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## Glossary of Abbreviations

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<th>Abbreviation</th>
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<tr>
<td>BCEAO</td>
<td>Banque Central des Etats de l’Afrique de l’Ouest (Central Bank of West African States)</td>
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<td>DAC</td>
<td>Development Assistance Committee (of the OECD)</td>
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<td>DDI</td>
<td>deep deepening index</td>
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<td>ESAF</td>
<td>Enhanced Structural Adjustment Facility</td>
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<tr>
<td>FDI</td>
<td>foreign direct investment</td>
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<td>HIPC</td>
<td>heavily indebted poor countries</td>
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<td>IDRC</td>
<td>International Development Research Centre</td>
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<td>ILO</td>
<td>International Labour Organisation</td>
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<td>NGO</td>
<td>nongovernmental organization</td>
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<td>NPV</td>
<td>net present value</td>
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<td>NRM</td>
<td>National Resistance Movement</td>
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<td>PAPSCA</td>
<td>Program to Alleviate Poverty and the Social Costs of Adjustment</td>
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<td>PDR</td>
<td>Policy Development and Review Department (of the IMF)</td>
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<td>PFP</td>
<td>Policy Framework Paper</td>
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<td>REDB</td>
<td>real external debt burden</td>
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<td>RENAMO</td>
<td>National Resistance Movement of Mozambique</td>
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<td>SAC</td>
<td>Structural Adjustment Credit</td>
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<tr>
<td>SAF</td>
<td>Structural Adjustment Facility</td>
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<tr>
<td>SAL</td>
<td>Structural Adjustment Loan</td>
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<td>UEA</td>
<td>Uganda Exporters Association</td>
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<td>UEMOA</td>
<td>West African Economic and Monetary Union</td>
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<td>UDI</td>
<td>Unilateral Declaration of Independence</td>
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<td>UMA</td>
<td>Uganda Manufacturers’ Association</td>
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<tr>
<td>UNCCI</td>
<td>Uganda National Chamber of Commerce and Industry</td>
</tr>
<tr>
<td>UNDP</td>
<td>United Nations Development Program</td>
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<tr>
<td>ZCCM</td>
<td>Zambia Consolidated Copper Mines</td>
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We were appointed by a decision of the Executive Board of the IMF in October 1996, to conduct the first-ever independent external evaluation of the Enhanced Structural Adjustment Facility (ESAF). The evaluation group was originally made up of Dr. Kwesi Botchwey, Harvard Institute for International Development (Coordinator and Convenor); Professor Paul Collier, Centre for the Study of African Economies, Oxford University; Professor Jan Willem Gunning, The Free University of Amsterdam; and Professor Yusuke Onitsuka, University of Tokyo. Following the unfortunate and untimely death of Professor Onitsuka, Professor Koichi Hamada of the Economic Growth Center, Yale University, was appointed as the new fourth member of the group.

Our evaluation was intended to complement an extensive internal review of experience under ESAF-supported arrangements by the Fund’s Policy Development and Review Department (PDR), which was expected to be concluded in the spring of 1997.

We held our first meeting in Washington in April 1997 to discuss administrative arrangements, to conduct preliminary discussions with Fund staff and with members of an Evaluation Group of IMF Executive Directors charged with the general oversight of the successful conclusion of our work, and to make all necessary arrangements for the release to us of all relevant information in possession of the Fund.

We met again in July 1997 to finalize the administrative arrangements, reach final agreement among ourselves on country sampling and other procedural matters, and conduct further in-depth meetings with staff of the PDR and other departments working on the countries in our sample. Most important, at this time we attended and participated in the meeting of the Executive Board devoted to a discussion of the full report on the PDR review of experience under ESAF-supported programs.

From about August through much of September and early October 1997, we undertook a program of country visits, which we interrupted in the latter part of September to attend the World Bank/IMF Annual Meetings in Hong Kong, where we conducted further interviews with governors and senior officials from a large number of countries, including some countries outside our sample. We also met with a number of IMF Executive Directors and senior officials from the Bank.

We resumed and concluded our program of country visits after the Annual Meetings and finally congregated at the Centre for the Study of African Economies at Oxford to review our findings from the field trips, debate outstanding issues, and agree on the form and content of our final report, which we present here.

We would like to express our gratitude and appreciation to all those who assisted us in various ways. In particular, we would like to thank the members of the Evaluation Group of Executive Directors; the Executive Directors of our sample countries; the Director and staff of the Office of Internal Audit and Inspection, especially Elena Frolia, Melanie Brown, and Cathy Song; the Directors and staffs of the Policy Development and Review Department and the African Department; and the Fund and World Bank representatives in the various countries we visited. We also wish to acknowledge the invaluable support provided by a number of research assistants—Michael Fabricius, Elizabeth Su-Dale (who also assembled the first draft), Yasuhisa Ojime, Mototsugu Shintani, and Alex Maynard. Above all, we would like to thank the ministers, government officials, private sector and trade union representatives, nongovernmental organizations (NGOs); and all others who gave us so much of their time during our country visits.
The terms of reference for this evaluation study distinguished three components: social impact, external viability, and ownership.

Social Impact

Although ESAF programs are often criticized for the uniformity of their design and policy focus, their social impact is highly diverse. There are instances of generalized initial losses in incomes and of generalized initial gains, of prolonged reductions in social expenditures and of sustained increases. The same social group may suffer severely in some ESAF programs and benefit in others: for example, ESAF radically lowered civil service real wages in Côte d’Ivoire while raising them in Uganda. Thus, the average experience across all ESAF programs conceals as much as it reveals, while a case study of an individual country is liable to be highly particular. Our approach has been to apply a simple analytic taxonomy, distinguishing a few important mechanisms whereby the poor might be affected.

We distinguish between two main channels by which ESAF programs can affect the poor: via private incomes and via social expenditures.

Private Incomes

Private incomes are inevitably affected by ESAF programs; indeed, the ultimate purpose of such programs is that incomes should be increased on a sustainable basis. However, any policy change that seeks to raise incomes in the aggregate is likely to inflict some income losses. A useful distinction in analyzing these losses is between those that arise as a result of a fall in the aggregate income of society and those that arise as a result of redistributions within society. In a well-designed program, any aggregate losses will be temporary: policy reform is intended to raise aggregate income in the medium and long term. In some societies, a temporary decline in aggregate income is unavoidable, the main instance of this being the transition economies. These economies have a large high-cost sector, which reduces the potential for other sectors to expand and which must therefore itself contract, while lacking the organizations of private enterprise so that growth elsewhere is initially slow. Because the temporary losses in transition economies are widespread, the targeting of safety net responses may not be difficult; rather, it is the sheer scale of need that may pose the challenge. National food-for-work types of intervention may be both simple and sufficiently self-targeting. The transition economies are, however, not the main focus of this study.

Most ESAF countries are not transition economies, although a few of them have one or other of the transition economy–type features. Hence, in most ESAF programs unavoidable income losses arise mainly or exclusively from redistributions between socioeconomic groups. Whereas the aggregate income losses in transition economies are inherently temporary in a well-designed program, the losses arising from redistributions are likely to be long lasting because they are caused by relative price changes that are intrinsic to policy reform. Such income losses are thus both more particular, hitting pockets of people in the midst of more generalized improvements, and longer lasting.

Safety net interventions are thus likely to need more targeting, and to last for longer periods. However, by no means do all losing groups warrant safety net intervention. The central issue is whether the losers are concentrated among the initially poor. Overall, we concur with the main academic study on this question, which concludes that reform will “generally have positive effects on growth and income distribution” (Sahn, 1996, p. 22). That is, on the whole, the groups that lose from reform are concentrated among the initially better-off rather than among the poor. However, this does not mean that there is no overlap between the poor and those who lose from the reforms. In some contexts, income redistributions work against important subgroups of the poor: we found this for maize growers in the remote regions of Zambia, estate workers in Malawi, and urban informal sector workers in Côte d’Ivoire.

The very particularity of these groups indicates that it is not possible to devise, a priori, safety net in-
terventions that will work across ESAF programs. There is no substitute for detailed country-level work using socioeconomic survey data. Usually, however, there is sufficient information available prior to ESAF programs for safety nets to be built into the program design. To date this has not been done. We recommend that the Fund draw formally upon the household poverty expertise of the World Bank, integrating projections of social impact into program design and monitoring the outcomes.

In some nontransition ESAF economies there have been large, temporary contractions in aggregate income, Zambia and Zimbabwe being the main cases in our sample. While there were complicating circumstances due to drought, we conclude that a significant part of the decline in income was avoidable, being due to errors in the sequencing of the reform program. In both countries financial liberalization was, in our view, premature, in that it preceded fiscal stabilization and considerably delayed its attainment. We are also concerned about the sequencing of some structural reforms. Some reforms that would have enhanced the ability of the poor to benefit from the ESAF program should have been given earlier priority. We recommend that sequencing issues be explicitly analyzed at the stage of program design.

The main scope for poverty reduction through rising incomes occurs in the poststabilization phase of ESAF programs. Whereas in the stabilization phase it is usually appropriate and indeed essential that fiscal and external deficits be reduced, in the poststabilization stage the most important objective may be to increase the investment rate so as to achieve sustainable rapid growth. In low-income ESAF countries both the scope for, and the desirability of, financing increased investment through domestic savings is limited. A successful poststabilization ESAF economy is likely to have a phase in which deficits temporarily increase again as investment is financed by increased aid and private foreign capital. Since it now appears that aid effectiveness requires that aid be targeted to countries with good macroeconomic policy environments, there is potentially a serious conflict between the common Fund practice of planning for a rapid tapering off of total aid in poststabilization situations and the donor objective of increased aid effectiveness. We recommend that ESAF have a continuing role in stabilized low-income countries, but that a sharper distinction be drawn between the phase in which policy is oriented toward stabilization and the phase in which it is oriented toward growth. In the latter, it may be appropriate for the investment rate to become a monitorable program objective. The original purpose of ESAF as stated by the IMF’s Executive Board on December 15, 1987, was “to promote in a balanced manner” the objectives of payments viability and growth. This balance should, in our view, be achieved through a changing emphasis over the duration of programs.

Partly as a result of the success of ESAF, there are now several low-income African economies that have recently achieved a satisfactory policy environment. These countries (Uganda in our sample) are currently growing rapidly. However, their investment rates remain low: current high growth is the temporary pay off to policy reform. This conjunction of high growth and low investment is not sustainable: either investment must rise or growth will decelerate. The increase in investment cannot be financed predominantly from domestic savings because incomes are so low: both enhanced private and public capital inflows will be needed until incomes have risen.

Private investment is currently deterred because these environments are rated as highly risky. The risk ratings for the newly reformed economies are improving, but from a very low base, and it will take another decade before the ratings reach the level of the current newly industrializing countries, at which major investment inflows become likely. Recent research has shown that in the reformed policy environments, aid acts as a catalyst for private investment: each dollar of aid induces almost two dollars of investment. Hence, investment inflows can be increased both by increased aid inflows and by a reduction in the perceived risks. In both of these, the Fund has a key role.

The Fund can reduce perceived risks by signaling that a country has reached the phase in which the macroeconomic policy environment is satisfactory for private investment. In this phase, the key role of the Fund is the surveillance of policy maintenance through the monitoring of a few key variables, rather than the negotiation of further promises of policy change. However, surveillance in itself may not be sufficient to achieve credible certification. To be fully credible, the Fund should put its own resources at stake and so have a program. However, it is essential that such a program be clearly distinguished from those that are designed to cope with crisis recovery. Countries would be seen to graduate out of a crisis period into a second phase of rising investment, before they graduated completely out of Fund programs. The graduation into this second phase would constitute a powerful signal to the investment community. It would also constitute a signal to the donor community. There is now compelling evidence that aid is effective in, and only in, satisfactory macroeconomic policy environments. The Fund has a key role in certifying that such an environment has been attained. Clearly, maintained Fund financing in these environments adds credibility to the
message that donor funds should appropriately increase. The Fund itself is not a development finance institution and should not become one. Rather, its new role for this group of graduated, but investment-scarce, countries is temporary, in the initial phase of a reformed environment. The recent wave of reforms and temporary high growth in Africa has thus created a window of opportunity. The Fund is instrumental in whether this opportunity is seized.

Social Provision

The provision of social services can be affected by an ESAF program in four distinct ways. First, if ESAF raises or lowers GDP, then, if all other ratios stay unaltered, real per capita social service provision will change accordingly. Second, ESAF may change the share of government expenditure in GDP. Third, ESAF may change the composition of public expenditure. Finally, relative price changes may change the amount of service provision that a given value of public expenditure will purchase. Each of these four routes for change has been important in one or other of the countries in our sample, and for each of the routes there are examples both of improvements and deteriorations in social provision. We are, however, concerned that there has been excessive focus on one of the channels, namely, the composition of public expenditure. In our sample, the most important changes in social provision often arose from changes in its relative price, yet this appears to have gone unnoticed.

We recommend that the Fund present data on the provision of social services in a standardized format that decomposes changes into the four components set out above, so that governments can more readily see what is happening and why.

A further factor affecting social provision is the volatility imposed on certain components of public expenditure by the operation of the cash budget. There is no easy solution to this problem. However, in some countries there is a clear trade-off between the procedures that have proved effective in controlling expenditure in aggregate and the efficiency of public expenditure. A mechanism such as the cash budget, which substantially reduces the efficiency of expenditure, should be regarded as a temporary stop-gap rather than as constituting a solution. Better forecasting of the intrayear pattern of revenues and a more appropriate pattern of expenditure smoothing will be necessary as countries graduate from the circumstances of fiscal crisis.

While in our view there is no systematic tendency of the poor to lose disproportionately from ESAF programs, there are important subgroups of the poor that are so weakly integrated into the economy that they are left behind during growth. In Uganda, growth has been predominantly urban based, and subsistence farmers have not been in a position to benefit. In the medium term, reintegration of these groups into the market economy will raise their incomes. In some countries, there is a conflict between this medium-term objective and the short-run objective of revenue maximization. In Uganda, both the current high level of petroleum taxes and the previous windfall coffee tax work to slow integration of rural households into the market. There are again no easy solutions to such problems, but government choices should be made in the context of a more informed appreciation of the costs of taxation. In the short term, the best way of improving the living standards of these economically detached households is through increased provision of basic social services. In the context of rapid growth, rising rural social provision is likely to be affordable and could reasonably have been included as monitorable program objectives.

Our recommendations on social impact are as follows.

• First, in our view the Fund should not invest in building up expertise in poverty analysis. Rather, we recommend that at the stage of program design the Fund formally ask the World Bank to identify ex ante which groups among the poor are likely to lose from the proposed reforms. The Bank would then provide the Fund with projected time paths of the real incomes of the main groups of the poor and also with projected outputs of social services. The output projections for social services would take into account the relative price changes that we have identified as so substantial that they can radically change the conclusion from social indicators. The projected time paths would be incorporated in program documents, along with the traditional fiscal and monetary monitoring variables. Whether a program would be considered in need of revision would be decided in part on the basis of a comparison of outcomes with these projections. Clearly, the time lag for income data is much greater than that for financial targets. However, the use of income data in assessing whether the outcome of a program was consistent with the initial projections would be salutary since major deviations would require explanation.

• Second, in program design, trade-offs between the short and the long run should be explicitly analyzed. This analysis would address sequencing issues, the efficiency costs of revenue measures, the need for front-loading of slowly maturing structural reforms, and the appropriateness of cash budgets.

• Third, in the area of fiscal policy, where the macroeconomic concerns of the Fund and the microeconomic concerns of the Bank currently
overlap, collaboration between the Bank and the Fund should be increased. Specifically, boundaries need to be more clearly delineated and, where overlaps are accepted, a more formalized requirement for joint analysis and decision should be negotiated so that country-level staff members are clear about their respective powers and duties.

• Finally, in already stabilized economies the Fund should shift from ex ante negotiation of short-term targets and policies to an ex post evaluation over a longer period. This would help reforming governments to build their reputations and would enable the Fund to play a useful role in potential ESAF countries that now reject the instrument. In postcrisis economies the Fund would focus on encouraging and managing increased external inflows, public and private. Except in the transition economies, ESAF funds would taper in with adjustment rather than taper out. Conversely, the Fund would be more circumspect in providing support in stabilization contexts where the commitment of the government is in serious doubt.

