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Conditionality in extreme circumstances: the IMF and emergency financing during the COVID-19 pandemic

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Abstract

The article highlights the shift in lending policy towards instruments without ex post conditionality by the International Monetary Fund (IMF) amid the COVID-19 pandemic in 2020. The objectives of the article are two-fold: Firstly, it aims to clearly indicate the shift of IMF lending policy towards instruments without conditionality in 2020; secondly, it complements the existing academic literature on changes in conditionality by testing three factors that contribute to the shift. It is concluded that similarly to the global financial crisis in 2008, more discretion was given to IMF staff to rapidly respond to the crisis and that the IMF staff increased the Fund's power position in the global financial safety net through expanded lending. A novelty around the COVID-19 crisis is the change in the normative debate around conditionality, which intensified in the years before the pandemic, suggesting that a more permanent change in IMF conditionality policy is taking shape.

Keywords

Conditionality • COVID-19 • Emergency Financing • International Monetary Fund

INTRODUCTION

The granting of emergency financial assistance without any strings attached by the International Monetary Fund (IMF) to around 80 countries in 2020 has given a reason to re-open the debate on the IMF's conditionality policy. Having received considerable criticism for a meagre and slow reaction to the global financial crisis in 2008, this time around, the IMF was geared up with roughly US$1 trillion in lending capacity and with a willingness not to repeat past mistakes.

The Great Lockdown contracted the global economy by an estimated 3% of the global GDP in 2020, but 'thanks to [the] unprecedented policy response, the COVID-19 recession is likely to leave smaller scars than the 2008 global financial crisis' (IMF, 2021: 18). Surely, the majority of the aforementioned response was not the IMF's effort. Advanced economies rebounded rather strongly on the back of large fiscal stimulus packages and unprecedented monetary policy efforts. The European Union (EU)'s multiannual financial framework was rediscovered in the form of a historic next-generation EU financial support package in July 2020. The US followed with US$1.9 trillion worth of coronavirus relief in March 2021 (Committee for a Responsible Federal Budget, 2021).

However, the situation has been more challenging in parts of the world with fewer financial resources. Emerging market economies and low-income developing countries had less fiscal space to manoeuvre themselves out of the crisis, and the IMF swiftly reinvented certain policy instruments for immediate financial assistance to serve the needs of these countries, even though the sums available were often rather limited. The sudden halt of economic activity due to the health-related lockdowns in 2020 made IMF staff and the Executive Board speculate that recovery will be 'V-shaped'—economic growth would rebound to pre-crisis levels as soon as the pandemic recedes, and lockdowns would be lifted.

Financial assistance needed to be available rapidly. Creating a new instrument would have taken time and may have been unnecessary; therefore, the Fund adapted one of the existing financial assistance instruments—the Rapid Financing Instrument (RFI) and its concessional variant for poorer states, the Rapid Credit Facility (RCF)—to serve as the key IMF instrument for crisis relief. Having been established more than a decade ago, these IMF emergency funding instruments had until the pandemic seldomly been used and were mostly associated with providing relief after natural (e.g. weather-related) disasters, not pandemics. In 2020, around 80 countries turned to the IMF for support through the emergency financing instruments. The lack of programme conditionality, reform guidance or follow-up on spent funds makes these developments striking. During the

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remote Annual Meetings of the IMF and World Bank in 2020, questions were raised by media outlets on whether there has been a change in the approach of the Fund, especially regarding its long-standing association with austerity and conditionality enforcement (Financial Times, 2020). The widespread use of the emergency financing instruments questions the present role of conditionality in IMF lending policy. Is it merely a practical, short-lived diversion during a pandemic-related assistance window, or is it a more general shift in IMF policy?

The objective of this article is twofold: Firstly, it aims to illustrate that there was a shift towards a larger share of financing instruments without conditionality in 2020; secondly, it will investigate some factors that may have led to the shift away from traditional financing instruments with *ex post* conditionality. Grounded in data analysis of the IMF's Key Financial Statistics and by tracking the lending conditions demanded by the IMF by type of lending instrument in the year following the outbreak of the pandemic, this article illustrates that the widespread use of the RFI/RCF instrument has led to an overall *weakening* of IMF conditionality. To understand the underlying dynamic of such a change, we draw on existing international political economy (IPE) and international relations literature on conditionality to derive the following hypotheses: IMF conditionality has been weakened due to (1) time pressure, (2) a desire to strengthen the IMF's power position and (3) normative indecisiveness around the usefulness of conditionality. The selected research methods are qualitative document analysis of official IMF executive management statements and reports. The relative scarcity of the publicly available documents does not prevent from proper investigation of the activities and reasoning of the international public institution, that is, IMF. The documents chosen for the applied positivistic approach to document analysis—search for factual material confirming hypothesis (Denzin, 2017), were selected in full, without sampling. The results challenge existing theoretical accounts that take conditionality as a fixed or given part of IMF policy. Some of the macroeconomic and political reasons for such a policy change amid the COVID-19 pandemic are discussed in the article, revisiting the academic debate on changes to and the continuity of the IMF's conditionality policy.

