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Social Implications of Governance Related Conditionality

Analysis of the roles of the WTO and the Bretton Woods Institutions in Fostering Stability and Long-Term Development

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Abstract

The Bretton Woods Institutions, and lately the World Trade Organisation, have all been accused of representing narrow Western economic interests and ignoring important elements of culture and local conditions in their policies towards the developing countries. In drafting 'one-fit-for-all' strategies and conditionalities they have paid little attention to existing governance structures and have ignored the social dimensions of their policies. The paper explores the underlying principles of governance and conditionality present in the operating mandates of these agents, and the observed effects on the long run development and social stability of affected countries. By drawing on historical references from different regions it investigates the relationship between conditionality clauses and the building of stable social, political and economic national structures. The role of the WTO as an international governance actor is analysed in the context of China's recent accession into the world trading system; while the Bretton Woods Institutions are looked at through the lens of conditionality clauses imposed on transitioning African economies. The conclusion reached in both cases is that governance-related conditionality may erode local ownership of, and commitment to, necessary economic and political reforms. Furthermore, by supplanting local governance mechanisms, conditionalities threaten fragile social structures and may lead to social and political instability and conflict.

Introduction

"International governance is understood as the formal and informal bundles of rules, roles and relationships that define and regulate the social practices of state and nonstate actors in international affairs -- an idea whose resemblance to International Relations definitions of international regimes and institutions is no coincidence." (Slaughter, Tulumello & Wood, 1998) Both standards themselves and the institutions by which they are created, administered, and enforced are subcategories of governance. The definition highlights two very important ideas: firstly, governance does not necessarily mean 'government', although the US government, for example, has taken the role of international governing body, perhaps in response to the institutional weaknesses demonstrated by organisations such as the UN. Secondly, standard -setting, where standards are defined as 'guides for behaviour and judging behaviour' are among the visible outcomes of international governance institutions. Abbott and Snidal point out that the diversity of governance arrangements stems from the interactions of private and public actors seeking to resolve diverse global issues through standards setting processes and oversight. The stage for interactions is made complex because of the differing mechanisms, as well as capacities for creating and managing these standards (Abbott, Snidal, 2000).

This paper attempts to analyse the complex relationship that exists between external problem structures and the governance mechanisms used to address the issues. It seeks to identify the trends and conditions that have historically guided governance mechanisms, the emergence of a pattern of aid response, and the implications posed for the future interactions among governance players.

Although, as was stated in the opening paragraph, international governance encompasses a wide and diverse spectrum of institutional and market actors, much debate has been focused on the changing role of the original agencies charged with the role of international governors, namely the Bretton Woods Institutions, and lately, the World Trade Organisation. The paper explores the underlying principles of governance and conditionality that are present in the operating mandates of these agents, and the observed effects on the long run development of affected countries. By drawing on historical reference from different regions it investigates the relationship between conditionality clauses and the building of stable social, political and economic national structures.

The paper is organised into two parts. The first examines the implications of China's economic expansion and the role of the WTO as an international governance actor. It investigates the capacity of the WTO to impose governance-related conditionalities, and studies the observed reactions and impact on the quality of the development process in China. These mechanisms are further explored in the second part of the paper. Here the focus is on the role of the

International Monetary Fund and the World Bank in peace-building and restructuring of emerging and post-conflict economies in Africa. Historically both the IMF and the World Bank have based their aid strategies on certain assumptions, which translate into conditionality principles underlying access to aid. The paper focuses on the external conditions that brought about international intervention in the regions of Africa, the aid strategies employed and their potential for dealing with the inherent regional problems. The discussion is presented as means of drawing conclusions about the relevance of conditionality in restructuring strategies and as development aid mechanisms.

PART I

The emerging nature of the WTO as an international governance mechanism

The extent to which any agency can be labelled an international governance organisation depends on the definition of international governance. It was suggested in the opening paragraph of the introduction that international governance is *the formal and informal bundles of rules, roles and relationships that define and regulate the social practices of state and non-state actors in international affairs.* Furthermore, the creation of standards is a visible outcome of many interventionist and governance practices. Given this definition, the WTO certainly qualifies as an international governance body. Its founding principles outline a goal of sustainable economic development of member countries and the pursuit of a higher standard of living for all through the promotion of free trade. Article III of the WTO charges the organisation with 'facilitating the implementation and operation of the multilateral trade agreements (**example of standards**), providing a forum for negotiations, administering the dispute settlement mechanism, exercising multilateral surveillance of trade policies (**example of oversight**), and cooperating with the World Bank and the IMF to achieve greater coherence in global economic policymaking' (Uruguay Round Agreement). The promotion of sustainable development is the overriding goal of WTO policies. Yet, if recent developments in the so-called 'globalisation' process are anything to go by, it appears that sustainable development and trade have become synonymous. Rodrik points out that trade was intended to be the means by which the WTO achieved its goals and brought aid to countries in crisis (the definition of 'crisis' as an externality prompting WTO involvement will differ from an externality guiding IMF aid, for example. This 'conflict' is illustrated in more detail in a section on China's recent accession into the multilateral trading regime). However, recently it has become 'the lens through which development is perceived, rather than the other way around' (Rodrik, 2001). If indeed, this is true, and the WTO has lost its sense of purpose and is pursuing a policy of free trade irrespective of the ensuing development implications, then the question being raised is:

how will accession to the WTO affect the well-being of a developing country? Do the conditionalities under which accession is granted serve as building tools of development, or merely trade creation? Or, are the two terms in fact interchangeable?

