Chapter – III

IMF LENDING AND CONDITIONALITY

- Introduction
- IMF Lending
- Objectives of IMF Lending
- Changing Nature of IMF Lending
- Types of Facilities
- Non-Concessional Instruments
  - Stand-By Arrangement
  - Flexible-Credit Line
  - Precautionary and Liquidity Line
  - Extended Fund Facility
  - Rapid Financing Instrument
  - Trade Integration Mechanism
- Recent Changes in Non-Concessional Lending
- Concessional Facilities
  - Extended Credit Facility
  - Standby Credit Facility
  - Rapid Credit Facility
  - Exogenous Shocks Facility- High Access Component
  - Policy Support Instrument
- Debt relief
  - Heavily Indebted Poor Countries (HIPC) Initiative
  - Multilateral Debt Relief Initiative
- Critical Evaluation of Conditionality
  - The Rationale of Conditionality
Trends in Conditionality Before 2000
Road to Streamlined Conditionality
Conditionality Guidelines Reforms of 2002
Effectiveness of 2002 Guidelines Reforms
  - Parsimony and Focus
  - Criticality and Clarity
  - Ownership of Programs
Conditionality and Lending Reforms of 2008-2009
Reforms of 2009 for Low-Income Countries
Results of 2008-2009 Reforms
  - Exceptional Access and Frontloaded Financing
  - Precautionary Instruments and Crisis Prevention
  - Changes in Conditionality
Review of Conditionality-2011
  - Focused Conditionality
  - Macro-Social Aspects
  - Enhancing Ownership and Transparency
  - Stronger Partnerships
Impact of IMF Lending and Conditionality Reforms on the Low-Income Countries
Review of Facilities for Low-Income Countries-2013
Implications of IMF Lending and Conditionality Reforms for the Developing Countries
Conclusion
CHAPTER-III

3.1 Introduction

The following chapter deals with the lending and conditionality framework of the IMF. The chapter is an attempt to explain different Fund programs with the member countries. The changes in the lending instruments of the IMF have also been explained. Plus, the conditions attached to its financing are also studied in this chapter. Lending and conditionality of the IMF has always been of great importance and at the same time target of great criticism. This framework has gone through major changes over the past few years and the reforms and their effects on the member countries have been studied in this chapter.

A descriptive and analytical method has been used to understand the lending and conditionality of the IMF with its members. The database used for this chapter is secondary data. The data has been collected from the IMF lending database with its member countries and from other available sources such as IMF working papers and reports on its lending arrangements.

This chapter has been organized into 3 sections. First chapter deals with the introduction of IMF facilities and its current outstanding programs with its member countries. Plus, a note has also been made on the changes in its lending facilities. Second section deals with the conditionality of the IMF. The trends in IMF conditionality from the day of its establishment till date have been studied in this section. The reforms on IMF lending and conditionality have also been studied in detail in this section. Section three studies the impacts of lending and conditionality reforms on IMF member countries, especially the low-income member countries.
3.2 IMF Lending

Any country in severe financial trouble poses threats to the stability of the international financial system since it is not able to pay its international bills. IMF provides temporary financing to its member countries with balance of payments problems as part its duties to stabilize the monetary system. The financing given by the IMF is provided under an arrangement, attached with specific policies and measures, also known as conditionality, which are basically intended to resolve the borrowing country’s balance of payments difficulties. IMF loans are disbursed in installments depending on the progress made by the country in implementing the conditions attached.

3.3 Objectives of IMF Lending

The objective of the IMF loans is to help countries overcome their balance of payments difficulties, stabilize their economies, and restore sustainable economic growth. Apart from its assumed role to tackle BOP problems, crisis resolution is also at the core of its lending. The recent global financial crisis has highlighted the need for an effective global financial safety net when the countries are faced with adverse shocks. The IMF in its recent reform efforts is trying to design better and more effective tools for crisis prevention and crisis resolution.

3.4 Changing Nature of IMF Lending

As per the visions of the Bretton Woods in 1944, the IMF was established to guard an adjustable peg exchange rate system. Plus, the Fund was also envisioned to provide short-term financing to members facing current account deficits. Most of these countries were the advanced economies at the time. However, with the breakdown of the par value system in 1973, the IMF lost its role in the international monetary system as the guarantor of fixed exchange rates especially among the advanced economy members. However, this loss of role and control did not cause the IMF to disappear. The Second Amendment of the Articles of Agreement which was done after the breakdown of the system instead expanded the role of the IMF into many other new areas. This was followed by oil price shocks, which led to severe
payments imbalances for a large number of developing countries. After the developing countries recovered from the debt crisis of the 1980s, other problems started to arise. Transition of the former communist countries and the Asian financial crisis are to name a few. These actually evolved the role of the IMF to become a crisis manager and development financier for the developing countries.

Table 3.1 shows the number and amounts approved for all types of IMF programs over the period 1970 to 2000. Over these three decades, a total of 725 programs were approved. This total includes 594 short-term and mid-term stabilization programs (SBA and EFF). With the Latin American debt crisis in the early 1980s, the number of these short-term programs peaked. Although the number declined after the crisis, the average size of IMF loans increased again as the result of the next crises experienced by Mexico, South Korea, Russia, Brazil, Argentina, and Turkey.

Table-3.1

Approval of IMF Programs, Fiscal Years 1970-2000

Number of programs approved (total amount committed under arrangements in million of SDRs)

<table>
<thead>
<tr>
<th>Period</th>
<th>Stabilization Programs</th>
<th>Structural Programs</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>SBA</td>
<td>EFF</td>
<td>SAF</td>
</tr>
<tr>
<td>1970-1974</td>
<td>82</td>
<td>4913</td>
<td></td>
</tr>
<tr>
<td>1975-1979</td>
<td>83</td>
<td>8091</td>
<td>7</td>
</tr>
<tr>
<td>1980-1984</td>
<td>116</td>
<td>20520</td>
<td>26</td>
</tr>
<tr>
<td>1985-1989</td>
<td>90</td>
<td>14117</td>
<td>3</td>
</tr>
<tr>
<td>1990-1994</td>
<td>79</td>
<td>14974</td>
<td>12</td>
</tr>
<tr>
<td>1995-2000</td>
<td>72</td>
<td>83250</td>
<td>24</td>
</tr>
</tbody>
</table>

Source: IMF, 2001

Benign economic conditions in the early 2000s reduced the need for IMF financing. However, the global financial crisis in the late 2008 and the European Sovereign debt crisis led to new interest of the member countries in IMF financing and a large group of European countries started programs with the IMF.
Most of the original 44 members of the IMF at the time of the establishment were industrial countries. As a result, most of the IMF facilities were designed to satisfy those members’ needs. As new members from different regions with different economic backgrounds were added to the IMF, these facilities were no longer helpful to all of them and hence had to change.

As a result of different needs of the countries for IMF loans and their respective differences of economic situation and their financial difficulties, IMF has evolved its lending during the years.

3.5 Types of Facilities

IMF has designed various loan instruments over the years to satisfy the needs of all of its members with their specific circumstances. Low-income countries can take advantage of the concessional terms attached with their loans while non-concessional terms are designed for all the members. However, these non-concessional loans are not very popular among the low-income members.

3.6 Non-Concessional Instruments

These instruments include:

1. Stand-By Arrangement (SBA)
2. Flexible-Credit Line (FCL)
3. Precautionary and Liquidity Line (PLL)
4. Extended Fund Facility (EFF)

Non-concessional facilities are subject to the IMF’s market-related rate of charge, and borrowing above certain limits carries a surcharge. The rate of charge is based on the SDR. This interest rate is revised weekly with the consideration of the changes in short-term interest rates in major international money markets.

3.6.1 Stand-By Arrangement

Created in 1952, SBA allows the Fund to respond quickly to countries’ external financing needs, and to support policies designed to help them emerge from crisis and restore sustainable growth.
All the IMF members experiencing external financing needs are eligible to apply for SBAs. However, they are mostly used by the middle income (and, more recently, advanced) member countries. The non-concessional facilities are not that famous among the low-income member countries since the concessional facilities are much more tailored to their needs. The length of the SBA is flexible between 12-24 months, but cannot exceed 36 months, consistent with addressing short-term balance of payments problems.

IMF reviews each member country’s needs for financing, capacity to repay, and its track record with use of Fund resources before approving any SBA package. Within its guidelines and its reviews, the SBA provides flexibility in terms of amount and timing of the loan to help meet the needs of borrowing countries. Some of these guidelines are:

- In 2009, the borrowing limits were doubled. For a 12-month SBA program, the member country can borrow up to 200 percent of its quota. Plus, a cumulative 600 percent of quota is scheduled over the life of the program.

- Under the IMF’s Exceptional Access policy and enhanced scrutiny by the Executive Board, the borrowing country can borrow above normal limits. Over the recent economic crisis, many countries used SBA above the limits originally set.

- The new SBA framework provides increased flexibility to front-load funds when warranted by the strength of the country’s policies and the nature of its financing needs.

- Under the Fund’s Emergency Financing, the member countries can accelerate the SBA approval process in case they are in need of rapid financing. This mechanism was utilized in several instances during the recent crisis.

- The new SBA framework has expanded the range of high access precautionary arrangements (HAPAs), a type of insurance facility against very large potential financing needs. When the member countries do not intend to withdraw the amount approved by the Fund, but they still plan to retain the
option to do so in case of any urgent need, they apply for the Precautionary arrangements.

SBA’s conditionality for countries is as follows:

IMF monitors the progress of the borrowing country using quantitative program targets (quantitative performance criteria and indicative targets). Further disbursements are conditional on the achievement of these quantitative performance criteria. However, there are cases where the IMF’s Executive Board decides to waive them. The Executive Board of the IMF scrutinizes the international reserves and government deficits or borrowing before releasing the next tranche of the loan program.

The new SBA framework decided to eliminate the structural performance criteria. According to the new SBA framework, the structural performance criteria in the SBA conditionality are eliminated. Instead, the progress of the borrowing is assessed.  

Regular reviews by the IMF’s Executive Board play a critical role in assessing performance under the program and allowing the program to adapt to economic developments. The new SBA framework is more flexible in the frequency of its reviews as they are more based on the strength of the country’s policies and the nature of its financing needs.

Repayment of borrowed resources under the SBA are due within 3¼-5 years of disbursement, which means each disbursement is repaid in eight equal quarterly instalments beginning 3¼ years after the date of each disbursement.

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86 Stand-By Arrangement, 2014, IMF factsheet, Repayment of SBA.
Table 3.2, shows the current IMF Stand-By Arrangements with.

### Table-3.2

**Current Outstanding SBA Arrangements (in millions of SDR)**

<table>
<thead>
<tr>
<th>Member</th>
<th>Date of Arrangement</th>
<th>Expiration</th>
<th>Total Amount A greed</th>
<th>Undrawn Balance</th>
<th>IMF Credit Outstanding Under GRA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bosnia and Herzegovina</td>
<td>September 26, 2012</td>
<td>June 30, 2015</td>
<td>473480</td>
<td>219830</td>
<td>389775</td>
</tr>
<tr>
<td>Georgia</td>
<td>April 11, 2012</td>
<td>April 10, 2014</td>
<td>125000</td>
<td>125000</td>
<td>133450</td>
</tr>
<tr>
<td>Jordan</td>
<td>August 03, 2012</td>
<td>August 02, 2015</td>
<td>1364000</td>
<td>682000</td>
<td>682000</td>
</tr>
<tr>
<td>Romania</td>
<td>September 27, 2013</td>
<td>September 26, 2015</td>
<td>1751340</td>
<td>1751340</td>
<td>3985000</td>
</tr>
<tr>
<td>St. Kitts and Nevis</td>
<td>July 27, 2011</td>
<td>July 26, 2014</td>
<td>52510</td>
<td>5141</td>
<td>47647</td>
</tr>
<tr>
<td>Tunisia</td>
<td>June 07, 2013</td>
<td>June 06, 2015</td>
<td>1146000</td>
<td>718080</td>
<td>427920</td>
</tr>
</tbody>
</table>

**Total** | 4912330 | 3501391 | 5665792

Source: IMF, 2014

#### 3.6.2 Flexible-Credit Line

Member countries with very strong policy frameworks and track records in economic performance may be in need of IMF financing for crisis-prevention or crisis-mitigation purposes. The Flexible Credit Line (FCL) is designed for these member states. A key objective of the lending is to reduce the perceived stigma of borrowing from the IMF. This facility actually encourages the members to ask for assistance before they face the actual crisis. Countries with very strong economic fundamentals and policy track records can apply for the FCL when faced with potential or actual balance of payments pressures.

