CRITICAL CONDITIONS

The IMF maintains its grip on low-income governments

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April 2008
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- Support the empowerment of Southern people to chart their own path towards development and ending poverty.
- Seek a lasting and sustainable solution to the debt crisis, promote appropriate development financing, and a stable international financial system conducive to development.

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Acknowledgements

The report has been written by Nuria Molina and Javier Pereira. We would like to thank Peter Chowla (Bretton Woods Project), Nancy Dubosse (Afrodad), Rick Rowden (ActionAid), Elizabeth Stuart (Oxfam International), and Alex Wilks (Eurodad) for their helpful and constructive comments.

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Critical conditions: The IMF maintains its grip on low-income governments

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Executive Summary

Faced with strong criticism for its expansive and erroneous use of conditionality, and in the wake of a financial crisis, the International Monetary Fund (IMF) approved in 2002 a set of guidelines to inform its use of structural conditionality. The Conditionality Guidelines committed the Fund to reduce the overall number of conditions attached to Fund lending and ensure that those attached respected and were drawn from nationally developed poverty plans in recognitions that developing country ownership is instrumental for successful development.

The IMF’s own Independent Evaluation Office (IEO) issued a study in January 2008 which concluded that the Fund dramatically increased both the number of structural conditions and their intrusiveness in recipient countries’ domestic affairs. However, this evaluation only covered a limited period of time after the Conditionality Guidelines were approved in 2002 (it assessed operations approved between 1995 and 2004).

This report by the European Network on Debt and Development (Eurodad) goes further, assessing more recent IMF loans and going into more detail on the content of the loans. This report looks at the effectiveness of the Conditionality Guidelines in reforming IMF conditionality during the five years since the Guidelines were approved. Based on IMF figures, Eurodad examines the share of Fund structural conditions which prescribe highly sensitive and intrusive policy reforms.

This report finds that since the Conditionality Guidelines were approved, the IMF has not managed to decrease the number of structural conditions attached to their development lending. Moreover, the Fund continues to make heavy use of highly sensitive conditions, such as privatisation and liberalisation. Eurodad’s analysis finds that a quarter of all the conditions in Fund loans approved after 2002 still contain privatisation or liberalisation reforms.

The IMF conditionality streamlining initiative was supposed to decrease the average number of structural conditions and increase ownership of national governments. It also introduced certain tests for whether IMF conditions were necessary, including a test of “criticality”. This report analyses the IMF’s own figures to demonstrate that no further progress has been made since 2004, and casts serious doubts about the genuine commitment of the institution to streamlining its structural conditionality and speed up the application of their own conditionality policy. Faced with in-depth structural reforms of its own, the Fund should take this opportunity to speed up implementation of their Conditionality Guidelines and take further steps in the streamlining initiative.

No change at the IMF

During the first two years after the Guidelines were approved the Fund attached an average of 12 conditions per loan granted to a poor country. After the 2005 review, our research finds that the number of conditions has increased to an average of 13 conditions per loan.

These numbers have to be interpreted with caution as the Fund often “bundles” several policy actions into one condition. For instance, in a loan approved in 2005 for Niger, the Fund required to approve an “extension of the VAT to processed food products (milk, sugar, wheat, flour)”; a “reduction of VAT exemptions on water and electricity consumption”; and “the application of the excise tax to soft drinks and sodas.” The Fund counted these actions as a single condition. However, if all such multiple policy actions prescribed by the Fund are counted separately, the figures given above increase the total number of conditions by 7 per cent in the two periods analysed, raising to 14 the average number of structural conditions per low-income country loan.
Imposing privatisation and liberalisation conditions

The IMF Conditionality Guidelines and their limited view of ownership is having serious social consequences. The Fund continues to push for privatisation and liberalisation of poor nations’ economies, interfering with decisions which should be freely taken by countries according to domestic priorities and needs. In Mali the IMF and the World Bank forced the reform and privatisation of the cotton sector despite opposition. The reforms went ahead and now cotton farmers face an even harder future.

A quarter of all IMF structural conditionality still promotes privatisation and liberalisation reforms, which have proven to be highly sensitive and often have had disastrous consequences for the poor. Out of the PRGFs approved during the last three years, the vast majority of countries assessed by Eurodad – 16 out of 20 – had liberalisation or privatisation conditions. However, some of the countries bear a much higher privatisation burden than others. In Benin, seven out of the thirteen conditions in 2005 required privatising state-owned enterprises in the infrastructure, telecommunications and cotton sectors.

Beyond liberalisation and privatisation, the Fund continues attaching highly sensitive economic policy reform conditions to their loans to poor countries. According to Eurodad, a third of all structural conditions attached to PRGFs approved since 2005 focus on sensitive policy reforms. This entails no change at all compared to the previous two years, which covered the period between the approval of the Conditionality Guidelines and their 2005 review.

This research classified as sensitive policy reforms all conditions geared to limiting the fiscal space available for governments to take spending decisions, regressive taxation conditions, and liberalisation and privatisation related conditions. All these policies may constrain the government's ability to invest in much-needed basic services.

Copper mining in Zambia perfectly illustrates this point. The IMF backed the privatization of the complex copper mining sector and introduced fiscal reforms to attract transnational corporations. Many of the reforms were far from the IMF field of expertise. This process has yielded far less poverty reduction and respect for environmental standards than was predicted.

Eurodad welcomes the decrease in the practice of cross-conditionality, whereby the Fund attaches conditions to its development finance which duplicate conditions already prescribed by the World Bank. Unfortunately, the IMF has not yet discontinued this practice, which has been widely criticised by civil society groups and numerous independent assessments.

