Staff Response to the Independent Evaluation Office Report on the IMF and Aid to Sub-Saharan Africa

Executive Board Meeting
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The IEO report underscores the challenges and complexities of the Fund's work related to both the availability of aid for countries in Africa and its effective use. The report contains insightful analysis, and staff concurs with many of its findings, conclusions, and recommendations, which will prove helpful in our ongoing efforts to define more clearly the institution's mandate and strengthen its effectiveness. The recommendations should be considered in the context of the Fund's Medium-Term Strategy (MTS), which sets out the framework for more focused engagement in low-income countries. The MTS has launched a process that will address substantive aspects of the IEO report's recommendations and these findings will be useful in ensuring that the MTS work is focused on the right problems.

The report acknowledges that Sub-Saharan Africa (SSA) has experienced a period of unprecedented high growth and low inflation, contributing to a reduction in poverty. Most of the report presents the improved performance in SSA as part of the "external context" in which the Fund's work in low-income countries took place, rather than analyzing the extent to which PRGF-supported programs, or other forms of Fund assistance, contributed to this outcome. While several factors were at play, the Fund's policy advice was instrumental in promoting sound macroeconomic policies and accommodating the effective use of aid. This advice was complemented by the Fund's extensive technical assistance on a range of fiscal, monetary, and financial sector issues. In addition, the HIPC Initiative and MDRI have greatly reduced debt-related vulnerabilities and the costs of debt servicing, thus increasing fiscal space. The report also acknowledges that the Fund has made progress in projecting aid inflows in the face of a changing and sometimes uncertain aid environment, and has catalyzed aid through the PRGF's macroeconomic assessment.

The report speaks throughout of considerable learning and adaptation in a range of areas, including a flexible approach to accommodating aid and a stronger pro-poor focus. Many specific improvements are discussed (for example, the promotion of higher domestic resource mobilization, floors for social spending, support for fiscal governance, and more relaxed program adjusters). In this context, the finding that the Fund "gravitated back to business as usual" by the end of the period seems at odds with the discussion in the main body of the paper.

In general, the interpretation of some findings is complicated by ambiguity about the evaluation standard utilized. The expected measure of the Fund's performance would be its mandate as given by the Executive Board or stated by management. While the report sometimes uses this as an evaluation standard, in many instances Fund performance is evaluated against the expectation of a subset of external stakeholders. We recognize that part of the report's criticism relates to areas in which the mandate is ambiguous, but in several instances the report could have been more explicit about whose expectations were or were not fulfilled.

Also, while the Fund's mandate as defined by the Board provides a benchmark for part of the assessments, the IEO's interpretation of this mandate does not always coincide with staff's reading of the Board's directions. PRGF-supported programs focus on macroeconomic stability and growth, which in turn will support the desired goals of higher living standards and poverty reduction. The "poverty-reduction orientation" of the PRGF, and the choices made by management and staff to help countries reduce poverty, need to be understood with these overarching directives in mind, and specific criticisms made by the IEO should be evaluated in that light:

- The Fund's role in mobilizing and advocating a scaling up of aid is a central topic of this report. The IEO notes that the Fund has done little to mobilize aid, while acknowledging that this is an area in which the Board has not given staff a clear mandate. At the same time, Fund staff are expected to make sure that each program approved by the Board is "fully financed." Here we recognize that clarifying the meaning of the term "fully financed" in the context of a growth-oriented development strategy will be important.

- Implicit in the report's analysis is also a supposition that the Fund should be more active in helping countries confront distributive issues associated with programming for higher growth. But again guidance from the Board has made it clear that while the Fund should be mindful of the distributive consequences of the programs it supports, the Fund is not intended to be the lead agency on a wide range of policies that impinge upon distribution—this mandate lies with the Bank and other donors.
- Finally, Fund staff should incorporate, whenever available, good-quality poverty and social impact analysis (PSIA) into its advice and programs. However, Fund staff is not responsible for conducting PSIA—even though staff has conducted limited PSIAs in house on an ad hoc basis when resources allowed, focusing largely on reducing costly and inefficient transfers or subsidies or mitigating the impact of fuel price increases on vulnerable groups. We accept, however, the report's view that there may still be scope for enhancing coordination with the World Bank on the use of PSIA in program design. In this context, we would note that the finding that Fund staff considered that the Bank did not always provide timely and quality PSIA, points to the initial lack of clarity on the role of the Bank rather than to the substance of the Bank's work per se. We would also note some additional successful examples of Bank-Fund collaboration on PSIA, such as on Ghana (electricity reform) and Burkina Faso (cotton sector reform).

