

## 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.