As limitações da condicionalidade: comparação entre o "Consenso de Washington e as reformas de "governação"

The limitations of conditionality: comparing the ‘Washington Consensus’ and ‘governance’ reforms

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No início dos anos 80, um grande número de países em desenvolvimento enfrentava grandes dificuldades na balança de pagamentos, tendo apelado às instituições financeiras internacionais (IFI), que forneceram essa ajuda mediante a aplicação de um conjunto de reformas ("condicionalidades"), depois resumidas no chamado “consenso de Washington”. Os resultados mistos destes programas levaram as IFI a conceber um novo conjunto de reformas nos anos 90, direcionadas para o funcionamento dos governos e da sua “governação”. Vários estudos afirmaram que os principais problemas dos países em desenvolvimento derivavam das características dos seus governos, descritos como corruptos e cujas políticas expressam os interesses de grupos particulares. Este paper analisa e compara estes dois conjuntos de condicionalidades – do consenso de Washington e da Boa Governação – demonstrando as limitações de ambos.

In the early 1980s, a great number of developing countries were facing severe balance of payments difficulties, and called upon the international financial institutions (IFIs) for financial relief, which came along with a set of reforms (‘conditionalities’), later summarised as the ‘Washington Consensus’. These reform programmes had mixed success and led the IFIs to devise in the 1990s a different set of reforms, which this time targeted the functioning of the government and its ‘governance’. Several studies had insisted that the genuine problems of developing countries stemmed from the characteristics of governments described as, e.g., rent-seekers, plagued by corruption and whose policies only expressed the interests of particular groups. The paper analyses and compares these two sets of conditionalities, that of the ‘Washington Consensus’ and that of ‘good governance’ conditionalities, demonstrating their respective limitations.
1. Introduction

In the early 1980s, a great number of developing countries were facing severe balance of payments difficulties, due in particular to important terms-of-trade shocks, which stemmed from a significant drop in the prices of the primary commodities exported by these countries. As members of the major international financial institutions (IFIs), in particular, the International Monetary Fund (IMF) and the World Bank, these countries called upon them for financial relief. In exchange for this relief, which at this time was thought to be temporary, the IFIs devised a set of economic reforms that these countries should implement, typically targeting fiscal, financial and monetary issues. This set of economic reforms, which were the conditions for IFI lending – i.e. IFI ‘conditionalities’ – was later summarised as the ‘Washington Consensus’.

The prescriptions of these reform programmes for developing countries during the 1980s and 1990s were, however, not associated with better economic performance in terms of growth or balance of payments – some observers even coined these decades as ‘the lost decades in spite of policy reform’ (Easterly, 2001). This mixed success led the IFIs to devise in the 1990s a different set of reforms for developing countries, which this time targeted the functioning of the government and its ‘governance’. Several studies had insisted that the genuine problems of such countries stemmed from the characteristics of governments and civil services, described as, e.g., rent-seekers, plagued by corruption and whose policies only expressed the interests of particular groups and lobbies.

The present paper analyses and compares the different modalities of these two sets of conditionalities, that of the ‘Washington Consensus’ and that of ‘good governance’ conditionalities, demonstrating their respective limitations. These limitations stem from: i) the concept of conditionality, the mechanism of exchanging finance for reform, per se; ii) the contents of the reforms summarised as the ‘Washington Consensus’ given the economic context of the countries under programme (typically an export structure based on primary commodities) and the weakness of the concept of ‘governance’ in view of these countries’ political economies; and iii) the intrinsic linkages between economic and political conditionalities, whose limitations thus retroact on each other, in particular regarding effectiveness and credibility. These limitations are examined in the light of the current theoretical debates on aid ineffectiveness and on the political economy of developing countries.

A particular stress is given to Sub-Saharan Africa (SSA), as it can be viewed as a ‘laboratory’: it has been the region where the first joint programmes have been implemented in the early-1980s (e.g., Senegal, Côte d’Ivoire), and where economic and governance conditionalities and IFI programmes have been repeated one after another – now for three decades, which illustrates their limitations –, and SSA is mostly constituted of low-income commodity-dependent countries.

The paper is structured as follows. It firstly explains the main features of what has been coined as the ‘Washington Consensus’ under its different forms, as well as the conditionalities attached to it. Secondly, the paper examines the context and elements of the conditionalities that focus on the concept of ‘governance’. Thirdly, it shows the limitations of conditional lending, both inherent to conditionality itself and those stemming from the economic and political economy characteristics of the countries to which economic and ‘governance’ conditionalities are applied.

2. Conditionalities as the exchange of finance for economic reform: the ‘Washington Consensus’

2.1. THE ‘WASHINGTON CONSENSUS’ AND ITS DIFFERENT FORMS

The understanding of what has been coined as the ‘Washington Consensus’ and attached conditionalities requires
the presentation of its context, in particular the evolution of the theories of the desirable role of the state and the associated policy prescriptions in developing countries, notably, the theories of effective public policies. These evolutions regarding the role of the state closely follow the evolution of development economics theories since WWII, and have been subject to drastic changes (Adelman, 2000). Indeed, after WWII, developing countries pursued a resource intensive development strategy with limited industrialisation. In some East Asian countries – the so-called ‘developmental states’, Japan, Korea, Taiwan –, governments implemented with spectacular success a mix of government and market and ‘entrepreneurial’ policies, where the state helped the functioning of markets (in providing the legal framework, infrastructure, and if necessary being an entrepreneur in last of coordination failures in developing countries and of poverty traps, which justified government intervention. The creation of complementarities (in demand, in markets) was viewed as crucial for development, which could not happen if left only to private sector (Matsuyama, 1997). In this regard, industrialisation had to be planned by the state.

