

Evaluation Report

# Evaluation of Prolonged Use of IMF Resources



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The following symbols have been used throughout this report:

– between years or months (e.g. 2000–01 or January–June) to indicate the years or months covered, including the beginning and ending years or months;

/ between years (e.g. 2000/01) to indicate a fiscal (financial year).

“Billion” means a thousand million.

Minor discrepancies between constituent figures and totals are due to rounding.

On September 30, 2002, SDR 1 = US\$1.3227.

Some of the documents cited and referenced in this report were not available to the public at the time of publication of this report. Thus, they have not been listed in the bibliography. However, under the current policy on public access to the IMF’s archives, some of these documents will become available five years after their issuance. They may be referenced as EBS/YY/NN and SM/YY/NN, where EBS and SM indicate the series and YY indicates the year of issue. Certain other documents are to become available ten or twenty years after their issuance depending on the series.

# Foreword

The Independent Evaluation Office (IEO) was established by the International Monetary Fund's Executive Board in July 2001. The office operates independently of IMF management and at arm's length from the IMF's Executive Board. Its mission is to provide objective and independent evaluation of issues related to the IMF's mandate and thereby support the Executive Board in its governance and oversight responsibilities, to contribute to enhancing the learning culture of the IMF, and to promote understanding of the IMF's work.

This *Evaluation of Prolonged Use of IMF Resources* is the first report produced and published by the IEO. The terms of reference for the evaluation were prepared following extensive consultation with various stakeholders. An initial draft of an issues paper for the evaluation was posted for comments on the IEO's website ([www.imf.org/ieo](http://www.imf.org/ieo)). After input from a range of groups and individuals, the final terms of reference were determined by the IEO, and also posted on the website. Interested parties were invited to submit material relevant to items included in the final terms of reference. This consultative approach will be followed for all IEO evaluations.

The process for review and publication of the final report followed the standard rules that have been established by the IEO; a detailed description of these procedures is also available on our website. The final report was circulated to IMF management and the Evaluation Group of Executive Directors at the same time. Subsequently, management's comments, and the IEO's response, were circulated to the Executive Board, but the report was not changed in light of these comments. The Executive Board discussed the evaluation on September 20, 2002, and the Chairman's summing up of that discussion is also included.

This report was prepared by a team headed by David Goldsbrough and including Kevin Barnes, Isabelle Mateos y Lago, and Tsidi Tsikata. Sections of the report have also benefited from comments and other input from Professor Graham Bird, Professor Jong-Wha Lee, David Peretz, and Professor Andreas Wimmer, but the final judgments are the responsibility of the IEO alone. Research assistance from Mwaffak Taib, Ned Rumpelstin, Yothin Jinjark, and Sergei Peredriy and administrative support by Annette Canizares and Arun Bhatnagar are gratefully acknowledged.

Montek S. Ahluwalia  
*Director*  
*Independent Evaluation Office*



# List of Abbreviations

AGSAC	Agricultural Sector Adjustment Credit
AsDB	Asian Development Bank
ASEAN	Association of South East Asian Nations
BCEAO	Banque Centrale des Etats de l’Afrique de Ouest
BIR	Bureau of Internal Revenue
BRS	Budget reporting system
CCFF	Compensatory and Contingency Financing Facility
CDB	Caribbean Development Bank
CPSD	Consolidated public sector deficit
CPSP	Caisse de Péréquation et de Stabilisation des Prix
CSP	Country strategy paper
CTRP	Comprehensive Tax Reform Package
DSA	Debt sustainability analysis
EAP	Enlarged access policy
EFF	Extended Fund Facility
EMBIG	Emerging Market Global Bond Index
ESAF	Enhanced Structural Adjustment Facility
FAD	Fiscal Affairs Department
FCD	Foreign currency deposit
FSAP	Financial Sector Assessment Program
GDP	Gross domestic product
GFS	<i>Government Finance Statistics</i>
GNP	Gross national product
GRA	General Resources Account
GST	General sales tax
HIPC	Heavily Indebted Poor Country
IDB	Inter-American Development Bank
IEO	Independent Evaluation Office
IFI	International financial institution
IFS	<i>International Financial Statistics</i>
INS	Information Notice System
LOI	Letter of intent
MEP	Memorandum of Economic Policies
NGO	Nongovernmental organization
NPV	Net present value
ODA	Overseas development assistance
OED	Operations Evaluation Department
OIA	Office of Internal Audit and Inspection
PC	Performance criteria
PDR	Policy Development and Review Department
PIN	Public Information Notice
PIU	Produce Index Unit
PFP	Policy Framework Paper
PNB	Philippine National Bank
PPM	Post-program monitoring

## LIST OF ABBREVIATIONS

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PRGF	Poverty Reduction and Growth Facility
PRSP	Poverty Reduction Strategy Paper
PU	Prolonged user
SAF	Structural Adjustment Facility
SAL	Structural Adjustment Loan
SB	Structural benchmark
SBA	Stand-By Arrangement
SBP	State Bank of Pakistan
SCA	Special Contingent Account
SDR	Special drawing right
SMP	Staff-monitored program
SRF	Supplemental Reserve Facility
TA	Technical assistance
TU	“Temporary” user
UFR	Use of Fund resources
USAID	U.S. Agency for International Development
WAEMU	West African Economic and Monetary Union
WAPDA	Water Resources Administration and Power Development Authority
WEO	World Economic Outlook
VAT	Value-added tax

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# **Report of the IEO on Prolonged Use of IMF Resources**

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# Executive Summary

## Introduction

1. *In this evaluation, which is the first by the Independent Evaluation Office (IEO), we examine the issue of the prolonged use of IMF resources, which has been the subject of external criticism and internal concern.* Some critics have argued that prolonged use constitutes a departure from the IMF's traditional mandate of providing temporary balance of payment support and suggests a lack of effectiveness of IMF-supported programs. Others have argued that frequent recourse to IMF arrangements is less of a problem than critics contend, that it can take place for good reasons in countries with deep-seated adjustment problems, and that it can be fully compatible with the IMF's mandate. We analyze the various reasons that have caused prolonged use to expand over the last three decades, be they related to IMF lending policies, to specific characteristics of the countries concerned, to shortcomings in program design and implementation, or to broader institutional factors. In so doing, we inevitably touch upon some issues that have been at the heart of recent controversies about the effectiveness of IMF-supported programs. Given the IEO's mandate, the focus is on the role of the IMF, but we are not suggesting that the IMF is responsible for all problems that contributed to prolonged adjustment difficulties. Clearly, the governments of the countries themselves bear primary responsibility for their policies.

2. *We used a combination of methodological approaches in the evaluation, including empirical and econometric analyses of the broader group of prolonged users; three main country case studies (of Pakistan, the Philippines, and Senegal); two more limited case studies of "graduators" from prolonged use (Jamaica and Morocco); interviews with a wide range of stakeholders in the countries studied and with IMF staff; and a series of questionnaires to prolonged users' authorities, official and private creditors, and IMF mission chiefs.*

3. *We find that the increase in prolonged use is partly a reflection of systemic factors arising from the changed role that the international community expects the IMF to perform—where the implications*

for the extent of prolonged use have not been fully recognized—and is also linked to program design and implementation problems, many of which are not specific to prolonged users.

## Definition and Scope of Prolonged Use

4. *There is no single definition of prolonged use and different definitions have been used in earlier studies on the subject. For this evaluation, we have used a definition that treats a country as a prolonged user if it has been under IMF-supported programs for 7 or more years in a 10-year period.* (For example, a country would have to be in more than two consecutive three-year arrangements to be classified as a prolonged user.) The "fixed" version of this definition looks at all countries that met this definition at some point in the period covered by the evaluation. On this basis, 44 countries (29 of them PRGF-eligible) were prolonged users at some point during 1971–2000; a further 7 countries were prolonged users if precautionary arrangements are included. For some purposes, we have also used a "dynamic" definition according to which a country is treated as a prolonged user in a particular year if it has had an arrangement for 7 of the previous 10 years.

5. *Prolonged use has expanded consistently since the 1970s in terms of number of countries, share of the IMF's membership, and total financial exposure.* This conclusion holds regardless of how prolonged use is defined and also if the analysis is done separately for low-income countries and middle-income countries. In terms of number of countries, most of the expansion is accounted for by those eligible for the concessional facilities; but in terms of financial exposure, it is predominantly associated with users of the IMF's general resources. Furthermore, prolonged use is persistent, in the sense that countries are generally slow to "graduate" from such use. In 2001, arrangements with prolonged users represented about half of the total number of ongoing IMF-supported programs, with a total exposure of SDR 24 billion (i.e., about half of total outstanding obligations to the IMF).

## Evolution of the IMF's Policies with Respect to Prolonged Use

6. *The emergence of the phenomenon of prolonged use is to some extent the consequence of the evolution of IMF policies on the length of use of its resources.* A review of the history of this evolution (in Chapter 3) suggests the following broad conclusions:

- Initially, the IMF was expected to provide financing only for a relatively short period, but over time the Executive Board accepted that many balance of payments problems, especially in the case of low-income countries, arose from deep-seated structural problems that required a longer time frame for adjustment. This led to acceptance of IMF financing being provided over a longer period. Even so, the departure was initially viewed as exceptional and access was not expected to be overly prolonged.
- With the establishment of concessional financing facilities in the late 1980s to address deep-seated external problems in low-income countries, policies applied to the use of concessional and general resources began to diverge, especially in the 1990s. There was a gradual relaxation of any implied upper limits on the time spent under IMF-supported programs in the concessional facilities. Simultaneously, there was a tightening of the rules governing the length of use of the IMF's general resources, although not to the point of setting a ceiling on that length.
- *The evolution of these facilities did not fully and explicitly recognize some of the consequences in terms of the extent of prolonged use and its potential adverse impact.* This was in part a consequence of differences of view within the Executive Board over what the longer-term role of the IMF should be in such cases. As a result, the IMF has been left with a mismatch between its core operational approach (which is still focused on promising and achieving a restoration of sustainability within a relatively short time frame) and some of the new tasks it is being asked to perform, especially the provision of support for longer-term structural adjustment.
- *The approach to prolonged use as it evolved over time reflected the nature of the financing constraint.* Initially, the limited availability of funding for the IMF's concessional facilities precluded any consideration of a long-term involvement. Subsequently, the reluctance of donors to maintain their aid flows at a level consistent with the intended diminished reliance on

IMF lending, implied that the IMF would either have to remain involved through repeated programs until a sustainable external situation could be reached, or withdraw from the countries concerned midway in the process before external viability could be achieved.

- *Over time, a set of guidelines was approved by the Executive Board to reduce the likelihood of prolonged use of IMF resources.* These guidelines called for front-loading the adjustment effort and monitoring implementation closely; calibrating access to IMF resources to ensure a diminishing reliance over time; comprehensive ex post assessments of previous programs; and the preparation of explicit exit strategies for prolonged users. The evaluation indicates that these guidelines were not implemented consistently. One reason may have been the Board's reluctance to endorse a specific definition of prolonged use, which led to ambiguity about the application of the guidelines in individual cases.

## Characteristics of Prolonged Users

7. *Prolonged users appear to face external circumstances and have fiscal characteristics that are less conducive to swift adjustment.* These include lower trend export growth and more volatile terms of trade, as well as a more rigid structure of government expenditure, lower tax revenues, and a higher public debt burden. Although the statistical significance of these differences between prolonged and "temporary" users is limited and directions of causation are hard to disentangle, some of these characteristics have potential implications for program design. For example, they suggest the need for caution against the danger of overambitious projections for exports or tax revenues being built into program targets, since these could cause problems for program implementation. Evidence from the case studies and cross-country analyses—discussed in Chapter 5—suggests that such overoptimism often was a problem in program design. However, there are also indications that prolonged users suffered from more serious imbalances than "temporary" users at the start of their prolonged use period, which might account in part for the greater length of their adjustment process.

## Effectiveness and Design of Prolonged Users' IMF-Supported Programs

8. *While it is hard to disentangle the effects of poor implementation from design problems, IMF-*

*supported programs in prolonged use cases achieved much less than projected:*

- Although the methodological problems are considerable, econometric evidence suggests that in cases of prolonged use of general resources, IMF-supported programs tend to be associated with a negative impact on growth—after controlling for the endogeneity of a country’s decision to seek IMF assistance and for other determinants of growth. There is no such negative association for “temporary” users. Prolonged users of concessional resources do not show any negative impact on growth.
- A cross-country analysis of the extent of fiscal adjustment suggests that, in multiyear arrangements, prolonged users adjusted less than “temporary” users over the program period. In Stand-By Arrangements (SBAs), prolonged users also appear to have achieved a slightly smaller reduction in the overall public sector deficit than “temporary” users and the shortfalls from the targeted fiscal adjustment seem to have been larger, although lack of a fully consistent database makes such comparisons difficult.
- The case studies show that, during the long period of IMF program involvement, significant progress toward solving these countries’ economic difficulties was eventually achieved in the Philippines and Senegal and even more so in Morocco, although with a mixed record across areas of economic policy and at a much slower pace than originally envisaged. The record in Pakistan and Jamaica was more disappointing. In all cases, substantial challenges remained at the end of the prolonged use period reviewed, especially as regards institutional reforms in tax administration and the broader public sector.

9. *A cross-section analysis of program design in prolonged use cases reveals interesting differences with “temporary” user cases. Some of these might have contributed to lower program effectiveness:*

- Prolonged users’ programs had an optimistic bias as regards projections of real GDP growth and (for users of concessional facilities) export growth.
- In both SBAs and multiyear arrangements, the magnitude of the targeted fiscal adjustment (as measured by the primary fiscal balance) was markedly lower in prolonged use cases. In SBAs, the targeted adjustment of the external current account was also much lower. Contrary to established guidelines the targeted adjustment effort in multiyear arrangements was less front-loaded in prolonged use cases.
- Conditionality in prolonged users’ programs was, on average, less extensive than in other programs and its modalities involved fewer performance criteria and prior actions (as opposed to structural benchmarks and reviews). Moreover, a higher proportion of prolonged users’ performance criteria were waived. However, the evidence from the case studies, discussed below, suggests that it was not so much the magnitude of conditionality as its prioritization and integration into program design that was critical.
- Programs with prolonged users, particularly those supported by general resources, were frequently subject to interruptions (both temporary and irreversible), to a greater extent than were “temporary” users’ programs.
- Access to IMF resources in successive prolonged users’ arrangements declined only in a minority of cases, and disbursements were on average somewhat more front-loaded than in arrangements with “temporary” users.
- Staff inputs in programs with prolonged users were smaller than in other programs, although the evidence suggests that this had no significant impact on program outcomes. Staff turnover on country assignments was very high in prolonged user countries, although not worse than in “temporary” users.

10. *The case studies broadly confirm the pattern emerging from the cross-section analysis and highlight a number of additional issues that hampered program effectiveness.* We note that not all programs suffered from these problems and there is some evidence of improvement over time. While these problems likely contributed to prolonged use, they were not special to such cases.

- *Discrepancies between the time frame of programs and the magnitude of their objectives.* There was a tendency to overoptimism about the effectiveness of the structural reform agenda in all three of the country cases. On the macro side, the tendency was most marked in Pakistan. Too little attention was often paid to analyzing how the real economy would respond to key policy measures and to assessing the expected sources of growth leading to overly optimistic forecasts of key magnitudes.
- *The risk to programs of weak ownership and political commitment was often understated,* and not enough attention was paid to assessing and developing implementation capacity. Assessments of such issues in internal documents

were variable and, in those relatively few cases where a clear assessment was made, subsequent Board papers were much less candid. There is evidence, however, of a somewhat greater attention to such issues in some more recent programs.

- *Many programs had difficulty in dealing with uncertainty*, in part because program documents often did not analyze the key risks to a program and specify how policies would broadly respond to those risks.
- *Relatively few systematic ex post assessments of programs were undertaken* and (with the exception of the Philippines) there was generally limited discussion of exit strategies from prolonged program involvement.

11. *The three main country cases also provide lessons for approaches to structural conditionality.* Many of these lessons are not specific to prolonged users, but they are especially important in these cases.

- The extent and structure of conditionality was much less important than an underlying political commitment to core policy adjustments. The three country cases illustrate a wide variety of approaches to conditionality, ranging from extensive and detailed in the case of Pakistan to a heavy reliance on reviews in the case of the Philippines; none proved especially effective in periods when ownership was weak. Likewise, very detailed conditionality (e.g., a detailed matrix approach) was not effective in enhancing implementation when political commitment was lacking.
- Structural conditionality was often poorly prioritized, so that compliance with a subset of these conditions did not ensure that the most critical problems were being addressed even though it was often sufficient for continued access to IMF resources.
- Forms of conditionality that focused on policy rules or procedures, rather than one-time discretionary actions, appear to have been ultimately more effective, especially when dealing with deep-seated structural issues.
- Prior actions were not always well integrated into program design and did not always focus on the most critical issues. This might explain in part the general finding that the number of prior actions has little influence on successful program implementation. The history of prior actions in the area of agricultural income taxation in Pakistan is one illustrative example.

## Influence of IMF Governance and Other Institutional Factors on Prolonged Use

12. *Internal institutional factors have contributed importantly to the program design problems outlined above:*

- The approach to structural reforms was, until recently, often characterized by insufficient emphasis on fostering the deep institutional changes needed in critical areas. These problems were compounded by the fact that collaboration between the IMF and the World Bank often did not yield an operationally effective integration of priorities and work programs. The case studies illustrate some of the difficulties that programs encountered in addressing some especially intractable structural problems that were central to the sustainability of adjustment (e.g., effective tax collection procedures in all three countries). Recent initiatives to streamline conditionality should help to address these problems and are welcome.
- The IMF's approach to program design has until now often given insufficient priority to a proper assessment of the implementation capacity constraints that a program might face, be they related to political feasibility or to administrative capacity. In best practice cases, efforts are made to take account of these constraints, but there are insufficient systemic incentives to ensure that such an approach would be followed more generally.
- Some of the case studies (most notably Pakistan) and a survey of IMF mission chiefs suggest that political considerations have been an important factor in program-related decisions on some occasions. While political considerations are bound to enter into decision making for an institution where the ultimate power of approval rests with shareholder governments, it is necessary to ensure that technical judgments and political considerations do not get blurred in these cases. This only dilutes accountability and tends to reduce the credibility of those programs.
- There is evidence that internal incentives in the IMF encourage overpromising in programs. This results from both the relatively short time frame of programs, forcing optimistic assumptions about the pace of adjustment and also from a desire to maximize the program's catalytic role. This led to a tendency to downplay risks. Even when, as was often the case, they were well identified during the internal review process, the assessment of risks was not candidly presented to the Executive Board.

- The case studies suggest that, by and large, surveillance failed to play a major independent role in prolonged user cases. In some cases (most notably the Philippines), doubts that surveillance would be a sufficiently strong instrument for some purposes (e.g., to provide a continuing framework for “good” policies and to send a signal to other lenders) appear to have contributed to continued program involvement even when there were questions about the balance of payments need.
- The IMF’s ability to learn from experience is hampered by (i) the relative scarcity of systematic ex post assessments of programs and (ii) the slow pace at which lessons learned in the context of cross-country policy reviews—which are often insightful—permeate operational practices. Moreover, many of the most candid internal assessments and debates on alternative policy strategies in individual countries were not reflected in subsequent Board papers.

13. *The international community’s evolving expectations of the IMF’s role contribute in important ways to the expansion of prolonged use.* In particular, official donors and creditors have tended to link increasing parts of their financing flows to the existence of an IMF lending arrangement acting as a “seal of approval” on recipient country policies. While this tendency can be justified by the legitimate desire to ensure aid effectiveness, it is not clear that the “seal of approval” provided by IMF-supported programs, especially as currently designed, suitably addresses all the concerns of donors and creditors—in particular those related to long-term sustainable growth and the deep institutional changes that it requires. Furthermore, there is some evidence that “seal of approval” demands are the source of pressures to agree to programs with a low probability of success, which only undermines the seal of approval.

### Implications of Prolonged Use of IMF Resources for the Member Country and the IMF

14. *Prolonged use appears to have both positive and negative implications for institutional development in prolonged users.* Most prolonged users’ authorities acknowledged that successive programs had been accompanied by a positive transfer of economic management skills, although views differed regarding the scope of that transfer. However, there was a general sense—both from the case studies and questionnaire responses from a broader group of

prolonged users—that throughout its involvement, the IMF had paid insufficient attention to institutional reform and to the development of implementation capacity, even in cases where programs had facilitated access to IMF technical assistance. The views expressed regarding the impact of prolonged use on the policy formulation process were generally negative, in particular because program negotiations were often characterized as proceeding in a way that left too little space for policy debate and the formulation of homegrown policies. While this is a general problem, it is particularly damaging in prolonged use cases because of the extended period involved. However, a number of officials acknowledged that the primary responsibility for any failures in policy implementation had to lie in the countries themselves and that a “blame-the-IMF” approach could, in itself, be detrimental to ownership.

15. *Prolonged use may also affect the IMF itself, in two ways: it has a potential impact on its finances, and there are indications that it also affects its credibility.* In terms of financial impact, our analysis indicates that, in spite of its expansion, prolonged use does not appear to have been a binding constraint on the IMF’s lending ability, either in the General Resources Account (GRA) or in concessional trusts. However, since decisions on the size of access to IMF resources and on quota increases are endogenous, it is difficult to determine ex post whether prolonged use led to implicit rationing of resources to other users. Prolonged users’ programs have also contributed significantly to the growing mismatch between the IMF’s staff resources and its lending activities. The impact of prolonged use on the IMF’s credibility cannot be quantified rigorously but there is anecdotal evidence that the willingness of the IMF to maintain or renew its support in the face of uneven implementation weakened the leverage of conditionality. There is also some econometric evidence that, where IMF resources have been found to have a catalytic effect on other financing flows, that effect weakens with prolonged use.

### Conclusions and Recommendations

16. *Prolonged use, even when it takes place for “good” reasons, can have significant adverse implications, both for prolonged users and for the IMF.* The expansion of prolonged use reflects both systemic factors and weaknesses in program design. The latter largely arise from a mismatch between the functions taken on by the IMF for systemic reasons and its institutional culture. Implementation weaknesses also played a part. While they largely reflect policy choices in the countries themselves, which are beyond the scope of this evaluation, their preva-

lence is also related to the systemic and institutional factors mentioned above. The IMF is in a process of change, and many initiatives have been adopted in recent years that, if implemented faithfully to their spirit, should go a long way towards addressing some of the problems highlighted by this report, particularly as regards ownership, the design of conditionality, surveillance in program countries, and IMF–World Bank collaboration.

17. *The recommendations summarized below have two objectives: to diminish the incentives for prolonged use, including by enhancing program effectiveness, and to reduce its adverse consequences.* Some of these recommendations would be applicable only to actual prolonged users. Others are of more general applicability to the IMF’s approach to programs, not just prolonged use cases, but they constitute a preventive strategy that would reduce the likelihood of prolonged use in future. We recognize that some of the recommendations are likely to require some increase in resources, especially in the short term when offsetting resource savings will not yet have materialized. Several of the recommendations are not new, either because they merely give renewed emphasis to existing policies and guidelines that do not appear to be uniformly implemented, or because they constitute an endorsement of recent initiatives, to which they only add specific proposals regarding their implementation.<sup>1</sup>

### Recommendations on the rationale for IMF involvement

1. The Executive Board should adopt an explicit definition of prolonged use, as a trigger for the adoption of automatic due diligence procedures. The definition could use different criteria for the general and concessional resources.

2. In view of the experience with ineffectively implemented programs, greater efforts should be made at judging when countries are ready to implement programs, especially in situations of prolonged use. On this basis, the IMF should be willing to be more selective in extending financial support.

3. The IMF should aim to provide the international community with credible alternatives to the current situation where IMF-supported programs have become a precondition for the provision of many other sources of financing by donors and creditors. This could be done by developing a mix of tools (e.g., strengthened surveillance, PRSP assessments, precautionary arrangements, or shadow programs) to deliver seals of approval suited to the varied needs of donors and creditors.

<sup>1</sup>Specifically, recommendations 4 and 9 concern existing procedures, and recommendations 6, 8, 10, and 11 are an elaboration of recent or ongoing initiatives.

4. An explicit “exit strategy” should be developed for identified prolonged users, although without setting rigid limits on the duration of IMF program involvement.

5. A differentiated rate of charge could be considered for prolonged users. While there is no evidence that cost of IMF resources is a factor in prolonged use, it would serve as a signaling device that could possibly provide at least a political incentive against prolonged use.

### Recommendations for program design and implementation

6. Since implementation is critically dependent on ownership, it would be desirable to evolve specific operational procedures to ensure that program design places greater emphasis on ownership and the nature of the domestic policy formulation process. This approach is already embedded in initiatives currently under way. The following specific suggestions are offered to operationalize the process.

- The IMF should move toward a situation where the normal procedure would be for the authorities to have the initial responsibility for proposing a reform program, which should be the starting point for negotiations. The speed at which this can be done will vary from country to country, depending on administrative capacity. Such an approach should not be an additional prerequisite for financial support, but countries should be encouraged to adopt it.
- The aim should be to move as soon as possible to a situation in which the core elements of a program are subject first to a domestic policy debate within the member country’s own policy-making institutions.
- As is already “best practice,” Article IV surveillance reports should actively seek to present alternative policy options and to analyze the trade-offs between them so as to encourage an open debate on alternative policy options.

7. Programs should give much greater emphasis to fostering key institutional changes and to strengthening implementation capacity. Staff reports should include an explicit assessment of key implementation challenges foreseen and ways to address them.

8. There should be greater selectivity in program content, based on a clearer prioritization of conditionality and a better integration of the latter in program design. This is the essence of ongoing efforts to streamline conditionality, which we strongly support. To reach this objective, the following steps would be key:

- A deepening of operational collaboration with the World Bank, to ensure an effective meshing of priorities and time frames of the two institutions on key issues. Recent initiatives in this area are welcome, but substantial changes in operating approach and sustained emphasis by management will be needed to make collaboration effective.
- Systematically incorporating into program documents more in-depth analyses of real economy responses to the key policy elements of programs and of the sources of growth, while spending proportionately less time fine-tuning traditional financial programming exercises. Such analyses would draw, where appropriate, on the expertise of the World Bank.
- Using conditionality as a means to direct attention to critical reforms and emphasizing substantive rather than formal progress toward the program's objectives both in setting conditionality and in assessing compliance with it. Greater selectivity in the use of conditionality should be accompanied by less recourse to waivers.
- Making greater efforts to tailor the effective time frame of program design to the foreseeable length of the reform and adjustment process, not necessarily by lengthening the time frame of arrangements themselves, but by casting individual arrangements within a longer-term strategic framework and recognizing upfront the need for repeat arrangements where adjustment is expected to be protracted. This approach would build on the existing internal country strategy papers, but with the core elements included in reports to the Executive Board.

9. UFR reports should include more explicit discussions of the major uncertainties faced by the program and of how policies will be adapted if underlying assumptions are not borne out by subsequent developments. To counteract any bias to overoptimism, the reports should discuss explicitly how programs would be adapted if other available forecasts were to prove more accurate.

### Recommendations for IMF governance

10. Systematic ex post assessments of programs should be undertaken, with the key messages reported to the Executive Board, as part of a broader effort to disseminate more effectively “best practices” and lessons learned, and to maximize the effectiveness of the review process. As part of this process, the following points deserve emphasis:

- Staff reports, especially those involving UFR requests by prolonged users, should provide more

perspective on the history of the IMF's program involvement in the country, highlighting what has been achieved and where previous programs have fallen short of their objectives.

- More follow-up monitoring should be undertaken when programs go off-track, especially for prolonged users. This will require improvements to the existing (MONA) database.

11. Steps should be taken to strengthen further surveillance in prolonged use cases, going beyond the recent revisions to surveillance guidelines aimed at improving surveillance in program countries. Further steps should include:

- A clarification of the expectations on the role of surveillance in program cases, going further than the simple reassertion of existing, but unevenly implemented, guidelines and stressing the need for ex post assessments of programs' achievements.
- There is a case for creating greater operational separation between UFR and surveillance missions in prolonged use cases, although implementing this separation raises delicate trade-offs. The appointment of a mission chief chosen from outside the area department for surveillance missions to prolonged users could be considered provided there are suitable continuity and coordination safeguards.
- There is merit in seeking a second opinion—including from outside the IMF—on key policy issues that appear to be contributing to prolonged use.
- The precise frequency of Article IV consultations with program countries is less important than that they take place at times when a “fresh look” would be most valuable.

12. The IMF should strengthen the ability of its staff to analyze political economy issues in order to achieve a better understanding of the forces that are likely to block or enhance reforms and to take these into account in program design.

13. A broad review of explicit and implicit incentives facing IMF staff should be undertaken, in particular with a view to reducing the excessive turnover of staff working on countries and to fostering increased candor in staff reports and greater accountability.

14. The appearance of undue political intervention in the IMF's decisions to grant a country access to its resources undermines the credibility of programs. Procedures should be evolved so that political considerations, which are inevitably present in these decisions, are seen to be taken into account in a transparent manner, with decisions and accountabil-

ity clearly at the level of the Executive Board on the basis of a candid technical assessment by staff of the risks and potential trade-offs.

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## Country Case Studies

### Pakistan

1. Since 1988, Pakistan has been almost continuously under IMF-supported programs. However, all but the last arrangement (the 2000 SBA) suffered from substantial policy slippages and soon went off-track. This intensive UFR period coincided with a marked fall in GDP and export growth, along with a steady increase in poverty, only minor corrections of fiscal and external imbalances, and a buildup in vulnerabilities associated with foreign currency deposits. Substantial progress was achieved in a few structural reforms areas: liberalization of interest rates, trade regime and external payments, modernization of indirect taxes, and utilities pricing. However, the reform process was protracted, and considerable problems remain for lack of in-depth institutional reform, particularly in the areas of tax administration and public enterprise management. Economic governance problems also became more acute and widespread.

2. The limited achievements of successive programs were associated with considerable political and regional instability, but also reflected design and implementation problems. Most of the programs negotiated from 1988 onward suffered from overoptimistic assumptions regarding the path of exports, GDP, and domestic savings/investment growth. They also proved to be unrealistic about the pace and breadth of the structural reform agenda that was likely to be implemented by the government, including in the area of tax reform. While it is difficult to distinguish between failure to implement agreed policies from ex ante overoptimism about key economic variables, there is little doubt that limitations on implementation ability were not fully taken into account in the program design, and the reform agenda was not sufficiently prioritized. Ex ante overoptimism was also important as some of the programs were based on projections (e.g., for tax revenues and exports) that would have been difficult to achieve even with full implementation of agreed policies.

3. A basic problem was that successive governments had limited ownership of the programs and were often unable to sustain the reform and adjustment effort for more than a short period of time. As a result, some of the policy prescriptions of the programs, implemented in isolation from other equally important parts of the agenda, turned out to have adverse side effects (e.g., the net revenue shortfall—leading to excessive expenditure compression—

caused by the substantial lag between the fall in revenues associated with import tariffs cuts and the full effectiveness of domestic tax reforms). Although there were limits to what an external agency could achieve in such circumstances, not all of the mitigating devices at the disposal of the IMF were utilized consistently, such as track record requirements, front-loading the adjustment effort while back-loading the disbursement of funds, or focusing conditionality on a few truly key objectives and pursuing them unwaveringly.

4. Programs with Pakistan had more than the average number of structural conditions, but this structure was not effective in overcoming weak political commitment and some of the conditions were not well integrated into program design. The history of the largely unsuccessful attempts to impose conditionality in the area of agricultural income taxation is an important example; a number of prior actions were met, but without a significant effect on the program's prospects and without yielding any significant advance in taxation of agricultural incomes. Moreover, the perception that the IMF would resume financing within a relatively short time whenever programs went off-track appears to have undermined incentives to undertake difficult adjustment decisions, especially in the fiscal area. However, the most recent programs (from late 1997 onward) do indicate some learning over time.

5. Most of these design and implementation problems had their roots in institutional factors. In particular, decisions regarding the IMF's involvement in Pakistan appear to have been heavily influenced by geopolitical considerations; the presumption of a short- to medium-term involvement only; the obligation to give IMF member countries the benefit of the doubt which, in combination with relatively frequent changes of government, contributed to many programs in succession; and collaboration with the World Bank that did not always produce an effective integration of priorities and time frames in dealing with key structural issues. As in other countries under program, IMF surveillance tended to be crowded out and, in particular, failed to give sufficient attention to the long-term implications of short-term stabilization measures for the sustainability of adjustment, to flag downside risks, and to highlight sufficiently the buildup of major vulnerabilities in the capital account (associated with the foreign currency deposits). Finally, as in many other prolonged use cases, there were too few occasions when the IMF was able to "step back" and reconsider the overall strategy on the basis of candid assessments of previous programs.

6. The main lesson to be derived from this experience is the need for greater selectivity, based on candid ownership assessments before committing the IMF's resources, along with greater efforts to tailor

program design to the specific circumstances and long-term needs of the country, focusing especially on key institutional changes.

### Philippines

7. The *Philippines* is the most extreme case of the prolonged use of IMF resources, with 23 programs between 1962 and 2000. The near-continuous involvement of the IMF in the 1960s and 1970s did not prevent an unsustainable debt buildup, which culminated in the early 1980s' debt crisis. In this period, the IMF was dealing with a very difficult situation, epitomized by deep-seated governance problems. Although program design did not address many of the key structural problems, a lack of political commitment was the core issue, and in the circumstances, it would have been better for the IMF to have refrained from lending.

8. In the ten years following the 1983 debt crisis, the Philippines underwent a protracted adjustment process along with the restructuring of debt by private and official creditors tied to a succession of IMF-supported programs. As this process was completed, an EFF that was explicitly intended as an "exit program" was agreed in 1994, but before it could be completed it was overtaken by the Asian crisis. Subsequently, the IMF's program engagement lasted until 2000, even though there were growing problems with governance and doubts about political commitment after the Estrada administration took office in 1998. Since 2000, the Philippines has been engaged in post-program monitoring with the IMF.

9. IMF-supported programs did encourage macroeconomic discipline and did assist in the substantial transformation of the Philippine economy that occurred between the mid-1980s and the second half of the 1990s under the Aquino and Ramos administrations. Considerable progress was made in liberalizing the trade and exchange system, abolishing agricultural marketing monopolies, opening the economy to competition, and eventually deregulating oil pricing. However, many of these reforms took much longer to implement than originally planned, in part because some of the original time frames were overambitious and in part because, with the exception of some important periods when political leadership was strong, domestic ownership of the reforms did not extend to the legislative branch of government, which was critical for implementation. The 1989–91 EFF, in particular, had a reform agenda that proved overambitious in retrospect. A few long-standing and critical weaknesses, including a low saving rate and weak tax collection (despite a temporary improvement in the first half of the 1990s) remained unresolved at the end of the period and contributed to prolonged use. Despite some progress, the incidence of poverty remained high.

10. The IMF's long involvement in the Philippines reflects a number of factors, including a difficult starting position; "seal of approval" influences; program design and implementation problems (especially difficulties of matching the time frame of longer-term institutional reforms to shorter-term programs); and fluctuations in the degree of political commitment to and ownership of economic reforms. Toward the end of the period, the rationale for program involvement seems at times to have been too broad, reflecting the perception that surveillance was not an effective instrument for some tasks. Thus, efforts to encourage reforms and reformers or to bind an incoming administration to "sound" macroeconomic policies appear to have been important factors behind continued programs, even when a balance of payments need had become questionable.

11. Institutional constraints on implementation, particularly the Philippines' congressional-style political system, posed special challenges for program design and required structural conditionality to be exercised flexibly, primarily through reviews. This was probably the correct approach, but combined with the tacit understanding that the program relationship was likely to continue for an extended period, there was a tendency to "overpromise" to meet the requirements of short-term programs in the belief that recontracting would be possible. This led to some erosion of the credibility of conditionality. For some elements of reform—such as tax administration, where repeated efforts yielded some results in raising the tax effort, but which were ultimately not sustained—it would have been preferable if a longer time frame had been adopted from the start, combined with a greater emphasis on strengthening implementation capacity, and more direct attention to governance concerns. While there were more efforts at ex post assessment of programs than in the other two country cases, not all of the results of these assessments were conveyed to the Executive Board.

### Senegal

12. Except for a nearly two-year period during 1992–93, *Senegal* has had a continuous succession of IMF arrangements since 1979. From 1986, the bulk of IMF lending to Senegal has been under multi-year arrangements supported by resources from the IMF's concessional facilities—one SAF and three ESAF/PRGF.

13. The main reasons for Senegal's prolonged use of IMF resources include (i) large initial imbalances, deeply rooted in structural weaknesses of the economy, which were likely to require a long time to address in a sustainable manner; (ii) a broadening of objectives of programs, in step with the evolution of the SAF to the ESAF and the transformation of the ESAF

into the PRGF; (iii) the use of IMF arrangements as a seal of approval for the provision of external finance by several multilateral and bilateral creditors and donors, combined with an approach to dealing with the debt problem that only brought about a resolution gradually; (iv) weaknesses in program design—in particular, the pre-1994 programs were too optimistic about how effective the adjustment strategy being pursued would be in promoting growth and sustainable financial viability; and (v) a stop-go pattern of program implementation that weakened the effectiveness of programs and contributed to the continuing “need” for IMF arrangements.

14. Successfully implemented programs tended to be characterized by strong political commitment (regardless of the precise nature of conditionality), significant upfront adjustment measures, and adaptations of policies during program reviews when there were substantial actual or prospective deviations from targets (usually fiscal targets). In the cases where implementation was weak, contributory factors included election cycle pressures that led to delays in implementing measures or sometimes to policy reversals.

15. IMF policies aimed at containing the phenomenon of prolonged use—such as reduction in access levels in successive arrangements, comprehensive ex post assessment of programs, and the formulation of “exit” strategies—were not applied consistently to Senegal. The rules on declining access levels were applied, although the country enjoyed slightly above average access levels in its three ESAF/PRGF arrangements. Ex post assessments were undertaken to some extent, although the most recent example, a country strategy paper prepared in 1998, did not draw lessons for program design from the nonimplementation of reforms under previous arrangements. On the issue of an “exit strategy,” we found no evidence that the issue of “graduation” from IMF-supported programs has been discussed internally or with the authorities in any systematic manner.

16. Key lessons for improving the effectiveness of Senegal’s IMF-supported programs include (i) the need to foster greater ownership of structural reforms; (ii) capacity constraints and measures for improving implementation should be articulated more clearly; (iii) in order to help programs adapt better to uncertainty, the principal risks and how policies would adapt to them should be set out more explicitly; (iv) Bank-Fund collaboration needs to improve to address fundamental institutional/structural issues at the heart of prolonged use; and (v) surveillance discussions and reports should be used as an occasion to “step back” and reconsider the overall strategy, including stress-testing of major vulnerabilities and downside risks, and a discussion of alternative policy options and trade-offs.

## Morocco and Jamaica

17. *Morocco* is one of the few recent prolonged users to have “graduated.” After nine arrangements starting in 1980, it has had no program since 1993. Progress, while eventually substantial, was not smooth. Programs were initially overoptimistic about the time frame needed to restore external viability. There were setbacks from exogenous shocks and periodic slippages in implementation, but policies on core issues continued to move in the right direction, although not always at the pace envisaged by programs, in part reflecting the authorities’ concerns over political feasibility. For the most part, there seems to have been little difference in the IMF’s approach in Morocco compared with other prolonged users. The real difference seems to have been made by strong domestic ownership and political stability, rather than by the structure of conditionality, which was generally exercised flexibly through program reviews. The IMF and the authorities appear to have taken a narrower view of what would justify further program engagement than in some other prolonged users—for example, it is not clear that Morocco’s situation differed greatly at the time of its graduation from that of the Philippines.

18. *Jamaica* is a former prolonged user that made a decision, after its last EFF expired in 1996, not to seek further financial support from the IMF, although at that time it still faced large adjustment challenges. In particular, the authorities strongly rejected the IMF’s policy advice at the time that a major adjustment of the exchange rate was necessary to restore competitiveness and favored instead a strategy based on running high fiscal surpluses to prevent the debt dynamics from deteriorating further. In the staff’s view, earlier programs had been mainly motivated by the need to obtain foreign financing and debt relief, and the weak ownership that resulted was a major reason why programs had not achieved their objectives. The authorities’ move away from a financial arrangement with the IMF was associated with much stronger domestic ownership of macroeconomic policies, which proved critical to firmer implementation of their chosen strategy. Jamaica remained able to access international capital markets at fairly low spreads, despite the absence of an IMF arrangement. In 2000, staff monitoring of the authorities’ economic program was agreed, and this has played a useful role, allowing room to combine a strong domestic policy formulation process with a healthier policy dialogue with the IMF—while providing a signal to donors and lenders, particularly the multilateral development banks, about the adequacy of the macroeconomic framework.

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**Part I**  
**Main Report**

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# CHAPTER 1

## Introduction

1. In recent years, the IMF has been at the center of an array of criticism concerning the adverse side effects of its interventions in the countries that it supports financially, the effectiveness of the economic programs that form the basis for this support, and even its very role in today's international financial system, with the fiercest critics arguing that it has outlived the mission for which it was created. While the criticism is extensive, it is not unanimous and there are many who recognize that the IMF has an important role to play in promoting stability in the international financial system and especially in helping member countries manage balance of payments problems in a manner consistent with the pursuit of other economic objectives.

2. The purpose of the Independent Evaluation Office is to undertake independent studies, which will further the objectives of strengthening the learning culture of the IMF and contribute to transparency by providing objective assessment of the effectiveness of IMF activities in various fields. This study, which is the first report of the IEO, focuses on the phenomenon of prolonged use of IMF resources by a number of countries. It is an issue that is closely related to the broader debate about the IMF's role and has been the subject of external criticism and also internal concern.

3. External observers have criticized prolonged use from a number of perspectives, suggesting that:<sup>1</sup>

- It contradicts the IMF's mandate as set forth in the Articles of Agreement, which stress that IMF resources should be made available to members "temporarily"<sup>2</sup> to cope with balance of payments disequilibria.

<sup>1</sup>Both the main criticisms and their counterarguments have been presented in more detail in the terms of reference of this paper, published on the IEO's website ([www.imf.org/ieo](http://www.imf.org/ieo)) on March 15, 2002. In this report, the terms "prolonged use" and "repeat use" will be interpreted to mean the same thing. (See Chapter 2.)

<sup>2</sup>Such temporariness is dictated by the need to ensure the revolving nature of IMF resources.

- It suggests a lack of effectiveness of IMF-supported programs, as the repeated need to make use of IMF resources indicates a persistence of the balance of payments difficulties which such programs are intended to solve (Meltzer and others, 2000; and Vásquez, 1999). In recent years, some critics have argued that lack of ownership, leading to poor program implementation, and program design flaws are key factors underlying the lack of effectiveness of IMF-supported programs and therefore a root cause of prolonged use.
- It may encourage overindebtedness because a prolonged "IMF seal of approval" encourages overlending in an environment where there is insufficient attention to debt sustainability (Bandow and Vásquez, 1994); in heavily indebted countries it could reflect a strategy of "defensive lending" by the IMF and other multilaterals to avoid default (Birdsall and others, 2001); and
- It may hinder institutional development in the borrowing countries by giving the IMF an overly intrusive presence in their policymaking process, thereby compromising the development of responsible, democratic institutions that correct their own mistakes and respond to changes in external conditions (Meltzer and others, 2000).

4. The issue of prolonged use has been discussed in the Executive Board on several occasions. These discussions have brought out several arguments suggesting that frequent recourse to IMF arrangements is less of a problem than critics contend and in any case it may take place for good reasons and be fully compatible with both the IMF's mandate and a broadly defined sense of economic efficiency:

- This could be the case for countries subject to frequent external shocks and for countries where external imbalances have deep-seated structural causes, which cannot be overcome over the short term, or only at a great cost to economic prosperity—an outcome IMF-supported programs are specifically intended to avoid. The

latter category could include many low-income and transition economies.

- Since the mid-1980s, most IMF arrangements intended to tackle the latter kind of balance of payments difficulties for low-income countries have been funded from special accounts (i.e., the SAF, ESAF, and PRGF) and consequently have not exerted pressure on the revolving nature of general resources.<sup>3</sup> Besides, it has been argued that the views of the official international community on the appropriate length of IMF financial involvement have changed over time, at least for the low-income group of countries, and the IMF has been given a mandate to provide support, via the PRGF, for programs intended to foster growth and poverty reduction over a longer time horizon.
- Prolonged use of IMF-supported programs may simply reflect the unwillingness of other lenders (be they private or public) to provide financing without the “seal of approval” they consider an IMF-supported program to be. This raises important questions with regard to the appropriate balance between the IMF’s lending and surveillance activities.

5. This evaluation investigates the issue of prolonged use by addressing three broad sets of questions. First, how extensive is prolonged use and what are its consequences for borrowing countries and the IMF? Second, to what extent is the phenomenon an inevitable consequence of conscious decisions made by the shareholders regarding the IMF’s role in the changed international environment? Third, to what degree can it be accounted for by shortcomings in the design of IMF-supported programs and how could the effectiveness of the programs be improved? We find that both systemic factors associated with the IMF’s role and program design and implementation issues have contributed to the extent of prolonged use. In addition, the topic of prolonged use touches upon many aspects of the IMF’s operations; in undertaking the evaluation we have identified a number of issues that, while germane to this topic, are of much broader relevance.

6. The evaluation has relied upon a combination of methodological approaches, including (i) empirical and econometric analysis of a wide range of prolonged users, taken both as a whole and in various relevant groupings; (ii) detailed case studies of three country cases (Pakistan, the Philippines, and Senegal) that have been among the most prolonged users

of IMF resources and illustrate different aspects of prolonged use. These case studies have involved country visits to seek the views of the authorities and a wide range of other stakeholders;<sup>4</sup> detailed reviews of both internal and publicly available IMF documents; and interviews with relevant IMF staff, management, and Executive Directors; (iii) more limited desk reviews of two countries (Jamaica and Morocco) that appear to have “graduated” from IMF financial support, drawing on IMF documents and interviews with staff and some senior officials; (iv) written submissions by the authorities in a number of prolonged use cases responding to an IEO questionnaire on specific issues; and (v) responses received to IEO questionnaires sent to official donors and creditors, members of the private financial sector, and a broad range of IMF mission chiefs designed to seek their views on a range of issues including the broader institutional framework and incentives that influence decisions on programs. In the empirical work, we have made a distinction, wherever possible, between prolonged use of general and concessional resources, since expectations of the IMF’s role are, to some extent, different for the two groups.

7. We relied heavily upon existing databases for all our quantitative analyses. In addition to general databases on economic indicators (including that maintained for the World Economic Outlook), we used internal IMF databases on programs (e.g., the database on the monitoring of arrangements—MONA—and those on IMF arrangements and financial transactions), as well as those set up on an ad hoc basis for policy reviews or working papers (e.g., databases on waivers and structural conditionality, both created in early 2001). We faced a number of difficulties in using these databases: in addition to time frame limitations, we found a number of gaps and inconsistencies between databases compiled from different sources as well as, occasionally, between the databases and program documentation. Whenever possible, we corrected these inconsistencies. However, it is clear that a further strengthening of the MONA database in particular is needed to help improve the basis for internal and external ex post assessments. We make a recommendation to this effect in Chapter 8.

8. The three countries chosen for the detailed case studies illustrate different aspects of prolonged use. The Philippines had had the longest involvement with IMF-supported programs, stretching back to the early 1960s, with only relatively brief interruptions until it finally exited from such programs in 2000. It

<sup>3</sup>To the extent that the PRGF Trust is expected to be self-sustaining at some point, concessional resources would also need to be revolving.

<sup>4</sup>A list of those with whom the evaluation team had discussions in the case study countries is given in Part II.

has used only the IMF's general resources. Pakistan had repeated, but discontinuous, use of IMF resources during the period 1970–88 and, since 1988, has had a long series of arrangements—almost all of which suffered from substantial policy slippages and soon went off-track. The only exception was the 2000 Stand-By Arrangement, which was completed as scheduled. Pakistan has used both general and concessional resources and is currently implementing a PRGF-supported program. Senegal has had an almost continuous succession of IMF arrangements since 1979, except for a nearly two-year period around 1992–93 (i.e., prior to the devaluation of the CFA franc). Periods of strong adjustment have been interspersed with periods of policy slippages, often around electoral cycles. Since 1986, it has used primarily concessional resources, although it has also used a number of Stand-By Arrangements, either to supplement access levels or as a transition to multi-year arrangements.

9. The mandate of the IEO is to evaluate the operations of the IMF, not the policies or actions of country authorities. Hence, the focus of this paper is on the former. This does not mean that we believe all of the reasons for prolonged use lie within the IMF, or that full implementation of our recommendations would eliminate all of the problems in the countries themselves that have contributed to a sometimes prolonged and difficult adjustment process. But

these issues are clearly the responsibility of the countries concerned.

10. The organization of the report is as follows. Chapter 2 proposes a definition of prolonged use and discusses its extent; Chapter 3 summarizes the policy discussions that have taken place within the IMF with respect to prolonged use and the strategy that evolved for dealing with it. Chapter 4 examines the characteristics of the prolonged users. Chapter 5 discusses the lessons from the prolonged users for the effectiveness of IMF-supported programs, drawing on both cross-country evidence and the country case studies. Chapter 6 discusses a number of issues concerning IMF governance raised by the phenomenon of prolonged use, including the appropriate balance between IMF surveillance and lending arrangements. Chapter 7 discusses a number of other implications of prolonged use for the borrowing countries and for the IMF. Chapter 8 summarizes the main conclusions of the report and makes recommendations geared to limiting the scope of prolonged use and reducing its drawbacks as well as for improving the overall effectiveness of IMF operations. Supplementary material to several of the chapters is provided in the appendixes. The detailed country case studies for Pakistan, the Philippines, and Senegal, as well as the shorter case studies of Jamaica and Morocco, are presented in Part II.

## CHAPTER 2

# What Is Prolonged Use and How Widespread Is It?

### What Is Prolonged Use of IMF Resources?

1. There is no official or generally agreed definition of prolonged use of Fund resources (UFR). In previous studies, undertaken both within and outside the IMF, prolonged UFR has been characterized in several different ways, focusing either on the number of years spent by a country under IMF-supported programs—in some cases approximated by the number of IMF-supported programs entered into—or on the length of time a country has outstanding obligations to the IMF. Annex 1 discusses the most commonly used definitions in more detail.

2. In the current project, the definition used is based on the concept of “time under arrangement”<sup>1</sup>: countries are defined as prolonged users if they have been under arrangements for at least 7 years out of any 10.<sup>1</sup> This concept was preferred to other alternatives mainly because it is more homogeneous across lending instruments (since a single IMF “lending arrangement” can vary in length and repayment period, depending upon the particular facility used). It permits the use of a single threshold for all member countries, regardless of the types of facility used.<sup>2</sup> Moreover, focusing on “time under arrangement” goes to the heart of issues such as program design, ownership, and conditionality.

<sup>1</sup>This definition is applied in two different ways in the report, depending on the type of analysis undertaken and the nature of the question being addressed: in one case, prolonged users (PUs) are treated as an invariant group that includes all the countries that met the 7 out of 10 years criterion at least once over the 1971–2000 period (i.e., a “fixed” definition); in the other case, the composition of the PU group varies each year, as it includes only the countries that met the criterion in that particular year (i.e., a “dynamic” definition).

<sup>2</sup>Short-term arrangements (SBAs) typically span 12 to 18 months, with no minimum and a maximum length of three years, whereas medium-term arrangements (under the EFF, SAF, and ESAF/PRGF) cover a three-year period. Repayment periods have been markedly differentiated across lending facilities, in order to take account of the different speeds at which various countries can be expected to return to balance of payments viability: from 2½ years for the SRF to 10 years for the EFF and PRGF.

3. The threshold of 7 years in any 10, which is higher than in previous reviews of the phenomenon, was chosen so that any country with just two three-year arrangements (EFF or ESAF/PRGF) in a decade, or a combination of a few Stand-By Arrangements with one medium-term arrangement, would be classified as a “temporary” user, not as a prolonged user.<sup>3</sup> This relatively high threshold means that some countries classified as “temporary” users might have made relatively frequent and/or protracted use of IMF resources.

4. The 2000 Review of Fund Facilities made a distinction between “repeat users”—that is, countries with many programs but where effective use of IMF resources was relatively low because the programs went off-track quickly—and “prolonged users”—that is, countries that made greater effective use of the IMF resources. The former type is represented in our country case studies by Pakistan and raises the most serious questions about program implementation and ownership. The latter type is, to some extent, closer to the examples of the Philippines and Senegal and raises questions about the appropriate length of IMF program involvement in cases with protracted adjustment difficulties and about the revolving nature of IMF resources. In general, however, the empirical evidence suggests no sharp dividing line between the two types and, for the purposes of this evaluation, the terms “prolonged use” and “repeat use” will be used to mean the same thing.

5. Moreover, neither the choice of concept on which to base the definition of prolonged use, nor the choice of threshold, has a major impact on the general trends observed, either as regards the extent

<sup>3</sup>However, unlike the definition used in previous IMF reviews, the proposed definition does not impose any threshold on the outstanding use of IMF resources at the end of the period. This is in order not to exclude countries that have repaid all or most of their outstanding obligations to the IMF and in that sense have subsequently “graduated” from IMF support. The terms “prolonged user” and “temporary user” (i.e., all those not counted as prolonged users) are employed as a convenient terminology for purposes of this evaluation. Under the IMF’s Articles of Agreement, all use of IMF resources is supposed to be temporary.

**Table 2.1. List of Prolonged Users at Some Time During 1971–2000<sup>1, 2</sup>**

Countries that would be classified as prolonged users excluding precautionary arrangements (44)		Countries that would be classified as prolonged users only if precautionary arrangements were included (7)
Argentina	<i>Malawi</i>	Costa Rica
Bangladesh	<i>Mali</i>	Egypt
Benin	<i>Mauritania</i>	El Salvador
Bolivia	Mexico	Korea
Bulgaria	<i>Mongolia</i>	Latvia
Burkina Faso	Morocco	<i>Liberia</i>
Congo, Dem. Rep. of	<i>Mozambique</i>	Uruguay
<i>Côte d'Ivoire</i>	<i>Nicaragua</i>	
Ecuador	<i>Niger</i>	
<i>Equatorial Guinea</i>	<i>Pakistan</i>	
Gabon	Panama	
<i>Gambia, The</i>	Peru	
<i>Ghana</i>	Philippines	
<i>Guinea</i>	Romania	
<i>Guyana</i>	<i>Senegal</i>	
<i>Haiti</i>	<i>Somalia</i>	
<i>Honduras</i>	<i>Tanzania</i>	
Jamaica	<i>Togo</i>	
Jordan	Turkey	
Kenya	<i>Uganda</i>	
<i>Kyrgyz Rep.</i>	F.S.R. of Yugoslavia	
<i>Madagascar</i>	<i>Zambia</i>	

<sup>1</sup>Figure 2.1 summarizes in graphic form the history of lending arrangements of the countries listed here. The vast majority of these countries were still under program at the end of the period. Of the 13 countries which were not, 4 countries (the Democratic Republic of Congo, Liberia, Somalia, and the Federal Socialist Republic of Yugoslavia) were no longer eligible to use IMF resources at the end of the period (the first three because of arrears to the IMF and the fourth because it was dissolved).

<sup>2</sup>Countries in italics are PRGF-eligible. However, a large part of the resources made available to them over that period came from the General Resources Account (GRA).

of the phenomenon of prolonged use or its evolution over the last three decades.<sup>4</sup> Settling on a specific definition was necessary in order to identify a list of countries on which to conduct quantitative analyses, but the general conclusions reached do not seem very sensitive to the precise definition.

## Extent and Evolution of Prolonged Use over 1971–2000

### Trends in prolonged use over 1971–2000

#### Scope of prolonged use

6. Out of 128 countries that made use of IMF resources during the 1971–2000 period,<sup>5</sup> 51 countries

<sup>4</sup>We reached this conclusion after mapping out prolonged use based on the alternative concept of number of IMF arrangements entered into, by including or excluding precautionary arrangements within the total for each country, and by raising or decreasing the “time under program” threshold by one year. Figure 2.1 below as well as the figures presented in Annex 1 broadly illustrate that point.

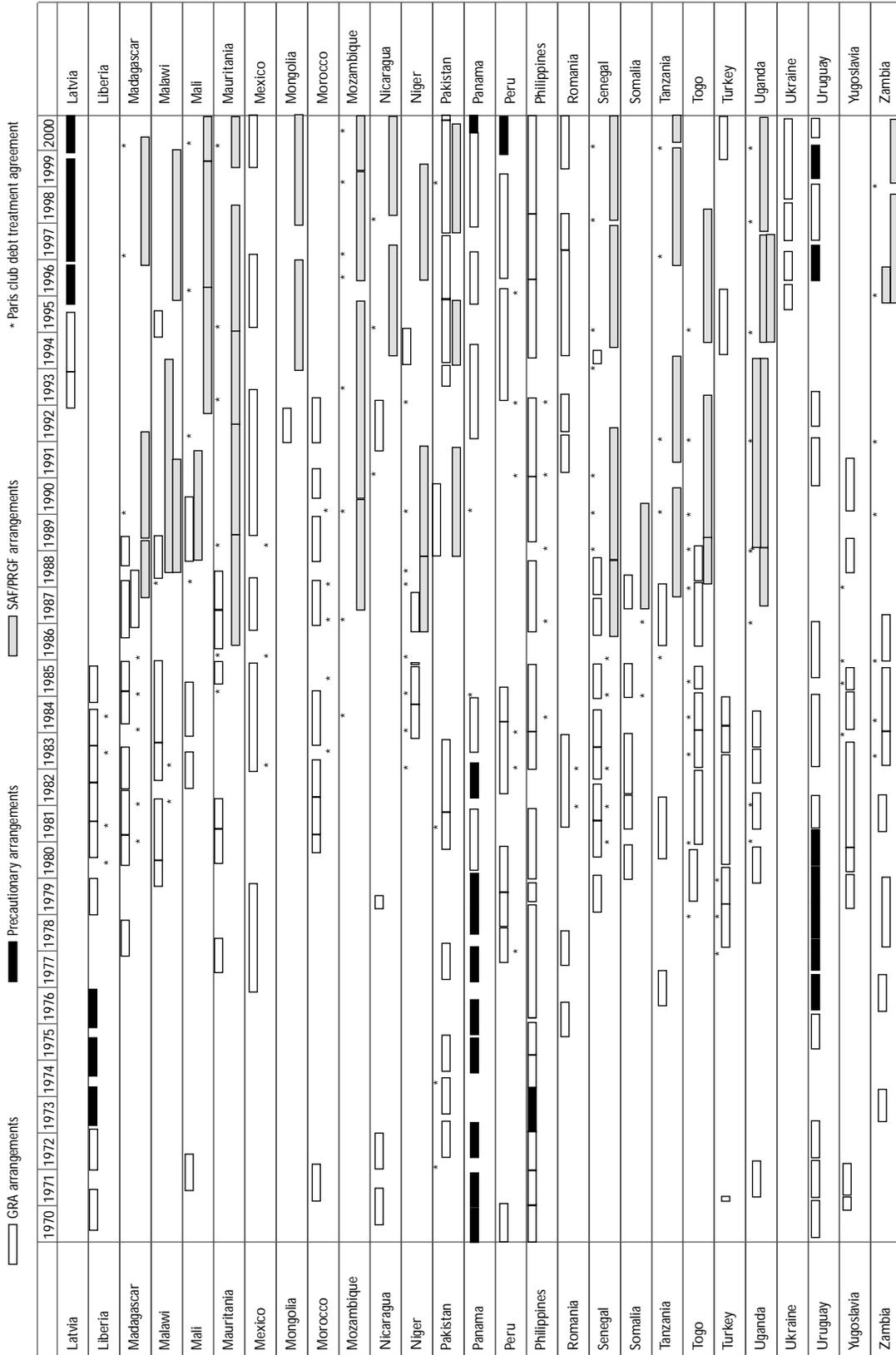
<sup>5</sup>This excludes countries whose UFR consisted exclusively of “outright purchases,” that is, was not associated with a lending arrangement or program (e.g., first credit tranche purchases).

meet our definition of prolonged use at some time during the period (44 countries if precautionary arrangements are excluded) (Table 2.1).<sup>6</sup> Prolonged users are predominantly—but by no means exclusively—low-income countries with little or no access to private capital markets. For example, in the group of prolonged users excluding precautionary arrangements, 29 of the 44 prolonged users are eligible for the IMF’s concessional facility (henceforth, PRGF-eligible) (Figure 2.1).

<sup>6</sup>So-called “precautionary” arrangements are the same as other IMF arrangements except that the authorities have indicated that they do not intend to draw on the resources made available. Even though that commitment is never binding, to the extent that it is observed, these programs do not reflect any actual balance of payments need nor involve any actual use of IMF resources. However, the program negotiation and Board approval process is identical, and the committed resources can be drawn upon if the authorities so wish, and indicate they have a balance of payments need; therefore the resources are not available for lending to other members. A significant number of precautionary arrangements were eventually drawn upon. Therefore, for completeness, the tables in this chapter identify those countries that would be classified as prolonged users if precautionary arrangements were included in the definition, but not otherwise. Arrangements under the ESAF/PRGF cannot be precautionary.



Figure 2.1 (concluded)



7. Nearly 40 percent of prolonged users made an intensive use of the IMF's general resources, in the sense that they had outstanding obligations to the General Resources Account (GRA) of over 100 percent of their quota for 10 years or more (Table 2.2). When both general and concessional resources are taken into account, more than half the countries had average outstanding liabilities over the 30-year period in excess of 100 percent of their quota, that is, they made both long and large use of IMF resources.

### *Evolution of prolonged use over time*

8. Prolonged use is neither a recent nor a rare phenomenon and contrary to what previous internal reviews, which focused on the use of the IMF's general resources, have suggested, it is also not one that is diminishing in importance. As indicated in the 1991 and 2000 reviews, prolonged use started to build up in the second half of the 1970s and accelerated sharply in the first half of the 1980s as a result of the debt crisis. Thereafter, the establishment of concessional facilities resulted in a large shift of prolonged users from the general to the concessional window, so that by 1990 the number of prolonged users of general resources had fallen dramatically. Prolonged use, thus defined, rose again slightly in the 1990s, partly due to the intensive involvement of the IMF in "transition" countries.

9. However, an analysis of prolonged UFR that does not limit itself to the General Resources Account (GRA) leads to different conclusions. First, the decline in the scope of the phenomenon that occurred in the late 1980s is largely cosmetic, since five of the countries previously characterized as prolonged users fell into arrears and were declared ineligible for further borrowing from the IMF,<sup>7</sup> and most of the others had become prolonged users of concessional resources. In fact, prolonged use, according to the definition used in this evaluation, has consistently expanded since the late 1970s. In terms of the number of countries, most of the expansion was in PRGF-eligible countries, but in terms of financial obligations, the expansion in prolonged use of general resources was greater (Figure 2.2).<sup>8</sup>

<sup>7</sup>These are the four countries mentioned in footnote 1 of Table 2.1, plus Zambia, which has subsequently regained eligibility.

<sup>8</sup>Outstanding obligations are shown according to whether or not a country is PRGF-eligible, not according to the nature of resources at stake. The figures are based on the "dynamic" definition of prolonged use, so that prolonged users' outstanding obligations in each year are taken into account only if they qualify as

10. Furthermore, the increase in the overall number of prolonged users exceeded the pace of increase of the number of countries making use of the IMF's resources. As a result, while prolonged users represented a little over 10 percent of users of IMF resources in the late 1970s, that proportion had gone up to over 30 percent in 2000, with an even higher proportion of PRGF-eligible countries (40 percent, against a little over 20 percent for GRA-only borrowers). The share of prolonged users in total resource commitments has also tended to increase over time, reaching 60 percent of PRGF resources and a little over 20 percent of general resources in 2000. (See the figures in Annex 1 for more details.)

### *Persistence of prolonged use*

11. The persistence of prolonged use is substantial: almost 40 percent of countries that became prolonged users in the second half of the 1980s were still in that group in 2000, and 60 percent of countries that were prolonged users in 2000 had joined that group prior to 1995. Moreover, over 1970–2000, the average length of episodes of prolonged use was 10 years, and even this indicator underestimates the eventual length since the majority of countries characterized as prolonged users were still in that category in 2001.<sup>9</sup>

12. Further evidence of the persistence of prolonged use is provided by the small number of "graduates," that is, prolonged users that have ceased to make use of IMF resources. Of the 51 countries that have been prolonged users at some time between 1971 and 2000, just 12 had less than 25 percent of quota outstanding at the end of May 2002.<sup>10</sup> It is also striking that only 15 of the 51 prolonged users did not have active arrangements with the IMF at some point in 2001–02 and this includes 3 countries that were in substantial arrears to the IMF and were therefore ineligible for such arrangements.

13. Another indication of the extent of prolonged use is found in Jeanne and Zettelmeyer (2001), who measure the time frame in which IMF members eliminate outstanding obligations to the Fund—after taking

prolonged user in that year. For example, Ecuador's obligations in 1999 are not taken into account because it did not qualify as a prolonged user in that year.

<sup>9</sup>This average is the same in the GRA-only and PRGF-eligible groups.

<sup>10</sup>Bangladesh, Costa Rica, Egypt, El Salvador, Equatorial Guinea, Haiti, Jamaica, Korea, Latvia, Morocco, Panama, and Mexico. Of these, Costa Rica, Egypt, El Salvador, Korea, and Latvia only qualify as prolonged users if precautionary programs are taken into account.

Table 2.2. Intensity of Use of IMF Programs, 1971–2000

Country	Time under program <sup>1</sup> (years)		First year under program (in period)	Last year under program (in period)	Number of programs		Percent of partially disbursed programs <sup>1</sup>	Use of Fund credit (GRA) (Years with outstanding obligations)			Outstanding credits and loans as of Dec. 2000 <sup>2</sup>
	Of which precautionary				GRA	Non-GRA		Over 100 percent of quota	Over 200 percent of quota	Average outstanding credits and loans <sup>2</sup>	
Philippines	24.7	1.0	1971	2000	16	0	60	24	4	172	177
Panama	20.8	10.0	1971	2000	17	0	50	13	8	110	24
Pakistan	20.1	0.0	1972	2000	12	3	80	13	4	146	114
Haiti	20.1	5.0	1971	1999	13	2	80	5	0	70	50
Senegal	19.8	0.0	1979	2000	9	4	23	13	1	174	121
Guyana	19.8	4.0	1971	2000	11	3	100	12	7	138	99
Kenya	19.2	1.0	1975	2000	9	4	67	13	6	160	36
Uganda	18.4	0.0	1971	2000	5	4	30	8	5	167	134
Madagascar	18.2	0.0	1978	2000	8	3	64	9	6	114	65
Uruguay	18.2	6.2	1971	2000	16	0	44	3	2	69	37
Jamaica	18.1	0.0	1973	1996	12	0	67	19	11	184	17
Mauritania	17.3	0.0	1977	2000	6	4	36	5	0	116	117
Mali	17.3	0.0	1988	2000	5	4	27	4	0	103	144
Malawi	17.2	0.0	1979	1999	6	3	55	11	7	160	91
Togo	17.2	0.0	1979	1998	7	3	70	5	0	96	73
Argentina	16.4	3.0	1976	2000	10	0	75	19	8	129	193
Bolivia	16.1	0.0	1973	2000	3	5	44	5	0	113	98
Côte d'Ivoire	16.1	0.0	1981	2000	6	2	83	10	8	151	130
Ghana	14.4	0.0	1978	2000	4	4	40	8	5	133	61
Guinea	14.3	1.0	1982	2000	0	3	50	0	0	60	81
Mexico	13.8	0.0	1977	2000	6	0	67	18	13	182	0
Zambia	13.7	0.0	1973	2000	7	3	70	19	15	200	179
Tanzania	13.3	0.0	1976	2000	2	4	57	7	1	106	125
Peru	13.3	1.5	1971	2000	9	0	100	23	4	135	67
Egypt	13.2	6.0	1987	1998	7	0	100	3	0	45	0
Gabon	13.1	2.0	1978	2000	6	0	20	4	0	43	46
Korea	13.1	4.0	1971	2000	12	0	57	16	14	225	273
Bangladesh	12.7	0.0	1974	1993	0	2	75	0	0	133	31
Honduras	12.5	2.0	1971	2000	4	2	17	5	2	78	128
Niger	12.4	0.0	1983	2000	4	2	33	5	1	92	86
Costa Rica	11.9	6.0	1976	1997	10	0	80	9	2	69	0
Romania	11.8	0.0	1975	2000	8	0	75	12	1	82	34
Gambia, The	11.7	0.0	1977	2000	3	3	50	6	1	102	45
Yugoslavia	11.5	0.0	1971	1991	9	0	44	n.a.	n.a.	n.a.	n.a.
El Salvador	11.5	7.0	1971	2000	10	0	25	0	0	33	0

Table 2.2 (concluded)

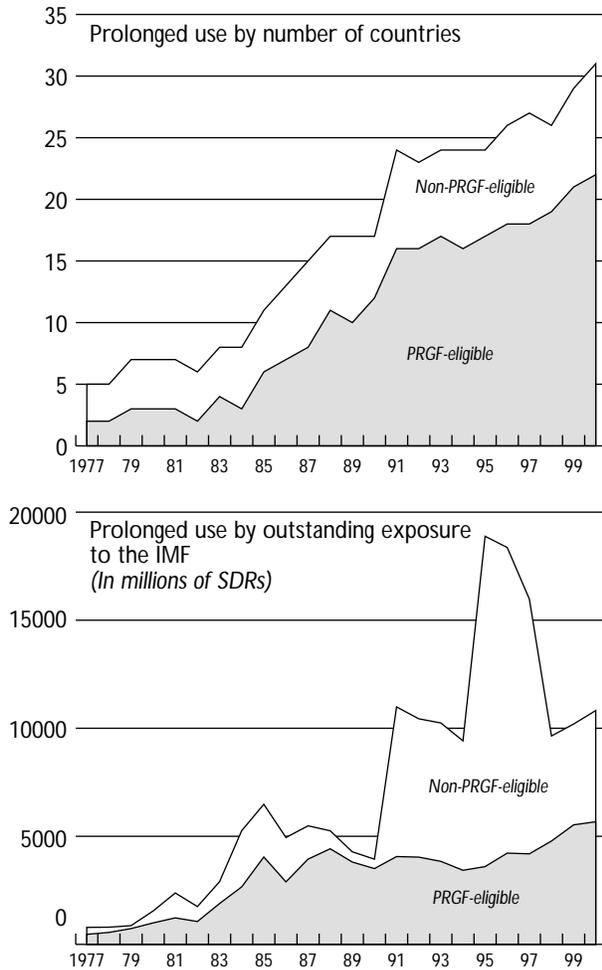
Country	Time under program <sup>1</sup> (years)		First year under program (In period)	Last year under program (In period)	Number of programs		Percent of partially disbursed programs <sup>1</sup>	Use of Fund credit (GRA)			Outstanding credits and loans as of Dec. 2000 <sup>2</sup>
	Of which precautionary	Non- GRA			GRA	Over 100 percent of quota		Over 200 percent of quota	Average outstanding credits and loans <sup>2</sup>		
Equatorial Guinea	11.0	0.0	1988	1996	2	2	60	0	0	40	12
Benin	10.7	0.0	1989	2000	0	4	33	0	0	50	104
Congo, Democratic Republic of	10.7	0.0	1984	1990	9	1	90	13	4	137	103
Liberia	10.3	3.0	1971	1985	11	0	50	20	19	219	315
Jordan	9.9	0.0	1989	2000	5	0	80	6	4	70	208
Morocco	9.9	0.0	1980	1993	10	0	60	16	8	127	0
Burkina Faso	9.8	0.0	1991	2000	0	4	50	0	0	47	143
Turkey	9.7	0.0	1971	2000	8	0	63	14	12	142	333
Ecuador	9.6	0.0	1971	2000	9	0	67	8	3	65	38
Mozambique	9.5	0.0	1987	2000	0	5	40	0	0	59	148
Nicaragua	9.2	0.0	1971	2000	4	2	80	1	0	32	100
Somalia	9.1	0.0	1980	1990	5	1	33	19	18	170	253
Mongolia	7.2	0.0	1991	2000	1	2	100	0	0	25	76
Kyrgyz Republic	7.1	0.0	1993	2000	1	2	50	0	0	38	163
Latvia	7.1	4.9	1992	2000	6	0	0	2	0	21	21

Sources: IMF Treasurer's Department; IMF Policy Development and Review Department; and IEO calculations.

<sup>1</sup>Time spent refers to the actual period covered by arrangements, whether or not a country was eligible to draw under the program. Only programs that were precautionary from the point of approval and were effectively treated as such are represented as precautionary.

<sup>2</sup>As a percentage of quota.

**Figure 2.2. Prolonged Use by Number of Countries and by Outstanding Exposure to the IMF**

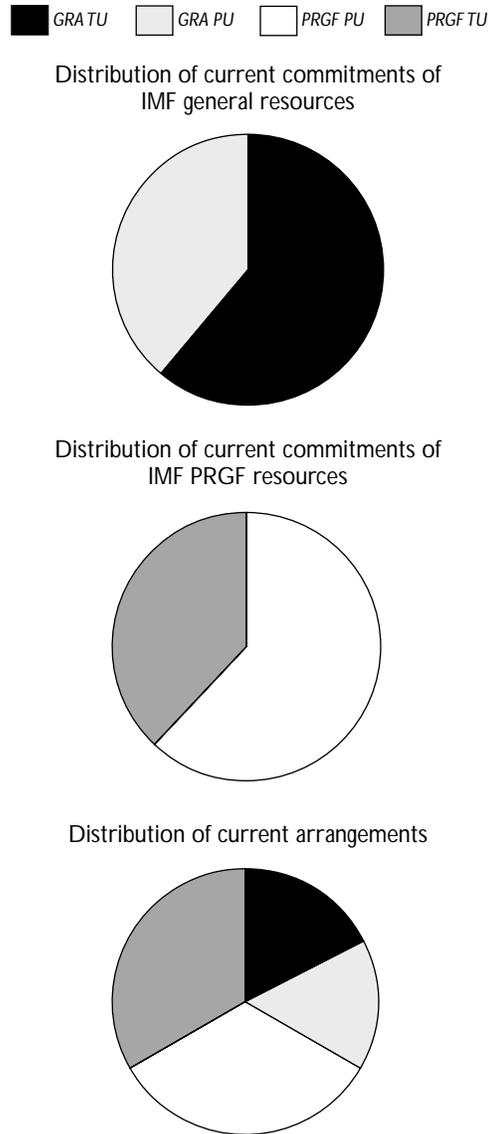


Sources: IMF Treasurer's Department and IEO calculations.

account of new lending.<sup>11</sup> They find that, for developing countries, about 40 percent of all the lending cycles initiated since the creation of the IMF were not completed at end-2000, and that the average length of such "incomplete" cycles is 18 years (see Table 1.1 in Annex 1). Not surprisingly, the proportion of uncom-

<sup>11</sup>In the absence of subsequent programs, the length of this time frame, which they call a "lending cycle," should be equal to the sum of the program and the repayment period, that is, a maximum of 13 years for an EFF or an ESAF/PRGF arrangement and 6½ years for an 18-month SBA. This concept would not be entirely satisfactory as the main basis for the definition of prolonged use, because it does not distinguish the respective contributions of repeat use and of the length of the repayment period (which can and has been increased by policy decisions).

**Figure 2.3. Distribution of Current Commitments of IMF Resources and Current Arrangements**



Sources: IMF Treasurer's Department and IEO calculations.

pleted lending cycles and their length is even higher for PRGF-eligible (and HIPC) countries. But they also find that 30 percent of emerging market countries<sup>12</sup>

<sup>12</sup>Defined as countries whose sovereign bonds are tracked in the J.P. Morgan Emerging Market Global Bond Index, which is an indication that they would normally be expected to have access to private market financing.

initiated a lending cycle prior to 1991 that was still incomplete at the end of 2000. The average length of time these countries had outstanding obligations to the IMF is about 21 years. Clearly, for these countries, IMF resources are revolving very slowly.

### **Prolonged use in 2001<sup>13</sup>**

14. A look at the extent of prolonged use in 2001 using the dynamic definition suggests that the incidence of prolonged use is important for both concessional and GRA resources. The largest number of prolonged users (22 out of 31) are accounted for by countries eligible for concessional resources. However, the exposure to prolonged users in the

<sup>13</sup>Data reported in this section refer to the situation as of December 31, 2001.

General Resources Account is much larger than in the PRGF Trust Fund (SDR 20.6 billion compared with SDR 3.5 billion).<sup>14</sup> Within each resource category, the incidence of prolonged use varies. Prolonged users account for 62 percent of the commitments of concessional resources. The proportion of GRA commitments absorbed by prolonged users in 2001 is lower at 37 percent but this is still substantial (Figure 2.3).

<sup>14</sup>Prolonged users in 2001 (i.e., countries that had IMF arrangements for seven or more years during the previous decade) were (i) Argentina, Bulgaria, Gabon, Jordan, Panama, Peru, the Philippines, Romania, and Ukraine (GRA-only borrowers); and (ii) Albania, Benin, Bolivia, Burkina Faso, Cameroon, Côte d'Ivoire, Ethiopia, Ghana, Guinea, Guyana, Honduras, the Kyrgyz Republic, Malawi, Mali, Mauritania, Mongolia, Mozambique, Nicaragua, Pakistan, Senegal, Tanzania, and Uganda (PRGF-eligible members).

# CHAPTER 3

## The Evolution of the IMF's Policies with Respect to Prolonged Use of Its Resources

1. This chapter describes how the IMF's policies with respect to prolonged use have evolved over time. It shows that these policies have moved gradually toward greater acceptance of the need to finance adjustment over a longer time period, especially in low-income countries, and that this has increased the probability of prolonged use. However, the implications of some of these changes both for the extent of prolonged use and possible adverse consequences may not have been fully and explicitly recognized. It also describes how some elements of a strategy for dealing with prolonged use were adopted by the IMF's Executive Board at various times; however, the country case studies and other evidence suggest that these strategies were not fully implemented.<sup>1</sup>

### Evolution of the IMF's View of Prolonged Use

#### Prolonged use of the IMF's general resources

2. The official interpretation of the mandate of the IMF was initially unambiguous on the temporary nature of its assistance, and policies on the use of Fund resources (UFR) reflected that interpretation. However, in the 1970s it became clear that even difficulties of a "temporary" nature could require a lengthy period of adjustment and this led in 1974 to the decision to create the Extended Fund Facility (EFF). Although the EFF recognized the need for a longer adjustment period, it was nevertheless expected that the economic program supported by an extended arrangement should be "adequate for the *solution* of the member's problem."<sup>2</sup> A further step was taken in 1981, with the institution of the enlarged access pol-

icy (EAP). This policy was intended to help members address balance of payments problems whose solution required "a relatively long period of adjustment and a maximum period for repurchase longer than the three to five years under the credit tranche policies."<sup>3</sup>

3. The creation of concessional facilities (the SAF in 1986 and the ESAF in 1987) reflected further endorsement of the idea that the adjustment process in low-income countries required an even longer time frame than implied by the EFF. However, the creation of concessional windows for the low-income countries also paved the way for a renewed emphasis on the temporary nature of the IMF's support in other countries. Thus, when the EAP was abandoned in 1992, its features related to the longer program and repayment periods were not retained in the new access policy, unlike those related to the magnitude of access to IMF resources. Subsequently, in 2000, a general review of IMF facilities led to the introduction of repurchase expectations, shorter than repurchase obligations, to signal the importance attached to the temporariness of the IMF's support, along with other incentives to encourage a faster repayment of outstanding credit by members in a position to do so.

#### Prolonged use of the IMF's concessional resources

4. When the SAF and ESAF were created, both were originally envisaged as one-off operations to support adjustment in low-income countries with protracted balance of payments problems, during a relatively short period and with limited resources.<sup>4</sup>

<sup>1</sup>Details on the various policies referred to in this chapter are provided in Annex 2.

<sup>2</sup>Executive Board Decision No. 4377-(74/144). Arrangements under the EFF would be for a period not exceeding 3 years, to be lengthened to 4 where appropriate, with a repayment period of 4½ to 10 years.

<sup>3</sup>Executive Board Decision No. 6783, para. 3, 6, and 10. Purchases made under the EAP were to be repaid within 7 years. This decision stressed the temporary character of the EAP, hence the requirement of annual reviews of the policy. However, the EAP was not allowed to lapse until 1992.

<sup>4</sup>As under the EFF, resources were to be committed in support of a three-year program, with a repayment period of 4½ to 10 years.

These facilities were not only concessional but also had a less demanding adjustment requirement than the EFF: specifically, programs supported by these facilities were not required to solve the balance of payments problem fully, but only to assure substantial progress in that direction. The original decisions establishing the facilities precluded the possibility of entering into more than one three-year arrangement with any single country, largely because of the limited availability of resources to fund the facilities and the short time frame set for the commitment period. This restriction was not entirely consistent with the recognition that the programs might not solve the problem within the time frame. It was gradually abandoned in several steps taken between 1990 and 1997, as experience showed that the initial estimate of the time frame needed for effective adjustment in low-income countries had proved overoptimistic, and also as more financing became available. However, the Executive Board consistently stressed that the purpose of these successive extensions was *not to provide a source of continuous financing for individual countries*, but rather to maintain the IMF's ability to respond to members' needs as they arose.<sup>5</sup>

5. A further step was taken in 1999, with the transformation of the ESAF into the PRGF and the close relationship established between the latter and countries' Poverty Reduction Strategy Papers (PRSPs), which are meant to provide a longer-term framework for donor support to low-income countries. This framework does not presume an extended IMF involvement but—unlike the case earlier—it does not rule it out, thus generating some ambiguity.

6. In part, this evolution reflected the understanding that the countries concerned were particularly vulnerable to exogenous shocks and were in need of continued IMF support for their macroeconomic policies. However, another factor was the growing pressure from official creditors and donors for an IMF-supported program with IMF monitoring, as a “seal of approval” for debt relief and donor support (see Chapter 6).

## Evolution of the Strategy Vis-à-Vis Prolonged Use

7. Each time prolonged UFR was discussed by the IMF Executive Board, Directors expressed concern not so much about prolonged use per se, but at the persistence of balance of payments imbalances in spite of protracted financial support from the IMF. This suggests that their primary concern was the inef-

<sup>5</sup>Cf. Chairman's summing-up of EBM/97/5, EBM/97/8, and EBM/97/10.

fectiveness of programs in achieving sustainable balance of payments adjustment. In each review, various remedial measures of increasing specificity were proposed by the IMF staff and endorsed by the Board. However, the Board consistently opposed imposing fixed limits on the length or extent of reliance on IMF support, out of concern that such limits might prevent the IMF from responding flexibly to members' needs as they arose. The Board also opposed endorsing any specific operational definition of prolonged use, owing to concerns that any definition would be arbitrary and assuming that good judgment would be sufficient to identify problematic cases of prolonged use. However, in practice, very few countries were even identified as prolonged users in staff reports to the Board,<sup>6</sup> which may account in part for the lack of consistent implementation of the guidelines approved by the Executive Board.

### Program design elements

8. All internal reviews of prolonged UFR identified inadequate program design and weak program implementation as key factors underlying prolonged use. The remedies envisaged focused on two aspects: the nature of conditionality and the extent of access.

### Conditionality

9. From 1985 onward, successive staff reports endorsed by the Board proposed dealing with prolonged use through (i) greater emphasis on prior actions and frontloading of policy measures, especially those related to past policy failures; (ii) a proactive use of conditionality—in particular, the use of more detailed conditionality covering structural aspects; and (iii) on a case-by-case basis, a tranching of the IMF financial support such that disbursements would be backloaded. In addition, the 1991 review recommended building policy contingencies into programs, along with IMF contingency financing if appropriate.

10. In fact, actual practice with regard to prolonged users did not correspond to the remedies suggested in the reviews (see Chapter 5).<sup>7</sup> Contrary to

<sup>6</sup>Based on a keyword search in the text of country reports recorded in the IMF's institutional repository, the only countries specifically characterized as prolonged, repeat, or long-term users in staff reports to the Board since 1983 are Argentina (2), Bulgaria (1), Cameroon (1), Côte d'Ivoire (1), Dominica (1), Jamaica (2), Malawi (1), Morocco (3), Pakistan (1), the Philippines (5), Senegal (1), and the Federal Socialist Republic of Yugoslavia (1). The figure in parentheses indicates the number of reports in which the terms above are mentioned.

<sup>7</sup>In assessing compliance with prolonged use guidelines throughout this chapter, for lack of a single officially recognized definition of countries to which these guidelines should be applied, we have used our own definition of prolonged use. Since it tends to be more demanding than the ones suggested by staff at

the policy directions endorsed by the Board, prolonged users as a group were actually subject to fewer prior actions and performance criteria, and even had slightly more frontloaded schedules of disbursement, on average, than “temporary” users.<sup>8</sup> However, as discussed in Chapter 5, there is little evidence that the extent of conditionality per se— as opposed to ensuring that it is well prioritized and integrated into program design—was an important determinant of a program’s successful implementation. In that narrow sense, the nonimplementation of these aspects of the guidelines was probably not a major cause of prolonged use. However, that does not mean the design of conditionality is unimportant; we will return to this issue in Chapter 5.

### Access to IMF resources

11. The general policy on access to IMF resources adopted in 1984 and still applicable today provided that “in determining the case for further Fund support and the amount of access in those cases where members have made repeated use of Fund resources, more careful attention will be given to the past record, the design of adjustment programs and the effectiveness of their implementation.”<sup>9</sup> In 1991, this policy was reinforced by making explicit that its purpose was to seek a net reduction in prolonged users’ outstanding liabilities to the IMF, through a strengthening of programs and, possibly, a greater use of arrangements involving only limited access to IMF resources, but which could serve as a catalyst in mobilizing resources from other creditors.<sup>10</sup> Later in the 1990s, as UFR policies became more differentiated between the GRA and the ESAF/PRGF Trusts, the

the time of various reviews, it seems fair to expect that most of the countries we define as prolonged users should have been subjected to these guidelines.

<sup>8</sup>It was not possible in the context of this study to assess on a large scale to what extent the recommendations related to contingency planning were followed, but evidence from the case studies suggests they were not. Furthermore, like the recommendations related to the use of conditionality, they do not appear to have ever been translated into actual operational guidelines for IMF staff.

<sup>9</sup>“Access Limits for 1985, Preliminary Policy Considerations” (EBS/84/168). To some extent, this is only an adaptation to the specific case of repeat users of the general guidelines on access adopted in 1983, according to which “*the amount of the member’s outstanding use of Fund credit and its record in using Fund resources in the past must enter into the judgment on the appropriate scale of further use of the Fund*” (EBS/83/233).

<sup>10</sup>“Selected Operational Issues Related with the Use of Fund Resources” (EBS/91/108). Similarly, in the 1990 Board discussion on “Strengthening the Cooperative Strategy,” Executive Directors had said that when there is evidence of repeated failure in program implementation, continued access to IMF resources would need stronger policy justification.

need to reduce access over time, even to concessional resources, was confirmed.

12. Our evaluation shows that these guidelines were not applied consistently in practice. In particular, our case studies show that the justification of the level of access proposed in staff reports was treated in a rather perfunctory manner. A broader look at the evolution of the level of access further indicates that only about one-fifth of prolonged users had a consistently diminishing access to either general or concessional resources.<sup>11</sup>

### Strengthened analytical and assessment efforts

13. The area of greatest consensus in dealing with prolonged users since the first time the Board reviewed the issue was the need to improve the understanding of the factors underlying a country’s prolonged need for IMF resources. This was to be achieved through a two-pronged analysis:

- a review of the historical background to a member’s problems and an analysis of the factors underlying its prolonged use experience at the time a new request for UFR was introduced;
- candid ex post assessments of performance under previous programs. The need for such assessments was repeated in successive Board discussions with increasing specificity over time.

However, the case studies show that these recommendations were generally not followed. A noteworthy exception is Morocco, whose entire IMF-supported adjustment experience was reviewed in 1994 as part of that year’s Article IV consultation. However, the practice was not followed for most prolonged users during the 1990s, although, as will be discussed later, somewhat more was done internally than was reported to the Board.

### Exit strategies

14. As early as 1984, the IMF recognized that “frequently, despite the progress achieved during the period covered by an arrangement or a succession of arrangements with the Fund, *the amount of adjustment remaining to be accomplished at the end of the period was substantial.*”<sup>12</sup> Two remedies were envisaged to prevent such a situation from leading to pro-

<sup>11</sup>The trend of access broadly reflects that of members’ gross financing needs, which also failed to decline consistently in a majority of cases. See Annex 2 for further evidence on the evolution of access.

<sup>12</sup>“Review of Upper Credit Tranche Arrangements and Some Conditionality Issues” (EBS/84/227).

longed UFR which, taken together, outlined an exit strategy from IMF lending.

### ***Ex ante assessments of time needed to complete the adjustment process***

15. In the early 1980s, it became a standard requirement for UFR staff reports to include a medium-term scenario, in order to identify *ex ante* cases where significant balance of payments gaps could be expected to persist over the foreseeable future. Subsequently, IMF staff was further requested to foresee a time frame for the disengagement of the Fund, particularly when prolonged users were involved.<sup>13</sup> Evidence from the case studies again suggests that this recommendation was often not followed.

### ***Strengthened surveillance at the post-program stage***

16. Surveillance has long been identified as an important instrument for promoting the sustained implementation of adjustment efforts beyond the immediate UFR period.<sup>14</sup> “Continued policy dialogue” was actually put on a par with improved program design to contain prolonged use. This was meant to involve anything between interim Article IV consultations and “shadow programs,” almost as detailed as UFR programs, but not linked to any IMF resources. This approach to safeguarding the IMF’s general resources beyond the program period received renewed emphasis in the 2000 “Review of IMF Facilities,” in the form of “post-program monitoring” (PPM). For concessional resources, the principle of post-program monitoring as a means of avoiding prolonged use was formally established in the early 1990s.<sup>15</sup>

17. However, few prolonged users have ceased to make use of IMF resources for longer than a simple interruption between programs and, among those

that did, few went through any of the envisaged exit strategies.<sup>16</sup>

### ***Implications for other creditors***

18. A key implication of the exit strategy outlined above was that, if the IMF was not prepared to provide financial support to its members for the entire period required to achieve a sustainable balance of payments situation, other donors and creditors would have to provide the necessary financing beyond the program period. This delicate problem was recognized in 1991, when a staff report noted that: “In cases where external viability is not in reasonable prospect, the Fund will need to carefully limit further provision of its resources. . . . Other creditors and sources of funds would then have to assume more of the responsibility for providing appropriate financing.”<sup>17</sup> In the event, although the Executive Board endorsed the staff’s analysis, such a sequencing of IMF and donors’ financing has largely failed to materialize, in part as a result of creditors and donors continuing to insist on an IMF lending arrangement as a “seal of approval” (see Chapter 6).

19. In conclusion, the evolution of IMF policies responding to changing circumstances and perceptions have contributed to the phenomenon of prolonged use of its resources in several ways. First, the evolution of the IMF’s facilities intended to address more deep-seated causes of external problems, especially in low-income member countries, clearly increased the likelihood of prolonged use, though it did not fully and explicitly recognize the potential consequences. This appears to have reflected in part differences of view within the Executive Board over what the longer-term role of the IMF should be in such cases.<sup>18</sup> As a result, the IMF has been left with a mismatch between its core operational approach (which is still focused on promising and achieving a restoration of sustainability within a relatively short time frame) and some of the tasks it is being asked to perform. As will be seen in subsequent chapters, this

<sup>13</sup>“Selected Operational Issues Related with the Use of Fund Resources” (EBS/91/108) recommended “systematically highlighting, in staff reports accompanying requests for UFR arrangements by prolonged users, the prospects for continued need for Fund resources in the future and, where possible, indicate the time frame and circumstances in which UFR might no longer be needed.”

<sup>14</sup>See “Review of Upper Credit Tranche Arrangements and Some Conditionality Issues” (EBS/84/227) and “Issues in the Implementation of Conditionality: Improving Program Design and Dealing with Prolonged Use” (EBS/85/265).

<sup>15</sup>“Operational Modalities and Funding Alternatives for an ESAF Successor—Preliminary Considerations” (EBS/93/32). Subsequently, it was also envisaged that one option for continued IMF support for the programs of former ESAF users that ceased to have a need for IMF financing would be through precautionary arrangements, but that option was eventually not pursued.

<sup>16</sup>Among prolonged users, The Gambia and Bangladesh went through the “enhanced surveillance” procedure in 1993/94, as did Uruguay and the Federal Socialist Republic of Yugoslavia in the late 1980s. Ecuador had a staff-monitored program in 1995/96, and the Philippines entered the post-program monitoring procedure after its last arrangement expired in 2000. In all these cases, these procedures were applied to the country after a long string of IMF-supported programs. Of these countries, Bangladesh and the Philippines are the only two which, to date, have not made further UFR.

<sup>17</sup>“Selected Operational Issues Related with the Use of Fund Resources” (EBS/91/108).

<sup>18</sup>The discussion in Annex 2 of the evolution of policies on the use of concessional resources provides further illustration of this point.

question of time frame lies at the heart of many of the problems associated with prolonged use.

20. Second, although the Board did on various occasions approve the elements of a strategy to reduce prolonged use, this has not been systematically implemented. A contributory factor here is the absence of formal definition of prolonged use, although various proposals have been made by IMF staff. In the absence of a formal definition, there is ambiguity about whether procedures prescribed to deal with prolonged use need to be followed in particular cases.

21. Finally, questions of financing have strongly influenced the approach to prolonged use. Initially, the limited availability of funding for the IMF's con-

cessional facilities precluded any consideration of a long-term involvement. Subsequently, the fact that the level of aid flows was not always consistent with the intended diminished reliance of SAF/ESAF users on IMF lending implied that the IMF would have to either remain involved until a sustainable external situation could be reached, no matter how long it took; or leave the countries concerned midway in this process, with a high probability of backsliding. Both options involved some departure from the IMF's original mandate, and the choice taken—to remain involved—while perhaps the only practical one under the circumstances, only deepened the mismatch with the IMF's operational approach mentioned above.

## CHAPTER 4

# Characteristics of Prolonged Users

1. This chapter describes some of the main characteristics of the prolonged users in terms of performance and key economic indicators and compares them with the characteristics of “temporary” users. Further details are provided in Annex 3. Differences in performance between the two groups obviously cannot be attributed in any simplistic way to prolonged use, or vice versa, since there are many other factors that could have influenced both economic performance and the need for prolonged use of IMF resources. Nevertheless, the comparison is relevant as a basic point of reference and points to structural features that should receive special attention in designing programs for these countries.

### Econometric Evidence on the Characteristics of Prolonged Users

2. Although there is a growing empirical literature on IMF-supported programs, very few studies have explicitly addressed issues related to prolonged or repeated participation in such programs.<sup>1</sup> One study that examined “recidivism” in the participation of IMF arrangements, Bird, Hussain, and Joyce (2000), found, among other results, that repeated participation was associated with (i) lower levels of international reserves; (ii) larger current account deficits; (iii) larger debt-service ratios; (iv) lower per capita income; (v) lower investment rates; and (vi) weaker governance. Another study that modeled the duration of participation in programs, Joyce (2001), found the duration of program “spells” to be inversely related to per capita income, and positively associated with export concentration in primary goods and being landlocked.

