INTERNATIONAL MONETARY FUND

Strengthening Country Ownership of Fund-Supported Programs

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I. Introduction

1. One of the fundamental tenets of the financial support that the IMF provides to its member countries is that financing should help the country design and carry out corrective economic policies. Through Article IV consultations and other dialogues, the Fund encourages countries to adopt policies that will help prevent the onset of balance of payments difficulties. If such efforts fail or are derailed by circumstances, and if the country asks the Fund for financial assistance, the Fund advises the authorities in the design of a specific adjustment program, while paying "due regard to the domestic social and political objectives, the economic priorities, and the circumstances of members, including the causes of their balance of payments difficulties." To qualify for support, the country's program must be judged by the Fund to be both credible and effective. "The Managing Director will recommend that the Executive Board approve a member's request for the use of the Fund's general resources in the credit tranches when it is his judgment that the program is consistent with the Fund's provisions and policies and that it will be carried out."[1]

2. As these guidelines for conditionality make clear, the borrowing country has a major responsibility for the design and implementation of effective economic policies.[2] The role of the IMF is to provide advice as needed and when requested and to make financing decisions based on its evaluation of the country's program. These ideas are not new, and they should not seem controversial. Difficulties frequently arise, however, when the initial judgments on appropriate policies made by the authorities and by the staff and management of the Fund are substantially different. Before the Fund can responsibly provide financing in such cases, the gap must be bridged through negotiation. If the country's need for financing is great enough, the authorities might be forced to agree to policies that they do not believe to be in the country's interests. If the Fund determines that the country's situation is dangerous enough, it might decide to approve a program despite serious doubts about its credibility or its effectiveness. It might also insist on completion of prior actions, or it might impose unusually extensive or detailed conditionality. In more moderate circumstances, negotiations might break down without a financing agreement.

3. As part of the ongoing review of the conditionality associated with Fund-supported programs, this paper examines the scope for improving the processes for resolving differences in view between the Fund and the authorities of countries applying for financial assistance. The ideal, that the authorities themselves should embrace and enact necessary

[1] Guidelines on conditionality, attached to Executive Board Decision No. 6056-(79/38), adopted March 2, 1979. The first quotation is from guideline number 4; the second is from number 7.

[2] The term "borrowing country" is used vernacularly in this paper to refer either to a member making purchases from the Fund under a stand-by arrangement or to a member receiving a loan through the PRGF. The guidelines cited above apply to the former.

reforms and that international involvement should be to support rather than impose those reforms, is encapsulated in the notion of "domestic ownership." If the country shares with the Fund the objectives of the program and an understanding of the model linking the objectives to policies, then the country is committed to the spirit as well as the letter of the program. The Executive Board, at its March 2001 meeting to review conditionality, agreed that ownership is "essential to the successful and sustained implementation of a program of economic policies," and that "conditionality cannot compensate for a lack of program ownership."[3] While ownership is thus an important element in the safeguarding of Fund resources, it is not the only one.The Fund may provide financing subject to conditionality despite doubts about the authorities' ownership, when it judges that the program is likely to be carried out anyway and that the consequences of not acting could be worse for the member or for the overall interests of the membership.[4]

4. A number of practical questions arise from these general propositions. First, what exactly do we mean by ownership, and how do we judge whether it is present? Second, whose ownership really matters? Third, is conditionality compatible with the requirements for ownership? Fourth, what steps can and should the IMF take to promote the right kind of ownership, and what results might follow?

II. What is Ownership?

5. Just as views differ on how to design economic policies, different concepts of ownership have been introduced into this debate. Not surprisingly, creditors and debtors often take conflicting positions on the meaning of ownership. For example, when Venezuela applied for an EFF arrangement with the IMF in 1989, the President of the country publicly accused the Fund of imposing harsh and unjust conditions on his people and preventing the government from continuing with its own policies. The Managing Director (Michel Camdessus) responded with an open letter stating that "It is a prerogative of sovereign states to decide for themselves what measures are required for recovery, however unpleasant those measures may be …. And it does them honor if they take responsibility for policies in the eyes of their people, even in the most adverse circumstances."[5] One issue raised by this

[3] Public Information Notice No. 01/28, March 21, 2001.