RESEARCH RESULTS AND DISCUSSION

IMF conditionality in a theoretical context

IMF lending and conditionality have become two inseparable terms over the course of the past couple of decades. Any country that has run into balance of payment difficulties and needs external financial assistance knows better than to approach the IMF unless it was ready to embark on an extensive reform trajectory as part of the IMF's programme conditionality, also referred to as *ex post* conditionality by IMF staff. The IPE literature has therefore largely focussed on analysing the effects of conditionality on economic and social developments (Lee and Woo, 2020; Rickard and Caraway, 2018), taking the very existence of conditionality as a given.

Some scholars have usefully pointed to the scope and diversity of IMF conditionality (Dreher and Rupprecht, 2007; Stone, 2008; Woo, 2010), arguing that conditionality cannot be taken as a homogenous policy that offers the same unified criteria for each country case. Rickard and Caraway (2019) more specifically discover that adding a condition for public sector reform would reduce government spending on the country's public sector wages. Lee and Woo (2020) suggest a country's labour rights worsen when the country is subject to greater labour market conditionality. While there is ample sectoral research on IMF conditionality, the academic literature has been inconclusive about whether or not IMF conditionality has positive effects in terms of bringing a country onto the path of sustainable economic growth (Rickard and Caraway, 2019). Moreover, the existing IPE literature tends to emphasise that the IMF lending and conditionality policy has remained largely unchanged despite attempts to encompass social policy in the post-Washington Consensus era (Broome, 2015). Conditionality has largely become synonymous with IMF lending policy as the IPE literature has been preoccupied with explaining the mechanism from constructivist or rationalist perspectives, or with assessing the effects and effectiveness of conditionality in bringing about inclusive and sustainable economic growth (Dimitrakopoulos, 2020; Rickard and Caraway, 2019).

The use of conditionality, and the analysis thereof in IPE and EU studies, has been growing in popularity since the IMF first exercised it in 1950s (Epstein and Sedelmeier, 2013). Judith G. Kelley provides a very useful definition of conditionality and distinction between normative pressure and conditionality: 'Briefly, normative pressure occurs when an institution advises a government on the direction a policy should take, offering no reward other than the approbation of the institution. Conditionality, on the other hand, involves explicitly linking the change advocated to an incentive, a particular benefit provided by the institution' (Kelley, 2006: 3). This distinction clearly indicates the causal link between the demands and rewards. In the case of economic relations, this correlation can be even stronger or can be legally binding.

Another valuable definition of conditionality that has been provided with regards to international lending programmes was put forward by Tony Killick, who finds that conditionality is 'a mutual arrangement by which a government takes, or promises to take, certain policy actions, in support of which an international financial institution or other agency will

provide specified amounts of financial assistance' (Killick, 1998: 6). The lending policy and conditionality of the IMF have been widely criticised not only by Killick himself but also by John Williamson in a highly influential article outlining the 'Washington Consensus' (1989), as well as by Mark. D. Copelovitch (2010) and other authors (see Collier and Gunning, 1999; Kapur and Webb, 2000), who have concluded that the link between conditionality and structural reforms is failing: 'In the general case, conditionality is not a credible commitment mechanism. Conditionality cannot substitute or circumvent domestic ownership of and commitment to reform' (Santiso, 2001: 8).

However, as explained by Dani Rodrik, when addressing the lending and conditionality capacities of international public lenders like the IMF and the World Bank: '[…] as long as multilateral agencies [i.e. international financial institutions] retain some degree of autonomy from the governments that own them, their interaction with recipient countries, while official in nature, can remain less politicised than intergovernmental links. This in turn endows multilateral agencies with an advantage in exercise of conditionality, (that is, in lending that is conditional on changes in government policies)' (Rodrik, 1995: 3). Rodrik's conclusion brings up two issues in relation to this article: Firstly, this explains the direct capacity of public economic institutions to impose legally binding conditions. Private economic institutions such as banks do not have such direct power. Secondly, unlike international public institutions such as the IMF, private banks will not immediately leave the negative image of a foreign agent imposing its rules.