China's Development History

While the after-shocks of the 1970s oil crisis, the abandonment of the Bretton Woods system of fixed exchange rates, and several other commodity cycle busts reverberated through many regions crippling developing economies, China weathered the storm with surprising resilience. According to Rodrik the real determinants of growth performance after the 1970s were rooted in the ability of domestic institutions to manage the distributional conflicts triggered by the external shocks (Rodrik, 2001). The management of social conflicts influenced, to a large extent, the economic performance of the country, and the extent of spillover of external shocks into domestic economies. During the turbulent 1970s China underwent a minimal set of reforms taken cautiously by the state so as not to disrupt the delicate social balance. Initially, the communal farming system was loosened to allow farmers to sell their crops in free markets, given that they first fulfilled their quota obligations to the state. Next, township and village enterprises were allowed and special 'economic zones' were created to attract foreign investment. (These economic zones are today a source of some debate given the unequal distribution of development that subsequently resulted.) The reform system in China came to be known as the 'dual track' reform because of its gradual integration with world economies, and simultaneous development of local expertise and knowledge through decentralisation of certain economic sectors. Economists credit the system with generating the right incentives for developing the tacit knowledge required to build and sustain a market economy. Clearly, China's success did not come about merely as a result of an opening up to international trade. In fact, the process was slow and gradual, and integrated this liberalisation with the building of domestic institutions to encourage the creation of national enterprise. This strategy, in light of China's continued economic success, points to a very important and often overlooked pre-requisite of sustainable development, namely the building of domestic institutions and the important role that the state plays during the process of economic transformation. Building up state capacity is an essential, and overlooked, component of development, often hampered by the conditionalities imposed by international governing institutions. Thus, although some may be tempted to credit China's openness to global trade and subsequent accession to the WTO with its phenomenal economic performance, its success is largely due to the domestic policies employed long before market liberalisation was introduced into the domestic agenda. Like India, another recognised success story, China remained very closed to trade for almost a decade after the initial onset of higher economic growth, and to this day maintains some of the highest trade restrictions in the world.

China's Accession into the WTO-Historical Perspective

Demands, Reactions and Implications

When the first talks regarding the formation of an international trade organisation were held in Havana in 1948, China was among the 23 contracting parties that signed the General Agreement on Tariffs and Trade (GATT). However, following developments in the early 1950s in China, which included Mao's creation of the 'people's democratic dictatorship', the country's relationship with other contracting parties deteriorated and GATT rights and obligations ceased to apply. After China's revolution in 1949 and the split between Mao Zedong and Chiang Kai-Shek, the government in Taiwan announced in 1950 that China would leave the GATT, although the government in Beijing never formally recognised this withdrawal decision. The strained relations continued throughout the validity of the Treaty of Friendship, Alliance and Mutual Assistance between China and the Soviet Union, which ended in 1980. In 1986 China filed an application with the GATT for the resumption of its status as a contracting party. Following standard procedure a Working Group was established to analyse the application and more than 4,000 questions were raised regarding China's foreign trade regime (USTR, 2002). In was only in 1999, and once the World Trade Organization had formally replaced the GATT, that China and the US signed a bilateral agreement recognising China's negotiations regarding accession to the WTO. Similar negotiations were held and bilateral agreement reached between China and the EU, and shortly afterwards all other WTO members concluded their own negotiations, which began the process of formal accession by China. As part of its commitment to abide by the rules of the WTO China agreed to several important concessions, or conditionalities, outlined in The Protocol of Accession. These concessions constitute a set of binding provisions regarding the trade in goods and services, as well as commitments that the government of China must meet within a given time frame in order to achieve full trading status at the WTO. It is not unusual that WTO accession working parties attach a number of annexes to the protocol, and this indeed was the case with China's accession. The annexes are legally binding and address specific issues related to the applicant's trade regime. As with all other accessions, the annexes are meant to provide WTO members with guarantees that the reforms or other transitional measures promised by the applicant will actually be implemented, and serve as a kind of negotiated timetable for bringing the applicant's trade regime into full conformity with the WTO's rules and obligations. In China's case the proceedings were quite lengthy and each member country held bilateral negotiations with China to ensure that individual concerns were met and that all outstanding issues were resolved in the course of the deliberations. On December 11, 2001, the Protocol was accepted by most WTO members, legally confirming China's WTO membership status. Interestingly, Mexico was the last member to sign a bilateral agreement with China due to several antidumping orders it maintained against the country, and which it agreed to abolish only six years after China's formal accession. El Salvador invoked the 'non-application' provision of the WTO against China and thus did not enter into negotiations as it recognises the sovereign status of Taiwan, and not the People's Republic of China, a contentious political issue certain to surface in China's trading relations in the future (Michalopoulos, 1998).