The qualification criteria are the core of the FCL and serve to show the IMF’s confidence in the qualifying member country’s policies and ability to take corrective measures when needed. A member country is qualified to apply for the FCL when:

- Its performance is strong with respect to its economic fundamentals and institutional policy framework.

87 Flexible Credit Line, Article Published by IMF, 2012, “who can apply for the FCL?”
• It should have a sustained track record of implementing strong policies.

• It is committed to maintaining this strong track record in the future.

Other criteria that the country should hold except the very strong policy frameworks to qualify for FCL are:

• The country should hold a sustainable external position;

• Private flows should be a dominant portion of the country’s capital account;

• The country should hold a steady track record of access to international capital markets;

• The country should hold a relatively comfortable reserve position when applying for the precautionary FCL;

• Public debt position of the borrowing country should be sustainable;

• The inflation of the country should be maintained at low and stable rates;

• To avoid a systemic banking crisis, the country should not have any bank solvency problems; and

• The country should practice effective financial sector supervision.

IMF can meet a broad range of country needs through FCL:

• Within a pre-specified period, the country which has qualified for the FCL can withdraw the approved amount at any time, or treat it as precautionary.

• Since the FCL is based more on a pre-conditionality basis and the strength of the policy framework of the country, the loan can be offered to the qualified member on an up-front basis with no further conditions.

• The FCL is basically a renewable credit line. The credit line could be for a period of one or two years. If the country decided to draw on the credit line, the repayment will be scheduled for a period of 3¼ to 5 years after the withdrawal.

• The amount of the FCL is decided merely by the Executive Board of the IMF on a case-by-case basis, with no specified cap.
The cost of borrowing under the FCL is the same as that under the Fund’s traditional Stand-By Arrangement (SBA) and the Precautionary and Liquidity Line (PLL).

As of April 2014, Colombia, Mexico and Poland are the three IMF members using FCL. However, none of these countries have withdrawn any amount from their lines.

Table 3.3, represents the current FCL arrangements of IMF.

Table-3.3

Current Outstanding FCL Arrangements (in millions of SDR)

<table>
<thead>
<tr>
<th>Member</th>
<th>Date of Arrangement</th>
<th>Expiration</th>
<th>Total Amount Agreed</th>
<th>Undrawn Balance</th>
<th>IMF Credit Outstanding Under GRA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Colombia</td>
<td>June 24, 2013</td>
<td>June 23, 2015</td>
<td>3870000</td>
<td>3870000</td>
<td>0</td>
</tr>
<tr>
<td>Mexico</td>
<td>November 30, 2012</td>
<td>November 29, 2014</td>
<td>47292000</td>
<td>47292000</td>
<td>0</td>
</tr>
<tr>
<td>Poland, Republic of</td>
<td>January 18, 2013</td>
<td>January 17, 2015</td>
<td>22000000</td>
<td>22000000</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td>73162000</td>
<td>73162000</td>
<td>0</td>
</tr>
</tbody>
</table>

Source: IMF, 2014

3.6.3 Precautionary and Liquidity Line

An important lesson from the global financial crisis was the need for effective global financial safety nets to help countries cope with adverse shocks. In recent years, IMF has tried to complement its traditional crisis lending tools with new instruments intended for crisis prevention. The Precautionary and Liquidity Line (PLL), which replaces the Precautionary Credit Line, is designed to help member countries meet their liquidity needs with sound economic fundamentals but not strong enough to use the Flexible Credit Line (FCL).

The PLL is designed to meet actual or potential BOP needs of countries with sound policies (while having some vulnerability). This instrument uses a pre-qualification process like the FCL and combines it with ex-post conditionality. The
conditions set after the release of the first disbursement are aimed at addressing the remaining moderate vulnerabilities identified during qualification.

The PLL also acts as a signal to show the strength of the qualifying countries’ fundamentals and policies. The qualification assessment process is to identify whether:

- Its performance is strong with respect to its economic fundamentals and institutional policy framework.
- It has a sustained track record of implementing strong policies.
- It is committed to maintaining this strong track record in the future.

In addition to a generally positive assessment of the country’s policies in the most recent Article IV consultations, qualification for the PLL is assessed in the following five broad areas: (i) external position and market access; (ii) fiscal policy; (iii) monetary policy; (iv) financial sector soundness and supervision; and (v) data transparency and adequacy. Although the qualification process allows for some moderate vulnerability in one or two of these areas, any substantial vulnerability in any of the above areas would disqualify the member country for the PLL.

Countries experiencing any of the following conditions at approval cannot use the PLL: (i) sustained inability to access international capital markets; (ii) a need for large macroeconomic or structural policy adjustment (unless such adjustment has credibly been launched before approval); (iii) a public debt position that is not sustainable in the medium term; or (iv) widespread bank insolvencies.

The duration of PLL arrangements can be between six months to 2 years. The six-month arrangement is available to those members with actual or potential short-term balance of payments needs that can make credible progress in addressing their vulnerabilities during the six-month period. Upon a six-month PLL arrangement, members can borrow up to 250 percent of their quotas. If a member country’s BOP need results from the impact of an exogenous shock, higher access is allowed.

PLL arrangements with 1-2 years duration allow the member countries to access up to 500 percent of their quotas for their first and a total of 1000 percent of their quotas cumulatively. In exceptional circumstances, a six-month PLL
arrangement can have an access of up to 500 percent of its quota. Under circumstances due to the impact of exogenous shocks, including heightened regional or global stress conditions, an additional six-month PLL arrangement will be approved without observing the cooling-off period, while maintaining the cumulative access limit of 500 percent of quota under all six-month PLL arrangements.

Countries under PLL arrangements commit to policies that are intended to reduce their vulnerabilities identified in the qualification process with focused conditionality. Thus, under one- to two-year PLL arrangements, prior actions, structural benchmarks, and quantitative performance criteria will only be used when considered critical for the achievement of the program’s objectives. Longer PLL arrangements are monitored every six month by the IMF’s Executive Board. The Board assesses the extent to which the program has been on track to achieve its objectives. If the borrowing country is facing balance of payments needs at the time of its program approval, access is phased through semiannual disbursements in line with the same periodicity of reviews. Six-month arrangements are not reviewed due to their short term nature. However, they could include prior actions if considered critical for the success of the arrangements.

As of April 2014, two of the IMF members (Former Yugoslav Republic of Macedonia and Morocco) have used the PLL. The following table shows the current IMF PLL arrangement active.

Table-3.4

<table>
<thead>
<tr>
<th>Current Outstanding PLL Arrangements (in millions of SDR)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Precautionary and Liquidity Line (PLL)</td>
</tr>
<tr>
<td>member</td>
</tr>
<tr>
<td>Morocco</td>
</tr>
<tr>
<td>Total</td>
</tr>
</tbody>
</table>

Source: IMF, 2014
3.6.4 Extended Fund Facility

A country with medium-term balance of payments needs due its weak structural weaknesses, can take IMF assistance under the Extended Fund Facility (EFF). Compared to SBA, assistance under an extended arrangement features longer program engagement—to help countries implement medium-term structural reforms—and a longer repayment period.

The EFF was established to provide assistance to countries: (i) experiencing serious payments imbalances because of structural impediments; or (ii) characterized by slow growth and an inherently weak balance of payments position. The EFF provides assistance to members combined with conditions aimed at correcting their structural imbalances over an extended period.

IMF’s engagement with its members under an EFF and its repayment are longer than the most of the Fund arrangements, since the structural reforms the members should go through to correct their deep-rooted weaknesses often takes longer to implement.

EFF arrangements can take up to three years. In some special cases, this period could be extended for one more year in case of the existence of a balance of payments need beyond the three-year period—the prolonged nature of the adjustment required to restore macroeconomic stability—and the presence of adequate assurances about the member’s ability and willingness to implement deep and sustained structural reforms. The repayment can take up between 4½–10 years, where the repayments are done semiannually.

The conditionality attached to an EFF arrangement mostly focuses on structural reforms to address institutional or economic weaknesses, in addition to policies that maintain macroeconomic stability. The Executive Board assesses the performance of the borrowing country regularly. The EFF has flexibility in the frequency of reviews based on the strength of the country’s policies and the nature of its financing needs.

The amount of the EFF loan package is decided based on the country’s financing needs, its capacity to repay, and also its track record with the IMF. Under EFF, a country can borrow up to 200 percent of its quota annually and a 600 percent
cumulatively. An exceptional access above normal limit could also be approved by the IMF’s Executive Board.

EFFs generally are not formulated on a precautionary basis in anticipation of a future balance of payments problem.

Table 3.5, shows the current members’ having EFFs active with the Fund.

### Table-3.5

**Current Outstanding EFF Arrangements (in millions of SDR)**

<table>
<thead>
<tr>
<th>Member</th>
<th>Date of Arrangement</th>
<th>Expiration</th>
<th>Total Amount Agreed</th>
<th>Undrawn Balance</th>
<th>IMF Credit Outstanding Under GRA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Albania</td>
<td>February 28, 2014</td>
<td>February 27, 2017</td>
<td>295420</td>
<td>295420</td>
<td>5073</td>
</tr>
<tr>
<td>Cyprus</td>
<td>May 15, 2013</td>
<td>May 14, 2016</td>
<td>891000</td>
<td>668250</td>
<td>222750</td>
</tr>
<tr>
<td>Greece</td>
<td>March 15, 2012</td>
<td>March 14, 2016</td>
<td>23785300</td>
<td>16574400</td>
<td>22680150</td>
</tr>
<tr>
<td>Jamaica</td>
<td>May 01, 2013</td>
<td>April 30, 2017</td>
<td>615380</td>
<td>438690</td>
<td>491428</td>
</tr>
<tr>
<td>Pakistan</td>
<td>September 04, 2013</td>
<td>September 03, 2016</td>
<td>4393000</td>
<td>3673000</td>
<td>2105139</td>
</tr>
<tr>
<td>Portugal</td>
<td>May 20, 2011</td>
<td>May 19, 2014</td>
<td>23742000</td>
<td>1560000</td>
<td>22182000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>53722100</strong></td>
<td><strong>23209760</strong></td>
<td><strong>47686539</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: IMF, 2014

Among other non-concessional facilities, we can point out to:

### 3.6.5 Rapid Financing Instrument

Member countries with urgent BOP needs can use IMF’s RFI, a rapid and low-access financial assistance, without the need to have a full-fledged program in place. RFI can help member countries address a wide range of their vulnerabilities such as those arising from commodity price shocks, or natural disasters. Low-income member countries can also tackle post-conflict situations or emergencies resulting from fragility by the help of RFI. Rapid Financing Instrument has replaced IMF’s Emergency Natural Disaster Assistance (ENDA) and Emergency Post-Conflict Assistance (EPCA).
The RFI is similar to the Rapid Credit Facility (RCF) for PRGT-eligible member countries. RCF is available to all members although it is not very popular among the low-income country members which can use the concessional RFI. RFI is designed for situations where a full-fledged economic program is either not necessary (due to the limited nature of the shock) or not feasible (since there is an urgent need for policy implementation).

A member’s access under an RFI is limited to 50 percent of its quota yearly and a 100 percent cumulatively. This level is decided by the Executive Board based on the country’s financing needs. Financial assistance provided under the RFI is subject to the same financing terms as the Flexible Credit Line (FCL), the Precautionary and Liquidity Line (PLL) and Stand-By Arrangements (SBA), and should be repaid within 3¼ to 5 years.

Financial assistance under the RFI is provided in the form of outright purchases without the need for a full-fledged program or reviews. A member country under RFI program is asked to cooperate with the Fund to solve its balance of payments problems. IMF requires the borrowing country to describe the general economic policies that it proposes to follow. Prior actions may also be included in the program.

The RFI can be used repeatedly over a limited number of years. This repeated use is allowed if the balance of payments need of the borrowing country is due to exogenous shocks or it has adequate macroeconomic policies verified by IMF staff monitoring.

Just like its predecessors, an RFI is accompanied by policy advice from the IMF. Technical advice is also important for building capacity to implement comprehensive macroeconomic policies. IMF focuses mostly on areas like building statistical capacity and establishing and organizing fiscal, monetary, and exchange institutions to help build tax and government expenditure capacity, payment, credit, and foreign exchange operations.
3.6.6 Trade Integration Mechanism

TIM is designed to mitigate the concerns (especially in developing countries) about financing balance of payments shortfalls that are a result of multilateral liberalization.

