Independent Evaluation Office

Annual Report 2004

International Monetary Fund

Established by the IMF's Executive Board in July 2001, the Independent Evaluation Office provides objective and independent evaluation on issues related to the IMF. The office operates independently of IMF management and at arm's length from the IMF's Executive Board. It enhances the learning culture of the IMF, promotes understanding of the IMF's work, and supports the IMF's Executive Board in its governance and oversight. Further information on the office and its work program can be found on its website (www.imf.org/ieo).

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Top: IEO speakers at a seminar in Tokyo.
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Center: IEO Acting Director and staff at a meeting in Washington.
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Bottom: Participants at an IEO workshop in Berlin.
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INDEPENDENT EVALUATION OFFICE

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The following symbols have been used in this report:

– between years or months (e.g. 2002–03 or January–June) to indicate the years or months covered, including the beginning and ending years or months;

FY to indicate a fiscal (financial) year. FY2003 is May 2002 to April 2003 and FY2004 is May 2003 to April 2004.

"Billion" means a thousand million.

Message from the Acting Director

The Independent Evaluation Office (IEO) was established by the IMF Executive Board in 2001 with a view to increasing transparency and accountability and strengthening the learning culture in the International Monetary Fund. This second *Annual Report* describes the activities of the IEO during its second full year of operation.

The report summarizes the findings and recommendations of two additional completed evaluation projects: on the IMF's experience with Poverty Reduction Strategy Papers and the Poverty Reduction and Growth Facility; and the role of the IMF in Argentina, 1991–2001. A third project, Assessing IMF Technical Assistance, will be submitted to the Executive Board in early 2005. This *Annual Report* also discusses the status of ongoing evaluations: the IMF's Approach to Capital Account Liberalization; the Financial Sector Assessment Program; and IMF Assistance to Jordan. Two additional projects are already on our agenda—evaluations of IMF Multilateral Surveillance and of IMF Structural Conditionality—and draft issues papers will be posted on the IEO website for public comments in early 2005.

We are now beginning the process of identifying potential candidates for the menu from which future IEO work programs will be chosen. A preliminary list of possible topics is described in this *Annual Report,* and we invite comments on these and other potential topics.

The IEO's terms of reference give an exceptional degree of independence, and we have developed procedures, described in this *Annual Report,* to promote high standards of transparency. Conducting effective evaluations would not be possible without the active cooperation of the institution being evaluated, and we would like to record our appreciation for the excellent collaboration we have received from the Executive Board, IMF management, and the staff.

Our experience in the first two full years of operation underscores the vital importance of giving interested external stakeholders an opportunity to interact with the IEO at various stages, including in defining the work program and determining the detailed terms of reference of individual studies. An increasing number of commentators are also taking advantage of the opportunities we provide to submit substantive inputs on items included in the terms of reference of each study. We welcome feedback on both our ongoing work and our future work program, which can be provided through the IEO website (www.imf.org/ieo).

Finally, I and the rest of the IEO staff would like to express our deepest gratitude to Montek Ahluwalia, the first Director of the IEO. Montek resigned at the end of June 2004 in order to take up a cabinet-level position in the Indian government. His contribution as a leader, the combination of intellectual insights and practical experience with policymaking that he brought to the complex task of evaluating the activities of the IMF, as well as his warmth as a friend and colleague are missed by all of us.

The IMF's Executive Board has begun the search for a new Director, with the goal that the person appointed will take up the position as early as possible in 2005.

David Goldsbrough

David Goldsbrough

Abbreviations and Acronyms

FSAP	Financial Sector Assessment Program
FSSA	Financial Sector Stability Assessment
GFSR	*Global Financial Stability Report*
IEO	Independent Evaluation Office (IMF)
IFI	International financial institution
IMFC	International Monetary and Financial Committee
JSA	Joint Staff Assessment
JSAN	Joint Staff Advisory Note
MDGs	Millennium Development Goals
OECD	Organization for Economic Cooperation and Development
OED	Operations Evaluation Department (World Bank)
PEM	Public expenditure management
PRGF	Poverty Reduction and Growth Facility
PRS	Poverty Reduction Strategy
PRSP	Poverty Reduction Strategy Paper
ROSC	Report on the Observance of Standards and Codes
SBA	Stand-By Arrangement
TA	Technical assistance
UN	United Nations
WEO	*World Economic Outlook*

CHAPTER I

The Independent Evaluation Office: Objectives and Modes of Operation

Independent evaluation is widely regarded as an essential requirement in international financial institutions (IFIs), contributing to increased transparency and accountability and strengthening the process of learning from experience. The IMF had a long tradition of internal evaluations of its operations and policies. These were regularly submitted to the Executive Board and led to new directions on policy and procedure. However, the IMF did not have a mechanism for independent evaluation of its activities until the establishment of the IEO by the Executive Board in the second half of 2001.

This chapter outlines the main objectives of the IEO as set forth in its terms of reference, and describes the operational modalities that have been developed by the IEO to achieve these objectives. The historical background to the creation of the IEO was discussed at greater length in last year's *Annual Report.*

Purpose of the IEO[1]

The purpose of the IEO, as outlined in its terms of reference, is to systematically conduct objective and independent evaluations "on issues, and on the basis of criteria, of relevance to the mandate of the Fund." The terms of reference, reproduced in Appendix 1, further elaborate that the IEO is intended to:

- Serve as a means of enhancing the learning culture of the IMF;
- Strengthen the IMF's external credibility;
- Promote greater understanding of the work of the IMF throughout its membership; and
- Provide independent feedback to the Executive Board in its governance and oversight responsibilities over the IMF.

The work of the IEO is envisaged as complementing the review and evaluation work being conducted within the IMF and is expected to improve the IMF's ability to draw lessons from its experience and to more quickly integrate improvements into its future work.

Independence

Independence of evaluation is critical if it is to be credible. This aspect of evaluation was emphasized in the Executive Board discussions that led to the establishment of the Independent Evaluation Office. The terms of reference explicitly state that the "IEO will be independent of Fund management and staff and will operate at arm's length from the Fund's Executive Board." The following provisions are designed to achieve this objective:

- The Director of the IEO is appointed solely by the Executive Board; IMF management, while it may be consulted in the selection process, is not involved in making the selection.[2] The Director is specifically precluded from appointment or reappointment to an IMF regular staff position at the end of the term of office.
- With a view to ensuring that the IEO is staffed with independent and highly qualified individuals, the Director of the IEO is solely responsible for the selection of IEO personnel, a majority of

[1]Additional background to the thinking behind the goals and modes of operation of the office is given in "Making the IMF's Independent Evaluation Office Operational: A Background Paper," prepared by the Evaluation Group of Executive Directors, August 7, 2000 (www.imf.org/external/np/eval/evo/2000/Eng/evo.htm).

[2]The initial terms of reference provided for a four-year term, renewable for a second term of up to three years. The Executive Board, in July 2001, appointed Montek Singh Ahluwalia as the first Director of the IEO. Mr. Ahluwalia resigned on June 30, 2004 to become Deputy Chairman of the Indian Planning Commission. When a search began for a new Director, the terms of the appointment were changed to provide for a nonrenewable term of six years.

whom must come from outside the IMF.[3] IEO staff reports exclusively to the Director of the IEO and not to IMF management.

- The budget of the IEO is prepared by the Director and submitted directly to the Executive Board for approval. IMF management is not involved at any stage of the process.
- The IEO's work program is determined by the Director in light of consultations with members of the Executive Board and other interested stakeholders, from both inside and outside the IMF. The work program determined by the Director is presented to the Executive Board for review, but is not subject to the Board's approval.

The IEO's terms of reference provide that within three years of the launch of IEO operations, the Executive Board should initiate an external evaluation of the IEO to assess its effectiveness and to consider possible improvements to its structure, mandate, operational responsibilities, or terms of reference. While the precise timing and modalities of this external evaluation will be determined by the Executive Board, the evaluation is expected to take place toward the end of 2005. The review is expected to solicit broad-based input from both within and outside the official community.

Budget and Staffing

The IEO's current budget is calibrated to allow the office to achieve an output equivalent to approximately four standard-size evaluations a year. The approved budget for FY2004[4] was US$3.9 million and estimated actual expenditure was US$3.4 million (Appendix 2). The approved budget for FY2005 is US$4.2 million. These amounts include staff costs, consultants, travel, outreach, and other miscellaneous costs. The FY2005 budget represents a real increase of 2 percent over the previous fiscal year, reflecting the phased buildup in the number of evaluation projects to four a year. The IEO's budget is equivalent to about 0.5 percent of the IMF's total administrative budget.

The IEO currently has 13 full-time staff positions, including the Director, the Deputy Director, nine professionals, and two administrative assistants. The majority of the staff has been recruited from outside the IMF and has wide experience in relevant areas. Since the IEO's evaluation work is expected to involve constantly changing topics, there is a shifting need for expertise of different types. This requires a greater use of consultants than in the IMF in general, a practice that also helps to achieve independence and credibility. The budget for consultants is about a quarter of the IEO's full-time staff budget.

The IEO Work Program and Future Menu of Topics

The terms of reference provide a very broad mandate for the work program of the IEO. It specifies that the IEO "should focus on issues of importance to the Fund's membership and of relevance to the mandate of the Fund taking account of current institutional priorities." Choosing three to four studies a year from the very wide range of issues potentially eligible under the IEO's mandate necessarily requires careful prioritization. This has been achieved through extensive consultations with stakeholders inside and outside the IMF, and by using transparent criteria.

In choosing its annual work programs, the IEO has consulted with internal and external interested groups, including representatives of civil society and academics, on the basis of a note that identifies a list of potential issues for evaluation. The IEO's first three annual work programs were guided by a core set of 15 possible topics, which had been chosen (again on the basis of extensive consultation with various stakeholders) from the initial list of over 30 topics prepared immediately after the office's establishment in July 2001.[5] The status of completed and ongoing evaluation projects is given in Table 1.1.

Now that 11 out of the initial set of 15 issues have been selected for evaluation—and priorities and pressing issues for the IMF may well have changed after three years—the IEO is initiating a new round of consultation to determine a menu of topics to guide its work programs over the coming years. For this purpose, the IEO has prepared a preliminary list of candidate topics, from which the work programs for the coming three years may be selected. As in the past, the criteria used for selection gave priority to topics that (i) had the greatest learning potential, (ii) had the greatest interest among the wide range of the IMF membership, and (iii) had been the subject of controversy and criticism while bearing in mind the IEO's comparative advantage. In addition, priority was also given to topics with a potential for producing recommendations that could assist the IMF as it embarks on the process of developing medium-

[3]The maximum length of appointment for full-time staff in the IEO is six years.

[4]The IMF's fiscal year begins May 1 and ends April 30.

[5]See www.imf.org/external/np/ieo/2001/eng/wp101901.pdf.

Table 1.1. Completed and Ongoing IEO Work Programs

Project	Expected Completion[1]
Initial round of evaluation projects	
Prolonged Use of IMF Resources	Completed
The IMF and Recent Capital Account Crises: Indonesia, Korea, Brazil	Completed
Fiscal Adjustment in IMF-Supported Programs	Completed
FY2004 work program	
The IMF and Argentina	Completed
Poverty Reduction Strategy Papers and the Poverty Reduction and Growth Facility	Completed
IMF Technical Assistance	Completed January 2005
FY2005 work program	
IMF's Approach to Capital Account Liberalization	February 2005
IMF Assistance to Jordan	April 2005
Financial Sector Assessment Program	September/October 2005
Multilateral Surveillance	Last quarter of 2005
FY2006 work program[2]	
IMF Structural Conditionality	First quarter of 2006

[1]The date refers to the time the completed report (and management/staff comments) is expected to be circulated to the Board. The timing of the actual Board discussion of each project is set as part of the overall schedule of the Executive Board and is not under the IEO's control. Publication is decided by the Board and takes place after the Board discussion.
[2]The remainder of the work program for FY2006 will be announced in the first quarter of 2005.

and long-term strategies. The list is being posted on the IEO website and is reproduced in Appendix 3. Comments are invited and may be directed to ieo@imf.org. The actual work program will be announced annually, and it is expected that the program for FY2006 will be announced in the first quarter of 2005.

Transparency and Accountability

For IEO evaluations to have credibility, it is important that they be conducted in a transparent manner, with adequate opportunity given to different stakeholders, especially those outside the IMF, to provide relevant inputs. To meet these objectives, the IEO has developed procedures that allow for extensive consultations in designing the evaluation project and also for receiving substantive inputs during implementation.

To ensure consultation at the design stage, each evaluation begins with the preparation of an issues paper that identifies the questions to be addressed and, to the extent possible, the methodology to be followed. The IEO seeks comments on this document from Executive Directors, IMF staff and management, member country governments (especially in the case of evaluations involving individual countries), and other interested observers. The issues paper is posted on the IEO website (www.imf.org/ieo) to elicit comments from a wider set of interested external observers. The comments received are taken into account in determining the final terms of reference for the study, which are also posted on the website.

The responsibility for the research undertaken and the conclusions reached must necessarily rest with the IEO. However, in conducting its evaluations the IEO interacts extensively with concerned parties both inside and outside the IMF. A unique feature of IEO evaluations, which distinguishes them from other external analyses of IMF activities, is that the IEO has access to internal IMF documents not normally made public and can also interview IMF staff concerned with the subject of the evaluation. For evaluations involving individual countries, consultations are held in the country concerned with both the authorities and a broad range of other interested parties, including civil society. Furthermore, the issues paper posted on the IEO website specifically invites interested parties to make submissions to the IEO on topics covered by the issues paper.

An important aspect of transparency and credibility is the assurance that IEO reports will be published and disseminated to a wide audience. The IEO's terms of reference provide that the reports, once they have been considered by the Executive Board, will be promptly published "unless in exceptional circumstances the Executive Board were to decide otherwise." All five evaluation reports prepared in the course of the first two years of the IEO's operations have been published.

To ensure full transparency, IEO reports are published in the form in which they were submitted to the Executive Board, without being changed in any way in light of comments received from management.[6] Comments received on the evaluation report from IMF management and staff, along with the IEO's reactions to those comments, if any, are submitted to the Executive Board as separate documents for the Board meeting at which the evaluation report is discussed. These documents are published together with the evaluation report and a summary of the Executive Board discussion. Once released to the public, the report is immediately posted on the IEO's website, followed by publication of the print version.

Outreach Activities, Opportunities for Feedback, and Follow-Up

One of the objectives of the IEO is to promote greater understanding of the work of the IMF. Accordingly, once an evaluation report is made public, the IEO engages in external outreach to make the evaluation report and the Board's decisions on it available to a wider audience. To promote this objective, various outreach events are organized to discuss each report after publication. To increase accessibility of the evaluation messages, a number of the country case studies have been translated into relevant local languages.[7]

During the past 18 months, the IEO participated in a number of outreach seminars and mid-pipeline workshops, generally at the invitation of third-party organizers. These are listed in Appendix 4.[8]

Following the approach begun in the *Annual Report 2003*, this report describes the status of follow-up on the five IEO evaluations completed to date. The matrices contained in Appendixes 5–9 track specific recommendations for each evaluation, noting the Executive Board's response to, and degree of support for, each recommendation; management's or staff's intended follow-up; and any actions to implement the recommendations that have been taken to date. Staff inputs are sought on the descriptions of the follow-up, but the final judgment on the language used is that of the IEO. This has proven to be a useful mechanism to track the extent to which IEO evaluations have elicited a response from the IMF to change aspects of its policies and operations. That said, the matrices are essentially of a descriptive nature and are not intended to make judgments on the *effectiveness* of follow-up actions in achieving their intended objectives.[9]

Relations with Other Evaluation Offices

Since independent evaluation is now a feature of all IFIs and there are evaluation offices in all bilateral donor agencies, there are networks of such offices that exchange information on issues of mutual interest, including methodological approaches. The IEO is a member of the Evaluation Cooperation Group, which comprises the evaluation offices of multilateral development banks and the IMF and aims to strengthen the use of evaluation for greater effectiveness and accountability as well as to share lessons and harmonize approaches (www.ecgnet. org). The IEO also participates in the activities of the Development Assistance Committee Working Party on Aid Evaluation, an international network for development evaluation experts and managers under the auspices of the Organization for Economic Cooperation and Development (OECD), which seeks to improve evaluation practice by sharing methods and experience and by elaborating technical guidance.

[6] The only exception would be for purely factual corrections, for which an errata page, identifying the specific corrections made, would be issued.

[7] A full list of IEO publications is available on the IEO website at www.imf.org/external/np/ieo/pap.asp.

[8] We would especially like to express our gratitude to InWent, Capacity Building International of Germany for hosting an annual workshop on IEO evaluation projects that has allowed us to receive feedback on completed and ongoing projects from a wide range of participants from Europe as well as from developing countries most directly associated with the various evaluations.

[9] Where subsequent internal assessments—for example, in the context of the regular biennial reviews of IMF surveillance and conditionality—assess progress on particular issues, the results are reported in the matrices, but without implying any IEO endorsement of these internal assessments. The role of the IEO in following up on evaluation recommendations may be revisited following the evaluation of the IEO itself.

