Conditionality as Policy Externalisation: the Inherent Impasses of Asymmetry[1]

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Abstract

The financing of international financial institutions (IFIs) for countries in financial need has always been based on conditional lending. Finance is disbursed on the condition that the borrowing country implement a set of policies that are devised by the IFIs (the lenders), with these policies expressing a specific theoretical paradigm, i.e. the neoclassical views of economic causalities. This mechanism has become particularly visible in developing countries from the 1970s onwards, after the fall in commodity prices revealed the vulnerabilities of these countries, as all of them have been subjected to similar conditionalities. This 'exchange of finance for policy reform' is an openly asymmetrical device. Moreover it can be described as a 'policy externalisation' and simultaneously a deep intrusion of outside entities within the sovereignty and the political economy of a country. The effectiveness of the reforms-cum-conditionalities that were prescribed by the IFIs has been limited, especially in Sub-Saharan Africa (almost four decades of conditional lending), leading the IFIs to make modifications (e.g., on 'governance', etc), which did not change the framework. The paper argues that this conditional policy externalisation is detrimental to the borrowing economies, due to the irrelevance or the non-developmental character of the content of the prescribed policies ('austerity' with liberalisation). Indeed, the countries that achieved high growth, e.g. the Asian 'developmental states', did so via economic-political arrangements that often were exactly the opposite. The paper also argues, moreover, that conditionality cannot be effective because it is affected by intrinsic impasses, which stem from the concept of conditionality *per se* due to the asymmetry inherent in the device of conditionality and to tensions between effectiveness and credibility. Despite the intrinsic ineffectiveness of the device and almost four decades of detrimental policies, the resilience across time and countries (from Sub-Saharan Africa to Greece) of both the device and policy contents thus seems a paradox: besides reasons related to cognitive issues (e.g., beliefs that the neoclassical framework is 'true'), it may be asked whether

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rather than the economic effectiveness of the 'content' (the prescribed policies), the continuation of the 'form' of the device, i.e. the global political economy that underlies the lenders-borrowers asymmetry, is not *in fine* a key aim of the policy externalisation that is created by conditionality.

Keywords: conditionality; international financial institutions; Sub-Saharan Africa; policy reform

1. Introduction

The financing of international financial institutions (IFIs, principally, the IMF and World Bank) for countries in financial need has always been based on conditional lending. Finance is disbursed on the condition that the borrowing country implement a set of policies that are devised by the IFIs (the lenders), with these policies expressing a specific theoretical paradigm, i.e. the neoclassical ('mainstream') views of economic causalities (e.g., 'liberalisation fosters growth'). Conditional lending is a central mechanism of IFI financing and has been the case since their creation. Yet this mechanism has become particularly visible in developing countries from the 1970s onwards, after the fall in commodity prices revealed the financial and fiscal vulnerabilities of these countries, as all of them have been subjected to similar sets of conditionalities. This 'exchange of finance for policy reform' is an openly asymmetrical device between the 'donor' and the 'recipient'. Moreover it can be described as a 'policy externalisation' (as borrowing governments' domestic policies are elaborated and imposed by outside entities) and simultaneously a deep intrusion of these outside entities within a key dimension of sovereignty and the political economy of a country, i.e. the choices of its long-term objectives and public policies (this sovereignty being definitional of a state). Policy externalisation and the associated conditionalities on reform programmes are likely to meet resistance from recipient countries - civil societies and governments -, create divisions between 'winners' and 'losers', and have often ended in failure.

Indeed, in the early 1980s, a great number of developing countries were facing severe terms of trade shocks and therefore balance of payments difficulties, which stemmed from a significant drop in the prices of the primary commodities exported by these countries. They called upon the IFIs for financial relief – being members of these institutions, and financial assistance being an element of the mandate of the IMF vis-à-vis its members. In exchange for their financial assistance (credits and loans), which at this time was thought to be temporary, the IFIs devised a set of economic reforms that these countries should implement, typically targeting fiscal, financial and monetary issues. These reforms were the conditions for their lending - paradigmatic examples being, among others, stabilisation and adjustment programmes, and compulsory compliance with a wide range of indicators, as in IFIs debt sustainability assessments. During the 1980s and 1990s, however, this forced externalisation of domestic policies to external agencies (the IFIs) and the prescribed reforms were not associated with better economic performance. In Sub-Saharan Africa, for example, these decades were even coined ‘the lost decades in spite of policy reform’ (Easterly, 2001), and the resumption of growth in the 2000s stemmed less from the implementation of IFIs reforms than from global processes on which Sub-Saharan African countries (and IFIs policies) have limited control (e.g., China’s growth and subsequent high commodity prices). Instead of drawing lessons and questioning the reforms’ conceptual framework or the mechanism of conditional lending, this mixed economic success in the 1990s led the IFIs to deepen and extend the domains of conditionalities to the functioning of the government of the developing country in difficulty, and to devise additional reforms, this time targeting its ‘governance’. The underlying theoretical framework here was that the economic problems of developing countries also stemmed from the characteristics of governments – being, e.g., rent-seekers, corrupt, and whose policies are ‘captured’ by interest groups, in line with the theories of public choice or those of ‘positive political economy’.

The fact that the effectiveness of the reforms-cum-conditionalities that were prescribed by the IFIs in the 1980s-1990s has been limited has even been acknowledged by the IFIs, leading them to make a series of modifications in the 2000s (recommending ‘ownership’, ‘ex post’ conditionalities, ‘reforms of governance’, etc), which did not significantly change the general framework of reform-based conditional lending. After almost four decades of conditional lending, most borrowing countries have not witnessed any structural change and incomes have not increased, especially in Sub-Saharan Africa.

Yet the resilience of such devices - conditional lending and policy externalisation - over the ‘*longue durée*’ is remarkable, having been stable across time and space and whatever the outcomes (implemented, e.g., in African or Latin American countries in the 1980s, or Southern European countries in the 2010s). The reform programmes required in the 2010s by the European Commission and the IMF from Southern Europe countries - and more generally by international lenders vis-à-vis countries affected by macroeconomic problems - are strikingly similar to those that have been prescribed to developing countries, notably in Sub-Saharan Africa from the 1980s onwards (despite obvious differences, stemming from, e.g., different monetary systems).

The paper argues that this conditional policy externalisation has been and still is detrimental to the borrowing economies, due to the irrelevance (given countries’ commodity-based economic structure) or the non-developmental character of the content of the prescribed policies (typically fiscal ‘austerity’ with liberalisation, which prevent growth and thus perpetuate in an endless vicious circle borrowing countries’ need for external conditional finance) – the extension to political conditionalities also being affected by theoretical flaws (e.g., their presentation as ‘technical’ reforms): this explains its recurrent failure. Indeed, the countries that achieved high growth from the last decades of the 20th century onwards, i.e. the Asian ‘developmental states’, did so via economic-political arrangements that often were exactly the opposite of conditionality (e.g. autonomy on domestic policies driven by internal coalitions, active state intervention). The paper also argues, moreover, that conditionality cannot be effective because it is affected by intrinsic impasses: the latter stem from the concept of conditionality *per se* (the mechanism of ‘exchanging finance for reform’) due to the asymmetry inherent in the device of conditionality and from the tensions on effectiveness and credibility created by the linkages between economic and political conditionalities.

The resilience whatever the outcomes and across time and countries of both the device and policy contents of conditionalities – and even the latter' extension – despite their intrinsic ineffectiveness, limited credibility and contradictions (e.g., between policy externalisation and intrusion, between the power asymmetry that is constitutive of conditionality on the one hand, and the latter's technical rationale and the credibility of sanctions for noncompliance on the other), is thus a paradox that must be analysed.