The TIM is not a special facility that offers new resources to IMF members. The member countries can access financial support for their BOP difficulties arising from trade-related adjustments under other IMF’s existing lending facilities. Trade Integration Mechanism is rather a policy designed to increase the predictability of resources that are available under existing facilities. The explicit emphasis on trade adjustments will ensure that their impact is carefully estimated and incorporated into Fund-supported programs.

A member country can request TIM if it expects to experience balance of payments problems as a result of the policies or measures implemented by other countries. These measures usually include those that lead to a more open market access for goods and services. Such measures would typically be introduced either under a WTO agreement or in some other way that treats all countries on a nondiscriminatory basis.

The TIM details how the Fund would provide access to its resources to meet a balance of payments need associated with such trade-related adjustments. In particular, the IMF would:

- Discuss with the member countries, that already have facilities with the Fund, how new arrangements can be added to their existing facilities to help overcome their BOP problems;

- Calculate the degree of the impact of the trade adjustment on the country to decide on the size of the lending package; and

- Consider the possibility to increase the size of the lending arrangement if the actual BOP effect turns out to be larger than anticipated.
The TIM does not cover the implications of “own liberalization” measures—for example, any deterioration in a country’s balance of payments that results from a reduction in its own import tariffs. Nevertheless, the Fund will continue to assist its members in anticipating and managing the implications of domestic reforms that may be associated with multilateral trade liberalization commitments or that are undertaken unilaterally, including through financing under the Fund’s existing policies.

As of April 2014, three member countries (Bangladesh, the Dominican Republic, and the Republic of Madagascar) have so far requested and obtained support in accordance with the TIM.

3.7 Recent Changes in IMF Non-Concessional Lending

Both the number of new non-concessional lending arrangements and the total amount of lending committed under these arrangements have increased sharply in recent years, as shown in figures 3.1 and 3.2.

**Figure-3.1**

*Number of IMF lending arrangements*

*Non-concessional*

Source: IMF, 2013
Since September 2008 (and the collapse of Lehman Brothers), the IMF has approved 45 new arrangements, compared with 18 in the preceding four years. Notably, however, during this recent crisis, the annual number of new arrangements approved did not go above the number of programs approved over previous crises, including the 1980s debt crisis.

Until 2013, the IMF has approved around SDR300 billion of new non-concessional lending commitments to its members. Half of this amount was under FCL arrangements and were treated as precautionary as none of which were drawn. The average size of recent arrangements excluding the FCL has still been large. For instance, as shown in figure 3.3, during the financial year of 2011 (till April), the average size of SBAs and EFFs approved was SDR7.4 billion, compared with SDR2.3 billion during the 1997–98 Asian financial crisis.

Source: IMF, 2013
The European countries have been the cause of the recent increase in lending (around half of the arrangements) since September 2008. These countries have received around 90 percent of the amount of new lending commitments, excluding those under FCL and PCL. As a result, the majority of the outstanding IMF arrangements are concentrated in Europe. As shown in figure 3.4, the credit outstanding accounts for 87 percent of the total credit outstanding.

Source: IMF, 2013
This is very different from earlier decades, where the majority of IMF lending was distributed among other regions and Europe did not have a very large share in this distribution. This shift is a reflection of the financial and external vulnerabilities built up in many Eastern Europe and CIS economies prior to the crisis, and their interconnectedness to the advanced countries at the center of the crisis. From 2008 onwards, the Ukraine, Hungary and Romania each received arrangements of more than SDR10 billion, while eight other European and CIS countries received loans totaling around SDR10 billion in the same year.\footnote{Tweedie Andrew, 2013, Review of the Adequacy of the Fund’s Precautionary Balances, IMF Finance Department, (http://www.imf.org/external/np/pp/eng/2010/082410.pdf)}

Plus, the sovereign debt crisis in Europe had Greece, Ireland, and the Portugal to apply and receive large rescue packages from the Fund. These very large assistance packages were organized in conjunction with the European Union, with the IMF providing around one-third of the €78 billion assistance to Portugal, and around one-quarter of the €85 billion pledged to Ireland and the €110 billion pledged to Greece. On the other hand, Asian and Latin American economies which have accounted for most of the IMF borrowings in the past decades have reduced their engagement and borrowings from the IMF. Many argue that this can be due to the imposition of tough conditionality that the Fund attaches to its funding. Because of that, these countries have turned to other alternatives of finance in case of future crisis or any other financing need.

### 3.8 Concessional Facilities

To address the specific needs of the low-income member countries and their diverse membership, IMF has evolved over the years and has developed various loan programs. These countries can borrow on concessional terms. Concessional loans carry zero interest rates until the end of 2014.

IMF increased its concessional lending commitments to satisfy the increasing needs of the low-income countries due to the effects of the global financial crisis. IMF concessional lending commitments increased significantly from $1.2 billion in 2008 to $3.8 billion in 2009 and an annual average of $1.6 billion during 2010–13.\footnote{IMF Support for Low-income Countries, 2014, (http://www.imf.org/external/np/ext/facts/pdf/poor.pdf)}
In addition, more than $18 billion of the $250 billion allocation of IMF Special Drawing Rights (SDRs) went to low-income countries. The low-income member countries can either sell their SDR to meet their BOP needs, or count them as extra assets in their reserves.\(^90\)

Main concessional loans include:

1. Extended Credit Facility (ECF)
2. Standby Credit Facility (SCF)
3. Rapid Credit Facility (RCF)
4. Exogenous Shocks Facility – High Access Component (ESF-HAC)

### 3.8.1 Extended Credit Facility

Countries experiencing protracted balance of payments problems can use the Extended Credit Facility (ECF). The ECF was created under the Poverty Reduction and Growth Trust (PRGT) as part of the reform efforts to make IMF’s financial support more flexible and tailored to the diverse needs of its low-income members, including in times of crisis. The ECF succeeds the Poverty Reduction and Growth Facility (PRGF). ECF is now the main medium-term tool of the Fund for the low-income countries that offers higher levels of financial resources, on more concessional and more flexible terms.

An ECF arrangement takes about three to four years, and can be extended up to five years maximum. Additional ECF arrangements can be approved again upon the expiration, cancellation or termination of a previous ECF arrangement.

Based on the country’s balance of payments need and strength of its economic program, the Executive Board of the IMF decides the access to ECF financing. Total access to concessional financing under the PRGT is limited to 100 percent of the quota per year, and a total outstanding credit of 300 percent cumulatively.

Under the ECF, the borrowing country agrees to implement a set of policies as part of the conditions attached to its borrowing. These policies are intended to help the country towards a stable and sustainable macroeconomic position over the

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medium term. These commitments and conditions are described in the country’s letter of intent.

As a mean to streamline IMF conditionality, IMF conditions now focus more on actions and policies that are critical for achieving the program’s objectives. Country ownership with respect to the ECF conditions have increased and the conditions are set based on the country’s own development strategy. IMF allows the borrowing country discuss its poverty reduction program with the Fund, and describe how the current fiscal budget year, and the next coming years with the ECF program will contribute to poverty reduction through their planned structural reforms.

The Fund sets specified quantitative conditions based on the country’s program objectives to monitor its macroeconomic policy variables such as monetary aggregates, international reserves, fiscal balances, and external borrowing. ECF conditionality focuses on safeguarding social and other priority spending through these quantitative targets as well.

Through the structural benchmarks, the Fund monitors the macro-critical reforms required to achieve program goals. These benchmarks are examined to identify any progress over the program reviews. Some of these structural benchmarks include strengthening public financial management or building up of social safety nets, etc.

Program reviews by the IMF’s Executive Board play a critical role in assessing performance under the program and allowing the program to adapt to economic developments. Reviews are scheduled semiannually under ECF.

Through the end of 2014, borrowing under ECF carries a zero percent interest rate. ECF has a grace period of 5½ years, which can be matured in 10 years. The next review, to decide on the interest rates of IMF loans, is expected to take place by the end of 2014.

Table 3.6 depicts current member countries’ arrangements under the ECF.
Table-3.6

Current Outstanding ECF Arrangements (in millions of SDR)

<table>
<thead>
<tr>
<th>Member</th>
<th>Date of Arrangement</th>
<th>Expiration</th>
<th>Total Amount Agreed</th>
<th>Undrawn Balance</th>
<th>IMF Credit Outstanding Under GRA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Afghanistan, Islamic Republic of</td>
<td>November 14, 2011</td>
<td>November 13, 2014</td>
<td>85000</td>
<td>61000</td>
<td>82770</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>April 11, 2012</td>
<td>April 10, 2015</td>
<td>639960</td>
<td>274268</td>
<td>437940</td>
</tr>
<tr>
<td>Benin</td>
<td>June 14, 2010</td>
<td>April 30, 2014</td>
<td>74280</td>
<td>10610</td>
<td>86015</td>
</tr>
<tr>
<td>Burkina Faso</td>
<td>December 27, 2013</td>
<td>December 26, 2016</td>
<td>27090</td>
<td>24540</td>
<td>139241</td>
</tr>
<tr>
<td>Burundi</td>
<td>January 27, 2012</td>
<td>January 26, 2015</td>
<td>30000</td>
<td>10000</td>
<td>91275</td>
</tr>
<tr>
<td>Central African Republic</td>
<td>June 25, 2012</td>
<td>June 24, 2015</td>
<td>41775</td>
<td>34812</td>
<td>64154</td>
</tr>
<tr>
<td>Cote d'Ivoire</td>
<td>November 04, 2011</td>
<td>November 03, 2014</td>
<td>390240</td>
<td>81300</td>
<td>609837</td>
</tr>
<tr>
<td>Guinea</td>
<td>February 24, 2012</td>
<td>February 23, 2015</td>
<td>128520</td>
<td>55080</td>
<td>73945</td>
</tr>
<tr>
<td>Haiti</td>
<td>July 21, 2010</td>
<td>August 29, 2014</td>
<td>40950</td>
<td>3276</td>
<td>37674</td>
</tr>
<tr>
<td>Kyrgyz Republic</td>
<td>June 20, 2011</td>
<td>June 19, 2014</td>
<td>66600</td>
<td>9516</td>
<td>128649</td>
</tr>
<tr>
<td>Liberia</td>
<td>November 19, 2012</td>
<td>November 18, 2015</td>
<td>51680</td>
<td>29534</td>
<td>64284</td>
</tr>
<tr>
<td>Malawi</td>
<td>July 23, 2012</td>
<td>November 22, 2015</td>
<td>104100</td>
<td>52040</td>
<td>133529</td>
</tr>
<tr>
<td>Mali</td>
<td>December 18, 2013</td>
<td>December 17, 2016</td>
<td>30000</td>
<td>24000</td>
<td>89561</td>
</tr>
<tr>
<td>Niger</td>
<td>March 16, 2012</td>
<td>December 31, 2015</td>
<td>78960</td>
<td>56400</td>
<td>48622</td>
</tr>
<tr>
<td>Sao Tome &amp; Principe</td>
<td>July 20, 2012</td>
<td>July 19, 2015</td>
<td>2590</td>
<td>1480</td>
<td>3412</td>
</tr>
<tr>
<td>Sierra Leone</td>
<td>October 21, 2013</td>
<td>October 20, 2016</td>
<td>62220</td>
<td>53330</td>
<td>82616</td>
</tr>
<tr>
<td>Solomon Islands</td>
<td>December 07, 2012</td>
<td>December 06, 2015</td>
<td>1040</td>
<td>594</td>
<td>12926</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td>1873665</td>
<td>789555</td>
<td>2217882</td>
</tr>
</tbody>
</table>

Source: IMF, 2014
3.8.2 Standby Credit Facility

Low income countries with sustainable macroeconomic positions experiencing episodic, short-term financing needs (including shocks) can use the SCF. SCF aims at restoring a stable and sustainable macroeconomic position for the borrowing country consistent with strong and durable growth and poverty reduction. The policy support makes this process faster for these countries.

PRGT-eligible member countries that are having an immediate or potential BOP needs can use the SCF. The SCF is scheduled to help member countries solve their financing and adjustment needs within two years. Duration of an SCF arrangement can vary between 12 to 24 months. Since the SCF is short-term in nature, the loan can take up to two and a half years.