[4] Article I(v) recognizes that "making the general resources of the Fund temporarily available to [members] under adequate safeguards" provides members the "opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity."

[5] *IMF Survey*, March 20, 1989, p. 82. A similar, and perhaps the first, public assertion of the Fund position on ownership was made in a television interview of a previous Managing Director (Per Jacobsson) during negotiations for a stand-by arrangement with Spain in 1959: "I must emphasize that such programs can only succeed if there is the will to succeed in the countries themselves. The Fund has always found people in these countries who know very

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exchange is whether policy adjustment is dictated by circumstances to which the government must react, in which case the government should take responsibility for its response; or whether adjustment is dictated arbitrarily in a way that would imply that the agency imposing conditions should take responsibility. A related and more practical issue is whether there are multiple approaches to reform and legitimate differences in view that might be reconciled through dialogue and negotiation.

6. The predominant view in the Fund has always been that the response to adverse circumstances requires a mix of financing and adjustment. The core of any Fund-supported adjustment program is an assurance that monetary, fiscal, and exchange rate policies will be formulated and implemented consistently with the requirements for external balance and financial stability. To further improve economic performance, the Fund generally advocates outward-looking and market-oriented reforms, seeks to minimize adverse social and environmental impacts, and insists upon certain standards of governance on matters pertinent to the use of Fund resources. It is natural to think of ownership as a shared vision and an active support of the broad objectives on the part of the authorities and the Fund, even if differences abound regarding specific policy requirements. If the Fund regards reform as essential for sustainable financial stability and economic performance, and if it is providing financing to the country for that purpose, then it should seek assurances that the country is fully committed to carrying out an adequate program of reforms.

7. Carried to the extreme, this concept of ownership implies that the Fund and other official creditors expect the country to take responsibility for doing what the international financial institutions (IFIs) insist they must do. That argument occasionally is made explicitly by official creditors. Helleiner (2000, p. 85) quotes an unidentified official of a donor agency to Tanzania as saying, “Ownership exists when they do what we want them to do but they do so voluntarily.” Even if that remark was meant facetiously, it represents one end of a broad spectrum of perspectives. If a meaningful and operationally acceptable definition is to be found for ownership, it must allow for the essential requirements of financially responsible lending without impinging on the primary responsibilities for policy formation that inhere in the country’s authorities.

8. At the other extreme, advocates for developing countries sometimes have argued that ownership means that IFIs should depend entirely or very largely on borrowers to design their own policies. Ownership, in that view, may be incompatible with policy conditionality. As stated in Helleiner and others (1995, p. 11), while consultation between donors and recipients on development projects might well be useful, “ownership must mean that the final decisions rest with the recipient government.” In other words, the IFIs should advise on but should not

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well what needs to be done. The Fund does not impose conditions on countries; they themselves freely have come to the conclusion that the measures they arrange to take—even when they are sometimes harsh—are in the best interests of their own countries” (quoted by James, 1996, p. 109).

impose policies. Going further, Helleiner and Tomlinson (2000) write that the "essence of ownership is that the recipients drive the process. They drive the planning, the design, the implementation, the monitoring, and the evaluation."

9. An intermediate concept of ownership would involve a process of dialogue and negotiation capable of bringing the views of the authorities and the IFIs closer together. Indeed, an assumption that is commonly implicit in this literature is that ownership is synonymous or at least closely linked with participation and ultimate control over the process as well as outcomes. A recent NGO report, Wood and Lockwood (1999), refers to "poor implementation, which is caused by a lack of ownership (i.e., governments and civil society have not fully engaged in designing their reform programmes, so they are not committed to implementing them)." This notion is appealing, in that participation in design and implementation processes obviously will promote ownership, even though circumstances in some countries might allow ownership to take hold without a participatory process. If policy reforms that had been blocked by political resistance are implemented as a result of conditionality, governments may be willing to take ownership and credit if they believe that the reforms are likely to have beneficial effects. Although participation and ownership are two distinct elements in the process of building the foundations for successful reforms, an effective participatory process within the country may facilitate coalition-building and make it easier for the government and other domestic groups to take ownership.[6]

