INTERNATIONAL MONETARY FUND

The Role of the Fund in the Poverty Reduction Strategy (PRS) Process and Its Collaboration with Donors

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and in consultation with Other Departments

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There is still considerable debate about the Fund's role and responsibilities in helping its low-income (LIC) members reduce poverty and reach the Millennium Development Goals (MDGs). The Fund is seen by some as extending its reach into areas outside its core competencies; and by others as focusing too narrowly on macroeconomic stability at the expense of growth and poverty reduction. More recently, the Fund has been chastised for failing to identify and help mobilize the additional aid necessary for more ambitious efforts to achieve the MDGs. The Medium-Term Strategy (MTS) proposes to address some of these concerns by re-focusing the Fund's work in LICs on macroeconomically critical and financial sector issues and on its areas of comparative advantage, while enhancing collaboration with the World Bank and other institutions in other areas. It calls for deeper involvement of the Fund in managing the implications of debt relief and assessing the relationship between aid inflows, MDG-related resource needs, and macroeconomic stability.

This paper proposes an approach to making the MTS operational as it relates to the Fund's work in LICs that would define more precisely the Fund's responsibility and accountability in the PRSP and donor collaboration processes. The proposed activities are not "new," but represent an intensification of existing work and its extension to the all LICs as appropriate. This would help clarify expectations as to the Fund's role, and establish a consistent institutional approach to collaborating with donors and other stakeholders on the ground.

The paper thus puts forward several proposals for refocusing and intensifying the Fund's activities in three major areas:

Macroeconomic Policy Analysis and Advice	• Step-up work on alternative macroeconomic scenarios, particularly articulated around scaled-up resource flows • Deepen advice on coordinating fiscal, monetary and exchange rate policies to manage the macroeconomic impact of scaled-up aid inflows • Point out where more aid could be accommodated without endangering macroeconomic stability and debt sustainability, or where current levels strain that capacity • Continue to support annual debt sustainability analyses in line with the revised joint debt sustainability framework, and medium-term debt management strategies • Deepen the analysis of macroeconomically critical structural and financial sector issues
PRS Process and MDGs	• Align the Fund's PRGF and other operational cycles in-country as closely as possible to the PRSP and budget cycles • Report on the consistency of MDG cost estimates with macroeconomic stability and, in summary form, on the annual progress toward the MDGs • Report on use of resources directed toward poverty reduction • Increase public outreach and discussion on macroeconomic and financial issues
Collaboration with Donors	• Inform donors of key concerns, the results of missions, and staff's assessments of macroeconomic performance and prospects • Discuss implications of projected aid flows for stability and debt sustainability; and encourage donors to adapt their planned support as appropriate.

The highlighted activities, many of which are already being undertaken by country teams, are those where the Fund can make the greatest effective contribution to LICs. Other activities are identified that should be scaled back, because they lie outside the scope of the Fund's core competencies and the Fund should rely to the extent possible on other development partners.

The proposals, if adopted, would also address some of the concerns raised in the recent IEO report on the IMF and Aid to Sub-Saharan Africa and the report of the External Review Committee on Bank-Fund Collaboration. The IEO report noted the need to define clearly the Fund's role in mobilizing aid and improve its collaboration with other donors at the country level. The External Review Committee also recommended a more clear delineation of the Fund's core responsibilities relative to those of the World Bank in work on LICs.

Resource Implications

Fully implementing the proposed steps to increase the effectiveness of the Fund's role in LICs could require additional resources estimated to be in the range of some six staff-years. This estimate includes potential savings from streamlining or scaling back other activities. Mobilizing additional resources internally for this work will be difficult in the present budgetary environment, and area departments will face tradeoffs in setting priorities for individual countries. One choice could be to limit the resource costs by implementing the proposals more modestly; another could involve cutting back further on some existing activities. Management and staff will need clear guidance from the Board on overall institutional priorities in making these choices.

I. INTRODUCTION

1. **The Fund has made considerable efforts to define more precisely its role in low-income countries (LICs) since the poverty reduction strategy paper (PRSP) approach was introduced in 1999**.[1] The Fund has also recently introduced additional instruments for assisting its LIC members: the Policy Support Instrument (PSI) and the Exogenous Shocks Facility.[2]

2. **LICs and their development partners have generally accepted the PRSP as the framework for coordinating their efforts to achieve the MDGs**. However, there is still some lack of clarity within and outside the institution about the role of the Fund in the PRS process and with respect to the MDGs. Some see the Fund engaged in a range of structural and institutional reforms in LICs that may be critical to growth, but are outside its core areas of responsibility and competence, possibly at some cost to its core work and overall effectiveness. Other observers see the Fund as excessively focused on macroeconomic stability, rather than growth and poverty reduction, and constraining country budgets to the envelope of available external financing, instead of identifying and helping to mobilize the resources necessary for a more ambitious effort to reach the MDGs.

3. **More recently, the 2007 IEO evaluation of the IMF and Aid to Sub-Saharan Africa criticized the absence of clear direction on what the Fund can and will contribute to mobilizing aid, poverty reduction, and the MDGs.** It found little evidence of efforts by Fund staff to mobilize additional aid or to analyze alternative scenarios, and considered that the Fund had been slow to incorporate higher aid inflows and the pro-poor agenda into PRGF program design. Moreover, the report noted the absence of an institutional strategy for engaging with local donor representatives and civil society.[3]

4. **The External Review Committee on Bank-Fund Collaboration also made a series of proposals in its recently presented report for strengthening this role.** Key recommendations include: that the Fund should refocus on its areas of comparative advantage (such as macroeconomic assessments and policy advice, and the provision of relevant technical assistance), while relying on the Bank for sectoral assessments; that fiscal policy design by the Bank and the Fund should integrate the treatment of macroeconomic and expenditure composition issues; that responsibility for financial sector issues and the provision of technical assistance should reflect the institutions' respective comparative advantage; and that the Fund, the Bank, and other development partners should agree on lead responsibilities for supporting policy and reform in each country.

5. **This paper seeks to clarify the parameters of the Fund's involvement with LICs in the PRSP and donor collaboration processes; in managing aid inflows and resource**

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[1] Several Board papers have considered various aspects of this role. See IMF 2003a, 2003b, 2004a, 2004b, 2005b, and 2005c.

[2] See, IMF 2005a, and 2005d.

[3] The IEO also criticized the Fund's communications strategy, noting the need for "consistency of institutional communications with Board-approved operational policies and Fund-supported operations." See IEO 2007.

fluctuations more generally; and in supporting macroeconomically critical structural reforms. It proposes for Board consideration some new priorities, and identifies the areas and the limits of the Fund's responsibility and accountability in the macroeconomically critical aspects of these processes. In clarifying the Fund's role and responsibilities, the paper seeks to provide information that can assist the Executive Board in defining what member countries, stakeholders, development partners and other interested observers can or cannot expect from the Fund in these areas, and in developing a clear institutional approach to collaborating with donors and other stakeholders on the ground.

6. **This paper is another element in the series of papers defining the Fund's role in LICs and is complementary to the recent paper on managing aid inflows.** Thus, the **paper does not cover the full range of the Fund's role in LICs**, nor the full range of criticisms put forward by the IEO and others. Staff anticipate preparing a summary paper on the role of the Fund in LICs in early 2008, bringing together these various strands of work.[4]

7. The remainder of this paper is structured as follows: Section II discusses the guiding principles for the Fund's role in LICs over the medium term. Section III discusses some of the elements necessary to make operational the objectives set out in the MTS. Section IV explores the Fund's role in collaborating with other development partners. Section V discusses the resource implications of the various proposals. Section VI raises some issues for discussion by the Executive Board.

II. The Context for Further Examination of the Fund's Role in PRSPs and Donor Collaboration

8. **The Fund's Medium-Term Strategy (MTS) provides the framework for addressing the concerns noted above.** It calls for re-focusing the Fund's work in low-income countries on its areas of core competence, and limiting its responsibility for policy advice, technical assistance and program design to those areas. One area in which the MTS emphasizes the need for deeper Fund involvement is in helping LICs manage the macroeconomic impacts of debt relief and aid inflows, in light of the international effort to meet the MDGs. Specifically, the MTS recommends that Fund staff assess whether projected aid flows are consistent with macroeconomic stability and with the estimated costs of achieving countries' development goals. Staff are to inform donors when more aid can be absorbed without endangering macroeconomic stability and debt sustainability and, together with the World Bank, assist LICs in designing medium-term debt management strategies. The MTS notes that a more focused approach will require enhancing collaboration with other institutions (particularly the World Bank) in areas outside its expertise.[5] Finally, it

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[4] There are various other strands of LIC work not covered by this paper. In particular, it does not examine in detail all relevant aspects of the Fund's technical assistance and capacity-building support, the Fund's work on financial sector issues in LICs, or its relationships with countries not yet engaged in the PRS process.

