Cross-conditionality or the Spread of Obligatory Adjustment

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"It is apparent that the 1980's have seen a veritable explosion of conditionality". Tony Killick[1]

A. Introduction

The issue of cross-conditionality arises in the context of a veritable explosion of conditionality that has characterised the 1980s. Not only are many developing country governments having to negotiate simultaneously with different international or bilateral institutions at the same time; also a far higher proportion of loans granted by each agency have tighter conditions than in the past, and these conditions relate to a far broader range of policy issues than in the past. The number of developing countries thus affected is also very large, because so many countries have been obliged to seek IMF/World Bank and bilateral official lending, as their foreign exchange situation has deteriorated in the early eighties and indeed as IMF/World Bank lending has become an almost obligatory part of debt rescheduling/new money packages; as a result, cross-conditionality and enhanced conditionality is a problem largely related to countries with severe foreign exchange strangulation, usually - but not always - manifesting themselves in debt crises. It is therefore highly concentrated geographically in Latin America and Africa. Indeed, those critical of the type of policy conditionality implied in IMF/World Bank lending could argue that these countries are suffering simultaneously from: 1) Inherited effects of mistaken or

1 Tony Killick, 'Issues in the Spread and Design of Obligatory Adjustment Programmes', Paper presented to ESRC Conference on Debt and Stabilization in the Third World, University of Essex, 29-30 October 1987.

inadequate policies in the past; 2) severe shocks coming from the 'darkening' international environment in the eighties and 3) pressure from the World Bank, IMF and other institutions to undergo structural transformations, several of which may not be consistent with the governments' objectives. Indeed it has been predicted[2] that "donors will impose the tightest conditions on those recipients who are in the weakest bargaining position", and that in particular "the World Bank has, on balance, imposed tighter conditions on countries which have relatively more serious balance of payments and debt problems, and which have the least access to alternative sources of finance".

It is important to put the debate in cross-conditionality and debt crises management in a historical perspective.[3]

In the period starting with the end of World War II and till 1982, Latin America tended to be a recipient of net resource transfers from the industrial world; conditionality attached to financial flows was relatively low key (for example in the seventies) or fairly non-controversial (as in the sixties), cross-conditionality practically did not exist till the eighties.

In the sixties, financial flows to Latin America were dominated by public flows, as the U.S. government - mainly through the Alliance for Progress - aimed to support growth and "stop the progress of Communism" through fairly generous financial support. To an important extent, the

2 P. Mosley and J. Toye "The design of Structural Adjustment Programmes," ~~paper presented at ODI Conference, 10-11 September, 1987~~. Development Policy Review.

3 For a more detailed discussion, see S. Griffith-Jones and O. Sunkel. The Crisis of Debt and Development in Latin America; the End of an Illusion. Oxford University Press, U.K. and U.S.; Grupo Editor Latinoamericano (Argentina); Editorial Brasileira (Brazil).

type of conditionality then imposed was development oriented; it reflected (in aspects such as priority to agrarian reform), and was strongly influenced by, progressive Latin American thinking. It should however be recognized that although the Alliance's rhetoric and initial thrust was geared towards progressive structural reforms, the performance criteria which tended to operate in practice for disbursement of aid flows were often largely financial ones, frequently coinciding with IMF criteria.

As is well known, in the seventies, it was the private international banks which channeled the largest part of financial flows going to developing countries; this trend was particularly marked for the Latin American case. At the time, it seemed as if there was practically no conditionality attached to this massive private lending, although the private banks' possible preference for economies that were more open to international foreign trade and capital flows provided one of the important incentives for rapid "opening up" in many Latin American economics. However, countries such as Brazil, were able to borrow vast sums from the international private banks during a whole decade without any conditionality from the International Monetary Fund.

In the eighties, neither private <u>nor</u> public actors are willing or able to lend or give aid to Latin America, to the extent which they did in the previous two decades. On the other hand servicing of already incurred debt - at far higher real interest rates than prevailed in the previous period - has become a major burden on those economies' balance of payments. The unfortunate result of both those trends is that Latin America - and indeed the developing world as a whole - have in the eighties made large net resource transfers to the far richer industrial

nations. These negative net transfers could have potentially strengthened the bargaining position of debtor governments to resist conditionality or even impose their own (on aspects such as international monetary reform), as the decision to make the net transfer of financial (and real) resources lies now not in the hands of international financial institutions or industrial governments, but in the hands of developing debtor governments. However, the way in which the debt problem has been "managed," and the fact that debtor governments have tended on the whole - even though with important exceptions, such as Peru since 1985 - to accept the framework designed for it basically by the IMF, the major industrial governments and the international banks, has implied that there has been both <u>a continuation of negative net transfers</u> from Latin America since 1982 - even though somewhat decreasing since 1986 - <u>and an increase in policy conditionality</u>. Even though new financial flows are smaller than in the past and - because they are lower than debt service payments - linked to negative net transfers, they have paradoxically been accompanied by far <u>tighter conditionality</u> then the higher new inflows which occurred in the previous period, when the context was one of positive net resource transfers!

In this new and difficult environment for many Latin American governments - low economic growth in industrial nations, with very week commodity prices, with negative net resource transfers and cross-conditionality, - <u>the bargaining process</u>, through which governments try to minimize both negative net transfers and reduce the negative impact of cross-conditionality becomes crucial. It is of course unfortunate that much of <u>the bargaining is defensive and reactive</u> to initiatives taken outside of Latin America; it therefore detracts energy and time of

policy-makers from the key task of defining and implementing long term development strategies, best reflecting countries' true history, resources, culture and preferences.

In the remainder of the paper, we will first raise the different types of issues posed by cross-conditionality; then we will explore the definition, scope and effects of cross-conditionality; in the next section we will briefly describe the origins of cross-conditionality. Finally, we will comment further on the appropriateness or otherwise of the type of conditionality developed by international financial institutions (IFIs),.