From the early 1980s onwards, the neoclassical paradigm progressively became preeminent in the economic theoretical literature as well as in development policy agencies. Instead of the many determinants of development defended by the first theorist after WWII (e.g., path dependence processes, non-linearities, low physical capital, incorrect relative prices, barriers to international trade), these theories isolated single causalities that would explain economic stagnation (Adelman, 2001), and state intervention has been seen as ineffective. The state became viewed as fostering rent-seeking, corruption and predation. Hence the best policies for development were those promoting a limited state, e.g. trade barriers, here viewed as creating an anti-export bias, which was the real cause of balance of payments problems. The best incentives provided by public policies regarding the allocation of resources are, in this view, the most neutral in terms of discrimination among foreign and domestic markets, with international trade being able to be a substitute for low aggregate domestic demand, as in, e.g., export-led growth (Adelman, 2001). ‘Getting prices right’ and removing price distortions are here the overarching objectives.

From the 1980s onwards, this paradigm has constituted the basis for the programmes of the IFIs, the IMF and the World Bank. The set of policy reforms put forward by the IFIs was later coined as the ‘Washington Consensus’ by John

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resort) (Aoki et al., 1996; Amsden, 1989; Wade, 1990). Developmental states promoted industrialisation via targeted policies (incentives, subsidies, tariffs, policies towards labour markets, technology, etc.). These states showed that opposing states to markets is a fallacy. ‘Developmental state’ governments displayed a capacity for implementing public policies, and, moreover credible policies.

From 1940 to 1979, the early theorists of development – Arthur Lewis, Paul Rosenstein-Rodan, Albert Hirschman, among others – viewed government as a prime mover and the only entity able to reallocate factors of production from a low-productivity sector (traditional) to a high-productivity sector (industrial) with increasing returns, to correct coordination failures, and to move the economy out of low-level equilibrium traps. Rosenstein-Rodan (1943), in particular, highlighted the importance of spillover effects, the possibility
Williamson (1990). Williamson summarised this ‘consensus’ as the recommendation of a list of ten reforms: fiscal discipline; reordering public expenditure priorities; tax reform; liberalising interest rates; competitive exchange rates; trade liberalisation; liberalisation of inward foreign direct investment (but not capital account liberalisation); privatisation; deregulation (easing barriers to entry and exit); the establishment of property rights.

As theoretical thinking also evolved in the 1980s, notably on optimal public policies and irrigated by concepts such as market and coordination failure, the Washington Consensus has been subject to debate. The above views have also been questioned due to the failure of their implementation in Latin America and in SSA. The 1990s thus witnessed more balanced views of the role of the state, in particular at low levels of development. Markets may be inefficient in the presence of externalities (e.g., leading to oligopolies) and be affected by failures – which may be a typical characteristic of low-income developing countries. States may be inefficient in terms of allocation of resources, but they may be better than markets in addressing externalities and correcting coordination failures that stem from externalities, economies of scale, and collective action problems. Markets and states are here viewed as complementary. This has inspired what has been coined as the ‘Post-Washington consensus’ (Stiglitz, 1997): here the state has the role of establishing infrastructure – educational, technological, financial, physical, environmental, social. For Stiglitz, the government has six roles: promoting education, promoting technology, supporting the financial sector, investing in infrastructure, preventing environmental degradation, creating and maintaining a social safety net. These roles are particularly important in developing countries, as in these countries market failures (information problems, missing markets) are larger and capacities of government to correct them are weaker.

For its part, the IMF has viewed the role of the state through the lens of its mandate since its creation, in particular the surveillance of fiscal deficits, and has therefore a strong focus on the public sector in developing countries. In the first stabilisation programmes in developing countries in the 1980s, the IMF prescribed a ‘first generation’ of reforms of the civil services centred on macroeconomic stabilisation, notably the reduction of the wage bill, and in the 1990s, in view of the disappointing results and the above mentioned theoretical evolution, it insisted on a ‘second generation’ of reforms of the civil services, which were based on improving ‘incentives’ and a ‘high-quality public sector’. The IMF also considers that under certain conditions, public investment has positive impacts in developing countries (Clark and Manuel Rosales, 2013).

Despite analyses associated with the ‘Post-Washington Consensus’ in the 2000s and many other studies on the necessary role of the state, the views on the minimal state remain pervasive in mainstream economics and IFIs operational thinking – sometimes close to an ‘anti-government ideology’ (Krugman, 2008). The rise of China in the 2000s, however, has promoted views of the role of the state that are closer to the first phase of development thinking in the aftermath of the WWII, which were coined as the ‘Beijing Consensus’. A similar perspective, coined ‘new structural economics’ was advocated within the World Bank in the late 2000s by Justin Yifu Lin, then chief economist (2008-2012) (Lin, 2011). For Lin, economic development requires an industrial upgrading that entails large externalities to firms’ transaction costs and returns to capital investment. Thus, in addition to an effective market mechanism, the government should play an active role in facilitating industrial upgrading and infrastructure. As underscored by Ricardo Hausmann in his comments on Lin, this confirms that development is about structural transformation and accumulating more productive knowledge, a process exposed to market failures.

2.2. THE CONDITIONALITIES OF THE PROGRAMMES OF THE INTERNATIONAL FINANCIAL INSTITUTIONS

The abovementioned views constitute the context of the IFI conceptual framework and ground its key conditionalities, which are centred on fiscal balance, monetary adjustment (devaluation), liberalisation and privatisation. As is well-known, the IMF stabilisation programmes that were implemented from the 1980s onwards in developing countries are based on a theoretical relationship between policy targets and
The underlying model reflects the Monetary Approach to the Balance of Payments (or the Jacques Polak’s model, or Financial Programming), which was developed in the 1950s within the IMF.

The model’s main focus – the core of IMF Financial Programming – is the balance of payments effects of credit creation by the banking system. The World Bank uses the same identities in its model for evaluating debt sustainability. The purpose of the IMF monetary model is the integration of monetary, income and balance of payments analysis. This model became the basis of the IMF conditionalities applied to its credits. Over time, the model was adapted, broadening and deepening of IMF credit arrangements, and included new specifications (see Agenor, 2004).

