investment or policy loans from the World Bank, or is supported by the IMF PRGF facility.

Conclusion

On balance, one may conclude that the Bank and the Fund still at times recommend privatization, but that there is a change towards recommendations of a more comprehensive

[85] World Bank, *Public and Private Sector Roles in Water Supply and Sanitation Services,* Operational Guidance for World Bank Staff, April 2004.
[86] World Bank, "Content of Conditionality in World Bank Policy-Based Operations: Public Sector Governance, Privatization, User Fees, and Trade", *Review of World Bank Conditionality*, Background Paper 4.
[87] Virginia Roaf, "*After Privatisation: What Next?*", Global Issue Papers No 28 (Heinrich Böll Stiftung, 2006)

reform, including carefully designed regulatory frameworks, and that the shift of ownership increasingly is viewed, not as a panacea, but as one possible item on the reform agenda. All indications are that the IFIs have changed thinking and even practice with regard to privatization and liberalization conditionalities in the utility sector, allowing a wider specter of alternatives and increasing the emphasis on government as an important player. After a decennium of reforms a new consensus seems to be emerging that:

- Privatization reforms cannot be successful without effective regulation, not only in law, but also in practice. This regulatory capacity is a problem in many developing countries which tend to lack personnel and institutions.
- When credible regulatory bodies cannot be established, most developing countries are probably better off keeping their utilities public, in particular the profitable ones.
- Private actors do have a role to play, and it would be a mistake to exclude them én bloc due to the privatization failures seen so far. Community participation in local infrastructure development appears to have gained importance.
- Competition is generally more important than ownership itself in explaining improvements in performance
- There is growing realization that water is special and needs its own solutions, independent of whatever development paradigm rules the day.

However, there is a perceptible time lag from theory to practice, with apparent differences between countries. Thus, in some IFI funded projects old habits appear hard to exorcise.

7.2. Social sectors

- The debate on user fees in primary education and basic health services has changed World Bank policies.
    - Removal of school fees in primary education is recommended.
    - Changes in health polices are less pronounced, but the Millennium Development Goals have caused a renewed emphasis on the public health system and bringing services to the poor.
- Critics warn of new conditionalities lacking sensibility for local contexts and leading towards increasing aid dependence.

The question of liberalization and privatization has been a recurrent theme in the World Bank's social sector policies since it emerged as a major lender to the education and health sectors. This started in the 1980s, but gained momentum in the 1990s with a focus on addressing social consequences of the structural adjustment related reforms. This trend was further enhanced by the UN Social Summit in Copenhagen in 1995 and 5 years later codified in the Millennium Development Goals. Today, the World Bank has emerged as the largest provider of ODA for both primary education and basic health services, and its policy influence has been substantial, even to the extent that UNICEF and WHO at country level in many instances have come to play the second fiddle in the policy dialogue with governments.

The "user fee" debate

Central to the policy debate in both sectors has been the issues of financing of services and access to services for the poor, typically branded as the "user fee" debate. NGO campaigns for reforms in the Bretton Woods Institutions – like "50 years is enough" and "Jubilee 2000 coalition" – have made active use of the user fee issue in the arguments. Their claims are twofold. Firstly, that the World Bank and IMF have forced or induced borrower governments to introduce user payments where services earlier were provided free of charge, and secondly, that this is the cause of declining school enrolment rates and increasing child and maternity mortality. These allegations presume that conditionalities imposed by the IFIs were in fact effectively implemented, and that poor people either could not afford paying even very modest fees or did not value the return to such payments. It has been documented, also by the Bank itself, that expansion of users fees has been a component in a major share of its social sector projects. The Operations and Evaluation Department reported in 1998 that 75% of the portfolio in Health, Nutrition and Population lending to sub-Saharan Africa included this element (40% globally).

There was for a long time very limited research on both the presumptions above. It is also fair to say that many studies coming out seemed to be based on preconceived conclusions – either pro or contra. Whereas intuitively user fees would represent a problem for poor families, less was know about the extent to which fees were actually collected or were replaced by other "fees", such as bribes for educational services and medical care. Why did even many poor families spend substantial resources on traditional medical practitioners or private peddlers of medicines, avoiding public services?

Cutting back on public expenditures in the sectors, for reasons of macroeconomic stability, while at the same time transferring some of the financial burden to users did create a downward spiral of declining quality combined with increased opportunity costs to users. The liberalisation policy also entailed the removal in many countries of barriers against commercial actors in these sectors opening the sectors also to the global market. This has had an impact on availability of services for the more affluent, while the poor became further marginalised.

Critique and changes in IFI practice

A paradigm shift is now under way, clearly influencing the World Bank. This involves a reconfirmation of pre-"Washington consensus" ideology that basic education and health care is a state obligation codified in terms of citizens' rights and duties. These rights should take precedence over other state concerns and may justify, for instance, more expansionary public financing – i.e. removing certain conditionalities on fiscal and monetary policies.[88] It is also argued more strongly that before, that investments in health and education, especially for women, are preconditions for economic growth and poverty reduction.

Bonal summarizes the negative effects of the "Washington Consensus" on education in six main points: (1) reduction of public expenditure in education in absolute figures or per capita; (2) prioritizing basic education at the expense of secondary and tertiary making the latter even more elitist; (3) privatization leading to sharper school segregation; (4) decentralization without transfer of financial resources; (5) increased school autonomy and competition without evidence of improved quality; and (6) a worsening of teachers' working conditions.[89] The so-called post-Washington Consensus entails bringing the state back in and an explicit

[88] Action Aid International, *Contradicting Commitments. How the Achievements of Education For Al is Being Undermined by the International Monetary Fund* (2005).
[89] X Bonal, "The World Bank Global Education Policy and the Post-Washington Consensus", *International Studies in Sociology of Education*, Vol 12, 2002 (1).

poverty reduction focus, but many critics argue that we are yet to see a big difference in World Bank educational policy. There is a commitment to universal schooling – education for all - but the policy toolbox does not include effective redistributional policies.[90]

While evidently there is no simple pattern of cause and effects, and it is difficult to pin down user fees as the main culprit for the alarming trend in social indicators, especially in Africa, the campaign against user fees in social sectors has been particularly successful. In October 2000 NGOs succeeded in getting the US Congress to pass a legislation requiring US representatives at the IMF and World Bank to oppose any loan or debt relief agreement which included "user fees" on access to primary health care and education.