B. Issues posed by cross-conditionality

In this paper we will discuss the issue of cross-conditionality at three different levels:

a) The mechanics, problems, effects and possible advantages of cross-conditionality itself

Cross-conditionality can be said to exist where acceptance by the borrowing country of the conditionality of one financial agency is made a pre-condition for financial support by the others.[4] The problems and effects caused by the phenomenon of cross-conditionality start at an

4 This definition follows that given in, Commonwealth Secretariat, Cooperation Without Cross-conditionality, An Issue in International Lending, London, September 1986. Other also very valuable discussions can be found in S. Dell, 'The question of cross-conditionality', Mimeo, June 1986, and E. Lizano and S. Charpentier, 'La Condicionalidad Cruzada y la Deuda Externa' in E. Rodriguez and H.Carrillo (eds.), Deuda externa: el caso de los paises pequenos latinoamericanos, B.C.I.E, 1987.

operational level; increased complexity of negotiations leads both to delay and extra costs. They cover a wide range of more substantive issues, including increased loss of national autonomy on economic policy-making. Perhaps most seriously, cross-conditionality inhibits and disrupts (far more than traditional conditionality did) the formulation of a national 'vision' and a strategy of long-term development, as well as the creation of a national consensus supportive of such a strategy. This is a cause of special concern, given that the most successful models of national development (e.g. Japan and the United States) seem to have occurred in those countries, where there was a clear coherent national 'vision' of development targets and instruments, accompanied by concerted national effort to sustain them, and with relatively little foreign interference in the definition of the strategy and the mode of its implementation (even though foreign technology, financial flows, trade, etc played an important role). This freedom for Third World Countries to elaborate their own development strategies is being eroded by conditionality and cross-conditionality.

b) Type of conditionality involved

The critique of cross-conditionality relates not only to the negative effects that it can have, either at an operational or a substantive level. It refers also necessarily to the content of the policy advice offered by the different international financial institutions, which determines the type of conditions they require.

It seems useful to distinguish between two areas of policy advice:

a) Technical advice. In this field, IFIs may play a positive role, when they point out inconsistencies or mistaken policies by governments, in areas where there is broad consensus among the economics profession. Examples are the need to approximate the price of petrol (for use of private cars) to international prices, or even the need, (once countries have defined their target for debt servicing and the likely level of external financial flows) to adjust the country's economy within the restriction of available resources, both domestic and external.

b) controversial advice. There is, however, a very broad range of issues, concerning both adjustment but perhaps even more long-term development, where there is an important range of opinion among analysts (both academic and practitioners) on the effectiveness of particular instruments or measures, as well as about the degree and timing to which they are optimally used. On issues such as liberalisation of domestic financial markets and, to a lesser extent, liberalisation of trade, there is no agreement among different schools of thought, nor is there conclusive empirical evidence to support the views of either school (note, for example the completely different conclusions on the effects of opening up in trade and finance, and thus the completely different policy advice implications, reached recently by L. Taylor and A. Fishlow on the one hand and by B. Balassa[5], on the other, both based on extensive examination of empirical evidence).

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5 The former in a Wider Report; the latter for example in Balassa et al, Towards Renewed Economic Growth in Latin America, Institute for International Economics, Washington D.C, 1986.

As there is genuine disagreement between analysts on these issues, and as particular strategies seem to be more successful in particular countries and possibly cultures - it seems very inappropriate for international financial institutions to collectively try to impose one particular view, on crucial matters such as trade and financial liberalisation, both of adjustment and development on a range of developing countries. Cross-conditionality - and conditionality more related to structural reforms and long-term development such as that exercised by the World Bank- make this problem significantly more acute, especially for countries whose economies are suffering foreign exchange strangulation.

Besides the fact that the policy conditions on such matters are very contentious intellectually , additionally there is the issue whether indeed trade and financial reform (tending either towards more or less government regulation) are necessarily the key issues on which individual governments wish to or should focus on in all countries. For example, as Mosley and Toye,op.cit point out, the IFIs and the World Bank in particular, focus more on what they see as structural distortions that are policy induced (financial repression, restraints on free trade, price controls, etc) and ignore structural bottlenecks to development that are related to the prevailing structure of particular societies (e.g. excessively concentrated land property, unequal regional development, inadequate development of technological skills). By focussing the debate so strongly on particular areas, the IFIs may through conditionality and cross-conditionality, contribute to cause the neglect by governments of other areas of action, which may be more crucial for long-term development, than the one which the 'dialogue' with the IFIs privileges.

Not only is an important part of conditionality controversial on purely intellectual grounds. In some cases - though obviously not in all - the IFIs may partly be offering policy recommendations/ conditionality, which represents, to an important extent, the interests (real or perceived) of actors or governments in the industrial world (e.g. creditor banks which give absolute priority to regular servicing of LDCs bank debt, investors which favour a liberal treatment to foreign capital, exporters wishing easy and unprotected access to developing country markets). In some cases, thought not in others, those interests may be in conflict with interests of actors or governments in developing nations (e.g. producers of goods and services behind tariff barriers, including not just entrepreneurial elites - as is implied in World Bank documents - but also workers in those sectors). In the sense that there are genuine differences of interests, the debates are not just 'technical'. It is essential therefore to analyse the contentious issues involved in cross-conditionality, in a context that includes the bargaining process and sees at least part of this bargaining as reflecting both different intellectual perceptions of 'optimum' policies and different economic, social and even political interests on both sides.

c) Analysis of the bargaining process of cross-conditionality

The process of bargaining is thus a third crucial level in the understanding of the practice and effects of cross-conditionality.[6] The

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6 In a previous international research project, funded by IDRC-ESRC, I have highlighted the role of bargaining in determining the type of deal on debt and adjustment, see: S. Griffith-Jones (ed.), Managing World Debt, Wheatsheaf (U.K), St. Martin's Press (USA) and Fondo de Cultura Economica (Mexico). El manejo de la crisis de la deuda. 1988.

process of bargaining on cross-conditionality has several distinctive features, as compared with bargaining on traditional conditionality.

Firstly, as we will detail below, there is a far greater number of actors involved, <u>not</u> just internationally but also nationally.

Secondly, the are as being negotiated cover a far larger spectrum than conditionality covered in the past.