A typical IMF programme is a set of macroeconomic identities. The IMF monetary model consists of a series of macroeconomic accounting identities that link growth, inflation, money supply, current account, and budget deficit, with intermediate policy targets (e.g., domestic credit to the private sector, reserve accumulation) designed to be consistent with macroeconomic targets like growth, current account adjustment, and inflation, which are supposed to resolve the country’s difficulties (Polak, 1997; Baqir et al., 2003). IMF programmes have the theory of ‘absorption’ as a background: private consumption, domestic investment and government expenditure should not be in excess in regard to domestic income. This is why IMF stabilisation programmes are focused on the reduction of domestic demand and fiscal deficits, on the stabilisation of public spending (i.e. wage bill, investment, equipment, maintenance and recurrent costs), and on the increase of public revenues, the broadening the tax base, and export growth. Hence the mechanisms of an IMF programme are short-term loans to promote balance of payments viability and redress fiscal imbalances and other disequilibria involving structural impediments to growth: typically a stand-by arrangement with credit available in instalments, conditional on the recipient country’s authorities’ agreement to restrict macro policies.

The notions of conditionality and conditional lending are therefore a key feature of an IMF programme: the disbursement of ‘tranches’ of loans is contingent on the implementation of a set of reforms monitored via criteria of performance, i.e. contingent on whether the country meets the intermediate policy targets. In the 1990s, besides the IMF model itself, theories of credibility and reflections on conditionality, together with theories of ‘global public goods’, provided an additional justification of IMF conditionality, and, more generally that of IFIs. Via the signing of an agreement that conditions finance to the implementation of a set of measures, the IFIs give credibility to the poorest countries, which otherwise are not credible vis-à-vis international investors (Rodrik, 1995).

Despite the implementation of the programmes from the early 1980s onwards, however, growth performances remain mixed in many countries, notably in SSA – ‘the lost decades’ of the 1980s and 1990s: lending was prolonged, one programme followed the other, conditionalities accumulated and repeated themselves, and as coined by the IMF Independent Evaluation Office, countries became ‘prolonged users’ of IMF conditional lending (IMF-IEO, 2002). In the 2010s, certain SSA countries are entering into their third decade under IFI programmes. The IMF progressively understood that short-term relief financing in fact addressed structural issues: until the early 1980s, IMF conditionality focused on macroeconomic policies, and then the complexity and scope of structural conditions increased, due to the IMF’s growing involvement in low-income and transition countries (IMF, 2014).

**FIGURE 1 GDP per capita, Sub-Saharan Africa vs. the world, 1960–2013 (constant 2005 USD)**

Source: World Bank World Development Indicators, December 2014
For the IMF, in addition to demand management and stabilisation policies, governmental and private practices may impede efficient production of goods and services (i.e., supply): this requires changes to the economy, which is to say structural policies. Stabilisation policies are important in the short run, because it is easier to alter the various components of overall demand for a short time than it is to make a country’s resources more productive. Stabilisation policies include taxing and spending actions, and changes to interest rates and the money supply. On the longer term, structural changes are required to improve aggregate supply. For the IMF, structural policies not only foster growth, but also the successful implementation of stabilisation policies. Their areas are typically price controls, management of public finances, public sector enterprises, financial sector, social safety nets, labour markets, and public institutions and governance. The latter refer to government salaries, e.g., in tax administration, which, if they are too low, can encourage corruption while employment in the public sector must be limited to business needs, or to inefficient legal systems, too complex business regulations and tax administration, which are detrimental to business climate, contracts enforcement, foreign direct investment and therefore growth (Abdel-Kader, 2013).

Regarding the World Bank, it was also in the early 1980s that the first adjustment programmes were devised and implemented, firstly in SSA countries, and for the same reasons as the IMF programmes, i.e. the severe balance-of-payment crises affecting commodity-dependent countries, which had been induced by the shocks created by the sharp drop in the terms-of-trade due to the fall in commodity prices. The World Bank is by mandate more focused on development, on sectoral issues and project financing. World Bank programmes’ main elements are privatisation and liberalisation, especially financial and trade liberalisation: in particular, the suppression of state subsidies (e.g., subsidies to the agricultural sector, or subsidised credit), tariff reduction, dismantling of marketing boards (objectives also being ‘getting prices right’ and limiting state intervention viewed as distorting prices), in addition to civil service reforms (e.g., in the initial programmes, the freezing of recruitment and wages, voluntary incentives-induced retirement). The 1980s, due to the prolonged problems of low-income countries, especially in SSA, witnessed closer coordination between the IMF and the World Bank for low-income countries, via the devising of joint programmes (the ESAFs/Enhanced Structural Adjustment Facility, a concessional facility launched in 1987, conditioned to the acceptance by recipient governments of a series of conditionalities set in the Policy Framework Papers). The ESAF programmes displayed quantitative macroeconomic benchmarks (monetary, fiscal – reduction of fiscal deficits, action on the public spending, contraction of the wage bill and numbers of civil servants, reduction of state subsidies and transfers, e.g. to state-owned-enterprises/SOEs –, international reserves, external debt) and structural benchmarks, e.g., institutional reforms of SOEs, financial sector, structural fiscal policy, tax and expenditure management. The stabilisation programmes of the IMF and the adjustment programmes of the World Bank, which support their lending activities, are linked in the different models that underlie them. While for the IMF the model is derived from the Monetary Approach to the Balance of Payments, for the World Bank the underlying model of the programme is a variant of the ‘two-gap growth model’ (Khan et al., 1990).

