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DEVELOPMENT FINANCE, GOVERNANCE AND CONDITIONALITY: POLITICS MATTER

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ABSTRACT: *A salient aspect of the reform of the international financial architecture concerns the uses and misuses of governance conditionality in aid policy. However, the debates tend to focus on the quantitative dimensions of conditionality, oscillating between concerns over how much is too much and how much is enough. Less attention is paid to the manner in which conditionality is applied and the politics of governance reform. This article examines the difficult combination of governance and conditionality in multilateral development finance. It argues that a fundamental paradox characterizes the multilateral development institutions' approach to governance. Furthering governance is conceived both as a condition and an objective of development finance. The effectiveness of multilateral development finance institutions will largely depend on how successfully they will resolve this tension. Ultimately, it is argued, these institutions of global governance ought to explicitly address issues of power, politics, and democracy. This requires ending the economic-political divide of international development assistance.*

Governance and conditionality do not marry well. This essay explores the difficult combination between governance and conditionality in international development finance. It argues that the use of conditionality by international financial institutions (IFIs) to induce governance reform is confronted with a fundamental paradox, as this tends to make improvements in governance both a condition and an objective of development finance. Since these dual objectives are seldom achieved in practice, the tension becomes a contradiction in operational terms. Ultimately, the dilemmas of the governance paradigm reside both in the way it is conceptualized and the manner in which it is applied, those two dimensions being intrinsically linked.

Strengthening governance in emerging countries has become a priority for the international donor community, which recognizes that the quality of domestic institutions explains the quality of growth and the variations in economic performance. It is now amply recognized that feeble governance institutions hamper genuine structural reform, sustainable development, and effective poverty reduction. Weak

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governance not only hurts the poor in low-income countries, but also affects the stability of middle-income countries.

In the 1990s, concerns over the ineffectiveness of aid and the pervasive effects of corruption prompted IFIs to revisit their approaches to economic policy reform. The research generated by the World Bank (1998) has been particularly influential in advocating a more selective approach for allocating aid. The new paradigm of aid effectiveness affirms that aid is basically wasted on uncommitted reformers, and that scarce aid resources should be directed towards those poor countries with good policies and sound institutions. This approach characterizes the March 2002 initiative of the U.S. administration, the Millennium Challenge Account (Radelet 2002, 2003).

Hence, aside from being an objective of development assistance, good governance also becomes a condition of it. Indeed, a salient aspect of the current debates on the reform of international development finance concerns the misuses of conditionality as a means to further governance. Defined as "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 et al. 1998, 6), conditionality is being used not only to induce economic policy reform, but also to alter the institutions of governance in borrowing countries.[1]

This new generation of conditionality, labelled "structural conditionality" in the case of the International Monetary Fund (IMF) (Collier and Gunnning 1999; Goldstein 2001) and "governance conditionality" in the case of the World Bank (Kapur and Webb 2000), has been described as both indispensable and unworkable. The Asian crisis in 1997-98 was pivotal, as it became clear even to the most fervent proponents of conditional lending that conditionality had gone too far (Feldstein 1998). Nevertheless, criticism of the IMF's policies towards Indonesia and Argentina centered on its failure to capture the governance constraints to economic policy reform (in particular, corruption), as well as the governance implications of its adjustment medicine.

Proposals now abound on how to reform the international financial system (Williamson 2000; Goldstein 2000; Kapur 2002). However, most proposals tend to focus on the quantitative aspects of governance conditionality, oscillating between concerns over how much is too much (Goldstein 2001) and how much is enough (IMF 2001e). The IMF's new conditionality guidelines, adopted in September 2002 and replacing those of 1979 (IMF 2002a, 2002b) were intended to streamline structural conditionality, reducing the number of conditions, and to achieve greater coordination between the World Bank and the IMF (IMF 2001f).[2] The overarching, guiding principle is that of parsimony and selectivity: conditionality is to focus on those policies that are critical to achieving the macroeconomic objectives. Nevertheless, this inflexion in IMF policy does not fundamentally question the principle of conditionality per se, but rather its scope, intensity, and degree of intrusiveness.

This article argues that politics matter to effectively reforming governance institutions. By advancing technical solutions to solve embedded political problems and thus circumventing politics, the IFIs' approach to governance reform fails to fully capture the political economy challenges of institutional development. Therefore, IFIs ought to acknowledge and address issues of power, politics, and democracy. This, in turn, would require rethinking the manner in which policy advice is provided and reinserting development lending into the democratic process.

The study is structured in three substantive sections. The first section underscores the tensions of the governance paradigm promoted by the IFIs, both directly through investment lending and indirectly through policy-based lending. The second section analyzes the limitations of the technocratic approach to governance reform in investment lending operations in the public sector, particularly in legal and judicial reform. The third section focuses on the difficult combination between governance and conditionality and the pitfalls of aid selectivity in policy-based lending.

GOOD GOVERNANCE AND DEVELOPMENT FINANCE

The Emergence of the Governance Paradigm

The governance agenda represents an ambivalent enterprise plagued with both promises and dilemmas. As Devesh Kapur and Richard Webb (2000, 18) underline:

> For the IFIs, the new mandate is a boost to their importance, but one fraught with peril. The new mission arrived at a moment when growing doubts regarding the purpose and effectiveness of the IFIs seemed to threaten their funding, and even their continued existence.

Reforming the systems of governance is a politically sensitive endeavor that has traditionally been considered outside the purview of the IFIs' mandates. However, and although the World Bank's founding charter prohibits it from taking into account political considerations when designing aid programs, it has nevertheless de facto stretched its policy frontiers by endorsing good governance as a core element of its development strategy.

The IFIs' preoccupation with the quality of governance and the strength of institutions reflects growing concerns over the effectiveness of aid, as well as its underlying rationale (Easterly 2001, 2002). After the end of the cold war, the pervasive effects of misgovernment, endemic corruption, and abysmal mismanagement in aid-recipient countries could no longer be ignored. The fight against corruption became a core concern of the World Bank in 1996 when its new president, James Wolfensohn, committed the organization to fighting the cancer of corruption. In 1997, the World Bank adopted an anticorruption strategy aimed at mainstreaming anticorruption in the bank's lending policies and practices. It is now well established that corruption has corrosive effects on both economic management and aid effectiveness. As Paul Collier and David Dollar (2001, 21) aptly remark, "aid allocation needs to take corruption into account because, even if aid cannot significantly reduce corruption, corruption can significantly impair aid effectiveness."

The World Bank thus began supporting programs to strengthen accountability institutions, such as the rule of law, judicial systems, public finance management systems, or parliamentary oversight mechanisms (World Bank 2000, 2001a). Between 1996 and 2000, the bank began over 600 governance-related programs and initiatives in 95 countries (World Bank Development Committee 2000). Between 1987 and 1998, the World Bank carried out 169 civil service reform programs in 80 countries. These trends irresistibly tempt IFIs into the uncharted terrain of the reform of domestic political systems (Chavagneux and Tubiana 2000).

Other multilateral development banks (MDBs) have also extended their mandates, some of them prior to the World Bank. In the course of the 1990s, the European Bank for Reconstruction and Development (EBRD 1992), the Inter-American Development Bank (IADB 1996), the Asian Development Bank (AsDB 1995, 1999) and, more recently, the African Development Bank (AfDB 2000) adopted guidelines on governance. Undeniably, there exists significant variation in strategies, dependent on the organization's constituency, mandate, and bureaucratic ethos.