3. Drawing on the above literature, we have attempted to isolate possible factors associated with prolonged use by estimating a series of probit regressions using various economic and institutional

<sup>1</sup>Studies that have examined factors that induce countries to seek IMF arrangements have also highlighted variables related to the external sector as well as growth performance. For example, Knight and Santaella (1997) and Barro and Lee (2002).

characteristics as explanatory variables. Two alternative definitions of “prolonged use” were employed in these exercises—one “fixed” and the other “dynamic.”<sup>2</sup> While some of the results were not statistically significant and they do not prove anything about the direction of causality, the main finding was that prolonged use was associated with lower levels of international reserves and higher debt-service ratios (see Annex 3 for details). To the extent that prolonged use reflects persistent external sector problems, these associations are not surprising. There was also some evidence that a measure of the (higher) quality of the civil service was associated with less prolonged use.

4. There were some notable differences in the results for PRGF-eligible and noneligible countries. With the fixed definition of prolonged use, the results appeared to be driven entirely by PRGF-eligible countries; within this group, prolonged use also appears to be associated with lower per capita GDP.<sup>3</sup> When the analysis was limited to the 35 countries in the sample that were not eligible for the PRGF, none of the explanatory variables used proved to be significant. With the dynamic definition, the differences between countries eligible for the PRGF and those not eligible were not as marked, but the same broad conclusions applied.

### Some Comparisons Between Prolonged and “Temporary” Users

5. A comparison of starting conditions, underlying characteristics, and economic trends during

<sup>2</sup>As explained in Chapter 1, the “fixed” definition classified a country as a prolonged user if it had IMF arrangements in 7 out of any 10-year period during 1971–2000. The “dynamic” definition that was employed in a panel probit regression framework classified a country as a prolonged user in a particular 5-year period if it had IMF arrangements in 7 or more years during that and the preceding 5-year period.

<sup>3</sup>Some of the other characteristics included in the regressions were real GDP growth, current account balance (in relation to GDP), openness, share of primary exports in total exports, and volatility in the terms of trade.

1971–2000 between prolonged users (identified on the basis of the fixed definition) and “temporary” users suggests that, as a group, prolonged users had some distinctive features although such differences cannot produce conclusive evidence on causal relationships. Details are provided in Annex 3, but the main results are as follows:

- Prolonged users’ economic conditions prior to the start of their prolonged use episode were generally characterized by larger imbalances than the “temporary” users that contemporaneously entered into IMF-supported programs in at least three respects: they had larger external debt stocks relative to GDP, larger current account deficits, and larger overall fiscal deficits.<sup>4</sup>
- Turning to trends in the 1971–2000 period, prolonged users were characterized by:
  - lower export growth (in low-income countries only), more volatile terms of trade, lesser degree of trade openness (particularly for middle-income countries), and a higher concentration of exports of primary commodities (particularly for low-income countries);
  - lower and more rigid government expenditure, owing to the weight of higher defense and interest expenditure (the former characteristic being more marked in middle-income countries and the latter more marked in low-income countries);
  - lower tax revenues relative to GDP (particularly for middle-income countries) and a higher public debt burden;
  - heavier external debt and debt-service burden up to the 1990s, leading to a much more frequent recourse to debt-rescheduling agreements with creditors—which suggests that creditors’ need for the IMF’s seal of approval may have been a factor contributing to prolonged use;
  - greater political instability; and
  - in terms of trend macroeconomic performance, there were no major differences in inflation between the two groups over the period. For much of the period, the group of countries defined as prolonged users grew at a slower pace, but there were exceptions (e.g., among the low-income countries, the group of prolonged users appear to have grown faster

<sup>4</sup>The difference between prolonged users and “temporary” users is statistically significant as regards the external debt to GDP ratio, but the other differences were not statistically significant at the 5 percent level.

on average in the 1990s than the group of “temporary” users). However, it is difficult to interpret such results without addressing the issue of the endogeneity of access to IMF resources.<sup>5</sup> This issue is addressed in Chapter 5.

6. Not surprisingly, in light of the greater preponderance of high debt and debt-service burdens, Paris Club debt-rescheduling agreements were much more frequent for prolonged users: among low-income countries, 93 percent of prolonged users had to negotiate a debt treatment with the Paris Club at some point over 1971–2000, against 61 percent for “temporary” users. Among middle-income countries, these proportions are, respectively, 100 percent and 28 percent. Moreover, prolonged users typically needed a larger number of debt treatments than “temporary” users (Table 4.1). Indeed, in many cases, the need for these reschedulings may have been one of the critical factors explaining prolonged use. As the discussion in the case studies illustrates, the evolution of the international community’s approach to the debt crises of the 1980s (in the case of the Philippines) and to the workout of the debt problems of highly indebted poor countries (in the case of Senegal) itself had a major influence on the length of the IMF’s program involvement.

## Overview of Characteristics of Case Study Countries

7. Among the three countries chosen as case studies, Pakistan and Senegal are broadly representative of the group of PRGF-eligible prolonged users, while the Philippines has the main characteristics of prolonged users of the IMF’s general resources.<sup>6</sup> In particular, all three countries are characterized, like most prolonged users, by (i) relatively low tax revenue to GDP ratios and a rigid structure of expenditure. This was especially true for Pakistan but less so for Senegal, in comparison with other low-income prolonged users; (ii) low trade to exports ratios and a relatively weak growth of exports (except the Philippines), and an initially high concentration of exports of primary products (except in Pakistan), as well as very low international reserves; and (iii) adverse political characteristics, with Pakistan and the

<sup>5</sup>For example, a number of PRGF-eligible countries were probably “temporary” rather than prolonged users because they encountered periods of severe political disruption and conflict that made it difficult to access IMF resources on a consistent basis. Such factors would also obviously affect their growth performance.

<sup>6</sup>Detailed statistics comparing the three countries with their respective control groups for the various indicators discussed in the previous sections are provided in Annex 3.

**Table 4.1. Average Number of Paris Club Debt Treatments Per Country Over 1971–2000<sup>1</sup>**

	1971–80	1981–90	1991–2000	1971–2000
Prolonged users	0.3	3.0	2.4	5.3
“Temporary” users	0.2	1.3	1.5	2.9

<sup>1</sup>For countries with at least one Paris Club debt treatment during 1971–2000.

Philippines suffering primarily from political instability and a lack of political cohesion, and Senegal primarily affected by ethnic fractionalization.

8. Against this background, a few specific features are worth noting:<sup>7</sup> (i) in terms of growth and correction of macroeconomic imbalances, Pakistan generally performed better than the group average until the 1990s, after which its performance was worse, while Senegal’s stop-go pattern of adjustment is reflected in an above-average growth performance with lower adjustment in the 1980s, while the opposite was true in the 1970s and 1990s;<sup>8</sup> (ii) the Philippines enjoyed a favorable position with respect to trade indicators, but was handicapped by a high external debt to GDP ratio; (iii) overall, Pakistan’s structural problems, as revealed by the indicators discussed above, appear to have been among the deepest of the group, whereas they were close to the average of prolonged users in the Philippines, and somewhat milder than average in Senegal.

9. While, technically, it should have been possible to take account of these characteristics in the design of IMF-supported programs in these countries, evidence from the case studies, discussed in more detail

<sup>7</sup>Data on the evolution of key economic variables for the three countries is provided in Table 5.8 in Chapter 5.

<sup>8</sup>In the 1990s, however, a distinction must be made between the pre- and post-devaluation period. Growth was significantly higher in the latter period (i.e., from 1994 onward).

in Part II, suggests that this has not always been the case. For instance, greater attention to the considerable rigidity of expenditure in all three countries, particularly in Pakistan, might have given a hint that as rapid a reduction of the fiscal deficit as was targeted would be very difficult to achieve in a sustainable manner. Moreover, as will be discussed in the next chapter, although programs repeatedly targeted higher tax/GDP ratios, the deeper institutional reforms necessary for sustainable gains in this area proved hard to achieve.

10. Bearing in mind the limited statistical significance of the differences observed between prolonged and “temporary” users in the cross-section analysis and the difficulties of knowing how representative are the more detailed analyses in the case studies, the characteristics highlighted do suggest some messages for designing programs in prolonged users. For example, the generally weak records of export and tax revenue growth suggest that it is important to be especially careful to avoid building programs around projections of rapid growth in exports and tax revenue, unless a solid case can be made to proceed otherwise. Likewise, when designing a fiscal adjustment package, enhanced due diligence should be applied to the analysis of the structure of expenditure, in particular with a view to assessing its rigidity and ensuring that the targeted reductions can be achieved in a manner that is both sustainable and consistent with long-term growth.

## CHAPTER 5

# Prolonged Use and Effectiveness of IMF-Supported Programs

1. Since UFR policies have been designed at least to contain, if not entirely avoid, prolonged use, the pervasiveness of the phenomenon raises questions about the effectiveness of IMF-supported programs in prolonged user countries. This chapter examines this issue at two levels. We first examine available evidence from cross sections of countries to see whether there are any differences in program design or implementation between prolonged and “temporary” users and what can be learned about the impact of IMF-supported programs on growth and adjustment in a prolonged use context.<sup>1</sup> Next we focus on lessons that can be drawn from our case studies (Pakistan, the Philippines, Senegal, Morocco, and Jamaica) and from responses to IEO questionnaires sent to authorities in prolonged user countries and to IMF staff.<sup>2</sup> Some of the issues that have surfaced from our investigation, especially from the case studies, are of general relevance for program effectiveness and not exclusive to prolonged users.

### Results from Cross-Sectional Evidence

#### Cross-country evidence on the effects of prolonged use

2. The empirical literature on the effects of IMF-supported programs (see Haque and Khan, 1998) has produced widely varying results depending upon the time period covered and the methodology for estimation. The more recent studies using the so-called general evaluation estimator all suggest that programs contribute to improvements in the current account balance and the overall balance of payments, but the evidence with respect to the impact on growth

is mixed.<sup>3</sup> Goldstein and Monteil (1986) and Khan (1990) found negative effects on growth. Conway (1994) finds that initial negative effects on growth are offset by subsequent positive growth rates. However, Przeworski and Vreeland (2000), using a broadly similar approach, find significantly negative and persistent effects on growth. A recent study, Barro and Lee (2002), which used a different (instrumental variable) approach to take account of the endogeneity problem, concluded that while programs do not have a significant contemporaneous effect on growth, they do have a lagged effect that is negative.

3. Not only are the results from the existing literature mixed, as summarized above, they do not distinguish between prolonged and “temporary” user cases. To explore this distinction we requested Professor Lee, one of the coauthors of Barro and Lee (2002), to extend their analysis so as to consider whether “prolonged use” has an effect on growth that is distinguishable from that associated with “temporary use.”<sup>4</sup> While the methodological problems are complex and hard to resolve entirely, the results, reported more fully in Annex 4, suggest the following:

- Programs have significant negative contemporaneous and lagged effects on growth in prolonged users, but no significant effect on growth in temporary users.
- Limiting the sample to only GRA arrangements, strongly negative contemporaneous and lagged effects on growth are found in prolonged users but not in “temporary” users.
- When only concessional facility arrangements are considered, there is a negative contemporaneous effect on growth that is more than offset by a positive lagged effect in the case of prolonged users, but there is no significant lagged effect in the case of “temporary” users.

<sup>1</sup>The cross-country results discussed in this section use the same basic definition of prolonged use set out in Chapter 2. Since the time periods covered by the various databases differ, the precise group of countries that are defined as prolonged users varies depending upon that time period. However, because prolonged use is highly persistent over time, the population of prolonged users does not vary greatly over time and the results do not seem very sensitive to this factor.

<sup>2</sup>The questionnaire sent to prolonged users is shown in Annex 5.

<sup>3</sup>For a survey of the literature, see Haque and Khan (1998). A significant recent development is Barro and Lee (2002).

<sup>4</sup>We also requested that he expand the coverage of the earlier Barro and Lee (2002) analysis to include arrangements under concessional facilities.

**Table 5.1. Actual Change in Key Variables<sup>1</sup>**  
(Average annual changes in percent of GDP)

	Prolonged users		"Temporary" users	
	Stand-By Arrangements	Multiyear arrangements	Stand-By Arrangements	Multiyear arrangements
	(T-1) to (T+1)	(T-1) to (T+3)	(T-1) to (T+1)	(T-1) to (T+3)
Overall public sector balance	0.75	1.43	1.07	2.36
Central government revenues	1.43	0.79	0.38	0.12
Central government expenditures	0.34	-0.70	-0.58	-2.52
Current account balance	0.97	1.21	-0.30	3.56

Sources: IMF, WEO database; and IEO calculations.

<sup>1</sup>T refers to the year of approval of the arrangement. Because the data on outcomes are drawn from the WEO database, definitions and sample sizes differ from those used in Table 5.4, making direct comparisons difficult.

4. From these results, it would appear that IMF-supported programs in the case of prolonged users have adverse consequences on growth in programs supported by GRA resources but not programs based on concessional resources. However, as noted above, previous exercises that have attempted to assess the impact of IMF-supported programs on growth have come to very different conclusions and it appears that the results can be sensitive to variations in approach and sample size. The difficulties in identifying the independent impact of prolonged involvement in IMF-supported programs are likely to be even greater.

5. It is useful to consider whether there are any substantial differences between the extent of adjustment achieved in prolonged and "temporary" users' programs, although similar methodological difficulties apply. We have used the World Economic Outlook (WEO) database to examine this issue.<sup>5</sup>

6. In Stand-By Arrangements, prolonged users achieved a somewhat larger adjustment in the current account than "temporary" users, but the extent of adjustment of the overall public sector balance was slightly smaller in the group of prolonged users (Table 5.1).<sup>6</sup> However, the results suggest that the shortfalls from the targeted fiscal adjustment—discussed in more detail below—were greater in the case of the group of prolonged users. Fiscal adjustment in prolonged user countries, on average, does not appear to have involved any reduction in government expenditure as a percentage of GDP.

7. In medium-term arrangements, prolonged users achieved a markedly smaller adjustment of both their current account and fiscal balances over the

three-year period. Once again, the differences in the extent of fiscal adjustment are accounted for by a much lower reduction in government expenditure in the group of prolonged users. These differences are largely at odds with those found between adjustment targets (see below), except for the relative sizes of fiscal adjustment.

### Cross-country evidence on program design and implementation

8. We begin with documenting whether IMF-supported programs with prolonged users differ from those with "temporary" users with respect to five characteristics: the extent of overoptimism of growth targets; the extent of targeted adjustment and outcomes; the nature of conditionality; degree of implementation; and size of "IMF effort."<sup>7</sup> A variety of databases, covering different time periods, are used.

### Projections for exports and real GDP growth<sup>8</sup>

9. A comparison of medium-term program projections and outcomes in ESAF-supported programs

<sup>5</sup>Since the IMF's internal (MONA) database on programs has incomplete information on outcomes and the coverage of the WEO database is different in several respects, it is not possible to make a systematic direct comparison of outcomes and program targets, as discussed below.

<sup>6</sup>None of the differences reported in this section is statistically significant. The usual caveats about inferring causality apply.

<sup>7</sup>It should be borne in mind that whatever specificities of prolonged users this analysis reveals may reflect a variety of factors and that there is no proven causal relationship with prolonged UFR.

<sup>8</sup>The analyses of ESAF-supported programs in this section are based on the database on medium-term program targets and outcomes prepared by PDR for the 1997 ESAF Review. More recent data were not available on a consistent basis for use by the IEO. The analysis of GRA-supported programs is based on the database used by Musso and Phillips (2001), which draws on the MONA database and covers 69 programs in 47 countries during 1993–97. The latter database excludes precautionary and SAF/ESAF programs. For purposes of the analysis, countries are defined as prolonged users if they met the definition used in this evaluation either at the beginning of the program included in the database, or if the program in question subsequently contributed to their classification as a prolonged user.

**Table 5.2. Optimism of Real GDP and Export Projections in ESAF Programs<sup>1</sup>**

	Prolonged users		"Temporary" users	
	Mean	Median	Mean	Median
Merchandise export growth				
Outturn	7.4	5.8	17.2	13.6
Projected	10.5	9.9	12.5	12.5
Real GDP growth				
Outturn	3.5	3.7	4.2	5.4
Projected	4.1	4.0	5.0	4.7

Sources: IMF Policy Development and Review Department and IEO calculations.

<sup>1</sup>Average annual growth in percent for years  $T$  to  $T+4$ , where  $T$  is the year in which the program started.

is presented in Table 5.2. It shows that projections for exports were greatly overoptimistic for prolonged users but not for "temporary" users.<sup>9</sup> Projections for real GDP growth were generally too optimistic for both prolonged users and "temporary" users. A comparison of the year-by-year differences suggests that the errors in projections for prolonged users' real GDP growth are greater in later years of multiyear programs than in the first year.

10. Programs supported by arrangements using general resources (GRA) typically include projections for a much shorter period. A comparison was only possible for real GDP growth projections covering the initial program year, drawing upon the database used by Musso and Phillips (2001).<sup>10</sup> Again, the results suggest short-term projections of real GDP growth were optimistic for both prolonged and "temporary" users but the overoptimism was actually greater in the latter case (Table 5.3).<sup>11</sup> The substantial differences between the median and mean errors suggest that a few, relatively large errors on the downside affected both "temporary" and prolonged users.<sup>12</sup> The Musso and Phillips database does not include export growth, making it difficult to

compare projections with outcomes in this dimension in GRA cases. These results suggest that programs with prolonged users under concessional facilities do have a tendency to be overoptimistic about medium-term export growth, which may have implications for program design. There also appears to be some overoptimism in projections of real GDP growth in programs under both GRA and concessional facilities, but in this case the overoptimism does not appear to be systematically related to the phenomenon of prolonged use.

#### *The magnitude of targeted adjustment*

11. The strategy for dealing with prolonged use set out by the IMF's Executive Board called for more "front-loaded" adjustment in such cases. It is, therefore, relevant to ask whether programs with prolonged users targeted greater adjustment in the external current account or fiscal deficit than other cases and whether they were more frontloaded. Because of limitations in the available IMF databases on programs, it is only possible to answer this question for the period since 1993.<sup>13</sup>

12. There are marked differences between prolonged and "temporary" users' programs concerning the extent of targeted fiscal adjustment and the current account adjustment but the pattern differs between SBAs and multiyear arrangements.<sup>14</sup> In Stand-By Arrangements, prolonged users' programs targeted a somewhat larger average adjustment of the

<sup>9</sup>In neither case, however, is the bias statistically significant, given the large variability of both projections and outturns for exports.

<sup>10</sup>The study looks at projections for the current calendar year when a program is approved more than three months before the end of the year, otherwise for the following year. Thus, the effective length of projections varies between 3 and 15 months.

<sup>11</sup>This result contrasts somewhat with the evidence from the Musso and Phillips study that "follow-up" programs have a larger bias in growth projections than other programs in their sample. "Follow-up" programs are defined as new programs for which there was some form of IMF arrangement active in the preceding year. This is because in the Musso-Phillips sample, a large number of countries that had one (immediate) follow-up program did not go on to be "prolonged users" under the definition used for this study.

<sup>12</sup>Among prolonged users, the programs with substantial overoptimism about GDP growth included Mexico (1995), Bulgaria (1996), and Romania (1997).

<sup>13</sup>The analysis in this section draws upon the IMF's MONA database, which has comprehensive data on program targets only for the period since 1993 and has incomplete data on outcomes. Therefore, the group of prolonged users for the purposes of the analysis of this subsection refers to those countries that either were prolonged users in 1993 or became prolonged users subsequently.

<sup>14</sup>None of the differences discussed here is statistically significant at the 5 percent level, due to very large variations within each group.

**Table 5.3. Accuracy of Short-Term Projections for Users of General Resources<sup>1</sup>**

	Prolonged users		“Temporary” users	
	Mean	Median	Mean	Median
Real GDP growth				
Outturns	1.7	3.9	-0.9	0.2
Projected	2.4	3.4	0.2	-1.0
Difference <sup>1</sup>	-0.7	0.0	-1.1	-0.4

Sources: Database assembled by Musso and Phillips and IEO calculations.

<sup>1</sup>The median of the differences is not necessarily equal to the difference of the respective medians.

overall public sector deficit than “temporary” users’ programs (2½ percentage points of GDP compared to 2 percentage points) (Table 5.4). However, if we focus on the change in the primary balance of the central government as the relevant measure of adjustment effort, the targeted fiscal adjustment in prolonged users on average (1.8 percent of GDP) was much lower than that in the case of “temporary” users (3.3 percent). Prolonged users’ programs supported by SBAs were also characterized by a higher share of the targeted fiscal adjustment expected to come from increased revenues, with much lower cuts in primary (i.e., noninterest) expenditure. While the data on outcomes, discussed earlier, are not strictly comparable, they suggest that prolonged users actually achieved less fiscal adjustment, with no expenditure reduction. The external current account adjustment required of prolonged users in SBAs was also much lower than in the case of “temporary” users.

13. In the case of multiyear arrangements, the magnitude of fiscal adjustment required from “temporary” users was higher than from prolonged users whether one looks at the overall balance or the primary balance.<sup>15</sup> In both cases, the primary expenditure contraction expected was similar but the magnitude of the revenue effort from “temporary” users was much larger. Unlike in SBAs, the extent of current account adjustment in the multiyear programs was of the same order for prolonged users as for “temporary” users. In effect, the fiscal adjustment was targeted to play a much larger role in bringing about adjustment in the “temporary” users than in the case of prolonged users.

14. An important difference between prolonged users and “temporary” users in multiyear arrangements is that the targeted adjustment in all the variables was *more* front-loaded in programs with “temporary” users, particularly as regards revenue increases and primary expenditure cuts. This is con-

trary to what might have been expected given the guidelines on prolonged use.

### *The extent and nature of conditionality<sup>16</sup>*

15. For the purposes of this study, conditionality can be classified into two types: “hard” and “soft.”<sup>17</sup> “Hard” conditionality consists of prior actions (PA) and performance criteria (PC), both of which are conditions that the country must meet in order to have access to the IMF resources under a program.<sup>18</sup> “Soft” conditionality consists of all the elements that are taken into account by the IMF in forming a judgment about whether or not to “complete” a review, which triggers the release of a financing tranche. It might include structural benchmarks, indicative targets, or general undertakings in the authorities’ letter

<sup>16</sup>The findings of this section are based on two databases: one, assembled by the Policy Development and Review Department for the 2001 “Review of Fund Conditionality,” is focused on structural conditionality and covers all IMF-supported programs over 1987–2000. The other database was assembled for an internal research project on the determinants of the effectiveness of IMF-supported programs, whose findings are reported in Ivanova and others (2001). It covers all conditionality contained in the approximately 170 arrangements approved between 1992 and 1998. The two datasets yield broadly similar conclusions even though they cover different periods.

<sup>17</sup>This classification of “hard” and “soft” conditionality is not one used formally by the IMF and it refers only to the form of conditionality, not to the strength of the underlying measure.

<sup>18</sup>However, they differ in the sense that prior actions are often imposed before the approval of an arrangement, whereas performance criteria are specified in the arrangement itself and only apply to subsequent disbursements. Prior actions linked to subsequent reviews rather than the program’s initial approval are sometimes referred to as “conditions for the completion of a review.” Until 2000, prior actions were generally not specified in the text of Executive Board’s decisions, which gave them a certain degree of informality (along with a lack of transparency). In both cases, the country may be granted access to the IMF’s resources even though not all conditions have been met, but in the case of performance criteria, this will require a decision by the Executive Board granting a waiver, whereas for prior actions, a judgment from management that a critical mass of measures has been taken would suffice.

<sup>15</sup>As noted earlier, the actual fiscal adjustment achieved by prolonged users in multiyear arrangements was also smaller.

**Table 5.4. Targeted Change in Key Variables***(Average annual changes in percent of GDP)*

	Prolonged users				"Temporary" users			
	SBAs		Multiyear arrangements		SBAs		Multiyear arrangements	
	(T-1) to (T+1)	(T-1) to (T+1)	(T-1) to (T+3)	Share of front-loading <sup>1</sup>	(T-1) to (T+1)	(T-1) to (T+1)	(T-1) to (T+3)	Share of front-loading <sup>1</sup>
Overall public sector balance <sup>2</sup>	2.5	1.59	2.92	54	2.0	1.95	3.57	55
Central government revenues	1.55	0.28	0.68	42	1.2	0.92	1.3	71
Central government total expenditure	-0.78	-0.93	-2.02	46	-2.05	-1.13	-2.02	56
Primary central government balance <sup>2</sup>	1.79	0.81	1.92	42	3.29	1.85	2.49	74
External current account <sup>2</sup>	0.09	1.07	3.18	34	0.62	1.25	3.31	38

Sources: MONA database and IEO calculations.

Note: *T* refers to the year of approval of the arrangement.<sup>1</sup>Targeted adjustment in the period *T*-1 to *T*+1 as a proportion of the targeted adjustment over the period *T*-1 to *T*+3.<sup>2</sup>Positive number implies an improvement in the balance.**Table 5.5. Average Number of Structural Conditions Per Program Year, 1987–2000**

	Total conditions <sup>1</sup>		Benchmarks		Prior actions		Performance criteria	
	Prolonged users	"Temporary" users	Prolonged users	"Temporary" users	Prolonged Users	"Temporary" users	Prolonged users	"Temporary" users
	All arrangements	6.5**	9**	3.6	4.8	1.6*	3.1*	1.0
ESAF/PRGF	8.4	10.1	5.5	5.8	1.0*	2.8*	1.7	1.5
SBA and EFF	4.9**	8.5**	1.8**	4.4**	2.1	3.3	0.5	0.6
Memorandum items								
Pakistan	10.4		4.9		0.8		4.7	
Philippines	2.2		0		0.8		0.2	
Senegal	7.1		4.7		0.1		2.3	

Source: MONA database.

Note: \*\* and \* indicate that the difference between both means is statistically significant at the 1 percent and 5 percent levels, respectively.

<sup>1</sup>Differences between total conditions and the sum of the other three categories are accounted for by "review" conditionality. The difference is particularly large in the case of the Philippines.

of intent,<sup>19</sup> sometimes expressly identified as elements that will be subject to reviews.

16. Available cross-country data summarized in Table 5.5 indicates that, on average, conditionality in arrangements with prolonged users typically had fewer formal structural conditions than arrangements with "temporary" users, regardless of the type of arrangement.<sup>20</sup> Moreover, most of the cases with very heavy use of structural conditionality did not in-

volve prolonged users; many involved the transition economies. For example, only 4 of the 17 programs that had more than ten prior actions per program year in the 1990s involved prolonged users—although Pakistan was one of these cases.

17. Not only was structural conditionality less extensive in prolonged users, but the evidence also suggests that it was "softer"—at least in the narrow sense discussed above.<sup>21</sup> In both prolonged and "temporary" users' arrangements, the largest part of structural conditionality was of the "soft" kind (mostly structural benchmarks). However, arrangements with prolonged users had fewer prior actions, especially in the case of arrangements under concessional facilities.

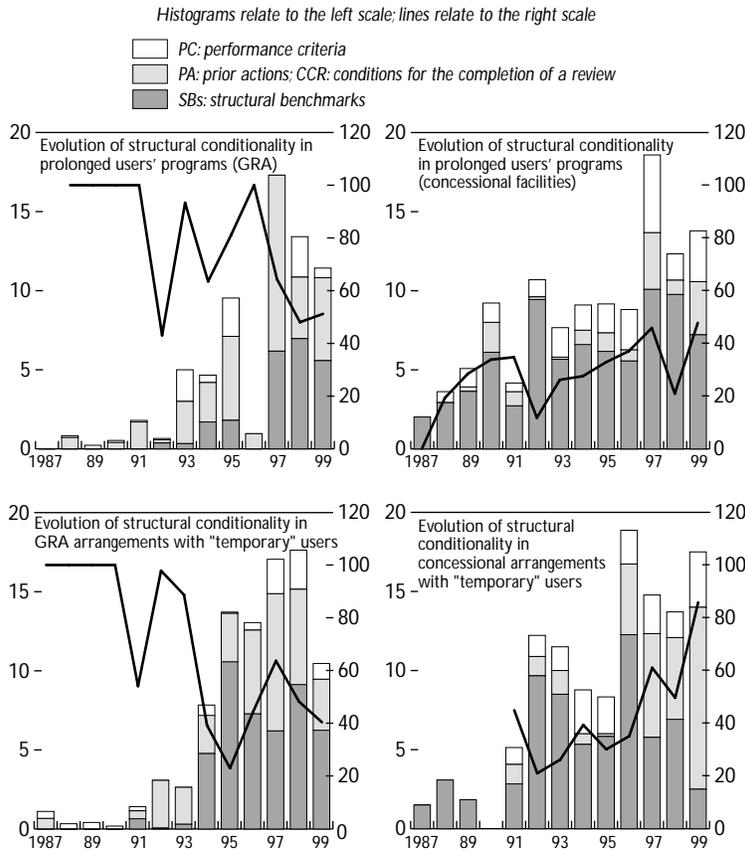
<sup>19</sup>However, not all general undertakings in the authorities' letter of intent qualify as conditionality strictly speaking.

<sup>20</sup>When transition countries are excluded from the sample, all the means reported in the table decline, and differences between prolonged and "temporary" users became somewhat smaller. However, the thrust of the comparison remains the same, with the exception of total conditionality in ESAF/PRGF arrangements, which was marginally higher for PUs than for TUs.

<sup>21</sup>Among the case study countries, Pakistan was an exception.

### Figure 5.1. Evolution of Structural Conditionality in IMF-Supported Programs

(Number of conditions per program year: left scale; and percent of PCs and PA/CCRs in total: right scale)



Sources: IMF Policy Development and Review Department and IEO calculations.

18. A distinctive feature of GRA arrangements with prolonged users was the comparatively large share of conditions to be appraised by program reviews in total conditionality (10 percent against 5 percent or less in all other cases), which gave the IMF more room for discretion in assessing the progress in structural reforms than other forms of conditionality. For example, the Philippines' programs came to rely almost exclusively on reviews in implementing structural conditionality because the political system made it hard for the government to commit to a specific timetable for passing measures through Congress. As the discussion in the Philippine case study illustrates, the trade-off for the greater flexibility and discretion of reviews was less certainty about the timing of disbursements, the content of policies, and pressures to "renegotiate the program at each review."

19. Structural conditionality also tended to get heavier and more constraining over time, but that tendency affected both prolonged and "temporary" users' programs, and there are no indications that the trend was stronger in the case of the former (see Figure 5.1).

20. The evidence suggests that macroeconomic conditionality was also more abundant in arrangements with "temporary" users than in those with prolonged users.<sup>22</sup> In GRA arrangements, there were

<sup>22</sup>Data on macroeconomic conditionality suffer from various availability and reliability problems, which limits the robustness of any conclusions. While initial observations by PDR, based on a small sample of arrangements, suggested that the total number of macroeconomic conditions (i.e., target values for key macroeconomic aggregates presumed to be under the control of the author-

**Table 5.6. Selected Data on Program Implementation, 1992–98**

	Percent of arrangements with at least one minor interruption <sup>1</sup>	Percent of arrangements seriously interrupted <sup>2</sup>	Percent of committed funds disbursed <sup>3</sup>	Average macro implementation index <sup>4</sup>	Average structural implementation index <sup>4</sup>	Average overall implementation index <sup>4</sup>
All arrangement types						
Prolonged users	72	47	77	81	68	77
“Temporary” users	68	39	76	82	67	75
ESAF arrangements						
Prolonged users	66	44	80	77	73	74
“Temporary” users	88	46	82	78	69	72
GRA arrangements						
Prolonged users	77	49	74	84	62	80
“Temporary” users	61	36	74	83	67	77
Memorandum items						
Pakistan	100	83	47	88	79	83
Philippines	100	50	77	88	68	86
Senegal	100	33	88	90	71	85

Source: Ivanova and others (2001) database.

<sup>1</sup>A minor interruption is defined as a delay of over three months for the completion of an SBA review or noncompletion; or a delay of over six months for the completion of an ESAF/PRGF review or noncompletion; or an interval of more than six months between two annual arrangements in a multiyear program; or the nonapproval of at least one annual arrangement in a multiyear program.

<sup>2</sup>An irreversible interruption occurs if either (i) the last scheduled program review was not completed (all program types); or (ii) all scheduled reviews were completed but the subsequent annual arrangement was not approved (ESAF/PRGF arrangements only).

<sup>3</sup>Not including precautionary arrangements.

<sup>4</sup>The implementation index is equal to 100 if the condition is met or met after modification, 50 if met after a substantial delay (for structural conditions only), and 0 if not met, waived, or not met after modification.

on average 31 macroeconomic conditions per program year for prolonged users, and 35 for “temporary” users, probably reflecting a higher frequency of reviews in the latter arrangements. In ESAF arrangements, these numbers were, respectively, 10 and 13. Both results suggest that there was not closer monitoring of performance under programs with prolonged users.

### **Differences in program implementation**

21. Assessing performance in terms of implementation presents problems since any single measure is inherently arbitrary. Table 5.6 presents six different measures of the extent of implementation. They show that, taking all arrangements together, prolonged users’ programs are more subject to interruptions, both “minor” and irreversible. However, disaggregating into programs supported by GRA

resources and those supported by concessional resources, we found that prolonged users as a group suffer from such interruptions more frequently than “temporary” users only for GRA-supported programs. Prolonged users score somewhat better than “temporary” users in terms of overall implementation while the program is on track,<sup>23</sup> which in the case of GRA-supported programs might suggest greater difficulties to sustain their efforts.

22. In theory, these two findings could reflect either a higher propensity of prolonged users to encounter serious policy slippages, or a more rigid stance of the IMF in appraising whether a given slippage can be corrected (and thus whether a waiver of the missed PC is warranted). However, the data indicate that prolonged users, particularly in GRA programs, were granted waivers on a slightly larger proportion of their structural PC than “temporary” users, whereas there is almost no difference between

ities) per test date varied little from program to program, the data collected in Ivanova and others (2001), which are reported here, do show significant variations, perhaps capturing differences in the frequency of test dates (this is because a macroeconomic indicator monitored, for instance, on a quarterly basis will count as four conditions during a year).

<sup>23</sup>Existing data resources do not allow us to track conditionality implementation in programs that go off-track and the indices reported here do not incorporate any measure of actual completion of programs. To that extent, they are biased toward overstating actual policy implementation.

**Table 5.7. Use of Waivers, 1987–2000<sup>1</sup>**

	Number of waivers granted per program year					Percentage of PC waived	
	Total	QPC+SPC	QPC	SPC	CPC	SPC/total	QPC/total
“Temporary” users	1.3	1.0	0.7	0.3	0.3	25	2.7
PRGF-eligible average	1.6	1.4	0.9	0.5	0.2	25	4.5
GRA-only average	1.1	0.8	0.6	0.2	0.3	25	2.1
Prolonged users	1.2	1.1	0.7	0.4	0.1	29	2.9
PRGF-eligible average	1.3	1.2	0.7	0.5	0.1	27	4.4
GRA-only average	0.9	0.8	0.6	0.2	0.1	33	2.1
Memorandum items							
Pakistan	1.4	1.2	0.6	0.6	0.2	10	NA
Philippines	0.8	0.7	0.7	0.0	0.1	0	3
Senegal	1.2	0.7	0.5	0.2	0.5	6	NA

Source: IMF Policy Development and Review Department database on waivers.

Note: PC: performance criteria; QPC: quantitative performance criteria; SPC: structural performance criteria; and CPC: continuous performance criteria.

<sup>1</sup>Not including waivers of applicability.

the two groups as regards waivers of quantitative PC (Table 5.7).<sup>24</sup>

23. According to IMF internal guidelines, waivers are to be used to deal with minor deviations from agreed targets, considered to be of a temporary or reversible nature. The fact that prolonged users had more of both program interruptions and waivers suggests that, in their case, waivers were more often followed by program interruptions, which might indicate that a higher proportion of waivers granted to prolonged users turned out, in hindsight, to be unwarranted.<sup>25</sup> This could be either because the IMF had a higher tolerance threshold regarding the magnitude of deviations waived for prolonged users or

because the corrective actions implemented were more frequently insufficient.

24. Even though prolonged users of ordinary resources were more prone to serious program interruptions, a similar proportion of funds committed got disbursed in their arrangements. This reflected a somewhat more front-loaded pattern of disbursements for prolonged users—which was not consistent with the strategy for prolonged use established by the Board.<sup>26</sup>

25. These findings are broadly consistent with recent internal reviews of the modalities of conditionality, which concluded that (i) there was no clear relation between the volume or modalities of conditionality (in particular, the quantity of prior actions) and the probability of success of an IMF-supported program and (ii) waivers had been predominantly used to address significant policy slippages, not—as they were originally intended—minor/technical factors or exogenous developments. They also suggest that the IMF’s practice with respect to prolonged users has not been wholly consistent with the guidelines calling for more intensive monitoring of programs in prolonged use cases (see Chapter 3).

#### *Differences with respect to IMF staff inputs<sup>27</sup>*

26. We find that arrangements with prolonged users were less resource intensive than those with

<sup>24</sup>However, when the Ivanova and others (2001) database is used to determine the percentage of macro PC waived, a noteworthy difference surfaces in ESAF/PRGF arrangements, where 17 percent of PC was waived for prolonged users, compared with 12 percent for “temporary” users. It may be recalled that the Ivanova database, unlike the one used in Table 5.7, reports the actual number of macroeconomic PC in programs instead of approximating them based on the number of test dates.

<sup>25</sup>This is only a conjecture, since it is possible that program interruptions were caused by factors totally unrelated to the waived conditions. Only a case-by-case analysis would allow firm conclusions to be drawn. However, the case studies suggest that the waivers were often related to significant policy slippages. For example, according to the decisions, none of the waivers granted to Pakistan or the Philippines since 1983 was motivated by exogenous shocks or technical reasons. By contrast, two of the three waivers on quantitative performance criteria granted to Senegal were motivated by exogenous shocks. This contrast is consistent with the differences noted between GRA and ESAF arrangements in this respect. The five waivers on quantitative performance criteria (along with two others on structural performance criteria) granted to Pakistan at the second review of its SBA in December 1996 are an example of waivers granted in the face of major policy slippages. The program fell apart soon after.

<sup>26</sup>On average, since 1993, the share of total program commitments disbursed in the first tranche has been 26 percent higher for prolonged users than for “temporary” users, suggesting more front-loaded disbursements in the former case.

<sup>27</sup>Comparisons of IMF financial effort were also undertaken, based on the ratio of gross IMF financing to gross financing

“temporary” users, but staff turnover was high for both groups. Details are provided in Annex 6.

27. Arrangements with “temporary” users were actually more mission intensive than arrangements with prolonged users, especially when the negotiation period is taken into account.<sup>28</sup> Most of the difference appears to stem from the implementation/supervision phase rather than from the design phase. These findings are difficult to interpret. One cannot conclude that greater staff input could have helped to avoid prolonged use because causality is elusive. It may be that the greater intensity of inputs into “temporary” use cases reflects the operation of other factors.<sup>29</sup>

28. Both “temporary” and prolonged users suffer from high staff turnover.<sup>30</sup> On average, program countries had four different mission chiefs over the last five years with very little difference between the two groups.<sup>31</sup> Turnover among other mission members was also high for both groups. These findings are consistent with comments received from prolonged users’ authorities as well as from IMF staff.

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requirements over the program period, for which available data cover the 1990–2001 period. The differences found between prolonged and “temporary” users were small and statistically insignificant.

<sup>28</sup>These conclusions are consistent with those suggested by data compiled by the Office of Internal Audit and Inspection (OIA) of the IMF in the course of one of its recent reviews and provided to the IEO, which confirms that prolonged users receive, overall, fewer missions than “temporary” users and also revealed that, for non-PRGF-eligible countries, this difference is compounded by a smaller average mission size. In PRGF-eligible countries, by contrast, mission size has generally been larger for prolonged than for “temporary” users (except in FY2001). A large part of the difference in mission size was accounted for by staff from functional departments.

<sup>29</sup>For example: because (i) programs with “temporary” users are less likely to have been immediately preceded by another arrangement, more preparatory work and consultations with the authorities and other stakeholders are needed to design the program; or (ii) programs with “temporary” users suffer from fewer fatal interruptions which means that, on average, more reviews get completed, with the associated mission work; or (iii) they have more conditions, thus requiring a more intensive monitoring process. Econometric tests on the determinants of success of adjustment programs (for instance, Ivanova and others (2001) and Dollar-Svensson (2000)) found that, once the endogeneity of institutional effort was taken into account, it did not have a significant impact on the probability of success of a program. Interestingly, this conclusion held regardless of the sign of the correlation: Ivanova and others (2001) found that the IMF seemed to invest more resources into successful than failed programs, while Dollar-Svensson (2000) found that the World Bank invested more efforts in operations that were eventually unsuccessful.

<sup>30</sup>Based on an analysis of mission travel data compiled by the OIA, as an extension of their previously mentioned work on mission organization and management. The data analyzed cover the period FY1996–2001.

<sup>31</sup>This count does not take into account cases where the permanent mission chief was outranked by a member of the area department front office as ad hoc head of mission.

Both groups identified excessive staff turnover as a significant problem. Although the evidence suggests that the problem is not specific to prolonged users, such a high turnover risks undue disruptions to the quality of country work and of the relationship with the authorities. These detrimental effects could be more costly in the case of prolonged users, owing to the importance of track record and learning curve issues in their case.

## Evidence from the Case Studies and Responses to Questionnaires

29. In this section, we present some evidence related to program design and implementation arising from the three detailed country case studies and the more limited case studies of two “graduators” from prolonged use. In all three of the countries that are the subject of full case studies, some progress toward the resolution of their economic problems was eventually achieved under IMF-supported programs, but this progress was uneven across areas, often took much longer to achieve than initially expected, and generally fell short of what was targeted when the programs were agreed upon (Box 5.1).

30. Drawing upon the evidence from the case studies and on the questionnaire responses from a broader group of prolonged users, we identify a series of problems that appear to have combined to limit the effectiveness of IMF-supported programs in these prolonged use countries. These are a discrepancy between the time frame of programs and the magnitude of their objectives; insufficient attention to program ownership and implementation capacity; issues related to the design of conditionality, especially in dealing with core institutional changes; issues related to the financial programming framework; and issues related to the IMF’s exit strategy for prolonged users. Most of these program design issues appear to have resulted less from weaknesses in the staff’s technical analyses than from a variety of institutional factors, which are discussed in Chapter 6.

31. Before turning to these issues, we should emphasize several points:

- There are obvious limits to how far any conclusions can be generalized from a small number of country cases—especially ones that, by selection, have encountered difficult and protracted adjustment processes. We are not suggesting that all, or even most, programs supported by the IMF suffer from the range of problems identified here, not even among programs with prolonged users. We do not have sufficient evidence to make such a determination. Even among the

### Box 5.1. Overview of What Was Achieved Under IMF-Supported Programs in the Country Cases

#### Pakistan

In Pakistan, little or no lasting progress was achieved on the macroeconomic front, except as regards inflation, which was halved to 4 percent over the 1990s. Both the fiscal and the current account deficits remained high throughout the period and stood, respectively, at 5 and 4 percent of GDP in 2000, while international reserves remained critically low (Table 5.8). Meanwhile, growth declined to an average of 4 percent a year over 1988–2000 and poverty rose steadily, with 30 percent of the population living below the poverty line in 2000.

Progress in structural reforms was mixed. There was substantial change in some of the core areas of the IMF's mandate, for example, liberalization of trade and external payments, public debt management and the conduct of monetary policy, including independence of the central bank. Progress in tax reforms and administered prices (including utilities) and in financial sector supervision was more protracted; but it was eventually significant, although by no means complete. In other critical areas, such as tax administration or public enterprises, only small improvements had begun to materialize at the very end of the decade. Furthermore, the quality of economic governance generally deteriorated during the period of intensive UFR, though for reasons largely unrelated to IMF-supported programs.

#### Philippines

In the Philippines, a long series of programs in the 1960s and 1970s were associated with a period of quite strong growth but heavy external borrowing. They achieved little lasting adjustment and failed to prevent a debt crisis in 1982–83. A large part of the problem appears to have been the difficulty of promoting lasting adjustment in the face of deep governance problems and a lack of political commitment to reform at the highest level, although—reflecting the general approach at the time—program documents tended not to discuss such issues. The eventual crisis was exacerbated by adverse global developments. Subsequently, a considerable degree of adjustment and structural transformation was achieved in the second half of the 1980s and the 1990s under successive programs, although progress took place in spurts and was slower overall than anticipated. Regarding macroeconomic developments, a rapid turnaround of the current account was achieved in the first half of the 1980s but only at the cost of a sharp output decline. Tight monetary policy was also instrumental in preventing a take-off in inflation, which remained moderate subsequently. A substantial current account deficit reemerged, however, in the late 1980s and for most of the 1990s, despite rapid export growth facilitated by a realignment of the incentives structure. Substantial debt restructuring combined with export growth was, however, instrumental in the

gradual resolution of the Philippines' external debt problem. The debt to GNP ratio was halved to 50 percent between 1985 and 1995. There was also considerable fiscal adjustment, with the consolidated public sector deficit reduced significantly from over 7 percent of GNP in 1984–85 to just 0.6 percent of GNP in 1993–97, before rising again to 3.7 percent of GNP in 1998–2000.

In the area of structural reforms, the programs of the 1980s achieved substantial progress in liberalizing the trade and exchange system, the abolition of marketing monopolies in the agricultural sector, public enterprise privatization, and financial sector reform. However, there was also a large unfinished agenda. These reforms were advanced further in the 1990s, with additional trade liberalization, the recapitalization of the central bank, the opening of critical sectors to new competition and foreign participation, and acceleration of the privatization program. There was also progress—although slower than desirable—in strengthening the prudential framework of the financial sector. However, despite these gains, a few long-standing and critical weaknesses, notably a low saving rate, problems with tax collection, and an inefficient public sector, remained unresolved. For example, tax/GDP ratios improved substantially in the mid-1990s, but collapsed again after 1998 as collection problems and other weaknesses reemerged. Moreover, despite some progress, the incidence of poverty remained high and widespread corruption concerns lingered.

#### Senegal

Senegal's adjustment process has been of a stop-and-go variety. After a severe financial crisis in the early 1980s, a period during which implementation of IMF-supported programs was weak, there was a period of improved implementation during 1984–88, which contributed to a marked decrease in fiscal and external current imbalances as well as to much reduced inflation. However, that period saw the emergence of a banking crisis. In the early 1990s, growth slowed down, as "internal" adjustment measures implemented by the authorities did not succeed in addressing competitiveness problems. A nearly two-year period of interruption in IMF arrangements occurred in 1992–93. The devaluation of the CFA franc in 1994 and accompanying measures gave new impetus to the authorities' adjustment effort. A surge in inflation was rapidly contained, fiscal and external imbalances were reduced, and real GDP growth has been at a steady 5–6 percent per annum. During the later part of that period, Senegal's debt problem was also significantly reduced, mainly by debt relief (after the debt was officially recognized as unsustainable in 2000). Since 2000, however, financial imbalances have reemerged, suggesting that the stop-and-go pattern has yet to be eliminated.

In the area of structural reforms, substantial progress was eventually made—broadly following the same stop-and-go pattern—in the areas of price liberalization, trade liberalization, and simplification of the tax system. Generally speaking, the role of the state in the economy has been significantly reduced and the economy has become more resilient to terms of trade shocks, in part thanks to a markedly reduced share of groundnuts and phosphates in total exports. By contrast, in spite of repeated attempts to tackle them over the last twenty years, the problems of the groundnut sector, the petroleum and power sectors and tax collection remain largely unsolved. Besides, with virtually no growth in per capita GDP in the 1980s and the first half of the 1990s, poverty has remained widespread.

### Morocco

Morocco faced very large domestic and external imbalances and a heavy debt burden in 1980 when it entered a long series of IMF-supported programs. It also faced major structural weaknesses, with heavy government regulation of the economy, including on consumer prices and credit allocation, and a strong inward economic orientation. Programs in the early 1980s had only a moderate impact in reducing these imbalances. Fiscal adjustment was initially achieved mainly through expenditure reduction, but substantial domestic arrears occurred. At first, progress on structural reforms was slower than planned, in part due to concerns over their social acceptability.

In the second half of the 1980s, financial adjustment policies and structural reforms became more mutually reinforcing, although progress was not smooth: there were a number of setbacks in the face of exogenous shocks and slippages in the timetable of policy implementation. Nevertheless, reinforced by a strong political backing for the broad direction of key reforms and an effective civil service, substantial progress was eventually achieved. Programs were successful in raising national saving (from an average of 16 percent of GDP during 1980–82 to almost 23 percent during 1990–92), with an improved tax effort contributing to these gains. Debt and debt-service ratios were reduced substantially, with the aid of significant debt restructuring. Significant structural change was also eventually achieved, including the liberalization of most foreign transactions and consumer prices; reform of public enterprises; and tax and public expenditure reform. Although significant challenges remained, including the need to generate faster growth, Morocco was able to “graduate” from IMF-supported programs in 1993.

### Jamaica

The case of Jamaica was examined not to analyze in-depth the effects of its IMF-supported programs, but to illustrate the importance of domestic ownership

of policies and the potential benefits of considering alternative policy options. Jamaica had a long series of arrangements with the IMF stretching from the 1960s until the last EFF expired in March 1996, after which the Jamaican government announced its “independence from the IMF,” indicating that it would not borrow again. At this time, Jamaica still faced large adjustment challenges. Public debt was high (over 100 percent of GDP, with over two thirds external); inflation was over 20 percent; the real effective exchange rate was appreciating; growth remained weak; and the first stages of a major financial sector crisis was under way.<sup>1</sup> The authorities rejected the IMF’s policy advice on several key aspects (notably on a substantial depreciation of the exchange rate and the closure of weak financial institutions) in favor of a “homegrown” macroeconomic program that included running very large primary fiscal surpluses and tight monetary policy to reduce gradually inflation and inflationary expectations. The IMF staff initially doubted that, in the likely protracted low-growth environment that such a stabilization strategy would involve, the authorities would be able to maintain the sizable fiscal effort necessary to avoid unsustainable public debt dynamics.

In the event, the government did manage to generate and maintain large primary fiscal surpluses and, as the authorities’ “homegrown” policy strategy was seen to be implemented quite forcefully, the IMF backed away in subsequent Article IV surveillance reports from its previous insistence on an initial large depreciation, although differences of view remained on the appropriate degree of exchange rate flexibility. In July 2000, it was agreed that there would be IMF staff monitoring of the government’s economic program—an option the authorities pursued in order to obtain an IMF “seal of approval” and consequent access to adjustment lending from the multilateral development banks. The authorities’ program achieved some important results, although Jamaica’s problems are far from resolved. High primary surpluses prevented the public sector debt dynamics from deteriorating further, although it still remains vulnerably high; real interest rates, although still very high, have declined moderately; and the cushion of external reserves has improved. Growth has only recently begun to recovery moderately, after a number of years of stagnation.

Whatever the relative merits of the two different policy strategies—and, it is not obvious that the one favored by the IMF was better—the Jamaican experience illustrates that, once the strong political commitment to the “homegrown” strategy was taken into account, its prospects for success were definitely higher.

<sup>1</sup>See Part II on the case studies for further details.

**Table 5.8. An Overview of Economic Performance in the Three Country Cases***(Period averages in percent, unless otherwise indicated)*

	Country	1971–75	1976–80	1981–85	1986–90	1991–95	1996–2000
GDP growth <sup>1</sup>	Pakistan	3.2	6.2	6.8	5.8	4.8	3.1
	Philippines	6.1	6.1	-2.0	5.4	2.8	4.2
	Senegal	2.4	1.0	3.0	3.2	1.5	5.3
Inflation	Pakistan	15.7	8.7	7.1	6.8	11.2	7.3
	Philippines	17.0	12.3	18.6	7.8	10.0	7.1
	Senegal	13.5	6.8	11.9	0.1	6.8	1.4
Overall budget deficit (percent of GDP) <sup>1</sup>	Pakistan	-7.6	-8.0	-6.1	-7.3	-7.6	-6.5
	Philippines <sup>2</sup>	0.6	-1.3	-2.8	-3.3	-0.7	-1.7
	Philippines <sup>3</sup>	n.a.	n.a.	-5.6	-4.0	-2.5	-2.6
	Senegal	n.a.	-8.2	-6.0	-1.6	-1.3	-0.3
Tax revenues (percent of GDP) <sup>1</sup>	Pakistan	10.3	12.3	10.6	12.4	15.6	16.0
	Philippines	10.3	12.1	10.1	12.3	15.2	14.8
	Senegal <sup>4</sup>	n.a.	21.1	19.5	17.7	17.1	17.1
Government expenditure (percent of GDP) <sup>1</sup>	Pakistan	16.9	17.4	19.0	23.3	23.6	22.2
	Philippines	13.9	13.8	13.1	17.2	18.4	18.2
	Senegal	n.a.	30.1	26.4	20.7	20.8	20.2
Public debt (percent of GDP) <sup>1</sup>	Pakistan	66.9	56.8	54.4	73.8	76.5	79.1
	Philippines	43.6	30.5	32.1	53.2	56.6	57.5
	Senegal	18.2	30.9	72.5	63.8	67.5	75.9
Exports growth	Pakistan	11.0	17.0	3.0	14.0	6.0	0.0
	Philippines	15.9 <sup>5</sup>	20.7 <sup>5</sup>	-2.4	9.9	9.4	3.3
	Senegal	1.2	-4.0	3.1	5.9	0.8	5.0
Current account balance (percent of GDP) <sup>1</sup>	Pakistan	-4.7	-4.6	-2.7	-2.6	-3.6	-4.8
	Philippines	-1.9	-6.9	-2.7	-0.8	-3.3	2.6
	Senegal	-4.6	-8.3	-13.4	-8.2	-6.4	-4.2
External debt (percent of GDP) <sup>1</sup>	Pakistan	52.2	47.0	40.0	47.8	50.3	51.5
	Philippines	29.2	45.4	73.6	80.5	61.4	59.8
	Senegal	17.0	36.7	61.0	59.7	66.2	75.4
Gross international reserves (months of imports)	Pakistan	0.5	1.0	1.8	1.3	2.2	0.2
	Philippines	1.0	2.5	1.5	2.3	6.1	4.9
	Senegal	0.0	0.0	0.0	0.0	0.1	0.0
Gross international reserves (percent of external debt)	Pakistan	9.9	11.5	15.1	7.5	8.3	5.6
	Philippines	32.8	23.0	6.3	7.9	17.0	25.8
	Senegal	11.5	3.9	1.0	0.7	2.8	10.6

Sources: IMF staff reports and WEO database.

<sup>1</sup>GNP rather than GDP in the case of the Philippines.<sup>2</sup>National government balance.<sup>3</sup>Underlying consolidated public sector balance.<sup>4</sup>Government revenue excluding grants.<sup>5</sup>Exports of goods 1971–80 for the Philippines.

case study countries, experiences have varied significantly. Nevertheless, many of the questionnaire responses suggest that the issues identified do not just reflect isolated occurrences.

- A number of the issues discussed are not particular to cases of prolonged use—or even more especially prevalent in such cases than others. But the problems identified do seem to have lengthened the IMF's program involvement in these specific country cases, and they suggest a number of lessons that are worth emphasizing.

- We were not able to quantify the specific contribution of program design issues to prolonged use, as opposed to other factors, including those that are beyond the IMF's control—such as the authorities' actions. However, based on all the evidence analyzed, our judgment is that these issues were significant.

- Finally, some of the problems identified are already well known, since they have been discussed in various previous assessments. For some, important initiatives are already under

### Box 5.2. Were Program Projections Overoptimistic? Lessons from the Case Studies

An examination of initial projections underlying all programs since 1983 for the three country cases as well as Morocco confirms the earlier cross-section evidence that there has been a strong tendency to overestimate export projections in all cases (see table below and Figures 5.2 and 5.3). Real GDP growth was also overestimated, on average, in all four countries. Projections of government revenue were markedly optimistic in Pakistan and the Philippines, but not in Morocco or Senegal. Projections of national saving also proved too high in all countries other than Morocco. In general, the extent of overoptimism embedded in programs was greatest in Pak-

istan and least in Morocco, which is not surprising given the respective track records on program implementation. It is not possible to ascertain from these comparisons whether it was unrealistic ex ante program projections that contributed to weak implementation or vice versa, and it is not possible to estimate precisely the counterfactual of what would have happened if all the programs had been implemented as agreed. Nevertheless, the more extensive discussion in the country studies suggests that, in the case of Pakistan in particular, both the authorities and staff recognized that programs were often built on very optimistic projections.

#### Realism of Program Projections: Average Projections Less Outturns<sup>1</sup>

(Percentage points a year)

	Pakistan	Philippines <sup>2</sup>	Senegal	Morocco <sup>3</sup>
Real GDP growth	1.4	2.1	1.7	1.2
Export growth (in U.S. dollar terms)	5.7	2.5	2.8	0.9
Fiscal balance (in percent of GDP)	1.9	1.6	1.9	1.8
Government revenue (in percent of GDP)	1.3	1.1 <sup>4</sup>	—	—
National saving (in percent of GDP)	2.3	0.5 <sup>5</sup>	2.8	-0.8

Source: IMF staff reports.

<sup>1</sup>Average of all initial projections for programs since 1983, for the year in which the program started and the two succeeding years.

<sup>2</sup>Growth and ratios expressed in relation to GNP, rather than GDP.

<sup>3</sup>For Morocco, except for export growth, projections are for the year in which the program started and the immediately succeeding year, due to the limited time horizon of projections in program documents.

<sup>4</sup>National government tax revenue as percent of GNP.

<sup>5</sup>The apparent rise in the saving rate in the late 1990s and early 2000s may be overstated as a result of statistical weaknesses.

way to try to address them, as will be discussed in Chapter 8.

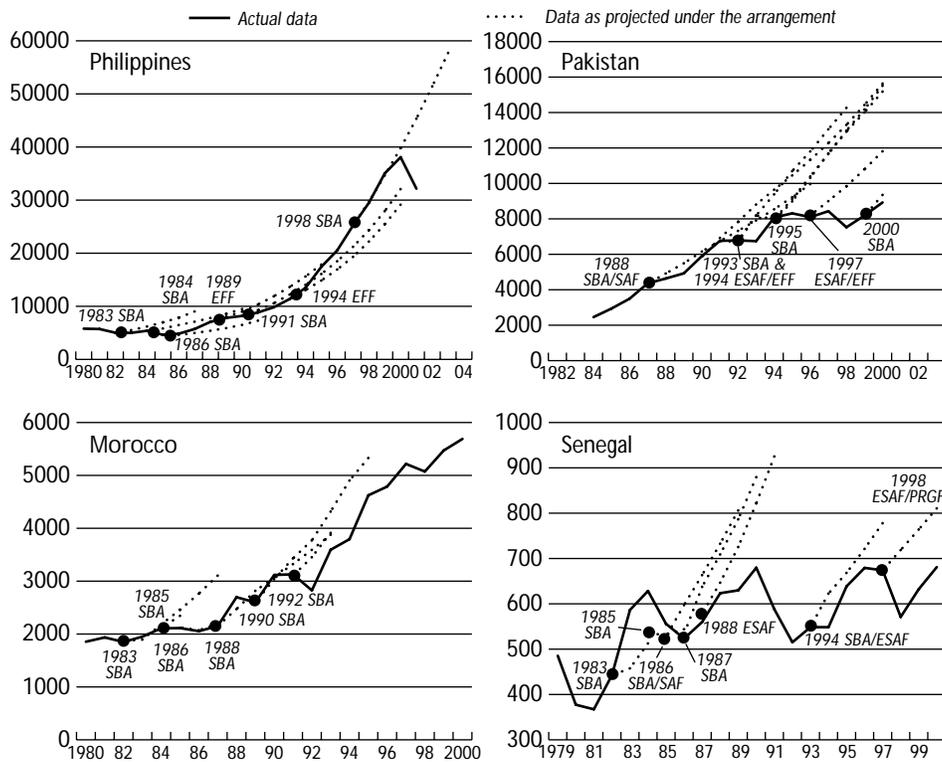
#### Time frame of programs

32. The case studies highlight many instances in which programs tended to “overpromise,” both on the speed of restoration of macroeconomic sustainability and on the pace at which structural reforms could be implemented. On the macroeconomic side, the tendency was most marked in the case of Pakistan, but was also present in expectations about Senegal’s graduation from reliance on debt relief. It is interesting to ask whether the overoptimism observed ex post was only because policies agreed under the program were not always implemented (Box 5.2). Weaknesses in implementation clearly played an important part, as the detailed discussion in the country notes illustrates; and it is no coinci-

dence that the “overoptimism” was least in Morocco, which had the best track record on implementation. However, repeated underestimation of the obstacles to policy implementation is, in itself, a program design problem. Moreover, some programs—especially those with Pakistan in the 1990s—relied on projections for exports and tax revenue that would have been optimistic even with full implementation. (Figures 5.2 and 5.3.) On the structural side, the overoptimism—about both the length and diversity of the reform agenda embedded in programs—occurred in all three cases.

33. As the discussion in Chapter 6 will illustrate, these factors seem to have stemmed in considerable part from institutional pressures to produce substantial visible progress within the relatively short time frame of the program. Interestingly, these pressures were present even in those cases, such as the Philippines, where staff reports were relatively candid

**Figure 5.2. Prolonged Users' Exports**  
(In billions of U.S. dollars)



Sources: Data provided by the national authorities and IMF staff reports.

from an early stage (i.e., following the 1982–83 debt crisis) that adjustment was going to take considerable time. In other words, recognition that IMF program involvement was likely to be lengthy does not appear to have changed fundamentally the approach to program design.

34. The relatively short time frame of program design also meant that, in some cases, less priority was given initially to those elements of the structural reform agenda that were inevitably going to take a significant amount of time, even though they were important for long-term sustainability or when their nonimplementation caused adverse side effects and ex post sequencing problems. For instance, in Pakistan, early programs envisaged a simultaneous cut in trade taxes and creation of a broad-based general sales tax. While the former reform was implemented broadly on schedule, the latter took over ten years to be fully effective, giving rise to large revenue shortfalls in the interim. In all three of the main country cases, the strengthening of regulatory and supervisory systems lagged

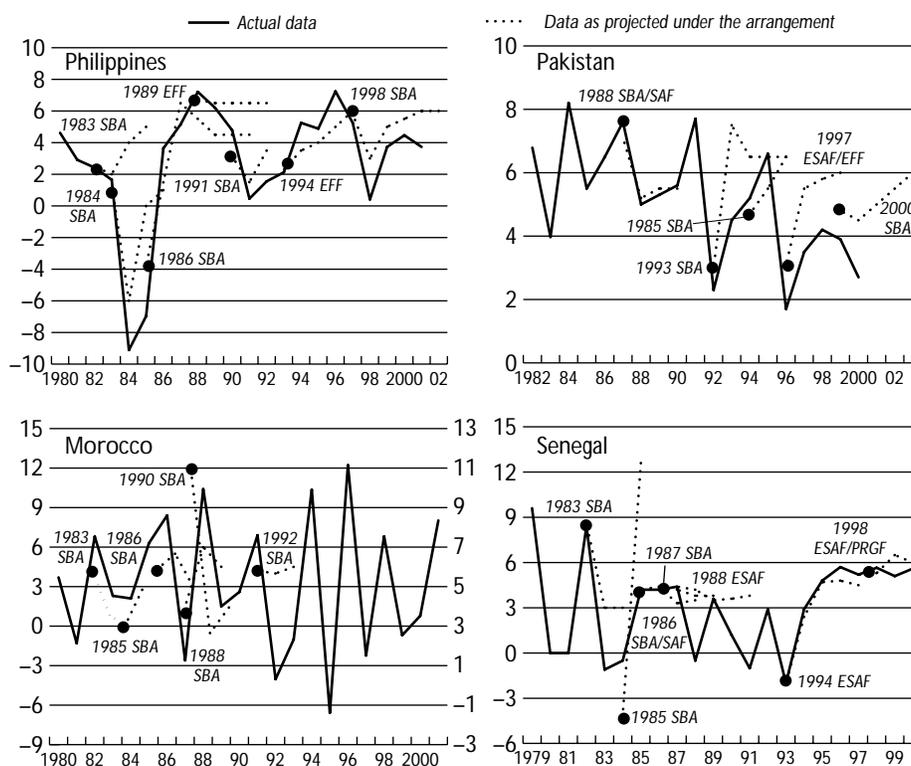
too far behind financial liberalization with adverse consequences for the banking system.

### The extent and nature of conditionality

35. The cross-section evidence discussed earlier suggests that—although there were wide variations from country to country—prolonged users as a group had less structural conditionality and relied upon conditionality that was “softer,” in the sense of being less directly monitorable (i.e., fewer prior actions and performance criteria). We use the case studies to examine, in a more qualitative manner, whether these factors influenced program effectiveness and hence prolonged use.

36. The three case studies illustrate rather different approaches to conditionality. In Pakistan, structural conditionality was extensive and very detailed, with a total number of conditions per program year well above the average of other programs whether with “temporary” or prolonged users (Table 5.5). These conditions overwhelmingly took the form of bench-

**Figure 5.3. Prolonged Users' GDP Growth**  
(Change in percent)



Sources: Data provided by the national authorities and IMF staff reports.

marks and performance criteria. In the Philippines, by contrast, conditionality relied primarily on reviews, with practically no benchmarks and a minimal number of performance criteria (0.2 per program year on average). Total formal conditions per program year were less than half as many as the GRA prolonged users' average. In Senegal, the approach adopted was broadly consistent with ESAF/PRGF prolonged users' average, with a heavy reliance on structural benchmarks and a somewhat above-average recourse to performance criteria. However, all three countries share a below-average use of prior actions. Interestingly, in spite of these differences in the overall approach to conditionality, all three countries had similar and significantly above-average implementation indices—as measured by the degree and timeliness of compliance with program conditionality as long as programs are on track (Table 5.6).<sup>32</sup>

<sup>32</sup>As noted earlier, the fact that implementation is not recorded systematically in the MONA database once a program is off-track biases this measure upward, especially in the case of Pakistan.

37. Our analysis of the nature of conditionality in the three cases—details are provided in the country studies—suggests a number of lessons. We are not implying that these lessons are germane only to prolonged use cases, or that their full adoption would have prevented prolonged use. Many are now well recognized within the IMF. Nevertheless, they are important for program effectiveness and are worth reiterating here.

(i) The specific structure of conditionality is much less important than an underlying domestic political commitment to core policy adjustments. Conditionality can be potentially useful as a device to signal that commitment and as a device for monitoring progress, but it does not appear to have been effective at enforcing changes in the cases where the necessary political commitment was absent. In that sense, the critical factor contributing to prolonged use was not that the guidelines calling for different approaches to conditionality in such cases were not followed—which, the cross-country evidence discussed earlier shows was often so—but that the IMF

often proved reluctant to be more selective in its involvement when political commitment to implement necessary changes was lacking. The case of Pakistan is one example. The Philippine case also suggests that the modalities of conditionality were not the critical factor explaining the relative lack of success in strengthening tax administration—since a variety of approaches were tried without lasting success, including prior actions, benchmarks, reviews, and detailed commitments summarized in a policy matrix.<sup>33</sup> In Senegal, restructuring of the groundnut sector remains incomplete in spite of various forms and types of conditions contained in programs since the early 1980s, in part reflecting policy reversals associated with social and political sensitivities.

(ii) Excessively detailed conditionality—whether resorted to because of a weak track record, doubts about ownership, or to support reform-minded groups within government—does not appear to have been effective in enhancing implementation.<sup>34</sup> One example is the effort to implement tax administration reforms in the Philippines under the 1998 SBA.<sup>35</sup> The “Memorandum of Economic Policies” contained an extremely detailed matrix of commitments, but this was agreed primarily with officials of the outgoing Ramos administration, and the incoming officials were not committed to it. In the event, the “matrix approach” proved ineffective, including as a monitoring device, because it was relatively easy to find superficial ways to meet the commitments. In Senegal, in response to weak implementation, there was a sharp increase in the number of structural conditions and an escalation from “soft” to “hard” conditions during the second and third annual arrangements under the 1998 ESAF/PRGF. This was only partially effective as some measures were implemented with significant delays or in ways that did not meet program objectives (e.g., the withdrawal of the state from the collection and transport of groundnuts did not lead to the liberalization envisaged in the program, as the authorities continued to set indicative margins rather than allow the market to determine transportation and collection costs).

<sup>33</sup>However, owing to the strong and consistent resistance of the authorities, almost no “hard” conditionality was used, in particular no quantitative performance criteria on tax revenues or indicative targets creating a presumption of corrective action when breached, such as were used in Senegal and Morocco for instance.

<sup>34</sup>This is not to suggest that overly detailed structural conditionality was especially prevalent in prolonged cases; indeed, the broader cross-country evidence discussed earlier suggests it was not, with the exception of a few countries, including Pakistan.

<sup>35</sup>See the Philippines study (Part II, Chapter 10, section on “Improving the tax structure and strengthening tax administration: an example”).

(iii) This is not to say that the form taken by conditionality is irrelevant. In particular, there is some evidence from the case studies that conditionality that focused on policy rules or procedures, rather than discretionary, one-time actions, was ultimately more effective.<sup>36</sup> For example, in Pakistan this approach was eventually adopted with some success in the area of tax exemptions as well as in the area of utilities price adjustments. However, the Senegal case study shows that reversals can occur even with policy rules, as happened with an automatic pass-through mechanism for the retail prices of petroleum products that was suspended prior to presidential elections in 2000.

(iv) The evidence is mixed as regards the effectiveness of prior actions. Historically, as noted in Chapter 3, staff reports and Executive Board meetings discussing strategies to deal with prolonged use had supported front-loading the adjustment and reform effort with a greater use of prior actions, while back-loading disbursements to provide an extra incentive to sustain the reform effort over the span of the program. In practice, most of the programs in Pakistan and the Philippines featured neither front-loaded structural reforms nor back-loaded disbursements—which is consistent with the cross-country evidence discussed earlier. The one program that most clearly did both (i.e., the 2000 Pakistan SBA) was implemented well, but it unfolded in an environment characterized by strong political commitment, which makes it hard to disentangle the independent impact of front-loading of reforms. In Senegal, disbursements were generally not back-loaded, but some programs did front-load the policy effort, including through prior actions—largely when the political circumstances, including the electoral cycle, were favorable—and these tended to be more successfully implemented.

(v) A closer analysis of some prior actions used in the three country cases casts light on the somewhat counterintuitive conclusion of several recent studies, according to which the number of prior actions has not had a significant influence on program implementation.<sup>37</sup> A large part of the problem was that the prior actions chosen were not always well-integrated into the program design. The discussion in the Pakistan country note of the prior actions related to agricultural taxation in the 1993 SBA and 1994 ESAF is

<sup>36</sup>Elborgh-Woytek and Lewis (2002) provide a detailed assessment of how IMF conditionality has operated in the case of privatization of state enterprises in Ukraine and come to a similar conclusion.

<sup>37</sup>See, for instance, IMF (2002d) or Thomas (2002).

especially informative:<sup>38</sup> both prior actions were judged to be met and yet neither resulted in meaningful taxation of agricultural incomes. Agricultural taxation became the focus of prior actions because conditionality in previous programs had been ineffective (i.e., there was a weak track record on the issue) and because it was highly desirable on equity grounds. But the prior actions specified were not critical to achieving the programs' macroeconomic objectives, since the revenues they would have raised, even if effectively implemented, were small. Moreover, other potential prior actions, that were more macro-critical, appear to have been dropped during the process of negotiation (e.g., extension of the GST base or reintroduction of the petroleum price adjustment mechanism). This example illustrates two lessons: (i) prior actions, like any other conditionality, can be subject to superficial or temporary observance if domestic ownership/political commitment is weak; and (ii) prior actions imposed for "symbolic" reasons, rather than in view of their criticality for the achievement of program objectives, do not enhance program effectiveness.<sup>39</sup>

(vi) Conditionality is especially difficult to apply to complex regulatory and institutional issues that are often critical to achieving longer-term sustainability and avoiding prolonged use. In these circumstances, use of reviews based on an assessment of outcomes is probably a better approach, rather than attempting to split the reforms into a detailed timetable of discrete, intermediate steps that are then subject to conditionality. But the Philippines' experience also suggests that while a use of reviews and a focus on broad outcomes is the best way of monitoring progress with complex reforms, even this approach has its drawbacks, since there was often a lack of clarity over the "bottom line" of conditionality. Each review became an occasion for "recontracting" the underlying commitments, which weakened their credibility. In retrospect, greater specificity in identifying a small number of critical outcomes, with progress assessed through reviews, may have been desirable.

(vii) The case studies provide some evidence that the credibility of conditionality can be eroded by

<sup>38</sup>See the Pakistan study (Part II, Chapter 9, section on "Lack of ownership and inconsistent monitoring resulted in poor implementation").

<sup>39</sup>Prior actions can also turn out to be counterproductive when they force the hasty adoption of a measure, through procedures that subsequently put its implementation at risk. This happened in the Philippines with a prior action for the 1994 EFF on expanding the VAT base, which although formally passed in 1994 was not implemented until 1996 because of a judicial challenge that might have been avoided if the authorities had followed a different, but lengthier, procedure for its adoption.

many repeated programs. According to many Pakistan officials, the expectation that the IMF would eventually provide financing—by agreeing either to waivers or to new arrangements shortly after program interruptions—weakened incentives to tackle the fiscal deficit forcefully. Similarly, in the Philippines repeated programs appear to have fostered the view that policy commitments could be readily renegotiated. In Senegal, the views expressed on this question by various stakeholders were mixed.

### Dealing with core institutional and structural changes

38. As discussed earlier, part of the explanation for prolonged use in all three countries was that a number of intractable issues took a very long time to correct and some have still not been resolved. This reflects the fact that attempts to fit complex reforms into the time frame and conditionality framework of IMF-supported programs sometimes caused priority to be given to easily measurable actions over more complex and more important institutional changes. For example, in all three countries, tax administration reforms were recognized as centrally important to achieving longer-term revenue improvements, but were often given less explicit focus in programs than more visible tax policy changes, even when technical assistance was offered in parallel to programs to address them. This was in part because the impact and timing on revenues was less easily measurable or could result in an initial revenue loss that would have complicated program design in the short run. The choice to pursue these reforms through means other than program conditionality appears to have sent a signal—or created an incentive—to treat them as secondary priorities. While this may be appropriate in a near crisis context, it is not effective in a de facto long-term relationship between the IMF and the member.

39. Other areas where a stronger early emphasis on institutional reforms in macro-critical areas might have mitigated subsequent problems were in the banking sector (in particular, risk management practices and prudential regulations, especially in Pakistan and the Philippines) and public enterprises (in all three countries). For example, in Pakistan, public enterprise adjustment in programs was not addressed from a broader institutional reform perspective until the end of the 1990s. Because earlier programs did not effectively come to grips with the broader reform needs of these enterprises, they tended to focus on tariff adjustments that although warranted from a purely fiscal perspective, implied an acceptance of low efficiency levels in these enterprises leading to a higher cost structure for Pakistan's industry. As discussed in the Pakistan study (see Part II, Chapter 9),

these problems reflected, in part, a failure of Bank-Fund collaboration to focus on such issues in an operationally effective manner at an early stage.

### Ownership and assessments of feasibility

40. In each of the three main country cases, the risks to the programs of weak political commitments were often understated. For example, reports to the Executive Board on Pakistan generally downplayed the effects of the considerable political instability that prevailed throughout 1988–2000 on governments' willingness and ability to implement far-reaching reforms—although there was more discussion of such issues in internal documents. Similarly, in the Philippines, programs tended to underestimate the difficulties of pushing reforms through Congress—although staff did make significant efforts to interact with key congressional committees in an effort to enhance domestic commitment. Coverage of such issues in internal documents was variable and only a few (e.g., an internal ex post assessment of the Philippines 1989–91 EFF) provided a candid assessment of such constraints. Even in these cases, subsequent Board papers were less candid. In general, most Board papers on the programs had no significant assessments of ownership. This is not surprising since this only became an operational concern very recently, but it points to areas where future policies should be different (see Chapter 6).<sup>40</sup>

41. There was also relatively little presentation in internal briefing papers—and even less in Board papers—of the trade-offs between potential alternative strategies, including in cases where there were substantial divergences of views between the staff and the authorities.<sup>41</sup> Furthermore, only limited attention was often paid to assessing and developing implementation capacity, both in a technical and political sense.

### Issues related to the IMF's financial programming framework<sup>42</sup>

42. There was broad recognition—both in the country cases and in the responses to the questionnaire sent to other prolonged users—that one of the

most valuable contributions of programs has been in focusing attention on a sound macroeconomic framework and in providing a consistency check on the key components of that framework. However, several weaknesses in the approach, as it is implemented in practice, occurred frequently. Once again, these issues are of broader relevance and not just for the prolonged users.

(i) Too little attention was often paid to analyzing the real economy dynamics and the expected sources of growth. In some cases (e.g., most of the Pakistan programs during the 1990s), overoptimistic growth and revenue projections in effect “squared the circle,” allowing projected fiscal deficits to appear consistent ex ante with other macroeconomic objectives, and thereby avoiding some difficult fiscal choices. The result was to force ad hoc policy adjustments that were inconsistent with the medium-term strategy and were generally not sustainable. Similarly, overoptimism about the speed of recovery in private investment, in the face of a continuing debt overhang, was a problem with the 1989 Philippines EFF.<sup>43</sup>

(ii) Many programs had difficulty in dealing with uncertainty. As in all macroeconomic policymaking, program design faced enormous uncertainties—including about the nature of behavioral relationships, key international prices, supply conditions, and the pace of implementation of reforms. But many program documents did not spell out the key risks facing the program, nor did they conduct suitable stress testing exercises. While the actual adaptation of programs to unanticipated events has to be left largely to reviews,<sup>44</sup> the limited ex ante discussion of the major risks and of how policies and targets could respond to deviations from program assumptions meant that there was generally too little mid-course reconsideration of the logic of program design until programs were already close to being off-track. As a result, policy adjustments were often too slow and risked being inconsistent with the long-term strategic objectives of the program (e.g., short-term expenditure squeezes or ad hoc revenue measures).<sup>45</sup>

<sup>40</sup>Cordella and Dell'Araccia (2002) also suggest a number of reasons why ex ante knowledge of a country's degree of commitment to a program can help reduce the costs associated with the imposition of suboptimal levels of conditionality.

<sup>41</sup>A notable exception in Senegal relates to the 1992 Article IV staff report and (especially) briefing papers for possible UFR in 1993 that contrasted the authorities' purely “internal” adjustment strategy with a more “comprehensive” approach—including exchange rate action—favored by the staff.

<sup>42</sup>See Mussa and Savastano (1999) and Khan and Knight (1985) for a discussion of this framework.

<sup>43</sup>Such overoptimism about the pace of response of private investment does appear to be a significant problem in the design of many programs. See, for example, Goldsborough and others (1996).

<sup>44</sup>The one example in the case studies where a program attempted to prespecify, in a fairly rigid quantitative manner, how the mix of adjustment and financing would respond to various exogenous shocks was the Philippines' use of the Compensatory and Contingency Financing Facility (CCFF) along with the 1989 EFF. It proved cumbersome and ineffective. See the Philippines case study in Part II, Chapter 10.

<sup>45</sup>Senegal's 1994 SBA and the 1994–97 ESAF arrangement contained understandings that in the event that world prices for

### Box 5.3. Exits from IMF-Supported Programs: A Comparison of Morocco and the Philippines

Morocco “graduated” from the use of IMF resources in 1993 and the Philippines in 2000. A review of various economic indicators suggests that their positions were not that different in the early 1990s: the Philippines had a higher current account deficit and lower, albeit still comfortable reserves, but had lower debt and debt-service ratios. The fact that the Philippines had almost fully liberalized its capital account, while Morocco still had a more restrictive system, could have implied the need for a higher reserve cushion, but the Philippines also had a more flexible exchange rate regime.

	Philippines			Morocco		
	1982–84	1992–94	2000	1982–84	1992–94	2000
Current account balance (percent of GNP or GDP) <sup>1</sup>	-7.0	-4.0	11.5 <sup>2</sup>	-8.7	-2.0	-1.7
External debt to GNP or GDP ratio <sup>3</sup>	73.4	62.1	63.1	100.2	89.0	48.3
Debt-service ratio						
Before rescheduling <sup>3</sup>	48.1	24.0	14.6	49.7	38.1	19.3
After rescheduling	44.3	19.7	14.6	33.9	38.1	19.3
Fiscal deficit (percent of GNP or GDP) <sup>4</sup>	8.2	2.7	4.6	12.1	2.8	6.5
Gross national saving (percent of GNP or GDP) <sup>1</sup>	21.4	20.0	28.3 <sup>2</sup>	18.6	20.4	23
Reserves (months of imports)	1.3	3.2	4.6	0.9	4.8	5.5
Inflation (percent)	20.7	8.5	4.3	9.7	5.3	1.9
Per capita income (U.S. dollars)	663	860	1,039	737	1,110	1,159

Source: IMF staff reports.

<sup>1</sup>Ratios and growth rates are in terms of GNP for the Philippines and GDP for Morocco.

<sup>2</sup>May be overstated as a result of statistical weaknesses (see the Philippines case study for details).

<sup>3</sup>Public and publicly guaranteed debt for Morocco.

<sup>4</sup>Underlying consolidated public sector deficit for the Philippines; central government overall deficit (payments basis) for Morocco, excluding privatization receipts.

In this respect, a large proportion of responses to the questionnaire noted that programs paid insufficient attention to how policies would respond to external shocks. However, a number of the more recent programs mark some improvement in that respect—for example, the 2000 SBA of Pakistan contained a candid discussion of risks and uncertainties. The guidelines and framework for assessments of external sustainability endorsed by the Executive Board in June 2002, which are meant to be applied in priority to program countries, are a further step in that direction

groundnut products and cotton turned out to be lower than projected, any associated fiscal shortfalls would be corrected by revenue-raising or expenditure-reducing measures. However, this approach appears to rule out the possibility of allowing an increase in the fiscal deficit to accommodate a temporary terms of trade shock. Moreover, the nature of the revenue and expenditure measures is not discussed, which increases the risk of ad hoc measures that are not consistent with the medium-term growth objectives.

and, if implemented consistently, could bring about significant improvements.

(iii) Many officials as well as many staff also noted that too much of the time available for program negotiations (as well as the authorities’ subsequent monitoring efforts) was spent on “fine-tuning” the details of the financial programming exercise—by more than was justified given the inevitable uncertainties about the underlying behavioral relationships and economic environment. As one response to the questionnaire put it, there was “too much focus on fine-tuning of technical issues with not enough attention to higher quality conditionality.”

#### Lack of well-defined exit strategies

43. The problems discussed above were sometimes accompanied by too broad a rationale for the IMF’s involvement through a program relationship

that inevitably encouraged prolonged use. This appears to have been the case in the Philippines for parts of the 1990s. Such an approach appears to have reflected, from the authorities' perspective, uncertainties as to the effects that putting an end to the 30-year program relationship would have on markets. From the standpoint of the IMF, it reflected a belief that a continued involvement would foster "good" policies, including by enhancing the leverage of domestic reformers, or (in 1998) would help to sustain earlier gains by avoiding backsliding during a change of administration. Indeed, a comparison of the situation of the Philippines and Morocco in the early 1990s does not suggest any clear rea-

sons why different approaches to an "exit" from IMF resources was taken (Box 5.3).<sup>46</sup> Similarly, there appears to have been little discussion of a possible exit strategy in the case of Senegal.

44. This experience suggests that, as more PRGF-eligible countries move toward having eliminated their structural balance of payments imbalances, the lack of a well-defined exit strategy—or criteria to guide such a strategy—could contribute to a more prolonged use of IMF resources.

<sup>46</sup>Clearly, the onset of the Asian crisis in 1997 justified renewed IMF financial support, but this was not a factor in deciding on the nature of IMF involvement in 1994.

## CHAPTER 6

# Influence of IMF Governance and Other Institutional Factors on Prolonged Use

1. In this chapter, we examine governance issues that are relevant to the phenomenon of prolonged use. These include institutional biases that can affect program design and contribute to prolonged use, including the issue of whether program activities have “crowded out” surveillance in these countries, and the implications of the IMF’s role in providing a “seal of approval” on policies.<sup>1</sup>

### Impact of the IMF’s Institutional Culture on Program Design

2. Some of the problems of program design identified in the previous chapter as contributing to prolonged use have their roots in the institutional culture of the IMF. These institutional characteristics are obviously not specific to prolonged users: they constitute the background to all IMF-supported programs and there is no straightforward and probably no unique explanation of why these institutional features led to prolonged use in some cases and not in others. However, any discussion of the causes of prolonged use that ignored these factors would be incomplete. We note, however, that recent initiatives have begun to address a number of the problems discussed below, and their success would help to reduce the occurrence of prolonged use in the future.

### The treatment of institutional reforms in program design

3. Two factors that are critical to the sustainability of any adjustment effort, namely institutional change

<sup>1</sup>In addition to the country case studies and the questionnaire sent to the authorities of all prolonged users, the discussion draws upon a survey of IMF mission chiefs. The questionnaire sent to prolonged users is reproduced in Annex 5. The main components of the mission chiefs’ questionnaire and its results are shown in this chapter. We would like to thank the IMF’s Office of Internal Audit and Inspection (OIA) for the help they provided in implementing the latter survey.

and good governance, have received too little attention until recently. The approach toward structural reforms adopted from the late 1980s onward often led to an overload of the reform agenda—a phenomenon observed in the country case studies—that resulted in a de facto failure to focus on the reforms that were most critical from the perspective of long-term sustainable adjustment and that often depended critically upon institutional development. (See Chapter 5 for a more extensive discussion of this point.) Governance problems, which were also important in all three case studies, were not discussed openly until the late 1990s, when the Executive Board adopted guidelines setting out the role of the IMF in governance issues. The case of the Philippines toward the end of the Marcos era, when governance issues were explicitly raised, was an exception.<sup>2</sup>

4. Mindful of these problems, the IMF in 2001 launched a review of conditionality.<sup>3</sup> Although the review is still under way at the time of this evaluation, it has already led to a strong drive toward streamlining conditionality, in particular through a stricter application of the macroeconomic criticality test. By narrowing the scope of structural conditionality, this initiative should pave the way for programs that incorporate a greater prioritization of structural reforms. We would, however, emphasize that streamlining by itself is no guarantee that the

<sup>2</sup>Even though these guidelines were adopted following a declaration of the IMF’s Interim Committee on September 26, 1996 that attached particular importance to “promoting good governance in all its aspects,” their adoption was controversial enough for the Fund’s Legal Department to be asked to ascertain their consistency with the Articles of Agreement. The conclusion of consistency was reached based primarily on the fact that the guidelines did not assert that the IMF had a general mandate to promote good governance, but rather identified certain areas of IMF involvement that were referred to as governance. In practice, the guidelines limit the IMF’s involvement to the economic aspects of governance that could have a significant macroeconomic impact. They were reviewed and left unchanged by the Executive Board in early 2001.

<sup>3</sup>See, for example, IMF (2001c and 2002d). Both are available on the IMF’s website.

few reforms pursued in each program will truly be the most critical ones, nor that they will be tackled in sufficient depth. Meeting these two challenges requires a strengthening of the treatment in program design of the key structural reforms, and a much closer and more effective collaboration with the World Bank than has generally been the case until now.

5. All three case studies reveal that one factor contributing to prolonged use was the presence of a few seemingly intractable structural problems, including in the areas of tax administration, public enterprises, and administered prices, that hampered adjustment. The IMF frequently approached those issues from the narrow angle of their direct—often just fiscal—macroeconomic implications, while the World Bank concerned itself with the design and implementation of the broader structural reform.<sup>4</sup> In practice, this joint involvement sometimes gave rise to coordination problems that in turn led to weaknesses in program design. Such problems included overlapping—and on occasion conflicting—policy advice, ex post inadequate sequencing of reforms, or de facto cross-conditionality, all of which contributed to the ineffectiveness of the reform process in these areas. For example, in Pakistan, at one point the World Bank and the IMF had different targets for power prices, the Bank’s target being geared to achieving a specific rate of return on investment, while that of the IMF was motivated by fiscal considerations. In Senegal, progress in the disengagement of the state from the groundnut sector, which was pursued in successive IMF-supported programs for fiscal reasons, was long hindered by the lack of progress of reforms targeted at the reorganization of the sector, even under World Bank sector and adjustment lending operations.

6. The different time frames on which the two institutions operate has often been blamed for these recurrent difficulties, along with various procedural differences. However, in the case of prolonged users, both the World Bank and the IMF have had de facto a long-term involvement, which makes time frame conflicts a not fully convincing explanation. While a full assessment of the causes of these problems is beyond the scope of the current evaluation, they appear to lie much deeper than a mere failure of the two staffs to coordinate adequately; they reflect different institutional cultures, program modalities, and objectives—and hence will be harder to resolve. Indeed, a number of the difficulties in tackling structural problems in a coordinated manner occurred in

<sup>4</sup>However, there were important exceptions. For example, in the Philippines, IMF-supported programs took the lead in the dismantling of sugar, coconut, and other monopolies that were part of the “crony capitalism” legacy of the Marcos era.

cases where the staff of both institutions characterized the working relationship as good.<sup>5</sup>

7. Several steps have been taken in the recent past to clarify further the division of labor between the two institutions and devise concrete mechanisms and procedures that should foster a more efficient collaboration, in particular the designation of a “lead agency” in each policy area of common interest, with close interactions and accountability built-in.<sup>6</sup> Most of the prolonged users surveyed as part of the evaluation recognized that there had been some improvement, because of the streamlining initiative and the PRSP process, but they emphasized that much more was needed. Looking ahead, the key challenge, in order to achieve sustainable adjustment earlier and thereby minimize prolonged use, is to ensure that the two institutions and the authorities will be able, jointly, to identify the limited number of structural reforms which are key to long-term macroeconomic sustainability and sustainable growth; to collaborate effectively in designing the most appropriate strategy for implementing such reforms; and to monitor their implementation through appropriate, but parsimonious, conditionality. This will require a much more effective meshing of the priorities and work programs of the IMF and the World Bank than in the past.

### Insufficient attention to assessments of political feasibility

8. The case studies make clear that ownership and implementation capacity were often the Achilles’ heel of IMF-supported programs in these countries. These were also the reasons most frequently cited by IMF mission chiefs participating in the IEO survey when asked to rank the reasons why the programs they had negotiated or overseen had been unsuccessful. Many country authorities in prolonged user countries also expressed the view that the underestimation by the IMF of the technical and political limits to implementation capacity, and the consequent overoptimism about the speed of success, was an important reason for their prolonged use of IMF resources.

9. Political feasibility is clearly closely related to ownership but is not identical to it, and in principle one could argue that the IMF should make a realistic assessment of political feasibility of any program as an essential aspect of ensuring credibility, whatever

<sup>5</sup>The history of cooperation between the IMF and the World Bank is reviewed in more detail in an annex to IMF (2001e).

<sup>6</sup>Additional initiatives are the creation in 1999 of joint Bank-Fund “products,” such as the FSAP and joint staff assessments of members’ PRSPs, along with the adoption of policies and operational guidelines to strengthen Bank-Fund collaboration in country programs and conditionality in 2001 and 2002.

the level of ownership.<sup>7</sup> It is certainly possible to envisage situations where programs are owned by the government but are not politically feasible.

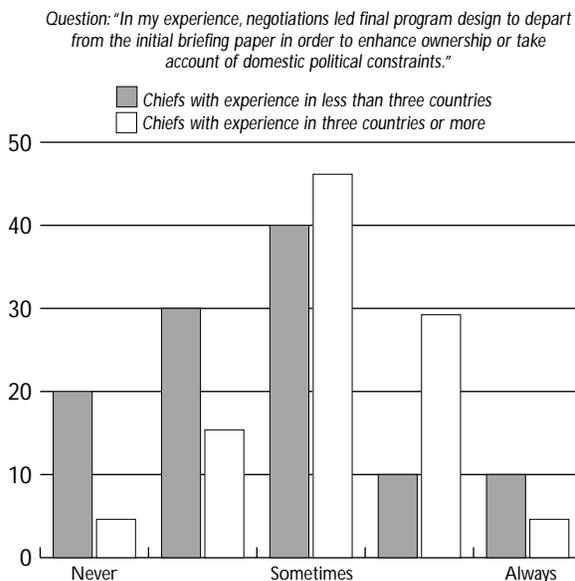
10. Surveys of authorities in prolonged users and IMF mission chiefs indicate that the latter are not insensitive to domestic feasibility constraints. Seventy percent of mission chiefs surveyed reported that, in their experience, the frequency with which final program design departed from the initial briefing in order to enhance ownership or take account of political constraints was more than occasional. Furthermore, most mission chiefs reported that they did not consider their performance assessments to be adversely affected when program negotiations departed from their brief. But the frequency of such departures seems to be positively correlated with the experience level of mission chiefs. About three quarters of mission chiefs with experience in three or more countries reported such departures “sometimes” or “frequently,” compared with less than half of chiefs with experience in less than three countries (Figure 6.1).

11. Many officials and other stakeholders from the prolonged user countries acknowledged that there were wide variations in approaches and that the most effective mission chiefs did invest considerable time in understanding the political situation and consulting with a broad range of participants, but they said that in general too little attention was paid to such issues. Discussions with IMF staff and reviews of internal documents (e.g., back to office reports routinely prepared following missions) also suggest that much more mission time is now devoted to discussions with various political and social groups in an effort to gauge, and enhance, the degree of consensus behind particular reform agendas. Any meaningful reforms will always attract some opposition and, as a number of staff stressed in our discussions, it is important to distinguish between genuine concerns about political feasibility and narrower considerations of short-term political inconvenience that may lead governments to delay reforms when the prospective benefits are only likely over the long term. Several internal documents reviewed by the IEO in the context of case studies suggest that IMF staff often has a good understanding of the political economy of program implementation and the potential risks. However, these considerations often did not surface in staff reports to the Executive Board.

<sup>7</sup>The concept of “ownership” and its possible operational implications were rarely discussed until the last few years. This situation has changed dramatically since 2001, and no fewer than six staff papers directly concerned with that subject have been issued, of which two are research papers and four policy papers discussed by the Executive Board. The most recent papers are IMF (2001d) and Boughton and Mourmouras (2002).

**Figure 6.1. Consideration Given to Ownership in Program Design**

*Distribution of mission chiefs' responses (in percent)*



Source: IEO survey of IMF mission chiefs.

12. The extent to which the IMF could or should analyze political factors in a more explicit and systematic way as part of its decision-making procedures on programs is an important but difficult question to address. A paper prepared at the request of the IEO by a team of political scientists illustrates some of the tools that might, in principle, be used in such political feasibility assessments, although incomplete information obviously limits how much such tools could be applied ex ante in highly complex situations. Nevertheless, the paper suggests that the application of some of these analytical tools to the Pakistan programs of 1993/94 and 1997 would have raised significant doubts about the government’s ability to implement them.<sup>8</sup> It is impossible to say with certainty whether such analyses would have led to different decisions regarding the IMF’s involvement or program design, especially since there was a strong and understandable tendency to give new governments the benefit of the doubt. However, such analysis might have enabled staff, management, and

<sup>8</sup>Wimmer and others (2002). The purpose of the paper is to illustrate the analytical tools that are available to address such issues, not to undertake a full-fledged political economy analysis of particular cases. The paper is available on the IEO’s website at [www.imf.org/ieo](http://www.imf.org/ieo). Its main points are summarized in Appendix 1 to the Pakistan case study (Chapter 9).

ultimately the Board to make better-informed judgments and could have influenced the content of programs. Chapter 8 discusses further how the IMF's handling of political feasibility in its decision-making process might be improved in the future.