Recommendations

The IMF is facing a deep legitimacy and financial crisis, partly due to the early repayment of loans by developing countries which find IMF conditions intrusive and inappropriate. It cannot afford to continue turning a blind eye to reality and pretending to implement a few incremental measures to reform its conditionality policy. If the IMF is serious about undertaking a broader and deeper reform, it will have to serious address conditionality and strengthen their Conditionality Guidelines by:

1. Sharply decreasing the average number of structural conditions per loan, including targets and a timeline to properly assess progress of the streamlining initiative;

2. Including a commitment to stop attaching sensitive economic policy reforms in structural conditionality – including privatisation and liberalisation;

3. Ending the practice of cross-conditionality, whereby the IMF attaches conditions to their development finance which have already been prescribed by the Bank;

4. Re-defining the principle of criticality and committing to an end to all non-binding conditions such as
5. Revisiting the definition of ownership to ensure that policies are country selected;

6. Explicitly assessing all new PRGFs to verify that the conditionality principles have been properly integrated into their design, and reforming staff incentives;

7. Working with donors to ensure a regular independent monitoring of the new improved Conditionality Guidelines that incorporate the views of southern governments, CSOs and independent researchers;

8. Ensure that before they recommend a course of action, the impacts of a range of options on poor people have been thoroughly explored by conducting country-led Poverty and Social Impact Analysis (PSIA);

9. Ensure that the IMF’s conditionality database is available on their website for all to analyse.
Section 1: Why IMF conditionality is important

“The IMF or any other institution must not be the ones telling us how to run the money that we borrow from them; but they do because they think they are infallible.”

Gregory Gondwe, Malawian columnist

The practice of attaching conditions to grants and loans has been widely criticised for being ineffective, undermining ownership and imposing inappropriate policy choices. Civil society, academics and southern governments agree that conditionality is an infringement on national sovereignty and has not been effective in inducing economic policy reform. But even the World Bank and the International Monetary Fund – the world’s leading advocates of economic policy conditions – agree that conditionality has failed to create incentives for policy reform.

The use of conditionality by the Washington-based International Financial Institutions (IFIs) has increasingly been under the spotlight. Since the 1990s, the Bank and the Fund have become conditionality “trend-setters”. This means that other bilateral and multilateral donors usually turn to the Bank and the Fund to determine their own economic policy conditions.

By the end of 2007, the IMF was lending through the Poverty Reduction and Growth Facility (PRGF) a total amount of $1.4 billion to low-income countries. This amount represents only 1% of the total global aid flows.

However, the influence of IMF programmes, and thus of their conditionality, extends also to a gatekeeping one, as most donors require that recipient countries are on-track with an IMF programme as a key “signal” to decide whether grants and loans continue flowing or come to a halt. The IMF has a strong role in determining what happens to incoming aid. Shockingly just 27% of aid to Sub-Saharan African countries with a PRGF programme has gone for government expenditures in recent years - the rest went to build up reserves and pay down domestic debt. In 2007 Sierra Leone’s foreign aid suddenly dried up because of a negative IMF assessment. Reports from Ghana and Malawi indicate suspension of financing for HIV/AIDS treatment because aid income was diverted by the government to meet IMF conditions on the level of international reserves. In Nicaragua in 2005 the IMF’s declaration that the country programme had gone off-track led to the suspension of aid and grants from the IDB, the World Bank, the European Commission, the United States and Sweden.

Thus, despite its modest volume of development finance, the IMF’s conditions are extremely influential as they are the traffic light for other donors’ aid. Meeting IMF conditions thus brings little direct financial reward but failing to meet them is very dangerous as it switches on the red light for the vast majority of Northern development finance. The IMF is thus pivotal to the major problem of aid volatility.

The IMF holds the global monopoly on assessing countries’ macroeconomic health, which in developing countries is measured by being “on-track” with an IMF programme, typically a Poverty Reduction and Growth Facility (PRGF). Thus, IMF conditionality hardly ever is contested by other donors, which perceive it as a scarce and necessary service for their own disbursement decisions. Moreover, the technical complexity of macroeconomic policies which the IMF addresses has also often dissuaded civil society groups from voicing criticism of the Fund’s measures.

The Fund attaches two different types of policy conditions to its loans in poor countries – quantitative and structural. Quantitative conditions are macroeconomic targets determining, for example, the level of fiscal deficit a government is allowed to run up or the permitted level of domestic credit. Structural conditions, on the other hand, push for institutional and legislative policy reforms within countries. They include, for example, trade reform, price liberalisation and privatisation.
There has been a wide range of criticism of quantitative conditionality by numerous civil society groups and UN agencies, arguing that this type of conditions pushes excessively tight macroeconomic targets which can restrict growth and prevent investment in basic needs and services. This report complements this existing civil society work, focussing exclusively on the structural conditions that the IMF imposes, which have been assessed by civil society groups to a lesser extent. It builds on the findings of previous Eurodad studies published in 2003 and 2006.

The rise of structural conditionality

A sharp increase in the number of structural conditions during the 1990s put IMF conditionality under the spotlight. A recent evaluation by the IMF’s own Independent Evaluation Office (IEO) records that the Fund dramatically increased both the number of structural conditions and their intrusiveness in recipient countries’ domestic affairs. By 2000 the IMF covered not only general macroeconomic factors, but also direct interference in tax rates, banking regulation, commodity prices and even institutional reform. This marked a clear shift from macroeconomic factors to microeconomic structural interventions. Structural conditions also spread to areas which are considered to be outside the Fund expertise, such as state-owned enterprise reform and privatization, social policies, or regulatory reform.

