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Expansive agendas and weak instruments: governance related conditionalities of international financial institutions

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Expansive Agendas and Weak Instruments: Governance Related Conditionalities of International Financial Institutions

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This paper analyzes the new lending conditionalities of the Bretton Woods institutions in the area of "governance" in a sample of twenty-five upper tranche arrangements in 1999. It finds that the scope and number of conditions, defined both narrowly and loosely, have expanded. Is this expansion likely to improve the quality of the development process? The paper's findings are negative based on a retrospective analysis of the effectiveness of conditionalities in shaping borrower behavior as well as the content of the current agenda with respect to three important issues: the problems posed by aggregation and trade-offs among conditionalities; the relative emphasis on external versus internal factors; and the temporal dimension of the institutional underpinnings of "good governance." The paper argues that the pessimistic prognosis is further reinforced when taking into account the governance and interests of the IFIs themselves and their consequences on the content and enforcement of conditionalities.

Keywords: IMF; World Bank; IDA; Governance; Conditionality; sovereignty

I. Introduction

The last decade has witnessed a weakening of developing country nation states relative to a multitude of transnational and local actors. Although the precise causes and degree of this weakening are a matter of considerable debate, the

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trend is unambiguous. A notable manifestation of this weakening is the extent to which developing countries have to conform to global standards and rules that they have little influence in crafting. An important mechanism in getting developing countries to accede to global standards is through the lending conditionalities of the International Financial Institutions (IFIs). This paper examines IFI conditionalities in the area of "governance" – a critical component of hitherto sacrosanct notions of sovereignty, but increasingly fair game for pressure from international forces.

The paper first examines the different rationale for IFI conditionalities and their evolution, particularly in the area of governance. It then attempts to document these conditionalities, pointing to the many caveats to precise quantification. Section III examines the historical record of this instrument: how effective have conditionalities been in the past in shaping borrower behavior, especially in issue areas that are congruent with the governance agenda? Section IV examines the impact on the quality of the development process, focusing on three issues: the problems posed by aggregation and trade-offs among conditionalities; the relative emphasis on external versus internal factors; and the temporal dimension of the institutional underpinnings of "good governance." Finally, the paper examines the governance and interests of the IFIs themselves and the consequences for the effectiveness of their governance agenda: *Quis custodiet ipsos custodes*? Who guards the guardians?

II. Conditionality: Rationale and Evolution

International agreements or collaborations – as exemplified by the relationship between the IFIs and their borrowers – must consider the risk of noncompliance that could arise by accident or opportunism. Different market mechanisms have evolved for dealing with this risk. First, ex ante demands on borrowers can be raised. By requiring larger concessions, the actor may be able to improve the expected outcome by enough to compensate for the risk of a breach. Second, parties could structure the agreement to control the level of risk, perhaps by including some hand-tying strategies. Markets have used a combination of higher risk premia, greater collateral, and shorter duration agreements to address this risk. None of these alternatives are available to IFIs; to a considerable degree they would vitiate the broader public purposes of the institutions. In the absence of such market mechanisms, it is argued that there is no alternative to conditionalities. In the absence of credible enforcement mechanisms, conditionality has been seen as a mechanism to overcome incentive problems leading to commitment failure.[1] IFI conditionalities (especially those of the IMF) have also been viewed as screening devices that enable a creditor to separate those debtor countries that are willing to use the additional IMF resources to invest and repay from those that are not (Marchesi and Thomas, 1999).

The introduction and growth of governance-related conditionalities (GRCs) in the IFIs are part of the evolution of the institutions themselves and the changes in their environment.[2] The original rationale of conditionality was to protect the financial integrity of the Bretton Woods institutions. It was particularly suited to the IMF's role in policing global systemic stability. However, in that role, the IMF's conditionalities had a narrow macro focus on monetary-fiscal issues. In the case of the World Bank, its conditionalities had a similarly narrow focus, concentrating on micro sector-specific financial issues. Conditionality gained greater importance in the IMF in the 1970s. The gradual increase of quotas relative to world trade led to higher levels of lending relative to quotas; with higher levels of lending came greater conditionality. The shift was pushed further by the mid-1970s, when industrialized countries effectively ceased borrowing from the IMF. Conditionality became much more central to the Fund's operations only in 1979, after the IMF's Board issued guidelines that effectively made it possible for the IMF to become a lender of first resort rather than just a lender of last resort. This coincided with a greater weight given to lending in order to enhance supply-side responses, for example, through addressing structural problems (de Vries, 1985, Ch. 25 and 26). The expansion of lending conditions followed thereafter.

In the World Bank's case, overt Fund type conditionalities were introduced through structural adjustment lending that commenced in 1980. During the 1980s, the scope of these conditionalities both widened and deepened as they embraced the liberalization agenda encapsulated in the "Washington Consensus." Traditional aggregate conditions on fiscal and monetary criteria became increasingly fine-tuned as sub-criteria (both ceilings and floors) proliferated. Additionally, general conditions expanded, for instance, on debt ceilings and arrears. Sub-criteria on these then proliferated as the IFIs scrambled to plug what seemed to be ever increasing leaks in the ship of the state. The micromanaging (for better or worse) was evident in the increasing number of conditions. In the IMF's case through 1982, less than five percent of upper tranche arrangements contained more than eleven or more performance criteria. By the end of the decade, more than two-thirds of such arrangements had eleven or more criteria. The average number of criteria rose from about six in the 1970s to ten in the 1980s (Boughton, 1999). In the Bank's case, the average number of conditions rose from 32 in 1980–83 to 56 by the decade's end.

Enter Governance

Governance issues had come to the fore in the World Bank's thinking by the end of the 1980s, especially with regard to Africa. However, in a fundamental sense, the issue was just one of the many waves thrown up when the cold war began to thaw. Quite simply, international political culture has changed significantly enough that state sovereignty is far less sacrosanct in international discourse: rules and norms are changing in a manner that weakens the "sovereignty" defense against intervention. The establishment of the International Criminal Court and of international conventions that allow crimes against humanity to be tried in countries where they were not committed provide examples of this shift. If the Pinochet case became the trend-setter, the indictment in early 2000 of former Chadian dictator, Hissène Habré, for "torture and barbarity" in a Senegalese court has broken a taboo on sovereignty in African countries as well. The extraordinary reaction in the EU over the inclusion of Mr. Jorg Haider's Freedom Party in the Austrian ruling coalition exemplifies the degree of this shift. The UN Secretary General, Koffi Annan, has made it clear that its members can no longer hide behind protestations of national sovereignity when they flagrantly violate the rights of citizens, arguing that "nothing in the [United Nations] Charter precludes a recognition that there are rights beyond borders (*New York Times*, September 21, 1999)." Increased governance conditionalities can be seen as part of this ideological trend.

Additionally, "aid fatigue," civil society pressures from borrowing countries, the particular loss of power and leverage of low-income LDCs within the international community, and epistemic changes driven by new research findings in political economy have added to the pressures driving toward governance related conditionalities (GRCs) in IFIs. The Bank in particular has put considerable resources in trying to "prove" that "governance matters" for "sustainable development" (it is not clear that prior generations had argued otherwise), and a large literature on this subject has grown in recent years (Kaufmann, Kraay, Zoido-Lobatón, 1999).[3] In September 1997, the World Bank adopted a policy statement that "corruption should be explicitly taken into account in country risk analysis, lending decisions, and portfolio supervision if it affects project or country performance." As has been the case with the World Bank since the 1980s, IDA replenishments have become the mechanism to push through changes in the institution at large. The inclusion of GRCs in the Bank's agenda was amplified by IDA 12, negotiated in 1998, which stated unambiguously, "good governance is *critical* to the development process and to the effectiveness of development assistance; this is a *key* concern of the IDA Deputies (IDA 12, 1998, emphasis added)." The changing reality has not been lost on African finance ministers (whose countries bear the brunt of GRCs), who recently agreed to meet loan conditions set by foreign donors and eliminate corruption as long as the countries were given an opportunity to fully discuss the conditions. "In the face of declining official development assistance, there is a realization and acceptance among African countries that individual countries will have to justify their case for additional assistance. This must be on the basis of high performance on the issues of good governance, observance of the rule of law and zero tolerance for corruption."[4]

In the Fund's case, the sharply enhanced role of private capital markets for developing countries led it to elaborate a new rationale for conditionality – giving confidence not only to the IMF but to private creditors as well. According to this rationale, poor borrower predictability meant that countries needed to establish a reputation for predictable behavior, and conditionality was the mechanism by which to achieve that credibility; in other words, conditionality was the bridge across the "predictability gap." Hence, instead of being imposed, the new argument went, conditionality was a sought after instrument that governments used to signal the predictability of their policies to private creditors. This new rationale for conditionality was interpreted as implying a substantially "far-reaching extension in the scope of needed reforms," especially a "strengthening of the whole civil administration, in particular the judiciary (Dhonte, 1997)." Finally, the expansion of the IFIs' conditionalities are a logical extension of their "mission-creep," expressed for instance in the widening agenda of the IMF's Surveillance and Article IV consultations (IMF, July 15, 1999). We shall return to this issue later.