**External Viability**

ESAF as an instrument is unusual in that it is not used as budget support (except in the CFA franc zone). It thereby directly affects only private incomes and not social expenditures. Its impact on private incomes is through the exchange rate. Inadvertently, this has the effect of implicitly taxing exports. While this is an inevitable feature of all public transfers, it is usually offset by the beneficial effects of increased public service delivery. We recommend that ESAF funding be provided as budget support, as indeed already applies in the CFA franc zone.

Since an ESAF program mainly consists of the provision of a concessional loan, it should be analyzed from an intertemporal perspective. The current account of the balance of payments is the difference between savings and investment, as well as the difference between exports and imports. It can also be regarded as the difference between savings and investment, which is an intertemporal concept. As Yusuke Onitsuka demonstrated, a typical nation goes through a dynamic pattern that starts from a debtor position and then approaches a creditor stage in its process of economic development. In this dynamic path of growth, or in the optimal growth path, such indicators as the debt-service ratio and the debt-GDP ratio do not necessarily stay constant. According to modern macroeconomics, a current account surplus emerges for a nation that expects a decline in the future (permanent) income.

There are many indicators of the external viability of a nation. As the numerators, we take debt service (a flow variable) at one time, and debt outstanding, or the net present value, at another. For the denominator, we use exports and GDP. The combination of these creates the debt-service ratio, for example, which is equal to the debt service divided by exports. All the combinations are static in nature, except the concept of net present value, which is the discounted sum of all future obligations.

In this report, we propose the use of more dynamic concepts: the real external debt burden (REDB) developed by Obstfeld and Rogoff (1996), and the debt deepening index (DDI). REDB indicates the rate of the change in the debt-GDP ratio in the absence of the current account deficit (or surplus), and DDI indicates the rate of change in the debt-GDP ratio under the actual current account balance.

In particular, we consider that the ratios with respect to exports are overemphasized in the practices of the ESAF program and the HIPC (Heavily Indebted Poor Countries) Initiative. For example, the debt-service ratio (i.e., the ratio of debt service to exports) and the ratio of debt service to GDP could produce quite a different ranking in the viability of nations because of the difference in the degree of openness of nations. We suggest that at least equal weight be given to the indicators related to GDP, compared with those related to exports.

Our recommendations on the issue of external viability are as follows.

• One should rely more on ratios of debt service to GDP and debt to GDP as indicators of external viability of a nation since they are less affected arbitrarily by the degree of openness of a nation than are ratios of debt service to exports and debt to exports, because the latter ratios are overly sensitive to the openness of the economy.

• To supplement the static nature of the above ratios, one should also refer to the REDB and to the DDI. The net present value of debt is indeed a dynamic concept, but it should be matched not only with the current GDP, which is a static concept, but also with the net present value of the national income of a nation or the net present value of the savings-investment balance.

**Ownership and Governance Issues**

The one common theme that runs through perceptions of ESAF at the country level is a feeling of a loss of control over the policy content and the pace of implementation of reform programs. On the one hand, there is broad agreement that ownership is a necessary condition of successful policy reform and
program implementation. This much is acknowledged in official declarations of both donor and recipient governments, and by most multilateral institutions, including the IMF, the World Bank, and the regional development banks. Academic writers on the subject also find, predictably in our view, that regional development banks. Academic writers on the subject also find, predictably in our view, that high conditionality programs do not generally do well, and the recent review by the Fund’s Policy Development and Review Department implicitly confirms this view in its finding that a substantial proportion of program interruptions are attributable to policy disagreements between governments and the Fund staff.

Our review of country experiences also shows a correlation between the degree of ownership and successful program implementation. Vietnam, especially before the ESAF program, Uganda, Ghana, and to a lesser extent, Côte d’Ivoire and Bangladesh before the instability of the Ershad period, are good examples.

On the other hand, in spite of the apparent consensus on the importance of ownership, it has not been possible to move matters beyond mere theory. On the donor side, development cooperation ministries and offices point to the need to explain to taxpayers how their money is used abroad. This is a real enough political problem, although it must be noted that it is in practice often aggravated by public misconceptions about the size of aid in relation to national budgets, the role of aid in domestic economic crises, and the extent of true charity in aid flows. On the part of the multilateral institutions, there is the sheer weight and convenience of established practice and the commanding authority that comes with controlling the purse, to say nothing of the genuine difficulties that complicate attempts at giving operational meaning to the concept of ownership.

The challenge therefore is how to foster strong country ownership and at the same time provide adequate assurances to both multilateral and bilateral sources of financial assistance that their resources will not be wasted. The solution, in our view, lies not in reducing ownership to simply persuading the country to adopt what others want, but in finding a middle ground that enables the country to express its will and build consensus behind a program capable of achieving sustainable growth. This requires actions both at the country level to improve the decision-making and consensus-building processes, and by the Fund to make the negotiation process and conditionality regime more supportive of country ownership.

Accordingly, we make recommendations for country initiatives, as well as for modifications in the Fund’s operating procedures. Without prejudice to our general and country-specific analysis on ownership and to the suggestions we make by necessary implication, we propose the following specific recommendations.

**Initiatives at the Country Level**

The country itself should, first and foremost, take steps to define its medium- to long-term vision and the policy agenda that goes with it before it begins formal negotiations with the Fund, the Bank, and other agencies. For this purpose, the country should avail itself of all possible sources of technical assistance, including those of its nationals abroad and technical assistance from the Fund, which many countries acknowledge is particularly helpful in such circumstances. The country then should take steps to build a body of national consensus behind such a national program.

It is obviously for each country to decide how national consensus can be built most effectively, and no ironclad laws can be laid down in these circumstances. Moreover, the idea is not to make this yet another conditionality, as it is tending to become with particular regard to donor demands for civil society participation. However, based on the experiences of countries that have managed to create space for sustained policy reform through national dialogue, we recommend, for the consideration of the countries themselves, the creation of economic management teams made up of the economic and key sector ministries and political leaders to oversee the reform process so that it does not become the exclusive burden of the minister of finance, and the holding of national conferences where alternatives and trade-offs can be openly debated.

**Initiatives by the Fund**

Side by side with what we propose should be done by the country to develop ownership, we recommend that the following steps be taken by the Fund to enhance national ownership in negotiating agreements.

First, we recommend that, at the earliest opportunity and at a sufficiently high management level, the Fund engage in intensive and informal policy dialogue with the country’s political leadership to understand the country’s political constraints and possibilities and, in this way, be able to form the right political judgment for determining the mandate for formal negotiation with the country.

Second, we recommend that the timing and duration of IMF missions be so arranged as to allow adequate time for country preparation in advance of negotiation and consensus building during the negotiation process itself.

Third, and perhaps most important, we recommend that steps be taken to relieve widespread concerns about the Fund’s perceived inflexibility in negotiations through the introduction of an element of choice in the negotiation and conditionality regime. We accordingly recommend that some flexibility be built into the mandate for negotiations in the currently es-
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sentially ex ante negotiation and conditionality regime. One of the ways (but by no means the only one) this could be done is to formulate alternative program paths through the negotiation process, leaving it to the country to decide, with the advice of the staff, what best (or better) suits its particular circumstances. We recognize and discuss some of the operational problems and risks associated with such a flexible regime more fully in the text of our report. At the very minimum, each alternative program path would need to satisfy a minimum condition of viability, in order not to saddle the Fund with unacceptable risks of program failure and, more important, to guarantee the country sustainable growth.

Next, we recommend that the Fund develop a more systematic mechanism for providing ex post support for country-initiated, or home-grown, programs. We believe that this will enable the Fund to play an important role in countries that have balance of payments need but where agreement is thwarted or delayed even though the areas of convergence between the Fund and government are substantial; this may happen, for instance, where a government feels unable to accede to formal agreement with the Fund, mainly for political reasons. We believe that an essential element of such a mechanism of ex post support for homegrown programs would be the provision of technical assistance to the countries wishing to develop such programs, as this will improve program quality and, commensurately, the occasion for exiting by the Fund for reasons of program failure. While such a system will need to have entry and exit points to make it workable the point should be to strive to reduce the prospect of such programs breaking down and, therefore, to minimize the risk of exits, which can be disruptive and costly to the country in the end. The entry point could be triggered, for instance, by a major reform initiative by the government, such as a strong budget or a major adjustment to an overvalued exchange rate.

We also recommend that ways be found to both humanize and demystify the Fund’s image, so as to assuage the political hazard that countries perceive to be associated with dealing with the Fund. Here, we have in mind not so much the dramatic new initiative by the Bank to send staff members on familiarization missions to villages, but simpler ways in which Fund staff can have more systematic and interactive contact with a broad cross section of stakeholders in the countries. In our view, the policy framework process could provide a more convenient forum for these broad-based contacts than the Article IV consultative mechanism because of its forward-looking policy focus.

In the area of Fund/Bank cooperation, we note that against the background of increasing overlap in the work of the Fund and the Bank—with the Fund becoming more “structural” in focus, while the Bank becomes more “macro”—it is particularly important that Bank/Fund relations be better coordinated, because they have an obvious bearing on country ownership. Policy choice by the country is not helped when the Fund and the Bank (and donors) pull the country in different directions. We therefore recommend that urgent steps be taken to develop more effective and operational instruments of coordination through close consultation between the two institutions.

Finally, to reinforce these strategies aimed at fostering country ownership, we strongly recommend that resident missions be established in all ESAF countries. We recommend further that the missions be strengthened by a delegation of more authority to them, especially in matters that are dependent on knowledge of the concrete domestic situation, and also through the selection of high-flying, technically strong, and politically mature staff members to head them. We believe that a strengthened resident mission is a more effective way to address concerns about program interruptions than is intensified monitoring and frequent visits by headquarters-based staff.
After over a decade of ESAF and, before it, SAF programs in low-income countries in Africa, Asia, and Latin America, with uneven outcomes, it is understandable that there should be so much debate in development circles about such programs’ effectiveness as instruments for bringing about sustainable poverty-alleviating growth. In the light of this continuing debate, and as part of its own program of internal evaluation, the Fund has conducted two major reviews of experience under the ESAF. The first one, discussed by the Executive Board in March 1993, covered the performance of 19 countries through mid-1992. The second one, discussed by the Board in July 1997, covered countries that began ESAF-supported programs before December 31, 1994, numbering 36. But the debate on country performance under the ESAF has continued, with a particular focus on its effectiveness in bringing about poverty-alleviating growth. In the circumstances, the Executive Board decided that the second internal review done by PDR should be complemented by an external evaluation, also to be completed in 1997, using mainly a case study approach.

Our terms of reference requested us to conduct an evaluation based on this approach, and to present unified conclusions for the design and implementation of ESAF-supported programs and the ESAF instrument focusing on three key topics, namely:

- development in countries’ external positions during ESAF-supported programs;
- social policies and the composition of government spending during ESAF-supported programs; and
- the determinants and influence of differing degrees of national ownership of ESAF-supported programs.

Our terms of reference also required us to select a sampling of countries, numbering between four and seven, that was geographically diverse and included both strong and weak performers for each of the three topics, allowing for as much overlap as possible.

Accordingly, we agreed to evaluate Côte d’Ivoire, Malawi, Uganda, and Zimbabwe on all three questions, and to cover the external viability and ownership issues for Bangladesh and Vietnam, the ownership issues only for Bolivia, and the social issues only for Zambia. Our method of evaluation was based both on surveys in the field, in which we spoke to a very wide cross section of stakeholders in each country, and on a thorough reading of internal Fund documents as well as other available literature. Although the three topics we were asked to focus on are not exhaustive of all the concerns that have been expressed in the continuing debate, we believe that they are among the major ones.

In the area of external viability, savings performance has been disappointing in relation to rising, even if modest, growth and improved macroeconomic policies in ESAF countries. Current account deficits have therefore seen little reduction on average over the decade of ESAF-supported reforms, while the stock of debt of ESAF users has about doubled over the period 1985 to 1995.

The issue, therefore, is how these problems can be addressed, and what trail a search for solutions should follow. We note first that the current account of the balance of payments reflects a process of the intertemporal choices of a nation. The main component of the current account is a trade balance, which is essentially exports minus imports. Through national income identity, exports minus imports equals savings minus investment. The latter is a dynamic concept and can be interpreted as a result of intertemporal optimization, a factor that has been relatively neglected in the discussion of external viability.

As is already shown by Onitsuka (1974), the normal and optimal process of capital accumulation of a growing economy is not proportional to its growth. First, external borrowing increases, domestic capital accumulation follows, repayment of borrowing starts, and finally the country converges to a steady borrower or a steady lender state where the debt and GDP grow more or less proportionally. Whether the coun-

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1 Schadler and others, 1993. The conclusions of the Executive Board discussion of this evaluation are published in the IMF’s 1993 Annual Report, pp. 61–64.
try ends up with a borrower position or a lender position depends upon whether its people are more patient or less patient than the average people of the world.

From this perspective, we have to reexamine various concepts of external viability. The ratio of exceptional finance is a good measure because it shows the degree to which a country should rely on nonmarket forces. Any ratios to export, like the ratio of debt service to exports or the debt-export ratio, are under suspicion because they are too sensitive to the openness of the economy. The ratio of debt service to GDP has better characteristics, but it is a static concept because it does not take into account the growth capacity of a country. We propose the use of REDB prepared by Obstfeld and Rogoff (1996), and the DDI, which built on the REDB. REDB is the change in the debt-GDP ratio if the current account is balanced, or the equivalently current account surplus as a fraction of GDP that is needed to keep the debt-GDP ratio constant. DDI is the change in the debt-GDP ratio that develops from the asset dynamics, and the ongoing current account, or equivalently the current account that is short of the current account corresponding to REDB.

The net present value is a dynamic concept. If one matches it with static concepts like exports and imports, the comparison is between two different dimensions—stock and flow.

The social impact of ESAF programs has also been controversial. Critics of the programs have claimed that they have accentuated poverty, whereas supporters have claimed the opposite. There are two broad mechanisms by which the poor can be affected by adjustment programs: through changes in their incomes and through changes in social expenditures. The 1997 internal review (IMF, 1997) did not give priority to analyzing the social costs, leaving this explicitly as an area for the external review, although it did investigate the effect on social expenditures and found that they were, on average, protected.

Policy changes can reduce or increase incomes, either of society as a whole or of particular groups. The transition economies are the most extreme example of society as a whole bearing short-term costs for long-term benefits. Since there is no doubt about the need for radical change in these economies, the policy issue is the extent to which social safety nets can be put in place. In the more usual ESAF cases, the main social effects arise not because of temporary, society-wide losses but because of long-lasting redistributions resulting from relative price changes. Here, one controversial issue is whether the groups that lose consist of poor people, since the compensation of better-off losing groups need not be a priority. A second controversy has been whether ESAF programs have, as a result of either suboptimal sequencing or public expenditure reductions, imposed avoidable temporary contraction on the economy.

Policy changes can also reduce or increase the delivery of basic social services. The most controversial issue has been whether ESAF programs have unnecessarily squeezed social expenditures, either as a side effect of generalized reductions in public expenditures, or because of an adverse change in the composition of expenditures. This is the issue on which the adjustment literature has focused. However, there are other ways in which social provision can be affected through ESAF programs, notably through relative price changes. The provision of social services may change substantially during adjustment, not because of a change in budget allocations but as a result of induced changes in the cost of provision.

In the area of ownership, in spite of near unanimity among all concerned—governments in both recipient and donor countries, the international and regional financial institutions, the Development Assistance Committee of the OECD, and the overwhelming weight of public opinion in developed and developing countries alike, that reform programs should be “owned” by the reforming countries—the debate on the subject has continued unabated. On the one hand, the Development Assistance Committee and its members, and their supporting financial institutions, have continued to profess their good intentions while recipient countries have, for their part, continued to protest in frustration.

The problem has been to define the concept of ownership for operational purposes. While it is indeed possible, as a number of academic writers and practitioners have demonstrated,3 to define ownership with a reasonable degree of intellectual rigor, it has been difficult, for reasons of domestic political considerations and the deadweight of tradition and habit in development cooperation offices and in the Fund and Bank alike, to reconcile the declared intentions with practice.

Donors tend to see ownership as an acceptance by the recipient country of donor-driven priorities and programs, and the same sentiment often lurks behind affirmations of the need for country ownership by IMF and Bank staff. For the external agents then, it is as if the whole struggle is about getting the countries to “volunteer to adopt” donor-driven programs.4 Thus, a number of issues still need to be addressed in order to move the matter beyond the domain of political correctness to actualization. These include the following.