Chapter 2 Evaluation Projects Undertaken in FY2003–04

This chapter summarizes the main findings and recommendations of the two most recently completed evaluation reports along with the conclusions reached in the respective Executive Board discussions. It also briefly updates the status of the Technical Assistance evaluation, which is expected to go to the Board at the beginning of 2005.

Poverty Reduction Strategy Papers and the Poverty Reduction and Growth Facility

The IMF and the World Bank introduced Poverty Reduction Strategy Papers (PRSPs) in 1999 to encourage broader-based participation in the development of country-owned, long-term strategies for growth and poverty reduction in low-income countries. Concurrently, the IMF transformed its concessional lending facility into the Poverty Reduction and Growth Facility (PRGF). PRSPs were intended to provide the basis for IMF and World Bank assistance to their low-income members. In particular, PRGF-supported programs were expected to be derived from PRSPs.

The IEO's evaluation focused on the role of the IMF in the Poverty Reduction Strategy (PRS) process and on the extent to which the PRGF is living up to the key features that were supposed to distinguish it from its predecessor—the Enhanced Structural Adjustment Facility. This evaluation was conducted in parallel with one by the World Bank's Operations Evaluation Department (OED), which assessed the effectiveness of the World Bank's support to the PRS process. Collaboration between the IEO and the OED included jointly undertaking a number of country case studies.[10]

Major findings

The evaluation concluded that while the PRS approach has the potential to encourage the development of country-owned and credible long-term strategies for growth and poverty reduction, actual achievements thus far had fallen considerably short of potential. It attributed this outcome, in part, to shortcomings in the design of the initiative that have reduced its effectiveness, including a lack of clarity about the role that the IMF should play. More specific findings are summarized below.

Participation and ownership

Participation in the formulation of PRSPs was found to be generally more broadly based than in previous approaches, although it was typically not designed to strengthen existing domestic institutional processes for policy formulation and accountability (for example, through parliament). In terms of the outputs from this participatory process in areas of direct relevance to the IMF, there has been limited discussion of alternative policy options related to the macroeconomic framework and macro-relevant structural reforms. The report attributes this in part to the absence of mechanisms to ensure that key macroeconomic issues are aired.

Results in terms of ownership have been mixed, with the least change in macroeconomic policy areas. In these areas, there has been relatively strong ownership in a narrow circle of official stakeholders responsible for driving the process, but much less among other domestic stakeholders. There continues to be a widespread perception that the PRS approach is overly influenced by the procedural requirements of the Bretton Woods institutions.

[10]Four joint country case studies (Mozambique, Nicaragua, Tajikistan, and Tanzania) were undertaken. In addition, both institutions' evaluations drew on country case studies prepared separately by the IEO (Guinea and Vietnam) and the OED (Albania, Cambodia, Ethiopia, and Mauritania). For all ten case studies, a joint IEO/OED survey of local stakeholders was undertaken. A compendium volume providing summaries of all ten case studies is being published and the six full case studies in which IEO was directly involved are available in English and relevant other languages on the IEO website at www.imf.org/External/NP/ieo/2004/prspprgf/eng/index.htm.

Content of PRSPs and implementation issues

In general, strategies outlined in PRSPs were found to be an improvement over previous development strategies, in the sense of providing greater poverty focus, a longer-term perspective, and some orientation toward results. However, most PRSPs were found to fall short of providing a strategic road map for policymaking, especially in the area of macroeconomic and related structural policies. PRSPs often avoided addressing key strategic choices involving "controversial" structural reforms. Thus, in many cases, PRSPs do not yet provide a policy framework in which PRGF-supported programs can be anchored. In a few countries where the process is beginning to be embedded in domestic institutions, there are signs of feedback from initial implementation to policy design, but these remain a minority.

Capacity constraints have impeded implementation. There has been insufficient attention to developing a systematic plan of action to strengthen capacity, including in the IMF's areas of primary competence. For example, budgetary processes are weak, and the linkages between the PRSP, medium-term expenditure frameworks, and budgets are generally poor. In particular, public expenditure management systems are generally too weak to allow the PRSP to play a central role in implementing expenditure priorities or modifying them on the basis of feedback on actual costs and outcomes.

Joint Staff Assessments

The evaluation found that, on balance, Joint Staff Assessments (JSAs) have not adequately performed the many tasks expected of them. Their main contribution has been in giving feedback to country authorities on weaknesses in PRSPs, but they are virtually unknown outside narrow official circles and consequently have had no impact on broad policy debates in countries. They also do not incorporate systematic inputs from development partners and, in practice, have played a limited role in informing lending decisions, including those of the Bretton Woods institutions. Factors limiting the usefulness of assessments include the lack of explicit benchmarks in most areas on which to base assessments and the fact that they were constrained to reach a binary (yes or no) conclusion on whether the strategies presented in PRSPs constituted a sound basis for concessional lending by the two institutions.

The role of the IMF

The effectiveness of the IMF's contribution has varied considerably across different components of the PRS initiative and across countries, with marked differences between "good" and "average" practice. Its overall contribution has fallen well short of the very ambitious goals set in the original policy documents. In particular:

- IMF staff typically did not participate actively to inform the policy debate among domestic stakeholders during the PRS formulation process; in fact, IMF staff generally interpreted the emphasis on country ownership as implying that involvement on their part should be limited.
- IMF contributions to developing a better understanding of country-specific micro-macro linkages have also been fairly limited. Although the process has led to much greater awareness within the IMF of the need for ex ante poverty and social impact analysis—with some "good practice" exceptions—this has not yet translated into general use of such analysis in program design. Part of the problem is that the PRS process itself does not yet generate sufficient signals—or accountability—on what the Bretton Woods institutions themselves should be delivering in terms of capacity-strengthening priorities.

On the positive side, there are signs that the "policy space" in the macroeconomic area has widened—in the sense of greater openness on the part of the IMF to considering alternative country-driven policies—at least in countries where macroeconomic stabilization is no longer a pressing issue.

PRGF-supported programs

Success in embedding the PRGF in the overall strategy for growth and poverty reduction has been limited in most cases, partly reflecting shortcomings in the strategies themselves. Nevertheless, program design under the PRGF has incorporated greater fiscal flexibility to accommodate aid flows, and there is no evidence of generalized "aid pessimism" or a systematic "disinflation" bias. Expenditures designated as poverty reducing have increased markedly since 1999, although there are questions about how "pro-poor" some of this spending is. IMF structural conditionality has been streamlined, but the evaluation was not able to reach a definitive conclusion on what has happened to aggregate IMF–World Bank conditionality, which is not monitored systematically by the institutions. There were only minor improvements in various measures of program implementation under the PRGF.

Outcomes

- Measures of the quality of policies and institutions by the IMF and the World Bank suggest that countries adopting poverty reduction strategies generally started out in a better position, but did not improve at a faster pace, than those low-income countries that did not adopt such strategies.

- Short-term growth for PRSP/PRGF countries is only marginally higher than in the earlier period. However, these countries seem to have weathered the worsening of the external environment in 2000–02 better than other low-income countries.
- Evidence on poverty-related outcomes, drawn from the parallel OED evaluation, is still too limited to reach definitive conclusions. The most notable improvements concern various input- and output-related measures (for example, number of teachers, school enrollment, and vaccination rates), but outcomes such as maternal and infant mortality rates have generally not improved.

Recommendations

The report makes six broad recommendations: three on aligning incentives with the objectives of the PRSP/PRGF approach, and three on improving the IMF's effectiveness.

Aligning incentives and objectives

Recommendation 1. Introduce greater flexibility in the implementation of the PRS approach to fit better the needs of countries at different stages of the process and with different capacities and political and administrative systems.

Countries need to be put even more firmly in the driver's seat by determining themselves:

(i) how the policy formulation, implementation, and monitoring processes will be conducted and built up over time, and with what rules of the game;

(ii) what the output of these processes will be in terms of documents (for example, PRSP, Progress Reports, and the like) and on what periodicity they will be prepared, relying as much as possible on domestic institutional arrangements and reporting vehicles.

IMF process requirements, such as linking reviews under the PRGF to completion of specific PRSP documents, should be minimized and oriented around domestic processes so that they do not conflict with domestic timetables and/or duplicate domestic instruments.

Recommendation 2. Shift the emphasis of the initiative from the production of documents to the development of sound domestic policy formulation and implementation processes.

Implementation of this recommendation would involve the following elements:

(i) As a way of building in a greater orientation toward results, countries should be encouraged to establish—with help from the IMF and the World Bank where needed—substantive criteria for judging progress toward key intermediate objectives.

(ii) A shift in the emphasis of the incentives structure faced by countries from procedural changes and production of documents to achieving substantive changes in domestic processes and policies. The new set of incentives would have the following elements:

- *Transparency*. Countries should present their intentions and objectives, along with the benchmarks selected to monitor progress, in a manner open to public scrutiny.
- *Accountability*. IMF (and World Bank) staff would be responsible for providing clear and *candid* assessments of the progress made by each country in implementing the PRS approach, both in relation to the goals set by the country itself and against initiative-wide benchmarks.
- *Support by the Bretton Woods institutions*. IMF (and World Bank) staff would help countries identify key constraints in making progress toward PRS objectives and support efforts to ameliorate them.
- *Selectivity*. Donor decisions on the volume of resources provided should be linked to the progress countries are making under the approach. To facilitate this, IMF assessments in its area of expertise need to provide as clear and candid a signal as possible. The criteria guiding the IMF's own lending decisions under the PRS approach could also be improved in this regard.

Recommendation 3. Clarify the purpose of the JSAs and redefine the vehicle accordingly.

The report's recommendations on JSAs include the following:

(i) JSAs should focus on the adequacy of domestic policy choices and the quality of domestic processes as well as on progress toward intermediate objectives, and less on the quality of the PRSP as a document.

(ii) In order to foster clear and candid assessments, JSAs should make explicit the criteria and benchmarks used by IMF staff to form their judgments, report the views of third parties (especially local stakeholders and donors) when available and discuss any differences of view, and eliminate the need to reach a binary (yes or no) conclusion as to the adequacy of the PRS process as a basis for concessional lending by the IMF and the World Bank. JSAs should also aim to provide a graduated assessment of the strength of the PRSP and related processes as well as of the quality of policies.

Clarifying the IMF's role and improving its effectiveness

Recommendation 4. Clarify what the PRS approach implies for the IMF's own operations and strengthen the implementation of the agreed role.

With respect to engagement in the PRS process, more emphasis should be given to IMF activities that facilitate the IMF's participation in broad-based policy discussions in its areas of competence. The IMF's role should be tailored to country-specific circumstances, including to the government's wishes; the resulting country-specific "rules of the game" should be made public and could describe how IMF staff is expected to participate in the broader policy debate.

With respect to PRGF-related activities, the rationale for IMF policy recommendations and program design should be subjected to broader scrutiny and debate. Possible steps in this direction could include (i) facilitating wider dissemination and discussion of IMF analysis that forms the basis of its policy advice (including, where appropriate, TA reports); and (ii) encouraging greater openness to "independent/external voices" as inputs into program design, when agreeable to the authorities.

There is a need to clarify the approach to be taken by the IMF in those cases where the PRS approach has added some value but has not yet produced an operational road map or the necessary institutional framework for implementation. Even in these cases, there may be significant scope for opening up the policy space and more systematically incorporating evidence on macro-micro linkages, including through poverty and social impact analysis.

Recommendation 5. Strengthen prioritization and accountability on what the IMF itself is supposed to deliver within the broader partnership framework, built around the priorities emerging from the PRS process, and ensure resources match commitments.

The IMF should tailor its involvement more closely to country needs, taking into account contributions from other partners. This can be done by generating, as part of the PRS process, specific priority actions for the IMF to assist the country concerned to reach its national objectives. The IMF's own budgetary decisions on the allocation of administrative resources would then be geared to these priorities.

Recommendation 6. The IMF should encourage a strengthening of the framework for establishing the external resource envelope as part of the PRS approach.

A country itself, not the IMF or the World Bank, should eventually play the central role in elaborating macro frameworks and catalyzing donor support. The pace at which this transition can be made will depend on specific capacity constraints in each country, but country leadership seems essential to "owning" the process. The IMF's role would be to provide debt and macroeconomic sustainability assessments and judgments on the policy framework, but the IMF would not be responsible for the "normative" judgment on appropriate aid levels over the medium term.

The tension between "ambition" and "realism" in determining the external resource envelope could be handled by presenting alternative projections (consistent with assumptions of stronger policy reforms as well as additional external financing). The IMF should provide increased analytical support for such approaches when requested, but the choice to prepare alternative projections should remain with the country and should not be a uniform requirement.

Executive Board response[11]

Executive Directors welcomed the report as a valuable contribution to the ongoing review of how to improve the effectiveness of the IMF's engagement with low-income countries. While most Directors considered that the PRS approach has had a positive impact on economic policy design and implementation, they stressed that substantial scope exists for better implementation of the current approach, based on the evolving experience and the directions of change identified in the IEO report. At the same time, Directors cautioned against drawing premature conclusions about the ultimate success of the PRS approach based on only five years of experience with its implementation. They encouraged the staff to draw on the IEO's recommendations to deepen and refine its analysis on ways to enhance the effectiveness of the PRS approach. They looked forward to the recommendations of the management-led committee on low-income country work to provide new impetus and focus to IMF work on low-income countries.

[11]The full Summing Up of the Executive Board discussion is available on the IEO website at www.imf.org/External/NP/ieo/2004/prspprgf/eng/index.htm. Staff and management responses to the evaluation report are also available on the website.

The Executive Board's responses to specific recommendations are summarized below.

Greater flexibility in implementation of PRS approach

Directors agreed that the PRS approach should be implemented pragmatically and flexibly, bearing in mind country-specific circumstances and capacity constraints. They stressed the need to ensure that IMF-supported programs are designed to assure macroeconomic stability as well as to help members accelerate the pace of progress toward the Millennium Development Goals (MDGs). They indicated that the PRGF should be tightly linked to PRSPs that provide a sound operational road map. Where PRSPs are not yet operationally viable, the IMF should not insist on immediate tight alignment. Instead, IMF staff should focus on working with the countries to strengthen the macroeconomic frameworks in their PRSPs in order to move toward eventual alignment. At the same time, Directors cautioned that increased flexibility should not imply delinking the PRGF from the PRS process, and noted that the IMF would still seek to apply the PRSP principles in its program work.

Shift emphasis to the development of sound domestic processes

Directors agreed that there should be less emphasis on document preparation, and more emphasis on improving the capability of countries to develop and implement policies supportive of growth and poverty reduction. Some Directors agreed with the recommendation that countries should set explicit criteria for judging progress toward key intermediate objectives and that IMF and World Bank staff should provide candid assessments of those benchmarks. Many other Directors cautioned against excessive IMF involvement in assessing a country's decision-making processes, which they feared would establish an unwarranted direct linkage between such assessments and IMF lending decisions, and which could undermine the legitimacy of domestic institutions and processes. Directors noted that further discussion would be needed on how the IMF should react in cases where it believes that the pace of progress chosen is not ambitious enough.

Joint Staff Assessments

Directors called for a reformulation of the JSA approach to emphasize graduated rather than binary assessments, with the objective of providing candid feedback to countries. They looked forward to discussing specific recommendations presented by the staff in the context of the annual Fund-Bank *PRSP Progress in Implementatio*n report.

Implications of the PRS approach for IMF operations

Directors agreed that the IMF needs to more clearly set out its role in the PRS approach in each country, based on the IMF's core mandate in macroeconomic and related structural policy issues. Many Directors supported a more active role for IMF staff in the public debate on macroeconomic policy design and implementation, but others thought a more proactive role would not be appropriate since it could be seen as influencing the political decision-making process of a country.

Strengthened prioritization and IMF accountability within the broader partnership framework

Directors welcomed the IEO report's emphasis on the need to define priorities for the work of the IMF in low-income countries. They indicated that the prioritization of budget resources must be guided by the IMF's overall mandate. They called for a careful assessment of the resource implications of adapting the IMF's role along the lines of the report's recommendations, and looked forward to staff views on ways to improve the IMF's involvement in the PRSP in the context of forthcoming Executive Board discussions of the annual Fund-Bank *PRSP Progress in Implementation* report and the review of the resident representative program.

Framework for establishing external resources envelope

Directors indicated that the IMF should play a supportive role with donors and low-income members to help ensure adequate provision of aid to achieve the MDGs. In this regard, the IMF needs to consider how its signals can be clear and useful to its members. In particular, IMF signals should not lead to inappropriate interruption of long-term development and poverty reduction finance.

The Role of the IMF in Argentina, 1991–2001

The Argentine crisis of 2000–02 was among the most severe of recent currency crises. In December 2001, Argentina defaulted on its sovereign debt and soon afterwards abandoned the convertibility regime, under which the peso had been pegged at parity with the U.S. dollar since 1991. The crisis had a devastating economic and social impact, causing many observers to question the role played by the IMF over the preceding decade when it was almost continuously engaged in Argentina through five successive financing arrangements.

The evaluation report examined the role of the IMF in Argentina during 1999–2001, taking advantage of the IEO's unique access to internal documents, in order to draw lessons for the IMF in improving both its surveillance and crisis management capabilities in the future. In accordance with the IEO's terms of reference, the report did not assess issues that would have a direct bearing on ongoing operations and hence did not discuss developments later than the first few days of 2002.