The Fund’s Evaluation Office’s criticisms are broad. It points out that structural conditionality is “intrusive and undermines national ownership of policies; it lacks prioritization and overwhelms local capacity; it is not useful because with strong ownership of reforms it is unnecessary, and without ownership it is unlikely to work; and conditions are imposed in areas such as trade reform and privatization which are ideologically based and often misguided.”

As in the case of the World Bank, IMF conditionality has often imposed inappropriate policy choices which do not take into account national circumstances. Moreover, it has undermined the development of domestic accountability relationships, as conditionality “takes policy decisions away from sovereign governments and places them in the hands of unelected donor officials. This means that citizens often cannot tell who made policy choices, and who to blame when things go wrong.”

However, differently from the Bank, the Fund received a deadly reputation after the institution’s intervention in the Asian and the Argentinean crisis in the late 1990s and beginning of the 2000s. These gave rise to harsh external criticism of Fund conditionality and created a great resentment among recipient countries, which – as soon as they could afford it – started to pay back their loans to the Fund, thank them for their services, and put an end to their financial relationship.

Faced with strong criticism for its expansive and erroneous use of conditionality, and in the wake of a broader and deeper legitimacy and financial crisis, the IMF approved a set of guidelines to inform their use of structural conditionality. The 2002 Conditionality Guidelines committed the Fund to respect five principles:

- Ownership: acknowledgement of recipient countries’ responsibility and respect for national policies.
- Parsimony and criticality: conditions should be limited to the minimum necessary to achieve the goals and should concentrate on the Fund’s core areas of expertise.
- Tailoring policies to recipient countries’ circumstances.
- Coordination with other multilateral institutions.
- Clarity: conditions should be clearly distinguishable from those of other programs.

At the beginning of 2005, the Fund conducted a review of the application of its Conditionality Guidelines and found that:

- The “numbers of structural conditions have not shown much of a decline.”
- “Fund-supported programs experience fewer permanent interruptions, although temporary interruptions and average review delays have not declined.”
- “There is some scope for further progress in streamlining the coverage of structural...
conditionality. In particular, greater care could be taken to set structural benchmarks only in critical areas, and to set out program strategies more clearly in staff reports."
• "It will remain difficult to gauge ownership, but substituting conditionality for ownership is not the answer."\(^\text{16}\)

Unfortunately, according to the recently published IEO evaluation, the IMF CG do not seem to have yielded the expected results: “there is not evidence of a reduction in the number of structural conditions following the introduction of the streamlining initiative”. Moreover, “arrangements continued to include conditions that do not appear to have been “critical” to the program objectives”.\(^\text{17}\)

Beyond the numbers, the principles of ownership and tailoring to national circumstances should entail refraining from placing controversial conditions which may be highly sensitive for some national constituencies and may lead to domestic tensions and social unrest. On this front, the Conditionality Guidelines are too limited. The CG defines the principle of ownership as the “willing assumption of responsibility for a program of policies, by country officials who have the responsibility to formulate and carry out those policies.” The Fund considers ownership is sufficient when there is enough “buy-in” by country officials of policy reforms designed by Fund economists. This deviates from the concept of genuine ownership as understood by civil society groups and recipient governments, which would require recipient governments and their citizens to take the lead in designing and prioritising policy reforms.

In the light of the poor results during the two first years of implementation of the Conditionality Guidelines, the Fund stated that this review was not intended to be a final assessment, but rather an “interim checkpoint” towards further change.\(^\text{18}\)

This report updates the story: what has happened three years on?
Section 2: No change at the IMF

“It is not the strongest of the species that survives nor the most intelligent, but the one most responsive to change.”

*Charles Darwin*

The story of conditionality at the Fund since the approval of the Conditionality Guidelines (CG) in 2002 is a story of glacial change at best, and a move backwards in some respects. According to IMF data, during the first two years after the Guidelines were approved the Fund attached an average of 12 conditions per loan granted to a poor country. After the 2005 review, our research finds that the number of conditions has increased to an average of 13 conditions per loan.

These are only the average number of structural conditions that the IMF attaches to their loans in low-income countries. However, if all conditions – both structural and quantitative – are taken into account, the average numbers increase to 24 per loan after the CG were approved and 25 after the first review of the Guidelines took place in 2005.

**Figure 1: Average number of all IMF conditions and structural conditions**

![Bar chart showing average number of IMF conditions](chart.png)

Source: Eurodad, based on IMF conditionality data.
These numbers have to be interpreted with caution as the Fund often “bundles” several policy actions into one condition. For instance, in a loan approved in 2005 for Niger, the Fund required to approve an “extension of the VAT to processed food products (milk, sugar, wheat, flour)”; a “reduction of VAT exemptions on water and electricity consumption”; and “the application of the excise tax to soft drinks and sodas.” The Fund counted these actions as a single condition. However, Eurodad considers that these are three different reforms in the tax system intended to extend VAT on essential products – a potentially regressive fiscal measure which may have harmful effects on the poorest sectors of the population.

If all policy actions prescribed by the Fund are counted as separate conditions, the figures given above increase the total number of conditions by 7 per cent in the two periods analysed, raising to 14 the average number of structural conditions per low-income country loan.

However this average conceals a much higher conditionality incidence for some countries. The Fund attached 28 structural conditions to Haiti’s 2006 PRGF. This is a heavy burden for an already overstretched government. Moldova faced 22 structural conditions in the PRGF approved in the same year. In both cases, the Fund attached highly sensitive economic policy conditions, such as requiring withdrawal of the Haitian Central Bank from the state-owned telecommunications company through adopting “a strategy for discontinuing BRH involvement with TÉLÉCO.” This condition is part and parcel of the privatisation of TÉLÉCO, which has been highly controversial for not addressing the social impact of the dismissal of hundreds of workers.