10. Another important supporting element in the process of successful policy reform is ownership by groups in the country other than the government in power. Members of the IMF are sovereign states, and the right of the authorities to implement economic policies of their own choosing should not and cannot be abrogated. In order to obtain essential external assistance, the authorities might choose to agree to alter those policies. In the absence of a conviction that the policy change is beneficial, the authorities will face a conflict of interest that will very likely result in poor implementation. For this reason, ownership most fundamentally means ownership by the country's authorities. But is that sufficient? Several caveats are in order. First, the authorities—economic and finance ministers, central bank governors—may not agree among themselves. Second, the highest political leaders might overrule the economic authorities. Third, parliamentary, regional, or other political opposition outside the government might block implementation. Fourth, interest groups and NGOs can play important roles in either creating or undermining public support for reform, especially in countries without an effective political opposition. The more broadly reforms are embraced across society (including by the public at large), the greater will be the chances of success, but it would be unrealistic to expect all affected groups in a country to benefit directly from reforms or to accept ownership of them. These considerations give rise to difficult questions about how the Fund should judge ownership and, possibly, whether it

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[6] Participation may also work against ownership if disaffected groups are able to use democratic processes to push their own agenda. For an introduction to the limits of participatory processes in this context, see Vieira da Cunha and Junho Pena (1997).

should become engaged at all in contexts where the need for reform and/or the policies that are required are not shared across the government or society. For example, while conditionality may strengthen the hands of pro-reform elements within the government when there are divisions within the government, it may also raise the odds of program failures if the pro-reform factions lose out despite Fund support.

11. With these caveats, the most useful definition of ownership is one that strips away these important but secondary relationships and stresses the basic objective. For this paper, therefore, ownership will be defined as follows:

> Ownership is a willing assumption of responsibility for an agreed program of policies, by officials in a borrowing country who have the responsibility to formulate and carry out those policies, based on an understanding that the program is achievable and is in the country's own interest.

12. Four implications of this definition should be noted. First, ownership primarily means ownership by the government, but the precise configuration of those whose support is critical will vary from case to case. Broad ownership within the government, parliament, and other major stakeholders in the country is highly desirable in order to ensure that the authorities are pursuing national rather than narrow interests and that the reform program will be sustained even as personalities change. Broad ownership may even be necessary, depending on the nature of the country's political system, but it may not always be a realistic goal. Second, this concept of ownership does not prejudge the process by which a positive commitment might be brought about. Participatory processes are highly desirable, but narrow processes may be necessary in some cases. Third, ownership cannot be directly observed until after policies are in place. Ex ante assessments will always be subjective and imperfect. Fourth, ownership and the capacity to implement appropriate policies are distinct but related concepts. This relationship underscores the importance of efforts to build implementation capacity as a means of strengthening and reinforcing ownership over time.[7]

13. To make this concept of ownership operational, it is necessary to make careful judgments on a case by case basis as to whether the government—and perhaps other domestic stakeholders—are fully committed to program objectives. The legislature is a key stakeholder outside government. The parliament's ownership of program objectives is critical as key policy measures typically require parliamentary approval. Yet in most programs where ownership is not in doubt, conditionality is attached to actions controllable by the authorities themselves (submission of a budget to parliament, rather than enactment of the budget into law). In cases of weak or uncertain program ownership, however, it may be appropriate for

[7] For example, the Polish authorities' commitment to reform at the outset of the far-reaching 1989-90 program was beyond doubt. Yet, their policy reactions in some areas (such as the social safety net) were crystallized only after substantial interaction with the Fund staff and other external advisors.

the Fund to insist on parliamentary approval of these measures as a prior action.[8] The Fund may also take account of the dynamic nature of ownership, especially in transition economies or others where major structural changes are required. A commitment to pursue reforms may be limited initially to finance officials who typically are the staff's interlocutors during negotiations, but it might reasonably be expected to spread as reforms take hold. In such cases, for the Fund to be actively supportive despite doubts about the breadth of ownership may result in—or to lead eventually to—the adoption of beneficial reforms that would not otherwise have been implemented.