Thirdly, the attempted level and pervasiveness of influence has been increased in recent years, particularly via the programme lending of the World Bank. Thus, the World Bank in a confidential report evaluating its' Structural Lending Adjustment (SAL) programme clearly states that: "<u>The designing of SALs increased the comprehensiveness, depth and impact of the Bank's economic policy discussions in many countries</u>". <u>Previously</u> such issues as rationalising public investment programmes or trade policy was discussed as part of the 'economic dialogue' between Bank programmes departments and governments, <u>but often had little effect on either the Bank's lending programme or country policies</u>. With the introduction of SALs, public investment reviews- including reductions of public investment levels - and trade policy reform have <u>for the first time</u> become part of World Bank programmes. 'Furthermore, areas such as comprehensive education reform' have become part of the SAL conditionality. (e.g.in Jamaica). The World Bank has thus consciously, deliberately <u>and</u> explicitly "laid siege to the high ground of economic policy-making in recipient countries".[7] With great frankness the senior author of the influential 'Berg Report' prepared on Africa by the World

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7 Mosley, P and Toye, J. op cit.

Bank[8] states that: "SAL money is mainly intended to help bring World Bank representatives to the borrowers policy-making high table, where basic policy issues are decided by policy-makers, not merely explored by technical analysts". The pervasiveness of conditionality relates to the fact that, according to the same document, "SALs are normally conceived as one of a series of up to five operations, with each SAL covering a period of one to two years and the whole adjustment process extending over five to seven years".

Fourthly, as already discussed the process of increased (and often cross-) conditionality is largely a response of the creditor countries and the Bretton Woods institutions to the 'debt problem' that became so widespread since 1982; in this context they have insisted that both debt rescheduling and new financial flows only be approved as a package and in support of an agreed programme of adjustment measures by debtors governments, accepting conditions from different industrial governments and IFIs. Thus, increased and cross-conditionality emerge in a context of far reduced external net resource transfers.

In this context, a situation emerges for the developing country government where there are trade-offs between the 'costs' of cross-conditionality and the 'benefits' of additional financial flows, involved in accepting a package. Thus, if additional financial flows (as compared to without a package) are meager, if cross-conditionality is heavy and implies a major departure from the government's preferred objectives and policy instruments, and particularly if even after the deal, net resource transfers remain negative, there is a strong

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8 Berg, E and Batchelor, E; Structural adjustment lending: a critical analysis, Alexandria, Virginia: Elliot Berg Assoc., 1984.

incentive to consider as options or adopt either: a) to refuse the package and continue to service the debt (less cost of conditionality, while worse financial deal), as Brazil did in 1986 or, b) limit unilaterally debt servicing (which implies less 'cost' of conditionality and better financial deal, with the short-term cost of possible retaliation on reduction of short-term credit lines and other measures, as well as the more doubtful long-term cost of a possible slower return to creditworthiness). This latter path is roughly that followed by Peru since mid-1985.

The options can be seen in Figure 1.

Square I (heavy cross-conditionality without additional financial flows from abroad) is unacceptable to developing country governments and square IV are unacceptable to IFIs and creditor governments. In analysing bargaining on cross-conditionality, we are focussing on square III, which implies high cross-conditionality on adjustment and a reduction of NRT, via a 'package deal', usually with the IMF and the World Bank, and possibly with others.

However, industrial governments and IFIs know that if the 'deal' offered is not 'good enough' for LDC governments they may move to square II - no 'package deal', or (what is far worse, from the point of view of creditor governments and IFIs) may move to square VI - no 'package deal' and limiting debt service payments. The debtor government of course also knows that if it gives priority to staying in square III (and arrange a "package deal" with new flows), it must accept a minimum of cross-conditionality, as if it does not do so, there is a risk that IFIs and creditor governments will not agree to a "package" of new funding,

Figure 1: Options for Countries Starting from a Position of Large Negative Resource Transfers

	Resulting external negative resource transfer \ Level of Cross-Conditionality	Cross-Conditionality	No Cross-Conditionality
Multilateral	Large NRT	I	II
Multilateral	Smaller NRT	III	IV
Unilateral	No or very small N.R.T	V	VI

and the LDC government would end up unwillingly in square III

Thus,a study on negotiation in cross-conditionality must focus on square III, but take into account that an important part of this bargaining involves the "threat" that the LDC government will move to square II or IV, or that the IFIs will move to square II, the latter case in which the LDC government could either accept staying there or move on to square VI.

C. The definition, scope and effects of cross-conditionality .

a) Attempt at definition

Cross-Conditionality can perhaps best be defined, to exist where acceptance by the borrowing government of the conditionality of the financial agency is made a pre-condition for financial support by another or others. The financial agency where pre-conditions most often need to be accepted to obtain financial resources from other agencies is the IMF, in its' high-conditionality lending, although increasingly also World Bank S.A.Ls or S.E.A.Ls (Sectoral Adjustment Lending) may become pre-conditions for other flows, or play the role of "completing" new flows, debt rescheduling packages (e.g. for the latter, Chile late 1986). Similarly, several (though not all) bilateral agencies -in particular, the US Agency for International Development (AID), the UK Overseas Development Administration (ODA) and the Canadian International Development Agency (CIDA) have shown interest in enhancing the perceived effects of their aid programme via conditionality , both as defined by themselves and/or by the IMF and the World Bank. Similarly there seems to be an increased shift towards policy conditionality by regional

development banks.

Thus the fundamental difference between traditional and cross conditionality lies in the fact that a bilateral relationship is transformed into a multilateral relationship, between the national government with different bilateral creditors/donors and different IFIs.

b) <u>The scope of cross-conditionality</u>

Though formal cross-conditionality has been ruled out by such august bodies as the IMFs Interim Committee[9],there is clear evidence that informal cross-conditionality does exist between the two Bretton Woods institutions.

There are two clear examples. One is the convention that for a country to obtain a World Bank Structural Adjustment Loan (SAL) it must first have undertaken an upper credit tranche high conditionality IMF programme, which is on-going at the time. Indeed, cases have been reported in which negotiations for a SAL from the World Bank have collapsed as a result of the country's failure to reach agreement with the Fund. The World Bank document quoted above further says that "Bank supported SALs therefore were designed in such a way that they would both reinforce the strategies pursued under IMF agreements and complement them in areas outside the pursuit of Fund activities". Furthermore, just as it is in practice a pre-condition that an IMF upper tranche credit agreement be in place before a SAL is approved, a 1987 UNCTAD study further reports that for 30 of the 35 Sectoral Adjustment Loans approved till early 1987 by the World Bank, the country had or was

9 See <u>IMF Survey</u>, October 28 1985

waiting for imminent approval of an IMF stand-by or extended arrangement.

