



THE IMF, CHINA AND CONDITIONALITY

AN EXAMINATION INTO THE IMPACTS OF CHINA'S RISE AS A DONOR
HAS HAD ON THE CONDITIONAL APPROACH TO AID TAKEN BY THE
IMF

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Abstract

This research is an attempt to critically examine the impact that China's aid program has had upon IMF conditionality. By building upon the work of Diego Hernandez (2017) who found that with every 1% increase in Chinese aid, the World Bank typically lessens its conditions for market liberalisation and economic transparency by 15%, this paper looks at the background surrounding China's rise to become an aid super power, the background of aid conditionality, and the IMF. The paper approaches the issue through the frame of Realism, and Politically Motivated Aid. By setting up a hypothesis and two research questions, the paper seeks to prove the hypothesis by looking at the example of Ethiopia and using it as a longitudinal case study. The number of conditions placed upon Ethiopia by the IMF are examined in two periods of time, before and after 2003, when there was a turning point in China-Ethiopia relations. By looking at this issue through the lens of these two theories, this research acts to both test the theories in the light of aid conditionality and seeks to uncover more information about how the IMF's conditional approach operates, when threatened by Chinese influence.

In the analysis of the paper, the conditions are sorted into 8 different categories. These categories are then individually examined in the time periods. After that, a document analysis is conducted to examine whether the IMF reported plan for development in Ethiopia, matches the conditions applied to the state. Alternate scenarios for what might explain what's going on are also examined, and future research is proposed which would shine a light upon the motivation and drivers of the IMF when conditions are dropped. The findings of this analysis point out a massive contradiction in what conditions the IMF places, compared to what the IMF's stated development recommendations for Ethiopia are

Key Words: Conditionality, Aid, IMF, China, Ethiopia, Realism, Politically Motivated Aid

List of Abbreviations

IMF	International Monetary Fund
SAP	Structural Adjustment Program
S&C	Standards and Conditions
IO	International Organisation
IPE	International Political Economy
FOCAC	Forum on China Africa Cooperation
SOE	State Owned Enterprise
OECD	Organisation for Economic Cooperation and Development

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1 Introduction

The purpose of this research is to analyse the impact China's unconditional aid program has had upon the International Monetary Fund (IMF), particularly the impacts upon the IMF's conditional approach. China's aid program has been subjected to a lot of criticism over the past decade, however much of the criticism is down to China being notoriously secretive about its aid program (Copper, 2016, pp. 11-12). Therefore, China is left open to accusations of propping up authoritarian states through rouge aid (Hatton, 2017). However, in 2014 the organisation AidData released a comprehensive data set of Chinese aid. Containing details of 4300 Chinese aid projects, set in 140 countries between the years 2000-2014 (Dreher, Fuchs, Parks, Strange, & Tierney, 2017). This research has allowed for a deeper analysis of China's aid program and opened different views into how China is impacting the aid sector. One of the most interesting impacts that China is having is on the conditional approach to aid taken by many western countries, but more importantly international organisations like the World Bank and IMF. This research will examine how China has impacted the IMF, by analysing the conditions, through data provided by the IMF Monitor. In addition to this, there will be an analysis of official reports from the IMF, to see if their actions are aligned with the strategy they take. The lens of Realism and Politically Motivated Aid will be used to examine how the IMF behaves when China enters a country, using Ethiopia as a case study, to help garner a deeper knowledge of how the IMF responds to specific circumstances. Due to the use of the Realist lens, aid will be defined as the voluntary transfer of economic resources from one country to another with the objective of enhancing the welfare of the recipient country (Broome, 2014, p. 239). In order to gain an understanding of what is happening, background literature into the IMF, China, and conditionality, will be examined.

2 Background

2.1 A History of the IMF

The IMF was originally established in 1945 as the agency charged with overseeing the Bretton Woods system, as well as encouraging post-war economic growth (Karabaic & Kincaid, 2012). This gave the institution a wide range of responsibilities, such as to regulate the volume of international liquidity, to ensure the stability of exchange rates, to promote freedom of trade and capital transactions, to coordinate the economic policies of member-states and to assist members with balance of payments difficulties (Overseas Development Institute, 1993). However once Bretton Woods broke down in the early 1970's the IMF was left with primary task of providing balance of payment assistance. Now the IMF has a total of \$1.3 trillion in resources at its disposal from its 188 member countries. As of 2012, it has \$243 billion in loans committed, of which only \$57 billion have been drawn. Thus, the IMF has more than \$1 trillion in lending capacity still available (Karabaic & Kincaid, 2012). The IMF has been and continues to be one of the most important cornerstones of the international economy, responsible for some of the most influential economic decisions of the 20th and 21st century (Zusy, 2013). In the 21st century, the IMF has been a primary lender to help boost the global economy, encouraging international capital flows to fuel a global expansion which enables many countries to repay the money they have borrowed from either the IMF or any other official creditor (IMF, 2013)

Despite being a cornerstone to the international economy, the IMF still faces fierce criticism from academics and authors. For this paper we will focus on one of the main criticisms levied against it, as it will help us shine a light on its behaviour regarding China. This is that the IMF is dominated by a

few major industrial countries, whom use their power to control the IMF's direction. For example, in using the Fund to impose a post-1982 approach to the debt problem which shifted a disproportionate burden onto debtor countries (Overseas Development Institute, 1993). This criticism of the IMF serving the needs of its major donors, is often mixed with criticism of the neo-liberal approach that the IMF takes. Encouraging policies aligned with a free market point of view, was often quite damaging for the recipient country, while being very beneficial for companies in these major industrial nations. For example, privatisation led to creation of private monopolies in developing countries, which exploited consumers, and shifted profits back to major industrial countries (Pettinger, 2016). Another example occurred in Kenya, when the IMF removed exchange controls from the Kenyan central bank, which controlled all currency movements in and out of the country. This decision resulted in no additional foreign investment but allowed corrupt politicians to funnel money out of the Kenyan economy (Pettinger, 2016). Because of these examples, critics often accuse the IMF of representing the interests and system of the western financial community, over that of the country they are trying to develop. But how does this compare to approach to aid taken by China?

2.2 China's Rise

A lot has been made of China's rise to global superpower. Some praise China's development, as it has brought hundreds of millions of people out of poverty, others have accused China of stealing jobs and unfair trade practises (Hatton, 2017). However, it is undeniable that China's rise has reshaped the international economy as it has become a global powerhouse, as the world's largest exporter (Morrison, 2018). But that's not the only thing China's rise has impacted (Copper, 2016, p. 99). In terms of aid between 2000-2014, Chinese official overseas finance was \$354.3 billion. During the same period, US official finance was at \$394.6 billion. This means China's annual provision of official finance now rivals the United States, and for some countries, China is now their largest source of official finance (Dreher, Fuchs, Parks, Strange, & Tierney, 2017) (Kitano, 2018). With China now one of the largest aid giving nations, it has caused shockwaves in the aid sector due to its unconditional approach.