The Accommodation of Aid Inflows

We appreciate the report's emphasis on the importance of accommodating higher aid, through higher spending and net imports. Indeed, as noted in the report, Board guidance fully supports a "spend and absorb" strategy for countries where it is compatible with maintaining macroeconomic stability. However, the report's suggestion that the Fund had promised a "shift . . . in program design with respect to the programmed absorption of increased aid" (page 7, first paragraph) needs to be nuanced because, under the PRGF, securing macroeconomic stability and limiting financial vulnerabilities continue to be the primary objectives of program design, in part by building up a prudent reserve buffer. While countries are establishing stability, full spending and absorption may not be the best path to sustained growth and poverty reduction. The Fund has indeed modified its program design in the post-stabilization countries (so-called mature stabilizers), where the objective has shifted from stabilization to accelerated growth.

The question then is whether the Fund's approach to accommodating aid use has gone far enough, fast enough. One could read the report as advocating that immediate spending and absorption of aid is always the preferred strategy; for example, the report suggests that the Fund has unduly blocked the use of aid in some countries with low reserves. We prefer to emphasize a strategy that, as countries emerge from instability, could include saving part of aid inflows as a prudent and fully justifiable policy—for example, to build up an external reserve buffer, curb an excessive debt burden, smooth expenditures over time in the context of aid volatility and limited absorptive capacity, or support disinflation.[1]

On a more technical note, while the quantitative analysis of the programmed use of aid is innovative and thought-provoking, its methodology and scope do not permit an assessment of whether Fund programs are accommodating the use of aid over time, in the context of a multiyear strategy. In particular:

- The analysis of the link between aid and spending and absorption is static. It suggests that in countries with problems of macroeconomic instability part of aid is programmed to be saved. This policy is good when it leads eventually to a situation where aid can be fully absorbed and spent—but the analysis gives us no insight into this.
- The focus on the immediate (i.e., same-year) use of increases in aid implies that any attempt at expenditure smoothing will show up as less than full spending and absorption.[2]

Aid Projections

We see merit in the report's call for greater transparency about the derivation of the Fund's aid forecasts. Fund projections have broadly reflected the changing aid environment, adapting to the evidence of scaling up in certain countries in recent years. In addition, we were encouraged by the important finding that aid forecasts are accurate for the program period one year ahead, which has the largest operational relevance. Nonetheless, the report's finding that it is hard for readers to understand the nature of the projections in Fund-supported programs calls for better explanations of the program strategy. In particular, in the absence of longer-term commitments by donors, outer-year Fund projections tend to be more cautious. Against this background, Fund-supported programs are being updated

[1]In this context, the repeated reference to a minimum level of reserves equivalent to two or three months of imports (which is modest in light of the prevalence of shocks) as "high" gives the impression that Fund teams were overly zealous.

[2]See Appendix 1 for an overview of further problems related to the methodology for estimation.

frequently (usually at least every six months), while outer-year projections have less operational impact. Moreover, in the context of aid uncertainty, the authorities often prefer cautious projections, avoiding costly disruptions to the budget process (for example, through start-and-stop projects).

We concur on the importance of the authorities, with the input of the Fund and other partners, developing alternative macroeconomic frameworks, based on different scenarios for aid inflows. PRGF-supported programs are necessarily based on a single baseline scenario to guide authorities in their immediate economic policy decision making, while being subject to frequent revision as the external environment, including aid allocations, changes. At the same time, there has been increasing use of alternative scenarios in PRSPs, debt sustainability analyses, and Fund surveillance reports, as encouraged by the Board, and more should be done in that context.

The "Key Features" Agenda and the PRSP[3]

The valid concerns expressed in the IEO report concerning the social impact of economic policies under PRGF-supported programs need to be taken up in the context of PRSPs, where these issues are considered by country authorities, in consultation with other stakeholders. The PRGF was expected to draw heavily on the PRSP on such issues as the identification of pro-poor spending, prioritization of expenditures, PSIA, absorptive capacity, and alternative expenditure scenarios. Accordingly, weaknesses in these areas can often be traced to the PRSP process (in which admittedly the Fund needs to play a key role), and in some cases the underlying issue may be need for more effective country/Bank/Fund collaboration in the PRSP context.

