Conditionality in Latin America

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Introduction

In Latin America, since the end of the 1980s, the IMF and the World Bank imposed conditionality directly linked to the launching of structural adjustment programs, more commonly known as the Washington Consensus. The shift towards these pro 'free trade' policies not only marked the Multilateral Development Banks' (MDBs) agenda but also the agenda of most of the funds allocated by OECD countries to international cooperation (what is commonly called Official Development Assistance).

However, the failure of neo-liberal policies in the economic field (Asian crisis of 1997, Russian crisis of 1998, Brazilian crisis in 1999) led to serious questioning, especially important in the academic field (for example, the work of Dani Rodrik, Joseph Stiglitz and also, Paul Krugman).

Strong political trends arose in Latin America, presenting different economic policy alternatives, aimed at a new equation for state and market relations, together with deepening, and in some cases, construction, of democratic institutions and measures of governability, which grant long term viability to the countries' economies and societies.

The ground gained by these initiatives can be seen in the fact that many governments in Latin America have an approach to economic policy that departs from the concepts of free market. While there are marked differences between countries' economic policies, it can be said that Argentina, Bolivia, Brazil, Chile, Ecuador, Nicaragua, Uruguay and Venezuela are oriented by this new framework[1].

Together with these proposals, there are important initiatives, which also go in the same direction, at the international level. First should be mentioned the United Nations Millennium Summit that proposed the Millennium Development Goals to which all participants adhere. This new way of proposing development objectives, especially for the reduction of poverty, and others, has had an impact on the formulation of policies in several countries in the Region

To this can be added the Conference on Finance for Development (Monterrey, 2002), that posed the formulation of a global policy constituted by six points: mobilization of internal resources for development, direct foreign investment, external debt, trade policies, official development assistance (ODA), and the systemic approach to a new international financial architecture. While progress has been scarce, these constitute a platform as a basis to move forward in changing economic policy.

Multilateral Banks have also had to change their traditional approaches to conditionality, at least in their speech. As is known, for many years the most important conditionality, in economic terms, has been the so called monetary approach of the Balance of Payments, used by the IMF. Today, the IMF has changed the definition of conditionality, binding it to the PRSP, but its essence has not changed, as we will see later.

The same happened with the World Bank. Initially their loans were to 'promote sectoral development' (infrastructure, education, health) and did not have conditionality. But, Policy Loans were instituted from the end of the 80's, where conditionality was linked to countries implementing structural reforms with neoliberal content (privatization, financial reform, trade reform, labor market reform, among others.)

After the publication of the book 'The East Asian Miracle' (1993), followed by the presentation of second generation reforms, the World Bank started to become self critical to a certain degree,. The problem here is that the WB never abandoned the economistic approach of the first generation reforms (Washington Consensus), but said that in order 'for them to operate', second generation reforms should be adopted.

Afterwards, new initiatives arose (Conditionality Revisited, 2005), which led to the adoption of 'Good Practice Principles for the application of Conditionality', also in 2005 (see later).

The Inter American Development Bank (IADB), a regional bank, is a major player in granting loans to Latin American countries. This bank continued, broadly speaking, the same policies of the World Bank, from the late 1980s. The IADB also became self critical but, like the WB, it has been fundamentally rhetorical.

Industrialized countries are directly responsible for the policies of IMF and World Bank, as they have a majority of votes in both agencies. While it is not the case for the IADB, it is no less true that the USA has the right of veto in what refers to 'fundamental changes' in IADB policies. There has also been a tendency of 'bilateralization' of multilateral aid, through special funds that countries allocate to the multilateral agencies[2].

As multilateral agencies provide the largest amount of funds, conditionality of industrialized countries has been less in regard to the granting of 'Official Development Assistance"' However, as is known, the amount of aid disbursed has always been far from 0.7% of GDP. In what concerns conditionality, the main criticism of the countries is that, in most cases, ODA has followed the donor countries' individual guidelines, without any greater coordination with them, and even less, with the policies of recipient countries themselves (when these existed)

For several years, but especially since the beginning of the new millennium, more specific changes in external aid policies and international cooperation have been proposed in some industrialized countries. This is the case of the Nordic countries and the United Kingdom. More recently, in 2005, the High Level Conference held in Paris in 2005 proposed the reformulation of international external aid policies as the axis (see below).