Nevertheless, most IFIs adopt a similar approach to promote good governance, either directly through targeted investment loans or indirectly through policy-based lending. Direct strategies entail providing technical assistance and designing loan operations aimed at strengthening specific institutions of governance, such as judiciaries, legislatures, civil services, tax agencies, or supreme audit institutions. Indirect strategies rely more explicitly on conditional approaches whereby the disbursement of sectoral loans is contingent on the fulfillment of previously agreed policy reforms, contained in the policy matrix of fast-disbursement, policy-based loans. The later strategies rely most heavily on conditionalities.

The World Bank struggles to adequately grapple with the challenges posed by the governance agenda to its traditional modes of operation (Wapenhans 1993). First and foremost, the contours of the concept remain uncertain and have changed over time. As Joachim Ahrens (2001, 54) underscores, "there are still no clear or settled ideas about how effective governance should be suitably defined, let alone how key governance issues can be appropriately incorporated into externally-financed programmes of policy reform." As a result, a variety of definitions, greatly differing in scope, rationale, or objectives, have been advanced. Thus, the mainstreaming of good governance has been fragmented, based on multiple, and at times conflicting, understandings of the concept.

The notion of good governance surfaced in 1989 in the World Bank's report on Sub-Saharan Africa, which characterized the crisis in the region as a crisis of governance (World Bank 1989). It then represented an important departure from previous policy, prompted in large part by the bank's experience in Sub-Saharan Africa. The 1993 report on the East Asian miracle expanded this approach to public policy reform to middle-income countries (World Bank 1993). By 1997, with the world development report on the changing role of the state (World Bank 1997), governance concerns had become an integral component of the bank's core agenda (Burki and Perry 1998).

According to the dominant World Bank definition, the concept of governance captures "the manner in which power is exercised in the management of a country's economic and social resources for development" (World Bank 1992, 1). In contrast, *Webster's Unabridged Dictionary* defines governance as the exercise of authority, control, management, or power of government—in other words, the ability and capacity to govern. The World Bank is careful to underline that its engagement through lending, technical assistance, and policy advice is confined to economic and social dimensions of governance. For the World Bank, governance encompasses the form of political regime, the process by which authority is exercised in the management of a country's economic and social resources for development, and the capacity of governments to design, formulate, and implement policies and discharge functions (World Bank 1991, 1992, 1994). Nevertheless, the World Bank notes that the first aspect—the nature of the political system—falls outside the purview of its articles of agreement.

The World Bank's understanding of good governance reflects a concern over the effectiveness of the state rather than the legitimacy of the power structure and the equity of the economic system. Although it recognizes that politics do matter, it is nevertheless unwilling to address the political roots of government failure and institutional dysfunction. Its conceptualization of governance reveals uneasiness in confronting the political incentives shaping policymaking and the behavior of the state bureaucracy. It also tends to reflect a preference for technical solutions and technocratic understanding of the policy process, emphasizing the organization, systems, and procedures of government.

The World Bank justifies its apolitical approach by arguing that technical improvements can, over time, contribute to improving governance without being diluted or neutralized by the trappings of politics. Similarly, the AfDB, which was the first regional development bank to adopt an official governance policy in 1995, also resists a political approach to governance (AfDB 2000). It defines good governance as sound development management based on four interrelated pillars: accountability, transparency, predictability, and participation. For the AsDB, good governance is good government (AsDB 1995, 1999).

There are understandable justifications for the World Bank's restraint. The pressure to address endemic corruption, bureaucratic ineptness, and economic mismanagement was such that the World Bank had to accommodate its shareholders' demands, in particular those streaming from donor governments. Framing governance as a technical question has allowed the World Bank to justify its involvement in governance issues while remaining within the boundaries of its restrictive mandate. Nevertheless, this compromise has been fragile and constantly questioned as either inadequate or deceitful.

The Limits of the Technocratic Consensus

There are limits to this technocratic consensus, however. The functionalist logic, which claims that economic questions can be separated from politics, gives the illusion that technical solutions can solve political problems. However, governance work always touches on politically sensitive areas, even if the World Bank seeks to confine itself to its economic and social aspects (Santiso 2001, 2002). Institutional reforms are political to the core (Shepsle 1999).

Clarifying the contours of the World Bank's approach to governance is not merely an esoteric exercise for the abstract enjoyment of secluded academics. The World Bank has become the main purveyor of development ideas and acquired a quasi-monopoly on institutional knowledge in the field of economic development (Bezanson et al. 2000). It "does not just lend money and produce ideas: it packages the ideas and the money together" (Gilbert et al. 1999, F610), combining lending with conditionality. In the World Bank's ethos, policy is essentially a sphere of rational analysis, whereas politics is the sphere of irrationality: "politics is treated as a negative input into policy decision-making" (Grindle 2001, 370). It tends to negate politics by circumventing them. This approach echoes the consensus on rational choice theory according to which policy is created in a fairly orderly sequence of stages. However, it fails to capture “the essence of policy making in political communities: the struggle over ideas” (Stone 1989, 7).

First-generation, market-oriented reforms in the early 1990s did indeed advocate for the isolation of economic policy from political processes. They sought to make the institutions of economic governance, such as finance ministries, central banks, and tax authorities, more independent. While macroeconomic orthodoxy and the need for fiscal discipline did justify such insular tactics, these reforms have nevertheless undermined the mechanisms of democratic accountability and have rendered insulated agencies vulnerable to capture. Thus, a tension exists between economic insulation and political accountability (Santiso 2004).

Furthermore, market-oriented economic reforms place a premium on the decisiveness of government in economic policy management. They tend to underestimate the importance of government resoluteness for ensuring the credibility of economic reforms (Haggard and McCubbins 2001.) Indeed, the “importance of government credibility and commitment to policy reform has been essentially neglected as a pivotal condition for effective economic reform” (Ahrens 2001, 75).

Reflecting the prevailing consensus on economic policy, the World Bank’s approach to governance reform aims at insulating policy from politics. For instance, its assistance to the institutions of governance such as the judiciary or supreme audit institutions tend to focus on increasing technical capacity and improving administrative efficiency (Santiso, forthcoming). However, strengthened technical capacity per se does not necessarily translate into improved effectiveness. Governance institutions are likely to remain ineffectual as long as sufficient political space does not exist for them to act independently. In Peru, for example, the modernization of the tax agency in the early 1990s, with the backing of the MDBs, did not prevent it from being captured by President Alberto Fujimori in the late 1990s. Insulation renders institutions more vulnerable to capture.

The inherent tension between the economic and political dimensions of good governance appears the most contentious conceptual issue. The World Bank does indeed experience great difficulty in separating the economic and political aspects of governance. A similar tension can be found in IMF policies (IMF 1997, 2001b; James 1998). In 1996, the IMF was urged by its board of governors to “promote good governance in all its aspects, including by ensuring the rule of law, improving the efficiency and accountability of the public sector, and tackling corruption, as essential elements of a framework within which economies can prosper” (IMF 1996, 3). Since then, its role in governance has expanded considerably.

The IMF has nevertheless couched its approach to governance in a technocratic and neutral mantle, focusing on those economic aspects of governance that could have a significant macroeconomic impact and those that condition the implementation of reforms. In 1997, it adopted guidelines specifying its “involvement in good governance should be limited to economic aspects of governance” (IMF 1997, 3), namely, the transparency of government accounts, the effectiveness of public resource management, and the stability of the regulatory environment for private-sector activity.