Conditionality has also been tackled from the point of view of power relationships between various stakeholders: the IMF, its staff, its Executive Board in the form of member states and countries subject to IMF programmes. The external incentives model is a rational-choice institutionalist framework that is popularly applied to conditionality exerted by the EU upon enlargement; it focusses on self-interested agents (accession countries) that willingly fulfil external requirements laid upon them by the European Commission to win the rewards of EU membership (Schimmelfennig and Sedelmeier, 2004). The model has been used when determining the policy success of IMF conditionality, in particular when referring to IMF-EU conditions during the 'euro crisis' (Featherstone, 2015: 6).

Incentives for domestic reform may not be as strong when seeking IMF financing as they are when desiring access to the EU internal market and other EU membership rewards (Sippel and Neuhoff, 2008). Dimitrakopoulos (2020) illustrates that in the case of the Greek IMF programme and the reforming of the tax administration, the model was useful in explaining the direction of reform, but not the final result. Alternative sociological institutionalist or constructivist scholars would argue that conditionality is stronger where staff and the borrowing country do not share the same normative orientations (Chwieroth, 2012, 2015), perhaps due to a form of distrust between parties of different cultural and ideological backgrounds. Featherstone (2015) argues that reform failures in the case of Greece's IMF programme could be attributed to a conditionality strategy that ignored conflicting domestic interests and, most importantly, administrative traditions and cultural norms.

While cultural differences can explain some of the friction surrounding IMF programme design and success rates, scholars inspired by the 'social learning' model would emphasise the role of culture and norm transfer in the process of change once a country under an IMF programme becomes subject to cultural or normative transformations. The work of Heinrich (2020) illustrates that rather than seeing conditionality as an instrument for forced policy transfer, conditionality is a means for international organisations to 'help transfer the intellectual matter that underpins policies' as countries go through stages of the perception, adaptation and translation of knowledge (Heinrich, 2020: 2). While this is useful when seeking explanations for conditionality effectiveness or failure, this vast body of literature is challenged by a shift in structures—the possibility that the IMF's conditionality has changed, potentially transforming the motivations or balance of power of various stakeholders.

There is limited academic literature for explaining changes in the Fund's lending and conditionality policy. This strand of research, which focusses on policy change, covers a range of theoretical ground, including both rationalist and constructivist aspects (Vetterlein and Moschella, 2014: 143). Case in point, the work of Guven (2018), provides evidence of a change in the IMF's conditionality towards the developing world before and after the 2008 crisis. He argues that it reflects an adjusted policy practice of greater flexibility, as well as decision-making discretion being placed in the hands of IMF staff due to challenging crisis circumstances. Interestingly, Guven (2018) and Broome (2015) conclude that the global financial crisis narrowed the IMF's conditionality back to its traditional realms of expertise or 'core business'—fiscal and financial policy—reducing its social and governance engagement within programme cases. One of the reasons for the narrowing of policy fields covered by conditionality appears to have been the operational constraints that arose amid a transforming development finance scene globally, with more alternatives to IMF financing (Guven, 2018: 3) becoming available. It has also been noted that there has previously been a weakening of conditionality in terms of its form: 'Hard' conditionality has been more often replaced with 'soft' conditionality, meaning structural performance criteria have over time been replaced with structural benchmarks (Guven 2017: 1157). However, Guven still points to the persistent presence of conditionality and criticises the IMF for not being adaptive enough in the light of the changing external environment and its own operational

constraints as 'there is the continued weight of conditionality' (Guven, 2017: 1165).

Other research on understanding changes in IMF policy has pointed out that increased lending, including the doubling of concessional lending (resources for low-income developing countries) is 'spectacularly good for business' (Clegg, 2012: 61). Crisis episodes could be a window of opportunity for IMF staff to expand its balance sheets on the back of arguments such as the need to fight poverty or increasing global inequality. He argues that a crisis legitimises bloating the IMF balance sheets and lending activities against the traditionally more 'minimalist' preferences of the United States. Nevertheless, it is clear that the 'developmentalist' behaviour of the IMF explained by Clegg is not quite that of a typical development aid player—the distributed funds are not grants, but rather favourable loans with conditionality and 'ring-fenced spending' (Clegg, 2012: 61). While policies may have become more flexible and friendlier to borrowers during previous crisis episodes, the removal of conditionality in 2008 was out of question.