- The need to undertake an analysis of absorptive capacity constraints for sectoral programs points to a tension in the agreed division of labor between the Fund and the Bank. The report first notes that the Fund's relative lack of "attention to aid absorptive capacity constraints in education, health, or infrastructure, where the Bank is the lead agency" is in line with this division of labor, but then goes on to note that this was a "missed opportunity for considering synergies between areas where the Bank has the lead on one issue and the Fund on another." The intimate link between microeconomic and macroeconomic policies in this area requires a closer institutional cooperation than now exists, as also recognized in the MTS. The suggestions for improved cooperation in the report are useful in this regard.
- Concerns about overly-constraining definitions of priority spending will also need to be addressed through the PRSPs, where such spending is defined. It should be noted that the Fund, with the donor community, has shown flexibility in the definition of priority spending in countries where the authorities' definition has evolved. In particular in the area of infrastructure, in order to determine whether spending can be considered as priority or pro-poor, the Fund has to follow the advice from other experts. A further observation is that there appears to be some tension between the statements in the IEO report that: (i) staff did not systematically encourage pro-poor budget provisions, (ii) the authorities considered that staff put too much emphasis on pro-poor spending.
- In summary, the suggestion that the Fund has "done little to take into account spending composition issues" merits qualification. In the division of responsibilities between the Bank and the Fund, the Bank is the lead agency in expenditure composition issues. However, within this framework, the Fund has been active on expenditure allocation concerns.[4] Indeed, as noted in the report, Fund efforts have helped to ensure that poverty-reducing spending expanded rapidly during the evaluation period (in fact, some authorities considered that staff put too much emphasis on pro-poor spending). In addition, recourse to wage bill ceilings reflected, in part, a concern to ensure that sufficient resources should be directed to priority nonwage or capital outlays. At the same time, recent Fund guidance to mission chiefs in SSA countries has been to discourage the use of wage ceilings, given their blunt nature.[5]

Communications Strategy and Coordination with Donors

The report's overall finding of a disconnect in external perceptions between the Fund's rhetoric on aid and its actual work at the country level calls for improvements in the Fund's communications. Future efforts should comprise both the clarification of the Fund's mandate, in the context of the MTS, and better communication on discussions and policies at the country level. These steps can build on recent work to strengthen external outreach. In particular, in 2004 the African Depart-

[3]The IEO report takes as a benchmark the "Key Features" agenda, a list of elements of PRGF program design that support the specific focus of these programs on growth and poverty alleviation anchored by the PRSP.

[4]The report could have mentioned the Fund's analytical work and pilot studies on public investment (including for Ethiopia and Ghana) and public private partnerships.

[5]In addition, country authorities have sometimes found wage ceilings useful instruments to help address wage pressures, overstaffed civil services, strong unions, or sectoral lobbies.

ment developed an external communications strategy comprising both country-specific and general policy messages. An External Communications Team comprising staff from the African and External Relations Departments has been established and country-specific strategies developed for eight countries.

In this context, the relatively positive assessment by the authorities of their working relationship with the Fund is important. The authorities are the Fund's primary counterpart, as the Fund's role is to target macroeconomic stability and growth through policy advice, financial support, and capacity building. A strong working relationship with the authorities is essential, and it appears the Fund has established that with its primary counterparts in the government (usually, the ministry of finance and central bank). However, in recent years, missions have regularly reached out to a broader set of ministries, including health and education, and to other official institutions.

The need to improve coordination with donors is of particular concern. Effective communication between Fund country teams and donors is critical for both sides to be effective in assisting low-income countries. These relationships are inherently complex, given the diversity of operations across the donor community. The Fund and donors are aware of coordination difficulties, and the Fund will continue to be an active participant in the international effort to work for better donor coordination in the context of the 2005 Paris Declaration.

It is also important to recognize the complexity of improving relationships with local nongovernmental organizations (NGOs). As the report recognizes, time constraints may not allow meeting them all, and the views of the authorities have to be considered. In the face of an extensive and diverse NGO community, better prioritization of outreach efforts is needed. In this context, the usefulness of developing regular communications between Fund country teams and parliamentarians also deserves mention.