The main channels through which the IMF can promote good governance are its surveillance function, its lending, and its technical assistance. In terms of surveillance, the fund seeks to promote standards and codes of good monetary and fiscal practice through its Article IV consultations. Since the Asian crisis in the late 1990s, the IMF has recognized the importance of transparency in monetary and financial policy management, adopting a *Code of Good Practices on Fiscal Transparency* in 2001.[3] A country's observance of these standards is assessed in the *Reports on the Observance of Standards and Codes* (ROSCs): 264 have been completed for 80 countries at the end of June 2002, 193 of which have been published.[4]

However, the IMF's position regarding the political context in borrowing countries remains ambiguous. There is an almost irresistible temptation to slip into more explicit normative questions about the nature of the political regime and the politics of policymaking, in particular when addressing the pervasive effects of structural corruption. The IMF's involvement in the reform of domestic governance stems from its changing role over the last decade, and is partly the consequence of structural adjustment policies introduced in the 1980s. For example, the prolonged negotiations between the IMF and Argentina since the tragic default of the winter of 2001-02 meant that the fund has become, willingly or not, a decisive actor in domestic politics. Similarly, the lending strategy used by the IMF during the Brazilian elections of 2002 effectively restricted national policy by locking in economic policy choices and committing the winner of the pool to a set of predetermined policies. Undoubtedly, the IFIs "have to reconcile their political character with their technical vocation" (Naím 1994, 229).

THE POLITICS OF GOVERNANCE REFORM

Rethinking Public Sector Reform

The limits of the technocratic consensus are particularly notable in the World Bank's public-sector portfolio (World Bank 1999a, 2000a). Investment lending operations in public-sector reform correspond to the aforementioned direct strategy for strengthening governance institutions.

Recent evaluations by the World Bank's Operations Evaluation Department (OED) show that support to state reform has largely failed to generate sustained improvements in public-sector performance. Navin Girishankar (2001) argues that the reason of this limited impact resides in the insufficient consideration of the politics of state reform and the political economy of institutional development. Reviewing a sample of ten country assistance evaluations, Girishankar argues that the World Bank's approach to public-sector reform is constrained by a series of internal institutional incentives and a marked bias for technical solutions. Efforts to improve public-sector management are compromised in particular by "overly technocratic approaches to institutional design [and] a bias toward supplying capacity inputs . . . before reforming governance structures" (Girishankar 2001, 1).

Furthermore, public-sector projects tend to adopt an enclave approach to institutional reform that fails to address the structural causes of poor governance. Relevance is also undermined by the World Bank's inability to respond swiftly to emerging crises either by developing new operations or restructuring existing ones, such as in the case of Thailand or Indonesia. According to Girishankar, "sound technocratic knowledge of institutional constraints and well-designed interventions were not sufficient in promoting public sector performance. . . . In other words, politics mattered" (2001, 27-28).

The Case of Legal and Judicial Reform

These shortcomings are particularly discernible in legal and judicial reform, the area in which MDBs pioneered their involvement in governance reform. It is amply recognized that judicial uncertainty and the weakness of the rule of law constitute the Gordian knot of poor governance in many emerging economies and transitional democracies. The World Bank stresses that its preoccupation with the effectiveness of the judiciary is primarily motivated by its concern with the regulatory environment for economic activity and private-sector development. Consequently, its interventions aim at securing the stability and predictability of the legal framework, focusing on private law, property rights, and contract enforcement. It specifically targets judicial rules, processes, and institutions to ensure their reliability, predictability, and consistency.

Judicial reform has become a core component of the World Bank's governance portfolio. Since 1991, the World Bank has financed 480 projects in 84 countries that deal with or include components of legal and judicial reform, totalling US$380 million. Between 1991 and 2001, it approved 35 projects exclusively devoted to judicial reform. It has also enhanced its technical capacities for assessing judicial performance. It now grounds its work on more comprehensive analytical assessments and a broader array of lending and nonlending instruments. It has regularly undertaken judicial sector assessments (JSA) since 1994, and more comprehensive institutional and governance reviews (IGR) since 1999. The largest judicial reform projects were developed in Venezuela (US$60 million) and Russia (US$58 million). Furthermore, the bank's Legal Vice Presidency has provided legal advice to over 87 countries in over 45 specialized areas since 1986. Training in legal and judicial reform has also become a core activity of the World Bank Institute (World Bank 2000a, 2001c, 2002a).

The World Bank resists addressing political constraints to judicial governance. Building on the 1997 world development report on the changing role of the state (World Bank 1997), the bank governance strategy, *Reforming Public Institutions and Strengthening Governance* (World Bank 2000), recognizes some of the dilemmas it faces in addressing the politics of judicial reform. It acknowledges that a judiciary independent from executive meddling is vital to ensure that the legislative and executive remain fully accountable under the law. Nevertheless, it shies away from pursuing reform initiatives that directly confront the political factors constraining the independence of the judiciary or restraining the Supreme Court's judicial review powers. It seldom confronts the corruption embedded in the judiciary's handling of its own finances. The World Bank's JSA for Argentina of 2001 constitutes an example of this reluctance (World Bank 2001d) when, in fact, the problems with the Argentinean Supreme Court were essentially political. The Supreme Court's automatic majority has sworn allegiance to former President Carlos Menem, who contributed to establishing it. Néstor Kirchner's first political victory has been to end this automatic majority with the resignation of the president of the Supreme Court in July 2003.

An important lesson of over a decade of rule-of-law promotion is that political will is a necessary condition for meaningful judicial reform. However, donors often misread or overlook it. The case of Peru is illustrative in this respect (Hammergren 1998a, 1998b). After a self-inflicted auto-coup by then President Alberto Fujimori in 1992, Peru undertook to reform its judiciary with the support of multilateral development institutions. The strategy sought to overcome the politicization of the courts by creating an independent judicial council. However, the government and Congress emptied the council of its prerogatives and transferred them to a politically complacent Supreme Court and the Public Ministry. All members of the judicial council resigned in protest. In 1998, the World Bank was forced to cancel its US$22.5 million loan, one of the first such occurrences. It subsequently recognized having misread and misjudged Fujimori's authoritarian tendencies, as, by 1997, "there were clear indications that the government was not committed to public sector reform" (World Bank 2002b, 18).

The World Bank's governance strategy of 2000, updated in 2002, reflects these contradictory forces (World Bank 2000a, 2002a).[5] On the positive side, the strategy broadens the initial approach to judicial reform by emphasizing the need to empower citizens and foster political accountability. However, it does not envision the World Bank becoming involved in criminal justice systems and penal code reform or in police and prison reform. The objective remains building institutions for the market (World Bank 2001b), clearly confining its justice-sector work to economic governance. As such, the World Bank's action plan tends to adopt the very enclave approach it criticizes in borrowing governments' reform strategies.

Insular judicial reforms implemented in a piecemeal fashion are bound to fail if they do not address the broader political context of judicial governance (Santiso 2003a, 2003b; Prillaman 2000). Sustaining judicial reform and improving courts' performance not only requires neutralizing opposition to reform, but also crafting pro-reform coalitions that will oversee the process and, more fundamentally, building political incentives for self-sustaining reform. Undeniably, judicial reform must be inserted into the broader context of the reform of the state, as the rule of law requires a state capable of enforcing it.