III. Does Ownership Matter?

14. The conceptual argument that ownership is critically important for successful implementation of policy reforms is unimpeachable. Moreover, as a cooperative institution, the IMF must rely on member governments to act in their own best interests, even though those interests may be specified in the conditions attached to the use of Fund resources. To provide financing quickly enough to alleviate members' balance of payments problems, the Fund normally must transfer resources partly on the basis of promises rather than performance.[9] This may lead to inconsistencies in the authorities' incentives to implement their commitments, especially if they are promising to undertake reforms that they do not believe to be in their own interest.[10] In the best case, the financing will enable the country to

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[8] The appropriate use of prior actions is discussed in a forthcoming paper on the modalities of conditionality.

[9] Conditionality on actions and/or outcomes is an incentive mechanism (see Dixit, 2000). Conditional lending is subject to a *participation constraint*; an *incentive compatibility constraint*; and a *comparability of treatment constraint*. In general, incentive mechanisms are mixtures of incentives based on actions and outcomes, depending on their signal qualities—the observability, accuracy, timeliness, etc, with which different actions or outcomes can be monitored (Dixit, 2000, p. 5). Khan and Sharma (2001) provide an insightful analysis of the role of country ownership using the framework of the incentives literature. This paper also discusses extensively proposals to improve IFI processes.

[10] The theoretical explanation for this possibility is rooted in the literature on markets with asymmetric information, the seminal articles being Grossman and Hart (1983), Holmstrom (1979), and Shavell (1979). Asymmetric information is key. If the authorities have better information than the Fund regarding their own policy intentions, and if financing must be provided on the basis of policy commitments rather than outcomes, then the program should be designed to provide appropriate incentives; that is, it should convey benefits to the country if it is fully implemented. That incentive structure, however, exposes the authorities to the risks associated with whether the program works and with how well the economy performs. The use of waivers and program revisions to allow for adverse shocks to the economy helps shift some of that risk to the Fund, but there remains an unavoidable trade-off between optimal incentive structures and optimal risk-sharing. There is no inevitable conflict between

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implement its own program, or a process of dialogue involving the Fund, the authorities, and possibly other influential stakeholders in the country will lead to a program that is generally acceptable and owned. If, instead, the need for financing forces the authorities to promise reforms that they believe are not in their interest, implementation can be assured only through prior actions—in which case the financing may not be made available in time to close the country's financing gap, the prior actions may be subject to reversal or offsetting actions after the funds are provided, and the program may fail.

15. It is more difficult to find empirical support for the role of ownership, simply because it cannot be directly observed or measured. Assessing program ownership will always be a subjective exercise with which the Fund, its management, and staff will have to contend. Ex ante, even public commitments at the highest level of government might mask reservations and conflicting policy agendas. Ex post, governments are more likely to embrace reforms that succeeded, regardless of their initial views. Moreover, one must avoid the temptation to equate failure to implement reforms with a lack of ownership, which would make ownership a tautological requirement for program success.

16. Ownership is only one of several prerequisites for successful completion of a Fund-supported program. When a member country requests the use of Fund resources, the staff has to evaluate the need for financing, the policy adjustments that might be required, the impacts of adjustment on growth and on social indicators, and the likelihood that an appropriate adjustment will be carried out. That likelihood, in turn, depends both on the authorities' willingness to implement reforms and on their ability to do so, but it also depends on a successful negotiation leading to an understanding and agreement between the member and the Fund on what reforms are appropriate and on how best to achieve them. If the Fund staff fails to understand or to communicate its understanding of the necessary reforms, or if the authorities are willing but lack the technical, administrative, or political capacity to implement reforms, failure will follow just as surely as it would from a lack of ownership.