The Bank's management has since declared that it no longer promotes user fees for primary health care and education, and there is evidence of a major shift in policy recommendations. A report on users fees in education prepared by the World Bank in 2004 in no uncertain terms states that "*User fees in primary education are pervasive and a serious obstacle to enrolment and completion for millions of children around the world. This has been evidenced by the huge surges in enrolment that have accompanied fee removal in countries such as Uganda and East Timor*."[91] Similarly, the recent Education Sector Strategy Update (2005 Final Draft) by the Bank refers to this analysis and the World Development Report 2004 as *new* lessons calling for elimination of primary school fees.[92] "*Strategies to promote equity include elimination of user fees at primary level, building of capacity to identify and provide services to rural children with disabilities, provision of early child development services in education programs, especially for children at risk, and scholarships for girls and poor children*".[93]

New perspectives on the financing of basic social services

Recently, the debate about user fees has become more nuanced. User fees have been implemented in a variety of ways and have given a variety of results, with only certain communist governments having retained the principle of free social services to all citizens. There are examples of the importance of user fees in upholding quality of services and of strengthened community involvement. In general, however, there seems to have been major problems in administering exemption schemes, unless they are based on very simple targeting, such as for pregnant mothers and children, as opposed to social and economic criteria.[94]

This takes us to the fundamental question for developing country politicians and planners: How to finance a critically needed expansion of public sector funding towards social sectors. The call for increasing aid flows is only a temporary solution and may even act against more fundamental reforms in revenue collection and redistributive policies.

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[90] Ben Fine, *Social Capital Versus Social Theory*, (London: Routledge, 2001).
[91] Raja B. Kattan and Nicolas Burnett, *User fees in primary education*, Education Sector, Human Development Network (World Bank, 2005).
[92] World Bank, *World Development Report 2004: Making Services Work for Poor People*, (New York, Oxford University Press, 2004).
[93] World Bank, *Education Sector Strategy Update: Achieving Education for All, Broadening our Perspective, Maximizing our Effectiveness,* Final Draft December 22 (2005).
[94] Guy Hutton, *Charting the path to the World Bank's "No blanket policy on user fees". A look over the past 25 years at the shifting support for user fees in the health and education, an reflections on the future* (London: DFID Health Systems Resource Centre, 2004).

Poor developing countries are faced with two alternatives: "(1) to abandon user fees and boost revenues from other sources to meet the population's expectations for basic social services; and (2) to reinforce the user fees system, strengthening exemption systems, at the same time promoting a shift to prepayment of services (in health)." There is obviously no blanket policy prescription, as the World Bank says, on which alternative to go for.

Equally important, however, is that the choice is highly political and will be determined not by technical feasibility assessments or dialogue with donors, but a domestic political and ideological struggle pitching the interests of new affluent elites against the impoverished.

7.3. Trade

- Both the World Bank and the IMF continue to advocate trade liberalization and export oriented growth.
- The World Bank becomes more pragmatic on regional trade integration, focuses increasingly on assistance in multilateral forums and on consequences of trade liberalization on poverty.
- IMF continues to focus on the need for unilateral trade liberalization.

Structural adjustment and the rise of the trade liberalization agenda

The issue of trade has periodically surged on the development agenda as a means to foster economic growth and development. The World Bank has itself divided its work on trade into three phases.[95] The first started in the mid 1980s. It was based on a belief that trade was critical to economic growth and it focused heavily on promoting import-liberalization. This was believed to enhance economic efficiency through improved resource allocation resulting from changes in relative prices, stronger incentives for adaptation and innovation, cheaper capital goods, and higher foreign investment flows associated with new trade opportunities. The inspiration for this approach came from a set of earlier studies[96] that gained influence as the import substitution model of the 1960s and 1970s lost legitimacy. The studies highlighted the correlation between economic growth and trade openness as well as the concrete efficiency gains from liberalization.

This first phase took place in a context of a quite limited multilateral framework for trade, and few realistic opportunities for regional trade agreements. Thus, the primary route to trade liberalization for most Bank clients during the 1980s was unilateral. A large share of the trade liberalization carried out in this period occurred through the dialogue with the Bank and associated lending.[97]

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[95] World Bank, *Assessing World Bank Support for Trade 1987-2004: An IEG Evaluation* (World Bank Independent Evaluation Group, 2006).
[96] Ian M.D. Little, Tibor Scitovski and Morris Scott, *Industry and Trade in Some Developing Countries* (Oxford, U.K.: Oxford University Press, 1970), Ann O. Kruger , *Foreign Trade Regimes and Economic Development: Liberalization attempts and consequences* (Cambridge, MA: Ballilnger, 1978), Bela Balassa and Associates,, *Development Strategies in Semi-Industrial Economies* (Baltimore: The Johns Hopkins University press, 1982).
[97] Michael J. Finger, "Trade Policy Reforms in Adjustment Operations", paper prepared for the U.S. Executive Director (1997), Martin and Ng, "A Note on Sources of Tariff Reductions in Developing Countries 1983-2000", background note prepared for Global Economic Prospects 2005, both referred in World Bank, *Assessing World Bank Support for Trade*, Appendix B1, n. 24.

The early phase of trade work in the World Bank was based on the recommendations made in the *World Development Report 1987: Industrialization and Foreign Trade*. This also recommended the increased use of conditionality in structural adjustment lending as a catalyst for trade reform. As a result, at the height of adjustment lending in the 1980s, trade policy accounted for a quarter of all structural adjustment conditionality of the World Bank. In a sample of 152 adjustment loans with trade components exceeding 10 percent, between 1987 and 1990, import-related policies comprised almost half of all conditions.[98]

The IMF's work in trade is rooted in its funding charter's Article I (ii), that it shall "facilitate the expansion and balanced growth of world trade". Subsequently, the Fund has focused on the trade issue either directly, as part of its core macroeconomic agenda, or because trade policy was viewed as significantly influencing the environment for that agenda.

The IMF's use of trade conditionality has followed a slightly different pattern than the Bank. According to the 2005 review of trade conditionality under fund-supported programs the incidence of trade-related conditionality increased steadily through the 1990s, from 55 percent of programs with at least one condition in the pre-1995 period to 70 percent in 1998-2000, and then fell to 46 percent during 2001-04. Over the whole period, longer term programs (in particular under the ESAF and the PRGF) had more trade conditionality than those supported by Stand-By Arrangements (SBA): 80 percent of programs under the ESAF/PRGFs carried such conditions compared with 42 percent of SBA cases. For the period 1990-2004 as a whole, of the 138 programs surveyed 43 percent had no conditionality on trade measures. However, when examined by country, only 20 percent had never had any binding conditionalities related to trade. But about three-fourths of the programs under review contained general commitments to trade liberalization.