[5] In this context, the MTS calls for Fund and Bank staff, together with country authorities and development partners, to reach agreement on the areas in which the authorities need assistance and the areas that each party is prepared to take the lead on. See IMF 2006a, paragraphs 30-31.

recognizes that an increased focus may require that resources within the Fund be redirected to some key activities.

9. **While the MTS principles build on previous work (see Box 1), there are some questions and criticisms that need to be addressed in more detail.** The 2004 IEO evaluation of PRSPs and the PRGF found a lack of clarity about what the Fund should be delivering in its involvement in the PRS process and its engagement with donors.[6] The IEO thus recommended: (i) clarifying the implications of the PRS approach and the broader partnership framework for Fund operations; (ii) strengthening prioritization, implementation and accountability for Fund "deliverables" in the PRS process; and (iii) encouraging a strengthening of the framework for clarifying resource requirements of the PRS.

10. **Changes to the architecture of the PRS approach were introduced in November 2004** to strengthen country ownership, and define clearly the link between the PRS and financial assistance programs from the Bank and the Fund. The changes also aimed to clarify the role and audience of the Joint Staff Assessments (subsequently renamed Joint Staff Advisory Notes, JSANs) and enhance their quality and candor; encourage the closer alignment of annual progress reports on PRS implementation (APR) with domestic processes; and increase the focus on improving underlying country processes, rather than on producing documents. Staff guidelines for the JSANs on PRSPs and APRs were also revised.

11. **However, the 2007 IEO evaluation noted that it was still difficult to understand clearly Fund responsibilities and policies toward its low-income members**. It thus recommended: (i) that the Executive Board clarify Fund policies on accommodating and mobilizing additional aid, alternative scenarios, PSIA, and pro-poor/pro-growth budget frameworks, and clear guidance be provided to staff on these matters; and (ii) that transparent mechanisms for monitoring and evaluating the implementation of the clarified policy guidance be established.

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[6] See IEO, 2004.

Box 1: Original Expectations of the PRS Process

The original policy documents introducing the PRSP and the PRGF established rather broad expectations of the Fund's role in the PRS framework:[1]

- Fund staff were expected to take the lead in the areas of the Fund's traditional mandate and responsibility, sharing this responsibility with the Bank in some areas, and collaborating closely with other major partners;
- Fund staff were expected to participate in broad-based consultations on the policy framework;
- Fund program conditionality was to be further streamlined and exclude conditions in areas within the primary mandate of the Bank, except where critical to the success of the PRGF-supported program;
- Given that external financing would need to play a crucial role in meeting poverty objectives within a stable macroeconomic environment, Fund staff were expected to take an active role in identifying financing needs and in mobilizing additional donor resources on appropriate terms for the countries that most need and can effectively use such support.

[1] See, IMF and World Bank, 1999, and IMF, 1999a and 1999b.

III. Making the Principles Operational in Country Work

12. **Effective implementation of the MTS principles in the Fund's LIC work requires observing a range of good practices in three areas**: macroeconomic policy analysis and advice, including capacity building; engaging in the PRS process and supporting the MDGs; and interacting with key stakeholders. In each of these areas, country teams are already engaged in a range of activities, some of which are highlighted here as priorities where the Fund can make the greatest effective contribution. Other activities (such as policy or analytical work on macroeconomically critical structural issues outside of Fund core competencies or analysis of non-core areas) could be scaled back or discontinued where such issues are covered by other development partners.

13. **In most cases, the Fund has become involved in these areas owing to a gap in coverage by other development partners.** However, an important distinction needs to be made between areas for which Fund staff would provide policy advice (e.g., core or shared areas of responsibility) and measures that might be subject to conditionality under a Fund-supported program. Under the Conditionality Guidelines, Fund-supported programs are generally to include as conditionality any reforms (whether in core or non-core areas) that are critical for achieving program goals or monitoring program implementation.[7]

[7] See IMF 2002. In particular, the guidelines note that "[V]ariables and measures that are outside the Fund's core areas of responsibility may also be established as conditions but may require more detailed explanation of their critical importance." (paragraph 7(b)); and that "[W]hen establishing and monitoring conditions based on variables and measures that are not within its core areas of responsibility, the Fund will, to the fullest extent possible, draw on the advice of other multilateral institutions, particularly the World Bank."(paragraph 8). The Guidelines thus do not reduce the importance of the lead agency concept and the agreed division of responsibilities for analytical work.

14. **The MTS principles provide guidance for the Fund's work in LICs, but require further elaboration and clear Board direction, in order to resolve some of the potential tensions** between refocusing on macroeconomically critical issues, while deepening involvement in some areas related to aid flows and the MDGs, and engaging appropriately with donors and other stakeholders.

A. Macroeconomic Analysis and Advice

Macroeconomic frameworks and macroeconomically critical structural reforms

15. **In most LICs, the Fund is the primary provider of advice and inputs into the design of macroeconomic policy frameworks** and related structural reforms. The improved macroeconomic performance and outlook of many LICs, especially in Sub-Saharan Africa, reflects this role, and represents the Fund's key contribution to their efforts to reach the MDGs. With the PRGF, there is already an increasing degree of flexibility in the design of macroeconomic frameworks,[8] and structural reforms are focused more on strengthening economic management and reducing financial vulnerabilities.[9] Fund program conditionality is focused on these key objectives, and structural reforms are derived wherever possible from the priorities identified in the country's PRSP. This focus on macroeconomically critical issues and flexibility in policy advice and program design should continue, including as more countries graduate from the need for Fund financial support.[10]

16. **Fund staff should be available to assist country authorities in preparing alternative scenarios of scaling up.** These scenarios should be consistent with macroeconomic stability and debt sustainability.[11] Ambitious alternative scenarios can help reconcile the need for a realistic macroeconomic framework with the need to demonstrate how the MDG effort could be accelerated with additional resources. The expected improvements in growth or poverty reduction outcomes set out in the alternative scenarios would reflect analysis of the growth process and the impact of investment done by the authorities or other development partners, particularly the World Bank.[12] Fund staff would

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[8] For example, program design in mature stabilizers has become considerably more accommodative of wider fiscal and external deficits in order to allow for higher priority spending in line with the availability of additional external resources. See IMF 2005b.

[9] These two reform areas account, on average, for three quarters of all structural conditionality in PRGF arrangements approved in 2004-06, an increase from slightly less than half in the 1990s. In some countries, the shift in focus of structural reforms has been quite striking—Armenia (2005) and Madagascar (2006) have over 90 percent of their structural conditions in these two main areas.

[10] The External Review Committee on Bank-Fund Collaboration argued that the Fund should withdraw from providing long-term financing to LICs through successive PRGF arrangements, and refocus its efforts and resources on areas where it has a comparative advantage. The PSI was seen as an instrument that could facilitate this withdrawal. See External Review Committee (2007).

[11] The Board has provided guidance on this issue in discussing two recent staff papers on scaled-up aid. See IMF 2007c.

[12] Most country teams already prepare alternative scenarios to highlight emerging policy challenges, assess specific vulnerabilities, or in the context of debt sustainability analyses. Extending this work to help define

(continued…)

primarily advise on the consistency of such scenarios with macroeconomic stability, recommending any necessary changes to monetary, fiscal, and exchange rate policy, but may need to take a more active role in formulating the framework where country capacity is particularly weak. It would also not be within the Fund's role or expertise to estimate the cost of achieving the MDGs as the basis for these scenarios, or to assess the reliability of such estimates done by others.

17. **PRGF-supported programs would continue to be articulated around a baseline macroeconomic framework, to preserve the clarity of program objectives and agreements on policies.**[13] Deviations from the underlying assumptions within the program period, including the accommodation of additional aid inflows, would be handled through program adjusters, waivers of conditions by the Board, and revisions of program targets during reviews, as needed. While alternative scenarios would underpin the staff's analysis and policy advice regarding the impact of scaled-up aid and debt sustainability, they would be formulated primarily within the context of the country's PRSP, and presented by staff to the Board in PRS-related documents such as JSANs or in Article IV consultation staff reports (see Box 2).[14] They would, however, inform or be integrated into the regular updates of the PRGF's macroeconomic framework.

Box 2: **Fund Assistance in Elaborating Alternative Scenarios for Scaling Up of Aid**

Fund staff have done alternative scaling-up of aid scenarios for several countries in Africa. Starting in 2004, the Fund has been actively helping the **Ethiopian** authorities formulate a macroeconomic strategy to accommodate a potentially large scaling up of aid to meet the MDGs. In the 2004 Article IV consultation, a framework was presented which, in the absence of MDG costings, assumed a doubling of aid flows as a percent of GDP, and discussed supporting policies required to accelerate growth and maintain macroeconomic stability. Discussions on strategies for achieving the MDGs continued during the 2005 Article IV consultation, and an updated scenario was presented in the staff report and accompanying Selected Issues paper. This illustrative macroeconomic framework drew on the lower-bound estimates of public sector costs for reaching the MDG developed by the authorities with the help of the UN Millennium Project, and informed by the World Bank's Maquette for MDG Simulations Model (MAMS). It incorporated a front-loading of infrastructure investments in line with the authorities' strategies, and presented a more detailed discussion of the policy challenges of managing the assumed scaling up of aid.