"Africa is beginning to do well economically. One of the main reasons for [this] turnaround in the economic fate of Africa is the emergence of the emerging nations in general and China in particular"
Melas Zenawi, former prime minister of Ethiopia, 2012

China has positioned itself as a leading global financier of the 'hardware' of economic development (Dreher, Fuchs, Parks, Strange, & Tierney, 2017). Through initiatives like the "Maritime Silk Road" China has pumped billions of dollars into Africa. For example, the Tanzanian fishing village of Bagamoyo is set to become Africa's largest port due to \$10bn of Chinese development finance (Van Mead, 2018). China's emphasis on infrastructure varies from traditional western donors, whom resist large infrastructure developments in favour of providing aid to social sectors, or social infrastructure projects like water supply and sanitation (Dollar, 2008). Despite its variation to western aid, evidence shows that Chinese aid does have a positive economic effect to the recipient country, at a similar level to aid from western sources (Dreher, Fuchs, Parks, Strange, & Tierney, 2017). Some critics of Chinese aid also argue that China, decreases the effectiveness of western aid, however there is little evidence to support this claim (Dreher, Fuchs, Parks, Strange, & Tierney, 2017). Despite China neither causing significant damage to countries which receive its aid, nor reducing the effectiveness of western aid in recipient countries, when Chinese aid enters a country, western nations and organisation respond.

Conditions have been part and parcel of western aid packages since the 1980's when following the debt crises, the IMF introduced structural adjustment programs (SAP's) (Heidhues & Obare, 2011). Though this program did not last long, the idea of conditionality, driven by the World Bank and IMF, advocated further conditionality and selectivity in aid allocation with respect to loans, debt relief and financial aid, the rationale being that this would enhance aid effectiveness, prevent corruption and promote a good political environment for making policy (Santiso, 2001). The Chinese approach eschews conditionality, as the state's official White Paper on aid describes:

"China will consolidate friendly relations and economic and trade cooperation with developing countries, promote South-South cooperation and contribute to the common development of mankind. While adhering to equality and mutual benefit, stressing substantial results and keeping pace with the times without imposing any political conditions on recipient countries" (Information Office of the State Council , 2014)

The decision taken by China to give aid unconditionally is one of major criticisms levied against the program from the West, where it is believed China's approach fails to create direct employment for skilled and unskilled African labor and hampers the creation of good governance (Wang & Ozanne, 2010). Despite unconditional aid being accused of this, when an African country is also assisted by China the World Bank attaches fewer conditions to its loans. In fact, it is found that with every 1% increase in Chinese aid, the World Bank typically lessens its conditions for market liberalisation and economic transparency by 15% (Hernandez, 2017). So, despite the criticism of China's aid, the World Bank contradicts its own policy advice by dropping the conditions to remain the main donor, in the face of a growing Chinese presence. This behavior suggests that aid in Africa by multinational organisations is largely driven by donor interests and that conditionality is inconsistent, as it used to grow and maintain influence over the recipient country (Hernandez, 2017). But if the conditional approach is being dropped because of China's influence, why was it there in first place, and does the IMF follow the World Banks example by also dropping conditions?

2.3 The Conditional Approach

According to the World Bank, conditions are meant to contribute to achieving the development objectives of the recipient country and to improve the recipient's economic situation thereby reducing the default risk the World Bank would have to bear (Breßlein & Schmaljohann, 2013) (World Bank, 2005). This is the same message proffered by the IMF, with the organisation arguing that conditionality covers the design of IMF programs, specifically macroeconomic and structural policies, and tools used to monitor progress towards the development goal, as well as ensuring an easy way to solve balance-of-payment problems without resorting to measures that are harmful to national or international prosperity, safeguarding the country and IMF resources (IMF, 2019 d). Reports like this send a clear message to anyone who reads them: conditionality is useful for effective, non-wasteful aid, which will protect both the reputation of the recipient country, and the resources that the IMF has committed to these aid schemes.

When a country wishes to receive aid from the IMF, they must write a letter of intent which often has a memorandum of economic and financial policies attached. This means that the country has primary responsibility for selecting, designing and implementing policies, which will be used as conditions for aid (IMF, 2019 d). However, despite the IMF claiming recipient countries get this degree of autonomy, many still claim that recipient countries are forced to implement economic reforms, to fix their budget surplus, in order to guarantee access to IMF resources. So recipient countries do not always have the primary responsibility as the IMF claims (Li, Sy, & McMurray,

2015). The programs objectives and policies that do become conditions vary depending on the circumstances of the country, but the main aim of the IMF is to maintain balance-of-payments and macroeconomic stability, while creating a platform for achieving quality economic growth (IMF, 2019 d) (Dreher, 233-267). In order to achieve this aid, the IMF and the World Bank have their “Standards and Codes” (S&C’s) for achieving development. The S&C’s are benchmarks of good practices to help implement policy reform to increase economic and financial stability by strengthening countries’ economic and financial institutions (IMF, 2019 c). These benchmarks help maintain the IMF’s main goals when setting conditions, keeping the conditions aligned with their main goals of strengthening the international financial architecture, the development of the recipient’s countries economic and financial institutions, greater market participation, and greater IMF surveillance and monitoring of financial networks. This helps the IMF with its goal of promoting greater economic and financial stability at domestic and international levels (IMF, 2019 d)

2.4 Review of the Background Literature

By looking at the background literature surrounding these three focal points, an interesting picture emerges. There is evidence to suggest that Chinese aid is beneficial to the recipient country, and does not cause western aid to be less effective, but in the case of the World Bank, conditions are dropped, when China arrives, even though these conditions are said to be for improving the recipients economic situation. This paper will study the effects that China has had on the conditions from the IMF, and whether they will do the same thing when threatened by China. However before looking at the stated purpose and aims of this research, the theoretical lens which will be used to examine this issue, will be described

3 Theoretical Framework

3.1 Background of Realism

International Political Economy (IPE) is an interdisciplinary field of enquiry within the social sciences that is concerned with the study of the past, present and future dynamics of the global political economy (Broome, 2014, p. 5). Within IPE, foreign aid is described as the voluntary transfer of economic resources from one country to another with the objective of enhancing the welfare of the recipient country. The expansion of foreign aid between countries represents a willingness to channel material capabilities towards strengthening strategic alliances and economic linkages between national markets, and to shape aid recipients’ foreign and economic policies (Broome, 2014, p. 239). This was previously used to describe the flows of aid during the East-West conflict of the cold war but is still used today to explain the pattern of international organisations and new donors like China. This pattern of expanding foreign aid to strengthen strategic alliances and economic linkages, leads to a range of problems for the efficiency and effectiveness of foreign aid, including a focus on maximising aid disbursements rather than the effectiveness of services delivered (Broome, 2014, p. 239). In his book *Issues and Actors in the Global Political Economy* (2014), Andre Broome breaks down the different actors in aid. He names 5 different actors. Everyday actors who are both the targets and agents of development, mostly consisting of non-elite actors in developing countries who play a critical role in shaping development policy outcomes. International organisations whom play critical roles in the shaping of the global development process. Non-Governmental Organisations whom shape global development policy and norms through advocacy. Market actors, such as transnational organisations whom impact development through investment and production decisions. And finally states, who play a key role as aid donors and aid recipients, and in terms of their administrative capacities for negotiating, coordinating, designing and implementing development and poverty reduction projects (Broome, 2014, p. 252).