The IMF has not been lacking criticism for its conditionality policy in the 60 years since its origin, and it has several times discussed and implemented tweaks to the policy against growing criticisms by borrowing countries (Best, 2012). Best finds that ambiguities have long existed in the conditionality policy when compared to the formal guidelines, with key actors within the staff, the Executive Board and stakeholder countries being aware of the discrepancy, and, in fact, welcoming it (Best, 2012: 3). Such 'mission creep' of policy practice has theoretical explanations in traditional principle-agent theory as a form of power struggle: The staff desires to expand the organisation's budget or seeks greater autonomy and discretion (Pollack, 1997). Nevertheless, the IMF staff may weigh the benefits of increased power and autonomy against concerns about a decline in legitimacy due to compromised neutrality or even-handedness, should the level of discretion become too large (Best, 2012: 19).

While there is ample academic literature on conditionality, there is limited existing literature on explaining changes in IMF conditionality. This is regretful, given the sharp and transformative external circumstances the IMF found itself during the COVID-19 pandemic in 2020. There is a clear literature gap to be targeted on the newest developments in IMF conditionality, most notably, the weakening of conditionality through conditionality-free loopholes in the existing lending toolkit. By building on the existing body of work on structural changes in conditionality (Best, 2012; Clegg, 2012; Guven, 2017, 2018), this article looks into new patterns of change via the use of the emergency financing instrument in 2020. Bringing the conclusions of the existing literature into the context of the COVID-19 pandemic, three arguments are derived regarding a potential change in IMF conditionality: (1) more discretion tends to be granted to the IMF staff during times of crisis due to the time pressure and complexity associated with times of crisis; (2) the IMF uses crises episodes to expand its balance sheets and thus increase its power position in the global financial safety net; (3) conditionality is subject to normative interactions between the various stakeholders, with knowledge transfer being based on dominant ideas that do not rapidly change.

RESEARCH RESULTS AND DISCUSSION

Emergency financing reinvented as a cure against the pandemic

The IMF's support to its members during the first year of the COVID-19 pandemic was timely, but not particularly large in size compared to the amounts disbursed during and after the global financial crisis.[1] At the start of the pandemic in spring 2020, the Executive Board agreed to fast-track procedures for granting countries emergency financing and doubled the yearly amounts available under the instruments. The IMF's Managing Director, Christiana Georgieva, voiced a readiness to react using the emergency financing channel:

> 'As we are responding to this unprecedented number of calls for emergency financing—from over 90 countries so far—doubling access to our emergency facilities will help us to meet the expected demand of about US$100 billion in financing and provide stronger support to our member countries in addressing the COVID-19 crisis' (IMF, 2020a).

The actual lending figures increased by slightly less than that the IMF originally anticipated, amounting to around US$70 billion over the course of 2020. When taking a closer look at the instruments through which financing was delivered, it becomes strikingly clear that the IMF's crisis response was largely delivered through a single channel—the emergency financing instruments, namely, the RFI and the variant for poorer states under the Poverty Reduction and Growth Trust (PRGT), the RCF (See Figure 1). Over 80 countries received financial assistance from one of the two emergency financing instruments in 2020. This calls for a closer look at what emergency financing instruments really are and why they were scarcely used before the COVID-19 crisis.

The instruments were set up in their present name and form in 2011 by simplifying and merging the previous Emergency

1 Credit outstanding increased by US$41 billion between 2020 and 2021. Credit outstanding increased by US$101 billion over the course of 2008–2011. Note that disbursements have been steeper in the first year of the COVID-19 crisis than the GFC, but they considerably slowed down in 2021.

Natural Disasters Assistance and the Emergency Post-Conflict Assistance streams of financing. As the word 'rapid' in the title of the instruments suggests, they were designed to give fast-track relief to countries with balance of payment pressures due to a natural disaster or exogenous shock. Health- or pandemic-related emergencies were never explicitly mentioned in the terms of use; in practical terms, the instruments were reformed multiple times to adjust access limits to meet the needs of small island states that are particularly prone to natural disasters that cause a significant drop in their GDP (IMF 2020a). The scope was more broadly interpreted in 2020 to include temporary shocks such as health pandemics.