Just like all other IMF arrangements, the Executive Board reviews the country’s balance of payments need and strength of its economic program before deciding on the borrowing country’s access limits. Total access under this arrangement is limited to 100 percent of quota per year, and a total of 300 percent of quota in total. However, these limits can be extended in exceptional circumstances.

The SCF can also be treated as precautionary. Any member with a potential but not immediate balance of payments can do so. There will not be any disbursements. However, countries retain and accumulate the rights to request disbursements under the arrangement if a financing need were to arise at a later stage.

Under the SCF, the borrowing country commits to implement a set of policies to achieve a sustainable macroeconomic position in the short term. These conditions are mentioned in the country’s letter of intent.

IMF has streamlined its conditionality framework to focus more on the macro-critical objectives of the program. Use of the SCF does not require a Poverty Reduction Strategy document. However, a country under SCF should entail poverty reduction and growth in its program objectives.

Normally, SCF carries a ¼ percent interest rate. But, this rate is released under the exceptional relief considered for the concessional facilities by the end of 2014.

Current SCF arrangements are shown in table 3.7.
### Table-3.7

Current Outstanding SCF Arrangements (in millions of SDR)

<table>
<thead>
<tr>
<th>member</th>
<th>Date of Arrangement</th>
<th>Expiration</th>
<th>Total Amount Agreed</th>
<th>Undrawn Balance</th>
<th>IMF Credit Outstanding Under GRA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Georgia</td>
<td>April 11, 2012</td>
<td>April 10, 2014</td>
<td>125000</td>
<td>125000</td>
<td>42000</td>
</tr>
<tr>
<td>Tanzania</td>
<td>July 06, 2012</td>
<td>April 30, 2014</td>
<td>149175</td>
<td>74575</td>
<td>297870</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
<td><strong>274175</strong></td>
<td><strong>199575</strong></td>
<td><strong>339870</strong></td>
</tr>
</tbody>
</table>

Source: IMF, 2014

### 3.8.3 Rapid Credit Facility

Low income countries may face an urgent balance of payments need. These countries can use the Rapid Credit Facility, which offers these members low access, but rapid and concessional financing assistance without any program-based conditionality. The low-income members of the IMF can use RCF when facing problems arising from shocks, natural disasters, and emergencies resulting from fragility. The RCF also provides policy support to help these countries restore their stability faster using the expert aid from the Fund. RCF replaces the Rapid Access component of the Exogenous Shocks Facility, as well as the subsidized components of the Emergency Disaster Assistance and the Emergency Post-Conflicted Assistance.

Under RCF, the members can use the facility through either a one-off disbursement or repeated disbursements. One-off disbursements are used when the country faces an urgent financing need for a limited duration, especially those arising from shocks. Repeated disbursements can be used over a limited number of years. This happens when the country is facing an exogenous shock or the country has a well established track record of adequate macroeconomic policies.

The RCF financing can vary based on the country’s financing need and its macroeconomic policies. Countries can access up to 25 percent of their quota annually and a 100 percent of their quota cumulatively. Countries facing severe shocks can borrow up to 50 percent of their quota per year and 125 percent cumulatively.
RCF loans carry a zero interest rate till the end of 2014. The loan period is 5½ years, with a final maturity of 10 years.

### 3.8.4 Exogenous Shocks Facility – High Access Component

The Exogenous Shocks Facility-High Access Component (ESF-HAC) was established in 2008. The objective of this arrangement is to provide concessional financing to member countries eligible under PRGT agreement that are facing balance of payments needs because of sudden and exogenous shocks. This facility has replaced the Standby Credit Facility (SCF) after the recent reforms of the IMF lending to make its facilities more flexible and better tailored to the diverse needs of LICs.

The ESF-HAC provides financing of up to 150 percent of quota. The resources are disbursed to the members in installments and the program usually takes one-to-two years.

Conditionality under ESF-HAC is based more on the adjustment to the underlying shock, rather than focusing on broad structural adjustments. The borrowing country can also use the Policy Support Instrument alongside the ESF.

Like other concessional facilities, ESF carries a zero interest rate until the end of 2014. Repayments of this facility are done semiannually and should be ended 10 years after the disbursement.

Credit outstanding from ESF-HAC arrangements amounts to SDR 677.5 million as of February 2014, and ESF-HAC terms will continue to apply to these balances.

### 3.8.5 Policy Support Instrument

Policy Support Instrument was established to create a close policy dialogue between the IMF and a member country. The countries’ economic and financial policies which have applied for the PSI are assessed semiannually. Apart from helping the member countries with their policies, the PSI can also act as a signal to other donors, creditors and can also provide general public about the strength of the country and its policies as a whole.
PRGT-eligible countries can apply for PSI irrespective of their balance of payments needs or their macroeconomic position. They can use this instrument for a period of one to four years, and a can be extended for a maximum period of five years. PSI can be used alongside the Rapid Credit Facility (RCF) or Standby Credit Facility (SCF). However, countries under an ECF arrangement cannot use the PSI.

One of the most important focuses of PSI is to help countries achieve their objectives of poverty reduction. However, the PSI gives these member countries the flexibility to design their own policy objectives and reform strategies that suits their own economic conditions best. In general, policies aim to consolidate macroeconomic stability and push ahead with structural measures to boost growth and jobs. These measures aim at improving public sector management and strengthening the financial sector.

To date, the Executive Board has approved 16 PSIs for seven members: Cape Verde, Mozambique, Nigeria, Rwanda, Senegal, Tanzania and Uganda.

### 3.9 Debt Relief

In addition to concessional loans, some low-income countries are also eligible for debts to be written off under two key initiatives. These two initiatives are:

1. Heavily Indebted Poor Countries (HIPC) Initiative
2. The Multilateral Debt Relief Initiative

#### 3.9.1 Heavily Indebted Poor Countries (HIPC) Initiative

IMF and the World Bank launched the HIPC in 1996 to help the heavily indebted poor countries reduce their external debt levels to sustainable level that they can manage to pay. This initiative has allowed the IMF to provide faster, deeper and broader debt relief to these member countries, and strengthen the links between debt relief, poverty reduction, and social policies.

As part of the initiative to achieve Millennium Development Goals (MDGs) faster, the Heavily Indebted Poor Countries was supplemented by the Multilateral Debt Relief Initiative. Through MDRI, a 100 percent debt relief is offered to the member countries by IMF, World Bank and the African Development Fund (AfDF) to members that have completed the HIPC initiative process.
Countries under this initiative should commit to policies to achieve poverty reduction and also demonstrate good track record. The World Bank and the Fund provide interim debt relief in the initial stage, and full debt relief will be provided if the country has met its commitments.

Debt relief is only the first step towards helping the low-income member countries’ needs. Aid flows are also planned after the debt relief to ensure debt sustainability and addressing of the development needs of these countries. Additional money must be spent through these programs to make sure poverty is reduced and the poor are also benefited along the program.

Before initiatives such as HIPC, average expenditure on health and education was less and the countries were spending more on debt services. Today, by the help of the HIPC, social spending on issues like health and education has increased remarkably. On average, such spending is about five times the amount of debt-service payments. For the 36 countries receiving debt relief, debt service paid, has declined by about one and a half percentage points of GDP between 2001 and 2012.91

HIPC initiative has improved the debt position of many low income country members. However, the still remain very vulnerable to shocks, especially those affecting exports. To reduce their vulnerability, these countries need to pursue cautious borrowing policies and strengthen their public debt management.

39 IMF member countries are eligible for the HIPC assistance. Out of these members, 35 of the total are receiving full debt relief from the IMF. Chad has recently reached its decision point and will benefit from the interim relief. Eritrea, Somalia and Sudan are the eligible members which have not yet received their decision point.

Table 3.8, shows the list of countries that have qualified for, are eligible or potentially eligible and may wish to receive HIPC initiative assistance. The following is the list of countries that have qualified for, are eligible or potentially eligible and may wish to receive HIPC initiative assistance as of March 2014.

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Table-3.8

HIPC Country Coverage

<table>
<thead>
<tr>
<th>Post-Completion-Point Countries (35)</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Afghanistan</td>
<td>Ghana</td>
<td>Mozambique</td>
</tr>
<tr>
<td>Benin</td>
<td>Guinea</td>
<td>Nicaragua</td>
</tr>
<tr>
<td>Bolivia</td>
<td>Guinea-Bissau</td>
<td>Niger</td>
</tr>
<tr>
<td>Burkina Faso</td>
<td>Guyana</td>
<td>Rwanda</td>
</tr>
<tr>
<td>Burundi</td>
<td>Haiti</td>
<td>Sao Tome &amp; Principe</td>
</tr>
<tr>
<td>Cameroon</td>
<td>Honduras</td>
<td>Senegal</td>
</tr>
<tr>
<td>Central African Republic</td>
<td>Liberia</td>
<td>Sierra Leone</td>
</tr>
<tr>
<td>Comoros</td>
<td>Madagascar</td>
<td>Tanzania</td>
</tr>
<tr>
<td>Republic of Congo</td>
<td>Malawi</td>
<td>Togo</td>
</tr>
<tr>
<td>Democratic Republic of Congo</td>
<td>Mali</td>
<td>Uganda</td>
</tr>
<tr>
<td>Cote d'Ivoire</td>
<td>Mauritania</td>
<td>Zambia</td>
</tr>
<tr>
<td>Ethiopia</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The Gambia</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Interim Countries (Between Decision and Completion Point) (1)</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Chad</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Pre-Decision-Point Countries (3)</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Eritrea</td>
<td>Somalia</td>
<td>Sudan</td>
</tr>
</tbody>
</table>

Source: IMF, 2014

3.9.2 The Multilateral Debt Relief Initiative

Eligible low-income countries receive 100 percent debt relief on their debt through Multilateral Debt Relief from the three multilateral institutions. MDRI was initiated as another mean to achieve the Millennium Development Goals, focusing on halving poverty by end of 2015.

The HIPC Initiative entailed coordinated action by multilateral organizations and governments to reduce to sustainable levels the external debt burdens of the most heavily indebted poor countries. The MDRI goes further by providing full debt relief to free up additional resources to help these countries reach the MDGs. Unlike the HIPC Initiative, the MDRI does not propose any parallel debt relief on the part of official bilateral or private creditors, or of multilateral institutions beyond the IMF, IDA, and the AfDF.
In deciding to implement the MDRI, the IMF Executive Board modified the original G-8 proposal to fit the requirement, specific to the IMF, that the use of the IMF’s resources be consistent with the principle of uniformity of treatment. Thus, it was agreed that all countries with per-capita income of $380 a year or less (whether HIPCs or not) will receive MDRI debt relief financed by the IMF’s own resources through the MDRI-I Trust. HIPCs with per capita income above that threshold will receive MDRI relief from bilateral contributions administered by the IMF through the MDRI-II Trust.

MDRI relief covers the full stock of debt owed to the IMF at end-2004 that remains outstanding at the time the country qualifies for such relief. There is no provision for relief of debt disbursed after January 1, 2005.

Table 3.9 lists the eligible countries for MDRI.

### Table 3.9

**Country Coverage of the MDRI**

<table>
<thead>
<tr>
<th>Countries that have benefited from MDRI as of end-March 2014</th>
<th>Eligible under the &quot;MDRI-I Trust&quot; (per-capita income at or below $380)</th>
<th>Eligible under the &quot;MDRI-II Trust&quot; (per-capita income above $380)</th>
</tr>
</thead>
<tbody>
<tr>
<td>&quot;Completion point&quot; HIPCs: 35 countries that have reached the completion point under the enhanced HIPC Initiative</td>
<td>Afghanistan, Burkina Faso, Burundi, Central African Republic, Democratic Republic of Congo, Ethiopia, The Gambia, Ghana, Guinea-Bissau, Liberia, Madagascar, Malawi, Mali, Mozambique, Niger, Rwanda, Sao Tome and Principe, Sierra Leone, Tanzania, Togo, Uganda</td>
<td>Benin, Bolivia, Cameroon, Comoros, Republic of Congo, Cote d’Ivoire, Guinea, Guyana, Haiti, Honduras, Mauritania, Nicaragua, Senegal, Zambia</td>
</tr>
<tr>
<td>Non-HIPC countries (2) with per capita income below $380 and outstanding debt to the IMF</td>
<td>Cambodia, Tajikistan</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Countries that will be eligible once they reach the completion point under the Enhanced HIPC Initiative</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>&quot;Decision point&quot; HIPC: 1 countries that have reached the decision under the Enhanced HIPC Initiative</td>
<td>Chad</td>
</tr>
<tr>
<td>3 additional countries may wish to be considered for HIPC Debt relief. They met the income and indebtedness criteria based on end-2004 and end-2010 data.</td>
<td>Eritrea  Sudan</td>
</tr>
<tr>
<td>Precise data on the per capita income of Somalia are not available at this juncture.</td>
<td></td>
</tr>
</tbody>
</table>

Source: IMF, 2014
The total amount of MDRI debt relief delivered by the IMF is estimated at about $3.4 billion in nominal terms as of March 31, 2014. In addition, the IMF delivered to Liberia beyond-HIPC debt relief amounting to $172 million on June 30, 2010.