Recommendations

In line with the above observations and assessments, staff concurs with each of the recommendations of the IEO Report.

The first recommendation calls for further clarification by the Executive Board of the Fund's mandate and policies on several aid-related issues. The IEO report demonstrates the scope for defining more clearly the Fund's commitments to outside stakeholders. In addition, on several issues, staff would benefit from greater clarity in their mandate, building on the MTS, in particular concerning the Fund's role in aid mobilization. The IEO suggests that further guidance should also cover thresholds for spending and absorption of aid increases, but general thresholds cannot properly take into account the wide variety of country-specific considerations (concerning, for example, absorptive capacity, macroeconomic vulnerabilities, the monetary and exchange rate regime, and the budgetary framework). Accordingly, guidance should focus on clarifying the conceptual framework and agreed best practices, which can then be applied for each country. In this context, the upcoming Board reports on the PRSP process, on aid inflows and program design, on the appropriate fiscal framework for managing scaled-up aid, and on public financial management issues in the context of scaled-up aid flows should provide useful vehicles for beginning to address this recommendation.

We also welcome the auxiliary recommendation to ensure the consistency of institutional communications with Board-approved operational policies. The Fund's External Relations Department has initiated such a process, by putting in place new procedures to integrate better Fund operations with communications.

The second recommendation aims to establish transparent mechanisms for monitoring and evaluating the implementation of clarified policy guidance. In this context, we note that a well-developed internal review process is in place to ensure that Board directives are consistently implemented across countries. We acknowledge, however, the case for additional mechanisms, in particular to address external concerns. In this context, we concur that both ex post assessments of past Fund arrangements for specific countries and a broader review of such issues in the context of periodic Board reviews of the PRGF could be helpful.

The report's final recommendation calls for a clarification of expectations—and resource availabilities—for resident representatives' and mission chiefs' interactions with local donor groups and civil society. As noted above, the mixed responses from donor groups are of particular concern and warrant new efforts to improve communication and coordination. The Fund will seek to address the serious and complex challenges to missions and resident representatives posed by the changing aid modalities and decentralization of donor operations, while also taking into account budget and staffing constraints. In this context, we note that the IEO report does not consider the need for prioritization in the current budgetary environment.

Appendix 1. Comments on the Quantitative Analysis of the Use of Aid Increases

In addition to the problems identified in the main text, several additional problems also impinge on the estimation and interpretation of the degree to which higher programmed aid inflows are accommodated in the form of increased fiscal spending and current account deficits. In particular,

- The focus on averages and regression results in analyzing the degree of spending and absorption of aid in program design could be misleading. For example, if all countries either "spend and absorb" or "don't spend and don't absorb," the average would show partial spending and partial absorption. The latter pattern would then be presented as the typical case, even though no country actually exhibited this behavior.
- The regressions supporting the results emphasized in the report exclude the constant term—a choice that may lead to biased estimates and incorrect inference.
- While the report suggests that programmed aid-based spending is limited if inflation exceeds 5–7 percent, efforts to reduce high domestic government borrowing may actually be driving this result. In the econometric estimation, macroeconomic conditions are always proxied by inflation. However, this abstracts from the potentially important role of high domestic public sector borrowing, which is often the cause of high inflation. In our view, this omission is sufficiently important to cast substantial doubt on any policy conclusions based on the results.
- The report does not always take account of the interaction of absorption and spending decisions. For instance, in Annex 2, the equations are estimated separately for absorption and for spending. However, from a policy perspective, the degree of absorption and spending are codetermined (for example, higher inflation can be related to a reluctance to absorb previous aid flows, leading to excessive liquidity injections as this aid was spent. In this situation, it would be wise to program lower spending, but because of the low expected absorption, not because of the high inflation per se).
- A question stems from the approach to measuring aid projections against outturns using the ratio of aid to GDP. The analysis does not indicate the reason for deviations between predictions and outcomes; is it a result of underestimating nominal aid or overestimating real GDP growth?