The technocratic consensus underpinning the World Bank's approach to governance makes it ill equipped to steer politically sensitive processes of judicial reform. Judicial reform programs tend to consider the building of the rule of law as a technical endeavor aimed at bettering the laws, enhancing their administration, and improving their enforcement. In the beginning, projects focused almost exclusively on improving infrastructure and building technical capacity. As Lawrence Tshuma (1999, 92) argues, a "problematic issue with the new institutional economic explanation of law and the Bank's legal framework is their use of the efficiency criterion to evaluate law," often at the expense of broader concerns such as ethical considerations and democratic principles. By proposing technical solutions to political problems, legal experts are vulnerable to the temptation of institutional modelling—replicating their own standard models of judicial organization and function.

In Latin America and the Caribbean, the IADB's approach to judicial reform has, in theory, broader political goals enshrined in the expansion of its mandate in 1994, which now includes the consolidation of democracy as one of its objectives (Biebessheimer 2001). Unlike the World Bank, the IADB does engage in the reform of civil and criminal law. Its policy on the modernization of the state, which was first articulated in 1996, was revised in 2002 to reflect its broader reach. Between 1993 and 2001, it approved eighteen loans and sixty-five technical cooperation operations to reform judicial systems and modernize the administration of justice in twenty-one of its twenty-six member countries, amounting to US$461 million in investment (Biebessheimer and Payne 2001). In practice, however, IADB judicial reform projects tend to focus on enhancing the efficiency of the existing legal and judicial system, rather than attempting to reform it. Furthermore, while World Bank's judicial reform projects tend to accompany larger structural adjustment loans, often attached to them as a condition, IADB projects are designed in response to a demand from its member states. Indeed, this difference partly explains the fact that the IADB has a higher proportion of loans to technical assistance.

An often-overlooked dimension of judicial governance is the need to simultaneously enhance independence and accountability (Santiso 2003b). This requires distinguishing more clearly the independence courts require to impartially impart the law from the accountability principles courts should abide by to account for the way in which they manage their finances and human resources. As a public institution financed by taxpayers' money, the judiciary should abide by the same standards of budget transparency and accountability as any other state institution.

In Brazil, for example, reformers clearly succeeded in restoring the political independence of the judiciary and isolating it from political pressures (Santiso 2003a). The paradox of judicial reform in Brazil is that reformers may have gone too far, and created a judiciary so autonomous that is has become devoid of all accountability. Unaccountable judicial independence has been widely criticized, and both the executive and legislative branches of government have repeatedly stated their support for establishing mechanisms of external control on the judiciary. The case of Brazil does indeed demonstrate that, without the restraining effect of accountability, independence in and of itself is not sufficient to anchor the rule of law. Finding the right balance between independence and accountability is the defining challenge of judicial reform in Brazil. The central question is not whether or not the judiciary is independent, but rather how independent it should be considering a country's specific circumstances. How much is enough? How much is too much?

The social legitimacy of the judiciary as an institution of horizontal accountability is undermined precisely by its lack of vertical accountability. While the courts' judicial decision must satisfy high standards of political independence, the judiciary must be held accountable for the manner in which it manages its finance. Transparency and accountability in judicial finances are critical to strengthen the judiciary's credibility and integrity. As the World Bank recognizes (2002b, 112), "Independence is most relevant to its role in deciding cases and applying the law, but not necessarily to how it handles its finances, makes its purchases, or selects its support staff." As such, the judiciary must satisfy the same external oversight and control by those state agencies responsible for guaranteeing integrity in public finance management. In the case of Brazil, the supreme audit institution at the federal level, the *Tribunal de Contas da Union* (TCU), exercises this function. However, the challenge for enforcing external oversight of judicial finances rests in the weakness of the external auditor itself, as in many developing countries and emerging economies. These considerations open a new area of inquiry for enforcing the accountability of state institutions, such as the judiciary or the parliament, in the management of their budgets, which are, after all, public resources.

The Case of Public Finance Management

Public finance management offers another credible entry into broader governance reform. It is a traditional area of intervention for the IFIs, as it targets those institutions central to economic governance, in particular public administration and public finance management. According to the standard division of responsibilities within Bretton Woods institutions, the IMF concentrates on fiscal policy and tax policy, while the World Bank engages in public expenditure management and tax administration. Needless to say, this odd division of labor has its own set of problems, as it tends to fragment international advice to fiscal policy reform, running the risk of generating contradictory signals. Since the 1980s and the introduction of structural adjustment programs, interventions to strengthen public finance management institutions have multiplied. Traditionally, technical assistance to public finance management systems has tended to concentrate either on the expenditure side, by providing assistance to the prime minister's office, the ministry of finance, or the central bank, or the revenue side, by providing tax reform advice and strengthening the capacities of tax authorities.

However, less attention has been paid to the simultaneous need to enhance the institutions of public finance accountability and oversight (Santiso, forthcoming). In recent years, the MDBs have broadened their reach to supreme audit institutions and parliaments, in particular in their role in the budget process. Nevertheless, their approach remains restrained by a technical bias. The IFIs have rediscovered the role of supreme audit institutions and parliamentary public accounts committees in enforcing public finance accountability and guaranteeing budget integrity. The OECD *Best Practices for Budget Transparency* incorporates specific considerations relating to the role of parliament in the budgetary process and the importance of the broader governance of the budget (OECD 2002.) As such, they go a step further than the IMF's *Code of Good Practices on Fiscal Transparency*, which tends to restrict itself to the governance of the budget within the executive. This restraint is also noticeable in the assistance provided by the IFIs to transitional countries attempting to reform their budget procedures.

Supreme Audit Institutions

In theory, supreme audit institutions act as the main institutionalized mechanism for overseeing the management of public finances and ensuring government accountability. Yet, the multilateral development banks have only recently begun to support the auditors general and strengthen supreme audit institutions, albeit modestly. In Latin America and the Caribbean, the IADB is increasingly active. In the last three years, it has approved over US$86 million in five operations to supreme audit institutions in Latin America (see table 1).

In broad general terms, IADB loans tend to concentrate on improving the administrative efficiency of supreme audit institutions through strategic and organizational development, human resource management, capability building and training, and improvements in information technology, equipment, and infrastructure. They sometimes include provisions for innovative initiatives, such as equity auditing of social spending or environmental audits.

The case of the support provided by the IADB to Colombia is notable, as it reflects an integrated effort to strengthen government accountability, public finance integrity, budgetary oversight, and law enforcement. In April 2003, the IADB approved a US$14 million loan (as part of a US$20 million program) to the office of the attorney general, the *Procuraduría General de la Nación* (PGN), the judicial office in charge of oversight and discipline of public agencies. This program completes a decade-long financing cycle of modernization of agencies of oversight and law enforcement in public finance management, which included a US$23 million loan (as part of a US$42 million program) to the offices of the comptroller general, the *Contraloría General de la República* (CGR), and auditor general, the *Auditoría General de la República* (AGR) in March 2000, and a US$9.5 million loan (as part of a US$15.7 million program) to modernize the administration of justice and the prosecutor's office, the *Fiscalía General de la Nación* (FGN) in December 1995. All three loans had significant counterpart funds (totalling US$31.2 million, or 40 percent of the total), reflecting the recipient country's commitment to the programs, which amounted to US$77.7 million.