**Binding versus non-binding conditions**

Eurodad analysis finds that half of all conditions imposed on poor countries through the PRGF are binding. Binding conditions imposed on poor countries include both prior actions (policy reforms that have to be acted upon prior to receiving funds) and performance criteria (policy reforms that have to be acted upon during the PRGF in order to gain access to subsequent disbursements).

According to IMF definitions only “legally binding conditions” are conditions, as they have the legal power to suspend finance. However, Eurodad along with many other NGOs have argued that non-legally binding conditions should also be counted as conditions, given that they influence recipient countries’ decisions and are used as a guide to assess performance of a loan throughout the year.

Non-binding conditions such as structural benchmarks account for the other half of the Fund’s structural conditionality. The proportion of binding and non-binding conditions has stayed steady over time.
### Figure 2: Distribution of structural conditions

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<td>Total sensitive</td>
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#### by sector:

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*Source: Eurodad, based on IMF conditionality data.*
Section 3: Still addicted to privatisation and liberalisation

The Fund continues to push for privatisation and liberalisation of poor nations’ economies, interfering with decisions which should be freely taken by countries according to domestic priorities and needs. Among the loans approved during last three years, almost a quarter of all conditions required policy reforms related to privatising or liberalising. This represents virtually no change with regards to the share of privatisation and liberalisation related conditions found in loans approved between 2003 and 2004.

Out of the PRGFs approved during the last three years, the vast majority of countries assessed by Eurodad – 16 out of 20 countries – had liberalisation or privatisation conditions. However, some of the countries bear a much higher privatisation burden than others. In Benin, seven out of the thirteen conditions in 2005 required privatising state-owned enterprises in the infrastructure, telecommunications and cotton sectors. And in Cameroon six out of the fifteen conditions attached to their PRGF in 2006 contained some sort of privatisation in the telecommunications, postal and airline sectors, one condition required price liberalisation and subsidy removal for the national oil company SONARA, and two conditions required restructuring of the public postal enterprise.

According to the Fund’s arguments, privatisation should lead – amongst other effects – to increased transparency and good governance in the sectors privatised. Unfortunately, the privatisation process of the Cameroon’s airline company shows that expected benefits in theory do not always translate into reality (see Box below).
Into thin air: controversial privatisation in Cameroon

In September 2007 a joint delegation of the International Monetary Fund (IMF) and the World Bank arrived in Cameroon to discuss the implementation of the three-year economic programme signed between the two institutions and the Cameroon government.

The meetings were expected to handle technical issues on the execution of the public investment budget, the implementation of the fiscal reforms and progress in the privatisation process – particularly focusing on financial sector reform with emphasis on the privatisation of Crédit Foncier.

Not content with the push made to the financial sector, the joint delegation was also reported to have successfully mounted pressure on President Paul Biya, to re-launch the privatisation process of the Cameroon Airlines, Camair, which the President had put on hold.

Local newspapers reported that the offer from the First Delta Air Services-led consortium had finally been selected. However, the privatization process was halted following a late submission of a better offer from an US group, Valiant Airways. This group was strongly backed by the US Ambassador to Cameroon and the Prime Minister. Later it was found that the bidder, Valiant Airways, was a fake and that the company was unknown to the American Federal Aviation Authority and other international organisations. Since the privatization started in February 2005, Camair’s debt and losses have mounted.

In general the privatization project has been cast in shadows. The attempt to privatise Cameroon Airlines clearly shows that processes leading up to privatisation are not necessarily respectful of minimum good governance standards, unless regulatory measures intended to ensure transparency are in place. Once again, pressure from the IMF to privatise may have not yield the expected results but may have worsened the company’s situation.
What is the IMF privatising?

The Fund heavily pushes privatisation and liberalisation of the banking and financial sector. On average, privatisation and liberalisation reforms in the banking and financial sector account for almost half of all privatisation and liberalisation conditions. Typically, these conditions prescribe upfront privatisation of national banks. In Afghanistan, the Fund required in 2006 to “Adopt long-term restructuring plan for Bank Millie and Bank Pashtany”. In other cases, the requirement for the government to withdraw from certain roles constitutes upfront privatization. An example is in the Central African Republic where the Fund attached the condition that “The government will refrain from providing resources to recapitalize the troubled commercial bank” in its 2006 PRGF.

However, the Fund also pushes privatisation and liberalisation beyond the financial sector including agriculture, energy, infrastructure, and telecommunications sectors. Whereas financial sector reforms are considered to be among the Fund’s core competences, the other sectors clearly fall outside the scope of the Fund’s core competences and the IMF lacks expertise.

The Fund continues pushing old-fashioned privatisation to ensure the completion of privatisation processes in countries like Benin, where the IMF required the “Adoption of a strategy to divest the final lot of ginneries” in its PRGF from 2005. In Burkina Faso, the Fund attached the condition to “secure government approval of a liberalization strategy for SOFITEX in collaboration with the World Bank” in the PRGF approved in 2007.

Figure 3: IMF’s privatization and liberalisation conditions by sector

Source: Eurodad, based on IMF conditionality data.
Often privatisation promoted by the International Financial Institutions has led to harmful results for poor people. Particularly as privatisation processes have too often been rushed, without taking into account painful effects on poor people’s access to basic services and increased vulnerabilities in already weak economies. Privatisation of water and electricity has undermined the access of the poorest to basic services. Moreover, the lack of an appropriate regulatory framework has turned some of the privatisation processes into a failure and has blown away any potential benefits for the poor. The Fund has done little to implement its pledge to conduct Poverty and Social Impact Analysis before it pushes a policy prescription. Privatisation of the agriculture and mining industries in countries heavily reliant on these sectors has also sometimes undermined the already fragile incomes of the poor.