Critique and changes in the 1990s

Over the course of the 1990s, both the bank and the fund were criticized for their approach to trade. The critique was launched at different levels. At the most general level, the benefits of an open trading system and particularly of a rapid liberalization of imports were cast in doubt. Some critics saw an open trading system with no protection of infant industry as a threat against technological progress of developing countries, a move towards deindustrialization and increased dependency on foreign capital and know-how.[99] Others focused on poverty effects of trade liberalization and how small and medium sized domestic producers often were hurt by rapid opening for imported goods.[100] From a narrower standpoint, the liberalization agenda was criticized for causing short term balance of payment problems as imports tended to surge following liberalization, as well as a possibly more long term fiscal problem arising from the loss of tariff revenue. The criticism of the World Bank was also partly related to its alleged one-sided focus on import liberalization rather than export promotion.[101]

[98] World Bank, *Assessing World Bank Support for Trade.*
[99] Erik Reinert , "Development and Social Goals: Balancing Aid and Development to Prevent "Welfare Colonialism", *Post-Autistic Economics Review*, 30 (March 2005), article 1.
[100] Saprin, *Structural Adjustment: The Policy Roots of Economic Crisis, Poverty and Inequality* (London & New York: Zed Book, 2004).
[101] World Bank, *Assessing World Bank Support for Trade*, p. 21.

Further critique was launched against export oriented development strategies. Rodrik argued against the belief that increased exports would automatically lead to economic growth. [102] He found that whereas the two were correlated, the causal relation was inverse: that economic growth has a tendency to lead to increased exports.

The approach of the Bank and the Fund to trade changed over the course of the 1990s and into the 2000s, but the change was more noticeable for the former. In the Bank, between 1987 and 2000 there was an increased focus on export promotion versus trade liberalization, and the standard package from the Bank came to include four elements: (i) import related reforms, (ii) export related reforms, (iii) exchange rate and foreign exchange management and (iv) industrial and other supporting policies, including pricing reform, investment promotion, competition policy, marketing, privatization, labor markets, and safety nets. However, at the same time as the agenda was broadened, trade received less focus in the Bank from the mid 1990s. This impasse is what the Bank calls the second phase and the lack of emphasis on trade was epitomized in the downsizing of the Bank units and a 1996 reform that dispersed trade experts throughout the institution.

The situation in the IMF was different. As shown above, the attention paid to trade issues in IMF programs and the number of conditionalities related to trade, increased steadily over the course of the 1990s. However, the focus of the conditionalities shifted from a focus on non-tariff barriers to trade, towards tariff reduction and later towards customs reform. Trade related measures were not defined as broadly in the Fund as in the Bank, and it continued to focus on import liberalization rather than export orientation.

The return of the trade agenda in a new context

Around the year 2000 trade returned to the agenda of the World Bank but within a different framework and with a broader aim. The context was the finalization of the Uruguay round of multilateral trade negotiations in 1998 and the initiation of the Doha-round of multilateral trade negotiations in 2001. This meant a new dynamics in the multilateral road towards liberalization, as well as a qualitative shift in the trade agenda. The most important elements of this for developing countries was the inclusion of the agricultural sector and services in multilateral negotiations, the broadening of new regulatory elements under the TRIPS agreement and various mechanisms for streamlining standards, and the phasing out of systems of preferences favoring developing countries products.

At the same time there was an unprecedented upsurge in regional trade agreements (RTAs) promising faster liberalization within specific areas. In sum, the focus was no longer on unilateral liberalization, but on regional and multilateral. Of the two, there was no doubt that both the World Bank and the IMF favored multilateral liberalization based on a classical economic argument about the possible trade diverting effects of regional integration. However, the IMF has been most insistent on the multilateral option,[103] whereas the World Bank adopted a more pragmatic view, arguing that RTAs could help countries adjust to a more open trading system.

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[102] Dani Rodrik , *The New Global Economy and Developing Countries: Making Openness Work*, Policy Essay No. 24 (Washington, D.C.: Overseas Development Council, 1999).
[103] IMF, *Review of Fund Work on Trade*, Prepared by the Policy Development and Review Department (February 7, 2005).

In either case, the main question shifted, at least for the World Bank from "how to liberalize?", as liberalization was already in motion in most of the IMF and the World Bank's client countries, towards "how to successfully negotiate within the multilateral and regional frameworks?", as well as "how to make use of the opportunities they offered in terms of increased exports?".

Consequently, the World Bank program on trade was revamped in 2001 with two objectives: (i) to make the world trading system more "friendly to development" or reciprocally open; and (ii) to make trade an important part of country development strategies. The resurgence in the Bank's attention to trade is not primarily characterized by greater trade lending or conditionality, but rather on increasing advocacy for an open trading system.

The IMF's agenda does not seem to have changed to the same extent and the advice given on trade remained quite similar into the 2000s. Yet, both the IMF and the World Bank also engaged in a new, multi-donor trade mechanism, the Integrated Framework for Trade Related Technical Assistance (IF) originally set up in 1997 to provide technical assistance to developing countries in the multilateral negotiations, and help them integrate trade issues into national development strategies.

The IF has only had limited success and a June 2006 report pointed to several shortcomings.[104] Shortly after (July 2006), a WTO Task Force launched its Aid for Trade initiative, including six broad categories of work: trade and policy regulations, trade development, trade-related infrastructure, building productive capacity, trade-related adjustment, and other trade-related needs.

It remains to be seen whether the Aid for Trade mechanism will have any effect and indeed the extent to which it will be able to raise sufficient funds to be influential.[105] What is clear is that the trade agenda of the IFIs and the means used to promote it has changed over time, although more so in the World Bank than in the IMF.

Conclusion: Consensus and contention on the role of trade in development

Over time, some consensus has emerged among different stakeholders about the role of trade in development. There is an increasing consensus that some form of trade openness is for the good, and that protection against foreign trade and investment often also means shutting the country off from important industrial inputs and technology. There is also increasing consensus on the need for mitigating mechanisms that can help countries overcome short term negative poverty and distribution effects arising from trade liberalization. A recent World Bank review recognizes that the World Bank's work on trade has been based on weak analyses of poverty and distributional incomes, and weak analyses of the impact of external shocks.[106]

However, the main thrust of the IFI agenda towards facilitating trade liberalization and export promotion continues, and this continues to be criticized. New economic analyses have show that although trade liberalization may not hurt the poor, it will have only a modest positive

[104] http://www.wto.org WT/IFSC/W/15.
[105] Carin Smaller, *Can Aid Fix Trade?: Assessing the WTO's Aid for Trade Agenda*, (Minneapolis, MN: The Institute for Agriculture and Trade Policy, 2006)
[106] World Bank, *Assessing the World Bank's Work on Trade.*

impact on poor people and may increase relative poverty and inequality, and trade may therefore be oversold as a poverty reduction strategy.[107] It is also argued that the Bank and the Fund's recommendations and subsequent conditionalities to make developing countries liberalized unilaterally from the 1980s have put them in a disadvantaged position in the multilateral trade negotiations.[108]

As the multilateral negotiations of the Doha round are suspended, this will again change the context of Bank and Fund work on trade. From the perspective of Norwegian policy on privatization and liberalization it seems to be particularly the Fund's approach that is problematic. It is clear both from the statutes and practice that the Fund sees the liberalization of trade as a goal in itself and not as a case dependent item on a menu of development policies. Furthermore, the way that the IMF has used trade conditionality may be contrary to the intentions of the Norwegian Government. Whereas the conditionalities are viewed as having been effective,[109] it is noted that few PRSPs contain trade strategies. This is deemed as unfortunate since "the participatory nature of PRSPs could allow the authorities to develop public support for trade reforms and facilitating their implementation."[110] While this may be true, it nevertheless reveals a certain lack of respect for the priorities emerging from the PRSP processes.