Although "good governance" became enshrined in the commandments of the IFIs, the term eludes operational precision. Governance has been loosely equated with the term "good government," which for the IFIs is deemed to have four principal components: sound economic policies, competent public administration, open and accountable government, and respect for the rule of law. Inherent in these components are the requirements of a liberal democratic state: a limited role for the state and (relatedly) an economy guided principally by market forces and open to international exchange. These two pillars should be strengthened by the supportive elements of transparent government, popular participation, accountability of rulers, and a strong and autonomous civil society. The polysemous nature and elasticity of the terms makes them all the more appealing to the IFIs who, not surprisingly, rarely speak directly of "governance" in their negotiations or agreements. Consequently, GRCs are, to a considerable extent, a matter of interpretation.

Whatever the definitional ambiguities, the IFIs' own interests, or those of its ever-widening stake-holders, the importance of the issue of GRCs and its resonance within developing countries, particularly with regard to corruption and accountability, cannot be overemphasized. The IFIs, as external agencies of restraint, have tapped into these wells of deep discontent. Their rationale therefore is obvious. However, this admittance still leaves three critical questions to be answered. One, do the IFIs have the mandate and the comparative advantage and competencies in this area? Two, given the vast terrain and range of issues that "governance" potentially covers, do they have their priorities right? And three, going beyond the "can they" and the "what" is the "how:" is the manner in which the IFIs have chosen to address this complex issue appropriate?

Documenting Conditionalities

There are two principal questions in measuring GRCs. First, what constitutes a "conditionality"? And second, what constitutes "governance"? A strict interpretation of traditional IMF conditionality would restrict itself to traditional quantitative "performance criteria," including "prior actions," "quantitative targets," and "structural benchmarks." But program documents go much farther; these documents have numerous "program objectives" and lay out "strategies and measures" to meet them. The language in the latter is awash with governments' promises to "adopt," "assess," "authorize," "build upon," "complete," "continue," "discontinue," "define," "ensure," "expand," "establish," "examine," "fill," "introduce," "improve," "increase commitment to...," "mobilize," "organize," "prepare," "pursue," "redefine," "reform," "reverse," "streamline," "strengthen," "study," "support," "update," "upgrade," – all sorts of worthy objectives. Sticking to the narrowest definition would be misleading because it would amount to saying that all of these other criteria mentioned in IFI documents are simply hogwash, no more than a Keynesian program to provide employment to their bureaucracies. If not, we should take them at face value.

Including them creates other problems of interpretation. In most cases they are dated covenants, but, unlike quantitative performance criteria, they are not explicitly tranche release conditions. A government may promise to do a, b, c, but the consequences of not doing so are unclear. There are many subjective elements in interpreting what constitutes a conditionality. If the government of Mali agrees to "organize a sectoral roundtable on housing," what would this mean in practice? What does one make of a condition that the same government should "ensure the coordination and the convergence of macroeconomic and sectoral policies" in pursuit of regional integration objectives (Mali, PFP, July 12, 1999)? When Senegal agrees to "pursue the development of animal production," or Tanzania to "support 'Water for Life' campaign," or Madagascar to "generalize the use of impact studies for sustainable development" and "mobilize decision-makers and the population to devise a joint communication plan," or Guinea to "continue rationalizing management of human resources in the agriculture sector," do they agree to conditionalities or simply banalities? In this paper we have clubbed together these statements of intent as "loose conditionalities." As stated earlier, these form part of the framework of agreement between the IFIs and borrowing governments – the quid for the quo. On the other hand, they are not very precise and their timetables for implementation are over the program period rather than specific dates linked to tranche releases.

Another problem of interpretation arises in the case of omnibus conditions, which can be interpreted either as a single condition or as several conditions depending on how one breaks it up temporally and by sub-issue. Thus is a structural benchmark for Albania that the country "complete at least 3000 sales transactions in agricultural land by end-June 1999, at least 3,500 by end-September 1999, at least 4,000 by end-December 1999, and at least 4,500 by end-March 2000," a single conditionality or four?[5] In such cases, the data in this paper counts them as four conditions on the grounds that there is a rational reason why this structural benchmark has four specific dated targets instead of one (simply the last number, "4,500 by end-March 2000"). A different problem arises from focusing on the aggregate number of conditions in that there is an implicit assumption that the conditions are all of equal importance and weight, which is obviously never the case. Critically, some of the most important conditions are not reflected in these numbers at all. They are to be found in "side letters" and "pre-program" conditions, the latter being particularly important in the case of the poorest aid-dependent countries, where they are put in place of meetings of CGs (Consultative Groups).

Finally, there is the issue of distinguishing governance related conditionalities from other conditionalities. In this paper, all conditions that have a clear impact on the quality of government are counted as GRCs. These include conditions that reduce the discretionary power of governments, improve information, and institute institutional changes. Thus, in the case of Mozambique, the quantitative performance criteria relate to macroeconomic targets including ceilings on government deficit, external borrowings, external debt, and floors on government revenue and international reserves of the central bank.[6] None of the eight performance criteria are GRCs. However, of the fourteen Structural Performance Criteria and Benchmarks, twelve are deemed GRCs. This is not surprising since four of the five sub-categories – public administration, tax and customs administration, public enterprise reform and statistics – are at the core of the governance agenda (the fifth relates to the financial sector). These conditions range from preparing "new civil service regulations" to strengthening "auditing capacity by recruiting ten tax officers and conducting two training courses" to revising national accounts statistics. Except for conditions that the government abolish the tourism tax and that the central bank be allowed to hold regular auctions of treasury bills, the others are included in our (admittedly liberal) criteria for GRCs.

Tables I–V attempt to give numerical estimates of conditionalities based on IMF Letters of Intent, Policy Framework Papers (PFPs) and Memoranda of Economic Policies. The selection is restricted to countries that had programs in 1999. The exception was East Asia (Indonesia, Korea and Thailand), where the programs studied were those that commenced in late 1997, following the onset of the East Asian Crisis. The reason is that later programs in these countries (in 1998 and 1999) were essentially a continuation of the programs that were initiated in 1997. While Tables I and II are based on a strict and narrow interpretation of conditionality ("Quantitative Performance Criteria"), Tables III and IV are based on a more loose interpretation of conditionality drawn from Policy Framework Papers and Memoranda of Economic Policies.

TABLE I IFI Conditionality Strictly Defined East Asia, Central Asia and East Europe, and Latin America

Countries	*Total*	*Prior Actions*	*Quantitative Performance Criteria*	*Structural Benchmarks*	*Of Which Governance Related*
Korea	10	--	4	6	4
Indonesia	18	--	8	10	8
Thailand	9	--	9	--	--
Cambodia	30	11	8	11	9
Romania	43	11	12	20	25
Albania	43	12	7	24	33
Kazakhstan	27	4	10	13	17
Kyrgyz	37	10	14	13	23
Latvia	28	--	8	20	20
Brazil	38	--	7	31	21
Bolivia	32	--	5	28	21
Nicaragua	29	--	7	22	18

Source: IMF

Letters of Intent. Korea: 12/03/97; Indonesia: 10/31/97; Thailand: 08/14/1997; Romania: 07/26/99; Albania: 12/21/99; Latvia: 11/10/99; *Policy Framework Papers.* Cambodia: 10/06/99; Kazakhstan: 11/22/99; Kyrgyz: 12/27/99; Bolivia: 08/25/99; Nicaragua: 08/23/99; *Memorandum on Economic Policies.* Brazil: 11/12/99.

TABLE II IFI Conditionality Strictly Defined Sub-Saharan Africa

Countries	*Total*	*Prior Actions*	*Quantitative Performance Criteria*	*Structural Benchmarks*	*Of Which Governance Related*
Cameroon	15	0	7	8	7
Djibouti	29	6	18	5	8
Gambia	20	0	11	9	5
Ghana	23	4	9	10	13
Guinea	17	0	11	6	5
Madagascar	30	7	13	10	11
Mali	26	5	10	11	13
Mozambique	22	0	8	14	12
Rwanda	25	1	14	10	7
Senegal	27	0	10	17	9
Tanzania	29	0	7	22	13
Uganda	22	3	8	11	12
Zambia	18	3	10	5	6
Average	23	2	10	10	9.3

Source: IMF. *Letters of Intent.* Cameroon: 08/09/99; Djibouti: 10/02/99; Gambia: 11/08/99; Ghana: 04/13/99; Guinea: 12/07/99; Madagascar: 06/28/99; Mali: 07/12/99; Mozambique: 06/10/99; Rwanda: 11/02/99; Senegal: 06/04/99; Tanzania: 07/13/99; Uganda: 11/19/99; Zambia: 03/10/99.