In **Rwanda** a macroeconomic framework for scaled-up aid was prepared and discussed with the authorities in the context of the 2007 Article IV consultations and as input into the PRSP. A scaling-up exercise was also done for **Zambia's** 2005 Article IV consultation. A Selected Issues paper was published on the topic, and the results presented at an IMF-DFID seminar. A scaling-up exercise has been done for **Sierra Leone,** and illustrative scenarios presented for **Mozambique** and **Tanzania**.

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consistent macroeconomic frameworks around scaled-up aid and an intensified effort to reach the MDGs may, however, require considerable additional resources, at least initially.

[13] See IMF 2007c. This policy would also hold for Staff-Monitored Programs (SMPs) or PSIs.

[14] See IMF 2007c, and footnote 12 above.

18. **Fund policy advice on the macroeconomic framework and alternative scenarios would be expected to take account of any relevant analysis of the sources of growth and related constraints**, particularly where an increase in aid-financed public investment and poverty-reducing expenditures is anticipated. This would be the basis for a credible medium-term macroeconomic framework and debt and fiscal sustainability analysis. Fund staff would not be expected to undertake microeconomic or sector-specific analyses of the sources of growth, but would draw on such work done by others.

19. **Fund staff would be expected to discuss with the World Bank and other development partners at the country level the coordination of support for the development effort** (including analysis of growth, fiscal policy, the financial sector, and the trade regime). Such discussions between Fund and Bank staff would help identify macroeconomically critical sectoral issues, lead to agreement on lead responsibilities in these areas, and highlight any gaps or overlaps in the analysis of, or support for, PRS priorities. They would also indicate the input requirements of each institution. This would enable the Fund to strengthen its focus on core areas and limit its engagement in non-core but macroeconomically critical areas covered by other development partners.[15] Fund staff will encourage other development partners to take the lead in those macroeconomically critical non-core areas where the Fund is not engaged. The reports by the External Review Committee on Bank-Fund Collaboration and by the IEO on the IMF and Aid to Sub-Saharan Africa both note that enhanced collaboration in this regard would likely produce desirable results for low-income members.[16] This process should be led by the country authorities, and staff will encourage them to do so.[17] In this context, the Fund and Bank staff have recently started an initiative aiming at strengthening collaboration in several areas (Box 3).

Box 3: Recent Initiative To Strengthen Bank-Fund Collaboration in Sub-Saharan Africa

Fund and Bank staff recently launched an initiative to strengthen collaboration between the two institutions to improve outcomes in areas critical to macroeconomic stability and sustained growth in Sub-Saharan Africa. The initiative, which has the strong support of both Fund and Bank management, focuses on public financial management, financial sector, and management of non-renewable natural resources. Pilot participants in the initiative are countries where there is a close involvement by the Fund and Bank in ongoing work and the authorities have high ownership of the reforms. The purpose of the initiative is twofold: (1) to achieve better outcomes in Africa by drawing lessons from these countries about what makes

[15] However, the scaling back of non-core area activities already underway may have to be gradual in cases where appropriate coverage by others is not immediately forthcoming, and, consistent with the Conditionality Guidelines, Fund staff may still have to design conditionality in non-core areas critical to the achievement macroeconomic program targets where support from other partners is not available.

[16] This country-level coordination of work programs is one of the key measures proposed by the managements of the two institutions as a follow-up to the recommendations of the External Review Committee.

[17] Such a division of labor in supporting the PRSP priorities could be discussed at consultative group or "results, resources and partnership" meetings (see footnote 34 below), or as part of the work of joint government-donor groups in country, and would be consistent with donor harmonization commitments in the Paris Declaration. However, the lack of an even distribution of donor comparative advantage across the various PRSP priorities, or of the necessary competence or resources among donor in-country representatives, could prevent adequate coverage of all priority areas simultaneously.

for more effective support of the authorities' goals; and (2) to foster greater coherence and coordination between the Bank and the Fund (and other donors) in supporting these key reforms.

20. **Staff will continue to tailor the design of Fund-supported programs to the specific circumstances of each country.** Program conditionality in countries with a good track record of policy implementation would closely reflect the authorities' own structural reform priorities and, within the range of stable and sustainable outcomes, their preferences for some of the quantitative macroeconomic targets.[18]

Debt and fiscal sustainability analysis[19]

21. **The Fund and the World Bank will encourage and support the use of the new forward–looking debt sustainability framework (DSF) for LICs to analyze the scope for sustainable new debt accumulation in individual countries,** and to assess the implications of alternative aid scenarios on debt sustainability. When the debt sustainability analysis (DSA) reveals an unsustainable path of debt accumulation, staff would encourage donors to provide a greater share of their assistance in the form of grants,[20] and explore with the authorities the scope for increasing domestic revenues, or other non-debt forms of financing. Staff will report to the Board on debt management discussions with countries and their donors/creditors, as well as on trends in overall poverty-reducing spending, in the context of debt relief under the Heavily Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI).

22. **As proposed in the MTS, Fund staff would encourage and assist LIC members in developing medium-term debt management strategies (MTDS) that draw on the DSF.** Such strategies should guide the authorities in managing new borrowing (including after debt relief) so as to avoid an unsustainable accumulation of debt. This is particularly important in countries where private capital flows and lending by new creditors are increasing.

23. **Fund staff would continue to assess the longer-term budgetary consequences of aid-financed spending increases** early in the PRS or aid commitment cycles as part of the

[18] As suggested in the MTS, a different approach, combining a large element of technical assistance with more focused conditionality, might be followed in dealing with fragile states, though this would have important resource implications for the functional departments. Staff is currently preparing a review of the Fund's support for post-conflict and fragile states.

[19] A full treatment of the issues associated with debt sustainability and debt management, and in the application of the new debt sustainability framework for low-income countries, is presented in IMF and World Bank, 2006a. Within this framework, the Fund has the lead on the medium-term macroeconomic projections, while the Bank has the lead on the long-term growth projections. Some of the proposals presented here will entail providing additional technical assistance, with resource implications for the respective departments.

[20] Staff continue to encourage all donors to use the DSF to inform their lending decisions, and to provide to the authorities on a timely basis the information necessary for conducting a thorough DSA.

DSF.[21] The Fund would continue to be pro-active in ensuring that scaled-up expenditures based on predictable medium-term donor commitments are accommodated, and would analyze with the country authorities the implications for future spending of donor-financed investment expenditures or new poverty-reducing programs. Staff would also monitor closely the mobilization of domestic revenues in the face of rising aid, pointing out consequences for the country's capacity to finance future expenditures out of own resources.

Managing Aid Inflows [22]

24. **The Fund would have a central role in helping countries ensure macroeconomic policies are consistent with expected aid flows, including debt relief; with changes in the composition or terms of aid; or with shifts in the level of public expenditure.** Aid surges of the magnitude envisaged in some cases may pose challenges in terms of debt sustainability; managing the potential impact on the real exchange rate and external competitiveness and growth; and achieving the appropriate mix of absorption and spending of the aid (see IMF 2005c). Staff would thus deepen their policy dialogue with recipients of scaled-up aid to coordinate effectively monetary, fiscal, and exchange rate policies so as to avoid a suboptimal macroeconomic and growth outturn. This would include assessing the impact of aid on the monetary aggregates, the consistency of the central bank's monetary policy with fiscal policy, and the appropriate policy response to temporary fluctuations in aid levels.[23] However, the assessment of the macroeconomic impact of increased aid inflows requires the assessment of sectoral issues and of public expenditure composition by the World Bank and others. This underscores the need for close collaboration between the Fund, the Bank, and other donors in advising LICs on the use of scaled-up aid to meet the MDGs.[24]

25. **The Fund's policy advice and program design will also continue to help countries deal with the volatility of aid disbursements.** Decisions on scaling up expenditures, including expanding or protecting poverty-reduction programs, must be carefully weighed when aid flows are volatile, or in the absence of reliable aid commitments over the longer-term. As elaborated in recent staff papers, baseline projections of aid inflows

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[21] This assessment would include scaled-up spending financed by other external sources, including new nonconcessional borrowing, private capital flows, foundations, nontraditional donors, vertical funds and global programs, etc.

[22] In the recent discussion on scaled-up aid, Executive Directors confirmed: that the Fund should help create and maintain an enabling environment for the use of aid, though most considered that the Fund should not actively engage in mobilizing a scaling-up of aid resources; that Fund-supported programs should generally support the full spending and absorption of aid provided that macroeconomic stability is maintained; that the coordination of fiscal, monetary and exchange rate policies, and a common understanding of the objectives of the exchange rate regime and monetary policy were important to managing aid inflows; that monetary policy should seek to reconcile the absorption of aid with price stability and reserve adequacy, while avoiding crowding out private investment; and that measures for eventually reducing reliance on aid should be an integral component of macroeconomic policy advice for managing scaled-up aid. See IMF 2007a, 2007b, and 2007c.