Indeed, in view of such stability despite its inherent ineffectiveness, the rationale of conditionality appears to be less economic than political. Conditionalities in fact do not stem from a particular economic fact in a given country (across time and countries, they have been justified by a great variety of facts), conditionalities often tend to be unfeasible or to accumulate, and they ignore collective preferences (e.g. expressions of democracy such as referendums). Similarly, even if they are aware of them, in their activity lenders ignore the debates on both the theoretical justifications and the consequences of conditionalities, including those that prevent conditionalities' success. The non-economic dimension of the device of conditionality also appears in its impact on recipient (borrowing) states: the simultaneous externalisation of policies and intrusion of external agencies into domestic policies 'split' recipient governments (some parts being externalized to foreign agencies, e.g. 'in Washington', and others being governed 'on site' by these agencies); they also break the state-citizens social contract (as it is based on taxation and redistribution, accountability and representation). Equally, in conditionality, the relationship is *ex ante* fundamentally asymmetric and involves hierarchy and coercion. Conditionality and policy externalisation express sheer power relationships. It is typically associated with donors' 'defensive lending' and generates asymmetric 'games' perpetuating conditionality despite its failure (an example being the accumulation of conditions imposed to Greece after 2010 despite the country's compliance with many of them). The 'exchange of financing for policy reform' that justifies conditionality may be analysed via the anthropological analyses of 'gift': these showed the intrinsic asymmetry of relationships presented as 'exchange', which actually create debt (obligation), anticipate a subsequent repayment, and thus maintain a dynamics of debt (and inferiorisation of the party that is unable to repay) – such circuits of both power and wealth being at the core of social relationships (if no debt is created, relationships end) (Mauss, 1954, on the *potlatch* of NorthWest-American Indians). In the 'exchange of financing for policy reform', the financing of fiscal deficits by the IFIs in fact creates debt, and debt is in essence an asymmetrical relationship ('creditors' vs. 'debtors'). In the conditional lending relationship, the asymmetry is even redoubled: the asymmetry inherent in debt (creditors vs. debtors) is doubled by that inherent in conditionality (policy prescribers-'donors' vs. compliers-'recipients'). Indeed a relationship of debt could be conceived without conditionalities (the debtor simply repays). Besides reasons related to cognitive issues (e.g., beliefs that the neoclassical framework is 'true', routines in lending institutions) or interests (Pepinsky, 2014), rather than the economic effectiveness of the 'content' (the prescribed policies), the continuation of the 'form' of the device, i.e. the global political economy that underlies the lenders-borrowers asymmetry, may *in fine* be the key rationale of the policy externalisation that is created by conditionality.

The paper is structured as follows. Firstly, it explains the main features of economic conditionalities. Secondly, it examines the extension of conditionalities to non-economic domains ('governance'). Thirdly, it shows the impasses of conditional lending, both inherent to conditionality itself and to the retroaction between economic and political-institutional conditionalities.

2. Conditionalities as the 'exchange of finance for economic reform'

2. 1. Conceptual premises

The economic conditionalities that the IFIs attached to their financing from the 1980s onwards have been coined the 'Washington consensus'. These can be understood only in their context, in particular the evolution of the theories of the desirable role of the state and those of the public policies that are effective in developing countries. These evolutions closely follow the evolution of development economics theories since WWII, and have been subject to drastic changes (Adelman, 2000a). Indeed, after WWII, developing countries pursued a resource intensive development strategy with limited industrialisation. In some East Asian countries – the so-called 'developmental states', Japan, Korea, Taiwan -, governments implemented with spectacular success a mix of government and market and 'entrepreneurial' policies, where the state helped the functioning of markets (in providing the legal framework, infrastructure, and if necessary being an entrepreneur in last resort) (Aoki *et al*., 1996; Amsden, 1989; Wade, 1990). Developmental states promoted industrialisation via targeted policies (incentives, subsidies, tariffs, policies towards labour markets, technology, etc.). These states showed that opposing states to markets is a fallacy. 'Developmental state' governments displayed a capacity for implementing public policies, and, moreover credible policies.

From 1940 to 1979, the early theorists of development - Arthur Lewis, Paul Rosenstein-Rodan, Albert Hirschman, among others - viewed government as a prime mover and the only entity able to reallocate factors of production from a low-productivity sector (traditional) to a high-productivity sector (industrial) with increasing returns, to correct coordination failures, and to move the economy out of low-level equilibrium traps. Rosenstein-Rodan (1943), in particular, highlighted the importance of spillover effects, the possibility of coordination failures in developing countries and of poverty traps, which justified government intervention. The creation of complementarities (in demand, in markets) was viewed as crucial for development, which could not happen if left only to private sector (Matsuyama, 1997). In this regard, industrialisation had to be planned by the state.

From the early 1980s onwards, the neoclassical paradigm progressively became preeminent in the economic theoretical literature as well as in development policy agencies. Instead of the many determinants of development defended by the first theorists after WWII (e.g., path dependence, non-linearities, low physical capital), these theories isolated single causalities that would explain economic stagnation, and state intervention has been seen as ineffective (Adelman, 2000b). The state became viewed as fostering rent-seeking and predation. Hence the best policies for development were those promoting a limited state and removing price distortions, and trade barriers, viewed as creating an anti-export bias, were the real cause of balance of payments problems. The best incentives provided by public policies regarding the allocation of resources should be the most neutral in terms of discrimination among foreign and domestic markets, with international trade being a substitute for low aggregate domestic demand, as in, e.g., export-led growth (Adelman, 2001).

From the 1980s onwards, this paradigm has constituted the basis for the programmes of the IFIs, the IMF and the World Bank. The set of policy reforms put forward by the IFIs (the ‘Washington consensus’, Williamson, 1990) prescribed fiscal discipline; reordering public expenditure priorities; tax reform; liberalising interest rates; competitive exchange rates; trade liberalisation; liberalisation of inward foreign direct investment (but not the capital account); privatisation; deregulation (easing barriers to entry and exit); the establishment of property rights.

As theoretical thinking evolved in the 1980s, notably on optimal public policies – being irrigated by concepts such as, e.g., market and coordination failure -, the above views have been questioned, also due to the failure of their implementation in Latin America and in Sub-Saharan Africa (SSA). The 1990s thus witnessed more balanced views of the role of the state, in particular at low levels of development: markets may be inefficient in the presence of externalities (e.g., leading to oligopolies) and be affected by failures, which may be a typical characteristic of low-income developing countries. States may be inefficient in terms of allocation of resources, but they may be better than markets in addressing externalities and correcting coordination failures that stem from externalities, economies of scale, and collective action problems. Markets and states are here viewed as complementary, and the state has the role of establishing infrastructure - educational, technological, financial, physical, environmental, particularly in developing countries, as in these countries market failures (information problems, missing markets) are larger and capacities of government to correct them are weaker (Stiglitz, 1997). Equally, the rise of China in the 2000s has promoted views of the role of the state that are closer to the first phase of development thinking in the aftermath of the WWII, e.g., ‘new structural economics’, which was advocated within the World Bank (Lin, 2011) and argued that economic development requires an industrial upgrading that entails large externalities to firms’ transaction costs and returns to capital investment. Thus, in addition to an effective market mechanism, the government should play an active role in facilitating industrial upgrading and infrastructure. As underscored by Hausmann (2012), this confirms that development is about structural transformation and accumulating more productive knowledge, a process exposed to market failures. The views defending a minimal state, however, remain pervasive in mainstream economics and IFIs operational thinking.

Theoretical causalities are not the operational ones: for its part, the IMF has viewed the role of the state through the lens of its mandate, in particular the surveillance of fiscal deficits, and has therefore a strong focus on the public sector in developing countries. In the first stabilisation programmes in developing countries in the 1980s, the IMF prescribed reforms of the civil services that were centred on macroeconomic stabilisation, notably the reduction of the wage bill, and in the 1990s, in view of the disappointing results and the above mentioned theoretical evolution, it prescribed reforms that were based on the improvement of ‘incentives’ and a ‘high-quality public sector’. The IMF also considers that under certain conditions, public investment has positive impacts in developing countries (Clark and Rosales, 2013).

2.2. The conditionalities of the programmes of the international financial institutions

Conditionality and conditional lending are a key feature of an IMF programme: for the IMF, conditionality implies that the borrowing government 'agrees to adjust its economic policies to overcome the problems that led it to seek financial aid', and loan conditions 'ensure that the country will be able to repay' the IMF (IMF, 2017). The disbursement of 'tranches' of loans is contingent on the implementation of a set of reforms monitored via criteria of performance, i.e. contingent on whether the country meets the intermediate policy targets.