17. In the absence of direct measures, an effective way to evaluate the importance of ownership is to rely on proxy variables. In particular, the literature in this field generally assesses ownership indirectly by looking at indicators of political openness and unity (i.e., the absence of major obstacles to reform) and administrative capacity (i.e., the presence of an ability to formulate and implement the government's own program). Although most of this literature focuses on grants or long-term concessional loans, the implications for ownership apply to official financing more generally. The literature finds that the effectiveness of IFI-supported programs depends heavily on domestic political economy conditions but not on Bank or Fund efforts. This is commonly interpreted as implying that IFIs cannot "buy

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conditionality and ownership, although in this framework full ownership would preclude the need for conditionality.

reforms" by offering conditional assistance to governments that are not otherwise committed to reforms.

18. One study of this type, by the World Bank's Operations Evaluation Department (OED), analyzed a large number of projects supported by the Bank. The study (World Bank, 1999) rated the government commitment in each project (measuring, in a sense, the degree of ownership) and the project outcome using several objective and subjective indicators. Econometric analysis of these ratings suggested that implementation rates were positively correlated with an index of government commitment. Staff estimates indicate that similar conclusions apply to the likelihood of major interruptions to Fund programs.[11] Another widely cited study, by David Dollar and Jakob Svensson (2000), found that domestic political economy factors were much more important than conditionality or other external inputs in determining whether programs supported by the World Bank were likely to succeed. Dollar and Svensson examined some 200 World Bank structural adjustment programs, a third of which had been rated by the Bank's Operations Evaluation Department as unsuccessful. The dependent variable was a zero-one variable indicating failure or success of each program.

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[11] Running a simple regression for 250 World Bank projects over the period 1996-2000 yields the following results (t-values in parentheses), where PO is an index rating the project outcome and GC is an index of government commitment:

$$\underset{(18.83)}{PO = 1.43} + \underset{(17.14)}{0.45\ GC},\qquad R^2 = 0.21$$

In the case of Fund programs, a probit regression was estimated by the staff (Ivanova and others, 2001), using a sample of more than 100 Fund-supported programs. The left-hand side variable, S, takes a value of one if there is no major program interruption, zero otherwise. The right-hand side variables are C, a constant; Y0, the log of per capita GDP; and GS, an index of government stability from the independent International Country Risk Guide (ICRG). This index, which measures both the government's ability to carry out its program and its ability to stay in office, depends on the type of governance, the cohesion of the government and governing parties, the closeness of the next election, the government's command over the legislature, and popular approval of government policies. The estimated regression is:

$$S = \underset{(-1.88)}{-1.7} + \underset{(1.1)}{0.12\ Y0} + \underset{(2.33)}{0.13\ GS},$$

The significance of the stability indicator is robust under varying specifications of the regression. Similar results also hold for other indices of program success studied in that paper (i.e., the share of Fund resources committed actually disbursed and the structural implementation index).

Explanatory variables were political economy indicators and donor inputs.[12] The study found that by far the most important contributor to success of reform programs was the presence of domestic conditions conducive to reform: democratically elected governments, political stability, absence of long-term incumbents in power, and absence of ethnic fragmentation. In other words, some governments and some societies are more likely than others to undertake policy reforms willingly. In contrast, the study found little relationship between program success and additional "effort" by the Bank or other outside agencies (whether measured by monetary commitments or staff time). Although the authors did not question the general effectiveness of conditionality, they concluded that, at the margin, "adding more conditions to loans" will not overcome unfavorable domestic conditions.[13]

19. This message—that domestic commitment to reform is a key determinant of success—is corroborated by other studies at the Fund and the World Bank. In a study of transition economies, Mercer-Blackman and Unigovskaya (2000) argued that government commitment was related positively to growth through better program implementation. Burnside and Dollar (2000) examined the relationships among aid, economic policies, and growth in per capita GDP. They found that aid has a positive impact on growth in developing countries that have good fiscal, monetary, and trade policies but has little effect in the presence of poor policies. Combined with the results discussed in the preceding paragraph, this finding implies that ownership is likely to enhance the effectiveness of aid. However, in light of the well-known limitations of panel data regressions and differences in findings between cross-section and time-series studies, it is useful to examine another source of evidence on the role of ownership, namely case studies based on interviews with government officials in member countries, Fund staff reports, and other analyses.