The analysis would have benefited from a distinction between the different types of aid delivery and a discussion of their treatment under Fund-supported programs (i.e., "budget" versus "project" support). Program targets generally accommodate *project* disbursements *in full,* given that these are directly tied to specific project expenditures—usually with a large import content—and may be subject to specific procedures with individual donors. By contrast, fiscal targets and program adjustors typically apply to *budget* support, which is *not* linked to specific outlays and may be less predictable in timing and amounts, particularly in outer years (i.e., given donor budget cycles). This distinction—full accommodation for project disbursements and targets and adjustors for budget support—might also have helped address some of the "disconnect in external perceptions." It could also explain part of the apparent "bias" against infrastructure spending, since infrastructure spending tends to be linked to project disbursements, which are not offset when they are delayed or do not take place.

Appendix 2. Factual Corrections/Typos

- The claim in page 6, footnote 3 that the (usually zero) limits on nonconcessional borrowing have generally not been binding (and, by implication, superfluous) is tenuous. The binding nature of zero limits cannot be observed directly. Moreover, there have been several cases in which these limits were breached.
- Page 6, fourth paragraph of the report suggests that there has not been significant poverty reduction in the 29 SSA PRGF countries, over the 2000–05 period that the review largely focuses on. This claim is based on Chen and Ravallion (2004). However, the data used in the latter study end in 2001 (see panel H of Figure 2.1 of the report). One might expect that in 2001–05, some poverty reduction was achieved in the SSA PRGF countries, as per capita income rose significantly (see panel G of Figure 2.1).
- Debt sustainability analysis using the Fund's standard framework for analyzing debt dynamics for low-income countries is mandatory for all low-income countries and is, thus, not limited to HIPC cases (page 10, last paragraph).
- There is an inconsistency in the language of the third bullet on page 2 and the third bullet on page 32. The authors give a sensible account of experience with PSIA in these bullets and also on pages 16–17, the section on "Poverty and social impact analysis" that indicates the constraints on the Fund's involvement and stops short of blaming anyone. However, when one looks at the beginning of the last sentence of the bullets, the use of "also" implies that this experience is an example of weak Bank-Fund collaboration, which is not really the case. We would drop the "also."

Country-Specific Comments

Benin

- Page 15, footnote 43: Benin has not had any formal conditionality (floor) on poverty-reducing expenditure under its PRGF-supported programs (current and past). However, under the 2002–05 PRSP, spending for priority sectors (education and health, agriculture, public works and energy, and water management) was targeted at 28 percent of total spending.

Cameroon

- Page 50, fifth paragraph: Cameroon did not have a ceiling on the wage bill but rather on goods and services. The reference in this paragraph should be nuanced in line with Table A3.4 (page 53).

Ghana

- Page 13, first paragraph: Staff's data do not show a projected increase in aid over the medium term.
- Page 21: On nonconcessional borrowing, the correct formulation is that the authorities are interested in nonconcessional borrowing only after exhausting all concessional financing sources and for high-return investment projects.
- Page 48, last paragraph: Ghana also belongs to the group of countries where discussion of the exchange rate included discussions of productivity, and efficiency reforms to increase competitiveness.
- Page 50: The size of the fiscal deficit was not a performance criterion in Ghana's 2003–06 PRGF. The performance criterion was on net domestic financing of the government.
- Page 50, fourth paragraph: The report mentions that the revenue ratio was a program conditionality, which was not the case.
- Page 61, seventh paragraph: Same revision as regards page 21 above on nonconcessional borrowing. In addition to discussion of this issue in the Consultative Group, the issue was also discussed in the context of some review missions.
- Table A3.6. In the case of Ghana, it should be noted that the PSIA was completed *ex ante* (before the petrol pricing reform in February 2005) rather than *ex post*. Indeed, the countervailing measures adopted by the authorities were largely drawn from the findings of PSIA carried out by FAD.