- What does ownership mean? What are its distinguishing determinants, and what are their

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3See, for instance, Helleiner (forthcoming) and Botchwey (1996).
relative weights and influences on program sustainability?

• How can ownership so defined be reconciled with a regime of conditionality that triggers access to resources, not only from the Fund and the Bank, but also from all other official development assistance sources?

• To the extent that a negotiated program is always a product of a largely lopsided compromise, especially for countries that have no alternative sources of financing, under what circumstances can it still be “owned,” if at all, by the country?

• Given the legitimate need to ration scarce resources in support of “correct” or “appropriate” policies that have a reasonably good chance of success, and in a situation where there are no arbiters nor appellate bodies, what sort of conditionality regime can both achieve efficiency in the use of external resources and address the concerns about national ownership?

In this review, we have attempted to test, through the case studies, a number of hypotheses, including a definition of ownership based on the “rooting” or “anchoring” of the reform program in country support, and determinants of such ownership that relate to program authorship or origination, the scope of societal support, the level of government commitment, the role of specific initiatives by government and by the Fund in promoting ownership, and the role of the Fund’s operating methods in fostering or inhibiting country ownership. We then make some recommendations for developing country ownership on the basis of common themes derived from the country experiences and lessons that they offer.
II  General Themes

Social Impact

ESAF as an Instrument

ESAF lending is a conditional transfer of resources. Both the conditions and the transfer are distinctive compared with other adjustment lending. The conditionality is far ranging and high level. It covers both medium-term policy changes across the economy, and short-term monetary and fiscal management. Its high power comes from cross-conditionality, with bilateral donor and other international funding institutions programs. Since this cross-conditionality is nonreciprocal, Fund conditions are thus at the top of the hierarchy of donor conditionality. The unique authority of the Fund derives from this hierarchy rather than from the amount of resources that the Fund transfers, which is typically relatively small in the context of overall transfers. The existence of a hierarchy reflects the donors’ need for coordination: some agent must take the lead role in judging country performance. The fact that the IMF occupies this role reflects the primacy of short-run macroeconomic policy, given the context of a long history of macroeconomic mismanagement in most low-income countries.

ESAF as a transfer mechanism is distinctive because, with an important exception, funds accrue to the central bank rather than to the government budget. ESAF does not generate any counterpart funds. The foreign exchange is used either to increase the level of reserves or to finance a higher level of imports. The part of ESAF funds that is used for reserves provides an income for the central bank since the interest rate earned on its deposits exceeds the interest rate charged by the IMF. Potentially, the government might capture this income, although the relationship between increased central bank surpluses and transfers to the government need not be a close one. This income transfer is, however, incidental to the purpose of ESAF funds used for reserve accumulation, since the rationale is the increased level of confidence that higher levels of reserves provide. Research by the Fund has established that investor risk ratings are strongly positively influenced by the level of reserves, and in turn the risk ratings appear to be important in determining investment flows (Haque, Nelson, and Mathieson, forthcoming).

That part of ESAF funds that is used to increase imports also indirectly benefits the budget. ESAF recipients have a high fiscal dependence upon import taxation, and the higher tariffs are, the larger is the proportion of ESAF funds that supports the budget. As with the support of the budget via increased central bank surpluses, this is an unintended effect. The major effect of ESAF import financing is, however, on relative prices. By augmenting central bank sales of foreign exchange, ESAF programs appreciate the exchange rate. This benefits net purchasers of foreign exchange, and adversely affects net sellers.

In this respect, ESAF is like Dutch disease. Since the export sector is a net seller of foreign exchange, the consequence is that ESAF operates like a tax on the export sector. While this may appear to be a general effect of all donor transfers, in fact all non-ESAF transfers potentially have an offsetting effect. ESAF is unique in that it does not accrue to the government budget (except through the two inadvertent channels identified above). Non-ESAF transfers, by augmenting public expenditure, are able to offset the negative Dutch disease effect on the export sector by pro-export public services. For example, donor support for a road program can reasonably be presumed to lower the transport costs faced by the export sector by more than it implicitly taxes the sector through an appreciation in the exchange rate.

The exception to the above is the operation of ESAF in the CFA franc zone. In the CFA franc zone, ESAF of course does not affect the exchange rate. However, the Fund does allow it to be used in its entirety as direct budget support since providing balance of payments support is unnecessary in the context of French support. Hence, in the franc zone ESAF is likely to benefit the export sector, whereas elsewhere it is likely to be detrimental.

The model that the Fund adopts in the franc zone appears to have advantages that could be extended to other ESAF recipients. It is an unfortunate side effect of present ESAF design that budget support accrues mainly to the extent that a government has
high trade taxes. It is also unfortunate that ESAF is the only transfer that operates as an unmitigated implicit tax on the export sector. Since there is evidently no issue of principle in whether ESAF accues to the budget, it might be desirable to unify the treatment of ESAF recipients by providing it as budget support in all instances.

Crisis Response: The Poverty Impact

To date, ESAF programs have generally commenced in the context of macroeconomic crisis, although the form of the crisis has usually been an unsustainable fiscal deficit or a severe decline in real incomes, rather than a run on the currency. As a result, the poverty impact of the policy package has not been foremost among the considerations of Fund staff. In recent years, there has been a noticeable increase in the attention paid to social impact in Fund documents. However, even in recent work, the discussion in effect relies upon government declarations about the efficacy of social programs. The IMF’s Executive Board may need to restate the purpose of ESAF arrangements to include the social concerns that it has articulated in the terms of reference for this study as an explicit requirement. IMF work on the social impact of programs could be both more analytic and more empirically based.5

In analyzing the social costs of adjustment, it is useful to distinguish between the two main routes by which living standards are affected by policy: changes in private incomes and in public social expenditures. A further distinction is between adjustments in which policy reform imposes substantial temporary costs in aggregate, and those in which losses for some groups arise predominantly because of redistributions to other groups.

Adjustment and Private Incomes

We first focus upon adjustment and private incomes. The case of temporary aggregate adjustment costs, where the entire economy initially contracts prior to sustainable growth, is exemplified by the transition economies of Eastern Europe and the countries of the former Soviet Union. Transition economies are characterised by two features that, in conjunction, produce this U-shaped response to reform. First, a large sector of the economy, typically industry, produces high-cost inputs that handicap the expansion of potentially viable sectors, and so must contract before such sectors can expand. Second, there is a lack of entrepreneurship, so that the pace of expansion of the newly viable sectors is slow. Thus, the aggregate economy contracts as the decline of the large, unviable sectors initially dominates the expansion of the newly viable sectors.

Some of the transition economies are also characterized by a lack of safety nets. Typically, there is no public system of welfare payments for the unemployed; there is no easy-entry job sector to which former workers of the declining sector could turn; and there is generally a less strong tradition of support through extended families than in Africa.

A few ESAF countries have all of these features of transition economies (although these were not included in our sample). Some other ESAF countries have one but not other features of transition economies. For example, Zimbabwe has a large industrial sector supplying capital goods and intermediates, much of which had to contract to make other activities viable on world markets. However, the social costs of this contraction were much lower than in the pure transition economies because there were already entrepreneurs able to take up new opportunities, and because there was a ready safety net through a large informal sector and a tradition of support through the extended family. In Zambia, there was less need for early contraction (since the industrial sector was largely producing final goods) but, owing to the long period of state ownership, there were few entrepreneurs to take advantage of new opportunities. In Malawi, previous repression of the urban informal sector limited the main safety net for displaced urban workers.

More commonly, ESAF countries do not share any of the characteristics of the transition economies. In this major group, the social costs of adjustment arise through redistributions within the society rather than through aggregate losses. For example, in Uganda and Ghana even the early stages of reform were growth enhancing so that, in aggregate, there were immediate social benefits. However, whereas aggregate losses from transition are temporary, losses arising from redistributions are likely to be long lasting, since the losses are usually due to relative price changes that are intrinsic to the policy changes.

Some of those who lose are likely to be poor. However, this is not equivalent to saying that the poor lose from adjustment. Usually, distributional changes arising from policy reform tend to favor the poor, but it is important to recognize that the poor are not a homogeneous socioeconomic group, so that among the poor there will often be identifiable losers. Because many of the losers from reform are not poor, the important question to ask is not “who loses from reform?” but rather, “who, among the poor, loses from reform?”

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5We focus here on the feasibility of ex ante analysis of the poverty impact of Fund programs. Whether such an extension of the work of the Fund staff is desirable is a question we will address later in this report.
In most ESAF countries, socioeconomic survey data were available at the start of the reforms so that this process of identification was feasible. However, in our sample, this analysis was typically not done. A notable exception is the recognition in Malawi that the rural poor were net purchasers of maize and hence would suffer from the increases in food prices envisaged under the program. More commonly, predictable negative effects for poor groups were missed. For example, again in Malawi, it could be established from survey work that households dependent upon wage income from agricultural estates were among the poor. Wages on the estates were set through a national-level government-regulated minimum wage. In the first two years of the ESAF program the nominal value of this minimum wage was not altered. As a result, owing to very high inflation, the real value halved. Two years into the program the nominal wage was raised, but this delay inflicted a severe decline in real income upon a group ill-prepared to cope with it. These temporary losses of the estate workers were a transfer to estate owners, and in no way a necessary cost of adjustment. Had available information been better used, it would have been easy to protect this substantial group by adjusting estate wages for inflation.

While improved analysis of adversely affected poor groups is both necessary and feasible, we will suggest below that this is not an appropriate task for the Fund.

**Adjustment and Social Expenditures**

Social expenditures can get squeezed during adjustment for four reasons. First, the entire economy might contract (the transition economies case), so that the protection of per capita expenditures would require a rising share of social expenditures in GDP. An example is Côte d’Ivoire prior to 1995. If aggregate income is falling, it is unlikely to be optimal for social expenditures to be maintained constant in absolute terms, but it may be desirable for them to fall less rapidly than aggregate income. Second, the adjustment might involve a decline in the share of public expenditure in GDP. An example is post-1991 Zambia. This is quite likely to be the case since adjustments often start from unsustainable fiscal deficits; however, it is far from universal. Attention has usually focused on whether deficits should be closed by higher taxation instead of reduced expenditure. In our sample, such a criticism would not usually have been reasonable. A more sustainable criticism would be that, through premature financial liberalization, governments have faced sharply increased interest expenditures, which have necessitated otherwise avoidable reductions in social expenditures: Zimbabwe and Zambia are examples. If GDP is not declining, there is a good case for maintaining social expenditures by increasing their share of public expenditure. Third, social expenditures might get squeezed because other public expenditures are given greater priority. An example is Uganda, where the government determined that infrastructure was likely to be more productive. Fourth, social expenditures might get squeezed because the cost of providing them rises relative to other prices. Examples of this are Uganda and Zambia.

Of these four, donors have paid most attention to the third: the share of social expenditures in the budget. However, in our sample the most important effects have come through the fourth: the change in the relative cost of providing social services. In Zimbabwe, Malawi, and Côte d’Ivoire, the relative cost of social services declined substantially, often converting declines in the real value of spending into increases in the volume of service delivery. In Zambia and Uganda, relative price changes worked in the opposite direction. Although the relative price effect was large in each of the countries in our sample, we have found no mention of it in Fund documents. Sometimes social expenditures are reported as a share of GDP, and sometimes they are reported in “real” terms when deflated by the GDP deflator; in each case an implicit assumption is that the deflator for social services is the same as for GDP. Generally, the large relative price effects arise from civil service wage policies and from exchange rate changes. For example, in Zimbabwe and Côte d’Ivoire civil service real wages have been sharply reduced, whereas in Uganda they have been increased. Since these changes in costs are part of the program, they should be integrated into the analysis of social provision. In some ESAF countries sectoral cost and price data are not available, but in the five countries in our sample data were not a constraint.

**Forecasting and Monitoring Social Costs**

While it would be feasible to reduce the social costs of adjustment by better attention to socioeconomic data, the IMF is not the appropriate institution for this expertise. The World Bank already undertakes considerable analysis of poverty. The Bank has a comparative advantage in this field given its microeconomic focus and its history of household data collection. However, at present this information is used predominantly for longer-term questions of poverty-alleviating development strategies. The appropriate way to harness this expertise into the better design of short-term stabilization programs is for the Fund to formally request the Bank to identify which groups among the poor are likely to lose from specific aspects of the program. As part of its response, the Bank should be asked to provide likely paths of
the incomes of the main poverty groups and of the monitarable outputs of social services. One advantage of this is that such forecasts would then get monitored. As a result there would be a better warning system when the poor are badly affected. We should make it clear that we do not intend that the income projections for poverty groups be criteria by which a program can be declared “off-track” in the same way as rapidly available financial targets are monitored. The delay in income data precludes such an approach. However, there is an important role for the review of program performance on poverty criteria. If program design has envisaged declining poverty whereas it is rapidly increasing, the presumption must be that either the program design was flawed or there have been unanticipated circumstances. In either event, it would be appropriate to reconsider program design. Poverty monitoring would thereby provide some mechanism for quality control of the program in an important dimension. It is possible that the present lack of formal Fund-Bank projections and monitoring of poverty outcomes increases the fear of policy change.

The Fund staff itself could monitor social expenditures more clearly than is currently done in staff reports. At present, the social expenditure data usually reported is the share of social expenditure in the budget. More important numbers are real per capita health and education expenditures. When these fall during an adjustment program it is useful for Fund staff to diagnose the cause, whether it is a decline in GDP, a decline in public expenditure relative to GDP, a decline in social expenditure relative to other public expenditure, or a rise in the relative cost of providing social services. The above is feasible based on data currently available to the Fund and with current Fund expertise. A much more ambitious step would be to attend also to the efficiency of public expenditure. While this is of obvious importance, the skills required make this more appropriate for the Bank and other agencies and we do not recommend Fund involvement.

Protecting the Poor

The poor are not, in general, disadvantaged by stabilization and adjustment, in that they do not usually systematically lose more than other groups. In transition economies, temporary hardship may be very widespread among social groups. In such circumstances food-for-work projects may provide a safety net into which the poorest self-select. In low-income countries the losing group is likely to be smaller but more particular. The best and most comprehensive academic study of the impact of policy reform on the poor in Africa, by David Sahn, concludes that reform will “generally have positive effects on growth and income distribution,” and that “concern for the welfare of the poor is a weak excuse for inaction and the perpetuation of failed policies” (Sahn, 1996, p. 22). Nevertheless, diverse subgroups of the poor may suffer temporary or long-term losses. We have already noted the example of estate workers in Malawi. In Zambia, those maize farmers who were remote from markets suffered by the ending of pan-territorial pricing and subsidized maize meal. In Côte d’Ivoire, workers in the informal sector of Abidjan faced large losses as devaluation squeezed the expenditures of higher income groups. In Uganda, demobilized disabled soldiers lost what were in effect welfare payments. In such cases, national food-for-work programs are less effective and case-specific solutions are required.

To date, safety net programs have tended to have three weaknesses. First, they have tended to be aimed at high-profile groups that lose, such as redundant civil servants, rather than those among the initially poor who lose. Second, their execution has tended to be slow, and more appropriately paced for the general problem of poverty alleviation than for the specific protection of those poor who lose from reform. Third, the budgets have tended to be small relative to the scale of the problem.

Sharing the Benefits

While the poor may not disproportionally suffer from stabilization and adjustment policies, large groups among the poor, such as subsistence farmers, may be slow to benefit from rising aggregate incomes. Thus, in Uganda, the benefits of income growth have to date largely missed the part of the rural population that derives its income predominantly from subsistence. In these circumstances, increased delivery of public services is a means by which the benefits of growth can swiftly be spread to a majority of the population. This may give rise to a short-run trade-off between growth maximization through spending on infrastructure and poverty alleviation through spending on social services. Faced with such a trade-off there is no obviously right answer, but governments should at least be appraised of the facts. There might at least be a presumption that in a growing economy the absolute per capita supply of basic social services would continuously increase. As discussed above, because of the large relative price changes that affect social service delivery, this is not automatically achieved by increased budgetary provision as a share of GDP. There may also be a conflict between the effective delivery of social services and the operation of the cash budget. Although there is no easy answer to these problems, the present lack of clarity in the presentation of data on social provision and its relationship to GDP
growth and budgetary decisions in effect biases decisions against prompt corrective action to maintain social provision on track.