### Political influences on IMF decision making

13. Another factor that may affect IMF decisions and underlie the phenomenon of prolonged use is “political” pressure from influential shareholders. Pakistan may be the clearest example of a case where the decision-making process of the IMF has come to be perceived as politically driven by many stakeholders in Pakistan.<sup>9</sup> Such perceptions were also present (although to a lesser extent) in other country case studies. More generally, political pressures were the third most frequent factor cited by mission chiefs participating in the IEO survey in explaining less-than-successful outcomes in the programs they negotiated or oversaw.

14. The impact of political considerations in the IMF decision-making process cannot be measured rigorously, but the survey of mission chiefs suggests that they are neither rare nor widespread. Only 7 percent of mission chiefs surveyed reported that their technical judgment regarding support for a UFR request had been overridden by political pressures “frequently” or “always.” However, as many as 48 percent reported that they had experienced such strong pressures “occasionally” or “sometimes.”

15. It is neither practicable nor desirable to expect that political considerations could be completely removed in an institution whose decisions have to reflect the views of its shareholder governments. However, a problem arises if political considerations are seen to overwhelm technical considerations, leading the IMF to support programs that have a low probability of success. This would inevitably raise concerns that the principle of uniformity of treatment across countries may not be upheld and it could also encourage a lax approach to implementation by the borrowing country. In our view, the focus of action should be on introducing greater clarity and transparency about the nature of the judgments that need to be made and who should make them. The existing guidelines state that the Managing Director of the IMF will recommend that the Executive Board approve a member's request for IMF resources “when it is his judgment that the program . . . will be carried out.”<sup>10</sup> This pre-

<sup>9</sup>Many of the staff members interviewed concurred that many of the decisions on the IMF's involvement in Pakistan since the 1980s had been politically driven to a large extent.

<sup>10</sup>1979 “Guidelines on Conditionality,” guideline 7. The revised guidelines that were under discussion by the Executive Board at the time of writing of this report contain identical lan-

guage. Guideline 8 further entrusts the Managing Director with a responsibility to ensure the nondiscriminatory treatment of members in the application of UFR policies.

<sup>11</sup>The only such process at present takes the form of “informal” Board discussions, convened in the most sensitive and high-profile cases. But since there is no official record of these discussions, they have little value-added in terms of transparency and accountability.

<sup>12</sup>If only by providing a convenient excuse to all parties involved in the negotiation for the shortcomings of program design, and by blurring the signals sent by the program to economic agents, both within and outside the country.

sumes that an absolute judgment can be made on technical grounds. In practice, however, all such judgments—about the likelihood that a program will be implemented and whether it will achieve its objectives if implemented—can only be made in a probabilistic sense, based on a clear assessment of the risks and trade-offs for both the member country and the world community. The present procedure does not make a sufficiently sharp distinction between the technical assessment of the risks and the judgments involved in weighing those risks, which is where any political considerations should presumably enter. This situation has important drawbacks. First, there is no formal and transparent channel through which political judgments on this balancing of risks can be suitably fed into the process before the final stage of Board approval even though it is at earlier stages that political pressures may be greater.<sup>11</sup> This was confirmed by the survey of mission chiefs, significantly more of whom indicated that political pressures occur at key times *before* the Board discussion rather than at the Board itself (Figure 6.2). Second, the line of accountability between staff, management, and the Board becomes blurred. Moreover, the lack of transparency can give rise to exaggerated perceptions of political pressures, which are likely to weaken the effectiveness of IMF-supported programs.<sup>12</sup>

16. We discuss in Chapter 8 what might be done to deal with this problem. The aim should be to ensure that such political judgments—which are an inevitable part of decisions on whether or not to proceed with programs whose outcomes are uncertain—should be clearly distinguished from technical judgments and should be made in a transparent manner at the level of the Managing Director and the Executive Board, who are accountable for them.

### Incentives to overpromise in programs

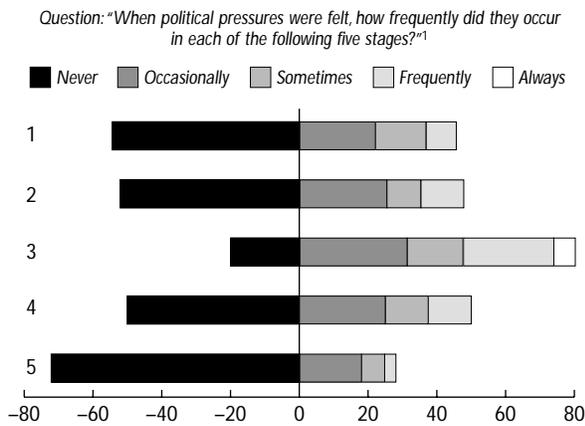
17. The IEO survey of mission chiefs suggests that internal incentives create a tendency to overpromise. As discussed in Chapter 3, until the late 1990s, the rules governing the use of IMF re-

guage. Guideline 8 further entrusts the Managing Director with a responsibility to ensure the nondiscriminatory treatment of members in the application of UFR policies.

<sup>11</sup>The only such process at present takes the form of “informal” Board discussions, convened in the most sensitive and high-profile cases. But since there is no official record of these discussions, they have little value-added in terms of transparency and accountability.

<sup>12</sup>If only by providing a convenient excuse to all parties involved in the negotiation for the shortcomings of program design, and by blurring the signals sent by the program to economic agents, both within and outside the country.

**Figure 6.2. Timing of Political Pressure**  
Distribution of respondents' answers (in percent)



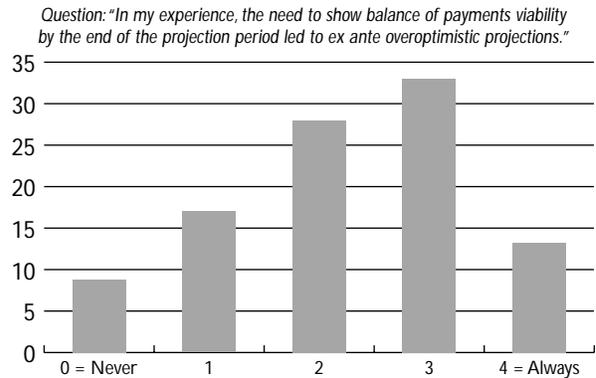
Source: IEO survey of IMF mission chiefs.

<sup>1</sup>1: Drafting mission brief; 2: Clearing brief; 3: Negotiating program; 4: Preparing Board meeting; 5: Board meeting.

sources implied that all programs submitted for Board approval had to show at least substantial progress toward viability within the program period, along with net repayments by the member after the expiration of the program. In practice, the IMF was often placed in a situation where it found it desirable to enter into an arrangement with a member even though there were good reasons to doubt that these viability requirements would be met. In a number of cases, this appears to have led to projections of a return to external viability over the medium term that were overoptimistic not just ex post, as discussed in Chapter 5, but also ex ante. About 45 percent of mission chiefs surveyed by the IEO reported that the need to show balance of payments viability by the end of the medium-term projection period had led to ex ante overoptimistic projections or overambitious program objectives "frequently" or "always," with another 28 percent reporting the same phenomenon "sometimes." In contrast, only about a quarter reported this practice occurring "never" or only "occasionally" (Figure 6.3).

18. While optimistic forecasts may appear to be supportive of borrowing countries in need of assistance in the short run, since they enable a program to be approved, their long-term effect is likely to be adverse. As the case of Pakistan illustrates, they create conditions in which programs are virtually certain to go off-track when the optimistic projections do not materialize, leading to new programs that often meet the same fate. This creates a cumulative impression of poor implementation on the part of borrowing

**Figure 6.3. Incentives Toward Overoptimism**  
Distribution of respondents' answers (in percent)



Source: IEO survey of IMF mission chiefs.

countries and also poor program design on the part of the IMF, eroding the credibility of both. More realistic projections would help to identify financing needs more accurately, both in terms of the volume of assistance needed and the length of time for which support may be necessary. If assistance on the scale required is not feasible, it would at least lead to more realistic assessments of likely outcomes in terms of performance, which would enable the international community to determine whether these are indeed acceptable or whether additional support can be mobilized.

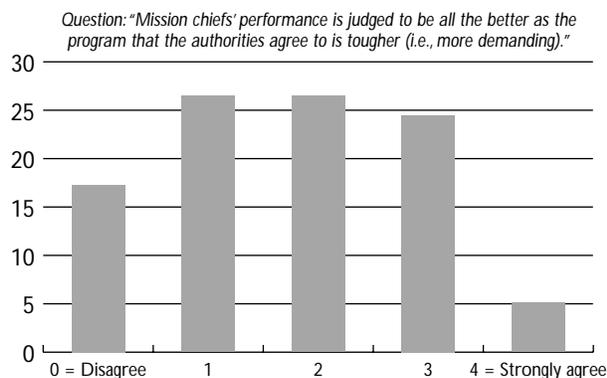
19. A significant proportion of staff members interviewed in the course of the country studies were also of the view that the internal review process gives a premium to "toughness" over realism in the setting of program targets, leading to targets that were more likely to be missed. The survey of mission chiefs further indicated that close to 30 percent of survey participants felt somewhat strongly that their individual performance appraisal would be better if they were "tougher" in negotiations with the authorities, with only 17 percent in clear disagreement with that view (Figure 6.4).<sup>13</sup>

20. The primary purpose of IMF-supported programs, as stated in the Articles of Agreement, is to "give confidence to members," and this objective probably contributed to the tendency to underemphasize downside risks in documents presenting a UFR request or a program review to the Board. The case studies—especially Pakistan—show that even when

<sup>13</sup>There were no marked differences across responses according to mission chiefs' exposure to prolonged users.

### Figure 6.4. Incentives Toward “Toughness” in Program Design

Distribution of respondents' answers (in percent)



Source: IEO survey of IMF mission chiefs.

those downside risks were identified at the stage of the interdepartmental review process, which was frequently the case, they were subsequently toned down in the final Board documents, as were any disagreements between functional and area departments on the appropriate adjustment path or program design. While the ability of the IMF to “speak with one voice” is one of the strengths of the institution, it should not be at the expense of full presentations of the risks to a program, an exploration of policy alternatives, and a frank assessment of implementation capabilities.

21. On the authorities’ side, the case studies suggest that there can be tactical incentives for knowingly agreeing to a program that overpromises in order to achieve a release of external financing. For example, in the particular case of fiscal revenue targets, ex ante overoptimism sometimes made it easier to reach a domestic consensus on the magnitude and design of fiscal adjustment (since overoptimistic revenue targets postponed difficult decisions on expenditure cuts).

#### The role of surveillance

22. In theory, the exercise of surveillance in program countries should provide an opportunity for a “reality check” to compensate for the incentives discussed above. However, the evidence from the case studies suggests that some important aspects of surveillance have been weakened in prolonged use cases. Since the early 1980s, Article IV consultations in program countries have generally been conducted jointly with UFR-related discussions. The case studies suggest that, compared to current

guidelines, there was often less in-depth medium-term sensitivity and vulnerability analysis, less exploration of the possible trade-offs between different policy options, and a less candid discussion of divergences of views between the staff and the authorities (Box 6.1).<sup>14</sup> This appears to stem from in-built concerns not to “rock the boat” by including any analysis that might undermine the credibility of the program and its desired catalytic effects.

23. In countries where programs are occasional events, the combination of Article IV consultations and UFR discussions may also reduce the quality of surveillance, but the impact is temporary. It is potentially much more significant for countries that have a long series of IMF-supported programs, as a weakening of surveillance in such cases could allow vulnerabilities to build up without appropriate warning signals being sent. The buildup of a large uncovered foreign exchange exposure through foreign currency deposits in Pakistan, which culminated with a deposit freeze in 1998, is one illustration of this risk.

#### The IMF’s learning culture could be improved, including through more systematic program assessments

24. Despite various policy requirements and frequent calls by the Board for more “stocktaking” opportunities, there are too few occasions when the institution steps back on country programs to reconsider its overall strategy. One attempt at creating systematic opportunities for staff to step back from routine program work and think strategically about the IMF’s involvement in the member country was made by management in 1992, with the creation of internal “country strategy papers” (CSPs). However, experience with that instrument proved unsatisfactory.<sup>15</sup> In response, a revamped CSP strategy was prepared in 1997, which called for such papers to provide essentially two elements: (i) a critical and frank review of the latest arrangements, covering not only whether program targets were met, but also the appropriateness of

<sup>14</sup>The 2002 Review of Surveillance, which looked at the implementation of surveillance in program countries during 2000–2001, came to similar conclusions. See “Biennial Review of the Implementation of the Fund’s Surveillance and of the 1977 Surveillance Decision: Surveillance in a Program Environment” (SM/02/82, Supplement 2, 3/15/2002).

<sup>15</sup>Memorandum from the then Director of PDR to IMF management. The memorandum indicated that, by mid-1997, only 31 CSPs had been produced (of which only 12 concerned prolonged users), and noted that “it is not clear that a number of the CSPs generated value added commensurate with the efforts involved. In addition, several were lengthy and heavy on detail, providing little assessment of operational relevance or guidance in terms of priorities.”

### Box 6.1. Factors Used to Assess the Quality of Surveillance in Prolonged Use Cases

To assess the quality of surveillance in the country case studies, we rated the performance of each surveillance report for nine functions viewed by the IEO as “key elements” of surveillance in a program context.<sup>1</sup> These nine functions are (i) provision of realistic medium-term and alternative scenarios; (ii) provision of meaningful sensitivity analyses; (iii) discussion of risks to the assumptions and projections; (iv) discussion of the risks and impact of policy slippages and of vulnerabilities; (v) balanced reporting of the authorities’ views, including any significant differences with staff; (vi) cogent presentation of proposed policy course; (vii) discussion of policy alternatives and trade-offs; (viii) criti-

cal and frank review of previous UFR performance; and (ix) presentation of collaboration/interaction with the World Bank.

It must be recognized that, to some extent, such a comparison does involve judging previous surveillance exercises by current standards. More specifically, whereas all the functions highlighted above have been part of surveillance requirements since at least the early 1990s, and often earlier, the emphasis they have received has tended to increase over time. For instance, discussions of risks and vulnerabilities received a much stronger emphasis after the 1995 Mexican crisis, and an even stronger one since the 1997/98 Asian crisis. In contrast, the requirement that staff prepare an analysis and assessment of performance under IMF-supported programs in connection with Article IV reports, adopted in 1979, was never emphasized in subsequent surveillance guidelines.

As noted in the main text, the overall assessment is that many of these key functions of surveillance were not fully implemented in the prolonged use case studies. However, there is some indication that the quality of surveillance in the case study countries did improve over time—most clearly in the Philippines—with respect to some of the key functions identified here, particularly as regards the identification of vulnerabilities. Nevertheless, the main conclusions that some key surveillance functions have not been fully implemented in prolonged use cases remain valid.

<sup>1</sup>These nine functions draw on the “minimum requirements” of Article IV reports as identified on the PDR’s website (which reflects the guidance given by the Executive Board in successive biennial reviews of surveillance up to the 2000 exercise as well as in ad hoc discussions of specific aspects of surveillance policy), as complemented by three other sets of internal guidelines of particular relevance for program countries (the 1979 “Guidelines on Conditionality”—especially guideline 11; the 1990 note on “Assessments of a Member’s Ability to Repay the Fund” and the 1997 note on “Country Strategy Papers,” both issued by PDR) and the 1998 instruction note on Report Writing by the First Deputy Managing Director. These internal instructions add a qualitative dimension to the general guidelines, which themselves are primarily concerned with coverage.

program design; reasons for the success of, or problems in, program implementation; the progress made relative to the ultimate objectives of the country; the remaining issues to be tackled; and an assessment of the effectiveness of the collaboration with World Bank staff; and (ii) a forward-looking strategy for future IMF involvement, taking account of the lessons drawn in part (i) and focusing on the broad pattern of macroeconomic adjustment and key areas of structural reform (including a discussion of the rationale for their choice, phasing, and prioritization).

25. The documents reviewed as part of the country case studies suggest that the quality of CSPs produced since this revamped approach did improve significantly. However, relatively few were produced (in total 24 full CSPs and 3 partial ones between mid-1997 and end 2001—that is, less than 6 a year on average), primarily due to workload constraints. Thus, most programs still do not benefit from any stocktaking exercise when they expire, and those that do are not necessarily the ones for which there would be the greatest need to learn from experience (i.e., in particular, programs that went irretrievably off-track). Moreover, those

prepared for the case study countries suggest that the judgments in CSPs were often not fully reflected in subsequent program or surveillance documents.

26. In contrast with specific country programs, experience with IMF general policies has been subject to quite intensive and usually high-quality reviews. Many of these reviews have drawn clear lessons from their analyses that are of relevance to program design in general, including for prolonged users.<sup>16</sup> However, the process often stopped at the diagnostic stage and some of the lessons identified subsequently took a long time to be actually incorporated into program practices. For instance, several staff papers from the mid/late 1980s identified the lesson that the authorities’ commitment was key to the success of any program and that, if it was lacking, efforts to optimize the program design were

<sup>16</sup>There have been 58 such policy reviews since 1979, covering the entire spectrum of UFR-related issues, from theoretical and operational aspects of program design to access policies, external financing, and the design of various facilities.

bound to be of limited effectiveness.<sup>17</sup> Similarly, most of the ingredients of robust and realistic sustainability assessments mentioned in a paper discussed by the Executive Board in June 2002 that proposed a formal framework for mainstreaming “best practices” in that area, were actually identified and circulated as guidelines to area department staff as early as 1990, with a view “to avoid well-known traps—such as scenarios which seek to establish viability by the use of optimistic assumptions. There is a need to be open about the possible dangers.”<sup>18</sup> Many of these reviews also drew useful lessons for program design that have yet to become fully operational—for example, the importance of an early focus on institutional reforms, particularly for sustainable fiscal adjustment.<sup>19</sup>

<sup>17</sup>See, for instance, EBS/86/211, “Program Design and Performance Criteria,” which noted that “it is important to bear in mind the fundamental limit to the efficacy of program monitoring imposed by the degree of commitment of the member to the policies that make up the program. The commitment of members to their program is essential to their success. While the Fund’s role in providing policy advice is important to the formulation and design of the program, it can only be effective if the member is committed to it and implements it with the consequent resolve.” Also, EBS/87/40, “External Adjustment, Financing and Growth—Issues in Conditionality,” which noted that “the politics of adjustment is often as important as the economics. With benefits of hindsight, it appears that in some particularly difficult situations the capacity to implement adjustment policies was not sufficient. In some instances time may be required for a strategy to emerge that is consistent with domestic political realities.”

<sup>18</sup>See “Assessments of Member’s Capacity to Service its Financial Obligations to the Fund,” memorandum from the Head of PDR to area departments, July 5, 1990: “[Medium-term] scenarios should prove useful in identifying cases where external viability would be ensured only if strong policy actions continued in the post-program period, only if the external environment remained particularly favorable (say, relative to developments in the past), or if creditors were to provide large amounts of exceptional financing through the projection period. It is important that these scenarios not be presented in a way that fails to warn of potential dangers. . . . When an improved policy stance in the post-program period is mainly an extrapolation of progress expected to be made under the program, or if further major improvements are expected in the post-program period without specific policy underpinnings, these limitations should be made explicit. Similarly, an attempt should be made to assess the quality of the adjustment effort, in particular from the point of view of the sustainability of the program. Temporary or cyclical factors should be identified in evaluating the underlying strength of the adjustment.” The note further stressed “the importance of evaluating the risks of policy slippages and the implications of such slippages for the medium-term prospects of the balance of payments and the member’s capacity to repay the Fund. These evaluations could be based on an assessment of those key policy areas where the authorities have had difficulties with program implementation in the past. Also, if key policy elements have been proposed but have yet to be legislated or implemented, the analysis would assess the implication of a failure to adopt the required measures in a timely fashion. Whenever possible, specific contingency measures should be outlined for cases when legislatures fail to act on key policy elements in the program.”

<sup>19</sup>Mackenzie and others (1997): “One basic lesson for successful growth-oriented fiscal adjustment is that, to the extent possi-

27. *Thus, the IMF often seems to have been quite good at identifying lessons, but less effective at ensuring that they were fully absorbed into its everyday operations.* The experience of the country case studies suggests that this slow absorption of lessons and broader policy guidance into actual operations on a systematic basis contributed to weaknesses in program effectiveness and hence to prolonged use. However, it is clearly not a phenomenon that is special to prolonged use cases.

28. These shortcomings in the IMF’s learning culture are compounded by two human resource management issues. First, as noted in Chapter 4, the internal turnover on country assignments is high. While not specific to prolonged users, this is a significant impediment to the development of an adequate learning culture, not least because many of the lessons to be learned from experience are country specific. Thus, even if the lessons from policy review were fully and swiftly incorporated into the IMF’s operational practices, an important gap would remain. Second, high staff mobility limits the accountability of mission chiefs: when mission chiefs have a shorter tenure, on average, than the time span of most programs, their contribution to the outcome of a given program becomes harder to assess. Clearly, program success depends to a very large extent on factors beyond the mission chief’s control, but an effective mission chief should make a difference. Yet, results of the IEO survey indicate that most mission chiefs do not feel that their career progression depends significantly on whether the programs they negotiate and oversee achieve their objectives (Figure 6.5).

### **The “Gatekeeper” Role Assigned to the IMF with Respect to Many Other Sources of Official Financing Also Contributed to Prolonged Use<sup>20</sup>**

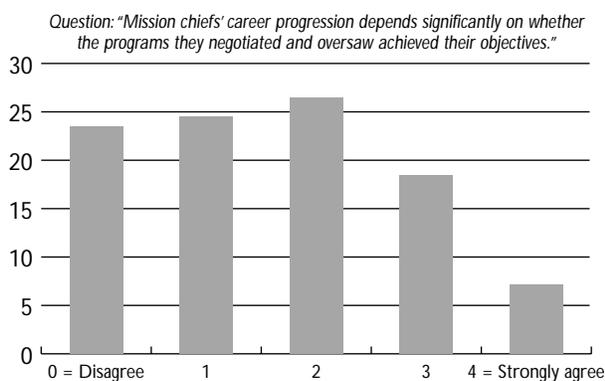
29. In addition to the internal factors affecting program design that lead to ineffective programs and thus encourage prolonged use, there is a systemic factor that has the same effect: the gatekeeper role of the IMF in providing a signal for other resource flows. There is considerable empirical evidence that aid is most effective when a sound eco-

ble, it should emphasize administrative reforms right at the outset. [Experience] suggests that early reform is more likely to be substantial reform.”

<sup>20</sup>The following sections draw upon a series of questionnaires to and interviews with the main bilateral donors and creditors, with the Paris Club Secretariat, and with a range of international banks and asset managers engaged in emerging market investments.

### Figure 6.5. Mission Chiefs' Career Progression and Program Outcomes

(Distribution of respondents' answers (in percent))



Source: IEO survey of IMF mission chiefs.

conomic policy framework, including a sound macroeconomic environment, is in place. The IMF is the international institution most suited to providing certification regarding the soundness of macroeconomic policies, and the main multilateral lenders and most major bilateral donors have come to rely upon the IMF to give this signal when making decisions about their program and adjustment lending. However, the expectation seems to be that the signal will be conveyed in the form of an IMF lending arrangement. Since many countries expect to rely upon bilateral and multilateral flows for an extended period, the requirement that there should be an IMF-supported program in such cases is a recipe for perpetuating prolonged use.

#### Is IMF financing necessary for a seal of approval?

30. It is appropriate to question whether creditors/donors should insist on an IMF-supported program as the only credible seal of approval or whether the same objective could be achieved in some other way, for example, through the surveillance process or staff's assessments of countries' PRSPs. In their responses to the IEO, official donors and creditors often justified their preference for a program on the grounds that a lending arrangement provides a clearer and more reliable assessment.<sup>21</sup> For creditors—especially the Paris Club and the private sec-

<sup>21</sup>The latter point, in some cases, appeared to stem from the perception that the IMF would conduct its assessments more seriously if its resources were involved than otherwise.

tor—"burden sharing" issues may also be important: some of these groups have been reluctant to provide additional financing if large net repayments are being made to the IMF or if the absence of new IMF financing implies that other new sources of financing will not be forthcoming.<sup>22</sup>

31. These considerations are reinforced by the fact that, historically, the Executive Board has been rather reluctant to generalize the recourse to intermediate signaling tools, such as "enhanced surveillance" in the 1980s, staff-monitored programs (SMPs) and other "shadow programs."<sup>23</sup> It is also possible that the various instruments of "strengthened surveillance" were not regarded as providing sufficient assurances to donors because of the lack of clearly defined standards for such instruments. In some cases, these instruments were resorted to when the member's program fell short of what could be supported by a lending arrangement; in other cases, the member's program met or even exceeded UFR standards, but the member did not want to be perceived as being in need of IMF resources.

32. It is worth noting that, unlike the official sector, private creditors have become less dependent on IMF-supported programs as a "seal of approval." Such a signal was needed to enable a debtor country to negotiate rescheduling or restructuring agreements with its private creditors in the decade or so after the debt crisis of the early 1980s and this contributed to prolonged use at the time, for example, in the Philippines. However, this factor has been much less important recently, owing to less widespread debt-servicing difficulties, together with an increasing tendency on the part of the private sector toward one-time restructurings of the debt stock or debt exchanges, rather than a succession of annual arrangements.

33. Nearly all the private financial institutions surveyed as part of this evaluation considered an IMF-supported program to be highly desirable for a debt restructuring or a coordinated debt rollover, but not absolutely necessary.<sup>24</sup> They observed that, his-

<sup>22</sup>In the case of the Paris Club, relying on the IMF has the added advantage of providing an objective framework to determine which countries should benefit from debt restructuring and on what terms. The multilateral and informal nature of the Paris Club also makes its reliance on the judgments of the IMF with regard to debt-service capabilities and the macroeconomic framework natural.

<sup>23</sup>This reluctance was based on varied reasons, including a fear that making IMF assessments too public or explicit might turn the institution into a universal credit rating agency and concerns about marginalizing the catalytic role of the IMF's resources.

<sup>24</sup>In most cases this was because they viewed agreement on an IMF-supported program as providing some assurance that realistic economic policies and reforms would be implemented, eventually leading to the restoration of external viability and so enhancing the value of the debt to be restructured. In many cases, the direct financing implications of IMF involvement were also considered important.

torically, a number of debt restructurings had been completed where an IMF-supported program was not possible. Examples include the reschedulings for a number of East European economies and for South Africa in the 1980s, and for the Islamic Republic of Iran in the early 1990s. In the view of some of the respondents, these reschedulings were “among the most successful.” Respondents also noted that the timing of restructurings by private creditors need not be tied as closely to IMF-supported programs as, for example, Paris Club reschedulings typically are. There are many examples of debt restructurings by private creditors that were completed when IMF-supported programs had gone off-track.<sup>25</sup>

34. For countries that are not facing immediate debt-servicing difficulties, many private investors and lenders take the country’s relationship with the IMF into account, directly or indirectly, in their investment and risk management decisions, but IMF financial involvement is not a necessary signal.<sup>26</sup> Several alternative mechanisms are available for that purpose, for example, precautionary arrangements, staff-monitored programs, and IMF surveillance through Article IV consultations—whose signaling role has been enhanced in recent years as a result of improvements in transparency, with many such reports now being published. These alternatives vary in the degree to which they imply formal IMF approval of policies. The Executive Board has traditionally emphasized that, unlike the so-called enhanced surveillance procedure or precautionary arrangements, staff-monitored programs do not constitute IMF endorsement of the country’s policies. Internal reviews of experience have shown that these distinctions may not always be clear to private market participants. Other factors mentioned as limiting the usefulness of surveillance reports to the private sector include the considerable variability from country to country in terms of disclosure and publication of reports, a lack of timeliness, and limited frequency. In this respect, staff-monitored programs or precautionary arrangements can add value by providing more frequent assessments of developments, at the time of periodic program reviews. In general, most respondents to the IEO survey found IMF surveillance to be a useful input into their risk management assessments.

35. Jamaica’s experience—discussed in more detail in Chapter 12—is interesting since it was able to maintain access to private markets on relatively good terms despite publicly ruling out new lending

<sup>25</sup>For example, Pakistan’s 1999 debt rescheduling agreements with private creditors were concluded as the EFF/ESAF arrangement was off-track, with little prospect of renewed IMF support in the near future.

<sup>26</sup>In a few cases, the relationship is even explicitly taken into account in quantitative risk management systems.

arrangements with the IMF. Senior Jamaican officials interviewed indicated that a commitment to transparency—including publishing the IMF surveillance reports, even when they did not fully share the assessment, and explaining the reason for their different approach—had helped maintain good private market access.<sup>27</sup>

36. The key reason why considerations of an IMF “seal of approval” for the private sector is rarely the determining factor behind prolonged UFR is that most investors and lenders ultimately rely on their own judgments, for which the assessments and analyses of the IMF are only one source of information. The views of other institutions—including credit rating agencies—often also play an important role. Some institutions also expressed reservations about relying too much on the IMF’s judgment, in part because of misgivings about its impartiality, noting its vested interest in helping its members.

37. An important question is whether a prolonged IMF program involvement weakens the credibility of the signals provided by lending arrangements and hence reduces its catalytic effect. It was not possible, in the context of this project, to test rigorously this question, partly because available cross-country evidence on the existence of any catalytic effect is inconclusive.<sup>28</sup> However, among the studies which found a positive correlation between IMF-supported programs and market access, those which tested for the impact of prolonged use found that the beneficial effect of IMF involvement declined in size with the length of past IMF involvement and that continuing IMF presence was associated with higher spreads.<sup>29</sup>

### Consequences of the gatekeeper role for lending arrangements and surveillance

38. There is some evidence from the case studies that insistence on having the IMF’s seal of approval delivered exclusively in the form of a lending arrangement can compromise the quality of IMF-

<sup>27</sup>One senior Jamaican official said that, in his experience, sending appropriate signals to private financial markets did not require an IMF-supported program, but it did require that the authorities not be “fighting with the IMF.”

<sup>28</sup>Several studies covering the 1970s and 1980 found evidence of a negative relationship between IMF involvement and the subsequent supply of new loans. Bird, Hussain, and Joyce (2000) find that the relationship is unstable but, when significant, strongly negative as far as private capital flows are concerned. Conway (2000) and Eichengreen and Mody (2001) find a positive relationship under particular specifications. Evidence is more consistent as regards official capital flows, for which there does appear to be a positive relationship between the presence of an IMF-supported program and those flows. However, the sustainability of aid flows in the post-program period is not established.

<sup>29</sup>See Eichengreen and Mody (2001) and Mody and Saravia (2002).

supported programs, and therefore the quality of the seal of approval. This is because the potential consequences for the member country, in terms of loss of financing, are so serious that pressures build—on both the authorities and the IMF—to agree to programs with a low probability of success.<sup>30</sup> There are similar pressures to keep the programs formally on-track as long as possible, often through unsustainable efforts, even when several performance criteria are not met, under the assumption that officially calling the program off-track would trigger adverse donor responses. Such factors contributed to the problems with a number of Pakistan's programs and have also been an issue in Senegal and the Philippines.

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<sup>30</sup>To be sure, countries with market access retain, to some extent, the flexibility of dispensing with an IMF lending arrangement if they feel the steps required from them to be granted the IMF's seal of approval are not in their best interests. The case of Jamaica, discussed in Part II (Chapter 12), is a good illustration of that situation. On the other hand, countries that do not have access to private capital markets, either permanently or temporarily, have strong incentives to accept the IMF's conditions even when they have misgivings about their feasibility or likely impact.

39. Whatever signaling device is used, it is clearly important to resist pressures to compromise quality. But there is a case for considering vehicles other than an IMF lending arrangement in some circumstances. Private sector creditors have already acknowledged this in their approach to lending to developing countries. Official donors surveyed by the IEO generally took a cautious stance, pointing out in particular that requiring an IMF "seal of approval" to target some of their aid flows had been instrumental in improving the effectiveness of their aid, so that any departure from this—sometimes hard-won—policy rule would imply a step backward in this respect. This premise notwithstanding, most acknowledged the above-discussed dangers of an exclusive reliance on IMF lending arrangements to deliver the requested seal of approval. Most were therefore open to considering alternatives, provided that (i) they suitably addressed the information needs of the donor community; (ii) they delivered sound and candid analyses of economic conditions and prospects; and (iii) they provided a clear assessment that the member's policies are sufficiently strong to be supported. Some possibilities in this regard are explored in Chapter 8.

## CHAPTER 7

# The Implications of Prolonged Use for the Member Country and the IMF

1. In this chapter, we examine the effects of prolonged use on institutional development within the borrowing countries and on the IMF's financial and human resources.

### Implications for the Borrower: Impact on Institutional Development<sup>1</sup>

2. There are two possible channels through which prolonged use of IMF resources could have an impact on a country's institutional development: (i) it may help, or hinder, the development of technical skills within the departments involved in the negotiation of IMF programs; and (ii) it may foster or undermine the country's policy formulation process; including the process of policy closure, that is, the way in which the political and bureaucratic system reaches consensus on a final strategy. The second channel is closely linked to the issue of ownership of IMF-supported programs.

### Impact of prolonged UFR on the buildup of economic management skills

3. Government officials in all three country case studies and in most other prolonged user countries generally agreed that the prolonged involvement of the IMF had resulted in some positive transfer of technical economic management skills. However, views differed as to the extent of that transfer.<sup>2</sup> In a

<sup>1</sup>This section draws on the relevant findings of country case studies and on the responses to a questionnaire sent to the authorities of all prolonged users.

<sup>2</sup>In one case, the authorities commented that it was still too early to judge whether the prolonged use of IMF resources had had a positive institutional impact, suggesting that the capacity building effect of programs, if any, had been limited thus far. In another case, the authorities were of the view that the prolonged involvement of the IMF had had "a debilitating effect on economic institutions," particularly due to a "collapse of the long-term economic planning function." A similar view with respect to long-term planning was expressed by the Senegalese authorities.

few cases, including Morocco and the Philippines, the prolonged time spent under IMF-supported programs was deemed to have made a major contribution to the development of technical and analytical skills. However, in several others, in particular Pakistan and Senegal, it was felt that the knowledge being transferred by prolonged exposure to IMF missions was too narrow and specialized to be of much use outside the context of IMF programs and that the ready availability of IMF models and methodologies weakened the incentives for local technicians to develop their own tools. The potential buildup of technical skills was also limited by the relatively low retention rate of technocrats having benefited from the IMF's training.

4. Notwithstanding the perception that there was some transfer of technical skills, officials in all three country case studies, as well as a number of respondents to the questionnaire, commented that programs had paid insufficient attention to institutional reform and to the development of adequate implementation capacity. Perhaps this is not surprising given the relatively short time span of individual IMF-supported programs. Even in cases where there has been a succession of programs following on one from another, the short-term horizon of each individual program naturally limits the extent of attention paid to capacity building. Respondents acknowledged the potential role of technical assistance (TA) and also recognized that IMF-supported programs made access to IMF TA easier, but they felt that in general IMF-provided TA was too transitory to have a sustained capacity building impact, in particular due to the lack of implementation followup. A general recommendation often made was that IMF TA should have a more direct focus on the ways and means of policy implementation.<sup>3</sup>

5. Finally, in several countries, including the three case studies, many commentators within and outside

<sup>3</sup>The effectiveness of IMF-provided technical assistance is a larger issue that goes beyond the scope of this evaluation. It is one of the items on the agenda for future evaluation by the IEO.

government were of the view that the nature of the IMF's involvement and its leverage could have given it scope for dealing with governance issues more than it did (for instance, in relation to connected lending practices in Pakistan's banking sector, or with tax evasion in all three countries).

### Impact of prolonged UFR on the policy formulation and closure process

6. With a few exceptions, comments received from country authorities regarding the impact of prolonged UFR on the policy formulation process were generally quite negative, primarily because prolonged use was not conducive to the development of a capacity to generate “homegrown” policies. Instead, it tended to create a situation where the policy formulation process revolved around negotiations with the IMF, locking domestic policymakers into a reactive rather than a proactive role. A typical comment was that IMF missions' briefing paper instructions become the framework of reference for negotiations, thereby giving too little scope for the discussion of alternative policy options and trade-offs. However, many country authorities acknowledged that the transformation of the ESAF into the PRGF and the creation of the PRSP process had begun to change the mode of relations with the IMF in a positive way, though it remained to be seen how this would evolve over time.

7. In several countries, including Pakistan and Senegal, it was also pointed out that the monitoring of program implementation—required not only by the IMF's own procedures but also by those of other donors whose financing was linked to the IMF program in some way—was a significant strain on limited administrative resources. As a result, local civil servants often simply did not have enough time left to focus on developing policies on aspects not covered by the program itself, or even to think through the implementation of the policies adopted under the program.

8. Some country authorities noted that the perceived need to consult the IMF on every single initiative in areas falling under the program's purview led to an inhibition of local policy formulation and into the attrition of policy development capabilities. This is a problem that could potentially arise in all IMF-supported programs, but it obviously becomes much more serious in a prolonged use situation, where the effect of attrition over time and the development of a culture of deferring to the IMF can be substantial. However, there were exceptions where the domestic policy formulation process was more centerstage, usually with beneficial results. For example, Pakistan was able to develop, largely on its own and outside the context of a program, a very far-

reaching tax administration plan in 2000. This example illustrates that where there is sufficient political will, the inhibition of local initiative can be rapidly overcome, even after more than a decade of use of IMF resources. Likewise, authorities in a couple of other countries noted that the policy formulation process had been largely country-driven, with policies implemented under IMF-supported programs being only part of their own, “homegrown” agenda. This suggests that even in situations where prolonged use is unavoidable, it is possible to ensure that policies are more homegrown and therefore more likely to be owned.

9. Similarly, it was mentioned, most notably in Pakistan, that once several successive governments had made a habit of justifying their policy decisions to the public by invoking the exigencies of IMF-supported programs, it was very difficult to reestablish a sense of ownership even for those policies that were genuinely “homegrown”: as soon as they were incorporated into an IMF-program letter of intent (LOI), they became perceived as IMF-imposed. The practice of trying to include a country's entire reform agenda in the IMF's LOI, rather than relying more on the country's own policy documents, exacerbates these perceptions.

10. More generally, the absence of a broad public debate on core policy “planks” resulted in giving policy decisions a flavor of “fait-accompli” to many stakeholders, even when there was, in fact, flexibility in the negotiations. Once again, this perception tended to undermine ownership. For example, in the Philippines under the Ramos administration in the early 1990s, considerable progress had been made on a range of structural reforms that emerged from the domestic political process and may have been more politically acceptable since they did not feature prominently in IMF conditionality. These included an extensive privatization program; the opening of certain sectors to foreign participation; and improvements in customs administration. The long-delayed decision to restructure and recapitalize the Central Bank was also implemented in 1993, in between programs. In contrast, some of the structural measures central to IMF conditionality in the period, including reform of the oil pricing system and tax reform, encountered serious political difficulties, probably in part due to a lack of ownership.

11. Many officials interviewed in Senegal and Pakistan pointed to the overly exclusive nature of the dialogue established by the IMF with the Finance Ministry and the Central Bank as a negative feature. In their view, this process de facto gave these agencies excessive power to make decisions and undertake commitments that have implications in areas which are the responsibility of other ministries and departments, without sufficient consultation, which

led to lack of ownership of some parts of the government and possible problems in implementation. While this problem arises in all IMF-supported programs, it becomes especially acute in situations of prolonged use because the process is seen to marginalize a number of agencies over an extended period of time.

12. It is interesting to note that IMF staff members involved in the negotiations in the three country cases have commented that they made every effort to associate line ministries in matters related to decisions affecting their field of competence. They also noted that initiatives to keep the negotiating circle small often came from the authorities' side. However, associating line ministries is not enough if these ministries are effectively excluded at critical decision-making points. We recognize that the perception of powerlessness of the line ministries and the resulting lack of broad ownership may have stemmed primarily from shortcomings in the domestic policy closure process, which may be unfairly blamed on the IMF and its procedures. However, the end result is clearly negative and the problem is not just one of perception, since it can compromise implementation.

13. In fairness, it should be noted that perceptions were not universally negative. In Morocco and a few other countries, the authorities noted that the formulation of IMF-supported programs had generally involved a relatively large group of stakeholders, even though negotiations per se were held strictly with the Finance Ministry and the Central Bank. This had contributed to educating managers across economic institutions about the benefits of prudent macroeconomic management and openness to the world economy. The Philippine authorities likewise credited the IMF's prolonged involvement with the strengthening of the cohesion of the economic team and said the IMF had played a useful role in interacting with a broader set of policymakers, including in Congress on the rationale for the IMF's prescriptions, even though they felt that this function had been underused. This suggests that efforts to broaden consultations, especially with line ministries but also with other agencies, should receive more attention and the IMF should work with the authorities to evolve country-specific modalities toward this end.

14. Yet another mechanism whereby IMF programs have an impact on policy closure is when they are used by some parts of the political establishment in an attempt to "tie the hands" of the incoming government with a program negotiated by the previous administration. Examples include Pakistan in 1988—in the transition from a military regime to an elected government—and also the Philippines in 1998—in the transition to the Estrada administration. While some argue that, in those cases, the presence of IMF-supported programs had a stabilizing

influence, the overall result seems to have been that the resulting program was not strongly "owned" by the incoming government, which led to weak implementation and ultimately a failure to meet program objectives.

15. In a few countries, including Senegal and the Philippines, it was pointed out that the IMF was not always sufficiently sensitive to the role of parliaments in the decision-making process. For instance, in Senegal, the ad hoc measures adopted in the course of a program under the IMF's pressure, particularly in the taxation area, often rendered meaningless the role of parliament in the budgetary process. This was a source of resentment from parliamentarians, potentially leading to difficulties in implementing other parts of the program at a subsequent stage. In other cases, such as the Philippines, Congress generally had the ultimate decision-making power in the approval of key reforms prescribed by the IMF, making it difficult to comply with program conditionality within the time constraints set by the program. As pointed out in the Philippines country study, the IMF team did interact informally with Congress on the rationale for the IMF's recommendations, but the problem was not necessarily overcome. Ultimately, it is the responsibility of country authorities to determine how parliaments should be associated with the government's negotiations with the IMF, but a greater mutual awareness by Fund missions and parliamentarians of their respective roles and objectives would help smooth program implementation.

16. Many of the problems mentioned above would arise in any IMF-supported program, but they become more serious in the case of prolonged use because the process of policy formulation and closure is seen to be affected over a much longer period. In principle, these problems should be reduced for PRGF countries with the introduction of the PRSP process, though it was too soon to judge in the cases of Pakistan and Senegal, or in the responses from other prolonged users, how much difference this was making in practice.

## Implications of Prolonged Use for the IMF

### Impact on IMF finances

#### *In the General Resources Account (GRA)*

17. As noted in Chapter 2, over the last 30 years, prolonged users have attracted a substantial share of IMF's GRA resources: over 20 percent of commitments per year on average (and close to one-third in the last 10 years). These substantial commitments to prolonged users do not appear to have significantly

constrained the ability of the IMF to extend loans to its members in need, as total commitments only rarely came close to the ceiling of available resources, and even then only for brief periods of time. Of course, since the IMF manages its liquidity position in part by decisions on the level of financing provided to particular countries, as well as through periodic reviews of its resource base, the fact that commitments only rarely reached the ceiling does not mean that the extent of financing to prolonged users did not affect the access level of other users or decisions on the magnitude of quota increases. Nevertheless, periods of resource scarcity were not associated with a sharp increase in commitments to prolonged users (see Figure 7.1).<sup>4</sup>

18. Although prolonged use did not preempt resources on a scale that constrained total lending, it did have a significant effect on the revolving character of IMF resources. This impact can be measured indirectly<sup>5</sup> by comparing the average length of lending cycles between prolonged and “temporary” users, taken as fixed groups, the latter being used as a proxy for standard lending cycle length (hence for standard revolution speed of IMF general resources): resources lent to prolonged users took, on average, almost twice as long as resources lent to “temporary” users (15 years against 8 years, respectively) to become fully available again to other members.

### In concessional Trusts

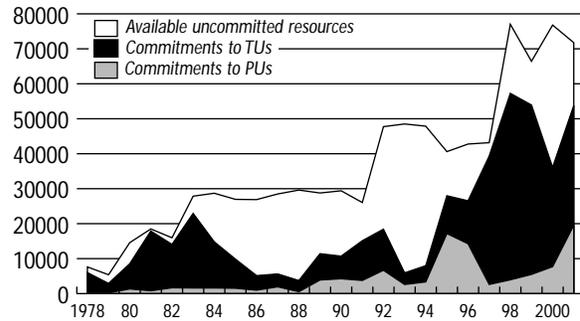
19. The resources of the ESAF/PRGF Trust are also intended to have a revolving character, albeit over a longer time frame than the GRA. For the reasons already discussed, that time frame could not be defined authoritatively, and instead was approximated by the average lending cycle length of “temporary” PRGF-eligible users. The comparison with prolonged users shows, once again, that the latter

<sup>4</sup>The concept of ceiling of available resources referred to here is defined on the basis of a liquidity ratio of 25 percent (i.e., 25 percent coverage of liquid liabilities by adjusted uncommitted usable resources, excluding borrowed resources). While the IMF does not have a mandatory minimum liquidity ratio, 25 percent is the lower end of the range historically observed for the minimum. A definition of available resources based on a more conservative liquidity ratio would reduce the amount of available resources. When its liquidity position becomes tight, the IMF has the recourse to activate its borrowing arrangements from creditor countries, which can temporarily increase available resources by about SDR 34 billion.

<sup>5</sup>Ideally, this impact would be measured directly by (i) determining a notional “standard” speed of turnover of IMF resources and (ii) comparing it with the actual speed of turnover observed over a given period. However, the first step involves a number of judgments and assumptions on “normal” frequency or length of UFR and the blend of facilities in use at any given time, which it was not found practical to make in the context of this study.

**Figure 7.1. Available IMF General Resources and Commitments**

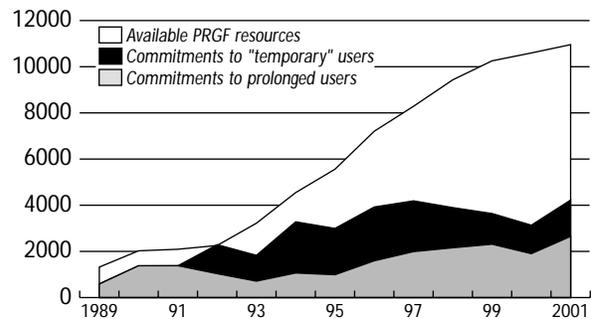
(In millions of SDRs)



Sources: IMF Treasurer's Department and IEO calculations.

**Figure 7.2. Use of PRGF Resources<sup>1</sup>**

(In millions of SDRs)



Sources: IMF Treasurer's Department and IEO calculations.

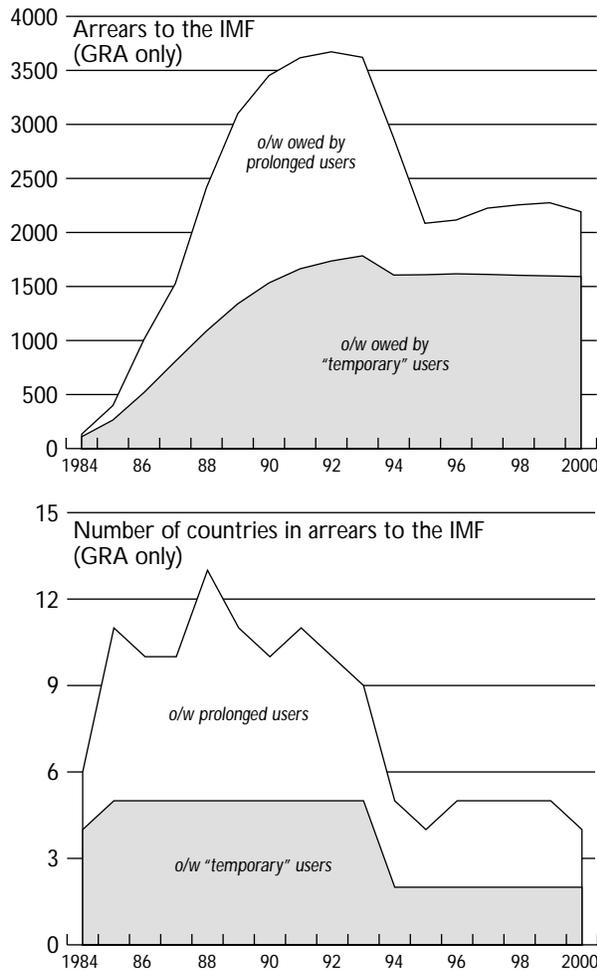
<sup>1</sup>“Available resources” is the difference between the total amounts provided to the trust funds and commitments.

take much longer to make the IMF resources they use available again for other members: 21 years on average, against 14 years for “temporary” users (over 1971–2000).<sup>6</sup>

20. As in the GRA, the scale of commitments to prolonged users in relation to total resources available for lending rarely came close to representing a significant constraint on overall lending. Nonetheless, commitments to prolonged users averaged just under half of total commitments of ESAF/PRGF resources since 1989 (Figure 7.2).<sup>7</sup>

<sup>6</sup>As before, these figures understate the actual average lending cycle length owing to cycles that remained uncompleted in 2000.

<sup>7</sup>In each year, only commitments to countries that were prolonged users in that year were taken into account.

**Figure 7.3. Evolution of Arrears to the IMF**

Sources: IMF Treasurer's Department and IEO calculations.

Notes: In these two figures, prolonged users are treated as a fixed group. Otherwise, by definition, few countries in arrears would qualify as prolonged users except in the year in which the arrears are first incurred, since their arrears make them ineligible to make further use of IMF resources. Arrears include both overdue repurchases and unpaid charges.

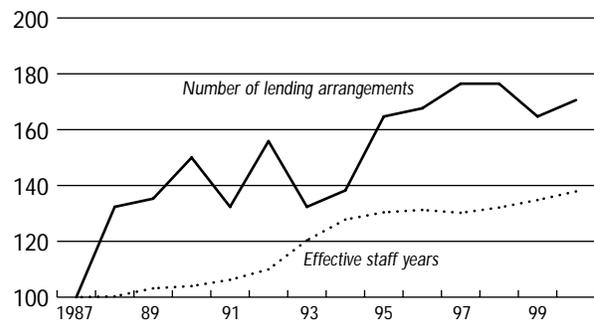
### Costs imposed on the membership through the accumulation of protracted arrears<sup>8</sup>

21. The problem of arrears to the IMF is much broader than prolonged use, and there is no obvious direct relationship between the two issues. However, close to 70 percent of countries which, at some point over the last 30 years, incurred protracted arrears to the IMF are prolonged users, and about one-

<sup>8</sup>Protracted arrears are defined as overdue obligations for six months or more.

**Figure 7.4. Use of Fund Resources and Staffing Indicators, 1987–2000**

(1987 = 100)



Sources: IMF budget, IMF Annual Report, and IEO calculations.

third of the countries identified as prolonged users in this study incurred protracted arrears to the IMF at some time (Figure 7.3). In most cases, arrears were accumulated after a period of prolonged use. However, in a number of cases, prolonged use began after the clearance of arrears; for these cases, prolonged use might have been part of a “defensive lending” strategy, aimed at preventing the appearance of new arrears.

22. The sharp reduction of the volume of arrears in recent years and of the weight of prolonged users within the total implies that the costs imposed on the membership as a whole through these channels are small.<sup>9</sup> However, the experience of the early 1990s shows that this was not always the case. Thus, enhanced attention to prolonged users’ ability to service their obligations to the IMF is warranted and

<sup>9</sup>Arrears impose costs on the IMF membership through two distinct channels, which have been designed to ensure symmetric treatment of creditors and debtors to the Fund. First, since 1986, the rate of charge (remuneration) is adjusted upward (downward) to cover the loss of income due to overdue charges on outstanding liabilities to the IMF. This burden-sharing mechanism replaced an earlier asymmetric mechanism under which the entire burden of arrears fell on borrowing members through an upward pressure on the rate of charge. Between 1987 and 2000, the adjustment averaged a little under 80 basis points per annum both ways. However, it has been much smaller in recent years (around or below 20 basis points) and only a fraction of it is attributable to prolonged users. It reached a peak of over 160 basis points (83 points) on the rate of charge and 79 points on the rate of remuneration) in 1991, at a time when prolonged users represented the bulk of overdue obligations. Second, the IMF’s precautionary balances, which according to general guidelines should fully cover credit outstanding to members in protracted arrears, must receive higher allocations when the latter increase, implying a higher net income target and/or larger allocations to the SCA-1, which are financed by symmetrical adjustment to the rates of charge and remuneration.

this has indeed been prescribed by operational guidelines since 1990. Evidence from the case studies suggests, however, that sections of reports addressing these issues were often perfunctory, giving little idea of the potential risks in the event of markedly worse, but still possible, outcomes.

### Pressures on the IMF human resources

23. The number of lending arrangements in effect each year has increased markedly since the late 1980s, from 34 in 1987 to 58 in 2000. As was explained above, that increase was, to a significant extent, due to an increase in prolonged use by certain countries (along with an expansion of the IMF membership in the wake of the collapse of the Soviet Union). Moreover, the share of arrangements under

concessional facilities—which are typically more resource intensive than GRA arrangements, and among which prolonged users are over-represented—also rose significantly: from 30 percent in 1987 to over 50 percent in 2000. However, staff resources did not increase commensurately (Figure 7.4). This contributed to a rising work overload, especially from the mid-1990s onward.<sup>10</sup>

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<sup>10</sup>According to the internal Budget Reporting System (BRS), in 2000, the shortfall in effective staff years (compared to the level needed to match the increase in UFR activity) exceeded 700 effective staff years. Over the last five years, prolonged users absorbed on average close to 130 staff years just for UFR-related work.

# CHAPTER 8

## Conclusions and Recommendations

1. This chapter summarizes the main conclusions of this study on the extent of prolonged use, on the factors underlying it, and on its effects. We then make a number of specific recommendations designed to counter the ill effects associated with this phenomenon. An important caveat is in order at this stage: since the IEO's mandate is to evaluate the IMF and not the policies followed by its member countries, the emphasis of both our conclusions and recommendations is on the IMF's role. This focus may give the impression that the IMF should be able to solve all problems in its areas of expertise, if only its interventions and modus operandi could be perfected. Clearly this is not the case. There are obvious limits to what any external agency can achieve, and the primary responsibility for the successes and failures of economic policies necessarily lies with the governments of the countries concerned. This point was emphasized by many officials we met during the evaluation and is the essence of ownership.

### Major Conclusions

#### The prevalence of prolonged use and the nature of prolonged users

2. Prolonged use of IMF resources, regardless of how it is defined, has consistently expanded since the 1970s among both low-income and middle-income countries, in terms of number of countries, share of the IMF's membership, and the extent of financial exposure. In terms of the number of prolonged users, most of the expansion is accounted for by those eligible for the concessional facilities; however, in terms of financial exposure, prolonged use of the IMF's general resources is much larger. Furthermore, prolonged use is persistent, with relatively few "graduators." In addition, arrangements with prolonged users now represent half the total number of ongoing IMF-supported programs.

3. Although prolonged users have attracted a substantial share of both the IMF's general and concessional resources, they were not a significant constraint on overall lending since the IMF's liquidity

position remained comfortable. However, since decisions on the size of access to IMF resources and on quota increases are endogenous, it is difficult to tell ex post whether prolonged use led to implicit rationing of resources to other users.

#### Factors underlying prolonged use

4. The increase in prolonged use is partly a reflection of systemic factors arising from the changed role that the international community expects the IMF to perform but it is also partly related to program design and implementation issues.

#### Systemic factors associated with the role of the IMF

5. There are three major systemic factors that lead to an increase in prolonged use, though their impact in this respect has not been fully acknowledged.

6. *A broadening of the rationale for IMF program involvement beyond achieving short-term balance of payments adjustment.* The international community increasingly looks to the IMF to help developing countries—particularly the poorest—implement and maintain policies and institutions needed for the achievement of sustainable growth. It looks to the IMF for an assessment of whether policies and institutions are in place that can deliver a sustainable macroeconomic position, and to monitor the situation over time to check that these policies remain on track. In low-income countries, it is also looking for a broader assessment, and subsequent monitoring of progress, on policies to achieve balanced growth over the longer term; many of the aspects of such an assessment go beyond the traditional concept of the IMF as being responsible primarily for short-term stabilization. The fundamental objectives of the IMF, as set out in Article I of the Articles of Agreement, are sufficiently broad that they could encompass such an expanded role. However, this raises the basic question of where a legitimate adaptation of roles ends, and where inappropriate "mission creep" begins. This inevitably involves judgments on the most efficient allocation of responsibilities among institu-

tions and also on whether lending arrangements are the most suitable tools to pursue the above objectives. Many of these questions go beyond the scope of this evaluation, but it is important to consider the potential consequences of the approach that has been adopted for the emergence of prolonged use and its possible adverse impact. We do not believe this has been done sufficiently.

7. *IMF lending as a seal of approval and the boundaries between programs and surveillance.* One of the factors underlying the expansion of prolonged use is that most official creditors/donors insist on an IMF-supported program as a seal of approval, which becomes a precondition for new adjustment loans and grants or for debt relief and restructuring. There is some evidence that such insistence compromises the quality of IMF-supported programs, and therefore the quality of the seal of approval. With so much riding on the decision, there are strong pressures to agree to a program even though the program may be deficient in several respects. The same tension would of course exist with any other form of seal of approval, but, for reasons discussed below, the association of the seal of approval with repeated programs is especially problematic. Moreover, the signal sent by a short- or even medium-term program may not be the type of seal of approval that official creditors and donors—who usually have a medium- to long-term perspective—should be seeking, especially if it does not ensure the strengthening of core institutions needed for good policies to stay in place beyond the term of the program. In whatever manner the seal is provided, it is important that its quality be maintained. This suggests the need to look for a mix of instruments that provide a seal of approval better suited to the needs of the global community.

8. *Choices on where the boundary between programs and surveillance should lie, and on the scope and strength of surveillance processes, will have a major impact on the extent of prolonged use.* The pre-eminence acquired by programs over surveillance in addressing the evolving needs of the international community in a number of circumstances appears to reflect a judgment that only an IMF financing arrangement provides a strong enough vehicle to achieve the desired results.<sup>1</sup> However, the nature of the surveillance process itself can be adapted to meet this need. Some of the recent initiatives go some way in this direction. For example, recent efforts to make surveillance assessments more transparent, to sharpen their diagnosis on vulnerability issues, and to promote

<sup>1</sup>As noted in Chapter 6, some donor respondents to the questionnaire suggested that one of the reasons why such an endorsement was taken more seriously was precisely because it involved a financial commitment by the IMF. But such an approach would by its very nature imply prolonged use.

the observance of internationally agreed standards and codes already provide a potentially stronger instrument for monitoring a country's progress than existed for much of the period covered by the evaluation. Such initiatives could be expanded further.

9. The expectations of the international community for some form of “seal of approval” signal by the IMF could be met through different combinations of enhanced surveillance, a series of programs, or precautionary arrangements. For low-income countries, this could also involve building on the PRSP process and the need for a positive joint IMF/World Bank staff assessment of each PRSP and PRSP review. It is for the IMF's members to decide which route they want to take. However, if they wish to continue to rely primarily on a series of programs, then the result is likely to be continued prolonged use of IMF resources for a significant proportion of the membership. This should be acknowledged explicitly and, as discussed below, is likely to have implications for how the IMF organizes its work in such countries. This evaluation also suggests that such an outcome could involve some significant drawbacks. Changes in the nature and modalities of programs can help mitigate these drawbacks, but are unlikely to eliminate them completely.

### **Program-related factors**

The evaluation suggests that a number of program-specific factors have also contributed importantly to prolonged use.

10. *Some deep-seated adjustment problems take a long time to fix, even in a perfect world where programs are well designed and implementation is smooth.* There is some evidence that the problems of countries that eventually became prolonged users were more severe at the start of their long program involvement. If the IMF is to continue to seek to help countries tackle these problems over an extended period then the challenge is to design programs that recognize from the outset that a longer time frame—with repeat programs and an appropriate division of labor among the IFIs—may be required to achieve lasting adjustment, while ensuring that such a time frame does not become a device to postpone action. Without such a recognition, our evaluation suggests that the short-term focus required by programs may lead to the adoption of approaches that are likely to be ineffective in tackling deep-seated problems because they are not complemented by effective implementation of core institutional and structural changes.

11. *Some programs have suffered from design and implementation problems.* The country case studies suggest a number of reasons why some programs have been less effective than initially expected in

achieving their longer-term objectives. It is not possible to say definitively how much these problems have contributed to prolonged use, since the cross-country evidence discussed in Chapter 5 suggests that these problems also arise in “temporary” user programs. Nevertheless, they are worth noting because they have implications for program effectiveness.

- Many programs suffer from an overoptimistic time frame—reflecting the difficulty of matching the short-term conditionality of a program to complex, structural and institutional changes that are central to sustained growth-oriented adjustment. There are also institutional incentives to “overpromise” on the speed at which core reforms can be implemented and longer-term sustainability attained.
- A lack of sufficient emphasis, until very recently, on strong domestic ownership leading to the approval of programs to which governments are inadequately committed.
- Structural conditionality that was insufficiently focused on key issues. The issue seems to be one of prioritization, rather than the number of structural conditions per se; indeed, programs with prolonged users were not, in general, more burdened with such conditions.
- Insufficient priority to assessing and improving implementation capacity, and to reforming core institutions so as to ensure that adjustments are sustainable.
- Insufficient assessment of the real economy responses to the program and to the sources of growth (e.g., leading, in a number of cases, to an overestimation of how rapidly private investment or exports would respond).
- Absence of a strategy for responding to inevitable uncertainties about the economic environment, which sometimes led to ad hoc corrections that were inconsistent with longer-term objectives.
- Insufficient opportunities to step back and reconsider the overall strategy pursued by programs while learning lessons from experience.

*We are not suggesting that all programs suffered from these problems, or that there was no learning over time.* In some of the case studies, IMF-supported programs were associated with significant improvements in the policy environment over time.

Many of the problems listed above have already been recognized within the IMF, and some important initiatives are under way to try to address them. Of particular importance are ongoing efforts to enhance ownership and to “streamline” structural conditionality, so as to concentrate the focus on medium-term,

macro-critical structural issues, and to improve collaboration with the World Bank. For the low-income countries, the PRSP/PRGF process is the key initiative to try to embody genuine government commitment, through a broader consensus building process, into the formulation of a medium-term policy framework. However, the jury is still out on how much these initiatives have changed the way the IMF operates in practice and therefore how well they will address core problems.

### Is prolonged use a problem?

12. Our evaluation suggests that prolonged use does present problems that were not sufficiently appreciated when decisions were made that were likely to encourage extended program involvement. These problems broadly fall into two categories: potential costs to the prolonged user countries; and adverse effects on the credibility of the IMF.

- There is some qualitative evidence that prolonged use hinders the development of robust domestic policy formulation processes over time, which partly reflects insufficient attention to country ownership in past programs—although it is not possible to test the counterfactual of how institutions would have developed in the absence of lengthy IMF program involvement.
- There is an inherent tension between the quasi-permanent conditionality implicit in prolonged use, and country “ownership,” in the sense of countries taking responsibility for the conduct of their economic policy, both by being in the driver’s seat and by facing the consequences of their decisions. Recent changes, including the PRSP process, may help mitigate these tensions but are unlikely to eliminate them.
- Some of the case study experiences also suggest that the perception that IMF resources would be available over the long term, despite policy slippages, may have weakened incentives to take decisive action to deal with some problems.
- If, as appears to be the case, prolonged use in some cases has resulted from pressures on the IMF to agree to a series of weak programs—for example, to open the way for donor support or debt rescheduling or because of political pressures—then the effectiveness of these programs will be weakened and the credibility of all IMF-supported programs may be adversely affected.
- Some aspects of the IMF’s independent surveillance functions tend to be crowded out by program activities in the countries concerned, which might reduce the credibility of surveillance.

13. We recognize that some of the adjustment problems faced by IMF member countries, especially the poorest of them, do indeed take a long time to resolve and this justifies somewhat greater acceptance of prolonged use in these cases. Nevertheless, many of the potential costs mentioned above would also be relevant in such cases. Moreover, acceptance of a lengthy program involvement in a significant share of the IMF's membership would have consequences for the IMF's role that, in our view, have not been fully recognized. Widespread prolonged use is to some extent inconsistent with current internal operational procedures that are still largely built around the relatively short-term framework of programs. Consequently, there needs to be a clear understanding of what the IMF's role is expected to be in such cases, so that its operational approach can match that role.

## Recommendations

14. In our view, the drawbacks associated with prolonged use are sufficiently serious to warrant a greater effort to reduce its extent; to look for other and better ways to provide the seal of approval that the international community wants; and, where prolonged use still does occur, to look for ways to mitigate its drawbacks since even in cases with “good” reasons for such use, there can be undesirable side effects. Our recommendations seek to address these challenges. Some of them would be applicable only to actual prolonged users. However, any strategy aimed at reducing prolonged use that restricted itself to tackling the problem once it has already materialized would be of limited value. Therefore, many of the recommendations are of more general applicability to the IMF's approach to programs. In that sense, they can be seen as elements of a preventive strategy for improving the effectiveness of the IMF's operations and hence reducing the likelihood of prolonged use.

15. The recommendations concern three aspects of the IMF's operations: (i) the rationale for IMF involvement and the use of its facilities; (ii) program design and implementation; and (iii) IMF internal governance issues.

### Recommendations on the rationale for IMF involvement and the design and use of its facilities

16. *We recommend that the Executive Board adopt an operational definition of prolonged use, as an essential requirement for evolving a strategy for reducing the likelihood of such use.* The evaluation shows that although there are current internal guidelines approved by the Board for dealing with prolonged use cases—calling in particular for the sys-

tematic ex post evaluation of programs, for specific justification of IMF involvement, and for a progressive reduction in the size of access in such cases—these guidelines have not always been implemented in a systematic manner. This is partly because there is no formal definition that would identify countries for which prescribed procedures must apply. We fully recognize and strongly endorse the need for flexibility in the decision to provide IMF assistance in individual cases, but the adoption of a formal criterion to identify prolonged users would not eliminate this flexibility. Its purpose would be to trigger automatic due diligence procedures whenever a country meets the prolonged user criterion. The operational definition could be based on the criterion we have used in this study, or indeed some other criterion that is felt to be more useful. The criterion could also distinguish between general and concessional resources, in order to reflect the special circumstances of low-income countries and allow more extended involvement in their case.

17. *We recommend that greater efforts be made at judging whether countries are ready to implement credible programs, and that the IMF should be more selective in extending financial support.* Many countries may be in a position where they need to make adjustments for which financial support is needed, but they may not always be ready, for complex political and social reasons, to implement the necessary adjustment measures. In these circumstances, IMF-supported programs are likely to be unsuccessful, and the IMF may well need to hold back from providing finance until circumstances are more appropriate. A more rigorous approach to assessing the willingness and ability to undertake adjustment measures and associated reforms should help to reduce prolonged use by encouraging a stronger commitment toward implementation and therefore a more effective adjustment process with a higher probability of graduation. Greater selectivity does not mean that the IMF should play no role where the conditions are not yet ready for financial support. It should (i) actively help to create the conditions for an effective domestically owned program through a frank and transparent policy dialogue, through candid surveillance, and through technical assistance; and (ii) be ready to provide financial and technical support in a timely manner when circumstances are conducive to effective implementation.

18. We recognize that a decision to withhold IMF financial support in such circumstances involves very difficult judgments since it may worsen the economic situation for the country concerned, at least in the short term. We are not suggesting that these implications should be disregarded; they involve very difficult trade-offs between undesirable alternatives that need to be weighed carefully in each case. However,

evidence from the case studies shows that there is a strong risk that programs approved under circumstances in which credible action is unlikely, for whatever reason, will only postpone the resolution of problems, perhaps even allowing them to get worse, without offering any good prospect of sustainable adjustment. In such cases, raising the threshold for what is required for IMF support, especially in terms of the probability of implementation, is likely to yield a better outcome in the long run. In calling for greater selectivity, we are not seeking programs that look “tougher” on paper; indeed, an essential counterpart of greater selectivity is that programs focus only on what is essential for longer-term sustainability and have a realistic time frame (see next section).

19. Operationally, this means that UFR proposals to the Board should contain an explicit and frank assessment of the readiness of potential borrowers to implement programs. Current guidelines already call for a judgment by management that the program will be carried out, but the evidence from the case studies indicates that the assessments on which this judgment is based are sometimes done in a perfunctory manner. Few such judgments are likely to be totally clear-cut, but the Board should be provided with a candid assessment of the risks.<sup>2</sup>

20. *We recommend that the IMF aim to provide the international community with credible alternatives to the current situation where IMF lending arrangements have become a precondition for many other bilateral and multilateral flows.* It is up to each donor and creditor to decide the conditions on which they will provide financing, and all legitimately want assurances that an appropriate policy framework is in place to make their financing effective. However, the requirements for effectiveness of different types of flows are different. For many longer-term flows these requirements could be met without always having an IMF-supported program if suitable alternatives are developed, such as greater use of strengthened surveillance, reliance on joint staff assessments of PRSPs, shadow programs, and precautionary arrangements. More generally, we recommend that the IMF should aim at developing a mix of tools that could serve to deliver a seal of approval in different ways, depending on the member’s circumstances (in particular, its eligibility for the PRGF and for the HIPC Initiative), donor/creditor requirements, and the strength of the member’s policies and institu-

<sup>2</sup>It is difficult to prespecify exact criteria that the Board should use in making such judgments, but the case studies suggest a number of examples where it would have been better if the IMF had been more restrained in entering into or extending programs—such as the Philippines during much of the Marcos and Estrada administrations (once the extent of governance-related problems become clear) and in Pakistan for parts of the 1990s.

tions.<sup>3</sup> Such forms of enhanced surveillance may even have an advantage over lending arrangements since they can have a longer-term and broader focus, covering all elements of a country’s economic strategy.

21. For PRGF-eligible countries, one possible approach could be to design a form of enhanced surveillance (once a degree of macroeconomic stability is restored), in order to provide a clear signal on the appropriateness of the macroeconomic framework and a monitoring of progress over time on both macroeconomic performance and on macro-critical structural reforms outlined in the PRSP. In effect, the IMF would start from the country’s own medium-term program as outlined in the PRSP, and assess it (in cooperation with the World Bank in aspects of policy and institutions that fall outside the IMF’s core areas). Thus, it should be made clear that not every PRSP would be accompanied by an IMF arrangement under the PRGF.<sup>4</sup> In whatever manner this was done, it would clearly be necessary to incorporate into surveillance reports and Board summings-up an overall judgment that a country’s economic strategy is sustainable and has good prospects of achieving the desired objectives, to give a clear signal to the donor community.

22. *We recommend that programs for identified prolonged users should include an explicit “exit strategy.”* This is already called for in current guidelines, but is often not implemented, possibly because of the lack of a specific definition of prolonged use. The details of the exit strategy would vary from country to country—and especially between PRGF-eligible countries and others. An important feature of any exit strategy would be for the IMF to reduce progressively its own resource contribution (which again is already a feature of current guidelines) while remaining actively engaged, along the lines discussed above, in providing the “seal of approval”

<sup>3</sup>One recent example of a development in this direction is the agreement concluded in July 2002 between Jordan and the Paris Club: in effect, Paris Club creditors agreed to a consolidation period more than twice as long as Jordan’s SBA and decided to rely on Executive Board discussions on post-program monitoring and Article IV consultations to assess Jordan’s performance after the expiration of the SBA as a basis for deciding on the entry-into-force of the annual phases of the debt rescheduling agreement. This example, along with donors’ responses to the IEO questionnaire on the topic (see Chapter 6), suggest that the scope for flexibility in the mix of tools to deliver the seal of approval should be explored further.

<sup>4</sup>Joint IMF–World Bank staff assessments of PRSPs are typically concluded by an assessment of whether or not the PRSP in question constitutes an adequate basis for IMF and World Bank concessional lending. These assessments could conceivably be tailored to donors’ concerns in such a way as to allow them to extend the concluding judgment to concessional lending from other sources, thereby making an IMF lending arrangement redundant for seal of approval purposes.

that may be needed for other donors and creditors to maintain their flows. Such an approach would enable the Board to be more proactive in identifying cases where a scaling back of IMF program involvement would be appropriate.<sup>5</sup>

23. *We recommend the introduction of a differentiated rate of charge for prolonged users as a signaling device.* We do not support formal restrictions on the duration of prolonged use because all member countries should have the ability to access IMF resources if the need is justified, and formal time limits would ignore both this right and the variability of country circumstances. However, there is a case for a differentiated rate of charge for prolonged use exceeding some limits. We recognize that there is no evidence that the cost of IMF resources has been a significant factor in determining prolonged use, but the introduction of such a charge could serve as a signal of excessive dependence on the IMF and possibly provide a political incentive to avoid such prolonged use.

### Recommendations for program design and implementation

24. Program design and implementation issues have been extensively discussed in the Executive Board on many occasions, and several of the recommendations in this section essentially consist of a reaffirmation of what are supposed to be existing guidelines or “best practices,” but which our evaluation suggests have not always been implemented on a consistent basis. In the recommendations on internal governance processes in the subsequent section, we make a number of suggestions on how internal incentives and procedures could be improved to encourage improved implementation and strengthened learning processes. Many of the issues discussed here have also been the subject of recent initiatives by the IMF; in these cases, we make a number of additional suggestions that could help increase their effectiveness.

25. *We recommend that specific operational procedures be developed that will ensure that program design places greater emphasis on the nature of the domestic policy formulation process, in order to maximize ownership.* The IMF has already recognized the importance of promoting ownership,<sup>6</sup> most notably in the PRSP process and in the ongoing review of conditionality, and this is the right direction in which to move. A number of steps could be taken to fulfill this objective:

(i) *The IMF should modify its procedures to move toward a situation in which the authorities have the initial responsibility for proposing a reform program.* Ideally, this could be done by having the initial request seeking an IMF arrangement take the form of a letter of transmittal of a domestic policy document outlining the broad approach of the authorities. This should be the starting point for negotiations. We are not suggesting that such an approach be an additional prerequisite for an arrangement, since differences in administrative capacity will affect the pace at which countries are able to take the lead in formulating programs. We understand that some countries already adopt an approach close to what is being proposed, whereas in many others the IMF staff takes the lead. Technical assistance could be provided to help build the capacity for policy formulation where needed.<sup>7</sup> Clearly, the submission of a domestic policy document would only initiate the process. It would still be the IMF’s responsibility to assess the proposed program to determine whether it has a good chance of achieving its objectives and to negotiate strengthening the program where needed. The specific structure of conditionality would emerge from the negotiations but could then be viewed as concrete commitments undertaken within the broad framework proposed by the authorities. Such an approach would help to ensure greater ownership of the broad directions of the program. We recognize that it would require greater flexibility in scheduling missions, which should be tailored to the timetable of national policy agendas, and may mean that negotiations take longer to complete. If a balance of payments crisis is imminent, there may be less time for detailed policy formulation in advance of a mission, but most program missions for medium-term programs—especially in the prolonged users—do not take place in such an environment.

(ii) *The IMF should, wherever possible, encourage a process whereby the core elements of a program are subject first to a domestic policy debate within the member country’s own poli-*

<sup>5</sup>The discussion that took place in the Executive Board at the time of the fifth review of the Philippines’ 1998 SBA—which triggered a wide-ranging internal discussion of future strategy—is one good example of such a proactive approach.

<sup>6</sup>See, for example, IMF (2001d), available on the IMF’s website.

<sup>7</sup>Many officials from the three country case studies and the questionnaire responses emphasized that IMF technical assistance had generally not been very effective in helping countries develop the capacity to design and, especially, implement economic policies—which are essential elements of ownership. Participants in the 2001 external consultation process on conditionality made a similar point.

*cymaking institutions.*<sup>8</sup> While the nature of this policy debate will vary with the particular institutional circumstances of each country, two general messages are relevant: (a) high levels of political authority need to be fully engaged; and (b) the more transparent and participatory the process the better.

- (iii) *High-quality surveillance should help to create a better understanding of what would be expected of the authorities should a program become necessary.* This would contribute to the perceived transparency of IMF policies in the design of programs.<sup>9</sup> Surveillance reports should, therefore, actively seek to present alternative policy options and to analyze the trade-offs between them: this is already “best practice” but it is not general practice.

26. *We recommend that programs give much greater emphasis to fostering key institutional changes and to strengthening implementation capacity.* Our assessment based on the case studies and questionnaire responses from prolonged users’ authorities suggests that strengthening the institutional base for implementing reform is a much more important determinant of the long-term success of programs than the detailed structure of conditionality. Staff program documents should include an explicit assessment of the key institutional requirements for effective implementation and how these can be strengthened. As already called for in the most recent procedures, they should also be clear about the division of institutional responsibilities between the IMF and the World Bank (see below), and reporting the Bank’s assessment of institutional constraints in those areas where it is in the lead.

27. *We recommend greater selectivity in program content along with further improvement of collaboration with the World Bank, a more differentiated use of conditionality, and a broadening of the time frame of program design.* This recommendation is in line with ongoing initiatives to streamline conditionality, which we strongly welcome. In our view, the thrust of streamlining should not be primarily on the quantity of conditionality per se but on improving its pri-

oritization and integration with program design, which should then be reflected in a more parsimonious recourse to waivers at the stage of implementation—in other words, picking the battles better and fighting them well.<sup>10</sup> The experience of the case studies indicates that, if the overall volume of conditions exceeds implementation capacity, some conditions—not necessarily the most important ones—may be effectively implemented, but others will not. In keeping with the spirit of the draft revised guidelines on conditionality, the IMF should identify those issues that are truly critical to sustainable macroeconomic adjustment and then focus on them in depth.<sup>11</sup> In our view, effective implementation of these principles would require a number of operational changes:

- (i) *Making a more differentiated use of the various modalities of conditionality.* Conditionality should be seen primarily as a tool to help focus on critical areas that need concentrated attention, as well as an instrument of mutual accountability between the IMF and the authorities. Structural conditions should focus on aspects of the program that are critical for sustainable adjustment, but it is equally important that all such aspects be addressed by the program. This was not always so in the programs examined in the case studies. The mix of various modalities of conditionality should reflect the order of priority attached to each measure by the authorities and the IMF as well as the planned sequencing of reforms, both of which should be explained in staff reports to the Board.<sup>12</sup> Furthermore, our analyses, especially in the case studies, also suggest that the sub-

<sup>8</sup>A robust domestic policy formulation process does not necessarily mean near-universal consensus or a requirement to consult nongovernmental groups in a particular way; it just means that the main policy elements of a program would carry sufficient support in the core political institutions, including parliaments. The extent to which this is possible will depend, inter alia, on how urgent is the need for IMF financial support.

<sup>9</sup>We recognize of course that in the event of unexpected developments leading to crises, programs may need to introduce measures not envisaged in surveillance. Nor should programs necessarily undertake to fix every single problem diagnosed in the surveillance process if there are higher priorities.

<sup>10</sup>Indeed, the data discussed in Chapter 5 indicate that prolonged users’ programs on average had less extensive conditionality than “temporary” users. Yet they also had a higher proportion of waivers, which were often followed by serious program interruptions. Thus quantity is not the critical issue.

<sup>11</sup>At the time this evaluation was completed, the Executive Board was in the process of completing the review of conditionality initiated in 2001, by approving a revised version of the “Guidelines on Conditionality” adopted in 1979.

<sup>12</sup>For example, prior actions should generally be limited to measures whose absence at the start of the program would jeopardize its chances of success, and that can effectively be put in place in a short time frame. Any measure that does not meet either of these criteria would be more effectively dealt with through otherforms of conditionality. In particular, prior actions on measures that are meant primarily as tests of the authorities’ ownership but the adoption of which, in and of itself, has little macroeconomic impact, should be avoided. If there are serious doubts about ownership, it is better to wait until some credible track record is established rather than devise tests through prior actions that are not critical to success. In intermediate situations, the actual implementations of existing guidelines on prolonged use related to the front-loading of the adjustment effort and the back-loading of disbursement could serve to mitigate implementation risks without jeopardizing ownership. (Data reported in Chapter 5 suggest that these guidelines were often not followed.)

stance of conditionality matters more than its formal structure. Particular efforts should be made, when negotiating conditionality with the authorities and when assessing compliance, to put the emphasis on actions that will ensure substantive progress toward meeting the program's objectives rather than on formal compliance with narrowly defined conditions on a checklist. We recognize that this would require greater flexibility and judgment.

- (ii) *Making greater efforts to tailor the effective time frame of program design to the foreseeable length of the reform and adjustment process.* This does not necessarily imply that the time frame of IMF arrangements should be further lengthened. Indeed, experience suggests that country authorities themselves are often reluctant to commit themselves firmly for long periods—partly reflecting political uncertainties. However, our study has shown that where a long-haul adjustment effort is required, it is at best ineffective and at worst counterproductive to try to force adjustment within a shorter, and essentially arbitrary, time frame. One way to proceed would be to design a medium-term strategy for IMF involvement, covering the full length of the required reform and adjustment process. The strategy would build on domestic documents (i.e., PRSPs where they exist, planning documents, programmatic laws, “lois cadres,” etc.) and indicate the nature of IMF involvement, including through successive programs, in different stages. The strategy should lay out several key elements: what the objectives of this involvement are; what combination of lending, including possible repeat programs, policy advice, and technical assistance are envisaged to achieve them; and also what exit strategy would be followed. Whether individual arrangements are signed and funds disbursed would continue to be guided by the same policies as before. We do not propose preparation of separate Board documents outlining the strategy: UFR request reports should be used to set out the proposed strategic framework, while surveillance reports or program reviews should update and monitor progress against them. Our proposal is therefore essentially a further strengthening of the approach that is supposed to be used with internal country strategy papers, but with the central elements of the proposed strategy—and subsequent assessments and possible reappraisals—conveyed to the Executive Board.<sup>13</sup>

<sup>13</sup>See Chapter 6 for a discussion of the role of the country strategy papers.

- (iii) *Further strengthening collaboration with the World Bank.* Initiatives such as the agreement on the “lead agency” concept are useful first steps, but ensuring that the new approach works effectively is likely to require deeper operational changes and sustained emphasis by management.<sup>14</sup> Where the World Bank does not appear to be in a position to deliver the necessary complement to the program, staff reports should be candid about the issue and let the Board decide to what extent the IMF should concern itself with those issues. To encourage such candor, the traditional appendix to staff reports describing the country's relations with the World Bank—which at present is typically pro forma and adds little of substance—could be replaced by a more substantive discussion of the World Bank's strategy in the country, showing how it complements that of the IMF and flagging any significant differences of view or areas where the two institutions' strategies are not fully integrated. However, the case studies suggest that meshing the approaches and time frames of the two institutions will be an enormous challenge.

- (iv) *Systematically incorporating more in-depth analysis of real economy responses to the key policy elements of programs, and the sources of growth* and devoting proportionately less attention—and staff time—to the fine-tuning of the financial programming exercises.<sup>15</sup> Ideally, such analyses should be conducted regularly in the context of the IMF's surveillance activities—drawing where appropriate, on the expertise of the World Bank and other institu-

<sup>14</sup>Since 1989, there have been approximately ten reviews and progress reports on IMF–World Bank collaboration, all of which diagnosed room for improvement and put forward remedies. This record suggests that the underlying problems are complex and deeply rooted.

<sup>15</sup>When we refer to the excessive amount of time devoted to the excessive fine-tuning of the financial programming exercise, we are not implying that IMF staff does this out of a misplaced sense of priorities, or that simple exhortation will correct the problem. Indeed, it is the staff themselves who have most emphasized this issue during our discussions. Rather, this issue is another example of the tensions between the short-term framework of a program and the more important, but often less precisely defined, longer-term goals. For example, the rather rigid formal framework for quantitative performance criteria—which requires Board approval of waivers whenever a deviation occurs, no matter how small—tends to raise the stakes for even minor deviations, since countries are often reluctant to be seen to request waivers. The recent heavy focus on cases of misreporting has added to these pressures. There is no easy solution to such problems, since a quantitative monitoring framework is justified, but it would help if Board papers were franker about the margins of uncertainty surrounding the details of program design.

tions—and the accumulated knowledge should be used at the time of programs involving UFR. This will help to avoid building programs around unrealistic expectations, especially as regards exports and tax revenue growth. Moreover, using the surveillance process to flag candidly weaknesses in the statistical base would help reduce the enormous amount of time that negotiating missions spend addressing data problems.<sup>16</sup>

28. *We recommend that programs include more explicit discussion of the major uncertainties they face and of how policies will be adapted if underlying assumptions turn out differently.* These problems are not new and are also not exclusive to prolonged use cases, but they are specially relevant for these cases as they would help to reduce the risks of programs being repeatedly blown off-track by the materialization of downside risks. It is not possible to pre-specify ways of dealing with all contingencies. However, the program review process needs to be sufficiently flexible to adapt the program in a timely manner when circumstances change, and an early understanding on the major uncertainties and proposed responses, even in general terms, can help this process. For example, in cases where other forecasts (e.g., private sector “consensus” forecasts) of growth or of exports differ significantly from those assumed in the program, staff reports should discuss in concrete terms how program design would be modified should these other forecasts prove to be more accurate. Such a requirement would also help reduce the risks to programs caused by overoptimistic forecasts.

### Recommendations for internal IMF governance processes

29. *We recommend that systematic ex post assessments of programs be undertaken, with priority given to identified prolonged users, and the key messages reported to the Board. Such assessments should be part of a broader effort to disseminate more effectively “best practices” and lessons learned, and to maximize the effectiveness of the review process.* Internal assessments of each program that is completed or permanently interrupted would help to ensure that the lessons for program design are absorbed more quickly and systematically. The country case studies highlighted a number of occasions where potential problems with program design (or its implementa-

tion) that contributed to prolonged use were identified, but where the lessons were not fully absorbed in the design of subsequent programs. Indeed, as is the case for several of our other recommendations, this is another example where existing guidelines require such action but they have not been implemented. The discussion in Chapter 6 also suggested that in a number of areas the IMF has been quite good at identifying lessons, but less effective at ensuring that they were absorbed into everyday operations. Building the review process around systematic ex post assessments will foster better implementation of “best practices” and provide clear opportunities for reconsidering the overall strategy.

30. One of the reasons why previous calls for more systematic assessments of programs have not been implemented was excess work pressure, and we recognize that implementation of this recommendation will require some additional resources. If necessary, the requirement for such ex post assessments could be phased in, with priority given to existing prolonged use cases. We also think it is important that the key elements of any debate on program design options that takes place during this process is conveyed to the Executive Board. Clearly, care must be taken not to hamper the ability to deliver a consistent message to the authorities, but the credibility of that message will ultimately be strengthened if it is seen to be derived from a process that considers different options and is designed to learn from experience. In this regard, we also recommend that:

- (i) *Staff reports—especially those involving requests for new arrangements for prolonged users—should provide more of a perspective of the history of the IMF’s program involvement with a country.* This should highlight what has been achieved and where previous strategies have fallen short of their objectives and why.
- (ii) *The MONA database, which is the key internal information system for tracking performance under programs, should be made more comprehensive, accurate, and up to date.* At present, the MONA database does not include information on programs that go off-track—even though these are the very ones that should be followed most carefully.<sup>17</sup> During the course of the evaluation, substantial errors and gaps in the database were also discovered, especially with regard to data on outcomes. Existing

<sup>16</sup>This is already supposed to be current practice. Area departments are expected to work closely with the IMF’s Statistics Department in developing strategies to remedy data deficiencies and to enhance statistical capacity, including through a prioritized use of technical assistance.

<sup>17</sup>Apparently, the reason why “off-track” programs are not monitored comprehensively in MONA is because it is the completion of the review that triggers the administrative process to update the database. No action is taken until the review is completed, so programs that are permanently interrupted cease to have their database updated.

weaknesses in data on how programs have performed are an impediment to efforts to enhance the IMF's ability to learn from experience and to monitor the implementation and impact of its own policies. We have discussed this issue with PDR staff and we understand that efforts along these lines have now been initiated. We also recommend that the MONA database be made accessible to outside researchers, in order to encourage further analysis and feedback on program successes and failures.<sup>18</sup>

31. *We recommend that steps be taken to further strengthen surveillance in prolonged use cases.* Evidence from the case studies suggests that some important aspects of surveillance have been weakened when undertaken in a prolonged program context. In countries where programs are temporary events, such a “crowding out” of surveillance by program activities could be less important, but its consequences are potentially more significant for countries that have a long series of IMF arrangements. We recommend the following steps:

- (i) *The surveillance guidelines should be modified to clarify the expectations on the role of surveillance in program cases.* The draft guidance note discussed by the Executive Board in July 2002 already takes a step in that direction by highlighting the need, in program countries, for surveillance to bring a fresh perspective by providing: “(i) a comprehensive assessment of economic developments, beyond the narrow focus of program targets; (ii) a candid analysis of short and medium-term prospects, including a thorough discussion of risks and vulnerabilities; (iii) a stock-taking of the policy strategy to date and the effectiveness of the measures implemented in pursuit of that strategy; and (iv) a candid account of the dialogue between the staff and the authorities on the key policy issues and the strategy looking ahead.”<sup>19</sup> As part of the discussion of risks and vulnerabilities, a useful addition to these requirements, in prolonged use cases, would be the presentation of a policy slippage scenario, to illustrate what implications the country and the IMF would be faced with should the current program go off-track. Furthermore, as discussed above, the sur-

veillance reports for prolonged users should be used as an opportunity to encourage a frank and open debate on the IMF's overall strategy in a country. Surveillance reports in program countries should also make a special effort to incorporate the views of the World Bank on those segments of the policy agenda where it is in the lead, and to report candidly about the quality of Bank-Fund collaboration in the country.

- (ii) *There is a case for creating some greater institutional separation between programs and surveillance, especially in the context of prolonged use.* The International Monetary and Financial Committee in its April 2002 communiqué called for a “fresh perspective and appropriate distance” in the conduct of surveillance. This is particularly important in prolonged use cases. Giving these expectations more emphasis in surveillance guidelines and, as discussed in the previous recommendation, embedding them in a systematic ex post assessment process, would go a considerable way in this direction.<sup>20</sup> One additional step that has been suggested would be to have entirely separate teams to conduct the two activities, but this would involve substantial resource and coordination costs for both the IMF and the authorities, and signals on policies might also become confused. However, there is merit in taking some institutional initiatives to achieve greater separation between surveillance and program activities for prolonged users. At a minimum, surveillance reports should not be treated as offshoots of program activities. For instance, the internal review process should deal with surveillance reports for countries under program in exactly the same way as other surveillance reports, which is not the case at present.<sup>21</sup> An option that might be considered in a limited number of cases, such as the most prolonged users, is for the chief of the surveillance mission to be chosen from outside the relevant area department.<sup>22</sup> We recognize, however, that

<sup>18</sup>We understand some researchers have already been given access to the database, on a case-by-case basis, with safeguards to protect confidential data.

<sup>19</sup>See SM/02/184 of June 14, 2002, “Biennial Review of the Implementation of the Fund's Surveillance and of the 1977 Surveillance Review—Follow-up.” As regards stock-taking, the 1997 guidelines on country strategy papers discussed in Chapter 6 constitute a good description of what “stepping back” should aim to achieve.

<sup>20</sup>Indeed, a few examples from the country case studies suggest that the country teams under the existing arrangement do have the ability to step back and take a frank look when circumstances permit (e.g., when there is not a strong incentive to avoid “rocking the boat” on an already agreed program).

<sup>21</sup>Thus, within PDR, the Surveillance Policy Division should have the primary role, not—as is currently the case—divisions in charge of reviewing programs.

<sup>22</sup>Implementing this recommendation would require particular precautions to ensure the adequate preparation and follow-up of Article IV consultation missions, allowing a suitable feedback to program discussion. The suggestions made by the OIA in its 2001 report on the organization and management of country missions, if implemented in these cases, would go a long way toward addressing the most critical issues in that respect.

making the greater separation operational in practice involves delicate trade-offs, in particular in terms of continuity of the policy dialogue and country knowledge management. These trade-offs would have to be appropriately managed.

- (iii) *In the same spirit, there is merit in seeking a second opinion—including from outside the IMF—on key policy issues that appear to be contributing to prolonged use.* Discussions with the staff and internal documents reviewed by IEO make clear that there can be considerable debate within the IMF (as well as between the staff and the authorities) on key policy options, and that this debate often draws upon outside analysis, including through informal contacts and seminars. However, the analysis presented in final reports submitted to the Board is often designed to support the final, agreed position at the expense of understating the extent of trade-offs between different strategies. One possible approach to improve on current practices would be to experiment with including “second opinion” analysis from outside sources in the selected issues paper prepared for Article IV consultations, along with any staff response. The focus of such analysis would be on critical issues where there is a wide divergence of views on the appropriate approach.<sup>23</sup>
- (iv) *The precise frequency of Article IV consultations with program countries is less important than that they take place at an appropriate time—that is, when a “fresh look” would be most valuable. It is especially important to have timely consultations when programs are faced with unexpected challenges, when they go off-track, or before a new program is negotiated.*<sup>24</sup>

32. *We recommend strengthening the ability of IMF staff to analyze political economy issues so that a better understanding of the forces that are likely to block or enhance reforms can be taken into account*

<sup>23</sup>One example of where such an approach might have been fruitful is the debate between the Jamaican authorities and the staff on the appropriate exchange rate and monetary framework in the late 1990s.

<sup>24</sup>This is the spirit of the decision approved by the Executive Board in July 2002, which shifts countries under program to a 24-month Article IV consultation cycle instead of the standard 12-month cycle. It is important that this decision be implemented faithfully to its spirit—that is, to ensure that surveillance takes place in a timely manner when needed—and not mechanically, as the latter might result in a further weakening of surveillance in program countries.

*in program design.*<sup>25</sup> Although it is widely recognized that ownership and political and social feasibility are crucial for effective implementation and sustainability of reform, too little attention is often paid to these aspects in program design. This is a complex area, and it would be unrealistic to expect the IMF, or for that matter any external agency, to do too much, since it is ultimately for governments to determine what sets of policies would be acceptable to their societies and to increase the acceptability of desirable reforms. Excessive involvement of external agencies in this area would itself be contrary to the whole idea of domestic ownership. The paper prepared as background to this evaluation sets out, by way of an illustration, a number of tools and proposes a series of basic questions that could be asked in trying to judge the political feasibility of a program.<sup>26</sup> To a large extent, using such questions to guide a basic assessment before supporting a program would only bring discipline and consistency to analyses that are already carried out in best practice cases, though their conclusions are not always reported to the Executive Board. More systematic assessments might also be commissioned in cases where political feasibility has been a major obstacle to program implementation. If more in-depth assessments were undertaken, priority should be given to the most prolonged use cases.