TABLE III IFI Conditionality Loosely Defined East Asia, Central Asia and East Europe, and Latin America

Countries	*Total Number*	*Of Which Governance Related*
Korea	114	44
Indonesia	81	48
Thailand	56	37
Cambodia	83	65
Romania	82	34
Albania	72	47
Kazakhstan	114	69
Kyrgyz	130	97
Latvia	65	28
Brazil	95	44
Bolivia	89	45
Nicaragua	50	34

Source: IMF. *Letters of Intent.* Korea: 12/03/97; Indonesia: 10/31/97; Thailand: 08/14/1997; Romania: 07/26/99; Albania: 12/21/99; Latvia: 11/10/99.
Policy Framework Papers. Cambodia: 10/06/99; Kazakhstan: 11/22/99; Kyrgyz: 12/27/99; Bolivia: 08/25/99; Nicaragua: 08/23/99.
Memorandum on Economic Policies. Brazil: 11/12/99.

TABLE IV IFI Conditionality Loosely Defined Sub-Saharan Africa

Countries	*Total Number*	*Of Which Governance Related*
Cameroon	92	77
Djibouti	134	106
Gambia	121	91
Ghana	80	61
Guinea	125	88
Madagascar	137	103
Mali	105	67
Mozambique	74	58
Rwanda	135	99
Senegal	165	99
Tanzania	150	104
Uganda	74	54
Zambia	87	59
Average	114	82

Source: IMF. Cameroon: LOI and PFP, 08/09/99; Djibouti: LOI and PFP, 10/02/99; Gambia: LOI and PFP, 11/08/99; Ghana: LOI, 04/13/99 and PFP, 04/14/99; Guinea: LOI, 12/07/99 and PFP, 12/08/99; Madagascar: LOI, 06/28/99 and PFP, 07/13/00; Mali: LOI and PFP, 07/12/99; Mozambique: LOI and PFP, 06/10/99; Rwanda: LOI, 11/02/99 and PFP, 11/04/99; Senegal: LOI and PFP, 06/04/99; Tanzania: LOI, 07/13/99 and PFP, 01/19/99; Uganda: LOI and PFP, 11/19/99; Zambia: LOI and PFP, 03/10/99.

Table V summarizes the burden of conditionality by region. The unequal sample sizes drawn from each region, as well as the fact that the countries chosen are not drawn randomly in the strictest sense, means that the numbers should be interpreted with caution. We are, however, confident that the numbers are broadly representative of recent trends in IFI conditionality.

Even if conditionality is interpreted narrowly, their burden on borrowers has grown significantly. The average number of criteria for a sample of 25 countries with programs initiated between 1997 and 1999 was 23 (26 if prior actions are included). This compares to about six in the 1970s to ten in the 1980s (Boughton, 1999). While the numbers may not be strictly comparable, there can be no doubt as to the trend: a sharp increase in conditions over the last three decades. Although a narrow definition of conditionality places the most acute burden in Central Asia and East Europe, a broader definition of conditionality places the largest burden on Sub-Saharan Africa. This latter region also stands out in its considerable number of GRCs. GRCs are more than half of all conditionalities (loosely defined) in all regions, and nearly three-fourths in Sub-Saharan Africa. Although there is little doubt that some GRC conditions are new (for instance those related to "transparency"), quantitative precision is rendered difficult by the plasticity of the concept, as well as the repackaging of some earlier conditionalities in a different intent and rhetoric. (Examples of some such earlier conditionalities are those related to bank mergers as a prelude to privatization or the dismantling of import monopolies that have fiscal consequences.) Moreover, a number by itself does not distinguish between conditions that are written into the agreements from those that have the most weight in determining whether or not agreements are signed and money disbursed.

TABLE V The Burden of Conditionality

Region	*Total Conditionalities*		*Governance-Related Conditionalities*	
	Strictly Defined	*Loosely Defined*	*Strictly Defined*	*Loosely Defined*
Africa	23	114	9	82
Asia	17	84	4	49
East Europe & Central Asia	36	93	24	55
Latin America	33	78	13	41

Data based on IMF Letters of Intent and Policy Framework Papers (PFPs) between 1997–99.
Africa: Cameroon, Djibouti, Gambia, Ghana, Guinea, Madagascar, Mali, Mozambique, Rwanda, Senegal, Tanzania, Uganda, Zambia.
Asia: Cambodia, Indonesia, South Korea, Thailand.
East Europe and Central Asia: Albania, Kazakhstan, Kyrgyz, Latvia, Romania.
Latin America: Bolivia, Brazil, Nicaragua.

III. Does the Past Record Inspire Confidence?

In considering the benefits likely to accrue from GRCs, two key lessons from the past need to be extracted. First, how effective has conditionality been in inducing behavioral change and accomplishing the earlier narrow objectives? And second, given the significant intersection between GRCs and public management and institutional concerns, does the past record of IFIs in these admittedly difficult areas inspire confidence? Only then can we examine which areas of governance the IFIs have a comparative advantage and competence in, and ask whether this is reflected in their conditionalities.

Numerous studies have sought to examine the effectiveness of the IFI conditionalities. The World Bank conducted several internal evaluations of its structural adjustment operations. These studies, as well as several external evaluations, all point to the modest effects of these operations.[7] In the IMF's case, where conditionality has a more central role, the record is equally modest. An internal IMF review in the late 1980s of 149 stand-by and extended arrangements by the IMF found that the performance criteria and overall external objectives had been met in a quarter of the cases. In another 36 percent, neither category was satisfied; in 17 percent, performance criteria had been met but not the external goals, while in the remaining 21 percent the opposite was true (IMF, March 2, 1988, Table IV, p. 28). Tony Killick's extensive evaluation of IMF programs found that an "overreliance" on conditionality as well as a proliferation of conditionality in Fund programs led to heightened non-compliance (1995). The limited success of IMF programs (and hence conditionality) can be found in another statistic. Two-thirds of IMF programs between 1973 and 1994 were oriented to countries still within four years of a prior program. In other words, sustained economic health was not achieved in a majority of IMF programs (Lee and Rhee, 1999).

Methodological limitations make any unequivocal judgement problematic (whether on the "before-after" approach, the "control group" approach, or the "comparison simulation" approach"). However, a broad consensus is reflected by Joseph Stiglitz, the former chief economist of the World Bank, who recently argued, "there is increasing evidence that it [conditionality] was not – good policies cannot be bought, at least in a sustainable way. Equally critically, there is a concern that the way the changes were effected undermined democratic processes (*The Economic Journal*, 109, November 1999, p. F591)." Since GRCs at least are driven by the normative criteria of improving democratic processes in IFI borrowers (as underlined by the emphasis on accountability, transparency, and participation), are undemocratic means justifiable for democratic ends? In a series of articles, the Bank's Director of Research, Paul Collier, has been even more categorical: "The extension of the practice of conditionality from the occasional circumstances of crisis management to the continuous process of general economic policy making has implied a transfer of sovereignty which is not only unprecedented but is often dysfunctional." Donor conditionality has "low credibility," and, as an institution, "donor conditionality was incredible since its inception" in three respects. The penalties inflicted by the conditionality regime "lacked moral legitimacy, the punishment was excessive relative to the 'crime' and the imposition of penalties was not in the financial interest of the donors (1999)."

Most of these studies agree that attaching conditions to aid can strengthen the arm of only those governments that are themselves trying to push through necessary but unpopular measures. It would seem intuitively obvious that reforms rarely succeed unless a government considers them essential and "owns" them; less likely to succeed would be those reforms reluctantly agreed to as merely a deadline for the release of a life-saving tranche. This importance of "ownership" would imply little need for conditionality. However, the reality remains that ownership can have a strong temporal and stakeholder component: an incumbent government might "own" a program, but a succeeding one may not; a government might genuinely believe in the need to abolish agricultural subsidies, farmers may not; technocrats may "own" programs that many other members of society do not.

In the IFIs' defense, they have argued that it is precisely in response to the criticisms of their programs that they waded deeper and deeper into structural issues, moving from economic to political structures and processes. They now agree that their programs did not work well in the past (the Bank is more adept at this than the Fund), and the reason was that they ignored critical issues of power – the interests and political processes that shape and subvert public institutions. So, finally, the magic key to unlock the gates holding back development has been found. It lies in the Bank's "discovery" of a new approach to development: the "Comprehensive Development Framework" (CDF), with its claims to have replaced "the old approach of an exclusive focus on growth" and "trickle-down approach" with a "comprehensive" and "holistic" approach.[8]

How much of this is "new" is debatable. Development economists and the World Bank itself have always known that there is no single magic bullet behind development, although at various times primacy has been given to particular factors: physical capital in the 1950s and 1960s, poverty in the 1970s, trade and structural adjustment in the 1980s, human capital and the financial sector in the 1990s and, more recently, governance. The cycles and lags between ideas, projects, and expertise invariably limit the duration with which the institution stays with any single idea. T. N. Srinivasan, one of the pioneers of development economics, acidly comments, "It takes one's breath away to read that 'we now see the centrality of issues of governance, both in the public and private sector.' Pray, what took so long to see this? 'Governance,' to use the buzz-word, is not a new issue–one already knows that rampant corruption is deleterious, or for that matter that openness to foreign trade and technology, macro-economic stability, investment etc. are all important! What do Messrs Wolfensohn and Stiglitz mean precisely by 'democratic, equitable and sustainable increases in living standards provide the right focus for policy makers'? What is the meaning of 'democratic' increases? Equitable in what sense? ... Some of us, at least, believe that five decades of development experience since the end of the second world war has shown that policies for poverty alleviation are not mysterious or new, but mundane, tried and tested. They are policies that bring about rapid and labour-intensive growth based on a better educated and healthier labor force, participatory democracy and fuller integration with the world economy (*Financial Times*, September 24, 1999)."