Accession and Conditionalities-Demands and Reactions

The WTO was founded with the ultimate goal of promoting development. Thus, it makes sense that its policies and demands should be geared towards meeting that goal, and ensuring that membership is a means of jump-starting economic development, especially in cases of less-developed countries. As an international governance institution, the WTO bases its membership criteria on the ability of an acceding country to meet certain provisions, which are much like the conditionality clauses imposed by the Bretton Woods agencies. The conditionality regime may encompass, explicitly or implicitly, policy measures and actions that fall into such sensitive domains as the character of the political regime and the governance standards including the nature and incidence of public corruption in recipient countries, although traditional conditionality clauses centred on macro-economic demands, which often spurred economic reforms (Hoekman, English, Mattoo 2002). Unfortunately, as with any international policy that fails to recognise the inherent domestic character of a nation, or policy that questions the legitimacy of sovereignty, conditionalities may spark resentment and internal unrest, especially when economic reforms severely impact on the daily lives of citizens, or their perception of security or culture. Conditionality clauses are meant to promote the development of transparent and sustainable internal structures to support future development and economic well being by prodding reforms in exchange for aid. The question being raised is whether aid conditionality, and in the case of the WTO, accession to the trading system, can yield the desired outcomes of good governance, stability and economic prosperity.

Following the recognised shortcomings of the original Washington Consensus, it was widely accepted, and conceptualised in the augmented Washington Consensus, that development hinges on internal capacity building. In the accession process, the country seeking accession is required to accept disciplines that imply economic, legislative and judicial reforms and to organise its administration so as to implement its obligations as a WTO member. This process is meant to contribute to building the country's institutional capacity as it establishes transparent and efficient economic and trade regimes, and to enhance its development through market mechanisms supported by a liberalised, democratic governing structure. Ideally, accession to the WTO should be seen not as an end in itself but as a key element in the pursuit of national development policy objectives. In many instances, China being one example, WTO compliance and development policy may be quite different, and may in fact have offsetting results.

For much of the past two decades, China had been gradually transitioning toward a market economy from what in the late 1970's was a strict command economy. In acceding to the WTO, the country is required to accelerate the process of market reform in order to comply with WTO requirements. Accordingly, China's WTO accession agreement embodies a set of extensive and far-reaching commitments on the part of China to change its trade regime, at all levels of government. According to these commitments (China Business Consultancy Limited):

- China will provide non-discriminatory treatment to all WTO Members. All foreign individuals and enterprises, including those not invested or registered in China, will be accorded treatment no less favourable than that accorded to enterprises in China with respect to the right to trade
- China will eliminate dual pricing practices as well as differences in treatment accorded to goods produced for sale in China in comparison with those produced for export
- Price controls will not be used for purposes of affording protection to domestic industries or services providers
- The WTO Agreement will be implemented by China in an effective and uniform manner by revising its existing domestic laws and enacting new legislation fully in compliance with the WTO Agreement
- Within three years of accession all enterprises will have the right to import and export all goods and trade them throughout the customs territory with limited exceptions
- China will not maintain or introduce any export subsidies on agricultural products

While China will reserve the right of exclusive state trading for products such as cereals, tobacco, fuels and minerals and maintain some restrictions on transportation and distribution of goods inside the country, many of the restrictions that foreign companies have at present in China will be eliminated or considerably eased after a 3-year phase-out period. In other areas, like the protection of intellectual property rights, China will implement the TRIPS (Trade-related Aspects of Intellectual Property Rights) Agreement in full from the date of accession. During a 12-year period starting from the date of accession there will be a special Transitional Safeguard Mechanism in cases where imports of products of Chinese origin cause or threaten to cause market disruption to the domestic producers of other WTO members. China did however negotiate to restrict foreign access in the service sector by requiring that all foreign entries be made through a joint venture with minority foreign ownership.

In order to meet its obligations under the WTO China will need to undergo one of the most dramatic episodes of liberalisation. Internally, the country will face important economic and political decisions in making possible the transition to a truly market economy. However, how will liberalisation affect the Chinese people? Is it going to bring about the promised economic growth and prosperity? What impact will improvements in telecommunications and services have on the diffusion of economic activity and stimulation of growth in in-land China? What are the repercussions associated with a promise to end cross-subsidisation, especially in the agricultural sector, where a vast majority of poverty stricken citizens eke out a meager living? Prior to joining the WTO, while reforms were slowly being implemented, an increase in efficiency had already resulted in the closing of many state-run enterprises and countless workers lined along the streets with cardboard signs listing their skills strapped around their necks, waiting for a job to get them through the day. Ultimately there is only one question: will the accession bring about the awaited prosperity through development and growth, or will it undermine the fragile social balance? The answer, at this stage, can be glimpsed from China's reactions to the WTO commitments and its initial strategy.