[23] For example, the reluctance to use foreign exchange from aid to sterilize the liquidity impact of aid-related spending may be inconsistent with that spending, and require either an adjustment of monetary policy, or a change in the nature and pace of spending.

[24] This was also the position taken by the External Review Committee on Bank-Fund Collaboration.

should represent staff's best estimate based on all available information and be consistent with debt sustainability, while programs should generally support the full spending and absorption of aid identified in the baseline projections, provided that macroeconomic stability is maintained. [25]

26. **Fund staff would point out if a country's macroeconomic policies and institutions would enable it to receive more aid effectively without endangering macroeconomic stability and debt sustainability.** However, Fund staff's role in mobilizing additional aid would be limited to making this general case for more assistance to donors. More specifically, Fund staff would not be expected to judge how much aid a country should be receiving; to advocate a particular level of aid as necessary for reaching the MDGs; to press individual donors to increase their contributions or seek their specific aid commitments; or to evaluate a country's overall absorptive capacity. Staff would, however, continue to encourage donors to make timely and early commitments of their support over the medium to long term to facilitate the planning and execution of scaled-up efforts to reach the MDGs.

27. **Similarly, staff would point out when the volume and composition of aid received or projected strain the country's capacity** to maintain macroeconomic stability, or have adverse consequences for debt or fiscal sustainability, although Fund staff neither can, nor should, monitor the effectiveness of specific aid-financed projects or programs. In doing so, staff must avoid giving the impression that the present resource envelope would always be the limit of what could be absorbed in a manner consistent with macroeconomic stability. In such cases, therefore, Fund staff would discuss with the authorities and other development partners steps to improve the economy's ability to manage higher inflows without these adverse consequences; a different pattern or pace of disbursements; or temporarily holding part of the aid in reserves, until it can be used effectively.

Technical Assistance in Support of Macroeconomic Management [26]

28. **Fund technical assistance in strengthening public financial management (PFM) and statistical systems enhances countries' ability to formulate and effectively implement and monitor spending policies, and to track poverty-reducing spending**.[27] It can also help countries overcome weaknesses that hinder the full absorption and spending of aid. Staff will continue to work with the authorities and the World Bank to strengthen aid

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[25] This is already standard practice in many PRGFs. The programs with Ghana, Mauritania, Rwanda, Sierra Leone, and Uganda during 2001-05 included floors for anti-poverty or social sector spending, and programs with the DRC, Ethiopia, and São Tomé and Principé had quantitative targets for increased spending.

[26] This paper does not attempt a full discussion of the scope or comparative advantage of Fund TA and capacity-building support, although this role is critical to macroeconomic policy implementation. Some of these issues will be addressed in a forthcoming Board paper on *Implementing the Medium-Term Strategy for Technical Assistance.*

[27] The MTS Working Group on Standards and Codes and Capacity Building underscored Fund TA in revenue administration and public expenditure management as a key priority for the short- to medium-term (see IMF 2006b).

management systems that improve the capacity to monitor the commitment and flow of aid resources; to handle anticipated aid increases through the PFM systems;[28] and to ensure that aid flows are integrated into medium-term expenditure frameworks and reflected in annual budgets.[29] This support should be consistent with a country's own capacity-building priorities. Staff should thus encourage the authorities to articulate these needs within their PRSs, and to use the PRS to gain support for the costing, budgeting, funding, prioritization, and sequencing of the reforms necessary for statistical and PFM capacity building. Staff have already taken steps to integrate TA recommendations more closely into program design. The priorities of the Fund's TA contributions would be clearly set out, and take into account how Fund TA could best be coordinated with other TA providers to ensure coverage of the identified needs and avoid duplication of effort.

B. Fund Engagement in the PRS Process

29. **The Fund's role in the PRS process has varied across countries and over time** as countries gain experience with the approach. There has been considerable interaction with a range of country officials on the macroeconomic framework of the PRSP, and some outreach work on the PRS process itself, particularly in its early stages. However, staff have usually not pursued an active policy debate with non-government stakeholders, or been involved in the design of participatory processes (see Box 4, and Appendix I).[30]

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[28] The Board has underscored that strong fiscal institutions and PFM systems are critical for effective utilization of scaled-up aid; stressed the importance of medium-term frameworks in formulating macroeconomic policy based on a longer-term view of spending plans and potential resource availability; and noted the merit of expenditure smoothing in the context of aid volatility (see IMF 2007c).

[29] In managing higher aid inflows, several LICs will also require assistance in enhancing liquidity management and the monetary policy framework, the functioning of exchange markets, and risk orientation in banking supervision.

[30] The IEO (2004) noted that this reflected staff concerns that active involvement might impinge on country ownership. Some Executive Directors shared this concern, but there was also support for a more active role in the public debate on macroeconomic policy design and implementation—especially regarding assumptions, alternative policy scenarios, and trade-offs. See *The Acting Chair's Summing Up, Evaluation Report of Poverty Reduction Strategy Papers (PRSPs) and the Poverty Reduction and Growth Facility (PRGF) by the Independent Evaluation Office,* Executive Board Meeting 04/71, July 21, 2004.

Box 4: Staff Engagement in the PRS Process—Examples of Good Practice

The 2004 IEO evaluation of the PRSP/PRGF noted several cases of good practice in the Fund's engagement in the PRS process, including Mozambique and Vietnam:

In ***Mozambique***, the authorities' ownership of the Fund-supported program increased as a result of the PRSP. PRGF objectives were broadly aligned with PRSP; the macroeconomic framework became more flexible to accommodate aid flows; and structural conditionality was reduced. The authorities provided positive feedback on their discussions of the macroeconomic framework with Fund staff. While civil society would have welcomed more interaction, the IEO report acknowledged that this had not been possible given resources constraints.

In ***Vietnam***, the IEO report noted that the close rapport between the authorities and the Fund resident representatives contributed to an atmosphere of trust resulting in mutually beneficial dialogue, with the authorities expressing an interest in the Fund playing a greater role in the policy debate, beyond the traditional official contacts. This example also illustrates the potential for resident representatives to facilitate a meaningful participatory discussion of the macroeconomic framework.

In ***Ghana***, Fund staff were closely involved in all stages of the consultations leading up to the finalization of the PRSP in 2003. The resident representative contributed to the process of identifying PRS priorities and allocating to them the available resources. The Fund has also collaborated closely in key macroeconomic areas with the Multi-donor Budgetary Support (MDBS) group created between the authorities and donors (including the World Bank). The Fund's resident representative participates in MDBS meetings, and in joint donor and government fora on the MDGs needs assessment, while MDBS donors have participated in meetings of the Fund's PRGF review missions.

30. **Staff would continue to encourage the authorities to give more detailed treatment to macroeconomic issues and constraints in PRSPs and annual progress reports** through advice and support. This should help reduce the gradual divergence of national budgets (and Fund-supported program targets) from the macro-fiscal frameworks set out in PRSPs.[31] Staff would also encourage and support the elaboration and presentation of consistent alternative macroeconomic frameworks in updates and full revisions of the PRS.

31. **Staff would seek to keep the Fund's operational cycles (including program work) as closely aligned as possible with domestic cycles, especially the PRS cycle.** Concretely, mission work could be planned so that assessment of macroeconomic performance, completed program reviews, and updates of the macroeconomic projections feed into budget formulation and reviews of PRS implementation (including any joint donor evaluation processes). However, major disruptions of the basic PRGF/PSI review cycle for reasons of alignment would not be envisaged under this flexible approach. Because of the budgetary focus of Fund-supported programs, this alignment would be simpler where the country's budget and PRS cycles are themselves aligned.

[31] This divergence results from the fact that the macroeconomic frameworks underpinning the first generation of PRSPs were not well elaborated, nor updated frequently enough to reflect short-term changes in economic conditions. Medium-term expenditure (and eventually fiscal) frameworks, whose time horizon is closer to that of the PRSP, can thus be an important planning tool for the authorities and an anchor for Fund-supported programs.

Box 5. Aligning the PRSP and PRGF Cycles—Mozambique

In 2004, Mozambique's program aid partners (the PAPs—providers of budget support) signed a memorandum of understanding with the Government, which scheduled joint assessments of progress under the Performance Assessment Framework (PAF) in April and September. The Government and the donors requested that the Fund schedule its PRGF reviews to feed into the PAF reviews. Mission teams met on several occasions with the PAPs in order to exchange views and coordinate relevant program conditions. For the September 2006 joint review, the PAPs for the first time refrained from analyzing the draft budget and relied exclusively on Fund analysis. As a result, the government and the PAPs have become increasingly positive about the coordination between Fund reviews and key events of the PAF review, praising the Fund's flexibility in joint board statements.