**Bypassing ownership: imposed cotton sector privatisation in Mali**

Mali is one of the world’s poorest countries and its economy is heavily reliant on the cotton sector. Since the 1990s, the World Bank and the IMF have pressed for the privatization of the Malian cotton sector and liberalisation of its pricing system, tying cotton prices to world market values. These reforms coincided with a period when the cotton prices were, and still are, heavily distorted by heavy subsidised production in developed countries.

In 2005 Malian President Amadou Toumani Touré opposed the reforms and spoke out against Bank and Fund conditions. He said “true partnership supposes autonomy of beneficiary countries in requesting aid and in determining its objectives... Often programmes are imposed on us, and we are told it is our programme... People who have never seen cotton come to give us lessons on cotton... No one can respect the conditionalities of certain donors. They are so complicated that they themselves have difficulty getting us to understand them. This is not a partnership. This is a master relating to his student.”

According to the World Bank and the IMF the reform was expected to improve management and increase cotton prices while decreasing the cost of farm inputs. The results could not have been gloomier. Data from the World Bank for 2005-06 cotton sales show that farmers were producing at a loss. The immediate impacts were a collapse of households’ purchasing power and increasing poverty and food insecurity. Long term effects include migration and price falls in the cereal sector as a consequence of farmers switching crops. The Oxfam study *Kicking the habit: How the WB and the IMF are still addicted to attaching economic policy conditions to aid* predicts economic losses of 2 to 4% of Mali’s GDP.

The reforms supported by the World Bank and the IMF, occasionally by means of cross-conditionality – identical conditions imposed by both institutions - have endangered the farmers’ livelihoods and Mali’s poverty reduction strategies more broadly. A villager from Wacoro complained that “before, at harvest time, a part of the income was given to the women. But this year, that was not the case. On the contrary, the livestock we have accumulated over many years had to be sold to enable us to cover our food costs, in particular the purchase of cereals. As a result, we have almost nothing left in terms of savings to protect us from the difficult times to come.”

Some bilateral donors are currently backing the introduction of support funds, having realised the importance of the cotton sector and the impact of its highly volatile prices. This fund should help to compensate price differences from one year to the other. Several donors support this initiative; however, the World Bank and the IMF remain in an uncomfortable silence.

Source: Oxfam International (2007) “Kicking the habit: How the WB and the IMF are still addicted to attaching economic policy conditions to aid”.
Cross-conditionality: the IMF and the World Bank double up on country conditions

The pressure on recipient governments to privatise is sometimes redoubled by the Bank and the Fund imposing the same condition. This is an inappropriate practice which mounts the pressure exerted over recipient countries and shows a lack of coordination between the two institutions.

Lack of coordination between the Bank and the Fund has been a long-standing problem. Over the last twenty years, as many as nine reports have been issued to address this problem. The last of these reports was conducted by an independent committee and published in February 2007. Once again, the findings of this work highlighted the need to increase coordination and division of labour between the two institutions and warned that “The Fund’s financing activities in low-income countries is an area where it has moved beyond its core responsibilities and moved into activities that increase its overlap with the work of the Bank.”

Cross-conditionality is not an example of good coordination, but rather an example of how the Fund is stepping into areas where the Bank has greater competences. It evidences the absence of division of labour between the two institutions and the waste of resources in duplicating their efforts to push the same reforms in poor countries.

This Eurodad research has found that fewer current Fund conditions now replicate reforms prescribed by the Bank. This is a welcome development. However, the remaining duplicated conditions fall in highly sensitive areas, such as privatisation of state-owned enterprises in Afghanistan or the cotton sector in Mali and Benin. In 2006, the Fund required the Afghan government to “adopt a comprehensive restructuring/divestment plan for the public entities and government agencies engaged in commercial activities but not covered by the state-owned enterprises (SOEs) law.” This condition duplicates current World Bank policy in Afghanistan which will lead to the privatisation of more than 50 state-owned enterprises in the country over the next two years. Even if privatisation is already part of the Afghan government’s plans, the IFIs should refrain from meddling in issues which are highly sensitive.

The case of Mali is even more controversial as privatisation plans were openly opposed by the Malian government, but still the Fund added pressure to the country by putting a privatisation condition in their development finance duplicating conditions by the Bank.
Section 4: Imposing sensitive economic policy reforms

Eurodad’s research reveals that the IMF continues to impose controversial structural economic policy reforms in poor countries. This research considered that all conditions geared to limiting the fiscal space available for governments to take spending decisions, regressive taxation conditions, and liberalisation and privatisation related conditions are highly controversial and thus were classified them as sensitive policy reforms. According to Eurodad, a third of all structural conditions attached to PRGFs approved since 2005 focus on sensitive policy reforms. This entails no change at all compared to the previous two years, running between the approval of the Conditionality Guidelines and their 2005 review.

The biggest share of sensitive policy reforms prescribed by the IMF focused on privatisation or liberalisation. However, beyond these reforms, the Fund-supported programmes also requiring public enterprise restructuring, sometimes hiding a stepping stone towards further privatisation; ceilings to public expenditure which limit the government’s fiscal space to allocate resources; or regressive taxation which either places the burden of raising government revenues on the poor or simply removes fiscal pressure from the wealthiest.