In this research the Realist theory of IPE is the main theoretical basis. The Realist approach to IPE examines the global political economy as being centred on the roles and activities of states and the dynamics of inter-state competition. Three key assumptions are made in the Realist perspective. Firstly, the state is the key actor in the international system, and therefore is the primary unit of analysis. Secondly, the international dynamic and system is shaped by the rational pursuit of a state's national interests. Thirdly, the international environment is an anarchic system, where states each interact and compete, prioritising their interests in the absence of an overarching authority which could constrain, regulate and sanction state behaviour (Broome, 2014, p. 20). Although Realist IPE frames states as primary actors, it does not exclude the significance of International Organisation's (IO's) from analysis. IO's such as the IMF and World Bank are considered relevant actors, but the role of the state is primary to understanding the processes and outcomes of the global political economy (Broome, 2014, p. 20).

By using this lens, we will treat the IMF as an instrument in the anarchic international system, which is used by its major shareholders, to some extent, to steer the organisations' funds in line with their geopolitical interests (Eichenauer, 2016). This paper will not seek to prove that the IMF is acting on the interests of its major donors, but will use the assumption that it does, in order to help with the analyse of the impact that China has had upon the IMF's conditions. The Realist definition of aid as a tool used to strengthen strategic alliances and economic linkages, links the Realist theory to the that of Politically Motivated Aid, which will also be used as a lens to study this issue

3.2 Background to Politically Motivated Aid

The theory of Politically Motivated Aid derives from the Realist international relations theory (Dreher, Klasen, Vreeland, & Werker, 2010). Supporters of this theory point out that since the late 1940's every US administration has considered foreign aid to be important to achieving policy goals (Dreher, Klasen, Vreeland, & Werker, 2010). By considering the theory of Politically Motivated Aid we acknowledge that the IMF could be dropping conditions in order to maintain the political favour of developing countries, for its major donors, whose political position is being threatened by China. Critics of the Politically Motivated Aid system say that it is no great leap to speculate that the political patterns of aid distribution is one of the reasons for development aid's general lacklustre performance (Dreher, Eichenauer, & Gehring, 2016). As politically motivated allocation of aid may result in the approval of lower-quality aid projects in favoured countries instead of more promising projects elsewhere. This presumes that the allocation decision is made in the presence of declining marginal returns, and political motivation results in projects with lower returns getting priority (Eichenauer, 2016). This may be down to the fact that politically motivated projects reduce the motivation of the donor and recipient to invest in the success of the project. This favouritism therefore might mean projects are pursued before important preconditions are met, threatening the effectiveness of the overall aid (Dreher, Eichenauer, & Gehring, 2016).

Literature about the relevance of politically motivated aid allocation in IO's such as the World Bank and IMF was also consulted. These IO's, though technocratic institutions, are still driven by the political motivations of their members. In fact, the World Bank itself freely admits that its lending practices during the cold war were politically motivated, and used to grow the influence of western values, however they are now much more tight-lipped about whether this is still the case. But by focusing on the IMF and the World Bank, Stone (2008), Kilby (2009), and Nooruddin and Vreeland (2010) suggest that political favouritism undermines the credibility of conditionality, rendering it ineffective.

4 Purpose and specific aims

By examining this issue of the conditionality and China through the lenses of Realism and Politically Motivated Aid, this paper makes two assumptions moving forward. Firstly, that the IMF is used as an instrument by its major shareholders, and secondly that aid is used by the IMF to maintain political control over the recipient country. This research aims to take a critical view on the IMF's motivations when it comes to dropping conditions, in order to maintain a political connection to the recipient country. Though the IMF states that conditions are meant to contribute to the development objectives of the recipient country and to reduce the default risk the IMF would have to bear. Examination of background literature surrounding this issue shows the IMF motives have come under question (Breßlein & Schmaljohann, 2013).

This research intends to examine the patterns of aid of the IMF when China enters a country. By studying the question of aid conditions through the lens of Realist theory and Politically Driven Aid, IMF's base reasoning for the use of conditions in its aid is called into question. In Realism IO's act as tools for the majority shareholders, in order to protect their interests. Conditionality will be treated as a tool intended to help maintain a political superiority over the recipient country, in line with the view of multiple scholars, such as Axel Dreher (2010) and Eichenauer (2016). As suggested by previous academic research on conditions, the introduction of China into the aid market has created additional information about how IO's and Western development agencies react when they feel that their political advantage over a recipient country is being undermined. This research intends to analyse this new information looking at two major points. Firstly, what conditions are dropped when the IMF feel their political advantage is threatened, and secondly, what development issues the IMF report in areas where they have dropped conditions. By studying which conditions the IMF dropped when China entered the aid market of a recipient country, it can be seen what concessions the IMF are willing to make in order to maintain a strong political connection to the recipient country.

From the literature and theories that have been reviewed so far, the hypothesis that 'The IMF drops conditions to combat the growing presence of Chinese aid, in the aid recipient country, even when it acts against the IMF's stated development recommendations' has been deduced. With this hypothesis, the paper will take an ontological approach to explain the power structures that exist in the field of aid, specifically taking an approach of critical Realism. Critical Realism is a specific form of Realism that seeks to recognise the reality of the order of the social world (Bryman, 2015, p. 29). As put by Roy Bhaskar (1989):

"we will only be able to understand—and so change—the social world if we identify the structures at work that generate those events and discourses . . . These structures are not spontaneously apparent in the observable pattern of events; they can only be identified through the practical and theoretical work of the social sciences" (Bhaskar, 1989, p. 2)

Through using Critical Realism, two things are implied. Firstly, by using Realism it is acknowledged that conceptualisation is being used as a way of simply knowing reality. This research acknowledges and accept that the categories they employ to understand reality are probably provisional. Therefore, there is a distinction between the objects that are the focus of their enquiries and the terms they use to describe (Bryman, 2015, p. 29). Secondly, with critical Realism, this paper is perfectly content to admit its explanations theoretical terms are not directly amenable to observation. As a result, hypothetical entities that account for regularities in the natural or social orders are perfectly admissible.