The second example of informal cross-conditionality, of particular concern to LDC governments and the Group of 24 representing them, is the operation of the recently created Structural Adjustment Facility (SAF),for low income countries. The SAF is a new IMF facility, to be provided to low-income countries presenting medium-term macro-economic <u>and</u> structural adjustment programmes. To be eligible for the loan, the low income country government has to develop a 'medium term policy framework' <u>jointly with the staff of the Fund and the World Bank</u>., setting out a three year adjustment programme. The SAF does represent a large step towards increased institutionalisation of 'cross-conditionality' between the IMF and the World Bank. The issue is particularly relevant, given the very <u>widespread</u> use of SAFs, facility which only started operating in early 1987. By October 1987, 21 countries (of which only two - Bolivia and Haiti - were in Latin America), already had SAF arrangements with the IMF, as compared with 25 countries having a stand-by, and one (Chile) having an EFF. (see Table 1). Furthermore, of the 21 countries having an SAF, 11 also had a stand-by.

LDC governments have expressed the fear that approval of a SAF could become the pre-condition for releasing additional external resources to low-income countries from the World Bank, other lending agencies and donor countries; they have also -via the Group of 24- expressed concern that with the establishment of the SAF, cross-conditionality may become in effect institutionalised, <u>not just for low-income LDCs, but also spread to other countries.</u>

Table 1: Stand-By, Extended, and Structural Adjustment Facitlity (SAF) Arrangements as of October 31, 1987 (thousands SDRs)

Member					Total Amount
Stand-by arrangements					**5,253,995**
Argentina					1,113,000
Burundi	Aug.	1986	Mar.	1988	21,000
Central African Rep.	June	1987	May	1988	8,000
China	Nov.	1986	Nov.	1987	597,725
Congo	Aug.	1986	Apr.	1988	22,400
Costa Rica	Oct.	1987	Mar.	1989	50,000
Côte d'Ivoire	June	1986	June	1988	100,000
Egypt	May	1987	Nov.	1988	250,000
Gabon	Dec.	1986	Dec.	1988	98,685
Guinea	July	1987	Aug.	1988	11,600
Jamaica	Mar.	1987	May	1988	85,000
Madagascar	Sept.	1986	Feb.	1988	30,000
Mauritania	May	1987	May	1988	10,000
Mexico	Nov.	1986	Apr.	1988	1,400,000
Morocco	Dec.	1986	Mar.	1988	230,000
Niger	Dec.	1986	Dec.	1987	10,110
Nigeria	Jan.	1987	Jan.	1988	650,000
Philippines	Oct.	1986	Apr.	1988	198,000
Senegal	Oct.	1987	Oct.	1988	21,275
Sierra Leone	Nov.	1986	Nov.	1987	23,160
Somalia	June	1987	Feb.	1989	33,150
Tanzania	Aug.	1986	Feb.	1988	64,200
Togo	June	1986	Apr.	1988	23,040
Tunisia	Nov.	1986	May	1988	103,650
Zaïre	May	1987	May	1988	100,000
Extended arrangement					**750,000**
Chile	Aug.	1985	Aug.	1988	750,000
Total					**6,003,995**
SAF arrangements					**971,302**
Bangladesh	Feb.	1987	Feb.	1990	182,563
Bolivia	Dec.	1986	Dec.	1989	57,595
Burundi	Aug.	1986	Aug.	1989	27,115
Chad	Oct.	1987	Oct.	1990	19,431
Central African Rep.	June	1987	May	1990	19,304
Dominica	Nov.	1986	Nov.	1989	2,540
Gambia, The	Sept.	1986	Sept.	1989	10,859
Guinea	July	1987	July	1990	36,767
Guinea-Bissau	Oct.	1987	Oct.	1990	4,763
Haiti	Dec.	1986	Dec.	1989	28,004
Madagascar	Aug.	1987	Aug.	1990	42,164
Mauritania	Sept.	1986	Sept.	1989	21,527
Mozambique	June	1987	June	1990	38,735
Nepal	Oct.	1987	Oct.	1990	23,686
Niger	Nov.	1986	Nov.	1989	21,400
Senegal	Nov.	1986	Nov.	1989	54,039
Sierra Leone	Nov.	1986	Nov.	1989	36,767
Somalia	June	1987	June	1990	28,067
Tanzania	Oct.	1987	Oct.	1990	67,945
Uganda	June	1987	June	1990	63,246
Zaïre					184,785
TOTAL					**6,975,297**

Source: IMF Survey, November, 1987

The two examples mentioned above are but the clearest instances of informal cross-conditionality and refer specifically to the two Bretton Woods institutions. In fact, lending by regional development banks and by several of the major donor countries has been increasingly conditional on previous IMF and in some cases World Bank conditionality. Indeed,the World Bank seems to be pressing for greater 'coordination' or 'cross-conditionality' with bilateral donors. Thus, the internal Bank document quoted above, (p.101), argues that 'failure of bilateral donors to design and limit their aid and levels in conformity with the objectives of stabilisation and structural adjustment programmes, has contributed to weakening implementation of the structural adjustment programme in several countries' Finally, the commitment of new lending by private banks, within the 'concerted package deals' has practically always -since 1982- been within the context of an IMF upper-credit tranche agreement , and often also linked to a World Bank SAL or SEAL.

Furthermore, informal cross-conditionality can be seen within the broader framework of extension of high conditionality. This also applies <u>within</u> the structure of lending of the Bretton-Woods institutions. In the case of the IMF, the proportion of lending under upper credit high conditionality drawings has increased rapidly. Furthermore, the previously low-conditional facilities (like the Compensatory Fund Facility and the Trust Fund flows, now transferred into SAF), have become far less automatic than in the seventies and far closer to conventional upper credit tranche conditionality. There are fears that also in the World Bank, an important proportion of non-SAL lending (either sectoral lending or indeed project loans) would be increasingly tied -formally or informally- to previous approval of a SAL.

