

September 25, 2002

**Summing Up by the Acting Chair**  
**Evaluation by the Independent Evaluation Office of Prolonged Use of IMF Resources**  
**Executive Board Meeting 02/100**  
**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 ownership, and access policy. The results of the debate

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<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."

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 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 structural 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 highlighted 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.