SECTION-II

3.10 IMF Conditionality

Conditionality may be defined as a means by which a party offers support and attempts to influence the policies of another in order to secure compliance with a program of measures; a tool by which a country is made to adopt specific policies or to undertake certain reforms that it would not have undertaken, in exchange for support.

IMF conditionality refers to the policies a member country commits to follow in order to access IMF resources. These policies are oriented towards helping the country overcome its external payments problem and thus be in a position to repay the Fund in a timely manner.

Since the early 1950s, member countries have received financial support (usually under SBAs) conditioned upon the negotiation and implementation of an agreed program of economic reform with the IMF. Between 1960s and 1970s, some IMF lending facilities (notably the CFF) exhibited low facility. These facilities entailed no specific conditions other than a statement by the borrowing country that it was committed to sound economic policy. However, since the 1980s, all major IMF facilities (SBAs, EFFs, CFF, and the PRGF facilities) have included very high conditionality in their programs.

Conditions that constitute the IMF conditionality are categorized into three groups:

1. Prior actions
2. Performance criteria
3. Structural benchmarks

‘Prior actions’ are the reforms the country has to implement before any access to the IMF resources. ‘Performance criteria’ are quantitative conditions set by the Fund in agreement with the borrowing country that has be implemented in order to
receive installments of the loan agreement beyond the first one. Failure to meet these quantitative objectives interrupts the program, unless the Executive Board decided to waive them which will exempt the country from compliance. These criterions are related to key macroeconomic variables such as fiscal deficits and monetary expansion, but they may also incorporate structural conditions applying to microeconomic supply-side policies. Those policies that are difficult to quantify are also known as the ‘structural benchmarks’. In case of failure to meet these benchmarks, the program will not be interrupted. However, if regarded as sufficiently important, it will lead to interruption until the benchmark is reached.

3.10.1 The Rationale of Conditionality

There are a wide range of justifications for conditionality. First of all, these conditions are used as potential safeguard to the IMF resources available to the members as per the Articles of Agreement. So, these conditions are intended to make sure that the borrowing country is able to return the money. Conditionality is therefore intended to constrain moral hazard.

Second, it seeks to deal with the problem of time inconsistency by endeavoring to lock governments into programs of economic reform. Moreover, capital markets may interpret conditionality as revealing a commitment to reform, and it may therefore transmit a positive signal to them, which then results in additional capital inflows.

Third, the conditionality is intended to guarantee the member countries they can receive future tranches of their loan if they implement the policies in their conditionality and achieve their set benchmarks.

Among other reasons, conditionality may be used in a paternalistic way to spread what the IMF’s major shareholders regard as good economic policy, or to ration scarce IMF resources (with the strictness of conditionality varying according to the IMF’s own financial situation). Furthermore there is the claim that it may be used as a way of ‘tipping the balance’ in countries where governments are less than fully committed to economic reform. It may even be used by governments that are in favor of reform as a way of endorsing measures that are domestically unpopular; the IMF may be used as a convenient scapegoat.
However, there are many critics who argue that the scope of the IMF conditionality has now gone beyond the levels required to ensure repayment as many countries have failed to do so. They argue that the low rate of compliance with conditionality and the high propensity for programs to be interrupted weaken the credibility of conditionality, and that this undermines its commitment and signaling functions. Plus, it is argued that the very austere and tough conditions expected from the Fund are inappropriate for many IMF members. In many cases, IMF imposes its reform policies on countries against the wishes of their governments. Finally, they argue that the IMF conditionality should rely on the governments owning those conditions and reform measures, whereas what is seen today is completely at odds with ownership as the IMF imposes the conditions and the governments do not agree to comply with them, there is no access to the Fund resources.

3.10.2 Trends in Conditionality Before 2000

As new lending facilities with a stronger structural content were introduced in the period following 1974, the number and scope of conditions in IMF programs tended to increase.

Study of the conditionality applied over years, we can see an increase in the average number of performance criteria from below six in 1968–1977, to seven in 1974–1984, to nine and a half in 1984–1987. Table 3.10 provides information on performance criteria over the period 1993–1999, and confirms the trend towards greater conditionality up until the late 1990s, with a particularly sharp increase in the number of structural performance criteria between 1993 and 1997.
Table 3.10


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Source: IMF, 2002

Figures 3.5 and 3.6 also show a similar pattern when including prior action and structural benchmarks.

Figure 3.5

Average number of structured conditions per program year

Source: IMF, MONA database, 2002
Figure-3.6

Average number of structural conditions per programme year by type of condition

Source: IMF, MONA database, 2002
As seen above, the number of structural benchmarks increased from zero in 1987 to an average of five per program by 1999. There was a surge in the use of prior actions between 1991 and 2001.

The Independent Evaluation Office of the IMF (IEO) published a report in 2007 on IMF conditionality. According to this report, IMF conditionality was increased both on concessional PRGF programs and on non-concessional programs (SBAs and the EFFs). Between the 1995 and 1999, the IEO confirms that there was an increase in the use of prior actions, structural benchmarks and structural performance criteria. By the end of the 1990s, GRA programs involved an average of about 20 structural conditions—these being in addition to quantified macroeconomic performance criteria.

To explain this increase in conditionality, one explanation is during these years the IMF decided to put more emphasis on economic growth. This was put in its conditions associated with the loans the Fund offered to its members. Structural conditionality was seen as a way of creating the economic circumstances in which conventional macroeconomic conditionality would work best. In the early 1990s, there was a view from the IFIs that favored not only policies directed towards securing macroeconomic stabilization, but also those designed to achieve microeconomic efficiency and openness. Furthermore, if conditionality was seen as a way of transmitting a signal that governments were committed to economic reform, perhaps greater conditionality was anticipated to transmit an even stronger signal. Beyond this, at a time in the late 1990s when the moral hazard of IMF lending was causing increasing concern in some quarters, perhaps increased conditionality was seen as being needed to constrain it more effectively.

In addition to these arguments, some ‘outsiders’ saw increased conditionality as being consistent with claims that the IMF was seeking to exploit its bargaining power in circumstances where private capital markets were reluctant to lend. This could be interpreted either within the context of a public choice framework, under which conditionality represents power, or within a principal–agent framework that sees the IMF as the agent for influential advanced member countries – the principals.

Whatever the motivation behind it, critics expressed strong reservations about the trend towards greater conditionality. They argued that it was based on flimsy
economic principles relating to economic growth and the role of economic liberalization in securing it, and that it could end up transmitting negative signals, with greater conditionality implying the need for greater reform. At the very least, it could obscure the signals being transmitted. They argued that it overwhelmed local capacity to implement reform. The basis of their case, however, was that the ownership of economic reform would be undermined by increasing conditionality and that, without ownership, economic reform would not be sustained. If more conditionality simply induced less implementation there would be little to be gained from it. Indeed, the net effects might be negative if greater conditionality meant that conditions that would previously have been fulfilled would now not be met. Critics raised the possibility of there being a conditionality Laffer curve under which increased conditionality would weaken the incentive to implement economic reform.

The Meltzer Commission (International Financial Institution Advisory Commission 2000) argued forcefully that conditionality did not work, and that the increases in it represented an example of the institutional mission creep that had taken the IMF away from the Fund’s area of comparative advantage.

3.10.3 Critical Evaluation of Conditionality

Structural policy recommendations in IMF conditionality received great criticisms starting from the early 2000s.

First of all, the critics argued that this wide-ranging structural conditionality attached to IMF financing is very costly and intrusive especially for the developing countries. This reason encourages these countries to stray away from the Fund resources and look for other sources of finance including other private creditors even though the cost of borrowing from the IMF is much lower. Because of these conditions, IMF members especially the developing nations will come to the Fund very late with high levels of finance needs due to their extreme balance of payments needs. All of these are because these developing countries want to avoid the conditions that come along with IMF financing. This could be clearly seen in case of Thailand in 1997. These developing countries would turn to other regional crisis lenders with easier conditionality. For example, in 1998 Malaysia benefited from the low-conditionality benefits of the Miyazawa Initiative funds. The outcome would be the countries coming to the Fund with more difficult initial crisis conditions, and a
greater resort to the anti-social behavior. This is exactly what the Fund was established to prevent.

A second concern is that insistence on deep structural reforms in cases of illiquidity (rather than insolvency) will serve only to frighten private investors about the size of the problem, thereby rendering more difficult the restoration of confidence and the rollover of short-term capital flows that are the keys to resolving the liquidity crisis. No country (including the G-7 countries) is without some structural weaknesses but it is argued that however desirable structural policy reforms may be for the performance of the economy over the longer term, it is a mistake to suggest that such reforms are indispensable to resolving the crisis (when they are not). Among the Asian crisis countries, Korea is identified as a case where solvency was never in question and where less emphasis on structural reform both in the diagnosis and the policy prescription would have produced a milder crisis.

The third concern is that the IMF treats all of its members equally in terms of the conditions. The conditions that the IMF sets for the developing nations are almost the same as those industrial members. These groups of countries are clearly very different in their economic and political backgrounds. Plus, asking these developing members to implement very tough and deep structural reforms clearly undermines the ownership aspect of the Fund programs.

A fourth criticism is that by focusing too much on structural reforms, the Fund is straying from its core competence, and will lead to being involved in areas lacking competent analysis and advice. In this connection, critics have maintained: that the Fund bungled bank closures in Indonesia and precipitated a credit crunch in the crisis countries by requiring an unduly rapid increase in bank capitalization; that the Fund does not have the adequate expertise and staff to recommend the member countries set policies regarding areas such as corporate governance, or poverty reduction; and the mission creep between the responsibilities of the Fund and the Bank will reduce the public and legislative support necessary for them to get required funds. World Bank should be the main agent for the long-term structural reforms (at least outside the financial sector) and poverty reduction.
3.10.4 Road to Streamlined Conditionality

Criticisms of the difficult conditionality attached to IMF programs brought about a wide range of reforms to the whole lending framework of the Fund, which resulted in new conditionality and even lending facilities for the IMF to better address the different needs of member countries.

3.10.5 Conditionality Guidelines Reforms of 2002

As the criticism of IMF conditionality began to grow in the early 2000s, IMF’s Managing Director at the time, Horst Kohler, mounted an attempt to reform IMF conditionality. An initiative was started by him in September 2000 emphasizing on streamlining the scope of conditionality to make the conditions ‘macro-relevant’ and increasing the ownership of the borrowing country. The initiative was launched in 2002, where the Executive Board of the IMF approved new Conditionality Guidelines. These guidelines focused on the importance of:

1. National ownership of IMF programs: the guidelines emphasized on the need of more involvement of the borrowing country in formulating the program and the conditions attached
2. Reducing the number of conditions per program, while focusing more on those critical to the success of the program
3. Designing the program on a case-by-case basis and tailoring the program based on each member’s circumstances separately
4. Clarity as to what are the essential aspects of the program that must be compiled with, and what are the additional measures contemplated whose non-observance does not constitute a breach of the agreement that will impair the country’s ability to draw Fund resources.

As per the new guidelines, Fund-supported programs should be more macro-relevant and focus on:

   a) Helping the borrowing member country solve its BOP problems without destructing its national or international prosperity; and
b) Helping the country achieve medium-term external viability and foster sustainable economic growth.

Plus, the conditionality in these Fund-supported programs should be streamlined significantly and 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 policy provisions set by the Articles of Agreement of the IMF.

b) Conditions should be set only in the core areas of expertise of the Fund. Those variables and measures that are not within the core areas of expertise of the IMF should be explained more in detail and should be macro-critical in nature. The Fund’s core areas of responsibility in this context comprise: macroeconomic stabilization; monetary, fiscal, and exchange rate policies can be mentioned as a few core areas of IMF expertise.

