INTERNATIONAL MONETARY FUND

FACTSHEET

IMF Conditionality

When a country borrows from the IMF, its government agrees to adjust its economic policies to overcome the problems that led it to seek financial aid from the international community. These loan conditions also serve to ensure that the country will be able to repay the Fund so that the resources can be made available to other members in need. Lending reforms approved in 2009 streamlined IMF conditionality in order to promote national ownership of strong and effective policies.

Designing effective programs

Conditionality in its broad sense covers both the design of IMF-supported programs—that is, the macroeconomic and structural policies—and the specific tools used to monitor progress toward the goals outlined by the country in cooperation with the IMF. Conditionality helps countries solve balance of payments problems without resorting to measures that are harmful to national or international prosperity. At the same time, the measures are meant to safeguard IMF resources by ensuring that the country's balance of payments will be strong enough to permit it to repay the loan. All conditionality under an IMF-supported program must be either critical to the achievement of macroeconomic program goals or for monitoring implementation, or necessary for the implementation of specific provisions under the IMF's Articles of Agreement and policies thereunder.

The member country has primary responsibility for selecting, designing, and implementing the policies that will make the IMF-supported program successful. The program is described in a letter of intent (which often has a memorandum of economic and financial policies attached to it). The program's objectives and policies depend on country circumstances. But the overarching goal is always to restore or maintain balance of payments viability and macroeconomic stability while setting the stage for sustained, high-quality growth and, in low-income countries, for reducing poverty.

How compliance with program conditions is assessed

Most IMF financing are disbursed in installments and linked to demonstrable policy actions. This aims to ensure progress in program implementation and to reduce risks to the IMF's resources. Program reviews provide a framework for the IMF's Executive Board to assess periodically whether the IMF-supported program is on track and whether modifications are necessary for achieving the program's objectives. Reviews combine a backward-looking assessment (were the program conditions met according to the agreed timetable?) with a forward-looking perspective (does the program need to be modified in light of new developments?).

The approval of an IMF arrangement or of reviews are based on various policy commitments agreed with the country authorities. These can take different forms:

- **Prior actions** are measures that a country agrees to take before the IMF's Executive Board approves financing or completes a review because their upfront implementation is critical in order to achieve program goals or monitor implementation. They ensure that the program has the necessary foundation to succeed, or is put back on track following deviations from agreed policies. Examples include the elimination of price controls or formal approval of a budget consistent with the program's fiscal framework.

- **Quantitative performance criteria (QPCs)** are specific and measurable conditions. QPCs always relate to macroeconomic variables under the control of the authorities, such as monetary and credit aggregates, international reserves, fiscal balances, and external borrowing. For example, a program might include a minimum level of net international reserves, a maximum level of central bank net domestic assets, or a maximum level of government borrowing.

- **Indicative targets** may be established in addition to QPCs as quantitative indicators to assess the member's progress in meeting the objectives of a program. Sometimes they are also set when QPCs cannot be, because of data uncertainty about economic trends (e.g., for the later months of a program). As uncertainty is reduced, these targets are normally turned into QPCs, with appropriate modifications.

- **Structural benchmarks** are (often non-quantifiable) reform measures that are critical to achieve program goals and are intended as markers to assess program implementation during a review. They vary across programs: examples are measures to improve financial sector operations, build up social safety nets, or strengthen public financial management.

If a QPC is not met, the Executive Board may approve a formal waiver to enable a review to be completed, if it is satisfied that the program will nonetheless be successfully implemented, either because the deviation was minor or temporary, or because the country authorities have taken or will take corrective actions. Structural benchmarks and indicative targets do not require waivers if they are not met but are assessed in the context of overall program performance. The IMF's database for the Monitoring of Fund Arrangements (MONA), which is publicly available, covers all aspects of program conditionality.

Conditionality framework continues to evolve

IMF lending has always involved policy conditions. Until the early 1980s, IMF conditionality largely focused on macroeconomic policies. Subsequently, the complexity and scope of structural conditions increased, reflecting the IMF's growing involvement in low-income and transition countries, where severe structural problems hampered economic stability and growth.

In recent years, the IMF has become more flexible in the way it engages with countries on issues related to structural reform of their economies. The guidelines on conditionality were revised in 2002 following an extensive review. In March 2009, the IMF further modernized its conditionality framework in the context of a comprehensive reform to strengthen its capacity to prevent and resolve crises. In particular, structural performance criteria requiring formal waivers were discontinued, and structural reforms, which should be focused and tailored to member countries' different policies and economic starting points, are covered by reviews of overall program performance.

In 2012, the IMF Executive Board discussed staff papers reviewing the guidelines on conditionality. The review highlighted the IMF's efforts to draw lessons from previous crises and provide better targeted and flexible lending. It found conditionality in programs to be generally better tailored to individual country needs, more streamlined, and better focused on core areas of IMF expertise than in the past. Programs have also adapted flexibly to changing economic circumstances, which has helped to achieve program objectives and safeguard social protection during crises (particularly in low-income countries). While the review found that the IMF's conditionality guidelines were broadly appropriate, it highlighted areas where further strengthening in implementation of underlying policies might be required. Hence, subsequent changes to the operational guidance to staff were primarily focused on conditionality in relation to "macro-social" (or jobs and growth) issues, better leveraging of surveillance and technical assistance in program design, and improving partnerships with other institutions. It also added guidance on the review-based approach to monetary policy conditionality in countries with inflation-targeting frameworks or evolving monetary policy regimes.

The IMF's debt limits policy is an integral part of IMF conditionality. A review of the policy in 2014 pointed to the need for reforms in its design and application in light of the evolving needs of low-income countries amid the changing global financing landscape. In response, a new policy became effective in June 2015. The new policy encompasses all public debt rather than only external public debt, integrates treatment of concessional and non-concessional external debt, and provides closer links between public debt vulnerabilities and the use and specification of public debt conditionality.