On December 11, 2002 the US Trade Representative Office released its Report to Congress on China's WTO Compliance (USTR, 2002). The report stated that China had 'embarked on an extensive campaign to teach central and local government officials and state-owned enterprise managers about both the requirements and the benefits of WTO membership, with the goal of facilitating China's WTO compliance'. It did however find that lack of compliance in certain aspects of its obligations, most notably the adoption of Intellectual Property Rights (TRIPS), could be traced to political discrepancies that exist between rural and urban areas. Compared with other countries China has retained very few limitations on national treatment, however, it has failed to remove restrictions on market access for commercial presence. Some of the more striking restrictions still visible include the requirement to form a joint venture. No foreign enterprise branches are allowed. Interestingly, foreigners may only concentrate business activity in Shanghai and special economic zones, where the Chinese government has granted significant tax concessions in order to induce foreign investment in the region. Judging from China's decision to control the levels and geographic location of investment it is clear that the government has opted to centrally control China's continued development, perhaps unwilling to let go of the policy of gradualism in favour of a fully market driven economy. This isn't necessarily surprising, nor does it need to be a strategically bad move. China's history as a command economy and the accompanying 'people reforms' have shaped not only the structure of the economy, but to a great extent the mentality and thinking of the people. As a nation of 1.3 billion used to being steered by central command, the people of China may not be ready to embrace full market reforms, and the government needs to consider the social implications of making drastic changes that may not be matched by changes in the social thinking (Zhang, 2002). China has indicated already that the restrictions are temporary and will be removed over the course of the next few years. Thus, while not entirely willing to let go of the control reins, China is also appeasing the WTO and the international community by promising to comply, and giving up its right to grant preferential treatment to domestic producers through any measure, at the same time working towards strengthening its regulatory and institutional framework. It appears that it is this mind-set, and not so much the liberalisation of markets that is fuelling China's growth. As new development theory suggests, international governance is futile without a firm backing of internal domestic structures and cultural concessions being made. Although such concessions are not recognised explicitly by the WTO, China's reactions to its WTO commitments suggests that the government recognises the important role it needs to play in the continued growth of its country.

Issues and Challenges

The issue of central command in a market driven economy is likely to generate some conflict in the future. The growing gap between China's increasingly more open economy and its closed polity puts pressure on the system for political reforms (Pei, 2002). As was discussed earlier, economic and institutional reforms do not take place in a vacuum and are expected to exacerbate social tensions. Employment levels in urban areas have already begun to fall as many state run enterprises have closed due to increased foreign competition. In the rural areas, China's small-scale farmers are suffering loss of income due to the reduction in agricultural subsidies. However, industry and citizen groups are not the only ones likely to be affected. WTO rules are going to reduce the ruling elite's power who may retaliate by seizing on growing social unrest to boycott WTO induced reforms, and not only undermine the commitments to open trade, but also create social instability. Should this occur, the benefits to development brought from liberalisation may be erased through the force of instability. China's leaders have tried to stifle opposition to WTO reforms by restricting public access to information, making themselves an easier target for opposition to be brought on by elite classes, who may attempt to turn the public against the government. Historically such opposition has been met with repressive enforcement of political rule by the government. Clearly, what has begun as a process towards development may turn into internal conflict fuelling instability, and it is critical to understand China's unique character in order to analyse the country's capability to withstand damaging policy shocks.

Political reforms began in China still under Deng's rule. The primary objective of these reforms was to prevent Maoist excesses from arising. However, Deng failed to address the issue of monopoly power of the Communist Party in its relationship with the central government. According to Minxin Pei Deng's reforms contributed to elite cohesion, and created inadequate state mechanisms for managing conflict between state and society, and they failed to address the growing conflict between central government and provincial jurisdictions. Pei further points out that the status quo is not sustainable, as political repression may work in the short-run, but will be met with criticism from the international community (Pei, 2002). November 2002 marked the Sixteenth Congress of the Chinese Communist Party (CCP) and a new era of leadership transition. The incompatibility of the CCP's goal of maintaining its political monopoly and pursuing economic development through market-oriented reform is becoming the main cause of China's governance crisis and rising social tension. An open economy thrives on decentralised decision-making and transparency and access to information. An autocratic, one-party state faces a conflict of interest when put in the position of governance: by promoting economic dynamism, it risks losing power. The only way that economic reforms can take place under a command-driven government is with the full support of the citizens. Unfortunately, China's long -standing policy on information control has resulted in an uninformed and distrustful nation alienated from the political process. Pei points out the severity of the CCP's power deterioration through the de-collectivisation of agriculture, and corrosion of CCP networks in response to liquidations of state enterprises. He emphasises that nearly 90% of China's private firms do not have even one CCP member in them, which is quite striking given past integration of politics and business. Reading this one might ask what the significance is in relation to the WTO and China's commitments. The answer is simple: Pursuing WTO policy with no consideration for political reform and China's governance crisis may threaten the internal stability of the country and undermine the sustainability of economic reforms, thus nullifying the positive effects of trade liberalisation. When taken a step further such instability threatens to give rise to a failed state, and in the rhetoric of the new-view development theory a stable state is a necessary foundation for future economic, social and political well being.

