

INTERNATIONAL MONETARY FUND

**Guidelines on Conditionality**

Prepared by the Legal and Policy Development and Review Departments

(In consultation with other departments)

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September 25, 2002

**Decision No. I - Guidelines on Conditionality**

**A. Principles**

1. *Basis and purpose of conditionality.* Conditions on the use of Fund resources are governed by the Fund's Articles of Agreement and implementing decisions of the Executive Board. Conditionality—that is, program-related conditions—is intended to ensure that Fund resources are provided to members to assist them in resolving their balance of payments problems in a manner that is consistent with the Fund's Articles and that establishes adequate safeguards for the temporary use of the Fund's resources.
2. *Early warning and prevention.* Conditionality is one element in a broad strategy for helping members strengthen their economic and financial policies. Through formal and informal consultations, multilateral surveillance including the World Economic Outlook and discussions of capital market developments, advice to members on the voluntary adoption of appropriate standards and codes, and the provision of technical assistance, the Fund encourages members to adopt sound economic and financial policies as a precaution against the emergence of balance of payments difficulties, or to take corrective measures at an early stage of the development of difficulties.
3. *Ownership and capacity to implement programs.* National ownership of sound economic and financial policies and an adequate administrative capacity are crucial for successful implementation of Fund-supported programs. In responding to members' requests to use Fund resources and in setting program-related conditions, the Fund will be guided by the principle that the member has primary responsibility for the selection, design, and implementation of its economic and financial policies. The Fund will encourage members to seek to broaden and deepen the base of support for sound policies in order to enhance the likelihood of successful implementation.
4. *Circumstances of members.* In helping members to devise economic and financial programs, the Fund will pay due regard to the domestic social and political objectives, the

economic priorities, and the circumstances of members, including the causes of their balance of payments problems and their administrative capacity to implement reforms. Conditionality and program design will also reflect the member's circumstances and the provisions of the facility under which the Fund's financing is being provided. The causes of balance of payments difficulties and the emphasis to be given to various program goals may differ among members, and the appropriate financing, the specification and sequencing of policy adjustments, and the time required to correct the problem will reflect those and other differences in circumstances. The member's past performance in implementing economic and financial policies will be taken into account as one factor affecting conditionality, with due consideration to changes in circumstances that would indicate a break with past performance.

5. *Approval of access to Fund resources.* The Fund will ensure consistency in the application of policies relating to the use of its resources with a view to maintaining the uniform treatment of members. A member's request to use Fund resources will be approved only if the Fund is satisfied that the member's program is consistent with the Fund's provisions and policies and that it will be carried out, and in particular that the member is sufficiently committed to implement the program. The Managing Director will be guided by these principles in making recommendations to the Executive Board with respect to the approval of the use of Fund resources by members.

6. *Focus on program goals.* Fund-supported programs should be directed primarily toward the following macroeconomic goals:

- (a) solving the member's balance of payments problem without recourse to measures destructive of national or international prosperity; and
- (b) achieving medium-term external viability while fostering sustainable economic growth.

7. *Scope of conditions.* Program-related conditions governing the provision of Fund resources will be applied parsimoniously and will be consistent with the following principles:

- (a) Conditions will be established only on the basis of those variables or measures that are reasonably within the member's direct or indirect control and that are, generally, either (i) of critical importance for achieving the goals of the member's program or for monitoring the implementation of the program, or (ii) necessary for the implementation of specific provisions of the Articles or policies adopted under them. In general, all variables or measures that meet these criteria will be established as conditions.
- (b) Conditions will normally consist of macroeconomic variables and structural measures that are within the Fund's core areas of responsibility. Variables and measures that are outside the Fund's core areas of responsibility may also be established as conditions but may require more detailed explanation of their

critical importance. The Fund's core areas of responsibility in this context comprise: macroeconomic stabilization; monetary, fiscal, and exchange rate policies, including the underlying institutional arrangements and closely related structural measures; and financial system issues related to the functioning of both domestic and international financial markets.

- (c) Program-related conditions may contemplate the member meeting particular targets or objectives (outcomes-based conditionality), or taking (or refraining from taking) particular actions (actions-based conditionality). The formulation of individual conditions will be based, in particular, upon the circumstances of the member.