TABLE 1
IADB Lending to Supreme Audit Institutions

Year	*Country*	*Title*	*Amount (in $US million)*		
			Total	*IADB*	*Counterpart*
2002	Brazil	Modernization of the Federal Court of Accounts	10	5	5
2002	Chile	Modernization of the Office of the Comptroller General of the Republic	25	15	10
2002	Nicaragua	Modernization of the General Auditing Office	6	5.40	0.60
2000	Colombia	Strengthening the Offices of the Controller and Auditor General of the Republic	43	23	19
2000	Dominican Republic	Program for modernizing the National Congress and the Office of the Comptroller General	28 (2.45)*	22.30	5.70
1999	El Salvador	Modernization of the Accounts Tribunal	Na	na	na
1994	Uruguay	Modernization of the Accounts Tribunal	1.50	1.41	0.09
1993	Caribbean	Audit institutions of the Caribbean countries	0.81	0.60	0.21
TOTAL			88.76		

* Amount allocated to the Dominican supreme audit institution.

Source: Author's compilation as per the IADB approved projects as of May 2003 (see http://www.iadb.org, Internet).

Nevertheless, IADB lending operations resist addressing the broader governance context in which supreme audit institutions operate and the incentives conditioning public finance accountability. These considerations reflect a reluctance to confront the factors conditioning the effectiveness of supreme audit institutions, in particular their political independence, financial autonomy, and functional links with parliaments. Nominations procedures and budget allocation decisions are determined by political considerations, which the MDBs resist addressing. Multilateral lending operations seldom seek to enhance the political independence and budgetary autonomy of supreme audit institutions in an active and purposeful manner.

Supreme audit institutions are particularly exposed to political meddling and prone to capture by partisan interests, especially in presidential systems of government. A strategy for preventing their capture by the executive branch lies in strengthening their functional links with parliaments. However,loans to parliaments and supreme audit institutions are designed separately. Consequently, multilateral lending operations fail to strengthen functional linkages between parliaments and supreme audit institutions. Only in a few instances, such as in the Dominican Republic in 2000 and El Salvador in 1999, did the IADB address the relationship between supreme audit institutions and parliaments. In these two instances, a loan to the supreme audit institution was designed in conjunction with a larger loan for the modernization of the legislature. In the case of the Dominican Republic, these were merged into one single loan operation.

Nonetheless, as table 2 underscores, there exists a series of institutional factors and political variables determining the effectiveness of supreme audit institutions, such as vested powers, supervising power, nomination and removal procedures, and terms of office. Supreme audit institutions in Latin America are indeed characterized by their great diversity. In Argentina, for example, the *Auditor General de la Nación* (AGN) is to act as the technical adviser to Parliament to ensure government accountability and budget oversight. The main opposition group in Parliament nominates the Argentinean auditor. In other countries, supreme audit institutions are nominally autonomous from both the executive and the legislative. Their relations with parliaments are often characterized by distrust, neglect, and suspicion, if not confrontation.

The IFIs should thus actively seek to strengthen the political independence of supreme audit institutions in order to enhance their effectiveness. In general, strengthening technical capacity per se has not dramatically improved the effectiveness of supreme audit institutions, nor has it prevented them from being captured, such as in the case of Nicaragua. Securing the effective independence of supreme audit institutions is a critical determinant of their ultimate ability to hold government accountable, as underscored by the 1977 Lima declaration of principle of the International Organization of Supreme Audit Institutions (INTOSAI) and, more recently, the final report of the INTOSAI task force on independent government auditing (INTOSAI 2001). It is widely recognized that an inherent weakness of the state in developing countries resides in the frailty of the institutional mechanisms of horizontal accountability anchored in those state institutions whose function is to control government and restrain the state (Mainwaring and Welna 2003; O'Donnell 1998; Schedler et al. 1999).

TABLE 2
IADB Lending to National Parliaments

Year	*Country*	*Title*	*Amount (in $US million)*		
			Total	*IADB*	*Counterpart*
2003	Peru	Institutional strengthening program for the Peruvian Congress	10	7	3
2000	Honduras	Modernization of the Honduran Congress	3.25	2.60	0.65
2000	Dominican Republic	Program for modernizing the National Congress and the Office of the Comptroller General	28 (25.55)*	22.30	5.70
1999	Colombia	Modernization of the Congress of Colombia	10	6	4
1999	El Salvador	Modernization and strengthening of the Legislative Assembly	4.40	3.50	0.90
1996	Panama	Project to modernize the legislature	4.10	2.80	1.30
1993	Peru	Institutional development for the legislative branch of government	3.74	2.70	1.04
TOTAL			61.04		

Note: * Amount allocated to the Parliament.

Source: Author's compilation as per the IADB approved projects as of May 2003.

National Parliaments

Parliamentary strengthening is also a relatively new area for multilateral development banks. Multilateral lending tends to focus on hardware investment such as human resources deployment, infrastructure development, and information technology improvements, with the stated aim of strengthening the representative, legislative, and oversight functions of parliaments. In the case of Latin America and the Caribbean, the IADB has approved seven loan operations in the last decade, totalling an investment about US$45 million (as part of parliamentary reform programs totalling over US$60 million) (see table 2).

A characteristic feature of IADB lending to this sector is its focus on improving the quality of the parliament's role in the budget process, primarily by improving strategic planning, the committee structure, and more specifically those parliamentary committees involved in the budget process (e.g., the public accounts committee, the budget committee, or the control and oversight committee). In several cases, IADB lending contributed to strengthen the research capacities for independent budget analysis and establish incipient parliamentary budget offices. There is indeed a heightened awareness of the role of parliaments in the budget process, and their responsibility in ensuring government accountability (Krafchik and Wehner 1998; Manning and Stepenhurst 2002; Schick 2002).

Nevertheless, the IADB remains reluctant to engage in reform of the role of parliament in the budget process, in particular the quality of the legislative process, the role of political parties and party groups in parliament, and executive-legislative relations. As a result, loan operations often fail to generate the systemic impact they potentially could on the quality of the budget process and parliament's role in budget oversight. In several instances, loans have been disbursed with difficulty as a result of questions over their purpose.

The nature of the political regime and the quality of the political party system are key variables, as "opposition parties have the greatest incentive to oversee government" (Messick 2002, 2). The parliamentary opposition has the greatest interest in insuring effective oversight of government. The degree of party cohesion and discipline determines, to a great extent, the effectiveness of the institutions of accountability and the quality of executive-legislative relations. Understandably, these are extremely difficult questions and highly contentious areas of engagement for the international financial institutions.

This brief overview of IADB lending to supreme audit institutions and parliaments in Latin America reflects a reluctance to engage in the political economy of budget accountability and explicitly acknowledge the politics of public finance integrity and anticorruption. The international financial institutions justify their apolitical approach arguing that technical improvements can, over time, contribute to improving governance without being diluted in the intricacies of politics. Framing governance as a technical question has allowed them to justify their involvement in governance issues, while remaining within the boundaries of their respective mandates.

There are limits to this technocratic consensus, however. While usually couched in the language of efficiency and effectiveness, institutional reforms in public finance affect the power relations between different actors. This makes them inherently political (Wildavsky 1964, 1992). Formal budget institutions and processes are indeed interwoven with political dynamics: determining who controls the budget process and how decisions on budgetary allocations are made are intrinsically political decisions over which political actors want to have an influence. As a consequence, trying to separate the economic and the political is, to a large extent, artificial.