32. **As the PRS cycle becomes more entrenched in countries, Fund staff should be able to focus on providing direct policy advice to strengthen the underlying macroeconomic framework,** and collaborate at the country level with the World Bank and other development partners in supporting the government's implementation of priority structural reforms. Both the Fund's MTS and the report of the External Review Committee on Bank-Fund collaboration proposed changes to the current arrangements regarding the JSAN (though the External Review Committee made no explicit recommendations). The staffs of the Fund and the Bank will come to the Boards soon with concrete proposals regarding the JSAN.

33. **Fund staff would encourage countries to integrate trade policies into their PRSs,** and to explore the potential benefits to growth and poverty reduction that could result from trade liberalization, especially when undertaken on a nondiscriminatory (MFN) basis through unilateral reforms or as a result of multilateral negotiations. Staff would assist the authorities in assessing and dealing with the economy-wide impact of such reforms, including with respect to their revenue effects and, with the World Bank, would discuss issues of timing and sequencing of trade reforms from this perspective. The Fund would encourage the incorporation in PRSs of recommendations from the Integrated Framework's country-specific Diagnostic Trade Integration Studies that fall in areas relevant to the Fund's work.

C. Fund Support for the MDGs

34. **The Fund remains firmly committed to supporting country efforts to reach the MDGs, and will continue to encourage the necessary changes in the international system to facilitate this**—including, in particular, increased and more effective aid; reforms to the multilateral trading system; and capacity-building support. Its own direct contribution to the MDGs is not in estimating the costs of, or financing, the necessary policies, but in helping countries maintain macroeconomic stability and debt sustainability, and accelerate growth, including through appropriate macroeconomic and fiscal frameworks.

35. **Staff would be expected to report on whether the estimated costs of meeting the MDGs are consistent with existing or projected aid flows, macroeconomic stability, and**

debt sustainability.[32] Where reliable and credible estimates of the resources required for reaching the MDGs are provided by others, or where higher aid flows become available, Fund staff would help countries to formulate a consistent macroeconomic framework and sustainable fiscal policies around these higher aid and spending levels.

36. **The role of Fund staff in consultative group meetings and roundtables is also evolving**. As the purpose of these events shifts from closing financing gaps toward mobilizing commitments of longer-term MDG support,[33] Fund staff may increasingly be called upon to assess the impact of changes in the volume or terms of aid flows on the macroeconomic situation and on debt and fiscal sustainability. Staff could use these events to do so.

37. **Fund staff would be expected to report to the Executive Board on progress toward the MDGs in individual countries in the context of Article IV staff reports,** presenting in concise summary form assessments prepared by the World Bank or others, in addition to relevant tables on key indicators. This reporting would highlight specific weaknesses, and point out cases where faster progress could be made without endangering macroeconomic stability if more resources were available. This reporting will draw heavily on analytical work done by countries and other development partners, and will depend on whether a costing exercise had been done. However, Fund staff would not be expected to determine precisely how much more progress could be achieved for a given increment in resources; to analyze developments of key social indicators; or to arbitrate budget allocation decisions.

D. Engagement with Key Domestic Stakeholders

38. **The Fund has gradually become more engaged with non-governmental interlocutors.** At the country level, staff have regular contacts with parliaments, business and private sector associations, academia, trade unions, and other major domestic civil society organizations (CSOs), and the press, to provide them information about macroeconomic developments and to raise awareness of constraints and tradeoffs. In most countries, the frequency of these contacts has increased since the introduction of the PRS approach, although they are constrained by other demands on staff time during missions and the limited resources of the Fund's resident representative offices. However, there has been considerable criticism, including by the IEO and CSOs, of what is seen to be the limited frequency and scope of these contacts.

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[32] As noted above, assessing the impact on macroeconomic stability and on debt sustainability within the joint DSF will require inputs from the Bank and other development partners on sectoral and public expenditure issues.

[33] The World Bank, the UNDP and the OECD-DAC jointly introduced in 2006 a conceptual adaptation of the traditional consultative group meeting format, termed country-based "results, resources, and partnership (RRP) meetings," at which countries and their development partners would discuss a country's plans for reaching the MDGs, the resources required, and the expected results. The concept has been tested in Ghana, and a RRP meeting is planned for Tanzania later in 2007.

39. **Fund staff would be expected to maintain an appropriate public outreach effort, including through open discussions on macroeconomic issues with key domestic stakeholders**. Key objectives would be to facilitate the understanding of macroeconomic constraints and the assumptions underpinning the Fund's policy advice; to help ensure that macroeconomic considerations feed into the design and updates of the PRS; to contribute to broader consensus around policy choices; and to facilitate discussion of alternative policy options. Listening to and using the feedback from stakeholders can also help to improve Fund operations in-country. Such discussions would be clearly separate from program negotiations, and would handle sensitive issues, such as exchange rates or interest rates, only in general terms.[34] The dialogue will normally take place within the institutional framework organized by the government,[35] and staff should encourage the authorities to take the lead role in these discussions, which would normally involve both the resident representative and the mission chief.

E. Recommendations

40. Based on the above discussion, beyond the normal provision of macroeconomic policy advice, financial and technical assistance, Fund staff would be expected to:

- *assist country authorities in preparing alternative macroeconomic scenarios, drawing on any existing in-depth analysis of the sources of growth and related constraints*;
- *assess the scope for sustainable new debt accumulation using the new DSF; encourage countries to develop a medium-term debt management strategy (MTDS); and assess the longer-term budgetary consequences of aid-financed spending increases*;
- *help countries to manage the macroeconomic impact of increased aid or persistent aid volatility; indicate to donors when more aid would not endanger macroeconomic stability and debt sustainability, without advocating a specific level of aid or assuming responsibility for mobilizing donor commitments; and signal when the volume and composition of aid would pose problems for stability or sustainability*;
- *push for detailed treatment of macroeconomic issues and constraints in PRSPs; and engage in early and open dialogue with key domestic stakeholders on macroeconomic issues*;
- *report on the consistency of estimated costs of meeting the MDGs with projected aid flows, macroeconomic stability, and debt sustainability; and on country progress toward the MDGs.*

[34] This aspect of the Fund's role in the PRS process will gain importance in the future as an increasing number of LICs no longer require the Fund's financial assistance.

[35] Staff must also ensure consistency with the Fund's guidelines for communications with CSOs, especially where the government does not provide such a framework. See www.imf.org/external/np/cso/eng/2006/101003.htm.

IV. THE FUND'S ROLE IN COLLABORATING WITH DONORS

A. Objectives of Collaboration

41. **The Fund's effectiveness in helping LICs meet the MDGs depends on close interaction with other development partners, particularly in the field**. Within the framework of the PRS, three elements of this interaction are particularly relevant. The first is the flow of information from the Fund to donors on the macroeconomic situation and prospects, and from donors to the Fund on their financial assistance and their assessment of PRS implementation. The second is the coordinated provision of capacity-building support and technical assistance. The third element is enhancing overall aid effectiveness, through predictable commitment and delivery of aid and effective macroeconomic management.

42. **The 2007 IEO evaluation noted that many donors are not fully satisfied with the Fund's willingness to engage with them**, both individually and in multi-donor meetings. Moreover, although they remain broadly satisfied with the Fund's macroeconomic assessments, the increasing provision of general budget support requires a more intensive and continuous dialogue with the Fund on macroeconomic and budgetary issues, and the availability of its assessments at specific points in the budget/donor calendar.[36]

B. The Changing Relationship with Donors in the Field

43. **Donors are increasingly devolving responsibility for administering their programs to their field representatives**, and are collaborating more closely with each other and the government though new partnership agreements, especially among budget support providers.[37] While contacts with donor representatives in the field have always been an important component of the work of Fund missions, this changing pattern of donor decision-making is shifting the locus of Fund interaction with them on specific countries to the field, with implications for the role of the Fund's mission chiefs and resident representatives. This applies as well to the Fund's contribution to consultative group meetings, as their nature evolves (see III.C above). This poses a challenge in ensuring effective collaboration on the ground, given the Fund's centralized and headquarters-based management model, especially in countries where the Fund does not have a resident representative office.

44. **The Fund must maintain and deepen its collaboration with other donors to ensure that its assessments remain relevant to their decisions**, given the approaching end of the coordinated structure under the HIPC Initiative and the MDRI. Also, in many LICs,

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[36] The survey of LICs and donors conducted for the Board paper on the Policy Support Instrument confirmed that Fund signals are used extensively by donors, and have an important influence on the provision of direct budget or program assistance. However, this influence is not mechanical, and the Fund's macroeconomic assessment is increasingly just one of the parameters in donor disbursement decisions. (See IMF 2005a: 24).

[37] Among providers of general budget support, such groups are becoming more frequent. In some cases (notably Rwanda and Cambodia), Fund staff played an active role in formulating the underlying partnership agreements and, particularly in the case of Mozambique, resident representatives have collaborated effectively with the groups (see Box 6).

the Fund can play a positive role in encouraging the engagement by other donors in the absence of a suitable country-led institutional framework.