33. Finally, there are two other internal governance issues that surfaced in the context of this study and, although not exclusive to prolonged users, deserve some consideration in view of their seriousness and potential aggravating effects on prolonged use.

- *We recommend that a review of (explicit and implicit) internal incentives facing staff be undertaken with a view to minimizing turnover of staff working on countries and to fostering increased candor and accountability.* Excessive staff turnover—between departments but also between different country assignments within the same department—appears to be a widespread problem. Although not peculiar to prolonged

<sup>25</sup>It has been suggested that the IMF should hire full-time political scientists to undertake such tasks, but a potential problem with such an approach is that a few such specialists would not be integrated into the negotiating process and would risk being marginalized. As a minimum, efforts should be made to enhance the training of IMF staff on the various political science tools that can be used to analyze the feasibility of policy reforms. In addition, as noted in Chapter 6, the views expressed in our interviews in the case study countries on the role of the resident representatives was very positive, with many officials and other stakeholders expressing the view that they should be provided with greater scope to provide input on the feasibility of particular proposals—an approach that is already supposed to be “best practice.”

<sup>26</sup>See Appendix 1 to the Pakistan country study (Chapter 9) for a further discussion.

users, such excessive turnover is particularly detrimental in their case. A revamping of internal personnel incentives to encourage greater stability is needed.<sup>27</sup> The focus of these incentives should be tilted toward encouraging the development of a deeper familiarity with the problems of individual countries, and correspondingly increasing responsibility, through longer country assignments rather than just acquiring the minimum necessary experience and moving on.<sup>28</sup> Furthermore, the questionnaire of mission chiefs, whose results have been discussed in Chapter 6, revealed that existing incentives, as perceived by mission chiefs, do not sufficiently encourage realism and candor, nor do they foster accountability. Efforts should be made to identify the source of these perceptions and, to the extent possible, correct them.

- *We recommend that procedures be evolved that will help avoid the appearance of political intervention in the IMF's determination of whether programs are deserving of support.* Political considerations are unavoidable in an institution governed by the votes of its shareholder governments. However, these considerations should be taken into account in a transparent manner—with decisions and accountability clearly at the level of the Executive Board. As discussed in Chapter 6, the process by which political considerations are currently handled in the IMF's decision-making process is inadequate, and this could affect the credibility of programs and thereby occasionally contribute to prolonged use. While it is reasonable for the Managing Director to take account of shareholder concerns about systemic trade-offs when deciding what risks are acceptable, the present approach has two problems. First, there is no formal—hence no transparent—channel through which political judgments can be fed into the process before the final approval stage. Second, the line of ac-

countability between staff, management, and the Board can, in practice, become blurred. The problems can be mitigated through greater transparency, to which two operational changes could contribute: (i) requiring all program presentations to the Executive Board to be prefaced by an explicit assessment of implementation risks and (ii) when management judged these risks to be high, giving the Board an opportunity to express—on the record—its own judgment on the trade-offs involved before the program was presented for approval, based on a candid assessment of these risks and of the implications of withholding IMF support.

34. Implementation of some of the recommendations would itself raise significant organizational issues. Where our evaluation has provided some insights as to how these implementation issues might be addressed, we make specific recommendations to that effect. However, we have not attempted to spell out operational details in all areas, and we recognize that further work would be needed to translate some of the recommendations into fully operational solutions.<sup>29</sup>

35. Several of the recommendations have resource implications. Some will clearly involve greater staff inputs, most notably those involving ex ante assessments of ownership and implementation capacity, ex post assessments of programs, and the provision of technical assistance. Others mostly involve a rationalization of current practices which, through greater focus and selectivity, should contribute to staff resource savings. In addition, to the extent that all these recommendations succeed in reducing the scope of prolonged use, the ensuing decline in the size of UFR activities would also eventually reduce the current excess demands on IMF staff time. Although it is difficult to quantify the overall impact of the recommendations, we anticipate that they would probably involve an overall resource increase in the short term, with some reduction possible in the longer term as the scope of the IMF's involvement in a number of prolonged users is reduced. But the most critical question from the perspective of long-term resource implications will be intensity of the IMF's involvement in those countries where achievement of sustainable, growth-oriented adjustment is inevitably going to be a protracted process.

<sup>27</sup>The only formal personnel requirement for intradepartmental mobility is that, to be promoted to the B-level (i.e., grades with greater management and supervisory responsibilities), an economist should have worked in at least two departments; otherwise, she or he can only be promoted to a B-level position outside their current department. However, there is ample anecdotal evidence that internal incentives strongly encourage mobility for IMF economists (see, for instance, "Review of Personnel Management in the Fund," OIA, February 2000).

<sup>28</sup>The internal "Economist Development Guide" recently prepared by the IMF's Human Resources Department is a step in this direction.

<sup>29</sup>In a few areas, recent reports by the IMF's Office of Internal Audit and Inspection (OIA) touch upon some of these organizational issues and we have made reference to these reports where they appear relevant.

## Possible Definitions of Prolonged Use

This annex describes various approaches to defining prolonged use that have been used previously in the IMF or elsewhere and presents more details on the evolution and persistence of prolonged use.

The precise definition resulting from each approach can be made more or less restrictive by varying the threshold that separates prolonged users from “temporary” users of IMF resources.

- (i) Prolonged effective use of the IMF general resources<sup>1</sup> (IMF, EBS/00/187)

This concept focuses on resources borrowed under stand-by and extended arrangements and excludes programs financed from concessional trust funds (SAF, ESAF, PRGF) for low-income countries, as well as programs in which the financing approved is not fully disbursed, either because they are off-track (i.e., the country is not eligible to borrow) or because they are treated as “precautionary” by the country’s authorities. This is the narrowest of the possible approaches and risks excluding important issues, such as the implications of failed/interrupted programs and the IMF’s role in low-income countries.

- (ii) Prolonged time spent under IMF-supported programs (IMF, SM/84/91 and EBS/ 91/108)

This concept encompasses programs funded both from the General Resources Account and from concessional trusts. It also includes programs that are only partially drawn upon. It may or may not include precautionary arrangements. It does not include drawings on IMF resources not backed by programs (such as first credit tranche purchases).<sup>2</sup>

<sup>1</sup>That is, purchases from the General Resources Account (GRA), which are typically associated with a Stand-By Arrangement (SBA) or an Extended Fund Facility (EFF) arrangement. The specific operational definition used in the 2000 review of prolonged UFR characterized as prolonged users countries with an outstanding use of IMF credit over 100 percent of quota and either 9 years or more of effective UFR in the previous 30 years, or 5 years of effective use in the previous 15 years.

<sup>2</sup>The thresholds used in internal IMF definitions have varied over time: in 1984, it was set at four or more programs with pur-

A slightly different version of this concept is used by Bird, Hussain, and Joyce (2000) to characterize frequent users of IMF resources. Their definition is based on the number of programs adopted by a country during a particular period, regardless of the type of arrangement at stake, its treatment (i.e., precautionary or not), its duration, or its degree of completion. However, because many programs have a multiyear time frame, particularly those under the EFF and PRGF, such a definition does not measure the time spent under IMF arrangements.

- (iii) Prolonged indebtedness to the IMF (IMF, EBM/86/13; Meltzer and others, 2000; and Jeanne and Zettelmeyer, 2001)

This concept focuses on the length of periods of indebtedness to the IMF, regardless of the origin of the outstanding obligations.<sup>3</sup> However, because IMF facilities have repayment periods varying from 2½ to 10 years, this definition does not distinguish between countries that had only a few arrangements with relatively long repayment periods and those that had a large number of arrangements with shorter maturities. An interesting application of this approach was used by Jeanne and Zettelmeyer (2001) to derive estimates of the length of “lending cycles” to particular countries (Annex Table 1.1).

As noted in the main text, the current evaluation project uses a definition based on the amount of time spent under IMF arrangements, whether or not a country was eligible to draw. In principle, a distinction could be made between continuous “prolonged” use and more episodic “repeat” use. These episodic users may have interludes when their balance of payments situation improves and they

chases in the previous 10 years ; in 1986 and 1991, it was raised to five annual arrangements in the previous 10 years. In all cases, an additional criterion was an outstanding IMF credit of over 100 percent of quota at the end of the period under review.

<sup>3</sup>This concept was used to define prolonged users in a 1986 internal IMF review, with a threshold of “continuously outstanding credit tranche positions in excess of 25 percent of normal maximum for six years or more” in the previous 10 years.

**Annex Table 1.1. Completed and Incomplete Debt Cycles for Borrowers from the IMF, 1947–2000**

	Number of countries	Incomplete debt cycles	Average duration of cycles (years)	
			Completed	Incomplete
All countries	186	88	7.1	17.9
Industrial countries	25	0	4.7	n.a.
Developing countries	161	88	7.6	17.9
Africa	52	38	6.1	22.7
Asia	29	13	9	21.2
Europe	28	21	10.2	7.9
Middle East	14	2	6.5	9.5
Western Hemisphere	37	14	7.6	18.1
HIPC countries <sup>1</sup>	42	38	6.1	23.5
Non-HIPC developing countries	119	50	8	13.6
PRGF countries <sup>2</sup>	80	58	9.3	20.6
Non-PRGF developing countries	81	30	8.2	12.7
Prolonged users (PU) <sup>3</sup>	44	41	7.3	22.3
Non-PU developing countries	117	47	9	14.1
EMBIG countries <sup>4</sup>	27	15	7.8	13.8
Non-EMBIG developing countries	134	73	7.6	18.8
Memorandum Item: excluding cycles initiated after 1991				
HIPC countries <sup>1</sup>	42	35	6.1	24.9
Non-HIPC developing countries	119	22	8.2	23.3
PRGF countries <sup>2</sup>	80	43	9.3	25.6
Non-PRGF developing countries	81	14	8.6	20.4
Prolonged users (PU)	44	35	7.3	24.7
Non-PU developing countries	117	22	9.5	23.7
EMBIG countries <sup>3</sup>	27	8	7.9	20.6
Non-EMBIG developing countries	134	49	7.8	24.9

Source: Database assembled by Jeanne and Zettelmeyer.

Note: This table is an adapted and expanded version of one shown in Jeanne and Zettelmeyer (2001). “Complete” and “incomplete” debt cycles refer to cases where a member has borrowed from the IMF and where the subsequent obligation to the IMF has eventually fallen to zero (“complete” cycle) or where further borrowing meant that the obligations to the IMF have not yet fallen to zero (“incomplete” cycle). The sum of complete and incomplete cycles exceeds the number of countries because each country may experience several lending cycles. The sum of HIPC, PRGF, PU, and EMBIG countries exceeds the total number of countries because these categories overlap in part.

<sup>1</sup>Highly Indebted Poor Countries.

<sup>2</sup>Low-income countries eligible for IMF lending on concessional terms (as of December 31, 1998).

<sup>3</sup>Excluding countries that meet the PU criterion owing to a large number of precautionary arrangements.

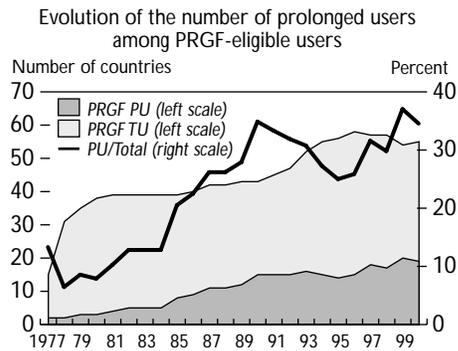
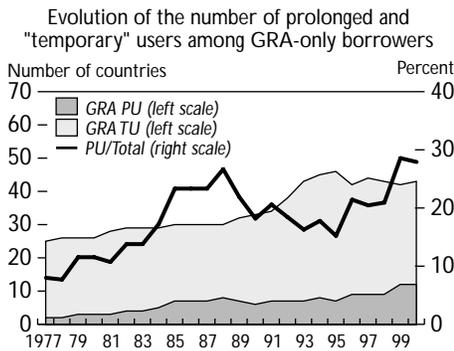
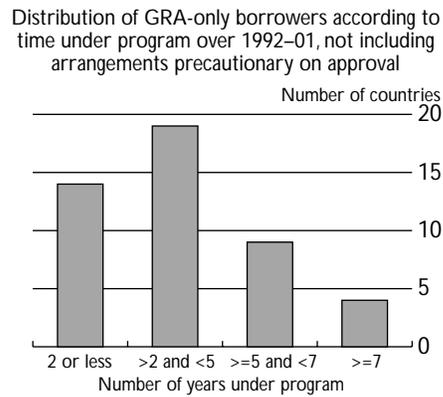
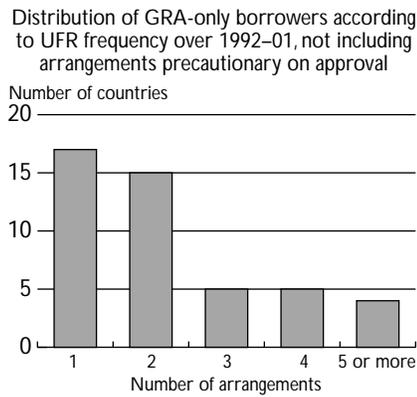
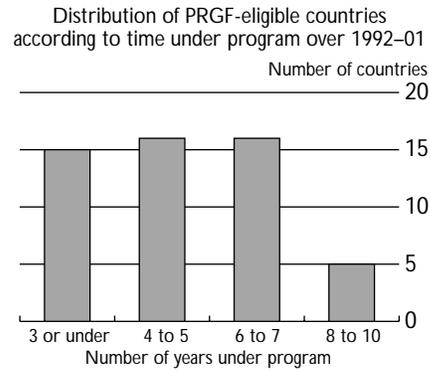
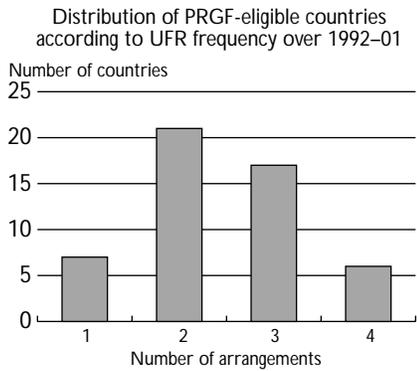
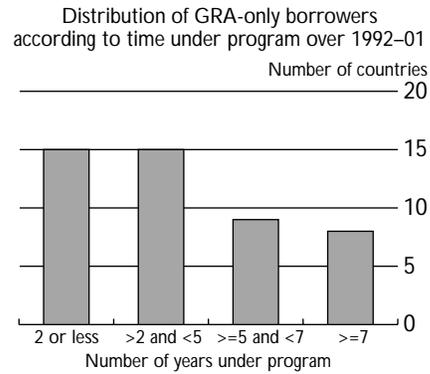
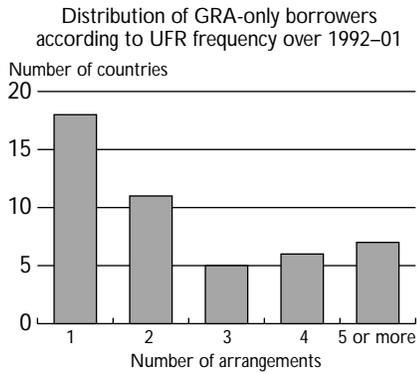
<sup>4</sup>Countries whose bond spreads are tracked by J.P. Morgan’s “EMBI Global” Index.

begin to repay the IMF, but such episodes are followed—perhaps as a result of intervening policy slippages—by further balance of payments problems and recourse to IMF financing. Prolonged users would encounter few such episodes of IMF “abstinence,” perhaps reflecting incomplete adjustment within the life of a program or longer-term debt sustainability problems that were not ade-

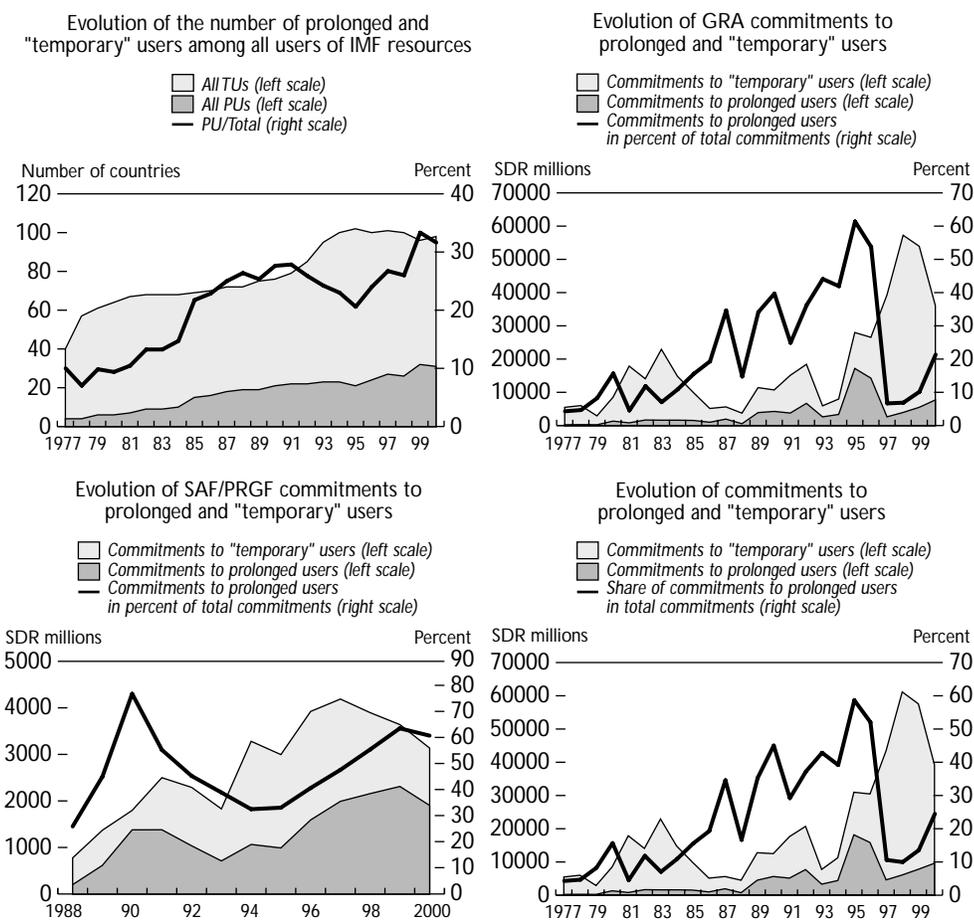
quately addressed up front. In practice, however, it is not possible to make such a clear-cut distinction: all such countries appear to have experienced interludes when their external position improved, followed by renewed difficulties.

Annex Table 1.1 and Annex Figure 1.1 provide further details of the intensity of prolonged use and its evolution to supplement the discussion in Chapter 2.

**Annex Figure 1.1. Frequency and Duration of Recourse to IMF-Supported Programs Across the Membership, 1992–01**



Annex Figure 1.1 (concluded)



Sources: IMF Policy Development and Review Department databases and IEO calculations.

Note: IMF members that did not enter into an arrangement with the IMF over the period are not represented in these figures. The number of prolonged users (PUs) and "temporary" users (TUs) correspond to the cumulative number of programs over a rolling 10-year time frame.

## ANNEX 2

# Background Material on the Evolution of IMF Policies on Prolonged Use

This annex provides additional information to support the discussion in Chapter 3.

### Evolution of the IMF's Attitude to Prolonged Use

On several occasions in past decades, the Executive Board recognized that adjustment often required a longer time frame than implied by existing UFR policies<sup>1</sup> and, in response, instituted new modalities of UFR. These new policies were initially conceived as short term and temporary, out of concern to preserve the monetary nature of the IMF and the revolving character of its resources, but they ended up being renewed year after year. Until the early 1990s, these guiding principles were thought to apply equally to the use of the IMF's general and concessional resources.<sup>2</sup> Thereafter, the policies applied to the two groups diverged, and there was a gradual acceptance of a greater degree of prolonged use of concessional resources while giving renewed emphasis to the revolving character of the IMF's general resources.<sup>3</sup>

<sup>1</sup>Initially, IMF financing in the upper credit tranches was typically provided under a Stand-By Arrangement, whose normal period is one year. It may extend up to but not beyond three years in appropriate cases (Executive Board Decision No. 6056-(79/38) of March 2, 1979). Since 1978, obligations incurred under a Stand-By Arrangement must be repaid within a period of 3¼ to 5 years.

<sup>2</sup>For example, EBS/91/108, "Selected Operational Issues Related with the Use of Fund Resources" explicitly notes that the principle of the revolving character of the IMF's resources must be applied consistently to general and concessional resources, and does not distinguish between the two in the remedial actions it suggests to deal with prolonged use.

<sup>3</sup>The Executive Board reviewed prolonged use on several occasions during the 1980s, starting in 1984. The last comprehensive review of prolonged UFR was discussed by the Board in 1991. Thereafter, the issue was not put on the Board's agenda until 2000, where prolonged use was discussed only as a background issue to the review of IMF facilities.

### Prolonged use of the IMF's general resources

The official interpretation of the IMF's mandate initially emphasized the temporary nature of the support that the IMF could provide to its members: "The authority to use the resources of the Fund is limited to use in accordance with its purposes to give temporary assistance in financing balance of payments deficits" and "the task of the Fund is to help members that need temporary help. The Fund's attitude toward the position of each member should turn on whether the problem to be met is of temporary nature and whether the policies the member will pursue will be adequate to overcome the problem within such a period."<sup>4</sup>

The creation of the EFF in the wake of the first oil shock marked the first important departure from the original conception. However, the wording of the decision made it clear that this departure was intended to be the exception, not the rule: the EFF was to be used in special circumstances, including where a member suffered serious payments imbalances relating to structural maladjustments and where it was expected that the needed improvement in the balance of payments could only be achieved over an extended period. Subsequent developments, which included an increasing use of series of one-year SBAs and the institution and prorogation until 1992 of the enlarged access policy, ensured that the use of the EFF indeed remained exceptional, although not the recourse to IMF resources for a more prolonged period of time than implied by the original interpretation of the IMF's mandate.

<sup>4</sup>Executive Board Decisions No. 71-2 of September 26, 1946 and No. 102-(52/11) of February 13, 1952, respectively. The "Guidelines on Conditionality" adopted in 1979 further stated that: "The normal period for a stand-by arrangement will be one year. If, however, a longer period is requested by a member and considered necessary by the Fund to enable the member to implement its adjustment program successfully, the stand-by arrangement may extend beyond the period of one year. This period in appropriate cases may extend up to but not beyond three years." (Executive Board Decision No. 6056-(79/38) of March 2, 1979.)

The 2000 Executive Board discussion of the “Review of Fund Facilities” marked a sharp reversal of attitudes toward prolonged UFR. On this occasion, a number of Board members expressed concern “that some members may rely unduly on Fund financial assistance in place of seeking market financing, and saw a need to review the Fund’s policies in this connection.”<sup>5</sup> These concerns led to the introduction of repurchase expectations<sup>6</sup> and of surcharges on outstanding obligations to the IMF in excess of normal access (i.e., 100 percent and 300 percent of a member’s quota). While primarily aimed at providing an incentive against large use of IMF resources, this measure was also presented as an indirect incentive to avoid prolonged use, to the extent that it is associated with rising outstanding obligations.

### Prolonged use of the IMF’s concessional resources

Beyond the concessionality of the loans attached to it, the main innovation brought about by the ESAF was the relaxation of the requirement that lending arrangements should solve entirely members’ balance of payments problems. Instead, programs supported by the ESAF were required only to “assure substantial progress during the three-year period toward an overall position and structure of the balance of payments that is consistent with orderly relations with creditors and a reduction in restrictions on trade and payments, while permitting the timely servicing of obligations to the Fund” (EBM/87/171). The ESAF being initially conceived as a one-off operation, the decision was ambiguous, to say the least, as to how the unfinished agenda should be tackled in the post-ESAF period.

Between 1990 and 1997, the ESAF was gradually transformed through a series of steps into a permanent facility without any restrictions on the number of arrangements that an eligible member could enter into. In late 1990, the ESAF Trust Instrument was amended so as to allow *one additional annual arrangement* at the expiration of the initial three-year ESAF arrangement, although only where performance had been satisfactory and within unchanged overall access limits. In 1992, the Board opened the possibility of renewing ESAF support through a *single one- or two-year arrangement*, when the three-

<sup>5</sup>See Chairman’s summing up (BUFF/00/41).

<sup>6</sup>For purchases in the credit tranches and under the CFF, the expectation schedule starts one year in advance of the obligation schedule, beginning 2¼ years after a purchase and ending after 4 years. For the EFF, the expectation schedule begins after 4½ years, as with the obligation schedule, but repurchases are to be doubled, such that the expectation schedule will end after 7 years rather than 10 years under the obligation schedule.

year commitment period had expired with undrawn amounts. Then, in 1993 the Instrument was amended again to allow for a second three-year arrangement, which could itself be followed by a single annual arrangement. This option was to be available only for good performers with appropriately strong adjustment programs. In 1995, the ESAF became a self-sustaining facility, offering eligible members indefinite access to concessional resources, though each member would remain bound by the limits set in 1993 regarding the number of arrangements and the “good performance” test. In 1997, these last limits were lifted.

These successive extensions were agreed upon only after protracted negotiations, due to the reluctance of a minority of Directors to legitimize prolonged use of the IMF resources, even concessional ones. The need to reflect these different perspectives led the Board as a whole to emphasize that the purpose of these successive extensions was *not to provide a source of continuous financing for individual countries*, but rather to maintain the Fund’s ability to respond to members’ needs as they arise.<sup>7</sup> Apart from the factors mentioned in Chapter 3, this decision also reflected a third, “defensive lending” motivation: ensuring a smooth repayment by the countries with the heaviest debt-service ratios to the IMF.<sup>8</sup>

## Evolution of the Strategy Vis-à-Vis Prolonged Use

### Program design elements

From 1984 to 1991, reviews of prolonged use put a strong emphasis on improvements in program design and implementation to address prolonged use, each of the reviews essentially building on the previous ones and increasing the specificity of its recommendations. By contrast, the 2000 review, which tended to downplay the importance of prolonged use, did not suggest any specific remedy related to

<sup>7</sup>See Chairman’s summing up of EBM/97/5, EBM/97/8, and EBM/97/10.

<sup>8</sup>The then Managing Director put the case in the following terms: “I would suggest that these few cases could appropriately be addressed through the continued availability of concessional ESAF resources on present terms” [as opposed to extending to them one further round of ESAF arrangements with a 20-year maturity, as proposed by the U.K. Chancellor of the Exchequer]. “Through this instrument, the Fund would have the possibility of tailoring its financing to the individual situation of each member, *extending for the period needed—in a few cases through several successive ESAF arrangements—the concessional financing required . . . , while avoiding significant humps in net transfers from the member to the Fund.*” (BUFF/95/31.)

program design, nor did it recall or call for the implementation of the measures endorsed in previous reviews.

### Access to IMF resources

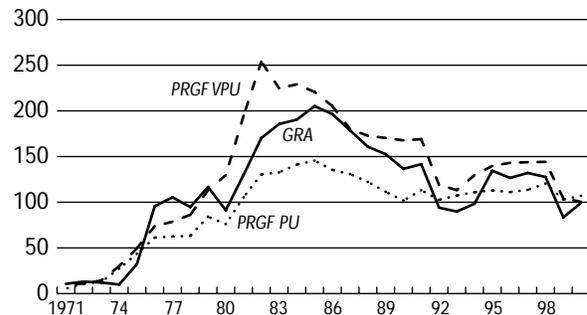
The majority view of the Executive Board regarding access has consistently been that it would not be appropriate to introduce strict rules limiting access based on the frequency or length of UFR, because even perfect implementation might fail to deliver the desired balance of payments outcome. However, the policies adopted in 1983/84 on the use of general resources made it clear that access should be reduced over time and that past performance in using the IMF's resources should be taken into account in the determination of further access.

While these policies were not applicable *ipso facto* to concessional resources, the decisions adopted by the Board from 1990 onward left little doubt that the guiding principles of access policy were similar for both categories of resources. In 1993, the Board decided that “for repeat users, access would take into account the amount of the member’s outstanding use of Fund credit and its record in using Fund resources. . . . This would signal the need to phase out the reliance on exceptional balance of payments financing” and “ensure that even with continued availability of the ESAF, individual members would, over time, phase out their reliance on ESAF support.”<sup>9</sup> In 1995, the Board further specified that “lower (or no) access may be appropriate in the case of . . . countries that have relatively weak track records and are not able to implement sufficiently strong policies . . .”

Our case studies suggest that the justification of the level of access proposed in staff reports was treated in a rather perfunctory manner. This eventually caused the Executive Board in July 2000 to ask for a revision of the operational guidelines calling on staff to provide more detailed justifications of access proposals. As regards the evolution of the level of access, only about one-fifth of prolonged users with more than one three-year ESAF/PRGF arrangement had a consistently diminishing access. A similar proportion had access that actually increased over time. The remainder had access that either was stable over time or diminished only between the first and second three-year arrangement, and remained broadly stable thereafter. Among GRA arrangements, since 1990, 43 percent of prolonged users had higher annual access in their most recent (or last) arrangement than in their first, and just over a fifth had a consistently

<sup>9</sup>EBS/93/32, “Operational Modalities and Funding Alternatives for an ESAF” and EBS/95/130, “Continued Financing and Adaptation of the ESAF.”

**Annex Figure 2.1. Average Outstanding Obligations of Prolonged Users to the IMF**  
(In percent of quota)



Sources: IMF Treasurer's Department and IEO calculations.

Note: In this figure, prolonged users are treated as a fixed group, consisting of the countries listed in Chapter 2. However, the broad trends are not very sensitive to the precise composition. Not every country in this sample was a prolonged user in each year. The choice of the fixed rather than the dynamic definition in this case was dictated by concerns not to understate the decline in outstanding obligations of the group of prolonged users. VPU: very prolonged users.

diminishing annual access. Another way to capture the lack of consistent implementation of access guidelines is to look at the evolution of prolonged users' outstanding obligations to the IMF over time (see Annex Figure 2.1). The general trend is fairly consistent both within and across groups: outstanding UFR declined sharply in the second half of the 1980s, but then remained fairly steady during the 1990s.<sup>10</sup>

### Strengthened analytical and assessment efforts

In 1990, the Executive Board approved the proposal to include in any new UFR request a systematic review of experience under preceding arrangements. In 1995, the Board went a step further by recommending stock-taking, on a case-by-case basis, toward the end of the three-year arrangement, to reflect on what has been achieved and how to ensure strong performance in a subsequent arrangement (i.e., without necessarily waiting for a new UFR request to arise).<sup>11</sup>

<sup>10</sup>The step declines observed in 1981, 1993, and 1999 partly reflect the impact of general quota increases. It should be noted that if access is reduced very gradually, disbursements may exceed repayments for a relatively long period, especially under concessional facilities, thus causing outstanding obligations to increase for a while even though access itself is being reduced.

<sup>11</sup>See BUFF/90/37 and BUFF/95/95 for the acting Chairman's summing up of the relevant Board discussions.

## Exit strategies

Evidence from the case studies again suggests that the recommendation that staff reports should provide medium-term balance of payments projections and attempt to foresee a reasonable timetable for the disengagement of the IMF was often not followed. For example, medium-term projections for the Philippines in the 1994 EFF projected financing gaps even after market access had been restored. Part of the problem was the lack of clear criteria for a balance of payments financing gap in cases where countries had access to private financial markets. By contrast, in Pakistan and Senegal, most medium-term projections showed no financing gap beyond the program period, but such projections proved unrealistic.

As concerns the use of strengthened surveillance in the post-program period, the emphasis put by the 2000 “Review of Fund Facilities” on post-program monitoring essentially just formalized a preexisting disposition. While all GRA arrangements have a consultation clause stating that, under certain conditions, members shall consult with the IMF after the expiry of the arrangement “at the request of the Managing Director,” the facilities review instituted a presumption that countries with obligations to the IMF exceeding 100 percent of their quota at the expiration of the program would undergo this procedure for as long as their outstanding liabilities to the IMF exceeded the threshold.

For users of concessional resources, the principle of post-program monitoring as a means of avoiding prolonged use of ESAF resources was formally established in the early 1990s. In considering operational details for an ESAF successor, the Board endorsed the suggestion of “post-ESAF enhanced consultations and program monitoring . . . on a limited transitional basis, in cases where the macroeconomic situation remains vulnerable and the authorities perceive benefits

in a continued close policy dialogue with the IMF.<sup>12</sup> Subsequently, it was also envisaged that one option for continued IMF support for the programs of former ESAF users that ceased to have a need for IMF financing would be through precautionary arrangements: “Directors considered that . . . a precautionary arrangement would signal the Fund’s approval of the country’s adjustment program, thereby catalyzing financial support from other sources, while providing assurances that Fund resources would be available should the country’s circumstances change. Directors were persuaded, however, by the arguments against granting precautionary ESAF arrangements. They broadly agreed that ESAF-eligible countries without a recurrent or prospective balance of payments need could instead request a precautionary extended arrangement, which could be replaced or supplemented by an ESAF arrangement in the event that a balance of payments need emerged.”<sup>13</sup>

The implications of this exit strategy for other creditors were spelled out rather bluntly in 1991, when a staff report noted that: “In cases where external viability is not in reasonable prospect . . . the Fund could provide support in the early stages of the adjustment process . . . to help ensure the establishment of an appropriate macroeconomic framework. However, other creditors may have to continue their contributions, in part to facilitate repayments to the Fund, and there would need to be a clear acknowledgement by creditors of the revolving character of the Fund’s resources.”<sup>14</sup>

<sup>12</sup>“Operational Modalities and Funding Alternatives for an ESAF Successor—Preliminary Considerations” (EBS/93/32).

<sup>13</sup>Chairman’s summing up of EBM/98/73 on “Distilling the Lessons from the ESAF Reviews.”

<sup>14</sup>“Selected Operational Issues Related with the Use of Fund Resources” (EBS/91/108).

# ANNEX 3

## Characteristics of Prolonged Users: Further Details on the Evidence

This annex provides more details of the analyses discussed in Chapter 4.

### Econometric Evidence on the Characteristics of Prolonged Users

We estimated a series of probit regressions to examine whether prolonged users had economic and institutional characteristics that were different from “temporary” users. The characteristics considered, which were drawn from the recent empirical literature on participation in IMF arrangements,<sup>1</sup> were (i) per capita GDP; (ii) real GDP growth; (iii) current account balance (in relation to GDP); (iv) international reserves (in months of imports); (v) debt-service ratio (measured in relation to exports); (vi) openness of the economy (measured as the ratio of the sum of exports and imports to GDP); (vii) primary exports (as a share of total exports); and (viii) volatility in the terms of trade (standard deviation of the terms of trade index).

Two definitions of “prolonged use” were employed in these exercises—one “fixed” over time, and the other “dynamic” (i.e., time-specific).<sup>2</sup> Using the fixed definition, which classified a country as a prolonged user if it had IMF arrangements in 7 out of any 10-year period during 1971–2000, and entire sample period average data, we found prolonged use to be associated with lower levels of international reserves, with higher debt-service ratios, and with lower real GDP growth. There was no statistically significant difference between prolonged and “tem-

porary” users with respect to the other characteristics considered (column 1 in Annex Table 3.1).<sup>3</sup> When the sample was limited to PRGF-eligible countries only, prolonged use was found to be associated with higher debt-service ratios and lower GDP per capita (column 2 in Annex Table 3.1).<sup>4</sup>

For countries not eligible for the PRGF (i.e., middle- and high-income users of IMF resources), we found no statistically significant differences between prolonged users and “temporary” users for any of the variables (column 3 in Annex Table 3.1).

Introduction of an institutional variable—quality of government bureaucracy<sup>5</sup>—suggested that prolonged use was associated with lower quality of government bureaucracy, and that once this factor was taken into account, the differences in economic characteristics (i.e., growth, international reserves, and debt-service ratio) were no longer significantly different between prolonged and “temporary” users (column 4 in Annex Table 3.1).

<sup>1</sup>See, for example, Bird, Hussain, and Joyce (2000); Joyce (2001); and Barro and Lee (2002).

<sup>2</sup>Due to data limitations for several users of IMF resources during the period covered by the evaluation (1971–2000), a maximum of only 83 countries were covered in the regressions. Also, because data for 1971–75 and for 2000 were missing for many variables for many countries, the annual time series data used spanned 1976–99. Among users of IMF resources that were excluded were countries that either did not exist in 1976 or had missing data for several variables during most of 1976–99.

<sup>3</sup>The list of distinguishing characteristics here is much shorter than that reported in Bird, Hussain, and Joyce (2000), in which the authors found that repeated participation in programs (“recidivism”) was associated with: (i) lower levels of international reserves; (ii) larger current account deficits; (iii) lower and less volatile terms of trade; (iv) larger debt-service ratios; (v) larger capital outflows; (vi) lower per capita income; (vii) lower investment rates; and (viii) weaker governance. Differences in methodology may account for the different results. Bird, Hussain, and Joyce do not predefine a threshold for “recidivism”; rather they regress the number of arrangements and the number of program years on a range of variables using Poisson and negative binomial models.

<sup>4</sup>These estimates do not take account of the likely strong endogeneity between growth and the likelihood that a country will request an IMF arrangement—for example, because exogenous shocks that worsen the balance of payments also harm growth. In Annex 4, when this endogeneity is taken into account, the negative association between growth on prolonged use disappears for PRGF-eligible countries.

<sup>5</sup>The institutional variable used is the “Bureaucracy quality” index calculated by the International Country Risk Guide. It is designed to provide an indication of the policy environment, especially the extent to which policy formulation and day-to-day administrative functions are able to withstand political changes.

Annex Table 3.1. Characteristics of Prolonged Users of IMF Resources<sup>1</sup>

Marginal probabilities	Fixed definition sample averages				Dynamic definition five-year averages			
	All (1)	PRGF (2)	non-PRGF (3)	All (4)	All (5)	PRGF (6)	non-PRGF (7)	All (8)
GDP per capita	-0.048 (1.09)	<b>-0.545</b> (1.73)*	-0.039 (0.66)	0.014 (0.26)	0.012 (0.08)	1.184 (1.47)	-0.057 (0.33)	-0.078 (0.31)
Real GDP growth	<b>-0.058</b> (1.72)*	-0.020 (0.42)	-0.077 (1.45)	-0.031 (0.84)	-0.020 (1.29)	-0.039 (1.33)	-0.021 (0.95)	-0.025 (0.93)
Current account balance	0.006 (0.45)	0.024 (1.29)	-0.028 (0.71)	0.013 (0.77)	-0.008 (0.93)	-0.021 (1.50)	-0.020 (1.35)	<b>-0.045</b> (2.19)**
Foreign reserves	<b>-0.070</b> (1.80)*	-0.084 (1.43)	-0.025 (0.42)	-0.063 (1.50)	<b>0.056</b> (2.07)**	<b>0.136</b> (2.75)***	-0.004 (0.10)	0.072 (1.44)
Debt-service ratio	<b>0.015</b> (2.16)**	<b>0.024</b> (2.10)**	-0.000 (0.03)	0.011 (1.28)	-0.004 (0.96)	-0.006 (0.72)	-0.008 (1.56)	-0.003 (0.35)
Openness	-0.001 (0.34)	0.005 (1.20)	-0.006 (1.28)	0.002 (0.76)	0.001 (0.40)	-0.003 (0.57)	0.007 (1.42)	0.008 (1.53)
Primary exports	-0.001 (0.42)	0.001 (0.20)	-0.007 (1.23)	-0.001 (0.34)	0.003 (0.63)	-0.003 (0.43)	0.008 (1.36)	0.008 (1.09)
Term of trade volatility	-0.004 (0.72)	-0.005 (0.70)	-0.006 (0.30)	-0.003 (0.66)	-0.009 (1.44)	-0.008 (0.84)	-0.015 (1.54)	0.005 (0.40)
Lagged GDP per capita					-0.000 (0.25)	-0.002 (1.83)*	0.000 (0.50)	0.000 (0.48)
Lagged real GDP growth					-0.015 (1.10)	<b>-0.040</b> (1.75)*	0.000 (0.02)	0.025 (1.05)
Lagged current account balance					<b>-0.020</b> (2.07)**	0.002 (0.18)	<b>-0.064</b> (3.58)***	<b>-0.076</b> (3.36)***
Lagged foreign reserves					<b>-0.070</b> (2.57)**	<b>-0.153</b> (2.79)***	-0.031 (0.98)	<b>-0.146</b> (2.54)**
Lagged debt-service ratio					<b>0.012</b> (2.91)***	<b>0.018</b> (2.18)**	<b>0.010</b> (2.20)**	<b>0.015</b> (2.25)**
Lagged openness					-0.003 (0.81)	0.004 (0.72)	<b>-0.010</b> (1.96)*	-0.008 (1.41)
Lagged primary exports					-0.002 (0.43)	0.006 (0.87)	-0.009 (1.40)	-0.008 (0.98)
Lagged terms of trade volatility					-0.000 (0.08)	-0.001 (0.26)	0.001 (0.22)	-0.004 (0.54)
Bureaucracy quality				<b>-0.231</b> (2.06)**				-0.077 (1.03)
Observations	83	48	35	65	218	105	113	124
Pseudo R-squared	0.14	0.26	0.18	0.13	0.18	0.32	0.29	0.32
p-value	<b>0.0378</b>	<b>0.0302</b>	0.3642	0.2603	<b>0.0000</b>	<b>0.0001</b>	<b>0.0011</b>	<b>0.0000</b>

Sources: IMF, WEO and MONA databases; ICGR database; and IEO calculations

<sup>1</sup>Bold numbers indicate that the coefficient on the variable is statistically different from zero at the following significance level: 10 percent (\*), 5 percent (\*\*), and 1 percent (\*\*\*).

In order to allow for some dynamics, a second set of exercises used a period-specific definition of “prolonged use,” based on five-year average panel data (columns 5–8 in Annex Table 3.1). A country was defined to be a prolonged user in a particular five-year period if it had IMF arrangements in seven or more years during that and the preceding five-year period. Prolonged use was found to be strongly associated with (i) lower international reserves in the

preceding five-year period but higher reserves in the current five-year period; (ii) lower current account balances in the preceding five-year period; and (iii) higher debt service in the preceding five-year period. No statistically significant difference was found in the quality of bureaucracy.

When the sample was limited to only PRGF-eligible countries, prolonged use was again associated with lower levels of reserves in the previous period

**Annex Table 3.2. Comparison of Starting Conditions for Groups of Prolonged and “Temporary” Users***(In percent of GDP, unless otherwise indicated)*

	Public debt	External debt	Current account balance	Overall budget balance	Inflation (in percent)
1976–79					
Prolonged users	31.9	37.7	–6.6	–6.7	23.7
“Temporary” users	58.9	15.2	–3.8	–6.0	19.0
Statistical significance	ns	**	ns	ns	ns
1988–91					
Prolonged users	116.1	157.1	–4.8	–10.1	9.8
“Temporary” users	45.3	57.1	–2.8	–5.3	24.5
Statistical significance	ns	*	ns	ns	ns

Sources: IMF, WEO database; and IEO calculations.

Note: \*\* and \* indicate statistical significance at the 1 percent and 10 percent levels, respectively; ns indicates no significance.

but higher levels in the current period; and with higher debt-service ratios in the preceding period. Prolonged use was also associated with lower GDP growth for this group of countries. For countries not eligible for the PRGF, taking account of both contemporaneous and lagged effects, prolonged use was found to be associated with larger current account deficits, larger debt-service ratios, and less open economies.

## Cross-Section Evidence on Comparison Between Prolonged and “Temporary” Users

### Starting conditions

To compare the “starting conditions” of prolonged users at the beginning of their episode of prolonged use with those of contemporaneous “temporary” users, we identified two subperiods (1976–79 and 1988–91) during which a large proportion of the episodes of prolonged use that we studied were initiated and looked at economic conditions in the three years preceding the first program of the prolonged use series for the two groups of prolonged users thus identified. We then identified two control groups of “temporary” users, consisting of all the countries that entered into an IMF arrangement during the same periods. Starting conditions were appraised by looking at five measures of potential macro imbalances: public debt, external debt, current account balance, overall fiscal balance, and inflation. The results of the comparison are shown in Annex Table 3.2.

### Economic performance and macroeconomic adjustment<sup>6</sup>

As regards GDP growth, a comparison between prolonged and “temporary” users of IMF resources over the last three decades suggests that, in most periods, prolonged users grew at a slower pace than “temporary” users, the exceptions being the early 1970s and early 1990s for middle-income countries (i.e., the times when there were few debt crises) and the 1990s for low-income countries (Annex Figure 3.1).

Export growth was generally much weaker, on average, in the group of prolonged users than in the “temporary users” group as far as low-income countries are concerned. For middle-income countries, the opposite was generally true, but differences were less pronounced (Annex Figure 3.2).<sup>7</sup>

The analysis of adjustment performance, as measured by trends in inflation and reductions in current account deficits, does not show any clear or consistent differences between the two groups, although

<sup>6</sup>See Annex Table 3.3 for detailed figures and statistical significance of the comparisons. In the results presented here, the groups “prolonged users” and “temporary users” are both fixed populations (the former group consisting of the countries listed in Chapter 2), that is, we are looking at the characteristics of a broad group of countries that, at some point in the overall period encountered episodes of prolonged use against other countries which, at some point in the same period, entered into an IMF-supported program, but which did not become prolonged users. However, because the population of prolonged users does not change much over time, the results would not be substantially altered if a “dynamic” definition of prolonged use were used.

<sup>7</sup>These results are statistically significant only for the PRGF-eligible group over the 1980s.

**Annex Table 3.3. Comparison of Prolonged and “Temporary” Users<sup>1</sup>***(In percent, unless otherwise specified)*

ECONOMIC PERFORMANCE									
	1971–75	1976–80	1981–85	1986–90	1991–95	1996–2000	1971–80	1981–90	1991–2000
GDP growth (Period geometric mean)									
PRGF-eligible users									
Prolonged	3.0	3.2	0.7	2.3	1.6	5.5	3.1	1.5	3.5
Temporary	3.3	2.7	3.2	2.8	0.5	3.9	3.2	3.0	1.7
<i>t</i> test significance <sup>1</sup>	ns	ns	**	ns	ns	ns	ns	*	ns
Non-PRGF-eligible users									
Prolonged	6.3	4.7	2.0	2.4	2.3	2.2	5.0	2.2	2.2
Temporary	5.5	5.1	2.2	2.7	1.0	3.0	5.2	2.7	1.6
<i>t</i> test significance	ns	ns	ns	ns	ns	ns	ns	ns	ns
<i>Memorandum</i>									
Pakistan	3.2	6.2	6.8	5.8	4.8	2.8	4.7	6.3	3.9
Philippines	5.8	6.1	-1.3	4.7	2.2	3.3	5.9	1.7	2.7
Senegal	2.4	1.0	3.0	3.2	1.5	5.3	1.7	3.1	3.2
Per capita GDP growth									
PRGF-eligible users									
Prolonged	0.5	0.4	-1.4	0.0	-0.9	2.7	0.4	-0.7	0.7
Temporary	2.3	1.9	-0.3	0.6	-2.7	1.5	2.1	-0.2	-0.6
<i>t</i> test significance	**	*	ns	ns	ns	ns	**	ns	ns
Non-PRGF-eligible users									
Prolonged	3.1	2.2	-0.5	1.3	0.9	1.2	2.6	0.4	1.1
Temporary	4.1	2.9	1.0	2.3	-0.3	2.1	3.4	1.7	1.1
<i>t</i> test significance	ns	ns	ns	ns	ns	ns	ns	ns	ns
<i>Memorandum</i>									
Pakistan	0.0	4.2	3.5	3.4	2.2	0.6	1.5	3.5	1.4
Philippines	2.9	1.9	-3.5	0.8	-0.1	1.5	3.1	-0.7	0.7
Senegal	-0.6	-0.3	-0.8	-0.7	-1.0	2.5	-1.2	0.3	0.7
Inflation									
PRGF-eligible users									
Prolonged	12.0	19.2	55.2	167.7	158.0	77.1	15.3	64.5	15.7
Temporary	10.7	11.1	13.2	13.6	18.6	33.4	10.7	14.1	23.3
<i>t</i> test significance	ns	ns	ns	ns	ns	ns	ns	ns	ns
Non-PRGF-eligible users									
Prolonged	19.5	18.9	27.8	55.1	77.6	48.3	21.1	32.1	22.4
Temporary	19.5	17.2	23.0	42.8	58.4	47.3	18.3	26.4	18.6
<i>t</i> test significance	ns	ns	ns	ns	ns	ns	ns	ns	ns
<i>Memorandum</i>									
Pakistan	15.7	8.8	5.2	9.4	11.2	7.3	12.2	7.0	9.2
Philippines	17.0	12.9	14.3	12.7	10.0	7.1	14.7	13.0	8.5
Senegal	13.5	8.9	7.5	-0.6	6.8	1.4	10.1	5.8	4.1
Growth of exports									
PRGF-eligible users									
Prolonged	3.2	5.7	-1.3	2.9	4.6	7.4	4.4	1.4	6.2
Temporary	4.9	4.7	2.4	4.6	4.1	9.1	4.3	3.2	4.4
<i>t</i> test significance	ns	ns	ns	ns	ns	ns	ns	ns	ns
Non-PRGF-eligible users									
Prolonged	8.3	7.3	4.2	5.5	7.2	6.8	7.7	4.8	7.0
Temporary	5.1	6.7	3.2	7.1	3.6	4.8	5.1	5.2	4.3
<i>t</i> test significance	ns	ns	ns	ns	ns	ns	ns	ns	ns
<i>Memorandum</i>									
Pakistan	-4.0	11.2	12.2	10.8	9.0	0.3	1.6	8.1	4.5
Philippines	4.4	8.6	2.4	7.2	9.4	3.3	9.7	3.6	6.3
Senegal	1.2	-2.7	0.5	1.2	0.8	5.0	-1.4	4.5	2.9

Annex Table 3.3 (continued)

FISCAL CHARACTERISTICS									
	1971–75	1976–80	1981–85	1986–90	1991–95	1996–2000	1971–80	1981–90	1991–2000
Overall budget deficit (percent of GDP)	(Period average)								
PRGF-eligible users									
Prolonged	-4.0	-6.0	-7.9	-4.5	-4.1	-3.1	-5.2	-6.8	-3.4
Temporary	-3.5	-5.6	-8.1	-6.1	-5.1	-3.8	-4.4	-4.3	-7.2
<i>t</i> test significance	ns	ns	ns	ns	ns	ns	ns	ns	**
Non-PRGF-eligible users									
Prolonged	-3.1	-4.8	-4.5	-2.6	-1.2	-2.2	-4.1	-3.8	-1.5
Temporary	-4.1	-4.2	-5.0	-3.2	-2.7	-1.9	-3.9	-4.0	-2.3
<i>t</i> test significance	ns	ns	ns	ns	ns	ns	ns	ns	ns
<i>Memorandum</i>									
Pakistan	-7.6	-8.0	-6.1	-7.3	-7.6	-6.5	-7.9	-6.7	-7.1
Philippines	-1.0	-1.3	-2.9	-3.2	-0.6	-1.3	-1.2	-3.1	-0.9
Senegal	-1.1	-0.7	-5.9	n.a.	n.a.	n.a.	-0.9	-5.9	n.a.
Tax revenues (percent of GDP)									
PRGF-eligible users									
Prolonged	13.8	14.9	16.0	14.3	14.3	14.1	16.1	15.2	15.3
Temporary	20.2	20.5	20.5	13.0	14.6	13.9	20.3	17.6	13.8
<i>t</i> test significance	ns	ns	ns	ns	ns	ns	ns	ns	ns
Non-PRGF-eligible users									
Prolonged	13.1	15.6	16.3	15.0	18.7	18.7	14.3	16.3	18.5
Temporary	18.4	21.6	24.1	24.0	25.1	25.0	20.2	24.2	24.9
<i>t</i> test significance	**	**	**	**	**	**	**	**	**
<i>Memorandum</i>									
Pakistan	10.3	12.3	10.6	12.4	15.6	16.0	11.4	11.5	15.8
Philippines	15.0	18.7	18.1	n.a.	n.a.	n.a.	16.9	18.1	n.a.
Senegal	11.0	11.8	12.9	13.4	12.7	13.1	11.5	13.1	12.9
Government expenditure (percent of GDP)									
PRGF-eligible users									
Prolonged	21.1	23.8	28.5	23.5	23.2	22.1	21.5	26.0	23.1
Temporary	17.4	23.0	27.5	25.7	25.2	23.2	21.3	26.0	23.9
<i>t</i> test significance	ns	ns	ns	ns	ns	ns	ns	ns	ns
Non-PRGF-eligible users									
Prolonged	22.9	26.1	25.0	22.5	23.5	24.0	24.1	24.5	23.6
Temporary	25.8	28.6	32.6	31.2	31.4	30.5	27.3	31.6	30.9
<i>t</i> test significance	ns	ns	**	**	**	**	ns	**	**
<i>Memorandum</i>									
Pakistan	16.9	17.4	19.0	23.3	23.6	22.2	17.2	21.2	23.0
Philippines	13.9	13.8	12.0	16.6	18.7	19.1	13.8	14.3	18.9
Senegal	18.2	20.3	27.1	n.a. <sup>2</sup>	n.a.	n.a.	19.2	27.1	n.a.
Of which interest (percent of expenditure)									
PRGF-eligible users									
Prolonged	5.1	6.2	10.8	10.0	14.9	16.8	5.2	10.3	14.7
Temporary	3.2	4.1	5.9	8.6	11.8	14.1	3.7	6.6	11.9
<i>t</i> test significance	**	**	**	ns	ns	ns	ns	**	ns
Non-PRGF-eligible users									
Prolonged	4.7	6.3	12.7	15.7	12.2	11.9	5.3	14.9	12.0
Temporary	4.7	5.7	9.6	13.0	11.3	10.3	5.1	11.5	10.9
<i>t</i> test significance	ns	ns	ns	ns	ns	ns	ns	ns	ns
<i>Memorandum</i>									
Pakistan	9.8	10.7	14.4	19.9	23.9	29.1	10.4	16.9	26.2
Philippines	3.7	5.6	13.8	32.4	27.2	18.4	4.8	23.1	23.3
Senegal	2.3	6.2	7.5	n.a.	n.a.	n.a.	4.3	7.5	n.a.

Annex Table 3.3 (continued)

FISCAL CHARACTERISTICS (CONTINUED)									
	1971–75	1976–80	1981–85	1986–90	1991–95	1996–2000	1971–80	1981–90	1991–2000
Of which defense (percent of expenditure)									
	(Period average)								
PRGF-eligible users									
Prolonged	n.a.	n.a.	n.a.	14.4	10.1	10.5	n.a.	14.5	9.9
Temporary	n.a.	n.a.	n.a.	20.6	16.4	17.1	n.a.	20.5	16.5
<i>t</i> test significance	n.a.	n.a.	n.a.	ns	**	**	n.a.	ns	**
Non-PRGF-eligible users									
Prolonged	n.a.	n.a.	n.a.	18.1	11.2	9.7	n.a.	17.2	11.2
Temporary	n.a.	n.a.	n.a.	10.5	9.3	9.0	n.a.	10.5	9.1
<i>t</i> test significance	n.a.	n.a.	n.a.	**	ns	ns	n.a.	**	ns
<i>Memorandum</i>									
Pakistan	n.a.	n.a.	28.1	27.6	26.6	24.0	n.a.	27.7	25.9
Philippines	n.a.	n.a.	9.5	11.2	10.1	8.4	n.a.	10.9	9.6
Senegal	n.a.	n.a.	8.8	6.6	10.3	8.7	n.a.	7.1	9.8
Public debt stock (percent of GDP)									
PRGF-eligible users									
Prolonged	30.6	46.7	90.2	90.8	92.0	94.9	38.6	86.2	81.9
Temporary	44.4	21.0	47.1	56.0	81.3	95.0	42.4	53.9	84.8
<i>t</i> test significance	ns	**	**	**	ns	ns	ns	**	ns
Non-PRGF-eligible users									
Prolonged	43.4	37.9	45.7	55.2	44.1	40.5	40.5	54.5	42.1
Temporary	29.2	36.1	51.7	48.4	45.4	43.3	32.6	47.6	43.3
<i>t</i> test significance	ns	ns	ns	ns	ns	ns	ns	ns	ns
<i>Memorandum</i>									
Pakistan	66.9	56.8	54.4	73.8	76.5	79.1	61.8	64.1	77.2
Philippines	43.5	30.2	29.6	51.9	58.1	60.3	36.8	40.8	58.9
Senegal	13.9	n.a.	60.0	n.a.	n.a.	n.a.	8.0	60.0	n.a.
Public debt service									
PRGF-eligible users									
Prolonged	10.0	14.2	22.6	26.2	22.1	17.0	13.6	24.2	19.8
Temporary	8.1	7.7	15.6	19.3	12.4	12.5	7.7	17.1	12.6
<i>t</i> test significance	ns	**	ns	ns	**	ns	**	**	**
Non-PRGF-eligible users									
Prolonged	5.4	25.1	28.4	26.1	18.6	19.8	24.5	27.3	19.1
Temporary	14.3	15.5	21.9	23.4	14.0	15.5	15.0	22.7	14.8
<i>t</i> test significance	**	**	**	**	**	**	**	**	**
<i>Memorandum</i>									
Pakistan	20.9	19.9	19.4	24.9	26.2	27.9	20.4	22.2	26.9
Philippines	n.a.	23.4	35.5	30.6	21.6	12.2	23.4	33.1	17.4
Senegal	6.2	14.6	15.8	27.7	15.5	18.4	12.2	21.8	16.8
PPG debt service (percent revenue)									
PRGF-eligible users									
Prolonged	14.2	15.5	19.7	23.2	24.6	19.4	14.8	21.0	23.5
Temporary	6.9	6.1	10.6	14.3	15.6	18.4	6.3	12.2	17.3
<i>t</i> test significance	ns	**	**	**	**	**	**	**	**
Non-PRGF-eligible users									
Prolonged	14.8	22.6	32.0	27.5	20.2	22.3	19.1	29.4	21.4
Temporary	8.4	10.3	15.7	23.8	15.5	14.5	9.4	19.2	15.0
<i>t</i> test significance	**	**	**	ns	ns	**	**	**	**
<i>Memorandum</i>									
Pakistan	19.1	15.9	18.0	18.8	23.6	21.3	17.1	18.4	22.6
Philippines	13.0	14.9	28.0	43.2	35.7	30.9	14.1	35.6	33.6
Senegal	10.0	24.1	18.1	n.a.	n.a.	n.a.	17.0	18.1	n.a.

Annex Table 3.3 (continued)

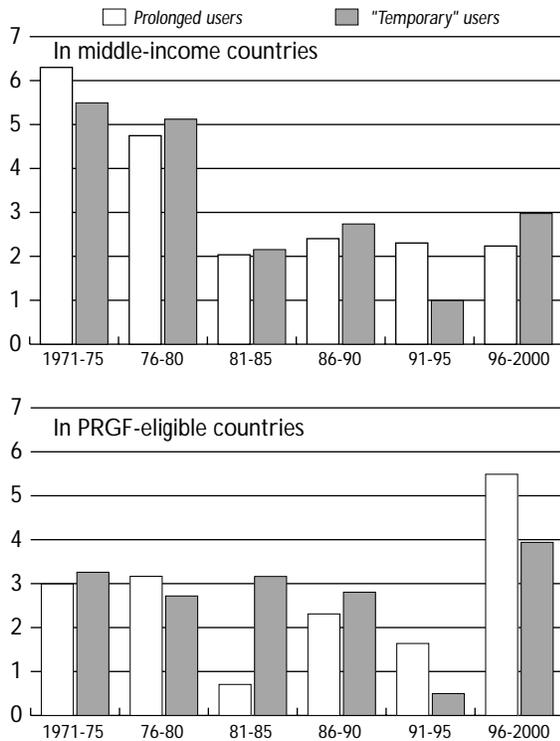
FISCAL CHARACTERISTICS (CONCLUDED)									
	1971–75	1976–80	1981–85	1986–90	1991–95	1996–2000	1971–80	1981–90	1991–2000
Stock of external debt (percent of GDP)	(Period average)								
PRGF-eligible users									
Prolonged	29.0	31.1	35.6	40.7	46.0	51.9	56.7	63.0	70.2
Temporary	12.4	27.3	45.1	78.3	109.8	98.7	19.9	59.4	111.1
t test significance	**	ns	ns	**	**	**	**	ns	ns
Non-PRGF-eligible users									
Prolonged	28.7	41.7	63.9	78.7	61.7	53.1	35.2	71.3	58.3
Temporary	20.0	28.1	43.0	54.1	47.0	42.5	24.1	49.7	47.6
t test significance	ns	ns	ns	ns	ns	ns	ns	ns	ns
<i>Memorandum</i>									
Pakistan	52.2	47.0	40.0	47.8	50.3	51.5	48.5	43.9	50.8
Philippines	29.1	45.3	72.1	79.4	62.5	61.2	37.2	75.8	61.9
Senegal	17.0	36.7	61.0	59.7	66.2	75.4	30.5	70.8	61.2
BALANCE OF PAYMENTS CHARACTERISTICS									
	1971–75	1976–80	1981–85	1986–90	1991–95	1996–2000	1971–80	1981–90	1991–2000
Current account deficit (percent of GDP)	(Period average)								
PRGF-eligible users									
Prolonged	-4.4	-3.2	-7.4	-5.7	-7.7	-9.0	-3.5	-6.1	-8.3
Temporary	-4.2	-4.5	-7.4	-6.0	-7.9	-9.1	-4.7	-6.4	-8.6
t test significance	ns	**	ns	ns	ns	ns	**	ns	ns
Non-PRGF-eligible users									
Prolonged	-2.8	-3.4	-3.9	-2.3	-2.8	-2.7	-3.4	-2.9	-2.8
Temporary	-4.5	-2.6	-5.6	-1.8	-1.9	-3.0	-2.9	-3.5	-2.3
t test significance	ns	ns	ns	ns	ns	ns	ns	ns	ns
<i>Memorandum</i>									
Pakistan	-4.7	-4.6	-2.7	-2.6	-3.6	-4.8	-4.6	-2.6	-4.1
Philippines	n.a.	-5.0	-5.4	-1.7	-3.4	0.7	-5.0	-3.6	-1.6
Senegal	-4.6	-8.3	-13.4	-8.2	-6.4	-4.2	-7.2	-10.8	-5.4
Gross international reserves (months of imports)									
PRGF-eligible users									
Prolonged	4.3	4.7	4.5	4.7	5.8	6.6	4.7	4.7	6.2
Temporary	5.0	3.4	2.6	2.5	2.7	3.4	3.4	2.5	3.1
t test significance	ns	ns	ns	ns	ns	ns	ns	ns	ns
Non-PRGF-eligible users									
Prolonged	5.5	8.5	7.4	7.8	8.5	8.8	8.5	7.5	8.6
Temporary	4.3	4.7	3.1	3.2	3.3	3.5	4.5	3.2	3.3
t test significance	ns	ns	ns	ns	ns	ns	ns	ns	ns
<i>Memorandum</i>									
Pakistan	3.6	2.9	3.0	1.8	2.0	1.3	3.2	2.4	1.7
Philippines	n.a.	4.3	1.7	2.4	3.1	3.2	4.3	2.0	3.1
Senegal	0.3	0.3	0.2	0.2	0.7	2.6	0.3	0.2	1.6
Gross international reserves (billions of U.S. dollars)									
PRGF-eligible users									
Prolonged	0.1	0.2	0.2	0.3	0.7	0.1	0.2	0.3	0.8
Temporary	0.1	0.4	0.8	0.9	1.7	4.8	0.3	0.8	3.0
t test significance	ns	ns	ns	ns	ns	ns	ns	ns	ns
Non-PRGF-eligible users									
Prolonged	0.6	1.5	1.5	2.5	5.1	4.2	1.0	2.0	7.0
Temporary	0.1	2.4	2.5	2.9	5.7	8.3	1.7	2.7	6.9
t test significance	**	ns	ns	ns	ns	**	ns	ns	ns
<i>Memorandum</i>									
Pakistan	0.5	1.0	1.8	1.3	2.2	0.2	0.7	1.5	1.9
Philippines	1.0	2.5	1.5	2.3	6.1	4.9	1.8	1.9	8.3
Senegal	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.2

Annex Table 3.3 (concluded)

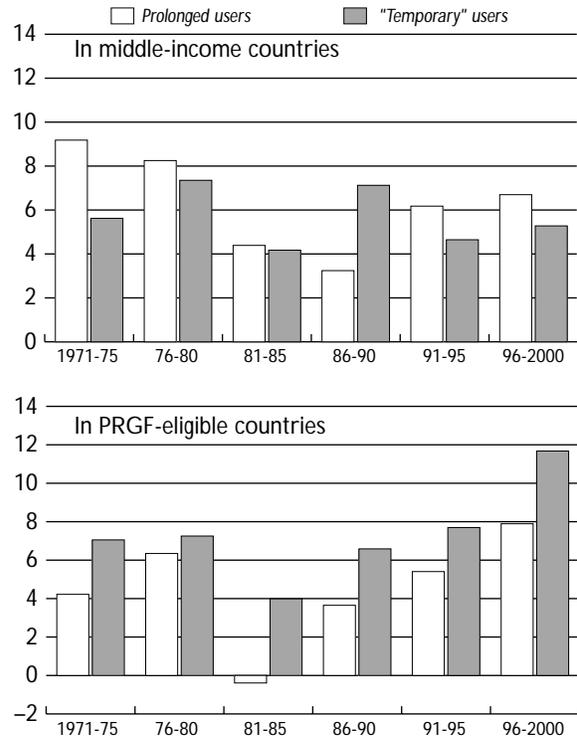
BALANCE OF PAYMENTS CHARACTERISTICS (CONCLUDED)									
	1971–75	1976–80	1981–85	1986–90	1991–95	1996–2000	1971–80	1981–90	1991–2000
Gross international reserves (percent external debt)	(Period average)								
PRGF-eligible users									
Prolonged	35.9	14.1	6.2	6.0	9.1	11.5	24.8	6.1	10.2
Temporary	103.3	64.0	33.6	20.4	18.2	23.9	84.7	25.2	21.0
<i>t</i> test significance	ns	**	**	**	**	**	**	**	**
Non-PRGF-eligible users									
Prolonged	60.4	33.3	14.7	17.2	28.8	25.4	44.1	15.9	26.3
Temporary	93.6	77.8	30.1	24.7	46.8	39.9	84.7	27.4	43.2
<i>t</i> test significance	ns	ns	**	ns	ns	**	**	**	**
<i>Memorandum</i>									
Pakistan	9.9	11.5	15.1	7.5	8.3	5.6	10.7	11.3	7.0
Philippines	32.8	23.0	6.3	7.9	17.0	25.8	27.9	7.1	21.4
Senegal	11.5	3.9	1.0	0.7	2.8	10.6	7.7	0.8	6.7
Terms of trade									
PRGF-eligible users									
Prolonged	141.7	146.6	119.9	113.0	96.6	105.3	144.1	116.5	100.9
Temporary	137.0	146.9	143.1	134.9	115.4	118.8	142.0	139.0	117.1
<i>t</i> test significance	ns	ns	ns	ns	ns	ns	ns	ns	ns
Non-PRGF-eligible users									
Prolonged	97.7	105.3	102.1	97.0	97.5	96.9	101.5	99.5	97.5
Temporary	99.5	103.7	106.1	103.6	99.5	100.2	101.6	104.8	99.8
<i>t</i> test significance	ns	ns	ns	ns	ns	ns	ns	ns	**
<i>Memorandum</i>									
Pakistan	132.5	133.6	124.2	120.2	97.1	118.7	133.0	122.2	107.9
Philippines	124.9	96.8	92.8	106.7	105.3	92.0	110.9	99.8	100.5
Senegal	100.6	105.3	103.6	112.7	100.7	100.3	102.9	108.1	100.5
Trade (percent of GDP)									
PRGF-eligible users									
Prolonged	58.6	65.2	60.8	60.1	68.4	73.7	61.5	61.1	70.7
Temporary	41.2	68.3	62.7	60.3	71.9	75.8	65.6	60.6	74.7
<i>t</i> test significance	**	ns	ns	ns	ns	ns	ns	ns	ns
Non-PRGF-eligible users									
Prolonged	48.2	59.8	61.0	60.8	66.4	73.4	58.9	61.9	69.5
Temporary	61.9	72.0	69.9	71.1	80.7	85.2	69.5	70.9	82.7
<i>t</i> test significance	**	**	ns	**	**	**	**	**	**
<i>Memorandum</i>									
Pakistan	29.2	31.2	33.8	35.7	39.0	37.8	30.2	34.7	38.5
Philippines	45.0	47.1	48.5	55.3	70.2	102.4	46.1	51.9	84.5
Senegal	69.5	76.3	79.7	56.1	62.9	72.8	72.9	67.9	67.3
Share of primary exports (percent of merchandise exports)									
PRGF-eligible users									
Prolonged	89.3	88.2	84.5	76.3	76.8	73.7	88.2	83.6	77.7
Temporary	86.5	82.1	76.5	68.0	69.4	59.5	84.8	75.6	67.1
<i>t</i> test significance	ns	ns	ns	ns	ns	**	ns	ns	ns
Non-PRGF-eligible users									
Prolonged	73.1	69.3	66.7	58.2	53.3	49.9	71.2	61.0	51.2
Temporary	72.5	67.8	65.4	56.2	47.8	45.9	69.7	61.5	47.0
<i>t</i> test significance	ns	ns	ns	ns	ns	ns	ns	ns	ns
<i>Memorandum</i>									
Pakistan	44.1	44.8	39.8	29.5	17.6	15.5	44.4	34.6	16.7
Philippines	90.2	81.0	75.5	65.9	52.4	24.5	85.6	70.7	40.0
Senegal	81.9	88.0	87.2	75.9	65.6	49.0	84.6	80.7	58.3

Sources: IMF, WEO, IFS, and GFS databases; and IEO calculations.

<sup>1</sup>ns indicates the compared means are not statistically significant, while \* and \*\* indicate statistical significance at 95 percent and 99 percent confidence levels, respectively, according to *t* student test.<sup>2</sup>n.a. denotes data are not available.

**Annex Figure 3.1. GDP Growth***(Five-year average annual change; in percent)*

Sources: IMF, WEO database; and IEO calculations.

**Annex Figure 3.2. Export Growth***(Average annual change; in percent)*

Sources: IMF, WEO database; and IEO calculations.

there are large variations within each group.<sup>8</sup> As regards fiscal deficits, in both middle- and low-income countries, prolonged users had higher deficits in the late 1970s, but they adjusted faster thereafter and thus had lower deficits than “temporary” users in subsequent periods (see Annex Figure 3.3).

**Key fiscal characteristics*****Prolonged users have lower and more rigid government expenditure***

Among middle-income countries, the expenditure to GDP ratio of prolonged users was consistently and markedly lower than for “temporary” users over 1971–2000. In other words, the prolonged users are not necessarily those with a tendency toward “big” government—indeed the reverse; as will be seen below, the most obvious distinguishing characteristic

appears to be a weak tax base. The differences were less marked for the PRGF-eligible countries.

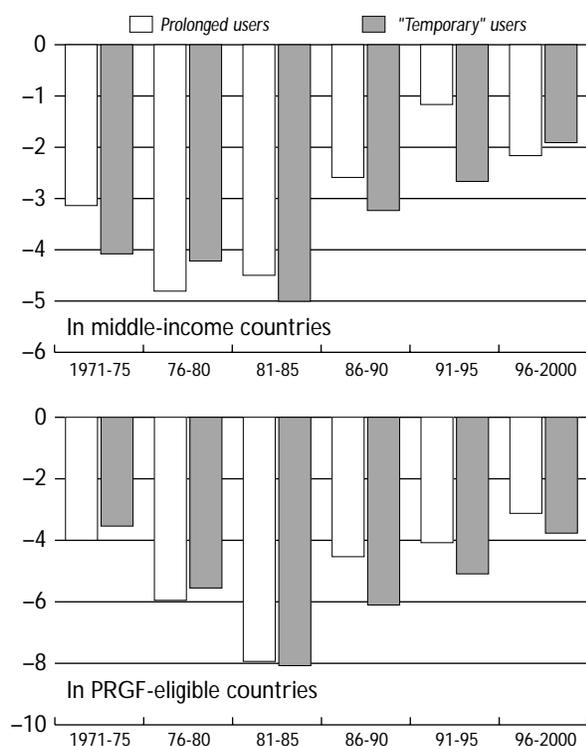
In both low-income and middle-income countries, the government expenditure to GDP ratio expanded significantly less over the last three decades in prolonged user countries than in “temporary” user countries, which might reflect either the fiscal discipline imposed by the successive IMF-supported programs entered into by prolonged users, or simply their generally poor ability to increase revenue collection, or some combination of the two (see below). The likely impact of IMF-supported programs is suggested by the pattern of government expenditure in low-income countries, which exhibits a clear downside break in the mid-1980s, when most of these countries started making extensive use of IMF resources, under newly created concessional facilities (Annex Figure 3.4).

The analysis of the composition of government expenditure further reveals that, regardless of the income group, *prolonged users had higher interest and defense expenditure* (as a proportion of total ex-

<sup>8</sup>See Annex Table 3.3.

### Annex Figure 3.3. Evolution of Overall Fiscal Deficit

(Five-year annual average; in percent of GDP)



Sources: IMF, GFS database; and IEO calculations.

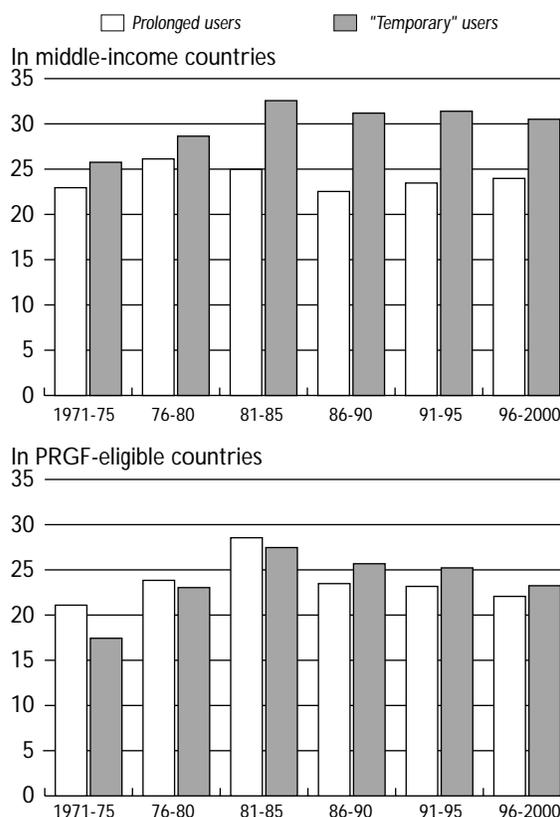
penditure) in all periods since 1970, and especially in the 1980s, largely reflecting a buildup in debt problems (see below). Other things being equal, these differences would result in a more rigid structure of expenditure in prolonged user countries, which might account for a more protracted adjustment process (Annex Figure 3.5).

#### Middle-income prolonged users collect less tax revenue

Differences related to the tax revenue to GDP ratio are particularly pronounced among middle-income countries: over 1971–2000, prolonged users in that category have consistently had lower tax to GDP ratios than “temporary” users. Both prolonged and “temporary” users have registered increases in that ratio over time, but that increase was faster for “temporary” users up to the 1990s. By contrast, among low-income countries, there was no sustained increase in the tax revenue to GDP ratio over time, and the gap between prolonged and “temporary” users, which pre-

### Annex Figure 3.4. Government Expenditure

(Five-year annual average; in percent of GDP)



Sources: IMF, GFS database; and IEO calculations.

ailed until the mid-1980s, was eliminated in later periods only owing to a decline in “temporary” users’ tax revenues (Annex Figure 3.6).

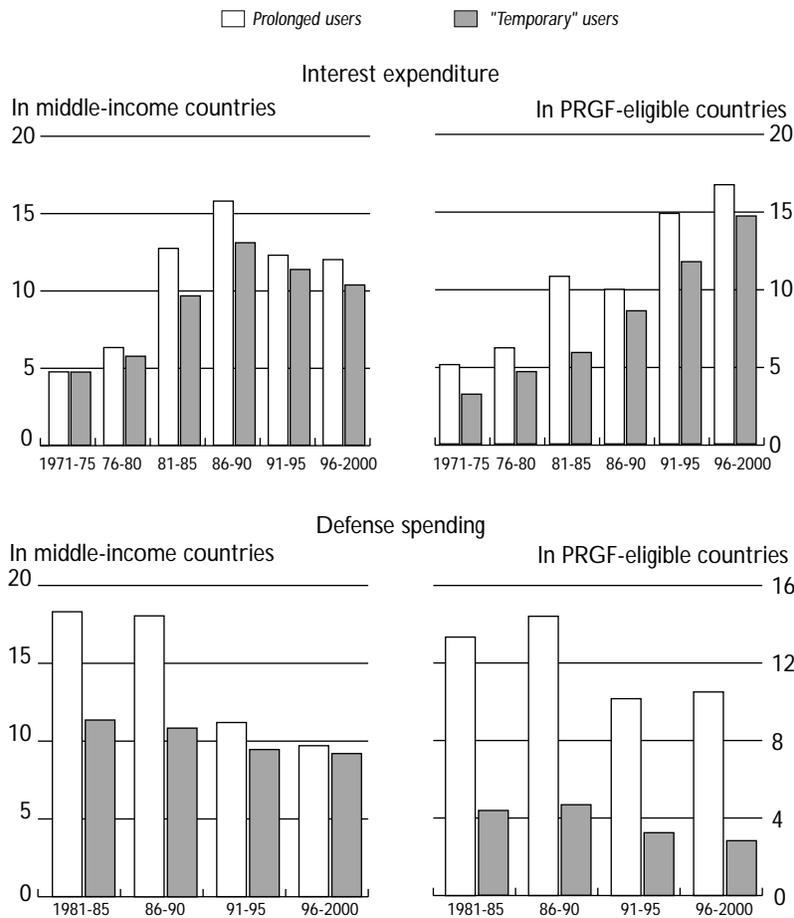
#### Prolonged users faced a higher public debt burden for most of the period

Among PRGF-eligible countries, prolonged users’ stock of public debt (relative to GDP) was three times as large as that of “temporary” users at the beginning of the period. However, differences rapidly diminished from the mid-1980s onward, as the “temporary” users borrowed at a much faster pace than the prolonged users, perhaps reflecting the fact that many prolonged users had already encountered debt problems.

Among middle-income countries, prolonged users initially had a substantially lower public debt stock (relative to GDP) but debt levels for the group built up rapidly during the 1980s (Annex Figure 3.7).

### Annex Figure 3.5. Interest and Defense Expenditure

(Five-year annual average; in percent of total government expenditure)



Sources: IMF, WEO database; and IEO calculations.

## External sector

### Trade

For both low- and middle-income countries, but particularly for the latter, terms of trade shocks<sup>9</sup> were, on average, of greater magnitude in prolonged user countries.

As regards trade openness, there is a marked difference among middle-income countries: prolonged users were continuously less open than “temporary” users, in the sense that their trade to GDP ratio was consistently lower—by 10 to 15 percentage points—

<sup>9</sup>The definition of terms of trade shocks used here is the same as in Ivanova and others (2001) and Dollar and Svensson (2000), namely the difference between the change in the price of exports weighted by the share of exports in GDP and the change in the price of imports weighted by the share of imports in GDP (see Annex Table 3.3).

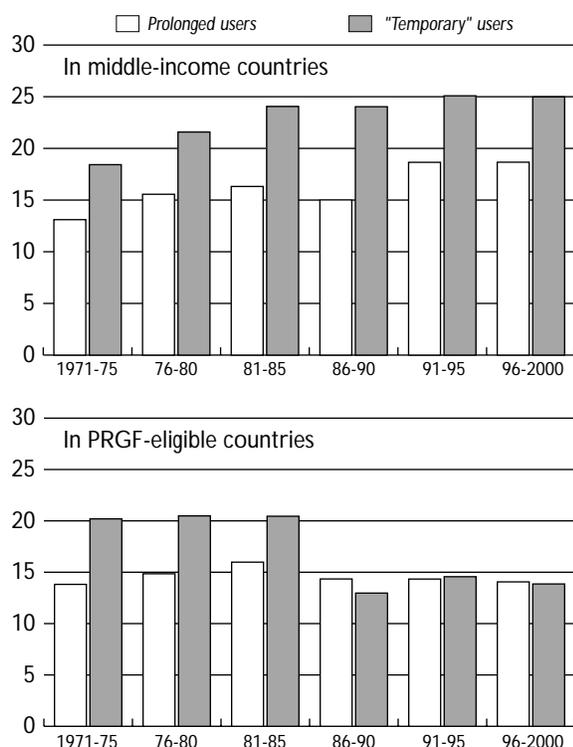
over 1971–2000, even though for both groups that ratio increased over the period (Annex Figure 3.8). By contrast, there is no significant difference between “temporary” and prolonged users as far as PRGF-eligible countries are concerned.

With respect to the composition of exports, *prolonged users* in both PRGF-eligible and non-PRGF-eligible groups had a higher share of primary exports than “temporary” users, and that gap tended to increase over time. The concentration of exports on primary commodities also declined faster in “temporary” users, which may be related to their greater openness to trade (see Annex Figure 3.8).

In keeping with the findings of previous studies on the determinants of repeat UFR,<sup>10</sup> both groups

<sup>10</sup>For example, Bird, Hussain, and Joyce (2000).

**Annex Figure 3.6. Tax Revenues to GDP Ratio**  
(Five-year annual average)



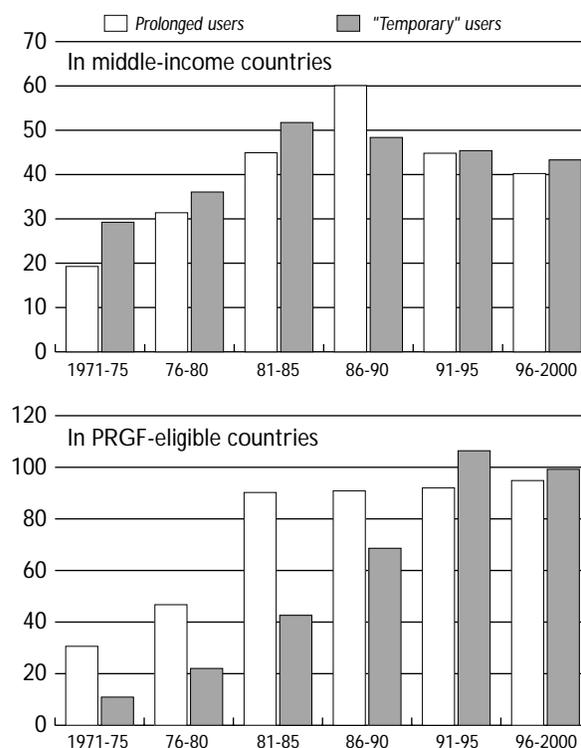
Sources: IMF, GFS database; and IEO calculations.

of prolonged users on average had markedly lower gross reserves (in relation to their external debt) than “temporary” users. However, data on imports coverage by gross international reserves unexpectedly indicate that prolonged users have had a slightly higher coverage of imports than “temporary” users throughout the 1971–2000 period, and the difference, although small, is statistically significant (Annex Table 3.3). Once again, this may reflect the generally lower trade openness of the prolonged users.

#### ***Prolonged users generally faced a heavier external debt and debt-service burden***

As far as the stock of external debt is concerned, prolonged users had a significantly larger debt/GDP ratio than “temporary” users until the late 1980s, after which the relationship reversed itself, even though the external debt of PRGF-eligible prolonged users kept rising in relation to their GDP. However, the debt-service burden, as measured by the external

**Annex Figure 3.7. Public Debt Stock**  
(Five-year annual average; in percent of GDP)



Sources: IMF, GFS database; and IEO calculations.

debt service to exports ratio, was significantly higher for prolonged users than for “temporary” users throughout 1975–2000.

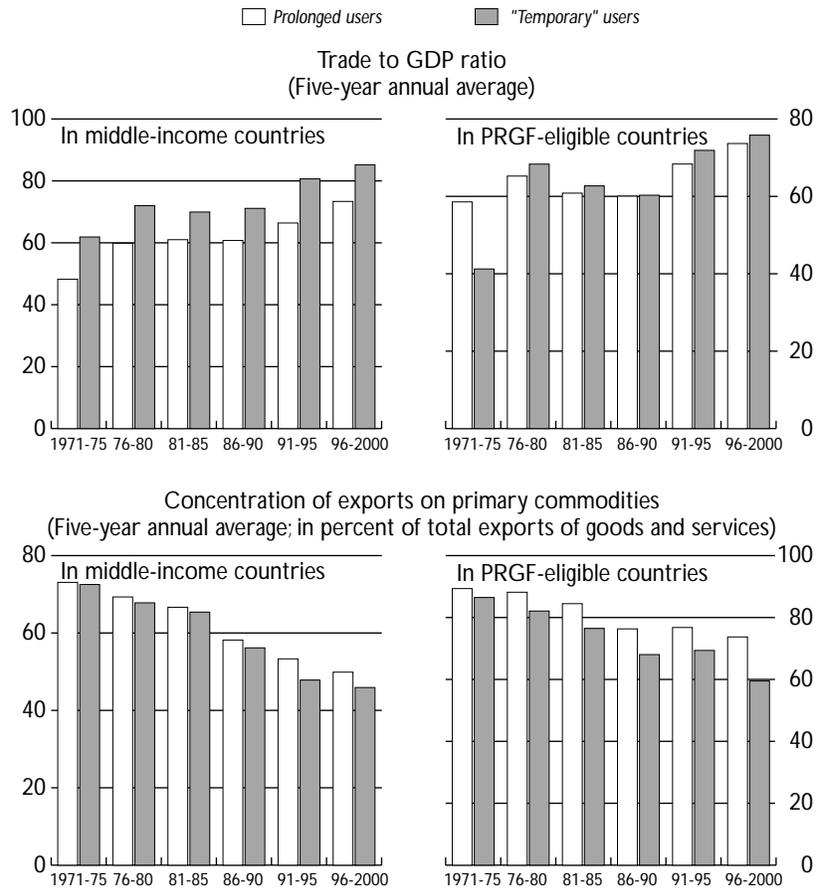
#### **Political characteristics**

The literature on the effectiveness of structural adjustment programs has emphasized the importance of political economy variables in determining the outcome of these programs.<sup>11</sup> It was not possible in the context of this project to collect data on the relevant variables over the entire period under review. However, based on the database used by Ivanova and others (2001),<sup>12</sup> there appear to be few consistent differences between prolonged and “temporary” users as far as political characteristics are concerned.

<sup>11</sup>See, for instance, Ivanova and others (2001) or Dollar and Svensson (2000).

<sup>12</sup>This database covers the countries that entered into the approximately 170 arrangements with the IMF between 1992 and 1998.

Annex Figure 3.8. Trade Openness and Concentration



Sources: IMF, WEO database; and IEO calculations.

The one important exception is the measure of political instability, which appears to be higher among prolonged than among “temporary” users for both middle- and low-income countries.<sup>13</sup> Prolonged users as a whole also appear to suffer from ethnic fractionalization to a greater extent than “temporary” users, but this is true only for middle-income countries.

<sup>13</sup>In contrast, measures of political cohesion and of quality of the bureaucracy suggest that prolonged users have a higher degree of political cohesion and a better bureaucracy than “temporary” users. Interestingly, the power of vested interests appears to be identical, on average, in all four country groupings.

Finally, while several authors have found a relationship between IMF-supported programs (related either to their presence or to their design) and the closeness of the relationship between the member country and the IMF’s major shareholders, the comparison between prolonged users and “temporary” users in terms of their closeness to G-7 countries found no major differences.<sup>14</sup>

<sup>14</sup>See for instance Bird and Rowlands (2001b), Thacker (1999), Barro and Lee (2002), and Ivanova and others (2001). The variable used here to test for the influence of proximity to G-7 countries was the share of G-7 bilateral aid.

## ANNEX 4

# Effects of Prolonged Use on Growth: Details of the Econometric Results

This annex provides details of the econometric results discussed in Chapter 5.

Based on empirical analysis of a panel data set spanning five five-year periods (1975–99) for 130 countries, Barro and Lee (2002) found that when they did not control for endogeneity, their results suggested that participation in IMF arrangements was associated with contemporaneously lower per capita growth. However, after controlling for endogeneity of participation in IMF arrangements and for other determinants of growth, IMF arrangements had no statistically significant contemporaneous impact on per capita GDP growth, but rather a lagged negative effect. The authors employed an instrumental variables approach to control for endogeneity of participation in IMF arrangements.<sup>1</sup> Specifically, they used the following as instruments for participation: (i) size of quota; (ii) political and economic proximity to IMF major shareholders (the United States, France, and the United Kingdom);<sup>2</sup> and (iii) national staff (economists) at the IMF.

For the purposes of this evaluation, one of the coauthors of Barro and Lee (2002), Professor Jong-Wha Lee, extended the analysis in that study to consider whether “prolonged use” has an effect on growth that is distinguishable from that associated with “temporary use.” The rest of this section reports on the findings of several exercises undertaken by Professor Lee, using panel data for 82 users of IMF resources (GRA and concessional) over five five-year periods (1975–79, 1980–84, 1985–89, 1990–94, and 1995–99). The determinants of long-

run per capita income growth used encompassed: (i) initial income; (ii) human resources (educational attainment, life expectancy, and fertility); (iii) investment rate; (iv) exogenous shocks (changes in the terms of trade); and (v) policy and institutional variables (government consumption, rule of law, openness, and inflation). Participation in IMF arrangements was measured by loan size.<sup>3</sup>

A first set of exercises estimated the effects of participation in IMF arrangements, without controlling for the endogeneity of such participation. The results suggested that after controlling for other determinants of growth, IMF arrangements were associated with lower growth contemporaneously and with a lag (equation 1, Annex Table 4.1). Incorporation of contemporaneous and lagged interactive terms to distinguish between “temporary” and prolonged participants in IMF arrangements yielded statistically significant coefficients on the interactive terms, suggesting significantly more adverse effects on growth for prolonged users than for “temporary” users (equation 2, Annex Table 4.1).<sup>4</sup>

A second set of exercises controlled for the endogeneity of participation in IMF arrangements, using the set of instrumental variables employed in Barro and Lee (2002). There was little difference in results when no distinction was made between prolonged and “temporary” users (compare equations 3 and 1 in Annex Table 4.1); the effects of IMF lending on growth were found to be still negative and signifi-

<sup>1</sup>The authors argue that the generalized evaluation estimator approach, characterized by Haque and Khan (1998) as the “estimator of choice” for evaluating the effects of IMF-supported programs, does not adequately correct for selection bias (e.g., by reliance on fragile assumptions about the distribution of error terms for identification). They propose a set of political and institutional variables for use as instruments to control for the endogeneity of participation in IMF arrangements.

<sup>2</sup>Political proximity is measured by voting record at the United Nations, and economic proximity by the ratio of bilateral trade to GDP.

<sup>3</sup>In the broader sample used by Barro and Lee (2002), other measures such as program approval, or program participation (the fraction of time that a country operated under an IMF program during the five-year period) do not seem to have a significant impact on growth independently of loan size.

<sup>4</sup>The definition of “prolonged users” was the same as that used in the “dynamic” definition in Annex 3, section on “Econometric Evidence on the Characteristics of Prolonged Users.” An alternative approach to exploring distinctions between prolonged and “temporary” users would have been to separate the data into two samples and estimate separate regressions for each group. The sample size for prolonged users was too small to implement this approach.

**Annex Table 4.1. Effects of “Prolonged Use” of IMF Programs on Economic Growth**

Instruments for IMF loan	Actual values of IMF loan size		IMF quotas and staff, political and economic proximity to the United States and Europe	
	(1)	(2)	(3)	(4)
Log (per capita GDP)	-0.0271 (5.988)***	-0.0260 (6.037)***	-0.0269 (6.042)***	-0.0279 (6.469)***
Male upper-level schooling	0.0036 (1.875)*	0.0030 (1.653)*	0.0035 (1.877)*	0.0034 (1.896)*
Log (life expectancy)	0.036 (1.841)*	0.040 (2.148)**	0.042 (2.171)**	0.054 (2.807)***
Log (total fertility rate)	-0.0281 (4.372)***	-0.0300 (4.891)***	-0.0273 (4.300)***	-0.0303 (4.918)***
Investment/GDP	0.0001 (0.004)	0.0128 (0.406)	0.0084 (-0.260)	0.0122 (0.398)
Government consumption/GDP	-0.092 (3.528)***	-0.069 (2.735)***	-0.068 (2.655)***	-0.049 (2.057)**
Rule-of-law index	0.0111 (1.374)	0.0023 (0.300)	0.0130 (1.638)	0.0064 (0.822)
Openness measure	0.0136 (3.046)***	0.0149 (3.500)***	0.0141 (3.266)***	0.0159 (3.771)***
Inflation rate	-0.0212 (2.644)***	-0.0263 (3.641)***	-0.0191 (2.838)***	-0.0192 (3.406)***
Growth rate of terms of trade	0.069 (2.594)***	0.052 (1.998)**	0.072 (2.706)***	0.062 (2.410)**
Contemporaneous IMF loan	-0.185 (3.000)***	-0.183 (2.846)***	-0.178 (2.008)**	-0.071 (0.789)
Lagged IMF loan	-0.117 (1.715)*	0.099 (1.323)	-0.214 (2.027)**	0.074 (0.818)
Contemporaneous IMF loan* prolonged user	—	-0.328 (2.899)***	—	-0.390 (3.062)***
Lagged IMF loan* prolonged user	—	-0.528 (4.663)***	—	-0.517 (4.416)***
p-value				
(a)	0.002	0.011	0.007	0.536
(b)	—	0.000	—	0.000

Sources: IMF, WEO database; ICGR database; World Bank, WDR database; and IEO calculations.  
\*, \*\*, and \*\*\* indicate significance at the 10 percent, 5 percent, and 1 percent levels, respectively.

cant.<sup>5</sup> This result contrasts with the finding in Barro and Lee (2002) that after controlling for endogeneity of participation in IMF arrangements, the contemporaneous effect on growth becomes insignificant. A likely source of the difference in results is the difference in coverage of IMF arrangements, demonstrating the sensitivity of findings of such cross-country regression exercises to sample coverage and size.

<sup>5</sup>Barro and Lee (2002) considered only Stand-By (SBA) and Extended Fund Facility (EFF) arrangements, while the current exercise also includes arrangements under the IMF's concessional facilities (i.e., Structural Adjustment Facility (SAF), Enhanced Structural Adjustment Facility (ESAF), and Poverty Reduction and Growth Facility (PRGF) arrangements).

When a distinction was made between prolonged and “temporary” users, the main change in results was with respect to the estimated coefficient on the contemporaneous IMF loan size. The estimated coefficient was no longer significantly different from zero. The coefficients on lagged IMF lending and the interactive terms between IMF lending and the prolonged use dummy did not change much.