**Trade-Offs Between the Short and the Long Run**

Fund programs describe both short- and long-term policies and objectives, but in practice tend to give priority to the former. Performance criteria are typically defined in terms of fiscal and monetary variables, measured at high frequencies. The programs we have described in the case studies invariably also included structural reforms and growth targets but these play a lesser role in the Fund’s high-level conditionality.

This is, of course, entirely appropriate when the prime objective is to stabilize the economy. However, with ESAF lending, the Fund became concerned with the issue of long-run growth. While stabilization is justifiably seen as a prerequisite for growth, this introduced trade-offs between short-run and long-run considerations. These trade-offs are not systematically analyzed in the programs. We consider five areas in which this lack of analysis can be problematic.

**Revenue Concerns**

First, the Fund often appears to encourage revenue raising measures without considering explicitly the cost and incidence of taxation. A possible consequence of this is the continuing heavy reliance of many ESAF countries (well documented in the internal review) on import taxation. Clearly, revenue considerations must be balanced here against the long-run welfare costs of delayed trade liberalization. In Côte d’Ivoire, the Fund argued in favor of the adoption of a high external (UEMOA) tariff, apparently without consideration of the long-run costs. In Uganda, there was also little reduction in the reliance on trade taxes. There was a shift from export to import taxation but we found no evidence in IMF documents that (by Lerner equivalence) import tariffs were seen as taxing exporters. The rural economy had retreated into subsistence in the prereform period, when exports were heavily taxed explicitly. The reversal of this retreat in the reform period was hindered by the implicit taxation of exports. In this sense, trade policy failed to benefit the rural poor.

Another consequence of the Fund’s revenue preoccupation arises in privatization programs. The Fund is primarily concerned with the effect of the selling of state enterprises on the budget and less with the efficiency implications of various alternative forms of privatization. This stance may encourage governments to adopt socially costly forms of privatization. An example is the privatization of the public telephone company in Côte d’Ivoire. Not only was the company sold as a monopoly, but prior to the privatization a regulatory framework was set up that ensured high profitability. While this obviously was fiscally advantageous (increasing the amount the government could raise from the sale), it imposed long-run costs on the economy. In this case the Fund abstained from taking a position on the microeconomics of the proposed form of the privatization, other than insisting on transparency in the bidding process.

In Fund documents we have found no analysis of the trade-off between short-run fiscal benefits and long-run social costs in such cases. As ESAF operations will increasingly involve the IMF in areas where such trade-offs are important, we recommend that they be explicitly analyzed, rather than being left implicitly to the Bank.

**Sequencing Problems**

Second, where ESAF programs involved both stabilization measures and structural reforms, sequencing issues have been given insufficient attention in our sample countries. A common problem has been that early financial and exchange rate liberalization has made stabilization unnecessarily difficult. Zimbabwe offers a striking example. The removal of financial repression when the budget deficit was still quite large led to a very large increase in the government interest bill (recall that this amounted to 5 percent of GDP). This made the planned, highly ambitious reduction in noninterest expenditure politically unsustainable and hence ultimately infeasible. The sequencing adopted in the Zimbabwe program was highly unfortunate. Not only did it contribute to the loss of fiscal control, making stabilization elusive, but it also led to a period of very high real interest rates, deterring investment. Errors in sequencing can therefore undermine both stabilization and (to the extent investment is reduced) structural reform. Clearly, this is not an argument for maintaining financial repression but rather for postponing financial liberalization until the budget has been brought under control.

Similarly, in Zambia domestic financial liberalization and liberalization of the foreign exchange market led to a large step-increase in the price level. The stabilization effort itself became inflationary and would have failed but for the introduction of the draconian measure of the cash budget. In Zambia the sequencing of the reforms in fact created an incentive for capital flight.

An important corollary is that such sequencing problems make it very difficult to protect desirable public expenditure. Recall that in Zambia the share
of public expenditure in GDP halved in a two-year period. In such a context, a careful consideration of the costs and benefits of public expenditure is clearly impossible. In Zimbabwe, sequencing problems contributed to avoidable reductions in per capita spending on health and education.

Errors of sequencing can also have grave implications for the poor. In Zambia, they led to a credit crunch in the private sector that delayed the emergence of rural food markets when the government withdrew from marketing.

**Postponement of Structural Reform**

Third, in some ESAF programs structural reforms have come too late rather than too early. Both in Zambia and Malawi growth required radical structural reforms in agriculture, with long lead times, as in the case of the rehabilitation of rural roads.

We have noted that Zambian farmers were effectively stuck in a “corner solution,” specializing in maize production. The withdrawal of the government from agricultural marketing operations should have been complemented with early reforms to improve rural transport, extension and storage. Similarly, reform in the export sector required the privatization of Zambia Consolidated Copper Mines (ZCCM) but as yet this has still not been achieved.

In Malawi, the first ESAF did not even involve substantial structural adjustment and while the program for the second ESAF did involve structural reforms, the transformation of the smallholder sector has begun only quite recently. In Uganda, after a decade of SAF programs there are still elementary infrastructure deficiencies, most notably in electricity and telecommunications.

Such problems require very early action on structural measures, to be initiated when the economy is still in the stabilization phase. The failure to front-load structural reforms with long gestation lags may well be the most serious defect of structural adjustment as currently designed. Without such early initiatives, there may be a long period of little growth, undermining the political support for the program.

**Cash Budgets**

Fourth, several countries (notably Zambia and Uganda, both in our sample) have been very successful in rapidly bringing down inflation by switching to a cash budget. However, a cash budget makes it impossible for the government to optimally allocate its expenditure intertemporally. Investment can easily be affected, even in cases where capital costs are fully borne by donors: when the cash budget prevents the government from making complementary recurrent expenditures, investments can be delayed. There is at present some concern among donors that the operation of a cash budget may have such adverse effects on the efficiency of expenditure that, in poststabilization economies, the instrument may have to be modified.6

Clearly, there is no simple answer to the question of when the costs imposed on the economy by intertemporal misallocation start to outweigh the benefits of the cash budget in terms of fiscal control and credibility. The Fund staff recognizes that cash budgets are only a short-term solution and we encourage further work on the question of the evolution of cash budgets to more sustainable systems of fiscal control. In this area, the Fund could in our view play an extremely important advisory role.

**Budget Deficits in Poststabilization Economies**

Fifth, probably the most damaging form of conflict between short- and long-run concerns arises in economies that have been successful in achieving stabilization. In such countries, such as Uganda in our sample, the traditional Fund concern with fiscal deficits needs modification. While the Fund is correct to emphasize that domestic deficit financing should always be avoided, the attempt to reduce current account and aid-exclusive fiscal deficits further (or indeed to run a surplus) has no bearing upon the control of inflation, while it is damaging for growth.

The original Executive Board statement of the purpose of ESAF was as follows: “to promote in a balanced manner, both balance of payments viability and growth, through mobilization of domestic and external resources . . . .” (December 15, 1987). A helpful approximation of this purpose is to think of it as two objectives with two instruments: “to promote balance of payments viability through the mobilization of domestic resources,” and “to promote growth through the mobilization of external resources.” Since the intention was to promote each of these “in a balanced manner,” we might think of the two objectives as on average being given equal weight.

In prestabilization environments, priority clearly must be given to external viability. Conversely, in poststabilization environments, where the budget deficit is covered by grants and the grant-equivalent of concessional lending, the priority for the Fund should shift to the “promotion of growth through the mobilization of external resources.” At present, the Fund gives the impression that it wishes to see aid tapered out over a quite short period in poststabilization environments. While, as the Fund notes, there must be contingency plans for a decline in the willingness of donors to provide aid (just as there must be contin-

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6We consider the role of the Fund in such economies in the next subsection.
This page discusses the role of the International Monetary Fund (IMF) in post-crisis management. It highlights the need for donors to provide aid in the medium term to ensure a conducive environment for growth. The Fund should, to be consistent with the statement of its Board, encourage both more public and more private capital to flow into those policy environments that seem to be satisfactory, and provide planning scenarios that show the growth path that such inflows would permit. 

The Role of the Fund in Postcrisis Management

The Fund’s traditional role is in crisis management. To date, this has also been the context in which ESAF programs have been introduced. However, in a few ESAF countries the Fund is now at a decision point since stabilization has been fully achieved and the major macroeconomic reforms have been implemented. Either the Fund maintains its exclusive focus on crisis management and its aftermath, and so withdraws from these countries, or it maintains its relationship with the countries and extends its remit. In our sample, the clearest case is Uganda, which has had a satisfactory inflation record for over five years, during which time it has adopted full convertibility of its currency. 

Second, if targets are set in terms of the current (rather than the total) budget, aid can be used not only for retiring government debt but also for public investment. However, even in this case the approach can be detrimental to growth since recurrent expenditure (e.g., on road maintenance or on teaching materials for schools) may well be growth enhancing. The implicit bias in favor of investment expenditure has become a matter of concern with several of the donors in ESAF countries.

Third, budget deficit targets are based on money demand estimates that treat GDP growth as exogenous. This is of course entirely appropriate for the short-run stabilization issues for which the Fund’s programming approach was developed. However, it is no longer appropriate in a context in which donors are willing to finance growth-enhancing expenditures (whether investment or recurrent expenditure).

There may be important interactions between the five types of trade-offs we have distinguished. Uganda is a case in point. As noted, Uganda is in the poststabilization phase and the public investment program needs to be expanded. Not only is the Fund’s concern to reduce the budget deficit excluding grants and IDA funds here counterproductive, it also encourages increased reliance on trade and petroleum taxes (the two main revenue sources) rather than on aid. These taxes have high costs in terms of growth, which can be avoided by aid financing.

Improving the analysis of the trade-offs between short-run and long-run effects is clearly essential for the success of ESAF programs. It is also important for improving the Fund’s signaling function. One of the IMF’s most valuable functions is the signal of credibility that it provides to private investors by approving a program. This signal becomes noisy as its recipients become aware that the design of approved programs may be faulty and that program interruptions are indeed common.

Investor Reassurance

The Fund’s role in investor reassurance is potentially important, but to date it has not been an unqualified success. A recent econometric study (Rodrik, 1995) found that the presence of a Fund ESAF program had no significant effect on private capital flows. This is presumably not helped by the fact that three-fourths of ESAF programs collapse or are interrupted. For the Fund to play a more positive role in raising the confidence of investors, its relations with governments need to be made more effective for signaling, and it needs to reconsider what would constitute success.
For the Fund to have a more favorable signaling role in a poststabilization economy, it may help for the change of role from that in the stabilization phase to be clearly identified by the Fund. One option that the Fund may consider is for already stabilized economies with a good record to be evaluated over a longer period, with more emphasis upon ex post assessment of performance and less on ex ante negotiation of promises and short-term monetary targets. That is, a government would graduate from a crisis management phase of ex ante negotiation, to a stabilization-with-growth phase of ex post evaluation. Such a change would enable a government to demonstrate its own choices more clearly, so that a good government could build reputation more rapidly. Such an innovation might also enable the Fund to become involved in low-income countries that have not had a macroeconomic crisis and where the government consequently does not see the present style of ESAF programs as appropriate (examples being Eritrea and India). Greater reliance upon ex post evaluation would not remove the need for continuous monitoring. As the Fund staff notes, “without such a provision, the Fund and other donors would risk squandering their resources on an unsustainable policy regime.” However, it would change the content of the monitoring. The major result on aid effectiveness identified by Burnside and Dollar (1997) is that it is the level of policy rather than its change that is important. Hence, the continuous monitoring role of the Fund in poststabilization environments would focus upon the maintenance of a few key features of macroeconomic policy, rather than upon the further improvement of other policies. In addition to this limited continuous monitoring, major reviews of performance would be conducted ex post every three years as with the present ESAF cycle. Specific arrangements would be needed for new governments. Newly elected governments lack both a track record and responsibility for past errors and so constitute an intermediate category. When they face a pre-stabilization situation, as in Zambia in 1991, the Fund’s approach would need to remain largely ex ante, while when they face a poststabilization situation, they could reasonably be presumed to inherit the performance rating of the previous government.

A successful IMF role in a poststabilization economy is one in which the growth rate is enhanced by increased investment. An environment of low and stable inflation is likely to be conducive to this objective but it should not be the limit of the Fund’s ambition. In particular, a successful ESAF economy will be integrating into world financial markets and attracting an increasing inflow of capital relative to GDP, which finances a rising private investment rate.

The recent evidence on aid effectiveness establishes that aid is only effective in raising growth in good policy environments (Burnside and Dollar, 1997). An implication (which we have already noted earlier) is that aid should, and perhaps will, become increasingly targeted on the successful ESAF economies. Hence, an ideal poststabilization ESAF country would go through a phase of rising external deficits, resulting from both private and public inflows, financing rising private and public investment. An important role of the Fund in this environment is to set these rising inflows in the context of a medium-term macroeconomic framework. Clearly, large external deficits can be either highly undesirable or highly desirable, depending upon the policy context, the growth rate, and the initial level and terms of indebtedness. By making this distinction, the Fund has an important role in reassuring both donors and private investors that, in some contexts, large deficits are appropriate. This requires a very different view of external deficits from the Fund’s customary work as a stabilizer, when deficits are necessarily undesirable because they are a sign of unsustainable levels of consumption. A somewhat analogous argument applies to the fiscal deficit. In the context of a successful ESAF economy with a satisfactory policy environment, the more grant aid that can be attracted and used, the better. It is dysfunctional to attempt to taper such aid out of the budget. The fiscal balance should be calculated to be inclusive not only of pure grants, such as European Union money, but also of the grant element in other aid. For example, around 70 percent of IDA money should be classified as grant aid, whereas it is presently treated by the Fund as if it were fully commercial borrowing. As a result, at present the Fund seriously exaggerates the size of the fiscal deficit. Since private investors generally do little research on ESAF countries, they are in no position to correct the impression conveyed by this misinformation, and so this bias can be presumed to be discouraging private investment, the opposite of the effect that the Fund should be setting as its objective in these economies.

Partly as a result of the success of ESAF, there are now several low-income African economies that have recently achieved a satisfactory policy environment. These countries (Uganda in our sample) are currently growing rapidly. However, their investment rates remain low: current high growth is the temporary pay-off to policy reform. This conjunction of high growth and low investment is not sustainable: either investment must rise or growth will decelerate. The increase in investment cannot be financed predominantly from domestic savings because incomes are so low: both enhanced private and public capital inflows will be needed until incomes have risen.

Private investment is currently deterred because these environments are rated as highly risky. The
risk ratings for the newly reformed economies are improving, but from a very low base, and it will take another decade before the ratings reach the level of the current newly industrializing countries, at which major investment inflows become likely. Recent Fund research has shown that the commercial risk ratings, although largely explicable in terms of fundamentals, are biased against Africa: African risk ratings are worse than is justified by the fundamentals. Further, recent World Bank research has shown that in the reformed policy environments, aid acts as a catalyst for private investment: each dollar of aid induces almost two dollars of investment. Hence, investment inflows can be increased both by increased aid inflows and by a reduction in the perceived risks. In both of these, the Fund has a key role.

The Fund can reduce perceived risks by signaling that a country has reached the phase in which the macroeconomic policy environment is satisfactory for private investment. In this phase, the key role of the Fund is the surveillance of policy maintenance through the monitoring of a few key variables, rather than the negotiation of further promises of policy change. As we discuss further in the Determinants of Ownership section below, the credibility of a policy environment is enhanced if it is manifest that the government has willingly chosen the policy regime. This is what we mean by “ex post evaluation.” However, surveillance in itself may not be sufficient to achieve credible certification. To be fully credible, the Fund should put its own resources at stake and so have a program. However, it is essential that such a program be clearly distinguished from those that are designed to cope with crisis recovery. Countries would be seen to graduate out of a crisis period into a second phase of rising investment, before they graduated completely out of Fund programs. The graduation into this second phase would constitute a powerful signal to the investment community. It would also constitute a signal to the donor community. As discussed earlier, there is now compelling evidence that aid is effective in, and only in, satisfactory macroeconomic policy environments. The Fund has a key role in certifying that such an environment has been attained. Clearly, maintained Fund financing in these environments adds credibility to the message that donor funds should appropriately increase. The Fund itself is not a development finance institution and should not become one. Rather, its new role for this group of graduated, but investment-scarce countries is temporary, in the initial phase of a reformed environment. The recent wave of reforms and temporary high growth in Africa has thus created a window of opportunity. The Fund is instrumental in whether this opportunity is seized.