45. **Fund staff would be expected keep donors informed of the timing, objectives, and results of Fund missions.** This may imply more regular contacts between headquarters-based staff and donor representatives, and during missions in the field. Closer and more frequent interaction with donors could require in some cases a greater commitment of time by resident representatives, particularly when their participation in joint donor processes is envisaged.

46. **Staff could also contribute to the work of joint donors groups that is of direct relevance to the Fund's LIC work**, particularly in the areas of public finance reforms and budget support, where several donors may be actively engaged at the same time. This could take the form of attendance by the resident representative (or where possible by headquarters-based staff via video-link) at relevant meetings of such groups; providing advice on issues in the Fund's areas of expertise and institutional mandate; and contributing inputs from the Fund's analytical work and technical assistance activities.[38] There may also be more scope for the Fund to time its macroeconomic assessments to feed into the joint donor evaluation processes (see Box 5 above).

47. **Fund staff would also need to assess the implications for debt and fiscal sustainability of the rising flows to many LICs from emerging, nontraditional aid providers, private sources, and vertical funds/global programs** (such as UNAIDS, the GFATM, etc.). These donors/creditors often do not maintain a significant permanent presence in-country to administer their programs, and typically have not been closely involved in the PRS process. This complicates the alignment of their support with country priorities or the coordination of their activities with those of other development partners. An additional effort by Fund staff to collect information on the scope and timing of their activities would thus be necessary.

C. Elements of Good Practice in Donor Collaboration

48. **Donors look to the Fund as the principal source of information and evaluation of the macroeconomic situation and prospects of recipient countries**. In coordination with the authorities, Fund staff would therefore continue to provide donors with information on key aspects of the country's macroeconomic performance and prospects, both during missions and at regular intervals between missions (usually in summary form and preferably through the resident representative's office, where one exists).[39]

49. **Staff would continue to seek necessary information from donors on their programs and on their current and planned financial assistance**, and in particular, would

[38] The involvement of TA-providing departments at HQ is a necessary complement to support this activity by the regional technical assistance centers.

[39] Specific information provided to Fund staff in confidence would only be shared with the agreement of the providers, and subject to the Fund's policies on sharing confidential information.

encourage more predictability in their medium-term commitments. Staff would also point out the adverse impacts of aid volatility on country planning and performance, and seek donors' views on the likely timing of, and the factors influencing, their disbursements, to assess the potential risk of volatility in the aid flows.[40] Again, most of this work could be undertaken outside of the usual mission cycle (either through the resident representative office or through direct contacts between headquarters-based staff and donors).

50. **As noted above, Fund staff would discuss with the World Bank and other development partners their provision of support in priority structural reforms that are growth-critical,**[41] and would seek to step up the collaboration with individual donors and government-led joint donor groups on diagnostic and analytical work in areas of common interest.[42] This would allow the Fund and other donors to share assessments and minimize duplication as well as gaps, including in joint work on alternative scenarios for scaled-up aid, where Fund staff could draw on analysis of the growth impact of aid and poverty-reducing spending done by other development partners. As suggested in the External Review Committee and IEO reports, Fund and Bank staff will discuss concrete steps to facilitate enhanced collaboration on countries' growth strategies. This collaboration would also promote the coordination of technical assistance and capacity-building support.

[40] This will inevitably entail some discussion of donor conditionality.

[41] Institutionalizing such discussions with the World Bank was a recommendation of the External Review Committee on Bank-Fund collaboration.

[42] The multi-donor Public Expenditure and Financial Accountability (PEFA) Initiative, of which the Fund and the World Bank are founding partners, is a good example of this type of collaboration. Joint PEFA assessments of country PFM systems are an increasingly important diagnostic tool shared by donors.

D. Role of the Resident Representative

51. **The role of the resident representative in donor collaboration would continue to be tailored to individual countries' changing circumstances.** The requirements of in-country collaboration with donors will depend on the number of donors and the extent of their involvement, and on the degree to which decision-making responsibility is devolved from donor headquarters to the field.[43] Area departments will have to assess in each country the extent to which additional engagement in donor collaboration would be required of the resident representative, and the terms of reference for each resident representative post could be adjusted to set out clearly the parameters of that collaboration.[44] The area departments will also need to balance any additional responsibility for donor collaboration against the other work of the resident representative.[45]

52. **Any change in the role of resident representatives in donor collaboration will require a reconsideration of how the resources allocated to the resident representative offices are used.** The 2007 IEO evaluation underscored the importance of resident representatives in donor collaboration and outreach efforts, and explicitly called on management to clarify both the expectations of, and resources available for, the interactions of resident representatives and mission chiefs with local donor groups and civil society organizations. The scope of this work will depend in part on the authorities' support for the Fund's outreach activities. A stepped-up engagement with non-governmental stakeholders also may require of resident representatives a different mix of skills. More experienced staff may need to be assigned to posts where this activity is emphasized. Similarly, more support from headquarters, particularly from EXR, may be needed to refocus and strengthen the outreach efforts.

53. **Any additional activities in the areas of donor collaboration or outreach by resident representatives will have a cost.** This could be covered either by increasing the resources allocated to LIC work; reducing existing activities by resident representatives; or mobilizing external financing for part of the work. There is little scope to reduce the present range of activities undertaken by resident representatives. However, the approach used by the African Department to enhance its field presence through the deployment of externally financed local consultants (see Box 6) seems promising, and could be applied more broadly in countries where enhanced donor collaboration is likely to have a large payoff.

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[43] In most cases, however, the Fund resident representative may not have the same degree of authority to take an official stance as the counterparts from other donor agencies.

[44] This review would build upon the 2005 Strategic Review of the Resident Representative Program, and may extend the recommendations of that review specifically for resident representatives in low-income member countries.

[45] A 2005 survey of staff showed that: (i) teams at HQs would prefer to spend more time on analytical work and less on civil society outreach; and (ii) resident representatives would prefer to spend more time on outreach (see Appendix I).

Box 6: An Alternative Approach to Enhancing the Fund's Field Presence in Africa

AFR has placed an externally financed local consultant in Mozambique to help coordinate the Fund's work with that of the government and donors in the areas of tax and PFM reforms, and to allow the Fund to collaborate actively with donors in these areas. The coordinator (i) organizes the monthly Steering Committee meetings for both reform programs; (ii) meets with the government, project staff, donors, visiting and resident Fund consultants, and FAD staff; (iii) participates in FAD backstopping missions; (iv) assists in ensuring that sufficient financing is available through a common donor fund and follows up on utilization; and (v) coordinates the on-budget task force, in which is set up to integrate externally financed off-budget projects into the government budget, and to execute them through the single treasury account.

Building on this experience, and given the progressive devolution of operational responsibility from donor headquarters to the field, over the coming year AFR intends to strengthen its own field presence to support MTS implementation by placing contractual economists in AFR's resident representative offices, co-funded along the lines of the Mozambique example. Indications are promising that the Mozambique model can be replicated in other countries, such as Mali and Ghana. In those cases, it is intended that the economist would seek to enhance capacity building by assisting the government in monitoring donor aid flows. In FY2008, AFR has earmarked resources to allow the department to begin the program in about 10 countries, depending on local market conditions and the donor's cost shares.

E. Recommendations

54. **Based on the above discussion, the effectiveness of Fund staff's collaboration with donors could be enhanced in a variety of ways**. The extent to which some or all of these activities can be pursued, particularly by resident representatives, will depend on the specific country situation. In deciding on the priorities, area departments will have to weigh the advantages of greater engagement by resident representatives in donor collaboration or outreach activities against the limited resources available to the resident representative offices, and the core mission of supporting the country authorities in the implementation of Fund policy advice and Fund-supported programs. In some cases, participation in the joint work of donors groups may be a feasible option. While the modalities and intensity will necessarily vary by country, Fund staff in general should :

- *Keep donor representatives informed of the key issues of concern in the Fund's relations with a country; and of the staff's assessment of major macroeconomic developments and the results of mission discussions and of other diagnostic work.*

- *Discuss the implications of projected aid flows for macroeconomic stability and debt sustainability; seek information from donors on their planned support; and encourage donors to adapt the timing or terms of their assistance as appropriate.*

V. Resource Implications

55. **Re-focusing the Fund's role in low-income countries along the lines of the MTS and intensifying certain activities as proposed in this paper, will have resource costs** which could be difficult to accommodate in the present budgetary environment. Although the activities set out are already being implemented to some degree in all area departments, the

ability to extend these activities to cover all low-income countries, as appropriate, will depend on the intensity of the effort involved and whether additional resources are made available. In making decisions going forward, therefore, management and staff will need to be guided by the priorities established by the Board.