20. Additional evidence comes from several case studies examined in the external evaluation of the ESAF and related case study work undertaken by Bank and Fund staff. The external ESAF review (Botchwey and others, 1998) stressed the benefits of several successful home-grown reforms that had been undertaken on government initiative and not under donor pressure. These included reforms in Vietnam, Eritrea, Burkina Faso, Uganda, and Mozambique. A common feature of many successful reforms was open, inclusive public debates sanctioned by the country's top leadership, which promoted ownership and effective program implementation. Uganda, for example, had success with key reforms in the late 1980s, such as abolishing price controls, liberalizing the foreign exchange market, and

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[12] For a more detailed explanation of this empirical work, see Annex II of "Conditionality in Fund-Supported Programs—Policy Issues," SM/01/60, Supplement 1 (February 20, 2001).

[13] For an overview on the policy implications and a set of country case studies, see Devarajan, Dollar, and Holmgren (2000). Also, Ivanova, Mayer, Mourmouras, and Anayiotos (2001), studying a sample of about 160 Fund-supported programs approved in 1992-98, found results that are broadly similar to those of Dollar and Svensson.

privatization, after a lengthy public debate. By contrast, where commitment was lacking, results were poor. In some cases, such as Zimbabwe (discussed further in the Annex to this paper), implementation was undermined by opposition within government and the political leadership, including the President, and opposition from business groups. In other cases (such as in Malawi) problems with donor coordination contributed to weakening ownership and implementation by overwhelming the capacity of the government and contributing to feelings of helplessness.

21. The Annex reviews the experience of several countries that had Fund-supported reform programs in the past decade and in which ownership issues were important. Two of these cases illustrate the difficulties of achieving and maintaining a broad and deep enough level of domestic support. In Zimbabwe, policy advice and financial assistance from the Fund and other IFIs was helpful for a brief period in the early 1990s when the government was interested in reforming its economic policies, but a surge in opposition to reform then undermined implementation and the effectiveness of aid and related assistance. In the Kyrgyz Republic, the government had repeated difficulties in gaining the political support necessary for undertaking needed reforms. The other four cases, in contrast, illustrate how strong ownership can overcome even very serious difficulties and how the Fund can help bring it about. In Uganda, as the government gradually adopted more stable and market-oriented policies in the late 1980s, the Fund was able to support the process by expanding its financial assistance and providing strong signals to other creditors and donors. The strengthening of ownership came primarily from within, and the Fund's role was to respond positively. And Bulgaria was another country that greatly increased its willingness to embrace structural economic reforms. In Bulgaria and Korea, major financial crises were instrumental in creating the broad consensus to back reforms that were needed to overcome market jitters and turn the economy around. In these cases, as well as in the case of Brazil, the Fund was able to play a more active role in promoting ownership through a continuous dialogue with the authorities.

22. A general lesson from case studies of program failure is that ownership is both dynamic and fragile. An effective dialogue between the Fund and the country's authorities can help build national ownership, but opposition to reforms from entrenched interests or a lack of protection or compensation for vulnerable groups hurt by reforms can seriously weaken ownership and program implementation. Because politically influential interests blocking reforms emerge naturally during the process of economic reform and change (Olson, 1982), an adequate understanding of domestic heterogeneity is crucial for appropriate design and sequencing of reform programs (Drazen, 2000). This need is particularly great when programs involve structural or "second-generation" reforms, which inevitably have negative impacts on some groups and generate resistance from vested interests.[14] The importance of

[14] Interests representing owners of specific factors of production may seek trade protection (Grossman and Helpman, 1994) or resist the adoption of new technologies (Bridgman, Livshits and MacGee, 2001) and thus lower growth. More generally, the importance of

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this problem is illustrated by Table 1. In a sample of about 160 Fund-supported programs approved between 1992 and 1998, the share of fully implemented macroeconomic conditions was 80 percent, while the share of fully implemented structural conditions was just 67 percent.[15] Similar differences are found in each major category of program (stand-by arrangements, EFF arrangements, and ESAF and PRGF loans).