Overview

Argentina's convertibility regime was a stabilization device to deal with the hyperinflation that existed at the beginning of the 1990s, and in achieving this goal, it was very successful. The regime was also part of a larger Convertibility Plan, which included a broader agenda of market-oriented structural reforms designed to promote efficiency and productivity in the economy. Under the Convertibility Plan, Argentina saw a marked improvement in its economic performance, particularly during the early years. Inflation, which was raging at a monthly rate of 27 percent in early 1991, declined to single digits in 1993 and remained low thereafter. Growth was solid through early 1998, except for a brief setback associated with the Mexican crisis, and averaged nearly 6 percent. Attracted by a more investment-friendly climate, Argentina experienced large capital inflows in the form of portfolio and direct investments.

These impressive gains, however, masked emerging vulnerabilities, which came to light when a series of external shocks began to hit Argentina and caused growth to slow down in the second half of 1998. Fiscal policy, though improved from the previous decades, led to a steady increase in the stock of debt, much of which was foreign currency denominated and externally held. The convertibility regime ruled out nominal depreciation when a depreciation of the real exchange rate was warranted by, among other things, the sustained appreciation of the U.S. dollar and the devaluation of the Brazilian real in early 1999. Deflation and output contraction set in, while Argentina faced increasingly tighter financing constraints amid investor concerns over fiscal solvency.

The crisis resulted from the failure of Argentine policymakers to take necessary corrective measures sufficiently early, particularly in the consistency of fiscal policy with their choice of exchange rate regime. Moreover, these policymakers had ownership in the fundamental policy choices, including in particular the commitment to the convertibility regime. However, the IMF on its part erred in the precrisis period by supporting the country's weak policies too long, even after it had become evident in the late 1990s that the political ability to deliver the necessary fiscal discipline and structural reforms was lacking. By the time the crisis hit Argentina in late 2000, there were grave concerns about the country's exchange rate and debt sustainability, but there was no easy solution. Given the extensive dollarization of the economy, the costs of exiting the convertibility regime were already very large. The IMF supported Argentina's efforts to preserve the exchange rate regime with a substantial commitment of resources, which was subsequently augmented on two occasions. This support was justifiable initially, but the IMF continued to provide support through 2001 despite growing signs that the existing policy regime was unsustainable and despite repeated policy inadequacies. In retrospect, the resources used in an attempt to preserve the policy regime during 2001 could have been better used to mitigate at least some of the inevitable costs of exit.

Major findings

Surveillance

Exchange rate policy. Although the IMF was initially skeptical of the convertibility regime's medium-term viability, its internal views as well as public statements became much more upbeat when Argentina—with financial support from the IMF—successfully weathered the aftermath of the Mexican crisis, at which time the IMF endorsed the convertibility regime as essential to price stability and fundamentally viable. Following the devaluation of the Brazilian real in early 1999, IMF staff began to consider more seriously the viability of the peg and possible exit strategies but, by this time, the risks and costs associated with any exit were already very high. Throughout the precrisis period, little substantive discussion took place with the authorities or at the Executive Board on Argentina's exchange rate policy.

Fiscal policy. The choice of the convertibility regime made fiscal policy especially important. Fiscal policy was rightly the focus of discussion with the authorities throughout the period, but the IMF's analysis was handicapped by its focus on annual deficits, insufficient attention to the provincial finances, and overestimation of the sustainable level of public debt for a country with Argentina's characteristics (such as a small export sector, a small tax revenue base, high interest rates, and small domestic capital markets). Enforcement of fiscal conditionality was also weak. While fiscal policy improved from previous decades, the initial gains were not sustained and the election-driven increase in public spending led to a sharp deterioration in fiscal discipline in 1999. As a result, the stock of public debt steadily increased, which diminished the ability of the authorities to use countercyclical fiscal policy when the recession deepened.

Structural reforms. The IMF correctly identified structural fiscal reforms, social security reform, labor market reform, and financial sector reform as essential to enhancing the medium-term viability of the convertibility regime by promoting fiscal discipline, flexibility, and investment. Most of the initiatives for reform in these areas came from the authorities, with the role of the IMF largely limited to providing TA in the fiscal areas. In fact, the remarkable feature of the successive IMF-supported programs with Argentina was the paucity of formal structural conditionality. Some gains were made in the early years, but the long-standing political obstacles to deeper reforms proved formidable. Little progress was made in later years, but the lack of strong structural conditionality fostered a continued program engagement with Argentina, when the evident lack of substantive progress in structural reform should have called for an end to the program relationship.

Crisis management, 2000–01

In the fall of 2000, Argentina effectively lost access to voluntary sources of financing. The authorities approached the IMF for a substantial augmentation of financial support under the Stand-By Arrangement (SBA) approved in March 2000, which up to that time had been treated as precautionary. In response, from January to September 2001, the IMF made three decisions to provide exceptional financial support to Argentina, raising its total commitments to US$22 billion. In December 2001, however, the fifth review of the program was not completed, which marked the effective cutoff of IMF financial support. The evaluation report assesses the key decisions made by the IMF during this period, bearing in mind the information available to the staff, management, and the Executive Board at the time.

The augmentation decision in January 2001. The decision to augment the existing arrangement was based on the diagnosis that Argentina faced primarily a liquidity crisis and that any exchange rate or debt sustainability problem was manageable with strong action on the fiscal and structural fronts. The IMF was well aware that the costs of a fundamental change in the policy framework would be very large. It wished to give the authorities the benefit of the doubt, when they were evidently committed to making strong policy corrections. Given the probabilistic nature of any such decision, the chosen strategy may well have worked if the assumptions had turned out to be correct (which they were not) and if the agreed program had been impeccably executed by the authorities (which it was not). The critical error was the failure to have an exit strategy, including a contingency plan, in place, inasmuch as the strategy was known to be highly risky.

The decisions to complete the third review in May and to further augment the arrangement in September 2001. While these decisions also had to be made in circumstances of great uncertainty, the weak implementation of the program in early 2001 and the adoption—without consultation with the IMF—of a series of controversial and market-shaking measures by the authorities after March 2001 should have provided ample ground for concluding that the initial strategy had failed. In fact, even within the IMF, there was an increasing recognition that Argentina had an unsustainable debt profile, an unsustainable exchange rate peg, or both. Yet, no alternative course of action was presented to the Board, and decisions were made to continue disbursing funds to Argentina under the existing policy framework, on the basis of largely noneconomic considerations (such as to make sure that the country, and not the IMF, took responsibility for the critical decisions needed), and in hopes of seeing a turnaround in market confidence and buying time until the external economic situation improved.

The decision not to complete the review in December 2001. After the September augmentation, economic activity and market confidence continued to collapse, making it virtually impossible to achieve the program's targets and salvage convertibility. While aware of this predicament, the IMF did not press the authorities for a fundamental change in the policy regime and announced in early December that the pending review could not be completed under the circumstances. Within a month of this announcement, economic, social, and political dislocation occurred simultaneously, leading to the resignation of the President, default on Argentina's sovereign debt, and the abandonment of convertibility, soon followed by government decisions that further amplified the costs of the collapse of convertibility. In those circumstances, the IMF was unable to provide much help and largely stood by as the crisis unraveled.

The decision-making process. Several weaknesses were evident in the IMF's decision-making process. First, contingency planning by IMF staff was insufficient. Too much attention was given to determining—inconclusively—which alternative policy framework should be recommended to the authorities, while little effort was made to determine what practical steps the IMF should take if the chosen strategy failed. Second, from March 2001 onward, the relationship between the IMF and the authorities became less cooperative, with the authorities taking policy initiatives that the IMF viewed as misguided but felt compelled to endorse. The authorities remained unwilling to discuss any alternative plan. Third, insufficient attention was paid to the risks of giving the authorities the benefit of the doubt beyond the point where sustainability was clearly in question. Fourth, the Executive Board did not fully perform its oversight responsibility, exploring the potential trade-offs between alternative options. To some extent, this reflected the fact that some key decisions took place outside the Board and that some critical issues were judged by management to be too sensitive for open discussion in the full Board.

Lessons from the Argentine crisis

The Argentine crisis yields a number of lessons for the IMF, some of which have already been incorporated into revised policies and procedures. The evaluation identified 10 lessons.

Surveillance and program design

- *Lesson 1*. While the choice of exchange rate regime belongs to country authorities, the IMF must exercise firm surveillance to ensure that the choice is consistent with other policies and constraints. Candid discussion of exchange rate policy, particularly when a fixed peg is involved, must become a routine exercise.
- *Lesson 2*. The level of sustainable debt for emerging market economies may be lower than had been thought, depending on a country's economic characteristics. The conduct of fiscal policy should be sensitive to the overall stock of public debt.
- *Lesson 3*. The authorities' decision to treat an arrangement as precautionary should not weaken standards for IMF support. Weak program design and weak implementation in the context of arrangements being treated as precautionary do not help a country address its potential vulnerabilities. When there is no balance of payments need and there are serious political obstacles to needed policy adjustment or reform, it may be better not to agree to an arrangement, thus subjecting the country to market discipline rather than to program reviews by the IMF.
- *Lesson 4*. Emphasis on country ownership in IMF-supported programs can lead to an undesirable outcome, if ownership means misguided or excessively weak policies. The IMF should be prepared not to support strongly owned policies if it judges they are inadequate to generate a desired outcome.
- *Lesson 5*. Favorable macroeconomic performance, even if sustained over some period of time, can mask underlying institutional weaknesses that may become insuperable obstacles to any quick restoration of confidence, if growth is disrupted by unfavorable external developments. The IMF may have only a limited role to play when institutional weaknesses are deeply rooted in the political system, and structural conditionality cannot substitute for domestic ownership of the underlying reforms.

Crisis management

- *Lesson 6*. Decisions to support a given policy framework necessarily involve a probabilistic judgment, but it is important to make this judgment as rigorously as possible, and to have a fallback strategy from the outset in case some critical assumptions do not materialize.
- *Lesson 7*. The catalytic approach to the resolution of a capital account crisis works only under quite stringent conditions. When there are well-founded concerns over debt and exchange rate sustainability, it is unreasonable to expect a voluntary reversal of capital flows.
- *Lesson 8*. Voluntary, market-based debt restructuring is costly and unlikely to improve debt sustainability if it is undertaken under crisis conditions and without a credible, comprehensive economic strategy. Only a form of debt restructuring that leads to a reduction of the net present value of debt payments or, if the debt is believed to be sustainable, a large financing package by the official sector have a chance to reverse unfavorable debt dynamics.
- *Lesson 9*. Delaying the action required to resolve a crisis can significantly raise its eventual cost, as delayed action can inevitably lead to further output loss, additional capital flight, and erosion of asset quality in the banking system. To minimize the costs of any crisis, the IMF must take a proactive approach to crisis resolution, including providing financial support to a policy shift, which is bound to be costly regardless of when it is made.

The decision-making process

- *Lesson 10*. In order to minimize error and increase effectiveness, the IMF's decision-making process must be improved in terms of risk analysis, accountability, and predictability. A more rule-based decision-making procedure, with greater ex ante specification of the circumstances in which financial support will be available, may facilitate a faster resolution of a crisis, though the outcome may not always be optimum. Recent modifications to the exceptional access policy have already moved some way in this direction.

Recommendations

On the basis of these lessons, the evaluation offered six sets of recommendations in order to strengthen the initiatives already being taken.

Crisis management

- *Recommendation 1*. The IMF should have a contingency strategy from the outset of a crisis, including in particular "stop-loss rules"—that is, a set of criteria to determine if the initial strategy is working and to guide the decision on when a change in approach is needed.

- *Recommendation 2*. Where the sustainability of debt or the exchange rate is in question, the IMF should indicate that its support is conditional upon a meaningful shift in the country's policy while remaining actively engaged to foster such a shift. High priority should be given to defining the role of the IMF when a country seeking exceptional access has a solvency problem.

Surveillance

- *Recommendation 3*. Medium-term exchange rate and debt sustainability should form the core focus of IMF surveillance. To fulfill these objectives (which are already current policy), the IMF needs to improve tools for assessing the equilibrium real exchange rate that are more forward looking and rely on a variety of criteria, examine debt profiles from the perspective of "debt intolerance," and take a longer-term perspective on vulnerabilities that could surface over the medium term.

Program relationship

- *Recommendation 4*. The IMF should refrain from entering or maintaining a program relationship with a member country when there is no immediate balance of payments need and there are serious political obstacles to needed policy adjustment or reform.

- *Recommendation 5*. Exceptional access should entail a presumption of close cooperation between the authorities and the IMF, and special incentives to forge such close collaboration should be adopted, including mandatory disclosure to the Board of any critical issue or information that the authorities refuse to discuss with (or disclose to) the staff or management.

The decision-making process

- *Recommendation 6*. In order to strengthen the role of the Executive Board, procedures should be adopted to encourage: (i) effective Board oversight of decisions under management's purview; (ii) provision of candid and full information to the Board on all issues relevant to decision making; and (iii) open exchanges of views between management and the Board on all topics, including the most sensitive ones. These initiatives will be successful only insofar as IMF shareholders—especially the largest ones—collectively uphold the role of the Board as the prime locus of decision making in the IMF. Some possible steps to modify Board procedures to strengthen governance are discussed in the concluding section of the report.

Executive Board response[12]

The Executive Board discussed the report on July 26, 2004. The Board welcomed the report and broadly endorsed the thrust of its findings, lessons, and recommendations. While noting that many of the report's recommendations were in line with policies and reforms that had recently been implemented, Executive Directors stressed the importance of making further progress in incorporating them into the IMF's operations and decision-making process.

Crisis management. Most Directors viewed contingency planning as useful. However, many Directors noted the difficulty of assessing the various contingencies that might occur in a crisis or precrisis setting and that an element of prompt adaptation to rapidly evolving events is unavoidable. Concern was also expressed that any indication that the IMF was developing a contingency plan could undermine confidence in the program. As regards "stop-loss" rules, most felt that defining and implementing such rules would be difficult or impractical. Directors agreed with the report's recommendation that the IMF's financial support should be conditional upon a meaningful shift in the country's policy when the sustainability of debt or the exchange rate is in question.

Surveillance. The Board agreed with the report's recommendation that medium-term exchange rate and debt sustainability analyses should form the core focus of surveillance. Directors stressed the need for greater candor in the treatment of exchange rate policy during Article IV discussions, both in meetings with the authorities and in information presented to the Executive Board. They suggested that IMF staff should explore the scope to establish procedures for

[12]The full Summing Up of the Executive Board discussion is available on the IEO website at www.imf.org/External/NP/ieo/2004/arg/eng/index.htm. Staff and management responses to the evaluation report as well as a statement to Executive Board members from the Argentine authorities are also available on the website.

handling sensitive topics during surveillance exercises in order to strike an appropriate balance between candor and confidentiality. As to debt sustainability analysis, while noting the progress made thus far, Directors asked the staff to continue to sharpen its analytical tools.

Program relationship. While noting the possible risks associated with precautionary arrangements, most Directors did not agree that standards for such arrangements tended to be weaker. As regards the presumption of close cooperation between the IMF and country authorities under exceptional access, Directors stressed that all cases of the use of IMF resources should entail such presumption and encouraged management and staff to keep the Board fully informed of the state of program discussions. Many Directors agreed with the report's recommendation that there should be a requirement of mandatory disclosure to the Board of any critical issues that the authorities refuse to discuss.

The decision-making process. Directors were concerned with the report's assessment of the IMF's decision-making procedures during the crisis, especially the role of the Board. A number of Directors saw a need for further discussion of approaches to strengthen the Board's role. While noting some progress, including the procedures for exceptional access adopted since the Argentina crisis, Directors called for further efforts to enhance decision making by the Board, including improving the provision of full information on all issues relevant to decision making, and opening exchanges of views between management and the Board on all topics, including the most sensitive ones.

Technical Assistance Provided by the IMF[13]

The IMF has provided a significant amount of TA to member countries over the years. In terms of person years, direct TA activities account for about 12 percent of the institution's administrative budget. The objectives of TA are twofold: (i) to support the efforts of members to strengthen their capacity—in both human and institutional resources—to formulate and implement sustainable, growth-oriented, and poverty-reducing policies; and (ii) to assist countries in designing appropriate macroeconomic and structural policy reforms, taking into account the lessons learned by other countries in addressing similar economic policy concerns.

This evaluation is in its final stage, and the report will be presented to the IMF Executive Board in early 2005. The evaluation will be addressing the following set of questions as well as providing recommendations on:

- What factors determine the allocation of TA resources across countries? How are TA priorities selected at the country level and across countries, and how well are they related to countries' broader economic policy strategies? How is the balance between short-term TA (to support the policy advice of the IMF) and long-term TA (to support institution building) being established? What can be done to make the prioritization of TA more strategic?

- What can be learned about specific modalities of TA delivery and ways to interact with authorities during its implementation in order to increase the effectiveness of TA? What can be done to enhance the participation of the authorities in the design of TA activities?

- What has been the impact of TA, and how is progress being tracked and monitored? What are the key factors (under the control of the IMF or the authorities) that enhance the impact of TA? How effectively does the allocation and design of TA respond to such feedback?