The 2002 Conditionality guidelines were not very different from the previous Guideline published in 1979, although the discussion of the streamlining of the structural conditionality was a very important development made by this initiative. The Guidelines clearly ordered to limit the number of performance criteria to the minimum to give the borrowing country more air to focus on other aspects such as its social and political objectives and its other economic priorities. Thus, the 2002 Conditionality guideline can be regarded as another reminder to return to old guidelines that have been breached in the 1980s and 1990s. However, some believe that the unclear guidelines of 2002 gave the IMF to impose more structural conditionality on the borrowing members.

3.10.6 Effectiveness of 2002 Guidelines Reforms

The 2002 Guidelines Reforms were the start of a move towards a more successful conditionality framework. The Guideline’s fundamental points are summarized as:
• Principle of parsimony
• Focus
• Criticality
• Country ownership

3.10.6.1 Parsimony and Focus

These were the elements that were breached in the 1980s and 1990s to make the conditions more effective and improve the implementation of the programs, these elements were re-added.

According to IEO and IMF MONA database (Monitoring of IMF Arrangements), during the 1995-2004, IMF had taken 7139 structural conditions across 216 programs in 94 countries. Of these programs, 119 are GRA programs and 97 are concessional programs. The effectiveness of these IMF programs is discussed with respect to each of above sections.

According to a report by the Independent Evaluation Office (IEO), there is no evidence of reduction on the number of structural conditions after the 2002 reforms. The average number of structural reforms per program during the years 2001-2004 remained at 17 per program. This number is the same number as the average number of structural programs before the 2002 Guidelines during 1997-2000. There can be seen a small reduction in this number from 16 to 15 for PRGF programs. However, for SBAs, this number increased to 19 from 18. As can be seen in figure 3.7, there cannot be seen any significant change in the number of structural conditions. Plus, the distribution of conditions (between the prior actions, performance criteria and structural benchmarks) has not changed significantly either.
However, there has been a shift in the composition of the IMF structural conditions. After the Guidelines IMF focused more on its core areas with its conditions like those affecting taxation, public expenditure management and the financial sector, while it reduces the number of structural conditions on its non-core areas such as civil service reform, social policies and judicial reform, competition laws, pricing reform and transportation. So the recent reform appears to have refocused rather than reduced structural conditionality.

3.10.6.2 Criticality and Clarity

Based on their level of depth or the degree of change they bring about, the IEO classified the structural conditions into three groups of ‘little or no’, ‘limited’, and ‘high’ structural depth. Among the 43 studies, the IEO finds that only about 5% of structural conditions involved ‘high’ structural content. The remaining 95% could not be considered as critical since they had limited or little depth. In its survey of staff opinion, the IEO discovers substantial disagreement over what ‘criticality’ means. For 28% of respondents it was interpreted as relating to the program’s stated objectives.
For 15% it needed to be macro relevant, and for nearly 50% it had to be both. A total of 86% of respondents believed that streamlining had led to the exclusion of measures that were critical to the program, with 40% believing that this happened either ‘often’ or ‘very often’.

To test the clarity of the IMF programs post the initiative, IEO analyzed 13 pre and post initiative programs. The studies revealed that there is no better explanation of the structural conditions in the programs post guidelines.

IEO report states that there is a clear lack of clarity in the post guideline programs. Plus, there are still many conditions in the Fund programs that are not considered critical as per the Conditionality Guidelines. Therefore, the initiative did not lead to better explanations of conditions or a better shift to conditions that are more critical to the objectives of the program.

3.10.6.3 Ownership of Programs

As the IEO confirms, the ownership by the government of the borrowing country is a very critical factor in further implementation of the conditions and hence better achievement of policy objectives. However, based on the discussions of the IEO representatives and the borrowing countries, there is nothing to suggest that ownership has been generally enhanced after the initiative to move to a program with higher country ownership.

If ownership varies inversely with the number of conditions then, since the volume of conditions in the streamlining period has not fallen, ownership will not have risen. If it is related to the scope of conditionality rather than its volume, changes in ownership will depend on the preferences of national policymakers in terms of particular areas of reform and whether these coincide with the composition of conditionality.

Furthermore, after the early 2000s, many IMF members especially the Asian and some Latin American country members decided to build up their own reserves and avoided to use IMF resources. The lack of country ownership could be the reason why these countries decided to take distance from the Fund because getting help by using IMF resources implied heavy conditionality which was very costly to those members. Plus, the governments had little ownership to their programs and policies.
The above discussion suggests that the IMF’s streamlining initiative did not have the impact that it was intended to have.

3.11 Conditionality and Lending Reforms of 2008-2009

The 2002 Conditionality Guidelines of 2002 to streamline conditionality were clearly not very successful. There had been no significant decline in the number of conditions per IMF programs offered to the countries. However, this was a start of a step towards better negotiation of the conditionality with countries, although there was no clear record of any change in the programs.

If, overall, IMF conditionality changed relatively little in the period from 2000 to 2008, a veritable avalanche of institutional reform occurred between late 2008 and early 2009. Events have driven the evolution of conditionality in a way and at a speed that the streamlining initiative had largely failed to do.

IMF modified its Exogenous Shocks Facility (ESF) in September 2008 to generate quicker access to finance for its low-income countries without any specific PRGF program in place. The rapid access component of the ESF allows the member countries to use up to 25 percent of their quota. Plus, in order to use ESF resources, the borrowing country just needs to commit to appropriate policies to address the shock, and in exceptional circumstances take targeted up-front measures.

For emerging market economies of the IMF, the Fund launched the Short Term Liquidity Facility (STLF). According to the Managing Director of the Fund at the time, Dominique Strauss Kahn, the conditions attached to this IMF package was based on measures necessary to tackle the crisis and restore a viable external position. If the countries have track record of sound policies, they can have access to this facility without standard phasing, performance criteria, monitoring and other conditionality of a Fund arrangement. Borrowers are merely expected to continue their commitment to maintain a strong macroeconomic framework.

In March 2009, as part of moves to support countries during the global economic crisis and further reforms, IMF approved a major overhaul of how it lends money by offering higher amounts and tailoring loan terms to countries’ varying strengths and circumstances.
The overhaul included the following elements:

- Modernizing conditionality: IMF conditionality linked to its financing should be more tailored to the circumstances and varying strengths of each borrowing country. The conditions should now focus more on pre-set qualification (ex-ante conditionality) rather than ex-post conditionality. Structural reforms in the form of structural performance criteria should be discontinued in all Fund arrangements and should now be monitored only in the context of program reviews.

- Flexible Credit Line (FCL): For the member countries with very strong fundamentals, IMF launches a new facility called the Flexible Credit Line (FCL). Access is available only to those countries that can pass very strict pre-qualification process. The flexibility built into the design of the FCL relates to its uncapped access, its long repayment terms (3 ¼ - 5 years), its unrestricted renewals, and its dual-use for contingent (precautionary) and actual balance of payments needs. FCL now replaces the STLF and CCL.

- Enhancing Stand-by Arrangements (SBA): For those countries with vulnerabilities that do not qualify for the FCL, High Access Precautionary SBAs (HAPAs) is available as a regular lending window. Just like the FCL, precautionary SBAs reviews the circumstances and strengths of the borrowing country and can be frontloaded based on the strength of a country’s policies and the external environment.

- Doubling lending access limits: As a mean to double the countries’ access limits, there is now a 200 percent of quota annually and a 600 percent of quota cumulatively available to the members. This is intended to give the borrowing countries more confidence to avail IMF finances and meet their needs. Under careful scrutiny by the IMF’s Executive Board, there is scope for higher access as well.

- Simplifying cost and maturity structures: the cost and maturity of IMF loans are also being overhauled to encourage more member countries borrow from the Fund instead of using other sources of finance.
• Simplifying lending toolkit: IMF facilities barely used will be eliminated from IMF lending toolkit. Some of the instruments include the Supplemental Reserve Facility, the Compensatory Financing Facility, and the Short-Term Liquidity Facility.

• Reform of facilities for low-income countries: As a part of the reforms and to strengthen the Fund’s capacity to help its low-income members, the Fund is designing new facilities to provide better concessional lending capacity to this group of countries. The IMF’s objective is also to at least double its concessional lending capacity for low-income countries.

This portfolio of IMF lending and conditionality reforms brings significant changes to the whole framework of lending. Low conditionality access is now embodied in the rapid access component of the ESF and, even for the high access component; adjustment is seen as needing to focus on adjustment to the underlying shock and not structural adjustment in general. Eligible countries will not be required to have a Poverty Reduction and Growth Facility program in place, and where they have, this will no longer contain structural performance criteria. The FCL could fill what has been perceived to be a gap in the range of IMF lending windows and allow IMF resources to be disbursed quickly and without the need to negotiate additional policy reform.

These institutional changes bring great change in the culture of the IMF. FCL, the new IMF facility is now hoping to be of better use instead of its predecessor, the Contingent Credit Line (CCL) since the CLL was abandoned unused. Countries would have to negotiate heavy and costly conditionality programs with the IMF prior to receiving any finances. This is no more the case for the FCL. Plus, the countries were concerned that applying for the CLL would send out adverse signals to markets about the circumstances of the country, whereas, in the case of the FCL, being eligible for this facility is a very positive sign showing the country’s strong fundamentals.

Prior to March 2009, stand-by programs in Hungary, Iceland, Latvia and Ukraine had exhibited many familiar features. On average, they involved about 14 conditions. Structural performance criteria were still being used in all four programs and the only clearly noticeable feature was a ‘lighter touch’ in terms of prior actions. Structural conditionality, perhaps unsurprisingly, focused on financial sector reform,
while conventional macro conditionality focused on limiting the growth of fiscal deficits and related debt accumulation. However, the conditionality involved seemed to distinguish between what might be necessary in the short term – as economic growth was declining and other components of aggregate demand in the form of consumption and private-sector investment were falling – and what was appropriate in the medium term as recovery occurred. In the context of economic crisis, IMF conditionality cannot escape the same dilemmas as those encountered by national policymakers.

The combination of changes introduces in 2008/09 brought about clearer changes to the IMF lending framework rather than the vague references mentioned in the Guidelines of 2000/02. These reforms hoped to provide additional incentive for the member country to make more use of IMF resources and also a better implementation of IMF conditions.

3.12 Reforms of 2009 for Low-Income Countries

Economic difficulties hit the low income countries in 2008 because of the spread of the global financial crisis and also due to sharp increases in food and fuel prices. These events put many LICs in a vulnerable situation and even threatened to push back many of these countries back into poverty. As a response to help LICs more, the IMF approved wide-ranging reforms to upgrade its concessional financing facilities in July 2009.

The reforms include:

- Scaled-up concessional financial assistance to LICs: according to the reforms, the amount of concessional lending resources available to the low-income member countries will come at US$4 billion per year for 2009 and 2010. There is significant increase compared to the available US$1.2 billion in 2008. This move actually exceeds the G20 call for additional lending of US$6 billion over the next two to three years. Through the end of 2014, a total of US$17 billion will be provided through concessional facilities of the IMF.

- A more effective structure of LIC facilities: concessional lending facilities of the Fund will be more flexible and tailored to the increasing diversity of the low-income member countries. The reforms recognize that different LICs might want to use the IMF facilities for different needs. Some of them might need IMF
resources to address their economic challenges, while others might use the
resources to satisfy their episodic financial needs (such as shocks due to crisis).
The new structure of IMF financing under the newly created PRGT, consists of
the following instruments:

1. **The Extended Credit Facility (ECF).** ECF which replaces the PRGF
   provides financial assistance to countries experiencing protracted balance
   of payments difficulties.

2. **The Standby Credit Facility (SCF).** Same as the SBA used by many
   emerging member countries, THE SCF is used to provide financial
   assistance to low income countries experiencing short-term financing
   needs. SCF can also be used for precautionary uses in case potential rather
   than actual financing need.

3. **The Rapid Credit Facility (RCF).** LICs experiencing urgent financing
   needs can use RCF. This program has very low conditionality attached to
   it.

- Enhanced focus on poverty reduction and growth: Poverty reduction and growth
  should be an essential part of the policies the countries follow. Based on their own
  strengths, the borrowing low-income member country should indicate how its
  policies will contribute to poverty reduction and growth. Plus, the member
  country should indicate their plans for safeguarding social spending.