**Fund Expertise**

Fund expertise has customarily had a dual role in ESAF countries: as the primary source of advice on macroeconomic policy, and as the highest level of conditionality on the entire process of policy reform. There is an obvious potential tension between these two roles, which becomes much more acute as reform proceeds from the core macroeconomic policies of exchange rate liberalization and the reduction of the inflation tax to the myriad of microeconomic choices facing governments. The Fund has specialized expertise in the core macroeconomic choices and correspondingly lacks expertise (as the staff recognizes) in the microeconomic sphere. At present, in poststabilization environments, the Fund is tending to broaden its agenda, maintaining the same negotiating style of short-term targeting as in crisis management, while changing the content of the negotiations from exchange rate policy to the details of sectoral policy. With the growing concern over the social impact of reform, the most natural evolution of this style would be for the inclusion of social sector policies in IMF conditionality.

A corollary of this extension of the sphere of policy over which the Fund might become concerned is that the Fund and the Bank would be performing essentially the same role, and the rationale for their continued distinct existence would not be obvious. In a few ESAF economies this is now the situation. In principle, there is close Fund-Bank cooperation and liaison in policy advice. In practice, the situation on the ground is highly variable, but the norm is for liaison to be seriously deficient. The building of genuine detailed liaison would require major institutional change, which we do not regard as realistic except in a small number of areas (most notably fiscal policy and trade policy) where Fund-Bank overlap is unavoidable. However, were the Fund to go in this direction, what would be required is not expressions of goodwill, but rather formalized procedures for cross-institutional teamwork and decision rules.

The alternative is for the Fund to remain focused on macroeconomic policy, leaving microeconomic and sectoral policies to the Bank. This would imply that in a poststabilization environment the Fund would have a diminishing role, refocused upon managing increased external inflows in an orderly fashion. The high-level conditionality role would fade out in such economies as Fund assessment became ex post. (See Collier and others, 1997.) We find this latter model for the Fund in poststabilization situations more appropriate than attempting to convert it into a full-fledged development bank or to integrate its day-to-day work much more closely with that of the Bank.

That is, we propose that the Fund focus more upon its core business of macroeconomics. This
would still leave an important area of overlap with the Bank with respect to fiscal policy. Revenue and expenditure decisions have both microeconomic and macroeconomic consequences and their reconciliation is one of the most difficult policy decisions facing governments. It is unfortunate that this decision trade-off straddles the institutional divide between the Fund and the Bank. Here, it is a very high priority that the two institutions cooperate much more effectively in advising on the trade-off. For collaboration to be effective, given the history of previous failure, requires not exhortation but institutional change, centered on the power of decision.

**Aid Effectiveness**

The new evidence on aid effectiveness shows that to date aid transfers have been ineffective both in promoting growth, except in good policy environments, and in inducing policy reform (see Burnside and Dollar, 1997). ESAF is a form of concessional lending and, like other donors, the Fund needs to draw lessons from these very disturbing results. Two lessons are particularly important.

First, the attempt to induce policy reform by offering incentives has not, on average, been successful. The econometric evidence suggests that, on average, where reforms have taken place they were not induced by aid but reflected the intentions of the government. The appearance of tough negotiations (“macho bargaining”) and enforced government policy change, while often true at the minute-by-minute level of the negotiating table, is largely a facade in the longer context of policy change. There is a danger that a culture of toughness prevails over a culture of analysis.

Second, the transfer of resources in poor policy environments is a waste, whereas in good policy environments it is productive. This implies that in the early stabilization phase the most important Fund product is expertise, not financing. The Fund should be more circumspect in advancing money to governments that are not committed to programs. Without such commitment, the Fund and other donors risk squandering their resources on unsustainable policy regimes. Announcements such as “It’s the IMF’s program, we had to go along with it” (Statement by Information Minister of Zimbabwe made on December 17, 1996, as quoted in newspaper) are prima facie evidence of overconfidence in past lending. Conversely, in the poststabilization phase, the most important product is finance rather than advice. Except in the transition economies, where there are genuinely large aggregate costs of adjustment, ESAF funds should taper in as reform proceeds, rather than taper out. Like other donors, the Fund needs to unbundle its advisory and financing roles, fitting the product to the problem. Doing so would not only make ESAF funds more effective, but would also improve signaling to private investors. The tapering in of ESAF funds would come to be regarded as the signal that stabilization had been completed and that a pro-growth policy environment had been achieved.

**The Determinants of Ownership**

**Country Perceptions**

We will now discuss what the country studies tell us about ownership, make recommendations on what can be done to strengthen country ownership, and finally explore the implications of these recommendations.

A number of themes stand out clearly in the country perceptions. They relate first to the Fund’s image, second to the Fund’s operating style and methods, and third, to the impact of Fund programs. Since the third is dealt with elsewhere in our report, we confine ourselves here to the first and second themes.

**The Fund’s Image**

To a very large extent, attitudes to the Fund differ according to which constituency one speaks to. For instance, businessmen in Malawi and Uganda who had lost protection and civil servants who had lost privilege tended to be anti-Fund, while smallholders whose cash incomes had improved in the wake of reforms tended to be pro-Fund, while often true at the minute-by-minute level of the negotiating table, is largely a facade in the longer context of policy change. There is a danger that a culture of toughness prevails over a culture of analysis.

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cussion. What is interesting, though, is that the Fund continues to be berated for its secrecy although Fund missions have, as the country studies show, for some time now been dealing with a broader cross section of government officials and departments. When asked to explain this apparent paradox, many interviewees argued that meetings with people outside the core ministries and allied agencies were seldom truly consultative since only the mission leader spoke—and even he usually did no more than seek viewpoints—while other mission members simply took notes.

We also heard criticism that the range of Fund contacts was still unduly restrictive. Even in ministries of finance and central banks, many complained that only a few assigned officials participated in discussions with the Fund. Although this was no doubt a government decision, it was interesting to note that many saw the Fund as partly responsible for their exclusion.

In some countries, program implementation has been slowed down by legislative processes because legislators felt excluded from government-Fund contacts, even though in some cases, Fund missions had made efforts to dialogue with them. In many of these cases, we found that the problem was the discontinuity in the membership of these bodies.

A number of ministers and senior officials we spoke to also felt that the effectiveness of Fund missions depended much too much on the personality of the mission leader, and how experienced and confident he felt about the support of various departments at headquarters. Many felt that the mission leader’s flexibility in negotiations depended too much on these factors, and that the negotiation process would be greatly facilitated if some institutional safeguards were found for reducing the role of these factors.

Almost without exception, technical personnel in ministries and political leaders in the various countries who deal regularly with the Fund complained about what they saw as the Fund’s inflexible attitude in its dealings with government. They complained that the Fund often came to negotiations with fixed positions so that agreement was usually only possible through compromises in which the country negotiating teams moved to the Fund’s positions.

Even in countries that had a reasonably good record of performance under ESAF arrangements, many interviewees felt that the Fund too often simply imposed its will, was generally insensitive to genuine constraints on policymaking and the pace of implementation, and was too quick to dismiss policy options favored by government.

As regards the policy framework paper (PFP) process, the predominant view—and many ministers and senior officials echoed it with some disappointment—is that although initially the PFP process had held great promise as an instrument of a genuine three-way dialogue between the government, the Fund, and the Bank, it has become a rather routine process whereby the Fund brings uniform drafts (with spaces to be filled in) from Washington, in which even matters of language and form are cast in colorless stone. Many senior officials expressed the view that the PFP has become so uniform that it is difficult to distinguish one from the other. Many interviewees, especially those outside ministries of finance and in the larger government machinery, who before had largely been excluded from the economic policymaking apparatus, found this atrophying of the PFP process particularly regrettable.

The general yearning therefore was for the realization of a potential that never was—a truly country-specific PFP, agreed to on the basis of a government-led consultation process. When asked what choice the staff had if they found government ill-prepared for or simply unable to produce a coherent draft, the recurrent response was that the staff simply had a bias against government drafts, although some officials acknowledged that Fund technical assistance could be helpful in such circumstances.

In contrast with the generally negative perceptions about Fund-supported reform programs, we found widespread approbation of IMF technical assistance programs, even among senior officials in economic ministries who were critical of Fund negotiating strategies and programs. There is a general view that Fund technical assistance is usually unobtrusive and much more effective than bilateral programs. Many found the secondment of Fund staff of national origin a particularly helpful form of technical assistance, both for the preparation for negotiations with the Fund and for the development of home grown programs. Because of its effectiveness and general acceptability, Fund technical assistance, in our view, has a particular significance in the development of national ownership.

Ownership, the Negotiation Process, and Conditionality

There is one common theme that runs through all the foregoing country perceptions. At the root of all the concerns they reflect is a feeling of a loss of control over the setting of the policy agenda in reform programs, as well as the pace of implementation of these policies. They therefore go to the very heart of the ownership problem.

All the available evidence suggests that conditionality-intensive programs seldom succeed in achieving their objectives. Moreover, all the parties in the development debate agree that ownership is the key to successful program implementation. This is true for the Development Assistance Committee (DAC) of the OECD. It is true of the Bank, the Fund, and all major
regional financial institutions. Members of the DAC meeting in May 1995 at the level of development co-operation ministers and heads of aid agencies, for instance, endorsed a number of strategic orientations that included a recognition that “developing countries themselves are ultimately responsible for their own development . . . For development to succeed, the people of the countries concerned must be the owners of their policies and programs” (OECD, 1996, Annex). In the same way, the final report of the DAC ad hoc working group on participatory development and good governance agreed on key conditions that included a recognition that “in development cooperation, legitimate ownership by the country partner is a primary objective” (OECD, 1997, p. 7).

In the Fund itself, there is a strong and genuine quest for stronger ownership of country programs. The Fund’s guidelines on the PFP state that to ensure ownership of the PFP, “the authorities should be encouraged to initiate the drafting of the PFP or to provide input on selected issues,” and also that the PFP preparation should involve “a close collaboration with the authorities, the Bank, Fund staff, key donors, and other relevant institutions.”

The World Bank, for its part, also states “typically, assistance programs that the recipient countries perceive as being imposed end in failure or have only a small development impact; government and beneficiaries do not feel they have a stake when they have not contributed to the development of a program” (World Bank, 1995c, p. 6).

The second PDR review report notes that “about two-thirds of the interruptions [in ESAF programs] were strongly affected by serious slippages in past policies that either weakened the government’s credibility, or produced protracted disagreements between the staff and the government on remedial measures.” Our country visits also provided evidence of a strong correlation between the degree of ownership and successful program implementation. This is borne out by the experiences of Uganda and Bangladesh before the instability of the post-Ershad period set in, and Vietnam under its go-it-alone policy—that is, before the ESAF program began. In the same vein, Uganda and Zimbabwe provide contrasting examples. Uganda tried a state-directed closed economy and failed, and turned to an IMF-supported program after a thorough process of national debate: the program has had a reasonable measure of success and has been sustained over a long period. Zimbabwe, on the other hand, also started with a closed economy in the immediate wake of its independence, ran into some difficulty and started reforms on the basis of a policy framework that it developed with the help of outside consultants and Bank advice, and then entered into the Fund-supported program. The first phase of the re-

form benefited from a substantial degree of ownership but the ESAF program ran into difficulties, partly because of weaker ownership and a less-than-spectacular program outcome.

So, what can be done to foster strong country ownership and leadership of the reform process and, at the same time, provide assurances to multilateral and bilateral sources of external funding that their assistance will not be wasted?

At present, there is an inherent tension between national ownership and the need to provide these assurances to external agencies of support; it is not reconcilable, but it is there. A forthcoming article by Professor Helleiner, based on a study of Tanzania’s relationship with donors, illustrates this tension rather dramatically. It reports that when asked how they understood ownership, a number of donor representatives reportedly said they saw ownership as the acceptance by the recipient country of what donors want. Some of the more forthright responses included: “Ownership exists when they do what we want them to do but they do it voluntarily”; “We want them to take ownership. Of course they must do what we want. If not, they should get their money elsewhere”; and, “We have to pressure the local government to take ownership”!

Clearly, therefore, the political problems that be-devil attempts at giving the idea of ownership an operational meaning are very real indeed. The solution, though, lies not in reducing ownership to simply getting the country to “volunteer” to do what others want, but in finding a real middle ground that balances the competing concerns through a review of the country’s own decision-making and consensus-building processes, on the one hand, and the IMF’s negotiation process and its conditionality regime on the other.

External Viability

An ESAF program influences the macroeconomic savings-investment process of a recipient country and affects its current account path because the current account balance is nothing but the savings-investment balance. Private agents are generally supposed to smooth the consumption paths, given macroeconomic policies by the government. Accordingly, the result of the agents’ intertemporal choices is the recipient country’s external current account path.

More precisely, a nation’s savings-investment path is the result of its aggregate savings and investment, that is, of the decisions of the economic agents in the private as well as the public sector. Private agents are supposed to optimize7 their objec-

7 “Optimize” may be too strong a word; as A.H. Simon argued, “satisfice” may be more proper.
atives under the intertemporal budget constraints. Economic agents optimize under certain technological production constraints, given terms of trade (if a country is not too large), given intertemporal terms of trade (conditions for external borrowing), and given bureaucratic as well as political constraints. 8

Those constraints on economic behavior are certainly affected by a concessional loan like the ESAF loan. Moreover, foreign donors are influenced by the existence of an ESAF loan in determining the conditions for extending loans. (Modern information economics offers a partial explanation of this kind of mechanism by appealing to the abbreviation of information asymmetry.) On the other hand, the government budget will be additionally constrained owing to the conditionalities of the ESAF program. Technological production constraints may be different because of technological progress that could be facilitated by the ESAF loan. The X-efficiency, that is, the inefficiency below the technological frontier, may be eased by the ESAF program.

The above points can be illustrated by the Irving Fisher Diagram (Figure 1). Consider the world consisting of two periods—present and future. 9 The present consumption and production are depicted by the horizontal axis; the future consumption and production are depicted by the vertical axis. Let TS be the production frontier of the recipient country. Given the real rate of interest \( r \), \( P_0 \) and \( C_0 \) indicate respectively the combination of consumption and production in the first period and in the second period before the ESAF program depicted by the vertical axis.

When the ESAF program provides the possibility that the recipient country receives a concessional loan with an interest rate lower than the market rate \( r \), then the production possibility locus of the recipient country expands like \( P_1 \). \( EL_1 \). \( P \) indicates the production combination in the present and in the future and \( C \) indicates the combination of present and future consumption after the ESAF. 10

\( L_0 \) and \( L_1 \) designate the limits of non-ESAF credit. Before ESAF, the amount of credit is restricted to \( P_0L_0 \). After ESAF it changes to \( EL_1 \). If the country is credit rationed, it utilizes the available credit limit so that \( C_0 \) coincides with \( L_0 \). Also, the ESAF encourages other private lenders to lend more to the country, and \( P_0L_0 \) will be lengthened to \( C_0 \). If the economy is still credit rationed, \( EL_1 \) will coincide with \( L_1 \).

In this framework, one can ask the following questions:

- Does a nation’s consumption path satisfy the non-Ponzi game conditions? Does \( P_0L_0 \) or \( P_1L_1 \) indicate the consumption possibility in this two-period case? In other words, does the consumption path satisfy the intertemporal budget constraints? If this condition is violated, a nation takes a path that accrues an infinite amount of debt in the future. This condition rules out the national consumption behavior of continuing to borrow to consume and to repay the previous debt. Nonstationary behavior of the borrowing is one of the symptoms. In our sample countries, we did not find a likely case for the violation of the non-Ponzi condition.

- What is the time horizon of nations in the sample? Because of the limitation of data, so far one example is studied, namely, the case of Bangladesh. In Bangladesh, the result of a time series analysis did not respect the hypothesis.
that the people’s time perspective in terms of the rate of time preference was invariant with respect to before and after the initiation of the ESAF program. The results in the Appendix, however, do not support the hypothesis that after the ESAF program the time horizon or the rate of time preference was positively affected.

1 For the econometric analysis of current account dynamics, see, for example, Ghosh (1995).

external viability or vulnerability of a nation? This question is always faced by national governments and international organizations, and has also been posed specifically to us. To measure the viability of a nation, one conventionally uses a variety of indicators such as debt-service ratios (i.e., the ratio of debt service to the exports of a nation); the ratio of debt service to GDP; the ratio of the outstanding stock of foreign debt to exports; the ratio of the outstanding stock of foreign debt to GDP; the ratio of net present value of foreign debt to exports; the ratio of the net present value of foreign debt to GDP; and the proportion of exceptional financing in the total debt.