These observations are borne out to a considerable degree in many of the PFPs examined here, particularly in the poorest countries. Conditionalities in the PFPs often demonstrate a slavish bent to fadishness rather than a sense of priority on the use of scare resources. Does a country like Mozambique, which has one of the lowest per capita incomes in the world, really need to "complete provincial poverty profiles" at this stage? Even more troubling are conditions that ask Rwanda to "Fill the gap left by genocide by strengthening vocational, technical, and management training," along with *134* other conditions ranging from being asked to "Complete the household living conditions survey in urban and rural areas," and "develop a vision for Rwanda's public service to guide the next stage of reforms of public administration." Given the unfortunate reality of that country, one wonders whether the PFP is simply a Potemkin Village, a classic bureaucratic document that blithely sacrifices realism at the altar of "comprehensiveness."

Although the newness of "ideas" inherent in "governance" is certainly questionable, the relative emphasis on issues such as transparency, accountability, participation, and corruption is certainly much greater than in the past. But to the extent that these translate into an agenda for broad transformation in public institutions, there is less reason to be sanguine; in a wide variety of institutional settings, public sector management projects have historically underperformed the Bank's portfolio average (World Bank, OED, 1998).

Out of 1,689 projects with institutional development goals approved between 1971–91 and evaluated by the World Bank's Operations Evaluation Department (OED), only 29 percent had a substantial impact on institutional development (ID). The impact on ID was modest in 45 percent of the projects and negligible in the remaining 26 percent. During the 1990s, "substantial" institutional development impact was evident in 32, 31, and 39 percent of the projects that exited the portfolio during 1990–93, 1994–97 and 1998–99 respectively. But even in the most recent cohort, performance was markedly lower in the case of IDA countries (a third), the countries where GRCs would be more apparent.

Periodically the Bank has done internal reviews on the effectiveness of its role in institutional development. An examination of three reports over the past three decades reveal an ingrained tendency in the institution to subject itself to careful analysis – and then continue without learning much.[9] The reasons are deeply structural. Institutional development is usually needed most where it is hardest to achieve. Consequently an important "condition" in loans with ID components is technical assistance.[10] Countless reports have documented the weaknesses and failures of donor-driven technical assistance (especially in Africa). It increases dependence and rent seeking by fostering the dispensation of favors through patronage relationships and distorts labor markets and wage scales. Contextual factors can make or break ID projects, and the design and approach of such projects presumably have to take into account prevailing culture, norms, attitudes, and behavior patterns. But institutional culture and incentives within the IFIs are quite inimical to the development of country specific expertise. The Bank's perpetual reorganizations truncate any tendency to acquire such expertise. The issue is moot for the IMF, which has always believed in universal nostrums. And in both institutions, personnel incentives are such as to encourage rotation rapidly through departments – not to develop country or even region specific knowledge. Additionally, the trend in social sciences in the academic institutions that the IFIs draw their research staff from is also to regard country specific knowledge as "low brow;" this further inhibits the possibility of understanding the country specific cultural, social, and political variables that affect institution building.

Three additional examples of governance related institutional changes illustrate the difficulties faced by the IFIs. Over the past two decades, the World Bank has supported ambitious efforts for civil service reforms (CSRs). In the 1980s, the Bank's initial strategy to combat bureaucratic dysfunction turned on the notion that governments could "do more with less." It supported downsizing measures to limit and cut CS size, while imposing hard budget constraints on wage expenditures. Subsequently, it added capacity building initiatives to supplement cutbacks; this would allow governments to "do more"–particularly implement difficult adjustment programs. By the early 1990s, the Bank added a third class of measures–institutional reforms such as intra-public sector regulatory reform and external checks and balances–in order to make governments "more transparent and accountable," in addition to being more efficient.

An internal review commented that "despite its growing importance, CSR continues to suffer from definitional, strategic, and operational ambiguities. Between 1980 and 1997, the Bank diagnosed three stylized forms of bureaucratic dysfunction that undermined the ability of governments to secure the fundamentals of adjustment and development (World Bank, OED, 1999)."[11] On average, only a third of closed CSR interventions and 38 percent of ongoing efforts achieved satisfactory outcomes. Even when desirable, these outcomes were often not sustainable. Downsizing and capacity building initiatives failed to produce permanent reductions in CS size and to overcome capacity constraints in economic management and service delivery. There was no evidence that civil servants began to "own" and follow formal rules such as codes of ethics in any meaningful way. As a result, institutional reforms could not substantially limit arbitrary action by bureaucrats or politicians. The review found that the limited success of the Bank's approach to CSR was largely due to its narrow "technocratic" character. "Rather than engaging CSRs as dynamic systems that are influenced by multiple stakeholders, Bank operations relied on small groups of interlocutors within core ministries to design and implement one-size-fits-all CSR blueprints in diverse country settings."

A review of the Bank's record on the reform of tax systems in the 1990s found two principal constraints on World Bank operations in tax and customs administration. One, the theoretical basis for the Bank's reformation of tax and customs administration was rudimentary. The review found little evidence in support of recent theories followed by the Bank that stress the importance of institutions that harness voice and improve transparency and contestability to render tax administration more effective. Furthermore, the Bank's institutional framework for accumulating knowledge from loan operations was inadequate. Institutional components of project design were biased toward organization, manpower upgrading, and procedures related to information technology while little attention was paid to improving accountability, administrative cost-effectiveness, and anticorruption institution-building (Barbone et al, 1999).

The Bank's foray into judicial reform is another example of the institution's approach to governance. Douglas North's thesis that the absence of low-cost means of enforcing contracts was "the most important source of both historical stagnation and contemporary underdevelopment in the Third World" was an important intellectual prop for resurrecting the "law and development" efforts in the 1960s and early 1970s; these proved rather unsuccessful.[12] Even if North was right (and there are good reasons to be skeptical, since cause and consequence are inextricably linked[13]), there is little reason to believe that contract enforcement can only be done through formal systems. Most societies have informal systems of enforcement. During the 1990s, judicial reform projects were in vogue in the World Bank, several regional development banks, and other donor organizations. Yet, as a recent bank publication argued, after dozens of projects and more than half a billion dollars in lending by the IFIs alone, "little is known about the actual effect of judicial reform on economic performance or even about what elements constitute a sound reform project (Messick, 1999)."[14] Indeed, in several cases, it has been found that the sudden introduction of formal mechanisms to resolve legal disputes has simply disrupted informal mechanisms without commensurate gains.

As we shall note later, judicial reform is a good example of several facets of the IFIs' foray into governance issues that have been underplayed. One, a temporal tension between a need to incorporate new intellectual developments into their advice and lending (lest they be accused of being tardy) and the reality that it is too easy to jump on the latest intellectual bandwagon as long as the incidence of risk is not borne internally. Two, the overwhelming dominance of ideas from US academia as intellectual justification for specific strategies. And three, a nimbleness in avoiding unpleasant realities. The World Bank's own country surveys have emphasized basic law and order issues as a major impediment to business – which means that it is impossible to ignore the issue of criminal law and police reform if one is keen on securing the "rule of law." The fact is that foreign investors are usually powerful enough to have less concern for local police shenanigans than for the ability of a judicial system to enforce contracts. The best of judicial systems is unlikely to succeed beyond a certain extent if the police (as well as the prosecution) are incompetent and corrupt–a ubiquitous feature in many countries. Although the Bank's General Counsel has argued against the Bank's involvement in this area on grounds that the issue is outside the purview of its Articles, one suspects that, from a public relations point of view, police reform presents severe risks for the institution.

IV. Impact on the Quality of the Development Process

What are the criteria for "success" of GRCs, and to what extent have governance related conditionalities enhanced the pace and quality of the development process? What are the assumptions implicit in the specific, detailed, governance-type conditions that are being demanded? To the extent that GRCs are a response of the IFIs to pressures from civil society – both international and from within borrowing members – how effectively do they address their concerns?

To answer these questions would require resources well beyond the scope of this paper, and the experience is too recent for such an evaluation. However, there are several critical weaknesses in the IFIs' approach to governance and, even though there are no easy answers, it is imperative that they be addressed.

While governance related conditionalities have economic consequences, there is little analytical basis that links the financial programming models of the IMF, for instance, and the scope of governance related conditionalities entailed in the program. More importantly, an analysis of GRCs leaves an observer with little basis to form any reasonable expectation of economic impact proportionate either to the GRCs or to the financial size of the program.