In order to address these questions, the evaluation uses different data sets and methodologies, including cross-country and time series allocations of field time devoted to TA, desk studies to assess the link between strategic documentation (such as Article IV reports and PRSPs) and a particular TA program, and interviews with IMF staff. The evaluation also includes six in-depth country studies designed to elicit the views of authorities and local counterparts. As part of the case studies, field visits have been made to Cambodia, Honduras, Niger, Ukraine, Yemen, and Zambia.

[13]A detailed issues paper/terms of reference for the evaluation is available on the IEO website at www.imf.org/external/np/ieo/2003/tas/tasip.htm.

CHAPTER

3

Status of Ongoing Projects

The IMF's Approach to Capital Account Liberalization[14]

Capital account liberalization and related issues re-emerged as a topic of intense debate among policymakers and economists in the early 1990s. Although the IMF does not have clear jurisdiction over capital account transactions, the increasing importance of international capital flows for macroeconomic and exchange rate management in many countries has caused the IMF to give considerable attention to capital account issues in recent years. Thus, an independent assessment of how the IMF has addressed these issues, particularly those related to capital account liberalization, seems warranted.

The evaluation seeks to (i) contribute to transparency by documenting the IMF's approach to capital account issues and capital account liberalization in particular; and (ii) identify areas, if any, where the IMF's instruments and procedures, including surveillance and TA, might be improved, in order to deal better with capital account issues.

Issues for evaluation

The evaluation, covering roughly the 1990s and early 2000s, poses the following two main questions:

- What was the IMF's advice on capital account liberalization and other capital account issues, and how did it change over time?
- Did the IMF's advice on capital account issues in specific instances sufficiently take into account the trade-offs involved in various alternatives in the light of the state of knowledge existing at the time?

These questions may be addressed by asking more specific questions about aspects of the IMF's two related areas of activity, namely (i) its specific advice on capital account liberalization and (ii) its analysis and surveillance of broader capital account issues.

For example, specific questions might include:

- Is there evidence that, in more recent years, the IMF has changed its approach toward encouraging member countries to liberalize the capital account?
- In countries that opened their capital accounts during this period, what was the role of the IMF in terms of policy advice and TA?
- Was the IMF's approach consistent across countries, as well as across departments or between the staff, management, and the Executive Board within the IMF?
- What was the IMF's position on policy choices available to member countries facing a sudden—and presumably temporary—surge of capital inflows?
- How did the IMF take into account the context within which a country seeking advice was placed? In this context, did the IMF take a consistent position on the role of temporary capital controls as part of crisis response and prevention?
- Did the IMF give sufficient attention to the consistency of policy toward the capital account with macroeconomic and exchange rate policies?

Scope and methodology of evaluation

The evaluation is designed to assess the IMF's approach to capital account liberalization, as it relates to the broader question of how to manage capital flows. The focus of the evaluation therefore will be primarily on emerging market economies, for which private capital flows have been important. Particular attention will be paid to country experiences with liberalization (in terms of speed, sequencing, and preconditions) and policy responses to capital flows, including temporary use of capital controls, and the IMF's role and advice in these areas.

[14] A detailed issues paper/terms of reference for the evaluation is available on the IEO website at www.imf.org/external/np/ieo/2004/cal/091504.pdf.

The evaluation will utilize three layers of analysis:

- Analysis of cross-sectional issues, including multilateral surveillance.
- A study of internal documents for about 15 countries.
- A more detailed analysis of country experience in about five countries.

The *first layer* uses public and internal documents to consider how the IMF viewed capital account issues, including its own mandate in this area. It will also examine how the IMF communicated its views to the international community through formal and informal channels.

The *second layer* is a cross-country analysis of about 15 countries, which are being selected on the basis of the size of portfolio capital flows during 1991–2003 and the changes introduced in capital account openness during the 1990s. The sample includes: (i) countries that significantly liberalized the capital account; (ii) countries that still maintain significant controls on capital account transactions; and (iii) countries that introduced measures to restrict capital account transactions.

Finally, the *third layer* is a more detailed analysis of about five countries with varied experiences with, and at different stages of, capital account liberalization. The purpose is to have a better understanding of the role of the IMF in countries that substantially eased restrictions on capital transactions during the early 1990s, the nature of IMF advice for countries that are in the process of liberalizing their capital account, and specific country experiences with capital controls and capital account liberalization. The countries will be selected from among those included in the second layer of analysis.

The work of the evaluation is based primarily on a study of internal documents, supplemented by interviews with IMF staff and a review of academic literature. In addition, brief field visits are being made to some of the countries selected for the evaluation, including all of the case study countries. It is expected that the evaluation report will be circulated to the IMF Executive Board in the first quarter of 2005.

Financial Sector Assessment Program and Financial Sector Stability Assessment[15]

The Financial Sector Assessment Program was introduced in May 1999 in response to the financial crises of the late 1990s, which had led to a call for the IMF and the World Bank to find jointly an effective way to provide policy advice to strengthen the financial systems of member countries. It was meant to fill an identified gap in the international financial architecture in support of crisis prevention, based on a judgment that existing approaches at the IMF under Article IV consultations were not sufficient for effective financial sector surveillance.

The FSAP was designed to strengthen the surveillance of member countries, facilitating early detection of financial sector vulnerabilities and identification of development needs in the financial sector. The recognition of the close relationship between financial stability and financial development issues led to the decision to adopt a joint IMF–World Bank approach. The FSAP has become a principal platform for financial sector diagnosis at the IMF. Over 80 country assessments have been completed or are under way. Drawing on the FSAP, the IMF staff also prepares a Financial Sector Stability Assessment (FSSA), which summarizes the FSAP findings of relevance to IMF surveillance, based on discussions with the country authorities as part of the regular Article IV consultations.

The instruments to achieve the FSAP initiative's objectives include: (i) identifying financial sector risks and vulnerabilities by a team of IMF and Bank staff and outside experts using a variety of tools and methodologies; (ii) articulating findings and prioritizing recommendations; and (iii) follow-up activities to assess implementation of recommended measures. In addition, the initiative contemplates reassessments to identify new sources of vulnerabilities (Figure 3.1).

Issues for evaluation

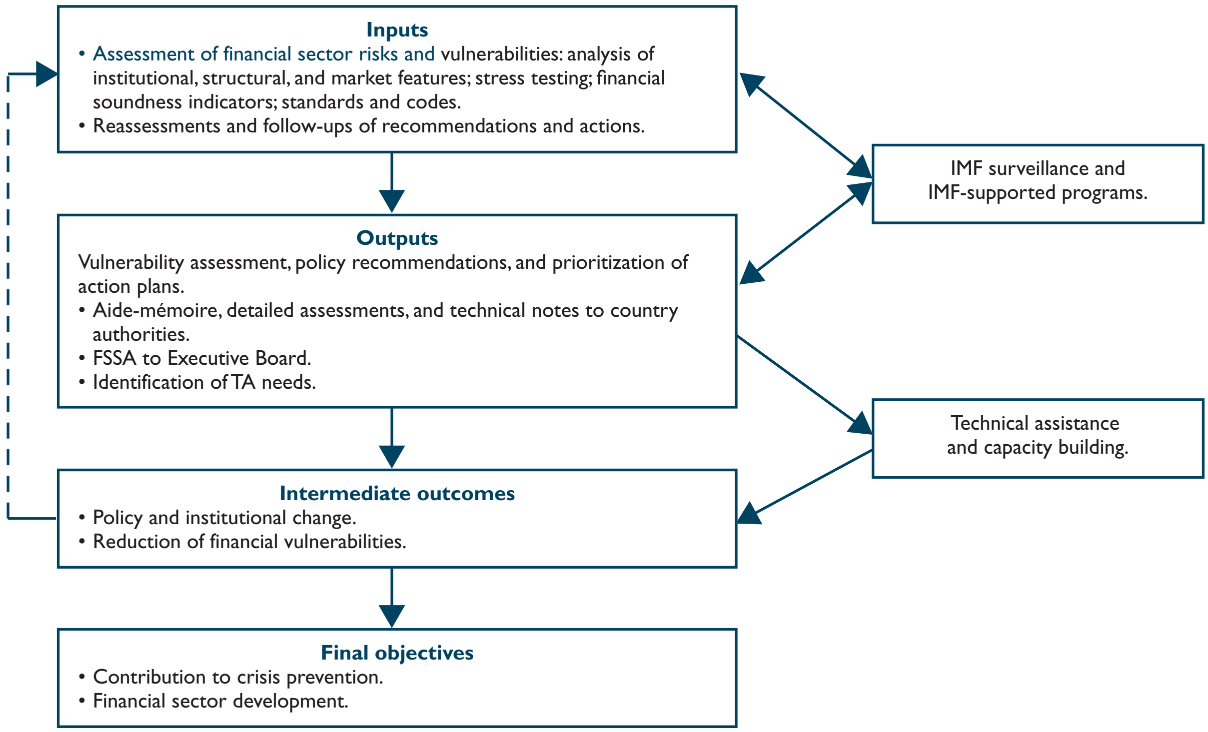
The IEO evaluation will focus mainly on those aspects of the FSAP for which the IMF has primary responsibility, in particular, on financial sector stability. Development issues will be considered inasmuch as they have direct influence on these aspects. A parallel evaluation by the World Bank's OED will assess the Bank's role in the FSAP initiative.

The ultimate objective of the FSAP initiative is to help countries reduce their financial sector vulnerabilities, thereby enhancing crisis prevention, with due consideration of the implications for financial sector efficiency. Consequently, a major question for the evaluation is how effectively the FSAP has achieved this objective.

Addressing this central issue involves evaluating four broad questions related to the architecture of the initiative and different parts of the results chain—its inputs, outputs, outcomes, and integration with the IMF's core activities (especially surveillance):

[15]A detailed issues paper/terms of reference for the evaluation is available on the IEO website at www.imf.org/external/np/ieo/2004/fsap/082504.pdf.

Figure 3.1. The FSAP Framework



(i) *Inputs.* Has the assessment of financial vulnerabilities been effective and cost-efficient in terms of identifying the principal sources of risks?

(ii) *Outputs.* Have findings and recommendations been clearly articulated and prioritized?

(iii) *Outcomes.* Has the FSAP process, as well as supporting IMF instruments, led to policy and institutional changes that significantly reduced financial vulnerabilities? Have follow-ups provided effective encouragement to this process?

(iv) *Integration with surveillance.* Has the overall surveillance function of the IMF with regard to the financial sector been improved by the integration of the FSAP/FSSA into Article IV surveillance? Have the arrangements for follow-ups and reassessments resulted in effective support for ongoing financial sector surveillance?

Methodology and time frame

The evaluation will use various types of evidence to address the above questions. Cross-country analysis will address such issues as how FSAP priorities were implemented, coverage of Reports on the Observance of Standards and Codes (ROSCs), characteristics of stress testing performed, and use of financial soundness indicators. Desk reviews will be employed systematically to collect evidence contained in FSAP documents and assess the main evaluation issues across a broad group of countries (that is, assessment effectiveness, articulation of recommendations, and overall surveillance integration under diverse country circumstances). More in-depth reviews, including country visits, will examine in greater detail how the FSAPs have been conducted, their interaction with IMF surveillance, and their policy impact. The evaluation will also make use of interviews and surveys to gather the views of diverse groups of stakeholders, including IMF and World Bank staff, financial market participants, regulators, and country authorities. Coordination with the OED will include cooperation on various joint inputs, including on the in-depth country reviews and survey exercises, but the two units will produce separate reports covering the roles of their respective institutions. The final IEO report is expected to be presented to the Board in the fall of 2005.

IMF Assistance to Jordan[16]

Jordan has been selected to be the subject of the single country case study in the IEO's work program for FY2004–05.[17] The evaluation will assess how effectively IMF assistance helped the country tackle major macroeconomic challenges since the late 1980s, including the shocks related to political and economic developments in the Middle East. The evaluation provides an opportunity to revisit—in a specific country context—some issues discussed in earlier IEO evaluations of program design and interactions between program, surveillance, and TA activities of the IMF. As indicated in the work program, the evaluation is intended to illustrate the scope for learning from a systematic ex post assessment of IMF activities in a country, and also to investigate in some detail what the case suggests about the IMF's recent approach to program design, including the structure and focus of conditionality.

After almost 15 continuous years under IMF arrangements, the Jordanian authorities indicated that the expiration of a Stand-By Arrangement (SBA) in July 2004 marked the country's "graduation" from reliance on IMF financial assistance. Altogether, since 1989, Jordan had IMF-supported programs under three SBAs and three Extended Fund Facility arrangements. Against a backdrop of marked slowdown in economic activity, double-digit inflation, and growing fiscal and external current account deficits, the program supported by the first arrangement sought to lower the country's macroeconomic imbalances while setting the stage for recovery in export-led economic growth. By contrast, the last arrangement was designed to consolidate macroeconomic stability. The arrangement was then converted into a precautionary one after the first program review because of significantly strengthened balance of payments and international reserves positions. The choice of Jordan allows for assessments of typical features of relations between the IMF and its borrowing members, while at the same time broadening the scope of members that have been the subject of case studies in IEO evaluations.

Issues for evaluation

The evaluation seeks to answer three principal questions:

- How effective were the programs—strategies and policies, as well as conditionality—in achieving their objectives, and what were the major factors that contributed to their success or lack thereof?
- To what extent did IMF surveillance contribute to identifying and tackling deep-rooted macroeconomic problems?
- What were the main considerations that drove the provision of TA, and how effectively did the assistance contribute to the country's capacity to formulate, implement, and monitor macroeconomic polices and performance?

While the focus of the evaluation is on the role of the IMF, including the extent to which internal policies and procedures permitted effective learning, implementation issues (which depend largely on government actions) and collaboration with Jordan's other international development partners will also be reviewed. Of particular interest will be collaboration between the authorities, the IMF, and the World Bank on issues related to growth strategies, structural reforms, quality of fiscal adjustment, and social safety nets.

Methodology of evaluation

The evaluation will include extensive desk reviews and interviews with a wide range of stakeholders. The desk reviews will cover internal IMF documents and reports as well as papers and publications from outside the IMF that address issues relevant to IMF-Jordan relations, including the rationale for IMF policy advice and program design. Interviewees will include current and former government officials, other stakeholders (for example, representatives of the business community, civil society groups, and academia), current and former IMF and World Bank staff, and representatives of Jordan's other development partners. A staff visit to Jordan took place in late 2004.

The evaluation report is expected to be completed by April 2005.

Structural Conditionality in IMF-Supported Programs

Largely responding to outside criticism of the increasing size and widening scope of structural conditionality in IMF-supported programs, IMF management appointed a Working Group on Streamlining Structural Conditionality in mid-2000. Following consultation with the Executive Board, new Conditionality Guidelines were approved in 2002. These guidelines stress the need for parsimony and a test of *criticality for the achievement of program goals* for the selection of any variable subject to conditionality.

[16]A detailed issues paper/terms of reference for the evaluation is available on the IEO website at www.imf.org/external/np/ieo/2004/jor/ip.pdf.

[17]For details on the selection criteria, see the issues paper.

They also encourage cooperation with other IFIs, especially in areas outside the IMF's expertise.

The evaluation is designed to (i) review how structural conditionality has been used in recent years, (ii) assess its effectiveness, and (iii) draw lessons for improving the design of structural conditionality in future programs. In pursuing these objectives, the evaluation aims to go beyond a simple analysis of compliance with conditions. Instead, it attempts to examine how conditionality has affected economic outcomes, including through IMF conditionality's impact on local ownership of reforms and on domestic policy processes more generally.

Because observed conditionality is largely the product of a negotiation process, a proper assessment of the effectiveness of structural conditionality must account for the various factors that play a role in that process. Without such information, little can be inferred from a simple measure of compliance.[18] The evaluation will also examine the channels through which conditionality can affect economic outcomes, either positively or negatively. To address these issues, it will examine the economic, social, and political factors at play over the lifetime of a typical IMF-supported program. The evaluation will examine various arguments advanced in academia, civil society, and policy circles regarding the pros and cons of structural conditionality.

Issues for evaluation

Key issues to be addressed will include:

- Has structural conditionality in specific instances contributed to improvements in policymaking processes or long-term economic performance?
- How has the test of macro-criticality been applied in practice? Have there been instances in which the streamlining initiative has led to the failure of a program to address areas deemed critical for the achievement of program objectives? Are there instances in which structural conditionality is still excessive or insufficiently focused?
- Are there areas in which structural conditionality is used despite the lack of a clear link with program objectives?
- Has the streamlining effort led to meaningful changes in interactions between IMF staff and national authorities, and has the IMF's internal review process been conducive to streamlining?
- Have certain types of conditionality (for example, conditionality focused on processes rather than on specific policy actions or on outcomes) worked better than others?
- Has the envisioned degree of cooperation with the World Bank in structural reform areas been achieved in practice?

The specific methodologies and time frame of the evaluation are being spelled out in the issues paper, which will be posted on the IEO website. The evaluation report is expected to be completed in the first quarter of 2006.