Figure 4: IMF sensitive policy conditions

Eurodad welcomes the fact that traditionally controversial conditions aimed at limiting the recipient government’s fiscal space, such as wage bills for civil servants particularly in the health and education sectors, as well as tax holidays for foreign companies, were at low levels right after the approval of the Conditionality Guidelines and they have continued to decrease after the 2005 review. However structural conditionality is not the only means at the IMF’s disposal to exert influence and give policy advice to recipient countries. Recent NGO research shows that strict inflation targeting and wage bills are still pushed by the IMF in the PRGF agreements with poor countries. They are not always present at the policy matrices which list the formal policy conditions. Instead, they are present throughout the loan agreements in the form of advice, desirable targets or scenarios that the recipient country should envisage.²⁸

This is the case with the PRGF signed with Sierra Leona in 2006. Even if the government wage bill is not a binding condition, it is explicitly cited as an indicative target. A similar treatment is given to inflation targeting, which is not a binding condition but is cited throughout the loan agreement as a
desired goal that the Sierra Leonean government should strive to achieve.  

Conditions prescribed in previous programmes are not an issue of the past. Their effects may persist, as the recent political crisis in Zambia over the taxation of international mining corporations suggests (see Box). In the late 1990s, the World Bank prescribed privatization reforms in the mining sector in Zambia as part of their development finance. This led to the sale of the state-owned mining company to foreign investors, matched with a number of measures to improve the business climate, such as granting tax concessions and loosening the labour and environmental standards to attract foreign investment. In 2004 the IMF asked the government to “Define a policy for the granting of tax concessions” as a condition attached to the PRGF. Tax concessions and exemptions have been almost phased out from recent loans, but the effects of IMF and World Bank conditionality still haunt the country.

Zambian mining: toughening the tax regime

Back in the 1990s, the World Bank insisted that as a condition on their finance that the state-owned Zambia Consolidated Copper Mines (ZCCM) should be privatized. The IMF backed the privatization of ZCCM through the three-year ESAF (Enhanced Structural Adjustment Facility) and one-year SAF (Structural Adjustment Facility) Loans approved in 1995. Subsequently ZCCM was chopped into several smaller companies and sold to private investors between 1997 and 2000.

Ahead of privatisation, the Washington-based IFIs advised the Zambian government that, in order to bring in investment, the country should make itself attractive by developing an “investor-friendly” regulatory regime. The World Bank and the International Monetary Fund then used Zambia’s dependence on their funding and debt relief to withdraw many of the controls that the state had previously established on company behaviour.

The IFIs continued imposing conditions even when the privatisation deals were done, including one-sided “development agreements” granting tax exemptions to foreign investors and all sorts of benefits not normally granted in the national legal framework. In its 2004 PRGF agreement with Zambia, the IMF required the government to “define a policy for the granting of tax concessions.” The consequence of this condition was that royalties raised by the Central Government represented just 0.2% of their revenues.

This deadly combination has prevented the increase of the profits in the Zambian mining sector translating into an increase in the standards of living of the population in these areas. As a report by Civil Society Trade Network in Zambia (CSTNZ) says “[given] the massive surge in world copper prices that occurred soon after privatisation things should now be significantly better than they are.”

As a result of the privatization formal employment has decreased. Several structural adjustment programs have also affected the informal sector. Additionally the communities of the Copperbelt now face acid rain, heavy metals pollution, silting and other environmental problems which not only affect peoples’ health, but also their capacity to grow their own food.
Section 5: Conclusions and recommendations

The IMF conditionality streamlining initiative was supposed to decrease the average number of structural conditions and increase ownership of national governments. This Eurodad research reveals that the average number of conditions faced by poor countries have instead increased from an average of ten conditions in 2002 to an average of 13 over the last three years.

The Fund has failed to implement its own Conditionality Guidelines. Even after the 2005 review, which showed limited progress in implementing the Guidelines, the Fund has not taken further steps to address this failure and streamline conditions. One of the main conclusions of the 2005 review was that: “numbers of structural conditions have not shown much of a decline.” This Eurodad report demonstrates that no further progress has been made since then and casts serious doubts about the genuine commitment of the institution to streamlining its structural conditionality and speed up the application of its own conditionality policy.

Faced with in-depth structural reforms of its own and the need to cut its staff due to the current budget crisis, the Fund may be forced to slim down its involvement in low-income countries. It is unlikely that it will have the capacity to be able to continue negotiating or monitoring a high number of conditions attached to its loans. At the very least the current crisis provides the institution with a good opportunity to speed up implementation of the Conditionality Guidelines and take further steps in the streamlining initiative. This is also the logic of the aid effectiveness commitments which many governments and international institutions – including the IMF - signed up to in 2005 and which will be subject of a high-level review in September 2008.

Beyond the numbers, the principles of ownership and tailoring to national circumstances should entail refraining from placing controversial conditions which may be highly sensitive for some national constituencies and may lead to domestic tensions and social unrest. On this front, the Conditionality Guidelines are too limited. The CG defines the principle of ownership as the “willing assumption of responsibility for a program of policies, by country officials who have the responsibility to formulate and carry out those policies.” The Fund considers ownership is sufficient when there is enough “buy-in” by country officials of policy reforms designed by Fund economists. This deviates from the concept of genuine ownership as understood by civil society groups and recipient governments, which would require recipient governments and their citizens to take the lead in designing and prioritising policy reforms.

The IMF’s limited view of ownership is having serious social consequences. In Mali the IMF and the WB forced the reform and privatisation of the cotton sector despite opposition. The reforms went ahead and now cotton farmers face an even harder future.

A quarter of all IMF structural conditionality still promotes privatisation and liberalisation reforms, which have proven to be highly sensitive and often have had disastrous consequences for the poor. Altogether, a third of the Fund’s structural conditions contain some sort of sensitive policy reforms – including privatisation and liberalisation, but also regressive reforms to the taxation systems or strict ceilings on national expenditures which may constrain the government's ability to invest in much-needed basic services.