4.1 Research Questions

In order to understand and solve the hypothesis a two-pronged approach is taken with the research question as the research aims to answer both whether the IMF drop conditions when China enters a country, and whether the conditions that are dropped are at a mismatch with the IMF's stated goals within the country. In order to do this, a case study of Ethiopia will be conducted, with the aim of answering these two research questions:

- 1) Did the Forum of China and Africa Cooperation held in Addis Ababa cause the IMF to drop the number of conditions it attaches to loans to Ethiopia?**
- 2) Do the conditions that have been dropped by the IMF regarding Ethiopia contradict its stated development recommendations to Ethiopia?**

By answering these two research questions, a clearer picture on whether or not our hypothesis holds true in this case will be seen, and this will enable us to shine a light on whether the theories of Realism and Politically Motivated Aid help understand the IMF's actions concerning the growing impact of China in the aid sector.

5 Method

5.1 Secondary Analysis of Conditions

Firstly, a detailed analysis of the conditions that are applied to Ethiopia will be conducted. This will be done through secondary analysis of the data collected by the IMF Monitor. Secondary analysis is the analysis of data which has been received from a different source, not independently collected for this research (Bryman, 2015, p. 312). This method was chosen for multiple reasons. Firstly, it provides access to high quality data at a lower cost. Secondly, as the data was received from a professional organisation, it is expected that the data is reliable and accurate, as the organisation will have well established procedures in place for checking and maintaining the accuracy of their data (Bryman, 2015, p. 314). Lastly it provides an opportunity for longitudinal analysis when conducting a case study as our next step, as the IMF Monitor has been compiling information about conditionality for a long time, and therefore has quality data, going back in time. While conducting secondary analysis will have limitations due to a lack of familiarity with the data, the time saved means that time can be devoted to understanding the reports, and data used by the IMF Monitor. By doing an analysis of each condition, it can be seen what each condition was put in place to combat, E.G. for conditions targeting financial sector transparency, would be looking to reduce the level of corruption in the financial industry in a developing country. This will enable a more detailed analysis further on in our research. To analyse these conditions reports put out by the IMF will be studied to understand the nature of their conditions, and why the IMF use this approach.

5.2 Case Study Approach

In order to get a clear picture about what is happening with conditions in aid recipient countries, a case study will be conducted. Ethiopia was chosen because conducting a detailed and intensive analysis of a single case will show the complexity and particular nature of the case in question, allowing a more comprehensive understanding (Stake, 1995, p. 49). As a case study is being conducted, it means the case is an object of interest in its own right, and the aim is to provide an in-depth elucidation of it, and what exactly is happening in the terms of this case (Bryman, 2015, p. 69). Ethiopia was chosen on the grounds that it will allow a better understanding of the circumstances in which the hypothesis will and will not hold, making it a critical case study (Bryman, 2015, p. 70). The other distinction of the case study approach is the longitudinal case. For a longitudinal case, a case is

chosen as it affords the opportunity to be investigated at two junctures. In this case, of looking at how conditions have changed before and after China has become a player in the market for aid in the recipient country. Therefore, a longitudinal, critical case study is conducted, to garner a better idea of whether the hypothesis holds up. A longitudinal case study will enable the detection of major differences between the conditions recommended at two points of time. This will flag up the major differences between conditions, when the IMF feel their position is threatened, which leads to the final part of the method, to see if the differences match what the IMF said.

5.3 Document Analysis

Thirdly, a document analysis is conducted by looking at development reports published by the IMF about Ethiopia's road to development. By analysing both IMF staff reports and the IMF's official development reports for Ethiopia in the period when there was a substantial drop of conditions, the paper presents a clear view of what themes the IMF considered to be threatening Ethiopia's path to development. These can later be compared to the drop-in conditions to see if there is a discrepancy. To do this a qualitative content analysis is conducted which comprises of searching for the underlying themes in the materials being analysed (Bryman, 2015, p. 557). As the stated development intentions of the IMF in Ethiopia are being uncovered, the approach of analysing official IMF reports is valid, as credible documents that represent the IMF's view are used. These documents are the valid opinions of staff of the IMF, as these documents will be used by multiple other institutes, think tanks, and development agencies (Bryman, 2015, p. 563). Depending on the content of these documents, the paper will study each category of condition with its own weight, looking at the percentage drop of each condition category, over the total number of conditions dropped.

5.4 Our Case

Ethiopia is a locus of international attention in the Horn of Africa, as it has consistently achieved high rates of economic growth, yet still faces continued problems with poverty and widespread famine. It is also highly dependent on foreign aid, as it has become essential for the Ethiopian government's development plan, its 2010 growth and development strategy (Oakland Institute, 2013). Ethiopia tops the worldwide list of countries receiving aid from the US, UK and the World Bank and received the second largest amount of Chinese ODA during the period 2000-2014 (Dunfjäll, 2018) (Oakland Institute, 2013). Ethiopia has received an average of \$3.5 billion on average from international donors in the past years, equivalent to 50-60% of Ethiopia's national budget (Oakland Institute, 2013). As it receives a large amount of its annual budget from overseas aid, Ethiopia undergoes a large amount of international scrutiny, about how, where, and how fairly this aid gets spent. This means over the past years that Ethiopia's donors have conducted assessments into how Ethiopia's government has used assistance as a tool for resettlement of ethnic and pastoral communities, as well as for intimidation and political purposes. They have done this while the government has introduced policies that deny basic human rights for some of the most marginalised communities in Ethiopia (Oakland Institute, 2013). Donor organisations like the IMF have failed to hold the Ethiopian government to standards of human and political rights, despite it being one of the top recipients of western aid.

China's development cooperation has been an important part of its relationship with Ethiopia since the establishment of diplomatic relations in the 1970's. The original Forum on China-Africa Cooperation (FOCAC) in Beijing in 2000 really moved China-Ethiopian partnership into a new phase, as it provided the countries a unique diplomatic mechanism for the sharing of mutual experience and a long-term cooperation framework (Liu, 2016). Since then Chinese companies have been actively involved in Ethiopia's Growth and Transformation Plan, with Ethiopia related projects being implemented step by step under the framework of FOCAC (Wei, 2018). This cooperation was

cemented between China and Ethiopia in December of 2003 when Addis Ababa was chosen to host the second FOCAC. Ethiopia thus found itself in a privileged position as it tightened its political and economic relationship with China.