  Greater concessionality: Through the end of 2011, all IMF concessional loans
  carry a zero interest rate on their outstanding payments. This relief gives the LICs
  great concessionality compared to the previous 0.5 percent of interest rate on
  concessional facilities.

- Financing: Consistent with the new LIC architecture of lending facilities, all
  concessional facilities of the IMF will be consolidated in the PRGT. Through
  PRGT, more flexibility and higher use of resources will be given to LICs.
  Through bilateral contributions, an additional SDR 9 billion will also be mobilized
  to PRGT accounts. New subsidy resources of SDR 1.5 billion in end-2008 net
  present value terms will be mobilized from the IMF’s internal resources, including
  the use of resources linked to the envisaged gold sales, and through bilateral
  contributions.
3.13 Results of 2008-2009 Reforms

IMF reforms of 2008-2009 brought about significant changes to the whole lending framework of the Fund. The facilities were now available for both crisis resolution and prevention. Higher access beyond limits and more frontloaded availability provided better incentives for the countries to come to the Fund before it is too deep in the crisis. The precautionary feature of the facilities and more streamlined conditions also played a major role.

3.13.1 Exceptional Access and Frontloaded Financing

If we consider the size of individual Fund arrangements as a proportion of the recipient’s quota in the IMF, the average access approved by the IMF in its non-concessional lending arrangements has increased markedly since 2008, to ratios well above historic norms. (Figure 3.8)

**Figure-3.8**

*Average Size of New IMF Arrangements*

*Non-concessional, as a percentage of quotas*

Source: IMF, 2013

This clearly shows that the member countries received larger amounts of loans than in previous years all because of the 2009 lending reforms. SBA’s access norms were doubled from 300 percent of quota to 600 percent. As shown in figure 3.9, over
half of the arrangements after the 2009 reforms have been equivalent to 300 percent of quota. Plus, many countries in recent years including Greece, Ireland and Portugal took advantage of the exceptional access beyond the 600 percent of quota. Greece’s arrangement with IMF was about 3200 percent of quota, where Ireland and Portugal had 2300 percent of quota in their arrangements.

Figure-3.9

IMF lending Arrangements Greater than 300 Percent of Quota

Non-concessional

![Figure-3.9 IMF lending Arrangements Greater than 300 Percent of Quota](image)

Source: IMF, 2013

IMF lending was established on the assumption to be disbursed in installments. However, the 2009 lending reforms allowed for a more frontloaded disbursement of the loans because the Fund saw that this kind of disbursements may in many cases boost the confidence of the borrowing country insulate recipients from the effects of external shocks. As a result, the recent IMF loans are more frontloaded than before. Countries are receiving bigger tranches of their loans in the beginning of their arrangements. For SBAs, the median value of their first tranche was about 35 percent of their total access for the 17 SBA programs between the mid 2008 and mid 2009. There is significant change compared to the 26.5 percent of total access approves in previous crises. However, considering their economic circumstances, the degree of frontloading is less for Greece, Ireland and Portugal. On average, these countries are receiving 22.5 percent of their total access as their first tranche.
3.13.2 Precautionary Instruments and Crisis Prevention

Crisis prevention is a very important factor in 2009 lending reforms. The IMF has been trying in recent years to encourage its member countries to ask the Fund for financial or policy help before they are deep in crisis. As a result, new facilities were designed with a focus on crisis prevention. The FCL and the PLL are the two important facilities that focus on this issue. If the countries qualify for these facilities, they can use the IMF resources without any subject to conditionality (unlike the SBA and EFF). Plus, in 2009 reforms the SBA was upgraded to facilitate high access borrowing on a precautionary basis for those members that are not strong enough to qualify for FCL or PLL.

However, despite the reforms, the countries have not responded to the introduction of these facilities very well. The proportion of arrangements approved on a precautionary basis has fallen to around 36 percent since 2009 from the 42 percent from 1998 to 2008. After the introduction of the FCL, only three countries have signed up for it (Mexico, Poland, and Columbia). Plus, Macedonia was the only country that applied for PCL before it was replaced by the PLL. The reason for these low numbers can be because the member countries are afraid that signing up for these facilities can be interpreted as a signal of external vulnerability despite the qualification criteria. Moreover, many countries in recent years including the Asian countries have started accumulating their own reserves the self-insure themselves against future possible threats and to not have to rely on the IMF anymore.

However, the three countries that have signed for the FCL have renewed their arrangements since they see a benefit in the insurance the facility provides for them and since if needed, the facility provides large amounts of finance for them.

3.13.3 Changes in Conditionality

2008-2009 reforms aimed at streamlining the conditionality of the IMF facilities to focus more on IMF core areas of expertise and also to set the conditions on the policies that are necessary for achieving program objectives.

As a result, the number of structural conditions has reduced after the reforms. Between 2008 and 2010, the structural conditions per program per year came at 10. There is a significant change where the average number of structural conditions between 2002 and 2007 were at 19. This number came at 17 per year for a period between 1995 and 2002.
According to figure 3.10, the emphasis of the structural conditionality of IMF programs have also changed. For instance, 28 per cent of the total structural conditions for the three largest Asian crisis borrowers are classified in the ‘Other’ category, which includes conditions pertaining to privatization, trade policy, labor market reform, and private sector legal and regulatory changes. Since these conditions are not among the core areas of Fund expertise, the IMF has shifted away from these areas and more towards core areas of expertise.

**Figure-3.10**

**Structural Conditionality**

**Percent of Total Structural Conditions**

![Bar chart showing structural conditionality across different countries and periods](image)

Source: IMF, 2013

Financial sector reforms have been a large proportion of the structural conditionality accounting for 43 per cent of the total conditions imposed across the entire sample, and more than half of the conditions in the three Asian crisis arrangements. Resolving financial sector vulnerabilities was an important priority of the Asian programs, and a large proportion of the structural reform conditions involved dealing with non-viable financial institutions, recapitalizing viable institutions, and improving prudential regulations and supervision.

Fiscal conditions have also been prominent in most programs in our sample, with the exception of the Asian crisis programs. Notably, fiscal conditions comprise just under half of the total structural conditions in the arrangements for
Greece, Ireland and Portugal. The fiscal conditions in these arrangements have been quite varied, although tax recovery, expenditure monitoring and control, and improving fiscal transparency are common themes.

### 3.14 Review of Conditionality-2011

The next review of conditionality happened in 2011. The review covered the period between 2002 and September 2011. It finds many positive results from the previous reforms and highlights challenges in some high-debt programs. The review includes examining the trends in conditionality in these years, plus the overall design and outcomes relative both to objectives and a control group of non-program countries. The review examined 159 Fund-supported programs from 2002 to September 2011 that meet the standard of upper credit tranche conditionality. The sample included 95 PRGT programs (60 percent of total; including 12 supported under the Policy Support Instrument (PSI)) and 64 GRA programs. The average access level for non-PSI, PRGT programs was SDR 96 million, and for GRA programs was SDR 3 billion. The review concentrated on those programs approved during 2006-11, which included 43 PRGT programs (54 percent of 2006-11 programs) and 37 GRA programs. (Figures 3.11 & 3.12)

**Figure-3.11**

Total Access in GRA Programs, 2002-11

Source: IMF, 2013
2011 review of conditionality finds positive results on conditionality and design in Fund-supported programs. Programs offered to member countries during this period, internalized lessons from the past crises (for example the Asian crisis). The conditionality attached to financing during this period also were more modified and tailored to the circumstances of the borrowing countries and took into account the recommendations mentioned in the Independent Evaluation Office report of 2007.

The review includes the following observations:

- Structural conditionality of the Fund-supported programs has decreased significantly and has mostly focused on macro-critical core areas of the Fund expertise.

- Fund-supported programs studied have been more tailored to the circumstances of the borrowing countries. Plus, most of these loans are more front-loaded. In general, program design and access also seemed appropriate and consistent with guidance.
• The country ownership of the programs were more seen than before since the programs were designed more flexibly to the policy references of the borrowing country. This was the reason for the better implementation of the programs despite the severe economic shocks. Average implementation rates of program conditionality have also improved, although the implementation was stalled in 2011 across a broad range of GRA programs.

2011 review of conditionality finds the existing conditionality framework broadly appropriate. However, the framework can be strengthened in four main themes:

• More focused conditionality
• Consideration of macro-social aspects in program design
• Enhancing country contribution and ownership in program design
• Higher collaboration with other institutions

3.14.1 Focused Conditionality

IMF conditionality is established to help countries solve their BOP problems and is also used to safeguard Fund resources. These conditions should be of critical importance to achieve program goals and should also be necessary to implement specific provisions under the Articles of Agreement.

Parsimony is a key principle of streamlined conditionality. Under the streamlining initiative taken, the conditions set by the Fund should be parsimonious and macro-critical. The conditions should be critical to the achievement of the program and other unnecessary conditions should be avoided. The criticality criterion should be applied to all reform measures, whether within or outside the Fund’s core areas of responsibility. The trend in the average number of conditions per programs shows a downward trend and it is a good sign. The structural conditionality in the programs has become more parsimonious and focused on Fund’s core areas of expertise. (Figure 3.13)
Flexibility in program conditionality is a key factor for a better program implementation. Since the early 2000s, the Fund has started to enhance country ownership in designing the Fund programs. Plus, the Fund is now taking a qualitative rather than a quantitative approach to conditionality. Since the member countries are more involved in designing the policy framework of the conditionality of their programs, the conditions are set more flexibly and are based on the circumstances of the country’s strengths. This results in better implementation of the programs.

Maintaining the principles of streamlining in recent, higher risk programs will be critical. The number and depth of structural conditions has increased in the Euro Area programs, compared to previous programs, including in areas outside the Fund’s core areas of responsibility. While it is difficult to judge whether all the conditions were critical, the increase in the number and depth of conditions warrants scrutiny. Some increase in the scope of conditionality was undoubtedly appropriate given the profound structural reforms required for program success, including in labour and product markets. But it is important to continue to scrutinize the macro-criticality of certain conditions in these programs, particularly given the large number of conditions in non-core areas (e.g., judicial reform and competition policy). Striking the balance

Source: IMF, 2013
between the structural reform needs and macro-criticality of measures has been complicated by collaboration with regional institutions with broader mandates than the Fund. It is also essential to keep in mind that countries often face additional conditions in the context of their relationships with these other institutions.

To keep more focused, the Fund should:

- Ensure that conditions are streamlined in each Fund-supported program. The macro-criticality criterion of the programs and staying in the core areas of the Fund expertise are very critical while setting the conditions.

- Clarity in conditions attached to the programs should be enhanced, particularly regarding macro-criticality, alternative structural measures that were considered (if any), and the adequacy of progress in structural reforms subject to review-based conditionality.

### 3.14.2 Macro –Social Aspects

Social aspects of the borrowing country have become an important factor while designing Fund-supported programs. The IMF is paying more attention about the unemployment level of the society and the level of inequality in the country. The Fund is more concerned these days about the effects of the programs and conditions on these social aspects since social stability can directly affect the macroeconomic stability and growth in the country. This focus also aims to help build the foundations for growth through investment in human capital (education and health). IMF conditionality is set in a way to protect the most vulnerable segments of the population. This feature enhances the ownership of the Fund-supported programs and results in better implementation since the policies are now set based on the circumstances of the country. Several programs addressed the need for better social safety nets and reforms to enhance sustainability of the social insurance systems. Policies in these areas have often been pursued in collaboration with the World Bank and other development institutions.

Social spending is another factor that has improved in recent IMF programs especially in PRGT programs. Social expenditure has increased as a share of total GDP and expenditure. The results of econometric analyses suggest that in the first year of Fund-supported programs with low-income countries, education and health
spending rose by, respectively, 0.22 percent of GDP and 0.27 percent of GDP (Figure 3.14). These improvements are due to the establishment of indicative targets for social spending in the Fund programs, and also due to the debt relief savings from the Heavily Indebted Poor Countries and Multilateral Debt Relief Initiatives for social and other purposes.

**Figure-3.14**

Median Annual Change in Social Spending, 1985-2009

(In percent of GDP)

However, in certain recent IMF programs, crisis resolution led to significant cuts in expenditure, including the social sectors and in wages. The case of Greece is a very clear evidence of this case. Due to very high debt levels, economic stability and sustained growth was possible only by cutting making spending which was very painful to the citizens. Although the Fund had tried to protect the most vulnerable segments of the population, some of these cuts were inevitable.