56. **As indicated in Appendix II, full implementation across the entire low-income membership could require additional resources in range of some 6 staff years.** Such cost estimates reflect the net impact of devoting additional resources to tasks that have now become mandatory or have been declared priorities by the Board, as well as anticipated savings from cutting back staff involvement in selected activities.[46, 47]

57. **It is not expected that each activity will be conducted each year in each country—rather, it is assumed that the range of activities will be undertaken as appropriate over a three- to four-year period** (consistent with the PRSP/PRGF cycle). Only a few activities, such as the DSA updates, need to be carried out each year.[48] The estimates assume that the resources required for a given activity will vary across countries, and within countries over time, depending on the specific country circumstances, and the nature of the Fund's engagement.[49]

58. **The resource estimates presented here refer only to the country work of area departments and the associated review and support by functional departments.** They exclude other activities which enhance the Fund's overall effectiveness and augment country capacity, such as technical assistance;[50] outreach by management and EXR; or staff participation in relevant international efforts.[51]

59. **Mobilizing any additional resources internally for LIC work will be very difficult in the current environment of declining budgetary resources**. Area departments

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[46] Staff estimated a gross requirement of 10 additional staff years for LIC work for the MTS (IMF 2006a, Table 7); the present estimate tracks closely with the estimated additional requirement of 7 staff-years that resulted from the 2005 staff survey of area departments.

[47] Some of these savings have already been incorporated into the Fund's budget as part of the MTS (e.g., reducing the frequency of Ex-Post Assessments (EPAs) or the number of Selected Issues papers).

[48] Area Departments would decide on the priority and timing of these activities in each country, based on specific country circumstances.

[49] For example, in post-HIPC completion point countries, the annual DSA updates will be considerably less resource-intensive than in countries approaching the HIPC decision or completion point. Similarly, updating an existing alternative macroeconomic scenario will require less time than the initial effort required to create it.

[50] Beyond the traditional technical assistance, this would include the work of STA and FAD in capacity building in their respective areas and in backstopping the RTAC experts; FAD's support for area departments on structural issues outside the core competencies of the Fund (e.g., on civil service reform); MCM's contribution to capacity building in a range of central banking, supervisory and market development areas, including debt management; assistance in integrating the DSF into country operations; or the coordination of TA and capacity-building work with other providers.

[51] Such as consultations with other organizations on alternative scenarios for scaling up toward the MDGs and fiscal space issues; participation in joint international efforts to improve the support for fragile and post-conflict states and to implement the aid effectiveness agenda; or deepening the engagement with emerging creditors.

will face difficult trade-offs in deciding which activity should receive priority in a given country. In making these decisions, management and staff will need clear guidance from the Board on the overall priorities of the institution.

60. **One choice would be to limit resources costs by implementing these activities more modestly.** This could involve, for example: undertaking the work on alternative macroeconomic scenarios in only about half of the PRGF-eligible countries (i.e. biennially); or limiting other activities (such as additional outreach on macroeconomic issues, monitoring of poverty-reducing expenditures, and more intensive field involvement with donors) to only the most "urgent" cases, i.e., in about 10 percent of the countries in any given year (see Appendix II, Table 3).

61. **Another choice would be to cut back further on some existing activities**. These could possibly include: reducing the number of background notes on country-specific or cross-country topics;[52] less frequent engagement with CSOs, private sector, academia and others; less involvement of resident representatives or area department staff in coordinating Fund-provided TA and training; and reducing the frequency or scope of work on topics of passing interest, or research projects outside the Fund's core areas of expertise, etc.

62. **Given the existing workload of resident representatives, it will be unrealistic for them to take on the additional responsibilities envisaged in the paper on a consistent basis unless they receive additional resources** (e.g. an increase in local staff, possibly via donor-financed trust find allocations or co-financing) **or other activities are cut back**. As country experiences and requirements will vary, it will be important that area departments review the terms of reference for each resident posting to ensure an appropriate balance of activities.

VI. Issues for Discussion

63. **This paper has set out a range of activities that staff considers should be undertaken more intensively and on a more consistent basis across the LIC membership, in order to operationalize the Fund's Medium-Term Strategy in low-income countries.** These proposals aim at refocusing the Fund's activities on its core competencies and enhancing cooperation with other development partners on providing support for key issues; strengthening further its contributions to rational debt management in the context of additional post-debt relief borrowing space and a likely increase in development assistance; and enhancing staff's collaboration with other donors, particularly in the field.

64. In the absence of a net increase in overall staffing in the Fund, meeting the net additional resource requirements for the LIC agenda implies generating savings, either from

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[52] For example: minutes of meetings; short memos for meetings with the authorities, and similar documents that are typically not shared with the authorities. Such work does, however, contribute to the analysis of country situations, and to the Fund's "institutional" memory.

other areas of the institution or in existing LIC work. To facilitate these decisions, Executive Directors may wish to consider the following issues:

- Do Executive Directors agree with the proposed areas for more intensive engagement, and with the relative priorities of these activities?
- Do Executive Directors agree that, in analyzing overall absorptive capacity, or sectoral policies for growth, Fund staff should draw on the relevant work done by others, but should not be expected to take the lead role?
- How do Executive Directors see the impact of the current limiting budgetary environment on these activities? How should the costs of more intensive engagement be met?
- If additional resources are not provided for LIC work, what areas of existing work should be limited to allow staff to engage more intensively in the priority areas of activity?

An Informal Survey of Staff Activities in the PRS Process.

A short survey of current practices in PRS countries was conducted in 2005 in which mission teams and resident representatives were asked to indicate the nature of the staff's involvement in PRS formulation and implementation and the time spent on these activities. They were also asked their views on the appropriate degree of involvement in various areas moving forward, including what activities should be continued or intensified.

The main focus of staff involvement in the PRSP formulation stage was the provision of policy advice and inputs on the macroeconomic framework, though this seldom involved detailed growth analyses or contributions to scaled-up alternative macroeconomic scenarios. Staff were seldom directly involved in drafting PRSPs, but did provide detailed comments on early drafts. Staff also participated in meetings with donors and civil society organizations, though less often in public fora, to discuss macroeconomic issues. In the post-PRSP phase, the most intensive work was on updating and revising the medium-term macroeconomic framework; supporting TA-related activities; and helping countries align their PRSPs, MTEFs, and annual budgets. Considerable time was spent in engaging with donors, particularly in providing assessments of the macroeconomic situation (both formal written assessments, and informal information exchange).

Looking forward, country teams saw the greatest value-added in providing additional analytical contributions in support of the PRS, including work on alternative scenarios for scaled-up aid (preferably in cooperation with other donors). Teams also supported extending the scope of their policy discussions with government officials beyond the annual economic program and the medium-term macroeconomic outlook to include, for example, assistance with country-specific debt management, or discussions of the pre-conditions for inflation targeting. Several teams also saw value in public presentations of the Fund's views on the macroeconomic situation and prospects. Resident representatives, in particular, saw scope for additional outreach and other interactions with CSOs/NGOs and donors.

APPENDIX II

Resource Estimates

This Appendix summarizes the resource implications of re-focusing the Fund's activities in low-income countries and explains the derivation of the estimates. As noted in the main text, around 6 staff-years in extra resources are estimated to be required, reflecting additional resources for high-priority tasks, as well as anticipated savings from cutting back staff involvement in selected areas. As the resource estimates of this Appendix refer only to the country work of area departments and the associated review and support by functional departments, the total net additional recourse estimate derived below is in the lower ranges of the requirements for implementing all the LIC-related aspects of MTS.

Box 1: IMF Involvement in Low-Income Countries and the PRS Process [1]

	Macroeconomic Policy Analysis and Advice	PRS Process and MDGs	Outreach	Engaging with Donors
ADDITIONAL ACTIVITIES				
Activities Partly Under way	Work on alternative macro scenarios (M)			
	Advice on management of scaled-up aid, including fiscal/monetary/exchange rate policy response (M)	Reporting on the consistency of MDG cost estimates with macroeconomic stability and in progress toward MDGs (L)		
	Annual DSAs in line with revised DSF & support for MTDS (H)	Reporting on resources directed towards poverty reduction (L)		
Priority Activities	Deeper analysis of macroeconomically critical structural issues (L)		Increasing public outreach on macroeconomic issues (L)	More discussions with donors on macroeconomic and related structural issues (L)
Potential Activities	Refining growth projections (M)			Initiating, as needed, more intensive field-level involvement (L)
REDUCED ACTIVITIES				
Expected Reductions	Reducing frequency of work on Ex Post Assessments (M)			
Possible Reductions	Reducing Selected Issues Papers (L)			
	Reducing work on non-macroeconomically critical structural issues, including micro/sectoral analysis, in the context of streamlined structural conditionality (L)			

[1] Letters in brackets refer to high (H), medium (M), or low (L) **additional** resource needs.