The set of reforms and the content of conditionalities recommended by the IMF have evolved over time. Their limited effectiveness in low-income countries led the IMF to launch in 1999 the Poverty Reduction and Growth Facility (PRGF), which succeeded the ESAF, jointly with the Poverty Reduction Strategy Papers (PRSPs) of the World Bank, with these new facilities hoping to be more effective in insisting on a greater ‘ownership’ of conditionalities by borrowing countries. Conditionalities also evolved after the 2008 global crisis. Until the 2008 crisis, conditionalities and their conceptual framework had displayed a remarkable stability across countries, from SSA to developed countries, including Southern Europe (Sindzingre, 2015). After the 2008 crisis – and then the eurozone crisis (and the creation of the ‘troika’ and some episodes of divergences with EU own conditionalities) –, the IMF recognised the weakness of some of its prescriptions – notably regarding fiscal policy –, and of the underlying conceptual framework (e.g. the calculation of the multiplier, Blanchard and Leigh, 2013). It has even been
argued that the IMF has taken a more ‘Keynesian’ turn, e.g.,
considering a fairer social distribution of the burden of fiscal
sustainability (e.g. more tax on the richest, IMF, 2013) and
more flexibility regarding the pace of fiscal consolidation and
the composition of fiscal stimulus (Ban, 2014; Ban and
Gallagher, 2014).

Indeed, the IMF has been criticised by its own auditor
(the IMF Independent Evaluation Office/IEO) for advising
budget cuts to ‘some of the largest advanced economies’ like
Germany, US and Japan in 2010-2011, and endorsing austerity
in a ‘premature’ way. The IEO acknowledges, however, that
observing that after the 2008 crisis, policies pursued so far did
not improve the growth outlook, the IMF has reconsidered its
fiscal policy prescriptions, calling for a more moderate pace
of fiscal consolidation and recommending fiscal expansion
where it is necessary (IMF-EIO, 2014). The criticisms
of conditionality had already led to a decrease in numbers
of conditions during the 2000s, e.g. on trade policies (IMF-IEO,
2009), and the number of conditionalities sharply decreased
since the 2008 crisis.

FIGURE 2 Structural conditionality in IMF Stand-by
arrangements, 1997-2000 vs. 2008-11 (number
of conditions per programme per year)

The IMF also displayed adaptability for its facilities and
the associated conditionalities in developing countries, notably
low-income countries. The IMF Poverty Reduction and Growth
Facility (PRGF) has been replaced by new and more flexible
lending instruments in 2010 (gathered in the Poverty
Reduction and Growth Trust/PRGT), which took into account
the vulnerability of these countries to external shocks,
including the major shock of the 2008 global crisis. It may also
be noted that, with higher growth rates during the 2000s,
some developing countries (e.g., in SSA) were less in need
of IMF external financing. The PRGT has three lending
instruments: the Extended Credit Facility (ECF) to provide
flexible medium-term support, with more focused and
streamlined conditionality; the Standby Credit Facility
to address short-term and precautionary needs; the Rapid Credit
Facility, offering emergency balance-of-payment support
without the need for programme-based conditionality. The IMF
has devised a non-financial instrument, the Policy Support
Instrument (PSI) in order to support low-income countries
that do not want (or need) IMF financial assistance, but seek
to consolidate their performance with IMF monitoring and
support. Though the objectives of the PSI are in line with the
IMF traditional conceptual framework, by definition they
do not include the usual conditional lending mechanisms.

Structural conditionalities have also been reclassified:
a key consideration here is the likelihood that a condition
is macro-critical and falls within the areas that the IMF
dconsiders to be within its core expertise, i.e. macroeconomic
stabilisation – specifically, fiscal, monetary and exchange rate
policies, including the underlying institutional arrangements
and related structural measures, and financial systems issues
related to the functioning of both domestic and international
financial markets. Structural reforms that are aimed
at strengthening public sector resource management and
accountability are here crucial for the IMF. The new
classification highlights the intersection between
macro-criticality and IMF expertise and distinguishes the
fiscal policy measures (taxation); public sector resource
management and accountability (public sector governance,

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2 In September 2014, PSI has been devised for 7 countries, all in Sub-Saharan Africa. http://www.imf.org/external/np/exr/facts/psi.htm
In the aftermath of the financial crisis, the IMF has continued reflecting on its conditionality policies (IMF, 2014). Conditionality remains the centrepiece of the act of borrowing from the IMF, which implies that the borrowing government agrees to adjust its economic policies to overcome the problems that led it to seek financial aid, and loan conditions also serve to ensure that the country will be able to repay the IMF. The IMF did, however, reform its lending and conditionality in 2009 in order to promote national ownership of the prescribed policies (IMF, 2010). While the overarching goal is always to restore balance of payments viability and macroeconomic stability, the borrowing country has primary responsibility for selecting, designing, and implementing the policies. The programme is described in a letter of intent (often including a memorandum of economic and financial policies). Compliance remains based on a variety of mechanisms, i.e. disbursements in instalments linked to observable policies, quantitative performance criteria and indicative targets, and structural benchmarks (often non-quantifiable reforms). Yet a subsequent review by the IMF of decade of lending conditionalities and their streamlining – influenced by the problems of the euro area –, while positively acknowledging that it is more flexible and focused, underscored its weakness regarding the ‘ownership’ of programmes and conditions, their transparency and their social consequences (IMF, 2012).

3. The inclusion of political conditionalities in the international financial institutions’ programmes

The limited effectiveness of the first stabilisation and adjustment programmes in the 1980s led the IFIs to examine causalities that would not be strictly confined to the conventional economic determinants of growth and stagnation. The 1980s and 1990s precisely witnessed the growing influence in academic studies of theories of rent-seeking (Krueger, 1974), bureaucracy’s inefficiency, and ‘heavy hand’ of government, in the light of rational choice and public choice theories (Bates, 1988): states became increasingly held responsible of economic failure. Rent-seeking behaviour has been said to be even more likely in resources-based economies (Auty, 2001), in line with the ‘resource-curse’ arguments. Studies in public choice-inspired political economy were enriched by reflections on governance developed for the analyses of the firm, contracts and regulation, and in developing countries, typically for the understanding of privatisation’s successes and failures (Estache and Wren-Lewis, 2009).