The sum total of all these different measures and trends would be to bring always more existing lending within high Fund conditionality, as well as, to perhaps a more limited extent, within the framework of World Bank SAL or SEAL conditionality. It is this broad trend that has become a source of concern to LDC governments and to many observers, given the fear that they will lead to IFIs and donor governments to exert an ever increasing 'concerted pressure' on the country seeking assistance, while providing declining supplies of resources.

c. The effects of cross-conditionality

The effects of cross-conditionality cannot be seen purely as problematic. Partly, cross-conditionality can be seen as a response to calls for increased coordination between the IMF and the World Bank.

The need for greater coordination between the Bank and the IMF was seen to arise from the blurring of the distinction between adjustment and development, originated particularly since the early seventies from the emergence of large and not easily reversible current account deficit in many developing countries often for reasons escaping the LDC government's control. As the area of structural adjustment, -adjustment to balance of payments desequilibria that provides a basis for sustainable growth and development- became a crucial area for both the World Bank and the IMF, the need for greater coordination and cooperation between the two institutions became evident. The advantages of such cooperation however are compensated (or more than compensated) by the costs; the costs to an LDC government are larger to the extent that its' objectives, preferred policy instruments, preferred timing of policies differ more from those of the Bretton-Woods institutions.

The problematic effects caused can be summarised as[10]:

i) At an operational level, cross-conditionality makes negotiations with external actors more difficult and complex. The financial package - implying new loans and re-scheduling of debts - includes normally a large number of external actors, each with a somewhat different desired conditionality, though with important overlaps, each of which will only commit new resources or reschedule existing debts, if all the other actors do so simultaneously.The complexity and difficulty of negotiations make them very costly, particularly in terms of very senior government officials' time, which has a very high opportunity cost. This is a problem not only for LDC governments - particularly for those with small economies - but also for the IFIs and donor governments.

ii) Cross-conditionality results in a major reduction in the freedom of action of borrowing countries in designing their own economic policies (especially the determination of targets and selection of instruments). As we have argued above, this is particularly problematic as there is no conclusive evidence that the type and use of policy instruments preferred by the IFIs lead to a <u>superior</u> economic performance than that preferred by LDC governments. Furthermore, it greatly inhibits the creation of a national consensus around a development strategy.

iii) Cross-conditionality constrains the <u>execution</u> of stabilisation and development programmes. Even where there is agreement on the measures required for adjustment and development , differences of

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10 These points draw on Charpentier S. and Lizano E, op. cit.

opinion arise between the Bretton-Woods institutions, as well as with LDC governments, as to the timing, and sequencing of policies, as well as on the overall rate of adjustment. Cross-conditionality tends to artificially reduce, or even possibly eliminate, flexibility of governments in this aspect

iv) Formal government authority can be undermined, as direct relations are established between IFIs and domestic actors (e.g. political parties, associations of entrepreneurs), which may weaken the government's strength. Within LDC governments, power will tend to shift in two, related directions. Firstly, the power and influence of the 'negotiating team' will be enhanced. Given the complexities of cross-conditionality and the significance, both economic and political, of obtaining a "financial package", the internal political power of the "negotiating team" is clearly strengthened, power which it may use to impose on the rest of the government and society their points of view. At the same time, it has become an explicit target of the IFIs, and the World Bank in particular, to shift the balance of power within governments towards those who expect to gain from the policy reforms encouraged by the IFIs and/or who are in any case, more sympathetic towards such changes. The World Bank explicitly stresses in its document, op. cit that the most successful SAL programmes (e.g. Turkey) were those where "the key actors in adjustment became informed supporters and implementors of the programme". The Bank strongly emphasises the importance of "consensus building" within key political and bureaucratic members of the government, as well as of public opinion more broadly, as ways to ensure support for its SAL programmes. Though this may be a desirable objective from the

IFI's point of view, such actions are clearly very problematic from the point of view of those who perceive that such structural reforms are - at least in part - damaging from the national interest.

To the extent, that these changes of balance of power within government are permanent, or for a long period, they may become more significant for future development strategy, than the policy changes introduced as a result of specific loans or package deals! Cross-conditionality clearly accentuates the effect of IFIs on relative balance within LDC governments between different groups because it implies a united front of external actors, simultaneously pressing for similar or related conditions, often during a long period. The attractiveness for national actors of having simpler and homogeneous views amongst themselves and with those of the foreign actors is thus enhanced. If the views of the foreign actors were technically superior and in the national interest such a change would be welcome; it is the doubts on the technical superiority of the packages which makes it problematic that groups supporting such changes are strengthened.

D. The origins of cooperation and cross-conditionality

Cross-conditionality is closely related to the wider question of co-operation between the international financial institutions (IFIs), and particularly the IMF and the World Bank. To the extent that the roles of IFIs increasingly overlap, there has been pressure for closer co-ordination accompanied by legitimate fears of cross-conditionality.

The Articles of the IMF and the World Bank provide the legal basis for cooperation with other organisations. The World Bank's Articles, say that "in making decisions on the applications for loans relating to matters directly within the competence of any international organisation; ... the Bank shall give consideration to the views and recommendations of such organisations". Three points are of interest here. Firstly, the World Bank is obliged to "give consideration" to the views of the IMF, but there is no comparable obligation from the point of view of the IMF. Secondly, it would seem that the World Bank should "give consideration" to views "within the competence of any international organisation, which has relevant expertise and participated in primarily by members of the World Bank". Thus, it is not only the IMF whose views should be given consideration to, but also other institutions, such as UNCTAD, UNICEF, ILO, UNDP, or regional organizations such as CEPAL would be relevant. The concrete link of course emerges with the IMF because of large lending carried out by it, but there would be at least legally, the prospect for greater account taken of the views of other institutions. Thirdly, the World Bank is not required to do more than "give consideration" to the views and recommendations of the Fund on others. Therefore, there is no legal or other reason that implies the World Bank has to be bound by any IMF action or view; the decision to subject granting of SALs or SEALS to a pre-condition of an upper tranche IMF agreement could easily be reversed, if the World Bank Executive Board wished to do so.

In analysing the evolution of World Bank/IMF cooperation, leading in some cases to cross-conditionality, it is useful to distinguish two stages. The dividing line between the two stages is set in the mid-70's, and particularly through the introduction of the Extended Fund

Facility (EFF) in 1974. Prior to that date,the functional differences between the Bank and the Fund were reasonably clear.