Multilateral Surveillance

It is generally understood within the IMF that multilateral surveillance is conducted mainly through *World Economic Outlook* (WEO) and *Global Financial Stability Report* (GFSR)[19] exercises, in which the Research Department and International Capital Markets Department, respectively, play the leading role. Complementing bilateral surveillance, these exercises are aimed at analyzing the forces driving the world economy, identifying global vulnerabilities, and advising on appropriate policies, especially in the most systemically important countries.

This evaluation is intended to assess the effectiveness and impact of multilateral surveillance in the IMF and to draw lessons that may help improve the content, process, and organization of multilateral surveillance in the future. Focus will necessarily be placed on major industrial countries whose policies have greater impact on the rest of the world economy. Some Executive Directors have expressed the view that the evaluation should also address issues related to regional surveillance.[20]

Potential issues to be addressed include the following:

- What has been the effectiveness of multilateral surveillance in giving "early warning" of potential global vulnerabilities, such as cross-country asset booms and sharp fluctuations in capital

[18]For example, an IMF-supported program may include a condition that reflects the country authorities' desire to send a positive signal to the markets. The effectiveness of conditionality in this case would then have to be assessed in terms of whether the intended effect on capital inflows materializes, rather than exclusively in terms of compliance with that particular condition.

[19]Previously called the *International Capital Markets Report*.

[20]While several regions are of interest for this evaluation, the IMF has formally applied an explicitly regional approach to only four regions in its surveillance work: the European Union, the Eastern Caribbean Currency Union, the West African Economic and Monetary Union, and the Central African Economic and Monetary Union.

flows to emerging markets? Does the staff produce sufficiently pointed analysis and recommendations on these issues; how effectively does the IMF follow up on them; and what has been the actual impact of IMF policy advice on the policy debate and on member country policies?

- Has interaction between multilateral surveillance and bilateral surveillance, particularly in major industrial countries, been effective? How could this cross-fertilization be improved?[21] How has the interaction of multilateral and bilateral surveillance dealt with the increasing "globalization" of some vulnerabilities, and does this suggest that changes in the way such surveillance is conducted are needed?
- In this context, has the IMF's bilateral surveillance work sufficiently considered increasingly important regional linkages? Has bilateral surveillance been consistent across countries that are part of a formal regional monetary arrangement? Should there be a greater formalization of regional surveillance in these countries?
- What has been the role of WEO and GFSR exercises in forecasting prospects for the global economy and identifying global vulnerabilities? How well are these exercises integrated into the IMF's other operational work, including the design of IMF-supported programs and advice to nonprogram countries?
- How effective a role has the International Capital Markets Department played in enhancing the coverage and integration of financial market issues into multilateral surveillance and in identifying systemic weaknesses originating in the financial sector?
- What has been the impact of the increased emphasis on capital market issues in multilateral surveillance and the enhanced interactions with private financial market participants? Has it led to a clearer focus on areas where action is needed on the supply side to mitigate volatility?
- What has been the effectiveness of the IMF's inputs into the deliberations of various international or regional groups, such as the G-7 and the Asia-Pacific Economic Cooperation?
- How does the product of multilateral surveillance (including economic forecasts) compare with similar assessments produced by other public and private institutions? What has been the value added to different parts of the international community, including member country authorities and the private sector?

The evaluation is at an early stage of preparation. The issues paper, detailing the methodologies and issues to be addressed, will be prepared and posted on the IEO website in the spring of 2005. It is expected that the evaluation report will be completed and discussed by the Executive Board toward the end of 2005.

[21]The December 1999 "External Evaluation of IMF Surveillance" identified inadequate cross-fertilization between multilateral and bilateral surveillance as a problem and made a number of recommendations (www.imf.org/external/pubs/ft/extev/surv/eval.pdf). The IEO evaluation may also assess the impact of those recommendations endorsed by the Executive Board in this area.

Chapter 4

Reflections on Some Overarching Issues

Evaluations completed during the last year illustrate that the common themes noted in the *Annual Report 2003*—which drew upon the first three IEO evaluations[22]—remain highly relevant.

The importance for effective surveillance of candid assessments of potential vulnerabilities, and the challenges posed in signaling such assessments in the context of prolonged program involvement, were again illustrated by the Argentina evaluation.

Two messages on program design from earlier evaluations were reinforced by the PRSP/PRGF evaluation: (i) the crucial importance of an underlying domestic commitment to core policy adjustments—without which conditionality alone is no substitute—and (ii) the value of indicating transparently the rationale underlying the design of specific programs so as to help cope with inevitable uncertainties.

The PRSP/PRGF evaluation also suggests that the PRS approach is in principle an appropriate framework for handling the mismatch between the time frames of IMF-supported programs and the much longer time frame needed for key structural and institutional reforms—a problem that was highlighted in both the Prolonged Use and Fiscal Adjustment evaluations. In practice, however, effective operational links between broader strategy and IMF-supported programs have been forged in only a limited number of cases so far.

In this chapter, we highlight two additional themes that have emerged in several evaluations.

Need for Greater Clarity About Intermediate Objectives

The ultimate objectives of the IMF are clearly set out in the Articles of Agreement.[23] However, many IEO evaluations indicate that the more immediate specific objectives to be achieved by particular initiatives, from which one could derive the criteria by which the effectiveness of the institution's contribution is to be judged, are often quite vague. For instance, the PRSP/PRGF evaluation concluded that the PRS approach lacked sufficient specific milestones to monitor progress vis-à-vis intermediate objectives, including strengthening domestic policy processes, and that there was a lack of clarity—and hence effective accountability—about what the IMF should deliver in some areas. The Prolonged Use evaluation suggested that the rationale for continued IMF program involvement in some countries was unclear or too open-ended. Similarly, the ongoing evaluation of IMF Technical Assistance suggests that few technical assistance projects specify clear criteria for measuring their effectiveness.

This lack of clear goalposts for what the institution is trying to achieve with certain initiatives, and the dearth of performance indicators to track progress against those criteria, is not unique to the IMF. Moreover, most IMF activities involve interventions in complex situations whose ultimate outcomes depend on many factors, and attribution of a specific impact to the role of the IMF can be difficult. In the literature on evaluation, this problem is usually referred to as a lack of "evaluability."[24] However, this is not a mere technicality that is of concern only to evaluators. Rather, it has substantive implications for the effectiveness of the institution, including priority setting and accountability. IEO evaluations suggest that the frequent lack of specificity about intermediate objectives and deliverables has contributed to several problems:

[22]On the Prolonged Use of IMF Resources, Fiscal Adjustment in IMF-Supported Programs, and the IMF and three Capital Account Crises cases.

[23]Article I sets out six broad purposes of the IMF, including to promote international monetary cooperation, to maintain orderly exchange arrangements among members, and to give confidence to members by making resources temporarily available to them under adequate safeguards, thereby providing them with the opportunity to correct balance of payments maladjustments without resorting to measures destructive of national or international prosperity. See www.imf.org/external/pubs/ft/aa/index.htm for the full list.

[24]If the objectives of a program or project are not indicated, it is difficult to evaluate whether it is succeeding or failing.

- *A tendency to "over-promise" on what the IMF can deliver*. (This problem is identified, inter alia, in the Prolonged Use and PRSP/PRGF evaluations.) More generally, vagueness about intermediate objectives makes it harder for the institution to say "no" on the grounds that some issues go beyond its comparative advantage.
- *Lack of prioritization*. Because objectives are set in very general terms, it is hard to specify clear trade-offs between various components.
- *Profusion of internal guidelines*, which cannot replace more effective priority setting (noted in both the Prolonged Use evaluation and the discussion of guidelines on Joint Staff Assessments in the PRGF/PRSP evaluation).
- *Overstretching of IMF staff*. Surveys and interviews of staff conducted in the context of the Prolonged Use, Fiscal Adjustment, and PRSP/PRGF evaluations all indicated that staff felt it did not have the resources to carry out effectively a wide range of responsibilities.
- The result of this overstretching was an *ad hoc approach to solving trade-offs between priorities*, with only superficial attention paid to implementing some requirements (i.e., the check list approach syndrome). It also contributed to excessive focus on procedural elements and a lack of uniformity across the institution. At times, this left a considerable gap between best and average practices.
- *The "broad tent" nature of some objectives can lead to "mission creep"* (suggested by some of the Prolonged Use case studies) or to a lack of clarity about precisely how the IMF's role fits into a broader partnership framework (indicated by the PRSP/PRGF evaluation and aspects of Fund-Bank collaboration in a number of the evaluations).
- *Difficulty in assessing the degree of progress and making mid-course corrections*. Because there is no way to determine when an initiative or activity is falling short, there is a risk of complacency, in the sense of being satisfied as long as some good is being done. (The PRSP/PRGF evaluation suggests that the lack of specific milestones has caused such problems for the annual reports on progress in implementation of the PRSP.)

This concern is now well recognized within the IMF, as reflected in recent initiatives to begin identifying more specific performance indicators to monitor how effectively the IMF is achieving its objectives. The International Monetary and Financial Committee (IMFC) recently endorsed such efforts in calling upon the IMF to develop a methodology for better assessing the effectiveness of surveillance. But the real payoff to such efforts will come when they force the institution to make difficult trade-offs between priorities, with clearer specification of objectives when policy initiatives are introduced.[25]

Decision Making in the IMF

IEO evaluations have suggested three sets of messages about the nature of decision making in the IMF.

First, the candor of assessments tends to become muted as they are transmitted through the institution. The evaluations of the three Capital Account Crises, Prolonged Use, and Argentina all suggest that, in various ways, candid internal assessments were toned down in staff reports sent to the Board. This tendency may, in part, reflect the tension between the IMF's role as a "confidential advisor" to the member country and its provision of signals to broader groups, including official sources of financing and private market participants. But other factors leading to a dilution of candor also appear to be at work. In fact, the tendency to lose some candor seems to be quite common, and is not just an issue associated with documents expected to be made public. These three evaluations all indicated that surveillance reports linked closely with program-related activities were especially unlikely to step back and raise potentially awkward questions. Recent steps to strengthen surveillance are, therefore, welcome, but it remains to be seen whether these changes will be sufficient to transform underlying incentives in favor of greater candor.

Second, there is a reluctance by the institution to address explicitly the question of what should be the alternative strategy if the preferred approach fails (as shown by the Argentina and Capital Account Crises evaluations). This is understandable for several reasons—including the concern to avoid self-fulfilling prophecies of failure and reluctance on the part of most country authorities, for deep-seated political economy reasons, to spell out publicly their contingency plans. But more could be done to explore alternative contingency plans in private, since this institutional reluctance can lead the IMF to be less

[25]An example of a move toward defining priorities among objectives is the recent conclusion of the biennial surveillance review, which set three priorities as monitorable objectives for the next surveillance review: ensuring deeper treatment of exchange rate issues; enhancing financial sector surveillance; and deepening the coverage of regional and global spillovers in bilateral surveillance. See www.imf.org/external/np/pdr/surv/2004/082404.pdf#pin.

ready to recognize when a strategy has failed and to adapt accordingly.

Finally, several of the evaluations raise a number of issues about the respective roles of IMF management and the Executive Board. The Prolonged Use evaluation (most notably the Pakistan case study) indicated the importance of ensuring that any political considerations, which are inevitably present in decisions on financing, should be taken into account in a transparent manner, with decisions and accountability clearly at the level of the Executive Board and on the basis of candid technical assessments by the staff. The Argentina evaluation also emphasized the need to strengthen the decision-making process, including the Board's role with respect to (i) the type of information and analysis that is made available, and (ii) transparency regarding who is responsible for a particular decision. These issues also raise complex issues of accountability when highly sensitive information is involved.

Appendix 1 Terms of Reference of the IEO

Purpose

The Independent Evaluation Office (IEO) has been established to systematically conduct objective and independent evaluations on issues, and on the basis of criteria, of relevance to the mandate of the Fund. It is intended to serve as a means to enhance the learning culture within the Fund, strengthen the Fund's external credibility, promote greater understanding of the work of the Fund throughout the membership, and support the Executive Board's institutional governance and oversight responsibilities. IEO has been designed to complement the review and evaluation work within the Fund and should, therefore, improve the institution's ability to draw lessons from its experience and more quickly integrate improvements into its future work.

Structure and Accountabilities

IEO will be independent of Fund management and staff and will operate at arm's length from the Fund's Executive Board. Its structure and modalities of operation must protect its operational independence—both actual and perceived.

A Director, to be appointed by the Executive Board, will head IEO. The Director's term of appointment will be for a nonrenewable term of six years. The Director's appointment may be terminated at any time with the approval of the Executive Board. At the end of the term of service, the Director will not be eligible for appointment or reappointment to the regular staff of the Fund. The Director will be responsible for the selection of IEO personnel (including external consultants) on terms and conditions to be determined by the Board with a view to ensuring that the office is staffed with independent and highly qualified personnel. The majority of full-time IEO personnel will come from outside the Fund.

Responsibilities

The Director of IEO will be responsible for the preparation of the work program. The content of the work program should focus on issues of importance to the Fund's membership and of relevance to the mandate of the Fund. It should take into account current institutional priorities, and be prepared in light of consultations with Executive Directors and management, as well as with informed and interested parties outside the Fund. The Director will present IEO's work program to the Executive Board for its review.

IEO, through its Director, will report regularly to the Executive Board, including through the preparation of an Annual Report. It is also expected that the IMFC will receive regular reports on the activities and findings of IEO.

With respect to individual evaluations, staff, management, and—when appropriate—the relevant country authorities will be given an opportunity to comment on the assessments being presented to the Executive Board. The Director of IEO, in consultation with Executive Directors, will prepare a budget proposal for IEO for consideration and approval by the Executive Board. Its preparation will be independent of the budgetary process over which management and the Office of Budget and Planning have authority, but its implementation will be subject to the Fund's budgeting and expenditure control procedures. IEO's budget will be appended to that of the Executive Board within the Fund's Administrative Budget.

If requested by the Executive Board, IEO will provide technical and administrative support for any external evaluations launched directly by the Executive Board.

Consultation, Publication, and External Relations

In carrying out its mandate, including in the preparation of its work program, IEO will be free to consult with whomever and whichever groups it deemed necessary, both within and outside the Fund.

IEO will have sole responsibility for drafting IEO evaluations, Annual Reports, press releases and other IEO documents, or public statements.

IEO's work program will be made public and there will be a strong presumption that IEO reports will be published promptly (within the constraints imposed by the need to respect the confidentiality of information provided to the Fund by its members), unless, in exceptional circumstances, the Executive Board were to decide otherwise.

Publication of evaluations will be accompanied by comments from management, staff, and others, including relevant country authorities, where appropriate, along with the conclusions reached by the Board in considering the evaluation report.

Relations with Fund Staff and Management

In conducting its work, IEO should avoid interfering with operational activities, including programs, or attempting to micro-manage the institution.

Review of Experience with IEO

Within three years of the launch of IEO operations, the Executive Board should initiate an external evaluation of IEO to assess its effectiveness and to consider possible improvements to its structure, mandate, operational modalities, or terms of reference. Without prejudging how that review would be conducted, it should be understood that the review would include the solicitation of broad-based input from outside the official community.

Appendix 2

Budget of the Independent Evaluation Office for FY2004 and FY2005[1]

(In U.S. dollars)

	FY2004		FY2005
	Budget	Actual	Approved Budget
Regular staff	2,615,420	2,436,460	2,800,380
Total discretionary budget	1,261,997	960,048	1,373,100
Experts and contractuals	715,722	575,325	860,600
Business travel	343,775	317,058	350,000
Outreach seminars	190,000	60,572	150,000
Other	12,500	7,093	12,500
Total	3,877,417	3,396,508	4,173,480
Memorandum item:			
Publications[2]	140,000	82,193	126,667

[1]The fiscal year runs from May 1 to April 30.

[2]Centrally managed resources (that is, not part of the IEO budget).

Appendix 3 Potential Candidate Topics for Future IEO Work Programs

The IEO is in the process of identifying a menu of potential topics to guide its work programs over the coming years. A preliminary list of such topics is provided in this appendix to serve as a basis for discussion. It has been derived drawing upon initial suggestions from external observers, members of the IMF Executive Board, and IMF staff. It also includes several items from the initial short list of 15 possible evaluation topics identified in 2001 that have not yet been taken up (see Chapter 1, "The IEO Work Program and Future Menu of Topics"). Following normal IEO practice, feedback on this list is being invited from a wide range of stakeholders within and outside the IMF before the final work program for each year is decided.

The size of the annual work program is decided as part of the regular discussions with the Executive Board on the IEO budget, but we have assumed for purposes of this note that the total workload will remain unchanged at its current level (that is, four evaluation projects a year, of which one will be somewhat smaller in size). We expect that the specific work program would be announced for only one year ahead (beginning with FY2006). This would allow for adjustments in priorities should circumstances change.

The choice of topics will be guided by a number of criteria, including: (i) substantial learning potential exists, especially on issues where the IMF is in the process of considering its longer-term strategies; (ii) the topic is of interest to a wide range of the IMF membership; (iii) the issue has been the subject of controversy and criticism; and (iv) the IEO has a comparative advantage in undertaking the evaluation. Selection of topics must also bear in mind the requirement, set out in the IEO's terms of reference, that it "should avoid interfering with operational activities, including programs, or attempting to micro-manage the institution."