IV. Implications for the IMF

23. A corollary to the notion that the formulation and implementation of economic policies is the responsibility and prerogative of the country concerned is that national ownership of those policies must be generated from within. In some cases, lack of ownership may reflect a profound disagreement with the Fund's diagnosis or its policy prescriptions. In others, lack of ownership of effective economic policies has resulted from domestic political difficulties, including pressures from election cycles (inducing the authorities to adopt myopic policies) or powerful interest groups (including in many cases those within the government) and the presence of vulnerable groups who are or expect to be adversely affected by reforms. As good governance, transparency, and participatory democracy take hold in an increasing number of countries, ownership problems of these types are expected to diminish. Nonetheless, the Fund, as a cooperative institution, may be able to help foster ownership by structuring and pacing its conditionality and its processes of interaction appropriately. If domestic ownership is an important determinant of program success, then it

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special interests for government policy choices has been recognized in the professional literature on public economics and IFIs. Dixit, Grossman and Helpman (1997) extend the classical theory of optimal commodity taxation due to Frank Ramsey (1927) to deal with self-interested governments. Dixit (2001) discusses the role of special interests in constraining reforms in less developed countries from the perspective of the theory of mechanism design and transactions costs politics. Adam and O'Connell (1997) emphasize the impact of self-interested politicians' taxation choices on investment and welfare and the impact of conditional and unconditional foreign aid in constraining such behavior. Similarly, Dalmazzo and de Blasio (2001) provide a theoretical model and empirical evidence on the influence of oil wealth on the policy choices of self-interested governments. Mayer and Mourmouras (2001) analyze the policy choices of a government subject to influence by vested interests. While conditional IFI assistance improves world welfare and the welfare of the recipient country (relative to the case where assistance is provided unconditionally), the recipient government would prefer assistance to be provided unconditionally. These authors also find that policy performance would improve if conditional assistance were provided in the form of grants rather than loans.

[15] The difference in the macro and structural implementation rates is statistically significant at the five percent level of significance. However, both figures overestimate program implementation as they pertain only to test dates subject to Board approval or review (information on programs experiencing major interruptions is not available in MONA).

is essential for the Fund to find ways to assess the extent to which ownership is present, promote ownership if it is initially lacking, and—if possible—compensate for it if it is slow in coming.

24. Critics of the way the Fund has interacted with borrowing countries have raised a number of issues suggesting that existing practices may have weakened domestic ownership. Some have charged that the Fund has imposed a narrow range of solutions to a wide range of problems and circumstances: a "cookie cutter" approach to conditionality that ignores the diverse needs of individual countries. Some have charged that the conditions on Fund lending have served the interests of creditor countries rather than the interests of borrowers, either because conditionality is thought to have been based on a "Washington consensus" on economic policy or because creditors are thought to have used the Fund to obtain desired policy changes. Some have charged that the Fund has often been heavy-handed both in its negotiating practices (e.g., by having the staff draft letters of intent and giving the authorities too little opportunity to formulate their own programs) and in the extent and intrusiveness of conditionality.[16] Although the merit of these arguments has been much disputed and should not be overestimated, the fact that such perceptions seem to be widely held suggests that a reexamination of the processes of interactions with members may be in order. In other words, if the outcomes are necessary and broadly appropriate but are nonetheless resisted, then the processes by which those outcomes are reached may be part of the problem.

25. Assessments of the authorities' commitment to reform have always been a standard part of the Fund's toolkit, in surveillance as well as program negotiation, but the staff has not had either a proven methodology for making such assessments or an accepted means of evaluating the extent of commitment ex post. Similarly, efforts to foster ownership in the context of requests to use Fund resources have relied on individual negotiating skills. To compensate for weaknesses in these processes, it has often been thought necessary to tighten or expand conditionality, even though the record of success in such cases has been at best mixed.