8. The case studies

In the following the results of the four case studies conducted for this report will be discussed. Here we will first give an introduction to the cases and why they were selected before we move on to discussion of the results responding to three major questions:

(i) What has been the role of the IFIs in forging policy change? Has there been any degree of pressure or imposition or have the IFIs influenced the policy choice in other ways? This question is approached through tracing the process of policy formulation, negotiation and implementation of conditionalities.
(ii) Can the policies be considered to be owned by the government and their constituency? The answer to this question is approached through a stakeholder analysis, and is based on interviews with all major actors in the processes.
(ii) Has there been a general change of IFI practices? This question is also approached through interviews with involved parties.

8.1. Introduction to the case studies

Bangladesh

The theme of the Bangladeshi case is the *Development Support Credit III* (DSC III), approved for financing by the World Bank in November 2005. It is a $200 million credit provided

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[107] Mark Weisbrot, David Rosnick and Dean Baker, *Poor Numbers: The Impact of Trade Liberalization on World Poverty* (Washington, D.C.: Centre for Economic and Policy Research,, 2004)
[108] Bank Information Center, *The World Bank, IMF and Trade* (IFI Innfo Brief, No.3, March 2006).
[109] Shang-Jin Wei and Zhiwei Zhang, *Evaluating the Effectiveness of Trade Conditions in Funds Supported Programs* (IMF, October 27, 2005).
[110] IMF, *Review of Fund Work on Trade*, p. 9.

under standard IDA terms. The loan is essentially a continuation of DSCs I and II and is expected to result in accelerated growth, higher exports and private sector investment.

DSC III supports governance related reforms in several sectors – i.e. banking, health, education, state-owned enterprises, energy, and general public administration and tax administration. For this study, the energy sector was chosen for particular focus, given the significant attention it attracts in current Bangladesh, where massive power shortfalls and the threat of rising fuel and gas prices has contributed to widespread public discontent.

Lack of investment in new generation capacity since the early 1990s has led to huge power shortages. Development partners like the World Bank have come to the conclusion that remedying such problems can only be realized if the sector is opened up to competition, privatization and corporatization within an independent regulatory framework.

This is reflected in the DSC III. For the next phase of reforms (for implementation over 2006) a set of 12 triggers were identified in the DSC III Project Document. These included "improving access, efficiency and governance of the energy sector". This trigger was specified in a set of actions that altogether envisaged a reform aiming to transform the energy sector, especially the power sector, from a public monopoly into a corporatized, unbundled entity that would function within a market-led operational framework and be regulated by an independent agency.

Much of the DSC reforms has been inherited from past programs and has been a part of the policy agenda for quite some time. This seems to be especially true for the power sector as the basic Power Sector Reform agenda or strategy was laid out in "A Report on Power Sector Reforms in Bangladesh" prepared by an inter-ministerial working group set up by the Government in 1993. The roots of this particular case are thus long, and it represents a highly interesting case of maturing and shifting relationships.

Mozambique

In Mozambique, the case selected is the Energy Reform and Access Project (ERAP), on which discussions officially began in September 2000. An important reason for choosing this particular project was that Nordic donors – including Norway – have long involvement in the sector, and in this case actively tried to influence project design and implementation.

The energy sector is given increased emphasis in Mozambique's second Poverty Reduction Action Plan (PARPA) from 2005. The main objectives in PARPA for the energy sector include expanding access, improving production and improving the commercial and financial performance of the national public power provider, Electricidade de Mozambique (EdM). EdM has limited generation capacity, but accounts for roughly 97% of the energy transmission and distribution in the country.

The ERAP preparation process involved long negotiations, a number of studies, and the final Project Appraisal Document (PAD) was not approved until August 2003. It took until March 2004 to become effective. The PAD stated that ERAP would run for eight years, divided into two four-year phases. The estimated total World Bank funding was USD 83.3 million, with USD 40.3 million agreed for Phase 1 and an indicative USD 45 for Phase 2.

The private sector aspects are contained mainly in the components of power sector reform and independent grid rural electrification. The objective is to improve electricity sector performance. In brief this entailed:

- Separation of the public power supplier EdM into several business units;
- Private sector participation (PSP) in EdM's distribution and supply business by a strategic private investor;
- Creation of a corporate public entity within transmission and system operation.

Phase 1 had four trigger conditions that would affect the content of phase 2 or even whether there would be a phase 2. All of these conditions concerned PSP in one way or another, as for instance separation of EdM's core functions (Generation, Transmission and Supply) and implementation of a private participation option in EdM's distribution business.

There were strong doubts all through the process about the privatization proposal and the government was concern about its limited options. Following the elections in December 2004, the new Ministry of Energy told World Bank that it was rethinking the sector reform as planned in the PAD. In November 2005 the government officially informed the World Bank that there would be no private participation at this time. EdM would remain a fully integrated state-owned company, with CNELEC evolving into a strong, independent advisory and regulatory body.

This is a case that thus traces both the initial process of introducing privatisation, and how these suggested reforms were later modified and even reversed. It paints an intriguing picture of a dynamic process involving conditionalities, privatisation, bilateral and multilateral donors.

Uganda

The main emphasis of this case study is the conditionality process in a budget support context, tied to a poverty reduction plan. The case was chosen to try to better understand the new types of conditionality discussions that arise in connection to supposedly more modern development instruments as budget support. This case study thus has a different focus and organization than the previously mentioned cases.

The case is mainly based on the Fifth Poverty Reduction Support Operation (PRSC 5), financed by the World Bank, approved in December 2005. The PRSC 5 is a combined loan and grant program supporting the national Poverty Eradication Action Plan (PEAP). The PRSC5 amounts to USD 135 million, with USD 112.5 million given as a grant, and USD 22.5 million as a credit. The financing for PRSC5 was reduced by 10% from 150 million USD because of uneven performance under the prior action on budget execution. However, there was no link to policies of privatization or liberalization.

It is arranged as a budget support operation, in tandem with other bilateral and multilateral donors, including Norway. The PRSC 5 operation supports the whole range of governance related reforms in all sectors included in the PEAP, and uses the full PEAP matrix as its own policy and result matrix. It can thus be considered as a mature PRSC operation that tries to fully align to the host government development policy.