A third set of exercises examined whether the effects of IMF arrangements on growth differed between arrangements supported by general resources (i.e., SBAs and EFFs) and those supported by concessional resources (SAF/ESAF/PRGF). The results indicate significant differences (Annex Table 4.2). When the sample was limited to only SBAs and EFFs, strongly negative contemporaneous and

**Annex Table 4.2. Alternative Specifications of Equation (4) in Annex Table 4.1**

	SBA and EFFs (1)	SAFs, ESAFs, and PRGFs (2)
Contemporaneous IMF loan	0.043 (0.326)	-0.043 (0.415)
Lagged IMF loan	0.082 (0.888)	0.328 (1.116)
Contemporaneous IMF loan * prolonged user	-0.542 (3.250)***	-0.677 (1.913)*
Lagged IMF loan *	-0.584	0.853
Prolonged user	(4.761)***	(1.760)*
p-value		
(a)	0.856	0.497
(b)	0.000	0.086

Sources: IMF, WEO database; ICGR database; World Bank, WDR database; and IEO calculations.

Note: The estimation is based on the basic specification of equation (4) of Annex Table 4.1 with the specific change indicated in each column.

\*, \*\*, and \*\*\* indicate significance at the 10 percent, 5 percent, and 1 percent levels, respectively.

lagged effects on growth were found in prolonged users but not in “temporary” users. When only concessional facility arrangements were considered, there was a negative contemporaneous effect on growth which was more than offset by a positive lagged effect in prolonged users, and no significant effect on “temporary” users.

Sample size limitations imposed by available data constrained the scope of the exercises undertaken by Professor Lee. As noted above, the results from such cross-country regression exercises can be sensitive to changes in the composition and size of the sample being studied. Bearing in mind these inevitable limitations the main findings were:

- After controlling for endogeneity of participation in IMF arrangements, IMF lending was found to have negative effects on growth, over the contemporaneous as well as subsequent five-year period, in prolonged users.
- For “temporary” users, the effects on growth of contemporaneous and lagged IMF lending are statistically insignificant.
- The adverse consequences for growth of prolonged use appear to be concentrated in programs supported under general resources, and not in those under concessional facilities.

# ANNEX 5

## Questionnaire Sent to Authorities of Prolonged User Countries

To check how representative of the broader group of prolonged users the findings of the country case studies were, the IEO sent a questionnaire to the authorities of all the countries identified as prolonged users in this study, as listed in Chapter 2.

Responses were received from the following 21 countries: Bulgaria, Costa Rica, Egypt, Ghana, Jamaica, Jordan, the Kyrgyz Republic, Malawi, Mali, Mexico, Mongolia, Morocco, Nicaragua, Pakistan, Peru, the Philippines, Senegal, Tanzania, Turkey, Uganda, and Zambia.

A copy of the questionnaire is reproduced below. Most respondents indicated that they did not want to be quoted directly, but the thrust of the views expressed are reflected in the main report, especially in Chapter 5.

### Overview

1. What is your general assessment of your country's relations with the IMF over the long term?
2. What do you see as the major factors that explain why your country made extended use of IMF resources? Could or should this have been avoided? What should the IMF have done differently? What has your country learnt from the experience of repeated programs?
3. To what extent were IMF-supported programs for your country motivated by the need for a "seal of approval" in order to mobilize funds from other sources, rather than a need for IMF financing, *per se*? Would it have been feasible or preferable to provide such a "seal of approval" in some other way?

### Program formulation and negotiation

4. Did the IMF pay sufficient attention to the concerns of the authorities and other groups in the formulation and negotiation of programs? Were any disagreements on policies generally concerned with their substance, or on the pace and sequencing of measures or to potential difficulties in implementing programs?

5. Was the IMF realistic about the political and social environment of programs and the constraints involved?
6. How did the IMF's prolonged involvement affect the development of economic institutions—including those involved in policy formulation and technical analysis—in the country?

### Program design

7. What, in your view, were the major strengths and weaknesses in the design of IMF-supported programs? Were IMF-supported programs too ambitious or overoptimistic? Did IMF-supported programs have an appropriate time-horizon? Did they pay sufficient attention to debt sustainability issues? Did programs make sufficient allowance for exogenous shocks?
8. Did IMF-supported programs put the emphasis on the right structural reforms and prioritize appropriately? Was there an appropriate division of labor between IMF and the World Bank with regard to structural reform?
9. Did the IMF learn from experience in designing successive programs?

### Post-program experience

10. In those cases where countries no longer use IMF resources, has the internal political dynamic altered since there has been no lending arrangement? Has the process of policy-making and related technical analysis process altered?
11. For those countries that have made repeated use of precautionary arrangements, what are the main reasons for such an approach? What advantages do you see for a precautionary lending arrangement over regular IMF surveillance?
12. Are there any other issues you would like to bring to our attention?

# ANNEX 6

## Data on Staff Inputs and Staff Turnover in Prolonged and “Temporary” Users

This annex provides additional information to support the discussion in Chapter 5, section on “Results from Cross-Sectional Evidence.”

Annex Table 6.1 provides details of the extent of staff inputs, as measured by the number of missions and mission days, in program countries. The results indicate such inputs were actually higher for “temporary” users. The difference is particularly marked for ESAF arrangements, which involved on average 51 mission days (41 percent) more for “temporary” users than for prolonged users. Likewise, the total staff resources invested by the IMF in programs with prolonged users were, on average, smaller than in “temporary” users’ programs: in both ESAF and GRA

arrangements, the IMF’s effort, measured by the personnel costs of its UFR and TA missions, was over 40 percent higher in programs with “temporary” users.

Excessive turnover of mission chiefs appears to be a problem for many program countries, but has not been worse among the prolonged users (Annex Table 6.2).

As regards mission team staffing, continuity has also been low across all country groups—in most cases, less than half of mission members were involved in the same country in the two previous years—but it has been slightly better in prolonged user countries than in “temporary” user countries (Annex Table 6.3).

**Annex Table 6.1. Data on IMF Effort<sup>1</sup>**

	Number of mission days		Number of missions		Administrative costs (In millions of U.S. dollars)	
	During program	Including three months before program approval	During program	Including three months before program approval	During program	Including three months before program approval
All arrangements						
Prolonged users	126	144	9	11	1.5	1.6
Nonprolonged users	163	186	12	14	1.9	2.1
ESAF arrangements						
Prolonged users	122	140	9	10	1.5	1.7
Nonprolonged users	173	189	14	15	2.2	2.5
GRA arrangements						
Prolonged users	117	138	9	10	1.2	1.4
Nonprolonged users	160	185	12	14	1.7	2.0

Source: Ivanova and others (2001).

<sup>1</sup>In this table, data on the number of missions and mission days do not take account of the size of missions.

**Annex Table 6.2. Mission Chiefs Per Member Country, FY1996–2001**

	No UFR	TU/PRGF	TU/GRA	PU/PRGF	PU/GRA
	(Number of mission chiefs)				
Mission chiefs per member country					
Average	3.4	4.2	4.1	3.9	4.2
High	6	7	10	7	8
Low	1	2	2	2	1
Share of member countries with five or more mission chiefs during six-year period (in percent)	13	34	32	19	31

Source: Internal data compiled by the IMF's Office of Internal Audit and Inspection at the IEO's request, based on data collected for its review of mission organization and management.

**Annex Table 6.3. Mission Staff Continuity, FY1996–2001**

(In percent of total mission staffing)

	Current fiscal year area department staff active in prior two fiscal years				Current fiscal year FAD staff active in prior two fiscal years				Current fiscal year PDR staff active in prior two fiscal years			
	1998	1999	2000	2001	1998	1999	2000	2001	1998	1999	2000	2001
No UFR	41	46	39	40	0	0	25	20	33	0	67	33
TU / PRGF	47	44	39	42	31	40	33	39	36	46	48	28
PU / PRGF	52	55	48	47	47	42	41	39	23	32	40	41
TU / GRA	50	43	51	45	47	40	47	40	25	40	40	42
PU / GRA	49	52	59	55	50	33	50	57	23	36	50	36
All countries	48	47	47	45	43	38	41	41	27	38	45	36

Source: Internal data compiled by the IMF's Office of Internal Audit and Inspection at the IEO's request, based on data collected for its review of mission organization and management.

Note: FAD: Fiscal Affairs Department; PDR: Policy Development and Review Department.

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**Part II**  
**Country Case Studies**

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# CHAPTER 9

## Pakistan

1. Pakistan is one of the most prolonged users of IMF resources and has been under IMF-supported programs almost continuously since the late 1980s.

2. This report aims to cast light on what successive IMF-supported programs achieved and failed to deliver and on the factors underlying their limited success.<sup>1</sup> In particular, two such factors, which appear to have been critical in the Pakistan case, are analyzed in depth, namely (i) program design and implementation problems; and (ii) internal IMF governance issues affecting the rationale for IMF involvement, the effectiveness of surveillance, and the program design itself. The report concludes by highlighting a few key lessons from this experience and outlining suggested remedies.<sup>2</sup>

3. This evaluation was conducted based on (i) reviews of IMF staff reports and internal documents (including mission briefs, internal review comments, and selected technical assistance reports); (ii) interviews with IMF staff, a broad range of Pakistani stakeholders, and staff of the World Bank;<sup>3</sup> (iii) a survey of relevant academic literature; and (iv) independent work commissioned by the IEO from the Center for Development Research at the University of Bonn (Appendix 1).

### Pakistan's Prolonged UFR Experience Points to a Limited Effectiveness of Its IMF-Supported Programs

4. Pakistan's economic history over the last 30 years can be subdivided in two periods. From 1970 to the late 1980s, Pakistan enjoyed an impressive growth performance (6–7 percent a year on average). Fiscal and external imbalances were large during

most of that period, but unlike in many other developing countries, they did not lead to hyperinflation or to a debt crisis, which led Pakistan to be sometimes referred to as a “development puzzle.”<sup>4</sup> However, the picture deteriorated markedly from the late 1980s onward, as growth faltered and the continued failure to rein in the fiscal and current account deficits led the debt—which had been accumulating for over two decades—to become unsustainable. Pakistan made an intensive use of IMF resources during both periods, but became continuously dependent upon IMF-supported programs only in the second one.

### Overview of Pakistan's history of use of IMF resources since 1970<sup>5</sup>

#### *1970/71–1987/88: repeated but discontinuous use of IMF resources*

5. Pakistan had four one-year Stand-By Arrangements<sup>6</sup> (SBAs) with the IMF between 1972 and 1977. They were followed by a three-year extended arrangement in 1980, which was to provide close to SDR 1.3 billion (445 percent of quota) over three years. The programs supported by these arrangements were classic macroeconomic stabilization programs, which put little emphasis on structural reforms (although the program supported by the 1980 EFF did consider reforms in the areas of taxation, tariff reform, and price liberalization).

6. All SBAs except the first one were entirely disbursed. However, they did not succeed in correcting durably the underlying imbalances. As the dollar (to which the Pakistani rupee was pegged) began appreciating in 1979, pressures on competitiveness increased, and a new recourse to IMF resources proved

<sup>1</sup>In keeping with the IEO's terms of reference, which prevent it from commenting on ongoing operations, the PRGF arrangement approved in December 2001 is not within the scope of this review.

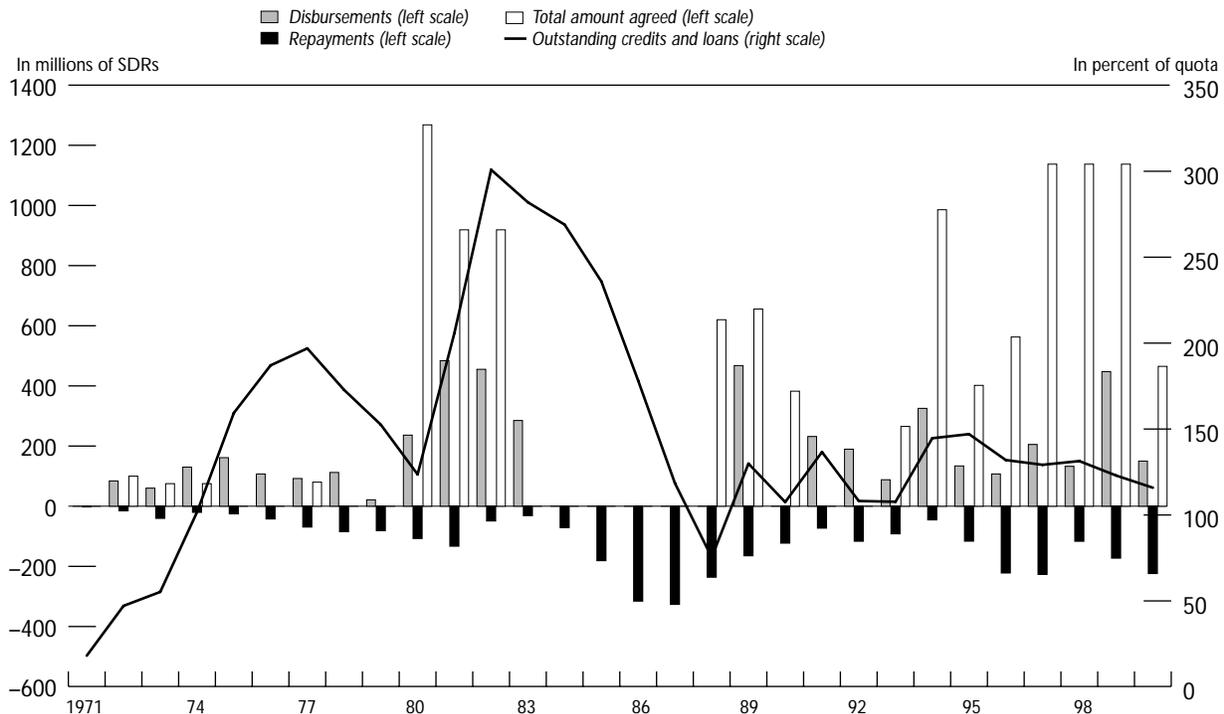
<sup>2</sup>Lessons and recommendations are elaborated in greater detail in Part I.

<sup>3</sup>A full list of people outside the IMF interviewed by the IEO is provided in Appendix 2.

<sup>4</sup>In fact, as the subsequent discussions will show, the achievements of that period hinged upon the buildup of partially disguised debt vulnerabilities.

<sup>5</sup>Figure 9.1 provides an overview of this history.

<sup>6</sup>These arrangements were supplemented by rather large drawings under special facilities (the Oil Facility and the Compensatory Financing Facility for export shortfalls).

**Figure 9.1. Pakistan: History of Lending Arrangements**

Sources: IMF Treasurer's Department and IEO calculations.

necessary. In spite of strong policy implementation in the first year of the EFF-supported program, in 1981 devaluation could not be avoided. Thereafter, slippages in the fiscal and monetary area grew larger and the pace of reform slowed, so that after several delays in the completion of reviews, the program was eventually declared off-track.

### **1988–2000: almost continuous IMF arrangements**

7. Pakistan had seven different arrangements with the IMF over the 1988–2001 period,<sup>7</sup> of which four were short term and three were multiyear arrangements. All put a strong emphasis on restrictive demand management policies and a variety of structural reforms to correct financial imbalances. The total amount of funds committed under these programs amounted to over SDR 4 billion.<sup>8</sup> All but the

<sup>7</sup>This count does not include the PRGF arrangement approved in late 2001, which, as an “on-going operation,” must be considered outside the scope of this evaluation.

<sup>8</sup>In addition, over that period, Pakistan had access to sizable resources under special facilities.

last arrangement (the 2000 SBA) suffered from substantial policy slippages and soon went off-track, usually after the first or second review. As a result, a large share of the committed financing was not disbursed: undrawn balances averaged a little over half the committed amounts, compared to one-third for all users of IMF resources and a quarter for prolonged users.<sup>9</sup> This suggests a rather poor implementation record overall.

### **Economic performance over 1988–2000 was unimpressive compared with previous decades**

#### **Macroeconomic performance deteriorated and financial imbalances largely persisted**

8. GDP growth fell to a little under 4 percent a year over 1988–2000, compared to almost 6 percent in the two previous decades, with a sharp slowdown

<sup>9</sup>Not taking into account precautionary arrangements, that is, those where the authorities indicate at the outset that they do not intend to avail themselves of the resources committed under the program.

in capital formation. Export growth slowed to under 3 percent a year, against over 10 percent in the 1970s and 1980s. Poverty rose steadily, according to most measures, after two decades of decline, and by the end of the 1990s close to 30 percent of the population lived below the poverty line, against less than 20 percent a decade earlier.

9. Only a modest correction of financial imbalances was achieved over the period. Inflation was halved to 4 percent by 2000, but the fiscal deficit declined only from 7.7 percent of GDP in 1989 to 5.2 percent in 2000. The current account deficit fluctuated around 4 percent of GDP. Gross international reserves fell as a share of imports over the period to under one month in June 2000, the symbolic threshold of three-month import coverage was reached only once, and the coverage of effective short-term debt by official reserves averaged just over 15 percent over 1991–2000.

#### ***Structural reforms progressed in some areas but significant challenges remain***

10. Significant progress was achieved relatively early on in the areas of interest rate liberalization and public debt management; liberalization of external transactions, both on the current and the capital account; and trade liberalization: tariffs were brought down sharply,<sup>10</sup> their structure was simplified, and quantitative restrictions on both imports and exports were substantially reduced. Nevertheless, Pakistan's trade regime remains relatively restrictive in comparison with most Asian economies.

11. In other areas, such as the implementation of a broad-based general sales tax (GST), taxation of the agricultural sector, liberalization of administered prices, and the setting of utilities tariffs, the reform process was very protracted. Progress was achieved many years later than initially intended, and most of these reforms have yet to be fully effective. By contrast, very little was achieved in the areas of tax administration or income tax reform, and public enterprises were still a considerable drain on the government's finances in 2000.

12. One indicator of limited progress in bringing about core structural changes needed for longer-term sustainability is the evolution of the tax revenue to GDP ratio: in spite of all attempts to increase it under repeated IMF-supported programs, the ratio was lower in 2000 than in 1988 (12.1 percent against 13.5 percent). This decrease in the overall tax ratio reflects

<sup>10</sup>The weighted average rate went down from 65 percent in 1988 to 19 percent in 2000. Pakistan is rated 7 on the IMF's 10-point index of trade restrictiveness (where 10 is the most restrictive), that is, below India (10), but well above China and Sri Lanka (5) or Indonesia, Malaysia, and the Philippines (4).

a shift in the structure of taxation away from international trade taxes, which *ceteris paribus* should have increased tax efficiency. But these possible gains must be weighed against the efficiency losses induced by the *de facto* very narrow base of domestic taxes, which fall on a very small number of taxpayers<sup>11</sup> despite significant steps taken to broaden the legal definition of the tax base.

#### ***Economic institutions do not seem to have benefited from prolonged UFR***

13. In Pakistan, the 1990s has been characterized as an era of "institutional decay."<sup>12</sup> This was manifested through increased political interferences in the management of public enterprises and in the operations of the predominantly public banking sector, more widespread corruption in tax administration, and increased clout of vested interests in all areas of public policymaking. Meanwhile, statistics and public accounts remained of very poor quality, as did technical skills at all but the highest level of public administration. The greater independence gradually granted to the central bank (State Bank of Pakistan) is one exception to that general trend.<sup>13</sup>

14. These problems obviously had other, deeper causes that were not directly associated with IMF-supported programs, but they proliferated in spite of these programs, which has prompted many in Pakistan to blame the IMF for failing to tackle governance issues directly. Addressing governance issues did not explicitly become part of the agenda of IMF-supported programs until 1997, and those negotiated with Pakistan were no exception in that respect. Within that context, however, the issue of institutional effectiveness could have received more emphasis than it did, both in the design of programs and in the policy dialogue with the authorities in the context of surveillance and technical assistance.

15. Moreover, many officials in Pakistan were of the view that protracted UFR has weakened the inde-

<sup>11</sup>In theory, broad consumption- or income-based taxes should be more efficient than trade taxes, but the problem in Pakistan is that these taxes have relatively high rates to compensate for the lack of broad base: in 2000, there were less than 100,000 registered GST taxpayers and under 2 million income taxpayers (compared to 1 million in 1990), in a population of roughly 140 million.

<sup>12</sup>See, for instance, "Economic Reforms and Macroeconomic Management in Pakistan (1999–2001)" by Ishrat Husain, Governor of the State Bank of Pakistan.

<sup>13</sup>Admittedly, changes in the legal framework of the central bank's operations do not necessarily imply that its *de facto* independence increased. Indeed, one former Governor of the SBP told the IEO that he had been able to perform his functions in great independence at a time when no institutional safeguards guaranteed it. However, there was broad agreement among both IMF staff and Pakistan stakeholders that the SBP was significantly strengthened during the 1990s.

pendent policy formulation capacity, in part because the policy closure process revolved around negotiations with the IMF, with little room for domestic initiative and open discussion of policy alternatives.<sup>14</sup> Most officials also viewed as limited the capacity building effect on economic management skills sometimes assumed to be associated with IMF-supported programs, because this “skills transfer” was largely concentrated in narrow areas geared to the technical implementation and monitoring of IMF-supported programs. Likewise, the unusually large amount of resources invested by the IMF in technical assistance to Pakistan produced a considerable amount of blueprints for reform.<sup>15</sup> But, according to the authorities, they failed to have a significant impact because the knowledge transfer involved in their conception was limited, and they were not sufficiently focused on implementation.<sup>16</sup>

### The Lack of Effectiveness of Pakistan's IMF-Supported Programs Stems from Both Design and Implementation Issues

16. At first glance, it is tempting to blame the lack of effectiveness of IMF-supported programs in Pakistan on their poor implementation by the authorities.<sup>17</sup> The prolonged political instability and regional disruptions undoubtedly weakened policies and the ability of the economy to respond to adjustment initiatives. To the extent that policy slippages

<sup>14</sup>However, former IMF mission chiefs for Pakistan pointed out that there were few cases where the authorities had approached them with viable policy alternatives. When they did, particularly from late 1998 onward, their proposals were often incorporated into the program framework (e.g., as concerns the exit strategy from the foreign currency deposit freeze or as regards the exchange rate regime).

<sup>15</sup>From 1990 to 2000, Pakistan received 40 IMF technical assistance missions, with over half of them concerning fiscal issues and about a quarter on monetary and banking issues. During that period, it also benefited from the presence of resident advisors for a cumulative total of five years. Furthermore, since FY1996, IMF TA to Pakistan has represented the equivalent of 13 staff years.

<sup>16</sup>Examples of such problems include the 1992 and 1997 TA reports on tax administration reform or the 1999 TA report on modernizing the income tax system. Numerous reports were also prepared on the reform of indirect taxation, with limited concrete results until the last couple of years.

<sup>17</sup>This dimension was frequently emphasized in performance assessments done by the IMF. For instance, the 2000 Article IV staff report notes that “Pakistan has had a series of adjustment and reform programs supported by Fund arrangements during the past decade. Policy implementation and economic performance have been disappointing. . . . This weak performance stems in large part from the failure of successive governments to carry through sustained reforms. . . .”

prevented the full disbursement of all but one of Pakistan's arrangements since 1980, poor implementation is also undeniable. However, there is a strong perception in Pakistan that the programs had a low probability of success from the outset, owing to various design flaws and weak ownership at the highest political level. These problems were compounded by shortcomings in conditionality and program “enforcement” by the IMF that resulted in some core underlying problems remaining unresolved. Many of these difficulties reflected “systemic” issues associated with the IMF's approach in Pakistan rather than just technical issues associated with the IMF staff's analysis (see the section “Some Program Design Problems Were Rooted in Deeper IMF Governance Issues” below).

### Most IMF-supported programs had several design flaws

#### *Overoptimistic assumptions and unrealistic objectives*

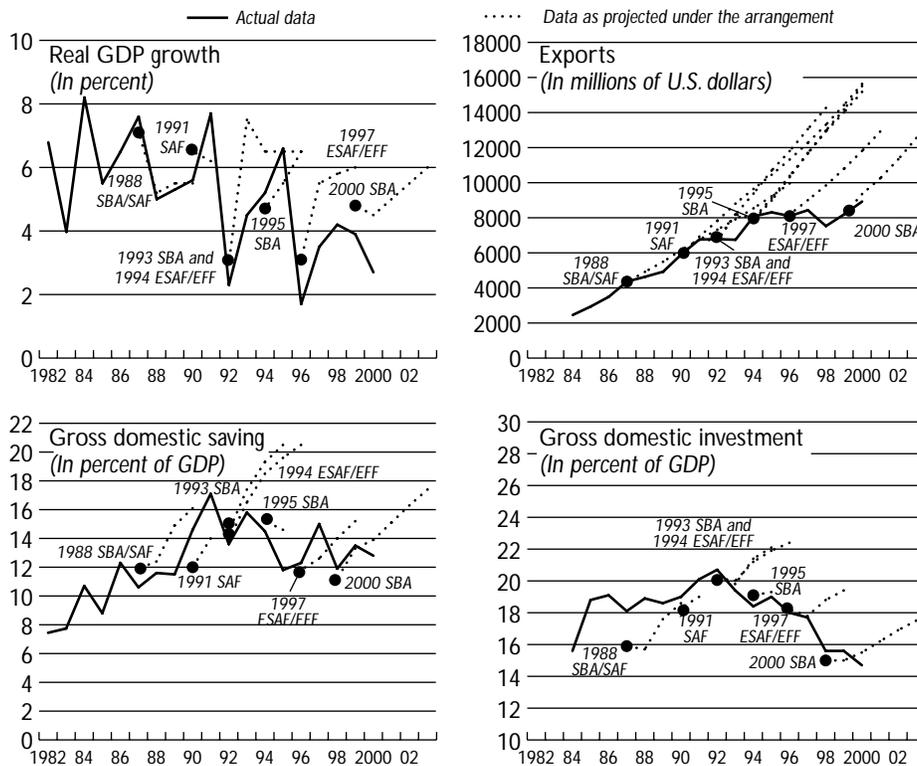
17. Most programs, particularly from 1993 onward, were based on overly optimistic projections as regards such key elements as GDP and export growth, as well as regarding the growth of domestic savings and investment (Figure 9.2).<sup>18</sup> Any such comparison needs to take account of the fact that macroeconomic projections made in IMF-supported programs are not unconditional forecasts: they implicitly assume that the program will be implemented as planned, which was clearly not the case in Pakistan. However, the discrepancies between projections and outturns are so large as to make it difficult to assess whether poor implementation was the cause or, at least in part, the consequence of these discrepancies.

18. The growth rate was overestimated on average by 1½ percentage points (over 2 percentage points from 1993 on). Whether this gap resulted from an excess of optimism *ex ante* or from unforeseen exogenous shocks, the IMF generally proved reluctant to adjust the program framework and key objectives, especially the fiscal deficit target. Reviews of internal documents suggest that this reluctance reflected concerns to avoid accommodating policy slippages that would undermine the incentives to persevere with the core fiscal reforms needed for long-term sustainability.<sup>19</sup> However,

<sup>18</sup>The starting point of projections is occasionally off the “actuals” line because of subsequent revisions to the data on which the projections were based.

<sup>19</sup>A justification for this reluctance is provided by the debt sustainability concerns that surfaced at the end of the 1990s. But, more than the level of the target itself, what appears to have hindered fiscal adjustment most is the stop-go process stemming

**Figure 9.2. Pakistan: Growth of GDP, Exports, Gross Domestic Saving, and Gross Domestic Investment**



Source: IMF staff reports.

since most programs did not incorporate specific contingency plans to deal with the effects of lower-than-projected growth, and in the absence of adequate methodology to distinguish the impact of policy slippages from that of exogenous shocks, the result was often lengthy negotiations on the scope and nature of the corrective actions needed. In most cases, this process resulted in fiscal targets generally being met at least up to the first review, at the cost of ad hoc efforts that were neither sustainable nor economically efficient, while negotiations on adaptations to the program framework and necessary policy changes dragged on thereafter, with lack of agreement on a suitable course of action de facto sending the program off-track.

19. Export growth projections also proved far too optimistic: instead of rising by roughly 15 percent a

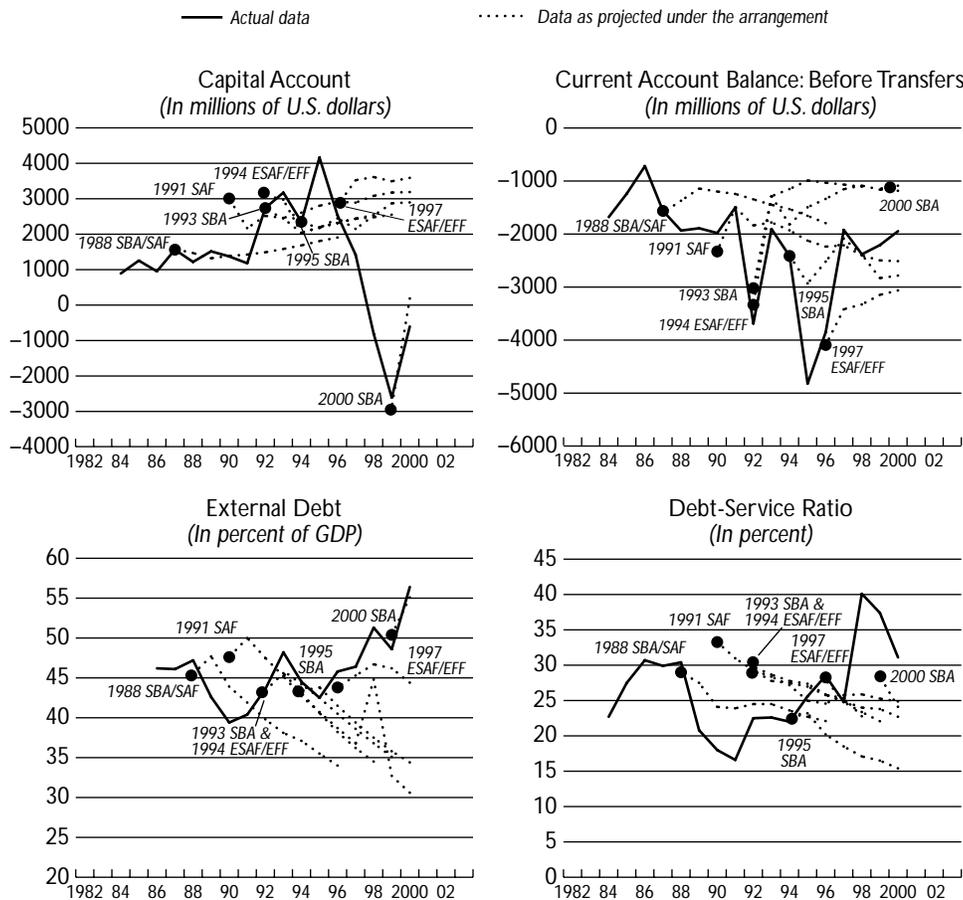
year, which was the average program projection and would have represented an acceleration from the 11 percent growth rate observed in the 1970s/80s,<sup>20</sup> exports rose by barely 5 percent annually during the 1990s. As a result, current account projections typically projected a too rapid improvement, while capital account projections were, on the whole, too conservative. The outcome was a substantial underestimation of the buildup of external debt servicing charges from the early 1990s onward (Figure 9.3).

20. Similarly, some program targets proved unrealistically ambitious given the time frame and the implementation capacity available. This was especially the case for tax revenues (Figure 9.4). These targets were also very ambitious compared to IMF-

from the inadequate macroeconomic framework, with the slippages that occurred during off-track periods more than undoing any progress previously made.

<sup>20</sup>These projections were also more optimistic than contemporaneous WEO forecasts for developing countries as a whole (9 percent) and for Pakistan's WEO country group (i.e., Asia: 10 percent).

**Figure 9.3. Pakistan: Current and Capital Account Projections and External Debt**



Source: IMF staff reports.

wide averages.<sup>21</sup> Indeed, these targets were never met over the 1988–2000 period in spite of frequent in-program downward revisions.

21. While stakeholders, including IMF staff, now generally agree that tax revenue targets were generally unrealistic *ex ante*, the reasons for it are not entirely clear. The authorities argue that the overoptimism of revenue projections reflected an overestimation of their implementation capacity. IMF staff, on the other hand, contend that the lack of realism of

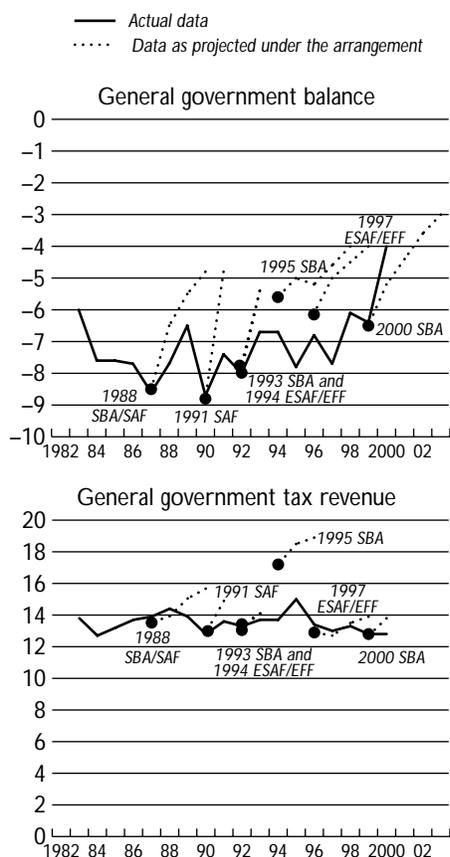
revenue projections reflected the authorities' pressures and was fueled by the political economy of Pakistan's budgetary process.<sup>22</sup> Staff memoranda exchanged during the internal review process indicate that they resisted what they viewed as overoptimistic projections as much as possible, but in the end had to defer to the authorities' knowledge of their own abilities on that issue. In any event, the overoptimism of revenue projections undoubtedly helped paper over

<sup>21</sup>In multiyear arrangements approved since 1993, the average targeted revenue increase over the three-year program period was 2.2 percentage points of GDP in Pakistan, compared to 0.7 points for prolonged users as a whole and 1.3 points for "temporary" users. Overall and primary fiscal balance targets were also more ambitious in Pakistan than in both "temporary" and prolonged users' programs on average. (Source: MONA.)

<sup>22</sup>The logic of the argument is the following: building the budget on the basis of overly optimistic revenue projections avoids making tough decisions on expenditure at the time of the budget debate, while the deficit that inevitably arises when revenue expectations fail to materialize makes it easier for the Finance Ministry to impose a degree of expenditure restraint that would have been unacceptable before. (Nonetheless, the cuts adopted in that context may not be—and in fact often were not—optimal in terms of economic efficiency.)

**Figure 9.4. Pakistan: General Government Balance and Tax Revenues**

(In percent of GDP)



Source: IMF staff reports.

difficult policy choices in a context of strong pressures to agree on a program.

22. As regards structural reforms, the overoptimism was reflected in the length and diversity of the reform agenda embedded in IMF-supported programs from 1988 onward and from the overambitious timetable envisaged for reforms that take time to implement even in countries with far more administrative resources than Pakistan.<sup>23</sup> The number of areas of economic policy covered by explicit conditions increased from four in the 1988 SBA/SAF to eleven in the 1997 EFF/ESAF. The result was insufficient prioritization and an overburdening of the

<sup>23</sup>For instance, effective taxation of the agricultural sector was expected to be put in place within one year and the implementation of a broad-based GST within two years. In both cases, after ten years full effectiveness had yet to be achieved.

policy formulation and implementation capacity of the authorities—a capacity that was limited in part by technical constraints, but mostly by the lack of political will to take measures with significant short-term costs (for instance, as concerning the removal of tax exemptions).

### **Some of the policy prescriptions had adverse side effects**

23. Some of the policy prescriptions embedded in IMF-supported programs turned out, owing to implementation difficulties, to have unintended side effects.

24. In the fiscal area, two mutually reinforcing problems occurred. First, the strategic orientation of shifting taxation from international trade to domestic activities, an important feature of all IMF-supported programs since 1980, proceeded at an uneven pace that caused de facto sequencing problems. While the reduction of tariffs and other taxes on international trade was relatively fast, it took much longer for the general sales tax (GST) instituted in 1990 to yield a comparable revenue, owing to numerous exemptions that took no less than ten years to eliminate, and to the shortcomings of tax administration.<sup>24</sup> Likewise, income tax was prevented by poor tax administration and too narrow a base from making a sufficient contribution to the revenue collection effort. These factors explain the bulk of the revenue shortfalls that were a common characteristic of all IMF-supported programs since 1988 (see Figure 9.5).

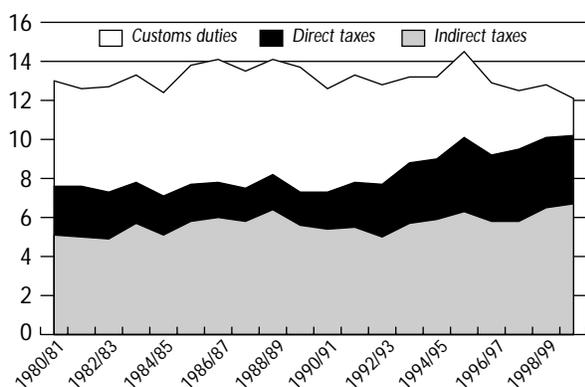
25. The second problem was that attempts to meet the fiscal deficit targets led to the frequent adoption of ad hoc tax increases and expenditure cuts in the course of the program. These measures were frequently inconsistent with the medium-term strategy pursued under the program. In particular, hikes in tax rates and surcharges, which in the short term appeared to be the most effective way to fill the revenue gap, might have contributed to reducing the tax base further by encouraging taxed activities to shift to the informal sector. They also led to an increased complexity of the tax system.<sup>25</sup> Many observers in Pakistan commented that such ad hoc measures have had a detrimental effect on business sentiment by making tax legislation unpredictable (owing to fre-

<sup>24</sup>In theory, a shift from trade taxes to broad-based domestic taxes, such as the VAT, should be revenue enhancing since the latter taxes would typically also include traded goods in their base. However, in Pakistan, this effect largely failed to materialize because of severe weaknesses in tax administration and of generous and widespread tax exemptions, which persisted in spite of specific conditionality to that effect in each of the programs.

<sup>25</sup>In particular, in the form of multiple tax rates, cascading sales taxes, multiple withholding taxes, and complex excises.

**Figure 9.5. Pakistan: Evolution of Tax Revenue Structure**

Revenue to GDP ratio (in percent)



Sources: IMF staff reports and IEO calculations.

quent legal changes but also to the increased scope for taxpayer harassment by the employees of the Central Board of Revenue, who traditionally have large discretionary powers in the implementation of tax policy). As regards expenditure cuts, given the inflexible structure of expenditure (due to the large share of military spending and the weight of interest expenditure) cuts inevitably fell on development and social spending, which resulted in a marked decline in public investment (from about 10 percent of GDP in 1992 to 4½ percent in 2000).

26. As regards financial sector reforms, the same process of uneven implementation of a package of reforms resulted in ex post sequencing problems. The 1988 SAF envisaged the simultaneous implementation of a liberalization of interest rates and lending practices, a major regulatory reform of the banking sector, and a significant reduction in the borrowing requirement of the public sector. In the event, only the first leg of this tripod was delivered. As a result, the financing costs of fiscal deficits ballooned, making it ever more difficult to balance the budget, and the soundness of the banking sector deteriorated as governance weakened. This led to the accumulation of large volumes of nonperforming loans. The very deteriorated state of public banks' loan portfolios also accounts for the high level of interest rate spreads that has had a depressing impact on economic activity in recent years.

27. However, it is worth emphasizing that the two types of side effects discussed above do not imply that the fundamental policy prescriptions were wrong. In particular, it is unlikely that economic performance would have been better had tariffs not been lowered until sufficient revenue could be ob-

tained from domestic taxes (i.e., in the late 1990s), or had interest rates not been liberalized until the fiscal deficit had been sharply reduced (i.e., not yet). Rather, these side effects demonstrate that a critical mass of reforms is needed for adjustment to take hold, and that the adjustment path chosen cannot ignore the longer time frame needed to implement the most complex of these reforms. Nonetheless, the trade-offs and risks involved (of which internal documents suggest that IMF staff was keenly aware) would certainly have warranted a more open debate in policy discussions with the authorities and in reports to the Executive Board.<sup>26</sup>

### *Insufficient emphasis was placed on institutional reforms*

28. In retrospect, there is ample recognition—both in the IMF (more in the views expressed in staff interviews than in reports) and in Pakistan—that IMF-supported programs should have put much stronger emphasis on institutional reforms, particularly in tax administration, the banking sector, and public enterprises, all of which have only begun to be addressed in recent years.<sup>27</sup> In addition to directing attention to implementation capacity issues, thereby making program objectives less unrealistic, an explicit emphasis on institutional reforms would have mitigated the program design problems discussed above.

29. As far as tax administration is concerned, interviews with Pakistani officials and a review of internal documents suggest that there was an implicit understanding on both sides that the revenue targets could only be met if far-reaching tax administration reforms were undertaken in addition to the changes in tax policy explicitly monitored under IMF-supported programs. However, none of the programs had an explicit focus on tax administration reform,

<sup>26</sup>For instance, an internal country strategy paper prepared in early 1993 noted, in drawing the lessons from past experience of IMF-supported programs in Pakistan, that “in sequencing the program measures, primary emphasis needs to be placed on fiscal consolidation and reform, *taking full account of the budgetary costs associated with trade and financial sector reforms*” (emphasis added).

<sup>27</sup>To some extent, this criticism reflects the application of current standards to past programs. Program documents typically did say that these aspects were important, but they put little emphasis on the detailed monitoring and implementation of deeper institutional reforms, in keeping with the IMF's own institutional culture at the time. Moreover, a number of these issues were rightly identified as being the primary responsibility of the World Bank but, as will be discussed in the section “Some Program Design Problems Were Rooted in Deeper IMF Governance Issues” below, this identification of the division of labor between the two institutions did not lead to an effective operational approach to ensure that the issues were addressed.

and even though Pakistan received several technical assistance missions from the IMF in relation to tax administration problems, the actual implementation of reforms was never pursued through specific conditionality until the 1997/98 EFF/ESAF.<sup>28</sup> As a result, no significant progress in revenue collection occurred during that period, in spite of protracted but eventually significant improvements in tax policy.

30. Likewise, stakeholders on both sides now generally agree that much of the deterioration in the quality of banks' portfolios that occurred in the 1990s might have been avoided had the financial sector reforms of the beginning of the decade been designed differently. In particular, giving the same weight to regulatory improvements as to interest rate liberalization and paying due attention to banks' management flaws (in particular, political interferences in lending decisions) would probably have led to a better outcome.

31. Finally, the effectiveness of IMF-supported programs would have been enhanced had public enterprises been handled from an institutional reform perspective from the start: IMF-supported programs' focus on preventing too large misalignments between public enterprises tariffs and world market prices was warranted, but it ignored the broader restructuring needs of these enterprises. The drawbacks of this approach are particularly visible in the case of the largest public enterprises (discussed further below), whose impact on the economy expand way beyond that of potentially distortionary prices and eventually took the form of a drain on fiscal resources, expensive and unreliable supply of basic utilities, accumulation of nonperforming loans in the banking system, and massive cross-arrears within the broader government sector.

### **Lack of ownership and inconsistent monitoring resulted in poor implementation**

#### ***Ownership was generally weak***

32. Pakistan suffered from a very unstable political environment throughout most of 1988–2000. No single government managed to stay more than three

<sup>28</sup>The fact that the achievement of revenue projections hinged critically on improvements in tax administration was repeatedly underscored in internal memoranda by the Fiscal Affairs Department, which also supplied abundant technical assistance in that area and frequently expressed concern that their recommendations did not appear to receive consistent follow-up. At the same time, they emphasized in their comments that improvements in tax administration should not be strongly relied upon to deliver large and quick increases in tax revenue. This might explain why improvements in tax administration were not aggressively pursued through conditionality until the most recent programs.

years in power, with an average tenure of 18 months.<sup>29</sup> The effects of this instability on successive governments' ability (and willingness) to implement comprehensive reforms and carry through an ambitious adjustment effort seem to have been largely underestimated—at least in reports submitted to the Executive Board. Most UFR staff reports during that period acknowledged the fluidity of the political situation, but usually stated that governments had strong ownership of the programs and were strongly committed to their implementation, even when programs were negotiated with caretaker governments and endorsed at the last minute by the incoming cabinet, as occurred for the 1988 SAF and the 1994 EFF/ESAF. While the claim made by successive IMF reports that there was a broad consensus across major political parties on economic policy matters was correct, this consensus gave no assurances as to the political ability of elected governments to carry through unpopular adjustment policies (Box 9.1).

33. In the event, as political difficulties arose, it often appeared that the reform agenda of the economic team had little backing at the highest political level,<sup>30</sup> at least in the sense that top decision makers were not sufficiently convinced that the reforms were necessary and that the economic price of postponement outweighed the political costs of early implementation. As a result, implementation efforts often limited themselves to the minimum needed to ensure the continued disbursement of IMF resources. In many instances, what was observed was more the letter of the conditions than their spirit, and even though the tightening of conditionality over time gradually reduced the room for such practices, it was insufficient to compensate for the lack of ownership. For instance, in the fiscal area, performance criteria initially targeted bank financing of the deficit, while the overall deficit was only a benchmark. Since bank financing was not a predominant source of financing of the deficit, Pakistan was able to comply with the fiscal performance criteria until 1994 in spite of substantial fiscal overruns.

34. As regards structural reforms, conditionality was initially set in the form of general commitments in the letter of intent or structural benchmarks, which were at best partially observed (e.g., the removal of exemptions from excises, custom duties, and other taxes targeted by the 1980 EFF and the

<sup>29</sup>By contrast, at the administrative level, there was a considerable degree of stability at the top of the two main institutions involved, namely the central bank and the Ministry of Finance.

<sup>30</sup>This problem was recognized in the 1993 country strategy paper, which highlighted as the first lesson to be learned from past experience that "it is important that the policy dialogue involve, at an early stage, full commitment at the highest political levels in Pakistan."

### Box 9.1. Ownership Assessment in the Context of Pakistan Arrangements with the IMF

A brief analysis of the politico-administrative context of Pakistan at the onset of the multiyear arrangements approved in 1993/94 and 1996/97, undertaken by a political scientist at the IEO's request, shows that there were conflicting factors at play, making the assessment of strength of ownership and political feasibility particularly difficult:

- *On the positive side*, governments in power at the time of program approval enjoyed a comfortable majority in Parliament and in key provincial governments and the reforms they put in motion before the program's approval were consistent with its spirit, they could rely on well-structured and, at the top echelons, skillful and stable bureaucracy. Moreover, there appeared to be a broad consensus across major political parties about the main thrust of economic reforms.

- *On the negative side*, vested interests weighed heavily in the political power base of every government and were in a position to block the approval of reforms (i.e., they had a "veto power"), many of which directly or indirectly threatened their privileges, implementation capacity was weak due to serve deficiencies in the rule of law and law enforcement; decision-making style (restricted to a narrow circle), and a policy dialogue that presented reforms as IMF-imposed, were not conducive to a broad ownership of reforms. Taking all these factors into consideration, serious doubts should have been raised about the prospects for consistent implementation of the programs.

See Appendix 1 for a more comprehensive presentation of the analysis conducted.

1988 SAF). When conditionality was "hardened," in the mid-1990s, conditions were often met in ways that minimized their impact. A few examples can illustrate the general problem:

- by enacting a law but not implementing it (e.g., extension of GST to the services sector and taxation of agricultural income);
- by adopting a new tax but with so many exemptions as to make its additional yield negligible (e.g., the GST act in 1990);
- by abolishing existing tax exemptions while simultaneously creating new ones;
- in other cases, measures adopted were subsequently reversed or suspended (e.g., the petroleum price adjustment mechanism from 1995 to 1998).

35. Furthermore, during much of that period, the government's practice was to use the IMF as a scapegoat for unpopular decisions, a strong indication of the limited degree of actual ownership. Over time, the result was that the surest way to undermine popular support for any measure was to give it an "IMF" label.<sup>31</sup>

<sup>31</sup>One telling anecdote heard during the evaluation team's mission to Pakistan illustrates how a long series of weakly owned programs can lead to perverse results: when the IMF suggested including in the program supported by the current PRGF arrangement key elements of the tax administration reform prepared by the authorities, some government officials initially resisted on the grounds that these reforms were ones they truly wished to implement, whereas including them in the LOI would give the impression they were IMF-imposed and hence would reduce their chances of implementation.

#### *The mitigating devices available to the IMF were not used fully*

36. The extent of political instability and ensuing low ownership during the period of prolonged UFR was such that even using the whole arsenal of safeguards at the disposal of the IMF would have been unlikely to produce the results promised in successive programs. However, many of the safeguards—which the Board had established as part of a strategy for minimizing prolonged use (see Chapter 3 of Part I)—were not used fully until late 2000. At that stage, practice shifted to the strictest standards of track record probing.<sup>32</sup> However, ownership too was higher, which was probably more determining in the success of the program than any parameter under the IMF's control.

#### *Track record requirements*

37. When there are significant doubts about the authorities' commitment or ability to pursue adjustment policies over a sustained period of time—perhaps as a result of previous policy slippages—it is customary practice for the IMF to ask a government to build a track record before engaging in a multi-year arrangement. In Pakistan, however, track record requirements were often squeezed out by protracted negotiations. For example, the 1994 EFF/ESAF, for

<sup>32</sup>The 2000 SBA was adopted only upon completion of an unusually long list of prior actions, going beyond the unfulfilled commitments of the preceding interrupted program, and its disbursements were slightly back-loaded. The current PRGF arrangement was approved only after one year of satisfactory performance under a Stand-By Arrangement.

which negotiations lasted 18 months, was preceded by a Stand-By Arrangement, but the SBA was not allowed to run its course: it was cancelled after six months to be replaced by the multiyear arrangement, even though the first review had not been completed due to slippages.<sup>33</sup> Negotiations for the 1997 EFF/ESAF started in mid-1996, at a time when Pakistan was under a Stand-By Arrangement following the collapse of the previous EFF/ESAF. The EFF/ESAF was eventually presented to the Board after a six-month track record—not under the SBA, which had been irremediably interrupted owing to very large policy slippages, but under a staff-monitored program (SMP) whose targets had been revised several times to accommodate various slippages and shocks.

38. Other tools available to the IMF are prior actions and the phasing of disbursements, with a back-loaded schedule providing a greater incentive to sustain the policy effort over the medium term.

- Prior actions were used in most UFR requests since 1988. However, these prior actions did not always include the key conditions whose nonobservance had sent the previous program off-track (e.g., GST base extensions in the 1994 program, or the petroleum price adjustment mechanism in 1997). In addition, prior actions, like any other conditionality, are subject to superficial or temporary observance only. Two examples drawn from agricultural taxation illustrate this point: the 1993 SBA included a prior action related to the extension of taxation to the agricultural sector. The prior action was considered to be met, but legal impediments that subsequently surfaced made it necessary to impose a new prior action in the 1994 ESAF, this time related to the parliamentary approval of the ordinance on federal agricultural taxation. Neither prior action resulted in meaningful taxation of agricultural incomes (Box 9.2).<sup>34</sup> Thus, the issue in Pakistan's programs appears to have been the prioritization of prior actions and their integration into program design, rather than their quantity.
- The tranching of disbursements was generally mildly front-loaded,<sup>35</sup> even in cases where facil-

ity specific rules allowed flexibility. This favorable tranching contrasts with the generally back-loaded design of the policy agenda: even in the 1997 ESAF/EFF, which came after a series of interrupted programs, half of the structural conditions specified from the outset were related to the second program year, and several pivotal measures, such as income tax reform, civil service reform, extension of the GST to the retail level, and tariff cuts were only planned for the third program year.

### *Conditionality*

39. The conditionality response to the practices induced by the low ownership of programs by the authorities was to gradually close as many loopholes as possible, through an increase in the overall number of both macroeconomic and structural conditions, through a larger recourse to performance criteria and prior actions as opposed to general commitments in the letter of intent, and through the use of continuous performance criteria and other non-reversal clauses (Figure 9.6).

40. It is doubtful that any form or volume of conditionality would have been sufficient to compensate for the authorities' fundamental unwillingness or inability to implement many of the policies promoted by successive programs. However, two lessons can be derived from this experience. First, strict implementation and enforcement would have been easier had conditionality been more focused on truly critical areas. Second, the approach—eventually adopted with success in the areas of tax exemptions and utilities price adjustment—consisting in setting conditionality on policy rules rather than discretionary actions by the authorities might have speeded up the reform process if adopted and generalized earlier.

41. More minor problems that hindered the effectiveness of conditionality in Pakistan are the following. First, the tightening of conditionality always occurred with a lag following repeated failures to deliver on policy undertakings, a lag that in some cases was very long (e.g., conditionality on the financing of the fiscal deficit or utilities price adjustments). Second, in some areas, such as tax administration, utilities pricing, or public enterprise reform, the effectiveness of conditionality was reduced by the lack of a sustained, consistent approach. These areas, which were presented as key to the success of the programs of the 1980s, subsequently ceased to be covered by conditionality for several years, despite very limited progress and occasional backsliding. In other cases (e.g., agricultural taxation), the inconsistency stemmed from the lack of follow-up on undelivered commitments from one review or program to the next.

<sup>33</sup>End-1993 targets, however, were reportedly met, which allowed the request for an EFF/ESAF to be presented to the Board and approved in February 1994.

<sup>34</sup>For a more comprehensive review of attempts to tax agriculture in Pakistan and impediments thereto, see Khan and Khan (1998).

<sup>35</sup>In Stand-By Arrangements during the 1990s, the amount disbursed upon approval by the Board was on average 12 percent higher than what would have resulted from a division of the total amount committed under the arrangement into tranches of equal size.

### Box 9.2. A Chronology of IMF Conditionality on Agricultural Taxation in Pakistan<sup>1</sup>

Agricultural taxation was pursued through IMF-supported programs since 1981 through the following conditionality (implementation status as reported in staff reports noted in parentheses). None of this conditionality—much of which was actually observed, in a narrow sense—had substantially increased the contribution of the agricultural sector to tax revenues by the end of the decade.

- **1981** (EFF): commitment in the authorities' Memorandum of Economic Policies (MEP) to tax agricultural output within one year (formally implemented, but with a very low yield).
- **1991** (SAF): commitment in the MEP to extend the scope of agricultural taxation in the 1992/93 budget (not implemented).
- **1993** (SBA): prior action on extension of taxation to the agricultural sector (met).
- **1994** (EFF/ESAF): prior action on parliamentary approval of ordinance relating to federal agricultural taxation (met) and performance criteria on expansion in agricultural tax base including through

Produce Index Units (PIU) adjustment, within six months (met).

- **1995** (SBA): performance criteria on inclusion of provisions in 1996/97 budget to broaden agricultural taxation through an increase in PIU to PRs 400 and extension of its base (met).
- **1996** (SBA, revised): performance criteria on adoption by all provinces (by end-December 1996) of ordinances on agricultural taxation (not met); establishment of a task force on the potential revenue from provincial agricultural taxes (met); and task force to present recommendations for 1997/98 budget and the medium term.
- **1997** (EFF/ESAF): performance criteria on harmonizing provincial taxation of agricultural income with that prevailing in Punjab, by end-June 1998 (not met; waived and rescheduled).
- **1998** (EFF/ESAF): performance criteria on harmonizing provincial taxation of agricultural income with that prevailing in Punjab, by end-June 1999 and structural benchmark on finalization by the same date of the rate and threshold structure for the provincial tax on agricultural income capable of yielding PRs 3.5 to PRs 4 billion in 1999/00 (both conditions partially implemented, with delay).
- **2000** (SBA): performance criteria on GST extension to urea fertilizers and pesticides by March 2001, and to all other agricultural inputs by September 2001 (both performance criteria met); structural benchmarks on full implementation of agricultural income taxes on the basis of provincial implementing regulations to become effective in each province by end-June 2001 (met with delay in two provinces, unmet in other two).

<sup>1</sup>Agriculture accounts for roughly 25 percent of GDP, employs half of the labor force, and is one of the largest earners of foreign exchange. Under the Constitution of Pakistan, farmers have been exempt from taxes on their incomes from agriculture, and only the provincial governments are permitted to levy a land tax. The political power of large landowners has long prevented the federal government from seeking the legal changes needed to give it authority to tax agricultural income or land and Provincial governments from using the authority they have to pursue the same goal. This situation has led the agricultural sector to become a legal, and sometimes illegal, shelter for other forms of income.

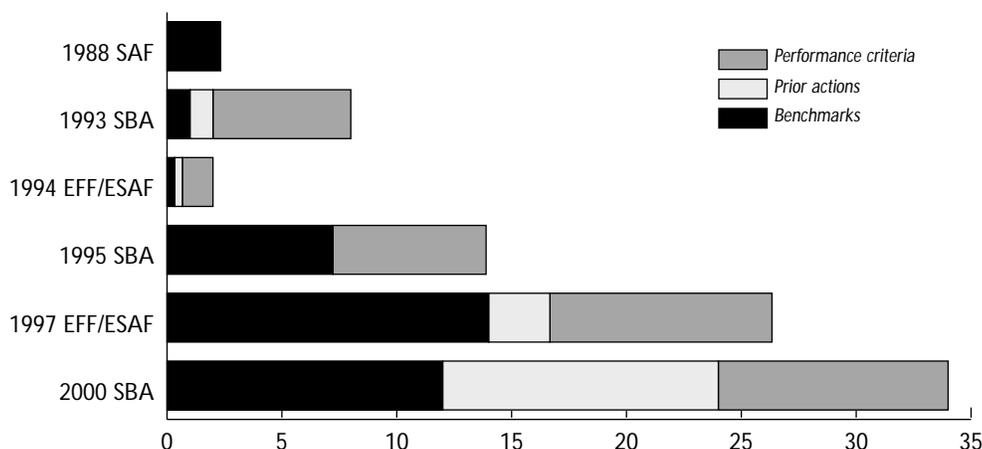
42. In the few cases where conditionality responded proactively and consistently, better results were eventually obtained, e.g., in the area of tax exemptions: conditionality evolved from a simple LOI commitment to phase out existing tax exemptions (in 1988), to a continuous performance criterion on the nonintroduction of new exemptions (in 1995), to a prior action on the passage of an act prohibiting the government from creating new exemptions (in 1998).

43. Finally, the relative generosity of the IMF in granting waivers to the authorities, or in consenting to renew its support soon after a program interruption typically caused by large fiscal slippages, led—according to many Pakistan officials—to a form of moral hazard: the expectation that the IMF would eventually provide financing weakened incentives to tackle the fiscal deficit forcefully. Indeed, of the seven program reviews completed in the 1990s, five

involved at least one and generally several waivers, mostly concerning fiscal performance criteria.<sup>36</sup> Furthermore, in spite of the many interruptions suffered by IMF-supported programs, the interval between two disbursements of IMF resources was generally short—never exceeding 12 months over 1991–99.<sup>37</sup>

<sup>36</sup>Over that period, Pakistan was granted 18 waivers of compliance, of which 8 concerned quantitative PC, another 8 concerned structural PC, and 2 continuous PC. In all three categories, half of the waivers concerned fiscal PC (two-thirds if PC on utilities prices are treated as “fiscal” conditionality). All the waivers on quantitative PC were requested for reasons other than “minor technical deviation” or “exogenous shocks.”

<sup>37</sup>Somewhat longer intervals occurred at the beginning and end of the decade, and coincided with episodes of major political disorder: from December 1989 to December 1991 and from June 1999 to November 2000.

**Figure 9.6. Pakistan: Evolution of Structural Conditionality***(Average number of conditions per program year)*

Sources: IMF staff reports and IEO calculations.

## Some Program Design Problems Were Rooted in Deeper IMF Governance Issues

### Institutional considerations weighed heavily in decisions regarding IMF involvement in Pakistan

#### *Geopolitical considerations*

44. “Most IMF-supported programs primarily served political purposes. Thus, it should come as no surprise that they did not achieve much in terms of economic results.” That view, expressed by a senior Pakistan official interviewed by the IEO, appears to be very widely shared in Pakistan, both within and outside official circles. A large proportion of IMF staff involved in Pakistan programs were also of the opinion that political considerations had, at times, prevailed over technical judgments, not necessarily on the details of program design but in terms of the overall threshold required for a program to be supported.

45. While there is no hard evidence or “smoking gun,” either in internal memoranda or in the record of Board discussions, that noneconomic considerations played a predominant role in IMF decisions to support a request for use of Fund resources or to complete a program review, there is no shortage of anecdotal evidence—coming from both former authorities and the IMF staff—that such considerations did matter importantly on some occasions. Moreover, a few significant “program events” closely followed major geopolitical developments, for instance the 1980 EFF following the Soviet invasion of Afghanistan; and the mid-1998 program interruption following Pakistan’s nuclear tests.

46. More generally, until 1998, the prevailing perception within IMF staff was that the principal IMF shareholders, no matter how demanding they claimed to be on the substance of programs, were not willing to take the risk of major turmoil in Pakistan that an interruption of IMF support might have caused. This resulted in a general sense, shared by staff and the authorities, that the IMF would remain involved irrespective of performance under a specific program. The succession of adverse events of 1998–99 (nuclear tests, a military coup, and the unveiling of past misreporting of fiscal data to the IMF) caused a dramatic reversal in shareholders’ views, after which IMF support was perceived by IMF staff and the authorities as unlikely—short of a very strong performance under an extremely ambitious program.

47. Assessing with accuracy to what extent geopolitical considerations did supersede economic ones in program or program-design decisions is virtually impossible, given the element of judgment appropriately present in any UFR decision. But the simple fact that IMF-supported programs are widely *perceived* as heavily influenced by political factors—both by the authorities who sign onto them and by the economic agents whose behavior they are meant to influence—probably weakened the efficacy of these programs.<sup>38</sup>

<sup>38</sup>In this connection, it has been suggested to the IEO by some IMF staff members that the program design weaknesses discussed in the section “The Lack of Effectiveness of Pakistan’s IMF-Supported Programs Stems from Both Design and Implementation Issues,” such as unrealistic macroeconomic projections, the pretence of toughness, and so on were symptomatic of attempts to find a face-saving way to justify continued lending to Pakistan.

### ***“Systemic” considerations related to the IMF mandate***

48. There are four dimensions of the IMF mandate that might account for some of the design problems discussed above. First, as a monetary institution, the IMF is traditionally viewed as primarily mandated to provide temporary balance of payment support to its members, not long-term financing. This means that its interventions are expected to allow a restoration of balance of payments viability over a relatively short period. While the creation of the EFF and, later on of the SAF, ESAF, and PRGF, has lengthened the time frame for the restoration of viability, until recently it would have been difficult to present for the consideration of the Executive Board a program that did not lead to a restoration of balance of payments viability within a short- to medium-term time frame. This constraint is likely to have contributed to two related problems: (i) a tendency toward overoptimism both in the speed with which the real economy would respond to the policy measures and in the pace at which difficult structural reforms could be implemented; and (ii) a focus on types of structural “conditions” that can be clearly delivered within programs’ time frame—or even in the few weeks separating the finalization of the program from its presentation to the Executive Board, in the case of prior actions. Complex institutional reforms, which are key to longer-term sustainability, are much harder to fit within such a framework.<sup>39</sup> As far as Pakistan is concerned, program assumptions did not become markedly overoptimistic until the early 1990s (see the figures in the section “The Lack of Effectiveness of Pakistan’s IMF-Supported Programs Stems from Both Design and Implementation Issues”). From then on, internal memoranda do suggest that several review departments had serious reservations about the optimism of program assump-

<sup>39</sup>Examples of such difficulties include tax reform, where setting conditions on the enactment or parliamentary approval of given measures failed to ensure their actual implementation (e.g., for agricultural taxation, where the first legal changes were approved in 1994, but full implementation was an unmet structural benchmark (SB) as of mid-2001, or for the extension of the GST to traders/retailers, where the timetable was similar); improvements in tax administration, where conditionality on the creation of a given administrative structure failed to ensure that it performed effectively the tasks it had been set up for (e.g., tax audit unit, an SB for 1997); or yet again privatization, where conditionality on “bringing to the point of sale” specified public enterprises, does not guarantee that they will ever be privatized (as was done in 1996/97 for companies in the oil and gas sector, which for the largest part had yet to be sold by end-2000). In such a context, an alternative is to specify the condition in terms broad enough to give staff room for judgment in appraising the extent of progress made at the time of the program review. However, evidence from other case studies (especially the Philippines) suggests that so-called “review” conditionality is no panacea.

tions, particularly regarding GDP and export growth, as well as revenue targets. The “systemic constraint” discussed above is a plausible explanation for why programs went ahead despite these reservations.

49. Second, until the late 1980s, the IMF interpreted its mandate as narrowly focused on macroeconomic policies and a few structural areas. That conception changed dramatically when concessional facilities were created, which led the IMF to embrace a broad agenda of structural reforms, without necessarily having the expertise needed for an optimal selection, sequencing, and design of these reforms, at least initially. While in theory these shortcomings could have been mitigated by a close collaboration with the World Bank (and the AsDB), in practice collaboration was imperfect. As a result, key areas, such as governance and institutional reforms in tax administration, civil service, and public enterprises, ended up being handled inadequately by both IFIs for lack of emphasis and coordination of their efforts. Both institutions implicitly or explicitly recognized that these issues were central to long-term macroeconomic sustainability. But they do not appear to have reached an effective agreement, among themselves and with the government, on what the priorities should be and on coordinated action plans to address them, until the EFF/ESAF approved in late 1997.

50. The problems of the power sector provide a good illustration. Initially (i.e., in the 1988 SAF), the IMF focused on power tariff adjustments, on an “as required” basis, with the primary purpose of containing the fiscal impact of the operational losses and investment needs of the power sector. However, that condition was omitted in subsequent arrangements,<sup>40</sup> while at the same time, the World Bank was shifting its focus toward human development, limiting its interventions in the energy sector to technical aspects. Meanwhile, severe institutional problems intensified.<sup>41</sup> As a result, by 1996–97, the overall borrowing requirement of the seven major public enterprises had reached 2½ percent of GDP (the bulk of which came from WAPDA and KESC, the two main public power producers). Their nonperforming loans had piled up in public banks to the point of threatening their stabil-

<sup>40</sup>Presumably because of a change of strategy, which, from 1993 onward, focused on privatizing these enterprises.

<sup>41</sup>The World Bank diagnosed them in 1998 in the following terms: “Public enterprises suffer from operational inefficiencies, overstaffing, inappropriate incentives, misdirected investments, inadequate O&M [operation and maintenance], political intervention in their decision making, and other problems which adversely affect their performance . . . [they] have become a vehicle for employment creation, political patronage and corruption. . . . Their inefficiency has resulted in high costs to the private sector as a result of high prices of utilities . . . [and] in many cases poor quality of supply. . . . Problems are most acute in the power sector.” (“Pakistan Public Expenditure Review,” 1998, pp. 15–16.)

ity and substantial cross-arrears had accumulated among public enterprises and vis-à-vis the government. At that point, the seriousness of the problem brought a greater focus on it by both IFIs. The World Bank helped the authorities draw up operational and financial restructuring plans, whose implementation was subsequently monitored through IMF-supported programs' conditionality.<sup>42</sup> By end 2000, both the financial and the operational restructuring were under way but are likely to take considerable time to yield substantial efficiency gains and cost reductions.

51. Third, the “seal of approval” function effectively given to IMF-supported programs by donors and creditors might account for the tendency to overpromise in programs and subsequently undersanction when the authorities did not deliver. The fact that the IMF acted as gatekeeper for access to many other sources of financing in one sense gave it great leverage, but also meant that the consequences of a prolonged interruption in programs would be very severe. Ultimately the IMF—presumably reflecting the views of its shareholders—proved extremely reluctant to risk the costs of such major disruption, which meant that there was an inbuilt tendency not to insist too hard on the core issues.

52. Fourth, the IMF's mandate gives it an obligation to support member countries making the necessary efforts to address their economic difficulties. Thus, any government committing itself to making such efforts has to be given the benefit of the doubt, at least initially. In Pakistan, since 1988, political instability was such that each new IMF arrangement practically coincided with a new government and it would have been extremely difficult not to give such a government the initial benefit of the doubt on its declared policy intentions.

### *Defensive lending considerations*

53. It has been argued<sup>43</sup> that a factor contributing to the prolonged use of IMF resources when adjustment fails to take place is the need to ensure that obligations falling due are met. The IMF did have a significant exposure to Pakistan throughout the period,<sup>44</sup> although Pakistan's record of repayment of

<sup>42</sup>Specific conditions included: introducing performance improvement arrangements between the government and WAPDA (by 12/97); developing action plans for restructuring seven major public enterprises (by 6/98); strengthening the National Electric Power Regulatory Authority (by 6/98); reconciling and settling electricity bills of federal and provincial governments (prior action, 1999); and implementing power sector restructuring program (by 3/99).

<sup>43</sup>See, for instance, Birdsall and others (2001).

<sup>44</sup>Pakistan's average outstanding obligations over 1988–2000 were SDR 904 million; annual repayments and repurchases averaged SDR 148 million over the same period.

its obligations to the IMF was impeccable even at times of severe stress on its international reserves position. The only times when there is evidence that “defensive lending” considerations could have been a significant factor, as reflected in explicit concerns about a possible default expressed in internal memoranda, were when Pakistan came closest to the brink of a foreign exchange crisis: (i) in late 1996, just before the revival and augmentation of the SBA; (ii) in the months preceding the completion, in January 1999, of the second review of the 1997 EFF/ESAF following its de facto interruption in May 1998; and (iii) in mid/late 2000, prior to the approval of the SBA.

### **Crowded out by UFR, surveillance played only a limited independent role**

54. In Pakistan, all but two of the Article IV consultations of the 1988–2000 period were conducted jointly with UFR activities. A comparison of the depth and quality of surveillance in stand-alone Article IV reports with joint Article IV/UFR reports and with surveillance guidelines over 1982–2000 indicates that joint consultations tended to make a more cursory treatment of such key issues as medium-term perspectives, sensitivity to shocks, and vulnerabilities.<sup>45</sup> They also tended to be less concerned about exploring trade-offs between policy options and less candid about divergences of views between the staff and the authorities.

55. Once again, this “crowding out” of aspects of surveillance appears to reflect systemic factors, rather than a particular shortcoming of the IMF staff's work on Pakistan. For example, since there is an inbuilt incentive not to undermine the catalytic role of an IMF-supported program in mobilizing other financing, surveillance activities that are closely associated with programs tend not to raise

<sup>45</sup>The quality of surveillance over that period was assessed by systematically rating the performance of each surveillance report for nine functions viewed by the IEO as “key elements” of surveillance in a program context (see Chapter 6 of Part I for a discussion of how these elements were identified). These nine functions are (i) provision of realistic medium-term and alternative scenarios; (ii) provision of meaningful sensitivity analyses; (iii) discussion of risks to the assumptions and projections; (iv) discussion of the risks and impact of policy slippages and of vulnerabilities; (v) balanced reporting of the authorities' views, including any significant differences with staff; (vi) cogent presentation of proposed policy course; (vii) discussion of policy alternatives and trade-offs; (viii) critical and frank review of previous UFR performance; and (ix) presentation of collaboration/interaction with the World Bank. The diagnosis is consistent with the findings of the 2002 “Biennial Review of Surveillance.” In other words, the Pakistan exception lies not so much in this absence of strong, independent role for surveillance as in the length of time it lasted.

too many questions about alternative policy design or downside risks.

***Implications of short-term stabilization measures for longer-term growth and sustainability of adjustment were not analyzed sufficiently***

56. There are three aspects where, with the benefit of hindsight, it appears that surveillance could have played a larger role in analyzing some of the longer-term implications for sustainability. First, the consequences for long-term growth and hence sustainability of the structure of fiscal adjustment could have been given greater attention—although more analysis was undertaken in internal reports than was reflected in Board papers.<sup>46</sup> Specifically, the adverse long-term effects of ad hoc revenue measures taken by the authorities to compensate for revenue shortfalls, or ad hoc expenditure cuts instead of fundamental improvements in the structure and quality of expenditure were not emphasized in surveillance reports, even when strong reservations were expressed about them in the internal review process.

57. Second, as most programs failed to deliver the required adjustment but nevertheless unlocked substantial financing flows, over time financing largely substituted itself for adjustment. To a large extent, this merely reproduced the pattern of the 1970s and 1980s, but this time in a low-growth environment with a much higher cost of financing (workers' remittances and ODA flows, relative to GNP, both fell by over 40 percent in the 1990s compared with the average of the two previous decades, and the average grant element also fell from 46 percent to 32 percent). As a result, Pakistan got trapped into a debt sustainability problem, which was not fully analyzed in IMF reports until 1997, apparently in part because of concerns about undermining the credibility-enhancing effects of programs.<sup>47</sup>

<sup>46</sup>In particular, several research papers of the early 1990s (see, for instance, Haque and Montiel, 1992) emphasized that in the Pakistan context, a deficit reduction strategy emphasizing cuts in public investment would have large output costs, because of lower public and private capital stocks, "since the smaller public capital stock would have depressed private investment as well. Crowding-in through lower interest rates does not materialize in this case because the lower public capital stock actually represents a substantial negative supply shock." (pp. 9–10.) Interestingly, the 1993 country strategy paper for Pakistan explicitly acknowledged the findings of that paper. To be sure, it could also be argued that in a corrupt environment, the supply impact of public capital expenditure is limited and, therefore, reducing capital expenditure makes sense in the short term, provided public expenditure management reforms are undertaken at the same time.

<sup>47</sup>As noted earlier, more analysis was undertaken internally—for example, in the late 1980s by economists from the IMF Re-

58. Third, surveillance failed to sound the alarm loudly enough at a sufficiently early stage about the gradual buildup of an eventually very large uncovered exposure of the central bank to foreign currency deposits (FCDs)—a central avenue through which the debt buildup occurred.<sup>48</sup> By the time the 1997 ESAF/EFF was approved, FCDs had reached over \$11 billion, that is, the equivalent of 17 percent of GDP and 9½ times the level of gross international reserves. This vulnerability turned into a foreign exchange liquidity crisis when capital outflows intensified in mid-1998 after Pakistan's nuclear tests and ensuing international sanctions, leading the authorities to impose a deposit freeze.

59. Surveillance reports, while factually accurate, never gave much prominence to the issue, even when the downsides of the heavy reliance on FCDs were mentioned, and mission briefs suggest that the buildup of large uncovered foreign exchange exposure through FCDs was never a pivotal issue of either policy or program discussions with the authorities until late 1996 (Box 9.3). However, we understand from interviews with staff and others that the potential vulnerabilities involved were raised with the authorities beginning in the early 1990s, even though the issue was not given prominence in IMF reports until much later.

***Factors that might have undermined confidence in the programs were downplayed***

60. Discussions of risks to the program outlook and sensitivity analyses of medium-term projections were

search Department. However, their work was not approved for publication as an IMF Working Paper until late 1992, apparently because of concerns about country sensitivity. This paper (Haque and Montiel, 1992) made it clear that "although the average cost of servicing this debt may have been low in the past, the marginal cost of debt service can be expected to rise in the coming years, since, as a result of the opening up of the economy, international interest parity is likely to prevail. . . . The high level of government indebtedness implies that debt servicing has the potential to frustrate future deficit reduction plans." Under assumptions of constant revenue to GNP and primary expenditure to GNP ratios and with a growth rate constant at 5.8 percent (i.e., much higher than it turned out to be), they found that the deficit to GNP ratio would rise to 8 percent over five years just through increased debt-servicing costs. Under similar GNP growth assumptions, they also found that an average deficit of 4 percent of GDP over the next five years would be consistent with lower macroeconomic imbalances (in fact, the fiscal deficit averaged 7 percent of GDP during the 1990s).

<sup>48</sup>The deposits, after being surrendered to the SBP, were effectively on-lent to the government and therefore did not result in a corresponding buildup in reserves. Hence the uncovered foreign exchange exposure. FCDs increased at a rapid pace starting in 1991, when they were first allowed for residents, partly reflecting various price incentives for both banks and depositors, partly owing to the advantages of their "no questions asked" status.

### Box 9.3. The Coverage of the Issue of Foreign Currency Deposits in IMF Staff Reports

From 1992 to late 1995, surveillance reports gave factual accounts of the evolution of FCDs,<sup>1</sup> and a few noted that they compounded the weakness of gross international reserves, but they did not flag them as a serious vulnerability,<sup>2</sup> nor did they offer any specific policy advice to address the problem. The IMF's approach changed dramatically in 1996: there was no Article IV consultation, but the staff report on the second review of the SBA, which was completed as Pakistan was on the verge of a foreign exchange crisis partly owing to

<sup>1</sup>However, from 1993 onward, those factual accounts were only partial, since—at the authorities' request—FCDs owned by residents were reported in the balance of payments “above the line,” as part of private transfers, and even FCDs held by nonresidents were not included in the stock of external debt in tables presenting key indicators. Furthermore, FCDs held by residents, even though they represented a liquid claim on the central bank's reserves, were not netted out from international reserves for the purpose of IMF monitoring of net international reserves.

<sup>2</sup>The first staff report that put some emphasis on the vulnerability aspect was the background paper to the 1995 Article IV report. Internal documents attest that the vulnerability aspect had been fully understood as early as 1993: a memorandum from the Research Department noted that “attempts by domestic residents to reduce their holdings of foreign currency deposits in the domestic banking system could precipitate not only balance of payment difficulties, but also a major banking crisis. Indeed, given the degree of mismatch between Pakistan's low gross international reserves and the uncovered foreign currency accounts . . . , even modest capital outflows could trigger a loss of confidence in the authorities' ability to sustain the convertibility of the foreign currency deposits. Avoidance of a foreign exchange crisis and reversal of the liberalization measures would be a major success at the current juncture.”

withdrawals from FCDs, clearly emphasized the risks of Pakistan's heavy reliance on short-term liabilities to finance its current account deficits and, for the first time, set specific conditionality on the preparation, at a future date, of an exit strategy from the forward exchange cover provided to banks by the SBP. In the event, the definition of a strategy took somewhat longer than initially expected, by which time the immediate crisis had passed, and the 1997 Article IV returned to a relatively relaxed stance: while the presence of a large uncovered foreign exchange exposure was still identified as a “major concern,” the emphasis was more on the constraint this exposure represented for the conduct of exchange rate policy and the distortions to incentives induced by the too low price of the SBP forward cover fee, than on the looming risks of foreign exchange crisis.<sup>3</sup> The EFF/ESAF arrangement approved at the same time did outline a detailed exit strategy, based on the recommendations of an IMF TA mission, which was partially supported by explicit conditionality. However, to the extent that financing needs had not diminished, it is doubtful that the authorities would have pressed ahead with its implementation even if the mid-1998 crisis had not struck.<sup>4</sup>

<sup>3</sup>However, the paper did note, in a separate section, that “Pakistan's fragile external reserve position is compounded by the accumulation of short-term foreign currency liabilities by the banking system, mostly . . . FCDs.”

<sup>4</sup>Indeed, the staff report on the first review of the ESAF/EFF, completed in March 1998, noted that the authorities viewed with concern the decline in FCDs registered in previous months.

generally limited, in the sense that sensitivity analyses never involved sufficiently large adverse shocks that they would push the medium-term outlook off its “sustainable” path, even though the Pakistan economy was subject to a variety of shocks of much broader magnitude.<sup>49</sup> Likewise, only exceptionally were substantive ex ante analyses of the implications of policy slippages offered (the 1993 SBA request report and the 1991 and 1995 Article IV consultations are the only, but welcome, counter-examples). When such analyses were provided, they did not spell out the side effects that might result from an uneven implementation of reforms intended as a package.

61. For the same reasons, most joint surveillance-UFR reports provided little analysis of trade-offs be-

<sup>49</sup>For instance, the only shock analyzed in the sensitivity analysis attached to the 1997 ESAF/EFF was a 1 percent lower than projected cotton exports.

tween alternative policy strategies and the divergences of views between IMF staff and the authorities as to the best option. For instance, when programs went along with the authorities' preference for imposing a turnover tax on traders instead of putting them under the GST net, as favored by staff, or for a tax registration drive instead of focused improvements in tax collection, only the retained options were presented, with no detailed discussion of their merits and downsides relative to the alternative. Likewise, disagreements between staff and the authorities (as well as within staff) on the appropriate exit strategy from the FCDs freeze were not discussed in the reports.

#### ***Only limited ex post evaluation of UFR was undertaken***

62. Another function of surveillance that was regrettably toned down in most Article IV reports—

and in other Board documents—since 1988 is the ex post evaluation of UFR experiences. Among earlier reports, only the report on the 1991 Article IV consultation provides a detailed review of performance under previous programs. Subsequent surveillance reports gave only limited factual accounts of the most recent UFR performance, and were generally silent about the recurrent implementation difficulties that were encountered, in contrast with the more critical tone of internal documents.<sup>50</sup> The 2000 Article IV report represented a marked improvement in that respect, by taking a long-term look at past economic performance, but it did not examine the reasons for the failures of the previous, or earlier, programs.

### **Internal governance issues occasionally contributed to program design imperfections**

#### ***Excessive attention is paid to fine-tuning the financial programming framework***

63. While a sound and internally consistent macroeconomic framework is essential to the success of any adjustment program, the IMF's "financial programming" framework, as implemented in practice in Pakistan, suffered from several imperfections that took extra significance owing to one major weakness: the soundness of the framework itself is heavily dependent upon the realism of growth targets. In Pakistan, for reasons discussed above, strong incentives to be overoptimistic were at play.

64. First, the precision with which quantitative targets are set (and monitored) is at odds with the severe imperfections of the data they are based on. Second, the weight attached to these targets in setting appropriate macroeconomic policies (and later appraising them) often does not recognize sufficiently the considerable uncertainties attached to the underlying behavioral relationships. In light of these considerations, the authorities and most staff were of the view that too much time had been spent on "fine-tuning" the financial programming variables, at both the negotiation and subsequent monitoring stages,

<sup>50</sup>Even internal documents, however, did not go beyond the stage of taking note of past implementation difficulties. The only effort to take stock of past experience and draw strategic orientations for future IMF involvement was done in a 1993 country strategy paper (CSP), but its close links with the briefing paper for the negotiation of what became the 1994 EFF/ESAF limited its "strategic" value, and the lessons it drew from past experience did not appear to be consistently reflected in the design of subsequent programs. No other CSP was prepared since then, even after CSPs were given new impetus in 1997 through guidelines aimed at making them a prime vehicle for staff to step back from the contingencies of program negotiations, learn lessons from past country experience, and design an optimal strategy for the IMF's involvement in the country.

when the time could have been better spent on more fundamental issues.

65. Issues that, according to IMF staff members themselves, did not receive sufficient attention as a result of this process in Pakistan are real economy dynamics (in particular the links between the policy variables monitored under programs and economic outcomes), analysis of the sources of growth, and impact on economic performance of a variety of exogenous shocks.

#### ***Some of the incentives to which IMF staff is subject may have perverse effects***

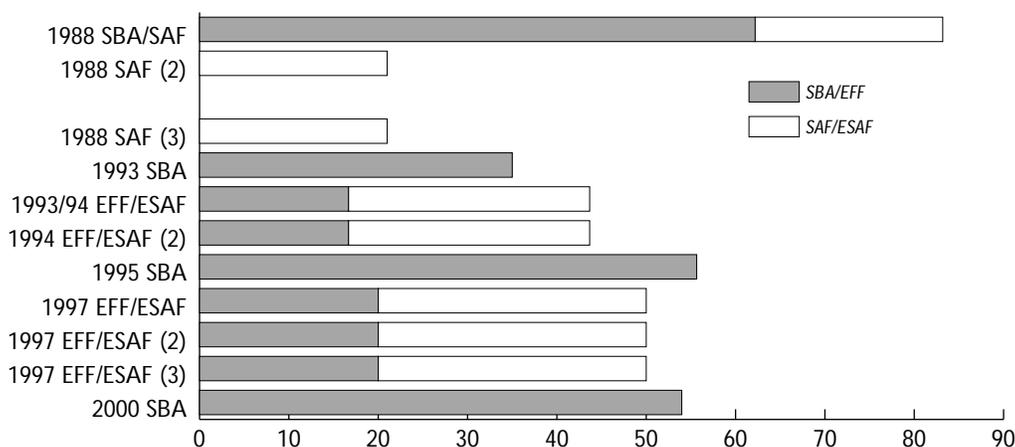
66. There is a rather widespread perception, shared by Pakistan officials and many IMF staff, that the decision-making process of the IMF was biased toward programs that look "tough" on paper, even if there were substantial doubts about their realism. A number of IMF staff who have worked on one or more programs with Pakistan noted that the internal incentive system rewarded toughness more than realism, and that negotiating a program with ambitious objectives and few departures from the mission brief smoothed the internal review process considerably, whereas attempts to be realistic and accommodative of the authorities' concerns—legitimate or not—did not.

67. Furthermore, a majority of staff interviewed expressed the view that the excessive attention paid to the fine-tuning of the financial programming reflected the focus of the internal review process on that aspect of programs,<sup>51</sup> at the expense of much greater attention to judgments on ownership and the capacity of the authorities to implement the policy undertakings couched in the program. While the move from the ESAF to the PRGF/PRSP approach was intended to bring about improvements in that respect, it is too early to judge whether this shift in emphasis will succeed.<sup>52</sup>

68. While there is no such intentional bias in internal guidelines, the fact remains that most of the concerns expressed on Pakistan's UFR requests by internal reviewers and in the record of Executive Board meetings were related to the lack of ambitiousness of the programs, in relation to both macroeconomic and structural aspects, not to their lack of realism or difficulty to implement.

<sup>51</sup>This focus itself is in large part a reflection of the legal framework of programs, which involves cumbersome and—from the authorities' standpoint—embarrassing procedures in case of deviations from targets, no matter how small.

<sup>52</sup>The first PRGF for Pakistan was approved in late 2001, and the interim PRSP was finalized not long before the IEO mission to that country. As such, both are beyond the scope of this evaluation.

**Figure 9.7. Pakistan: Evolution of Access in IMF Arrangements***(Average annualized access in percent of quota)*

Source: IMF Policy Development and Review Department.

69. A related problem is staff turnover, which accelerated dramatically in the 1990s.<sup>53</sup> While Pakistan's experience is broadly in line with recent Fund-wide practice (see Chapter 4 of Part I), it has led the authorities to feel that significant amounts of time are wasted, in the conduct of negotiations, as new mission members gain familiarity with the issues at stake.

70. Finally, Pakistan officials noted that IMF Resident Representatives played a very useful role, and they were generally very complimentary about their inputs. However, they felt that the Resident Representatives' better understanding of "ground realities" was not sufficiently taken into account in policy formulation at IMF headquarters.

### **Several internal guidelines were not fully implemented**

71. Over time, the IMF has developed a series of internal guidelines aimed at ensuring an efficient use of its resources, either specific to prolonged users or applicable to all UFR cases (see Chapter 3 of Part I for a detailed discussion). While it is unlikely that a full implementation of these guidelines would have avoided Pakistan's prolonged UFR, or would have had a dramatic impact on program ef-

fectiveness, two procedural slippages are nevertheless worth mentioning.

72. First, general guidelines on the justification of the level of access and the capacity to repay the IMF call for particularly strong motivation in cases involving prolonged use and/or a poor track record. In practice, such discussions have been largely superficial in successive UFR reports on Pakistan, even though approved access was always on the generous side of the range until the end of the period and increased moderately over time instead of decreasing (see Figure 9.7).

73. Second, the guidelines specific to prolonged users, as endorsed by the Executive Board in 1984 and 1991, do not appear to have been fully adhered to. These guidelines require a proactive use of program design to ensure strong implementation (track record requirements, prior actions, back-loading of disbursements, diminishing access, etc.), along with a critical appraisal in staff reports of performance under previous programs and an analysis of the reasons why their objectives were not achieved. As noted earlier, candid ex post assessments were undertaken only rarely.

## **Conclusions and Suggested Remedies**

74. The various factors discussed in this report are present to some extent in many IMF-supported programs, and it is clearly their combination, more than the isolated influence of any single one of them, that resulted in a limited effectiveness of programs and a consequent prolonged use of IMF resources. More-

<sup>53</sup>Pakistan had six different mission chiefs and nine different desk economists over 1990–2000. Only two of the desk economists subsequently became mission chief. However, some greater continuity was provided by the fact that the Department Director, or another senior staff member, typically participated in key aspects of the discussions.

over, the IMF was clearly faced with an extremely difficult situation in Pakistan, and one where the ability of any external agency to achieve a better outcome would be limited. In the absence of any way of testing a counterfactual, it is impossible to state with certainty that any alternative course of action by the IMF would have led to a better outcome. However, the following lessons are worth pointing out. These issues are discussed in greater depth in Part I.

### **Program design was affected by pressures to overpromise and downplay risks**

75. A number of factors led IMF staff and the Pakistan authorities to agree to programs that were overoptimistic in their assumptions and that favored quick fixes over more difficult but essential reforms. At the stage of program implementation, these pressures led to actions that sometimes met the letter but not spirit of the agreements. In other cases, the agreed policies were only partially implemented, in a way that turned out to have adverse side effects (e.g., reducing tariffs with no replacement tax in place), while other critical steps (e.g., the strengthening of domestic tax collection) were not insisted upon. A more consistent and proactive use of conditionality, track record requirements, and other monitoring devices might have improved the outcome of successive programs. But beyond that, to address these problems in future IMF programs, each of the following factors deserves some attention:

- The pressures for an IMF-supported program to produce “success” in a very short time frame: it is counterproductive to try to cram long-term reforms into an unrealistically short time frame, especially with regard to the implementation of complex reforms that may be central to longer-term sustainability. In some cases, this might call for more realistic assessments of the possible speed of adjustment. In this context, more thought needs to be given to the question of how to deal with the implementation of long-term institutional reforms, such as reform of the tax system/administration, that stretch beyond the time period of programs and where, by their nature, it is often not possible to condense the needed action into only a few concrete measures. This is true whether these reforms are critical to macroeconomic stability (i.e., clearly related to a core IMF responsibility) or critical to future growth/poverty reduction in some other way that is less clearly an IMF core responsibility (e.g., public enterprise reform and other forms of institutional reform). The Pakistan case illustrates that just requiring a law to be passed, for example, is not sufficient. On the latter aspects, an important

lesson is the importance of the IMF engaging with partners such as the World Bank and others to ensure that all such reforms are given appropriate external support (as a better option than trying to expand the IMF’s own mandate).

- Pressures to agree a “seal of approval” for other financing. This raises questions about whether the seal of approval could be given in another way, and the risks of devaluing the seal of approval if these pressures lead to poor quality IMF-supported programs.
- The perception, at least, that political influences on the IMF determined the outcome: eliminating political considerations altogether would not be realistic, since the IMF as an institution should respond to its shareholders, whose views should be taken into account in difficult cases where judgments as whether or not to proceed are finely balanced. But such political judgments should be made in as transparent a manner as possible, that is, at the level of the Executive Board, which is accountable for them, and should be distinct from technical assessments by the staff. Candid staff reports, with a clear discussion of implementation risks and their consequences, is one way of ensuring such transparency.

### **Programs did not always focus on the right issues**

- Tailoring programs as closely as possible to country-specific circumstances would be instrumental in “getting the program design right,” that is, (i) building as much as possible on domestic policy formulation, based on local expertise, to determine what reforms need to be made, in what sequence, what is feasible in a given time frame, and what milestones would constitute meaningful benchmarks to measure progress (in the spirit of the strategy followed for tax administration reform in the recent PRGF); (ii) showing flexibility in the face of unexpected developments: either exogenous shocks, or when the policies agreed upon do not produce the intended/expected results. That implies being prepared to question the validity of initial assumptions and to communicate about revisions made necessary by initial design flaws in a way that clearly distinguishes them from policy slippages. Meaningful sensitivity analyses ex ante could help prepare adequate contingency plans.
- More attention should be devoted to debt sustainability issues. The debt crisis faced by Pakistan in late 1999/2000 rightly, but belatedly, led IMF staff to focus on that issue. Recent initia-

tives to bring more discipline and consistency to sustainability assessments are a further step in the right direction.

### **Ownership matters enormously, and should be linked to greater selectivity**

76. This issue goes beyond ownership of the program by the immediate economic team. Had the IMF insisted more on the presence of strong ownership and devoted greater efforts to promoting it, *ex ante* design flaws might have been reduced by a more substantive negotiation process, as the authorities would have refused to commit themselves to undertakings viewed as unrealistic or ill-suited to the needs of the country. Similarly, *ex post* side effects could have been mitigated by stronger and more consistent implementation. Political and institutional factors would have still existed, but they would have become less critical.

77. This approach also implies greater selectivity: the IMF should refrain from providing resources in support of a program that is not genuinely owned by the authorities and when there is not a strong commitment to a core set of necessary adjustment and reform measures. This can imply either fewer IMF-supported programs or more focused programs. It also implies dedicating more resources and attention to assessing implementation capacity (of which ownership is a strong component) and political feasibility, and being more candid about uncertainties and downside risks in documents submitted to IMF management and to the Executive Board. In retrospect,

some of the programs with Pakistan would probably not have been entered into had these precautions been taken (especially considering that, in the absence of candid assessments of the implementation risks, the Board generally regretted that those programs were not more demanding). Clearly, greater selectivity in those circumstances might have implied a worsening of economic conditions in the short run, perhaps to the point of a full-blown crisis, and such implications are not to be taken lightly. However, such an evolution might have been more conducive to the strengthening of ownership needed for adjustment to take root than the provision of new financing in a context where it was *de facto* little more than a device to postpone hard decisions. Clearly, such a judgment is easier to make in hindsight, but this does not mean that the trade-off should not have been faced in those terms at the time.

### **IMF surveillance did not act as a second opinion on program design and performance**

78. This raises the issue of whether the surveillance function can or should be separated from program design and monitoring. At the very least, care must be taken in the relationship with the member country to avoid being trapped in a narrow program perspective. To that end, surveillance should be used as a tool for stepping back from time to time, to take a broader strategic look and to reexamine vulnerabilities, assess alternative strategies, and foster a debate on key reforms that can help build the necessary consensus.

## **APPENDIX 1**

### **An Illustration of Ownership and Political Feasibility Assessment in the Context of the 1993/94 Programs Through the Use of Basic Political Science Tools**

The developments below are drawn from a paper prepared at the IEO's request on "Political Science Tools for Assessing Feasibility and Sustainability of Reforms."<sup>54</sup> They are meant to illustrate the type of analyses that might have been undertaken by

IMF missions to make a methodical assessment of the authorities' ownership of the programs supported by the IMF and of their ability to implement them. There are essentially three different tools: (i) stakeholder analysis, which focuses on the balance of power, policy preferences, and modes of interaction of key individuals and interest groups having a stake in the decision-making process; (ii) institutional analysis, which looks at the institutional dynamics of this process, including the identification of institutions in a position to veto certain reforms, along with an analysis of capacity constraints; and

<sup>54</sup>"Political Science Tools for Assessing Feasibility and Sustainability of Reforms" by Professor Andreas Wimmer, Director of the Department of Political and Cultural Change at the Center for Development Research, University of Bonn, with Indra de Soysa and Christian Wagner. This paper is available on the IEO's website at [www.imf.org/ieo](http://www.imf.org/ieo).