8. *Responsibility of the Fund for conditionality.* The Fund is fully responsible for the establishment and monitoring of all conditions attached to the use of its resources. There will be no cross-conditionality, under which the use of the Fund's resources would be directly subjected to the rules or decisions of other organizations. When establishing and monitoring conditions based on variables and measures that are not within its core areas of responsibility, the Fund will, to the fullest extent possible, draw on the advice of other multilateral institutions, particularly the World Bank. The application of a "lead agency" framework, such as between the Fund and the Bank, will be implemented flexibly to take account of the circumstances of members and the overlapping interests of the two institutions with respect to some aspects of members' policies. The Fund's policy advice, program design, and conditionality will, insofar as possible, be consistent and integrated with those of other international institutions within a coherent country-led framework. The roles of each institution, including any relevant conditionality, will be stated clearly in Fund-related program documents.

## **B. Modalities**

9. *Nature of Fund arrangements.* A Fund arrangement is a decision of the Executive Board by which a member is assured that it will be able to make purchases or receive disbursements from the Fund in accordance with the terms of the decision during a specified period and up to a specified amount. Fund arrangements are not international agreements and therefore language having a contractual connotation will be avoided in arrangements and in program documents. Appropriate consultation clauses will be incorporated in all arrangements.

10. *Members' program documents.* The authorities' policy intentions will be described in documents such as a Letter of Intent (LOI), or a Memorandum on Economic and Financial Policies (MEFP) that may be accompanied by a Technical Memorandum of Understanding (TMU). These documents will be prepared by the authorities, with the cooperation and assistance of the Fund staff, and will be submitted to the Managing Director for circulation to the Executive Board. The documents should reflect the authorities' policy goals and strategies. In addition to conditions specified in these documents, members requesting the use of Fund resources may in exceptional cases communicate confidential policy understandings to the Fund in a side letter addressed to the Managing Director and disclosed to the Executive

Board. In all their program documents, the authorities should clearly distinguish between the conditions on which the Fund's financial support depends and other elements of the program. Detailed policy matrices covering the broader agenda should be avoided in program documents such as LOIs and MEFPs unless they are considered necessary by the authorities to express their policy intentions.

11. *Monitoring of performance.* The implementation of the member's understandings with the Fund may be monitored, in particular, on the basis of prior actions, performance criteria, program and other reviews, and other variables and measures established as structural benchmarks or indicative targets.

- (a) *Prior actions.* A member may be expected to adopt measures prior to the Fund's approval of an arrangement, completion of a review, or the granting of a waiver with respect to a performance criterion when it is critical for the successful implementation of the program that such actions be taken to underpin the upfront implementation of important measures. In reaching understandings on prior actions, the Fund will also take into account the strain that excessive reliance upon such actions can place on members' implementation capacity. The Managing Director will keep Executive Directors informed in an appropriate manner of the progress of discussions with the member.
- (b) *Performance criteria.* A performance criterion is a variable or measure whose observance or implementation is established as a formal condition for the making of purchases or disbursements under a Fund arrangement. Performance criteria will apply to clearly-specified variables or measures that can be objectively monitored by the staff and are so critical for the achievement of the program goals or monitoring implementation that purchases or disbursements under the arrangement should be interrupted in cases of nonobservance. The number and content of performance criteria may vary because of the diversity of circumstances and institutional arrangements of members.
- (c) *Reviews.* Reviews are conducted by the Executive Board.
  - (i) *Program reviews.* Program reviews provide a framework for an assessment of whether the program is broadly on track and whether modifications are necessary. A program review will be completed only if the Executive Board is satisfied, based on the member's past performance and policy understandings for the future, that the program remains on track to achieve its objectives. In making this assessment, the Executive Board will take into consideration, in particular, the member's observance of performance criteria, indicative targets, and structural benchmarks, and the need to safeguard Fund resources. The elements of a member's program that will be taken into account for the completion of a review will be specified as fully and transparently as possible in the arrangement. Arrangements will provide for reviews to take place at a frequency appropriate to the member's

circumstances. Reviews are expected to be held every six months, but substantial uncertainties concerning major economic trends or policy implementation may warrant more frequent monitoring. In cases of major delays in the completion of a review, the Managing Director will inform Executive Directors in an appropriate manner.