The abovementioned views constitute the context of the IFI conceptual framework and ground its conditionalities. The IMF stabilisation programmes that were implemented from the 1980s onwards in developing countries are based on a theoretical relationship between policy targets and macroeconomic aggregates, e.g., growth. The underlying model reflects the Monetary Approach to the Balance of Payments (or the Jacques Polak's model, or Financial Programming), which was developed in the 1950s within the IMF. The model's main focus – the core of IMF Financial Programming - is the balance of payments effects of credit creation by the banking system. The World Bank uses the same identities in its model for evaluating debt sustainability. The purpose of the IMF monetary model is the integration of monetary, income and balance of payments analysis. This model became the basis of the IMF conditionalities applied to its credits. Over time, the model was adapted, broadening and deepening of IMF credit arrangements, and included new specifications (Agenor, 2004).

A typical IMF programme is a set of macroeconomic identities. The IMF monetary model consists of a series of macroeconomic accounting identities that link growth, inflation, money supply, current account, and budget deficit, with intermediate policy targets (e.g., domestic credit to the private sector, reserve accumulation) designed to be consistent with macroeconomic targets like growth, current account adjustment, and inflation, which are supposed to resolve the country's difficulties (Polak, 1997; Baqir *et al.*, 2003). IMF programmes have the theory of 'absorption' as a background: private consumption, domestic investment and government expenditure should not be in excess in regard to domestic income. This is why IMF stabilisation programmes are focused on the reduction of domestic demand and fiscal deficits, on the stabilisation of public spending (i.e. wage bill, investment, equipment, maintenance and recurrent costs), and on the increase of public revenues, the broadening the tax base, and export growth. Hence the mechanisms of an IMF programme are short-term loans to promote balance of payments viability and redress fiscal imbalances and other disequilibria involving structural impediments to growth: typically a 'stand-by' arrangement with credit available in instalments, conditional on the recipient country's authorities' agreement to restrict macro policies.

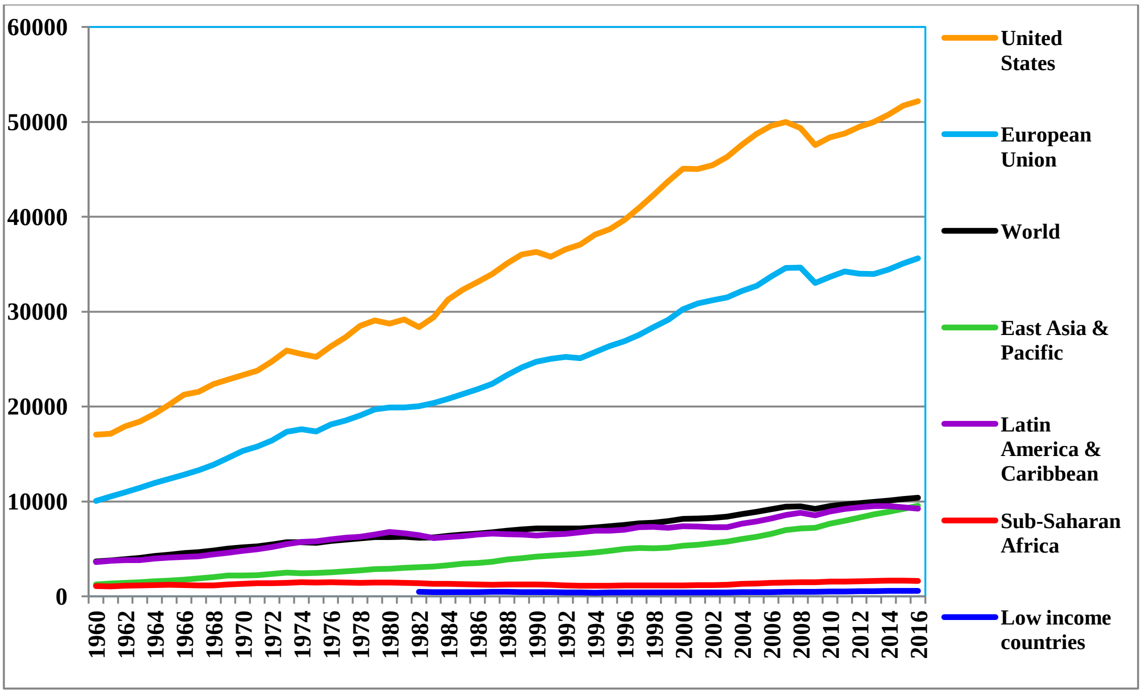
In the 1980s, the IMF progressively underscored that short-term relief financing in fact addressed structural issues: the complexity and scope of structural conditions increased, due to the IMF's growing involvement in low-income and transition countries (IMF, 2017). For the IMF, in addition to demand management and stabilisation policies, governmental and private practices may impede efficient production of goods and services (i.e., supply): this requires changes to the economy, which is to say structural policies. Stabilisation policies are important in the short run, because it is easier to alter the various components of overall demand for a short time than it is to make a country's resources more productive. Stabilisation policies include taxing and spending actions, and changes to interest rates and the money supply. On the longer term, structural changes are required to improve aggregate supply. For the IMF, structural policies not only foster growth, but also the successful implementation of stabilisation policies. Their areas are typically price controls, management of public finances, public sector enterprises, financial sector, social safety nets, labour markets, and public institutions and governance. The latter refer to government salaries, e.g., in tax administration, which, if they are too low, can encourage corruption while employment in the public sector must be limited to business needs, or to inefficient legal systems, too complex business regulations and tax administration, which are detrimental to business climate, contracts enforcement, foreign direct investment and therefore growth (Abdel-Kader, 2013).

Regarding the World Bank, it was also in the early 1980s that the first adjustment programmes were devised and implemented, firstly in SSA countries, and for the same reasons as the IMF programmes, i.e. the severe balance-of-payment crises affecting commodity-dependent countries, which had been induced by the shocks created by the sharp drop in the terms-of-trade due to the fall in commodity prices. The World Bank is by mandate more focused on development, on sectoral issues and project financing. World Bank programmes' main elements are privatisation and liberalisation, especially financial and trade liberalisation: in particular, the suppression of state subsidies (e.g., subsidies to the agricultural sector, or subsidised credit), tariff reduction, dismantling of marketing boards (objectives also being 'getting prices right' and limiting state intervention viewed as distorting prices), in addition to civil service reforms (e.g., in the initial programmes, the freezing of recruitment and wages, voluntary incentives-induced retirement).

In the 1990s, theories of credibility, together with theories of 'global public goods', provided an additional justification of IFIs conditionality. IMF conditionality can serve as a commitment device: via the signing of an agreement that conditions finance to the implementation of a set of measures, the IFIs give credibility to the poorest countries, which otherwise are not credible vis-à-vis international investors (Rodrik, 1995). A consequence of this view - commitment as a justification of conditionality – is that enforcement must be credible (Dreher, 2009).

Despite the implementation of the programmes' conditionalities, however, growth performances remain mixed in many countries, in particular from the early 1980s onwards (after the international debt crisis and terms-of-trade shocks that affected developing countries, notably Latin American and SSA countries) – 'the lost decades' of the 1980s and, for SSA, also the 1990s. Lending was prolonged, one programme followed the other, conditionalities accumulated and repeated themselves, and some countries became 'prolonged users' of IMF conditional lending (IMF-IEO, 2002). In the 2010s, certain SSA countries are entering into their third decade under IFI programmes. Despite decades of reforms and conditional lending, SSA growth and income levels remain low, and are, moreover, characterised by a spectacular divergence when compared with the rest of the world: conditionalities did not improve economic performances and at best have been inefficient (figure 1).

Figure 1: GDP per capita, SSA, world, other regions, 1960–2016 (constant 2010 US$)



Source: World Bank World Development Indicators (online), July 2017.