A key element to the instruments' great popularity in 2020 might have been the fact that emergency financing was made available to countries in which setting up full-fledged upper-credit tranche (UTC) programmes was neither necessary nor feasible. Therefore, it was achieved without involving the typical *ex post* conditionality. As such, it became one of the rare instruments in the IMF's lending arsenal that does not demand any reforms or periodical reviews (IMF 2020a). Although many country stakeholders in the Executive Board repeatedly called for sufficient safeguards on the use of Fund resources (IMF 2020a), emergency financing instruments only have two minor elements that act as safeguards: (1) a letter of intent that the borrowing country drafts ahead of receiving financing and (2) an arrangement with an auditing company to prevent corruption in the use of the funds. Perhaps the more noteworthy built-in 'safeguard' for IMF resources was the low access limit. In 2019, it was only 50% of a country's quota per year (and 100% of quota on a cumulative basis). For comparison purposes, the average Stand-by Arrangement (SBA) with *ex post* conditionality was nearly three times higher—145% of quota in the same 12-month period.

The yearly access limit for the RFI and RCF was subsequently doubled to 100% of quota in the spring of 2020 (with the cumulative access limit rising to 150%). While the SBA access limit was significantly increased, SBAs were not the most favoured instrument during the first year of the crisis. As illustrated in Figure 1, the largest increase in IMF credit outstanding was due to emergency financing instruments (RFI/RCF), with roughly US$30 billion disbursed in 2020.

Another noteworthy development in 2020 was related to the use of *precautionary* lending instruments—the Flexible Credit Facility (FCL) and the Precautionary and Liquidity Line (PLL). These instruments are also exempt from typical *ex post* conditionality, though they do contain the so-called *ex ante* conditionality, meaning a country needs to pre-qualify by showing strong economic fundamentals. The FCL and PLL have higher access limits than the other IMF lending instruments, with a complicated, case-dependent access level assessment procedure. The amounts set aside for Chile and Peru in 2020 were 1,000% and 600% of quota, respectively—potentially 10 times higher than a single disbursement under emergency financing instruments. It can be granted to a country to meet a potential or an actual balance of payment need, but before the COVID-19 crisis, it was merely used as a precaution, without drawing on the sums committed to a country, acting as a type of 'insurance' or backstop. It is therefore particularly noteworthy that in April 2020, Morocco set the precedent of actually drawing on its precautionary envelope of US$3 billion, or 240% of its quota. In other words, in 2020, the previous stigma around drawing from precautionary instruments had faded against the pressing need for external financing.

As illustrated earlier, the new IMF lending patterns that emerged over the course of 2020 point to a weakening in IMF conditionality. This appears both through the widespread

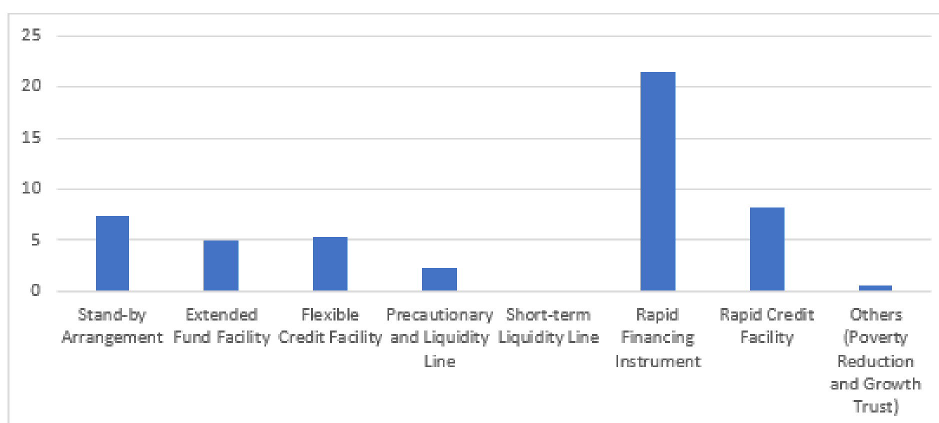

Figure 1. Difference in credit outstanding by lending instrument 2020–2021 (billion USD). *Source*: IMF Weekly Report on Key Financial Statistics (January 2020 and 2021).

use of emergency financing, including through the doubled access limits, and through requests for and the simultaneous drawing of precautionary lending instruments, as in Peru's case in 2020. If we divide IMF lending instruments into two groups—those (1) with *ex post* conditionality, being the SBA and the Extended Fund Facility, versus those (2) without *ex post* conditionality, being the Flexible Credit Line, the PLL, the RFI and the RCF—then the following stands true for 2020: 70% of the increase in credit outstanding was due to instruments *without ex post* conditionality.[2]