Possible topics have been grouped by four categories, namely, the IMF's main types of activities and IMF organization. However, some evaluations would cut across several categories. Several of the suggested topics cover overlapping ground and, therefore, could be viewed as alternatives. This list does not attempt to make any judgment on the most suitable timing of possible projects. Some topics may be strong candidates for eventual evaluation but would be best taken up in several years' time after further experience has been gained with ongoing internal initiatives or when relevant country experience would be available for evaluation.

Surveillance

- Modalities and effectiveness of bilateral surveillance in large industrial countries.
- The IMF's advice on exchange rate policy.
- Approaches to crisis prevention (or a project that focuses on assessing IMF approaches to debt sustainability).
- The IMF's role in the dissemination and assessment of various standards and codes. (The IMF's role concerning standards and codes in the financial sector is already being addressed in the ongoing FSAP evaluation. A subsequent evaluation could cover all other Reports on Standards and Codes (ROSCs) in the IMF's areas of primary responsibility or could focus on specific areas such as the effectiveness of the IMF's role in promoting enhanced Data Dissemination Standards, fiscal transparency, and so on.)
- The IMF's approach to governance issues.

IMF Financing Instruments and Program Activities

- The IMF's role in countries emerging from conflict.
- The IMF's role in African countries, based on a small number of case studies. (This evaluation could either review all aspects of the IMF's role in selected African countries or could focus on more specific issues, such as post-HIPC completion cases or aspects of program design.)
- The role of the IMF in debt restructuring.
- Single country cases with important learning potential, including:
  - —Turkey.
  - —A low-income transition economy.

Capacity Development

- IMF external training activities.

IMF Organization

- World Bank–IMF collaboration. (Various approaches to such an evaluation are possible. For example, it may be useful to focus on assessing the modalities and effectiveness of collaboration in specific areas.)
- Effectiveness of internal assessment and self-evaluation processes (or a broader review of IMF approaches to "knowledge management," including how well the IMF provides relevant cross-country experience to its members).
- A number of commentators have suggested that the IEO might also address various internal organizational issues, with more or less direct bearing on the IMF's governance. Topics suggested include the issue of the diversity of the IMF staff, the role of resident representatives, or the effectiveness of integration between various IMF departments. However, some of these topics might take the IEO into areas that risk interfering in the management of the institution, which is against the IEO terms of reference, or are beyond the IEO's comparative advantage.[26] Some of these issues, including various aspects of the IMF's decision-making processes and governance, are likely to emerge in the context of other evaluations. In any event, issues involving the range of potential topics for evaluation could be revisited at the time the IEO itself is evaluated, which is expected to be toward the end of 2005.

The final list of topics will be determined on the basis of consultations with various stakeholders and taking account of the IEO's assessment of the potential benefits of each project for the institution, in light of the criteria indicated earlier. It is expected that the final list will be posted on the website in the first half of 2005.

[26]For an interesting earlier discussion on the possible division of labor between an independent evaluation office and internal assessment units such as the Office of Inspection and Audit (OIA), which conducts a variety of managerial reviews, see *Making the IMF's Independent Evaluation Office Operational,* prepared by the Evaluation Group of Executive Directors, August 7, 2000 (www.imf.org/external/np/eval/evo/2000/Eng/evo.htm).

Appendix 4 IEO Outreach Seminars and Workshops

The IEO seeks to reach as broad an audience as possible in its outreach efforts. For budgetary reasons, for events in developed countries, the IEO has generally relied upon offers made by various partners to organize such events. In addition, a number of events in developing countries have been organized and financed by the IEO; some events discussing the PRSP evaluation were undertaken jointly with the World Bank's OED.

The following is a list of events in which IEO staff has participated.

September 16, 2003, Tokyo, Japan
Symposium and experts seminar on the Capital Account Crises evaluation, jointly hosted by the Institute for International Monetary Affairs and the IMF Regional Office for Asia and the Pacific.

September 22–23, 2003, Berlin, Germany
International Experts Meeting on IEO evaluation projects, jointly hosted by Capacity Building International, Germany (InWEnt) and the IEO. Focus was on the Prolonged Use, Capital Account Crises, and Fiscal Adjustment evaluations, with representatives invited from countries covered by the case studies for these projects.

September 24, 2003, London, United Kingdom
Seminar on the Fiscal Adjustment evaluation organized by the U.K. Department for International Development.

September 25, 2003, Paris, France
Seminar on the Fiscal Adjustment evaluation organized by the IMF Paris Office.

November 3, 2003, Beijing, China
Seminar on the Capital Account Crises evaluation held at the China Center for Economic Research, Peking University.

November 11, 2003, Tokyo, Japan
Seminar on the Capital Account Crises evaluation held at Hitotsubashi University.

December 1, 2003, Seoul, Korea
Symposium on the Capital Account Crises evaluation, jointly hosted by the Korea Economic Research Institute and the IEO.

December 1–2, 2003, Addis Ababa, Ethiopia
Mid-pipeline workshop on the PRSP/PRGF evaluation, hosted by the United Nations (UN) Economic Commission for Africa.[27]

January 8, 2004, Washington, D.C., United States
Workshop on future evaluation topics held at the Institute for International Economics.

January 26–27, 2004, Santiago, Chile
Presentation of the Fiscal Adjustment evaluation at a Latin American Conference on Public Finances, organized by the UN Economic Commission for Latin America.

February 6, 2004, Dublin, Ireland
Presentation on the IMF's role in the PRS approach at a seminar on "Poverty Reduction Strategies" attended by government officials and civil society representatives, and hosted by Trocaire as part of their European Union Presidency Seminar series.

June 8, 2004, Washington, D.C., United States
Presentation of the evaluation of Fiscal Adjustment in IMF-Supported Programs at the IMF Book Forum.

June 24–25, 2004, Antwerp, Belgium
Presentation of the PRSP/PRGF evaluation at a conference on "Development Cooperation and PRSP Challenges for Belgian Development Agencies" held at the University of Antwerp.

September 9, 2004, New York City, United States
Presentation of the PRSP/PRGF evaluation at a seminar on "The Role of PRSPs in Financing for Development," held at the UN, and jointly hosted by the Friedrich Ebert Foundation and the UN Financing for Development Office.

September 9, 2004, New York City, United States
Seminar on the Fiscal Adjustment evaluation organized by the UN Development Program.

[27]The Commonwealth Secretariat helped finance the participation of representatives from a number of Commonwealth countries in the workshop. Its assistance is gratefully acknowledged.

September 19, 2004, London, United Kingdom
Participation in high-level seminar on "The Role of the Fund," jointly organized by the U.K. Treasury and the U.K. Department for International Development.

September 21–22 2004, Brussels, Belgium
Presentation of the PRSP/PRGF evaluation at a workshop of officials and civil society representatives, hosted by the European Network on Debt and Development.

September 27, 2004, Washington, D.C., United States
Presentation of the PRSP/PRGF evaluation and discussion of the IEO work program attended by civil society representatives.

October 4, 2004, Washington, D.C., United States
Presentation of the PRSP/PRGF evaluation at a workshop on "Taking Stock of the PRSP Process and Looking Toward the Future" organized by InterAction.

October 21–22, 2004, Berlin, Germany
International Experts Meeting on IEO evaluation projects, jointly hosted by Capacity Building International, Germany (InWEnt) and the IEO. Focus was on the PRSP/PRGF and Argentina evaluations, attended by selected country representatives invited from relevant countries; a mid-pipeline discussion of the Technical Assistance evaluation was also held.

October 25, 2004, OECD, Paris, France
Presentation of the PRSP/PRGF evaluation at the OECD Development Assistance Committee.

October 26, 2004, London, United Kingdom
Presentation of the PRSP/PRGF evaluation and participation in the Steering Group on Bilateral Evaluation of General Budgetary Support.

October 26, 2004, Rome, Italy
Symposium on the Argentina evaluation, held at the University of Rome—Tor Vergata.

October 27, 2004, The Hague, Netherlands
Seminar on the PRSP/PRGF and Argentina evaluations attended by European officials and private sector representatives and held at the Dutch Ministry of Finance.

October 31, 2004, Paris, France
Presentation of the PRSP/PRGF evaluation, at a seminar on human development hosted by the French Ministry of Foreign Affairs.

November 4, 2004, Washington, D.C., United States
Workshop on Structural Conditionality attended by nongovernmental organization representatives.

November 5, 2004, San Jose, Costa Rica
Presentation of the PRSP/PRGF evaluation at Latin American and Caribbean Economic Association meetings.

November 9, 2004, New York City, United States
Seminar on the PRSP/PRGF evaluation, organized by the UN Department of Economic and Social Affairs.

November 17, 2004, Berne, Switzerland
Seminar on the PRSP/PRGF evaluation hosted by The Berne Declaration (a Swiss nongovernmental organization).

December 2, Tokyo, Japan
Seminar on the Argentina evaluation, hosted by the Bank of Japan.

December 4–6, Nairobi, Kenya
Joint IEO/OED presentation of the PRSP/PRGF evaluation at a meeting of the African Economic Research Consortium.

December 8, 2004, Hanoi, Vietnam
Joint IEO/OED seminar on the PRSP/PRGF evaluation attended by representatives from Indochina.

Appendix 5

Evaluation of Prolonged Use of IMF Resources: Recommendations, Board Response, and Subsequent Follow-Up[1]

IEO Recommendation	Executive Board Response[2]	Staff Task Force Recommendations and Board Response[3]	Follow-Up[4]
Institutional arrangements and rationale for IMF involvement			
Adopt an operational definition of prolonged use, as a trigger for enhanced "due diligence" (i.e., ex post assessments and forward-looking consideration of "exit" strategies). The criterion could distinguish between general and concessional resources.	Directors saw merit in a definition to trigger greater due diligence. Many Directors noted that a definition should carefully differentiate low-income countries relying on concessional resources. Several Directors cautioned that a definition should not be interpreted as creating a new classification of member countries and that there should not be an a priori judgment that prolonged use necessarily implies a problem.	For general resources cases, prolonged users should be defined as countries that have spent seven or more of the last ten years under Stand-By or Extended Arrangements, including precautionary arrangements, which was the definition used in the IEO evaluation. For concessional resources, enhanced assessment and strategy procedures would be triggered after a country has gone through two multiyear arrangements under concessional facilities.	Definition adopted. Semiannual reporting of the incidence of prolonged use is taking take place on this basis.
Make greater efforts to judge whether countries are ready to implement credible programs and be more selective in extending financial support. Use of IMF resources proposals should contain an explicit and frank assessment of the readiness of borrowers to implement programs.	Directors supported the recommendation that staff papers be more candid in assessing institutional capacity and ownership. They emphasized the importance of explaining downside risks and avoiding any bias toward overoptimism. Implementation of initiatives relating to ownership would be an ongoing process, sometimes involving difficult judgments, in particular regarding more selectivity in the provision of IMF financial assistance, where strong country ownership is lacking. A number of Directors stressed that greater selectivity should not imply giving up on difficult cases.	Efforts to improve program design should be accompanied by greater selectivity in extending IMF financial support, based in part on the assessment of implementation capacity and ownership.	Principal case-by-case follow-up will be through the internal review process and Board review of individual country cases, with periodic assessments as part of the regular conditionality review.
Aim to provide the international community with credible alternatives to IMF lending arrangements as a condition for other official flows.	Directors noted that it would be desirable to develop credible alternatives to indicate to the outside world the IMF's approval of members' policies and looked forward to a discussion of the signaling function. They noted need for care in preparation and consultation, including with the Paris Club.	The IMF should have effective ways to signal its views on policies to a country's donors and creditors outside a Fund-supported program. Article IV staff reports, Public Information Notices, and "assessment letters" provide important vehicles. This topic should be taken further in the review of the IMF's role in low-income countries. Donors' and other lenders' concerns about burden sharing should not lead to inappropriate lending decisions by the IMF.	The issue of signaling was taken up in the Board's subsequent discussion on "Signaling Assessments of Members' Policies," although it did not address all the relevant issues brought up in the evaluation. This review resulted in the discontinuation of Staff Monitored Programs for signaling purposes. More recently the Board again discussed signaling in the context of the 2004 Biennial Surveillance Review, and has discussed suggestions for a specially designed nonfinancial signaling instrument—policy monitoring arrangements—against the background of a review of the IMF's experience with signaling mechanisms. No consensus was reached, but Directors encouraged staff to continue to explore the merits of a new signaling mechanism and its possible features, and to pursue consultations with potential users, donors, and private market participants.

Appendix 5 *(continued)*

IEO Recommendation	Executive Board Response[2]	Staff Task Force Recommendations and Board Response[3]	Follow-Up[4]
Programs for identified prolonged users should include an explicit exit strategy.	Directors stressed the desirability, where appropriate, of the elaboration of corrective measures as part of a conscious "exit strategy."	The proposed assessment and strategic planning exercises (see below) would include an explicit "exit strategy" where appropriate for ending prolonged use. An element of such a strategy would include helping countries widen their options for external financing.	Policy adopted, with an explicit definition of prolonged use as the trigger (see above).
Introduce a differentiated rate of charge for prolonged users as a signaling device.	The Board did not support a differentiated rate of charge for prolonged users.	Not recommended.	Recommendation rejected. No follow-up necessary.
Program design			
Specific operational procedures should be developed to ensure greater emphasis in program design on the domestic policy formulation process, in order to maximize ownership: (i) modify procedures toward the authorities having the initial responsibility for proposing a reform program; (ii) encourage a process whereby core program elements are subject first to a policy debate within the member's own political institutions; (iii) surveillance should help create a better understanding of what would be expected if a program should become necessary; and (iv) more explicit discussion of major uncertainties and how policies would be adapted if things turn out differently.	Directors broadly agreed with the recommendations. Many Directors underscored that they should be seen as part of a broader effort to ensure greater effectiveness of programs. They saw a need for continuing effort to improve program design, which would draw on the fresh perspectives provided by the report.	IEO's recommendations were consistent with lessons emerging from recent country experience. The revised conditionality guidelines,[5] incorporate many of the recommendations and provide the appropriate vehicle to put them into practice.	The regular conditionality reviews will be the main vehicle for monitoring progress on this and other recommendations on program design.
Programs should emphasize key institutional changes and further strengthening of implementation capacity.	Directors underscored the importance of increasing the effectiveness of technical assistance in support of institutional capacity building.	The Task Force recommended that ongoing efforts to address these issues in operational work should be enriched by future work on program design, including research efforts, focusing on links between structural reforms and program objectives.	Regular conditionality reviews will monitor progress.
Greater selectivity in program content with: (i) further strengthening collaboration with the World Bank; (ii) a more differentiated use of conditionality; (iii) greater efforts to tailor the time frame of program design to foreseeable length of reform and adjustment; and (iv) more in-depth analysis of real economy responses to key policy elements and less attention to fine-tuning financial programming.	Directors were encouraged that recommendations on the streamlining of IMF conditionality and the need for more effective collaboration with the World Bank were already being internalized as part of the review of conditionality.	The Task Force agreed with the IEO recommendations, many of which were already incorporated into the revised conditionality guidelines. Directors stressed the importance of continued efforts to improve program design, including improved collaboration with the World Bank. Directors looked forward to further work by the staff on the relationship between external financing, adjustment, and sustainability;	Principal case-by-case follow-up will be through the internal review process and Board review, with periodic assessments of progress as part of the regular conditionality reviews.

		on the analytic framework for program design; on trade-offs between macroeconomic and structural policies; and on the parameters for assessing program success.	
Systematic ex post assessment of programs, with priority to identified prolonged users and key messages reported to the Board. Key internal database on program targets and outcomes (MONA) should be upgraded to facilitate such assessments.	Directors endorsed the recommendations.	The Task Force proposed that a process of ex post assessment and strategic planning would take place for all prolonged users, with lessons presented to the Executive Board.	The operational guidance note on assessment of countries with a longer-term program engagement has been posted on the Internet. As of end-June 2004, 11 ex post assessments were completed. A number of these assessments were led by staff from outside the area department. The MONA database is being upgraded.
Surveillance			
Steps should be taken to further strengthen surveillance in program cases. A case exists for greater institutional separation between surveillance and programs, especially in the context of prolonged use.	Regular IMF surveillance of program countries should reassess economic developments and strategy from a fresh perspective.	The Task Force agreed with the overall thrust of the IEO recommendations, which it believed would be best addressed through continuing implementation and refinement of recently revised (i.e., 2002) surveillance guidelines. These guidelines proposed that surveillance should assess more carefully social and political realities; reach out more widely to legislative bodies and line ministries; and ensure that the timing of consultations is such as to enable them to influence policy. Directors concurred with the priority given to increasing effectiveness of surveillance, including the need to combine clarity and candor with recognition of social and political realities. They highlighted the importance of efforts to ensure that Article IV consultations in program countries "step back" from program context.	Progress will be monitored as part of regular biennial reviews of surveillance. At the 2004 review, Directors concluded that the quality of surveillance in program countries had improved since 2002.[6]
Internal governance issues			
The ability of staff to analyze political economy issues should be strengthened.	Most Directors encouraged the staff to enhance its analysis and reporting of political economy issues in staff reports. Some Directors cautioned that the IMF should be careful in venturing into this area, given its comparative advantage in technical analysis and the need to avoid intruding on internal political matters.	The Task Force recommended an effort to enhance reporting and analysis of political issues, when it has important implications for economic policy. Staff capacities could be strengthened through a modest investment in training.	Training courses in political economy have now been established.