In the same vein, in order to explain the mixed economic performances of states in developing countries, theories in political science and political economy during the 1980s qualified these states with concepts such as neopatrimonialism, predation, corruption, cronyism, nepotism, patronage, clientelism, personal rule, authoritarianism (states being said
The argument of ‘extraction’ has been particularly popular, with these economies having been analysed as ‘extractive economies’ – an argument that in fact continues Olson’s (1993) analyses on the detrimental effects on development of ‘roving bandits’ (vs. ‘stationary’ ones), as in a world of ‘roving banditry’ there are no incentives to production or accumulate anything. In ‘extractive’ economies, governments typically base their legitimacy on the extraction of natural resources and have no incentive to promote human capital, developmental institutions and growth, and they may even have an interest in preventing development (Acemoglu and Robinson, 2006; 2012).

In the 1990s, many economic studies explored the ‘political economy of policy reform’, or theories of ‘endogenous policies’ and of ‘bad policies’, the latter being viewed as the key determinants of stagnation. Irrespective of the type of political regime, ‘bad policies’ may stem from governments’ inability to use transfers in separating efficiency and distribution, and inability to commit credibly. As shown, in particular, by the 2004 Nobel Prize winners Finn Kydland and Edward Prescott (1977), the credibility of policy and the capacity for a government to credibly commit is crucial for these policies’ effectiveness – this argument has been a justification for the creation of independent agencies and ‘hand-binding’ devices (e.g., independent central banks). All governments, however, face a problem of credibility for their policies, as there is no meta-level above government that has the coercive capacity to enforce its policies and promises (Acemoglu, 2003). Political attitudes are determined by economic incentives, and the form of political and economic institutions results from conflict between groups that have diverging interests (the ‘elites’ and the ‘citizens’): this endogeneity of political and economic institutions (e.g., the locking-in by oligarchies of financial capital enabling that of human capital) may lead to stagnation (Acemoglu and Robinson, 2006).

This inherent lack of credibility affecting developing countries’ governments more than others has thus fed the argument that developing countries’ governments should create independent ‘agencies of restraint’ (Collier, 1991) and ‘hand-binding’ devices, which would give to their policies and commitments the credibility they lack. As mentioned above, for the IFIs conditional lending typically constitutes such a device. Indeed, confronted with their programmes’ mixed outcomes, the IFIs have argued that policy externalisation is beneficial in predatory states, because in such states policies lack credibility, especially external credibility vis-à-vis international markets and investors: rulers’ domestic policies must therefore be ‘locked’ by external ‘hand-binding’ devices that are costly to renege; such costs are incentives to comply with conditions and reforms, and give domestic policies credibility. Examples of such ‘agencies of restraint’ are international treaties, regional or monetary arrangements, the allocation of policymaking to independent agencies (e.g., central banks, revenue collection agencies) or agreements with the IFIs (e.g. stabilisation or adjustment programmes). For the IFIs, such hand-binding devices are also beneficial for citizens in predatory or dictatorial regimes, as they protect them against these regimes’ arbitrariness and clientelism.

The concept of ‘failed’ states – or ‘fragile’, or ‘collapsed’ states – was also crafted within the IFIs and the broader donor community in the 2000s, and was viewed as providing a better account of some situations of programme and conditionality failure. Such ‘failed’ states include a significant number of low-income countries, and notably SSA countries: e.g., for the Foreign Policy index, in 2013, Somalia, DR Congo, Sudan, South Sudan, Chad, Yemen, Afghanistan, Haiti, Central African Republic,...³ ‘State failure’ has also been explained by initial endowments, e.g., geography and demography (which may be endogenous to each other): ‘state failure’ is indeed the incapacity to provide public goods such law and order, defence, contract enforcement, infrastructure, which is typically hindered when demographic densities is low, as is the construction of state authority in the context of scattered populations (Herbst, 2000).

In this theoretical context, from the 1990s onwards, the improvement of recipient countries’ ‘governance’ thus became an additional objective within the IFIs programmes, with conditionalities increasingly extended to non-economic issues. The conceptual framework keeps the mix of coercion and provision of incentives that characterise economic conditionalities. This period witnessed studies within the IFIs that argued that aid is effective only in countries that are willing to implement the ‘good policies’ – i.e. in fact the conditionalities put forward by IFIs programmes (Burnside and Dollar, 2000; 2004). Beyond the IFIs, this legitimised for donors the selectivity of their aid flows, i.e. aid should be firstly directed towards the countries that show willingness to implement conditionalities – the ‘good policies’. An illustration is the assessment by the World Bank, for IDA resources allocation, of countries’ economic policies and institutions ‘quality’ and their compliance with conditionalities via the indicators of the Country Policy and Institutional Assessment (CPIA) (16 criteria grouped in 4 clusters: economic management; structural policies; policies for social inclusion and equity; and public sector management and institutions)⁴.

Hence from the late 1990s onwards, programmes included conditionalities related to governance. It may be noted that they focused on administrations and their behaviour, and were distinct from other conditionalities, conceived as more ‘economic’, which nonetheless usually affect ‘governance’ (e.g., politically influential interest groups), such as trade liberalisation. Programmes focused, for example, on corruption, accountability, decentralisation and the creation of independent agencies (e.g. for improving the levying of taxes), in line with the theories of independent ‘agencies of restraint’ as key instruments of policy credibility and hence effectiveness. They also focused on ‘democracy’, typically the implementations of elections or the support to parliaments. A key issue is that conditionalities on governance are not political reform. In putting forward the improvement of ‘governance’, donors focus on mechanisms that are presented as technical and a matter of incentives, rather than political, e.g. involving the functioning of civil services. For example, dysfunctionings are identified (e.g., by consultancy firms), and donors formulate conditions for their financing in terms of technical reform of the management of public administration.