Conditionalities in the PRSC5 come primarily as Prior Actions, and the case tries to trace the development of these from the first PRSC to the fifth. The case finds no Prior Actions requiring privatisation and liberalisation in their more classic form in the PRSC5.

The case provides an interesting supplement to the other cases, and illustrates that also supposedly more modern cooperation instruments have their fair share of challenges.

Zambia

The Zambia case is based on the IMF's PRGF approved in November 2005, which is based on Zambia's own poverty reduction strategy, now termed the Fifth National Development Plan (FNDP). The credit facility supports macroeconomic management, public sector financial management, and structural reforms in sectors like the financial, electricity and private sector development. The current PRGF is a three year program running from 2004 to June 2007, and amounts to SDR 220.095 million (about US$320.41 million).

The link between the HIPC Initiative and PRGF has been intimate. Two structural reforms were identified under PRGF, which also served as HIPC Completion Point triggers in the area of divestiture. These were (a) the privatization of the state-owned energy utility, ZESCO; and (b) the privatization of the remaining state-owned commercial bank, namely, the Zambia National Commercial Bank (ZNCB). Thus, we have chosen to focus our case on the role of the IMF and the PRGF in the preparation and implementation of reforms in precisely these two cases. It should be noted that the basic justification for reform of these two enterprises is difficult to argue with, as both institutions are clearly underperforming.

Zambia has had a varied and at times rather troubled relationship with the IFIs. The 1999 PRGF arrangement expired for instance at the end of March 2003 without the completion of the final review and agreement on a new three-year PRGF arrangement. Eventually, the IMF granted a new three-year PRGF in 2004, but Zambia has for a long time been perceived as a relatively frail partner having trouble standing up to the IFIs. The case to some degree modifies this perception.

Thus, at the same time as the Zambia case gives an interesting analysis of IMF and its application of conditionalities, it also provides insight into how the relationship between the Government and the IMF has developed over time.

8.2. The role of the IFIs in encouraging policy change

- In one case, Zambia, the IFIs are reported to have used conditionalities to pressure for the adoption and implementation of policies to privatize state owned banks and utilities.
- In the case of Mozambique, the World Bank was the main proponent of privatization in the energy sector, but when government priorities shifted away from privatization, the World Bank accepted it.
- In the case of Bangladesh, the privatization of parts of the energy sector was viewed as being in line with governmental priorities and earlier reviews of the sector. However, the World Bank was viewed as having been deeply involved in the elaboration of these reviews and thus setting the agenda for reforms.
- In the case of Uganda, privatization and liberalization are not important elements in current reforms, and all PRSC conditionalities are jointly decided by the government and donors.

The question of what role the IFIs have played in encouraging policy change includes into the question of whether policies have been imposed through the use of conditionality. On this, the experiences from the cases are quite mixed.

The case of Zambia is the only case in which the question of whether the IFIs (in this case mainly the IMF) did put pressure on government in Zambia to introduce policies of privatization and liberalization through the use of conditionalities is answered with a straightforward YES. The case shows how the IFIs first used conditionalities to pressure for the privatization of the Zambia Consolidated Copper Mines Limited (ZCCM) in the late 1990s, but also how the later PRGF was used to pressure for the privatization of the ZNCB and the ZESCO that were the main foci of study in this report. The privatization of ZNCB and ZESCO had been a condition in the 1999 ESAF and the failure to implement it was one of two major reasons why the IMF rejected to enter into a PRGF with Zambia when the ESAF expired in 2003 and rather approved a Staff Monitored Program. In 2004 the IMF granted a PRGF to run from 2004-2007. By this time, Zambia had elaborated a PRSP that had been endorsed by the World Bank and the IMF, and it had been accepted for the HIPC initiative.

Among the HIPC completion point triggers were the privatization of the ZNCB and the commercialization of ZESCO. The formulation "commercialization" was based on an agreement reached in 2003 between the Government, IDA and the IMF that the objectives of restructuring and privatization as originally envisaged could be pursued by the commercialization of the company instead of privatization. This was as a result of the Government resistance to privatizing the utility company. Under the commercialization option, the Government would retain its ownership of ZESCO while allowing it to operate purely on commercial basis without state interference. Also in the PRGF agreed in 2004, privatization of ZNCB and commercialization of ZESCO were conditions.

However, efficiency of this pressure is questioned. Despite the Government's preference of the commercialization option as opposed to privatization, there were initial delays to its implementation, most notably in the preparation of a business plan that was expected to address, inter alia, risks, pricing strategy, and electricity tariff issues. The ZESCO management, in consultation with IDA and IMF staff, eventually did this. ZESCO's revised business plan for the financial year starting April 1, 2005 was later approved by the Company's Board in late December 2004. Based on the progress achieved thus far, the IMF Board granted a waiver for the nonobservance of the HIPC completion point conditions regarding the restructuring and privatization of ZESCO. In terms of progress since Zambia's April 2005 ascendance to the HIPC Completion Point, it is noteworthy that ZESCO, as of July 2006, had not completed preparing the required information for the assessment of its performance under the commercialization process (end-April 2006 benchmark). However, so far, no punitive measures has been taken by IMF in spite of the earlier threat that "Government would proceed with the original objective of restructuring and privatizing the company" if ZESCO fails to adhere to the expectations under the Evaluation Point of the commercialization process.

With respect to ZNCB, the IMF called for the issuance of international bidding documents for the sale of a majority (controlling) interest in the bank as a HIPC completion point trigger. International bidding documents were issued in March 2003. However, the prolonged negotiations with the selected preferred and reserve bidders could not be successfully concluded and the board of the Zambia Privatization Agency (ZPA) terminated the negotiations on March 15, 2005, but promised to issue a new invitation to bid for the sale of 49 percent equity in ZNCB with management control "as soon as possible." In addition, the Government has agreed to offer a 26 percent share of ZNBC on the Lusaka Stock Exchange, following an agreement with a strategic investor, which would reduce government's ownership to 25 percent. This trigger was not fully met by the time Zambia was being considered for HIPC Completion Point status. Nevertheless, based on the Government's commitment to restart the privatization process expeditiously, the IMF Board granted a waiver for the nonobservance of this HIPC completion point condition. Zambia eventually reached the HIPC Completion Point in April 2005. The post-Completion Point negotiations for the sale of 49 percent of ZNCB have been completed and the privatization is expected to be completed soon.