As in this document we analyze conditionality, we do not get into the analysis of recipient countries' performance, which has been addressed in the Ownership Paper. But we want to highlight two themes: 1) much has been talked about changes in conditionality, but achievements are few; 2) the attitude of recipient countries and their willingness to change policies is very important. So, we believe that approaches such as launching the South Bank, using the international reserves of countries that promote it, could be an important step forward. We will be waiting for the final documents of the constitution of this bank (in December 2007) to be able to emit a definitive opinion on its objectives, loan mechanisms, duration and rates of interest, also on the conditionalities if there are any.

Recent aspects of IADB's conditionality

The Inter American Development Bank has recently undertaken diverse analyses of the evaluation of their loans, especially through the Office of Evaluation and Oversight (OVE)[3]. We reviewed several recent OVE's documents, which analyze some countries' performance, taking as a starting point the Bank´s Country Strategy formulated by the IADB. The countries analyzed by OVE in 2006 and 2007 (after the High Level Conference in Paris) were Costa Rica, Haiti and Honduras.

In all the documents analyzed, we found that IADB affirms the need to recommend that 'the Bank should not structure its countries' programs around goals and objectives related to structural reforms'[4]. They go on to say that the IADB should propose 'appropriate realistic levels, taking into account the country conditions'. In the same document, they make it clear that, from 2003 to 2006, the starting point for its approach was to assume that a direct relationship exists between economic growth and poverty, despite the 'stability' of poverty rates in Costa Rica since 1994. The OVE document on Honduras explicitly stated that one of the problems found is that 'the Bank's effectiveness and efficiency have been constrained by the difficulty to incorporate the country's bureaucracy in to the execution of the Bank's program', showing us that little has been assimilated from the Paris Declaration[5].

OVE's working proposal document for 2007 (Office of Evaluation and Oversight Annual Report 2005–2006 and Working Plan and Budget Proposal for 2007) establishes that the Bank should be aligned to a 'new business model based on results and risk management', a topic also addressed in various World Bank's documents and which is being introduced to the ministries of different countries of the Region[6].

A 'new technique' ('evaluation by results') leads us to ask this central question: what is the economic and social policy that should be applied in order to achieve these results? This new 'approach' (that programs, loans and national budgets are no longer based on objectives but on outcomes) diverts attention to 'technique' and separates it from what is essential: conceptual and social frameworks of the economic policy in force.

This is corroborated with IADB's definition of 'institutional strategy' in its 2006 Annual Report (published in April 2007); where the Bank establishes four pillars that guide its work: modernization of the State, competitiveness, social development and integration. IADB states that 25 loans for a total of US$ 1,5 billion and 92 technical cooperation projects were approved for the 'Modernization of the State' objective[7], introducing new themes and innovative approaches' (Annual Report, 2006).

Recent aspects of World Bank's conditionality

Much has been written about the recent evolution of the World Bank's approach to conditionality, especially from the analysis of two central documents, Conditionality Revisited (2005) and Good Practice Principles, adopted in the Review of World Bank Conditionality (DC2005–0013), September 9, 2005. Among those works, we can mention Angela Wood, EURODAD and Nuria Molina's papers.

The World Bank papers proposed five Good Practices Principles 'to strengthen the quality of the Bank's application of operational policy for development policy lending (DPL), which are summarized in Box 1, below' (World Bank, 2006). Regardless what these documents say, the central issue is that the definition of conditionality of the World Bank has changed very little. The following is the definition of the World Bank (2006a).

Box 1. Good Practice Principles

Ownership: Reinforce country ownership.

Harmonization: Agree up front with the government and other financial partners on a coordinated accountability framework.