However, the social aspects of these policy measures in programs should be considered in broader context. Some of the reforms may be harmful and costly in the near term, but may yield significant longer term benefits. The long term benefits can
result in better growth and sustainability, which may result in better employment, equality and better social status in the future.

Key recommendations to better consider social aspects of programs are:

- Better surveillance and technical expertise to offer advice on macro-social issues at any time of the program to the borrowing country.

- Conduct additional analysis of macro-social issues, in close cooperation with the authorities, with the aim of further promoting sustainable inclusive growth, evaluating additional policy options, and fostering dialogue. Consider the social aspects of policy measures in a broader context, including implications for growth and fiscal sustainability, and thereby members’ BOP and external viability.

- Better discussion with the borrowing countries on the long-term benefits of the policy measures to understand better the short term costs of these social aspects.

- Ensure the adequacy of social safety nets and possible temporary targeted transfers to protect the most vulnerable in the borrowing country.

### 3.14.3 Enhancing Ownership and Transparency

Ownership is a very critical factor for program implementation and program success. The more the country is involved with the Fund in designing the program policy measures, the more motivating it is for the country for better implementation of these policies. The Fund’s policies should be more flexible and the conditions should be more focused based on the circumstances of the borrowing country. Higher ownership results in better streamlined conditionality, higher consideration of macro-social aspects of the country and all these results in a better programs design.

Country authorities were fairly positive on ownership in survey results, while other stakeholders were less positive in countries with recent high risk programs. Consistent with the concerns on some recent programs, prior actions (PAs) for program approval have been on a downward trend, but the improvement stalled in 2011 (Figure 3.15).
Figure-3.15
Ownership: Downward Trend and Volatility in Prior Actions
2002-11

Note: There was only one program in 2006

Source: IMF, 2013

Key recommendations to enhance ownership are:

- Provide for better discussion of alternative policy options at the design stage with the authorities and through the whole program.

- The staff should collect and reflect on external views of other stakeholders while designing the Fund programs.

3.14.4 Stronger Partnerships

Coordination and collaboration with other institutions can result in better and more successful program design and more streamlined conditionality. IMF along with the World Bank and other institutions can discuss better design and better implementation of conditionality. The areas that are beyond the core expertise of the IMF can be discussed with other institutions before being included in the Fund programs. These areas may include decentralization, energy sector reform, and pension reform. Plus, this collaboration can eliminate the duplication of conditionality
by both the institutions. The important institutions that can help the IMF in designing its programs are the World Bank, ILO, OECD, ECB and other institutions. These institutions can be a big help in designing the macro critical structural reforms of the programs outside the area of expertise of the Fund.

The recent global financial crisis has also highlighted the need to not only work with international institutions, but also the private sector. Since these institutions are gaining more importance especially in their regions, the Fund should engage more with them (for example the European Commission and ASEAN+3). The recent European Debt Crisis showed what an important part the regional entities like the EU institutions or the ECB play in overcoming the crisis. Since the debt was too high for the IMF only to overcome, the collaboration between these institutions and the IMF was very significant since a large share of financing packages came from the EU/EA agencies. Plus, the expertise offered by the ECB on the region, helped the IMF a lot in designing its program policies. The debt restructuring policy options offered by the ECB to Greece and Ireland were significant. These difficulties illustrate the value of building relationships and mutual understanding with regional institutions with which the Fund may collaborate more closely and systematically in future financial arrangements. They also highlight the importance of clearly communicating the Fund’s financing principles when joining in co-financing operations.
3.15 Impact of IMF Lending and Conditionality Reforms on the Low Income Countries

IMF program and conditionality reforms for the LICs have proven to be very successful over the long term, although there are many places to fill the gap.

Based on a review of the Independent Evaluation Office (IEO) in December 2013, LICs experienced long-term increases in real GDP per capita growth, government balances, reserves, current account balances, foreign direct investment (FDI), exports, institutional quality, and social spending while also achieving noticeable reductions in economic volatility, inflation, external debt, as well as poverty (Figures 3.16 and 3.17). This finding holds across country sizes (small versus non-small economies), geographical groupings (coastal versus landlocked), institutional capacity (as measured by the World Bank’s CPIA), and per-capita income. The studies can be shown in the following graphs. (Figure 3.18)

Figure-3.16
Changes in Average Decadal GDP Per Capita Growth and Poverty Gaps, 1986–2010 (In percent)

Source: IMF Staff Calculations, 2013
Figure 3.17

Macroeconomic Conditions in LICs across Decades

Source: IMF Staff Calculations, 2013
Figure-3.17

Macroeconomic Conditions in LICs across Decades (continued)

Source: IMF Staff Calculations, 2013
Figure-3.18
Macroeconomic Conditions in LICs across Decades and County Groupings

Source: IMF Staff Calculations, 2013
LICs with longer-term IMF program engagement have experienced, on average, a comparatively stronger improvement in longer-term economic performance. Looking at the past three decades, countries with extensive program engagement faced comparatively weaker initial economic conditions in the 1980s, and experienced on average larger increases in real GDP per capita growth, government balance, exports, FDI and social spending than countries without such extensive engagement. LICs with longer-term program engagement also achieved a more marked reduction in economic volatility, inflation, and external debt. This stylized fact was first reported in IMF (2009) and continues to hold after updating the data to include the most recent years covering the global financial crisis. This strong economic improvement of extensive program users has largely eliminated the performance gap that existed relative to other LICs around the time the Enhanced Structural Adjustment Facility (ESAF) was created in 1987. Figure 19 shows a similar result when looking at the change in decadal averages of economic indicators and splitting the country sample into LICs with longer-term engagement (at least five years within the second decade) and those without such engagement.
Figure-3.19

Changes in Macroeconomic Performance of LICs

Source: IMF Staff Calculations, 2013
Figure-19

Changes in Macroeconomic Performance of LICs (continued)

Source: IMF Staff Calculations, 2013
Figure-3.19

Changes in Macroeconomic Performance of LICs (continued)

Source: IMF Staff Calculations, 2013
Long-term engagement of the Fund with LICs results in:

- higher long-term real per capita GDP growth
- higher reductions in growth volatility and inflation
- Larger increases in FDI.
- Higher social spending, especially in education. However, the social spending on health is not significantly changed.
- Reduction in poverty, however not very significant.
- Less income inequality

3.16 Review of Facilities for Low-Income Countries-2013

As part of an attempt to make IMF facilities more tailored to the needs of its low-income members, IMF reviewed its facilities in 2013 and examined the experience of the Fund with its facilities for these members, since the reforms taken after 2009.

The 2013 review of IMF conditionality found the 2009 reforms broadly successful with respect to the low income countries. The Fund programs have been successful in closing the gaps and creating streamlined architecture of financing for these countries. The conditions are also better tailored to the diverse needs of LICs. Medium term IMF financing has helped boost the Poverty Reduction and Growth Trust’s lending capacity. Plus, longer term involvement of the Fund in low income countries has supported economic growth and build macroeconomic buffers.

With respect to low income countries relationship with the IMF, there are specific challenges:

- The Fund should create a sustainable lending framework. The framework should aim at boosting the IMF resources in PRGT programs after the 2014. The Fund should be able to create a framework able to provide effective policy and financing support for low income countries;
• since the IMF concessional resources are scarce, the Fund should make efficient use of these resources by better tailoring access and financing terms to countries’ individual needs and capacities;
• The Fund should improve its expertise in these areas for further policy support since the demand for expertise will be more as these countries integrate into the global markets;

IMF’s concessional financing framework is designed for the period till the end of 2014. After 2014, the interest rates should be reviewed and decided whether they stay at zero percent or they may increase. Plus, the concessional lending capacity will also decrease by the end of 2014. Therefore, the Fund should preserve its ability to continue providing concessional financing support the LICs. The Fund should identify substantial additional resources for its PRGT programs.

Many directors suggest using resources from the windfall profits from the gold sales and use them as resources for PRGT programs. Some other directors proposed regular fund raising as a complement to the gold sales profits. However, many critics believed that the gold sales profits should be used toward the Fund’s precautionary programs in the current circumstances of elevated credit risks. Whatever the option, there should be a clear program framework by the end of 2014. Plus, the programs should be designed in a way to best use the scarce IMF concessional resources. The Fund could collaborate with the World Bank in designing new programs for the LICs aiming at better overcoming Poverty while avoiding double conditionality or any waste of expertise in policy support.

Second stage of this review is set to take place in 2015 as part of a broad review of conditionality and lending framework. This review, along with the 15th General review of Quotas is hoped to bring major positive changes to the relationship of the Fund with all its members.

3.17 Implications of IMF Lending and Conditionality Reforms for the Developing Countries

The recent reforms of IMF lending aimed at streamlining the conditions to better satisfy the diverse needs of its members. The results have been very positive for
the low income countries. However, the same could not be said for the developing economies.

First of all, after the 2009 reforms of IMF lending only 11 developing countries have signed up for IMF programs. Out of these 11 programs, 6 of them which are related to Morocco, Mexico, Colombia, Georgia and Romania have not been drawn yet. These countries have signed up for SBA, FCL and one PLL. The not withdrawal of these member countries is a sign of uncertainty these countries may still have in the IMF programs. Some of them may also have been treated as just precautionary.

The other 5 ongoing IMF programs are related to Jamaica, Pakistan, Jordan, Bosnia and Tunisia. All of these programs are again started after the 2009 reforms. These five programs have one thing in common. A small tranche of the loan is disbursed and the remaining is on hold.

Overall, the changes have not brought about much difference in the engagement of the Fund with the developing countries. The reasons may be because these countries in the recent years have started accumulating their own reserves due to their lack of confidence in the IMF and since they still find the conditions very costly to them. This accumulation of reserve is intended to self-insure them against future potential threats. In case their reserves are not enough, these countries still prefer other sources of finance with lower conditions. Regional financial institutions have attracted more attention in recent decades.

Moreover, IMF has not designed any special facility oriented towards these developing countries. The previous Fund-programs were mostly designed for the needs of IMF’s original member which were mostly advanced economies. Plus, the recent changes have failed to consider these countries’ circumstances. Only SBAs were upgraded to give more flexibility on the conditions of this program. By the lack of signing up of the developing countries for these programs, it can be said that the changes did not attract the attention of the developing nations. IMF has made great efforts to reform the lending framework and the conditionality of the Fund programs to make it more efficient for the low income countries. However, the same effort has not been made towards the developing nation members of the Fund.
3.18 Conclusion

The recent IMF lending and conditionality reforms have made significant improvements. The Fund has designed new facilities to satisfy different needs of the IMF members. The conditionality is more streamlined and more flexibly set based on the circumstances of the borrowing countries. The country ownership is now a major factor considered while designing the policy programs of the Fund programs since it was approved that enhanced ownership leads to better implementation of policy measures and results in better programs success.

However, the efforts do not end here. With respect to its PRGT programs, the IMF should make major decisions on what is its next step after the end of 2014. The PPRGT concessional resources will drop significantly after 2014. The Fund should decide how to collect additional resources for its future concessional needs. Whether it should be from gold sales or regular fundraising or contributions from its stronger members, the Fund should find the best way to deal with these concerns. Plus, in the 2015 review of conditionality, the Fund should decide on whether to continue the zero interest rate on its concessional loans or not. Since the PRGT programs have brought about very positive results with the relief on interest rates till the end of 2014, this approach may be continued.

Regarding the very high-debt program countries, such as Greece, the IMF have not shown very positive results with its engagement. Although this cannot be overall blamed on the Fund, the Fund programs have proven to be insufficient in high debt country members. the Fund should improve its expertise in these areas, and try on designing better programs to help these countries overcome their difficulties. However, the precautionary instruments added recently can be a very good start to encourage the member countries to come to the Fund before it is too late. The streamlined initiative also is another encouragement for these member countries to rely more on the IMF facilities rather than other costlier sources of finance.

Since the number of developing country members of the IMF has increased over the past three decades, the IMF should focus on designing more programs for this special group of countries to make their transition easier and with more confidence that in case of any fall, a reliable source of finance is available. Plus, the IMF should improve its expertise on these areas to enhance better policy design better
tailored to the circumstances of these countries based on their strength and macroeconomic situation. Better MF facilities for these countries may result in lower reserve accumulation and less volatility which will all result in a more stable monetary system which the IMF was supposed to protect in the first place.