4. The limitations of conditionalities

Conditionalities, however, are confronted with a series of limitations. Moreover, the addition of governance conditionalities to economic conditionalities has induced unexpected effects and paradoxes. Though the IFIs conducted several reflections on conditionality, e.g., on its time span (short or longer term), it has remained difficult, however, to question its very existence.

4. 1. THE LIMITATIONS INHERENT IN THE MECHANISM OF CONDITIONALITY

Conditionalities multiplied since the first stabilisation and adjustment programmes but recipient countries’ economic performances did not markedly improve – and when they improved, such as in SSA countries in the second half of the 2000s, this was, in fact, due less to the implementation of conditionalities than to these countries’ dependence on commodities and the increase in international commodity prices in that period. In commodity-dependent economies, the reform programmes that started in the early-1980s did not modify the root cause of fiscal crises, i.e. vulnerability to external shocks due to a distorted export structure that is based on primary commodities with volatile prices. Higher growth rates have not therefore changed the initial economic structures that generated the dependence on external reform-based conditional lending and the associated externalisation of domestic policies. These improvements are vulnerable to any reversal of the international environment, the latter being obviously out of the control of SSA governments’ domestic policies (e.g. China’s growth deceleration).

The argument that IFI programmes provide credibility through conditionality does not seem to be confirmed. For some studies, IMF conditionality appears to be ineffective, and there is no empirical evidence showing that conditionalities have enhanced recipient countries’ ‘ownership’ (Dreher, 2008). When they appear to be effective, there seems to be a tautological process that conditionalities are effective mostly in countries that show willingness to reform (Wei and Zhang, 2010). This may question the argument that conditionality should be abandoned in favour of selectivity, i.e. lending to governments that already have good policies and institutions.

A justification of conditionalities is that financing cannot be given without economic programmes of reforms and conditions, as otherwise money would line private and corrupt pockets. A similar argument is that without conditions money would be wasted in inefficient policies; conditions oblige governments to make a use of financing that pave the way of future growth, and projects that yield profit or social welfare. Likewise, the World Bank has consistently justified its adjustment programmes in arguing that privatisation and liberalisation break the rents that characterise developing countries, especially the rents of political rulers and the monopolies of the interest groups and oligarchs thus rewarded in exchange for political support. These arguments, however, do not always hold: conditionalities may indeed destabilise anti-developmental rulers and oligarchs, but the latter can sometimes adapt them to their own advantage. Equally, the argument that conditionalities channel the lent money in a way that is more economically efficient may not be valid, as argued by a large ‘heterodox’ literature since the first stabilisation and adjustment programmes in the 1980s. In developing countries, from the 1980s onwards, several studies pointed at the failures of the design, the fallacies of the underlying theories and the inadequacy of conditionalities to borrowing countries’ characteristics. Both regarding developing countries and developed countries (e.g. in the EU after 2010 and the ‘troika’ programmes), such studies argue that these conditionalities are not conducive to growth and actually aggravate countries’ macroeconomic problems, e.g. debt and fiscal deficits, and, for developing countries, do not foster structural transformation and departure from commodity-dependence and aid-dependence. Since the 2008 crisis, even non-‘heterodox’ economists have underscored that the economic content of conditions – macroeconomic stabilisation, the standard Washington Consensus, i.e. reduction of fiscal imbalances, privatisation, liberalisation –, are not credible regarding their aims of restoring growth (Wyplosz, 2013; O’Rourke, 2014).

In addition, the externalisation of policies and the very mechanism of conditionality inherently generate resistance from governments (e.g., policy reversal) and citizens, and may induce endless detrimental games and moral hazard effects (conditionality may also be impossible to implement). The focus of IFI programmes on ‘ownership’ and ‘participation’ of recipient governments, together with the notion of ‘partnership’ put forward as a description of the relationship between the donor and the recipient, stumbles over the intrinsic asymmetry of the relationship: one party finances and exchanges its financing for compulsory reform and the other is in need for financing and has no other choice than to accept this relationship. An IMF Independent Evaluation Office’s assessment observed that in 2007 only about half of the structural conditions were complied with on time (IMF-EIO, 2007). This contradicts the objective and requirement of ‘ownership’ and internalisation of reforms. Over decades of lending and mixed results, the relationships between IFIs and governments have been described as a ‘ritual dance’ (Kahler, 1992), with some ‘aid fatigue’ on both sides, and as a ‘game’ with permanent negotiations – politics of recipient countries have even been coined the ‘politics of non-reform’ (Van de Walle, 2001).

Conditionality indeed implies and highlights the inherent divergence of interests and asymmetry between the finance-providing IFI and the finance-receiving government (including other domestic interest groups). Aid is typically affected by the ‘Samaritan dilemma’ (Gibson et al., 2005): e.g., if the recipient government knows that donors condition their aid on a reduction of poverty, it has little incentive to exert high effort toward this objective, as in doing so it will receive less aid in the future. The ‘Samaritan’s dilemma’ is aggravated by moral hazard: the donor can never know if a poor outcome
is the result of low effort (‘bad policies’) or ‘bad luck’ (Svensson, 2005). Rulers may also exploit policy externalisation in order to stay in power: e.g., using the IFIs and their conditionalities as ‘scapegoats’ (Vreeland, 1999), manipulating conditionalities in order to put forward their own policies and interests, or practicing ‘double-edge diplomacy’ (Putnam, 1988). On their side, aid agencies may not enforce conditions, due to their own institutional incentives to lend (or make grants). The device of conditionality has also contributed to the erosion of the credibility of the IMF vis-à-vis borrowing countries (notably the credibility of the IMF threat of sanctioning non-compliance) due to the dual role of the IMF as a creditor and a monitor of reform ratio net ODA/GNI is by far the highest for low-income countries as a category – 7.4% in 2012 – and some SSA countries, typically oil producers, do not depend on foreign aid.