Several considerations counsel reconsidering the technocratic consensus underpinning the IFIs' approach to institutional reform in public finance. First, supreme audit institutions occupy a key position in the architecture of public finance management and the broader governance of the budget, in particular vis-à-vis the executive and legislative branches of government (Petrei 1998). Second, their ability to fulfill their mandate largely depends on their independence from government, in particular in presidential systems such as those prevalent in Latin America. Third, their effectiveness and ultimate impact also depends on the quality of their functional linkages and institutional relationships with parliaments in the exercise of their oversight functions (SIGMA-OECD 2002.) Fourth, the quality of parliaments' oversight of government finances also depends on the availability of credible information provided by supreme audit institutions in a timely manner. As such, the quality of the relations between supreme audit institutions and parliamentary public accounts committees is critical.

Thus, there exists unexplored potential in the support provided by MDBs to Latin American auditors general. The second stage of MDBs' support to budget institutions should seek to strengthen the political independence and financial autonomy of supreme audit institutions, and promote more effective links between supreme audit institutions and parliamentary public accounts committees. Furthermore, the IFIs should also seek to devise integrated initiatives addressing the entire budget cycle and the broader governance dimensions of the budget process. This would require, in particular, integrating their efforts to improve public finance management and accountability more closely with those aimed at consolidating the rule of law, reforming public administrations, strengthening legislatures, and combating corruption.

MDBs' support to budget institutions should seek to modify the incentives influencing the behavior of public finance management systems in their entirety. Rather than looking at institutions in isolation by advancing vertical technical solutions, the MDBs ought to simultaneously enhance horizontal dimensions such as interagency cooperation and address the incentives and interests shaping the performance of individuals in institutional contexts. Supreme audit institutions, for instance, are part of a broader system of public finance oversight, whose effectiveness is dependent on the effectiveness of the other institutions in that system. Increasing technical capacity and enhancing analytical capabilities through building legislative research services or improving investigation techniques in audit institutions are likely to remain ineffectual as long as there is insufficient political space for them to be exercised effectively. Technical improvements are likely to be emasculated by unfavorable political environments. The key question for multilateral development institutions is whether oversight institutions can be strengthened by giving them more technical capacity, or whether increased independence and assertiveness would lead these institutions to create and utilize more technical capacity. The IADB's approach to strengthen budget oversight institutions focuses overwhelmingly on the former—building the technical capacity of oversight institutions. However, there are reasons to believe that the latter might be a more efficacious strategy.

GOVERNANCE, CONDITIONALITY AND SELECTIVITY

A second way in which multilateral development institutions attempt to further governance is indirectly, conditioning their structural adjustment lending on governance-related issues. However, the uses and misuses of governance conditionality have spawned intense controversies in recent years.

The Failure of Conditionality

Policy-based lending is inherently conditional. Article III, sec. 5(b) of the World Bank's mandate gives it a duty to "ensure that the proceeds of any loan are used only for the purposes for which the loan was granted." Conditionality is the basis of the contractual relationship between the bank and borrowers throughout the period of a policy reform program (World Bank 2002c). Furthermore, borrowers often use conditionality as an instrument to enhance the credibility of their policy commitments. As Pierre Dhonte (1997, 7) argues, “conditionality outgrows its traditional posture as a frequently obtrusive means of enforcing creditors’ views and becomes an instrument of governments to establish the predictability of their policies.” In this view, the IMF and the World Bank provide useful scapegoats assuming part of the political burden of economic restructuring, in particular in the fiscal arena.

Nevertheless, while the principle of conditionality is not being questioned, the IFIs recognize that its effectiveness must be greatly enhanced. The World Bank’s policy-based loans and the IMF’s structural adjustment programs include a wide array of conditions. However, experience has proven that, for a variety of reasons, conditionality is unable to foster better policies, craft more efficacious institutions, or act as a credible commitment mechanism (Devarajan et al. 2001; Killick et al. 1998; Collier 1997; Mosley et al. 1991). The evidence from multiple evaluations and studies of structural adjustment and policy conditionality suggests that policy measures taken from conviction are more sustainable and more effectively implemented than policy changes introduced through coercive conditionality. Furthermore, the fungibility of aid questions the extent to which targeted lending and earmarked aid can contribute to their intended objectives.[6] Conditionality also fails because of the inability or unwillingness of IFIs to enforce their own conditions when borrowers do not comply with them. Enforcing conditionality would entail suspending disbursements, cancelling loans, or restricting access to future lending for noncomplying borrowers.

However, MDBs have powerful institutional incentives to lend and are therefore reluctant to enforce conditions. One reason is linked to the cost of enforcement itself, as cancelling a disbursement or a loan program disrupts expectations and may destabilize the borrowing country. A second reason is linked to institutional and individual incentives within the MDBs themselves, and their drive to lend money (Naím 1994). The *2001 Annual Review of Development Effectiveness* suggests pressure to lend tends to lead to poorly designed, unrealistic, or ambiguous conditions (World Bank 2002d). A third reason is that weaknesses in supervision, compliance monitoring, and impact evaluation inhibit effective enforcement.

Pressure to lend does not only introduce perverse institutional incentives, it can also create predatory lending practices and the accumulation of what Jeffrey Winters (1997) has labelled criminal debt. Reckless lending occurs when lending is knowingly accorded to corrupt regimes, such as Indonesia under Suharto (Pincus and Winters 2002). Winters (1997) alleges that shoddy accounting practices had allowed corrupt Indonesian officials to steal as much as 30 percent of World Bank loans over a thirty-year period, or approximately US$10 billion (World Bank 1999b; Rich 2002). In such circumstances, the question becomes who is most responsible for reckless lending: the debtor, the creditor, or both?

IFIs recognize that the use of financial leverage cannot compensate for weak domestic institutions or feeble political will. It can actually delay the necessary reforms even further. To a large extent, the World Bank’s own definition of success, largely measured by the level of disbursement, is one of the causes of these dysfunctional incentives. As Melissa Thomas (2002, 6) observes, “the claim that the Bank is constitutionally unable to enforce its own conditions cast doubts on its ability to carry out its mandate.”[7] Furthermore, as Paul Collier (1999, 325-326) notes, “the IFIs have radically overestimated their own power in attempting to induce reform in very poor policy environments. They have, in effect, ignored domestic politics." In order to alleviate the credibility problem, Collier argues, the IFIs must radically redesign their lending policies, revisit their assumptions, and adopt a more selective approach.

The Challenges of Selectivity

The failures of conditionality have prompted a search for alternative strategies. The World Bank's influential report, *Assessing Aid: What Works, What Doesn't and Why* (1998), recommends an approach based on increased selectivity. Recent research has evidenced that the effectiveness of aid on growth tends to increase with the quality of policy and the strength of institutions (Burnside and Dollar 1997, 1998). Consequently, it is argued, aid would be more effective if it were either more systematically targeted to poor countries with sound policies and adequate governance institutions, or used to promote good policies.

Selectivity approaches tend to conceive governance as an objective, rather than a condition for development finance. By promising more assistance to better performing countries, its ultimate objective is to create an incentive mechanism that will entice aid recipients to sustain reform strategies. It is a particular form of ex post conditionality, as it links aid allocations with country performance.

Effective selectivity nevertheless requires instruments to accurately measure the quality of governance and the strength of institutions. The World Bank has thus upgraded its analytical and diagnostic instruments to better capture the strength of governance institutions in aid recipient countries. Traditional instruments to assess budgetary processes, the public expenditure reviews (PER), and public finance management systems, the country financial accountability assessments (CFAA), now integrate governance considerations. Since 1999, the bank regularly conducts institutional and governance reviews (IGR) specifically designed to evaluate the quality of governance. However, there does not yet exist an instrument to adequately diagnose corruption.