Malawi

- Page 15, footnote 43: Malawi does not have any conditionality (floor) on poverty-reducing expenditure under the current 2005 PRGF arrangement. For the 2000 PRGF arrangement, neither the original program nor the 2003 first review included conditionality (floor) on poverty-reducing expenditure.
- Page 16, first paragraph, last sentence: Under the current 2005 PRGF arrangement, program adjustors allowed for increased central government discretionary expenditures in the event of higher than programmed health SWAp-financed other recurrent expenditures, and allowed for increased spending on central government wages and salaries in the event of higher than programmed health SWAp-financed wage expenditures. Poverty-reducing expenditure was not a quantitative target in the 2000 PRGF arrangement and hence there were no adjustors.
- Page 17, third paragraph: The report is correct that program documents (to date) have not indicated any countervailing measures linked to PSIAs. However, this is largely because the fertilizer PSIA was undertaken in February 2006 and the last issued staff report was in August 2006. However, as of now, the government has not indicated whether it would adopt the recommendations of the PSIA.
- Page 50, third paragraph: Malawi has not had any conditionality on the size of the fiscal deficit under either the current PRGF arrangement approved in 2005, nor the previous one approved in 2000. In both instances, a performance criterion was placed on the central government domestic borrowing.
- Page 52, first paragraph: Malawi has not had any conditionality on priority expenditures under either the current PRGF arrangement approved in 2005, nor the previous one approved in 2000. The current 2005 PRGF includes a ceiling on central government discretionary spending.
- Page 52, first paragraph: The current Malawi PRGF arrangement only includes an adjustor for higher wage spending in the event of higher SWAp-financed wage spending in the health sector, not in priority areas in general.
- Page 54, Table A3.5: The 2000 PRGF arrangement expired with only the first review being completed in October 2003. There was no second review. In neither instance was there quantitative conditionality on the wage bill. This conditionality exists in the 2005 PRGF arrangement.
- Page 54, Table A3.5: The 2000 PRGF arrangement expired with only the first review being completed in October 2003. In neither instance was there an indicative target in poverty-reducing expenditure. What is the reference to the 2002 program?

Mali

- Page 55, Table A3.6 (which discusses the use of PSIA) should mention the Mali selected issues paper issued in March 2006, which assesses the distributional effects of an increase in petroleum prices.

Rwanda

- The report states that Dutch disease was not a major concern (page 48, last paragraph, Annex 3 and also Annex 4). This does not correctly reflect staff's views. In fact, in EBS/05/55 (4th PRGF review, ¶11), staff wrote: "As large external inflows could put pressure on the real exchange rate to appreciate penalizing net exports, it is essential to raise productivity in the export sector. . . ." Also in subsequent reviews and the new PRGF, export promotion was a critical program element, acknowledging that a further real appreciation of the exchange rate is likely with a scaling up of aid.

- We believe that there is too much emphasis on the PSIA, given the questionable quality of the document (page 60, third paragraph, Annex 4).

Tanzania

- Page 50, third paragraph: Tanzania programs used net domestic financing, not fiscal deficits as performance criteria; the language should be altered to reflect that.
- Page 61, Figure A4.5: In the row "before" of the column on "financing of aid shortfalls," the Tanzania box should be gray; Tanzania did allow limited domestic financing of shortfalls before 2001/02.

Uganda

- The performance criterion on poverty-reducing expenditure (page 15, third paragraph; page 15, footnote 43; Annex 3, page 52, first paragraph; and Table A3.5) was changed to an indicative target under the last (2002) PRGF arrangement.

Zambia

- Page 16, first paragraph: The report misrepresents the process that took place in modifying the indicative target for the wage bill ceiling in Zambia in 2004. A modification to the program was made on the basis of the authorities' request, and was not a reaction to negative publicity and controversy on wage bill ceilings. That is, when the wage bill ceiling could have potentially interfered with teacher hiring, the ceiling was appropriately modified. Persistent claims that the Fund-supported program in Zambia restricted the hiring of teachers and health workers have repeatedly been refuted (see the link below from November 2004). The IEO report could have usefully pointed this out. See http://www.imf.org/external/np/vc/2004/111804.htm.
- Annex 3, page 48, fourth paragraph: We would categorize Zambia as having a low level of international reserves. The PRGF-supported program aimed for a gradual buildup of reserves over the medium term.
- Annex 3, page 50, third paragraph: "The size of the fiscal deficit was typically used as a performance criterion (… Zambia)." The fiscal performance criterion in the program for Zambia is a ceiling on net domestic financing. While an adjustor for excess budget support implicitly creates a temporary cap on the fiscal deficit, the program would allow for spending the excess in subsequent periods (by drawing down government deposits) after appropriate expenditures have been identified and budgeted for.
- Annex 3, page 50, fourth paragraph: Tax revenue was not an indicative target in the PRGF arrangement for Zambia approved by the Board in June 2004.