Copper mining in Zambia perfectly illustrates this point. The IMF backed the privatization of the complex copper mining sector and introduced fiscal reforms to attract transnational corporations. Many of the reforms were far from the IMF field of expertise. This process has yielded far less poverty reduction and respect for environmental standards than was predicted.

Eurodad welcomes the decrease in the practice of cross-conditionality, whereby the Fund attaches conditions to its development finance which duplicate conditions already prescribed by the World Bank. Unfortunately, the IMF has not yet discontinued this practice, which has been widely criticised by civil society groups and numerous independent assessments.

The IMF is facing a deep legitimacy and financial crisis, partly due to the early repayment of loans.
by developing countries which find IMF conditions intrusive and inappropriate. The pace of early repayments speeded up after the IMF intervention in the South-East Asian and Argentinian crises at the end of the 1990s which showed that the Fund’s stringent conditions worsened the economic recovery of these countries and provoked long-lasting social damage to the poorest of the poor.

The Fund cannot afford to continue turning a blind eye to reality and implementing just a few incremental measures to reform its conditionality policy. The Fund’s strategy so far has yielded poor results, aggravating the institution’s general difficulties. If the IMF is serious about undertaking a broader and deeper reform which is to culminate in an agreement on the Fund’s mandate and corporate governance before the end of this year, and increasing legitimacy among its membership, it will have to seriously address conditionality as one of its most dangerous Achilles heels.

If the Fund continues, against the advice of many external stakeholders and independent experts, to continue to provide development loans, it should commit to strengthening its Conditionality Guidelines by:

1. Sharply decreasing the average number of structural conditions per loan, including targets and a timeline to properly assess progress of the streamlining initiative;

2. Including a commitment to stop attaching sensitive economic policy reforms in their structural conditionality – including privatisation and liberalisation;

3. Ending the practice of cross-conditionality, whereby the IMF attaches conditions to their development finance which have already been prescribed by the Bank;

4. Re-defining the principle of criticality and committing to an end to all non-binding conditions such as structural benchmarks;

5. Revisiting the definition of ownership to ensure that policies are country selected rather than the result of governments supporting policies selected by the IMF;

6. Explicitly assessing all new PRGFs to verify that the Fund’s conditionality principles have been properly integrated into their design, and reforming staff incentives accordingly;

7. Working with donors to ensure a regular independent monitoring of the new improved Conditionality Guidelines that incorporate the views of southern governments, CSOs and independent researchers;

8. Ensure that before they recommend a course of action, the impacts of a range of options on poor people have been thoroughly explored by conducting country-led Poverty and Social Impact Analysis (PSIA);

9. Ensure that the IMF’s conditionality database is available on their website for all to analyse.

European governments should:

1. Use their significant presence and influence in the board of the IMF to promote these changes;

2. Increase their aid predictability and support for government ownership by de-linking their aid disbursement decisions from IMF judgements on recipient country performance.
Annex 1: Methodology

Country and year coverage
To assess the evolution and trends in IMF structural conditionality, Eurodad assessed all Poverty Reduction and Growth Facility (PRGF) credits approved by the IMF between the beginning of 2003 and the end of 2007. This set of loans comprises 37 operations in 35 countries.

These countries are: Islamic Republic of Afghanistan, Armenia, Bangladesh, Benin, Burkina-Faso, Burundi, Cameroon, Central African Republic, Chad, Gambia, Georgia, Ghana, Grenade, Haiti, Honduras, Kenya, Kyrgyz Republic, Madagascar, Malawi, Mali, Mauritania, Moldova, Mozambique, Nepal, Nicaragua, Niger, Republic of Congo, Rwanda, Sao Tome and Principe, Senegal, Sierra Leone, Sri Lanka, Tanzania, and Zambia.

Timeline
To evaluate the ongoing impact of the IMF Conditionality Guidelines (CG) and the streamlining initiative, Eurodad has compared the conditions attached to all loans signed after the Conditionality Guidelines were approved in the last quarter of 2002 with the conditions of all loans approved after the first review of the CG at the beginning of 2005. The first set of data comprises loans approved from the beginning of 2003 until the beginning of 2005 and evaluates the immediate effect of the implementation of this policy. The second set includes loans approved from the beginning of 2005 until the end of 2007 (the cut-off date of the data which was provided by the IMF). This shows the IMF engagement with the Conditionality Guidelines in a later stage, when some lessons have been learnt on the implementation of the CG during their first two years, as well as the impact of the Paris Declaration. Both periods comprise a similar time span and number of PRGF agreements (17 and 20 respectively). Moreover, the analysis has used average figures, which provides an overview and overcomes any difficulties caused by data spikes.

Loan coverage
Eurodad examined all IMF PRGF loans agreed with these 35 countries between 2003 and 2007. The PRGFs are the loans the IMF gives to low-income countries. According to the IMF, this lending facility is framed around recipient countries’ Poverty Reduction Strategy Papers (PRSPs), the same instrument which is required to enter the Heavily Indebted Poor Countries (HIPC) debt reduction initiative. The data made available to Eurodad from the IMF MONA database contained initial PRGF conditions, and not those included in the subsequent reviews. Thus, this research does not include an analysis of the conditions attached during the course of the PRGF reviews.

Conditionality types
The Fund attaches two different types of policy conditions to their loans in poor countries – quantitative conditions and structural conditions. Quantitative conditions impose a set of macroeconomic targets on poor country governments determining, for example, the level of fiscal deficit a government is allowed to go into or the level of domestic credit allowed. Structural conditions, on the other hand, push for institutional and legislative policy reforms within countries. They include, for example, trade reform, price liberalisation and privatisation. This report focuses exclusively on the structural conditions.