As it has become a focal point of aid for both Western and Chinese aid, and good data is available, Ethiopia offers a strong critical case study to test whether the hypothesis holds. In turn, understanding the key elements of this case study, will allow a better understanding of how the hypothesis will hold in different countries and conditions. Ethiopia also offer the opportunity for a longitudinal case study, and by looking at the history of China’s cooperation with Ethiopia, there is a key time in which China’s and Ethiopia’s cooperation became a lot closer. By using the 2003 FOCAC as a turning point in China-Ethiopia relations, it enables the examination of the conditions the IMF put on Ethiopia in two different focal points.

6 Analysis

In total, Ethiopia had received 337 policy reforms mandated by the IMF between 1990 and 2014 (IMF Monitor, 2019). By looking at figure 1 it can be seen that of the 337 conditions, 272 were placed before FOCAC, and 65 were placed after. Meaning that only 24% as many conditions were but in place in 11 years from 2003 to 2014, compared to the 13 years before that, a 76% drop in the amount of conditions. This is a more significant drop in conditions than that of other aid receiving African states. For example, Cote d’Ivoire had a 31% increase in conditions, over the same period Ethiopia experienced this drop (IMF Monitor, 2019). In fact, the number of conditions placed on IMF’s loans and grants worldwide fell from 17941 to 10096, a 44% drop in the total number of conditions, far less than the percentage drop in conditions Ethiopia experienced.

When conducting an analysis of these policies, it was found they fall roughly into 8 different categories. These categories can be summarised as follows:

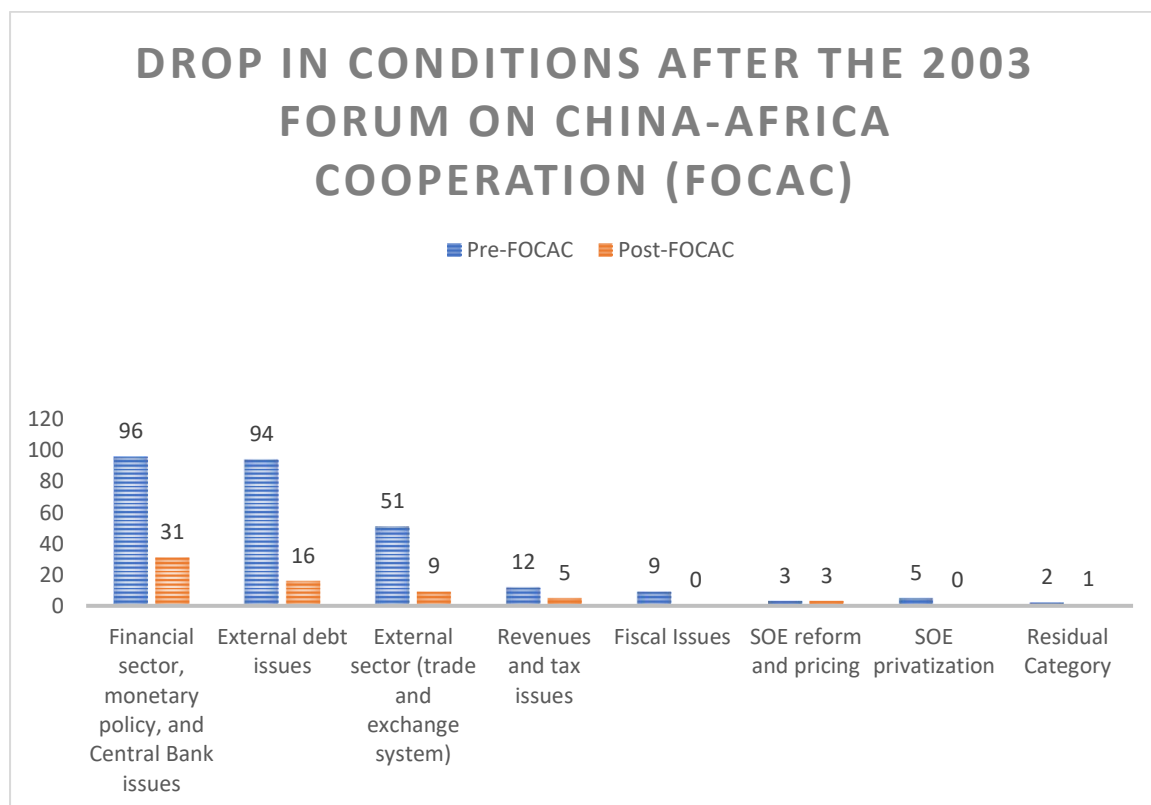


Figure 1: Number of Conditions in comparison of before and after FOCAC, 1990-2014, data retrieved from IMF Monitor (2019)

Financial sector, monetary policy, and central bank issues – Which consist of Financial institution regulations, financial State-Owned Enterprise (SOE) privatisation, treasury bills, interest rates, Central Bank regulation, money supply, and domestic credit.

External debt issues – Tackling issues to do with debt management and external arrears.

Fiscal issues – Including expenditure administration, fiscal transparency, audits, budget preparation, domestic arrears, and fiscal balance.

External sector (trade and exchange system) – Involving trade liberalisation, exchange rate policy, capital account liberalisation, foreign direct investment, and foreign reserves.

Revenues and tax issues – Such as customs administration, tax policy, tax administration, and audits of private enterprises.

State Owned Enterprise (SOE) reform and pricing - Involving SOE restructuring, subsidies, price liberalisation, audits, marketing boards, and corporatisation and rationalisation.

SOE privatisation - Non-financial SOE privatisation (incl. liquidation and bankruptcy proceedings for SOEs).

Residual category - National accounts framework, balance of payments reporting, and household surveys.

In order to gain a more comprehensive view on the how the conditions are changed, the problems each of these categories tackled will be examined.

6.1 Understanding the conditions

In order to get a better idea of the impact that the IMF was willing to accept by dropping conditions, it is important to study and analyse the intended effects of each condition. Therefore, an analyse of each condition category will be conducted, by looking at official IMF statements about each one, and determining what development problem each is trying to tackle.

When it comes to conditions surrounding the *financial sector, monetary policy, and central bank issues*, the IMF believes central banks are key to conducting monetary policy to achieve price stability and help manage economic fluctuations. Therefore, through this category, the IMF promotes effective central bank frameworks through multilateral surveillance and bilateral dialogue with its member countries. Countries who are supported by an IMF arrangement, often have conditions to strengthen monetary policy and central bank governance. This technical assistance helps the development of more effective institutions and financial capacity. The technical assistance offered can vary from exchange rate regimes, moving from targeting a monetary aggregate to inflation targeting, and improving central bank operations (IMF, 2019 b). In guaranteeing the good monetary policy of the recipient country, and therefore achieving price stability and hindering economic fluctuations, the IMF helps secure the money it loans out. This helps solve the balance-of-payment problems when it comes to the recipient country repaying the IMF. Ensures that the IMF will get its money back without any harm to national or international prosperity, and safeguards the recipient country (IMF, 2019 d).