The issue of cross-conditionality has emerged as a result of increased realisation that the external payments problems of LDCs are not amenable to short-term solutions, and that the Fund alone has neither the resources, nor the basic approach, to address the situation entirely on its own. This trend has been strongly reinforced by the "need" to put together "package deals" since the early eighties, so LDC governments can continue to service their debts and sustained minimum levels of imports, within the difficult international environment that they face. Had for example Latin American government limited debt service payments unilaterally the "need" for cross-condisionality would have not emerged, or would have done so in a far milder way.

Since the early seventies, there were increased demands on the IMF to provide for longer periods of adjustment and greater flexibility in the application of its performance criteria; simultaneously, there were demands on the World Bank and the regional development banks to extend on a far larger scale than they had in the past, long-term programme support to LDCs. The first stage in responding to these demands was the introduction of the Fund's EFF and the Bank's SAL programme. Existing IMF practices seem to have changed very little, after the EFF's introduction. However, the creation and operation of the EFF generated a first instance of growing interest in Bank/Fund collaboration. The collaboration was further enhanced with the World Bank's growing involvement in the late seventies, with assisting members with overall balance of payments difficulties. This role became more formalised with the creation of the SAL programme, launched in 1980.

There are two main reasons why the SAL became a key element in cross-conditionality. Firstly, as mentioned, the convention has evolved that before a country approaches the World Bank for a SAL, it must have previously entered into a stand-by arrangement with the IMF. Secondly, the rationale for close coordination was strengthened by the nature of the policy reform areas which are the focus of the World Bank's programmes; as the World Bank points out these were "designed in such a way that they would both reinforce the strategies pursued under IMF agreements and complement them."

As can be seen in Table 2, there are a number of topics in SAL programmes which are also included in concurrent IMF agreements.For the credits analysed in Table 2, the most common areas of overlap (in all cases but one), are tariff reform and import liberalization, and incentives for exporting; such high overlap in this particular area is not surprising as the World Bank document explicitly emphasises that the nine country programmes analysed in detail in Table 2 were "designed to achieve export-led growth". Areas where overlap is also frequent (in all cases but two) are: agricultural pricing, energy pricing, budget revenues, public enterprise financial performance and improvement of external borrowing and debt. The World Bank document, op. cit. also highlights three areas where the Bank's SAL usually go beyond the Fund in requiring more specific and detailed measures: 1) measures to reduce import restrictions and levels of, and disparities in, rates of effective protection. 2) considerable depth and detail, concerning measures to review and improve productivity of public investment. (In several cases such as that of Chile (II) Bank staff played a major role in the review of these programmes) 3) seeking to develop institutional structures, to strengthen formulation and implementation of development

Table 2: Policy Components in SALs and in Concurrent IMF Arrangements

	IVORY COAST SAL I		JAMAICA SAL I		KENYA SAL I-II		PHILIPPINES SAL I-II		SENEGAL SAL I		THAILAND SALs I-II		TURKEY SALs I-III	
	SAL I	IMF	SAL I	IMF	SAL I-II	IMF	SAL I-II	IMF	SAL I	IMF	SAL I-II	IMF	SAL I-III	IMF
I. Trade Policy														
Tariff reform and import liberalization	0	X	X	X	X	X	X	X	X	X	X	X	X	X
Exchange rate policy	0	0	0	X	S	X	X	X	0	0	0	X	X	X
Incentives for exporting	0	0	X	X	X	X	X	X	X	X	X	X	X	X
Institutional support for exports	0	0	X	X	S	0	X	0	0	0	X	0	X	0
II. Resource Mobilization														
Budget revenues	0	X	X	X	X	X	0	X	X	0	X	X	X	X
Current expenditures	0	X	0	X	0	X	0	X	X	X	X	X	0	X
Public enterprise financial performance	X	X	X	X	0	0	0	X	X	X	X	X	X	X
Interest rate and credit policies	0	X	0	X	S	X	0	X	X	X	0	X	X	X
Improved management of external borrowing, debt	0	X	X	X /b	X	X	0	0	X	X	X	X	X	X
Strengthen financial and capital market	0	S	X	0	0		S	0	0	0	0	0	X	X
III. Efficient Use of Resources														
Review of Public Investment Program and structural priorities	X	X	X	X	X	0	S	0	X	0	X	X	X	0
Agricultural pricing policies	X	X	X	X	X	0	0	0	X	X	X	X	X	X
Industry incentive system	0	0	0	0	X	0	X	X	X	X	X	X	/a	/a
Energy pricing	0	X	X	X	X	X	X	X	0	0	X	X	X	X
Energy conservation	0	0	X	X	S	S	S	0	0	0	X	X	X	0
Development of indigenous energy resources	0	0	X	X	S	S	S	X	0	0	X	0	X	X
IV. Institutional Development														
Strengthen formulation and implementation of public investment program	X	X	0	0	X	0	0	0	X	0	X	X	S	0
Improve efficiency of public enterprises	X	0	X	0	X	0	0	0	X	X	X	0	X	0
Improve institutional support for agriculture	X	X	X	0	X	0	0	0	X	X	X	0	X	0
Improve institutional support for industry	0	0	X	0	X	0	X	0	0	0	X	0	0	0
Improve institutional support for energy	0	0	0	0	S	0	S	0	0	0	X	0	X	0

X - Included in SAL on stabilization program.

0 - Not included in program.

S - Study to be undertaken.

/a Only indirectly as result of changes in trade policies concerning tariffs and restrictions and tax and credit incentives for exports.

/b Agreement that debt management unit to be established with World Bank technical assistance.

Source: World Bank

programmes and increase efficiency of organisation and production.[11]

The next steps in the development of cross-conditionality refers to the creation of the S.A.F. and to the increased lending by the World Bank to major bank debtors, particularly in the context of the "Baker initiative".