The Zambian experience has been quite different from that of the other cases. In the case of Bangladesh, no outright pressure was reported to have been used by the IFIs, and the reforms of the energy sector envisaged in the DSC III were viewed as reflecting governmental priorities. More specifically, they were based on the 1994 Report on Power Sector Reforms in Bangladesh prepared by an inter-ministerial working group set up by the Government. This document has remained the corner stone of all subsequent policies supported by WB. The subsequent negotiation of conditionalities for the different DSC projects were by most of the heads of energy sector entities characterized as congenial discussions, close and cordial consultations and a good understanding of each other's position. At this level, the question of pressure seemed unimportant, especially since there is little difference of opinion about the need for the energy-power sector reforms that are currently under different stages of implementation.

However, this view was not shared uniformly among the stakeholders. Many top civil servants and bureaucrats felt that there was significant pressure applied to conform to the official view of the government and the World Bank, to which sector heads (e.g of power-energy entities like PDB and DESA) did not agree. Moreover, several informants emphasized the role of the World Bank in elaboration of the sector reforms, and charged that the 1994 report owed its existence to a careful hand-holding undertaken by the WB. The World Bank took top civil servants and agency heads on study tours during the process and in general the Bank engaged heavily in "marketing and sales efforts". The WB also insisted on employing its private sector branch, the International Finance Cooperation (IFC) to prepare bid packages and oversee procedures.

The case of Mozambique shows yet a different experience. It is clear that during the protracted negotiations for the ERAP that begun officially in September 2000, the World Bank was the main proponent of privatization and private sector participation. The World Bank also supported the 2002 report which elaborated different options of how to involve the private sector in the electricity sector. However, this was described as a “how to” not a “what if” document. It did not assess the pros and cons of different alternatives; privatization was a given. Several bilateral donors were concerned that policy alternatives had not been properly studied, and that the social implications of privatization had not been sufficiently considered. In September 2002, a Joint Scandinavian review team studied the implication of the privatization proposal. The review team found there were sufficient reasons for concern to justify a list of additional issues that should be studied before the reform was approved. This contributed to increasing governmental concerns and after the 2005 elections in Mozambique, the new government announced it would rethink the original reform envisaged in the PAD of the ERAP. Later the same year it announced that it would continue the reforms, but without the privatization element. After a new round of negotiations with the World Bank, the World Bank accepted the new priorities of the government and agreed to review the ERAP.

Uganda is the case in which privatization now apparently is less controversial and where the case observed no major pressure. There are for instance no conditions (i.e. Prior Actions) requiring privatisation and liberalisation in their more classic form in the PRSC5. Privatisation debates now appear to evolve mainly around governance issues, questioning the transparency and soundness of some of the divestiture processes.

The main trace of liberalisation intentions in the PRSC conditionalities are related to the Water and Sanitation Sector (WSS). One of the prior actions involve an institutional reforms in the urban WSS that imply “increased allocation of commercial risks to the private sector”, and undertaking 5 under this prior action asks for “Accelerating Urban WSS Reforms”. However, the case argues that this is jointly agreed between the Government and development partners, and with little criticism from the civil society. Furthermore, all the Prior Actions are derived from the PEAP matrix and based on shared expectations between the Government, the World Bank and other development partners. The PEAP matrix entails measurable target indicators for most of the agreed PEAP outcomes, and is expected to play a key role in guiding policy analysis, budget prioritization, work planning, performance assessment and development partner dialogue.[111]

[111] Harmonisation efforts have continued after PRSC5 – the GoU is launching its “Annual PEAP Implementation Review” (APIR) in November 2006, and budget support partners are discussing a possible new joint budget support mechanism aligned to the APIR.

8.3. The issue of ownership

- Most programs adequately reflect government priorities set out in national development plans.
- In the majority of cases there have been internal differences within the government, and the IFIs have often tried to establish alliances with the actors that share their opinions.
- Civil society has been consulted in the majority of the cases, but the quality of the participatory processes is questioned in some of them.
- Parliaments seem to play a marginal role in economic policy making.
- Significant use of external consultants reduces customization to local circumstances and impedes ownership.
- One reason for the extended use of external consultants is lack of domestic capacity for policy analysis.

The question of ownership is of key importance to the conclusion on the extent to which pressure has been exerted by the IFIs. We understand this question to not only include whether the programs adequately reflect government priorities set out in national development plans, but also whether the process of elaborating these plans have been inclusive, and finally whether the countries have been given sufficient "policy space" and assistance in development of policy alternatives.

Regarding the first of these questions, most policies do seem to reflect national development plans as also noted above. The two subsequent questions are more contentious.

Regarding whether the processes of elaborating these plans have been inclusive, the opinions are diverging and the experiences differ from case to case. The question of inclusion relates to, on the one hand, inclusion of different parts of the executive branch of government as well as the legislative. On the other hand, it relates to the inclusion of civil society groups and the private sector.

In the case of Bangladesh, it was reported that the main donors: the IMF, the World Bank and the Asian Development Bank (ADB) all felt strongly that the reforms, including energy sector reforms are fully owned by the Government. Yet the World Bank also noted the presence of the "good guys" and the "bad guys", and how it tried to work with the good guys in the Ministries and agencies to push the reforms along.[112] The internal differences within the government and the World Bank's attempt to create strategic alliances were confirmed by a senior official of the Central Bank. He contended that:

> The reforms (in general) are supply driven and do not reflect the country's priorities. Pressure is applied on us to accept these policies. During the implementation stages, different stakeholders are played off against each other. For example, in the context of the banking sector reforms, NCB [National Commercial Bank] is used to attack the central bank while we are played off against the

[112] A senior World Bank representative noted that the reform agenda did not change with changes in the Government. However, the relationship of World Bank was extremely bad with the Finance Minister of the previous regime, and this had made things hard. The relationship with the current Finance Minister was excellent so that it was possible to make much better progress.

> private commercial banks. In addition, triggers are often introduced arbitrarily and we are forced to comply. The basic attitude of donors is principally that of "master" engaging with servants.

In the case of Bangladesh it was also noted that the Parliament was included to a very limited degree, and that the process did not seem to involve any public information or dissemination effort. Also civil society inclusion was found to have significant shortcomings. Indeed one informant argued that “ownership remains largely personalized rather than generalized”.

Also the case of Mozambique show mixed experiences. At the general level the elaboration of the second PARPA II (2006-2009) was viewed as being consultative with strong engagement by civil society, donors and government officials in 23 working groups and discussions in provincial and national “Poverty Observatories” that will continue to monitor implementation of the PARPA programs. The case study does not describe in detail the extent of civil society inclusion in the ERAP, nor the inclusion of parliament or the private sector. However, it does describe internal differences within the government, with the EdM management as the most skeptical. Indeed, in the case of Mozambique, the WB was quite cognizant of the internal differences in the government as well as between the government and the World Bank, as the following quote from the CAS attest to:

> Government-Bank Group differences: While the Bank and the Government broadly agree on the overall direction of reform, as set out in PARPA, they differ in places about the pace and scope. In particular, the Government favours labour regulations, including foreign hire restrictions, that the Bank believes hinder competitiveness and limit job creation; the Government is reluctant to reform the politically-charged area of land use rights, whereas the Bank believes reform is inevitable and favours more marketable rights in order to realize allocative efficiencies; some parts of Government (though not all) are reluctant to proceed with the divestiture of particular state-owned enterprises, due to vested interests or concerns about the buy side of the market, or disappointment with some earlier divestitures, which failed to realize expected returns in investment, domestic product and job creation; and the Government prefers moderate reforms in the legal and judicial sector, while the Bank favours more proactive action, including restructuring of the sector institutions. Through its country dialogue and AAA the Bank is working with the Government and other donors to help reduce these differences” (Country Assistance Strategy 2004-2007, p.21).