Implications

Literature on the subject paints a vivid picture of China's failing governance mechanism. Rampant corruption, lack of support for communist ideology and the growing divisions between central and provincial government structures threaten social stability. Pei links the deterioration of a party state to the crumbling of state capacity identified through environmental degradation and the low social spending already evident in China (Pei, 2002). In response to the failing state, riots and demonstrations have become more common among the Chinese, another sign of growing impatience and dissatisfaction. The implications of a crumbling governance structure in China are quite severe. What the WTO viewed as China's threat to the global trading system could become China's threat to geo-political security. Which brings us back to the original equation: accession into the WTO is meant to generate growth and sustainable development.

Entry into the organisation is granted on the basis of standard requirements, which centre on the adoption of uniform trading rules and the creation of supporting domestic institutions. Thus, conditionalities are viewed as safety valves ensuring that a favourable internal environment is generated in order for liberalisation to bring about prosperity and growth. However, it appears that the WTO bears a fixed formula for the institutional foundation of a market economy, ignoring the unique characteristics of a nation or its existing governance structure. Furthermore, it demands the emergence of democratic governance entrenched in rule-of-law principles as a prerequisite for economic development. However, as China demonstrates, the pursuit of market economy and political reform at the same time may be working to undermine the desired outcome of trade policy. Whereas economic openness may trigger development, internal instability and failed states act to destruct social order and economic development. Thus, it emerges that the WTO needs to redefine accession conditionalities and classify some of them as outcomes rather than prerequisites, where participation in an open trade system acts to promote the development of supporting institutional frameworks over time. As Rodrik pointed out: 'Markets require governance, which remains co-extensive with the nation state. These simple facts impose serious limits on how far we can push global economic integration and international institutionalisation. Ignoring this is a recipe for economic failure and social instability' (Rodrik, 2001).

PART II

Good Governance and Aid Strategy

The increased focus on governance mechanisms is a reflection of the shortcomings of traditional economic tools in bringing sustainable stability and growth to developing regions. Good governance is fast becoming the new buzzword of international aid strategies. As Kofi Annan pointed out….

> ***"…Good Governance is perhaps the single most important factor in eradicating poverty and promoting development…"***

It is also central to the debate surrounding aid strategies employed by donor agencies, in particular the World Bank and the IMF. Over the last few years attention has shifted from the immediate goal of poverty eradication through free-market promotion, to strengthening governance mechanisms in developing countries--all in an attempt to externally affect the conditions necessary for sustainable economic development. However, in reassessing aid strategies good governance has become both an objective of, and a condition for, development assistance (Santiso, 2001). The remaining part of the paper examines how this emerging duality impacts on the effectiveness of aid, and how it challenges the legitimacy and fairness of the international financial institutions (IFIs) themselves.

The Origins of Good Governance

The concept of good governance is relatively new, and did not emerge until 1989, when the term was first used in a World Bank report on Sub-Saharan Africa (Santiso, 2001). The report focused on the crisis of African economies and called it a 'crisis of governance', reflecting the repeated failure of Bank policy in the region to stimulate development (Kapur, Webb, 2000). In 1945 when the Bank first came into existence, it was seen as the lender of last resort, supplying funds to economies recovering from post war depression to help them build modern infrastructures and encourage international trade. The original founders (Britain and the US) allowed loans to be used only for 'productive purposes' and 'specific projects' (Welch, 1998). Such caution was necessary to ensure that borrowers would be able to generate enough foreign exchange for repayment. During the 1960s it became clear that the wealth and economic growth that was being spurted by the loans was doing little to alleviate poverty. The economic notion that investment created wealth was not being supported in practice, and the Bank decided to relax the conditions it attached to its loans and began making loans for education, housing, and social services lacking among the poor. By 1980 the value of Bank loans being made each year exceeded US$ 12 billion, most of it tied up in long-term debt in countries with waning ability to repay their obligations. Lending to countries already mired in severe debt eventually led to a debt crisis with several key borrowers threatening to default on hundreds of billions of dollars worth of foreign debt (Caufield, 1998). Working alongside the Bank, its sister organisation, the IMF, continued to make short-term loans to help countries through balance-of-payment crises. Yet like the World Bank, it too was losing its focus. When the gold standard was suspended in 1971 the IMF lost its core mission of ensuring that national exchange rates stayed within their set values, as dictated by the gold standard (Welch, 1998). Beginning with the oil shocks of the 1970s the IMF gradually began to expand its scope of activity, though its expertise in many of its areas of engagement was limited given its macroeconomic foundation. Its excessive lending and distribution of funds during the oil crisis contributed to the massive debt crises that ensued. It was then, while the World Bank was redefining its role and making short-term loans, that the IMF extended its scope of programmes to the structural development field. The Structural Adjustment Facility (SAF) and Enhanced Structural Adjustment Facility (ESAF) came into existence to provide medium-term loans and set strict economic conditions for broad sectors of the developing economies. Increasingly, the IMF created a culture of dependence, whereby a borrowing country needed the IMF's 'seal of approval' to qualify for aid assistance (Welch, 1998).

