III. STATUS OF ONGOING PROJECTS

This section describes the main features of three evaluations currently underway. The first two, Structural Conditionality in IMF-Supported Programs and The Role of the IMF in Determining the External Financing Envelope in Sub-Saharan African Countries, are nearing completion whereas work on the third on IMF's Advice on Exchange Rate Policy began in spring 2006.

A. Structural Conditionality in IMF-Supported Programs

The use of structural conditionality (SC)—involving changes in policy processes, legislation, and institutional reforms—by the IMF gained prominence in the late 1980s and rose significantly in the 1990s with the emergence of new lending facilities for low-income countries (whose main objective was the removal of obstacles to growth) as well as the new challenges posed by the transition economies. SC also became important as the IMF increasingly recognized the need for structural reforms to achieve sustainable results in macroeconomic and financial areas. More recently, SC gained importance as a signal to other sources of finance, such as multilateral agencies, bilateral donors and private capital markets.

The proliferation of structural conditions in the 1990s was met with strong criticism outside the IMF. It was argued that many structural conditions were not needed for the achievement of program goals, and that there was not a clear division of labor between the IMF and the World Bank. In addition, it was argued that there were areas where the IMF had become too "ideological," such as privatization and trade reforms.

Largely in response to this criticism, the IMF launched in 2000 a "streamlining initiative" aimed at reducing the volume and scope of SC. Subsequently, the IMF issued in 2002 new conditionality guidelines, stressing the need for parsimony in the use of conditionality and including a test of "criticality" for any variable selected for conditionality (i.e., to be included in a program, conditions must be "critical" for the achievement of a program's objectives). The guidelines also stress the need to seek national ownership of programs and for programs to reflect the authorities' policy goals. Programs supported by the PRGF are expected to be based on the PRSP resulting from a broad consultative process within the country.

Issues addressed by the evaluation

- How has SC worked in practice in different types of arrangements? Under what conditions has it helped in promoting medium-term structural reform? What is the role of country ownership and what are the views of the authorities on the negotiation process? How do country-specific initial conditions and program design issues interact with each other in determining outcomes? Can best practices be identified in the area of SC design (i.e., practices leading to a better process of interaction with the authorities and more effective SC)?

- To what extent is SC addressing multiple objectives? Has SC been excessive or overused, or has it been the wrong instrument of engagement in particular circumstances?

- Are there general areas of collaboration between the IMF and the World Bank that require particular attention so that both can better contribute to structural change? What is the experience of SC in supporting privatization and what are the links with World Bank operations in this area?

- What has been the effect of the streamlining initiative and the 2002 Conditionality Guidelines on the numbers and direction of SC? Are there areas of increased or reduced emphasis, and why? Has the process of setting SC become more strategic and focused, and better linked to program objectives? How well is SC linked to a long-term policy framework in the case of PRGFs?

Methodology

The evaluation uses various techniques to address the issues:

- To study the rationale for SC and assess whether SC helped structural reforms, the evaluation examines in depth 13 arrangements approved in 1999–2003 and completed by 2005, which account for about 17 percent of all structural conditions set in that period. The sample includes a mixture of regular stand-by arrangements (precautionary and non-precautionary), and PRGFs. In addition, evaluation teams visited five of countries in the sample. In the other cases, the authorities were contacted to assess their views on the process of negotiation.

- To examine the impact of the streamlining initiative the evaluation uses a cross section of data on all structural conditions in programs approved in the 1995–2004 period, as well as desk studies of post-streamlining arrangements to assess the criticality test, and a survey to examine how staff is interpreting the guidelines and elicit their views on the effects of the streamlining initiative.

B. The Role of the IMF in Determining the External Financing Envelope in Sub-Saharan African Countries

This evaluation examines IMF experience in assisting low-income Sub-Saharan African countries in determining their external resource envelopes. Recent years have seen calls by the international community for more and better aid to help countries achieve the MDGs and related development goals. With higher levels of aid being committed by major donors—especially for Sub-Saharan Africa—identifying the lessons that can be learned from past experience with different aid flow levels becomes increasingly important. The evaluation builds on an earlier IEO evaluation of the IMF’s role in PRSPs and PRGFs, which was completed in 2004.