The failure of IFIs programmes in low-income countries, especially in SSA, induced a closer coordination between the IMF and the World Bank for these low-income countries via the devising of a joint concessional facility - the ESAFs/Enhanced Structural Adjustment Facility (1987). The belief prevailed within the IFIs that recipient governments would 'internalise' conditionalities with time (Coate and Morris, 2006). The ESAF programmes displayed quantitative macroeconomic benchmarks (monetary, fiscal - reduction of fiscal deficits, action on the public spending, contraction of the wage bill and numbers of civil servants, reduction of state subsidies and transfers, e.g. to state-owned-enterprises/SOEs -, international reserves, external debt) and structural benchmarks (e.g., reforms of state-owned-enterprises, financial sector, structural fiscal policy, tax and expenditure management). The stabilisation programmes of the IMF and the adjustment programmes of the World Bank, which support their lending activities, are linked in the different models that underlie them – and also in practice at the country level. While for the IMF the model is derived from the Monetary Approach to the Balance of Payments, for the World Bank the underlying model of the programme is a variant of the 'two-gaps growth model' (Khan *et al*., 1990)**.**

The set of reforms that were the content of conditionalities have evolved over time. Their limited effectiveness in low-income countries led the IMF to launch in 1999 the Poverty Reduction and Growth Facility (PRGF), which succeeded the ESAF, jointly with the Poverty Reduction Strategy Papers (PRSPs) of the World Bank, with these new facilities hoping to be more effective in insisting on a greater 'ownership' of conditionalities by borrowing countries. Conditionalities also evolved after the 2008 global financial crisis. Until the 2008 crisis, conditionalities and their conceptual framework had displayed a remarkable stability across countries – developing and developed. After the 2008 crisis and the ensuing Eurozone crisis (and the creation of the 'troika' for Eurozone's Southern countries with some divergences between the conditionalities of the IMF for its financial relief and those of the European Commission), the IMF recognised the weakness of some of its prescriptions - notably regarding fiscal policy -, and of the underlying conceptual framework (e.g. the calculation of the multiplier, Blanchard and Leigh, 2013). The IMF recommended 'parsimony' (i.e. a focus on conditions that are really 'macro-critical'), flexibility and 'clarity' in the specification of conditions (IMF, 2012; 2014). It has even been argued that the IMF has taken a 'Keynesian' turn, e.g., considering a fairer social distribution of the burden of fiscal sustainability (e.g. more tax on the richest, IMF, 2013) and more flexibility regarding the pace of fiscal consolidation and the composition of fiscal stimulus (Ban, 2014; Ban and Gallagher, 2015).

After 2008, the IMF claimed its adaptability for its facilities and the associated conditionalities in developing countries, notably low-income countries – while, with higher growth rates during the 2000s, some developing countries (e.g., in SSA) were less in need of IMF external financing. The IMF PRGF has been replaced in 2010 by more flexible lending instruments (gathered in the Poverty Reduction and Growth Trust/PRGT), which claimed to take into account the vulnerability of these countries to external shocks, including the major shock of the 2008 financial crisis. The PRGT has three lending instruments: the Extended Credit Facility to provide flexible medium-term support, with more focused and streamlined conditionality; the Standby Credit Facility to address short-term and precautionary needs; the Rapid Credit Facility, offering emergency balance-of-payment support without the need for programme-based conditionality[3]. The IMF has devised a non-financial instrument, the Policy Support Instrument (PSI) in order to support low-income countries that do not want IMF financial assistance, but seek to consolidate their performance with IMF monitoring and support[4]. Though the objectives of the PSI are in line with the IMF 'traditional' conceptual framework, by definition they do not include the usual conditional lending mechanisms.

Equally, the IMF reformed its lending and conditionality in 2009 in order to promote 'national ownership' of the prescribed policies (IMF, 2010). While the goal remains balance of payments viability and macroeconomic stability, the borrowing country is said to have the primary responsibility for selecting, designing, and implementing the policies. Compliance is based on a series of mechanisms, i.e. disbursements in instalments linked to observable policies, quantitative performance criteria and indicative targets, and structural benchmarks (often non-quantifiable reforms) (IMF, 2017). Structural conditionalities have also been reclassified: a key consideration here is the likelihood that a condition is 'macro-critical' and falls within the areas that the IMF considers to be within its core expertise, i.e. macroeconomic stabilisation - fiscal, monetary and exchange rate policies, including the underlying institutional arrangements and related structural measures, and financial systems issues related to the functioning of both domestic and international financial markets. Structural reforms that are aimed at strengthening public sector resource management and accountability are

[3] See 'IMF Support for Low-Income Countries', 11 April 2017. http://www.imf.org/external/np/exr/facts/poor.htm

[4] In April 2017, a PSI had been devised for 7 countries, all in SSA. http://www.imf.org/external/np/exr/facts/psi.htm

here crucial for the IMF. The new classification distinguishes the fiscal policy measures (taxation); public sector resource management and accountability (public sector governance, transparency and financial management); monetary policy, exchange rate policy, accounting, and transparency, which are included in the public sector resource management and accountability category; public enterprise pricing and privatisation; financial sector reforms (IMF, 2009).

Indeed, the IMF has been criticised by its own auditor (the IMF Independent Evaluation Office/IEO) for advising budget cuts to 'some of the largest advanced economies' like Germany, US and Japan in 2010-2011, and endorsing austerity in a 'premature' way. The IEO acknowledges, however, that observing that after the 2008 crisis, policies pursued so far did not improve the growth outlook, the IMF has reconsidered its fiscal policy prescriptions, calling for a more moderate pace of fiscal consolidation and recommending fiscal expansion where it is necessary (IMF-EIO, 2014). A review by the IMF of a decade of lending conditionalities – influenced by the problems of the Eurozone - , while positively acknowledging that it is more flexible and focused, underscored its weakness regarding the 'ownership' of conditions, their transparency and their social consequences (IMF, 2012). The criticisms of conditionality had already led to a decrease in numbers of conditions during the 2000s, e.g. on trade policies (IMF-IEO, 2009), and notably since the 2008 crisis (IMF-EIO, 2014).

Yet, conditionality and its conceptual pillars remain the centrepiece of the act of borrowing from the IMF. The device of 'lending-conditional-to-reform' exhibits a remarkable stability, with, moreover, much similarity in the content of reforms across borrowing countries, be they developing or developed, as shown by the conditionalities attached to the financial rescue of Southern Eurozone countries from 2010 onwards (Sindzingre, 2015) – differences lying mainly in the types of facilities and arrangements. With the debt problems affecting developed economies since the 2008 crisis, this similarity across borrowing countries also refers to the repetition of conditionality-based programmes: as has been the case with its 'prolonged lending' over decades to developing countries, the IMF has been described as engaged in 'serial lending' with some advanced economies (Reinhart and Trebesch, 2016).

Indeed, in 2017 as in previous decades, a typical set of reforms prescribed in exchange for an IMF loan (to a developing or developed country) includes fiscal reforms and adjustment together with structural reforms: e.g.,, the increase in revenue, hiring freeze and control of the wage bill, cut in subsidies, the raising of taxes, privatisation of state-owned enterprises, deregulation and restructuring state-owned enterprises, public financial management (e.g., debt) and monetary policy (e.g., inflation targeting) - conditionalities being monitored via 'quantitative performance criteria', 'indicative targets', and 'macro-critical benchmarks'. Equally, in order to cope with the fall in commodity prices of 2016 and the subsequent terms-of-trade shock and decline in growth rates, the reforms that the IMF recommends to SSA economies consist in, e.g., exchange rate flexibility and reduction of fiscal deficits 'even at the cost of short-term output losses' (IMF, 2016).

Similarly, regarding the Southern Eurozone countries, while the IMF acknowledges that its other partners had 'broader mandates' than its own and prescribed 'additional conditions' (IMF, 2012: 10), it still defends structural reforms for, e.g., the labour and product markets (in Greece, for example, it defends reforms that were already prescribed more than three decades ago in developing countries, such as reduction in the numbers of civil servants and ceilings on pensions[5]). As shown by Kentikelenis et al. (2016), the IMF has even increased the number of structural conditionalities over the period 1985-2014, refuting the '*70 years of reinvention*' claimed by the IMF (Reinhart and Trebesch, 2016).

3. The inclusion of politico-institutional conditionalities in the international financial institutions' programmes

The limited effectiveness of the first stabilisation and adjustment programmes in the 1980s led the IFIs to examine causalities that would not be strictly confined to the conventional economic determinants of growth and stagnation.

The 1980s and 1990s precisely witnessed the growing influence in academic studies of theories of rent-seeking (Krueger, 1974), bureaucracy's inefficiency, and 'heavy hand' of government, in the light of rational choice and public choice theories (Bates, 1988): states became increasingly held responsible of economic failure. Rent-seeking behaviour has been said to be even more likely in resources-based economies (Auty, 2001), in line with the so-called 'resource-curse' arguments. Studies in public choice-inspired political economy were enriched by reflections on 'governance' developed for the analyses of the firm, contracts and regulation, and in developing countries, typically for the understanding of privatisation's successes and failures (Estache and Wren-Lewis, 2009).