(iii) “Delphi” study, which involves seeking the views of an expert panel in a systematic manner on each of the relevant dimensions of the political economy setting. Each of these tools can be used in three different modes, namely (i) trend extrapolation; (ii) impact analysis; and (iii) scenario building. Scenario building and “Delphi studies” are not meaningful when applied retrospectively. Therefore, they are not discussed in the following presentation.<sup>55</sup> The overall analysis summarized below and the characterizations of the Pakistan politico-administrative system contained therein are those of Wimmer and others (2002) and do not necessarily reflect the views of the IEO.

## Stakeholder Analysis

### Trend extrapolation

- *Reforms under way.* Since coming to power in 1990, the government of Nawaz Sharif favored economic liberalization and had already launched a deregulation program strengthening the private sector. The budget deficit had been brought down (by cutting expenditure in health and education and by reducing public works programs). However, there were no plans to introduce an agricultural tax or increase tax revenues in general. Looking at the measures already undertaken, the government thus seemed to have the political will to continue the process of reforms, and it seemed to enjoy a large enough political basis both at the national and provincial levels to do so. But the existing reform trend was clearly selective and avoided important areas that would have touched the entrenched interests of groups on whose political support the government depended (such as the Jamoori Ittihad coalition—IJI) in Punjab, with its important landowners.

- *Decision-making style.* Political decision making was mostly concentrated in the higher echelons of the government, with major reform steps being decided upon by the inner circle of a relatively isolated group of decision makers and then left to the respective ministers to implement. Despite political rivalries, there was agreement between the main political parties about the necessity to continue reforms. Indeed, Benazir Bhutto, the leader of the opposition in 1993, had declared she would not reverse the process of privatization if she came back to power, and she did not, but under her government decision making followed the same pattern and was likewise restricted to a very

small group of advisers. Given this structure of decision making, a broad ownership of the reforms had certainly not yet developed.

- *Attribution of agency.* IMF-sponsored reforms were generally presented as a bitter pill that the country was forced to swallow by a powerful outsider. Implicitly and sometimes explicitly, however, the message was that the pill would not be consumed as bitter as it looked at the time of the negotiations, given the apparently widespread assumption in the informed public that lending was politically motivated (i.e., the reward of the political alliance with the United States). The style of communication on the reforms thus does not show signs of genuine ownership by the major political forces.

### Impact analysis

The implementation of the program would not have affected the power balance between the army, the prime minister, and the president, given the generous treatment of military expenditures in the proposed agreement. However, the other parts of the political equation would have changed quite a bit. Taxation of agricultural incomes, one of the cornerstones of the agreement, would have seriously reduced the support of the government by the IJI coalition. The increase in indirect taxes may have heightened public discontent and may have strengthened opposition parties. Thanks to the broad agreement between the main parties on the general direction of reforms, this would perhaps not have stopped them, but it would certainly have brought about increased pressures for softening the consequences for the public and taking tax reforms back. The reform of credit-awarding mechanisms would have seriously limited the capacity of government employees to distribute credit along the lines of political patronage, which may have weakened the support of the bureaucracy, traditionally regarded as another important power center in Pakistan. In sum, it seems that effective implementation of the reform program would have shaken at least part of the political basis of the regime and it is doubtful whether it would have survived a comprehensive enforcement of reforms in the tax and financial sectors.

## Institutional Analysis

- *Veto point analysis.* The institutional position of the government was restricted by two factors inherited from military rule: (i) the constitution allowed the indirectly elected president to dismiss the di-

<sup>55</sup>A schematic presentation of these tools and modes is provided in Figure 9.8.

Figure 9.8. Political Economy Analysis Toolbox

		Tools		
		Stakeholder analysis	Institutional analysis	Delphi study
Modes	Trend extrapolation	<ul style="list-style-type: none"> <li>• <i>Reforms under way</i></li> <li>• <i>Decision-making style</i></li> <li>• <i>Attribution of agency</i></li> </ul>	<ul style="list-style-type: none"> <li>• Institutional mapping</li> <li>• <i>Veto point analysis</i></li> <li>• <i>Capacity assessment</i></li> </ul>	General trends
	Impact analysis	<i>Impact on power balance</i>	<i>Impact on institutional setup</i>	General impact
	Scenario building	Scenarios of political events and trends	Scenarios of institutional reforms	General scenarios

Note: Tools in italics are those whose conclusions are reported above.

rectly elected prime minister and his government; (ii) the army was still the most important veto actor that could influence all government decisions (as illustrated by the exclusion of the defense budget from any expenditure cuts undertaken under most IMF-supported programs). Besides these two institutional actors, the bureaucracy and the national assembly (MNA) would have been two other important veto players. Given the strong representation of landed interests within these groups, it was highly unlikely that any law would have been enforced that would seriously introduce taxation on agricultural income. Large parts of the bureaucracy would also not have been in favor of privatization programs that would have implied serious cuts in their domains of political influence.

- *Implementation capacity.* Despite the long tradition of military rule, Pakistan showed a serious weakness of its law and policy enforcing authorities. Widespread corruption, clientelistic practices, and recruitment procedures based on patronage explain at least in part the difficulties in enforcing basic rights and duties in different areas. Most ministries use the large discretionary powers that these deficits imply in order to build up their own net-

work of patronage relationships and therefore enhance their standing in the all-embracing web of political alliances. A good example of this is the way that the Central Board of Revenues interprets the myriads of exemptions in tax law on a case-by-case basis. The situation in public enterprises and in the banking sector was comparable. Every government would face the problem of such deficient implementation capacities, a weakness that would also have an impact on the design of the reform programs. The rise of indirect taxes, for instance, would be favored in order to circumvent the enforcement problems of direct taxation.

## Overall Assessment

Serious doubts about the prospects of future implementation of the program would have had to be raised. The decision-making coalition endorsing the reform was not broadly built. It did not include large sections of the public in order to counterbalance the possible loss of support that effective implementation would have brought about from the power base of the current regime and from within the administration.

## APPENDIX 2

### Pakistan: List of People Interviewed in Connection with the Evaluation of Prolonged Use of IMF Resources

#### Senior Officials

Mr. Mueen Afzal, Secretary General Finance  
 Mr. Shaukat Aziz, Ministry of Finance  
 Mr. A.R. Chughtai, Deputy Governor, State Bank of Pakistan  
 Mr. Ishrat Husain, Governor, State Bank of Pakistan  
 Mr. Ashfaq H. Khan, Economic Adviser, Ministry of Finance  
 Mr. Yunis Khan, Finance Secretary  
 Mr. Mushtaq Malik, Joint Secretary (External Finance), Ministry of Finance  
 Mr. Riaz Ahmad Malik, Chairman, Central Board of Revenue  
 Mr. Altaf M. Saleem, Minister for Privatisation  
 Mr. Murtaza Ahmad Shaikh, Special Assistant to Deputy Chairman, Ministry of Planning & Development  
 Dr. Abdul Naseer, Economic Adviser, State Bank of Pakistan

#### Former Senior Officials

Mr. Aitzaz Ahsan, former Minister of Law and Interior  
 Mr. Qazi M. Alimullah, former Finance Secretary  
 Mr. Sartaj Aziz, former Minister of Finance  
 Mr. H.U. Beg, Chairman, Ad-hoc Public Accounts Committee, and former Finance Secretary  
 Mr. Mushahid Hussain, former Minister for Information  
 Mr. Fakhar Imam, former Minister  
 Mr. Vaseem A. Jafarey, former Governor of State Bank of Pakistan and Adviser to the Prime Minister  
 Mr. A.G.N. Kazi, former Governor, State Bank of Pakistan  
 Mr. M. Farooq Leghari, former President  
 Mr. Saeed Qureshi, former Secretary General Finance

#### Academics

Mr. Akhtar A. Hai, Senior Research Economist/ Associate Professor, Applied Economics Research Centre, University of Karachi  
 Dr. Akmal Hussain, Economist, Syeed Engineering  
 Dr. A.R. Kamal, Director, Pakistan Institute of Development Economics

#### Banking Sector

Mr. S. Ali Raza, President & Chief Executive Officer, National Bank of Pakistan  
 Mr. Masood Karim Shaikh, Chief Financial Officer, National Bank of Pakistan  
 Mr. Zubyr Soomro, Chief Executive & Country Corporate Officer, Citibank

#### Business Community

Dr. Anwarul Haque, Secretary General, The Federation of Pakistan Chambers of Commerce & Industry  
 Mr. Sheikh Javaid, Chairman, The Federation of Pakistan Chambers of Commerce & Industry  
 Mr. Tahir Khaliq, Chief Executive, Chamber of Commerce & Industry, Karachi-Pakistan  
 Dr. Mohammad Zubair Khan, Managing Director, Financial Techniques Internationals (and former Minister of Commerce)  
 Mr. Haroon Rashid, Vice President, The Federation of Pakistan Chambers of Commerce & Industry

#### Journalists

Mr. Farhan Bokhari, Pakistan Correspondent, *Financial Times*  
 Mr. Nadeem Malik, *The News*  
 Mr. M. Ziauddin, Resident Editor, *Dawn*  
 Mr. Arshad A. Zuberi, Deputy Chief Executive, *Business Recorder*  
 Mr. M.A. Zuberi, Editor, *Business Recorder*

#### Nongovernmental Organizations

Mr. Khadim Hussain, Senior Programme Officer, Action Aid Pakistan  
 Dr. Asad Sayeed, Social Policy and Development Centre

#### Trade Union Representatives

Mr. M. Zahoor Awan, Secretary General, All Pakistan Federation of Labour  
 Mr. Raja Khalique A. Khan, Vice President, Pakistan National Federation of Trade Unions

The mission also met with a large number of current and former IMF and World Bank staff involved with these institutions' work on Pakistan.

## APPENDIX 3

## Pakistan: History of Lending Arrangements

	Facility	Date of arrangement	Initial date of expiration	Actual date of expiration <sup>1</sup>	Amount agreed (In thousands of SDRs)	Amount drawn	Percent undrawn
1	SBA	Dec. 8, 1958	Dec. 7, 1959	Sep. 22, 1959	25,000	0	100
2	SBA	Mar. 16, 1965	Mar. 15, 1966		37,500	37,500	0
3	SBA	May 18, 1972	May 17, 1973		100,000	84,000	16
4	SBA	Aug. 11, 1973	Aug. 10, 1974		75,000	75,000	0
5	SBA	Nov. 11, 1974	Nov. 10, 1975		75,000	75,000	0
6	SBA	Mar. 9, 1977	Mar. 8, 1978		80,000	80,000	0
7	EFF	Nov. 24, 1980	Nov. 23, 1983		1,268,000	1,079,000	15
8	SAF	Dec. 28, 1988	Dec. 27, 1991	Dec. 15, 1992	382,410	382,410	0
8	SBA	Dec. 28, 1988	Mar. 7, 1990	Nov. 30, 1990	273,150	194,480	29
9	SBA	Sep. 16, 1993	Sep. 15, 1994	Feb. 22, 1994	265,400	88,000	67
10	ESAF	Feb. 22, 1994	Feb. 21, 1997	Dec. 13, 1995	606,600	172,200	72
10	EFF	Feb. 22, 1994	Feb. 21, 1997	Dec. 13, 1995	379,100	123,200	68
11	SBA	Dec. 13, 1995	Mar. 31, 1997	Sep. 30, 1997	562,590	294,690	48
12	PRGF	Oct. 20, 1997	Oct. 19, 2000		682,380	265,370	61
12	EFF	Oct. 20, 1997	Oct. 19, 2000		454,920	113,740	75
13	SBA	Nov. 29, 2000	Sep. 30, 2001		465,000	465,000	0
Total					4,071,550	2,099,090	

<sup>1</sup>If different from initial date of expiration.

## Introduction

1. The Philippines is probably the most extreme case of prolonged use of IMF resources, with 23 programs between 1962 and 2000. Over the 30-year period 1971–2000, the Philippines had programs for almost 25 years (Table 10.1) with credit outstanding from the IMF continuously since 1967.<sup>1</sup> The Philippines' status as a "prolonged user" was recognized by the Executive Board as early as 1984.<sup>2</sup>

2. This study presents an assessment of the nature of the IMF's prolonged involvement with the Philippines and attempts to draw lessons for the future. The evaluation is based on an extensive review of published and unpublished IMF documents and interviews with (i) current and former Philippine officials and a range of other stakeholders, including academics, NGOs, and representatives of the private sector, undertaken during an IEO mission to Manila in March 2002; (ii) current and former IMF staff; and (iii) staff of the Asian Development Bank, the World Bank, and some bilateral donors. The study is organized as follows: the second section presents a brief overview of the experience over three decades; the third section examines the factors that led to prolonged use; the fourth section focuses on implications for program design and implementation; the fifth section considers the implications of prolonged use for IMF surveillance; and the final section presents conclusions and recommendations.

## Overview of the Philippines' Experience with IMF-Supported Programs

3. The extent of continuous involvement by the IMF in supporting programs in the Philippines is re-

flected in Table 10.1, which lists the various stand-by arrangements (SBAs) and Extended Fund Facility (EFF) programs since 1967.<sup>3</sup> Rather than provide a detailed evaluation of each program, we attempt a summary assessment of the experience in four distinct periods.

### The Marcos period prior to the 1982–83 debt crisis: almost continuous programs that achieved no lasting adjustment

4. In this period there were a total of 10 SBAs and one EFF in 15 years but this near continuous involvement with the IMF did not prevent a widening of external imbalances and a sustained debt buildup that eventually resulted in a crisis.

5. The deterioration in economic performance and vulnerability is evident from Table 10.2. Economic growth was relatively strong during the 1970s, averaging 6 percent a year, but it fell to about 2½ percent in 1981–83. After approximate balance in the first half of the 1970s, a large current account deficit emerged from 1975—averaging 5½ percent of GNP in the second half and rising to 8 percent in 1981–83. The higher deficit was financed by rising external debt, most of which was directed to financing large-scale investment projects that subsequently proved to be of low efficiency. Programs struggled to deal with the aftermath of the liquidity expansion associated with the 1973 increase in commodity prices and a subsequent deterioration in the terms of trade later in the decade. The two oil price shocks of 1973 and 1980 also added to these challenges. A major structural weakness that developed over the period, and was to plague the Philippines for a long time, was a fall in gross national saving. This deterioration partly reflected a worsening fiscal balance that changed from a surplus of 0.6 percent of GNP<sup>4</sup> on

<sup>1</sup>Amounts outstanding were initially small as a percentage of quota, in line with general IMF policies at the time, but then rose quickly to the 250–300 percent range by the time of the 1982 debt crisis. They declined by the mid-1990s, but picked up again in the aftermath of the Asian and Russian crises.

<sup>2</sup>See "Prolonged Use of Fund Resources," SM/84/91, April 27, 1984.

<sup>3</sup>There were also several precautionary SBAs prior to this starting in 1962. The background paper to the 1984 review of prolonged use of IMF resources contains a detailed review of the IMF's involvement in the Philippines since the 1960s. See also Boughton (2001).

<sup>4</sup>National government balance.

**Table 10.1. Philippines: Chronology of IMF Arrangements Since 1967<sup>1</sup>***(In millions of SDRs)*

Type of arrangement	Date of arrangement	Original expiration date <sup>2</sup>	Actual expiration date or cancellation	Size of arrangement	Percent drawn	Paris Club debt restructuring	Commercial bank restructuring
SBA	Jan. 1967		Jan. 1968	55.0	100.0		
SBA	March 1968		Mar. 1969	27.5	100.0		
SBA	Feb. 1970		Feb. 1971	27.5	100.0		
SBA	Mar. 1971		Mar. 1972	45.0	77.8		
SBA	May 1972		May 1973	45.0	77.8		
SBA	May 1973		May 1974	29.0	0.0		
SBA	July 1974	July 1975	May 1975	38.8	100.0		
SBA	May 1975	May 1976	Apr. 1976	29.1	99.9		
EFF	Apr. 1976		Apr. 1979	217.0	100.0		
SBA	June 1979		Dec. 1979	105.0	86.9		
SBA	Feb. 1980		Dec. 1981	410.0	100.0		
SBA	Feb. 1983		Feb. 1984	315.0	31.7		
SBA	Dec. 1984	Dec. 1986	June 1986	615.0	65.5	Dec. 1984	Jan. 1986
SBA	Oct. 1986	Apr. 1988	Aug. 1988	198.0	100.0	Jan. 1987	Dec. 1987
EFF	May 1989	May 1992	Feb. 1991	660.6	35.7	May 1989	Jan. 1990
SBA	Feb. 1991	Aug. 1992	Mar. 1993	334.2	100.0	June 1991	Dec. 1992
EFF	June 1994	June 1997	Mar. 1998	791.2	100.0	July 1994	
SBA	Apr. 1998	Mar. 2000	Dec. 2000	1020.8	76.7		

<sup>1</sup>The period 1967–2000 spans four administrations: Marcos, 1967–86; Aquino, 1986–92; Ramos, 1992–98; and Estrada, 1998–2001. The following programs spilled over into succeeding administrations: 1984 SBA, 1991 SBA, and 1998 SBA.

<sup>2</sup>Only if different from the actual expiration date.

**Table 10.2. Philippines: Selected Economic Indicators***(Period average, in percent of GNP, unless otherwise noted)*

	1971–75	1976–80	1981–83	1984–85	1986–88	1989–92	1993–97	1998–2000
Real GNP growth (in percent)	6.1	6.1	2.6	-8.0	5.3	3.5	4.9	2.9
Export growth (in billions of U.S. dollars, in percent)	15.9	20.7	2.8	-3.8	15.2	8.6	20.8	14.7
Inflation (CPI, annual average, in percent)	17.0	12.3	10.9	34.4	5.3	13.0	7.9	6.9
External current account	-0.4	-5.4	-8.1	-2.1	0.2	-3.4	-4.9	7.9 <sup>1</sup>
External debt (in billions of U.S. dollars)	2.5	10.8	23.0	26.0	28.3	29.3	40.3	50.5
Debt-service ratio (in percent, after rescheduling)	23.4	33.5	33.0	39.7	34.7	22.9	16.8	14.8
National government fiscal balance	0.6	-1.3	-3.4	-1.9	-3.5	-2.2	-0.3	-3.7
Consolidated public sector balance	...	...	-4.5	-7.2	-3.8	-3.3	-0.6	-3.7
Tax revenue	10.3	12.1	10.3	9.9	11.3	14.2	16.1	13.9
Gross national saving	n.a.	27.7	23.4	17.5	19.5	19.8	18.2	24.5 <sup>1</sup>
Gross investment	...	...	...	16.6	15.6	19.8	23.4	17.9

Sources: IMF staff reports and WEO database.

<sup>1</sup>National saving may well be overstated in 1998–2000, because of statistical weaknesses, particularly suspected underrecording of imports, which led the current account also to be overstated.

average in the first half of the decade to a deficit of 3½ percent in 1981–83.

6. Several sources of structural inefficiency also prevailed in this period. A system of monopolistic practices allowed political favorites to extract eco-

nomics rents especially in key agricultural marketing areas (sugar, coconuts, bananas, etc.) that weakened incentives and harmed small producers, who were among the poorest groups. Inadequate governance and supervisory controls allowed widespread lending

to insiders by financial institutions, including publicly owned banks. Several Article IV staff reports did discuss the distortions caused by the monopolistic practices, but—reflecting the general approach of IMF-supported programs at this time—there was little effort to address these issues in any of the programs prior to 1984. Some structural measures to make the economy more export oriented were implemented in 1970–72, including liberalization of exchange controls and tariff reforms. However, the main structural component of the 1976 EFF—an effort to improve the tax effort—failed.<sup>5</sup>

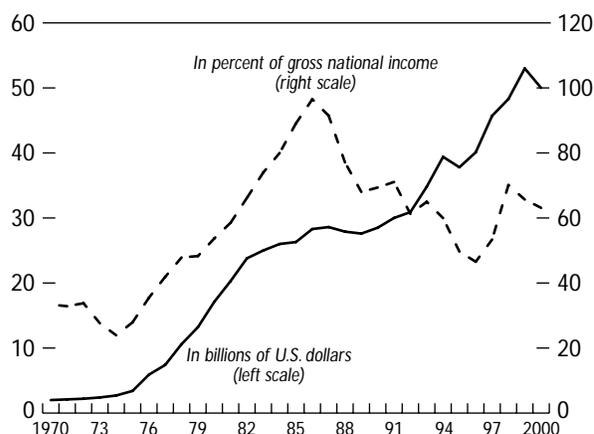
7. The rapid buildup in external indebtedness in the second half of the 1970s (Figure 10.1), which in part reflected excess liquidity in the industrial countries, eventually resulted in a serious economic and financial crisis culminating in a standstill on external debt service in October 1983. The standstill was accompanied by widespread failure of domestic banks and corporations, and a subsequent recession. The discovery that the authorities had misstated the international reserves position exacerbated the crisis and contributed to a program agreed in early 1983 going quickly off-track. Although staff reports show an awareness of the dangers of the debt buildup, programs were not able to address in a systematic way the factors that were leading to it.<sup>6,7</sup> Moreover, the risks to the quasi-fiscal deficit implied by a series of exchange rate guarantees and forward cover arrangements were not fully recog-

<sup>5</sup>The EFF initially targeted an increase in the ratio of tax to GNP from 13½ percent in 1975 to 16 percent in 1978; the actual outturn in the latter year was under 14 percent. This largely reflected shortfalls in indirect taxes but does not appear to have been related to adverse exogenous shocks since real growth was broadly on target and the terms of trade were better than expected under the program.

<sup>6</sup>Moreover, at the time there were significant IMF-wide shortcomings in the design of limits on the external debt contracted by the public sector, in particular the exclusion of short-term debt from these performance criteria and insufficient attention paid to the impact of public guarantees on external debt contracted by the private sector. These problems are now well recognized, and external debt ceilings generally now have a more comprehensive coverage.

<sup>7</sup>The internal 1984 review of prolonged use was quite candid in its assessment of the reasons why the long series of programs with the Philippines had failed to achieve their targets. For example, it noted that, while growth had been quite high for much of the period, “these developments reflected, in part, an unsustainable accumulation of foreign debt as the external position and domestic saving performance remained unsatisfactory. . . . Subsequently, unfavorable external developments, inadequate structural policies, and inadequate demand-management policies, in particular in 1981–83, resulted in a sharp worsening of the balance of payments position.” It also noted the problems with wasteful public expenditure but shied away from an explicit discussion of governance-related factors: “A significant part of the public investment program, which was largely financed abroad, consisted of projects with doubtful economic justification.” See “Prolonged Use of Fund Resources,” SM/84/91, April 27, 1984.

Figure 10.1. Philippines: External Debt



Sources: IMF staff reports.

nized and eventually contributed to significant central bank losses when the exchange rate depreciated sharply following the crisis.

8. It is interesting to note that economic performance deteriorated and vulnerabilities increased despite the fact that most of the specific performance criteria in the various programs were satisfied and 94 percent of the amount committed in arrangements between 1968 and 1981 were disbursed. This suggests that the problem was not just one of program implementation.

9. Staff and former staff interviewed who were involved with the Philippines during this period, or in its immediate aftermath, were generally of the view that the extensive IMF involvement for much of the Marcos era had been a mistake, sending the wrong signals to markets and effectively helping to postpone adjustment. This was also the view of most of those with whom the evaluation team discussed the issue in the Philippines. A number of officials as well as some staff and former staff also expressed the view that, until 1983, political factors—that is, the close relationship between the Philippines under the Marcos regime and the United States as well as, to a lesser extent, some other major IMF shareholders—were important in explaining the lengthy IMF involvement during this period. We have not found any documentary evidence to support such a judgment, but the fact that such a view is held by a number of those who were close to the negotiations is, in itself, significant.

10. However, it has to be recognized that the IMF was dealing with a very difficult situation—epitomized by deep-seated governance problems and a lack of commitment to fundamental reform at the

highest political level—at a time when it did not have adequate instruments, or even an explicit policy, for addressing such issues.<sup>8</sup> While greater attention at an early stage to the structural and institutional problems discussed above might have helped, it is quite likely that program design was not the core issue. In these circumstances, it would have been better for the IMF to have refrained from lending.

### The debt crisis and subsequent prolonged debt workout, 1983–93

11. In the 10-year period following the onset of the debt crisis, the Philippines had to undergo a protracted adjustment to correct the initially large external imbalances and to deal with the accumulated debt problem. There were five programs in this period, spanning the last year of the Marcos administration, the whole of the successor Aquino administration, and the early days of the Ramos administration.

12. As noted above, the 1983 SBA quickly went off-track and, after an interval of nearly a year, was followed by the 1984–86 SBA, the last of the Marcos administration, which prescribed tight macroeconomic policies combined with floating of the exchange rate. The program also made a significant effort to address some of the major structural problems, most notably to dismantle the sugar and coconut monopolies, to establish a more elastic domestic tax system to replace taxes on trade, and to rehabilitate public financial institutions and strengthen control over public sector investment decisions. The program went off-track because of policy slippages in the run-up to the February 1986 election. Fiscal policy turned sharply expansionary and implementation of reforms to the tax system and the sugar and coconut sectors and import liberalization were delayed, with several measures reversed. The program did achieve a sharp reduction in inflation, while there was an even greater current account adjustment than envisaged under the program. This sharp adjustment was driven by the cutoff in private external financing and involved a large contraction in imports and in economic activity. Real GNP fell by a cumulative 17 percent during 1984–85, compared with the projected 7 percent fall.

13. The Aquino administration negotiated three arrangements with the IMF: an initial SBA in 1986, which was successfully completed; an ambitious, growth-oriented EFF covering 1989–91 that quickly went off-track as a result of major policy slippages

<sup>8</sup>A guidance note on governance calling for a more comprehensive treatment of governance issues and a more proactive approach in advocating policies that promote good governance were only approved by the Executive Board in 1997. See IMF (1997 and 2001b).

amid considerable political instability and severe exogenous shocks (Box 10.1); and finally, in 1991, a less ambitious SBA—successfully completed—that focused on stabilizing the economy in the run-up to the May 1992 election, which was won by President Ramos.

14. The programs negotiated with the Aquino administration increased the focus on structural reforms with greater emphasis on dismantling the administrative and other restrictions that had hindered private sector activity and exports, distorted prices, and favored inefficient industries and vested interests. While continuing to aim at improving public sector revenue and the elasticity of the tax system, the tax reforms envisaged were more far-reaching than earlier reforms, paying greater attention to the structure of incentives and equity. There was initial success on reforms covering trade, taxes, and the agricultural sector, especially in those areas that represented a dismantling of the “crony capitalism” privileges of the Marcos era and the creation of a more level playing field. However, progress then slowed, as the administration tackled more politically sensitive structural issues.

15. The realignment of incentives for exports, arising from the exchange rate depreciation and trade liberalization in the 1980s, led to a sharp improvement in export performance as reflected in the growth rate of over 15 percent a year in the period 1986–88. Rapid export growth, combined with the series of reschedulings of commercial bank and official debt, contributed to a significant reduction in the Philippines’ external debt problems. Indicators of the debt and debt-service burden started to improve markedly in the late 1980s with the debt-service ratio (after rescheduling) falling to below 20 percent in the early 1990s and to 14 percent by the mid-1990s. The debt/GNP ratio fell from a peak of 100 percent in 1985 to less than 60 percent in 1992.<sup>9</sup>

### The 1994 EFF: restoration of access to private financial markets and the planned “exit” from IMF programs

16. From the time of the accession of the Ramos administration in 1992, staff and management planned a final EFF explicitly intended to be an “exit program” from prolonged use. In the view of staff, a recurrence of external financing problems could not be ruled out if the economy were to resume sustained growth of 5 percent a year or more and further structural changes were needed to ensure medium-

<sup>9</sup>Public debt service also fell—from an average of 48 percent of central government revenue in 1986–88 to 26 percent in 1994–97.

### Box 10.1. Why Did the 1989 EFF Fail?<sup>1</sup>

One important development that prolonged the length of the Philippines' adjustment was the failure of the 1989 EFF to achieve its objectives. The three-year program was intended to be growth oriented: (i) the targets for investment and saving were ambitious, while the current account deficit was projected to increase modestly rather than decline; (ii) the fiscal program allowed for a substantial increase in public infrastructure investment, to be financed by higher public saving but also by a modest increase in the fiscal deficit in the first year; and (iii) a wide range of structural reforms, including financial sector strengthening, trade reform, privatization, power tariff reform, foreign investment and exchange market reform, elimination of the Central Bank deficits, and land reform. Unfortunately, actual performance fell well short of these objectives. Rather than going through a consolidation phase with rapid growth, the economy slipped back into significant vulnerability: growth declined; inflation accelerated; and both the fiscal and current account deficits widened sharply.

Three sets of factors accounted for the disappointing performance:

- **Adverse exogenous shocks**, in the form of considerable political instability with several coup attempts; natural disasters (including a drought, typhoon, and severe earthquake); and an unanticipated 10 percent weakening in the terms of trade. While these adverse shocks put the short-term balance of payments and growth objectives out of reach, they were temporary in nature and, by themselves, should not have caused the program to fail in its longer-term objectives.<sup>2</sup> But the degree of political instability that occurred would have been hard to predict.
- **Program design issues**, including: (i) A structural reform agenda that proved to be overambitious and insufficiently prioritized, especially in the context of a newly restored Congress that wanted a sub-

stantial say in economic policy matters. In retrospect, it would have been better to have concentrated on a shorter and more specific agenda.<sup>3</sup> (ii) An overoptimistic projection of the speed of recovery in private investment, reflecting an apparent underestimation of the adverse impact of the debt overhang on investment.<sup>4</sup> (iii) The program rightly placed more emphasis on measures to improve tax administration and compliance rather than on discretionary measures. However, this posed challenges for program design since the revenue impact was uncertain in terms of both magnitude and timing—and progress proved slower than expected. (iv) The move to six-monthly performance criteria appears to have been a mistake. It permitted the buildup of large policy slippages that proved too large to correct by the time of the next test dates. Quarterly performance criteria were reinstated in June 1990.

- **Weaknesses in program implementation** were probably most important of all, although the timetable of reforms would have been difficult to deliver even without the disruptions caused by the coup attempts. The Government's ability to implement the program was hampered by its inability to pursue its economic policy agenda—particularly revenue and structural reform measures—in Congress, a constraint that had been insufficiently recognized when the program was prepared. Some actions by Congress that were opposed by the Government—notably approval of a large wage increase and a cut in oil taxes—seriously aggravated the fiscal situation.<sup>5</sup>

<sup>3</sup>For example, internal assessments by the staff suggest that the lack of specificity in the program on action to deal with the central bank deficit contributed to the lack of progress in this area.

<sup>4</sup>Overoptimistic projection of investment appears to be a common problem in program design. See Goldsborough and others (1996).

<sup>5</sup>Implementation problems began at the outset of the program when the authorities indicated that the oil price increase agreed upon as a prior action would have to be delayed. Combined with an unanticipated increase in world oil prices, the delay had a significant fiscal impact. Oil price issues remained highly sensitive, since the December 1989 coup attempt was timed to coincide with the date of the postponed price increase, in order to exploit expected social unrest.

<sup>1</sup>This box draws in part on internal ex post staff assessments, which were quite candid, but tended to put even more emphasis on implementation failures.

<sup>2</sup>IMF staff estimates suggest that the natural disasters accounted for about half of the deterioration in the external current account, mostly financed through foreign emergency assistance.

term viability. A new three-year EFF was agreed in June 1994 after lengthy negotiations with the Ramos administration. In the interim, the Philippines had regained access to international capital markets when it floated a \$150 million Eurobond issue in 1993. It also resumed servicing Paris Club debt, although it would soon seek further rescheduling.

17. The 1994 EFF aimed at fiscal consolidation; tax reform; financial sector reform; and continued economic liberalization, particularly in the fields of the deregulation of oil pricing and the abolition of remaining quantitative import restrictions (Box 10.2). In order to meet program objectives, it was judged necessary to improve the saving/investment

### Box 10.2. Original Aims and Outcomes of the EFF, 1994–96

Aims	Outcomes
<b>Macroeconomic targets</b>	
Increase investment by 3 percentage points of GNP.	In 1996, investment was 23.1 percent of GNP, slightly lower than in 1994.
Reduce the current account deficit to about 3 percent of GNP from 6 percent of GNP.	The current account deficit was 4.6 percent of GNP in 1996.
Increase national saving by 6 percentage points of GNP by 1996, almost all through fiscal adjustment.	By 1996, the saving rate had risen just 0.8 percentage points.
Reduce consolidated public sector deficit (CPSD) from 2.7 percent of GNP in 1993 to 0.5 percent of GNP by 1996.	Outturn in 1996 was a surplus of 0.2 percent of GNP.
Reduce <i>underlying</i> CPSD <sup>1</sup> from 4.2 percent of GNP in 1994 to 0.7 percent of GNP by 1996.	Outturn was 0.2 percent of GNP.
Raise government tax revenue by 4 percentage points of GNP between 1993 and 1996.	Tax revenue rose just 1 percentage point.
Increase real GNP growth from 2.3 percent in 1993 to 5 percent by 1996.	Real GNP growth exceeded the target, rising to 7¼ percent in 1996.
<b>Key structural measures</b>	
Tax reform, including adoption of a minimum business tax, phased abolition of tax exemptions, and improved VAT administration.	Comprehensive tax reform was eventually passed in December 1997 but major tax exemptions and incentives remained. Minimum business tax based on sales, not assets. Tax administration weaknesses remained.
Deregulation of oil pricing and importation.	Deregulation of oil prices was completed in early 1998 and the Oil Price Stabilization Fund abolished.
Tariff reduction and elimination of nearly all quantitative import restrictions.	Quantitative import restrictions were removed (except for rice). Average tariff was reduced to 15 percent.
Public expenditure reform.	Legislative action on rationalizing civil service stalled.
Local government devolution.	Devolution of public expenditure did not match large increase in transfers to local government.

<sup>1</sup>The underlying CPSD treats privatization receipts “below the line,” rather than “above the line” as in the standard CPSD.

balance significantly, and this was to be achieved through a substantial fiscal adjustment. The program aimed at increasing tax revenue by nearly 4 percentage points, to 19 percent of GNP, over the three-year period by broadening the tax base, reducing exemptions, and improving tax administration.

18. An interesting feature of the EFF-supported program is that the fiscal targets of the program were met—mainly because of lower interest payments and lower public investment than targeted—although the aim of increasing tax revenue was not achieved. Tax revenues rose by only 1 percent of GNP over the period. Thus it was possible to meet the fiscal targets even though the structural strengthening on the tax side had only partially occurred, leaving the economy vulnerable on this front when economic circumstances changed.

19. Considerable progress was made on some of the structural measures included in the program. Under the Ramos administration, banking, telecommunications, domestic shipping, and the oil sector were opened to new competition, and limits on foreign participation were eased in a number of sectors. Import tariffs were reduced markedly, and quantitative import restrictions largely eliminated. The privatization program was accelerated, and the central bank recapitalized under a new statute. However—as discussed in the section “Implications for Program Design and Implementation”—progress in implementing tax reform proposals was slower and less complete than envisaged. The 1994 EFF was associated with improved export performance and a modest improvement in growth, but it did not bring about the sustained current account adjustment originally

envisaged. Until the Asian crisis, however, the current account deficit was easily financed by buoyant capital flows.

20. In retrospect, it can be questioned whether the 1994 EFF was needed—in a balance of payments sense—and we take up this issue in the section “Why Did the IMF Remain Involved for So Long?” In any event, since financing problems eased subsequently, the authorities began to treat the EFF as precautionary after the initial purchase—indicating their intention to refrain from further purchases. As the fourth and supposedly final review approached in early 1997, staff briefing papers noted that the authorities were looking forward to a graceful exit from a long line of IMF arrangements, but delays in the progress on the tax reform because of opposition in Congress meant that the review could not be completed as scheduled. Rather than let the program lapse, the authorities requested an extension as they wanted to “graduate” on a successful note, following passage of the Comprehensive Tax Reform Package (CTRP) by Congress. The original extension of the arrangement was not therefore driven primarily by a perception of balance of payments need, but rather the desire to end the program successfully. However, before this could happen, the program was overtaken by the Asian crisis.

### Asian crisis and its aftermath

21. As the Asian crisis hit, the EFF was augmented and further extended first until December 1997 and then to March 1998 and the authorities again decided to draw on the program. The peso was floated in July 1997.<sup>10</sup> Initially, the authorities showed no interest in a follow-on arrangement, in part because graduation from IMF-supported programs had become a political issue in the Philippines. However, as the regional crisis unfolded, both the authorities and IMF management became concerned about the risks of such an exit amid the turbulent financial market conditions. The IMF management was anxious to have a “follow-on” program to help ring-fence the Asian crisis and also to serve as a policy blueprint for the new administration which would take over following the May 1998 presidential election. Fund management

<sup>10</sup>Exchange rate policy was the subject of some disagreement between the staff and the authorities in the mid-1990s. The Philippine peso was pegged de facto to the dollar in late 1995, as the authorities tried to prevent a real appreciation, encouraging short-term capital inflows. The risks of this policy, particularly if capital flows were reversed, were highlighted in the Article IV consultation in December 1996. Following the float of the peso in July 1997, the authorities initially engaged in substantial one-way intervention to support the peso and took other measures designed to prevent depreciation, including limiting access to the foreign exchange market by some foreign banks, while rapidly reducing interest rates contrary to commitments in the letter of intent.

therefore pressed for a precautionary Stand-By Arrangement prior to the elections.<sup>11</sup>

22. The new two-year SBA entered into with the outgoing Ramos administration centered on fiscal and monetary tightening, banking sector reform, improved tax administration, and other structural reforms in order to provide a framework for orderly adjustment to the reduced level of capital inflows. The program included a new emphasis on tax administration, as well as an effort to complete the original CTRP agenda, by reintroducing legislation to reduce tax exemptions and incentives. A revised version of the program<sup>12</sup> was endorsed in October 1998 by the incoming Estrada administration. The program was originally intended to be precautionary but, at the time the revised program was approved, the authorities decided to make purchases in response to reduced access to international capital markets following the Russian default and collapse of Long Term Capital Management.

23. At first, the momentum of the policy envisaged in the program was maintained, but over time policy slippages grew and concerns over governance problems mounted. Policy slippages, related in part to the privatization of the Philippine National Bank, led to a delay of almost a year in completing the Fifth Review until mid-2000.<sup>13</sup> This review was the occasion of a critical discussion in the Executive Board, which focused on persistent policy slippages, governance concerns, and the rationale for continued IMF program involvement. Some Executive Directors were highly critical of the IMF’s prolonged and, in their view, ineffective relationship with the Philippines and raised the issue of the future relationship after the conclusion of the arrangement. A few suggested that the program should become precautionary after the drawing that was the subject of the review.

24. The authorities noted that their earlier exit strategy had been frustrated by the Asian crisis and that they intended to develop a new one. They argued, however, that the reserve position remained somewhat vulnerable, implying a need for further

<sup>11</sup>The existing EFF could only have been further extended until June 1998.

<sup>12</sup>The program was revised to take into account weaker economic activity and a deteriorating external environment, in particular through a somewhat looser fiscal stance. It also reflected the announced policy agenda of the new government, with greater attention to corporate governance issues, power sector reform, and medium-term public sector reform in addition to existing planned reforms for the banking sector and tax administration.

<sup>13</sup>The program aimed at the full privatization of the PNB by mid-2000. However, the situation was complicated by the non-transparent acquisition of a controlling stake by a local group, headed by a close associate of then President Estrada, which owned several companies that were nonperforming debtors of PNB, and by the revelation of increasing concerns about the group’s financial position.

IMF support. Staff took the view that, since the IMF's presence in the Philippines had encouraged the implementation of sounder macroeconomic policies and had had an important catalytic effect, a close policy dialogue should be maintained with the authorities, while encouraging an exit from use of IMF resources. In the event, the 1998 SBA was extended to end-2000, but it expired without the last review being completed, as a result of further fiscal slippages, reflecting weak revenue collection and mounting governance concerns. Thereafter, the authorities requested post-program monitoring in line with the expectation of the Board for a country whose credit outstanding exceeds a threshold amount.<sup>14</sup>

25. In defense of the long involvement of the IMF, and particularly its continued involvement in the mid-1990s, it could be argued that, although not all aspects of the 1994 EFF were implemented as planned, it helped the economy to weather the Asian crisis fairly well. The Philippines did not suffer as severe a downturn as its neighbors; growth decelerated but remained positive. This was partly the beneficial consequence of the cumulative impact of structural changes that had been introduced over the years under successive programs, and which accelerated as a result of strong political leadership during the Ramos administration. The generally sound macroeconomic management under the framework of the 1994 EFF<sup>15</sup> probably also helped, although, as already noted, there continued to be differences of view about exchange rate policy. A number of the vulnerabilities that were central to the severity of the dislocation in other economies most affected by the Asian crisis were also present in the Philippines, nonetheless.<sup>16</sup> However, imbalances did not build up

<sup>14</sup>In September 2000 the Executive Board had agreed that, when a member's credit outstanding exceeds a threshold of 100 percent of quota, there should be a presumption that the member will engage in post-program monitoring (PPM) by the IMF of economic developments and policies after the expiration of its arrangement. To this end, the member engages in discussions with the staff on its policies, including a quantified macroeconomic framework. The staff then reports formally to the Board, normally twice a year, on the member's policies, the consistency of the proposed policies with the objective of medium-term viability, and the implications for the member's capacity to repay the IMF.

<sup>15</sup>The question addressed in the section "Continuous Programs Have Limited the Independent Role of Surveillance" is whether surveillance could also have provided the necessary framework.

<sup>16</sup>Over the years of IMF-supported programs, various efforts were made at reform of the financial sector, including the rehabilitation and restructuring of the Philippine National Bank and the Development Bank of the Philippines in the late 1980s. After the opening of foreign direct investment in 1991, most capital account restrictions were removed in a wide-ranging reform in 1992. Measures to strengthen the supervisory and regulatory regime for commercial banks and to increase competition in the banking sector were taken at about the same time. In particular, the move was accompanied by a change in the prudential formula

over as long a period as they had in other Asian countries, in part because earlier problems meant that capital inflows were smaller and did not last for as long prior to the crisis as in the other countries.

### Despite some progress, poverty remains high

26. The incidence of poverty has declined from 45 percent in 1985 to 32 percent in 1997, but remains high in absolute terms. Moreover, income distribution has not changed much in the last three decades and remains among the most unequal in South East Asia: in 2000, the richest 20 percent accounted for over one-half of total expenditure and the poorest 20 percent for about 5 percent.<sup>17</sup> Significant progress was made in improving health and education indicators over the period of IMF program engagement, but these improvements did not match those in other Asian economies, in part neglecting fiscal policy shortcomings.

### Why Did the IMF Remain Involved for So Long?

27. In this section, we explore the main reasons why the IMF became as closely and continuously involved as it did in the Philippines over the past 30 years or so and whether the involvement was consistent with Board guidelines on the subject.

### Starting imbalances and structural problems were large

28. Part of the explanation for prolonged involvement lies in the fact that despite the IMF's long engagement in the Marcos era, imbalances were large when the standstill on external debt service was declared in 1983. The current account deficit reached about 9 percent of GNP in 1982–83. External debt peaked at 100 percent of GNP in 1985, which was

determining the maximum net open foreign exchange position for each bank. Restrictions on entry and operation of foreign banks were eased in the early 1990s to increase competition, and other measures were taken to tighten prudential regulation, including a tightening of minimum capital requirements and the imposition of a liquid asset requirement on foreign currency deposit unit loans. Nevertheless, private credit grew very rapidly ahead of the Asian crisis, and bank supervision and regulation continued to exhibit serious shortcomings compared with best international practice. Since 1998, the authorities have adopted further financial sector reforms, with the help of the IMF and a Banking Sector Reform Loan from the World Bank (Rodlauer and others (2000), Chapter VI: Banking System Reform).

<sup>17</sup>According to the World Bank's World Development Indicators, 2001.

higher than in most of the other problem debtors of the time. Debt service, before rescheduling, was equivalent to about 50 percent of exports of goods and services and private transfers.

29. The Marcos administration also left its successors a daunting legacy of structural problems, including severely indebted state corporations and government financial institutions, including the central bank.<sup>18</sup> A small elite controlled a large part of the economy and proved resistant to many reforms that threatened this control.<sup>19</sup> As a result, the economic system remained quite closed, with patronage playing a dominant role with a limited scope for competition. Many industries benefited from a high degree of protection and there were barriers to the entry of foreign corporations. The Philippines was much more closed than other ASEAN economies even though the economy was smaller in size.

30. Moreover, staff reports were quite candid in indicating that it would take a long time to return to external viability. For example, the staff appraisal in the Request for SBA in 1984 notes that “effective adjustment will undoubtedly require time, stretching well beyond the program period.” Medium-term projections in subsequent program documents continued to imply that the restoration of external viability would take a long while, typically extending well beyond the projection period. Indeed, with hindsight the IMF was at times too pessimistic about the timing of the return to external viability, reflecting the difficulty of predicting when full access to private financial markets would be restored.<sup>20</sup>

### “Seal of approval” influences on IMF program involvement

31. “Seal of approval” considerations, linking the provision of financing or restructuring of debt from

<sup>18</sup>The Central Bank incurred large liabilities, due to the impact of sharp exchange rate depreciation on the cost of the exchange rate guarantees and forward cover arrangements, provided in the early 1980s. The authorities took a policy decision not to monetize these liabilities—which was of critical importance in helping the Philippines avoid high inflation in the aftermath of the crisis—but interest payments on central bank bills issued to cover the losses gave rise to continuous quasi-fiscal deficits and a highly negative net worth. It also affected the Central Bank’s ability to conduct monetary policy. The Central Bank was eventually recapitalized and restructured, under a new statute, in 1993. This was a prior action for the EFF, which was agreed the following year.

<sup>19</sup>See, for example, Bresnan (1986) and Gutierrez and others (1992).

<sup>20</sup>Projections for the 1991 SBA foresaw financing gaps throughout the decade, noting that this pointed to the continued involvement of the IMF and further Paris Club and commercial bank financing packages through the mid-1990s. The 1989 EFF request incorporated financing gaps of \$1.7 billion a year in 1993–95, and suggested that an end to exceptional financing and a return to normal market access might not occur until after 1995.

other creditors to an IMF-supported program, were particularly important during the period 1982–92 as the Philippines sought to work out its external debt problems. IMF programs were formally required in order for Paris Club creditors to reschedule debt. Commercial banks also made it clear to the Philippine authorities that an active IMF-supported program was the sine qua non for the concerted commercial bank lending and restructuring that took place between 1986 and 1992. Apart from the various commercial bank restructurings in 1986, 1987, and 1990, the release of intermediate tranches of new money by commercial banks were also dependent on IMF-supported programs. This remained so until the final Brady restructuring in 1992, which was financed in part from “set-asides” under IMF arrangements together with support from JEXIM, the Japanese export credit agency, and from the World Bank—both of which were also tied to the programs.<sup>21</sup> The timing of donors’ Consultative Groups was also closely related to the inception of IMF-supported programs.

32. Did the debt workout phase in the Philippines—and IMF involvement related to this factor—take longer than in most other countries that encountered debt problems in the 1980s? The answer appears to be no, in large part because the broader international strategy vis-à-vis the middle-income highly indebted countries took about a decade to evolve to the Brady plan. Therefore, most of these countries also had a series of programs lasting a decade or so, linked to debt restructuring (Box 10.3).

33. Even after the Philippines had regained market access in 1993 and IMF-supported programs were no longer required specifically for concerted debt arrangements, they were still seen to satisfy the demand for a positive signal on the macroeconomic framework to donors and private financial markets. In this situation, donors did not formally require an IMF arrangement to be in place in order to provide support, but they appear to have been more comfortable with such an approach. For example, former officials stated that one of the primary rationales for the 1994 EFF was that the authorities felt that, in the light of the Philippines checkered track record, an IMF-supported program would be helpful to reassure lenders as the country started to reaccess international capital markets. Both IMF staff and Philippine officials appear to have been concerned that a discontinuation of the prolonged relationship would be interpreted negatively

<sup>21</sup>More recently, full activation of bilateral swap arrangements with other Asian economies have been tied to the existence of an IMF-supported program. In 1994 the program was also associated with a Paris Club rescheduling but, in this case, the Philippines (uniquely in the history of the Paris Club) eventually decided to cancel the agreed rescheduling, apparently because of the implications for cover from export credit agencies and the questionable need for a rescheduling.

### Box 10.3. Many Highly Indebted Countries Took as Long as the Philippines to Resolve Their Debt Problems and Consequently Also Had Repeated IMF Arrangements

The Philippines is not unusual in the length of time it took to complete the debt workout after the debt crisis of the early 1980s. Most of the heavily indebted middle-income countries that were affected also took about a decade to work out their debt problems with the help of Paris Club reschedulings and commercial bank restructurings, culminating in the Brady restructurings of the early 1990s. Of the 17 highly indebted middle-income countries,<sup>1</sup> Philippines was the eleventh to complete its series of reschedulings with commercial banks and the Paris Club, in July 1994<sup>2</sup> (Table 10.3).

<sup>1</sup>The “Baker 15” countries, plus Costa Rica and Jamaica. Colombia is not shown because it did not reschedule in the relevant period, although it did benefit from concerted lending arrangements with commercial banks in 1985, 1989, and 1991.

<sup>2</sup>If this Paris Club rescheduling, which was never implemented, is discounted the Philippines would rank as the sixth of

Six of these countries completed their restructurings in a concentrated period between 1992 and 1994, with five earlier and six later.

In most of these cases, countries had a succession of IMF-supported programs lasting a decade or more linked to the need for a seal of approval for restructuring. Up until the 1991 SBA tied to the 1992 Brady deal and the 1991 Paris Club rescheduling, the Philippines was fairly typical in the length of programs associated with restructuring. However, to the extent that the abortive Paris Club rescheduling was one of the rationales for the 1994 EFF, which lasted until 1998, IMF involvement linked in some way to restructuring lasted a little longer than in most other countries.

the 17 to complete rescheduling. Nevertheless, the Paris Club rescheduling was one of the rationales for the 1994 EFF although a number of Executive Directors questioned its need.

by participants in the international capital markets. The EFF was therefore viewed as desirable in part because so many players in the system had become accustomed to the existence of a program.

34. Internal briefing papers and interviews with a number of staff suggest that the strong “gatekeeper” role implied by the close linkage of programs to other forms of financing has had a potentially adverse effect on the quality of programs, in two ways: (i) the severe consequences, in terms of loss of other financing, of the IMF’s potential disengagement probably caused it to be less selective in choosing to be involved only at times when a lending arrangement was likely to be most effective in advancing reform; and (ii) since the seal of approval from IMF-supported programs has typically been linked primarily to agreement on a program, rather than to its successful implementation, it increased pressures on the authorities to agree to policy timetables that looked strong on paper, even if they were unlikely to be delivered within the agreed time frame.

35. These tensions were frankly discussed in internal briefing papers prepared when the 1994 EFF was under negotiation, at which time staff expressed a concern to resist being pressured into early agreement on a less than adequate program. The authorities were apparently keen to agree on a new program relatively quickly in order to pursue a Paris Club rescheduling and an early meeting of official donors, both of which were linked to such a program. This wariness on the part of the staff appears to reflect a number of earlier episodes where seal of approval

considerations influenced IMF agreement on programs, and where, in the staff’s judgment, these programs suffered from weaknesses as a result.<sup>22</sup> However, these internal concerns were not reflected in the Board papers for the 1994 EFF.

#### Fluctuations in political commitment and ownership

36. One of the reasons why adjustment took a long time is that there was strong political resistance by vested interests to implementing some key structural changes essential for success.<sup>23</sup> The Philippines’ political system required a strong political commitment of both the executive and legislative branches to ensure the passage of enabling legislation to support the economic policy agenda. However, the programs supported by the IMF were based primarily on agreements between staff and the executive branch, and important elements of the reform agenda often stalled in Congress or ran into judicial challenges.

37. Strong leadership, with ownership of reform, did at times help achieve the necessary political com-

<sup>22</sup>For example, in 1992, the tight links between Paris Club rescheduling and IMF-supported programs caused the program to be extended through a change of administration, risking compromising program ownership.

<sup>23</sup>The 1993 and 2000 country strategy papers—and the 2000 Occasional Paper (Rodlauer and others, 2000)—were quite candid in identifying these factors as key obstacles to faster adjustment and growth.

**Table 10.3. Heavily Indebted Middle-Income Countries: IMF-Supported Programs Tied to Debt Restructuring Following the 1980s' Debt Crisis**

Country	First program linked to 1980s' debt restructuring	End of last IMF program linked to 1980s' debt restructuring	Last commercial bank restructuring	Last Paris club
Argentina	Jan. 1983	Mar. 1996	Apr. 1993 <sup>1</sup>	July 1992
Bolivia	Feb. 1980	Ongoing	July 1992 <sup>1</sup>	July 2001
Brazil	Mar. 1983	Aug. 1993	Apr. 1994 <sup>1</sup>	Feb. 1992
Chile	Jan. 1983	Nov. 1990	Dec. 1990	Apr. 1987
Costa Rica	Mar. 1980	Feb. 1994	May 1990 <sup>2</sup>	June 1993
Ecuador <sup>3</sup>	July 1983	Dec. 1995	Feb. 1995 <sup>1</sup>	June 1994
Jamaica	June 1978	Mar. 1996	June 1990	Jan. 1993
Mexico	Jan. 1983	May 1993	Mar. 1990 <sup>1</sup>	May 1989
Nigeria	Jan. 1987	Apr. 1992	Jan. 1992 <sup>1</sup>	Dec. 2000
Peru	June 1982	Mar. 1999	Nov. 1996 <sup>1</sup>	July 1996
Philippines	Dec. 1984	Mar. 1998	Dec. 1992 <sup>1</sup>	July 1994
Uruguay	Apr. 1983	Mar. 1992	Feb. 1991 <sup>1</sup>	...
Venezuela	June 1989	Mar. 1993	Dec. 1990 <sup>1</sup>	...
Côte d'Ivoire	Feb. 1981	Ongoing	May 1997 <sup>1</sup>	Apr. 2002
Morocco	Oct. 1980	Mar. 1993	June 1990	Feb. 1992
Former Yugoslavia	May 1979	Sep. 1991	Sep. 1988 <sup>4</sup>	July 1988 <sup>4</sup>

Sources: Paris Club; Global Development Finance database; and IMF *Annual Reports*.

<sup>1</sup>Brady deal.

<sup>2</sup>If this Paris Club rescheduling, which was never implemented, is discounted the Philippines would rank as the sixth of the 17 to complete rescheduling. Nevertheless, the Paris Club rescheduling was one of the rationales for the 1994 EFF although a number of Executive Directors questioned its need.

<sup>3</sup>Ecuador rescheduled debt with official and private creditors again in 2002.

<sup>4</sup>These are the dates of the reschedulings of the debt of the former Yugoslavia, whose debt problems had not been resolved at the time the federation was dissolved.

mitment and overcome vested interests—such as in 1986–87 and during much of the Ramos administration. During these periods, much was achieved under the IMF-supported programs, even if the need to mobilize a political consensus and push reforms through Congress meant that the ambitious timetables set out in program documents could not be attained. However, when political leadership was weaker, reforms stalled despite the commitment of the direct economic ministries and the Central Bank. Prolonged political uncertainties—including several coup attempts during the Aquino administration—added to these problems.

38. What could the IMF have done differently during these periods of weaker ownership? In many cases, there is no clear answer. In principle, a different approach might have involved a combination of three elements: greater efforts to build consensus, greater selectivity, and changes in conditionality.

39. On the first element, IMF missions did engage in extensive dialogue on economic policy with members of key congressional committees and both officials and staff interviewed thought this dialogue had been helpful. Some missions also reached out to “civil society” more generally, and resident representatives generally engaged in a policy dialogue with a broad range of groups, within and outside government, to explain the IMF point of view. However, such contacts could not create, or serve as a

substitute for, broader domestic political commitment and ownership.

40. Greater selectivity in entering into, or extending, lending arrangements would have been highly desirable during those periods when it became evident that there was no commitment at the highest political level to reforms necessary for sustainable adjustment. This was the case for much of the Marcos era and should have been evident earlier in the Estrada administration. At other times, however, when the issue was more one of the Executive's ability to implement measures they agreed to, the IMF was faced with a more difficult situation. On a number of occasions when policies went off-track, the IMF did halt programs—by not completing reviews—while seeking corrective actions (Box 10.4). However, partly because of the “seal of approval” issues discussed above, pressures often grew to resume the program and a compromise was generally reached that involved some erosion of the original policy measures.

41. Finally, could a different approach to conditionality have helped overcome the periods of weak ownership and thereby reduced the length of IMF program involvement? As will be discussed further in the section “Implications for Program Design and Implementation,” a greater prioritization of structural reforms—with greater flexibility on the timetable but

not on the substance of those judged to be critical to macroeconomic sustainability—would probably have helped; however, as the later discussion of the efforts to improve the tax structure and strengthen tax administration will show, there are limits to what any specific modalities of conditionality can be expected to achieve, in the absence of strong domestic ownership.

### Program design and implementation

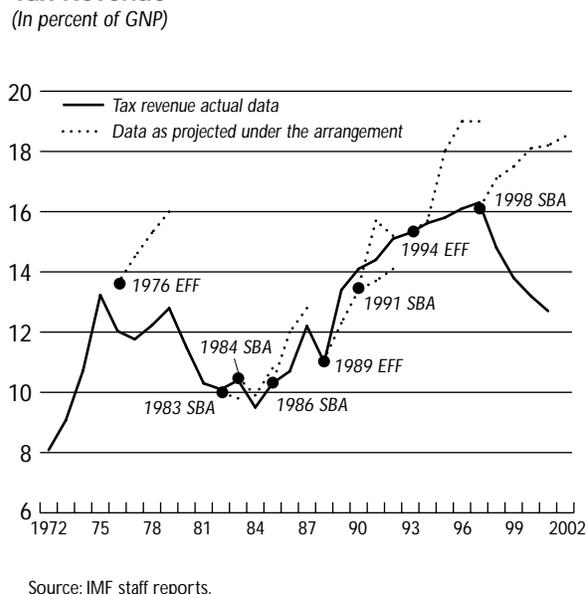
42. Several key weaknesses were consistently identified by the IMF as at the core of the longer-term adjustment problem—notably weak tax collection and low public saving, which in turn contributed to low levels of gross national saving in comparison with the Philippines' neighbors. This was long seen as a factor that limited the ability of the economy to invest and grow without running into periodic external financing constraints. Nearly all IMF-supported programs over the last 30 years identified increasing saving rates as a central aim, and sought to address this problem by improving public saving through a greater tax effort, which was also low in comparison to other economies in the region. However, programs were not consistently successful in achieving these goals, either because of overoptimism of the original projections or policy slippages.

43. As shown in Figure 10.2, programs generally targeted a large sustained improvement in tax revenues as a share of GNP as a means of boosting public and gross national saving.

44. Tax reform and efforts to improve administration did yield some benefits in raising the tax ratio in the late 1980s and early 1990s, although progress was intermittent. The tax ratio rose from 11 percent of GNP in 1986 to 15 percent in 1993 and peaked at over 16 percent in 1997. However, except for the 1989 EFF and to some extent the 1991 SBA, actual performance still fell far short of the sharp increases in tax revenues targeted under successive programs. Perhaps more important than this overoptimism was that part of the improvements that were achieved were the result of ad hoc measures. The increase in tax revenue in proportion to GNP also owes something to the recovery in activity in the late 1980s. In any event, the revenue gains were not sustained. Performance was particularly poor after 1998, when the tax ratio deteriorated significantly. These issues are discussed in more depth in the section “Improving the tax structure and strengthening tax administration: an example.”

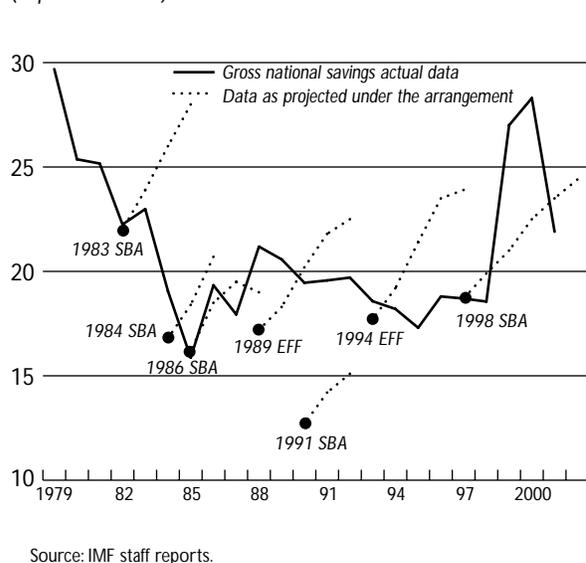
45. The gross national saving rate was also projected to rise markedly in each program but the actual outturn usually fell short (Figure 10.3). Gross national saving as a percentage of GNP declined

**Figure 10.2. Philippines: National Government Tax Revenue**  
(In percent of GNP)



Source: IMF staff reports.

**Figure 10.3. Philippines: Gross National Savings**  
(In percent of GNP)



Source: IMF staff reports.

continuously in the first half of the 1980s, improved briefly between 1986, and then deteriorated again. The measured saving rate shows a sharp increase in 1999 and 2000, but there is reason to believe that this may simply reflect statistical weak-

### Box 10.4. Examples of Major Interruptions to IMF-Supported Programs in the Philippines

As discussed in the main text, conditionality in the Philippines—especially structural conditionality—relied heavily on program reviews. On a number of occasions, program reviews were delayed for extended periods—sometimes leading to permanent interruptions—as policies diverged from program commitments. By interrupting programs, the IMF was sometimes able to secure desired policy changes. However, if such interruptions took place within a context where it was tacitly understood by both sides that outside factors—including “seal of approval” considerations—would be likely to ensure the eventual restoration of a program relationship, this may have affected the efficacy of efforts to impose greater selectivity. This box examines several such episodes to examine the major reasons for program interruptions and to assess the extent to which the policy slippages were corrected by the time programs were resumed, or new arrangements agreed. The broad conclusion is that the program interruptions were partly effective in correcting policy slippages, but that substantial “recontracting” also occurred, resulting in a weakening of original commitments.

#### Interruption of the 1989 EFF

The IMF took contrasting approaches to successive reviews under the 1989 EFF.

- The first review of the 1989 EFF was completed on schedule in December 1989, despite significant slippage in monetary and fiscal policies that largely reflected the delayed implementation of politically sensitive oil price increases and a large public sector wage increase. The authorities eventually raised oil prices at the beginning of December, and promised to take remedial fiscal actions, including several discretionary tax increases, to permit the review to be completed. As noted below, these promised increases did not materialize. One motivation for completing the review on time was to free up IMF “set-asides” and linked financing from donors to help finance the “buy-back” of commercial bank debt that took place in January 1990.
- The program went more seriously off-track during 1990 in light of policy slippages and a series of large exogenous shocks. Net international reserves targets and fiscal targets were missed, the latter largely because Congress failed to pass the tax

measures promised earlier as a condition for completing the first review.<sup>1</sup> Staff decided that the original aims of the EFF were unattainable and that the second review of the program could not be completed. This decision appears to have reflected the judgment that in the political environment following the earthquake and the previous year’s coup attempt, it was unlikely that the government would be able to take the comprehensive and strong policy measures that would justify the resumption of IMF support.

- However, the IMF was keen to head off the risk of an intensifying crisis and also to free up needed financing from donors and creditors. Six months after the review was originally scheduled, agreement on a new Stand-by Arrangement was reached in January 1991. In order to meet the schedule for a donors’ group and avoid the damage to confidence that a further delay would cause, the IMF compromised on its initial requirements for a new program, accepting the President’s assurance that she would use veto powers and administrative means to keep expenditure in line with the program, as a substitute for full enactment by Congress of the budget. Reflecting political sensitivities, revenue measures were confined to a temporary import levy, rather than the measures promised under the previous program. Other prior actions were agreed, including the elimination of administrative foreign exchange arrangements that artificially supported the peso and the announcement of a power tariff increase. In the event, the politically sensitive power tariff increase was not implemented until a year later, and was subsequently partly rolled back. The band around the reference exchange rate for commercial transactions was eliminated as scheduled. More far-reaching reforms of the exchange system were introduced only in early 1992.

<sup>1</sup>In the aftermath of the June earthquake, the authorities were pressing for the early provision of emergency assistance from the IMF while Congress threatened a debt moratorium. Congress also voted a substantial reduction in oil taxes in the face of the run-up in world prices, and a tariff reform was withdrawn in the face of congressional pressure.

nesses.<sup>24</sup> The failure of successive programs to increase the saving rate in turn left the economy

<sup>24</sup>Private saving, which is calculated as a residual, apparently rose from 19.9 percent of GNP in 1998 to 29.2 percent in 2000, while the current account surplus rose to 11.8 percent of GNP from 2.2 percent over the same period. However, a staff analysis of partner country trade data suggests that the current account surplus may be overstated by as much as 9–10 percentage points

vulnerable to stop-go cycles and to exogenous shocks.<sup>25</sup>

of GNP, mainly due to the underrecording of imports. Given the method of calculation, this would imply that the saving ratio is correspondingly overstated.

<sup>25</sup>More recently, additional vulnerability concerns have focused on public sector debt dynamics and continuing weaknesses in the financial sector. Exports remain heavily concentrated in the electronics sector.

### Delayed first review under the 1994 EFF

- Policy performance in the first six months of the 1994 EFF deviated substantially from program expectations. In particular, the introduction of an automatic oil price adjustment mechanism, which was an original condition for completing the review, was postponed until late 1995, after it was determined that this would require legislation. Monetary policy also went off-track. There were also delays in establishing a simplified tariff regime, revising the National Power Corporation's pricing formula, and liberalizing entry into the oil sector. To complete the review, the IMF therefore pressed for the implementation of these trade and energy reforms and for demonstrated adherence to the monetary program in early 1995. It also sought new understandings on compensatory measures that would be taken if there were unforeseen developments, such as weaker-than-expected capital flows, following the Mexican crisis.
- The review was eventually completed in September 1995, after a ten-month delay. The IMF settled for the administration's submitting of bills covering the measures required for completion of the review to Congress, rather than their actual implementation. The administration submitted a bill to remove quantitative agricultural import restrictions, which was passed in March 1996, and a comprehensive oil sector reform bill, as well as a tax reform bill.<sup>2</sup> The decision to complete the review appears to have reflected the strong macroeconomic performance, recognition that the authorities had limited influence over the Congressional timetable, and the judgment that the authorities' efforts to advance structural reform deserved encouragement.
- An Oil Deregulation Bill was passed in 1996, but was subsequently judged to be unconstitutional. Replacement legislation was eventually passed in February 1998, some two and a half years later. The Comprehensive Tax Reform legislation was

<sup>2</sup>There was also a major revision to monetary policy, as the authorities adopted a limited form of inflation targeting.

### Adverse shocks

46. Bad luck—in the form of a long string of adverse shocks—also played a role in extending the period of prolonged use. A dramatic series of adverse supply shocks in the early 1990s (including an extended drought and related power shortages, a severe earthquake, and a damaging volcano eruption) and deteriorating terms of trade adversely affected the balance of payments, while political uncertainties—re-

passed in December 1997, but suffered some important shortcomings (discussed in the section “Improving the tax structure and strengthening tax administration: an example”).

### Fifth review of the 1998 Stand-By Arrangement

- Completion of the fifth review of the 1998 SBA, originally scheduled for September 1999, was delayed by ten months. As a condition for completing the review, the IMF sought renewed momentum in key structural reforms, with specific prior actions required in banking reform, tax administration, and power sector restructuring. Missions in September and December 1999 were unable to complete the review because of slippage in the fiscal program and because key structural reforms were delayed—particularly power sector reform legislation and the adoption of a plan for the privatization of the Philippine National Bank (PNB) by mid-2000. Growing governance concerns, including those related to the PNB privatization, also added to difficulty in completing the review.
- The program was extended beyond its original termination date of March 2000 to permit completion of the review in July 2000. This followed agreement on a fiscal program for 2000, incorporating a slightly higher targeted fiscal deficit<sup>3</sup> as well as approval of the power sector reform by the Lower House of Congress in April (a prior action), and by the Senate in June. In the event, approval of unified legislation was delayed for much longer—until late 2001. The review went ahead despite the failure of the auction of the government's stake in PNB in June. Progress was slower than the IMF originally sought in some other areas of structural reform, including tax administration, but a General Banking Act was passed prior to the completion of the review. The arrangement was extended a second time until end-2000, but was ultimately permitted to lapse amid increasing governance concerns, without completion of the final review.

<sup>3</sup>To 2.9 percent of GDP compared to an original target of 2.2 percent. In the event, the actual fiscal deficit for 2000 was 4.6 percent of GDP.

flected in several coup attempts—affected investor confidence. Later in the 1990s, the timing of the Asian and Russian crises, and the associated contagion, disrupted what would otherwise probably have been a successful “exit” from use of IMF resources in 1997.<sup>26</sup>

<sup>26</sup>This does not imply that policies in the Philippines—including exchange rate policy, remaining financial sector regulatory weaknesses, and relatively shallow domestic capital markets—had no role in magnifying the effects of the crisis.

### The rationale for program involvement was sometimes too broad

47. The rationale for IMF program involvement in the Philippines appears to have been very broad. The traditional criterion of balance of payments need was clearly evident from the onset of the debt crisis in 1983 until the restoration of market access in 1993 and, once again, during the height of contagion from the Asian and Russian crises in 1997–98. During the 1983–93 period, IMF gross financing typically provided a relatively small proportion of projected financing gaps, but IMF involvement was necessary to catalyze other flows, mainly through reschedulings. Much of the IMF financing in fact represented a rollover of payments falling due.<sup>27</sup>

48. However, the balance of payments need was less evident from 1993, when market access was regained, until the Asian crisis. It is also doubtful for how long there was balance of payments need after 1998. Admittedly, an element of judgment was involved in such cases, since the justification for access to IMF resources can refer to a potential, as well as an actual, balance of payments need. In both periods, the Philippines probably could have raised from private markets the amounts that were borrowed from the IMF, but it could be argued that, at both times, this market access was not fully assured. However, two points are worth noting in this respect: first, both arrangements were extended at times when there appeared to be even less balance of payments need;<sup>28</sup> second, there was very little discussion in internal documents of whether such a need existed. In the Board discussion in March 1993 relating to the augmentation of the then Stand-By Arrangement, some Executive Directors questioned the balance of payments need for the augmentation, and a few noted that they would want to carefully consider the balance of payments need for any successor arrangement. At the Executive Board discussion on the 1994 EFF, a year later, one Director noted that in spite of these reservations about a future program expressed earlier, there was no discussion of these issues in the Staff Report.

49. The broader rationale for continued program involvement at these times seems to have included three factors. First, a desire to send a positive signal to donors and creditors (discussed above). Second, the belief that it would foster “good” policies and bolster internal groups in favor of reform. A number

of staff interviewed argued that the IMF’s continued presence in a program context, even when there was no pressing balance of payments need for IMF financing or a catalytic role, was still an important pressure in favor of the “right” policies in key periods. In their view, policy implementation and economic management would have been weaker without a program. A number of staff and former officials also noted that the existence of a program had helped to increase the leverage of internal groups that favored a strong macroeconomic policy framework and continued reforms.

50. Finally, one of the major motivations for the 1998 SBA according to internal briefing papers and interviews with staff and former Philippine officials, was to sustain earlier gains and avoid “backsliding” during a change of administration. In the event, while the program helped macroeconomic policies remain prudent during the transition period itself, this was not sustained and the approach ultimately proved unsuccessful. Although the incoming President signaled his agreement to the program, ownership eventually proved weak and implementation suffered, especially after the first year. (The discussion of efforts to strengthen the tax system, in the section “Implications for Program Design and Implementation,” gives a specific example of how a detailed set of measures negotiated with an outgoing team was not implemented because they were not effectively “owned” by the incoming team.)

### Sponsorship by key shareholders

51. International political factors probably also have their place in explaining the IMF’s long program engagement in the Philippines, particularly in the 1960s and 1970s. In the view of a number of officials and staff, up until about 1983, the close relationship of the United States—and some other shareholders—with the Marcos regime in the context of the cold war and regional tensions appears to have been reflected in the favorable attitude of IMF management and the Executive Board to the authorities’ requests for support. Subsequently, tensions in the political relationship between key shareholders and the then Philippines leadership may also have contributed to delays in agreeing on a program in 1983 and an increase in the threshold of what would be viewed as an acceptable program. The interests of key shareholders in regional stability and their support for the efforts of President Aquino to restore and maintain more democratic institutions were probably also a factor influencing decisions to continue program involvement at times when weak ownership of some core economic reforms might otherwise have argued for greater selectivity.

<sup>27</sup>Between 1982 and 1993, there were small net repayments to the IMF, which was in line with the guidelines that called for a gradual reduction in exposure to prolonged users.

<sup>28</sup>As noted earlier, the first one-month extension of the 1994 EFF took place in June 1997 before the floating of the Thai baht, and was related to the desire for a “graceful exit” after completion of the (postponed) tax reforms.

### Borrower incentive because of low cost

52. Some external observers have argued that continued use of IMF resources by countries that have access to private financial markets is driven by the borrowing countries' incentives to reduce their borrowing costs, by substituting lower-cost IMF financing.<sup>29</sup> It is not possible to test this proposition directly, but the impact on the Philippines' overall borrowing costs, if it had ceased to use IMF resources in 1994 and from 1999 onward, would have been small. During the 1994 EFF the Philippines only made the initial SDR 36 million drawing before the Asian crisis, treating the program as precautionary for the most part. The relative cost of borrowing from the IMF and the markets might have been a more relevant consideration in 1999–2000. During this period, the Philippines borrowed SDR 491 million from the IMF. At the time, issue spreads on the Philippines' sovereign international bonds ranged from about 350 to 425 basis points over U.S. treasuries of comparable maturity—implying an interest saving of about SDR 20 million a year.

53. Officials and staff interviewed were all of the view that a more important factor driving the authorities' interest in continued programs, both during and after the restoration of market access, was the belief that there was a catalytic role of an IMF-supported program—that is, the signal it sent to other creditors and donors.

### Did the IMF's approach in the Philippines match its guidelines on prolonged use?

54. Whatever the reasons explaining prolonged use, and there are many, it is relevant to ask whether such use in the Philippines was in accord with the underlying policy governing prolonged use as articulated in Board discussions. This policy consists of the following elements (see Chapter 3 of Part I for a more detailed discussion): (i) front-loading the adjustment effort, including greater emphasis on prior actions, and closely monitoring program implementation; (ii) seeking a net reduction in prolonged users' outstanding liabilities to the IMF, including through arrangements with limited access but that would still serve a catalytic role, and back-loading disbursements; (iii) an analysis of the factors underlying a country's prolonged use and a candid ex post assessment of performance under previous programs at the time of new program requests; and (iv) an "exit" strategy including ex ante assessments of the time needed to complete the adjustment process and of the time frame to

<sup>29</sup>See, for example, Meltzer and others (2000) and Vásquez (1999).

disengage from IMF lending along with strengthened surveillance at the post-program stage.

55. In the Philippines' case, some elements of this strategy were implemented and some were not.

- (i) It is hard to argue that the adjustment effort was "front-loaded" in practice and, as will be shown in the next section, prior actions were used sparingly. For example, fiscal adjustment and the program of tax reform in the 1994 EFF were substantially back-loaded, although expansion of the coverage of the VAT was made a prior action,<sup>30</sup> with most of the planned fiscal adjustment to occur in 1995 and 1996, after the Task Force on Tax and Tariff Reform had formulated more detailed plans for tax reform. However, as the discussion below of the various efforts to strengthen the tax effort will show, the precise structure of conditionality, including prior actions, does not seem to have been a critical factor.
- (ii) Access under arrangements did in general seek a net reduction in the Philippines' liabilities to the IMF, while preserving a catalytic role, but disbursements were not always back-loaded.<sup>31</sup>
- (iii) There was not a systematic ex post assessment of each program, although the staff did "step back" on several occasions to conduct such assessments (e.g., in 1991, 1993, and 2000)—more so than in the other country cases examined in the evaluation. However, internal assessments were much more candid than those in final Board papers.
- (iv) While parts of an "exit" strategy were set out, and early Board papers were reasonably forthcoming about the time frame involved, the rationale for the IMF's continued program involvement once market access was restored was not fully presented in Board papers, nor does it seem to have been subject to much internal debate. In any event, the strategy was overtaken by the Asian crisis. A comparison with Morocco, which exited from 10 years of IMF-supported programs in 1993 after extended adjustment and debt restructuring, is in-

<sup>30</sup>It was not ultimately implemented until 1996 as a result of a judicial challenge.

<sup>31</sup>For example, disbursements under the 1994 EFF were evenly loaded. The guidelines appear to have been more closely followed in some respects in the case of the 1998 SBA. The arrangement was back-loaded with 5 percent of quota available on approval, while the first four installments each for 14 percent of quota and the remainder each for 25 percent of quota. This back-loading was not maintained when the program was rephased in its later stages.

teresting. The key macroeconomic indicators for the two countries, discussed in more detail in Part I, were quite similar by the early 1990s. While it would not be desirable to pre-establish simplistic quantitative “exit” criteria for a prolonged user, it is not obvious why such different approaches were taken in the two cases.

56. The latter two points raise a more general question about whether the internal review process played its role sufficiently. While any summary of a review process spanning several decades is bound to involve some generalization—especially since guidelines on the review process changed over time—an assessment of internal briefing papers, country strategy papers, and review department comments on those papers suggests the following points. First, the diagnosis of the main problems and the content of the proposed policy framework was typically the subject of a detailed internal assessment and often considerable debate. Second, several of the ex post assessments mentioned above did draw potential lessons for program design (e.g., the 1991 assessment pointed to the need for greater prioritization and a more realistic time frame on structural reforms), but these lessons were not always fully absorbed or debated in the subsequent review process (see the next section for more discussion of the time frame of program design). Third, many of the often quite sharp differences of view about the overall strategy that emerged during the review process were not reflected in subsequent Board papers, which tended to focus on an explanation and justification of the agreed consensus approach and the program as negotiated.

57. The period leading up to the 1994 EFF provides a good example of the process. From the early 1990s, the IMF did have an exit strategy for the Philippines, including an ex ante assessment of the time it would take to complete the adjustment process. From the time the 1989 EFF went off-track, the consistent game plan was that an SBA, primarily focused on stabilization, would be followed by an EFF, which would include the major structural changes that would permit the Philippines to “graduate.” There was considerable internal debate, ahead of agreement on the EFF, as to how strong—particularly in terms of fiscal adjustment—any successor program would have to be to warrant IMF support. However, there was not a full discussion of time frame and ownership/implementation issues, even in the draft 1993 country strategy paper that aimed to draw lessons from earlier experience. The area department was of the view that one lesson was that an unrealistic time table and overcrowded agenda had contributed to implementation difficulties, whereas review departments generally took the

view that strong up-front actions were needed in light of the Philippines’ perceived poor record of program implementation. Nor was there an explicit discussion of whether any follow-up program was needed at all.<sup>32</sup> Although PDR implicitly questioned the balance of payments need, by drawing attention to the tenuous nature of the small financing gaps assumed, it apparently did not argue against an arrangement per se. In retrospect, the country strategy paper—which was never completed—was a missed opportunity for a broader debate on the lessons from past programs and the IMF’s role.<sup>33</sup>

58. As noted above, the critical nature of the Executive Board discussion at the time of the fifth review of the EFF did trigger a more comprehensive assessment of the IMF’s role and approach in the Philippines, in the form of the internal (2000) country strategy paper.

## Implications for Program Design and Implementation

59. This section discusses issues relating to program design and program implementation, which arise from our review of the Philippines’ experience and which suggest lessons to help avoid some of the problems associated with prolonged use.

### Program design

60. *A recognition of the longer time frame required for adjustment could have led to a greater prioritization of structural reforms.*

61. As noted earlier, the IMF recognized at an early stage that the Philippines would require a relatively long time to restore external sustainability, but program design remained focused on a relatively short time horizon. The short-term focus was partly a reflection of the institutional constraints requiring programs to offer evidence of concrete progress within the time frame of the program itself. In the view of some IMF staff interviewed by the evaluation team, this excessively short-term focus caused programs to address structural issues across too

<sup>32</sup>This may in part reflect the commitment of management to a follow-up program communicated to the Philippines authorities as early as June 1992.

<sup>33</sup>Similarly, a number of internal comments prepared by reviewing departments at the time of the various reviews of the EFF did question some of the underlying rationale for the program. In particular, the weak correspondence between the Philippines’ economic performance and its compliance with program conditionality was noted, since strong capital inflows had continued despite repeated delays in completing reviews and the breaching of a number of performance criteria and structural benchmarks, suggesting that any “signaling” rationale was weak.

broad a front and to target timetables for various structural reforms that were often unrealistically ambitious. Tax reform and tax administration, examined in detail below, is one example where, in the view of many staff and officials, program design would have benefited if a longer-term perspective had been adopted from an early stage.

62. Program design may also have paid insufficient attention to political implementation capacity. The case of the 1989 EFF which went off-track is one example (Box 10.1). Several IMF staff noted that the programs on which they worked would likely have been more effective if the program had been focused on a smaller number of core structural reforms. For example, in the latter stages of the 1994 EFF, the IMF was simultaneously pushing for reforms to the oil-pricing system and to tax policy, each of which required congressional approval, as prior actions for the completion of program reviews. In the view of some staff, this may have been overambitious, exceeding the capacity of the political system to digest several major reforms at the same time.

### ***Difficulties in strengthening key institutions were critical***

63. The issue of tax administration has featured in virtually all IMF-supported programs for the Philippines, dating back to the 1970s.<sup>34</sup> As discussed below, several different approaches were tried in successive programs, including efforts to promote ownership of these reforms through local working groups to develop detailed measures. With hindsight, while programs incorporated a wide range of measures to improve tax administration and policy, based on extensive technical assistance, they failed to achieve the strengthening of institutions, particularly the Bureau of Internal Revenue, which was critical to achieving program aims.

64. The effectiveness of the Bureau of Customs was greatly strengthened, at least temporarily, under the Ramos administration, as a result of reforms—and strong leadership of the agency—initiated in 1993.

65. Could the IMF have done more to strengthen tax institutions? It did make repeated efforts to tackle the issue—as the discussion below will illustrate. It would likely have been more effective if the IMF had focused on a limited number of measures that were critical to achieving success, along with

greater on-the-ground follow-up to technical assistance missions to monitor and facilitate program implementation, and a greater willingness to halt programs when implementation of these core measures was inadequate. However, the experience may indicate the limitations of what conditionality from an outside agency can reasonably be expected to achieve, unless there is strong commitment from the country in question.

### ***Dealing with uncertainty in programs***

66. Some staff interviewed also believed that program design would have benefited from more explicit attention to contingency planning. The Philippine economy has remained vulnerable to exogenous shocks. Moreover, the revenue impact of certain tax administration measures was highly uncertain and the program would have benefited if contingency actions to be introduced in the event of revenue shortfalls had been specified at the outset.

67. In practice, program reviews were generally used to adjust programs in the light of unexpected developments, which was probably the correct approach, but the adjustments often did not occur in a sufficiently timely fashion. It would likely have been more effective if programs had paid more attention to identifying up-front the major risks—including implementation risks—along with a more systematic stress-testing of how the program framework would be affected by such risks and a discussion of how policies would respond.

68. However, better contingency planning does not require a detailed ex ante quantification in the letter of intent of responses to specific shocks. For example, the Philippine authorities did request access to contingent financing under the Compensatory and Contingency Financing Facility (CCFF) in association with the 1989 EFF. The view of both staff and officials was that the CCFF experiment had not been helpful. The effort consumed considerable time and administrative resources since the formulas determining eligibility were very complex and hard to check, and the mechanism proved excessively rigid and overconstrained as it simultaneously tried to satisfy a number of inconsistent considerations. As a result, the focus was more on rigid formulas rather than on the broader logic of policy adjustments.

### **Program implementation**

#### ***Implementation of IMF-supported programs has been mixed***

69. The effectiveness with which programs have been implemented has varied markedly, with phases

<sup>34</sup>Tax administration was not featured prominently during the 1994 EFF, which focused more on tax policy issues, but, according to staff, even then efforts continued on the ground to improve tax administration.

of strong implementation—for example 1987–88, and to some extent 1991–92—alternating with periods when implementation has been much weaker. There have also been phases, such as during the 1994 EFF, when economic performance was strong and significant progress was achieved on some structural reforms, even though overall program implementation was inconsistent.

70. Over the period 1970–2000, 8 of the 16 arrangements were fully disbursed, while 77 percent of commitments were disbursed on average, a relatively high proportion by comparison with other countries (see Table 10.1).<sup>35</sup> Four of the seven programs since 1983 were not completed. Even those programs that were completed suffered implementation problems as program reviews were subject to frequent long delays, sometimes of as much as ten months.<sup>36</sup> This reflected in part the heavy reliance on reviews to provide structural conditionality. For the same reason, the Philippines has not been a heavy user of waivers.<sup>37</sup>

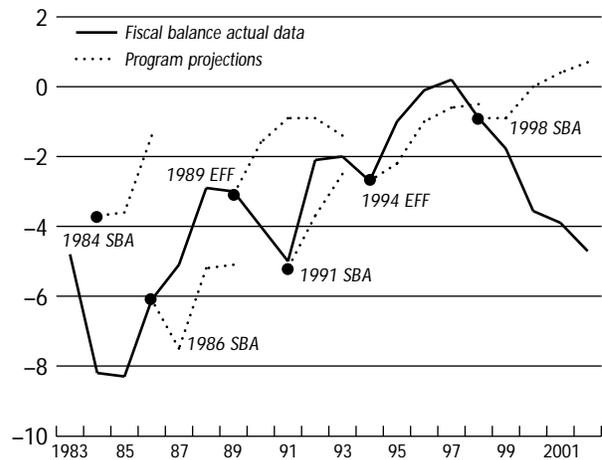
71. The implementation of the fiscal component of programs has been patchy. For example, deficits were narrowed substantially in the first half of the 1990s—by more than the program targets—but have subsequently widened again (Figure 10.4). Moreover, as noted earlier, revenues were generally overestimated except during the early 1990s. As a result, fiscal deficit targets were often achieved at the expense of shortfalls in planned public spending, particularly on infrastructure investment. Given the typically limited scope of discretionary expenditure, such ad hoc adjustments distorted expenditure priorities and at times prevented planned increases in capital expenditure. For example, under the 1986–88 SBA, public investment remained at 3.5 percent of GNP throughout the program rather than rising to 5 percent of GNP as targeted. Public investment also remained well below program projections under each of the three arrangements in the 1990s.

<sup>35</sup>Over the same period, the average disbursement ratio for all arrangements using general resources was 64 percent.

<sup>36</sup>For example, of the 22 program reviews scheduled under the seven arrangements since 1983: just 6 were completed on schedule, with a further 3 completed with a delay of three months or less. Nine were delayed for longer, including 2 reviews delayed for ten months each. Four of the scheduled reviews were never completed, as arrangements were cancelled.

<sup>37</sup>Over the 1987–99 period, the Philippines ranks fifty-fourth out of 105 countries that had programs in terms of waivers per program year with just eight waivers. None of these waivers related to structural performance criteria and all but one of these waivers related to quantitative performance criteria. In addition, the Executive Board granted three waivers of applicability over this program period, related to delays in completing reviews.

**Figure 10.4. Philippines: Implementation of Fiscal Programs—Consolidated Public Sector Balance**  
(In percent of GNP)



Source: IMF staff reports.

### **Impact of prolonged use on domestic policy formulation**

72. The close and continuous relationship between the Philippine authorities and the IMF also needs to be evaluated in terms of its impact on institutional development. Current and former officials and staff noted that IMF involvement had a strong influence in shaping the macroeconomic framework as well as the technical and data systems used by the Philippine authorities, which were essentially a mirror image of the IMF's financial programming framework. In the view of most officials interviewed, IMF training and technical assistance played a constructive role, most notably in enhancing the skills needed for the formulation of a comprehensive and consistent macroeconomic framework.

73. While it is impossible to judge how policy formulation processes would have developed in the absence of almost continuous programs, formulating policies around negotiations with the IMF for more than 30 years must have had an impact. Both the 1993 and 2000 country strategy papers noted that there was a strong risk that the Philippines had become overdependent on the IMF and that this was an important reason why the prolonged program engagement should eventually be discontinued. The 2000 CSP stated explicitly that "Institutional development has likely been hampered in some respects by the dependence of the authorities on the IMF to articulate a consistent policy package, monitor its implementation, and provide discipline in the short-term. This may not have left room for the develop-

ment of the authorities' own institutions or procedures to ensure internal accountability and discipline in policy-making and implementation." Nevertheless, the Philippines does have considerable strengths in some of its major policymaking institutions—including economic ministries, the Central Bank, and key congressional committees. The fact that, under the post-program monitoring (PPM) arrangement in effect since 2000, the government has continued to set goals and establish targets on key macroeconomic and financial aggregates, to ensure a forward-looking aspect to monitoring, without being required to do so under the PPM, suggests that domestic economic managers have been able to adapt quickly and prudently to the absence of an IMF arrangement.

### ***Prolonged use has probably eroded the effectiveness of conditionality***

74. The nature of conditionality in programs for the Philippines has evolved markedly over time, as it has for programs in general. Conditionality in programs during the 1970s centered on quantitative performance criteria related to the financial programming framework and to quantitative limits on contracting medium-term external debt. The breadth of conditionality increased markedly from 1983 onward as programs increasingly addressed structural issues. Conditionality on these issues was exercised mainly through prior actions and program reviews (often in combination). There was limited use of structural benchmarks and virtually no use of structural performance criteria.<sup>38</sup> In deciding whether to complete a review, the IMF typically exercised a high degree of flexibility in relation to original program targets, at times introducing new conditions to complete reviews in light of evolving circumstances. Reviews were often substantially delayed, but generally the program remained in existence and reviews were eventually completed.

75. This flexible approach was developed at least partly in response to the Philippines' congressional-style political system, whereby the Executive has limited control over the legislative agenda and therefore often cannot credibly commit to a specific timetable for measures that require legislation.<sup>39</sup>

<sup>38</sup>Programs varied greatly in the degree of detail with which conditions on structural measures have been specified. For example, some programs incorporated highly detailed agendas for action against which progress on structural reforms could be monitored, while others were simply specified in terms of reviewing general progress in a particular area of structural reform.

<sup>39</sup>In the mid-1990s, the Philippine government formed the Legislative-Executive Development Advisory Council (LEDAC) as a vehicle to push through Congress certain bills identified as priorities by the Executive.

Moreover, the IMF frequently had to decide whether to compromise over shortcomings in measures passed by Congress that deviated from those that were originally envisaged (see Box 10.4 for examples).

76. While the reliance on reviews seems to have been broadly appropriate under the circumstances, there was inevitably a trade-off between the flexibility gained from exercising a high degree of discretion, and the consequences in terms of a lack of clarity for the authorities, markets, and the wider public over the "bottom line" on conditionality. Each review became an occasion for "recontracting" the underlying commitments, which weakened their focus and credibility. In retrospect, greater specificity on a small number of critical outcomes for completion of reviews may have been desirable. In the words of one Executive Director, "including the most important policy commitments as formal conditions . . . reduces the risk that, ex post, measures used to justify completing reviews are the ones the authorities completed rather than the ones they needed to complete." One example is the Comprehensive Tax Reform Package (CTRP), the structural centerpiece of the 1994–98 EFF, which is discussed in the next section.

77. Both IMF staff and former officials acknowledged that such factors contributed to a tendency for the authorities to "overpromise" with regard to the timing of structural measures, even when they knew that these commitments were politically unrealistic, knowing that failure to meet their commitment would be unlikely to prompt program cancellation.<sup>40</sup>

### **Improving the tax structure and strengthening tax administration: an example**

78. As pointed out earlier, virtually all IMF-supported programs have aimed at raising the tax ratio as a key to raising domestic saving. The relatively low tax ratios have in general not been the result of low statutory tax rates, but rather of a narrow tax base and poor compliance in relation to that base. Over the past 30 years, several attempts have been made to increase the tax effort through broadening the tax base and improving tax administration. Since these efforts have taken place against a background of moves to open up the economy, an increasing emphasis has been placed on taxes on domestic economic activity as trade taxes have been reduced.

<sup>40</sup>The following quote illustrates the problem: "Contrary to common belief, the IMF is not really that inflexible. . . . The Philippines has had 25 programs covering 35 years. The first lesson I learned is you do not have to do everything the IMF wants you to do. Secondly, even if you agree with the conditions and you do not comply, you can always ask for a waiver" (Senior Philippine official, 1998).

**Table 10.4. Tax Efficiency in Selected Asian Economies**

	Statutory VAT rate	VAT effort <sup>1</sup> (1994)	Efficiency ratio <sup>1</sup>
Indonesia	10	4.8	0.48
Thailand	7	3.18	0.45
Korea	10	4.27	0.43
Philippines	10	3.33	0.33

Sources: IMF Fiscal Affairs Department and IEO calculations.

<sup>1</sup>The efficiency ratio is equal to the VAT effort (i.e., VAT revenue as a percentage of GDP) divided by the statutory rate of VAT.

79. Successive tax reforms have achieved some important gains, including a simplification and improvement of the tax structure by reducing distortions and increasing its progressivity, and have also reduced the dependency of revenue on trade taxes. The tax revenue/GNP ratio was also improved markedly between 1989 and 1997. However, continued weak tax administration and large exemptions and incentives mean that revenues remain low by international standards and inelastic with respect to economic activity (Table 10.4). Moreover, as noted earlier, revenue projections in many programs proved too optimistic and the considerable gains achieved in the first half of the 1990s were eroded after 1998. As will be discussed below, some of these later slippages were related to weaknesses in tax administration and governance and some to shortfalls in the tax reform program.

80. The Philippines has received extensive technical assistance (TA) in this area, with nine TA missions on tax between 1984 and 2001. Moreover, efforts were made to develop reform strategies suited to the Philippine environment. A number of times,<sup>41</sup> working groups were established within the government to develop detailed proposals for tax reform with the help of IMF technical assistance, in the hope of developing proposals adapted to local circumstances and with ownership by the authorities. However, as pointed out earlier, the results have been disappointing.

81. Could the IMF have done more to improve the performance on the tax front? The Philippine experience on this issue suggests that it is not possible to correct for weaknesses in the domestic political commitment through variations in the form of conditionality. However, in retrospect one can identify several issues.

82. One set of problems arose from the authorities' strong reluctance to accept any form of direct conditionality specifying tax collection as a concrete quantitative performance criterion. Staff proposed to establish a formal performance criterion on tax revenues of the National Government under the 1989 EFF, but this was strongly resisted.<sup>42</sup>

83. As a result, when tax revenue did not materialize as expected, either because the required tax structure or tax administration measures were not implemented or because other macroeconomic assumptions turned out to be inaccurate, there was a tendency to squeeze expenditure in an effort to meet fiscal targets. Under some programs, stop-gap measures to raise revenue with undesirable efficiency and equity implications—such as the special import levy in 1991—were imposed pending action on more desirable structural reforms.