As regards bank debtors, the recent increase in cross-conditionality has occurred mainly via the growing role played by the World Bank - broadly in the context of the Baker initiative, but clearly beginning slightly before - in the management of the debt problem in Latin America. This is reflected in the increase in SAL lending to countries heavily indebted to banks (Costa Rica, Chile and Jamaica), as well as sector loans to major debtors (Brazil for export development and agriculture, Mexico for export development); it is also reflected in the growing catalyctic role for encouraging new private lending, via some type of guarantees (as in the cases of Chile, Uruguay and others). The arithmetic of the current debt crisis management strategy is such that the World bank steps in "to plug gaps" either directly and/or indirectly (via guaranteeing new private lendings) and brings its SAL or SEAL conditionality with it. It is noteworthy that smaller countries - both in Latin America <u>and</u> Africa - tend to accept SALs, whereas large countries however highly indebted have till now only accepted SEALs. The only fairly large country to accept several SAL's till late 1987, was Chile, country whose government is probably more committed to economic orthodoxy than the World Bank.

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11 For a discussion of the World Bank's role in recent reviews of the Chilean investment programmes see S. Griffith-Jones <u>Chile till 1991; the end of an era?</u> Economist Intelligence Unit 1987.

A final instance of emerging cross-conditionality arises from current U.S. thinking, behind the proposals presented by Secretary Baker at the 1987 IMF/Bank Meeting, to modify IMF lending policies. The stated objective of these proposals are related to the emphasis by the IMF on "structural measures needed to support growth and greater integration of these policies with macro-economic policies in order to enhance their overall effectiveness". One aspect of the proposal would clearly be welcomed by LDC governments, as it would imply, reducing the frequency of performance criteria and disbursements. However, the other aspect of the proposal imply a clear increase in cross-conditionality. The performance criteria of the IMF could include "structural reforms". The performance criteria could involve the following.

- Pricing measures such as raising producer prices, rationalising administered prices, and eliminating price controls

- Reform or privatisation of public enterprises, elimination of constraints to private sector activity

- Tax reform and strengthened financial management throughout the public sector

- Development and liberalisation of financial markets

- Trade liberalisation

- Removal of barriers to foreign investment, and development of proposals for realistic and workable debt/equity instruments

Structural performance criteria in this proposal, would complement, not replace, the Fund's traditional emphasis on macro-economic and exchange rate policies.

These proposals on IMF lending policies are accompanied by a suggestion to replace the CFF by a new facility (ECF), which would have far tighter conditionality, as it would only be granted to countries with stand-by or EFF or SAFs. Though again implying some positive element (eg. it would be a somewhat higher percentage of quota than the CFF at present), it would clearly imply a severe tightening of conditionality, as the CFFs previously semi-automatic nature (related mainly to external shocks) would disappear. If that happened, the IMF would have practically no low conditionality lending! This is in sharp contrast with the mid 1970's, when about three fourths of IMF lending had low conditionality!

E. The content of conditionality and cross-conditionality; the areas of debate

Cross-conditionality is to an important extent a problem, because of the controversial nature of the policy recommendations offered. We cannot here pretend to summarise the literature on this broad area, but only wish to draw out the central issues of controversy, between LDC governments and IFIs, as well as between IFIs and independent analysts.

Before discussing the areas in which cross-conditionality is most active and controversial, two caveats need to be made. Firstly, given the state of knowledge of economics and related social sciences, and the complexities of "the real world" most policy packages and development

strategies are controversial to some extent, and have some contradictory elements within them. (Indeed, extreme versions of dirigisme may be even more controversial and internally contradictory than the 'orthodox approach'). We are concentrating on a critique of the 'orthodox' package, not only because it seems very controversial and problematic in many aspects, but particularly because it is being pushed with such unjustified confidence on large number of LDC governments. A second caveat is that the debates relate to a number of different levels : choice of broad development strategy, choice of policy instrument, degree of use of particular policy instrument, timing and frequencing of its use. In what follows we will concentrate more on the first two.

<u>Areas of reform</u>

The areas of reform and their frequency in SAL programmes are presented in Table 3 , their overlap with IMF programmes were presented in Table 2. The most controversial areas seem to be the following:

a) <u>The basic model : Export led growth</u>

Particularly explicit in World Bank documents is the fact that the 'key objective' of structural adjustment is to achieve export-led growth. A more implicit assumption is that the external funding of structural adjustment will be forthcoming at sufficient levels; countries must adjust while servicing their debt to the multilaterally agreed levels, and hope that enough new lending will emerge to smooth the adjustment, and reduce the adjustment cost.

Table 3: Types of Policy Measure Requested in Return for SAL finance, 1980-October, 1986

Measure	Percentage of SALs Subject to Conditions in this area
Trade policy:	
Remove import quotas	57
Cut tariffs	24
Improve export incentives and institutional support	76
Resource mobilization:	
Reform budget or taxes	70
Reform interest-rate policy	49
Strengthen management of external borrowing	49
Improve financial performance by public enterprise	73
Efficient use of resources:	
Revise priorities of public investment programme	59
Revise agricultural prices	73
Dissolve or reduce powers of state marketing boards	14
Reduce or eliminate some agricultural input subsidies	27
Revise energy prices	49
Introduce energy-conservation measures	35
Develop indigenous energy sources	24
Revise industry incentive system	68
Institutional reforms:	
Strengthen capacity to formulate and implement public investment program	86
Increase efficiency of public enterprises	57
Improve support for agriculture (marketing, etc.)	57
Improve support for industry and subsectors (including price controls)	49

Source: P. Mosley, Conditionality as bargaining process: SAL Lending 1980-86 Essay in International Finance 168, Princeton University, October, 1987 based on World Bank data.

Several key questions arise in this context to which we will refer only briefly. Firstly, doubts must be raised on too much emphasis on export-led growth. On the one hand, are issues of supply elasticity. To what extent can changes in relative prices encourage increases in supply of goods that are tradeable in world markets; what is the time frame of such changes ? These questions are more relevant to low-income, less diversified economies than to middle income, more diversified economies; they probably are more relevant to agricultural products than to industrial products. Perhaps more crucial is the issue of world demand for increased exports and changes in supply of other countries. Particularly given current world market conditions, very uncertain expectations about their future evolution, the fallacy of composition arises particularly strongly; will not the aggregate effect of aggregating single-country expansion result in self-defeating price declines or run up against quota barriers?

Secondly, there is the issue of timing. Even supposing that export-led growth were a desirable model in the long-term (which is doubtful), the timing for extensive import liberalisation (seen by the World Bank as a pre-condition for export-led growth) is particularly poor in the eighties, and especially so for LDCs which are severely foreign exchanged constrained. Thus, a package of import liberalisation/export promotion is both costly (in development terms) and risky in the current international environment.