4.2. THE LIMITATIONS OF CONDITIONALITIES ON GOVERNANCE AND THE INHERENT LINKS BETWEEN ECONOMIC AND POLITICAL CONDITIONALITIES

Since the 1980s, in many developing countries, the implementation of conditionalities has not produced tangible outcomes for citizens in terms of standard of living, inequality or corruption. The implementation of ‘good governance’

Conditionalities, however, are confronted with a series of limitations. Moreover, the addition of governance conditionalities to economic conditionalities has induced unexpected effects and paradoxes. Though the IFIs conducted several reflections on conditionality, it has remained difficult, however, to question its very existence.

(Marchesi and Sabani, 2007). More generally it has contributed to the erosion of the effectiveness and legitimacy of IMF policies, even if their objective is growth.

This policy ineffectiveness may perpetuate aid dependence (Sindzingre, 2012), which is detrimental per se – due to, e.g., Dutch disease effects or aid volatility (Bulir and Hamann, 2008). Since the 1980s, some SSA countries depend on external aid for basic public goods such as infrastructure, health or education. Net official development assistance (ODA) to SSA represented in 2012 3.2% of GNI, 15.9% of gross capital formation and 8.3% of imports of goods, services and income (World Bank World Development Indicators, 2014). Besides the small island economies of Oceania, SSA is the region of the world that is the most dependent on aid. This poor performance is driven by SSA low-income countries: indeed the programmes has often been confined to reforms of the form of institutions, e.g. the introduction of elections, of agencies of restraint, e.g. for tax, the drafting of constitutions, etc. Similarly, the same oligarchies have kept the power, and in some countries, whatever the donors governance conditionalities, whatever the formal democratic institutions (elections, parliaments, agencies anti-corruption) rulers could remain decades in power, with no visible opposition from donors when they correctly implemented IFIs programmes.

In addition, geopolitical motives may drive IFI loans. Aid is typically a dimension of donors’ foreign policy (Alesina and Dollar, 2000) and does not always go to the less corrupt, the more democratic or the poorest (Alesina and Weder, 2002; Easterly and Williamson, 2011). 'Good governance' conditionalities may here clash with other priorities, which can

5 http://wdi.worldbank.org/table/6.11
contribute to the weakening of the credibility of governance requirements for the citizens of recipient countries. Donors may here reveal that they do not always believe themselves in these conditionalities and may forget that they are not complied with when other superior interests are at stake – typically regarding their own foreign policy. Recipient countries’ citizens may therefore also not believe donors when they recommend these conditionalities.

Also, the fact that reforms centre mostly on institutional forms and do not address the structure of local political economy explains that these conditionalities cannot be effective: this ineffectiveness in terms of, e.g., inequality and voicing of citizens also contributes to the lack of credibility of ‘good governance’ conditionalities for recipient countries citizens.

Here IFIs are trapped by their own organisation and conceptual frameworks: the fact that they devised a concept of good governance that is primarily technical, due to their Articles of Agreement, prevents the IFIs from intruding in the domestic politics of its members (as borrowing countries are IMF members), despite the fact that conditionalities by definition impinge on political economy and that ‘governance’ is intrinsically a political concept, which refers to the core of political economy – corruption, inequality – of a government and public administration. This ex ante prevents the conditionalities attached to the concept of governance to be effective, if they are confined to forms, e.g. changing organisational charts, providing incentives, but not touching core political structures and their historical determinants. Donors may also be trapped in the ‘double edge diplomacy’ of local rulers, which always have two divergent agendas, one internal, e.g., staying in power, and one for the external, e.g., donors or investors.

The ‘governance’ conditionalities exhibit several contradictions. Good governance has to be endogenous, internalised, as, e.g. ‘participation, ‘ownership’ cannot by definition be prescribed. ‘Ownership’ contradicts with the intrinsic asymmetry of the lending relationship (likely to generate resistances). ‘Good governance’ cannot come from the outside, as prescriptions from external agencies are ‘processed’ by local norms: prescriptions are external inputs and are necessarily retransformed according to local social norms and by political groups and their interests. Institutions are indeed composite entities and result from complex combinations of economic, political, social elements (Sindzingre, 2007).

The combination of economic and governance conditionalities may be self-contradictory and generate a series of paradoxes. Political conditionalities, participation, democracy, may contradict with the IFIs economic conditionalities. The requirements by donors in the 1990s of the simultaneous implementation of economic reform and political reform (democratisation) often had detrimental effects, typically the generation of political business cycles (e.g., fiscal deficits created by the costs of elections) in countries in fiscal problems, and hence the aggravation of these problems while IFIs require countries to reduce their fiscal deficits. The injunction of compliance with economic and political conditionalities is a double bind for recipient rulers in low-income countries with limited resources: requirements of democracy are costly in developing countries given a pervasive context of patronage politics and clientelist redistribution that are difficult to break, and they may therefore increase fiscal deficits that other conditionalities require to reduce (Williamson, 1994). Here the recurrent solution for developing countries’ governments is to ask donors for more aid for implementing the ‘good governance’ reforms: in countries under programmes, it is typically donors who finance the deficit, via budget support and sectoral support, while conditionality on spending makes it so that education or health are sacrificed by rulers in favour of more discretionary spending driven by their political interests and the local political economy (and usually indifferent to citizens’ welfare). Finally, donors also finance the other ‘good governance’ reforms, typically elections, the functioning of agencies created for improving accountability, transparency, the training and equipment of customs and tax administrations. In fine, this generates another vicious circle, i.e. the increase in aid dependence.

Also, economic conditionalities in their quest for being effective may bypass democratic institutions, typically
constitutions and parliaments. The latter may vote against certain conditionalities (e.g., the layoff of civil servants, which is part of stabilisation programmes in both developed and developing countries), but this is likely to be ignored by programmes. Yet the effective functioning of such institutions – parliaments, rule of law – is precisely an important dimension of governance conditionalities (Sindzingre, 2014).