The second category of interest is the *external debt issues*. As low-income countries often struggle with large external debts, the IMF has developed a framework to help guide countries and donors in

mobilising the financing of low-income countries development needs while tackling the future risk of excessive growth of debt. By using a debt sustainability framework, the IMF will assess two different aspects of a country's economy. Firstly, an analysis of the countries projected debt burden over the next 10 years, and its vulnerability to economic and policy shocks. Secondly, an assessment of the risk of external and overall debt distress, based on the debt burden thresholds, and the country's specific macroeconomic framework (IMF, 2019 a). This debt sustainability assessment is considered when determining how much access to IMF financing the recipient country has, as each program has a debt limit. The conditions attached to the category of *external debt issues* attempt to tackle the same problem as the conditions attached to the category of *the financial sector, monetary policy, and Central Bank issues*. Each one aims to address the balance of payment problems when it comes to repaying the costs of the IMF's development loan. The conditions also encourage a sensible approach to debt, encouraging countries not to take more debt than they can handle.

Thirdly, the category of fiscal issues which has two main purposes. Firstly, much like the previous two categories (*financial sector, monetary policy, and Central Bank and external debt issues*) fiscal policy has focused primarily on macroeconomic stabilisation in response to shocks such as the global financial crisis. With a slowing global economy, and rising uncertainty, the IMF recommends that fiscal policy be implemented in preparation for facing downturns in economic growth. While there should be emphasis on reforms to adapt to changing demographics, advancing technology, and deepening global integration, the IMF advises a more conservative approach when recipient countries come for aid, as it needs to protect its resources (IMF, 2019 e).

In the category of *External sector* (trade and exchange systems) the IMF takes a globalist approach. It acknowledges that policies need to be carefully sequenced and calibrated to achieve domestic and external objectives. However, its policy advice in this matter takes a neo-liberal worldview, stating that that protectionist policies should be avoided at all costs as they have significant detrimental effects on domestic and global growth. The IMF states that countries who have either have a trade surplus or deficit should work towards trade liberalisation efforts by strengthening their multilateral trade, and removing the barriers that make trade too costly (IMF, 2018). This makes it clear that the focus the IMF has on the *external sector* is to support the international trade system which makes its donors very wealthy. Though there is an argument that again the IMF could support these policies in order to protect their investment, and make the investment more resilient to an internal economic shock.

In a recent speech Christine Lagarde, the head of the IMF, spoke about the need to reimagine the global tax system. IMF analysis shows that non-OECD (Organisation for Economic Cooperation and Development) countries lose about \$200 billion in revenue per year, equivalent of 1.3 percent of GDP because of companies shifting profits to low tax locations (Lagarde, 2019). This shows that tax revenue and issues are a massive problem for developing countries, as it creates a big hole in the countries total revenue when this tax is not received. Therefore, when it comes to conditions for this issue, the IMF takes a three-pronged approach in what it recommends. Firstly, they recommend reforms of indirect taxes and exemptions, as it is a common and sensible tax policy measure. Secondly, multiple reforms to the tax administration, as well the implementation of tax policy and standalone measures are recommended. Thirdly, sensible and sustainable policy on tax administration reform is recommended in multiple key areas, such as risk-based audits, registration, filing, payment and reporting (Akitoby, et al., 2018).

Regarding SOE's, the IMF take the approach that they are very costly to run, are rarely profitable, or at least do not tend to pay dividends on a consistent basis. This problem is large in developing countries and emerging markets, with SOE's being pervasive and their failure having huge economic

and fiscal costs (Chaponda, 2017). The IMF view SOE's as damaging to a state's market, they acknowledge that it is not something many developing countries want to give up, as many governments feel that these entities are there to provide a public good which should not be left to the private sector. However, the IMF still recommends deregulation to encourage competition and allow the industry in which an SOE operates to flourish. Because of this belief that SOE's can act as providers of a "public good" it means that IMF two-pronged approach makes sense, as it tries to tackle either the removal of SOE's, through *SOE privatisation*, or the proper management and regulation of SOE's, through *SOE reform and pricing*.

The arrangements and conditions not put into any of the above categories were characterised as the *residual category*. These conditions fail to fit into the distinct categories where the strategies of their implementation are clear. Because of their lack of a clear category, the conditions will not be analysed in the same style as the other categories but will be included in analysis looking at the broader trend in the number of conditions before and after FOCAC.

To summarise the analysis of each condition, almost every condition has some element of protecting the IMF's resources. Policy to do with the *Financial sector, monetary policy, and central bank issues*, as well as *external debt issues*, receive the most conditions. These two categories are in place to assure that the country's economy is resilient, and won't cause issues down the line, when it comes to repaying the IMF. The conditions to do with the *external sector* are also very numerous and are for guaranteeing the balance of payment to IMF. They also serve the purpose of encouraging developing countries to open trade barriers, which is beneficial to the IMF's major donors. For the revenue and tax issues category, the encouragement of reform in this area means that large companies find it harder to hide money in developing countries and can provide a massive amount of finance for developing countries. For *SOE privatisation*, as well as *SOE reform and pricing*, the IMF's ultimate view is that SOE's disrupt markets, and therefore should be privatised, however they acknowledge that this won't always be the case so focus on reform and pricing to bring more competitiveness to the developing countries economy. Finally, for the *residual category* as noted before, there is no clear strategy for the conditions in this category, but they will still be used in analysis when looking into the amount of conditions applied to Ethiopia.

6.2 What Happens to the Conditions?

When each condition category is looked at respectively, almost every category sees a massive drop in the total conditions, apart from conditions in the category SOE reform and privatisation, which had 3 conditions put in place both before and after FOCAC retrospectively. For 2 of the categories, Fiscal issues and *SOE privatisation*, conditions stopped altogether after FOCAC, though they only represented a small number of conditions before FOCAC, 9 conditions on Fiscal Policy and 5 conditions *SOE privatisation*. For the categories that had the most numerous conditions placed on Ethiopia, each saw a large drop of over 50% For conditions concerning the *financial sector, monetary policy and central bank issues*, the number of conditions dropped from 96 to 31, a 68% decrease. For conditions concerning *external debt issues*, the number of conditions dropped from 94 to 16, an 83% decrease in the number of conditions. And for conditions concerning the *External sector (trade and exchange system)*, conditions dropped from 51 to 9, an 84% decrease in the number of conditions. Outside of these 3 big categories, which between them consisted of 88% of the total conditions, there are still 2 other categories to be looked at. Firstly, *Revenues and Tax Issues*, in which the conditions dropped from 12 to 5, a 58% drop. And secondly, the *residual category* which dropped from 2 conditions to 1 condition, a mere 50% drop compared to rest, not much above the global average in drop of conditions, 44%. While these two categories are small compared to the total

number of conditions, they are important to note, as other than *SOE reform and pricing*, they each receive the smallest drop in the number of conditions.