(ii) *Financing assurances reviews.* Where the Fund is providing financial assistance to a member that has outstanding sovereign external payments arrears to private creditors or that, by virtue of the imposition of exchange controls, has outstanding non-sovereign external payments arrears, the Executive Board will conduct a financing assurances review to determine whether adequate safeguards remain in place for the further use of the Fund's resources in the member's circumstances and whether the member's adjustment efforts are undermined by developments in creditor-debtor relations. More specifically, every purchase or disbursement made available after the approval of the arrangement will, while such arrears remain outstanding, be made subject to the completion of a financing assurances review. Financing assurances reviews may also be established where the member has outstanding arrears to official creditors.

(d) *Other variables and measures.* In monitoring the implementation of a member's program, the Fund may also examine variables and measures established as indicative targets and structural benchmarks. The same principles governing the scope of conditions set out in paragraph 7 apply to these variables and measures as well as to other program-related conditions.

(i) *Indicative targets.* Variables may be established as indicative targets for the part of an arrangement for which they cannot be established as performance criteria because of substantial uncertainty about economic trends. As uncertainty is reduced, these targets will normally be established as performance criteria, with appropriate modifications as necessary. Indicative targets may also be established in addition to performance criteria as quantitative indicators to assess the member's progress in meeting the objectives of a program in the context of a program review.

(ii) *Structural benchmarks.* A measure may be established as a structural benchmark where it cannot be specified in terms that may be objectively monitored or where its non-implementation would not, by itself, warrant an interruption of purchases or disbursements under an arrangement. Structural benchmarks are intended to serve as clear markers in the assessment of progress in the implementation of critical structural reforms in the context of a program review.

12. *Waivers.* The Fund will grant a waiver for nonobservance of a performance criterion only if satisfied that, notwithstanding the nonobservance, the program will be successfully implemented, either because of the minor or temporary nature of the nonobservance or because of corrective actions taken by the authorities. The Fund will grant a waiver of the

applicability of a performance criterion only if satisfied that, notwithstanding the unavailability of the information necessary to assess observance, the program will be successfully implemented and there is no clear evidence that the performance criterion will not be met.

13. *Floating tranches.* Conditions will normally apply to specified dates or continuously. However, when the Fund judges that the member will need to implement a particular structural measure or meet a particular performance target during the program period but not necessarily by a specific date, and when flexibility in timing would promote national ownership, the arrangement may provide for the purchase or disbursement of Fund resources to be made available whenever the measure is implemented or the target observed. These “floating tranches” are expected to apply primarily to structural performance criteria that are included because of their importance for medium-term external sustainability and growth.

### **C. Evaluation and Review**

14. *Program evaluation.* The staff will prepare an analysis and assessment of the performance under programs supported by use of the Fund’s resources in connection with Article IV consultations and as appropriate in connection with further requests for use of the Fund’s resources.

15. *Periodic review.* The Fund will review the application of this Decision at intervals of two years and at such other times as consideration of it is placed on the agenda of the Executive Board. These reviews will evaluate the consistency of conditionality with these guidelines, the appropriateness and implementation of programs, and the effectiveness of policy instruments.

16. Decision No. 270-(53/95), adopted December 23, 1953, *Stand-by Arrangements* as amended, Decision No. 6056-(79/38), adopted March 2, 1979, *Guidelines on Conditionality*, and Decision No. C-3220-(01/24), adopted March 9, 2001, *Concluding Remarks by the Chairman—Conditionality in Fund-Supported Programs*, are repealed.