In the World Bank's case conditionalities were introduced through structural adjustment lending during the debt crisis, whereby countries had to agree to convert to a free market economy by instituting a vast array of reforms (Kapur, Webb, 2000). The conditionalities mirrored the liberalisation agenda outlined in the Washington Consensus, which trumpeted the free market price mechanism as essential for sustainable development and poverty eradication. However, to achieve the goals outlined in the Consensus, both the Bank and the IMF began to focus increasingly on conditionality clauses as means of forcing reforms, and extending their scope of policy to good governance issues. Governance became an especially important topic of debate at the end of the Cold War with the need for the recreation of civil societies in former communist states. The World Bank introduced governance into its policies as a response to the continuing lack of effectiveness of aid, the failure of indebted governments to reform, and the rising levels of corruption that further erode potential benefits of external financial support. Given the more apparent failure of the price mechanism alone to bring about much needed reforms, the Bank has put new emphasis on the *quality* of a country's governance system as a key determinant of the ability to pursue sustainable economic and social development (Santiso, 2001). According to Kapur and Webb good governance has become 'enshrined in the commandments that rule IFIs, yet the term eludes operational precision' (Kapur, Webb 2000). Despite the lack of a precise definition there has been consensus among international actors that good governance should include some prospects of increased public accountability and transparency, respect for the rule of law, democratisation, decentralisation, and civil society participation. An increased awareness for human rights has opened the door for intervention to be justified, and for sovereignty no longer to be exempt from any intrusion. Recent literature suggests that the factors of good governance can be summarised in what has come to be known as the four pillars of governance: accountability, transparency, rule of law, and participation. However, each of these pillars is subject to much flexibility in interpretation and as a result raises questions regarding its operational effectiveness as aid conditionality.

Kapur and Webb point to the two principal problems encountered in measuring governance related conditionality (GRC): what constitutes governance, and what constitutes conditionality? Even if attention is focused on the four pillars, in themselves they say very little about gauging the existence and extent of the governance mechanism (Kapur, Webb 2000). IMF and World Bank guidelines are equally vague. Loan agreements specify certain performance objectives, and quantitative criteria. In return borrowing governments promise to 'ensure', 'improve', 'increase commitment to' and 'reform' many worthy objectives, but no action plan on how they propose to accomplish this is specified. What is the meaning of conditionalities when no targets exist, and no benchmarks are provided? And more alarmingly how credible are conditionalities that impose prerequisites that in many cases should be made the desired goals of aid strategy?

Should the IFIs lend selectively to those countries that exhibit good governance or should they formulate strategies that allow countries to evolve good governance mechanisms? In other words: what should come first—the chicken or the egg?

Irrespective of the dilemma, conditionality remains the newest tool in the aid-box of IFIs. It is meant to exert pressure on governments to improve their policies and enhance the effectiveness of aid. In the last two decades the number of conditionalities attached to loan agreements from the World Bank alone more than doubled, from an average 1980 figure of 12, to an average of 25 by 2000. The following table highlights this trend (Source: World Bank Operations Policy and Country Services, *Adjustment Lending Retrospective: Final Report,* 15 June 2001)

World Bank Conditionality 1980-2000

	Average no. of conditions	
Financial Year	All conditions (incl.nonbinding)	Legally binding tranche release conditions
1980	21	12
1985	34	19
1990	55	34
1995	53	37
2000	33	25

In the rhetoric of the World Bank governance is concerned with reforming the relationship between government, civil society, and the market in developing countries seeking aid. No longer is the free market mechanism viewed as sufficient to bring about growth and prosperity, and a new role has emerged for the state institutions that exist in recipient countries. Since 1996 the Bank alone has set up over 600 governance related programmes in 95 developing countries (Collingwood, 2003). The average number of conditionality criteria inherent in an average programme instituted by an IFI is 26, with the greatest burden falling on sub-Saharan Africa (Kapur, Webb, 2000). In fact, three quarters of all GRCs have so far been burdened onto the region.