Customization: Customize the accountability framework and modalities of Bank support to country circumstances.

Criticality: Choose only actions critical for achieving results as conditions for disbursement.

Transparency and predictability: Conduct transparent progress reviews conducive to predictable and performance-based financial support.

Definition of World Bank Conditionality

Conditionality, in the World Bank context and for the purposes of this paper, is defined as the set of conditions that, in line with the Bank's Operational Policy 8.60, paragraph 13 must be satisfied for the Bank to make disbursements in a development policy operation. These conditions are (a) maintenance of an adequate macroeconomic policy framework; (b) implementation of the overall program in a manner satisfactory to the Bank; and (c) implementation of the policy and institutional actions that are deemed critical for the implementation and expected results of the supported program. Only these conditions are included in the Bank's loan agreements.

In Peru's case, the recent Fiscal Management and Competitiveness Development Policy Loan (DPL) (World Bank, 2006a), clearly states that Peru's Country Program Strategy (CPS) is the basis to grant this loan. CPS's objectives are: 'maintaining macro stability; accelerating growth and widening the base of growth; and modernization of institutions[8]' (World Bank, 2006a).

One appreciates that World Bank's core conditionality has not changed.[9] This is confirmed with the analysis of one of the 'triggers' that the loan has to carry out in order to be disbursed. In this case, the conditionality applied refers to continued fiscal discipline, which includes a limit of 3% real annual increase in current expenditure, monitored by the Fiscal Policy Committee and the Republic General Controller, at all levels of government[10]. (World Bank, 2006a).

Recent aspects of IMF conditionality

IMF's point of view regarding conditionality is well known, and has been widely studied in recent years. Despite their statements about the decline in terms of conditionality, as well as the number of conditions, it is clear that this organisation has not changed its basic parameters[11].

It is important to mention the fact that, in Latin America, in recent years, few countries have taken out loans from the IMF. In South America, as an example, the following countries have no agreement: Argentina, Brazil, Bolivia, Colombia, Chile, Ecuador and Venezuela. Only two countries have an agreement: Paraguay and Peru. In smaller countries from Central America and the Caribbean, the situation is variable. Honduras and Nicaragua have an agreement with the IMF (within the Poverty Reduction and Growth Facility – PRGF – framework) as well as Haiti (PRGF), whereas the Dominican Republic has a Standby Arrangement (September 2007).

It should also be said that Argentina, Brazil, Uruguay and Ecuador pre-paid its debt to the IMF for not having to submit to IMF's conditionality. This issue deserves to be more broadly studied, because IMF's loans have been considerably reduced in the past two years.[12]

Recent aspects of industrialized countries' conditionality

Industrialized countries' conditionality is mainly related to Official Development Assistance (ODA). Its most recent development has been the High Level Conference in Paris in 2005. This issue has been widely developed in Mariano Valderrama's paper on Ownership; so we will not discuss this further in this paper.

However, it should be highlighted that the relative importance of ODA has been declining for several years and that its importance is at present lower than private capital flows in absolute and relative terms. While the abundance of these flows does not imply direct conditionality, it is no less true that the international capital market (bonds, private loans) take IMF and World Bank analyses and views as a reference. In other words, 'sound and coherent policies', which are no other than neoliberal policies, should be followed by this countries. Having said this, ODA is still very important for the poorest countries, which cannot access private capital flows in the international capital markets.

Conclusions

The situation of Latin American countries must be understood in a differentiated way. There are large economies, medium economies and small economies. For this reason, a single undifferentiated analysis is not possible.

The current international economic situation has allowed significant improvement in the prices of raw materials for Latin America exports: mainly minerals, oil and agricultural products. For this reason the Region's economic situation is in a relative boom. Additionally, migrants' remittances also constitute an important entry of foreign exchange for many countries, particularly for Central America's poor countries.

However, a single analysis is not possible. For example, all Central American and Caribbean countries (small countries) lack oil (except for Guatemala), which gives a slant to previous information.