Our main task is to find the proper indicators of external viability. Indicators that grasp the dynamic optimization process are hard to find, and in practice we have to rely on those indicators that can be evaluated by observable data present at the time of decision. In discussing the meaning of various indicators and their effectiveness for assessing viability, we would emphasize the distinctions between static and dynamic indicators, and the distinctions between export-related indicators and GDP-related indicators. Our point is that when using the export-related measure, one assumes that all the export proceeds can be used for repayment by halting imports altogether. This is an extremely strong assumption.

Though it may go against conventional wisdom, we argue that those ratios mentioned above, with respect to exports, have such a strong bias that the viability is exaggerated in an open economy with a high propensity to export. Also, we would like to argue that almost all the indicators are static and should be supplemented, if not replaced, by more dynamic concepts. Though we recognize the difficulty of providing a universal measure of external viability, we propose two measures that take account of the dynamic or growth aspects of the economy: the REDB and the DDI.

The external position of a country can be regarded as vulnerable when it does not appear to satisfy intertemporal constraints, that is, the non-Ponzi constraint. The ratio of indebtedness to GDP and the ratio of debt service to GDP are reasonable measures of vulnerability. The ratios of debt and debt service to exports, which are more frequently used, are hard to justify on theoretical grounds. Compare two countries that have the same debt service to GDP ratios, but with different export-GDP ratios. The debt-export performance would be judged to be favorable for the country with a large export-GDP ratio.
ever, the country with a higher export-GDP ratio is not necessarily healthy. At the very least, indicators relative to GDP should be taken as seriously as indicators relative to exports.

According to modern macroeconomic theory, the normal and often desirable pattern of indebtedness is as follows for modern expositions. We call a development path “normal” when the path is to be realized by the competitive interest rate mechanism, and call it “desirable” when the path is the result of optimizing national agent. They coincide with each other when the international capital market is competitive and there is no externality. First, when a low-income country with scarce capital opens up its economy, the country incurs substantial international debt. The ratio of indebtedness to income may grow at first during a transition stage. In the meantime, the country begins capital accumulation. After a while it starts to gradually repay its debt. If the rate of time preference of the country is higher than the average rate of time preference of the world, then the country will remain as a debtor, but the ratio of debt to national income will become more or less constant. If the rate of time preference of the country is lower than the average rate of time preference of the world, the country will eventually repay its external debt and then become a creditor country in the world.

In other words, a nation less patient than the average nation will become a debtor nation in the long run; a nation more patient than the average nation will become a creditor nation. According to a stochastic version of the above theory, a nation that expects growing permanent income becomes a borrowing nation and a nation that expects declining permanent income becomes a lending nation. This process is characterized by the relationship of the amount of external debt (or credit) to national income and by no means by the relationship of the amount of external debt (or credit) to exports.

In our opinion, the ratio of debt service to exports has less importance than conventionally considered. The debt-service ratio with respect to the income variable, that is, the ratio of debt service to GDP, has more meaning since it indicates the magnitude of debt burden relative to the scale of national economic activities. It does not need to be constant through time, however, because according to the above theory this ratio is supposed to increase when a country opens its door to the international capital market and then decrease during the process of developing a balanced growth path.

The ratio of debt service to exports can be misleading under certain circumstances. Suppose there are two countries, country A and country B, of identical size. The magnitude of debt service is also identical for the two economies, say at 10 percent of GNP. Suppose the propensity to export of country A is 40 percent, and that of country B is 20 percent. (Also, assume that the propensity to import of A is 30 percent and that of B is 10 percent.) The ratio of debt service to exports in A is 25 percent, but that in B is 50 percent. Can you say country A is much more externally viable than country B? According to the above analysis, the two countries are similarly vulnerable. The proponents of the ratio of debt service to exports seem to assume that, in an emergency, a nation can suspend total imports and use the total exports to repay the debt. However, in a very open country like A, it is highly likely that exports need a certain amount of imports, so that imports cannot be suspended overnight. A strong emphasis on the ratio of debt service to exports rather than to GDP should be reexamined to restore a balance between a very open economy and a relatively closed economy.

In fact, the choice of denominator between exports and GDP can make a drastic difference. As will be seen, the order of eligibility for a HIPC country will change from Uganda to Côte d’Ivoire depending on whether one uses exports or GDP.

The IMF relies on the government revenue-based and export-based indices. The former depends on the

13 One might argue that, theoretically, the most useful concept to match indebtedness is the capacity to pay, that is, the potential savings-investment balance (S–I). S–I is likely to be related to GDP rather than to exports. At least, there is no theoretical ground that S–I is related to exports more than to GDP. Models that exclusively consider export sectors important imply a similar result. That is, the degree of indebtedness is more directly related to the rate of time preference rather than to the openness of the economy. See Baxter (1992), and Svensson and Razin (1983).

15 Milesi-Ferretti and Razin (1996) suggest that the debt-service ratio is the primary index to be complemented by other measures. We would rather recommend the use of the ratio of debt service to GDP in general, possibly to be adjusted by other measures relative to export. Milesi-Ferretti and Razin argue that empirically export is related to capacity to repay from historical experiences. We instead cast doubt on the logical connection from exports to the capacity to repay. IMF publications indicate that specialists recognize the existence and analytical implication of those indexes. We also seldom observe, however, cases where the GDP-related indexes are viewed to be as important as export-related indexes like the debt-service ratio in actual assessments of debt situations in recipient countries. We also seldom observe cases in which the static factors are supplemented by the dynamic factors, that is, the factor due to asset dynamics and the factor due to the balance of payments current account.

14 A strong emphasis
assumption that government can stop spending on government expenditures, and the latter, on the assumption that imports can be stopped to pay the debt in an emergency. Such assumptions seem to reflect the ideas that the IMF can easily manage the government and that the government’s policy will steer the economy to a sufficient degree.

In a broader perspective, we must note that both debt-service ratios are static concepts. Take the better one, the debt service to GDP concept, for example. Suppose two countries share the same debt-service ratio, say 5 percent, but country A is growing at 7 percent and country B is growing at 2 percent. If neither country repays its interest obligation or retires or incurs any debt, the ratio of debt service to GDP of country B will be increasing at the rate of 3 percent, but that of country A will be decreasing by 2 percent. For both countries the debt in the numerator of the debt-service ratio will be growing at 5 percent, while GDP in the denominator will be growing at 7 percent in country A and 3 percent in B. Thus, if the rate of interest on external debt is smaller than the rate of economic growth, the ratio of debt service to GDP will be declining. It is, accordingly, crucial for the viability of the international debt position to know whether or not the economy is growing.16

Obstfeld and Rogoff propose on these grounds a new measure called the real external debt burden (REDB). This is expressed as

\[
(r - g)D/Y,
\]

where \( D \) is the outstanding foreign debt of the economy, \( Y \) is the GDP, \( r \) is the real interest rate paid on the debt, and \( g \) is the real growth rate of the economy. This measure shows the trade balance (surplus to a positive value) as a fraction of GDP necessary to maintain a constant debt-GDP ratio. The higher this ratio is, the higher is the likelihood that the debt is unsustainable.

We would like to propose another indicator, to be called the debt deepening index (DDI), which is defined as

\[
(r - g)D/Y - T/Y,
\]

where \( T \) is the current account balance excluding the debt service payment. This measure—DDI—is the percentage of GDP that the economy has to improve in the current account of balance of payments from the present value in order to keep the constant debt-GDP ratio. It is easy to see (subscript \( t \) signifies time) that

\[
\frac{d}{dt} = rD_t - T_t, \frac{d}{dt} Y_t = gY_t,
\]

so that

\[
\frac{d}{dt} \left( \frac{D_t}{Y_t} \right) = (r - g) \frac{D_t}{Y_t} - \frac{T_t}{Y_t}.
\]

As shown in this equation, REDB (the first term in the right-hand side of the equation) indicates the asset dynamics, namely, which of \( D \) and \( Y \) is growing faster, and the second term in the right-hand side indicates the contribution of current account deficit to the \( D/Y \) ratio. In other words, the above equation indicates the interaction of asset dynamics and the influence of flow variables to the debt income ratio. DDI in the left-hand side of the equation encompasses both the asset effect (REDB) and the flow effect.17

Finally, the net present value (NPV) is certainly a dynamic concept that takes account of the future payment stream of debt. Unfortunately, it is usually compared to the static flow concept such as export and income. (The inappropriateness of exports as the denominator is as in the case of debt-service ratio.)

The comparison of the NPV of national debt and present national income is a comparison of concepts of different dimensions—stock and flow. Suppose two countries, A and B, have identical NPVs of foreign debt and identical current GDPs, but A is growing at 3 percent and B at 7 percent. The future resources for B to repay the debt in the future must be much higher for country A. The problem remains as to how one can be sure of the course of future economic growth. (Similar problems exist in estimating the rate of interest to discount the future payment stream to calculate the NPV.) In any case, one must be aware that calculating the NPV of the national debt is only a half step to the dynamic treatment of the debt problem. Given the above theoretical discussions, let us examine the performance of external balances of the countries we study. The movements of indexes and the comparison of indexes tell us about various aspects of these economies.

We preface our analysis with some general observations. A number of views and propositions that are widely held in popular and even professional circles are often highly debatable. They include the following.

Reduction in the budget deficit will improve the current account of the balance of payments by the same amount.

Fund research shows that there is a negative relationship between public savings and private savings.

---

16One may say the long-term forecasts in the PFP are the long-term components of the ESAF, but we cannot help but feel that filling the forecasts becomes more like a ritual the longer the time horizon is. Forecasting is being done in an economy where the present statistics are not so accurate. There is no penalty for making a wrong forecast.

17In fact, DDI is a simplified form of the viability index proposed by Cohen. See Cohen, 1996 and 1985.
in many of the countries that have arrangements under the stand-by and extended arrangements. On average, private savings fell 1 percent, while public savings increased 1.7 percent. This means that a 1 percent decrease in the budget deficit is partially offset by about a 0.6 percent decrease in private savings. The regression coefficient of the private savings on the public savings is about 0.7 and roughly coincides with the latter figure (Savastano, 1995).

Naturally, full neo-Ricardian equivalence implies a 100 percent negative offset. Therefore, the private sector responds to the decline of government deficits by taking partial account of future liabilities, and not a full account of them. This means that undue emphasis on the budget deficit may be misleading for the economy as a whole.

The more “private” lending, or the more foreign direct investment, the greater will be the probability of insolvency of the borrowing country.

Since the IMF is one of the country’s creditors, this is also true. From the standpoint of the borrowing country, however, it is dubious. New concessional loans and grants may disappear if the benevolence of donors disappears. On the other hand, the private flow of funds such as FDIs and commercial loans may indicate that other economic agents consider it profitable to lend to that country or to invest in its future. The existence of private capital inflows implies the normal function of the price mechanism. It may also imply that the borrowing country is situated near the optimal path of development in the world market.

Country-Specific Analysis

In this section, movements of indicators developed above will be illustrated by country experiences. The calculation of indicators is made using Fund statistics. We took the proxy for real debt—the U.S. dollar value of debt. In accordance with this, we took the U.S. dollar values of GNP as real GNP. Also, note that the debt-service ratio is calculated here as the percentage of annual exports, rather than monthly.

Bangladesh

Compared with the preadjustment period (1973/74–85/86), the Bangladesh economy recovered its macroeconomic stability during the post-ESAF period (86/87–94/95: SAF 86/87, ESAF 89/90–92/93), as shown in Table 1.

During the post-ESAF period, there was no sign of any acceleration in real GDP growth. The growth rates remained arrested at about 4 percent, on average lower than those that prevailed in the 1970s and early 1980s.

Meanwhile, Bangladesh has accomplished a slight improvement in its investment-GDP ratio. It also reduced its level of inflation to about 6 percent, its government deficit-GDP ratio to 6.7 percent, and its current account deficit-GDP ratio to –1.1 percent. In the fiscal area, Bangladesh increased tax collection by the introduction of the VAT and by the improvement of the efficiency of tax collection.

Moreover, the export-GDP ratio increased. This export surge was mainly sustained by nontraditional exports such as ready-made garments, leather, leather products, fish, and shrimp. The share of nontraditional exports (gross values) has risen from 31 percent in 1989 to 87 percent in 1995, while the share of traditional exports, that is, jute-based exports, has declined and stands at 13 percent in 1995.

Thus, ESAF successfully brought to Bangladesh price stability, which is an important benefit. It is not clear, however, whether or not ESAF brought growth to the economy. ESAF merely sustained growth. Bangladesh may, thus, be said to be a typical

<table>
<thead>
<tr>
<th>Table 1. Bangladesh: Comparison of Pre-Adjustment and Mid- and Post-Adjustment by Macro Key Indicators</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Pre-Adjustment</strong></td>
</tr>
<tr>
<td>Sample</td>
</tr>
<tr>
<td>Real GDP growth rate</td>
</tr>
<tr>
<td>Current account/GDP</td>
</tr>
<tr>
<td>Investment/GDP</td>
</tr>
<tr>
<td>Exports/GDP</td>
</tr>
<tr>
<td>Inflation (CPI)</td>
</tr>
<tr>
<td>Government deficit/GDP</td>
</tr>
</tbody>
</table>

Note: All the above figures are calculated based upon the data from the IMF’s International Financial Statistics.
case of an ESAF program that emphasized civilization but no growth.

In Bangladesh, people are concerned with the need for regional coordination of trade policies, which between India and Bangladesh are often emphasized. According to public view, trade liberalization without considering the relationship with neighboring countries would create current account problems. Since Bangladesh strove toward liberalization without India’s move toward liberalization, the trade imbalance vis-à-vis India has increased. While exports from Bangladesh to India tended to decline, imports from India tended to increase. Most of the trade deficits were financed by the continuous growth in overseas remittances, but the external debt stock has been growing gradually (Table 2).

As Figure 2 shows, the debt-service ratio increased on average, but other indicators show a declining tendency. The ratio of debt service to GDP is almost constant throughout time after the adoption of ESAF. The debt-GDP ratio is increasing slightly. However, the dynamic indicators are different. The REDB is gradually improving, and the DDI has decreased since 1990 except for the last

### Table 2. Bangladesh: Key Indicators from Balance of Payments

<table>
<thead>
<tr>
<th>Years</th>
<th>Trade Balance</th>
<th>Remittance</th>
<th>Current Account</th>
<th>External Debt (millions of dollars)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1989–90</td>
<td>–74,329</td>
<td>26,312</td>
<td>–26,798</td>
<td>12,757</td>
</tr>
<tr>
<td>1992–93</td>
<td>–69,325</td>
<td>36,985</td>
<td>1,499</td>
<td>14,619</td>
</tr>
<tr>
<td>1994–95</td>
<td>–97,428</td>
<td>48,140</td>
<td>–5,974</td>
<td>16,370</td>
</tr>
</tbody>
</table>

Sources: Bangladesh Bank; Bangladesh Bureau of Statistics; and World Bank, Global Development Finance (World Debt Table).

Notes: Trade balance includes freight, insurance, and net amount of other goods and services. For up to 1991–92, the amount of remittance is substituted by “Transfer by Bangladesh nationals.” External debt is defined as the sum of public and publicly guaranteed long-term debt, the use of IMF credit, and short-term debt.

### Figure 2. Bangladesh: Several Indicators for External Debt

Pre-ESAF Post-ESAF

[Graph showing various indicators for external debt]
observation. In sum, both the debt-service ratio and DDI indicate the improvement in external balance. Though static indicators do not show significant changes, dynamic indicators reflect the improvement in growth.

Côte d'Ivoire

Côte d’Ivoire’s external sector performance has been characterized by a period of high growth under improving terms of trade in the mid-1980s, a stagnant period of price stability under the fixed exchange rate mechanism of the CFA franc zone until 1994, and a period of rebounding growth after the critical devaluation in 1994.

During the first period, economic activities were greatly influenced by a generally optimistic outlook on the economy, which in turn laid the foundation for the accumulation of later debt. In the second period, the Côte d’Ivoire economy was constrained by the CFA franc zone mechanism. Indeed, the price level was stable; consumer prices decreased substantially during 1993, but GDP growth was extremely stagnant. After the devaluation, the economy rebounded. Recent data on growth are sparse, but the rebound seems to be continuing.