The IFIs have used their agenda setting power in the competitive struggle to get particular definitions accepted; almost inevitably, once a definition gets accepted, it tends to de-emphasize considerations not included in the definition. This is evident in the way the several concepts central to the governance agenda are defined. For instance, corruption has been defined as "the abuse of public power for private gain." It is clear that, for the Bank, "public power" means public *office* rather than the arbitrary exercise of power by any actor, public or private, but in the public *domain*.[15] The failing of many bureaucracies is not that they are manned by evil or even pecuniary corrupt individuals, but rather that their actions are merely an extension of increasingly common values. They adopt the mores of "get-ahead, go-along organization who takes on the coloration and the value system of whatever organization they belong to."[16]

By definition, the contributions to corruption of markets, the private sector, and all non-state actors are wished away. In many developing countries, audit firms are private. The accountancy profession, which should normally be part of the solution of governance, is part of the problem. In practice, its role has been to determine how best to help conceal information, whether to avoid taxes or sweep the dirt under the rug by obfuscation – the caveats tucked away in a small footnote on an obscure page instead of being upfront. Rather than focus on tougher self-regulation of professional bodies, the standard prescription is always to insist that a foreign audit firm act as auditor. The result, as we note later, has short-term benefits but reduces the pressures for long-term gains from tougher domestic self-regulation by professional bodies. Similarly, as NGOs become bigger players in the development endeavor, their accountability is often more upwards to donors and rarely downwards to "the people." Civil society can be uncivil and NGOs can and do have interests other than the public good, just as do governments and IFIs.[17]

Aggregation and Trade-Offs

Globalization is buttressed by a thickening mesh of global rules and standards, whether on child labor or governance or accounting. Increasingly, many of these rules have implications for institutional change and development. However, the direction of institutional convergence is inevitably towards those of advanced industrialized democracies. The result is that those with the least resources have to travel the greatest distance; those with the most resources have to go the least distance. But the rules have to be implemented by all – and immediately. What are the implications of this for institutional sustainability in poorer countries, and for the success of globalization more broadly?

There are four troubling implications of the simultaneous increase in rules promulgated through a wide array of global fora. One, it is forcing those countries with the least capacity to change (albeit perhaps the greatest need) to change the most. Second, the countries that are being required to change the most so as to conform to global rules are the ones that have the least influence on crafting the very rules that effectively designate them as principal targets. Third, as the number of global rules multiplies, so do tradeoffs among the rules – and no amount of linguistic sleight of hand and misty-eyed "holistic" development rhetoric can avoid the tension. And fourth, there is a pro rich-country bias in the sectoral priorities of institutional harmonization – compare for instance the priority placed on building the infrastructure of financial markets relative to the efforts directed at institutional harmonization in labor markets. None of the four issues have received the attention they deserve.

The conditionality aggregation problem is related to but more overarching than another issue that has been much discussed in earlier years: namely, that of cross-conditionality between the BWIs. The lines between coordination, collusion and cross-conditionality have become increasingly blurred over the years, and realistically there is little alternative. However, as developing countries increasingly have to conform not just to conditions arising from Bank-Fund programs but a host of global conventions and rules, the implications of the aggregation problem have become much more severe.

To take just two examples in very different issue areas, rules related to global financial governance are being crafted by more than a score of institutions ranging from the purely public to the purely private, from globally representative (at least theoretically in terms of country coverage) to privileged clubs with limited membership. There are some forty international bodies dealing with forestry in some form and at least twenty treaties that touch on the issue.

The limited substantive representation of many developing countries in these fora means that the rules (and by implication, conditions) not only misdiagnose the problems faced by developing countries but also do not take adequate cognizance of the needs and resource bases of these countries in their solutions. In recent years, the WTO has emerged (in addition to the IFIs) as the most important source of rules and conditions. Relatedly, the Bank has raised the welfare implications of the WTO for its borrower nations. A recent research paper, for instance, has argued that the WTO agreements were an "inappropriate diagnosis and an inappropriate remedy, one incompatible with the resources they [developing countries] have at their disposal (Finger and Schuler, 1999)." The problems of governance are severest in some of the poorest countries, but these countries also have the most limited institutional resources. It is not the pressing priority to improve the effectiveness of their customs services as per the customs valuation agreement of the WTO for these poorest countries, but they have little option. Although the governance agenda was not overtly on the table when the Bank began to press for trade reforms in the 1980s, its implications for governance are evident. Similarly, customs reforms have been part of governance – rent seeking arising from inappropriate WTO obligations add to the institutional reform agenda of customs reforms, which are clearly not a priority.

The World Bank has itself questioned "the content of obligations imposed by the WTO agreements on customs valuation, intellectual property rights and SPS [Sanitary and Physiosanitary Standards], which can be characterized as advanced countries saying to the others, *Do it my way*! (ibid.)" The IPR regime is even more evident of the aggregation problem. Despite the well documented negative welfare implications for poor countries, particularly when reforming their legal systems and enforcement mechanisms, these countries will at the margin have to give priority to IPR related issues rather than the many pressing domestic needs.

External versus Internal Factors

One observation is noteworthy in the IFIs' governance agenda – the almost complete emphasis on factors internal to the country while under-emphasizing the external factors that may also be part of the problem. For instance, the IFIs have used Public Expenditure Reviews (PERs) to highlight wasteful and/or inequitous expenditures. This approach has been quite useful, for instance in health sector spending, where the pattern and not just the level of expenditures leaves much to be desired. But external factors are also affecting health outcomes in LDCs. In 1998, when member nations proposed that the World Health Organization be granted more power to monitor international trade agreements and their effects on global public health, the WHO intimated that it would support improved access to patented medicines in developing countries. Pressured by pharmaceutical firms, the U.S. State Department threatened to withhold funding to the WHO unless it weakened its initiative. When the Thai government established a Pharmaceutical Patent Review Board to assess the effects of patents on drug accessibility, the U.S. Trade Representative's office threatened sanctions on certain Thai exports. The board was quickly disbanded and Thailand, which sends a quarter of its exports to the U.S., set limits on the right to issue compulsory licences for pharmaceuticals (*Asiaweek*, February 17, 2000).

On issues of corruption and transparency, the operational emphasis of the Bretton Woods Institutions has similarly been almost exclusively on transparency in the financial accounts of emerging-market governments, presumably to deter corruption. But there has been much less stress on transparency on the part of private parties in these markets, particularly as it bears on capital flight and money laundering.

Capital flight is a mix of legal money seeking a better investment climate and dirty money, illegally earned and laundered abroad. The international financial community, supported by the IMF, has always argued that capital flight is a symptom and not a cause of a country's predicament. This misses the point. Given the realities of poor countries, it is absurd to argue that ill-gotten gains of elites, whether through corruption, tax evasion or other symptoms of crony privilege, are not part of the problem. Money laundering is the handmaiden of international corruption, and efforts to curb money laundering can help to reduce corruption. The linkage is clear: those who take bribes must find safe international financial channels through which they can park their ill-gotten gains. Most anti-laundering regimes are still in their infancy. The integration of financial markets has been a haven for money laundering since the harmonization of laws across national jurisdictions has sharply lagged behind market integration. Even as barriers to the movement of money have almost vanished, they remain obdurate in informational disclosure.

Banking secrecy has made it exceedingly difficult to monitor and regulate private banking activities in most jurisdictions, even where there are stringent laws on *domestic* money laundering. Even in high profile cases, such as a Mobuto or the Marcoses, it has been extremely difficult for the countries to recover even a fraction of their looted wealth. The role of private banking in abetting capital flight gained prominence in 1999 when the Bank of New York helped to shift at least $7 billion in ill-gotten gains out of Russia into private bank accounts in the west. The problem is by no means new. Over the last couple of decades, private banking has been a growing and highly profitable niche of the banking business, which has seen its traditional business of spread banking decline. During the 1980s debt crisis, even as US banks were pressing floundering Latin American countries to service their debt, their private banking operations provided easy avenues for escape and havens for capital flight, thereby exacerbating the problem of debt servicing (Lissakers, 1991). Some of the largest and most venerable banking institutions have been implicated in recent years.[18] The Mexican crisis and the travails of Indonesia and Russia have been sharply exacerbated by massive capital flight involving nationals of these countries. In all these cases, the benefits of borrowings are privatized and the costs socialized in that capital flight reduces the foreign exchange available to governments to pay off their debts, and these governments cannot capture private foreign assets to offset private and/or public liabilities.

The current approach to tackling the problem of onshore and offshore laundering havens has only now begun to attract the commitment that the magnitude of the problem deserves. The IMF and the World Bank have become more engaged in the issues of money-laundering and capital flight and have attempted to limit money laundering by emphasizing good governance and banking supervision.[19] In September 1997, the Fund supported and pushed through the Basle Committee the Core Principles for Effective Banking Supervision, including strict "know-your-customer" rules. It has been nudged further in this direction by the embarrassment of financial scandals involving the IMF in Russia in 1996 and Ukraine in December 1997, when its funds were diverted and reinvested in speculative government debt markets (*Financial Times*, January 28, 2000).