Finally, there is the assumption in the IFIs model that countries will service debts at multilaterally agreed levels, and that if sufficient new finance is not available, they will further adjust their economies mainly by lowering growth, or worse,lower GDP levels. The economic and

political feasibility and desirability of this is increasingly queried, particularly for countries with large negative net transfers.

b) <u>'Getting the prices right', is it enough?</u>

The World Bank and the IMF attach great importance to 'getting the prices right', so as to improve incentives for increased production and to remove distortions in resource allocation. In many aspects, these proposals contain positive elements (e.g. in improving domestic terms of trade for agriculture and avoid excessively low prices for state enterprises or para-statals). A number of problems arise however :

i) To what extent can nominal changes in relative prices lead to changes in 'real' ones; this issue is perhaps most important in relation to exchange-rate devaluation, and in relation to countries with high rates of inflation. Is the method and level of devaluation suggested by the IMF and World Bank, not only the most appropriate but also a sustainable one in real terms ? The type of answers will differ from country to country.

ii) To what extent are changes in relative prices <u>sufficient</u> to achieve the desired objectives ? For example, the underlying assumption behind a more active use of price incentives for agriculture is that supply is fairly elastic. However, if there are non-price impediments to increased supply (e.g. insufficient infrastructure, insufficient availability of key inputs or credit at the appropriate time) it is necessary to <u>complement</u> action on pricing policy with policy actions to reduce such bottlenecks. Where such actions requires substantial resources (for increased fixed

investment and working capital), this is particularly problematic, given limits imposed on government spending by foreign exchange constraints and by the programmes agreed with the IMF and the World Bank.

Another area where there is even more doubt about the effectiveness of response to price changes is that of interest rates. Even the IMF's own research[12] concludes that "it is still uncertain whether an increase in interest rates will, on balance, raise the savings rate". Furthermore, high interest rates may potentially increase savings, but be counter-productive by depressing investment, as the experience of the Southern Cone countries of Latin America has shown. In this case, the change in prices has a perverse effect, in relation to the ultimate target pursued: increase in investment.

In other cases, changing relative prices may have a positive effect on the immediate targets pursued, (increased production in agriculture or reduction of the level of government deficit) but may have a negative effect on other key variables, such as a decline in real incomes of the urban poor and urban workers. The World Bank report evaluating SALs openly admits these problems : "Reduction in budget and balance of payments deficits, as part of stabilisation/structural adjustment programmes <u>caused lower standards of living for significant numbers of individuals</u>. For the countries reviewed (those in Table 2), <u>it is clear that urban wage earners have suffered losses as wages did not keep up with inflation</u>. Public sector employees seem to have been especially hard hit, in virtually every country. Moreover, previously subsidised

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12 See M Kahn and M Knight <u>Fund supported adjustment programs and economic growth</u> Occasional Paper no 41, Nov. 1985.

or regulated prices of basic consumer goods, that account for a substantial part of total expenditures of low and middle income groups - such as foodgrains, electricity, public transport- have risen faster than other prices, as government subsidies have been substantially reduced or eliminated. Government spending cuts have also adversely affected public services such as education and health, that can be equally important to low and middle income groups. Gainers in the resulting income re-distribution appear to have been the owners of capital , farmers and the rural sector.

c) The human and developmental cost of adjustment; are there alternatives?

The point raised above is part of a larger concern. To what extent is structural adjustment as defined by the IFIs the most efficient response if evaluated from the point of view of long-term development, particularly from the point of view of satisfaction of basic human needs of the majorities ?[13] In this respect, UNICEF has posed the need for concern with 'human face' objectives to be explicitly accepted by national and international decision-makers, and its principles applied consistently at all levels of decision-making. Great emphasis is placed by UNICEF on the need for 'prioritising and selectivity', in government spending, credit policy, producer price policies, etc , so as to protect vulnerable groups from the cost of adjustment. An important issue - somewhat forgotten in the debate - is whether such prioritising and selectivity is feasible in a context where governments are being deprived (or depriving themselves) of many instruments (e.g. selective

13 For an excellent and comprehensive discussion, see A. Cornia, R. Jolly, F. Stewart (ed.) Adjustment with a Human Face. Oxford University Press 1987 and Siglo XXI 1987

credit and import policy) normally used for such a purpose. A second issue is the extent to which -in very resource constrained economies and governments- enhanced expenditure on protection of vulnerable groups is consistent with minimum levels of 'directly productive' investment. To what extent is a "humanly" oriented adjustment consistent with servicing the debt at current levels?

The crucial issue is the extent to which in different countries structural adjustment as carried out within the framework of advice from the IFIs , has increased poverty rates (either by its effects on growth and/or on relative income distribution). In the countries where this was the case, to what extent, could alternative adjustment policies -at a macro, meso and micro-economic level- have led to a more favourable outcome from the point of view of poverty minimisation as well as from growth maximization.

d) A fourth area of controversy in the recommendations of the IFIs relates to the size and role of governments in the economy. three linked, but separate issues can be distinguished here:

i) reduction of the government deficit.

ii) reduction of the size of the public sector, via privatisation of state enterprises.

iii) reduction of the role of government policy in economic management. Measures in the third category include for example liberalisation of the financial system and reduction in credit selectivity defined by the government or central bank.

Cross-conditionality has increased the influence of IFIs not just on the level of the budget deficit, but on its composition. In particular, public investment programmes have been the expenditure area of principal focus by the World Bank.

In its review of SALs, the World Bank notes that of 7 countries analysed in detail, 5 were able to lower budget deficits as a percentage of GDP between 1980 and 1984. However, in most cases revenues, as percentage of GDP also fell. The reduction of budget deficits was mainly achieved via, a cut in government expenditure. It concludes " The largest reductions, as might be expected took place in capital expenditure. Capital expenditure represented a smaller share of GDP in all seven countries by 1984 ". This mainly occurred by curtailing investment in the state enterprises. The reduction of public investment in reality 'kills three birds with one stone'from the World Bank point of view. It clearly reduces the budget deficit (which may be a necessary objective, but one that could be achieved by other means, e.g. reduction in taxation). However, it also reduces relatively the size and importance of the state sector in the economy, as well as reducing the role of government policy in economic management.