However, it is clear that it is not only the World Bank or the IMF that attempt to use differences between governmental representatives strategically. There are also several reports of government representatives that have fallen prey to appearing as if it is only the donors and multilateral agencies that can induce it to alter domestically-unpopular policy stance. For example, in the case of Zambia, it is often one centrally-placed individual (and not a body) within the Government system (often the Minister in charge of the Finance portfolio) that almost single-handedly broadcasts and defends the ”government view” and around whom the government-IMF consultative process revolves. Here, the current Minister of Finance is nick-named “Mr. HIPC,”, a title he seems to relish as he even used it in his parliamentary campaign material in the September 2006 general elections.

In the case of Uganda, there are few reports of major differences within the government. It is noted that the Government of Uganda (GoU) is certainly not one entity with one voice, but different institutions with different agendas and incentives. But at the same time development partners emphasise that the process of elaborating Prior Actions and other budget support conditions should be participatory and GoU owned, within the spirit of harmonisation and partnership.

The case of Zambia further emphasizes the role of civil society. Civil society's reaction to the quality of its involvement in decisions that led to the PRGF is quite mixed. While most acknowledge that there have been some attempts at implementing participatory processes, the quality of such processes is said to be weak and tends to be ad-hoc, thus, denying the stakeholders an opportunity for more structures input and easier follow-up of outcomes in the monitoring processes. Two main concerns were raised. Firstly, most civil society bodies argued that the content of the PRGF is generally unclear to the average stakeholder beyond the Government. Even within the government system itself, it is mainly senior officials in the Ministry of Finance and National Planning as well as those at the Bank of Zambia that possess a clearer picture of what PRGF entails. Secondly, non-state actors, particularly the academia, argued that their meaningful participation during the preparation of the PRSP was checked by the poor quality of available data, weak infrastructure and resources for collecting additional data and low analytical capacity on the government side.

Furthermore, it was noted that there is no provision that compels the Executive to present international treaties or loan agreements to Parliament for approval/ratification. Under such conditions, Parliament is usually located at the tail end of the policy-making process and is often called upon to debate issues over which it has little influence or control. This constitutional flaw has significantly reduced the influence of the people's representatives over issues as strategic as the country's economic route as guided by, for example, the HIPC Initiative and PRGF.

The issue of ownership also involves the question of embeddedness of the process of elaboration of reform in local conditions and with local input.

In several of the cases it was reported that the use of foreign consultants was extensive and that this reduced the consideration for local conditions and in turn the sense of ownership of reforms. In the case of Bangladesh some stakeholders claimed that the donors impose too many unnecessary consultants from abroad. Moreover, it was reported that the dominant view of Government officials and civil society representatives was that there is a strong tendency to adopt a "one size fits all" approach. In the specific context of the power sector, most respondents agreed with the diagnosis of the problems faced and the solutions put forward, but argued that the lack of adjustment to local conditions constituted an impediment to ownership, and caused slow implementation. For example, the Secretary of the Power Division of the government noted:

> Generally, the reform models are transplanted with little or no adaptation; these can work only for a limited time when donors are closely hand-holding the operation but collapses once they have left […] Reforms have to be internalized – otherwise it is difficult to implement.

Along the same lines, the Chairman of the Energy Regulatory Commission (ERC), said that:

> The donors wanted ERC because "there are ERC's everywhere, and so we should have one too"! The ERC Act calls for an independent, transparent and financially independent entity. However, "it is not enough to just make laws. We are far from achieving operational readiness – progress is very slow.

One major reason for this dominance of foreign consultants is the lack of domestic capacity for policy analysis. For example, in the case of Bangladesh the influence of the World Bank on the elaboration of the energy policy was attributed to the lack of national analytical capacity. A main consequence seems to have been slow implementation and lack of ownership.

Similarly, in the case of Zambia the absence of an institutionalized policy analysis structure within the Ministry of Finance, the IMF teams that usually arrive in the country better briefed with much more enlightened assessment on the performance of Zambia based on more focused reviews by qualified Fund staff gain significant influence. Faced with such a scenario, it has been argued, the Government often fails to challenge remedies from outside the country that could be faulty. Combined with a perception that failure to adhere to the conditionalities of the IMF and the World Bank, the Government's room for maneuver is significantly checked and the role of external actors in shaping economic policy has remained quite significant over the years.

8.4. General changes in practices

- Change in IFI practice noted in all the cases:
    - greater inclusiveness;
    - greater openness and transparency;
    - greater flexibility;
    - greater donor harmonization.
- But also some critical comments:
    - Donor harmonization means that donors can "gang up" against the government.
    - IFI flexibility questioned when used on conditionalities related to accountability and anti-corruption measures.

The question of change of practices partly overlaps with the questions above, but it is somewhat broader. In the following, we do not aim at a full analysis of the implementation of the Good Practice Principles or the IMF's guidelines, but rather summarize the views expressed by the main stakeholders.

The case that clearly represents the most significant degree of change from the donor practices as described in the "old conditionality debate" is Uganda. Here it is reported that most stakeholders in Uganda seem to agree that conditions aimed at ensuring that money is spent as intended and accounted for is warranted, whereas more general conditions on politics imposed by development partners are more problematic. As a matter of fact, the civil society encourages development partners to demand accountability.

At the same time the nature of the PRSP processes with broad participation domestically and with a greater degree of donor harmonization has in many respects "changed the game" between donors and recipients. This changes also the power-relations between donors and recipients. One issue that the Uganda case brings up is that the the PRSC instrument now has become so large that it "cannot be used credibly as pressure to make the Government stick to all its promises with respect to the reform program". For instance, there is a danger that an entire program can be delayed if one single important action is delayed, on the insistence of a single donor. To avoid this, the Uganda PRSC donors have agreed on a graduated response mechanism that reduces the total amount with a certain percentage if parts of the conditionalities are not met. PRSC 5 was actually cut with 10% in this way. It is in this context intriguing that many of the bilateral donors wanted a tougher stance, while the World Bank appeared more conciliatory towards the Government of Uganda. The issue was in particular governance, and whether Uganda had met prior actions related to this area.