Moreover, in 2002, the World Bank updated its operational directive on adjustment lending (OD8.60) to integrate governance concerns and reform conditionality (World Bank 2002c). The World Bank's country assistance strategies (CAS) and the poverty reduction strategy papers (PRSPs) now integrate detailed assessments of the strength of governance. In 1998, the twelfth replenishment of the resources of the International Development Association (IDA) introduced a performance-based allocation system, which underscored the importance of governance factors (IDA 1998, 2001, 2002).[8]

Furthermore, debt relief could give multilateral institutions a way out of the patterns of defensive lending and nonselectivity in the high multilateral debt countries (Birdsall et al. 2001). However, debt forgiveness should be carefully linked to improvements of governance so as to avoid countries' reengagement in unsustainable debt strategies.

The Limits of Selectivity

Nevertheless, aid selectivity has been criticized on a number of grounds. First, even though greater selectivity is likely to increase aid effectiveness, the practice has often

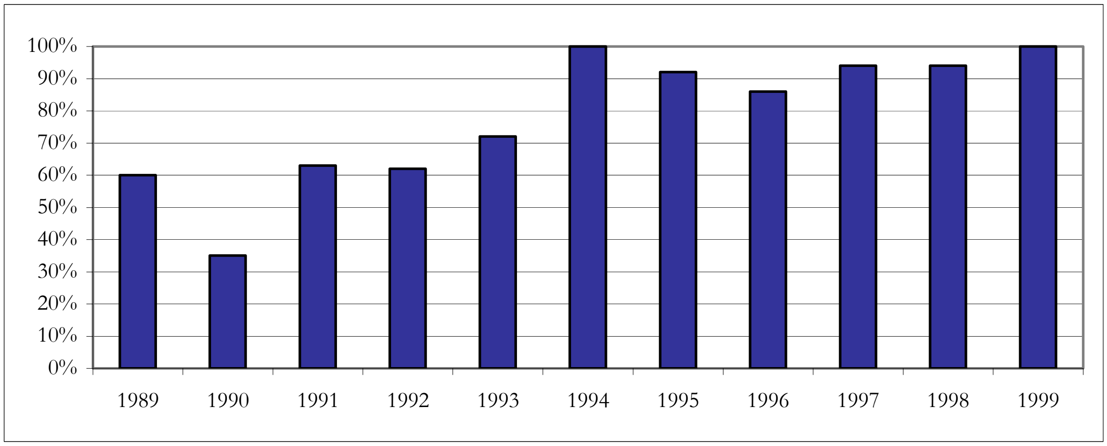

FIGURE 1. Share of IMF Programs with Structural Conditions (1989-1999)

Source: IMF 2001a, 25.

contradicted the evidence. Recent research on aid policy has found that there is no direct relationship between aid flows and policy reform (Burnside and Dollar 1997). Better policies and improving performance too often lead to decreasing levels of development aid (Collier and Dollar 1998). This apparent contradiction tends to undermine the credibility of selectivity-based policies.

Second, as figures 1 and 2 illustrate, the use of conditionality expanded in coverage, scope, and depth during the 1990s. According to the IMF's own assessment, from 1989 to 1999 the share of programs with structural conditions increased from 60 percent to 100 percent, and the average number of structural conditions per program increased from 3 to 12 (IMF 2001a, 2001b).

Governance-related conditions constitute the bulk of the IMF's structural conditions. They represent, on average, 72 percent in Africa, 58 percent in Asia, 59 percent in Central Asia and Eastern Europe, and 53 percent in Latin America and the

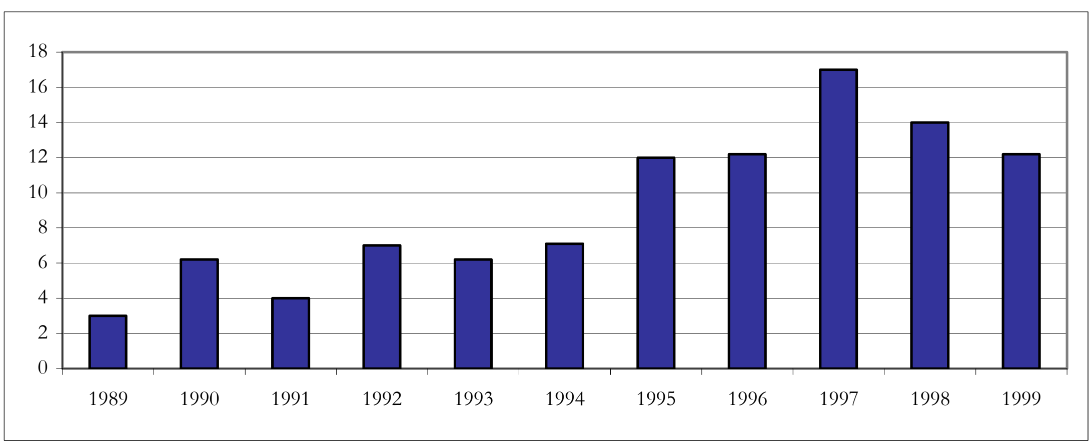

FIGURE 2. Average Number of Structural Conditions in IMF Programs (per Program, per Year, 1989-1999)

Source: IMF 2001b, 10.

Caribbean (Kapur and Webb 2000). For example, according to Kapur and Webb's data, the 1997 IMF program with Indonesia contained eighty-one conditions, of which forty-eight were governance related. Most of the conditions were geared towards improving fiscal transparency and accountability (IMF 2001c). "The difficult paradox," says Naím (2000, 9), "is that any country that is capable of meeting such stringent requirements is already a developed country."

Third, the issue of cross-conditionality and the collective action dilemmas to reduce it compound the problem of conditionality overload. Indeed, a reduction in the conditions imposed by the IMF should not lead to an increase of those imposed by the World Bank, and vice versa. Nevertheless, the rationale for conditional lending is different for the World Bank and the IMF. For instance, in 2001 the World Bank approved a US$400 million loan to Colombia to finance its fiscal reform. However, as Jacques Polak aptly remarked in a seminar on IMF conditionality (IMF 2001e), fiscal reform does not cost money. It could thus be argued that while IMF conditionality is designed to support its loans, World Bank loans are introduced to support its conditionality.

Fourth, selectivity is difficult to implement in practice, as high levels of poverty are often associated with weak governance. It is extremely difficult to devise objective criteria to accurately and consistently measure the quality of governance across countries and over time (Linder and Santiso 2003). In reality, few countries exist that can be classified as either good or bad performers. Most of them lie in the grey area in between. Individual country circumstances make judgmental approaches inescapable.

Finally, the research sustaining selectivity is also being questioned. More recent research argues that while aid might be ineffective in inducing and sustaining reform, it is effective in stimulating growth. There may exist, after all, a positive relationship between aid and growth even in inhospitable environments (Hansen and Tarp 2000). However, at the opposite end, William Easterly et al. (2003) cast doubt on the conclusions reached by Burnside and Dollar, which argued for greater selectivity in aid allocation.

Selectivity may have led to the dangerous exaggeration that aid only works in an environment of sound policy (Beynon 2001). The doubts and controversies surrounding the rashly espoused paradigm of aid policy suggest that it may be, at best, an unreliable guide to policy. Hence, "economists and policymakers should be less sanguine about concluding that foreign aid will boost growth in countries with sound policies" (Easterly et al. 2003, 8).