COVID-19 AND THREE REASONS FOR WEAKENING IMF CONDITIONALITY

This section looks into three reasons why the IMF and the Executive Board agreed to disburse resources without the same degree of conditionality as in previous crises. Three justifications are put forth and analysed based on the existing IPE literature, theory on conditionality in international relations and a document analysis of press statements by the Managing Director of the IMF, formal statements of IMF members (International Monetary and Financial Committee [IMFC] Communiqués), staff policy papers, IMF Independent Evaluation Office reports, etc. The three reasons analysed are (1) time pressure, (2) a desire to strengthen the IMF's power position and (3) normative indecisiveness on the usefulness of conditionality. Empirical data illustrate that the changes in IMF lending that took place in 2020 were not temporary and that certain underlying conditions were ripe for a more permanent change in IMF conditionality policy regardless of the pandemic.

Time pressure

As the World Health Organization declared the COVID-19 outbreak a pandemic on March 11 and lockdowns were put in place across the globe, the IMF felt the urgency to be prepared to effectively serve its membership with its US$1 trillion lending capacity. Mirroring a certain level of urgency present among state leaders across the globe, the original communication of the IMF contained expectations for a serious economic crisis, with a forecasted 3% fall in the global GDP in 2020 (IMF, 2020b). In the IMF policy paper *Enhancing the Emergency Financing Toolkit—Responding to the COVID-19 Pandemic* published on 2 April 2020, staff envisaged a spike in demand for IMF resources, especially from emerging markets and developing countries:

> '… there could be an unprecedented surge in demand for Fund financing over the next 6–9 months. The Fund has already received requests or inquiries from 87 members, for emergency financing or augmentation of existing arrangements, involving financing of around US$27 billion, based on current access limits. This number is likely to increase as the crisis unfolds—and where necessary emergency support will pave the way for follow up Upper Credit Tranche (UCT)-quality programmes—with the potential for Fund financing to substantially exceed that provided during other global crises' (IMF 2020a, 3).

Interestingly, the demand for IMF resources plateaued at around the mentioned 87 emergency financing requests, neither increasing far beyond the initial interest nor shifting to UCT programmes that would demand resources with higher access limits. Nevertheless, it was natural for the IMF to react to the acute projections as they were lacking previous experience in dealing with global health pandemics. Of course, reacting immediately would prevent the need to give more financing later, after bankruptcies and other economic troubles increase. In fact, the IMF expected the sharp fall in global GDP to be followed by a quick recovery a year later—the so-called V-shaped recovery:

> 'In a baseline scenario, which assumes that the pandemic fades in the second half of 2020 and containment efforts can be gradually unwound, the global economy is projected to grow by 5.8% in 2021 as economic activity normalizes, helped by policy support' (IMF, 2020b: 1).[3]

This original thinking helps explain the background against which the Fund was making decisions: It was believed that may countries would ask for financing to weather the storm, but the external nature of the shock would mean that macroeconomic adjustment, and therefore an IMF programme with conditionality, would not be needed.

On 9 April 2020, the IMF reacted by shortening procedures related to the approval of emergency financing (the RFI and the RCF). Before the pandemic, the time it took for the formal approval of *emergency* financing would be between 3 and 4 months. With this decision, it was cut to 4 working days (for review by the Board and the circulation of documents). This is longer than the already existing Emergency Financing Mechanism (EFM) approval period of 48–72 h that was used at the time of the GFC in 2008. A special streamlining mechanism was established for pandemics, be it the COVID-19 health

2 Source: authors' calculations based on IMF weekly financial statistics. Note that figures for credit outstanding, not committed, are used. The share 'without ex post conditionality' would be even higher if figures of committed resources had been used as precautionary lending instruments take up large sums that are not drawn upon.

3 The original expectations for a quick recovery were later corrected downwards in subsequent IMF World Economic Outlook reports in autumn 2020 and spring 2021.

pandemic or any future pandemic, keeping in mind that all work by Fund staff and the Executive Board needed to take place in a more challenging, freshly established virtual format. The response to time pressure was justified in the IMF in the policy paper as follows:

> 'The risks of contagion, both within and across borders, mean that even the normal lags associated with the approval and disbursements under the RCF and RFI of "urgent" emergency financing could be costly' (IMF, 2020c: 3).

If procedures for adopting emergency financing instruments needed streamlining, slow-burning negotiations between the Fund, Board and the recipient country on the appropriate conditionality seemed even more out of question.

Desire to strengthen its power position

The second proposed reason for the weakening of IMF conditionality, which is also documented in the academic literature in the previous section, is the opportunity to increase the IMF's power position in the global financial safety net through expanded lending and balance sheets. The possibility to forego conditionality would lead to an increase in the demand for IMF resources, as financing could be accessed freely without conditions for painful reforms.