In the same vein, in order to explain the mixed economic performances of states in developing countries, theories in political science and political economy during the 1980s qualified these states with concepts such as neopatrimonialism, predation, corruption, cronyism, nepotism, patronage, clientelism, personal rule, authoritarianism (states being said to be, e.g., 'quasi-states', 'kleptocratic', 'vampire states' and the like). The argument of 'extraction' has been particularly popular, with these economies having been analysed as 'extractive economies' – an argument that in fact continues Olson's (1993) analyses on the detrimental effects on development of 'roving bandits' (vs. 'stationary' ones), as in a world of 'roving banditry' there are no incentives to production or accumulation. In 'extractive' economies, governments typically ground their legitimacy on the extraction of natural resources and have no incentive to promote human capital, developmental institutions and growth, and they may even have an interest in preventing development (Acemoglu and Robinson, 2006; 2012).

In the 1990s, many economic studies explored the 'political economy of policy reform', or theories of 'endogenous policies' and of 'bad policies', the latter being viewed as the key determinants of stagnation. Irrespective of the type of political regime, 'bad policies' are here viewed as stemming from governments' inability to use transfers in separating efficiency and distribution, and inability to commit credibly – in line with 2004 Nobel Prize winners Finn Kydland and Edward Prescott (1977) and their argument that the credibility of policy and the capacity for a government to credibly

[5] Poul M. Thomsen: Greece: Toward a Workable Program, *IMF Direct*, 11 February 2016. https://blog-imfdirect.imf.org/2016/02/11/greece-toward-a-workable-program

commit is crucial for these policies' effectiveness (this argument has been a justification for the creation of independent agencies and 'hand-binding' devices, e.g., independent central banks). It has also been argued, however, that all governments face a problem of credibility for their policies, as there is no meta-level above government that has the coercive capacity to enforce its policies and promises (Acemoglu, 2003). In this view, political attitudes are determined by economic incentives, and the form of political and economic institutions results from conflict between groups that have diverging interests (the 'elites' and the 'citizens'): this endogeneity of political and economic institutions (e.g., the locking-in by oligarchies of financial capital enabling that of human capital) may lead to stagnation (Acemoglu and Robinson, 2006).

This inherent lack of credibility affecting developing countries' governments more than others has thus fed the argument that developing countries' governments should create independent 'agencies of restraint' (Collier, 1991) and 'hand-binding' devices, which would give to their policies and commitments the credibility they lack. As mentioned above, for the IFIs conditional lending typically constitutes such a device. Indeed, confronted with their programmes' mixed outcomes, the IFIs have argued that policy externalisation is beneficial in predatory states, because in such states policies lack credibility, especially external credibility vis-à-vis international markets and investors: rulers' domestic policies must therefore be 'locked' by external 'hand-binding' devices that are costly to renege; such costs are incentives to comply with conditions and reforms, and give domestic policies credibility. Examples of such 'agencies of restraint' are international treaties, regional or monetary arrangements, the allocation of policymaking to independent agencies (e.g., central banks, revenue collection agencies) or agreements with the IFIs (e.g. stabilisation or adjustment programmes). For the IFIs, such hand-binding devices are also beneficial for citizens in predatory or dictatorial regimes, as they protect them against these regimes' arbitrariness and clientelism.

The concept of 'failed' states – or 'fragile', or 'collapsed' states - was also crafted within the IFIs and bilateral donors in the 2000s, and was viewed as providing a better account of some situations of programme and conditionality failure. Such states include a significant number of low-income countries, and notably SSA countries: e.g., for the Fund for Peace Fragile States index, in 2017, the worst cases were (in decreasing order) South Sudan, Somalia, Central African Republic, Yemen, Sudan, Syria, DR Congo, Chad, Afghanistan,…[6] 'State failure' has also been explained by initial endowments, e.g., geography and demography (which may be endogenous to each other): 'state failure' is indeed the incapacity to provide public goods such law and order, defence, contract enforcement, infrastructure, which is typically hindered when demographic densities is low, as is the construction of state authority in the context of scattered populations (Herbst, 2000).

In this theoretical context, from the 1990s onwards, the improvement of recipient countries 'governance' thus became an additional objective within the IFIs programmes, with conditionalities increasingly extended to non-economic issues. The conceptual framework keeps the mix of coercion and provision of incentives that characterise economic conditionalities. This period witnessed studies within the IFIs that argued that aid is effective only in countries that are willing to implement the 'good policies' – i.e. in fact the conditionalities put forward by IFIs programmes (Burnside and Dollar, 2000;

[6] Source: Fund For Peace, Fragile States Index 2017: http://fundforpeace.org/fsi/data

2004). Beyond the IFIs, this legitimised for donors the selectivity of their aid flows, i.e. aid should be firstly directed towards the countries that show willingness to implement conditionalities (the ‘good policies’). An illustration of this extension of economic conditionalities to conditionalities regarding governments’ behaviour is the assessment by the World Bank, in order to calculate its IDA[7] resources allocation, of countries’ economic policies and institutions ‘quality’ and their compliance with conditionalities via the indicators of the Country Policy and Institutional Assessment (CPIA) (16 criteria grouped in four clusters: economic management; structural policies; policies for social inclusion and equity; and public sector management and institutions)[8].

Hence from the late 1990s onwards, IFI programmes included conditionalities that were centred on the behaviour of the government and the functioning of political institutions. These were distinct from economic conditionalities, even if the latter affect ‘governance’ (e.g., politically influential interest groups), such as trade liberalisation. Programmes focused, for example, on corruption, accountability, decentralisation and the creation of independent agencies (e.g. for improving the levying of taxes), in line with the theories of independent ‘agencies of restraint’ as key instruments of policy credibility and hence effectiveness. They also focused on the strengthening of ‘democracy’, typically the implementation of elections or the support to parliaments. A key issue is that conditionalities on ‘governance’ are not political reform. In putting forward the improvement of ‘governance’, IFIs and other donors present mechanisms as a matter of incentives (e.g. in civil services) and as technical rather than political. For example, ‘dysfunctionings’ are identified (by donors or consultancy firms), and conditions for financing are formulated in terms of reform of the management of public administration.

4. The impasses of conditionality and of its extension

Conditionalities, however, are confronted with a series of impasses. Moreover, the addition of politico-institutional conditionalities to economic conditionalities has induced unexpected effects and paradoxes. Though the IFIs conducted several reflections on conditionality, e.g., on its time span (short or longer term), they do not question its very existence.

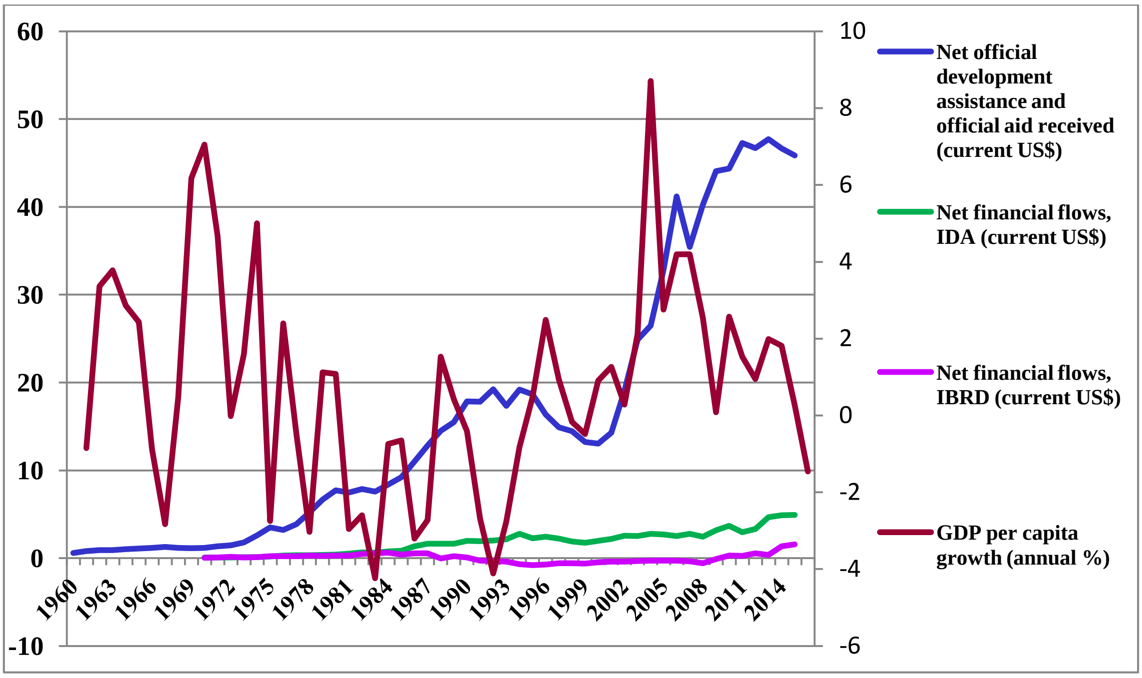
4. 1. The impasses inherent in the mechanism of conditionality *per se*