The debate on aid effectiveness is likely to remain imbued with controversy. Nevertheless, the fact that aid works better in good policy environments appears undisputed (Tarp 2000), although this is a tautological conclusion. More fundamentally, concentrating aid on good performers begs the original concern that spurred the current shift in policies: how can external agencies promote development in poor performing countries? After all, unsatisfactory performance is often associated with poor policies and weak governing institutions. Aid selectivity remains silent on how to improve policies, institutions and governance in poorly performing countries. The policies of aid selectivity, most recently espoused by the U.S. Millennium Challenge Account, circumvent these questions by pushing them aside.

CONCLUSIONS: POLITICS MATTER

> Justice without strength is helpless, strength without justice is tyrannical. Unable to make what is just strong, we have made what is strong just.—Blaise Pascal, *Pensées* (1670)

The governance agenda holds both promises and dilemmas. Over a decade after its emergence in the development agenda, the tension generated by conceiving governance as both a condition and an objective of development finance remains largely unresolved. The efficacy of IFIs in promoting good governance will largely depend on how successfully they resolve this tension. A critical aspect of the reform of IFIs resides in the need to rethink policy advice, both in terms of its contents and the manner in which it is applied.

Undoubtedly, the introduction of the concept of governance has affected what IFIs do and how they do it. The World Bank's recent focus on good governance and corruption reflects a broader trend in which the standard separation between economic and political change has become increasingly difficult to sustain (Pincus and Winters 2002). Traditionally, multilateral development institutions have operated ignoring the realities of power and circumventing the intricacies of politics. This approach faces significant hurdles when applied to reform of the institutions of governance.Governance work is, nevertheless, inherently political.

Three main conclusions can be drawn from the assessment of the difficult combination of governance and conditionality in development finance. The first relates to the nature of policy advice. The second concerns its insertion in democratic processes and the perverse effects of reverse accountability. The third underscores the role of parliamentary oversight.

Rethinking Policy Advice

A frequent failure of the Washington consensus' policy prescriptions has been to not draw attention to some of the trade-offs that policy choices entail, and the centrality of implementation. Implementation failure is a determining cause of reform failure. Thus, as Stiglitz (2003, 117) forcefully argues, "policies have to be designed so that they can be implemented by the kinds of institutions and individuals existing in the developing world [and, consequently,] awareness of the implementation problems should be a central part of the program design." The technical and political feasibility of reforms should be central in the design of reforms. However, the obstinate search for optimal solutions tends to underestimate the advantages of gradualism and muddling-through in complex environments.

A more parsimonious agenda for good-enough governance and second-best options needs to be more carefully considered (Grindle 2000). Feasible reforms are those that effectively integrate considerations about political feasibility and state capacity in their design. Critical reforms such as fiscal policy reform and tax modernization must thus be designed with realistic expectations about the capacity of the state bureaucracy to implement them. These considerations question the rationale and contents of conditionality—both in terms of the number of conditions and their level of detail, as well as the manner in which they are applied. The multiplicity of objectives, the tendency to confuse means and ends, and the failure to prioritize and sequence conditions runs counter to the principles of feasibility and parsimony (Stiglitz 2003).

Restoring Democratic Accountability

Furthermore, the way in which reforms have been designed and implemented have tended to undermine the democratic process itself. Choosing the most adequate set and sequence of reforms is an inherently political decision. As Stiglitz (2003, 119) notes, “macro-issues are far from merely technical matters; they involve trade-offs requiring political judgements” and pragmatic compromises about what is politically feasible. Policy advice should thus restrict itself to delineating the trade-offs between alternative reform strategies. Critics of governance conditionality underscore that the choice of policy course must result from the democratic process.

Policy advice should refrain from prescribing solutions through conditionality, but rather lay out the risks, consequences, and trade-offs of alternative policies, with their respective advantages and disadvantages (Stiglitz 1999, 2000, 2003). The domestic political process will determine the most adequate reform trajectory. IFIs should restrict their role to ensuring that such decisions are sufficiently well informed (Feldstein 1998). Hence, a key procedural reform entailing a cultural shift “would require that the IMF present governments with alternative courses of action” (Stiglitz 2003, 131-132).

The danger, then, is not that the governance agenda per se is wholly undesirable. Rather, it is that “too little attention has been paid to the trade-offs involved in implementing it and the means by which conflicts between liberal, economic and political aspects of the agenda are to be decided” (White 2002, 26-27). For example, effective administrative reform and government transparency are undisputedly laudable goals of reform. However, different interpretations of the concepts may lead to completely different reform objectives and strategies. For economists, government accountability and transparency might well translate into a requirement for predictable policymaking that takes away government discretion in the form of increased independence for the central bank.

Strengthening Parliamentary Oversight

Ultimately, restoring the democratic process would entail strengthening the role of the institutions of representative democracy in the monitoring of multilateral lending and debt strategies. Greater parliamentary oversight of international development finance would significantly contribute to abate the perverse dynamics of reverse accountability.

National parliaments in creditor countries are calling for greater transparency in the operations of the IMF and the World Bank.[9] In 1999, the creditor countries were asked to increase the resources of the IMF and, as a result, have become more wary of the performance of IFIs. They are thus reasserting their authority on foreign economic relations, which until 1999 were monopolized by finance ministries and central banks, mainly through their role in national budget processes. However, parliaments in developing countries have more difficulty in asserting their authority. Truthfully, one must recognize that they are often the origin of governance dysfunction and economic mismanagement. Nevertheless, as the main mechanism of representative democracy, parliaments have a key role to play in overseeing a country's finances. The next frontier for improving democratic accountability in multilateral development finance is thus to enhance the role of national parliaments in developing countries. In May 2003, members of the Brazilian Parliament established a caucus to encourage greater scrutiny and control over multilateral development lending to Brazil.

Undoubtedly, increasing democratic accountability of IFIs toward the poor in developing countries remains a distant ambition. Nevertheless, increasing parliamentary oversight of IFIs is likely to create greater incentives for democratic accountability.

NOTES

1. Various forms of conditionality exist, including preconditions or prior actions as well as trigger actions that determine continued access to development financing and the next outstanding installment of the credit.
2. Upon assuming office in 2000, the IMF's managing director, Horst Köhler, launched an effort aimed at streamlining and focusing conditionality in fund programs (IMF 2001a-d).
3. The code can be accessed at: http://www.imf.org/external/np/fad/trans/code.htm#code, Internet.
4. See: http://www.imf.org/external/np/rosc/rosc.asp, Internet.
5. In recent years, the MDBs have revisited their governance assistance strategies, starting with the World Bank in 2000, the AfDB and the AsDB in 2001, and the IADB in 2002.
6. Aid is said to be fungible when the marginal increase in public expenditure in response to an inflow of aid is not always realized in the targeted area of public expenditure.
7. She adds: "A deeper investigation of Bank incentives and their impact on the institution's ability to carry out its mandate is urgently needed, as is an analysis of institutional and staff incentives" (Thomas 2002, 7).
8. The IDA's country policy and institutional assessment (CPIA) framework has been expanded to take into consideration: (i) accountable and competent public institutions, (ii) transparent economic and social policies and practices, (iii) a predictable and stable legal framework, and (iv) participation by affected groups and civil society.
9. The United States Congress and General Accounting Office, the United Kingdom House of Commons, and the French *Assemblée Nationale* have been particularly assertive in recent years.

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