Data sources and definitions
The research is based on the analysis of data from the IMF’s own conditionality database. This set of data from the IMF database has been made available to us for the first time and contains all the structural and quantitative conditions attached to PRGF agreements. The release of this data to civil society researchers is a welcome move by the Fund and allows us to examine and debate in detail the status of its conditionality. In order to allow for an accurate analysis of conditionality, Eurodad has re-classified some of the data.
What counts as a condition?
Firstly, Eurodad counted as a condition in this report both legally binding conditions (usually referred to as prior actions and performance criteria) and non-legally binding (structural benchmarks). According to IMF definitions only “legally binding conditions” are conditions, as they have the legal power to suspend finance. However, Eurodad along with many other NGOs have argued that non-legally binding conditions should also be counted as conditions, given that they influence recipient countries decisions and are used as a guide to assess performance of a loan throughout the year. Therefore, within this study, we have counted as a condition the following:

- Prior action – legally binding
- Performance criteria – legally binding
- Structural Benchmarks – not legally binding, but very influential in the reviews of government performance under the PRGF carried out by the IMF every six months, which give clearance for the release of a subsequent loan tranche.

“Bundled” conditions
The IMF often counts as a single condition several policy actions “bundled” together. Eurodad “unbundled” these policy actions and counted them as separate conditions.

Classifying conditions: defining sensitive policy reforms and privatisation-related conditions

Limiting fiscal space conditions
Eurodad has counted as ‘limiting fiscal space conditions’, all those economic policy conditions related to public financial sector development and economic management, which impose severe restrictions to public spending and borrowing. These include ceilings on public borrowing and spending, such as rigorously limiting or reducing wage bills.

Regressive taxation conditions
This category includes all the conditions aimed at introducing regressive taxation mechanisms in recipient countries. A regressive tax is defined as a “tax that imposes a smaller burden (relative to resources) on those who are wealthier”. VAT taxes on food, for instance, are regressive taxes. Given that low-income families’ demand for food is very inelastic, poor families would pay in taxes significantly higher share of their incomes than wealthier ones.

Liberalisation related conditions
This classification is based on the World Bank’s definition of sensitive conditions as written in the 2006 World Bank Conditionality Progress Report. This category includes price, trade and exchange rate liberalisation and associated reforms. In addition we have also included the lifting of monopolies and opening up private sector participation in production of goods and services. This slightly broader concept than the Bank’s is based on the report commissioned by the Norwegian Government in 2006.

Privatisation-related conditions
We also draw on the definition of privatisation used in the report commissioned by the Norwegian Government. This includes a number of practices including: transfer of public assets to private ownership through sale or lease of public land, infrastructure, and enterprises; public financing of private services through for examples contracting out governmental services or the cessation of public programmes and disengagement of government to specific kinds of responsibilities that may lead to a shift by consumers towards privately produced and purchased substitutes. We did not consider general efforts to improve the business climate or encourage private sector development to be privatisation unless these efforts include the transfer of property or responsibility from the public to private sector.

In addition, Eurodad has also decided to collect data on those associated reforms that pave the way for privatisation, but are not privatisation themselves. For example within this category Eurodad has counted conditions which call for the exploration of restructuring a sector or call for a study to be
undertaken to look at the profitability of a certain sector, of call for a management review and change regulatory environment of a given sector.

**Public enterprise restructuring conditions**
This group contains all the conditions which, despite not meeting the criteria to be classified directly as privatisation or liberalisation related conditions, introduce substantial changes on the organization and structure of public companies. This type of reforms is clearly beyond the IMF’s field of expertise.

**Banking and financial sector privatisation and liberalisation conditions**
Eurodad has classified as ‘banking and financial sector liberalisation and privatisation’ all conditions which, according to the previous definitions, could be defined as either ‘privatisation-related’ or ‘liberalization related’ and where applied to the banking and financial sectors.
## Annex 2: List of PRGFs assessed

<table>
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<tr>
<th>COUNTRY</th>
<th>APPROVAL DATE</th>
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<td>Zambia</td>
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Endnotes:

2 It is important to note that the data made available to Eurodadb from the IMF MONA database contained initial PRGF conditions only, and not those included in the subsequent reviews. Thus, this research does not include an analysis of the conditions attached during the course of the PRGF reviews.
9 In 2005 the IMF Board approved the establishment of a Policy Support Instrument (PSI), a non-lending programme which provides policy advice to poor countries and sends a signal to donors about the quality of a country’s economic policies. Some countries are now subject to PSIs instead of PRGFs.
10 The UK and Norway have official policies de-linking aid disbursement from the conditions of a country being on-track with an IMF programme. However, in reality there are few occasions when even these donors have continued disbursing aid despite a recipient country being off-track with an IMF programme.
14 Ibid.
19 The IMF kindly made available to Eurodadb the MONA database used for tracking the evolution of arrangements.
20 It is important to note that the data made available to Eurodadb from the IMF MONA database contained initial PRGF conditions only, and not those included in the subsequent reviews. Thus, this research does not include an analysis of the conditions attached during the course of the PRGF reviews.
Critical conditions: The IMF maintains its grip on low-income governments

22 Benin, PRGF 2005.
23 Société burkinabé des fibres textiles, the Burkinabe cotton state-owned enterprise.
26 Oxfam International (2007) “Kicking the habit: How the WB and the IMF are still addicted to attaching economic policy conditions to aid”.
29 PRGF Sierra Leona 2006.
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