Conditionalities’ uncertain effects

Conditionalities multiplied since the first stabilisation and adjustment programmes but recipient countries’ economic performances did not markedly improve. In the case of SSA for example, there are no clear links between GDP per capita growth and net World Bank financing – as well as net official development assistance in general (figure 2).

[7] International Development Association, the World Bank’s fund for the poorest countries.
[8] See http://data.worldbank.org/data-catalog/CPIA

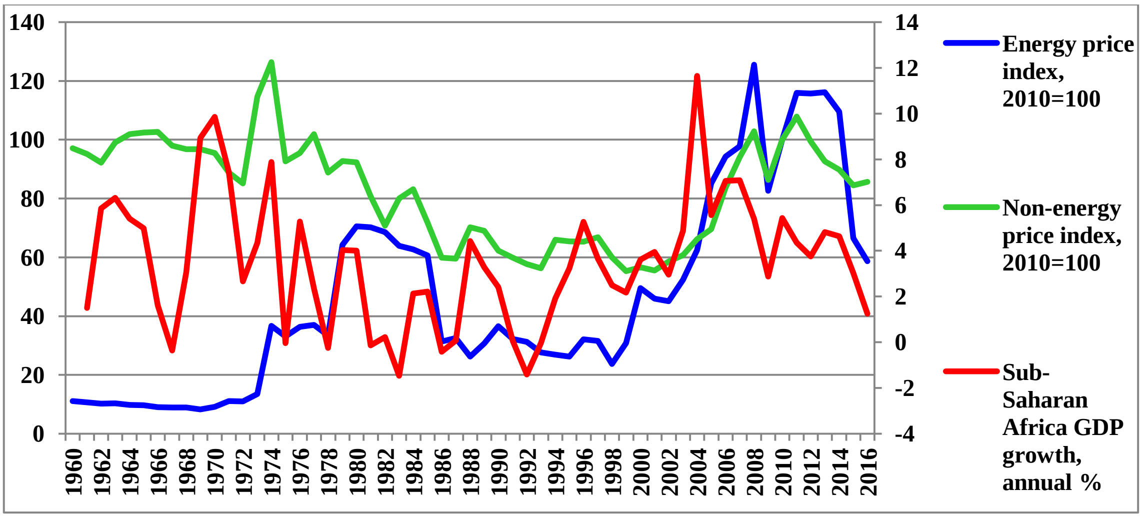
Figure 2: SSA: net financial flows from the IBRD and IDA, net official development assistance (bn current USD) (left scale); GDP per capita growth (right scale), 1960-2016



Source: World Bank World Development Indicators, July 2017. IBRD: International Bank for Reconstruction and Development, the part of the World Bank offering non-concessional financing. IDA: International Development Association, the part of the World Bank offering concessional financing to low-income countries.

Indeed, the coercive power and depth of intrusion of conditionalities is not proportionate to the size of the financing at stake and, moreover, the resources of the IFIs (credit and loans) have grown smaller as a percentage of world income, trade and financial flows since the early-1980s (James, 2017). When economic performances improved, such as in SSA countries in the second half of the 2000s, this was, in fact, due less to the implementation of conditionalities than to these countries' dependence on commodities (precisely the key factor of their fiscal problems and hence their need for IFI conditional lending): i.e. this was due to the increase in international commodity prices in the 2000s. In SSA, growth rates have closely followed international commodity prices in that period (figure 3).

Figure 3: SSA economies' growth rate (right scale) and commodity prices (real 2010 US$, left scale), 1960-2016



Source: World Bank Commodity Price Data, http://www.worldbank.org/en/research/commodity-markets; World Bank World Development Indicators, July 2017.

Indeed, in commodity-dependent economies, the reform programmes that started in the early-1980s did not modify the structural cause of fiscal crises, i.e. vulnerability to external shocks due to a distorted export structure that is based on primary commodities with volatile prices. Behind higher growth rates during the 2000s, the economic structures that generated the dependence on conditional-to-reform lending and the associated externalisation of domestic policies have remained unchanged. These improvements are vulnerable to any reversal of the international environment, the latter being obviously out of the control of borrowing governments' domestic policies - e.g., China's growth deceleration or the fall in commodity prices from 2014 onwards.

The low credibility of the underlying theoretical framework

Equally, the argument that conditionalities channel the lent money in a way that is more economically efficient may not be valid, as argued by a large 'heterodox' literature since the first stabilisation and adjustment programmes in the 1980s. In developing countries, from the 1980s onwards, several studies pointed at the failures of the design, the fallacies of the underlying theories and the inadequacy of conditionalities to borrowing countries' characteristics (Mosley *et al.*, 1991; Taylor, 1993; Adelman, 2001). Both regarding developing countries and developed countries (e.g. in the Southern Eurozone with the joint European Commission-IMF programmes after 2010), such studies argue that these conditionalities are not conducive to growth and actually aggravate countries' macroeconomic problems (e.g. debt and fiscal deficits), and, for developing countries, do not foster structural transformation and departure from commodity-dependence and aid-dependence. Since the 2008 crisis, even non-'heterodox' economists have underscored that the standard economic content of conditions – macroeconomic stabilisation, reduction of fiscal imbalances, privatisation, liberalisation -, is not credible regarding its aims of restoring growth (Wyplosz, 2013; O'Rourke, 2014).

The argument that IFI conditional-to-reform lending provides borrowing governments' policies with credibility vis-à-vis international and domestic agents is not confirmed. For some studies, IMF conditionality appears to be ineffective, and there is no empirical evidence showing that conditionalities have enhanced recipient countries' 'ownership' (Dreher, 2009). It has even been argued that IMF programmes have a negative impact on borrowing countries' growth (Przeworski and Vreeland, 2000). Moreover, for a country the mere fact of having signed a reform programme with the IMF in exchange for financing can even be a negative signal for international investors (Thacker, 1999). When conditionalities appear to be effective, there seems to be a tautological process that conditionalities are effective mostly in countries that show willingness to reform (Wei and Zhang, 2010) – which may question the argument that conditionality should be abandoned in favour of selectivity, i.e. lending to governments that already have 'good' policies and institutions.

A justification of conditionalities is that financing cannot be given without programmes of economic reforms and conditions, as otherwise money would line private and corrupt pockets. The World Bank has consistently justified its adjustment programmes in arguing that privatisation and liberalisation break the rents that characterise developing countries, especially the rents of political rulers and the monopolies of the interest groups and oligarchs thus rewarded in exchange for political support. A similar argument is that without conditions money would be wasted in inefficient policies: conditions oblige governments to make a use of financing that pave the way of future growth, and projects that yield profit or social welfare. These arguments, however, do not always hold: conditionalities may destabilise anti-developmental rulers and oligarchs, but the latter can sometimes adapt them to their own advantage.