Both institutions have been working with the OECD sponsored Financial Action Task Force (FATF). Until recently, the latter organization was cautious in even censuring member countries who were dragging their feet on problems highlighted by the task force. In June 2000, the FATF published a list of 15 jurisdictions which it deemed were "non-cooperative in the fight against money-laundering," and warned these financial centers to step up efforts to combat money laundering or face the threat of (as yet unspecified) international counter-measures. The FATF's new activism has been driven in part because the US has crucially become more proactive. Legislation under consideration in the US Congress would force US banks to identify the real beneficiary of an account and make it a crime to conceal the true owner. It would also make it more difficult to set up correspondent relationships with so called "brass plate" banks as well as grant the Treasury Secretary broad discretionary powers and allow the U.S. to "act unilaterally when necessary" to crack down on foreign countries deemed to pose a money laundering threat. Importantly, the proposals broaden for the first time the scope of money laundering to include foreign corruption as a recognized offence under US money laundering laws.[20]In theory, international pressure on this issue should come most from developing countries, which have the most to gain (relatively speaking). Instead they have shown a noticeable lack of enthusiasm. This is perhaps not surprising given the involvement of their elites in this matter.

The IFIs have insisted on transparency in certain financial issues (budgets and firms' balance sheets for instance) but not others. They have stayed away from inserting into any program dealing with the financial sector an insistence that the borrowing country make public the list of defaulters (above a certain value). They have also shied away from a requirement that if foreign creditors are to be bailed out, they should make available data of the overseas accounts of nationals (and associated firms) of emerging market economies. Such an approach would seem vital to curb the corruption and capital flight that has put the burden of economic adjustment so thoroughly on ordinary citizens in those countries.[21] These steps would not eliminate corruption, but the transparency would make it more difficult to launder ill-gotten gains. More importantly, transparency aided by the spread of democracy should empower a country's citizens to judge their elites.

Time

GRCs face a fundamental tension in trying to reconcile the time horizons of the issue areas they target, which can entail political and social reengineering – historical processes that have traditionally had much longer time frames than many economic issues addressed by the IFIs – and the much smaller time horizons of the global community's programs, budget cycles, and academic fashions. Unlike first generation reforms, the changes entailed in governance related issues involve complex organizational change in bureaucratic, regulatory, and legal structures. The experience of organizational changes in the World Bank, where despite expensive and repeated efforts "success" has been a chimera, is an object lesson on how long a haul this task can entail.

In a narrow sense, GRCs assume a degree of capability that is often simply unrealizable. In the post-mortems of the Asian financial crisis, the Fund argued that the steps to forestall future crises should include such guidelines: "*sound* macroeconomic policies to contain aggregate financial imbalances and to ameliorate the effects of financial disturbances can be combined with *sound prudential* policies designed to ensure proper private incentives for risk management, especially in the financial sector. With these safeguards, *orderly* and *properly* sequenced capital account liberalization and the broader financial liberalization of which it is part are not only inevitable but clearly beneficial (Eichengreen and Mussa, 1998, emphasis added)." "Sound," "prudential," "properly," "orderly" – these are hardly contentious terms. There is, however, little analysis of just what it takes – in terms of organizational and human capital – and *how long it may take* to develop "sound" and "prudential" regulatory and supervisory systems (as distinct from sound exchange rate policies). Weak institutions are inherent in the very reality of being a developing country, and institutional development is a gradual, long term process. Unfortunately, there is a fundamental disjunction between the time frame that institutions develop and the rate that financial markets move, so that even as institutional design is barely coping with the lessons of the last battle, the environment has sharply altered. This tension, which is also inherent in the short duration of IFI programs relative to the time it takes to institutionalize new systems and processes, is particularly sharp in the financial sector – the top two to three percent of human capital critical to developing public regulatory institutions is more prone to leave for the private sector due to stark salary differentials.

To be sure, capacity is not exclusively exogenously determined – its determinants are rooted to a considerable extent in local politics. However, the standard response is that expertise can always be hired – indeed, hiring foreign consultants is often mandated in IFI conditionality. A World Bank loan to Albania's power sector insisted that international managers be appointed as a condition to reduce theft and mismanagement. A conditionality in the IMF's Indonesia program stated that the government "appoint high level foreign advisors to BI [the Indonesian central bank] to assist in the conduct of monetary policy." The incentives for IFIs (and donors) as well as borrowing governments invariably favor short-run "expertise gap-filling" measures over long-term capacity building. The experience of African countries in particular has shown that foreign experts are an expedient that helps IFIs meet unrealistic program time frames, not a sensible approach for sustainable development. Impatience imposes another cost on borrowers.[22] Rather than build capabilities, borrowing countries resort to copying. "Appropriate technologies," appropriate in particular to the informal institutions of the country, do not get a chance.

The tempo can also direct whose ideas and models prevail. The temporal mismatch between the time given to achieve certain standards and goals and that needed to build capabilities means that borrowing countries invariably end up simply copying. As a result, the possibility of experimentation that allows for the development of approaches more appropriate for their institutions is rendered moot. It invariably takes much less time to copy than to come up with something new. Examples of the problems and failures that occur when societies are subject to rapid institutional change can be found in the cases of virtually all indigenous peoples; usually, they have fared poorly in the assimilation to modernity – even those who live in richer countries (in terms of resources).

Perhaps most importantly, key elements of the governance agenda seem to scarcely recognize just how long it has taken for the efficient, transparent, accountable institutions in the advanced industrialized democracies to emerge (Tilly, 1990; Ertman, 1997). Path dependency and history shape social capital, political and civic cultures, and social norms – the informal institutions on whose foundations formal institutions seek their legitimacy and authority. Despite enormous expensive recent interventions to jumpstart the process of building "modern institutions" in Bosnia, Kosovo, Haiti, and Kampuchea, success has been elusive. Values and attitudes cannot be radically changed simply by decrees, be it from the government or from outside. If democracy in the West was preceded by an era of constitutional liberalism, LDCs are being asked to do the two simultaneously, while at the same undergoing major changes in economic (market-based) institutions. Unfortunately, GRCs create an expectation that the required social reengineering can be carried out rapidly.

V. Alternatives to Conditionality

There have been suggestions from time to time that, instead of traditional *ex ante* conditionality, the IFIs (and especially the Bank) move to *ex post* conditionality. In this scenario, the IFIs define the set of good policies and then reward countries that move towards them (Collier and Gunning, 1999). In principle, ex post conditionality would presumably strengthen the incentive to good performance and reduce non-compliance. However, it suffers from two weaknesses. One, countries that receive funds after building up the necessary performance record can renege. Second, and perhaps more important, it can run against the "need-based" rationale of aid. If the poorest countries were all endowed with well-intentioned leaderships, this would not be an issue; otherwise, a performance-based criteria will inevitably redirect aid to countries that are already receiving funds from financial markets (van de Walle, 1999).

In reality, current procedures in the IFIs already amount to a compromise between ex ante and ex post conditionality. Ex post conditionality enters into current arrangements, first, because loans often require "prior actions," second, when disbursements are structured in tranches conditioned on performance, and third, through the increasing weight given to country performance in IDA allocation. In the 1980s, the IMF had begun using "prior actions" – actions undertaken by borrowers before drawing upon the Fund's resources –, especially prior actions in the areas of exchange rate adjustments, administrative price changes, and tax reforms. Their importance was endorsed by the IMF's Board, though not without dissent. They have also modified their lending instruments to better address governance related issues. The IMF has over time set up facilities with longer horizons to try and match its structural conditionalities (e.g. PRGF, erstwhile ESAF) and the Bank has introduced Adaptable Program Loans/Credits and Programmatic Structural Adjustment Loans/Credits.

Suggestions for alternatives to conditionality have involved some form of reciprocal obligation in the form of development contracts and, less ambitiously, development compacts (Stoltenberg, 1992). The EC has developed a proposal aimed at a possible reformulation of conditionality. A pilot exercise is being conducted in Burkina Faso, with the Bank and several donors participating.

VI. Quis Custodiet Ipsos Custodes?

GRCs, more than other types of conditionalities, impinge on sovereignty. In a world of unequal sovereign states, are governance related conditionalities equitable among borrowers? Moreover, programs with governance conditionalities tread in areas where considerable analytical uncertainty persists, given that the analysis of political and social change is hardly a "science." Is there (or should there be) greater risk sharing in programs with governance related conditionalities since they entail greater *ex ante* analytical uncertainty? Furthermore, does the combination of the substantially greater intrusive role of the IFIs and the greater risks inherent in GRCs require greater accountability within the IFIs? This issue has proven exceedingly elusive in practice. Finally, the implications of broader and deeper GRCs for the IFIs should not be underestimated. To the extent that governance-related issues are a critical factor in economic development, the fact that IFIs can address them directly through GRCs could well enhance the effectiveness of these institutions.