The aggregate estimates were derived as follows. First, all 78 PRGF-eligible countries were divided into three major groups: (i) 45 countries with active PRGF or PSI arrangements, or near-program status; (ii) 8 post-conflict countries; and (iii) 25 "lower-activity" countries. For each group, estimates were made of the *extra* time needed for additional or intensified activities under consideration, as well as the savings possible from reducing selected activities (Table 1). The estimates were based on several inputs: a 2005 survey of time spent by area department staff working on this range of activities in LICs (which serves as the baseline for the estimates); follow-up questionnaires sent to selected country teams; surveys of country teams conducted for the DSF paper (see IMF 2006c); the resource costs estimates identified in staff's review of Ex-post Assessments; and other staff estimates.[53]

The main assumptions used in deriving the cost estimates in Table 1 were:

- In *program or near-program countries*, staff are likely to focus most of their additional efforts on developing alternative scenarios; supporting the development of MTDSs; and providing advice on an appropriate policy mix for managing aid flows. In *post-conflict countries*, staff are likely to spend substantial additional time on deepening the analysis of macro-critical structural issues, and developing debt management strategies. In *lower-activity countries*, additional work would likely be limited to debt sustainability analyses and developing comprehensive debt management strategies.
- In all three country groups, additional savings could accrue from scaling back the production of selected country documents, and especially from reducing further the analytical work on structural issues in non-core areas (such as civil service reform, privatization, etc.). Some savings will be also achieved by reducing the frequency of Ex-post Assessments in program and near-program countries.

[53] Approximate ranges, expressed in staff-days, were used in assigning time estimates to particular activities: high (H) resource needs correspond to activities deemed to require an extra 24-27 staff-days, while medium (M) and low (L) resource needs correspond to 14-17 and 4-7 extra staff-days, respectively.

Table 1. Additional Resources for PRGF-eligible countries

	PRGF/PSI or near PRGF (45)		Post-conflict (8)		Low-Activity (25)		All (78)	
	Low-	High-end	Low-	High-end	Low-	High-end	Low-	High-end
	(In staff days)							
1. Net Additional Resource Needs -- per PRGF-eligible country	**44**	**62**	**82**	**106**	**32**	**56**	**44**	**65**
1a. Additional Resource Needs per PRGF-eligible	70	100	100	130	40	70	63	93
Macroeconomic analysis and advice	*50*	*65*	*80*	*95*	*20*	*35*	*43*	*58*
Work on alternative macro scenarios	14	17	14	17	4	7	11	14
Deepening advice on response to scaling up (M)	14	17	4	7	4	7	10	13
Deeper analysis of macro-critical structural issues (P)	4	7	24	27	4	7	6	9
Refining growth projections	4	7	14	17	4	7	5	8
Carrying out annual DSAs and supporting MTDS (M)	14	17	24	27	4	7	12	15
PRS process and MDGs	*8*	*14*	*8*	*14*	*8*	*14*	*8*	*14*
Reporting on resources for poverty reduction	4	7	4	7	4	7	4	7
Reporting on MDG progress, costs & consistency	4	7	4	7	4	7	4	7
Engagement with donors	*8*	*14*	*8*	*14*	*8*	*14*	*8*	*14*
Discussions with donors on macroeconomic issues (P)	4	7	4	7	4	7	4	7
Initiating more intensive field involvement (N)	4	7	4	7	4	7	*4*	*7*
Outreach on macroeconomic issues (P)	*4*	*7*	*4*	*7*	*4*	*7*	*4*	*7*
1b. Reduced Needs per PRGF-eligible	26	38	18	24	8	14	19	29
Reducing frequency of Ex-post Assessments	18	24	0	0	0	0	10	14
Reducing Selected Issues and Statistical	4	7	4	7	4	7	4	7
Reducing work on non-core structural issues	4	7	14	17	4	7	5	8
Reduced work on	0	0	0	0	0	0	0	0
	(In staff years)							
2. Net Additional Resource Needs -- Total	**7.6**	**10.7**	**2.5**	**3.3**	**3.1**	**5.4**	**13.2**	**19.4**
2a. Additional Resource Needs for all PRGF-eligible	12.1	17.3	3.1	4.0	3.8	6.7	19.0	28.0
a. Macroeconomic analysis and advice	8.7	11.3	2.5	2.9	1.9	3.4	13.0	17.5
b. PRS process and MDGs	1.4	2.4	0.2	0.4	0.8	1.3	2.4	4.2
c. Engagement with donors	1.4	2.4	0.2	0.4	0.8	1.3	2.4	4.2
d. Outreach on macroeconomic issues	0.7	1.2	0.1	0.2	0.4	0.7	1.2	2.1
2b. Reduced Needs	4.5	6.6	0.6	0.7	0.8	1.3	5.8	8.7

Note: **M** refers to mandatory activities (partially underway); **P** to other priority activities; and **N** to potential new activities.

Estimates in Table 1 were based on a simplified assumption that each country would fully implement the additional MTS priorities every year. However, for each country the actual work is likely to be spread over several years, with only some of the additional activities undertaken by every PRGF-eligible country every year.[54] Some activities, such as policy

[54] Specifically, it is assumed that all country teams would develop alternative macroeconomic scenarios and DSAs every year, and would also report annually on resources directed towards poverty reduction. It is also

(continued…)

advice related to managing scaled-up aid, are also likely to be relevant only in a sub-set of countries at any given time. Finally, the estimates implicitly recognize that – once initiated – similar time commitments may not be required in continuing a given activity. This fact is reflected in the calculations of "baseline" additional demand in Table 2.With respect to projected savings, these are assumed to occur every year, i.e., the activities would be eliminated once and for all. The mid-point between the low-end and the high-end estimates provides the estimated net requirement of 6.3 staff years presented in the main text.

Table 2. Net Additional Resource Needs for PRGF-eligible countries

	PRGF/PSI or near PRGF (45)		Post-conflict (8)		Low-Activity (25)		All (78)		
	Low-end	High-end	Low-end	High-end	Low-end	High-end	Low-end	High-end	Mid-point
	(In staff years)								
1. Net Resource Needs -- Total	**3.0**	**3.6**	**1.3**	**1.5**	**1.2**	**2.1**	**5.5**	**7.2**	**6.3**
1a. Additional Resource Needs for PRGF-eligible countries	**7.5**	**10.2**	**1.8**	**2.3**	**1.9**	**3.4**	**11.3**	**15.9**	**13.6**
A. By topics area	*7.5*	*10.2*	*1.8*	*2.3*	*1.9*	*3.4*	*11.3*	*15.9*	*13.6*
Macroeconomic analysis and advice	6.0	7.5	1.5	1.8	1.1	1.9	8.7	11.2	10.0
PRS process and MDGs	0.9	1.6	0.2	0.3	0.5	0.9	1.6	2.8	2.2
Engagement with donors	0.4	0.6	0.1	0.1	0.2	0.4	0.6	1.1	0.9
Outreach on macroeconomic issues	0.2	0.4	0.0	0.1	0.1	0.2	0.4	0.7	0.6
B. By priority area	*7.5*	*10.2*	*1.8*	*2.3*	*1.9*	*3.4*	*11.3*	*15.9*	*13.6*
Mandatory (partly under way) activities (M)	6.6	8.5	1.4	1.7	1.4	2.5	9.4	12.7	11.0
Other priority activities (P)	0.7	1.2	0.3	0.4	0.4	0.7	1.4	2.3	1.9
Potential new activities (N)	0.3	0.5	0.1	0.1	0.2	0.3	0.5	0.9	0.7
1b. Reduction in Resource Needs	**4.5**	**6.6**	**0.6**	**0.7**	**0.8**	**1.3**	**5.8**	**8.7**	**7.2**
Reducing frequency of Ex-post Assessments	3.1	4.2	0.0	0.0	0.0	0.0	3.1	4.2	3.6
Reducing Selected Issues and Statistical Appendixes	0.7	1.2	0.1	0.2	0.4	0.7	1.2	2.1	1.7
Reducing work on non-core structural issues	0.7	1.2	0.4	0.5	0.4	0.7	1.5	2.4	2.0

A final exercise involved the identification of potential ***additional*** savings should there not be sufficient resources to meet the projected requirement of 6 additional staff-years. Two types of potential *additional* savings are identified: (i) a more gradual and/or less

expected that about one third of teams in any given year would be providing additional advice on scaling up, deepen their advice on macro-critical structural reforms, report on MDG costs, intensify their discussions with donors, and increase their outreach work.

comprehensive implementation of the MTS priorities (e.g., limiting the extra increase planned for, say, alternative scenarios, DSA-related work, or macroeconomic analysis related to scaling up); and (ii) cutting back on activities that are already undertaken (e.g., engagements with CSOs; technical assistance coordination conducted by country teams and resident representatives).

Table 3. Possible Additional Savings
(In staff-years, for all countries)

Limiting the proposed increases to LIC work	**6**
Less resource increase for scaling up related work	2
Less resource increase for alternative macro scenarios	2
Less resource increase for outreach on macro issues	2
Reducing activities already undertaken	**6**
Reducing background notes	2
Less engagement with CSO, less TA coordination	2
Less work on non-core areas	2

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