**Decision No. II – Stand-by Arrangements**

1. Access to Fund resources in the credit tranches will normally be provided through a stand-by arrangement.
2. A representation of need by a member for a purchase requested under a stand-by arrangement will not be challenged by the Fund.
3. The normal period for a stand-by arrangement will range from 12 to 18 months. If a longer period is requested by a member and is considered necessary by the Fund to enable the member to implement its adjustment program successfully, the stand-by arrangement may extend beyond this range, up to a maximum of three years.
4. Phasing and performance clauses will be omitted in stand-by arrangements within the first credit tranche. They will be included in all other stand-by arrangements but will apply only to purchases outside the first credit tranche. For an arrangement within the first credit tranche, a member may be required to describe the general policies it plans to pursue, including its intention to avoid introducing or intensifying exchange and trade restrictions.

## **Staff Statement Principles Underlying the Guidelines on Conditionality**

1. The IMF provides financing to assist a member country to resolve balance of payments problems. IMF conditionality specifies how the Fund's financing will be linked to the member's implementation of an adequate program of policy adjustments in response to its external imbalances. Conditionality is one element in a broad strategy for helping countries design and carry out programs of strong economic and financial policies.
2. Adoption of new guidelines for conditionality has been motivated by an increasing recognition of the importance of several interrelated principles for successful design and implementation of Fund-supported programs. Chief among these are national ownership of reform programs, parsimony in the application of program-related conditions, tailoring of programs to the member's circumstances, effective coordination with other multilateral institutions, and clarity in the specification of conditions.
3. *National ownership* refers to a willing assumption of responsibility for a program of policies, by country officials who have the responsibility to formulate and carry out those policies, based on an understanding that the program is achievable and is in the country's best interest. Conditionality, if well designed and established through a mutually acceptable collaborative process, can promote and strengthen ownership, in particular by demonstrating the authorities' commitment to a course of action. Judgments on the depth and breadth of national ownership of a proposed Fund-supported program are inherently subjective and difficult, and ownership itself is likely to change and develop over time. Nonetheless, ownership—along with the member's administrative capacity to implement reforms—is a key determinant of success, and the guidelines aim to promote ownership by ensuring that conditionality is well designed and is formulated through a mutually acceptable process led by the member. The guidelines also note that the need for ownership implies selectivity: approval of the use of Fund resources depends in particular on the Fund's assessment that the member is sufficiently committed to successful implementation.
4. Promotion of ownership depends in part on effective and inclusive processes of program development in which the authorities and the staff are both fully engaged. Therefore, in responding to a member's request for access to Fund resources, it is expected that the initial response by the staff will be to ascertain, through dialogue, how the authorities intend to adjust policies. Based on those intentions, the staff will 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, including the causes of the balance of payments problem and the member's capacity to implement reforms in the necessary time frame. Particularly in cases where the member's administrative capacity is weak, the staff will stand ready to advise the authorities on a range of available policy options and implementation plans, and to provide technical assistance as appropriate, so as to enable them to make informed choices.



5. It is also expected that program documents, including Letters of Intent, will be prepared by the authorities, with the cooperation and assistance of the fund staff, and will reflect the authorities' policy goals and strategies. Programs supported by the Poverty Reduction and Growth Facility (PRGF) will normally be based on a Poverty Reduction Strategy Paper (PRSP) resulting from a broad consultative process within the country.
6. *Parsimony* means that program-related conditions should be limited to the minimum necessary to achieve the goals of the Fund-supported program or to monitor its implementation and that the choice of conditions should be clearly focused on those goals. As stated in the conditionality guidelines, the macroeconomic goals of Fund-supported programs are to solve the member's balance 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. In this context, sustainable growth means growth that is strong, durable, and equitable, with reasonable price stability. Particularly for PRGF-supported programs, the growth objective is linked to the pursuit of higher living standards and a reduction of poverty.
7. 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 of Agreement or policies adopted under them, are to be avoided. A judgment that a condition is of critical importance for achieving the macroeconomic goals means that if it were not implemented, it is expected that the goals will not be achieved. Conditions may also be applied in particular to the provision of accurate information, the adequacy of internal controls and procedures in a member's central bank, and other requirements for the safeguarding of Fund resources. Conditions to implement specific provisions of the Articles will include the avoidance of exchange measures subject to Fund jurisdiction and of import restrictions for balance of payments reasons.
8. The principle of parsimony in application pertains to all program-related conditions including the establishment of variables and measures as indicative targets or structural benchmarks. Decisions on whether to recommend waivers will be based on the criteria specified in the guidelines with the aim of avoiding excessive reliance on their use.
9. *Tailoring* of programs implies a recognition that the causes of balance of payments difficulties and the emphasis to be given to various program goals may differ among members. In addition, economic policy understandings should be consistent with the member's capacity to implement policies. Because conditionality must be aimed appropriately at the achievement of the program goals set out in the guidelines, most Fund-supported programs will include certain common elements. Moreover, Fund policies must be applied consistently so as to maintain the uniform treatment of members. Nonetheless, the specification and timing of policy adjustments and the appropriate mix of financing and adjustment will reflect the member's circumstances and the provisions of the facility under which the Fund's financing is being provided. For example, in some cases the overriding goal of Fund-supported programs has been to restore market confidence, ensure orderly