84. The implementation of conditionality through program reviews was also not fully satisfactory. For example, some of the original targets for structural tax reforms under the CTRP during the 1994 EFF were achieved, but many were not and the IMF progressively agreed to a number of modifications as the authorities encountered difficulty in getting the program through Congress. For example, there was little progress in reducing fiscal incentives for investment, which was an important element of the EFF. The excise bill signed in November 1996 was expected to account for most of the revenue gains of the CTRP, but in its ultimate form it was seriously flawed because in shifting from an ad valorem to a specific basis, in order to make collection more effective, the provision for full indexation was eliminated. This was one of the reasons for the subsequent sharp fall in collection relative to GNP in later years as Congress proved reluctant to increase excise tax rates in line with inflation. Similarly, a minimum business tax based on gross assets for all companies above a certain asset size (which could be credited against corporate income tax due) was originally a central component of the CTRP. The version that was ultimately passed did include an alternate minimum corporate income tax, but it was based on sales rather than assets. Implementation of this tax has reportedly been very weak, partly because of this change in its structure.

<sup>41</sup>This approach was followed in 1986/87, 1994/95, and 1999.

<sup>42</sup>In the 1991 program, an unusual type of "implicit" structural benchmark was used. In order to meet pressing short-term fiscal needs a temporary (9 percent) import levy was introduced and this was to be phased out as Congress passed other tax measures submitted by the government. Completion of the reviews was made dependent on progress in phasing out the import levy and hence, implicitly, on progress in Congress in passing the alternative tax measures. However, the levy was in fact eliminated ahead of schedule in 1991, despite considerable slippage in the authorities' revenue efforts as some of the tax administration measures were delayed.

85. Weak ownership presented special challenges for the design of conditionality during a transition in administration. The 1998 SBA included a renewed emphasis on tax administration, as a “structural pillar” of the program.<sup>43</sup> The Memorandum of Economic Policies, based on the advice of an IMF technical assistance team, contained a matrix of extremely detailed commitments to reorganize the Bureau of Internal Revenue (BIR) and improve its operations, focusing on increasing control over large taxpayers, strengthening audit arrangements, and completion of a computerization project. However, according to interviews with IMF staff, the package was agreed primarily with officials of the outgoing Ramos administration. With the change in administration, and the appointment of a new Commissioner for the BIR, the incoming officials did not necessarily accept what had been agreed earlier and were not necessarily committed to implementing the measures.

86. The detailed “matrix approach” was also not very effective because it was relatively easy to find superficial ways to meet the commitments and because judgments on effective progress could not rely on a checklist of items achieved. For example, the staff report for the Third Review of the SBA judged that “good progress” had been made with tax administration in 1998, whereas a subsequent mission noted that “The implementation of reform measures had slowed down in the second half of 1998, after the new administration took office” and that, while progress had been made in some areas, “it had become increasingly clear that the new administration has not bought into key reform elements such as the control of large taxpayers and the need to strengthen BIR’s audit and enforcement programs.”<sup>44</sup>

87. Another approach that was tried subsequently to develop a more “owned” program involved a three-day workshop with IMF staff, key officials in the Philippines, and representatives from other agencies, including the World Bank and USAID, on ways of improving tax administration in the Philippines. While this is a potentially promising approach, the action plan developed in the workshop was not ef-

fectively implemented because commitment from top political leadership was lacking.

88. A more difficult question to address is whether IMF-supported programs could have done more to address the pervasive corruption that is widely seen to lie at the root of problems with tax administration in the Philippines. A World Bank study published in 2000<sup>45</sup> identified the BIR as one of the agencies that should be targeted as a priority for anticorruption efforts. IMF-supported programs were not able to come to grips with the impact of corruption on tax administration although programs have from time to time touched on issues of corruption, including through pressing for tax structures that limit corruption by reducing tax collectors’ scope for discretion. More direct targeting of conditionality on governance concerns in the field of tax administration—perhaps accompanied by more specific conditionality on the collection of tax revenue, based on more realistic and conservative projections of the impact of policy changes and administrative measures—might have yielded better results. However, it should be recognized that the IMF’s decision to be more directly involved in governance issues is relatively recent. There are also difficult questions about how much any outside agency such as the IMF can realistically be expected to achieve in such areas.

## Continuous Programs Have Limited the Independent Role of Surveillance

89. An important issue is whether surveillance functions are crowded out during periods of prolonged program involvement. In order to examine this issue systematically, the quality of surveillance in the Philippines was assessed in relation to nine “key elements” of surveillance, derived from the IMF’s most recent surveillance guidelines.<sup>46</sup> Since the guidelines evolved over time, such a comparison does involve, to some extent, judging previous sur-

<sup>43</sup>The tax administration weaknesses were due to major problems with compliance and widespread corruption; weak control over granting refunds and tax credit certificates, which were major loopholes in VAT collection; a failure to implement fully the large taxpayer scheme launched in the early 1990s; and lack of an effective tax information system.

<sup>44</sup>Both missions included FAD tax experts and overlapped with FAD technical assistance missions on tax administration, although a lack of continuity contributed to the differences in judgments. One of the major areas of differences between the authorities and the staff (which was complicated by the change in administration) proved to be on the scope and functions of the large taxpayer unit. In the event, many of the institutional changes took much longer to implement than originally envisaged.

<sup>45</sup>World Bank (2000).

<sup>46</sup>These elements and their derivation are discussed in Chapter 6 of Part I. The quality of surveillance was assessed by systematically rating the performance of each surveillance report for nine functions viewed by the IEO as “key elements” of surveillance in a program context. These nine functions draw on the “minimum requirements” of Article IV reports as listed in internal guidance notes. They are (i) provision of realistic medium-term and alternative scenarios; (ii) provision of meaningful sensitivity analyses; (iii) discussion of risks and the assumptions and projections; (iv) discussion of the risks and impact of policy slippages and of vulnerabilities; (v) balanced reporting of the authorities’ views, including any significant differences with staff; (vi) cogent presentation of proposed policy course; (vii) discussion of policy alternatives and trade-offs; (viii) critical and frank review of previous UFR performance; and (ix) presentation of collaboration/interaction with the World Bank.

veillance exercises by current standards. However, the functions highlighted have been part of surveillance requirements, or related guidelines, since at least the early 1990s. One area that has received much stronger emphasis since the 1995 Mexican and 1997/98 Asian crisis is the analysis of potential risks and vulnerabilities. In what follows, we note those areas where more recent surveillance reports have addressed these issues in greater depth.

90. Since 1986, nearly all the staff reports on Philippines' Article IV consultations have been combined with papers relating to the use of Fund resources. Given the predominance of combined papers, and the almost continuous nature of IMF-supported programs, it is difficult to generalize from the Philippines' experience about the relative adequacy of surveillance in program periods and outside them, and the relative merits of joint and stand-alone consultations. In general, the content and assessment of programs seem to have dominated joint reports. Surveillance reports that were combined with requests for new programs have tended to be relatively stronger in reviewing performance under previous programs, compared with those prepared along with program reviews.

91. All the Article IV staff reports included substantive medium-term scenarios for the economy. However, the related sensitivity analysis and discussion of risks to the projections were often limited to presenting the impact that relatively small changes in export growth, global interest rates, or the oil price would have on the projections, rather than on presenting alternative scenarios that focused attention on the major vulnerabilities. Even in one case (1996) where the text of the paper did a good job of identifying these vulnerabilities, the formal sensitivity analysis only examined the impact of a marginally slower growth in remittances. More recent reports have improved in this respect. For example, the stand-alone staff report for the 2000 Article IV consultation examined the impact of policy slippage explicitly in an alternative medium-term scenario.

92. In general, however, there was little candid discussion of implementation capacity of the authorities in any of the surveillance reports, although from time to time, uncertainties over a program's prospects for success have been noted. Staff papers typically emphasized in general terms the importance of implementation of the agreed program for the medium-term health of the economy. By contrast, a number of internal documents did contain a substantive discussion of implementation issues.

93. For the most part, presentation of collaboration with the World Bank was confined to the standard proforma appendix setting out World Bank activities. However, the most recent papers have given greater consideration to the role of the World Bank

and coordination with its activities—especially in the financial sector.

94. With a few notable exceptions, most of the staff reports on Article IV consultations do not give much sense of the long history of IMF involvement with the Philippines, and any lessons that this experience may have had for the assessment of the current situation. Many of the staff interviewed by the evaluation team believe that explicitly standing back and reviewing the history of the relationship, as was done for example in preparing internal country strategy papers (CSPs) in 1993 and in 2000, had been very useful. However, even these exercises had their limitations. As noted earlier, the preparation of a draft country strategy paper in 1993, which was never completed, prompted a lively internal debate about the lessons from previous programs for the design of the new program. However, little of the candid flavor of this internal stocktaking showed up in the subsequent 1994 Article IV consultation report. Even the 2000 Article IV report, which had considerable strengths (see below), does not reflect much of the candid flavor of the 2000 CSP.

95. Discussion of policy alternatives and trade-offs was typically limited, although such issues have more recently been covered in greater detail particularly when there were clear divergences between the staff's view and that of the authorities.

96. There is some sign that recent Article IV reports, even when combined with UFR issues, have become somewhat more effective at "standing back" from immediate program issues to assess the totality of the relationship and the vulnerabilities inherent in the existing situation. Some reports have also become a little franker in airing areas of disagreement between the staff and authorities. To give a few examples:

- The 1991 Article IV Report/ Request for Stand-By included a critical review, unusually candid for the time, of performance under the preceding EFF. It drew upon an even franker internal assessment. However, not all of the lessons—including the dangers of overloading the structural reform agenda—were fully taken into account in subsequent program design.
- The Staff Report for the 1996 Article IV consultation identified a number of key vulnerabilities facing the economy and was used to put a number of issues, which were not central to the original program, onto the policy agenda. In particular, the report noted, *inter alia*, the risks of the *de facto* exchange rate peg that the authorities had maintained since late 1995 in encouraging large short-term capital inflows; the dangers of the rapid rise in private credit in 1995–96 and its concentration in real estate and consumer lend-

ing; and the risks in the way in which the large credit expansion was being financed, through a buildup in banks' net foreign currency liabilities and foreign currency deposits, offset imperfectly by domestic foreign currency lending. The report highlighted the potential market risks of this financing structure. Circumstances at the time, particularly the program's then precautionary nature, likely made it easier for surveillance to provide added perspective.

## Conclusions

97. Before discussing potential lessons for the IMF from its prolonged involvement in the Philippines, the first question to ask is: Was this involvement a failure? In the sense that having lending arrangements in place for 25 years in a 30-year period is clearly not what the IMF is trying to achieve, the answer must be, at one level, yes. But this is not to deny that a number of IMF-supported programs achieved important successes: between 1984 and the second half of the 1990s a substantial transformation of the Philippine economy took place, and the programs assisted that transformation. So a more nuanced response to the question would contain the following elements: (i) the IMF-supported programs with the Marcos administration prior to the debt crisis clearly failed to achieve their objectives and a much more selective IMF involvement, conditional upon better policies, would have been desirable; (ii) the long IMF involvement from the 1983 debt crisis until the restoration of market access in the early 1990s could probably have been shortened with a program approach that insisted upon stronger implementation of a smaller set of core measures. However, considerable progress was eventually achieved—some of it masked by a tendency of programs to overpromise. Global systemic factors—especially the evolving approach to debt workouts—also extended the IMF's program involvement in this period; in this respect, the Philippines' experience was not unusual; and (iii) even after allowing for the unlucky timing of the Asian crisis, which prolonged the Philippines' use of IMF resources even further, the IMF maintained its program involvement for too long in the 1990s. In particular, the IMF should probably have disengaged earlier during the Estrada period, by not completing reviews, once it became clear that there was insufficient support from political leadership for core elements of the program, including stopping corruption.

98. With this background, the main messages arising from the Philippines' experience with prolonged use are as follows:

(i) *The rationale for continued lending arrangements needs to be spelled out clearly in each case and pressures to expand this rationale resisted.*

99. In the Philippines, the rationale for continued arrangements—well after market access had been restored, and any actual or potential balance of payments need was questionable—was too broad. The underlying motivation to support reforms and reformers or to provide a framework to guide an incoming administration was understandable. But if applied IMF-wide, such an approach would lead to many more prolonged users. While it is probably not possible or desirable to specify ex ante precise quantitative exit criteria, a more rigorous discussion and justification of the reasons for continued lending arrangements is needed than occurred in this case.

(ii) *The choice of the appropriate boundaries between programs and surveillance will be one of the critical determinants of the extent of prolonged use.*

100. The decisions to continue with programs in the Philippines in 1994 and again in 1998–2000 in effect reflected judgments that surveillance alone would not be adequate to the tasks of encouraging macroeconomic discipline, promoting structural reform, and providing some “seal of approval” for investors and lenders. In preparing “exit strategies” for prolonged users, the IMF should consider making greater use of alternative mechanisms, which do not involve IMF financing, to ease the transition from program arrangements. Greater transparency in recent years has increased the potential for surveillance to signal the IMF's views on the adequacy of the macroeconomic framework to the private sector as well as to official creditors and donors.

(iii) *IMF-supported programs since the 1983 debt crisis did encourage macroeconomic discipline and structural reform, but problems associated with the time frame of programs and implementation failures during periods of weak ownership prolonged the length of the adjustment.*

101. Institutional constraints on implementation, particularly the Philippines' congressional-style political system, posed special challenges for program design and required structural conditionality to be exercised flexibly. Moreover, programs tended to “overpromise” on both the number and timing of structural reforms—reflecting systemic pressures to show substantial progress within the relatively short time period of the program. Combined with the tacit understanding that the program relationship in the Philippines was likely to continue for a prolonged period, and that continual recontracting of conditions was possible, this overpromising led to a weak-

ening of the credibility of conditionality. During those periods when it had become evident that there was no political commitment at the highest level to the reforms and that governance problems were themselves a major threat to macroeconomic stability, the IMF should have been more selective in agreeing to, or extending, programs. However, during other periods when the issue was more one of the authorities' political ability to push through a wide-ranging reform program, the IMF was faced with more difficult and finely balanced judgments. In retrospect, programs would likely have been more effective if they had focused on a narrower set of critical reforms; for some elements of reform, notably those involving deeper institutional changes such as tax administration, it would have been preferable if a longer time frame had been adopted from the start, combined with an increased emphasis on strengthening implementation capacity and more direct attention to addressing governance concerns. Nevertheless, it should be recognized that the IMF's role in the latter area has been clarified only relatively recently and there are clearly limits to what outside agencies can be expected to achieve.

(iv) *The IMF's role as a gatekeeper for many other sources of financing, through the "seal of approval" element in programs, can be a two-edged sword.*

102. It can potentially increase the IMF's leverage on policies, but in practice, it also appears to have influenced the IMF's reluctance to disengage, since to do so would have had severe consequences in terms

of financing from other creditors and donors. As a result, the IMF was unable to be as selective as would have been desirable in focusing its efforts on periods of crisis management or when political circumstances were ripe to advance reform.

(v) *The Executive Board's guidelines for dealing with prolonged use were only partly followed.*

103. Although there was no general common agreed definition of prolonged use, the Philippines has been unambiguously identified as a prolonged user since the early 1980s. In spite of this, the policy governing prolonged use as articulated in Board discussions was not fully implemented. In particular, there was too little systematic candid assessment of program experience in papers for the Executive Board. Opportunities to reconsider the overall strategy and learn from experience were too limited. The staff did step back a few times to review strategy, informed, inter alia, by fairly candid ex post assessments of programs. This stepping back went further than in the other countries subject to case studies, but the most candid elements of the assessments and of the internal review process generally were often not communicated to the Board. Consequently, they were not used by the institution as a whole to critically reconsider the IMF's overall strategy in the Philippines. A more regular and systematic approach to appraising the overall strategy, on the basis of frank assessments of previous programs, and in a manner that involved the country authorities and the Executive Board would have been desirable.

## APPENDIX I

### Philippines: List of People Interviewed in Connection with the Evaluation of Prolonged Use of IMF Resources

#### Government Officials

Mr. Jose Isidro N. Camacho, Secretary of Finance  
 Mr. Rafael B. Buenaventura, Governor, BSP  
 Mr. Amando M. Tetangco, Jr., Deputy Governor, BSP  
 Mr. Nestor A. Espenilla, Jr., Managing Director, BSP  
 Mr. Gil S. Beltran, Assistant Secretary, Department of Finance  
 Ms. Emilia Boncodin, Secretary, Department of Budget and Management  
 Ms. Laura Pascua, Under Secretary, Department of Budget and Management  
 Mrs. Maribel D. Ortiz, Director, Economic Research Department, Social Security System

#### Former Senior Officials

Mr. Fidel V. Ramos, former President of the Philippines  
 Mr. Cesar E.A. Virata, former Prime Minister and Secretary of Finance  
 Mr. Gabriel Singson (former Governor, BSP), Chairman/President, JG Summit Capital Markets Corporation  
 Dr. Jesus P. Estanislao (former Secretary of Finance), President & CEO, The Institute of Corporate Directors  
 Mr. Victor Macalincag, former Under Secretary of Finance  
 Dr. Felipe Medalla, former Director-General of NEDA

Mr. Roberto De Ocampo (former Secretary of Finance), President, Asian Institute of Management  
 Mr. Jose L. Cuisia, Jr. (former Governor, Central Bank of the Philippines), President & CEO, PHIL-AM  
 Mr. Romeo L. Bernardo (former Under Secretary of Finance), Managing Director, Lazard Bernardo Tiu & Associates, Inc.  
 Ms. Wilmida Guevara (former Under Secretary of Finance), Ford Foundation

#### **Academics**

Mr. Mario B. Lamberte, President, Philippine Institute for Development Studies  
 Mr. Ponciano Intal, Professor, de la Salle University  
 Mr. Ruperto Alonzo, Professor, University of the Philippines School of Economics

#### **Banking Sector**

Dr. Placido L. Mapa, Jr., President, Metropolitan Bank & Trust Company  
 Dr. Vaughn F. Montes, Senior Vice President, CitiBank, N.A.  
 Mr. Don Hanna, Salomon Smith Barney  
 Mr. Tim Condon, Chief Economist, Asia, ING

#### **Business Community**

Mr. Raul Concepcion, Chairman, Federation of Philippines Industries

#### **Nongovernmental Organizations**

Mr. Carlito T. Anonuevo, Action for Economic Reforms  
 Ms. Jessica Reyes Cantos, Action for Economic Reforms  
 Ms. Maria Teresa D. Pascual, Freedom From Debt Coalition  
 Mr. Jose Luis Gascon, National Institute For Policy Studies  
 Mr. Ed Tongson, World Wildlife Foundation  
 Mr. Carlos H. Aquino Jr., Philippines Peasant Institute

#### **Representatives of Donors**

Mr. Khaja H. Moinuddin, Director General, Southeast Asia Department, AsDB  
 Mr. Ricarda Rieger, Deputy Resident Representative, UNDP  
 Ms. Jennifer Navarro, UNDP

The mission also met with a large number of current and former IMF and World Bank staff involved with these institutions' work on the Philippines.

## Introduction

1. Growing external imbalances and diminished prospects for continuing private external financing led Senegal to seek its first IMF arrangement in 1979. Since then, the country has had an almost continuous succession of IMF arrangements, except during 1992–93 (Table 11.1). A short-lived arrangement under the Extended Fund Facility (EFF) was followed by four Stand-By Arrangements (SBAs) during 1981–85. Since 1986, the bulk of IMF lending to Senegal has been through concessional facilities—a Structural Adjustment Facility (SAF) arrangement and three Enhanced Structural Adjustment Facility (ESAF) arrangements—with resort to regular facilities/resources limited to supplementing access levels (1986, 1987) or in a transition to a multiyear concessional facility arrangement (1994). Following the transformation of the ESAF into the Poverty Reduction and Growth Facility (PRGF), Senegal’s third ESAF arrangement was converted to a PRGF arrangement in 2000; it expired in April 2002.<sup>1</sup>

2. Senegal has had outstanding IMF credits and loans continuously since 1975.<sup>2</sup> They increased from SDR 110 million (174 percent of quota) at end-1980, to SDR 221 million (260 percent of quota) at end-1990, and then fell to SDR 205 million (127 percent of quota) at end-2001, partly reflecting Senegal’s net repayments to the IMF in recent years (Figures 11.1 and 11.2).

3. What factors contributed to this prolonged use of IMF resources, and what have been the effects? In particular, to what extent were the objectives of the programs supported by these arrangements achieved? To the extent that key objectives have not been achieved (or achievements have not been sustained), do the failures represent weaknesses in policy imple-

mentation or in the design of programs? What can be learned about improving the effectiveness of IMF-supported programs and avoiding permanent reliance on IMF financing? These are the main questions addressed in this evaluation.

4. The evaluation is based largely on an extensive review of (published and unpublished) IMF documents and interviews conducted in Dakar (during an IEO mission in March 2002) and in Washington with (i) current and former senior officials of the Senegalese government and of the Banque Centrale des Etats de l’Afrique de l’Ouest (BCEAO); (ii) a broad range of other Senegalese stakeholders, including leaders of political parties and representatives of trade unions, NGOs, and journalists; (iii) representatives of the donor community based in Senegal; (iv) the IMF Executive Director for Senegal; (v) current and former IMF staff; and (vi) World Bank staff.

5. Senegal’s membership of the CFA franc zone limits the authorities’ scope for independent exchange rate and monetary policy actions.<sup>3</sup> Arrangements for pooling international reserves, limits on central bank financing of government operations, and support of the French Treasury have succeeded in maintaining the convertibility of the CFA franc. Monetary policy is set at the regional level by the central bank, BCEAO. Since 1993/94, the principal instruments of monetary policy have moved away from administratively set interest rates and country-specific credit ceilings to indirect instruments; this change further narrowed the scope for country-specific monetary policy. Thus, fiscal policy and structural reforms are the principal means available to the authorities for effecting macroeconomic adjustment. Not surprisingly, these two policy areas feature prominently in this evaluation.

<sup>1</sup>The authorities are expected to request a new PRGF arrangement as part of the process toward reaching completion point under the enhanced HIPC Initiative.

<sup>2</sup>Including loans from special facilities—Oil Facility and the Compensatory Financing Facility—which did not require a formal arrangement to be in place.

<sup>3</sup>Senegal is a member of the eight-country West African Economic and Monetary Union (WAEMU), which together with the six-member Central African Economic and Monetary Union and the Comoros form the CFA franc zone. Each of the three parts of the zone has its own central bank. The other members of WAEMU are Benin, Burkina Faso, Côte d’Ivoire, Mali, Niger, Togo, and Guinea-Bissau (which joined in 1997).

Table 11.1. Senegal: IMF Arrangements

Arrangement <sup>1</sup>	Date of arrangement	Original expiration date	Date of expiration or cancellation	Amount agreed (SDR million)	Amount agreed (In percent of quota) <sup>2</sup>	Average annual access level (In percent of quota)	Amount drawn (In percent of agreed amount)
SBA I	Mar. 1979	Mar. 1980	Mar. 1980	10.5	25.0	25.0	100.0
EFF <sup>3</sup>	Aug. 1980	Aug. 1983	Sept. 1981	184.8	440.0	146.7	22.2
SBA II	Sept. 1981	Sept. 1982	Sept. 1982	63.0	100.0	100.0	100.0
SBA III	Nov. 1982	Nov. 1983	Sept. 1983	47.3	75.0	75.0	12.5
SBA IV	Sept. 1983	Sept. 1984	Sept. 1984	63.0	100.0	100.0	100.0
SBA V	Jan. 1985	Jul. 1986	Jul. 1986	76.6	90.0	60.0	100.0
SBA VI	Nov. 1986	Nov. 1987	Sept. 1987	34.0	40.0	40.0	100.0
SAF <sup>4</sup>	Nov. 1986	Nov. 1989	Nov. 1988	54.0	63.5	21.2	78.7
SBA VII <sup>5</sup>	Oct. 1987	Oct. 1988	Oct. 1988	21.3	25.0	25.0	79.8
ESAF I <sup>6</sup>	Nov. 1988	Nov. 1991	Jun. 1992	144.7	170.0	56.7	100.0
SBA VIII	Mar. 1994	Mar. 1995	Aug. 1994	47.6	40.0	40.0	65.0
ESAF II <sup>7</sup>	Aug. 1994	Aug. 1997	Jan. 1998	130.8	110.0	36.7	100.0
ESAF/PRGF III <sup>8</sup>	Apr. 1998	Apr. 2001	Apr. 2002	107.0	90.0	30.0	90.2

Source: IMF Treasurer's Department.

<sup>1</sup>Roman numerals are used to indicate the sequence of arrangements, by type.

<sup>2</sup>The size of Senegal's quota at the IMF increased from SDR 42 million to SDR 63 million in December 1980, to SDR 85.1 million in December 1983, to SDR 118.9 million in December 1992, and to SDR 161.8 million in February 1999.

<sup>3</sup>Approved as a three-year arrangement. The first review, envisaged for completion by December 1980, was not completed.

<sup>4</sup>The approved amount was increased from SDR 40 million in July 1987. The second annual arrangement was approved on October 26, 1987.

<sup>5</sup>Combined with second annual SAF arrangement

<sup>6</sup>The second and third annual arrangements were approved in December 1989 and June 1991, respectively.

<sup>7</sup>The second and third annual arrangements were approved in December 1995 and January 1997, respectively.

<sup>8</sup>The second and third annual arrangements were approved in July 1999 and February 2001, respectively.

## Overview of Policies and Performance

### Background: the 1970s and early 1980s

6. Senegal's external current account deficit almost doubled in the 1970s from an average of about 4½ percent of GDP in the first half of the decade to over 8½ percent in the second half, and the rising deficit was financed by public sector foreign borrowing. Total external debt rose from about \$130 million in 1971 to almost \$1 billion in 1979 (going from 19 percent to 35 percent of GDP). Real GDP growth averaged 2 percent a year but with wide fluctuations that partly reflected the impact of exogenous shocks, especially weather conditions and fluctuations in the international terms of trade. Favorable developments in the world prices of two of Senegal's main exports (groundnut oil and phosphates) helped temper the effect of rising international oil prices on the terms of trade; on average, the terms of trade improved by about 15 percent in the second half of the 1970s, compared with the first half. Inflation followed an upward trend in the first half of the decade, peaking at over 30 percent in 1975, and then subsided to an average of less than 7 percent during 1976–80.

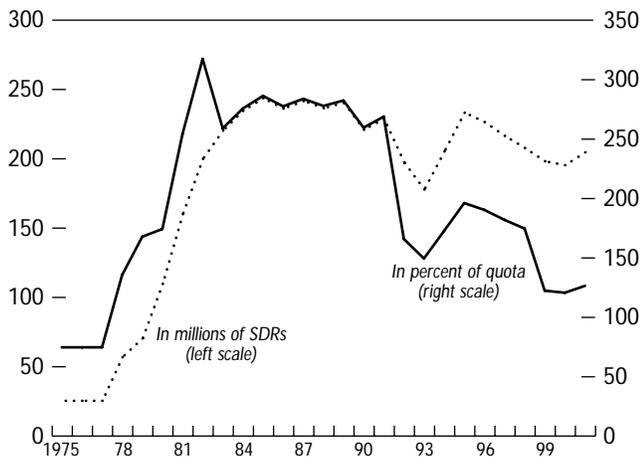
7. Senegal faced a severe financial crisis in the late 1970s and early 1980s, when deteriorating terms of trade and the government's pricing policies pro-

duced a large external current account deficit (averaging 13 percent per annum during 1979–83) and an expansion in the public sector deficit.<sup>4</sup> The staff estimated that at the end of the 1980/81 fiscal year, internal arrears accumulated by the central government and public enterprises exceeded total government revenue during the year.

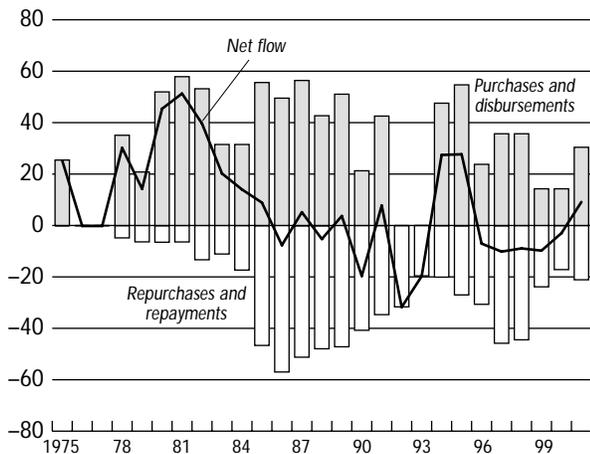
### Objectives and policies of the IMF-supported programs

8. The principal medium-term objective of Senegal's IMF-supported programs during 1979–85 was to reduce internal and external financial imbalances to sustainable levels. With respect to external imbalances, the objective was to reduce the current account deficit to a level that could be financed without recourse to debt rescheduling or accumulation of arrears. The objective was to be achieved mainly through policies that restrained aggregate demand. The structural weaknesses that underlay Senegal's macroeconomic imbalances—for example, a large inefficient public sector, extensive subsidies through

<sup>4</sup>The pricing policies that led to problems were (i) not passing on to consumers increases in import costs of several consumer goods and (ii) setting the producer price of groundnuts above world market prices.

**Figure 11.1. Senegal: Outstanding Obligations to the IMF**

Source: IMF Treasurer's Department.

**Figure 11.2. Senegal: Net Borrowing from the IMF**  
(In millions of SDRs)

Sources: IMF Treasurer's Department and IEO calculations.

controls on producer and consumer prices—were recognized at an early stage, and the early programs included measures to deal with them.<sup>5</sup> In particular, they included measures to contain financial losses

<sup>5</sup>The 1980 EFF was an attempt at a comprehensive approach to tackling Senegal's financial imbalances using the IMF's only available "structural" facility at the time; the authorities had expressed a strong preference for an EFF over an SBA. In the event, the EFF was short-lived and was replaced by a succession of SBAs.

associated with government intervention in sectors such as agriculture and energy, policies to limit growth in public service employment, and attempts to strengthen tax administration. The operations of agencies performing quasi-fiscal functions (e.g., the Caisse de Péréquation et de Stabilisation des Prix (CPSP)) received particular attention.<sup>6</sup>

9. Structural reforms and social policy issues received greater prominence under the arrangements supported by the concessional facilities, beginning with the 1986 SAF. The advent of the Policy Framework Paper (PFP)—associated with SAFs and ESAFs—provided a vehicle for incorporating the authorities' sectoral and social programs into IMF-supported programs. The PFP for the first ESAF arrangement (1988) indicated a "two-pronged medium-term strategy entailing (i) a reduction in the obstacles to private sector initiative and growth; and (ii) the achievement of greater efficiency in public resource management, including a strengthening in government finances." Policies to be implemented included: a public investment program to support directly productive sectors, abolition of virtually all price controls, reduction in labor market rigidities, strengthening of the government budget through shifting to a more stable revenue base (including reform of taxation and pricing policies for petroleum products), and reinforcing efforts to improve the delivery of basic services (e.g., education and health care) to the population.

10. With the transformation of the ESAF into the PRGF, programs continued to emphasize structural reforms to remove impediments to growth, but also made poverty reduction a more central goal. Furthermore, they have paid greater attention to the allocation of resources to priority social sectors and to rural infrastructure. In May 2002, Senegal submitted to the IMF and the World Bank, a PRSP that was produced from an extensive consultation process involving a wide range of domestic stakeholders and international development partners.<sup>7</sup>

11. The World Bank supported Senegal's adjustment efforts in the 1980s and 1990s with, among other operations, four Structural Adjustment Loans (SALs) and several sectoral adjustment credits (including in the financial, agriculture, and energy sectors). The first SAL, which was approved in 1980, was closely aligned with the 1980 EFF.<sup>8</sup> The second

<sup>6</sup>The CPSP was responsible for administering producer prices for agricultural products, notably groundnuts and cotton. Its financial position went from substantial surpluses in the 1970s to large deficits in the early 1980s.

<sup>7</sup>Preparation of the PRSP is one of the conditions for reaching completion point under the enhanced HIPC Initiative.

<sup>8</sup>A program performance audit report of the SAL prepared by the World Bank's Operations Evaluation Department (OED) reported that "full cooperation between the staffs of the Bank and

and third SALs, approved in 1986 and 1987, respectively, run in parallel with SBA and SAF arrangements. The fourth SAL, approved in 1990, aimed to build on achievements under the 1986 and 1987 SALs and to tackle some of the remaining challenges. To that end, it sought to help the authorities “restore Senegal’s competitive position and achieve growth with macroeconomic equilibrium.” It was to focus on, among other things, measures to improve production incentives (e.g., reducing tax burdens, costs of production, and labor market rigidities) and to rationalize the public sector (e.g., through civil service reform, reducing government subsidies to public enterprises, and privatization). A Financial Sector Adjustment Credit (approved in 1989) was instrumental in restructuring the banking system in Senegal and strengthening the BCEAO’s banking supervision capabilities. Adjustment credits to the agriculture and energy sectors (in 1995 and 1998, respectively) endeavored to tackle long-standing structural problems in those sectors and included some that had featured prominently in IMF arrangements.

### Program implementation

12. Senegal’s record shows a stop-go pattern of program implementation as measured by compliance with performance criteria and benchmarks (hereafter referred to as “performance targets”) and timeliness of the completion of program reviews. Implementation was generally weak in the early programs during 1979–82. Two of the programs in this period (the 1980 EFF and the 1982 SBA) went off-track soon after they were approved, because of policy slippages (especially in price liberalization and tax measures) and the failure of IMF staff and the authorities to agree on policy adaptations required to attain program objectives in the face of unanticipated shocks. In the case of the EFF, part of the problem appears to have been weaknesses in the data used for establishing performance targets, which understated the magnitude of prevailing and prospective financial imbalances. By contrast, all the arrangements approved between 1983 and 1987 (two stand-alone SBAs and two combined SBA/SAFs) were characterized by high compliance with performance targets and timely completion of program reviews. This period was also marked by significant deregulation of the economy, including a reduction in the scope of price controls, partial liberalization of

the agriculture sector, and the phasing out of most quantitative restrictions on imports.

13. Program implementation weakened again between 1988 and 1992. Under the first two annual arrangements of the 1988 ESAF, performance targets linked to midterm reviews were observed, but were followed by a loosening of fiscal policy after completion of the reviews. These policy slippages were judged by IMF staff to be sufficiently serious to warrant a reestablishment of a track record of good performance under a six-month staff-monitored program (July–December 1990) before the request for a third annual arrangement was submitted to the Executive Board. Under the latter arrangement, implementation was once again satisfactory prior to the completion of the midterm review (in November 1991), but this was not sustained.

14. Discussions on a successor ESAF arrangement started in 1992, before the expiration of the 1988 ESAF, but no agreement was reached over a period of nearly two years.<sup>9</sup> In this intervening period, some measures that had been delayed under the ESAF were implemented, including extension of the coverage of VAT to the transport sector, and the starting of operations of a company hired to improve the system of valuation of imports in order to curb underinvoicing. Measures envisaged under a banking system reform program were also fully implemented. On the other hand, the authorities took several steps that worsened the public finances: an increase in the producer price of groundnuts (contrary to understandings under the ESAF) widened the deficit of the groundnut sector, and a reduction in selected customs tariffs and VAT rates lowered revenues. Furthermore, an agreed mechanism for automatic adjustment of domestic petroleum prices to reflect developments in world prices was not implemented.

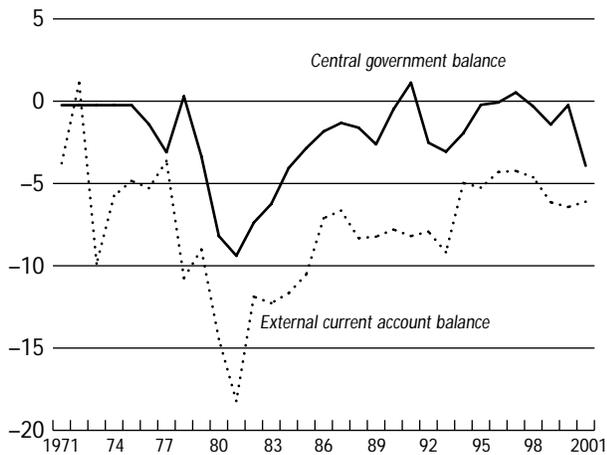
15. Legislative and presidential elections in the first half of 1993 constrained policy actions needed to address the reemergence of severe financial problems. In August, the authorities announced a package of corrective “internal” (i.e., nonexchange rate) measures that included a 15 percent cut in most public sector nominal wages, increases in import duties, and increases in the retail prices of petroleum products. The reduction in wages was not implemented, following strong protests by trade unions.

16. Discussions between the staff and the authorities during 1992–93 covered the issue of devaluation as a policy option for the CFA franc zone. Similar discussions were held with the authorities in other

the Fund was achieved” during the preparation of the SAF and the EFF and that some of the performance targets in the EFF and the SAL were identical or very similar. The authors did not think this overlap in conditionality was appropriate, arguing that failure to meet “short-term IMF performance criteria” should not automatically lead to disruption of a SAL.

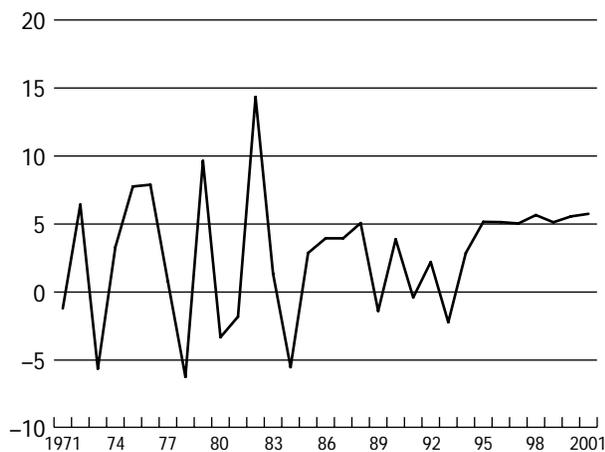
<sup>9</sup>The staff report on the 1992 Article IV consultation noted that “it had not been possible to reach understandings with the authorities on the required set of strong measures that would permit a resumption of credible adjustment, and thus establish a firm basis for a new Fund-supported program.”

**Figure 11.3. Senegal: External and Fiscal Balances**  
(In percent of GDP)



Sources: IMF, WEO database; and IEO calculations.

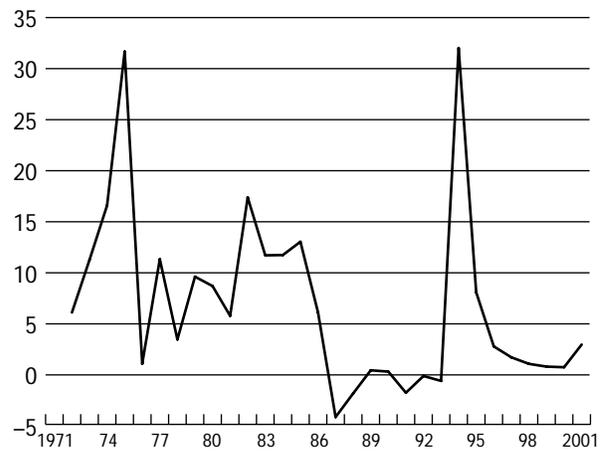
**Figure 11.4. Senegal: Real GDP Growth**  
(In percent per annum)



Sources: IMF, WEO database; and IEO calculations.

CFA franc countries, against a background of real exchange rate appreciation and persistent adverse terms of trade developments in most of the member countries. A historic 50 percent devaluation of the CFA franc in January 1994 paved the way for new arrangements in support of a renewed adjustment effort—initially, an SBA to provide quick financial assistance, followed by a new multiyear ESAF arrangement five months later. Implementation of policies was generally good during 1994–99, al-

**Figure 11.5. Senegal: Inflation**  
(In percent per annum)



Source: IMF, WEO database.

though the pace of structural reforms was slow and there were policy slippages in the period leading up to legislative elections in 1998 and presidential elections in 2000.

17. The incumbent president, Mr. Diouf, was defeated by the veteran opposition leader, Mr. Wade, in presidential elections in early 2000 to end 40 years' rule by the Socialist Party. President Wade's Senegalese Democratic Party won a majority of seats in legislative elections for a new national assembly held in April 2001. Significant slippages in the timetable for structural reforms occurred during the political transition that extended into the period covered by the third annual PRGF arrangement (approved in February 2001). On the strength of some corrective measures taken by the new government, the IMF Executive Board completed the second of three envisaged reviews in April 2002, shortly before the expiration of the PRGF arrangement.

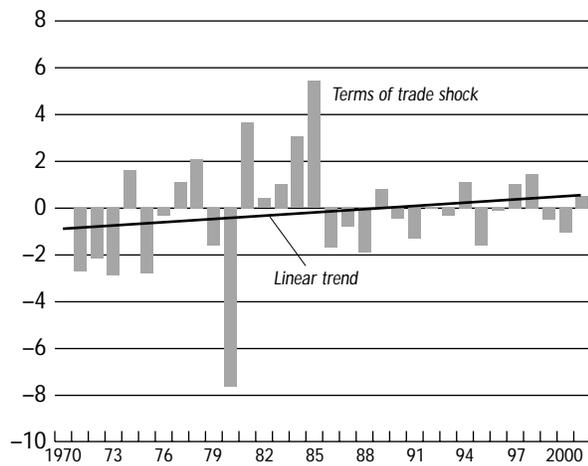
#### What was achieved over the extended period of programs?<sup>10</sup>

18. Over the period of Senegal's prolonged use of IMF resources there has been a significant reduction in macroeconomic imbalances and less volatility in real GDP growth (Figures 11.3 and 11.4). Inflation

<sup>10</sup>The data on which the tables and graphs in this section are based are mostly from the IMF's World Economic Outlook (WEO) database supplemented by data from the following databases: the African Department's WETA database, International Financial Statistics (IFS), and the Information Notice System (INS).

**Figure 11.6. Senegal: Impact of Terms of Trade Shocks**

(In percent of GDP)



Sources: IMF, WEO database; and IEO calculations.

has followed a downward trend, except for a spike in the rate following the large devaluation in the exchange rate in 1994 (Figure 11.5). The impact of terms of trade shocks on the overall economy has also declined, although there continue to be large fluctuations in the world prices of two commodities—crude oil and groundnut oil—which have been associated with periodic adjustment problems and linked in part to government policies (Figures 11.6–11.10).<sup>11</sup>

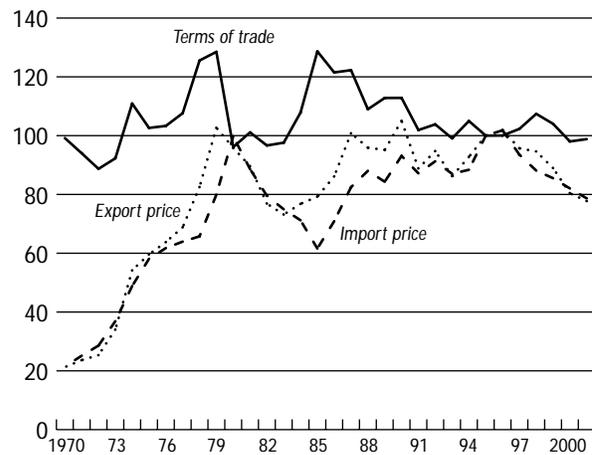
19. Table 11.2 presents selected indicators of macroeconomic performance during the three years before Senegal's first IMF arrangement and five subperiods during 1979–2001. The subperiods are broadly based on “adjustment effort” as judged by consistency of program implementation (discussed above):<sup>12</sup>

- (i) 1979–83: characterized by weak implementation.
- (ii) 1984–88: characterized by strong implementation.
- (iii) 1989–93: spanning the period of the 1988 ESAF arrangement (uneven implementa-

<sup>11</sup>The “impact of terms of trade shocks” measures the effect (in percent of GDP) of annual changes in export and import prices, holding trade volume constant. See McCarthy, Neary, and Zanalda (1994).

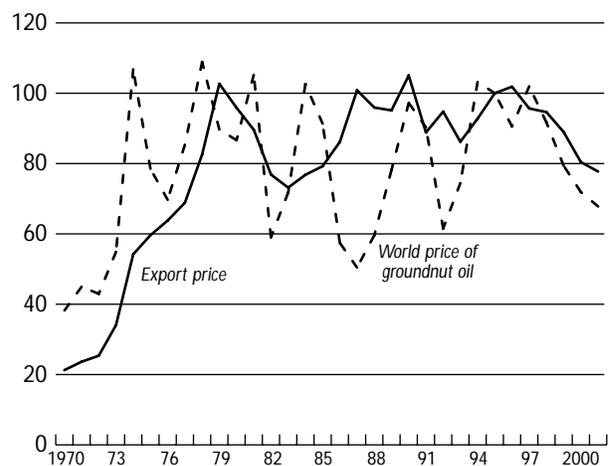
<sup>12</sup>A summary of the factors considered in coming to a judgment on each of Senegal's IMF arrangements, including annual arrangements within multiyear arrangements, is presented in Appendix 1.

**Figure 11.7. Senegal: Terms of Trade Indices**  
(1995 = 100)



Sources: IMF, WEO database; and IEO calculations.

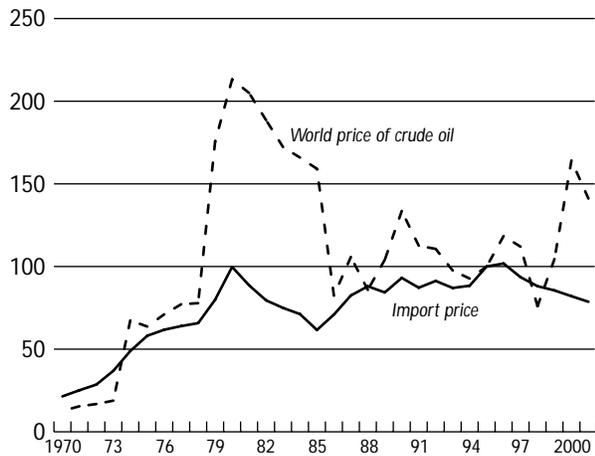
**Figure 11.8. Senegal: Export Price Index and World Price of Groundnut Oil**



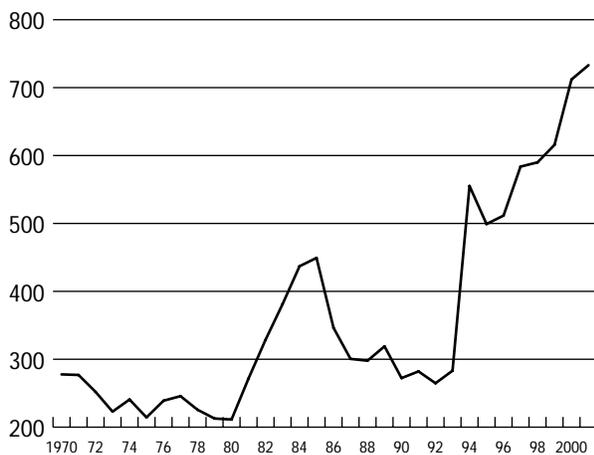
Sources: IMF, WEO database; and IEO calculations.

tion) and a period when there was no IMF arrangement.

- (iv) 1994–99: during which there was strong implementation of macroeconomic policies, and modest progress on structural reforms.
- (v) 2000–01: marked by some policy reversals but continuing relatively good macroeconomic performance.

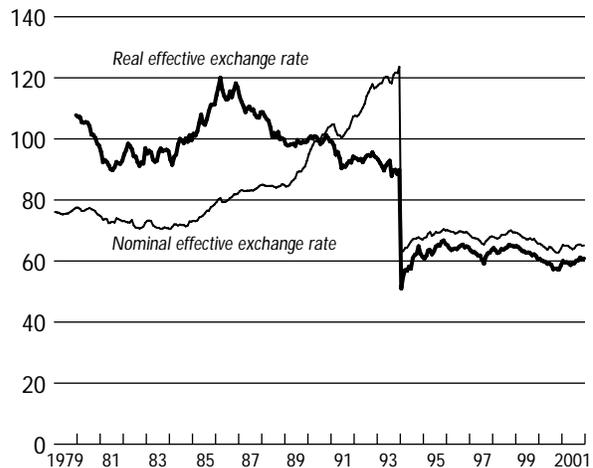
**Figure 11.9. Senegal: Import Price Index and World Price of Crude Oil**

Sources: IMF, WEO database; and IEO calculations.

**Figure 11.10. Senegal: Nominal CFA Franc/ U.S. Dollar Exchange Rate**  
(Annual averages)

Sources: IMF, WEO and WETA databases.

20. The most significant adjustment took place during 1984–88, when the average annual current account deficit improved to about 9 percent of GDP from 13 percent of GDP during 1979–83 and average inflation was halved. An improvement in the fiscal balance—driven by a 6 percentage point reduction in the expenditure/GDP ratio—was the principal contributor to that outturn. The adjustment achieved during the period was aided by relatively favorable

**Figure 11.11. Senegal: Real and Nominal Effective Exchange Rates**

Sources: IMF staff reports and IEO calculations.

developments in the terms of trade. During 1989–93, there were slight improvements in average fiscal and current account deficit compared to 1984–88.<sup>13</sup>

21. Another significant adjustment in the external and fiscal balances occurred during 1994–99, following the devaluation of the CFA franc. This time, in contrast to 1984–88, the adjustment was accompanied by significant and sustained growth and progress on structural reforms. The period 2000–01 was marked by continued growth in spite of some backsliding on structural reforms and a reversal of the downward trend in fiscal and external imbalances. The authorities' success in sustaining most of the real depreciation achieved in 1994, contributed to the better growth performance. At the end of 2001, the real effective exchange rate was at about the same level it was at the end of 1994, implying a real depreciation of about 30 percent compared to its predevaluation level (Figure 11.11).<sup>14</sup>

22. There was a banking crisis in the late 1980s, brought about by severe liquidity problems that reflected government payments arrears and a sizable (and growing) share of nonperforming loans in banks' portfolios. A regional (WAEMU-wide) banking system restructuring project, financed by the World Bank and other donors, succeeded in cleaning up the sector and strengthening banking supervision. A Financial Sector Stability Assessment undertaken

<sup>13</sup>This comparison of averages obscures trend improvements that were partially reversed, especially in 1993.

<sup>14</sup>NEER and REER are indices of the nominal effective exchange rate and the real effective exchange rate, respectively.

**Table 11.2. Senegal: Selected Economic Indicators***(In percent of GDP, unless otherwise indicated)*

	Period averages					
	1976–78	1979–83	1984–88	1989–93	1994–99	2000–01
Real GDP growth (percent per annum)	0.8	4.0	2.1	0.4	4.8	5.7
Inflation (percent per annum)	5.3	10.6	5.0	–0.3	7.8	1.9
Terms of trade (percent change per annum in U.S. dollar price indices)	7.2	–5.9	2.8	–1.8	0.9	–2.5
External current account balance, including transfers (balance of payments) of which: official transfers <sup>1</sup>	–6.6 ...	–13.2 4.9	–8.9 4.9	–8.3 1.3	–4.9 3.0	–6.3 1.4
Gross national saving <sup>2</sup>	5.8	–2.4	3.0	5.3	12.8	11.9
Gross investment	12.3	10.7	11.8	13.5	17.7	18.1
Central government balance	–1.4	–6.9	–2.3	–1.5	–0.6	–2.1
Total government revenue and grants	19.1	21.1	19.4	19.4	19.7	19.8
Of which: grants	...	0.8	1.2	1.5	3.2	1.8
Total government expenditure and net lending	20.5	28.0	21.8	20.9	20.3	21.9
Final consumption expenditure	98.6	103.7	97.4	93.4	88.9	90.7
Public consumption expenditure	19.2	19.3	16.2	14.8	11.5	13.6
Private consumption expenditure	79.4	84.5	81.2	78.7	77.4	77.1
Gross capital formation	12.3	10.7	11.8	13.5	17.7	18.1
Gross public capital formation	4.7	4.7	4.0	4.5	6.3	6.9
Gross private capital formation	7.6	6.1	7.8	9.1	11.5	11.3
Imports of goods and services	48.7	48.3	38.9	31.7	38.1	38.7
Exports of goods and services	37.2	33.8	29.6	24.7	31.4	30.0
Memorandum items						
Decomposition of external adjustment (change, in percent of GDP)						
Current account		–6.6	4.3	0.6	3.3	–1.3
Fiscal balance		–5.5	4.6	0.8	0.9	–1.5
Private sector saving-investment balance <sup>3</sup>		–1.1	–0.3	–0.2	2.4	0.2

Sources: Calculated from IMF, WEO and WETA databases.

<sup>1</sup>The decline between 1994–99 and 2000–01 partly reflects a reclassification of project grants from the current account to the capital account.<sup>2</sup>Calculated as the difference between the external current account balance (balance of payment) and gross investment.<sup>3</sup>Calculated as the change in the current account balance minus the change in the fiscal balance.

by a joint IMF–World Bank team in 2001 concluded that the banking system in Senegal had recovered from the crisis and was in good health. However, it highlighted as a significant risk factor in the system the high exposure of banks to parastatals in the agriculture and energy sectors—reflecting the continuation, after two decades of programs, of problems with restructuring the groundnut sector and inefficiencies in the energy sector—with significant macroeconomic impact.

### Why Was There Prolonged Use of IMF Resources?

23. Five main reasons were found for Senegal's prolonged use of IMF resources.

24. First, the initial imbalances were large and deeply rooted in structural weaknesses of the econ-

omy that were likely to require a long time to address in a sustainable manner. The weaknesses included the vulnerability of the economy to weather and terms of trade shocks, and the heavy burden on public finances exerted by a large inefficient public sector, by extensive price controls over both consumer and producer prices, and by a heavy external debt-service burden.

25. The second reason was a broadening of objectives associated with programs supported under the IMF's concessional facilities. The introduction of the SAF and its evolution to the ESAF, and the latter's transformation to the PRGF, were accompanied by an elevation of growth, social policy issues, and poverty reduction, as explicit goals in programs. This evolution has been accompanied by a lengthening of the time frame within which users of these resources are expected to achieve goals specified under programs.

26. A third factor is the use of IMF arrangements as a seal of approval for the provision of external finance by several multilateral and bilateral creditors and donors.<sup>15</sup> One example of this is the Paris Club of official creditors, which requires the existence of an IMF arrangement for its debt rescheduling agreements. Senegal has had 13 such agreements. The earlier approach to debt rescheduling—with its focus on restructuring of debt service falling due within the limited period covered by the IMF arrangement—provided only temporary respite, and required a succession of programs to continue to receive debt relief. Senegalese officials confirmed in interviews that this catalytic role of IMF arrangements was an important consideration in the country's continuing requests for use of IMF resources. There is some evidence from internal documents that, on occasion, the “seal of approval” role was a factor in efforts by the staff to keep programs afloat when slippages occurred, and to try to work on corrective measures rather than interrupt the program. Senegal's good standing among donors, based in part on its historical role as the administrative center of French West Africa and its tradition of regular democratic elections, may also have earned it the benefit of the doubt from time to time.<sup>16</sup>

27. Weaknesses in program design also contributed to prolonged use. In particular, the pre-devaluation programs were too optimistic about how effective the adjustment strategy being pursued would be in promoting growth and sustainable financial viability. For example, the successful stabilization during 1984–88 was accompanied by low growth and, in retrospect, programs during this period may have been too sanguine about the scope for achieving growth and external viability objectives without an exchange rate adjustment. Furthermore, the programs could have paid more attention to the consequences for growth of some of the measures employed to contain public sector deficits. For example, Rouis (1994) argues that a persistent focus on addressing short-term financial imbalances with ad hoc revenue measures and a lack of attention to needed structural reforms (e.g., to address tax administration and international competitiveness problems) produced a fiscal adjustment that hurt growth.<sup>17</sup> Although there is a limit to how much an

IMF arrangement by itself can address structural reforms, the persistence of problems in areas such as the energy and groundnut sectors, civil service reform, labor market regulations, and public enterprise reform, raise questions of the effectiveness of IMF–World Bank collaboration in program design (including measures to enhance implementation prospects).

28. Finally, the stop-go pattern of program implementation weakened the effectiveness of programs and thus contributed to the continuing “need” for IMF arrangements. The wide variations in the degree of implementation under different arrangements reflected several factors. Successfully implemented programs tended to be characterized by strong up-front adjustment measures and adaptations of policies during program reviews when there were significant actual or prospective deviations from targets (usually fiscal targets).<sup>18</sup> In the cases where implementation was weak, contributory factors usually included social and political concerns of the authorities which translated into (i) nonimplementation of agreed measures (e.g., the contingency mechanism of freezing lower priority expenditure in the event of a shortfall in government revenues during the second annual arrangement under the 1988 ESAF was not implemented because of concerns about social unrest); (ii) delays in implementing measures (e.g., weakening in macroeconomic management and slippages in the timetable for structural reforms in late 1999 and early 2000, ahead of Presidential elections); or (iii) policy reversals, which were also often linked to the electoral cycle (e.g., suspension of the petroleum pricing mechanism in February 2000).

## Effectiveness of the IMF-Supported Programs

### Program design: the macroeconomic framework

29. Against the backdrop of very low (and sometimes negative) saving rates in the late 1970s and early 1980s, increasing the domestic saving rate has been a key objective in Senegal's IMF-supported programs. This was not only to contribute toward narrowing the external current account deficit, but also to help boost investment and, ultimately, growth. The efficiency of investment was to be enhanced through various structural reforms.

<sup>15</sup>See Chapter 6 of Part I.

<sup>16</sup>During the period under review (1979–2001), presidential and legislative elections were held in 1983, 1988, and 1993. In line with changes in electoral laws, presidential elections were also held in 2000, and legislative elections in 1998 and in 2001. Governments of national unity (which included members of opposition parties as cabinet ministers) were formed in 1991 and 1994 in efforts to diffuse rising social and political tensions in the country.

<sup>17</sup>Rouis (1994) and Tahari and others (1996) provide comprehensive analyses of economic performance in Senegal during this period.

<sup>18</sup>Examples include the 1983 and 1985 SBAs and the 1994 ESAF (see Appendix 1). The up-front measures in the earlier programs included increases in the administered prices of consumer goods and petroleum products.

### ***Realism of key assumptions and projections in the macroeconomic framework***

30. Between 1986 and 1992 (spanning two combined SBA/SAF arrangements and three annual arrangements under the 1988 ESAF), programs projected sharp drops in the external current account and the government budget deficit over the medium term. There were improvements in both balances, but outturns tended to fall short of projections. In particular, exports consistently fell short of projections, and budgetary revenues tended to be lower than envisaged. Projections of domestic saving and investment were consistently higher than the outturns, and the projected real GDP growth also tended to be higher than actual growth (Appendix 2).

31. Under the immediate post-devaluation ESAF (1994–97), the divergence between medium-term projections and outturns narrowed considerably for several variables, most notably real GDP growth, current account balance, government balance, domestic saving, and exports. Significant deviations between projections and outturns reappear under the 1998 ESAF/PRGF for the current account balance (i.e., outturns worse than projected) even though export performance was better than projected. In contrast to the earlier period, government revenues have tended to be higher than projected.

#### *Progress toward external viability*

32. The first six rescheduling agreements concluded between Senegal and the Paris Club (between 1981 and 1987) provided nonconcessional flow relief in successive program periods. Between 1989 and 2000, Senegal concluded another seven agreements with the Paris Club on increasingly more concessional terms, reflecting the evolution of Paris Club policies with respect to low-income countries.<sup>19</sup> Throughout the 1980s, programs repeatedly indicated that Senegal would be able to stop reliance on “exceptional financing” (rescheduling and accumulation of arrears) within a few years. For most of the 1990s, programs suggested that once account was taken of traditional debt relief mechanisms, Senegal’s external debt would be sustainable. For example, as recently as 1998, a debt sustainability analysis (DSA) conducted by IMF and World Bank staffs and the authorities indicated that Senegal’s debt burden was sustainable when gauged against the thresholds under the initial HIPC Initiative. However, an updated DSA done in early 2000 indi-

<sup>19</sup>Three were on Toronto terms (one-third reduction in the net present value of eligible debt), one was on London terms (50 percent reduction), two were on Naples terms (two-thirds reduction), and the last was on Cologne terms (up to 90 percent reduction).

cated that the country’s debt burden was not sustainable when judged against the lower sustainability thresholds of the “enhanced” HIPC Initiative.<sup>20</sup> Senegal reached the decision point under the enhanced HIPC Initiative in June 2000, and was, at that time, expected to reach completion point in 2002.

33. Several staff members interviewed acknowledged that the medium-term balance of payments projections and debt sustainability analyses prepared for Senegal had been influenced by an incentive to “overpromise” on the pace of restoration of sustainability that stemmed from internal guidelines requiring that there be significant progress toward external viability by the end of three-year arrangements. A second factor that contributed to this overoptimism was the heavy weight given to export-based indicators in HIPC thresholds; this focus on “external” burden indicators, rather than “fiscal” burden indicators, tended to downplay the extent of Senegal’s debt problems (Figures 11.12 and 11.13). Indeed, it was consistently pointed out in staff reports that the debt-service burden was much heavier when viewed in relation to government revenues rather than to export earnings.<sup>21</sup> A number of Senegalese officials interviewed indicated that program limits on nonconcessional borrowing have been a useful device for instilling discipline in external debt management. The share of total debt owed to private (commercial) creditors fell from a peak of nearly 50 percent in 1978 to 8 percent ten years later (1988) and to less than 1 percent in 1999.<sup>22</sup>

#### ***Dealing with uncertainty***

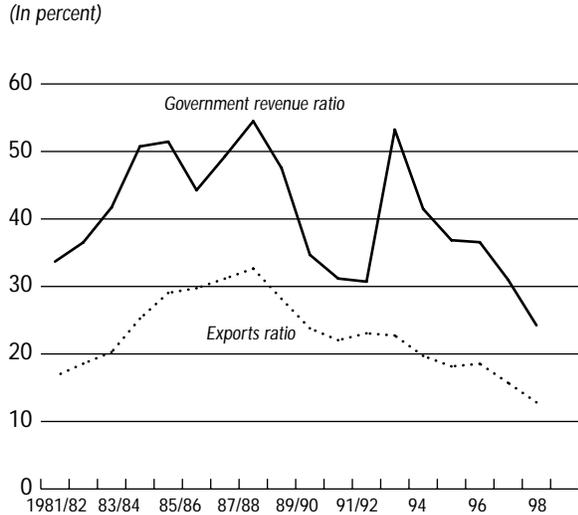
34. For the major shocks that Senegal is susceptible to—droughts and terms of trade—programs have

<sup>20</sup>Under the original HIPC Initiative, the sustainable threshold was the range of 200–250 percent for the ratio of NPV-of-debt to exports. Countries with very open economies (export/GDP ratios of 40 percent or higher) and that had government revenue/GDP ratios of at least 20 percent were eligible for assistance if the ratio of their NPV-of-debt to government revenue exceeded 280 percent. Under the enhanced HIPC Initiative, the threshold for the NPV-of-debt to export ratio was lowered to 150 percent (no longer a range), and the requirements for eligibility for assistance through the fiscal window were changed to an export/GDP ratio of 30 percent, government revenue/GDP ratio of 15 percent, and NPV-of-debt/revenue ratio exceeding 250 percent. For further details, see, for example, Andrews and others (1999).

<sup>21</sup>Foreign exchange restrictions are sometimes cited as a reason for favoring export-based debt burden indicators over GDP- and government revenue-based indicators (see, for example, “Staff Response to the External Evaluation of the ESAF” (IMF, 1998). For Senegal, the convertibility of the CFA franc removes this concern, and allows other factors to come to the fore (e.g., dominance of public debt in total debt, a “reasonable” revenue/GDP ratio, and considerations of debt service crowding out “productive” government spending).

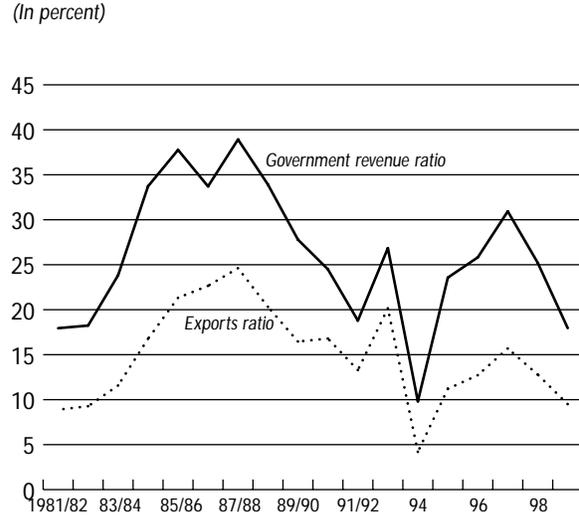
<sup>22</sup>The ratios were calculated from the World Bank’s Global Development Finance database.

**Figure 11.12. Senegal: Debt-Service Ratios Before Rescheduling**  
(In percent)



Source: IMF staff reports.

**Figure 11.13. Senegal: Debt-Service Ratios After Rescheduling**  
(In percent)



Sources: IMF, GFS database; and IEO calculations.

tended to deal with their effects in the context of program reviews, rather than through prespecified contingencies. The 1994 SBA and 1994 ESAF arrangement went a limited way toward prespecifying contingency measures for some terms of trade shocks (discussed below). In principle, program reviews provide greater flexibility than prespecified contingencies, but if there is not a broad understanding of how policies will respond to the major risks, they increase the chances of disagreements over, and hence delay in, the appropriate policy response that may push programs off-track.

35. Virtually all the arrangements have had some mechanism for automatic adjustment of selected quantitative financial performance criteria in the event of deviations from underlying program assumptions. Typically, ceilings on net domestic assets of the banking system and on the banking system's net claims on the government were automatically adjusted for deviations in (i) the amount of crop credit extended by the banks; and (ii) external financing of the budget (excluding grants). There tended to be full accommodation for crop credit deviations. For external financing, there tended to be a requirement to either use "excess" amounts to reduce domestic debt (especially expenditure arrears) or to save such amounts and discuss their use during subsequent missions. Shortfalls tended to be partially adjusted for, up to prespecified amounts; shortfalls beyond these amounts were to be offset by additional measures.

36. Since 1994, programs have contained quarterly benchmarks for government revenue and the

government wage bill, deviations from which were to be corrected by additional tax measures or reduction in nonpriority expenditures, in order to achieve the fiscal objectives of the programs. This feature was deemed by IMF staff to be an important device to ensure that the fiscal policy stance was appropriately supportive of the devaluation. The 1994 SBA and the 1994 ESAF (but not the 1998 ESAF) contained prespecified contingencies in the event that world prices for groundnut products and cotton turned out to be lower than projected under the programs; they required that the fiscal implications of such shortfalls be offset fully by additional revenue-raising or expenditure-reducing measures. This was too rigid an approach, since it implied that there would be no situation in which a higher fiscal deficit would be allowed to accommodate a temporary adverse terms of trade shock. Moreover, the lack of a clear indication of the types of revenue and expenditure actions increased the risks of ad hoc adjustments that would be unsustainable and inconsistent with the medium-term growth-oriented strategy.

### Structural reforms

37. Senegal has made major strides in some structural reforms (notably in the areas of price liberalization, trade liberalization, and simplification of the tax system). But reforms aimed at restructuring the groundnut sector and at liberalizing petroleum product prices have proved to be intractable, resurfacing

periodically with significant adverse effects on the government budget and on production incentives in the economy. Moreover, tax reforms have not yielded significant increases in revenue (measured in relation to GDP), reflecting, in part, the short-term revenue-reducing effects of some of the reforms (e.g., tariff reduction).

### Restructuring of the groundnut sector

38. A lack of clarity on the aims of restructuring (expansion of production, diversification of agricultural output, or stabilization of farmers' incomes) and sociopolitical sensitivities explain the lack of progress on restructuring the groundnut sector. The recurring issues about the groundnut sector in programs have revolved around government interventions that contribute to financial losses of the sector—namely subsidization of inputs, and the setting of producer prices above world market prices. However, there have been periods when the sector has been in surplus (reflecting favorable developments in world prices that were not passed on to producers). During 1984/85 and 1985/86, producer prices were increased in order to improve production incentives. A subsequent sharp drop in the world price of groundnut oil led to the reemergence of a financial deficit for the sector in 1986/87, just as output was responding positively to the increased incentives (and good weather). The government was reluctant to reduce producer prices so soon after they were raised, and in any case, expected that financial assistance from STABEX would compensate for the revenue loss (which it did for 1986/87).

39. Under the 1988 ESAF, the government reduced producer prices and undertook to adopt a flexible system for the determination of producer prices that would take account of developments in the world market. Under the 1994 ESAF, attention shifted toward privatization of SONACOS (the groundnut milling and marketing parastatal). After a delay of about a year from the initial target date, bids were issued in December 1995, but the authorities did not consider the bids received to be satisfactory. A second call for bids in 1997 also proved unsuccessful.<sup>23</sup>

40. After adhering to a producer pricing policy based on world prices for about four years, the government returned to a more interventionist policy in 2000. In response, the third annual arrangement under the PRGF stipulated as performance criteria a

return to the pricing mechanism based on world market prices (by end-September 2001), and the withdrawal of SONAGRAINES (a wholly owned subsidiary of SONACOS) from the collection and transportation of groundnuts (by December 2001). Both measures were implemented but the dissolution of SONAGRAINES did not lead to the liberalization envisaged in the program, as the authorities continued to set indicative margins rather than allow the market to determine transport and collection costs.

41. Although the sector's share in the economy has dwindled since the 1960s, it remains a source of income for the majority of the population in the rural areas, and the authorities regard it as a key sector in the fight against poverty. The failure to deal permanently with the problems in the sector contributed to periodic fiscal pressures, as in 2001 when the government took over obligations of SONACOS to the tune of about 2 percent of GDP. Over the years, programs have applied various types of conditionality with little lasting effect, reflecting wavering political commitment of the authorities to the reforms. The move away from the earlier ad hoc discretionary adjustments worked for a while but did not prove a permanent solution because the underlying institutional approach remained unchanged.

### Petroleum pricing policy

42. As was the case with groundnuts, the early IMF-supported programs were concerned with establishing a pricing mechanism for petroleum products that would reflect world market prices and obviate the need for a subsidy from the budget; the 1983 and 1984 SBAs each had a benchmark to that effect. However, in 1986 (under the SBA/SAF), the policy changed to "mobilization of prospective surpluses of the oil sector in support of the budget," by maintaining retail prices while import costs were falling. While this change was prompted by revenue difficulties, it damaged the credibility of the system of automatically linking retail prices to developments in the international market. Eventually, this system was reinstated in 1998, but it was suspended once again in 2000, this time in order to avoid passing on rising costs to consumers in a period leading up to presidential elections—at a cumulative cost to the 2000 and 2001 budget of about 1 percent of GDP.<sup>24</sup> While the focus of programs on the issue was appropriate (given its macroeconomic implications), use of ad hoc discretionary deviations for revenue purposes, rather than a consistent approach to establishing the pricing mechanism, probably undermined the strategy.

<sup>23</sup>A World Bank evaluation of performance under the 1995 agriculture sector credit noted that SONACOS was not privatized because the conditions imposed by the government (e.g., requirement to provide seeds and fertilizers to farmers on credit and to maintain the integration of the industry) were not attractive to potential investors.

<sup>24</sup>The pass-through mechanism was reinstated in June 2001.

### Tax reform

43. Since the mid-1980s (following the recommendations of an IMF technical assistance mission in 1985), the authorities have endeavored to modernize the tax system, as well as broaden the base and increase yields. Measures undertaken through 1991 included introduction of a new tax code (with most specific duties converted to ad valorem rates), simplification of the structure of the tax system (by reducing the number of rates for import taxes and VAT), and increased coverage of VAT (to include the service sectors). However, the reforms did not yield much improvement in revenues for reasons that included pervasive exemptions and weak tax and customs administration.

44. There have been further significant reforms since the 1994 devaluation, mostly in the context of a harmonized tariff regime and domestic taxes within the West African Economic and Monetary Union (WAEMU). The 1994 and 1998 ESAF/PRGF arrangements contained several measures aimed at strengthening tax administration and expanding the tax base (e.g., computerization and expansion of coverage of VAT).

45. Conditionality (in terms of performance criteria and benchmarks) on tax reform measures was virtually absent in programs until 1997. Since then there have been several, including on the elimination of hundreds of tariff lines, the establishment of a large taxpayer unit, the implementation of a single taxpayer identification number in all revenue collecting agencies, and a single rate VAT.<sup>25</sup>

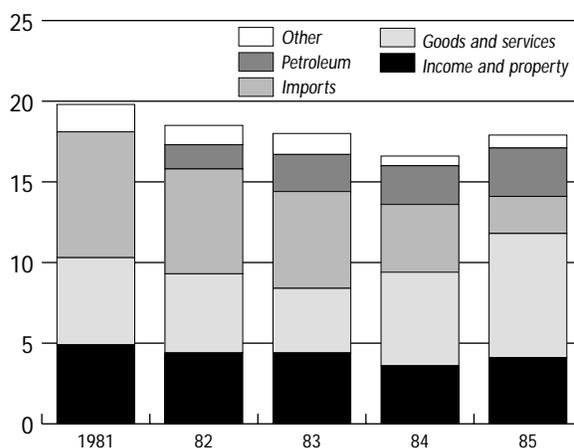
46. In the event, the revenue effort did eventually show some improvements—rising from an average of about 16.5 percent of GDP in 1994–99 to 18.1 percent in 2000–01 in spite of a lowering of tariffs in the context of a common external tariff in WAEMU (Figure 11.14).<sup>26</sup> However, greater emphasis in the early programs on improving tax administration and reducing exemptions could have yielded significant additional benefits and would have reduced the reliance on various ad hoc revenue and expenditure measures at times of fiscal pressure.

<sup>25</sup>Most of the measures were specified as performance criteria, except the establishment of the large taxpayer unit, which was a benchmark. Most were observed on time or with slight delays. One measure that was delayed and that became a prior action for completion of a review was the introduction of the single VAT rate, which was implemented in September 2001 (instead of May).

<sup>26</sup>Figure 11.14 breaks down government revenue into: (i) income and property taxes; (ii) taxes on domestic goods and services; (iii) taxes on nonpetroleum imports; (iv) petroleum revenues; and (v) other revenues. For the period 1981/82–1982/83, petroleum revenues are distributed between import taxes and “other” revenues.

**Figure 11.14. Senegal: Composition of Government Revenue**

(In percent of GDP)



Source: IMF staff reports.

### Social policies

47. While several programs contained social safety net measures to cushion the impact on the poorest groups of some price increases, problems with targeting of the measures limited their effectiveness. Two examples are:

- (i) Under the 1988 ESAF, a reduction in the producer price of groundnuts was a key measure for eliminating the deficit of the sector. In order to provide some relief to farmers, administered prices of selected key consumer goods (rice, sugar, groundnut oil) were subsidized.
- (ii) Both the post-devaluation SBA (1994) and the subsequent ESAF arrangement that replaced it contained budgetary provisions for subsidizing the price of a number of products deemed “sensitive” for low-income households (e.g., bread, rice, medicines).

48. Neither of the two programs was well targeted. An internal World Bank evaluation of the Bank’s Economic Recovery Credit (approved in March 1994 to provide emergency support to the post-devaluation reform program) concluded that the subsidies designed to limit the impact of price increases of basic consumer goods had been poorly targeted and had not delivered the expected benefits to the most vulnerable groups.

### Collaboration with the World Bank

49. Program documents presented to the IMF’s Executive Board convey the impression of close col-

### Box 11.1. Selected Lessons from World Bank Evaluations

The World Bank employs a range of evaluation reports to take stock of achievements and failures, and to draw lessons from experiences under its lending operations. At the completion or termination of such operations, a “project completion report” or “implementation completion report” is prepared. The Operations Evaluation Department (OED) may comment on these reports, and/or undertake a “performance audit” of its own. This box draws on a range of such evaluation reports on the four SALs and the Agricultural Sector Adjustment Credit (AGSAC) extended to Senegal, since a number of the lessons highlighted are also relevant for the IMF’s operations.

- Under the first three SALs, incomplete and tenuous links between proposed measures and objectives gave rise to overestimation of likely performance and underestimation of constraints (e.g., in agriculture and industry).
- Notwithstanding significant achievements, including transformation of the economy away from excessive state intervention, about one-third of measures envisaged under SAL II and SAL III were not implemented as scheduled. These measures were concentrated in areas—labor regulations, parastatal reform—where there was strong political opposition from vested interests. The lesson drawn was that politically sensitive reforms are unlikely to be implemented unless a prior internal debate has taken place and consensus reached on key issues. It is important to encourage internal agreement on key issues, and based on that formulate upfront measures to be implemented under programs.
- A basic design flaw in SAL IV was expecting a positive supply response to improvements in regulations and incentives at a time when demand compression was being relied on to achieve external equilibrium. By the time of SAL IV (1990) work undertaken in the World Bank suggested that devaluation would be essential for restoring competitiveness and boosting growth.
- Lack of consensus among donors and the government on the strategy for restructuring the groundnut sector has contributed to the slow pace of reform. In retrospect, too much emphasis may have been placed on privatization of SONACOS, at the expense of other reforms to improve the efficiency of the sector.

laboration between the staffs of the IMF and the World Bank, especially on sectoral issues (e.g., the banking system, agriculture, energy, and industry). Discussions with staff members of the two institutions confirm that there have always been regular contacts and exchange of information, including in areas not highlighted in staff reports (e.g., the preparatory work that informed the staffs’ advice to the authorities of the CFA franc zone in the period leading up to the 1994 devaluation). A recent staff report clearly described the division of responsibilities between the two institutions.<sup>27</sup>

50. Nevertheless, there have been some problems in matching the time frame and priorities of the two institutions, which affected the timeliness of World Bank inputs on some sectoral issues in IMF-supported programs. Some of the differences in the timetable may be related to the World Bank’s attempts to encourage internal consensus on structural

reforms before going ahead with lending programs (Box 11.1).

51. Several Senegalese officials interviewed emphasized the need for better collaboration between the IMF and the World Bank, especially with respect to the structural reform and social policy content of programs. The PRSP and the recent formalization of the “lead agency” approach are the major instruments for improving such collaboration, although in the case of Senegal it is too early to judge their impact.

### Ownership, Conditionality, and the PRSP Approach

52. The evaluation sought views on what impact, if any, prolonged engagement in IMF arrangements has had on (i) “ownership” of programs and on the economic policymaking process; (ii) capacity building in institutions responsible for formulating and implementing macroeconomic policies; and (iii) the effectiveness of IMF conditionality.

<sup>27</sup>Box 4 in EBS/02/50, March 21, 2002.

### Ownership and capacity issues

53. Interviews with many Senegalese officials and with IMF staff indicate a striking difference in perceptions about the degree to which policies had been “imposed” on the authorities without sufficient consultation. However, there was broad agreement that the successful programs had been those to which there was strong domestic political commitment, regardless of the precise nature of IMF conditionality. The main lesson drawn by the World Bank from a review of its structural adjustment loans to Senegal was that politically sensitive reforms are unlikely to be implemented unless there has been prior internal debate and consensus building on key issues (see Box 11.1).

54. A number of Senegalese officials who have participated in negotiations with the IMF over time thought that the level of “country ownership” of programs has generally been low. In their view, the “seal of approval” role of IMF arrangements in unlocking other sources of financing gave the IMF the upper hand in negotiations with the authorities, and that sometimes the authorities went along with these proposals—even though they had doubts about their ability to deliver on implementation—in order to secure urgently needed resources. Several indicated that, more often than not, they were in agreement with the IMF’s diagnoses of the country’s financial problems, but sometimes differed on the pace of implementation of measures. In their view, the IMF tended to underestimate implementation constraints and overestimate the speed with which some structural reforms (e.g., privatizations) could be brought to conclusion. However, a few officials put the onus of responsibility for the content of programs and for implementing them on the authorities (including themselves), noting that while it was convenient to blame the IMF for implementation failures, the primary responsibility for difficulties in addressing some well-recognized problems belonged at home.

55. The IMF staff appears to share the characterization of weak ownership of programs, at least with respect to structural reforms: the staff report for the 2001 Article IV consultation noted that the new government that took office in April 2000 “inherited a legacy of weak implementation and ownership of the structural reforms program, particularly the long-standing structural problems of the groundnut and energy sector.”

56. A number of staff interviewed thought that officials tended to underestimate the scale of quasi-fiscal activities and the risks such activities pose to macroeconomic stability. However, they noted that there had been periods when senior Senegalese officials clearly were convinced of the merits of ad-

ressing these issues in IMF-supported programs and had been able to persuade the highest political authorities to implement difficult reforms. They accepted that there was a need to bring greater transparency to discussions with officials and other stakeholders about financial constraints in the broadly defined public sector, highlighting the risks of disorderly adjustment in the absence of measures to tackle the financial problems. It appears that the active involvement of senior political leaders in program negotiations can help increase political commitment to programs.

57. With regard to the effects of “prolonged use” on the policymaking process, there was broad recognition by those interviewed in Senegal that the IMF had contributed importantly to an “internalization” of the need for prudent fiscal management. However, many pointed to problems in the way programs had been negotiated, notably that they (i) tended to undermine the policymaking processes of the government, especially parliament’s role in economic decision making; and (ii) provided an excuse for government to stifle domestic policy debate.

58. On capacity building, many officials interviewed thought there had been significant knowledge transfer from IMF staff at the technical level. At the same time, they felt that a lack of flexibility in the formulation of IMF-supported programs had discouraged local initiative, and that the system had become too dependent on the IMF for diagnosing and proposing remedies to the country’s macroeconomic problems. Several also expressed regret that an excessive focus on short-term solutions to financial problems had led government officials to abandon medium-term “planning” and long-term strategic thinking about Senegal’s development challenges. The response of staff to these criticisms was that programs are usually constructed in a medium-term framework with growth as one of the key planks, and that the PRSP process had been designed to help improve the integration of programs with the longer-term strategy into PRGF arrangements (see below).

### Conditionality

59. The evolution of the IMF’s concessional facilities has been marked by significant changes in conditionality: from the low-access, low-conditionality SAF; to the relatively high-access, high-conditionality ESAF; to the PRGF, which has been accompanied by efforts to streamline structural conditionality but at the same time has introduced some new conditionality (e.g., preparation of PRSPs through a participatory process). The average number of structural conditions (prior actions, performance criteria, and benchmarks) per program year increased steadily in

successive multiyear ESAF/PRGF arrangements, from 4 in the 1988 ESAF to 10 in the 1998 ESAF/PRGF (Figure 11.15).<sup>28</sup>

60. With regard to the impact of “prolonged use” on the effectiveness of conditionality, views ranged from “conditionality had lost its bite over time” to “effectiveness of conditionality had been strengthened, as officials have learned from experience the importance of compliance.” On balance, the evaluation found no clear evidence of weakening; there was some evidence of “elevating” targets from benchmarks to performance criteria and prior actions in response to implementation slippages. However, as noted earlier, in the discussion of several “intractable” structural problems, a “hardening” of conditionality does not appear to have been successful in fostering permanent changes if political commitment was weak. For example, prior actions were effective in the early programs in bringing about once-off discretionary changes (several increases in administered prices were effected before programs were presented to the Board), but they did not permanently change the price-setting systems. Prior actions have also been extensively used recently in conjunction with completion of reviews for measures whose implementation had been delayed.<sup>29</sup> But they cannot ensure that there will be no policy reversals, as demonstrated by the abandonment of the mechanism for setting petroleum product prices in the lead-up to elections in 2000 when world prices were on the rise.

### The PRSP approach

61. In many respects, changes under way at the IMF—most notably, the transformation of the ESAF to the PRGF (and related to that, the PRSP approach), the increased emphasis on country “ownership” of programs, and attempts to streamline structural conditionality—already have begun to respond to many of the criticisms of the IMF that the IEO mission heard in Senegal (and reported above).

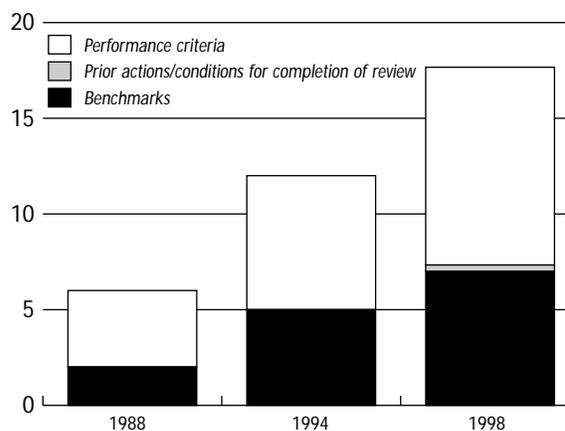
62. Most of those interviewed in Senegal for this evaluation welcomed the PRSP process as an appropriate way of promoting country ownership and hence increasing the likelihood of consistent imple-

<sup>28</sup>The increase in the 1998 ESAF/PRGF partly reflects the effect of carrying over missed performance targets from one annual arrangement to a successor annual arrangement.

<sup>29</sup>The reintroduction of the pass-through mechanism for petroleum product prices and the submission to parliament of a draft bill introducing VAT at a single rate were performance criteria for May 2001 that were missed. They became prior actions for the completion of the first review under the third annual PRGF which was completed in September 2001.

**Figure 11.15. Senegal: Structural Conditionality Under ESAF/PRGF Arrangements**

(In number of conditions per program year)



Sources: IMF Policy Development and Review Department and IEO calculations.

mentation of IMF-supported programs. A common view was that it goes some way to address criticisms of the process of formulating previous programs. However, most argued that the jury was still out on whether the PRSP (which has only recently been completed) will significantly influence the policy content of the next PRGF arrangement. A number of people interviewed stressed the key role IMF resident representatives can play in the implementation of the PRSP approach by widening the range of stakeholders with whom the IMF interacts on a regular basis.

### IMF Internal Governance Issues

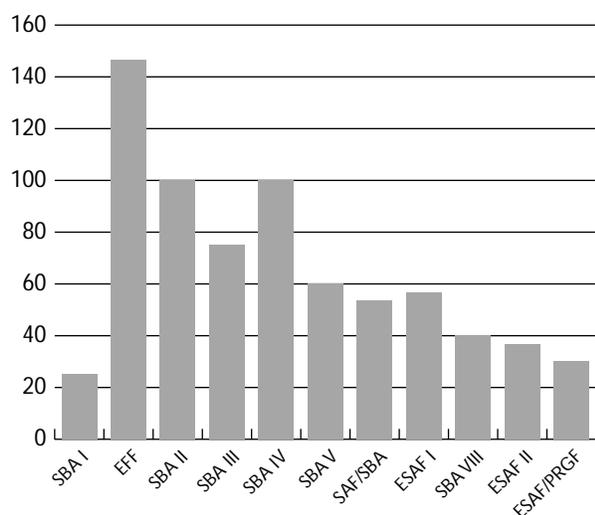
#### Were IMF policies to contain “prolonged use” applied to Senegal?

63. The IMF has developed policies aimed at containing the phenomenon of prolonged use, the main elements of which are (i) reduction in access levels (in relation to size of IMF quota); (ii) front-loading of adjustment effort and close monitoring of program implementation; (iii) comprehensive ex post assessment of programs; and (iv) the formulation of “exit” strategies.<sup>30</sup>

64. Average annual access levels in Senegal’s IMF arrangements have followed a declining trend,

<sup>30</sup>These policies are discussed at greater length in Chapter 3 of Part I.

**Figure 11.16. Senegal: Average Annual Access Levels Under IMF Arrangements**  
(In percent of quota)



Source: IMF staff reports.

although the country has enjoyed above-average access levels in its three ESAF/PRGF arrangements (Figure 11.16).<sup>31</sup> Over the course of the 1998 ESAF/PRGF, there was a move toward closer monitoring (more reviews in annual arrangements), and conversion of measures that had not been implemented at the time of review missions into “prior actions” for the completion of reviews.

65. With regard to ex post assessments, a country strategy paper prepared in early 1998, before the negotiations for a new three-year ESAF, took stock of performance under previous arrangements and set out an agenda of remaining challenges to be tackled under the new arrangement. However, it had little discussion of lessons from the nonimplementation of earlier reforms. Nor did it have a forward-looking medium-term macroeconomic framework and a discussion of alternative scenarios and policy options. Another ex post assessment, this time limited to Senegal’s pre-devaluation IMF-supported programs, was contained in the background paper to the 1995 Article IV consultation. It contained a comprehensive analysis of the rela-

<sup>31</sup>Access under the 1988, 1994, and 1998 ESAFs was 90 percent, 81 percent, and 66 percent, respectively. This compares with IMF-wide averages for first, second, and third three-year ESAF/PRGF arrangements of 85 percent, 72 percent, and 65 percent. Current access norms under the PRGF are 90 percent of quota over three years for first-time users and 65 percent of quota over three years for second-time users.

tive roles of shocks and policies in Senegal’s economic performance from the late 1970s through the early 1990s. However, it is not clear what impact the analysis had on the design of subsequent programs.

66. One set of “stepping-back” exercises that definitely influenced the design of a subsequent program was work done during 1992–93, some of it in close collaboration with the World Bank that provided advice given to CFA franc countries prior to the 1994 devaluation. The key issues tackled related to the limits of a purely “internal” adjustment strategy for dealing with loss of competitiveness and low growth. The analysis presented in internal documents was significantly more comprehensive than that contained in subsequent staff papers to the Board. However, we were told that the Board was briefed at greater length in an informal session.<sup>32</sup>

67. We found no evidence that the issue of an “exit strategy” from the use of ESAF/PRGF resources had been discussed in any systematic manner within the staff (e.g., in the internal review process) or with the authorities.<sup>33</sup> On the occasion of Board consideration of the request for the 1998 ESAF arrangements, one Executive Director expressed the hope that the third set of ESAF arrangements would represent an “exit” arrangement for Senegal. The absence of systematic discussion of the issue of exit from the use of concessional facilities may have reflected an implicit acceptance that the deep-seated structural problems of Senegal would require its continued use of IMF resources for some time—but it also probably reflected the fact that overall, IMF-wide criteria and strategies for exit are not well defined in such cases.

### Surveillance and program activities

68. To assess whether program activities have “crowded out” surveillance, the evaluation examined how staff reports on Senegal measured up against a checklist of “best practices” inferred from various internal IMF guidelines on reporting on Article IV consultations.<sup>34</sup> Virtually all such consultations with

<sup>32</sup>The staff report for the 1992 Article IV consultation contained some discussion of the issue, in rather general terms, leading to some discussion at the Board meeting of the appropriateness of using a purely “internal” adjustment strategy to address external competitiveness issues in Senegal and other CFA franc countries.

<sup>33</sup>The issue of IMF long-term involvement in Senegal arose during the process of clearing briefing papers in 1987. The remedy for the “problem” of the country’s prolonged use of “regular” IMF resources was to shift to arrangements under a concessional facility (at the time, the SAF).

<sup>34</sup>The factors considered were (i) presentation of alternative medium-term scenarios; (ii) quality of sensitivity analyses; (iii) discussion of risks of deviations from assumptions and projections; (iv) discussion of risks and impact of policy slippages; (v) reporting on the views of the authorities; (vi) cogent presentation of proposed/recommended policy course; (vii) discussion of pol-

Senegal have tended to be combined with either requests for arrangements or program reviews during 1980–2001; there were only two stand-alone Article IV consultation discussions at the Board (out of a total of 16) during this period.

69. For a persistently active program country like Senegal, the line between program and surveillance activities becomes blurred; indeed, an effective program design process should cover all the issues on the surveillance “best-practice” checklist. But regardless of how and in what context, there should be opportunities to step back periodically from the details of designing and monitoring compliance with program targets, so as to review the overall adjustment strategy underpinning programs. A natural point to do this for “prolonged users” is between arrangements and in the context of surveillance. In this context, the main points from the review are as follows:

- Staff reports generally did a reasonable job on the presentation of medium-term scenarios, but sensitivity analyses tended to consider relatively small shocks—in other words, they did not “stress test” the consequences of markedly different, but still possible, outcomes. Nonetheless, the reports from the mid-1980s through the early 1990s demonstrated how even small adverse changes in the external environment could significantly delay the attainment of external viability. The sensitivity analyses in recent reports have tended not to include any stress testing of major vulnerabilities and downside risks. Consequently, they have been somewhat perfunctory.
  - In general, there was relatively little discussion of risks of deviations from assumptions and projections, and how programs might be adapted. A handful of reports contained candid discussions of the risks of policy slippages and policy reversals.<sup>35</sup>
  - Reports usually provide an indication of the authorities’ views; in most cases, however, there were no reports of significant differences and so no sense of any compromises that might have been reached between the staff and the authorities. Two exceptions to this were the 1992 Article IV staff report (which covered a period when there was no IMF arrangement in place), and the 2001 Article IV consultation report (which indicated differences on the timing of an increase in electricity tariffs).
- Presentation of the reform strategy and reviews of performance under previous or ongoing programs were broadly satisfactory. However, discussion of alternative options and trade-offs was almost completely absent from reports, except in the 1992 report, which presented an account of the authorities’ internal adjustment efforts.
  - Little detail was provided in reports about the substance of the collaboration with the World Bank; often there were statements affirming close collaboration and—as is general practice—an appendix listing World Bank operations in Senegal, but with no sense of how the strategies of the two institutions were integrated and what the mutual priorities were. In a few cases, where there had been a recent World Bank operation with objectives that were similar to those in IMF arrangements—for example Structural Adjustment Loans—a summary of the content of the authorities’ Letter of Development Policy to the World Bank was provided.<sup>36</sup>

70. In terms of topics covered, it is striking how little explicit discussion of exchange rate misalignment there was in the reports before the 1994 devaluation, with most of the focus on traditional measures of the real effective exchange rate.<sup>37</sup> This was explained by the staff as the result of a deliberate decision by management to keep discussion of a possible devaluation of the CFA franc confidential. As discussed above, the issue was analyzed extensively in internal documents during 1992–93.

<sup>36</sup>For example, in the reports for 1983, 1988, 1989, and 2001.

<sup>37</sup>The staff report for the 1989 Article IV consultation indicated that the authorities held the view that “the benefits of full convertibility and stability of the CFA franc afforded by membership of WAMU outweighed the potential advantages of a more flexible exchange rate policy.” The 1991 Article IV staff report elaborated on the benefits (promotion of confidence in the currency/country and contribution to domestic price stability—essential factors for attracting foreign investment and mobilizing domestic saving), and on how the authorities intended to support the system (appropriate financial and structural policies, notably a restrained incomes policy, a restructuring of energy pricing, and reforms designed to increase productivity). In neither report were the staff’s own views spelled out. However, the latter report noted that there had been a 5.7 percent depreciation in the real effective exchange rate between 1985 and 1990, at a time when the terms of trade had improved, thus betraying no “overvaluation” concerns. Even the 1992 Article IV report, which went beyond the standard presentation of real effective exchange rate indices to consider other indicators (e.g., relatively high cost of labor), stopped short of advocating an exchange rate adjustment, though it did provoke a discussion of devaluation of the CFA franc at the Board discussion. The inadequacies of the real effective exchange rate index as an indicator of international competitiveness are well known. Using a method that incorporates terms of trade shocks, Devaranjan (1997) estimates that on average the real exchange rate was overvalued by about 30 percent for 12 countries in the CFA franc zone prior to the January 1994 devaluation. He estimates the real exchange rate in Senegal was overvalued by 22 percent.

icy alternatives and trade-offs; (viii) critical and frank review of performance under (previous and ongoing) IMF-supported program(s); and (ix) account of collaboration with the World Bank.

<sup>35</sup>Examples include the report on the midterm review under the third annual arrangement under the 1988 ESAF and the 2001 Article IV consultation report.