Sanctions and conditionalities that are not complied with may also generate paradoxical and unexpected effects. Firstly, as in any binding arrangement in international relations, sanctions of non compliance reflect the balance of power relationships of the parties of the arrangement: the implementation of sanctions depends on the geopolitical importance of the non-complying countries – this is shown not only by arrangements with the IFIs, but, as is well-known, by the compliance with fiscal rules of EU member countries, where sanctions appear difficult against the most important founding members6.

Secondly, as is often the case in low-income commodity-dependent countries, conditionalities are not complied with not always because governments do not want it, but because they cannot do it, e.g., as countries may be caught in a poverty trap combining very limited fiscal resources, strong interest groups and generalised corruption: getting out of such stabilised low equilibria is very difficult, and even if governments adhere to and wish to apply programmes’ conditionalities, they may be powerless (Sindzingre and Milelli, 2010).

Thirdly, economic sanctions, e.g., stops in disbursements or suspension of projects, aggravate countries’ economic problems, and therefore may make compliance still more unlikely (as has been the case for the EU with member countries that do not comply with the thresholds on debt and fiscal deficit). Similarly, sanctions for non compliance with ‘good governance’ are usually a cut in aid flows from the IFIs and other donors: for example, in triggering a stop in aid flows, a military coup may plunge a country in deeper economic difficulties (even if this would have the positive aspect of a diminution of aid dependence) and it may not necessarily foster a better governance, e.g. more aspiration to democracy or lesser corruption7. An example is the US AGOA8, which grants unilateral trade preferences to SSA countries and includes conditionalities on governance – suspension of preferences may with time constrain rulers to implement policies aiming at democracy or rule of law, but these may remain mainly formal (e.g. limited to elections, or to the creation of anti-corruption agencies). The Generalised System of Preferences ‘plus’ (GSP+) of the EU also includes provisions on governance, and for a developing country not having them means a privation of resources. In poor countries, however, which are caught in the vicious circle of aid-dependence, these types of sanctions may less affect the rulers than the poor.

Regarding bilateral donors, such unexpected and negative effects can also characterise the mechanisms of selectivity of aid, of the conditioning of financing to the willingness to implement ‘good policies’. The withdrawal of financial support by donors is indeed likely to affect the poor more than the elites in given countries, and this is even more the case as many countries that are unwilling or unable to implement programmes are undemocratic or authoritarian political regimes where citizens are voiceless. Also, the selectivity mechanism has difficulties in functioning at the concrete level, as donors may be driven by their interests or ideology (Brech and Potrafke, 2014).

Finally, throughout history, state-building has relied on centralisation and accountability (Tilly, 1985). The ‘good governance’ agenda and conditionalities do not modify the general framework of poor countries fiscal dependence on


7 Embargoes are well-known examples of such lacks of impact or even perverse effects at the local level.

external flows. This dependence generates problems of accountability and legitimacy. Aid dependence fosters ‘policy externalisation’ – to agencies that are external to the government and condition financing to policy –, which is a key constraint on the effectiveness of recipient countries’ public policies and institutions, as it erodes their legitimacy and credibility, in particular tax institutions (Moss et al., 2006). When domestic policies are devised by external agencies and when rulers are more accountable to these external agencies than their own citizens because they get their resources from these agencies rather than from citizens via taxation, this breaks the link between rulers and citizens established by taxation and redistribution, and the citizens’ consensus that underlie state legitimacy. Indeed, accountability of rulers to citizens is a central element of state formation, notably via the mechanisms of taxation and redistribution (Kaldor, 1963), and a central element of the effectiveness of their policies; it is a central element of legitimacy of political regimes and institutions, notably of delegation (democracy), as otherwise citizens feel unable to weigh on domestic policies and deprived of ‘voice’. In this context, the ‘good governance’ paradigm may be viewed as more an ‘outsourcing of state authority’ than state-building (Meagher, 2014). The paradoxical and unexpected effects here are that an effectively functioning state is necessary for economic conditions and reforms to be implemented.

5. Conclusion

This paper has analysed the concept of conditionality in developing countries, and compared economic conditionalities (‘Washington Consensus’) and conditionalities applied to ‘governance’. It has shown its limitations, both in terms of conceptual rigour and policy feasibility, as well as the commonalities and differences between the two regimes of conditionalities. In particular, it has highlighted the trapping processes for donors (e.g., addressing political issues via technical instruments) – but also for recipients (e.g., the trapping in repeated games conditionality/resistance) –, and the unexpected effects and paradoxes that are associated with conditionalities.

Several questions require further analysis, in particular as to whether it would be possible to finance development without conditions. Many attempts at changing have been made by the IFIs and other donors since the 2000s, e.g., budget support, ex-post monitoring, output-based lending, evidence-based lending, among others. Ex post or ex ante, however, conditions to financing remain an intrinsic element of conceptual frameworks (Dixit, 2000). Some bilateral donors’ development cooperation, e.g. China, is reputed to include little conditionality (‘non interference’): this may not last as China becomes a major player, e.g. in SSA (Grimm, 2014), and in addition such stance may not be possible for international financial institutions.

In addition, another question would be whether it is desirable to finance development without conditions. Indeed, regarding China, the ‘non interference’ principle has been subject to criticism, as a support for political regimes that may be illegitimate, thus showing that governance conditionality could bring positive outcomes in terms of political economy of development processes. Also, the suppression of conditionalities would require the complete reshuffling of the existing conceptual and policy framework elaborated by donors, and of the political economy of borrowing countries: i.e. the end of the repeated games associated with aid dependence, between lenders and borrowers, between donors and governments (and between rulers and citizens), between conditionalities and resistance. This may be desirable, but may not be possible in the short-term.
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