In the other cases, there are more mixed messages regarding the degree to which there has been significant policy change. In the case of Bangladesh, some informants view the changes in conditionality practices as primarily another way of packaging the same commodity. Moreover, it was argued that the new donor coordination has increased the amount of conditionalities that had to be complied with. Some academics involved viewed this as a case of “syndication” or “cartel” amongst donors to put additional pressure on the country. However, the dominant view was that there was a change in the use of conditionality-based lending over time. The World Bank was perceived as more flexible than before. Indeed in the opinion of some donors, there was now “too much flexibility on several conditions. An example of this was when the bilateral donors wanted to put stricter demands on the government than the World Bank in order to make the government establish an Anti Corruption Commission (ACC). It arose from insistent pressure from some bi-laterals (presumably, mainly the then Danish Ambassador). The World Bank buckled under the bi-lateral pressure and took a hasty, premature decision to include it as a condition for the DSC II.

There was also a clear perception that there was more discussion and dialogue today instead of “blunt requests”. Information available had also improved greatly.

The case of Mozambique focuses primarily on the changes of the World Bank regarding the attitude towards privatization. It shows how World Bank confidence in the power of market forces, initially manifested as an unquestioned, ideological belief in privatization as good in its own right and as the best solution (losing sight of the prime objective of improving the standard of living in Mozambique) was transformed into a less forceful, more conciliatory approach involving a strong public regulatory body enforcing a stringent performance contract between EdM and the Government.

The case of Zambia shows that there has been a noticeable change over the years at the level of *processes* regarding the manner the IMF has handled its conditionality and triggers/benchmarks. Firstly, there has been an effort to include stakeholders beyond government officials during the consultations/discussions around PRGF. Secondly, the IMF can now freely talk to the press, unlike in the past. This has allowed the press to get a better glimpse into the workings of the Fund and to tease the Breton Woods institution regarding its position on a host of issues of national significance, and it has opened the political space for dialogue with an institution that, for a long time, was perceived to be ‘too closed.’ Thirdly, the decision to allow Zambia reach the HIPC Completion Point in spite of a good number of conditionalities unfulfilled suggests increased flexibility there and an emerging awareness within the Fund regarding the weak effectiveness of benchmarks in securing compliance. Furthermore, the clear Government ‘victory’ over the refusal to privatize ZESCO, to the extent that the IMF capitulated without the ‘usual noises’ is indicative of the emerging flexibility posture that the Fund seems to increasingly assume.

9. Concluding remarks: Balancing sovereignty, influence and control – the way forward for donor conditionality

The conditionality debate reflects inescapable dilemmas in the relationship between donors and recipients of aid. The term “development partnership”, currently the official term for the aid relationship, signals a desire to make an intrinsically unequal relationship more balanced and reciprocal; and the 2005 Paris Declaration on Aid Effectiveness formulates a set of broad partnership commitments to the achievement of this objective. The basic idea is to develop a mechanism of *mutual accountability* between the parties: based on the recipient country’s own development policy, a mutually agreed commitment will be developed in which donors will be responsible for providing predictable finance and recipient countries will be responsible for effective implementation.

There is nothing magic, or even new, in these principles. Similar ideas have been presented throughout the era of official development assistance, addressing the basic question: what is a legitimate set of reciprocal rights and obligations in an aid relationship? Do donors have a right to influence policy-making? Do recipients have a right to fully determine how aid money is spent? Do recipients have a right to demand resources transfers based solely on needs? Do donors have a right to demand specific results as a condition for their funding?

The case studies and the general literature reviewed in this study reveal some changes in conditionality practices over the recent decade:

- There is a change in policy orientation towards governance and overarching reform processes. Conditionalities have accordingly become broader, more general, and hence possibly less “enforceable”.
- The IFIs are more flexible in their enforcement of conditionalities, and bilateral donors and civil society organizations sometimes demand stricter enforcement of governance-related conditions.
- Increased donor coordination at country level makes the IFIs more sensitive towards bilateral donors’ views.
- In several aid dependent countries, government institutions exercise stronger ownership than was the case the decade before. But it should be noted that for many African countries the 1980s and 1990s was a period of declining national sovereignty, compared with the 1960s and 1970s.
- Strengthened donor coordination may constrain the policy space of recipient countries and weaken their bargaining power.

The case studies above amply illustrate how conditionalities are playing an important part in the exercise of rights and obligations in the aid relationship. They show that conditionalities serve, or potentially may serve, rather different objectives:

- *To influence policy-making*: Prior actions and tranche release conditions have been used for this purpose. The degree of coercion involved is difficult to determine, but the IFIs clearly espouse particular policy agendas which they promote. To what extent is it legitimate for IFIs and bilateral donors to exercise “the power of the purse” or more subtle forms of influence? Is it the particular policy – such as privatization as opposed to abolition of school fees – rather than the application of conditions per se, which is deemed unacceptable? Development agencies have their different agendas, but particularly multilateral agencies should attempt to convey alternative views and policy options to recipient countries.

- *To ensure accountability for results*: Benchmarks are common features in contractual arrangements and represent essential vehicles for assessing progress in implementing agreed commitments. Aid effectiveness is a legitimate concern of donor agencies, and constituencies and governing bodies of donor agencies increasingly demand better accountability for results. The question is not whether it is legitimate to have contracts with benchmarks or not, but rather what kind of benchmarks best serve the two key components of accountability: answerability and enforceability.

- *To make power-holders answerable*: The terms and conditions of an aid agreement should facilitate the ability of constituencies on both sides of the relationship to debate the objectives and results of the agreement. This takes us straight to the issue of good governance. Here, the aim should be not only to make the recipient government or institution accountable to the donor, but answerable to the intended beneficiaries, and to its citizens at large. To achieve this, it is necessary to build in requirements of participation in the process of formulating benchmarks, and to ensure that they are transparent and easily understood.

- *To punish in cases of bad performance or abuse of power*: The challenge is to develop agreements with enforcement mechanisms directed both ways – making it possible for recipients to hold donors to account and vice versa. Enforcement requires political will and institutional capacity, as well as a set of benchmarks that are legally monitorable. We have seen in the past that donors are very reluctant to hold back committed funds, partly because it is difficult to determine what constitutes a breach of the aid contract.

Conditionality in aid cannot be wished away. An aid relationship is a negotiated contractual arrangement between unequal partners, and it is naïve to assume that conflicts of interest and divergent opinions will not exist, or can simply be removed. The current trend – of seeking full consensus and formulating conditionalities in increasingly general terms – is not likely to produce the desired result: effective implementation by country level institutions. The challenge is for recipient countries not only to seize, or be given, ownership of the aid funds, but to take full responsibility for their effective use. It means moving towards greater national sovereignty in aid dependent countries, while increasing accountability for results.