A different set of concerns stems from the possible consequences of the legal wriggles that have allowed the IFIs to finesse the reality that governance is an explicitly political issue. In fact, the Articles of these institutions (EBRD excepted) proscribe political considerations in lending. In the last replenishment of IDA (IDA 12), Deputies "stressed that governance is a broad-based concept intended to encompass *all* factors that impact on a country's ability to assure sustained economic and social development and reduce poverty" and noted that "addressing those factors is compatible with IDA's mandate (IDA 12, 1998, emphasis added)." Article V, Section 6 of IDA's Articles of Agreement provides that "the Association and its officers shall not interfere in the political affairs of any member; nor shall they be influenced in their decisions by the political character of the member or members concerned." Concerned that the World Bank's involvement not cross the mandate of its Articles, the Bank's legal counsel had attempted to limit the institution's concern with governance to the "contribution it makes with social and economic development and not with the form of the political regime," and emphasized the need for judgements based on country traditions and circumstances. For this reason, the Bank tried to maintain that, in the area of human rights, its Articles mandate it to focus on economic, social, and cultural rights (one of the two UN covenants on human rights) and not on political and civil human rights (the other UN covenant on this issue).

But even that distinction is eroding as governance becomes defined ever more broadly. In the process, the IFIs' policies are unambiguously incompatible with the institutions' articles. Instead of explicitly addressing the need to modify the articles in a changed world, the Bank and the IDA deputies have assumed an interpretation that is as malleable as the definition of the underlying rationale, namely, governance. Core tenets of governance are that rules matter and arbitrariness has been the bane of public action. Consequently, the more the IFIs make this a central part of their agenda, the more they have to strive to be like

Ceasar's wife and appear above suspicion. The effectiveness of their actions is more likely to be based on legitimacy than on conditionality, and legitimacy requires credibility. And there is no better way to undermine their own credibility on this score than by appearing to be selective in the application of GRCs amongst their borrowers as well as between borrowers and non-borrowers. Additionally, if mission multiplicity erodes institutional autonomy, the new GRC driven agenda has also rendered them more susceptible to pressures from major shareholders to underwrite their foreign policy interests. While this is hardly new, the pressures on the IFIs to accommodate a certain part of its membership are greater than ever before.

An interesting insight into this comes from the IFIs' relationship with Indonesia, which until 1996 had been hailed as an exemplary borrower. The draft 1999 Country Assistance Review explicitly critiqued the Bank for not pushing hard enough for fundamental changes in the political system in Indonesia. It argued that "the CG under the chairmanship of the Bank in other countries (i.e. in Africa) has been viewed by bilaterals as a valuable opportunity to collectively condition their aid to leverage changes in such areas as a government's electoral policies, human rights practices, and the treatment of the media and civil society organizations, but this was not the case in CGI [Consultative Group of Indonesia] (World Bank, OED, 1999)." The Government of Indonesia, in its reply, asked "if the authors of the Report genuinely believe that the Bank should have leveraged its aid to insist on electoral reform, a free press, and government transparency, they should clarify whether they believe that this approach should be applied consistently, including the Bank's second biggest client in Asia (Government of Indonesia, 1999)." The offending paragraph was dropped in the final report, but it was nonetheless revealing of the widespread belief that political conditionalities are now commonplace (and where they are not, they should be).

Russia is a prime example of the extent to which the IFIs became hostage to political pressure from western governments. Even as the G-7 has been strongly pressing the Bretton Woods institutions to put governance and respect for the rule of law at the center of their lending criteria, lending to Russia was discretionary, with a political calculus not dissimilar to those practiced by poor country member governments. The IMF went ahead with several multibillion dollar loan packages, even though Russia had not met its economic criteria: in March 1996, three months before Russia's presidential election and in an effort to bolster Boris Yeltsin's election prospects; and the July 1998 program with $4.8bn in new loans, aimed at defending the rouble that collapsed barely a month later. By that time, Russia had emerged as the largest debtor to the Fund, owing it more than $19bn – over one-fifth of its outstanding loans (*Financial Times*, December

9, 1998). In April 1999, Western governments, keen to blunt Russia's opposition to NATO's bombing in Kosovo and eager to help Moscow avert a default on its foreign debt, bought support by pressuring the IMF to resume lending. Given Russia's debts to the IMF, the entire $4.5bn program was designed to stay with the Fund to help Russia repay its debts to the lending agency. (The proceeds of the current loan are not transferred to Moscow; they are paid into an account at the IMF that can be used only to repay the Fund.) While the first of seven $640 m installments was released in late July, the second installment, originally slated for release in October, was held up pending an investigation into alleged Russian diversions of past IMF loans.[23] In late 1999, Michel Camdessus hinted that Russia's campaign against Chechnya could lead to suspension of the IMF money. If this did happen, the difference would be that the Fund would be suspending, not releasing, funds for political reasons.

If, as has been alleged, Russia's Chechnyan campaign has involved massive human rights violations, it would be hard to dismiss concerns about the IMF *de facto* financing the war: money is fungible. However, since the money is really repaying the IMF itself, the fungability argument only holds true if one assumes that Russia would have modified its campaign instead of simply ceasing to repay the IMF. But the IMF's role in Russia amidst the latter's Chechnya campaign raises far deeper issues about the Bretton Woods institutions' political role. How narrow or broad should their mandate be construed? If, as some argue, it would be "naïve if not unprincipled, to suggest that IMF decisions should be made in a political vacuum," it is equally naive to presume whose politics prevail when the vacuum is replaced by decision making in a political pressure cooker. Similar issues have underlay the decision to cut lending to Indonesia amidst its East Timor campaign (where the Bank Bali scandal was fortuitous in avoiding unpleasant decision making) or to India and Pakistan after the nuclear tests.

To a considerable degree, this was inevitable due to the steady expansion of IFI objectives (and loan conditions). Like any bureaucracy in the absence of rules designed to ensure self-restraint, bureaucratic propensities will always tend to drive the IFIs toward policy prescriptions designed to give its staff greater prominence. Observers of government bureaucracies have long recognized that multiplicity of missions impairs bureaucratic incentives and erodes institutional autonomy (Wilson, 1989).[24] The widening agenda of the IFIs have both reduced their bureaucratic effectiveness as well as left them more vulnerable to politicization, thus tarnishing the technocratic smock essential to the credibility of its prescriptions.[25]

It has also undercut a founding principal of these institutions as "institutions of restraint" – as a set of rules designed to restrain member countries from indulging in behavior which may have short-term payoffs but high long term costs. The effectiveness of institutions of restraint is critically dependent on their adhering to a norm of self-restraint themselves. In their absence, bureaucratic propensities will always tend to drive them towards policy prescriptions designed to give themselves greater prominence.

Hitherto, a natural check to this propensity was the attitude of the principal shareholders. However, in recent years, the reality is that the political, economic, and financial risks of IFI programs are asymmetrically borne by the borrowing countries. The minimal downside for major shareholders and the institutions' management or staff has resulted in greater risk taking. Recently, an external review of the IMF's surveillance questioned the expansion in the scope and coverage of bilateral surveillance, especially into structural issues of a non-binding nature. The doubt stood on the grounds of the Fund's competence on these issues as well as the concerns that an expanding coverage could be reducing the effectiveness of surveillance overall (IMF, July 1999). These recommendations were rejected by the key shareholders as well as the IMF's staff (IMF Staff Response, July 1999).

Financially, IMF and World Bank programs impose few net costs on the industrialized countries other than contributions to IDA and ESAF. There is no downside risk on the actions of these institutions for their non-borrowing shareholders and their management and staff. The rarity of defaults and the growing reserves of the IFIs mean that their contingent liabilities have been declining as well. And potentially large arrears can always be staved off by refinancing, as in the case of recent lending to Russia.

If the financial risks are low, the political risks are even lower. The Fund's irrelevance to managing economic relations among major economic powers has divided member countries into "structural" creditors and debtors, the latter group comprising LDCs and, more recently, countries making the transition from central planning to market economies. With this division, the essence of the institution as a cooperative dwindled. This bifurcation meant that the major economic powers, knowing that they were unlikely to borrow from the IMF, had fewer qualms about continually expanding the domain of the IMF's role and loan conditions. European members of the IMF signed on to conditions relating to easing labor market flexibility in Asia with great ease and without much ado, de-linking them from the situation in their own countries, where extremely rigid labor markets have resulted in soaring unemployment. This contradiction was not an indication of their conviction, nor even of double standards, but rather of the reality that the IMF's strictures are irrelevant to their own situation.

Reduced risks coupled with sharper domestic constraints on funding foreign policy objectives have meant that major shareholders have increasingly sought recourse to the IFIs as a form of off-budget financing to underwrite their foreign policy interests. While this is hardly new, the pressures on the IFIs are greater, seemingly in conjunction with the greater willingness of their managements to accommodate these pressures.