6.3 Preliminary Findings

Looking at figure 1, shows a major trend, as there is a substantial drop of 76% in conditions after FOCAC in 2013. The drops in conditions can be summarised into four different categories in order to get a clearer picture of what happened. Firstly, you have the 'big three' of both *financial sector, monetary policy and central bank issues* (63% drop), *external debt issues* (83% drop), and *external sector conditions* (84% drop). As these categories consisted of 88% of the total conditions it is important to understand their goals. Our research told us that these conditions were put in place in order to protect the balance of payment when it comes to repaying the IMF, so the IMF must have felt more secure about their loan in order to drop these conditions. The conditions regarding the *external sector*, can also be said to be protecting the IMF's investment, but because of the focus on neoliberal trade policies, they also serve the purpose of supporting the IMF's goal of free and open trade. The fact that these conditions have been dropped shows that the IMF is willing to let countries decide their own trade policy. This 'big three' shows that the IMF must of relatively secure about any balance of payment problems that

The next category is named the 'small drop' category. This category involves two categories of conditions, both *revenues and tax issues* (58% drop) and the *residual category* (50% drop). While it was chosen not to look at the effects of the *residual category*, for anything other than analysis of the total number of conditions, the drop in the number of revenues and tax issue conditions is interesting. While the drop of 58% is still a large percentage drop, only 7 less conditions were offered. As tax avoidance from company's cost's developing countries about 1.3% of their GDP each year (Lagarde, 2019), it is interesting that there is this drop in encouraging sensible tax policy, and administration, which would seemingly both get the developing country more money and protect the IMF's resources. Especially considering that it would only take better administration of tax information.

The third category is the 'completely removed' category this includes both *fiscal issues* and *SOE privatisation*. That these conditions have been completely removed paints a very interesting picture. To start, the removal of *fiscal issues*, seems to be counter intuitive by the IMF, as it addresses some major development issues. Firstly, it is one of the key policy areas used to tackle macroeconomic stabilisation, which is critical for the IMF in protecting its resources, as it prepares the economy for economic shocks, and the demographic transition Ethiopia will most likely go through. Fiscal policy also tackles corruption, by making transparency common place, and maker harder to hide illegal monetary flows. With *SOE privatisation*, it seems counterproductive that the IMF dropped all conditions to try and get rid of something labelled as very costly and rarely profitable, with the possibility of causing massive economic costs when they fail (Chaponda, 2017). The category of the 'completely removed' is one of the key findings of the analysis, as it seems to be completely counterproductive to the IMF's main goals, and the information they themselves have presented.

the final category is 'unchanged' and involves only one of the conditionally categories, *SOE reform and pricing*. This is one of the few categories where the IMF's view still matches what it does. While its ultimate goal is to abolish SOE's for the reasons noted earlier, it acknowledges the view of many countries is that this SOE provides a public service and is therefore essential. For this reason, *SOE reform and pricing* is recommended as it brings more competitiveness and stability to the country's economy. Therefor for the fact that *SOE reform and pricing* remains the same, even when *SOE*

privatisation conditions are completely removed, remains aligned with the IMF's view on how to handle this development problem.

6.4 The IMF suggestions

If the reports published by the IMF at the 2003 turning point are looked at, it can be seen whether the views of the IMF aligned with the approach they took. For this document analysis both the 2004 IMF staff worker report, and the IMF's 2004 Poverty Reduction Strategy Paper Annual Progress Report for Ethiopia, will be search for information about the 8 condition categories excluding the *residual category*, which was solely used in the first part of analysis.

6.4.1 Financial sector, monetary policy, and Central Bank issues

By and large, the IMF strategy report found that the direction taken by the National Ethiopian Bank, the supervising authority over this issue, has been aligned with the views of the IMF. Bringing Ethiopia's financial sector, more in line with the global financial economy. However, it was noted that there was a need to improve the legal and regulatory environment, to encourage banks to modernise and adopt improved banking practices, including strengthening credit evaluation and risk management skills. It was also found that while the fiscal and monetary policies implemented by Ethiopia, were aligned with the strategy report, they were overly cautious, compared to the approach that the IMF wanted to take. The staff report mirrors the claims of the strategy report, in calls for an accelerated implementation of bolder financial and monetary policy. The staff report also recommends the improvement of the legal and regulatory environment through the restructuring of financial institutions. So though both reports do agree that Ethiopia is taking the right direction, more reform is needed (IMF, 2004) (IMF , 2005).

6.4.2 External debt issues

Both IMF reports say that Ethiopia's external debt burden remains high due to exogenous shocks particularly significantly reduced export prices, exchange rate changes, and lower interest rate. However, both reports also mirror each other when they say, the government has made some progress in addressing the previously identified deficiencies in external debt management. Which allowed Ethiopia's external debt to be reduced and brought scheduled debt service obligations to more manageable levels. So, while both reports recommended a public debt strategy that will cover both external and domestic debt, by expanding exports rather than constraining borrowing, the IMF was still happy with the way Ethiopia was handling these issues. (IMF, 2004) (IMF , 2005)

6.4.3 External sector (trade and exchange system)

Unsurprisingly when it comes to issues surrounding the *external sector*, both IMF reports recommend a neo-liberal approach, by encouraging policies of neo-liberal trade. They do this by widely encouraging the privatisation of state-owned companies, the removal of tariffs and other trade barriers. The IMF's approach here is not a big surprise, but from the reports you can see that they strongly recommend this approach, and it is key to their development approach. (IMF, 2004) (IMF , 2005)

6.4.4 Fiscal Issues

Both IMF reports mention the Ethiopia's prudent fiscal stance, and therefore recommend pursuing sustainable fiscal policies, and a monetary stance that is non-inflationary. They do this by recommending quicker fiscal reporting, as well as the development of a robust intergovernmental fiscal framework consisting of appropriate fiscal instruments that can meet the recurrent, capacity building or performance, as well as the investment needs of the local government sphere. This

requires a process of decentralisation in which the IMF acknowledge will be difficult to achieve while maintaining financial responsibility. (IMF, 2004) (IMF , 2005)

6.4.5 Revenues and tax issues

Again, the IMF reports both take a very strong opinion on this matter, recommending the speeding up of tax reform, and tax and customs administration. Again, it is acknowledged that Ethiopia is moving in the right direction, but a lot more action is needed for the tax reform to be effective. One of the strongest recommendation was for better oversight of tax, and the better enforcement of a newly created tax and VAT. (IMF, 2004) (IMF , 2005)

6.4.6 SOE reform and pricing

In both reports, not much is mentioned about the reform and pricing, other than to mention its strong recommendations of privatisation. There is the mention of a recommendation to create a pricing strategy for public owned banks, but when it comes to this, the first choice of the IMF is always privatisation. (IMF, 2004) (IMF , 2005)

6.4.7 SOE privatisation

As previously mentioned, the IMF take a strong view on SOE's and both reports mirror this view, with strong recommendations of privatisation. However, privatisation has not progressed as rapidly as originally hoped, due to delays in auditing and the lack of serious buyers for large enterprises. Privatisation was occurring in Ethiopia, but at an incredibly slow rate, which the IMF found was damaging Ethiopia's fiscal programs, as a large amount of resources went to funding these SEO's (IMF, 2004) (IMF , 2005).