Appendix 5 *(concluded)*

IEO Recommendation	Executive Board Response[2]	Staff Task Force Recommendations and Board Response[3]	Follow-Up[4]
Procedures should be evolved to help avoid the appearance of political interference in determining whether programs deserve support. All programs should be prefaced by an explicit assessment of implementation risks. When management suggests risks are high, the Executive Board should be given an opportunity to express on the record its own assessment of the trade-offs.	Directors underscored the importance of distinguishing clearly between technical and political judgments and that staff should be candid in its assessment of risks.	The Task Force noted that there can be no question about the responsibility of management for recommending and the Executive Board for considering and approving all requests for the use of IMF resources. Staff nonetheless has an important responsibility for providing candid technical assessment of risks and trade-offs, and should continue to strengthen both substance and presentation of this material.	Some indication that greater candor on risks is being adopted in presentations to the Executive Board. For example, the Managing Director's statement for the 2003 transitional program with Argentina emphasized the risks to the IMF, including the political risks to implementation.
A review of internal incentives facing staff should be undertaken with a view to minimizing turnover of staff working on countries and to foster increased candor and accountability.	Recommendations are largely management responsibility. They have important implications for internal governance and deserve careful consideration.	While overall personnel policies do not need to be changed, management should consider guidelines and incentives to reduce excessive mobility in country teams. The best way to guard against excessive mobility would be to re-establish spare staff capacity to absorb changing demands.	The Human Resources Department, at the request of management, is developing a more centralized approach to mobility. As part of an effort to ensure appropriate incentives, the Human Resources Department, in collaboration with departmental senior personnel managers, provides career counseling that emphasizes the acquisition of new competencies rather than frequent mobility.

[1]Following the Board discussion of the IEO report on September 23, 2002, management established a Task Force to follow up on the recommendations contained in the evaluation report. The specific proposals of the Task Force were then discussed by the Executive Board on March 7, 2003.

[2]This column summarizes the reaction of the Executive Board on each recommendation as reported in the Summing Up by the Chair. Readers are invited to refer to the full text of the summary of the discussion, which is included in the published version of the report and can be accessed from the IEO website (www.imf.org/External/NP/ieo/2002/pu/index.htm).

[3]"Conclusions of the Task Force on Prolonged Use of Fund Resources," February 4, 2003. The Task Force report and the Summing Up of the subsequent Board discussion on that report are available at www.imf.org/external/np/pdr/ufr/2003/020403.pdf.

[4]The column on follow-up is meant to provide factual information on additional steps taken after the Board discussion of the Task Force report. It is not intended to be an evaluation of any follow-up by management or the Executive Board.

[5]"Guidelines on Conditionality," September 8, 2002. Available at www.imf.org/External/np/pdr/cond/2002/eng/guid/092302.htm.

[6]See Public Information Notice at www.imf.org/external/np/pdr/surv/2004/082404.pdf#pin.

Appendix 6

Evaluation of the Role of the IMF in Recent Capital Account Crises: Recommendations, Board Response, and Subsequent Follow-Up

IEO Recommendation	Executive Board Response[1]	Follow-Up[2]
Pre-crisis surveillance		
Article IV consultations should take a stress-testing approach to exposure to a potential capital account crisis, extending and systematizing existing approaches. Staff should assess the potential impact of itemized risks. Staff should develop greater understanding of political constraints on policy, in part through wider dialogue. Market views and political economy analysis should be reflected in staff reports.	Directors concurred with the overriding message of the report for surveillance: to strengthen the effectiveness of IMF surveillance by extending and systematizing current guidelines for assessing vulnerabilities. They supported the call to itemize major potential shocks. Directors emphasized that stress-testing should not be overgeneralized and mechanical, but should focus on key risks facing a particular country. Most agreed that the IMF should develop greater understanding of political constraints on policy while cautioning that this should not lead to interference in domestic affairs. A number cautioned that this could be counterproductive if it causes staff to lose focus and press for policies and reforms that are not macrocritical. Most Directors saw great value in systematic discussions with the domestic and the international financial and business communities—but emphasized that the staff would need to assess private sector views critically.	The Board paper for the August 2004 Biennial Review of Surveillance noted that the IMF had substantially strengthened its capacity to identify vulnerabilities in member countries. In particular, it noted that balance sheet issues had received substantial attention in surveillance of advanced and emerging market economies, although various components of vulnerability assessments were not well integrated when presented in staff reports.
Management and the Executive Board should take additional steps to increase the impact of surveillance, including through making staff assessments more candid and more accessible to the public. In particular, there should be a presumption of publication for Article IV staff reports. A clear presumption of publication for country-related staff working papers should also be established. Biennial reviews of surveillance should focus on assessing the impact of surveillance on key systemic issues in major emerging market economies.	Directors strongly supported greater candor in the assessment of country risks and vulnerabilities in staff reports, building on the increase in candor that has already occurred. Nevertheless, Directors expressed a range of views regarding the potential conflict between candor and transparency, and the implications of the proposed shift from voluntary to presumed publication of staff reports. Many Directors warned that greater candor could adversely affect both the IMF's dialogue with countries and market confidence in the context of the publication of staff reports. Some of these Directors felt that what really matters is candor in face-to-face consultations with the key decision makers in a country, rather than in the staff report. Many other Directors strongly supported presumed publication. These believed that concerns about candor are overstated, and that surveillance would be more effective in building ownership and influencing policy if IMF analyses and recommendations are made public. It was agreed that the Board would return to the issue of presumed publication of staff reports during the discussion on transparency. Many Directors were not in favor of shifting from voluntary to presumed publication of staff reports, but a number strongly supported presumed publication.	The Operational Guidance Note on Document Publication issued for staff in March 2004 notes that staff reports should be drafted independently of the authorities' publication intentions and should include the staff's candid assessment of risks, its frank views on the authorities' policy stance, and its policy advice on all areas deemed relevant. According to the new policy that came into effect on July 1, 2004, publication of staff reports for Article IV consultations and use of IMF resources is now "voluntary but presumed." Moreover, the member's agreement to publish staff reports is now required for management to recommend a program with exceptional access to the Board.
The Executive Board should agree on a systematic plan to provide institutional incentives for greater candor in the assessment of country risks and vulnerabilities, possibly including measures to give greater independence to surveillance teams.	Directors encouraged the provision of institutional incentives to the staff to facilitate candor.	Some area departments have experimented with having a different mission chief for Article IV consultations with program countries or have a senior staff member not assigned to the country concerned participate in Article IV consultation missions. Biennial reviews of surveillance will remain the main vehicle for assessing progress.

Appendix 6 *(concluded)*

IEO Recommendation	Executive Board Response[1]	Follow-Up[2]
Escalated signaling should be used when key vulnerabilities identified over several rounds of surveillance are not addressed. Such a policy would help strike the necessary balance between the role of the IMF as confidential advisor and its role as a vehicle for transmitting peer reviews on members' policies and for providing quality information to markets.	Many Directors considered that escalated signaling might be an idea worth pursuing. A number of these Directors reserved judgment on the suggestion until they had more information about how it would work. A few Directors felt that escalated signaling would undermine the IMF's role as confidential advisor, and doubted that it would help in preventing crises or designing more effective programs.	There was no consensus in the Board on escalated signaling or second opinions.
Moreover, management and the Board should explore the possibility of seeking "second opinions" from outside the IMF as part of the surveillance process when the authorities disagree with the staff's assessment on issues that are judged to be of systemic importance. This would also serve as a building block for the idea of escalated signaling.	Many Directors were not in favor of inviting second opinions from outside the IMF. Whereas some Directors considered that a second opinion would bring a fresh perspective that could help resolve differences of opinions with the authorities, many were concerned that it could encroach on the role of the Board, and undermine the work of the staff. A few Directors also noted that this approach has been tried and has failed.	
Program design		
A comprehensive review of the IMF's approach to program design in capital account crises should be undertaken. In particular (i) greater attention should be paid to balance sheet interactions and their consequences for aggregate demand; (ii) program design should allow for a flexible response, in case unfavorable outcomes materialize; (iii) conventional financial programming-based conditionality should be reviewed, and possibly adapted for capital account crisis circumstances; (iv) parsimony and focus should be basic principles of structural conditionality and crises should not be used for pushing reforms that are not critical to crisis resolution, however desirable they may be in the long run; and (v) there should be an agreed communications strategy, characterized by a high degree of transparency.	Directors endorsed these recommendations and hoped forthcoming staff papers on program design and balance sheet effects would give due attention to them. They endorsed the report's focus on the restoration of confidence, and the importance of balance sheet effects on key macroeconomic variables. The balance sheet approach should be closely linked to debt sustainability analysis. There should also be more work on twin (banking and capital account) crises. Directors agreed that design should allow for a flexible response to unfavorable developments; that the conventional financial programming conditionality should be reviewed; and that there should be an agreed communications strategy. Nevertheless, a few Directors cautioned against excessive emphasis on risks and alternative scenarios in program documents, since it would be difficult to know all risks upfront and since such emphasis could erode the program's effectiveness in building confidence in the chosen action plan.	The forthcoming review of conditionality will include a review of program design, including the issue of parsimony and focus in structural conditionality. For the Board discussion, staff is preparing three papers on program design, which discuss, among other things, objectives and experience of various types of IMF-supported programs, recent enhancements to the IMF's analytical tool box, and policy instruments to achieve the various objectives.
The IMF as crisis coordinator		
The IMF should ensure that financing packages provided in response to capital account crises are sufficient to generate confidence and be of credible quality. In particular (i) packages should not rely on parallel official financing unless the terms of access are transparently linked to IMF-supported strategy; and (ii) terms for the involvement of other institutions providing parallel financing should be specified at the outset.	The Board agreed with the recommendation, while noting that there are limitations on the IMF's influence on other sources of financing. The Board stressed that the recently revised access policy must be observed and emphasized the importance of program credibility, not large financing packages, as the heart of IMF involvement. Directors fully supported the idea of moving toward more explicit procedures for collaboration with regional development banks and others and clear delineation of responsibilities, while noting that such procedures do not by themselves guarantee effective coordination.	

Internal governance issues		
The IMF should be proactive in its role as crisis coordinator. In particular (i) management should provide a candid assessment of the probability of success to the Executive Board and shareholders; (ii) management should ensure that the technical judgment of staff is protected from excessive political interference; and (iii) the nature of private sector involvement will have to be determined on a case-by-case basis. The IMF should play a central role in identifying circumstances where concerted efforts can help overcome "collective action" problems, based on meaningful dialogue with the private sector.	The Board endorsed the recommendations. Political judgments and decisions should be the exclusive domain of the Board. While Directors were in favor of early involvement of the Board in program discussions, a number of them observed that the Board and major members should not seek to micro-manage the operational details of programs or influence IMF missions in the field. Directors attached particular importance to the early involvement of the private sector as an integral element of crisis resolution.	The new framework for exceptional access decisions provides a mechanism for encouraging more systematic early consideration of circumstances in which the success of a program would be enhanced by voluntary efforts to address collective action problems among private creditors and where steps to address an unsustainable debt burden need to be part of a strategy to restore growth and financial viability.
Human resource management should be adapted to develop and better utilize country expertise, including political economy skills, and to establish "centers of expertise" on crisis management issues. In particular (i) the length of staff assignments should be monitored to ensure continuity of staff expertise and a critical mass of country expertise in each systemically important emerging market economy should be developed; (ii) resident representatives should play a more central role in surveillance and program design; and (iii) internal procedures should protect those who raise uncomfortable issues through proper channels, but consequently attract complaints from the authorities.	The Board generally agreed on the need for institutional change to ensure that the IMF is in a position to respond rapidly to member countries facing crises. Some Directors supported creation of centers of expertise in crisis management, whereas others put greater emphasis on mechanisms for drawing upon available expertise and experience in the event of a crisis. A number of Directors favored longer country desk assignments, while others noted the importance of staff mobility in broadening the experience and perspectives of the staff and maintaining its impartiality. Most Directors favored a greater role for resident representatives with a few noting that only relatively senior resident representatives would be sufficiently acceptable to the authorities to play such a role; Directors supported modification of internal guidelines and human resource procedures. They also noted that human resource issues are management's responsibility.	The Monetary and Financial Systems Department was reorganized, with steps taken to provide a center of expertise on banking crisis resolution issues. An Internal Task Force is reviewing broad strategic issues related to the IMF's resident representative program. The Board paper for the August 2004 Biennial Review of Surveillance called for a reassessment of mechanisms for staff rotation and mobility to achieve greater continuity in the policy dialogue, enhance mutual trust, and build up country-specific knowledge. Recent data reported in the paper suggest that excessive staff turnover is still a problem.

[1]This column summarizes the reaction of the Executive Board on each recommendation as reported in the Summing Up by the Chairman of the July 16, 2003 Board meeting. Although care has been taken to ensure accuracy, readers are invited to refer to the full text of the summary of the discussion, which is included in the published version of the report and can be accessed from the IEO website (www.imf.org/external/np/ieo/2003/cac/index.htm).

[2]The description of follow-up is intended to provide a factual indication of any additional steps taken since the Board discussion of the evaluation report. It is not intended to be an evaluation of any follow-up by management or the Executive Board. Where staff internal assessments have been made of relevant issues, these are reported but have not been subject to any independent confirmation by the IEO.

Appendix 7

Evaluation of Fiscal Adjustment in IMF-Supported Programs: Recommendations, Board Response, and Subsequent Follow-Up

IEO Recommendation	Executive Board Response[1]	Follow-Up[2]
Program design and internal review		
Program documentation should provide a more in-depth and coherent justification for the magnitude and pace of programmed fiscal adjustment and how it is linked with assumptions about the recovery of private sector activity and growth. It will also facilitate the review process and discussions at the Board, as well as provide external audiences with a more convincing explanation for the rationale for the program and identify possible risks and subsequent corrective measures.	Directors supported this recommendation, and deemed that this initiative would instill greater discipline in program design, enhance transparency, and provide the public and the private sector with a more convincing rationale for the program, thereby helping to overcome political obstacles to implementation. Nevertheless, they recognized that uncertainties regarding key macroeconomic variables, particularly in countries in crisis, and concern about the implementation of policy measures and reforms complicate this task. A few Directors cautioned against spurious precision in such justifications, and others noted that the magnitude and pace of programmed fiscal adjustment may also reflect political constraints. Several Directors stressed the importance of better integrating debt sustainability analyses into program work. Directors looked forward to further staff analysis of growth projections in the context of program design discussions.	The Fiscal Affairs Department has prepared a guidance note to staff on how reports might best present the appropriate size, pattern, and composition of fiscal adjustment. Papers on program design to be discussed by the Board in late 2004/early 2005 will analyze the issue of growth projections.
The internal review mechanism should place more emphasis on the early stages of the process. A more intensive process of brainstorming is needed at the time of the initial brief, and the brief should also articulate more clearly the basis for the fiscal program, and its links with debt sustainability issues.	Directors supported this recommendation. They welcomed management's recent initiative aimed at enhancing the effectiveness of the review process, which, inter alia, encourages early consultation between departments.	Following a recent assessment of the internal review process by a staff task force, management endorsed several changes to the process, including more systematic discussions of key issues prior to the preparation of briefing papers.
Programs should give greater emphasis to the formulation and implementation of key institutional reforms in the fiscal area, even if (as is likely) they cannot be fully implemented during the program period. Programs should make stronger efforts to specify those structural reforms that should be carried out during the program horizon as part of a broader road map of priority reforms. This road map, and its prioritization, should ideally have emerged in the course of surveillance and be updated regularly as outlined below.	Directors agreed that key institutional reforms can be more critical for fiscal sustainability than short-term expenditure and revenue measures. However, they recognized that short-term measures are hard to avoid in many cases, especially if the immediate objective is economic stabilization. Medium-term institutional reform may be of particular relevance in countries that have achieved macroeconomic stability and where "second generation" reforms are necessary to foster growth and reduce longer-term vulnerabilities. Some Directors agreed with the report's suggestion that reforms should be broken down into those that require executive action, legislation, and capacity building. Directors, however, pointed out that in crisis situations, the pressing need to resolve the crisis may pose serious constraints on a medium-term approach. They reiterated the conclusion of the discussion on the Evaluation of the Role of the Fund in Recent Capital Account Crises that a crisis should not be used as an opportunity to force long-awaited reforms, however desirable they may be, in areas that are not critical to the resolution of the crisis or to address vulnerability to future crises. Careful judgment will continue to be needed to focus conditionality on those reforms judged critical while at the same time ensuring that adequate progress is made in addressing vulnerabilities and achieving the program's goals during the period of the arrangement, thus safeguarding the IMF's resources.	See below.

Surveillance

The surveillance process should be used more explicitly to provide a longer-term road map for fiscal reforms and to assess progress achieved.

- In collaboration with the authorities, the IMF should clearly identify in surveillance reports the most critical distortions in a country's public finances from the perspectives of equity and efficiency.