Additionally, GRCs have heightened the tension between the need for greater autonomy for IFI staff and management, which would allow them to better their role as international civil servants and the need for greater accountability given their increasingly intrusive role within the borrowing members. While institutional autonomy has eroded in the face of less self-restraint by the major shareholders, accountability has proven exceedingly difficult to implement in practice. Consequently, for the time being, IFIs are left to rely largely on internal norms.

VII. Conclusion

The looseness of the term notwithstanding, governance has emerged as a crucial part of the agenda of the IFIs. For better or worse, the wide array of issues subsumed under that term will occupy center-stage in the IFIs' agendas in the coming years. The IFIs' involvement in governance is a no-win situation. If they ignore an issue that is clearly at the core of the development dilemma, then they are seen to be ostriches burrowing their heads in the sand. But jumping in does not mean a refreshing swim – it can easily be a quagmire that does not allow them any more immunity from criticism. The IFIs dilemma is one shared by international intervention more broadly, as evident in the UN's travails. As UN Secretary General, Koffi Annan, put it, "while the genocide in Rwanda will define for our generation the consequences of inaction in the face of mass murder, the more recent conflict in Kosovo has prompted important questions about the consequences of action in the absence of complete unity on the part." But as the cautionary response from President Abdelaziz Bouteflika of Algeria speaking for the OAU put it, developing countries "remain extremely sensitive to any undermining of sovereignty, not only because sovereignty is our best defense [in] an unequal world, but because we are not taking part in the decision-making process of the Security Council."

That dilemma also faces the IFIs. In a way, GRCs are an attempt – at least in intent – to empower powerless people in powerless nations, perhaps even at the cost of the latter. Such an outcome may well be justified on normative grounds. But an ad hocism in application and an international regime where rules are selectively applied means that we simply do not know the likely consequences of these actions.

What can or should the IFIs do in their use of GRCs? First, they have to shake off their hubris and be willing to recognize the severe limitations of the instrument of conditionality to address an issue as inherently complex as "governance." Much of the "governance problem" in poor countries stems from two broad weaknesses: an unwillingness or incapacity to enforce existing laws and rules and, in some cases, laws and legislation that patently discriminate against particular groups. The current emphasis on using GRCs to draft new rules is consequently largely misplaced. GRCs should instead be deployed in a manner that would promote the convergence between formal rules and actual practice by pressing borrower governments to act in accordance with their *own* laws. The sovereign must have the right to legislate; however, the sovereign cannot argue that it has the freedom to legislate and then only selectively enforce its own laws. In addition, conditions should focus on removing laws that evidently violate a basic sense of fairness, either by granting egregious privileges to individuals or groups, or the reverse (discriminating against particular groups). The IFIs' efforts are likely to carry greater legitimacy and be more helpful if they use GRCs to hold governments' feet to fire if they violate their own constitutions, laws, and legislation than if they press for new laws and legislation drafted from outside. This role can be discharged more effectively if the IFIs are willing to make a much greater commitment to disseminate information and analysis in local languages, particularly the *lingua franca* of the poor, than they have been willing to do in the past.

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Endnotes

1. In the case of external capital flows, conditionality helps the repayment of sovereign debt but when anticipated by lenders, it can get international financial institutions and sovereign debtors into a trap where the debt overhang persist, debt rescheduling takes place periodically, and condtionality continues indefinitely. See M. Fafchamps (August 199).

2. For an earlier overview see Devesh Kapur (1996).
3. Daniel Kaufmann, Aart Kraay, and Pablo Zoido-Lobatón, "Governance Matters," World Rank, Policy Research Paper, # 2196, October 1999. The authors construct six aggregate indicators corresponding to six basic governance concepts: voice and accountability, political instability and violence, government effectiveness, regulatory burden, rule of law, and graft. According to the authors based on a cross-section of more than 150 countries, there is a strong causal relationship from better governance to better development outcomes
4. Botswana President Festus Mogae at a meeting in Nairobi, quoted in "Africans agree to Donor Conditions on Aid Loans," *Development News*, Sept. 1, 1999
5. IMF, "Albania: Letter of Intent," May 22, 1999.
6. IMF, "Republic of Mozambique-Enhanced Structural Adjustment Facility Policy Framework Paper for April 1999-March 2002," June 10, 1999.
7. For a succinct summary of evaluations of World Rank adjustment operations see Devesh Kapur, John Lewis and Richard Webb, *The World Bank: Its First Half Century. Volume 1: History*, 1997, pp. 541–44.
8. See World Bank, World Development Report, 1999–2000 and James Wolfensohn and Joseph Stiglitz, Personal View, *Financial Times*, September 22, 1999.
9. Projects Advisory Staff, "The World Bank and Institutional Development," May 1980; Samuel Paul, "Institutional Development in World Bank Projects," WPS 392, April 1990; "Reforming Public Institutions and Strengthening Governance: A World Bank Strategy," December 1999.
10. Ninety-five percent of all World Bank operations have a public sector component. In recent years "institution building"has emerged as a major component of World Bank lencing averaging $5 billion a year (about a fifth of all lending) in the period 1997–99. It covers virtually the entire front of public institutions reform ranging from administrative and civil service changes, public expenditure management, tax administration, legal and judicial reform, and public enterprise reform. Technical assistance amounted to almost nine percent of all World Bank lending between 1997–99 – an average of $2.2 billion a year.
11. The study sampled 124 loans to 32 countries, as well as economic and sector work (ESW) from a sub-sample of 11 countries, over the 1980–97 period.
12. Douglas North, *Institutions, Institutional Change and Economic Performance*, Cambridge: Cambridge University Press, 1990, p. 54.
13. See Gregory Clark for a skeptical reading of the view that the Glorious Revolution ushered in a stable regime of taxes and property (1996, p. 588).
14. Richard E. Messick "Judicial Reform and Economic Development: A Survey of the Issues," *The World Bank Research Observer*, Vol. 14 (1) February 1999, pp. 117–36.
15. Indeed, an issues paper on combating corruption, prepared for the September 1997 meetings of the Development Committee by the staffs of the Bank and IMF, defined corruption as "the abuse of public *office* for private gain" (emphasis added).
16. Elliot Richardson, former US Attorney General, who resigned rather than fire special Watergate prosecutor Archibald Cox on the orders of Richard Nixon, lamented that an important ingredient in the Watergate scandal, "an amoral alacrity to do the president's bidding," was traceable less to flaws in the president's own character (although it was reinforced by them) than to "the political and cultural evolution of twentieth century America." (1996).
17. See, for example, Peter Uvin (1998) and Michael Maren (1997 and 2000).
18. A recent report by the US Senate permanent investigations subcommittee charged that foreigners, with Citibank's help, used deliberately opaque networks of shell corporations, offshore trusts and other instruments to shield their identities as they secretly transferred money out of their own countries. The cases reviewed by the Congressional investigations involving Citibank included: tens of millions of dollars transferred by Raul Salinas de Gortari out of Mexico and into overseas accounts in 1993 and 1994 during the presidency of his brother, Carlos Salinas de Gortari; more than $40 million moved through accounts controlled by Asif Ali Zardari, husband of Benazir Bhutto, former prime minister of Pakistan; more than $130 million moved through accounts controlled by El Hadj Omar Bongo, president of Gabon since 1967; more than $110 million moved through accounts connected to Mohammed, Ibrahim and Abba Abacha, sons of the late Gen. Sani Abacha, former military leader of Nigeria.
19. See, for instance, the address by Michel Camdessus on "Money Laundering: the Importance of International Counter measures," in Paris, February 10, 1998 and the communiqué at the spring

1999 meetings of the Interim Committee which stated that the "IMF regards the anti-money laundering actions advocated by the FATF as crucial for the smooth functioning of the financial markets."

20. United States Department of Treasury, *The National Money Laundering Strategy for 1999*, Washington D.C., September 1999.
21. This argument was made by Nancy Birdsall and Devesh Kapur (1999). Vito Tanzi, the head of the IMF's fiscal-affairs division, has argued that the world's financial community should set minimum standards covering anti-laundering rules. Countries that refuse to abide by them would face punitive taxes on capital channeled through their financial centers and have international legal recognition denied to financial transactions taking place on their soil.
22. See for instance Eliot Berg, coordinator for *Rethinking Technical Cooperation: Reforms for Capacity Building in Africa* (1993).
23. The latter fact came to light amidst investigations of $10 billion money laundering by US and Swiss banks and forced the IMF to move the goalposts and change the criteria for Russia to receive the second tranche, with calls for more audits and safeguards against misuse of the current loan program (an audit in early 1999 had revealed that the Russia authorities had given false figures to the IMF on its level of its reserves in 1996).
24. These results have been recently formalized in Dewatripont, M, Jewitt, I. and J. Tirole, "Missions and Accountability of Government Agencies," 1998, mimeo.
25. For a recent analysis supporting the proposition that the influence of politics on IMF lending has increased since the end of the cold war see Strom Thacker (1999).