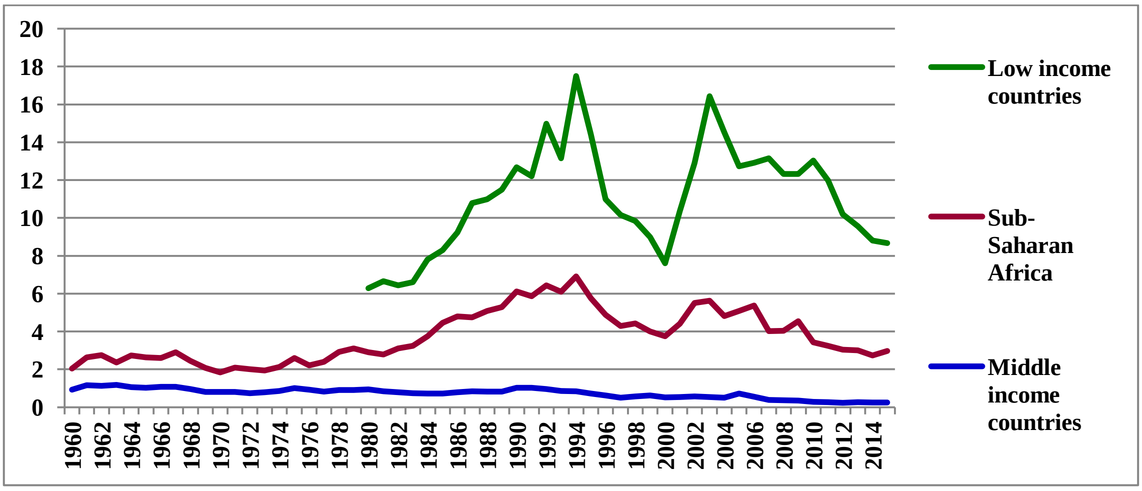
Conditionality as a mechanism that prevents its own objectives

In addition, the externalisation of policies and the very mechanism of conditionality inherently generate resistance from governments (e.g., policy reversal) and citizens, and may induce endless games and moral hazard effects (conditionality may also be impossible to implement). The focus of IFI programmes on 'ownership' and 'participation' of recipient governments, together with the notion of 'partnership' put forward as a description of the relationship between the donor and the recipient, stumble over the intrinsic asymmetry of the relationship: one party finances and exchanges its financing for compulsory reform and the other is in need for financing and has no other choice than to accept this relationship. An IMF Independent Evaluation Office's assessment observed that in 2007 only about half of the structural conditions were complied with on time (IMF-EIO, 2007), which contradicts the objective and requirement of 'ownership' and internalisation of reforms. Over decades of lending and mixed results, the relationships between IFIs and governments have been described as a 'ritual dance' (Kahler, 1992), with some 'aid fatigue' on both sides, and as a 'game' with permanent negotiations - politics of recipient countries have even been coined the 'politics of non-reform' (Van de Walle, 2001).

Conditionality indeed implies and highlights the inherent divergence of interests and asymmetry between the finance-providing IFIs (or other donors) and the finance-receiving government (including other social groups in the receiving country). Aid is typically affected by the 'Samaritan dilemma' (Gibson et al., 2005): e.g., if the recipient government knows that donors condition their aid on a reduction of poverty, it has little incentive to exert high effort toward this objective, as in doing so it will receive less aid in the future. The 'Samaritan's dilemma' is aggravated by moral hazard: the donor can never know if a poor outcome is the result of low effort ('bad policies') or 'bad luck' (Svensson, 2005). Rulers may also exploit policy externalisation in order to stay in power: e.g., using the IFIs and their conditionalities as 'scapegoats' (Vreeland, 1999), manipulating conditionalities in order to put forward their own policies and interests, or practicing 'double-edge diplomacy' (Putnam, 1988). On their side, aid agencies may not enforce conditions, due to their own institutional incentives to lend (or make grants). It has thus been argued that the device of conditionality has in fact contributed to the erosion of the credibility of the IMF vis-à-vis borrowing countries (notably the credibility of the IMF threat of sanctioning non-compliance) due to the dual role of the IMF as a creditor and a monitor of reform (Marchesi and Sabani, 2007). More generally conditionality has contributed to the erosion of the effectiveness and legitimacy of IMF policies, even if their objective is growth.

This policy ineffectiveness may perpetuate aid dependence (Sindzingre, 2012), which is detrimental *per se* – due to, e.g., Dutch disease effects of aid or to its volatility (Bulir and Hamann, 2008): conditionality here creates the conditions of economic failure and its perpetuation. Indeed, since the 1980s, some SSA countries depend on external aid for basic public goods such as infrastructure, health or education. Net official development assistance (ODA) to SSA represented in 2015 3% of GNI, 14.1% of gross capital formation and 9% of imports of goods, services and income[9]. Besides the small island economies of Oceania, SSA is the region of the world that is the most dependent on aid. This poor performance is driven by SSA low-income countries: the ratio net ODA/GNI is by far the highest for low-income countries as a category – 8.7% in 2015 – and some SSA countries, typically oil producers, do not depend on aid (figure 4).

Figure 4: Net Official Development Assistance (ODA) received in percentage of Gross National Income (GNI), 1960-2015



Source: World Bank World Development Indicators, July 2017.

[9] Source: World Bank World Development Indicators, 2017, table 6.11. http://wdi.worldbank.org/table/6.11

4. 2. The impasses of the extension of conditionalities and the inherent links between economic and 'political' conditionalities

The combination of economic and non-economic conditionalities induces self-contradictory processes and paradoxes.

The inherently low credibility and effectiveness of politico-institutional conditionalities

International financial institutions are trapped by their own organisation and conceptual frameworks: the fact that they devised a concept of 'good governance' that is primarily technical due to their Articles of Agreement, prevents the IFIs from intruding in the domestic politics of their members (as borrowing countries are IMF members), despite the fact that conditionalities by definition impinge on political economy and that 'governance' is intrinsically a political concept, which refers to the core of political economy – corruption, inequality – of a government and public administration. This *ex ante* prevents the conditionalities attached to the concept of governance to be effective, if they are confined to forms, e.g. changing organisational charts, providing incentives, but not touching core political structures and their historical determinants. Donors may also be trapped in the 'double edge diplomacy' of local rulers, which always have two divergent agendas, one internal, e.g., staying in power, and one for the external, e.g., donors or investors.

Since the 1980s, in many developing countries, the implementation of conditionalities has not produced tangible outcomes for citizens in terms of standard of living. The implementation of 'governance' programmes has often been confined to reforms of the form of institutions, e.g. the introduction of elections, of agencies of restraint, e.g. for taxation, the drafting of constitutions, etc. Similarly, the same oligarchies have kept the power, and in some countries, whatever the donors' governance conditionalities, whatever the formal democratic institutions (elections, parliaments) rulers could remain decades in power, with no visible opposition from donors when they formally implemented IFIs programmes.

In addition, geopolitical motives may drive IFI loans (Keaney, 2011; Carroll and Jarvis, 2014). Aid is typically a dimension of donors' foreign policy (Alesina and Dollar, 2000) and does not always go to the less corrupt, the more democratic or the poorest (Alesina and Weder, 2002; Easterly and Williamson, 2011; Deaton, 2013). Conditionalities may here clash with other priorities of donors, which can contribute to the weakening of the credibility of governance requirements for the citizens of recipient countries. Donors here reveal that there may be a hierarchy in conditionalities and that they do not always believe in their own conditionalities; they may 'forget' that conditionalities are not complied with when other 'superior' interests are at stake – e.g., regarding their own foreign policy. Recipient countries' citizens may therefore also not believe donors when they recommend these conditionalities. Also, the fact that reforms centre mostly on institutional forms and do not address the structure of local political economy explains that these conditionalities cannot be effective: this ineffectiveness in terms of, e.g., inequality and voicing of citizens also contributes to the lack of credibility of 'governance' conditionalities for recipient countries citizens.

Contradictions between economic and political conditionalities

Economic conditionalities in their quest for being effective may bypass democratic institutions, typically constitutions and parliaments. The latter may vote against certain conditionalities (e.g., the layoff of civil servants, which is part of stabilisation programmes in both developed and developing countries), but this is likely to be ignored by IFIs sequences of conditions-disbursements. Donors may even take over the management of state's institutions (e.g., fiscal institutions) – though this substitution does not result in higher government revenues and better effectiveness (Maurer and Arroyo Abad, 2017, on the example of the United States in Latin America). Yet the effective functioning of such institutions – parliaments, rule of law - is precisely a central dimension of governance conditionalities (Sindzingre, 2014).