There is no denying that the IMF expressed a readiness to react both in words and in deeds, with a long queue of interested countries forming at the start of the pandemic, even though the amounts disbursed through the emergency financing instruments were not large:

> 'The IMF has moved with unprecedented speed—providing emergency financing to 72 countries in 4 months—and we will continue to support our member countries relentlessly' (IMF, 2020d: 1).

The swift reaction was also associated with the desire to remain relevant in the network of international financial institutions:

> 'The IMF will explore additional tools that could further help in this crisis that is like no other and play our role at the centre of the global financial safety net' (IMF, 2020d: 1).

It also has to be noted that the concessional lending landscape was changing, making it harder than ever for the IMF to remain relevant:

> 'There have… been changes in the credit landscape facing low income countries (LICs), with concessional financing becoming scarcer relative to countries' investment needs and with an increasing number of LICs beginning to access financing from international financial markets' (IMF, 2020e: 3).

In a competitive spirit vis-à-vis these external circumstances, the IMF staff explicitly suggested easing conditionality for certain countries in November 2020 to 'allow for greater tailoring of debt conditionality for LICs that have been accessing international financial markets on a significant scale' (IMF, 2020e: 2).

Various interests are always at play in decisions being made by the IMF. Despite the pressures for the IMF to remain relevant advocated by its staff, there were divergent views as regards the need for maintaining loan safeguards, given that no *ex post* conditionality existed in emergency financing instruments:

> 'Many Directors emphasized the importance of implementing appropriate governance safeguards to mitigate the misuse of emergency financing, and welcomed staff's guidance encouraging commitments related to audits and procurement' (IMF, 2020d: 1).

This protest by some Executive Directors is also a signal that there was indeed a change in risk aversion in the IMF. The IMF's communication illustrates that there was a readiness to expand balance sheets, particularly vis-à-vis emerging market economies, despite the cost of lower safeguards or control over the use of funds, which normally would be ensured thorough conditionality.

Normative indecisiveness on the usefulness of conditionality

Thirdly, the IMF may have weakened conditionality due to an ongoing normative debate around the usefulness of conditionality. The empirical findings point to a more normative change in the IMF conditionality policy that, arguably, had already intensified in the 2 years before the COVID-19 pandemic.

During the Global Financial Crisis, the IMF accelerated its lending through IMF programmes with the granting of 18 new General Resources Account (GRA) programmes in the 20-month period between January 2008 and August 2009 (IMF, 2009). The decade after the crisis was a time of reflection for the IMF, given the widespread criticism of its stringent conditionality policy that came from receiving countries and the academic community. A periodic review of IMF conditionality took place already a few years after the crisis, in 2011. The conditionality policy was considered broadly appropriate with a few lessons learnt, notably in regard to the euro area, where conditions were deemed too stringent and the fiscal adjustment too steep (IMF, 2011). It was decided to improve the targeting of the conditions and make them more parsimonious, to give greater consideration to socio-economic circumstances and to give more ownership and transparency to the authorities of borrowing countries. However, more time was needed to be able to evaluate programme success rates and to clearly understand what challenges the conditionality policy was facing after the spike in lending during the GFC.

The subsequent review in 2018 was more sobering. It was indeed 'the first comprehensive stocktaking of Fund lending operations since the global financial crisis' (IMF,

2019: 1). Looking at the GRA (regular IMF lending) and the PRGT (lending for poorer sates) separately, the following disappointing conclusions were drawn regarding success rates:

- **GRA**: 'One-third of GRA programmes are assessed as successful, one-quarter as unsuccessful, and the remainder as partially successful. Successful arrangements typically managed to both reduce vulnerabilities and eliminate or significantly reduce the BoP [balance of payments] need. Partially successful programmes accomplished one of these two objectives'.
- **PRGT**: 'About 25% of PRGT programmes are assessed as successful, about 50% as partially successful, and about 25% as unsuccessful' (IMF, 2019: 15).

A long list of issues was identified as reasons for the low success rate: GDP growth estimations were too optimistic, fiscal consolidation was more harmful than anticipated, debt sustainability often deteriorated (mostly in programmes that went off-track) and communication surrounding improved ownership on the part of authorities could still be enhanced (IMF, 2019). In the review, the IMF argued that the overly optimistic growth assumptions (which was the case in most programmes) was the dominant factor that correlated with the rate of failure. At the time, the IMF decided not to change its *Guidelines on Conditionality*, but rather to implement its recommendations through the *Operational Guidance Note on Conditionality* and to integrate them in other Fund workstreams. However, Board discussions around the review pointed at the need for a more fundamental shift in the IMF conditionality policy: 'successful implementation of the recommendations would require a change in culture, and continued adaptation and learning' (IMF, 2019: 6).