external adjustment, address the weaknesses that had made these countries vulnerable to capital account shocks, and create the conditions for a resumption of growth. In transition economies, completing the transformation into a competitive market economy while restoring or maintaining stable macroeconomic conditions has been the key challenge. PRGF arrangements seek to promote poverty reduction by removing impediments to strong, sustainable growth and a viable external position. More generally, it is expected that arrangements supporting longer-term programs will have more extensive structural conditionality than shorter-term arrangements, because structural reforms are more likely to be critical for the achievement of longer-term goals.

10. The guidelines note that program-related conditions may contemplate the member meeting particular targets or objectives (outcomes-based conditionality), or taking or refraining from taking particular actions (actions-based conditionality). Outcomes-based conditionality may be beneficial where additional flexibility in policy implementation is desired and may be achieved without unduly weakening the member's assurances of Fund financing. In such cases, conditions will apply to performance objectives that are reasonably within the authorities' direct or indirect control and can be evaluated and verified within the required time frame.

11. *Coordination* with other multilateral institutions is often necessary in order for the Fund to provide consistent and effective assistance to members. Accordingly, 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. Responsibility and accountability for all conditions attached to the use of Fund resources reside with the Fund.

12. The primary relationship in this context is between the IMF and the World Bank and is based on a coordination framework that has been agreed between the two institutions.<sup>1</sup> A central element of that framework is the concept of "lead agency." When conditions in Fund-supported programs apply to measures that are not clearly within the Fund's core areas of responsibility as set out in the guidelines, the design and monitoring of those conditions will, to the fullest extent possible, be based on the advice of the World Bank. Each institution should communicate its work and its views systematically to the other institution, in Board documents and meetings, on the substantive areas and conditionality with respect to which it is in the lead. When appropriate, the staff may also draw upon the work and advice of other multilateral institutions. The application of lead agency should be flexible enough to accommodate the substantial areas of overlapping responsibility between the Fund and the Bank as well as differences in country circumstances. These overlapping areas include

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<sup>1</sup> See "Strengthening IMF World Bank Collaboration on Country Programs and Conditionality" (SM/01/219, Suppl. 1, Rev. 1, August 23, 2001), at <http://www.imf.org/external/np/pdr/cond/2001/eng/collab/coll.htm>; and "Guidance Note on Fund-Bank Collaboration" (FO/Dis/02/176).

elements of financial sector work, some elements of public sector reforms, and issues of transparency, governance, corruption and legislative reform, trade policy, and debt management.

13. *Clarity* means that program-related conditions should be transparently distinguished from other elements of the authorities' program both in staff reports and in the member's program documents. In particular, although program documents, if the authorities so wish, may set out the authorities' broad policy agenda for national or international audiences, such documents as well as staff reports should clearly specify the parts of the agenda that constitute understandings on which continued access to Fund resources depends.

14. The guidelines on conditionality are supplemented by separate Board decisions and related documents, such as the guidelines on performance criteria with respect to external debt in Fund arrangements, guidance on the role of the Fund in governance issues, the decision on side letters and the use of Fund resources, and operational guidelines on the relationship between performance criteria and the phasing of purchases under Fund arrangements. In case of conflicts between this explanatory staff statement and the guidelines or other related Board decisions, the language in the relevant decision takes precedence.