Côte d’Ivoire’s balance of payments is distinguished by the fact that, unlike many developing African economies, the trade balance was in surplus throughout the 1980s. It is the burden of servicing the large outstanding debt that turns the current account into deficit (or, in 1994, barely balanced).

Now, let us apply the concepts of various indicators that we have introduced above. The paths of the ratio of debt service to exports, the ratio of debt service to GDP, the debt-GDP ratio, REDB, and DDI, in a way, measure the health of a country’s external position.

As shown in Figure 3, Côte d’Ivoire is noted for its high value of international debt. All of the three ratios—debt-service, debt service to GDP, and debt-GDP—are high. The debt-service ratio is decreasing because of the openness of the economy. On the other hand, the debt-GDP ratio is growing reflecting the slow GDP growth until the devaluation.

In contrast, two measures, REDB and DDI, that are related to the change in the debt-GDP ratio fell substantially in 1993, but grew rapidly in 1994 and 1995. This implies that if we count both debt dynamics and current account, the debt-generating mechanism is still working substantially in Côte d’Ivoire. These figures confirm that Côte d’Ivoire is a country heavily in debt. Because Côte d’Ivoire is a very open economy, the value of the debt-service–exports ratio and the ratio of outstanding debt to exports underestimate the difficulty of the debt problem. From the movement of these indicators before and after the ESAF program, whose initiation year is depicted by the solid vertical line, the external viability of Côte d’Ivoire does not seem to be favorably affected by the ESAF program.
Only the debt-service ratio shows some promising change.

Under the fixed exchange rate mechanism of the CFA system, a country can hardly conduct an independent monetary policy. After 1994 when the devaluation took place, Côte d’Ivoire was able to initiate a de facto inflationary policy, and the economy started to grow. Because of our use of the U.S. dollar term for calculating a proxy for the real dollar value of GDP, the improvement of the dynamic indicators, REDB and DDI, are exaggerated in 1993. This example casts some doubt on the view, sometimes shared by the Fund, that price stability is always good. In certain circumstances, as in Côte d’Ivoire in the early 1990s, an inflationary policy is useful. By allowing or encouraging the devaluation, the IMF in fact supported such a reflationary policy.

**Malawi**

We begin by reviewing Malawi’s external viability indicators. The trade account was in a small surplus until 1992, but it turned to a deficit after that, and the current account was in deficit. The debt-service burden was reduced from 60 percent of exports in 1986 to 22.5 percent in 1995. The debt-service situation seems to be improving. In 1995, the outstanding debt was $2,148 million and the NPV was $1,135 million, representing 509.1 percent and 289.2 percent of exports, respectively.

All the indicators of external viability showed steady movements (see Figure 4) until 1993. In 1993, the economic growth rate fell so REDB and DDI increased sharply. In spite of the improvement in the level of debt service, the relative magnitude of Malawi’s debt to GDP grew fast, owing to Malawi’s slow GDP growth and the current account deficit. In general, Malawi’s external position appears to have been managed rather well.

However, there is a contrast between the declining debt-service ratio and other rising indicators. Among the dynamic indicators, the most comprehensive—DDI—shows a sharp rise. This casts doubt as to whether or not the ESAF helped the external viability of Malawi. It also offers another explanation as to why relying solely on the debt-service ratio could be misleading. If the Fund overemphasizes the static indicator such as the debt-service ratio or the ratio of debt service to GDP, the dynamics of debt in a growth process will be neglected.

**Uganda**

Uganda has emerged from a difficult and protracted period of internal conflict. The economy has been stabilized since 1989, thanks to the adoption of a cash budget. The economy started real growth after a trough in 1986 and was able to sustain its pace. The level of real GDP per capita is now approaching the level of its prewar peak.
Uganda’s economy is quite self-sufficient. Export-GDP ratios are less than 10 percent. Also, Uganda is growing relatively quickly compared with other African countries. These characteristics imply two things. First, not only export-related indicators but also GDP-related indicators should be considered. All the export-related measures, such as the debt-service ratio and the debt-exports ratio, are relatively high, while the GDP measures, such as the ratio of debt service to GDP and the debt-GDP ratio, indicate a rather healthy situation. The use of export-related measures presents Uganda as a country more vulnerable than it actually is.¹⁸

From the viability indicators (Appendix Table A1), it is hard to tell if the ESAF functioned well after 1988. Debt-service ratios increased until 1991 but they have been decreasing since then. The dynamic indicators REDB and DDI have been falling sharply—that is, improving—since 1992 and 1990 respectively (see Figure 5). Thus, the ESAF does not necessarily improve the viability situation at first. However, after 1993, the economy has been on the right track. This shows the burden of debt was already winding down even before Uganda was selected as the number one HIPC Initiative country.

Since the Ugandan economy is relatively closed because of the relatively self-sufficient production structure, the export-GDP ratio is smaller in Uganda than in many other African countries considered here. The debt-service ratio is large and, accordingly, Uganda is treated relatively favorably in its designation as a HIPC although its indebtedness is subsiding.

Vietnam

Since the announcement of the Doi Moi policy in December 1986, Vietnam has been trying to transform a centrally planned economy into a market-oriented economy. Although the conceptual meaning of Doi Moi used in the Congress’s decision at that time has little to do with the abandonment of socialism in favor of capitalism, the new policy has had drastic effects on the economic system (see Tables 3 and 4). The principal driving forces in capital accumulation and in resource allocation have shifted from the government-prepared, command-style economic planning to something midway on the road to the free interplay of market forces. This change has been reinforced by the obligation to meet the conditionalities for financial support set out by the World Bank and the IMF.

In Vietnam, we see steady growth in the export-GDP ratio (see Table 5: from 30.5 percent to 35.2 percent) and worsening of trade balance deficits as a result of extraordinary import growth (see Table 6: from 30.4 percent to 44.4 percent). The export surge

¹⁸Of course, we do recognize the merit of self-centered development. Development of domestic markets that sustain growth are something to be encouraged, if possible; in a fast-growing country such as Uganda, reference to dynamic indicators that reflect growth is essential.
Country-Specific Analysis

was almost entirely sustained by primary goods such as crude oil, rice, fish and shrimp. The sharp increase in import was accelerated significantly by trade liberalization, such as the reduction in tariffs and elimination of import shipment licenses. Another factor that strengthened this import growth was the increase in FDI. FDI stimulated the import of intermediate goods and capital goods, and the import of consumer goods increased as well. So long as flows of FDI are driven by market forces, the financing of the current account by FDI hardly presents any problems.\(^{19}\)

The current account deficit also grew (see Table 5: from 4.3 percent to 8.5 percent), paralleling the expansion of trade balance deficit. Most parts of the current account deficit have been financed by FDI and official development assistance. To reduce this imbalance, the Vietnamese government has attempted to impose restrictions on imports by limiting the issuance of letters of credit.

Another feature related to the external sector is the enormous outstanding external debt (see Figure 6), although the proper statistical treatment of ruble-denominated debt leaves room for discussions. The ratio of debt to GDP improved (see Table 5: from 296.8 percent to 148.1 percent). It remains to be seen whether this improvement is good enough.

Zimbabwe

Historically, Zimbabwe was a country that accumulated wealth and a sound infrastructure. It has not had its external debt rescheduled. However, two recent droughts (in 1992 and 1995) made steering the economy difficult, and the above-mentioned intrinsic dilemma of fiscal incompatibility created difficulties in the balance of payments as well.

Statistics are not well prepared in Zimbabwe and IMF’s International Financial Statistics has many blanks for Zimbabwe. The macroeconomic picture is not very encouraging. Real growth is severely disrupted by droughts, though the tentative 1996 figures seem promising. Inflation has been running at more than 20 percent in most recent years.

The current account balance was affected negatively in the drought years, but that is accounted for by the consumption-smoothing motives. Outsiders, including the IMF, should show understanding when adverse shocks hit a country, although, of course, it is true that fiscal rigidities can exacerbate the difficulty created by such external conditions.

Most of Zimbabwe’s external viability indicators were worsening when the ESAF program was adopted. (See Figure 7.) Subsequently, some indicators showed improvement, but their levels in 1995 were not very encouraging. The lack of growth in the present causes a problem in REDB and DDI. The lack of the future prospect for growth gives a pessimistic picture for the future. Incidentally, since smoothing consumption is a natural concern, the Fund could be relatively tolerant about the development in the balance of payments current account due to droughts.

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\(^{19}\)Another question remains as to whether the composition of FDI is desirable or not. We hear the concern, for example, that FDI in automobile factories is excessive.
In short, the basic difficulty in presenting a viability measure is that our observations are limited to the past and present, while we would like to compare the present value of future liabilities with the present value of capacity to pay in the future. Indicators such as the ratio of debt service to REDB or DDI are measures of (instantaneous) flow variables. They consider rate of growth, but only the instantaneous rate of growth. NPV of debt considers the future courses of debt payments, but one has difficulty matching it with the present value of potentially capable payments. Finally, Figures 8–13 illustrate the effect of indicators for six countries and present examples of how those indicators offer different views of the debt problem.

In the pre-ESAF period, most indicators roughly move together. In terms of debt-service ratios, Vietnam and Malawi are ranked as the two best (lowest), and Uganda is ranked as the worst (highest) in the mid-post-ESAF period. In terms of the ratio of debt service to GDP, on the other hand, Bangladesh and Vietnam are the two best-off countries and Zimbabwe and Côte d’Ivoire are the two worst off. According to the debt-GDP ratio, Bangladesh and Zimbabwe are the two lowest and Côte d’Ivoire is the highest.

In terms of REDB, which captures the debt dynamics in growth, Vietnam and Côte d’Ivoire are the best, and Malawi, Zimbabwe, and Bangladesh are the worst. This reflects the stagnant nature of the Malawian economy. Finally, according to the most comprehensive index here (DDI), Côte d’Ivoire and Vietnam are the best (lowest), and Malawi is the worst (highest). This comparison shows that judging from a single index such as the debt-service ratio can be quite misleading.
Figure 6. Vietnam: Several Indicators for External Debt

Figure 7. Zimbabwe: Several Indicators for External Debt
Figure 8. Debt-Service Ratio Versus Ratio of Debt Service to GDP

Figure 9. Debt-Service Ratio Versus Real External Debt Burden (Pre-ESAF)
Figure 10. Debt-Service Ratio Versus Debt Deepening Index
(Pre-ESAF)

Figure 11. Debt-Service Ratio Versus Ratio of Debt Service to GDP
(Mid- and Post-ESAF)
Figure 12. Debt-Service Ratio Versus Real External Debt Burden
(Mid- and Post-ESAF)

Figure 13. Debt-Service Ratio Versus Debt Deepening Index
(Mid- and Post-ESAF)
Without prejudice to the generality of the foregoing analysis, and to various suggestions that we make by necessary implication, we propose the following specific recommendations.

Social Impact

First, in our view, the Fund should not invest in building up expertise in poverty analysis. Rather, we recommend that at the stage of program design the Fund formally ask the Bank to identify ex ante which groups among the poor are likely to lose from the proposed reforms. The Bank would then provide the Fund with projected time paths of the real incomes of the main groups of the poor as well as with projected outputs of social services. The output projections for social services would take into account the relative price changes that we have identified as so substantial that they can radically change the conclusion from social indicators. The projected time paths would be incorporated into program documents, along with the traditional fiscal and monetary monitoring variables. Whether a program would need revision would be decided partly on the basis of a comparison of outcomes with these projections. Clearly, the time lag for income data is much longer than for financial targets. However, its use in assessing whether the outcome of a program was consistent with the initial projections would be salutary since major deviations would require explanation.

Second, in program design, trade-offs between the short and the long run should be explicitly analyzed. This analysis would address sequencing issues, the efficiency costs of revenue measures, the need for front-loading of slowly-maturing structural reforms, and the appropriateness of cash budgets.

Third, in the area of fiscal policy, where the macroeconomic concerns of the Fund and the microeconomic concerns of the Bank currently overlap, collaboration between the Bank and the Fund should be increased. Specifically, boundaries need to be more clearly delineated, and where overlaps are accepted, a more formalized requirement for joint analysis and decision should be negotiated so that country-level staff are clear about their respective powers and duties.

Finally, in already stabilized economies, the Fund should shift from ex ante negotiation of short-term targets and policies to an ex post evaluation over a longer period. This would help reforming governments in building reputations and would enable the Fund to play a useful role in potential ESAF countries that now reject the instrument. In postcrisis economies, the Fund would focus on encouraging and managing increased external inflows, public and private. Except in the transition economies, ESAF funds would taper in with adjustment rather than taper out. Conversely, the Fund would be more circumspect in providing support in stabilization contexts where the commitment of the government is in serious doubt.

External Viability

First, we recommend that the operation of ESAF as an inadvertent tax on exports be mitigated by allowing ESAF funds to accrue as budget support, as already happens in the case of franc-zone ESAF countries.

Second, as indicators of external viability of a nation, one should rely more on debt-service–GDP and debt-GDP ratios since these ratios are less affected arbitrarily by the degree of openness of a nation than ratios of debt service to exports. To supplement the static nature of the above ratios, one should also refer to the REDB as well as to the DDI. NPV of debt is indeed a dynamic concept, but it should be matched not only with the current GDP, which is a static concept, but also with the net present value of the national income of a nation or the net present value of the savings-investment balance.

As discussed above, debt service to exports ratios and debt-exports ratios are less reliable indicators than the ratio of debt service GDP and the debt-exports ratio, because the latter ratios to exports are overly sensitive to the openness of the economy.
Ownership and Governance Issues

Responsibilities of the Country

The Fund often gets cast in the role of the villain when, in fact, the problem lies with the country itself. Corrupt and autocratic regimes, some of them propped up by vested interests abroad, are often the first to plead ownership and then bemoan the lack of it when they feel the pressure of donors and the multilateral system to rectify things. The role of the multilateral system (and also of bilateral donors) in such situations is to reinforce the leverage of national democratic forces by requiring a restoration of the integrity of the system of public resource mobilization and expenditure and its oversight institutions (Auditors’ and Accountant-Generals’ Offices) as a minimum condition of assistance. The Fund’s policy in this regard is, in our view, entirely appropriate. The real solutions must begin at the country level. Here, the government’s space for maneuver will obviously depend on the credibility it enjoys in the eyes of the governed, especially organized constituencies, and this credibility in turn depends, among other things, on the openness and accountability of political and fiscal institutions.

Defining a Vision and Setting the Agenda

National ownership requires, first and foremost, that the country itself define its medium- to long-term vision along with a supporting policy agenda and that it mobilize a sufficient body of national consensus behind it before it begins negotiations with the Fund and other external agencies. Where the capacity does not exist in the country or with its nationals abroad to elaborate a national program, it is for the country to “acquire” it by whatever means are available—free-standing technical assistance, hired consultancies, etc. Our discussions in the various countries show that Fund technical assistance provided independently or collaboratively with the UNDP and/or bilaterals can be particularly useful in these situations.

The Fund’s technical assistance program in Vietnam is an outstanding example that needs to be studied and replicated in this regard. A number of country experiences (Ghana, Côte d’Ivoire) also suggest the secondment of Fund-based staff of national origin—nationals of the country working at the Fund—can be similarly useful for this and other purposes.

Broadening and Sustaining the National Consensus

At the country level, there are a number of ways in which government can deepen ownership and build consensus. One of these is the formation of economic management teams with a technocratic and political composition. The experience of a number of countries suggests that the formation of such economic management teams drawn from the technical and economic ministries, along with political leaders, especially the prime minister or head of government, and some senior members of cabinet, can be an effective way of building consensus and managing programs. Such management teams will usually take charge of the overall policy reform package and the coordination of the roles of different ministries and government agencies and departments in the implementation of the program. This is particularly important since, in practice, it is difficult for the ministry of finance by itself to achieve this coordination and monitoring of the different roles of these other ministries and agencies. The one caveat, however, is that these management teams can be counterproductive and may, in fact, deepen the rivalry between the minister of finance and his colleagues unless proper liaison is established between the management team and the cabinet as a whole. The tendency is for cabinet members to feel resentful if policymaking suddenly shifts to a management team that includes just a few of their number, and if major policy decisions are taken by this group without reference to them. It is important, therefore, that there be regular communication between the economic management team and the full cabinet through regular briefings to the cabinet by the minister of finance or, preferably, by the prime minister or whoever chairs the management team. In some countries, these management teams are headed by the president himself, and this is often even more effective in getting all ministers to cooperate in the reform effort.