Good governance has to be endogenous, internalised, as, e.g. 'participation, 'ownership' cannot by definition be prescribed. 'Ownership' contradicts with the intrinsic asymmetry of the lending relationship (likely to generate resistances). 'Good governance' cannot come from the outside, as prescriptions from external agencies are 'processed' by local norms: these prescriptions are external inputs and are necessarily retransformed according to local political and social norms and by various groups and interests. 'Institutions' are indeed composite entities and result from complex combinations of economic, political, social elements (Sindzingre, 2007).

Political conditionalities, participation, democracy, may contradict with the IFIs economic conditionalities. The requirements by donors in the 1990s of the simultaneous implementation of economic reform and political reform (democratisation) often had detrimental effects, typically the generation of political business cycles (e.g., fiscal deficits created by the costs of elections) in countries in fiscal problems, and hence the aggravation of these problems while IFIs require countries to reduce their fiscal deficits. The injunction of compliance with economic and political conditionalities is a 'double bind' for recipient rulers in low-income countries with limited resources: requirements of democracy are costly in developing countries given a pervasive context of patronage politics and clientelist redistribution that are difficult to break, and they may therefore increase fiscal deficits that other conditionalities require to reduce (Williamson, 1994). Here, in the context of the asymmetry of the conditionality relationship, a recurrent solution for developing countries' governments is to ask donors for more aid for implementing the 'good governance' reforms: donors thus typically finance these governance' reforms, e.g., elections, the functioning of agencies created for improving accountability, transparency, the training and equipment of customs and tax administrations. Equally, in countries under assistance programmes, it is typically donors who finance fiscal deficits, e.g. via budget support, while conditionality on spending makes it so that education or health are sacrificed by rulers in favour of more discretionary spending driven by their political interests and the local political economy (and usually indifferent to citizens' welfare) – health and education becoming funded via multiple projects from a great number of external donors (which generate detrimental coordination problems that weaken public policies effectiveness, which in turn fosters the need for external financial support). *In fine*, the asymmetry of aid dependence and conditional financial support (loans or grants), and their detrimental consequences, perpetuate themselves in vicious circles.

The contradictions inherent in sanctions for non-compliance

Sanctions for non-compliance with conditionalities also highlight contradictory effects. Firstly, as in any binding arrangement in international relations, sanctions of non-compliance reflect the balance of power relationships of the parties of the arrangement: the implementation of sanctions depends on the geopolitical importance of the non-complying countries. This is shown not only by arrangements with the IFIs, but, as is well-known, by the compliance with fiscal rules of EU member countries: sanctions appear difficult against the most important founding members[10] while explicit political power relationships, the toughest sanctions and even 'financial asphyxia'[11] are chosen vis-à-vis the weakest countries if lenders and borrowers openly express their divergence on the policies they want to implement (as in Greece in 2015).

Secondly, as is often the case in low-income commodity-dependent countries, conditionalities are not complied with not always because governments do not want it, but because they cannot do it, e.g., as countries may be caught in a poverty trap combining limited fiscal resources and strong interest groups: getting out of such stabilised low equilibria is difficult, and even if governments adhere to and wish to apply programmes' conditionalities, they may be powerless (Sindzingre and Milelli, 2010).

Thirdly, economic sanctions, e.g., stops in disbursements or suspension of projects, aggravate countries' economic problems, and therefore may make compliance still more unlikely (as has been the case for some EU member countries that after the 2008 crisis did not comply with the thresholds on debt and fiscal deficit). Similarly, sanctions for non compliance with 'good governance' are usually a cut in aid flows from the IFIs and other donors: for example, in triggering a stop in aid flows, a military coup may plunge a country in deeper economic difficulties (even if this would have the positive aspect of a diminution of aid dependence) and it may not necessarily foster a better governance, e.g. more aspiration to democracy or lesser corruption[12]. An example is the US African Growth and Opportunity Act (AGOA), which grants unilateral trade preferences to SSA countries and includes conditionalities on governance – suspension of preferences may with time constrain rulers to implement policies aiming at democracy or rule of law, but these may remain mainly formal (e.g. limited to elections or to the creation of anti-corruption agencies). The Generalised System of Preferences 'plus' (GSP+) of the EU also includes provisions on governance, and for a developing country not having them means a privation of resources. In poor countries, however, which are caught in the vicious circle of aid-dependence, these types of sanctions may less affect the rulers than the poor. Regarding bilateral donors, such unexpected and negative effects can also characterise the mechanisms of selectivity of aid, of the conditioning of financing to the willingness to implement 'good policies'. The withdrawal of financial support by donors is indeed likely to affect the poor more than the elites in some countries, and this is even more the case as many countries that are unwilling or unable to implement

[10] See for example 'Pierre Moscovici rejects economic sanctions for member states' (Euractiv, 2014).
[11] Romaric Godin, 'Europe: l'échec de la stratégie du 'containment'' (*Europe: the failure of 'containment' strategy*), *La Tribune*, 26 May 2015. http://www.latribune.fr/economie/union-europeenne/europe-l-echec-de-la-strategie-du-containment-478798.html
[12] Embargoes are well-known examples of such lacks of impact or even perverse effects at the local level.

programmes are undemocratic or authoritarian political regimes where citizens are voiceless. Also, the selectivity mechanism has difficulties in functioning at the concrete level, as donors may be driven by their interests or ideology (Brech and Potrafke, 2014).

In fine, throughout history, state-building has relied on centralisation and accountability (Tilly, 1985). The 'good governance' agenda and conditionalities do not modify the general framework of poor countries fiscal dependence on external flows. This dependence generates problems of accountability and legitimacy. Aid dependence fosters 'policy externalisation' - to agencies that are external to the government and condition financing to policy -, which is a key constraint on the effectiveness of recipient countries' public policies and institutions, as it erodes their legitimacy and credibility, in particular tax institutions (Moss *et al*., 2006). When domestic policies are devised by external agencies and when rulers are more accountable to these external agencies than their own citizens because they get their resources from these agencies rather than from citizens via taxation, this breaks the link between rulers and citizens established by taxation and redistribution, and the citizens' consensus that underlie state legitimacy. Indeed, accountability of rulers to citizens is a central element of state formation, notably via the mechanisms of taxation and redistribution (Kaldor, 1963), and a central element of the effectiveness of their policies; it is a central element of legitimacy of political regimes and institutions, notably of delegation (democracy), as otherwise citizens feel unable to weigh on domestic policies and deprived of 'voice'. In this context, the 'good governance' paradigm may be viewed as more an 'outsourcing of state authority' than state-building (Meagher, 2014). The paradoxical effects here are that an effectively functioning state is necessary for economic conditions and reforms to be implemented.

5. Conclusion

This article has analysed the concept of conditionality in developing countries, under the two forms of economic and 'political' conditionalities. It has shown its impasses, both in terms of conceptual rigour and policy feasibility, the device of conditionality being inherently ineffective and its extension to non-economic domains weakening further the effectiveness and credibility of conditionalities. In particular, it has highlighted that conditionality may be a trapping process for donors (e.g., addressing political issues via technical instruments), but also for recipients (e.g., the trapping in repeated asymmetric games of 'donor' conditionality and 'recipient' resistance).

Yet conditionality is remarkably resilient - i.e. the devices of conditional lending, 'exchange of finance for reforms' and 'policy externalisation' that in fact means a massive intrusion in and control of domestic policies. Even after decades of failure in developing countries, conditionality remains the only mechanism that is used by all international lending institutions, as shown by ex-troika management of the economic difficulties of Eurozone's Southern countries from 2010 onwards. Many attempts at changing the device of conditionality have been made by the IFIs and other donors since the 2000s, e.g., budget support, ex-post monitoring, output-based lending, evidence-based lending, among others. *Ex post* or *ex ante*, however, conditions to financing remain an intrinsic element of conceptual frameworks (Dixit, 2000). Some bilateral donors' development cooperation, e.g. China, is reputed to include little conditionality ('non interference'): this may not last as China becomes a major player, e.g. in SSA (Grimm, 2014), and in addition such stance may not be possible for international financial institutions.

The causes of such resilience must therefore be questioned: it has been argued that the rationale of conditionality may not be the expression of a conceptual economic truth or the quest for economic effectiveness, and indeed may not be primarily economic.

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