The inclusion of conditionality in loan agreements has its merit given that despite multiple disbursements being made to regions of sub-Saharan Africa, Latin America and Asia, the average per capita growth rate during the period between 1980 and 1998 was zero (Collingwood, 2003). The failure of aid to encourage growth has been blamed on poor governance of recipient countries, and especially inadequate legal frameworks, inefficient financial systems, and corruption. In its 1997 *World Development Report* the Bank identified the critical role of the state in inducing development and envisaged the state '*not as a direct provider of growth, but as a partner, catalyst, and facilitator*' (World Development Report 1997: The State in a Changing World). The new role of the government should extend to upholding the rule of law, promoting competition, and regulating the financial system, but without becoming overly involved in the economy (Collingwood, 2003). The Bank expands its stand further in the 2002 World Development Report by stating that while markets are catalysts in stimulating the economy in the long run, they often fail due to the lack of sound underlying economic institutions. According to economists economic institutions are defined as mechanisms that allow market transactions to take place without hindrance (Ray, 1998). Examples of market supporting institutions include credit reforms and land titling programmes. Unfortunately, when applied collectively without taking into account the inherent cultural character of a given region, the development of institutions as prodded by the IFIs is doomed to fail. A simple example to highlight this important point is the comparison between land titling reform in Thailand and sub-Saharan Africa. Although sub-Saharan Africa comprises 41 distinct countries empirical studies have shown that the intrinsic character of the region is highly comparable (Nkwi, 2001). The titling study was carried out in three countries of sub-Saharan Africa, namely Ghana, Kenya and Rwanda, with ten diverse ethnic regions being included. The results all point to the same conclusion: land titling programmes in sub-Saharan Africa are not worthwhile because indigenous land rights systems are adapting efficiently to changes in factor scarcities. In contrast, similar land titling programmes implemented in Thailand led to an increase of 250% in investments in certain regions of Thailand, and the development of credit markets, which ultimately stimulated significant economic growth. As one of many similar case studies the example shows that although in theory certain pre-conditions may be beneficial, unless they are judged against the existing institutional and cultural character of a given country or region, the desired outcome may not be reached, and may lead to social unrest and conflicts, as was the case when land reform took place in Colombia. It appears that it may not be a question of the ends, but the means—meaning that the desired outcome of a conditionality may be worthy and well intended, yet its effectiveness is governed by the internal process that steers the reform.

Conditionality and Aid Effectiveness

One of the most contested issues with respect to the practical applications of conditionality is the questionable track record of the IFIs in applying the criteria to their own actions. The IMF in particular has met with serious criticism, including allegations that it does not possess the expertise to back its advice to the developing countries (Welch, 1998). When it first introduced good governance conditionality into its programmes the organisation became much more stringent when choosing to dispense loans. In 1997 it refused to grant Kenya its promised loans because of concerns over corruption. The move was met with criticism given the IMF's history --it lent over $1 billion to Zaire's corrupt leader Mobutu Sese Seko, even though his corruption was well documented. In 1998 the IMF supplemented Russia's outstanding debt of $10 billion with another instalment of $11 billion despite evidence of rampant corruption. Not without reason the organisation is seen as a pawn of US foreign policy--the US is the main contributor of funds and holds the greatest number of voting seats at the organisation. The best known example of US involvement in IMF policies catapulted into the 1997 financial crisis in Asia--years of artificially stabilising the American stock exchange through monetary bailouts of struggling economies like Mexico eventually led to countries defaulting en-masse on their debts (Jomo, 2001). Massive stock sales and transfers of rapidly shrinking foreign exchange currencies led to serious crises, unemployment, social unrest and staggering inflation in the Asian region and soon spread to areas of Latin America. As an institution promoting good governance the IMF is overly secretive disclosing minimal information to the public regarding the programmes it negotiates with recipient states. Also, it conducts all evaluations and audits of its policies and programmes internally raising concerns that it may be withholding important findings. Yet perhaps its most serious shortcoming is the one-policy-fits-all approach with which it devises aid programmes. There is no formal process of consultation with the civil society of recipient countries to identify the unique characteristics and cultural norms that will determine adoption and future success of any strategy. By ignoring these essential components of field-study the IMF risks upsetting social balances and instilling unrest. Following the 1997 Asian crisis millions of people in the region marched through streets rioting against the IMF, burning cars, and waving banners in protest of external involvement. Such bitterness and anger breed contempt and lasting opposition, which serve to undermine the effectiveness of aid.

Unlike the IMF, the World Bank is deeply involved in the projects that it undertakes, overseeing their implementation and making recommendations 'in-the-field': Bank staff are present on site and work in collaboration with the governments and civil society of recipient countries. However, despite these precautions, the Bank's track record is hardly impressive. A large proportion of Bank loans are failures (Caulfield, 1998). According to its internal Operations Evaluations Department almost one third of all projects and loans does not meet the minimum criteria of economic productivity and 56% is deemed unsustainable in the long term. One of the charges brought against the Bank by critics is that its lending policies contribute to the failure of its projects. In his study of cross-country analysis Stephen Knack of the World Bank found that higher aid levels erode the quality of governance, as measured by indexes of bureaucratic quality, corruption and rule of law (Knack, 2000). Furthermore this negative relationship is strengthened when financial instruments in the form of repeated loans are used to cover the shortcomings of initial aid. This policy of repeated lending has been a common bail-out mechanism of the World Bank and the IMF. However, the policy changes inherent in this finding suggest that the IFIs should be more selective in dispensing loans and base their aid on governance criteria, which in application translates into *more* governance-related conditionalities!