The IMF's Independent Evaluation Office published the report *Adjustment and Growth in IMF-Supported Programs* a year before the COVID-19 pandemic, in 2019. It confirmed the existence of a growth bias present in the *2018 Review of Program Design and Conditionality* (IEO, 2019). Furthermore, the findings pointed at an overall *fall* in GDP growth in the sample countries of both GRA and PRGT countries during Fund-supported programmes and in the 5 years following them (IEO, 2019). This was surely identified as a problem—'[it was] indicative of an excessive tightening bias and resulted in a perceived stigma, potentially discouraging use of IMF financing and challenging the Fund's reputation' (IEO, 2019: 2).

The empirical analysis illustrates that there was a wind of change in the debate around IMF conditionality in 2018–2019. While the academic literature has been critical of austerity since the GFC, the IMF needed to carry out its own internal evaluations and review process based on accumulated data and lessons learnt before any reconsiderations of the decades-old policy could be made. The findings of the reports were brought to the attention of Fund staff and the Executive Board only a year or two before the outbreak of the pandemic, providing a confusing normative background against which to launch a new wave of crisis lending. Continuing with the old course of action in the light of the lacklustre success rates of IMF programmes may have created legitimacy concerns in an institution that prides itself on data-driven and impartial analysis.

CONCLUSIONS

The main tool with which the IMF responded to the crisis caused by the COVID-19 pandemic in 2020 was an emergency financing instrument without any *ex post* conditionality. This article has illustrated that the instrument was rapidly made available for Fund members through increased access limits and through shortened time periods needed to administer the loan disbursements. The novelty of emergency financing taking centre-stage of the IMF lending toolkit gave this study a reason to investigate the amount of Fund disbursements in 2020 that were not subject to *ex post* conditionality. Dividing the IMF's lending instruments in two groups—those with *ex post* conditionality and those without—it was estimated that 70% of the increase in credit outstanding during 2020 was due to instruments without *ex post* conditionality.

IMF conditionality has been intensively debated in the academic literature for the last decade. The process of demanding reform through awards has been criticised due to the limited domestic ownership and success rates of IMF programmes, especially in terms of economic growth—criticism that in the past decade was only to some extent taken onboard by the Fund. The limited academic literature has focussed on the change that takes place in conditionality over time. Existing arguments have been that the global financial crisis in 2008 resulted in greater flexibility and discretion being given to the IMF staff—the complexity of a crisis makes stakeholders (the Executive Board) more inclined to trade some control for greater operational efficiency. Furthermore, the lending policy may change due to the desire of the international financial organisation to gain more power through expanded balance sheets.

These arguments were taken onboard in the analysis of the COVID-19 pandemic crisis episode; the following three factors were empirically tested as justifications for a weakening of IMF conditionality: (1) time pressure, (2) the IMF's desire to strengthen its power position and (3) normative indecisiveness on the usefulness of conditionality. The empirical analysis confirms the presence of all three factors in the IMF's response in 2020. While the first two drivers have also been noticed in the GFC, the third driver brings particular novelty to the

debate on changes in conditionality. This article has illustrated that the weaknesses in the conditionality mechanism, leading to the high rate of programme failure, were discovered in the IMF's *2018 Review of Program Design and Conditionality* and two Independent Evaluation Office reports.

While conditionality has been tweaked and reformed at regular intervals, these findings and subsequent discussions left the IMF staff and the Executive Directors under pressure to change the conditionality practice more fundamentally. The timing of the crisis, which occurred just a couple years after these evaluations, suggests that there was an interplay of ideological change (shifting consensus around the usefulness of conditionality) and more practical aspects related to the desire to forcefully and rapidly respond to the economic fallout of the pandemic.

Although further research is needed on the evolution of IMF lending as the COVID-19 crisis evolves, these early findings on the first year of the pandemic contribute to the existing literature on changes in conditionality, suggesting that the temporary increase in emergency financing access limits and other temporary policy changes were more than simply part of the expectation of a 'V-shaped' recovery of global economies. Rather, the normative change in the IMF's ideas around conditionality provides a basis for a more permanent shift away from conditionality in Fund lending.

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