The IMF influences the external resource envelope in low-income countries primarily through PRGF financial program design, which implicitly determines how much available aid can be used, and through its dialogue with donors. Both channels have attracted criticisms by external observers. These critics contend that IMF assumptions about aid absorptive capacity and availability tend to be too conservative, imparting a negative—and, they argue, frequently self-fulfilling—bias to PRGF program design and donor flows, which in turn reduce country prospects for growth and poverty reduction.

Against this background, the evaluation zeroes in on the features of PRGF program design and implementation that relate to aid inflows. Its analytic framework focuses on aid absorptive capacity—both its underlying macroeconomic, fiscal and debt sustainability, governance, and sectoral dimensions and the integration of those dimensions (and the tradeoffs across them) into a coherent assessment. Noting that the World Bank, among others, plays a central role in carrying out much of the relevant sectoral and governance analysis, the evaluation also looks at how well IMF-supported programs drew on the expertise and analysis of partners. It also documents how and in what circumstances IMF-supported programs have catalyzed donor funding and affected aid predictability.

Issues for evaluation

As set out below, key evaluation questions being addressed consider how IMF staff approached the diagnosis of aid absorption capacity and availability; the implications of PRGF program design for the availability and use of aid; and, where feasible in light of timing considerations, program outcomes:

- *Diagnostics.* The evaluation focuses on how IMF staff analyzed the underlying macroeconomic and sustainability dimensions of aid absorptive capacity and took into account the analyses of the World Bank and others of the sectoral and governance dimensions. It also asks whether and how staff integrated these different dimensions into an overall assessment of country aid absorptive capacity that was in turn reflected in the PRGF's financial program. Looking at the supply of aid, the evaluation examines how staff formulated the program's aid projections and how they took into account aid modalities, volatility, as well as upside and downside risks.

- *Program design.* The evaluation takes an ex-ante perspective for much of the analysis of program design. In so doing, it considers: (a) the stance of policies in the program, including with respect to the utilization of aid; (b) whether the program drew on the full array of thinking and intellectual capital available at the time; (c) how well the program accommodated available aid and dealt with its uncertainty; and (d) how the program addressed the need for policy/institutional changes to strengthen absorptive capacity if the latter was a binding constraint to program design. The evaluation also looks at IMF staff's dialogue with and signals to donors, including in cases where projected aid flows fell short of absorptive capacity.

- *Outcomes*. Where the timeframe permits, the evaluation also takes an ex-post perspective. It looks at what was actually achieved under the program in terms of growth and poverty reduction, and—mindful of the methodological complexities—tries to identify the IMF's contribution to these outcomes through its influence on program design, policies, and aid levels.

Methodology

The evaluation utilizes several sources of evidence. Where data and methodology permit, quantitative analyses—covering the sample of 29 Sub-Saharan African countries with completed or lapsed PRGF programs—are being carried out. For about half these countries, in-depth desk analyses of program documents are being undertaken, with country visits planned in some cases. The latter will allow for structured interviews with the authorities, country-based donor agencies, civil society, research institutions, and others, complementing surveys of these groups in all sample countries as well as IMF and World Bank staff. Structured interviews are also being planned for donor headquarters.

C. The IMF's Advice on Exchange Rate Policy

The IMF was created with a key mandate to promote exchange stability and prevent competitive exchange rates depreciation. Originally, the IMF was the guardian of the system of fixed (but adjustable) exchange rates. In 1978, the Articles of Agreement were amended to allow each member the freedom to choose its exchange rate regime and, as a result, IMF's role was changed. The IMF assumed an obligation to exercise surveillance over the effective operation of the international monetary system and members' obligations under Article IV.[20] In turn members undertook to collaborate with the IMF to promote a stable system of exchange rates and to avoid manipulating exchange rates or the international monetary system to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members.