Moreover, in the consensus-building process, it is important that opposing views within government are allowed to be expressed freely and openly, and where they appear to be predominant, they should not be browbeaten into silence. On the contrary, such predominant opposing views and positions should be discussed fully and, if need be, put to the test even if at the cost of further economic deterioration, as this is often the only way to create space for change. In Ghana and Uganda, for instance, alternative policies to Fund-supported programs were tried before these reform programs began. For purposes of wider national consensus building, national conferences have also proved, in many countries, to be an effective way of building consensus, especially where they have a high degree of inclusivity and openness. The role of political leadership, at the level of the presidency itself, is often decisive in these matters.

Initiatives by the Fund

Side by side with what we recommend must be done at the country level, we also recommend that steps be taken by the Fund to make the negotiation
and conditionality regime more ownership-friendly, so to speak.

**Prenegotiation Contacts**

We recommend that, before formal negotiations with the country begin, the Fund, at a sufficiently senior management level and with the active participation of the country’s Executive Director, engage in intensive and informal political dialogue with the country’s political leadership (and other key constituencies) in a bid to understand the country’s political constraints and possibilities. In appropriate circumstances, the Fund may consider, for this purpose, the use of emissaries or third parties who may enjoy a special relationship of trust and friendship with the country’s political leadership. The idea is for management in this way to form the necessary political judgment that should then inform both the choice of the mission leader and the formulation of the mission’s mandate. We are aware that the Fund does some of this already. Visits by Fund management to the countries are everywhere appreciated. Our proposal is to make these informal contacts a systematic and regular feature of Fund-country relations.

**Timing of Missions**

The timing and duration of country missions came up frequently in our interviews with government officials. Although both of these matters are always discussed and agreed upon with government representatives (usually ministers of finance), there are concerns that the timing and duration of missions do not always allow sufficient time for the government to fully consult and build consensus, especially during the negotiation process itself as compromises are made. This was a major complaint in Vietnam, for instance. In a slightly different variant of this problem, governments are sometimes ready to conclude negotiations but are unable to do so because missions are not mandated to reach agreement; indeed, some missions set out with the explicit anticipation that a program would be concluded by a follow-up mission.

A related aspect of the timing problem is that governments’ preparation for negotiations is often compromised by undue concentration of government staff time on collating statistical and other information required by missions in the framework of Article IV consultations.

Now, quite obviously, the timing and duration of staff missions cannot be made exclusively dependent on the country’s or government’s needs; they also depend on the Fund’s administrative and staff constraints. Our proposal is for a proper balance to be struck between these competing considerations, which allows the country time to prepare the ground adequately for the appropriate policy choices to be made. In particular, new governments, especially those made up of people with little or no experience in government, need even more time to consolidate power and build consensus. While a rush by the Fund to the support of a new government may be entirely warranted and necessary to provide early support and thus to strengthen the position of key reformers, it must be coordinated carefully with other donor missions so as not to put the consensus-building process under undue strain and leave the reformers too far ahead of the rest of the cabinet and government. Programs arranged in these circumstances often make swift progress but leave a trail of recrimination in their wake that may prove costly to the reformers themselves (Malawi), whereas those that are agreed in less hurried circumstances usually prevail (Uganda, Ghana).

**The Element of Choice**

The most common complaints from which we heard but few dissenting voices concerned the Fund’s perceived “inflexibility” in negotiation and its “insensitivity” to domestic political constraints. Many finance ministers and senior officials with long experience with Fund negotiations complained about what they perceived as “imposition” and the absence of choice in the way Fund programs are negotiated. Understandably, the complaints were loudest among, but by no means limited to, countries experiencing difficulties in negotiations with the Fund (Ethiopia, Bangladesh, and to some extent, Vietnam). In our view, this is the greatest source of tension in Fund-country relations, and the main reason why the Fund is often cast in such a villainous role.

To be sure, as we have already noted, the Fund is often a victim of circumstances of the country’s own creation. Many ESAF countries come to the Fund when they are in a deep macroeconomic crisis requiring dire measures to bring much needed stabilization. In such cases, the country’s objective situation itself imposes limits on policy options for corrective action.

But we believe that there is more than a grain of truth in these widespread complaints. We heard complaints about Fund “inflexibility,” even from Bank sources. The persistent concerns about the loss of national ownership come from the feeling that governments are left no choices in negotiations, that the staff come with fixed positions and preferences for instruments that are considered “safe” and “reliable,” and that alternatives are often dismissed much too summarily and without objective appraisal. For example, a petroleum tax was cited as a frequently invoked “safe” instrument.

We do not, of course, state these views here to say that they reflect every negotiating experience, nor do
we intend to suggest that the complaints are necessarily valid in each case. The point we wish to make is that they reflect a fairly widespread feeling that the negotiation process tends to be one-sided and produces agreement mostly through a convergence around Fund staff positions. Agreements that are concluded in these circumstances and the conditionalsities that regulate them can obviously not be said to be compatible with true ownership.

To put the matter in the right perspective, it is necessary to clarify the nature of the concern we are here addressing. There is nothing inherently contradictory between conditionality and ownership, and a negotiated program that is “owned” does not cease to be so merely because it is tied to conditionalsities. The complaints, rather, are about conditionalsities taying financial support to the implementation of a program that is not owned, one that a government in distress and with no alternative source of funding feels compelled to accept.

We accordingly recommend that some flexibility be built into the mandate for negotiations in the current essentially ex ante negotiation and conditionality regime. One of the ways, but by no means the only one, this could be done is to formulate alternative program paths through the negotiation process, leaving it to the country to decide, with the advice of the staff, what best (or better) suits its particular circumstances. What we have in mind is not a glorified lottery in which the country makes its choice, more or less in the blind, leaving the Fund to bear the risk of default, nor is this the product of sheer brilliant intuition. On the contrary, we believe that the element of choice will not only help relieve the perception of one-sidedness and inflexibility in the existing negotiation regime, but it may also help to achieve an agreement in many of the cases where negotiations break down over narrow areas of divergence. It may also help address the large element of interruptions that the internal review of the ESAF reported “were strongly affected by serious slippages in past policies that either weakened the government’s credibility, or produced protracted disagreements between the staff and the government on remedial measures.”

To provide this element of choice without jeopardizing basic discipline, alternative programs must each satisfy a minimum condition of viability—they must each be capable of bringing about sustainable growth.

We recognize that it cannot be a choice between a “strong” and “weak” program in the ordinary sense, for typically a “weak” program—one with a weaker-than-desired fiscal adjustment—will have a larger financing gap and therefore require more external, including Fund, resources. However, a country may in practice decide that it needs time to build consensus and strengthen support for reform, and would therefore prefer to undertake the needed fiscal adjustments in, say, the second or third year, instead of the first year, of an ESAF program. In such situations, what the Fund typically does in the existing regime is to backload its funding (along with other external funding) and in this way complicates the implementation of the program in the first year or perhaps even condemns it to failure. Our proposal would mean that in these circumstances the Fund would grant the country its choice and be willing to frontload its funding to enable the government to demonstrate success and thereby strengthen its credibility. Fund assistance could, in such situations, be made contingent on strong signals by the country in the form of some upfront major structural reform along with measures designed to prepare the ground for credible revenue and expenditure measures in the succeeding years.

Such a posture would enable the Fund to demonstrate its flexibility as well as its support for the reformers, and at the same time would enable the country to exercise some choice in determining the configuration of the program. The high-level political contacts that we recommend elsewhere should also enable the Fund to form a judgment as to the depth of the country’s commitment to sustained reform.

Second, we recommend that the Fund develop a more systematic mechanism for supporting homegrown programs ex post. The objective of such a mechanism would not be to condemn countries with a poor track record but, with new governments committed to reform (Ghana 1983, Uganda 1987, Malawi 1994), to wait till they have established a track record and allow them to bear the cost of adjustment on their own while they are at it, before they can receive Fund support. For precisely these reasons, homegrown programs would be entirely unsuitable for countries needing immediate balance of payments assistance.

A systematic mechanism for supporting homegrown programs ex post would enable the Fund to engage itself in countries that do not have critical balance of payments crises but need Fund certification for access to private capital markets or in low-income countries with some balance of payments need but which decide that, for reasons of political principle, they would rather create their own programs.

A system or mechanism for providing ex post support for homegrown programs should aim to provide ample technical assistance for the development of such programs. It should obviously also have entry and exit points although the purpose of active Fund technical assistance support in such cases would be precisely to minimize the risk of program default (and therefore of exit in the first place). The entry point could usefully be made to be triggered by some signal by the government in the form of a major reform initiative.
The Fund’s Image: Explaining the Fund’s Role and Method

We have already observed that the Fund’s image in most of the countries we visited was rather negative. In our view, this is a matter that needs to be addressed in its own right. It has implications for the Fund’s effectiveness as an institution on whom the entire donor community and private sector agents have thrust a leading role in macroeconomic policy management. It also has implications for the credibility and sustainability of the government’s role in the reform process. Already, some countries, notably those that have a history of protracted revolutionary struggle (Ethiopia and Eritrea) and therefore have a greater capacity for political mobilization and a more resolute and militant vision of the national development path, have begun to balk at Fund-supported arrangements, preferring to pursue macroeconomic and structural reforms on their own.

We believe it is important that ways be found to both humanize and demystify the Fund’s image to relieve the political hazard that countries sometimes perceive to be associated with dealing with the Fund. In this regard, the Fund might consider following the example of the Bank, not so much in its rather quixotic recent decision to send staff members to the villages to give them a taste of poverty, but perhaps from the Bank’s country strategy and implementation review meetings in countries where heads of sector ministries and their staff and key political leaders meet with Bank staff to review program performance and discuss future strategies. In our view, the PFP preparation process provides a perfectly suitable forum for Fund staff interaction with a broad cross section of political leaders and technical staff, instead of the bilateral sector meetings that the PFP process usually entails. We also endorse wholeheartedly the recommendations made in a 1993 internal Fund document for Bangladesh: it proposed, among other things, that the resident representative “play a leading role through the development of a wide range of contacts and by direct participation in the national debate.” It also recommended the publication of IMF Occasional Papers on Bangladesh to focus discussion in high-level seminars, as well as Fund participation in meetings with opponents of reform, both in and outside the government.

An improvement in the image of the Fund would not only, in our view, be good for the Fund from the point of view of its effectiveness as an institution, but it would also help country ownership. When the image of the Fund becomes so negative that countries begin to feel a palpable political risk in associating with it, they deny themselves the technical support and policy advice that they acknowledge the Fund does have and that they can avail themselves of, in formulating and developing their own programs. Thus, a negative Fund image does not, in the end, promote country ownership.

The Role of the Resident Representative

We acknowledge that we did not visit a large enough sampling of resident missions, and that therefore the assessment we make in this regard cannot be too categorical. In what follows, we make judgments that are, to some extent, intuitive but which we believe are reliable on account of the frankness and confidentiality that characterized our interaction and discussions with resident representatives and government officials, as well as donor representatives who have had regular contacts with resident missions.

First, the resident missions tend to be very small missions, with a solitary resident representative working with a skeletal administrative staff. In some cases, we sensed that, beneath the veneer of loyalty to the institution, the resident representatives felt some frustration at their isolation from headquarters. Some of them also expressed concern about the career advancement possibilities following their postings.

Our general impression is that the role of the resident representative is perhaps not being maximized enough, although it holds great potential not only for improving the Fund’s image in the countries but also for facilitating the conduct of its relations and negotiations with them.

In our view, the role of the resident representative is critical as a point of continuing contact with a country and government and, therefore, for program implementation. For this reason, we strongly recommend that there be resident missions in all ESAF countries. The matter is important enough to warrant that resources be found to make it possible to have these missions established.

The full-fledged Fund mission that we recommend for all ESAF countries should preferably be headed by a high-flying and relatively senior staff member and an assurance given to them of their reintegration into headquarters once their mission abroad is over. We found the absence of this assurance to be a source of concern with some resident representatives.

In the framework of such a strengthened mission, greater authority should devolve to resident representatives, especially in areas or matters that depend crucially on knowledge of concrete country circumstances, such as the fulfillment of tranche conditions or the impact of unexpected shocks or developments that require minor variations of program targets.

In the light of the foregoing recommendations, we believe that more country visits and intensified program monitoring by Washington-based staff would be largely superfluous. Not only would they be a curious affirmation of the Fund’s professed belief in the primacy of country ownership, but they are also
unlikely to prove as effective a way of aiding successful implementation of country programs as competently manned and strengthened resident missions.

**The Fund’s Cooperation with the Bank**

In the area of Fund/Bank cooperation, while a great deal has been done to better define and clarify the areas of the core competencies of the two institutions and to provide guidelines for the management of areas of unavoidable overlap, a bit of confusion still reigns. Behind the facade of the close Fund/Bank cooperation that Fund missions cite in staff reports, there is much frustration on both sides. Among the Fund staff, there is some impatience with what is perceived as indecision on the part of the Bank on key issues within its core competence (especially expenditure analysis) and undue tardiness in delivering inputs for joint documents and programs.

On the Bank’s side, the sources of frustration are many. First, while the particular weaknesses complained of by Fund staff are acknowledged, there is a general feeling (and some resentment) that the Bank plays second fiddle to the Fund, and that once an ESAF has been negotiated, the Fund expects a Structural Adjustment Credit to follow. Second, there are complaints that Fund staff are often cast in an inflexible mold by their briefing papers and mandates, and are much too quick to plead jurisdiction and turf when differences arise. Needless to say, Fund staff, for their part, feel (and this, not without some justification) that Bank mandates and negotiating styles are no less inflexible.

The real sources of friction include the sharing of draft reports and position papers. Bank staff complain that while they share their documents readily with their counterparts in the Fund, there is too much hierarchy and rigidity in the Fund’s attitude in this regard. We heard complaints about the coordination of policy positions and the sharing of PFP drafts on Vietnam and Burkina Faso. There is also a widespread feeling on the part of the Bank staff that there is continuing tension between the objectives of short-term stabilization and sustainable growth, and that the Fund “needs to rethink growth.” The Fund staff, on the other hand, feels that the Bank needs to better appreciate the role of macroeconomic stabilization in fostering and sustaining growth.

Financing plans of programs constitute another source of friction. The Fund staff often complains—and there are many references in staff reports on this—that the Bank does not always deliver or disburse programmed resources on time, while the Bank staff complains that the Fund controls its money flow and takes the Bank’s for granted.

The tensions appear to center mostly on structural reforms, especially financial sector reforms where the specific issues cover the areas of microfinance, the formulation of policy instruments that are compatible with private sector development, and the promotion of small- and medium-scale enterprises.

Our sense is that in spite of the progress that has been made in the past few years in forging harmony in Fund/Bank relations, too much still depends on personalities. We are unable, on the basis of the case studies alone, to formulate any concrete remedial measures. We wish to stress, however, that the situation requires urgent resolution, especially with the new strains that are bound to be caused by the asymmetry in the levels of decision-making authority of resident missions and country staff of the two institutions, following the Bank’s recent decentralization program, to say nothing of the problem of policy cohesion and coordination posed by this program within the Bank itself. There is a pressing need therefore to improve Bank/Fund cooperation further, through the development of more effective and operationally reliable instruments of cooperation. Policy choice and ownership are not helped when the country is pulled in different directions by the two institutions and perhaps by donors.

**Conclusion**

We have put a great deal of emphasis on country leadership as a condition of national ownership. We talk of the country developing its own medium- to long-term vision, of the need for the country to be allowed time to build consensus, of the timing and duration of missions being arranged to enable consensus-building, and of allowing and assisting the country to develop its own program if it so desires. We do not intend, by these proposals, an endorsement of selectivity in the sense of a withdrawal by the Fund from engagement with countries until perfect conditions for ownership have been established.

Accordingly, while we put a premium on country preparation and leadership in setting the policy agenda and pace of reform, we recommend also that the Fund engage the country at the highest political level and at the earliest opportunity to both listen and offer advice. We further propose the stationing of resident representatives in all ESAF countries and the strengthening of the Fund’s technical assistance work. We believe that these measures can go a long way in supporting what countries must do at their level to promote national ownership. We therefore urge that every effort be made to provide the necessary budgetary resources to enable the Fund to strengthen its work in the countries in these two important areas.

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20 Interviews, Hong Kong and Vietnam, September/October 1997.