## Conclusions and Recommendations

71. Five main reasons were found for Senegal's prolonged use of IMF resources.

- First, the initial imbalances were large and deeply rooted in structural weaknesses of the economy, including vulnerability to terms of trade and weather-related shocks, which were likely to require a long time to address in a sustainable manner.
- Second, Senegal's prolonged use of IMF resources can also be attributed to the broadening of objectives associated with programs supported under the IMF's concessional facilities.
- A third factor is the use of IMF arrangements as a seal of approval for the provision of external finance by several multilateral and bilateral creditors and donors.
- Fourth, overoptimism about the effectiveness of the pre-devaluation adjustment strategy on promoting growth may have contributed to prolonged use.
- Weaknesses in program design that were compounded by a stop-go pattern of program implementation, especially with regard to structural reforms, undermined program effectiveness.

### *Ex post assessments and exit strategy*

- We recommend that guidelines on ex post assessments be applied more consistently and forcefully for countries that have had a succession of multiyear arrangements.
- A more explicit strategy for eventual exit from use of IMF resources is needed. Attainment of the completion point under the enhanced HIPC Initiative would be one possible opportunity for discussion of such a strategy for Senegal, drawing on the assessments of previous programs.

### *Program design*

- Successful programs have been those to which there was strong political commitment, regardless of the precise nature of conditionality.
- Key lessons for improving the effectiveness of Senegal's IMF-supported programs include (i) fostering greater ownership of reform programs; (ii) reflecting capacity constraints more realistically in implementation schedules; and (iii) articulating measures for improving implementation—including through a greater flow of technical assistance on implementation aspects.
- Programs need to be set in a realistic time frame that avoids overpromising on the pace of adjustment toward external viability; if the adjustment

is realistically expected to extend well beyond the period of a three-year arrangement, then the consequences for IMF involvement should be discussed explicitly as part of a medium-term strategic framework.

- To help programs adapt better to uncertainty, the principal risks to the program, and how policies would adapt to those risks, should be set out explicitly.
- There is room for improving Bank-Fund collaboration to address fundamental institutional/ structural issues at the heart of prolonged use. The PRSP provides an instrument to that end, but will need to be matched by operational changes to ensure that the work priorities and time frames of the two institutions mesh effectively.
- In countries like Senegal where quasi-fiscal activities are significant, the macroeconomic framework needs to focus on a broad coverage of the public sector accounts (instead of focusing mainly on central government balances), in order to provide a more comprehensive and more transparent basis for considering public sector financial problems, and for discussing risks of disorderly adjustment in the absence of corrective measures.

### *Surveillance*

- Surveillance discussions and reports should be used as an occasion to “step back” and reconsider the overall strategy. While such reconsiderations should be a normal part of any effective program process, a natural time to reconsider the overall strategy is between arrangements and in the context of surveillance. Such a strategic review should include an assessment of performance under previous programs, including a frank appraisal of previous assumptions about implementation; a stress-testing of major vulnerabilities and downside risks; and a discussion of alternative policy options and trade-offs. The results of such reassessments should be reported candidly to the Executive Board.

### *Outreach*

- Persistence of criticisms of the IMF, in spite of its embrace of the PRSP approach, suggests that many people do not believe that the IMF has changed the way it does business. The IMF has increased its outreach activities in Senegal in recent years, including through the role of the resident representative. These efforts need to be sustained and broadened, including more public discussion of the rationale for policy advice, especially on sensitive issues.

## APPENDIX 1

## Senegal: Implementation of IMF Arrangements

Arrangements <sup>1</sup>	Financial and structural PCs and benchmarks <sup>2</sup>	Program reviews	Slippages and proximate causes	Shocks	Comments
SBA I (1979)	No formal PCs, but significant deviations from indicative targets.	None.			
EFF (1980/81–1982/83)	Observed at first test date only.	First review was not completed	Nonimplementation of price liberalization measures and lack of agreement on policy adaptations; political changes took focus away from economic policy.	Drought.	President Senghor (President since independence in 1960) retired in December 1980; replaced by Mr. Diouf (Prime Minister at the time).
SBA II (1981/82)	Original program set PCs for first half of program year only. These were observed.	Midterm review completed four months behind schedule.	Delay in completion of midterm review. The original program stipulated that additional measures to reduce projected fiscal deficit be agreed during midterm review mission and implemented in January 1982.	Good weather. Decline in world price of groundnut oil.	Original program envisaged only one (midterm) review. Delay in completing that review led to modification of arrangement to add a second review and rephase disbursement.  Decision to modify rather than cancel arrangement partly influenced by link to Paris Club agreement.
SBA III (1982/83)	Most not observed.	Midterm review was not completed.	Tax measures envisaged for November 1982 not implemented; election pressures.	Sharp downturn in world price of groundnut oil.	Presidential and legislative elections held in February 1983.
SBA IV (1983/84)	Observed.	Midterm review was completed on time.		Severe drought. Higher-than-expected export price for groundnut products (partly offset large fall in output and export volumes).	Measures implemented before Board approval included significant increases in prices of several consumer goods.  Expenditure cuts more than compensate for revenue shortfall.
SBA V (1984/85–1985/86)	Almost all observed.	Envisaged reviews (three) were completed on time.		Improved weather conditions.	Increase in some petroleum product prices to avoid deficit in National Energy Fund  Significant policy adaptation in response to shortfalls in export earnings and government revenue (e.g., extension of service tax to telecom services, tightening of credit ceiling).

## Senegal: Implementation of IMF Arrangements (concluded)

Arrangements <sup>1</sup>	Financial and structural PCs and benchmarks <sup>2</sup>	Program reviews	Slippages and proximate causes	Shocks	Comments
SBA VI and SAF_1 (1986/87)	All PCs under SBA observed; nearly all benchmarks under SAF observed.	Midterm review under SBA completed on time.	Delay in formulation of action plan for determination of producer prices of cereals (benchmark under SAF).	Sharp decline in export price of groundnuts; decline in import price of petroleum products.	Windfall profits from petroleum sector and from rice imports mobilized for the government budget.
SBA VII and SAF_2 (1987/88)	All PCs under SBA observed. Benchmarks under SAF observed, with slight delay in one.	Midterm review under SBA completed on time.	Slight delay in removal of remaining quantitative restrictions on imports (benchmark under SAF).	Good weather conditions. Sharp deterioration in the terms of trade.	Presidential and parliamentary elections held in February 1988.
ESAF I_1 (1988/89)	Observed.	Midterm review completed on time.	Slippages in implementation of tax reform measures in the second half of the year (after midterm review).	Locust infestation of crops. Uneven distribution of rainfall.	Social unrest in second half of program period.
ESAF I_2 (1989/90)	Observed.	Midterm review completed on time.	Slippages after midterm review: — delay in implementing tax reform measures (expanding VAT base). — contingency mechanism for freezing lower priority expenditures, in the event of a revenue shortfall, not implemented.		Measures to increase tax revenue implemented prior to approval of arrangement.
ESAF I_3 (1991)	Observed.	Slight delay (one month) in completion of midterm review.	Weakening of performance after midterm review.	Sharper drop in export.	Tighter monitoring; introduction of monthly revenue targets, and a PC on minimum revenue collection. Request for third annual arrangement was delayed until successful implementation of six-month staff-monitored program.
SBA VIII (1994)	All PCs for March 1994 were met, except accumulation of new arrears.	Midterm review completed slightly behind schedule (two months).	Delays in implementation of structural measures.	Poor weather conditions.	Only the purchase associated with approval of the arrangement was made before the SBA was replaced by an ESAF.
ESAF II_1 (1994/95)	Observed.	Midterm review completed slightly behind schedule (two months).			
ESAF II_2 (1995/96)	Most observed.	Midterm review completed slightly behind schedule (two months).	Delays in reform of energy sector. Slow pace of privatization program.		
ESAF II_3 (1997)	Most observed.	Midterm review completed slightly behind schedule (two months).	Delays in public enterprise and energy sector reforms; resistance from interest groups.	Unfavorable weather conditions.	

ESAF III_1 (1998)	Most observed.	Midterm review completed slightly behind schedule (one month).	Drought. Declining oil prices.
ESAF III_2 (1999/ 2000)	Most of targets prior to December 1999 test date were met. Thereafter, most structural and some financial benchmarks were not observed.	Completion of first review delayed by six months. Envisaged second review was not completed.	Presidential elections held in February and March 2000: won by opposition candidate (Mr. Wade). New dates for meeting structural benchmarks agreed with new government.
ESAF/PRGF III_3 (2001)	Several PCs related to second and third reviews were not observed.	Delays of two months and four months for first and second reviews, respectively. Envisaged third review was not completed.	Eight months elapsed between completion of review under second annual arrangement and approval of year (first, second, or third) arrangement.  Legislative elections held in April 2001. Implementation of some corrective measures allowed completion of second review, but not the third review, just before the expiration of the arrangement.

Source: IMF staff reports.

<sup>1</sup>Roman numerals are used to indicate the sequence of arrangements, by type. For multiyear arrangements, number suffix refers to arrangement year (first, second, or third).

<sup>2</sup>PCs = Performance criteria.

## APPENDIX 2

## Senegal: Projections and Outturns of Selected Variables

(In percent of GDP, unless otherwise indicated)

	Current account deficit (excluding official transfers)			Export growth (in percent per annum)			Government balance			Government revenue			Real GDP growth			Gross domestic saving			Gross domestic investment			
	Pro- jection	Out- turn	Differ- ence <sup>1</sup>	Pro- jection	Out- turn	Differ- ence <sup>1</sup>	Pro- jection	Out- turn	Differ- ence <sup>1</sup>	Pro- jection	Out- turn	Differ- ence <sup>1</sup>	Pro- jection	Out- turn	Differ- ence <sup>1</sup>	Pro- jection	Out- turn	Differ- ence <sup>1</sup>	Pro- jection	Out- turn	Differ- ence <sup>1</sup>	
<b>Medium-term projections<sup>2</sup></b>																						
SAF/SBA	9.2	10.8	-1.6	13.2	-0.4	13.6	-0.9	-1.5	0.6	18.4	18.8	-0.4	4.4	4.2	0.2	6.3	6.9	-0.6	14.0	13.7	0.3	
1986/87	7.8	11.4	-3.6	11.1	-5.2	16.3	0.5	-1.2	1.7	18.0	17.5	0.5	3.3	4.4	-1.1	8.0	7.2	0.8	14.0	12.5	1.5	
1987/88	6.6	10.0	-3.4	10.4	13.4	-3.0	1.3	-2.1	3.4	17.7	16.8	0.9	3.5	-0.5	4.0	9.5	7.5	2.0	14.0	12.6	1.4	
1988/89	5.5	8.4	-2.9							17.5	16.9	0.6				10.5	8.5	2.0				
1989/90	9.1	10.0	-0.9	11.8	13.4	-1.6	0.2	-2.1	2.3	17.7	16.8	0.9	4.2	-0.5	4.7	10.6	7.5	3.1	14.5	12.6	1.9	
ESAF I	7.8	8.4	-0.6	12.2	13.1	-0.9	0.6	-3.2	3.8	18.1	16.9	1.2	3.5	3.6	-0.1	11.8	8.5	3.3	14.6	13.4	1.2	
1989/90	6.5	8.9	-2.4	13.3	2.9	10.4	1.9	2.0	-0.1	18.8	18.9	-0.1	3.6	1.3	2.3	13.2	8.8	4.4	14.9	13.7	1.2	
1990/91	5.4	8.4	-3.0	12.6	-3.4	16.0	2.7	0.2	2.5	19.0	18.6	0.4	3.8	2.3	1.5	14.1	8.5	5.6	14.9	13.5	1.4	
1991/92	9.8	9.3	0.5	6.5	9.5	-3.0	-0.7	-1.8	1.1	14.4	14.0	0.4	2.4	2.0	0.4	9.3	9.6	-0.3	15.1	16.2	-1.1	
ESAF II	7.8	9.2	-1.4	13.5	15.1	-1.6	-1.4	-0.2	-1.2	15.0	15.1	-0.1	4.7	4.8	-0.1	11.2	11.3	-0.1	15.5	16.9	-1.4	
1994	7.3	8.0	-0.7	7.3	6.4	0.9	-0.6	-0.2	-0.4	15.3	16.0	-0.7	4.8	5.2	-0.4	12.6	12.8	-0.2	16.7	16.3	0.4	
1995	6.8	7.8	-1.0	7.9	-0.3	8.2	0.8	0.5	0.3	15.7	16.9	-1.2	4.5	5.0	-0.5	14.0	11.6	2.4	17.8	17.3	0.5	
1996	7.3	5.3	2.0	7.1	8.2	-1.1	-1.0	-0.3	-0.7	15.6	16.8	-1.2	5.3	5.7	-0.4	13.8	10.4	3.4	19.2	17.5	1.7	
ESAF/PRGF III	6.8	7.9	-1.1	6.1	10.7	-4.6	-0.1	-1.4	1.3	16.0	17.3	-1.3	6.5	5.0	1.5	14.7	11.8	2.9	19.9	19.4	0.5	
1998	6.7	9.0	-2.3	6.1	3.6	2.5	0.1	0.1	0.0	16.1	18.1	-2.0	6.0	5.6	0.4	15.4	8.4	7.0	20.7	18.4	2.3	
1999																						
2000																						
<b>Annual projections<sup>3</sup></b>																						
1986/87	9.2	10.8	-1.6	13.2	-0.4	13.6	-0.9	-1.5	0.6	18.4	18.8	-0.4	4.4	4.2	0.2	6.3	6.9	-0.6	14.0	13.7	0.3	
1987/88	9.2	11.4	-2.2	19.5	-5.2	24.7	-0.4	-1.2	0.8	18.0	17.5	0.5	4.2	4.4	-0.2	9.5	7.2	2.3	14.0	12.5	1.5	
1988/89	9.1	10.0	-0.9	11.8	13.4	-1.6	0.2	-2.1	2.3	17.7	16.8	0.9	4.2	-0.5	4.7	10.6	7.5	3.1	14.5	12.6	1.9	
1989/90	8.2	8.4	-0.2	-0.4	13.1	-13.5	-1.3	-3.2	1.9	17.6	16.9	0.7	4.6	3.6	1.0	10.2	8.5	1.7	15.2	13.4	1.8	
1990/91	7.2	8.9	-1.7	13.7	2.9	10.8	1.5	2.0	-0.5	18.8	18.9	-0.1	1.3	1.3	0.0	9.2	8.8	0.4	12.9	13.7	-0.8	
1991/92	7.3	8.4	-1.1	-0.9	-3.4	2.5	1.6	0.2	1.4	18.0	18.6	-0.6	5.1	2.3	2.8	10.1	8.5	1.6	12.3	13.5	-1.2	
1994	9.8	9.3	0.5	6.5	9.5	-3.0	-0.8	-1.8	1.0	14.4	14.0	0.4	2.4	2.0	0.4	9.3	9.6	-0.3	15.1	16.2	-1.1	
1995	7.7	9.2	-1.5	10.6	15.1	-4.5	-0.9	-0.2	-0.7	15.3	15.1	0.2	4.5	4.8	-0.3	11.3	11.3	0.0	15.6	16.9	-1.3	
1996	7.3	8.0	-0.7	7.4	6.4	1.0	-0.8	-0.2	-0.6	15.5	16.0	-0.5	4.5	5.2	-0.7	12.8	12.8	0.0	16.9	16.3	0.6	
1997	6.7	7.8	-1.1	6.9	-0.3	7.2	0.5	0.5	0.0	15.5	16.9	-1.4	4.5	5.0	-0.5	11.7	11.6	0.1	16.5	17.3	-0.8	
1998	7.3	5.3	2.0	7.1	8.2	-1.1	-1.1	-0.3	-0.8	15.6	16.8	-1.2	5.3	5.7	-0.4	13.8	10.4	3.4	19.2	17.5	1.7	
1999	7.0	7.9	-0.9	7.5	10.7	-3.2	-1.9	-1.4	-0.5	16.8	17.3	-0.5	6.4	5.0	1.4	13.9	11.8	2.1	19.7	19.4	0.3	
2000	6.6	9.0	-2.4	15.0	3.6	11.4	-1.6	0.1	-1.7	17.3	18.1	-0.8	5.5	5.6	-0.1	14.2	8.4	5.8	19.6	18.4	1.2	

Source: IMF staff reports.

<sup>1</sup>Projection minus outturn.<sup>2</sup>Projections in the document for the initial request for the multiyear arrangement.<sup>3</sup>Updated projections for the year.

## APPENDIX 3

## Senegal: List of People Interviewed in Connection with the Evaluation of the Prolonged Use of IMF Resources

**Current Senior Officials**

Mr. A. Boucar, Deputy Governor, BCEAO  
 Mr. Ababacar Diop, Cabinet Director  
 Mr. Serigüe Babacar Diop, Directeur de Cabinet, Ministère des Mines  
 Mr. Pape Diouf, Minister of Agriculture  
 Mr. A. Fall, President, Power Sector Regulatory Commission  
 Mr. Alioune Gassama, Director of Analyses, Forecasting and Statistics  
 Mr. Ambroise Koné, Director of Research, BCEAO  
 Mr. Seyni N'Diaye, National Director, BCEAO  
 Mr. Souleymane Saib, Director of Administrative and Financial Affairs  
 Mr. Macky Sall, Minister of Energy  
 Mr. Abdoulaye Sene, Technical Advisor  
 Mr. Chiekh Soumare, Minister of Budget

**Former Senior Officials**

Mr. Serigne Lamine Diop, Minister of Finance  
 Mr. Mamadou Lamine Loum, Prime Minister, Minister of Finance  
 Mr. Famara Ibrahim Sagna, Minister of Finance  
 Mr. Djibril Sakho, National Director, BCEAO  
 Mr. Magatte Pathé Sené, National Director, BCEAO  
 Mr. Mamoudou Touré, Minister of Finance

**Representatives of Political Parties**

Mr. Amath Dansokho, Parti pour l'Indépendance et le Travail (PIT)  
 Mr. Sakhma Diouf Faye, PIT  
 Mr. Sémun Pathé Gnèye, PIT  
 Mr. Makhtar Mbay, PIT  
 Mr. Ibrahima Sène, PIT  
 Mr. Dibo Ka, Union pour le Renouveau Démocratique  
 Mr. Amath Wade, PIT  
 Mr. Landing Savane, Jef/PADS

**Academics**

Mr. Abdoulaye Diagne, Director of Research, Economics Faculty, Cheik Anta Diop University

**Business Community**

Mr. Amath Benoit Gaye, Secretary General, National Union of Chambers of Commerce, Industry & Agriculture

Mr. Nor Talla Kane, Executive Secretary, Conseil National des Employeurs du Senegal  
 Mr. Mamadou Lamine Niang, President, National Union of Chambers of Commerce, Industry & Agriculture

**Journalists**

Mr. Abdou Diarra, *Le Matin*  
 Mr. Malik Diaw, *Le Soleil*  
 Ms. Aissatou Fall, Walf-FM  
 Mr. Mounirou Fall, *Sud Quotidien*  
 Mr. Amadou Gueye, *Le Journal de l'Economie*  
 Mr. Josias Toba Tanama, *Le Journal de l'Economie*

**Nongovernmental Organizations**

Mr. Mame Gueye, President, Civil Forum, National Chapter of Transparency International  
 Mr. Jacques Habib Sy, Founder, Aid Transparency

**Trade Union Representatives**

Mr. Pape Diallo, UNSAS  
 Mr. Madia Diop, President, CNTS  
 Mr. Abdoulaye Gueye, President, Union Nationale des Syndicats Autonomes du Sénégal (UNSAS)  
 Mr. Mody Guiro, Secretary General, Confédération Nationale des Travailleurs du Sénégal (CNTS)  
 Mr. Jhohume Kout, Secretary General, AGHTS  
 Mr. Waly Ndiaye, Confédération des Syndicat Autonomes  
 Mr. Mademba Sock, Secretary General, UNSAS

**Representatives of Donors**

Mr. Jean de Gliniasty, Ambassador of France  
 Mr. Matar Fall, Senior Sanitary Engineer, World Bank Acting Country Director, and water sector lead specialist  
 Mr. Alain Frossard, Conseiller économique et commercial régional, French Embassy  
 Mr. Xavier Rose, Counselor, French Embassy  
 Mr. Jean-Luc Supera, Country Director, Agence Française de Développement  
 Mr. Daniel Voizot, Chef de la Mission de Coopération, French Embassy  
 Mr. Richard Young, Economic Adviser, European Union Delegation

The mission also met with a large number of current and former IMF and World Bank staff involved with these institutions' work on Senegal.

## CHAPTER 12

# Evidence from Two Countries That “Graduated” from Prolonged Use

### Morocco

1. Morocco is one of the few recent prolonged users of IMF resources to have “graduated.” It had a series of nine arrangements between 1980 and 1993,<sup>1</sup> but has not had an IMF-supported program since then and completed repaying its borrowing from the IMF in 1997.

2. After a temporary sharp increase in phosphate prices in the early 1970s that led to a boom in expenditures, the Moroccan economy ran into major problems in the late 1970s, as the global recession and falling phosphate prices led to sharp declines in exports and budgetary revenues. At first, the government maintained spending and this resulted in very large current account and budget deficits, financed mainly through external borrowing on commercial terms. Consequently, the imbalances Morocco faced as it entered a series of IMF-supported programs were very large. In 1981, the external current account deficit (excluding grants) exceeded 12 percent of GDP, while the central government budget deficit reached 14 percent of GDP. Between 1982 and 1984, the stock of external debt averaged over 100 percent of GDP, while the external debt-service ratio, before rescheduling, averaged 50 percent of exports of goods and services. In addition, Morocco faced major structural weaknesses, with heavy government regulation, including on consumer prices and credit allocation, a strong inward economic orientation, and considerable vulnerability to exogenous shocks due to its dependence on the agricultural sector and on phosphate exports.

3. Programs in the early 1980s had only a moderate impact in reducing these imbalances. Fiscal adjustment was achieved mainly through expenditure reduction, but domestic payments arrears rose. At

first, progress on structural reforms was slower than planned, in part due to concerns over the social acceptability of a more rapid pace of reform. For example, there were serious riots over increases in the prices of some heavily subsidized consumer goods.

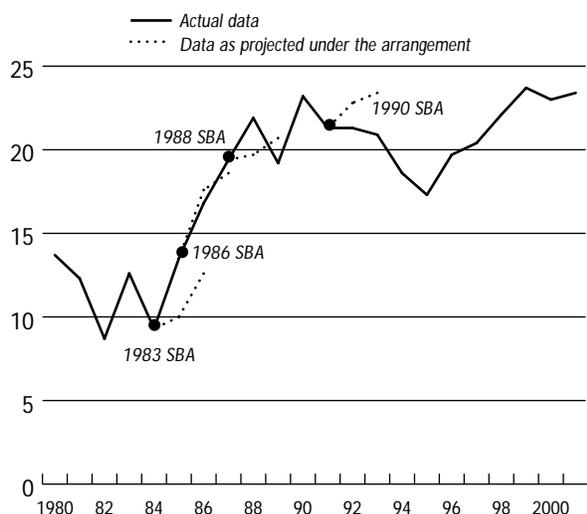
4. In the second half of the 1980s, as the structural reforms started to reach maturity, the contribution of the private sector to investment and growth increased as it benefited from deregulation and improved access to credit. Moreover, financial adjustment policies and structural reforms became mutually reinforcing, as for example tax reform contributed to a greater tax effort, and as export growth accelerated. Over the course of its IMF programs, Morocco eventually achieved significant structural changes, including the liberalization of most foreign transactions and consumer prices; reform of public enterprises; tax and public expenditure reform; and the removal of administrative impediments to private investment. Moreover programs were successful in raising saving: the ratio of gross national saving to GDP rose from an average of 16 percent during 1980–82 to almost 23 percent during 1990–92 (Figure 12.1). Tax reforms contributed to this change, with the tax effort rising from 19¼ percent of GDP to 22¼ percent of GDP over the same period.<sup>2</sup> Progress, while eventually substantial, was not smooth. There were a number of setbacks in the face of exogenous shocks and periodic slippages in policy implementation.

5. This experience suggests a number of questions. Were there elements of the design and implementation of programs that helped Morocco achieve greater external sustainability and dispense with IMF support more quickly than many other prolonged users? Why did core policies continue to move in the right direction? And compared with the other case studies, were there any differences in terms of “exit strategies” once Morocco had reached a certain threshold in terms of external viability? The following aspects help to cast light on these issues:

<sup>1</sup>Two EFFs in the early 1980s, both of which quickly went off-track and were cancelled, followed by seven SBAs between 1982 and 1993 (see Figure 3.1 in Part I, Chapter 3). Morocco also had six nearly continuous annual SBAs between 1965 and 1972.

<sup>2</sup>Morocco’s adjustment experience is described in more detail in Nsouli and others (1995).

**Figure 12.1. Morocco: National Saving**  
(In percent of GDP)



Source: IMF staff reports.

### No obvious differences in the time frame of programs from other prolonged users

6. As in Pakistan and Senegal (but less so in the Philippines), programs were initially overoptimistic about the time frame needed for external viability to be restored.<sup>3</sup> For example, the 1983 staff report stated that despite large disequilibria, Morocco “must aim at reaching a sustainable position in a relatively short period. . . . the medium-term scenario in which the program is set aims at reaching this sustainability by 1988. . . . which, in the view of the staff, is an appropriate time horizon.”<sup>4</sup> Later, programs appear to have become more realistic about the timetable for restoring external viability: by the 1986 program viability was not expected until about 1993. Medium-term projections in subsequent programs broadly maintained this time horizon.

7. Programs from 1982 onward were supported by 12–18 month SBAs, but there was some recognition on both sides that this was part of a more medium-term effort. Nevertheless, the Moroccan authorities have expressed the view that programs still had an overly short-term time horizon, particularly

<sup>3</sup>The first programs in 1980 and 1981 turned out to be particularly unrealistic, assuming as they did that commercial banks would continue to lend on a significant scale.

<sup>4</sup>However, even then the medium-term projections showed large overall balance of payments deficits (equivalent to 6 percent of GDP) persisting through 1987. The staff report claimed that “beyond 1987, the situation could be regarded as more sustainable in the light of the resumption of normal capital inflows. . . .”

as far as structural reforms were concerned and that, at least formally, staff could not candidly position programs within the longer-term framework. Thus, initial programs were too ambitious about the timetable for structural reform.

8. For example, the 1983 program called for a value-added tax (VAT) to be implemented by July 1984, and for draft bills for reform of the general income tax and the corporate income tax to be submitted along with the 1984 budget. In the event, the VAT was not implemented until 1986, after extended consideration in Parliament, and a global personal income tax was only implemented in 1989. Despite this initial “overpromising” on the timetable of tax reform—which appears to have reflected institutional pressures to demonstrate concrete progress within the time frame of the program—one factor that helped maintain progress was that an initial “Loi Cadre” adopted by Parliament had defined the overall framework for tax reform, so that the ultimate objectives remained clear despite slippages in the timetable of individual components. Indeed, officials and staff interviewed were of the view that, with hindsight, the additional time taken for preparation and debate, including in Parliament, on the VAT and the income and profits taxes contributed to their eventual successful implementation by helping to secure greater popular support.

### Program design and the nature of conditionality showed no major differences in approach from that in other prolonged users

9. Until 1985, IMF-supported programs focused on fiscal adjustment, primarily through large reductions in capital spending and public sector wage restraint, tight monetary policy through credit controls, and a flexible exchange rate. Structural reforms were also envisaged, but in practice were largely limited to preparatory work. From 1986 on, programs gave greater emphasis to structural reform, including of the fiscal system and trade regime. Programs continued to target moderate strengthening of the fiscal position, while the nominal exchange rate was fixed in relation to a basket of the currencies of Morocco’s principal trading partners.

10. Programs generally took a fairly gradual approach to adjustment. On average, the six IMF-supported programs between 1983 and 1992 targeted a reduction in the fiscal deficit by an average of 1.3 percentage points of GDP between the year in which the program started and the next,<sup>5</sup> while the current account deficit was projected to narrow on average by

<sup>5</sup>That is, between the projection or estimate for year  $T$ , and the projection for year  $T + 1$ .

**Table 12.1. Morocco: Implementation of Fiscal Programs<sup>1</sup>**

Year	Program	T - 1	T		T + 1	
			Projected	Actual	Projected	Actual
1981	EFF	10.1	7.4 <sup>2</sup>	14.5	...	12.4
1982	SBA	12.4	8.2 <sup>2</sup>	12.5	...	12.1
1983	SBA	12.1	8.7	12.1	7.2	11.2
1985	SBA	11.2	6.0	9.6	4-4.5	5.4
1986	SBA	9.6	6.6	5.4	4.3	5.9
1988	SBA	4.6	4.5	4.6	3.5	6.0
1990	SBA	5.7	2.8	3.5	2.0	3.1
1992	SBA	3.1	0.8	2.2	0.0	4.0

Source: IMF staff reports.

<sup>1</sup>Central government deficit, payments order basis, excluding grants; unless otherwise stated.

<sup>2</sup>Budget deficit, excluding grants, and excluding changes in "Fonds réservés."

1.4 percentage points of GDP over the same period (Table 12.1 and Figures 12.2 and 12.3). In both cases, the targeted adjustment was somewhat greater in the earlier programs than in later ones, in part reflecting the scale of the initial imbalances. Although there was considerable slippage in individual programs, there was a substantial reduction in the fiscal deficit over the period of IMF-supported programs, from 14 percent of GDP in 1981 to a little over 2 percent in 1992.<sup>6</sup>

11. Conditionality in most programs concentrated on the standard macroeconomic quantitative performance criteria. Programs typically also included indicative benchmarks for government revenue, which would trigger consultations on corrective actions if they were missed. Conditionality on structural measures was exercised primarily through the review process, with little use of specific benchmarks. There seems to have been relatively limited use of prior actions even though the guidelines on prolonged use called for greater emphasis on such actions.<sup>7</sup>

12. Given the basic commitment of the authorities, the IMF's flexibility in exercising conditionality—with the focus on reviews to judge whether sufficient progress was being made in key structural areas—was probably appropriate. However, there is no evidence that the IMF was more "flexible" than

in many other cases; for example, programs with the Philippines also relied primarily on reviews for structural conditionality.<sup>8</sup>

**Ownership and implementation: despite slippages in timing, political commitment to the broad direction of the reforms and good implementation capacity appear to have been the critical factors**

13. Implementation of the programs was somewhat mixed, but despite periodic slippages, particularly in relation to fiscal targets, policies on core issues continued to move in the right direction, although not always at the pace envisaged in programs.<sup>9</sup> Implementation of the monetary aspects of programs was generally strong. This consistent direction appears to have owed much to a high degree of commitment by the economic team to the underlying aims and content of successive programs, with the backing of the highest levels of government, and to a high degree of political stability. Interviews with staff also suggest that the strength of Morocco's civil service was a major factor in successful implementation of key reforms. Increasing transparency in putting information and policies out for public discussion also appears to have helped develop a broader consensus, although this consensus was by

<sup>6</sup>Year-to-year comparisons are complicated because of arrears and other data issues. Much of the fiscal adjustment apparently occurred in 1986, after the 1985 program went off-track and before a new program was approved in December of that year.

<sup>7</sup>However, they were used on occasion. For example, parliamentary approval of a revised budget, upward adjustment of retail prices of subsidized commodities, and partial reversal of recently introduced import restrictions were required as "prior actions" for approval of the 1983 SBA arrangement. The 1992 SBA also included a number of prior actions relating to fiscal issues and the reform of interest rate policy, open market operations, and consideration of a new banking law.

<sup>8</sup>The Executive Board did grant waivers of fiscal performance criteria in the 1983, 1986, and 1988 programs, in addition to waivers for primarily technical breaches of performance criteria relating to external arrears.

<sup>9</sup>Both the 1980 and 1981 EFF programs went off-track quickly and were cancelled, with less than 20 percent of the planned disbursements made. The remaining SBAs were more successfully implemented; on average 78 percent of planned disbursements were made. However, neither of the last two programs in 1990 and 1992 was completed as performance criteria were missed and program reviews were not completed.

no means complete since some measures—especially price increases on consumer goods—continued to meet considerable social resistance.

14. In this context, the pace of adjustment and reform was set to some degree by the authorities' perceptions of the domestic political acceptability of reform. In practice, the IMF accommodated this approach by tolerating minor policy slippages and taking a flexible attitude to progress on structural reform in completing program reviews. But this approach does not seem to have differed fundamentally from that in the case study countries where there was also considerable de facto flexibility. The real difference appears to have been made by strong domestic ownership, rather than by the structure of conditionality.

**The economy was highly vulnerable to exogenous shocks, but the approach of programs to this uncertainty was not different from that in other prolonged users<sup>10</sup>**

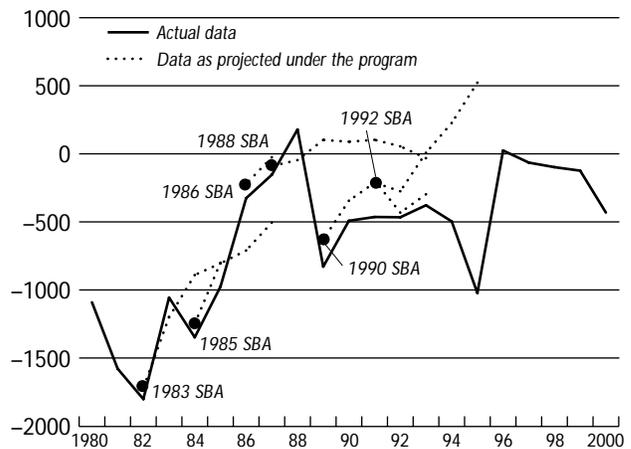
15. However, although exogenous developments led to some relaxation of adjustment efforts in 1981–82 and caused temporary problems in other programs, more generally, shocks do not seem to have distracted the authorities from their broad commitment to advancing reform. For example, there was no major erosion of earlier gains even in the face of the Middle East crisis in 1990–91 and episodes of severe drought. Nevertheless, in their questionnaire responses, the Moroccan authorities said that programs were insufficiently flexible with regard to exogenous shocks. In their view, advance agreement on how supply shortfalls would be dealt with in programs would have made the process smoother and programs less subject to interruption.

**With regard to the exit strategy, the authorities and the IMF appear to have adopted a narrower rationale for continued program involvement than in some other prolonged users**

16. The staff appraisal for the 1992 SBA request noted that Morocco was poised to achieve viable budgetary and external sector positions, and that with the help of the program in 1992 and a further concerted effort in 1993, Morocco would graduate from the use of IMF resources, restore normal rela-

<sup>10</sup>However, unlike, for example, in Senegal, there was only very limited use of automatic adjustments to quantitative performance criteria. The 1990 and 1992 programs did include adjusters in relation to net external financing and to privatization proceeds.

**Figure 12.2. Morocco: Current Account Balance<sup>1</sup>**  
(In millions of U.S. dollars)

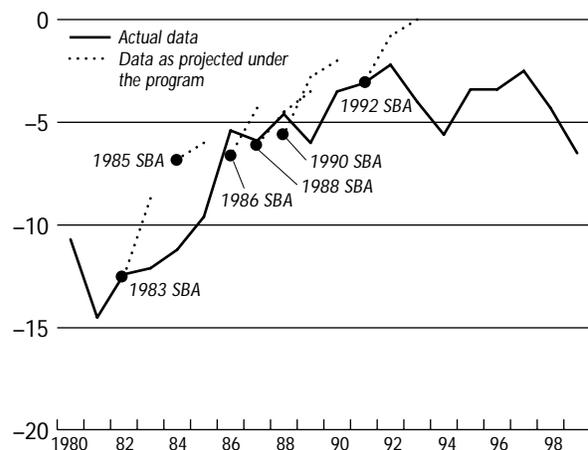


Source: IMF staff reports.

<sup>1</sup>The starting point of projections is occasionally off the "actuals" line because of subsequent revisions to the data on which the projections were based.

**Figure 12.3. Morocco: Central Government Balance<sup>1</sup>**

(Payments order basis; in percent of GDP)



Source: IMF staff reports.

<sup>1</sup>The starting point of projections is occasionally off the "actuals" line because of subsequent revisions to the data on which the projections were based.

tions with its creditors, be able to service its future debt obligations, and achieve current account convertibility in 1993. This "graduation" certainly did not mean that all structural adjustment problems had been solved. Indeed, the economy continued to

face major challenges, including in the areas of public enterprise reform, the regulatory environment for private investment, and reform of the financial system. Moreover, the economy remained insufficiently diversified, with its heavy reliance on rain-fed agriculture leaving it still very sensitive to weather variations.

17. However, it is not clear that common standards were applied with respect to different countries when judging when an exit from IMF-supported programs was justified. For example, a comparison of Morocco's situation in 1993 with that of the Philippines, where the IMF judged that a further EFF arrangement was justified, does not suggest any obvious reasons for the differences in approach (see Box 5.3 in Chapter 5 of Part I).

### Lessons from Jamaica: Implications for Ownership and the "Seal of Approval"

18. Jamaica is a former prolonged user of IMF resources that made a decision not to seek further financial support from the IMF. The current evaluation has not attempted to investigate all aspects of IMF-supported programs with Jamaica, but focuses on two issues: (i) how did the authorities' decision not to enter into new lending arrangements with the IMF affect the nature of the policy dialogue and "ownership"; and (ii) what lessons does Jamaica's recent experience suggest for the IMF's role in signaling a "seal of approval" on the macroeconomic framework to donors, including other IFIs? The evaluation is based on reviews of internal and published IMF documents, interviews with IMF staff and a senior Jamaican representative as well as written responses by the authorities.

19. Since the 1960s, Jamaica has had nine SBAs and four extended arrangements with the IMF. The last EFF expired in March 1996, after which the Jamaican government announced its "independence from the IMF," indicating that it would not borrow again. The authorities explained in interviews with the IEO that this decision was taken in large part because of their assessment that previous IMF-supported programs had not achieved success and that they had consequently prepared a "homegrown" macroeconomic program.

20. At the time the EFF expired, Jamaica still faced large adjustment challenges. Public debt was high (over 100 percent of GDP, with over two-thirds external); inflation was over 20 percent; the real effective exchange rate was appreciating under the combined impact of sizable wage increases in the public and private sectors and an anti-inflationary

monetary policy that had pushed up real interest rates;<sup>11</sup> growth remained weak (recorded GDP rose by only 3 percent during the decade of the 1990s);<sup>12</sup> and the first stage of a major financial sector crisis was under way. The IMF policy advice at the time was that (i) a major adjustment of the exchange rate was necessary in order to restore competitiveness and thereby contribute to higher sustainable growth, along with (ii) some fiscal adjustment (i.e., small overall surpluses). Later, IMF staff also recommended a workout strategy for the financial sector that involved the separation of banks from insurance companies and the intervention and closure of all insolvent institutions. The authorities strongly rejected the advice on the exchange rate, arguing that, with a wage formation process that was heavily influenced by the exchange rate, a sizable devaluation would only accelerate the wage-price spiral so that the best way to assure competitiveness was through a tight monetary policy. The IMF staff initially doubted that, in the likely protracted low-growth environment that such a stabilization strategy would involve, the authorities would be able to maintain the sizable fiscal effort necessary to avoid unsustainable public debt dynamics. On the financial sector, the government feared that outright intervention and closure of banks would lead to a crisis of confidence and capital flight. They opted instead for a strategy based on guaranteeing all deposits and other liabilities; keeping all institutions open; and dealing with problem institutions more gradually, albeit at a high fiscal cost. An off-budget institution, FINSAC, was created and gradually acquired shares in a number of institutions in return for official liquidity support until it effectively controlled all domestically owned commercial banks; a process of merger, reorganization, and gradual privatization then followed.

21. In the event, the government did manage to generate and maintain large primary fiscal surpluses (Figure 12.4), involving some difficult budgetary decisions, including a squeeze on capital spending. As the authorities' "homegrown" policy strategy was seen to be implemented quite forcefully, and the IMF backed away in subsequent Article IV surveillance reports from its previous insistence on an initial large depreciation while still encouraging greater exchange rate flexibility, the nature of the policy dialogue gradually improved. In July 2000, it was agreed that there would be staff monitoring of the government's economic program. The authorities have indicated that they sought the SMP specifically

<sup>11</sup>The real effective exchange rate appreciated by over 20 percent in the two years prior to March 1996 and appreciated by a further 30 percent in the next two years, before leveling off.

<sup>12</sup>However, GDP growth was probably under-recorded because the sizable informal sector appears to have grown much faster.

in order to obtain policy-based loans from the multi-lateral development banks by sending a signal on their macroeconomic framework.<sup>13</sup>

22. The authorities' program achieved some important results, although Jamaica's problems are far from resolved.<sup>14</sup> High primary fiscal surpluses prevented the public sector debt dynamics from deteriorating further; real interest rates declined moderately, although they are still extremely high; and the cushion of external reserves improved. However, the public sector debt (at around 130 percent of GDP) remains a major source of vulnerability and real GDP growth has only recently begun to recover moderately, after a number of years of stagnation. Nevertheless, given the extremely difficult starting conditions and the consequences of the financial sector crisis, any adjustment was bound to be protracted and difficult, with or without IMF support.

23. This experience suggests some interesting lessons:

#### *On ownership*

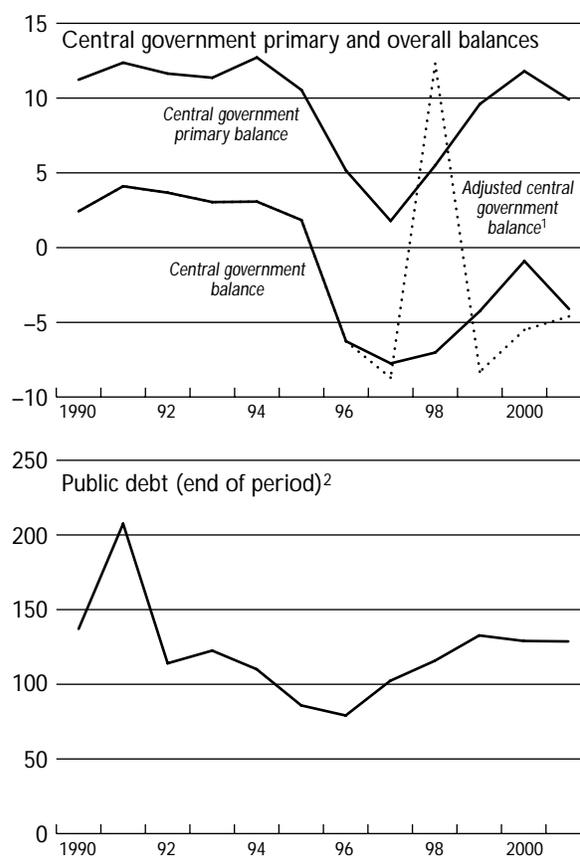
- The staff's own assessment was that one of the main reasons earlier programs had failed to achieve their objectives was a lack of ownership. In their view, as reflected in an internal review prepared in 1998, the authorities' agreement to programs had been mainly motivated by the need to obtain foreign financing and debt relief—a view shared by the authorities. Under these conditions, program implementation, when it was successful, was geared to meeting specific quantitative performance criteria rather than to the implementation of the underlying policy approach. Indeed, a principal conclusion

<sup>13</sup>A staff-monitored program (SMP) is an informal agreement between the authorities and the IMF staff to monitor the implementation of the authorities' economic program; such monitoring does not imply endorsement of the program by the IMF Executive Board, management, or staff, but management and staff should consider that the program is capable of achieving its targets if it is consistently implemented. See "Guidelines for the Use of Staff Monitored Programs." While SMPs can serve several purposes, the objective of Jamaica's SMP was to serve as a signal to official lenders—specifically, the World Bank, as the text notes, and the Inter-American Development Bank (IDB) and the Caribbean Development Bank (CDB)—about the authorities' commitment to sound macroeconomic policies. While the minimum requirement of the World Bank to proceed with policy-based adjustment (as opposed to project) lending is that IMF management provide a "comfort" letter indicating that, in its view, macroeconomic policies are being conducted in a satisfactory manner, in the case of Jamaica the World Bank had initially indicated that it preferred an IMF-supported program to be in place. It eventually agreed to accept the SMP as the necessary seal of approval.

<sup>14</sup>See the staff report for the 2001 Article IV Consultation and Review of Staff-Monitored Program, available on the IMF's website, for further details.

**Figure 12.4. Jamaica: Trends in Fiscal Balance and Public Debt**

(In percent of GDP)



Source: IMF staff reports.

<sup>1</sup>Includes FINSAC interest payments on a full year base. Fiscal year starts in April.

<sup>2</sup>Excluding Bank of Jamaica's external debt and net of public enterprises' holding of FINSAC and government securities.

of the internal assessment was that unless the authorities made a future economic program a matter of national political priority, it was unlikely that any such program would achieve the stated objectives.

- In this case, the move away from a financial arrangement with the IMF—at the authorities' initiative—was associated with much stronger domestic ownership, which proved critical. The policy strategy they pursued, while not in accord with the IMF's recommendations on some key points, does not appear to have been a less appropriate strategy in Jamaica's circumstances, especially since it was implemented with commitment. Although any counterfactual cannot be

assessed with rigor, it seems likely that, if Jamaica had been obliged at that time (e.g., in order to unlock other sources of financing) to adopt a program along the lines proposed by the IMF staff, the eventual outcome would have been worse than the current situation, especially because a lack of ownership would have led to weak implementation. It is more difficult to judge which set of policies might have been preferable, abstracting from political commitment.<sup>15</sup>

- With the benefit of hindsight, the IMF should not have been so dogmatic in insisting upon its preferred strategy, which also involved substantial risks. However, the IMF was prepared to modify its position, once it was clear that the authorities had a strong commitment to an alternative strategy and were prepared to back it up with action, especially on fiscal policy. Indeed, records of the surveillance Board discussions in May 2001 suggest that a number of Executive Directors expressed sympathy for the authorities' position on the exchange rate/monetary policy framework.
- The authorities' strong commitment to transparency was a major advantage. They agreed to the publishing of a (rather critical) Public Information Notice (PIN) following the 1997 Article IV consultation—an action that had a favorable effect on private financial markets (reflected in quite narrow spreads)—and have consistently agreed to the publishing of Article IV consultation missions' concluding statements, including information on performance relative to SMP targets, as well as staff reports for the consultations and SMPs. Their normal practice has been to issue, around the time of publication, their own “commentary” on the staff reports, emphasizing both points of agreement and disagreement, which has helped foster a more open debate.

#### *On the seal of approval*

- Internal IMF documents and staff interviews suggest that the need for an IMF arrangement in order to have access to Paris Club rescheduling was a major motivation behind the authorities'

proceeding with many earlier programs.<sup>16</sup> But, as noted above, many of the programs appear to have been weakly owned. By the time the government decided to forgo any further lending arrangements with the IMF, any further rescheduling of (pre-cutoff date) official debt would have had little impact, and Jamaica was able to access private financial markets without an IMF-supported program. Therefore, the initial lack of a “seal of approval” from the IMF mainly affected program lending by the multilateral development banks.

- The ambiguous nature of the staff-monitored program (SMP) as a seal of approval on the macroeconomic framework caused some initial problems. On the one hand, the authorities were concerned that the IMF might become an impediment to their access to much needed resources from other sources, notably the World Bank and the IDB, while the latter institutions were concerned that the IMF staff might not be as rigorous in their policy advice and assessments if no IMF financial resources were involved. The World Bank also had burden-sharing concerns. Eventually, both institutions did undertake lending for financial sector restructuring, using the SMP as the basis for the signal on the macroeconomic framework.
- Despite these initial concerns about the role of the SMP, it does appear to have played a useful role in the case of Jamaica—allowing some room for maneuver to combine a strong domestic policy formulation process with a healthier policy dialogue with the IMF. IMF staff expressed the view that the authorities became more receptive to a discussion on alternative policy mixes—within their own overall framework—once the SMP route became an option, and the authorities have also indicated that they found the approach useful. The point is not that the SMP as an instrument necessarily had any major advantages over a lending arrangement. Although the IMF did have initial reservations about the authorities' approach, these reservations diminished, and the IMF might have been willing to agree to a lending arrangement in support of the authorities' program rather than a SMP. But in this case a SMP did provide an alternative approach to signaling on the “seal of approval” that was more acceptable to the authorities, and hence more likely to foster ownership.

<sup>15</sup>Kirkpatrick and Tennant (2002) attempt to assess what the outcome would have been if an alternative financial sector strategy, closer to one like that recommended by the IMF, had been adopted. However, their counterfactual assumes that the IMF strategy would have led to a major currency crisis and output collapse and hence an obviously inferior outcome. There is no way to test this assertion. It is also possible that the counterfactual would have been a stronger flow of funds into foreign-owned domestic banks.

<sup>16</sup>Jamaica reached seven rescheduling agreements with the Paris Club between 1984 and 1993.

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# Glossary of Selected Terms<sup>1</sup>

## A

### Access Policy and Access Limits

Policies that govern the use of IMF resources by its members, including access limits set in terms of members' *quotas*. The access policy, including annual and cumulative limits, under the *credit tranches* and the *Extended Fund Facility* (EFF) are reviewed each year. Access under other facilities also is reviewed periodically. Access under the *Supplemental Reserve Facility* (SRF) and the *Contingent Credit Line* (CCL) are not subject to limits in relation to *quotas*.

### Arrangement

A decision by the IMF that gives a member the assurance that the institution stands ready to provide foreign exchange or SDRs in accordance with the terms of the decision during a specified period of time. An IMF arrangement—which is not a legal contract—is approved by the *Executive Board* in support of an economic program under which the member undertakes a set of policy actions to reduce economic imbalances and achieve sustainable growth. Resources used under an arrangement carry with them the obligation to repay the IMF in accordance with the applicable schedule, and to pay charges on outstanding *purchases* (drawings) and loans.

### Article IV

Article IV consultations are the main vehicle through which the IMF exercises its bilateral *surveillance* mandate. In accordance with Article IV of its *Articles of Agreement*, the IMF holds consultations, normally every year, with each of its members. The purpose of these consultations is to assess whether a country's economic developments and policies are consistent with the achievement of sustainable growth and domestic and external stability. In this way, the IMF seeks to provide a preventive mechanism that is capable of signaling dangers on the economic horizon and anticipating the need for policy action. The outcome of these consultations is a staff report discussed by the IMF's *Executive Board*. Many countries choose to make these reports public after they have been discussed by the Board.

<sup>1</sup>This glossary is based on the "Glossary of Selected Financial Terms" and various factsheets prepared by the IMF's External Relations Department. The full glossary is available on the IMF's website at <http://www.imf.org/external/np/exr/glossary/index.asp>. The factsheets are available at [http://www.imf.org/cgi-shl/create\\_x.pl?fcteng](http://www.imf.org/cgi-shl/create_x.pl?fcteng). Words in light italics are "see also" references.

## Articles of Agreement

An international treaty that sets out the purposes, principles, and financial structure of the IMF. The Articles, which entered into force in December 1945, were drafted by representatives of 45 nations at a conference held in Bretton Woods, New Hampshire. The Articles have since been amended three times, in 1969, 1978, and 1992, as the IMF responded to changes in the world economic and financial structure.

## B

### Basic Rate of Charge

A single unified rate of charge that is applied to the outstanding use of IMF credit financed from the IMF's general resources. The basic rate of charge, which is set as a proportion of the weekly *SDR* interest rate, is applied to the daily balance of all outstanding *purchases* (drawings) during each of the IMF's financial quarters. A surcharge is added for use of resources under the *Supplemental Reserve Facility* and the *Contingent Credit Line*.

### Benchmarks

In the context of IMF arrangements, a point of reference against which progress may be monitored. Benchmarks may be either quantitative or structural in content, and may be set on a quarterly or semiannual basis.

## C

### Compensatory Financing Facility (CFF)

A special IMF financing facility (window) that was established to provide resources to members to cover shortfalls in export earnings and services receipts, as well as excesses in cereal import costs, that are temporary and arise from events beyond the members' control.

### Conditionality

Economic policies that members intend to follow as a condition for the use of IMF resources. These are often expressed as *performance criteria* (for example, monetary and budgetary targets) or *benchmarks*, and are intended to ensure that the use of IMF credit is temporary and consistent with the adjustment program designed to correct a member's external payments imbalance.

### Contingent Credit Line (CCL)

The CCL is aimed at preventing the spread of a financial crisis, enabling countries that are basically sound and well managed to put in place precautionary financing in the event a crisis should occur. Short-term financing would be

provided under a *Stand-By* or an *Extended Arrangement* to help members overcome the balance of payments financing needs arising from a sudden and disruptive loss of market confidence due to contagion, and largely generated by circumstances beyond the member's control.

#### **Credit Tranche Policies**

Policies under which members may make use of IMF credit. The amount of such use is related to a member's *quota*. Early in its history, the IMF made credit available in four tranches (segments), each equal to 25 percent of a member's quota. Provided a member is making reasonable efforts to solve its balance of payments problems, it can make use of IMF resources up to the limit of the first credit tranche on fairly liberal terms. Requests for use of more resources (upper credit tranche purchases) require substantial grounds for expecting that the member's balance of payments difficulties will be resolved within a reasonable period of time. Such use is almost always made under a *Stand-By* or an *Extended Arrangement*, entailing phasing of *purchases*, *performance criteria*, and reviews.

## **E**

#### **Early Repurchase Expectation**

The expectation of repurchase (repayment) in advance of its originally scheduled due date. According to the *Articles of Agreement*, a member is normally expected to repurchase its currency (make repayment of usable currencies) as its balance of payments and reserve positions improve. The current early repurchase policy has been in effect since June 1979 and establishes amounts expected to be repurchased taking into account the level of a member's reserves and their growth, as well as other parameters. A separate repurchase expectation applies to purchases made under the *Supplemental Reserve Facility* and the *Contingent Credit Line*. Such repurchases are expected one year before they become obligatory, except that at the request of the member the IMF may decide to extend the expectation period by up to one year, though not beyond the due date.

#### **Enhanced Structural Adjustment Facility (ESAF)**

Facility established in December 1987 to provide assistance on concessional terms to low-income member countries facing protracted balance of payments problems. (Changed to the *Poverty Reduction and Growth Facility* in 1999.)

#### **Enhanced Surveillance Procedure**

Policy introduced in 1985 to help members make progress in addressing their debt problems and improving relations with their creditors. During the enhanced surveillance period, economic developments in the member country are monitored by the IMF. The staff prepares an assessment of the member's economic program, which may be presented by the member to official and private creditors for consideration. The policy was broadened in 1993 to cover any situation in which a member would find this enhanced monitoring by the IMF helpful.

#### **Executive Board**

The Executive Board consists of 24 Executive Directors representing the IMF's 184 member countries. At present,

eight Executive Directors represent individual countries: China, France, Germany, Japan, Russia, Saudi Arabia, the United Kingdom, and the United States. The 16 other Executive Directors each represent groupings of the remaining countries. The Executive Board rarely makes its decisions on the basis of formal voting, but relies instead on the formation of consensus among its members.

#### **Extended Arrangement**

A decision of the IMF under the *Extended Fund Facility* that gives a member the assurance of being able to purchase (draw) resources from the *General Resources Account (GRA)* during a specified period, and up to a particular amount.

#### **Extended Fund Facility**

A financing facility (window) under which the IMF supports economic programs that generally run for three years and are aimed at overcoming balance of payments difficulties resulting from macroeconomic and structural problems. Typically, the member's economic program states the general objectives for the three-year period and the specific policies for the first year; policies for subsequent years are spelled out at the time of program reviews.

## **F**

#### **Financing Assurances**

An IMF policy developed in response to the external debt crisis of the late 1970s and early 1980s to help mobilize financial support from the international banking community for countries experiencing debt-servicing difficulties. Under the policy, the IMF would not make its resources available to a member undertaking an adjustment program until receiving assurances that the financing for the program would be forthcoming.

## **G**

#### **General Resources**

Assets, whether ordinary (owned) or borrowed, maintained within the IMF's General Resources Account (GRA), that constitute the bulk of resources available to the IMF to provide financial support to its members.

## **H**

#### **Heavily Indebted Poor Countries (HIPC)**

##### **Initiative**

The HIPC Initiative, adopted in 1996, provides exceptional assistance to eligible countries to reduce their external debt burdens to sustainable levels, thereby enabling them to service their external debt without the need for further debt relief and without compromising growth. It is a comprehensive approach to debt relief that involves multilateral, Paris Club, and other official and bilateral creditors. Assistance under the HIPC Initiative is limited to PRGF- and IDA-eligible countries that have established a strong track record of performance under PRGF- and IDA-supported programs. A strong track record of policy implementation is intended to ensure that debt relief is put to effective use. Recent enhancements to the HIPC Initiative aim to provide deeper, broader, and quicker debt relief. It is expected that as many as 36 IMF members could qualify for assistance under the enhanced Initiative.

**I****International Monetary and Financial Committee (IMFC)**

The IMFC consists of 24 Governors representing constituencies or groups of countries, corresponding to those of the Executive Board. It meets twice a year, on the occasion of the IMF–World Bank Annual and Spring Meetings, to advise the IMF on the functioning of the international monetary system. In April 2002, the members of the IMFC were the Governors of the IMF for Algeria, Argentina, Australia, Belgium, Botswana, Brazil, Canada, China, Finland, France, Gabon, Germany, India, Italy, Japan, Mexico, Netherlands, Russia, Saudi Arabia, Switzerland, Thailand, United Arab Emirates, United Kingdom and United States.

**L****Letter of Intent**

A document emanating from country authorities that presents to the *Executive Board* the economic programs that they formulated in consultation with the IMF, in support of their request for IMF lending.

**Liquidity Ratio**

A measure used to gauge the IMF's capacity to provide financial assistance to members and meet members' claims on the IMF. It is the ratio of the IMF's net uncommitted usable resources to its liquid liabilities.

**M****Management**

IMF management consists of the Managing Director and three Deputy Managing Directors. The Managing Director is Head of IMF staff and Chairman of the *Executive Board*. He is appointed by the Executive Board.

**P****Paris Club**

The Paris Club is an informal group of official creditors, industrial countries in most cases, that seek solutions for debtor countries facing payments difficulties. Although the Paris Club has no legal basis, its members agree to a set of rules and principles designed to reach a coordinated agreement on debt rescheduling quickly and efficiently. The Paris Club and the IMF have extensive contacts, since the Paris Club normally requires countries to have an active IMF-supported program in order to qualify for a rescheduling agreement.

**Performance Criteria**

Macroeconomic or structural indicators that must be met, typically on a quarterly or semiannual basis, for the member to qualify for purchases under the phasing schedule for *Stand-By Arrangements*, *Extended Fund Facility* (EFF) Arrangements, and *Poverty Reduction and Growth Facility* Arrangements. Some performance criteria are those necessary to implement specific provisions of the Articles of Agreement.

**Phasing**

The practice of making the IMF's resources available to its members in installments over the period of an *arrangement*. The pattern of phasing can be even, front-loaded, or back-loaded, depending on the financing needs and the speed of adjustment.

**Poverty Reduction and Growth Facility (PRGF)**

Established as the *Enhanced Structural Adjustment Facility* (ESAF) in 1987, enlarged and extended in 1994, and further strengthened in 1999 to make poverty reduction a key and more explicit element. The purpose of the facility is to support programs to strengthen substantially and in a sustainable manner balance of payments positions, and to foster durable growth, leading to higher living standards and a reduction in poverty. Eighty low-income countries are currently PRGF-eligible. Loans are disbursed under three-year arrangements, subject to observance of *performance criteria* and the completion of program reviews. Loans carry an annual interest rate of 0.5 percent, with a 5½ year grace period and a 10-year maturity.

**Precautionary Arrangement**

A *Stand-By* or an *Extended Arrangement* under which the member agrees to meet specific conditions for use of IMF resources although it has indicated to the *Executive Board* its intention not to make *purchases* (drawings).

**Program Monitoring**

Monitoring by the IMF to determine whether the *performance criteria* specified and policy commitments made in the context of a *Stand-By* or an *Extended Arrangement* are being observed by the member receiving resources (see *Conditionality*).

**Purchases and Repurchases**

When a member draws on the IMF's *general resources*, it does so by purchasing *SDRs* or other members' currencies in exchange for its own (domestic) currency. The IMF's general resources are, by nature, revolving: purchases (or drawings) have to be reversed by repurchases (or repayments) in installments within the period specified for a particular policy or facility.

**Q****Quota**

The capital subscription, expressed in *SDRs*, that each member must pay to the IMF on joining. Up to 25 percent is payable in *SDRs* or other acceptable reserve assets and the remainder in the member's own currency that the IMF in turn can use to obtain reserve assets from the member. Quotas determine the maximum amount of resources a member is called upon to provide to the IMF, serve as the basis for voting power on IMF decisions, determine the distribution of *SDR* allocations, and serve as the basis for access to IMF resources. Quotas are normally reviewed every five years.

**S****Special Drawing Right (SDR)**

International reserve asset created by the IMF in 1969 to supplement existing reserve assets. The currency value of

the SDR is determined daily by the IMF by summing the values in U.S. dollars, based on market exchange rates, of a basket of four major currencies—the euro, Japanese yen, pound sterling, and the U.S. dollar. The SDR valuation basket is normally reviewed every five years. Members of the IMF may use SDRs in a variety of voluntary transfers, including in operations and transactions involving the *General Resources Account* (GRA), such as the payment of charges and repurchases (repayments). The SDR is also the unit of account of the IMF's financial activities.

**Stand-By Arrangement**

A decision of the IMF by which a member is assured that it will be able to make *purchases* (drawings) from the *General Resources Account* (GRA) up to a specified amount and during a specified period of time, usually one to two years, provided that the member observes the terms set out in the supporting arrangement.

**Supplemental Reserve Facility (SRF)**

A facility (window) established in December 1997 to provide financial assistance to members experiencing exceptional balance of payments difficulties due to short-term financing needs resulting from a sudden and disruptive loss of market confidence reflected in pressure on the capital account and the members' reserves.

**Surveillance**

The IMF has a mandate under its *Articles of Agreement* to exercise firm surveillance over the exchange rate policies of members in order to oversee the international monetary system and ensure its effective operation. To this end, the IMF assesses whether a country's economic developments and policies are consistent with the achievement of sustainable growth and domestic and external stability (bilateral surveillance). The IMF also assesses the global implications of members' policies and reviews key developments and prospects in the international monetary system (multilateral surveillance). In this way, the IMF seeks to provide a preventive mechanism that is capable of signaling dangers on the economic horizon and anticipating the need for policy action. (See also *Article IV*.)

**U****Use of IMF Resources (or IMF Credit)**

The extension of credit to members through the use of IMF resources under the *General Resources Account*, loans made to members of resources in the Special Disbursement Account, or resources borrowed by the IMF as Trustee for the PRGF Trust.



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**IMF Management Response**

**IMF Staff Response**

**IEO Response**

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**Summing Up of IMF Executive Board  
Discussion by Acting Chair**

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# STATEMENT BY THE MANAGING DIRECTOR ON THE EVALUATION BY THE INDEPENDENT EVALUATION OFFICE OF PROLONGED USE OF FUND RESOURCES

Executive Board Meeting  
September 20, 2002

1. We welcome this first report of the Independent Evaluation Office (IEO), and would like to express our appreciation for the extensive work that has gone into it.<sup>1</sup> The high standard of the report shows that this office should make a major contribution in improving the Fund's work. We are in general agreement with many of the report's findings, and plan to conduct an internal review of how we utilize a number of recent policy initiatives to address the problems identified in the report.

2. One of the important contributions of the report is to raise the question of when prolonged use is a problem, and if so, why. Prolonged use—in some cases—reflects benefits to a member of longer-term involvement with the Fund. It is therefore important to recognize that there are tradeoffs to be considered in addressing the problems associated with prolonged use, and that a sustained period of engagement is not always detrimental. We would appreciate hearing the views of Executive Directors on this important issue.

3. In turning to the report's concrete recommendations, we agree with the need to strengthen surveillance procedures, particularly for program countries. At the conclusion of the 2002 biennial surveillance review, the Executive Board took important steps toward this objective. Most importantly, the Board clarified that surveillance in program countries include a reassessment of economic conditions and policies from a fresh perspective, and agreed to enable greater flexibility in the timing of Article IV consultations to allow them to occur at points in the budget or program cycle when they may be most beneficial. A guidance note—incorporating these recommendations—has already been issued to the staff. The report's recommendation for conducting systematic ex-post assessments of programs would appear to be another promising avenue.

4. Similarly, in the recommendations concerning program design and implementation, we see a great deal of congruence with the findings of the review of

conditionality. As in the IEO report, the review of conditionality emphasized the importance of the principles of country ownership, streamlined conditionality, tailoring programs to member's circumstances, and effective coordination with other multilateral institutions for the successful design and implementation of Fund-supported programs. These principles are incorporated in the new draft guidelines on conditionality, to be discussed by the Board on September 16th, and will be subsequently disseminated to staff.<sup>2</sup> The guidelines provide a framework for moving forward, but they are really only the beginning of a process that will require continued attention.

5. The report calls for greater selectivity in extending Fund financial support. The principle of selectivity has been discussed, and reaffirmed, by the Board, and it is included in the draft of the new conditionality guidelines. As the report acknowledges, the judgment of whether to extend or withhold financial support will often be an exceptionally difficult one. With this in mind, we need to ensure that our procedures for entering into arrangements with members include careful and explicit assessments of the conditions for successful program implementation, particularly when a member has a poor track record of implementation. Some of the other recommendations in the report, such as the stress it places on an assessment of the political support for the adjustment program, may help in this regard.

6. The policy initiatives already underway, and described briefly above, should go some way to reduce the incidence of inappropriate prolonged use of the Fund's general resources by members. The report, however, also suggests that specific policies be tailored to the Fund's relations with those of its members that are deemed prolonged users. We will be particularly interested in hearing the views of Executive Directors on whether they view special (and more restrictive) policies to be appropriate or whether they see a broader, preventive approach as being sufficient.

<sup>1</sup>A Fund staff response to the Report, discussing some technical aspects, has also been distributed to the Board.

<sup>2</sup>SM/02/276, August 23, 2002.

7. Looking ahead, Management will establish an internal task force to examine and make recommendations on how the issues raised in the present report can best be addressed going forward, taking account of the views of Executive Directors. The task force's main objectives would be to prioritize the report's recommendations and propose a strategy to most efficiently implement agreed-upon priorities. In doing so, we will ask the task force to look at (i) how best

to build on current policy initiatives to address the problems identified in the report; (ii) other recommendations that can improve program design to achieve a better balance between ambition and realism; and (iii) whether issues not already included in the work program need to be studied further. We propose to return to the Board early next year for a discussion of the recommendations of the staff task force.

# STAFF RESPONSE TO THE EVALUATION BY THE INDEPENDENT EVALUATION OFFICE OF PROLONGED USE OF FUND RESOURCES

Executive Board Meeting  
September 20, 2002

## Introduction

1. This first evaluation conducted by the Independent Evaluation Office presents a useful analysis of the prolonged use of Fund resources over the past three decades and is a welcome addition to the set of independent evaluations of Fund policy and practices. The common objective of the Fund staff and the IEO is to strengthen the Fund's lending decisions and improve the design and implementation of Fund-supported programs, so that they foster lasting improvements in members' growth and welfare. The underlying issues raised in the report—how to enhance program ownership, how to help countries establish a track record of reform, and when to give the authorities the benefit of the doubt—are ones with which Fund staff and management grapple every day. In this regard, many of the report's useful recommendations—such as those pertaining to streamlining conditionality and enhancing program ownership—are being implemented under initiatives undertaken by management or the Board, while others will require further consideration.

2. Although the staff agrees with much of the report, there were also issues where it would take a somewhat different position. The purpose of this note is not to address every such issue, but to provide an initial reaction to some important issues the report raises.

## Nature and incidence of prolonged use

3. One of the important contributions of the report is to raise the question of when prolonged use is a problem, and if so, why. Prolonged use has emerged in part due to a recognition of the benefits that longer-term involvement may be able to offer the Fund's members in some cases. This is true, for example, of the Fund's involvement in low-income countries, where there has been an increasing appreciation of the protracted nature of their balance of payments needs. For other developing countries engaged in a transition to the point when they can benefit from durable access to international capital markets, the process of developing the macroeconomic

policy framework and institutions necessary to deal with the risks that come with integration can be protracted. Given the challenges associated with this transition, and the new challenges that have accompanied global capital market integration, many countries have faced the need for periodic engagement with the Fund.

4. These examples would not justify the suggestion that there are no problems associated with prolonged use, and here, the report correctly identifies several issues. The report's basic premise, which is widely accepted—and the staff would strongly endorse—is that the Fund is not intended to be a continuous source of financing for its members over a protracted period of time. As Executive Directors have noted on a number of occasions,<sup>1</sup> the Fund's capacity to provide support under a succession of arrangements or purchases over time is not intended to enable it to become a source of continuous financing, but to maintain its ability to respond to its members' temporary needs for balance-of-payments financing as and when they arise.

5. The definition of a prolonged user of Fund resources presented in the report is that the member has been under Fund-supported programs for seven or more years in a ten-year period. On this basis, 44 members (29 of them PRGF-eligible) were prolonged users at some point during the period 1971–2000; a further seven members were prolonged users if precautionary arrangements are included. But in reporting on the overall incidence of prolonged use, grouping together GRA and non-GRA users may give a misleading picture: about 40 percent of PRGF-eligible members would be classified as prolonged users, while among middle-income members the ratio is closer to 20 percent (or about 25 percent if precautionary arrangements are included).

6. The evidence on the incidence of prolonged use presented in the report is broadly consistent with the findings of other work by the staff. The preparatory

<sup>1</sup>Chairman's Summing Up, "Modalities for Special ESAF Operations in the Context of the HIPC Initiative and Other ESAF Issues," Executive Board Meetings 97/5, 97/8, and 97/10.

work done for the review of Fund facilities in 2000 found relatively few cases of members drawing resources in the credit tranches year after year, but many more cases where members entered repeat arrangements while making few purchases, because the programs went off-track relatively soon.<sup>2</sup> This indicates that, in general, the fundamental issue is not that of tying up Fund resources for excessively long periods, but of negotiating programs that, for whatever reason, were not implemented. Consequently, our approach has not been to tackle prolonged use *per se*, but to promote more successful program design and implementation and enhance ownership by modifying Fund policies in the areas of conditionality, surveillance, and technical assistance.

7. The report finds that the rising incidence of prolonged use is largely accounted for by the increase in such use by PRGF-eligible members. For these members, the causes of prolonged use and the issues it raises are generally somewhat different than for the rest of the membership. The report rightly notes that the balance of payments needs of many low-income members are of a protracted nature, and thus the Fund's assistance needs to be sustained over a considerably longer period than for other members. Under the ESAF, and now the PRGF, current Fund policies recognize that prolonged support is legitimate (in contrast to the situation under the earlier Trust Fund and Structural Adjustment Facility (SAF)). The guiding principles for the use of our concessional resources are governed by the terms of the PRGF Trust instrument, rather than the general provisions of the Articles. In these cases, the central problem is not the prolonged nature of the Fund's involvement, but the failure of some PRGF-supported programs to produce the intended results. At the same time, one must bear in mind that some prolonged users among the low-income members have very strong records of successful program implementation, and indeed, it is because their records are strong that their programs have been supported with successive Fund arrangements. Uganda is one such example. While we do not intend to suggest that prolonged use of this kind has no potential difficulties associated with it, such differences should be borne in mind in understanding the phenomenon of prolonged use and in devising strategies to address it.

8. The report also notes that prolonged use by low-income members is related in part to the need of aid donors and other providers of funds to have assurances that they are disbursing into a sound macroeconomic policy environment. Whether a PRGF arrangement is in every case the appropriate vehicles

through which the Fund should signal its endorsement of a member's macroeconomic and poverty reduction policies is a good question, and one that will be explored further in a note on the Fund's role in its low-income members that will be ready for discussion sometime after the Annual Meetings. In addition, shortly after the Annual Meetings we plan to present a paper revisiting the more general issue of the use of Fund arrangements as a signaling device, and the extent to which other vehicles, such as staff-monitored programs or some form of enhanced surveillance, could be used for this purpose.

### Consequences of prolonged use

9. In evaluating prolonged use as a whole, it is important to take account of the important tradeoffs involved. It is important to recognize that a sustained period of engagement is not always exclusively detrimental, but in a number of other cases, prolonged use is an indication that the adjustment programs that the Fund has been supporting may not have been effective in delivering the balance of payments adjustment anticipated. The latter cases are more clearly problematic, even recognizing that a variety of factors, including adverse shocks and political developments, contribute to program outcomes.

10. The report presents a body of analysis characterizing prolonged users and the associated economic outcomes, concluding also that prolonged use of Fund resources is associated with widespread adverse economic effects. However, it does not seem to find such effects in cases of prolonged use of concessional Fund resources, where there is a significant positive coefficient for output per capita. It should be noted that, in attributing such effects, there is an important identification problem, since the correlation may simply reflect countries subject to larger shocks and slower growth being more likely to need to turn to the Fund. The econometric techniques employed do not provide completely convincing results on the direction of causation.<sup>3</sup> However, some other negative effects, such as the impact of successive program negotiations on the process of economic policy formulation, are likely to be signifi-

<sup>2</sup>Review of Fund Facilities—Preliminary Considerations, EBS/00/37, March 2, 2000, pages 29–30, and Annex IV.

<sup>3</sup>The econometric work presented in an annex to the paper is an extension of recent work by Barro and Lee (2002). While the annex does not present enough information to permit a full assessment, it would appear to share the shortcomings of that paper, including with regard to the choice of instrument and variables (the possibility that they may be correlated with the error term; their explanatory power; and their interpretation), and of the treatment of PRGF programs in the sample. It is also not clear in the report how the analysis took account separately of the endogeneity of the existence of a Fund-supported program versus the prolonged nature of the use of Fund resources, given that both aspects are likely to be correlated with the error term.

cant in some cases, even if they cannot be statistically identified.

11. The potential problems associated with prolonged use are most clearly illustrated by the report's critical and insightful look at three case studies (Pakistan, Philippines, and Senegal). The discussion of the selected case studies highlights discrepancies between the time frame of programs and the ambition of their objectives, the understatement of program risks associated with weak ownership and political commitment, insufficient analysis of the key risks to the program, and relative absence of *ex post* assessments of programs. In addition, the report argues that structural conditionality was often poorly prioritized, so that compliance with a subset of conditions did not ensure that the most critical problems were being addressed.

12. While these case studies highlight many issues that are both valid and concerning, the staff's overall assessment of these country cases is somewhat different from that in the report. For example, the 1986–97 programs with the Philippines achieved some measure of success, laying the foundation for its return to the capital markets—access which has been sustained without interruption (even during the Asian crisis) for nearly a decade. Indeed, of the Asian crisis countries, the impact on output growth was the smallest in the Philippines, in part because of the wide-ranging structural reforms that the country had undertaken under successive Fund-supported programs.

13. It is also important to recognize the element of selectivity in choosing these case studies. To take another example, the report could have included a study of at least one case, such as Bulgaria or Latvia, in which Fund support, although prolonged under the report's definition, has been more clearly and overwhelmingly positive. Indeed, the willingness of member countries to request precautionary arrangements—and pay the associated commitment fee—suggests that engagement with the Fund carries substantial economic value.

14. In those cases in which prolonged use is motivated by the prolonged nature of the structural and institutional factors underlying the country's balance-of-payments problems, the report rightly notes that the objectives of Fund-supported programs have not always been clearly articulated. In particular, when the SAF and ESAF were created, both were envisaged as one-off operations to support adjustment in low-income members during a relatively short period and with limited resources. These constraints were gradually lifted in several steps during the 1990s, culminating in the transformation of the ESAF into the PRGF. However, the intended duration of Fund involvement in individual cases often remained unclear, because the program objectives were not sufficiently clearly defined. The need for a

clear articulation of program objectives is an important lesson.

### Main recommendations

15. Given that prolonged use reflects virtually every aspect of the way the Fund interacts with member countries, the report's twenty-two recommendations are wide-ranging. Here we focus on a few of those recommendations that are most directly related to prolonged use—specifically the suggestions of greater selectivity in extending financial support, developing alternative vehicles to deliver a seal of approval, adopting explicit exit strategies, and establishing a higher rate of charge for prolonged users. In the following section, we discuss these recommendations in relation to the staff's existing work.

16. Exercising greater selectivity in extending financial support is a long-standing idea, which was most recently considered in the context of the Fund's conditionality review; the merits of greater selectivity are recognized, in particular, in the draft of the new conditionality guidelines. Weighing the consequences of a refusal to support the member's policies against the need to give the authorities the appropriate degree of benefit of any doubt, especially when a new government takes office, or when there is a lack of sufficient track record, will always be a difficult matter.

17. A related proposal is the establishment of higher charges as a financial incentive for the country to curb prolonged use. It is not clear whether such incentives would be effective. This issue was considered during the 2000 review of Fund Facilities when the Board approved new surcharges on large amounts of credit outstanding, and stated its intention not to review Fund charges for a period of four years.

18. Whether there are viable alternatives for the “seal of approval” function of Fund-supported programs—whether staff-monitored programs or enhanced surveillance could fulfill this function—remains an open question. There is a general perception, however, that the credibility of the Fund's approval is significantly greater when the Fund commits its resources to the member's program. This perception is bolstered by questions about the quality of the “seal of approval” provided by staff-monitored programs (SMP), given that, as noted during the 2002 biennial review of surveillance, they do not carry Fund endorsement, they do not have to meet the standards of upper-credit-tranche conditionality, and reporting on performance under SMP is often limited. As regards providing a “seal of approval” for other donors and the Paris Club, this topic is perhaps best discussed in the con-

text of the review of the role of the Fund in low-income countries; to date, however, bilateral donors and lenders, including the Paris Club, have typically insisted on the financial presence of the Fund as a condition for their support (and, in response, the Fund has at times reduced access to token amounts).

19. The report also calls for greater selectivity in program content, concluding that the reform agenda in many countries was overloaded. In other contexts, the report argues that the Fund has been too accommodative of program slippages, which is one of the factors behind prolonged use—implying that conditionality (including prior actions) should have been enforced more rigorously. A key impetus of the current conditionality review—expected to be codified in the new conditionality guidelines—is to streamline and focus conditionality on those measures deemed critical to the program’s objectives. An important element of this streamlining process is enhanced collaboration with other multilateral institutions, especially the World Bank; to this end, an operational framework for Bank-Fund collaboration has recently been formalized and a staff guidance note issued.

20. Finding the right balance between realism and ambition remains a difficult challenge to the in-

stitution. In this context, the recent initiative to improve the Fund’s analysis of public and external debt sustainability emphasizes the need to discipline projections and to undertake adequate sensitivity tests of scenarios. While this will not, in itself, necessarily reduce instances of prolonged use, it should result in a better articulation of realistic program objectives and projections. Recognition that a member’s reform agenda will take many years to complete may argue for more explicit recognition that external support, including that of the Fund, will need to be prolonged, rather than doing anything to reduce prolonged use.

21. There is widespread agreement that national ownership of reform programs is essential to their success, although the report glosses over the difficulty of achieving and sustaining national ownership of sound macroeconomic and structural adjustment policies. The PRSP process, initiated in 1999, is intended to help promote stronger ownership of PRGF programs, and in 2001, the Board discussed operational procedures aimed at increasing national ownership of Fund-supported programs more generally. In any case, nationally-owned policies should not mean not weaker, but better, programs.

# INDEPENDENT EVALUATION OFFICE COMMENTS ON MANAGEMENT/STAFF RESPONSES TO THE EVALUATION OF PROLONGED USE OF FUND RESOURCES

Executive Board Meeting  
September 20, 2002

1. The statement by the Managing Director and the staff response circulated separately indicate general agreement with many of the report's findings and state that a number of the report's recommendations have been addressed by recent initiatives taken by management. We welcome the broad congruence of views and recognize that the recent strengthening of guidelines on conditionality and surveillance provides a framework for moving forward. However, as the Managing Director has himself noted, changing guidelines is only the beginning of the process and there can be a very long lag between the identification of the changes needed to address a problem and the effective implementation of these changes. Our report recommends a number of additional steps that could be taken to encourage effective implementation. These include some of the systemic issues identified in the evaluation, including changing the nature of the IMF seal of approval, defining the boundaries between programs and surveillance, and evolving more explicit exit strategies, including from the PRGF. All of these require specific consideration and decision by the Executive Board.

2. We have the following comments in some of the specific issues raised, mainly in the staff response. (Para. references are to those of the staff response.)

## **The nature of prolonged use and degree to which it is a problem (Paras. 5, 6, 7 and 9)**

3. The staff argues that the IEO evaluation may give a misleading picture of the incidence of prolonged use and extent to which it is a problem because (i) prolonged use as defined in the report is more heavily concentrated in PRGF-eligible members where the issues raised by the Fund's long-term involvement are different than for the rest of the membership; and (ii) most cases of prolonged use of nonconcessional resources involve members who enter into arrangements that go off-track quickly after their approval and the fundamental issue in these cases is not prolonged use per se but the need for more successful program design and implementation. These arguments underlay the approach taken to prolonged use in the most recent internal review

of the issue, which judged that prolonged use was not a major problem. We have carefully considered this approach and we feel it represents too narrow a view of the issue which risks understating the nature of the problem, thereby also avoiding some fundamental questions about the Fund's role.

4. We fully agree, and have explicitly noted, that there are important distinctions between prolonged use by members that have used primarily the PRGF/ESAF resources and those that use the Fund's general resources. However, a situation in which a large proportion of the Fund's low-income member countries spend very long periods under IMF arrangements raises important questions about the appropriate timeframe of Fund-supported programs, the consistency with the goal of enhanced ownership, and the longer-term impact on domestic policy formulation processes which need to be explicitly addressed. We agree with the staff that improving the effectiveness of Fund-supported programs is a very important part of the challenge. But there are also other systemic issues arising from the present institutional framework that encourages continued prolonged use for a significant number of member countries, which in our view have not been sufficiently recognized and addressed.

5. Turning to prolonged use in the GRA, the staff are correct to emphasize that cases of programs going off track quickly and repeatedly are especially problematic, but this is not the only aspect of prolonged use that warrants attention. As our report shows, the Fund's general resources lent to prolonged users revolve very slowly—with obligations effectively outstanding for several decades in some extreme cases. This raises questions about the consistency with the mandate of providing financing for temporary balance of payments needs. Prolonged use also raises other important issues, such as the credibility of the seal of approval signal and the consistency of long-term program involvement with robust domestic ownership.

## **Consequences of prolonged use**

6. The staff point out (in para. 10) that there are considerable methodological problems in identify-

ing causal links between prolonged use of Fund resources and specific economic outcomes. We agree that identifying causality poses formidable problems, especially those associated with the endogenous nature of the decision to request IMF financial support. The evaluation report therefore does not claim that there is strong statistical evidence associating prolonged use with widespread adverse economic outcomes. Moreover, as the staff notes, some of the most important potential negative effects, such as the impact of successive program negotiations on the process of economic policy formulation, are not amenable to statistical analysis.

7. We agree with the staff's observation (in para. 13) that there will always be questions as to how far conclusions reached from particular case studies can be generalized. Nevertheless, the lessons emerging from the case studies are relevant because they involved countries that had been among the most prolonged users and illustrated four different types of prolonged use: prolonged use of concessional resources (Senegal); prolonged use of general resources with high disbursement rates (Philippines); prolonged use of interrupted programs (Pakistan); graduation from prolonged use (Jamaica and Morocco). Moreover, the questionnaire responses from the broader group of prolonged users suggest that many of the issues that surfaced in the case studies are of broader concern. We would also emphasize that we do not suggest that no progress was achieved in these cases over the long sweep of the Fund's involvement (e.g., in the Philippines, as mentioned in para. 12 of the staff response). The staff also suggests that prolonged involvement in precautionary arrangements may have different (and more beneficial) effects from other types of prolonged use. This may well be true, but it is not an issue that we addressed in the evaluation.

### Main recommendations

8. The Managing Director notes in his statement that the Executive Board will need to take a view on whether specific policies need to be evolved for dealing with prolonged users or whether a broader, preventive approach will suffice. The IEO sees the two approaches not as alternatives but as complements. One of the messages that has emerged from the evaluation is that in the past, strategies explicitly approved by the Board for addressing the issue of prolonged use have not been implemented consistently. In the IEO's view, the lack of a clear definition of what constitutes prolonged use was an important contributing factor because it created ambiguity on whether the procedures prescribed were necessarily applicable in particular cases. It is for this reason that we have recommended the adoption of a defini-

tion of prolonged use, distinguishing suitably between low income countries and others, which would help to identify cases where special procedures would be automatically triggered. We wish to emphasize that these procedures do not necessarily imply greater restrictiveness in lending—only greater clarity and due diligence on the appropriate strategy to deal with prolonged use.

9. In connection with the need for greater selectivity in extending financial support, we agree with the staff (para. 16 of staff comments) that weighing the consequences of not extending support involves very difficult judgments. But we would emphasize two points. First, the Executive Board needs to be given candid assessments of risks, including nonimplementation risks, and of the implications of withholding Fund support, to make such judgments. Second, the long-term interest of member countries is not well-served by having a series of programs with a high probability of nonimplementation.

10. With regard to the "seal of approval" function, the staff notes (in para. 18) that there is a general perception that the credibility of the Fund's seal of approval has been greater when the Fund commits its resources and that the quality of the seal of approval provided by some alternatives (such as staff-monitored programs) has been questionable. We agree that there is indeed such a general perception but the thrust of our recommendation is that this is not immutable. The boundaries between surveillance, other instruments (e.g., the Joint Staff Assessment in the case of PRSPs) and IMF lending arrangements could be changed by further modifications of existing instruments and/or the creation of new ones. Such efforts are desirable if, as the IEO report suggests, the insistence on lending arrangements leads to prolonged uses which has significant adverse effects. However, IMF lending arrangements may in fact not always be the instrument best suited to the varied needs of the donor community.

11. The staff statement (in para. 19) seems to suggest that two related conclusions of the evaluation: (i) the reform agenda in many countries was overloaded; and (ii) the Fund was too accommodative of program slippages are somewhat inconsistent. We would like to stress that these two messages are entirely consistent: the fundamental issue is one of prioritizing conditionality and ensuring that streamlined conditions (including, where appropriate, prior actions) are well-integrated with the core program design and lead to effective monitoring. Examples from the case studies suggest that it was weaknesses in these latter areas, rather than the volume or precise form of the conditionality, that lead to most problems. Indeed, such an approach is the essence of the ongoing efforts to streamline conditionality.

12. Finally, we do not believe, as the staff claims, that the evaluation report glosses over the difficulty of achieving and sustaining national ownership (para. 21). We recognize that this is an extremely difficult area where the Fund will need to learn through experience. The report makes a number of specific suggestions for adapting Fund procedures to enhance the prospects for ownership, including steps to embed the program formulation process more deeply in domestic policy-making institutions (see paras. 25 and 26 of Chapter 8 of the main report). The staff response concludes with the concern that “nationally-owned programs should not mean weaker, but better, programs.” There can be no disagreement with this general statement, but it hides considerable ambiguity about what an increased emphasis on ownership (and an associated greater se-

lectivity) implies in practice. One of the messages emerging from the case studies was that the Fund’s internal review procedures, including Board discussions, tended to focus mainly on enhancing the strength of the policy measures contained in programs, with less attention to assessing the feasibility of implementation, whereas in practice it was problems in the latter area that typically led to program failures. The evaluation report calls for much greater attention to issues of ownership and political feasibility as part of the program formulation and review process. In our view, greater focus on ownership and more selectivity is not about raising or lowering the threshold on the content of programs per se; it is primarily about ensuring agreement on a set of policies that have a good chance of both being implemented and achieving their objectives.

## SUMMING UP BY THE ACTING CHAIR

### EVALUATION BY THE INDEPENDENT EVALUATION OFFICE OF PROLONGED USE OF IMF RESOURCES

Executive Board Meeting  
September 23, 2002

Executive Directors welcomed the inaugural report on the Evaluation of Prolonged Use of IMF Resources prepared by the Fund's Independent Evaluation Office (IEO) which was established by the Fund in 2001.<sup>1</sup> The report presents a candid, comprehensive, and broad-ranging analysis which raises key issues about the Fund's approach to the prolonged use of resources by members, and makes a number of recommendations to address them. In addition the IEO report deals with several related aspects of the Fund's core activities.

Directors commended the prompt and favorable response to the IEO report by the Fund's Management. They agreed with Management that this report—and other projects now being undertaken by the IEO—should play a helpful role in further developing the IMF as a listening and learning institution which is willing to adapt its policies in the light of experience, in order to improve its effectiveness. Directors welcomed Management's proposal to set up a task force to prioritize the recommendations and lay out a strategy to implement them, and looked forward to following up on the recommendations early next year. The initial reactions and views of Directors, while preliminary, will certainly contribute to the work of the task force.

Directors noted that the report raises a number of important issues in areas that are not only relevant to prolonged use *per se* but also relate to key aspects of the reform agenda that the Fund has already begun to implement. Among the latter are Fund surveillance, conditionality, program design and owner-

ship, and access policy. The results of the debate that will draw on the IEO's fresh perspectives on these areas will be folded into our future work.

Directors agreed that over time, different definitions of prolonged use have been used. They noted the definition in the IEO report, which treats a country as a prolonged user if it has been under Fund-supported programs for seven or more years in a ten-year period. On this basis there is evidence of an increase in prolonged use in recent decades in terms of the number of countries, share of the Fund's membership, and total financial exposure. Directors saw merit in the IEO's recommendation to develop a definition of prolonged use, to enable the Fund to pursue greater due diligence in these cases. Many Directors, however, noted that any definition must be carefully crafted and differentiated to take into account the specific situation of low-income countries relying on Fund-administered concessional resources. Several Directors cautioned that any effort to develop a definition should not lead to the creation of a new class of members.

Directors agreed with the IEO's finding that the increase in prolonged use has been due to a variety of systemic and country-specific factors. The growing integration of many countries into an increasingly complex and more open global environment, while bringing major economic benefits and opportunities, has also in many cases made them more vulnerable to external shocks and propelled members to seek Fund resources. In addition, prolonged use reflects the evolution of the role of the Fund—particularly as regards its key responsibility in assisting low income countries. This group of countries now comprises the largest number of prolonged users, according to the definition used by the IEO. In the transition economies, the longer framework of Fund involvement has been associated with the Fund's role in supporting the transformation to a market-based economic system, which requires major structural reforms and fundamental changes in institutions.

Directors reviewed the circumstances in which long-term Fund financial involvement can be an appropriate response to help countries sustain strong macroeconomic policies and address, through struc-

<sup>1</sup>The terms of reference of the IEO state its purposes: "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 currently underway 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."

tural reforms, deep-seated problems that, by their nature, require many years to resolve. Many considered that for low-income and transition economies, the key challenge is to design sound programs and to ensure their implementation on the basis of strong ownership and close monitoring, rather than to avoid prolonged use *per se*. For low-income countries relying on concessional financing administered by the Fund, most Directors did not consider the relatively high incidence of prolonged use analyzed in the report as necessarily indicating a problem that needs to be corrected. A few Directors, however, called for a re-assessment of the Fund's strategic role with respect to low-income countries and possible further delineation of the respective mandates of the Fund and the World Bank.

Directors also noted, however, the evidence on the association of prolonged use with economic programs that turned out to be less successful than expected. The report points to a variety of reasons, including weak implementation capacity, lack of firm ownership and commitment, or weakness in program design. In addition, concerns were expressed about a mismatch between a program's long-term objectives and the shorter-term instruments available to the Fund to help achieve these objectives, and about the moral hazard risk associated with the perception that Fund resources would be available over a long period. As a result, prolonged use can have significant adverse implications for the credibility and effectiveness of Fund-supported programs. In addition, the countries themselves may suffer if longstanding exposure to conditionality becomes a hindrance to domestic policy formulation. Several Directors also expressed concern about the financial implications of prolonged use, noting the adverse impact of prolonged use of the Fund's regular resources on the Fund's liquidity and its monetary character, and the limited availability of PRGF-resources to support low-income countries.

Directors associated themselves with the main objectives of the IEO report, which include tailoring policies to address the special situations of prolonged users and aim to eliminate the incidence of inappropriate prolonged use, while reducing its adverse consequences. Many Directors underscored that this should be seen as part of a broader effort to ensure greater effectiveness of member country programs supported by the Fund.

Directors were encouraged that some key IEO recommendations regarding streamlining of Fund conditionality, the importance of country ownership, and the need for more effective collaboration with the World Bank are already being internalized as elements of the review of Fund conditionality. They saw this as confirmation that the Fund is moving in the right direction. At the same time, the discussion high-

lighted that implementation of these initiatives will be an ongoing process, involving sometimes difficult judgments, in particular regarding greater selectivity in the provision of Fund financial assistance where strong country ownership is lacking, as well as the proper use of prior actions.

Directors also underscored the importance of increasing the effectiveness of Fund technical assistance in support of institutional capacity building. Regular Fund surveillance of program countries should reassess economic developments and strategy from a fresh perspective. They also saw a need for continuing effort at improving program design.

Noting the difficulty of judging *ex ante* whether a particular user would become a prolonged user, Directors supported the IEO recommendation that staff papers presented to the Board in support of requests for Fund financial assistance should be more transparent and candid in assessing the adequacy of institutional capacity and the degree of ownership—both essential for program success. In particular, Directors underscored the importance of also explaining clearly the downside risks surrounding a program, and of avoiding any bias toward over-optimism, including by ensuring that the program is based on realistic growth and export assumptions.

As recommended by the IEO, Directors called on the Fund management and staff to adhere more closely to the existing guidelines for dealing with prolonged use. In this context, they stressed especially the desirability of more systematic *ex post* assessment of cases where prolonged use occurs, with follow-up monitoring of program implementation, and where appropriate the elaboration of corrective measures as part of a conscious "exit strategy." A number of Directors suggested that, to be useful, exit strategies should be sufficiently flexible, taking into account country-specific circumstances and incorporating policies to help countries access international capital markets and attract foreign direct investment.

Directors noted that cases of prolonged use are often related to the demand for Fund programs as a signaling device that gives a "seal of approval" to the country's economic policies and is required by some donors and creditors. Noting that it would be desirable to develop credible alternative ways for the Fund to indicate to the outside world its approval of a member's policies, Directors looked forward to a forthcoming discussion on the signaling function. They noted that such alternatives would need to be prepared carefully and on the basis of consultations, including with the Paris Club.

A number of IEO recommendations have implications for important aspects of internal governance, including career incentives for staff, continuity of staff missions, the role of resident missions, and the importance of providing full and timely information

to the Executive Board members. These deserve careful consideration.

Directors expressed a wide array of views on whether and how staff should take account of political economy issues. One suggestion to be explored further is that staff reports should include a candid assessment of domestic social and political conditions and related potential risks to the program. Directors recognized, however, the need to proceed with caution in this area, given sensitivities relating to even the appearance of political interference by the Fund in members' internal political affairs.

There was virtually no support for the idea of imposing a differentiated rate of charge—i.e., a higher rate of interest for prolonged users—which Directors felt would be particularly inappropriate for low-income member countries that need highly concessional assistance.

Finally, Directors commended the high quality of the IEO report and expressed their confidence that it will serve to establish the IEO's credibility and its value to the Fund. They agreed that the report and related documents should be published, including on the IMF and IEO websites.