Since then, surveillance has largely evolved into a form of policy dialogue between the IMF and its members, with the IMF's view on advice on exchange rate policies becoming the subject of considerable debate. The IMF's view has been that exchange rates are only one element of economic policy and must be seen in this overall context. The IMF's views on exchange rate regime choice seems to have shifted after major crises, and currently the IMF is seen by many as strongly favoring a flexible exchange rate underpinned by inflation targeting as the only viable regime under most circumstances. In this contest, some critics have charged that the IMF has become less willing to express clear views on exchange rate issues and that it should be more open to other types of arrangements better attuned to country-specific considerations.

[20] The IMF's Articles of Agreement are available at http://www.imf.org/external/pubs/ft/aa/aa.pdf.

Issues for evaluation

The Independent Evaluation Office (IEO) is undertaking an evaluation of the IMF's advice on exchange rate policy broadly defined to include any IMF advice on exchange rate issues, particularly those relating to members' regime choice and sustainability, and to measures directed at resolving or avoiding currency misalignment and external imbalances.[21] On the basis of this definition, the evaluation seeks to answer the following overarching questions:

- Is the role of the IMF in exchange rate policy advice clearly defined and understood?
- What has been the quality of IMF advice on exchange rate policy? Has it kept up with best practice and structural changes in global capital markets?
- Have multilateral perspectives adequately complemented the bilateral assessments?
- Has the dialogue with country authorities been effective?
- What has been the impact of IMF advice on exchange rate policy?

Exchange rate surveillance is a continuous process. For each "cycle," however, the process of providing advice on exchange rate policy can be represented by a multi-stage "results chain" that connects "inputs" with IMF activities and their outcomes. The questions above are being examined along the different stages of the chain, namely (i) analysis and assessments; (ii) communication of policy advice (including review by the Executive Board); and (iii) follow-up, including continuous monitoring between cycles. Each stage embodies bilateral and multilateral components, which we consider to be two complementary perspectives inherent to any surveillance activity.

In asking these questions, the IEO hopes to enhance transparency and contribute to ongoing discussions on how best to conduct exchange rate surveillance. Although exchange rate surveillance has been frequently reviewed within the IMF, internal reviews have not assessed the content of policy advice per se, as called for by the Executive Board during the 2002 and 2004 Biennial Surveillance Review discussions. This evaluation seeks to shed light not only on the process of surveillance, but also on the content of the advice itself. It intends to be as forward looking as possible, and thus it has chosen to place the focus on the 1999–2005 period (following the East Asian crisis) but in line with the IEO's terms of reference it will not make judgments on the IMF's policy advice currently being given in specific country cases.

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[21] On June 26, 2006, the IEO posted the final issues paper for this evaluation on its website incorporating comments from Executive Directors, staff, and the public, which is available at http://www.imf.org/External/NP/ieo/2006/erp/eng/041906.pdf.

Methodology

The evaluation is drawing on multiple sources of evidence including a desk review of the IMF's public and internal documents and interviews with staff, country authorities, Executive Directors, and other stakeholders, including academics and market participants. The evaluation may also conduct a survey of national authorities, members of the Executive Board, and IMF staff.

The evaluation work is proceeding with a review of the latest Article IV staff reports for all member countries (and economic areas), while at the same time a more selective, but intensive, review of a limited number of economies (Table 3.1) will be conducted. In addition, the evaluation team will visit a number of these economies to gather the views of the authorities and the private sector on the work of the IMF. Work on the soundness of certain analytical tools used by the IMF will also be undertaken.

Table 3.1. Sample Countries for the Evaluation 1/ 2/

Africa	Asia-Pacific	Europe	Middle East and Central Asia	Western Hemisphere
CEMAC/WAEMU	Australia	Bulgaria	Egypt	Brazil
Guinea	China	*Euro Area*	Morocco	Ecuador
Rwanda	Hong Kong SAR	Iceland	Saudi Arabia	El Salvador
South Africa	Japan	Lithuania		Jamaica
Tanzania	Korea	Norway		Mexico
	Malaysia	Russia		Peru
	Singapore	Ukraine		United States
		United Kingdom		

1/ Italicized entities refer to regional monetary unions.
2/ The regions correspond to the geographical jurisdictions of IMF area departments.