6.5 Findings

By combing the knowledge of the conditions that were dropped, and that of the key issues for the IMF in this 2004 period, some interesting points arise. When it comes to the conditions, labelled the 'Big Three' it is found that by in large the IMF is happy with the approach Ethiopia is taking, particularly surrounding categories in both the *financial sector*, *monetary policy*, and *central bank issues*, and *external debt issues*, where the strategy of the Ethiopian government aligned with the IMF's thinking. This explains why there was such a large drop in conditions in these two categories, even though the drop was higher than expected when compared to worldwide figures. When it came to the *external sector*, the IMF was strongly in favour of taking a more neoliberal approach than Ethiopia, which still required the abolishment of many tariffs, and privatisation of industry. This explains the smaller drop of in number of conditions that the *external sector* received, though it was still larger than worldwide levels.

For the 'small drop' category of revenue and tax issues, again the IMF agreed that Ethiopia was moving in the right direction, but there was a lot more action needed. From the earlier research it is clear the IMF know how much money is lost to developing countries through poor tax administration. So, it is no surprise the recommended a lot more action when it came to tax reform. However, it is still surprising that the number of conditions drop over 50%. This drop-in condition is not aligning with what the IMF state their goals are in Ethiopia, as the IMF calls for a lot more action.

For the "total drop" category, the IMF's actions are completely counter intuitive when compared with there stated goals in Ethiopia. For *fiscal issues*, a more sustainable approach is recommended, but all conditions about *fiscal issues* attached to its loans after 2003 vanish. This is the same with *SOE privatisation*, which the IMF strongly encouraged in 2004, yet attached no conditions about privatisation after 2003. This "total drop" category is the clearest, when it comes to discrepancies between what the IMF said and what IMF did.

Finally, for “no change” category, *SOE reform and pricing* is a curiosity. As the IMF made very little mention to it in any reports from 2004, and yet it received the same amount of conditions. This could simply be a compromise between the IMF and Ethiopia, for Ethiopia, to keep its SOE's, but to limit them in order to encourage private sector to grow.

7 Conclusion

For this paper, two research questions were proposed “Did the Forum of China and Africa Cooperation held in Addis Ababa cause the IMF to drop the number of conditions it attaches to loans to Ethiopia” and “Do the conditions that have been dropped by the IMF regarding Ethiopia, coincide with its stated development recommendations to Ethiopia”. While there is a strong correlation between a dramatic fall in conditions, and the occurrence of FOCAC, alternative scenarios must first be discussed.

7.1 Alternative scenarios

Firstly, it may be the case that the drop of conditions is because the IMF doesn't implement as many conditions as it used to. This is the case, but Ethiopia experienced a drop-in condition 70% greater than the average country did, so the drop-in conditions cannot solely be explained in the global drop of conditions. Secondly, Ethiopia in many sectors were taking the direction the IMF wished for Ethiopia's economy, and therefore the IMF applied less conditions. There is evidence to support this scenario, as the reports by the IMF commended Ethiopia's direction, however this scenario offers no explanation as for why Ethiopia dropped all conditions in *fiscal issues* and *SOE privatisation*, while they recommended the opposite. Therefore, this scenario can be used to explain the drop in some categories, but not all, so doesn't offer a strong alternative to our hypothesis. Finally, as Ethiopia is one of the fastest growing economies in the world, its position means it has more leverage with the IMF when it comes to negotiating conditions attached to loans. If Kenya, which shares a similar size economy, is compared to Ethiopia in the number of conditions, it is found that Kenya had a 40% drop in conditions, so still much less significant than the drop of conditions experienced by Ethiopia (IMF Monitor, 2019).

The alternative scenarios presented each offer a different explanation as to why Ethiopia is receiving less conditions, but there are reasons why each scenario does not hold completely true, when the full picture is looked at. Therefore, the initial hypothesis of ‘The IMF drops conditions to combat the growing presence of Chinese aid, in the aid recipient country, even when it acts against the IMF's stated development recommendations’ remains the strongest explanation

7.2 Concluding Remarks

The information released by the IMF Monitor shows a correlation between the FOCAC and the IMF's dropping of conditions. By exploring the bigger picture surrounding the drop of conditionality globally, as well as alternative scenarios to this correlation, it is shown that China is making the IMF rethink its approach to conditionality. When the focus was narrowed onto exactly what conditions were kept and which were dropped, a damning picture emerged of the conditions. While all conditions faced a big drop, which is notable, the removal of any conditions in the categories of *fiscal issues*, and *SOE privatisation*, is completely counter intuitive to the IMF's stated goals in Ethiopia in 2004. The most obvious explanation for these two categories being the completely removed, is that Ethiopia had a large public sector in the early 2000's. Once investment came in from China, they were in position to be selective with aid, so could negotiate with the IMF about the restrictions it was making on its public sector. As the IMF saw the expansion of foreign aid between China and Ethiopia, Realism, and Politically Motivated Aid states that this is China moving towards strengthening strategic alliances and economic linkages between the two states' national markets,

putting in the position to shape aid recipients' foreign and economic policies (Broome, 2014, p. 239). Threatening the position of the IMF's major donors. Therefore, the IMF allowed Ethiopia, to lessen the restrictions on its public sector. The drop of overall conditions can be explained in the same way, but *SOE privatisation* and fiscal policy is the clearest example of this happening. Because of this, the hypothesis of 'The IMF drops conditions to combat the growing presence of Chinese aid, in the aid recipient country, even when it acts against the IMF's stated development recommendations' remains true, and both research questions find a positive correlation.

In order to get a better understanding of what conditions are dropped, it would be important to gain a better understanding between the relationship of the IMF's major industrial donors, and the organisation itself. Research into the representatives of each country whom decided the conditions would also be key. This would allow a more detailed understanding of which countries interests the IMF seeks to protect, when it drops conditions, and to see whom uses the IMF as an instrument to further its interests.

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