That is why we consider it important to suggest the carrying out of an analysis of cases. The global vision does not contribute to the understanding of particular situations.

In what relates to conditionality, a first problem is the large number of actors in this process; starting from the IMF, the multilateral development banks, donor countries' agencies, to which United Nations agencies and development NGOs should be added. In this sense, it is quite difficult to unify conditionality criteria, although we consider as positive the progress achieved at the High Level Conference of Paris in 2005, despite its limitations.

In general terms, it can be said that the negotiation of international cooperation is tied to considerations of political negotiations with the host State in geopolitical, trade and investment topics. This is the case of cooperation with Central American countries. In Colombia's particular case, its relations with the USA are emphasized, where this country's conditionality for assistance is guided by safety interests related to the fight against drugs (Plan Colombia).

Changes in the multilaterals' conditionality are based more on 'cosmetic' changes than on real changes, as demonstrated by different recent analyses. Under these circumstances, the pressure for changes in conditionality must be understood as a component of changes in broader aspects of multilateral agencies' governance and democracy (Quota/vote mechanism; election of Presidents of the IMF and World Bank).

We consider important that, besides the analysis of the fact that the number of conditionalites has not changed (as shown by EURODAD) it should be possible to clearly establish that the main problem has to do with the concept of alternative approaches to development needed by the countries. A new proposal is needed, posing a new equation for the roles of the market, the State, and of civil society, and construction of institutions that guarantee long-term governance.

This conception opposes the 'loans for results' or 'results budget' proposal, which is currently being adopted by multilateral organisations. This proposal aims to empty the contents of the roles of the market and the state, focusing instead in the results to be obtained.

In the analysis we have seen the importance that multilateral organisms attach to 'State modernization to achieve competitiveness', understood as the achievement of fiscal balances and ensuing controls on the current expenditure. However, little or nothing is said about a tax reform that would enable the Region's countries to make investments in infrastructure, health and education, precisely those investments that allow to raise competitiveness.

This issue is linked to the mobilization of internal resources, proposed by the Conference on Financing for Development in Monterrey. From my point of view, the 6 points mentioned in the Monterrey Conference, mentioned previously (and which include ODA) should always be considered as the central point of support in initiatives and relations with donor countries.

An adequate elaboration on this issue, starting from civil society, will allow us to have better tools to discuss conditionalities related to State reforms, from a neo-liberal point of view.

One of these examples, which we did not develop in this paper, is various Latin American countries' growing initiative to constitute the Bank of the South. This Bank is conceived, expressly, as an alternative to World Bank and IADB. In this sense, it extends the development of criticism to the Washington Consensus previously mentioned. This Bank of the South will not have conditionalities and its resources will come from international reserves of its member countries, which are greater than US$ 150 billion.

The initiative must be closely followed because, in fact, it could be the starting point for alternatives where there is no conditionality. However, once again, this initiative is spearheaded by Latin America's large countries and the smaller countries remain outside. It is known that the World Bank, the IADB and Washington do not welcome the Bank of the South, for the reasons outlined. If it should really materialize, it could indeed be an important tool that contributes to change conditionality in multilateral organisms and donor countries.

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Endnotes

1 Argentina, Brazil and Ecuador pre-paid their loans to the IMF so that they do not have to follow its conditionality. This topic will be further developed.

2 'However, there has been a trend towards the 'bilateralization` of multilateral aid, as donor countries began to use multilateral institutions in the mid-1980s to manage their own bilateral aid programs, primarily by establishing trust funds and co-financing projects. This has reduced the amounts of 'core' resources available to multilateral institutions, increased the proportion of 'non-core' resources provided by donor countries for specific purposes, and led to hidden subsidies as donors rarely pay the full administrative costs associated with the use of non-core resources' (Sagasti, 2005).