The argument that aid is only effective in stimulating growth in a stable policy environment is further reinforced by Gwin and Nelson. They suggest that evidence shows little support for the use of aid as being effective in promoting good governance in recipient countries (Gwin, Nelson 1997). This inherent failure is tied the inability of conditionality clauses to provide credible incentives 'sufficient to induce recipient governments to implement policy reforms they otherwise would not undertake, or would undertake more gradually' (Killick, 1998). In order to address this credibility problem Collier suggests that IFIs must radically redesign their lending policies, and adopt a selective approach to reward good behaviour and performance (Collier, 1999). However, unless they take into account domestic politics and the pervading cultural and social norms even such selectivity is doomed to fail. Paul Nkwi argues that the process of democratisation based on European and Western principles ignores historical responses in Africa, which impede democratic development, as far as democratisation is characterised by the Four Pillars of good governance (Nkwi, 2001). He stresses that because of its colonial history two forms of social relations coexist on the African continent--one African and one European. The lack of a purely native character brings into question the possibility of a dual civil response to any policy, and reinforces the need for in-depth internal analyses prior to programme implementation. In an interesting twist Nkwi presents the theory of the *Big Man Syndrome* in Africa, which pervades social thinking and challenges democratisation attempts. He argues that 'the spread and institutionalisation of corruption, considered an illicit practice in all functioning democracies, promotes this syndrome' (Nkwi, 2001). As much as corruption may be stigmatised, there is overwhelming reverence for the Big Man and his wealth, and the ends to which he puts this wealth. No attention is paid to the process of wealth accumulation making civil oversight as means of ending corruption quite difficult. 'A person who can demonstrate generosity at public expense is not only forgiven by his people but is also seen as having acted correctly'. Yet despite these cultural obstacles to reform case studies point to an increased internal effort to punish corrupt leaders. However, such efforts are made difficult by lack of an appropriate legal structure and enforcement mechanisms. Corrupt leaders often become 'undesirable refugees' by virtue of their fortunes, and escape punishment. What makes the democratisation process even more challenging is the ethnic power division. Group identity makes affiliation, not objectivity, the determining factor in decision-making. Given vast differences in ethnic norms and values that exist, to what extent can any policy unite a nation in pursuit of a single goal without a clear and unanimously elected leader? Sectional moralities have led to political divisions and conflict, a case in point being Nigeria, where the North region has adopted its own Muslim law (Sharia) and violence has marked its relations with the South. As Nkwi points out, 'these considerations deal a severe blow to some of democracy's building blocks, such as one-man-one-vote and equal representation'. And they also raise a question regarding the validity of a single 'civil society' in the African context (Nkwi, 2001).

It may seem, in light of the evidence, that democratisation through good governance is not plausible in Africa. Yet Botswana, Senegal, Ghana, and most recently, although it may be too soon to tell, Kenya, are examples of the democratisation process going right. Where do all these questions and possibilities lead? They create the need to recognise the importance of internal leadership reform as the first step towards good governance, but given the social and historical fabric of African life, such leadership cannot be forced onto an unsuspecting public, and certainly not through inflows of aid, where sector spending is not considered. True aid must begin with an effort to change the mentality of the people, and to create an arena for the adoption of a common 'civic' culture. Success hinges on the ability of external organisations to cooperate with the African societies and groups and allow them to 'own' the reforms and the process towards good governance and prosperity through self-determination. The recognition that good governance is a very personal and culturally influenced outcome of reform is essential to ensuring the IFI policies and programmes have an increased chance of success in distinct regions of the world.

Conclusion

On the whole it is apparent that democracy and good governance can only thrive in an enabling social and cultural environment. All these concepts are interlinked, yet the nature of those links is subject to the realities of every distinct region or state. How does conditionality fit into this enabling environment? Santiso suggests that it 'supplants public policy making and undermines domestic democratic processes' (Santiso, 2001). Collier further points to the dangers inherent in governance-related conditionality: 'The extension of the practice of conditionality from the occasional circumstances of crisis management to the continuous process of general economic policy-making has implied a transfer of sovereignty which is not only unprecedented but is often dysfunctional' (Collier, 1999). Ownership of, and commitment to, economic and political reform is a major determinant of the success of aid, yet conditionality erodes both.

The World Bank and the IMF have recognised the shortcomings of economic policy as dictated by the Washington Consensus, and made great strides in building governance issues into their agendas. The IMF released its new guidelines for the inclusion of governance reform as a selectivity criterion in January 2003. The Bank too has radically changed its course within the last decade introducing new programme initiatives aimed at building governance, and new monitoring procedures. Much remains to be done still. In Santiso's words: 'reforming foreign aid requires crafting genuine partnerships and processes for reaching agreement on priorities, procedures and reciprocal obligations toward specified objectives. In particular, the governance agenda compels development institutions and aid agencies to link economic assistance and political aid. So far, these two agendas have evolved independent of each other, leading to fragmented aid policies' (Santiso, 2001).

Despite the glum predictions of academic and field experts, and the many ills that plague external aid, aid effectiveness is possible, but it must begin with reform of the philosophy, mandate and governance of the IFIs themselves, in order for them to recognise that a one-policy-fits-all approach is analogous to trying to fit a square peg into a round hole.

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