- Such an analysis would provide a road map for fiscal reform in the future, with a clear sense of priorities. It would help to provide the basis for identifying critical reforms—particularly in areas where these reforms have been lagging—that would need to be addressed should IMF financing be required in the future.

- The identification in advance of areas considered critical will allow the authorities flexibility in the timing and packaging of reforms, which is often lost if these reforms are flagged at the last minute in the context of a crisis situation. This approach would also help foster greater domestic debate on key reforms and hence would encourage homegrown solutions and greater ownership. Early and clear prioritization of reforms is also consistent with streamlining objectives—it will avoid last minute bunching of reforms under crisis situations.

- The analysis of fiscal reform priorities should be accompanied by an assessment of why certain important distortions were not addressed in the past and what lessons have been learned from past experience. This should include an effort to identify and unbundle the various constraints to critical reforms, including lack of technical capacity, areas where additional legislative action is necessary, and areas where key decisions from the executive branch are required.

- Surveillance should include more systematic efforts to estimate the extent of tax evasion and tax exemptions, including the use of cross-country comparisons.

- Public debt sustainability could help anchor the road map of fiscal reform priorities proposed above and to assess trade-offs over time. At the same time, debt analysis provides a check of cumulative progress in improving fiscal systems that could also be reported in successive surveillance reports.

Most Directors agreed that Article IV consultations should play a stronger role in identifying longer-term reform priorities and the causes of past failures in addressing fiscal problems, and that these analyses should inform subsequent program design. In this respect, the various initiatives to distinguish Article IV surveillance from program work are aimed at providing fresh perspectives.

Some Directors considered the current framework of surveillance to be adequate for achieving the objectives of the IEO's recommendation. Directors also called for staff reports to set out in more detail the progress in implementing the recommendations of ROSC and technical assistance missions, as well as key reform priorities. Nevertheless, they underscored that the ultimate responsibility to develop a fiscal reform agenda resides with the individual country authorities, while the IMF should stand ready to provide advice.

Directors also stressed that, consistent with the IMF's mandate, surveillance needs to focus on key issues of macroeconomic relevance, which will be different in each country, and should draw on the expertise of other institutions as appropriate. They encouraged the use of cross-country experiences and comparisons, including inputs from regional and multilateral surveillance, to assist in program design. Most Directors viewed Article IV consultations as the appropriate vehicle for staff to identify countries in need of an in-depth fiscal review, stressing that this identification process should be applied uniformly to all member countries of the IMF. In most cases, these needs could be accommodated through technical assistance and ROSCs.

The Fiscal Affairs Department is preparing revised fiscal strategy briefs in 16 pilot countries where special efforts will be made to identify critical structural and institutional fiscal issues that can then be discussed in Article IV consultations. One example is the recent 2004 Article IV staff report on Lebanon.

In many other countries the Fiscal Affairs Department is preparing revised fiscal strategy briefs.

Appendix 7 *(concluded)*

IEO Recommendation	Executive Board Response[1]	Follow-Up[2]
Role of the IMF in social protection		
The IMF should clearly delineate the operational framework in which social issues will be addressed within program design in non-PRGF countries. This should include a clear indication of the IMF's responsibilities and activities in this area. The objective should be to assist middle-income countries to prepare and improve their institutional framework to allocate resources to critical social programs and to establish mechanisms to protect the most vulnerable groups in the face of external shocks and budgetary retrenchment. • The IMF could invite the authorities regularly during Article IV consultations to identify the existing critical social programs and social services that they would like to see protected in the event of adverse shocks. Participation on the part of the authorities would clearly be voluntary. • Successful implementation will depend heavily on having better and more transparent expenditure monitoring systems. On the basis of the priorities identified by the authorities, the IMF and the World Bank could join their accelerated efforts to reform public expenditure management (PEM) systems, specifically geared toward the social area, with a view to protecting the specified programs and spending categories. • This concrete application of the PEM initiative is particularly important because in many cases where there is an IMF-supported program the World Bank is also active with adjustment lending supporting the budget. • Surveillance would routinely report on these initiatives and their progress over time.	Directors agreed that an important aim of program design should be to protect critical social expenditures. However, they stressed, as recognized in the report, that the IMF should not become involved in the detailed selection and design of social policy; this task is outside both the IMF's mandate and its expertise. A number of Directors supported the IEO's call for updating of the 1997 guidelines that direct IMF work in the social area, in order to improve their clarity and effectiveness as an operational tool in protecting the most vulnerable from economic shocks and budgetary retrenchment. Other Directors, however, viewed the existing guidelines as adequate, and a few considered that the annual and medium-term budgets of non-PRGF countries already adequately identify critical social sector programs. These Directors recalled that the new framework for Bank-Fund collaboration on public expenditure issues should enhance countries' public expenditure reform strategies, including measures to protect critical social spending. Most Directors agreed with the recommendation that staff should inquire, during Article IV consultations, whether the authorities have identified social programs that they would like to protect in the event of a crisis, as they believed this would help dispel the criticism that IMF-supported programs unduly curtail social spending. A few others considered this recommendation impractical, as it would create significant costs and pressures for the authorities with little benefit.	During the discussions of the Biennial July 2004 Review of IMF Surveillance, the Executive Board concluded that, "in members where shocks could have a sizeable impact on social conditions, most Directors were of the view that Article IV consultations and other contacts can offer an opportunity to solicit interested members' views on protection of social safety nets or of other priority expenditures in times of economic stress." An operational guidance note to reflect the conclusions of the review is under preparation.

[1]This column summarizes the reaction of the Executive Board on each recommendation as reported in the Acting Chairman's Summing Up of the August 29, 2003 Board meeting. Although care has been taken to ensure accuracy, readers are invited to refer to the full text of the summary of the discussion, which is included in the published version of the report and can be accessed on the IEO website at www.imf.org/External/NP/ieo/2003/fis/index.htm.

[2]The column on follow-up is meant to provide factual information on additional steps taken after the Board discussion. It is not intended to be an evaluation of any follow-up by management or by the Executive Board.

Appendix 8

Evaluation of Poverty Reduction Strategy Papers and the Poverty Reduction and Growth Facility: Recommendations, Board Response, and Subsequent Follow-Up

IEO Recommendation	Executive Board Response[1]	Follow-Up[2]
Aligning incentives and objectives		
Introduce greater flexibility in the implementation of the PRS approach to fit better the needs of countries at different stages of the process and with different capacities and political and administrative systems. Countries would be put more firmly in the driver's seat by determining the following for themselves: • How the policy formulation, implementation, and monitoring processes will be built up over time. Progress would be monitored against an explicit set of country-determined intermediate benchmarks. • What the output of these processes will be in terms of documents, with IMF process requirements minimized.	Directors broadly endorsed the recommendation, agreeing that the PRS approach will need to be implemented flexibly taking due account of country-specific circumstances and the core objectives of the PRS approach.	Several changes have been made to introduce greater flexibility. In addition to the shift in focus from the JSA to the Joint Staff Advisory Note (JSAN) (see below), the Annual Progress Report can now be more closely aligned with domestic processes, giving the country an opportunity to assess progress and set the agenda for the period ahead. In most cases, the Annual Progress Reports will not be discussed by the IMF and World Bank Boards and will be distributed for their information only. The requirement that the PRS strategy and the PRGF be fully consistent has been eased, with the aim of eliminating the need for minor, last-minute formal adjustments to the strategy document that only served to ensure such detailed consistency.
Shift the emphasis of the initiative from the production of documents to the development of sound domestic policy formulation and implementation processes. This would involve the following elements: • Build in greater results orientation. • Shift the emphasis of the incentives structure to achieving substantive changes in domestic policies and processes that are objectively measured.	Directors agreed that there should be less emphasis on document preparation and more on improving the capability of countries to develop and implement policies. Some Directors agreed that countries should set explicit criteria for judging progress toward key intermediate objectives, but many Directors cautioned that this should not imply excessive IMF involvement in assessing the country's decision-making process and should not establish an unwarranted direct linkage between such assessments and the IMF's lending decisions. Directors noted that further discussion was needed on how the IMF should react in cases where it believes that the pace of progress chosen is not ambitious enough.	JSANs (see below) are to provide constructive feedback to the authorities, focusing on a limited number of suggested key improvements that could be made to the strategy. This increased selectivity is intended to focus efforts on substantive changes in policies and processes.
Clarify the purpose of the JSA and redefine the vehicle accordingly.	Directors called for a reformulation of the JSA with an emphasis on graduated rather than binary assessments.	The Board subsequently accepted the staff proposal to replace the JSA with a JSAN that focuses on providing feedback to the authorities on the PRSP and that drops the binary (yes or no) assessment of the suitability of the PRSP as a basis for concessional lending. The JSAN is no longer required for some country documents (e.g., PRSP preparation report).

Appendix 8 *(concluded)*

IEO Recommendation	Executive Board Response[1]	Follow-Up[2]
Clarifying the IMF's role and improving its effectiveness		
Clarify what the PRS approach implies for the IMF's own operations and strengthen the implementation of the agreed role. This would affect the following areas:	Directors agreed that the IMF needs to set out more clearly its role in the PRS approach in each country, based on the IMF's core mandate in macroeconomic and related structural policy issues.	The management-led Task Force on Low-Income Country Work is coordinating work on various aspects of the IMF's strategic role in low-income countries.
• IMF engagement in the PRS process. • PRGF-related activities, including classifying the IMF role where the PRSP does not yet provide an operational road map. • Streamline IMF documentation and Board scrutiny.	Many Directors also supported a more active role for the IMF in the public debate on macroeconomic policy design and implementation. Where PRSPs are not yet operationally viable, the IMF should not insist on immediate tight alignment between the PRSP and PRGF-supported program. Instead, IMF staff should work with these members to strengthen their macroeconomic frameworks in PRSPs. However, increased flexibility should not imply delinking the PRGF from the PRSP, and the IMF would still seek to apply the PRSP principles in its program work.	Board scrutiny has been simplified, as PRS documents and corresponding JSANs will no longer be put automatically on the Board agenda. Instead, they will be issued for information and discussed only at an Executive Director's request.
Strengthen prioritization and accountability on what the IMF itself is supposed to deliver within the broader partnership framework, built around the priorities emerging from the PRS process, and ensure resources match commitments.	Directors welcomed the emphasis on better defining priorities for the IMF's work in low-income countries and indicated that the prioritization of budget resources must be guided by the IMF's overall mandate. They called for a careful assessment of the resource implications of adapting the IMF's role along the lines of the report's recommendations.	
The IMF should encourage a strengthening of the framework for establishing the external resources envelope as part of the PRS approach.	Directors indicated that the IMF should play a supportive role with donors and low-income members to help ensure adequate provision of aid to achieve the MDGs. In this regard, the IMF needs to consider how its signals can be clear and useful to its members.	The IMF and World Bank are working with a number of countries to develop alternative macroeconomic framework that reflect the larger amount of aid needed to meet MDGs.

[1]This column summarizes the reaction of the Executive Board on each recommendation as reported in the Acting Chairman's Summing Up of the July 21, 2004 Board meeting. Although care has been taken to ensure accuracy, readers are invited to refer to the full text of the summary of the discussion, which is included in the published version of the report and can be accessed on the IEO website at www.imf.org/External/NP/ieo/2004/prspprgf/eng/index.htm.

[2]The description of follow-up is intended to provide a factual indication of any additional steps taken since the Board discussion of the evaluation report. It is not intended to be an evaluation of any follow-up by management or the Executive Board.

Appendix 9

Evaluation of the Role of the IMF in Argentina, 1991–2001: Recommendations, Board Response, and Subsequent Follow-Up

IEO Recommendation	Executive Board Response[1]	Follow-Up[2]
Crisis management		
The IMF should have a contingency strategy from the outset of a crisis, including in particular "stop-loss rules"—that is, a set of criteria to determine if the initial strategy is working and to guide the decision on when a change in approach is needed.	Most Directors viewed contingency planning as useful, but many noted that in a crisis or precrisis setting, it is not always possible to assess the various contingencies that might occur. Concern was also expressed that any indication that the IMF was developing contingent strategies could undermine confidence in the program. As regards specific stop-loss rules, most felt that defining and implementing such rules would be difficult or impractical.	No consensus emerged in the Board meeting.
Where the sustainability of debt or the exchange rate is in question, the IMF should indicate that its support is conditional upon a meaningful shift in the country's policy while remaining actively engaged to foster such a shift. High priority should be given to defining the role of the IMF when a country seeking exceptional access has a solvency problem.	Directors agreed with the IEO's recommendation. At the same time, they noted that assessing exchange rate or debt sustainability will necessarily entail judgment, and it is essential that the Board be provided with up-to-date and comprehensive information and analysis. Steps have already been taken since the Argentine crisis to strengthen the basis on which debt sustainability assessments are made. Directors indicated that they looked forward to an opportunity to assess whether further changes may be needed.	In June 2002, the Board adopted a framework for more objective and standardized debt sustainability analysis; refinements to this framework were endorsed by the Board in July 2003. Debt sustainability analyses are now regularly included in staff reports for Article IV consultations and use of IMF resources. They play a central role in considering exceptional access and in the Evian approach of Paris Club creditors. Some progress is being made in the Board to define the role of the IMF in solvency problem cases, with emphasis on the use of Collective Action Clauses.
Surveillance		
Medium-term exchange rate and debt sustainability should form the core focus of IMF surveillance. To fulfill these objectives (which are already current policy), the IMF needs to improve tools for assessing the equilibrium real exchange rate that are more forward-looking and rely on a variety of criteria, examine debt profiles from the perspective of "debt intolerance," and take a longer-term perspective on vulnerabilities that could surface over the medium term.	Directors concurred with the IEO's recommendation that medium-term exchange rate and debt sustainability should form the core focus of IMF surveillance. They cautioned that finding an appropriate operational measure of exchange rate sustainability would be difficult, but a few suggested that the development of such a measure by the staff should be a priority. Directors saw a continued need for greater candor in the treatment of exchange rate policy in the context of Article IV discussions. In order to avoid triggering a potentially destabilizing market reaction, some suggested that the scope for establishing procedures for handling sensitive topics during surveillance exercises should be explored by staff. As to debt sustainability, recent events have led to a reassessment of what level of debt is sustainable for emerging market countries, which is already reflected in the IMF's work. Directors asked staff to continue to sharpen its analytical tools, and a few called for examining ways to strengthen the organization and independence of debt sustainability analysis work.	The Executive Board in the August 2004 Biennial Review of Surveillance called for sharpening the focus of Article IV consultations, including deepening the discussion of exchange rate issues. In particular, it called for clear identification of the de facto exchange rate regime and use of a broad range of indicators and analytical tools to assess external competitiveness.

Appendix 9 *(concluded)*

IEO Recommendation	Executive Board Response[1]	Follow-Up[2]
Program relationship		
The IMF should refrain from entering or maintaining a program relationship with a member country (in the form of a precautionary arrangement) when there is no immediate balance of payments need and there are serious political obstacles to needed policy adjustment or structural reform.	Directors noted the possible risks associated with precautionary IMF arrangements, especially where there are serious political obstacles to needed policies and reforms, but most did not support the implication that the IMF should not enter into a program relationship with a member country when there is no immediate balance of payments need. They reiterated the value of precautionary arrangements as an important tool for supporting sound policies, while agreeing that there is a need to ensure that program standards and requirements are the same as those for all other arrangements.	The Board did not support the recommendation, so no explicit follow-up is expected. However, in response to the expiration of the Contingent Credit Line, there is an ongoing debate on the need for, and desirability of, a new policy that would clarify the use of exceptional access under precautionary arrangements. Many Directors support the existing IMF policies as adequate.
Exceptional access should entail a presumption of close cooperation between the authorities and the IMF, and special incentives to forge such close collaboration should be adopted, including mandatory disclosure to the Executive Board of any critical issue or information that the authorities refuse to discuss with (or disclose to) staff or management.	Directors stressed that all cases of the use of IMF resources, particularly cases of exceptional access, should entail a presumption of close cooperation. Many Directors agreed that there should be a requirement of mandatory disclosure to the Board of any critical issues which the authorities refuse to discuss.	
The decision-making process		
In order to strengthen the role of the Executive Board, procedures should be adopted to encourage (i) effective Board oversight of decisions under management's purview; (ii) provision of candid and full information to the Board on all issues relevant to decision making; and (iii) open exchanges of views between management and the Board on all topics, including the most sensitive ones.	Directors noted that the procedures for exceptional access adopted since the Argentine crisis have generally worked to strengthen the Board's involvement and ensure that decisions to continue program engagement under exceptional access are adequately informed. A number of Directors, however, saw a need for further discussion of approaches to strengthen the role of the Board. Further efforts to enhance decision making by the Board would include improvements in the provision of full information on all relevant issues and open exchanges of views between management and the Board on all topics.	

[1]This column summarizes the reaction of the Executive Board on each recommendation as reported in the Summing Up by the Chair. Although care has been taken to ensure accuracy, readers are invited to refer to the full text of the summary of the discussion, which is included in the published version of the report and can be accessed from the IEO website (www.imf.org/ieo).

[2]The description of follow-up is intended to provide a factual indication of any additional steps taken since the Board discussion. It is not intended to be an evaluation of any follow-up by management or the Board.