3 http://www.iadb.org/ove/Default.aspx?Action=WUCHtmlAndDocuments@Methodology

4 'The lessons learned from the way in which the 2003–2006 Bank Country Strategy with Costa Rica (BCS–CR) has unfolded once again demonstrate the need to recommend that the Bank should not structure its programming exercises around targets and objectives relating to structural reforms. The Bank's support for such efforts on the country's part should focus on technical assistance and on economic studies and analyses. The new BCS-CR should be based on the lessons learned from previous programming efforts and should propose realistic approval levels in keeping with conditions in the country' (OVE Costa Rica).

5 'The Bank's effectiveness and efficiency have been attenuated by the difficulty of incorporating the execution of the Bank program into the country bureaucracy. The model of intervention based on project-executing units has contributed to this difficulty' (OVE Honduras).

6 The General OVE states: '(i) improvements are needed in the design stage of projects to develop better results frameworks, to gather baseline data and to establish/strengthen borrowers' monitoring and evaluation systems with a view to continue with the progress of projects in terms of achieving results; (ii) is necessary to promote links between the Bank and borrowers' information systems, to improve the results of information at country, sector and project level; (iii) risks at country and projects level have to be more explicitly

defined, prioritised and managed over the loans' cycle, and (iv) greater supervision is required for dealing with initiative risks and projects' implementation problems .

7 'Modernization of the State operations covered a wide range of categories: fiscal, financial and public sector reforms, decentralization and sub-national governments development, public safety, civil society participation, justice administration, electronic public administration, ethics and planning' (IADB, Annual Report, 2006).

8 'Link to Country Partnership Strategy and Other Bank Operations. This programmatic series on improving fiscal management and competitiveness is at the core o f the CPS's proposed assistance program, and is envisioned as part of the country's base-case lending scenario. The CPS foresees several thematic 'clusters' forming the basis of the Bank's partnership with Peru, and this proposed loan series directly addresses aspects of maintaining macro stability; accelerating growth and widening the base of growth; and modernization of institutions. Policies which form part of the FMCDPL series include, among other reforms, simplifying and improving tax collection, controlling sub-national debt, implementing incentives for greater sub-national revenue creation and judicious use of natural resource revenues, promoting performance-based budgeting, expanding e-governance procedures, streamlining administrative obstacles faced b y the private sector, and strengthening Peru's ability to take advantage of opportunities offered by international trade. All of these directly promote the goals stated in the CPS', page 26.

9 We did not analyze how many conditions WB's loans have at present, an analysis that would be important to be done in order to compare its results with recent EURODAD's analysis.

10 Triggers for FMCDPL II: Comply with fiscal rules-including a limit of 3 % real increase annually on current spending-with a fully functioning Fiscal Policy Committee, and Comptroller is monitoring compliance with fiscal rules to all levels of government. *This trigger is intended to ensure a continued disciplined fiscal stance, which is an essential precondition for Peru to achieve the levels of growth it has targeted, as has been amply documented in numerous Bank studies, including the Country Economic Memorandum, the Bank thematic policy note on growth, and Bank policy notes on macroeconomics and the fiscal framework* (page 19).

11 Despite apparent acceptance of the need for greater ownership, and the IMF staff's findings that prior action conditionality has not been useful for signalling commitment to reform, the IMF's Board has not been able to agree on scrapping them. Contrarily, the board has argued that the use of prior actions should be minimised but they are still useful to signal ownership, where a government's commitment appears to be weak. The recent IMF review of conditionality streamlining (2005) found that prior action conditionality continues to be used as a screening device in the face of difficulties in gauging ownership. (Angela Wood – Cidse)

12 'IMF credit outstanding at the end of FY2007 declined to SDR 7.3 billion from SDR 19.2 billion in April 2006, owing to continued early repayments of outstanding loans and a low level of new disbursements. During FY2007, nine members – Bulgaria, the Central African Republic, Ecuador, Haiti, Indonesia, Malawi, the Philippines, Serbia, and Uruguay – repaid their outstanding obligations to the IMF ahead of schedule, for a total of SDR 7.1 billion. IMF disbursements totaled SDR 2.3 billion, the bulk of which went to Turkey' (IMF Annual Report, 2007).