26. Before examining how conditionality might be structured so as to foster ownership, it is necessary to respond to the charge made by some analysts that the two concepts are fundamentally incompatible. In addition to the papers by Gerald Helleiner cited above, Jan Gunning (2000, p. 3) takes note of "the incompatibility of conditionality and ownership, a point which some donor agencies, notably the IMF, do not like to accept." Many participants in the external consultations undertaken by the Fund earlier this year—including

[16] For example, the "Zedillo Report" on financing for development noted that "concerns are frequently expressed about the breadth of Fund conditionality, the perceived arrogance of its staff, the application of a one-size-fits-all approach to policies, and insensitivity to political realities" (Zedillo and others, 2001 p. 63).

representatives of borrowing countries—made similar points.[17] Others, however, have acknowledged that conditionality can complement the authorities' own commitment by providing international support and financing assurances. For example, Nancy Birdsall (2000) argues that conditionality is "no substitute for ownership, but if ownership is there—by governments that are accountable to their citizens—then agreements, understandings, and yes, 'conditions' can complement that ownership, signaling a government's credible commitment to sustaining their reform efforts." And in a study for the World Bank, William Branson and Nagy Hanna (2000, p. 3) offer this explanation of the potential complementarity:

> Effective conditionality is an instrument of mutual accountability. Rather than imposing a position on the borrower, the Bank and its partners commit themselves to lend under certain jointly determined conditions. This view of conditionality is consistent with the concept of ownership by and partnership with borrowers. External assistance agencies commit themselves through conditionality, while the borrowing government commits itself through ownership of programs it has designed in consultation with internal and external partners. In this sense, conditionality can be seen as a policy compact or mutual accountability to poverty reduction and policy reform.

27. Without question, conditions are most conducive to ownership when the country has no need for external official financial assistance and is conducting economic policies in a sustainable manner. If conditionality is well designed and is part of a process aimed at achieving or restoring such conditions, then just as clearly it will support and complement ownership. What is essential is that the conditions be consistent with the authorities' own understanding of the policies and conditions that will benefit the country and that those conditions be agreed upon through a process in which the authorities are a full partner. Otherwise, as Martin Khor (2001) has emphasized, "Since participation is so limited, and since in many cases the recipient does not really agree with many of the conditions, it is difficult or impossible to have genuine national ownership."

28. The IMF has always responded to financing requests from its members on a case-by-case basis and has attempted to find a path in each country that will lead toward agreement. A common feature of many successful cases is that the authorities initially will resist undertaking difficult reforms, but by the time a program is approved they will fully embrace

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[17] See "Conditionality in Fund-supported Programs – External Consultations," SM/01/219, Supplement 2 (July 17, 2001), revised and posted on the IMF website (http://www.imf.org/external/np/pdr/cond/2001/eng/collab/econ.htm).

at least its major components.[18] In such cases, the final program usually will be the outcome of a productive if lengthy dialogue and may differ substantially from the initial suggestions of both the Fund staff and the authorities. In other successful cases, often those where the balance of payments problem arose under a previous regime or before the onset of a crisis, the role of the Fund has been primarily that of a technical adviser on how the government can best design a set of policies to meet objectives that the authorities already "own." In either case, conditionality is specified so as to provide credibility and assurances to all concerned parties. In contrast, a common feature of many unsuccessful cases is that the government never does completely buy into the program to which some of the authorities agree, and conditionality is designed to ensure that the policies will be carried out anyway.

29. Conditionality based on policy commitments rather than performance has been shown to be ineffective in situations where the incentives for countries to carry out those commitments and the incentives for donors or creditors to stop aid are weak. Because neither bilateral donors nor multilateral agencies can directly observe a country's degree of commitment ex ante, one function of conditionality is to protect the integrity of Fund resources and trigger a cessation of flows if promises are not carried out. If recipients face "time-inconsistent" incentives, leading them to promise more than they intend to deliver, conditionality can help overcome the problem by forcing the authorities to make credible commitments or by increasing the leverage of reformers over those who object to reform (see Vreeland, 2000). In many cases, however, agencies face incentives to disburse their budgets in full, or to continue to provide financing in spite of policy failings—because of a general reluctance to be sufficiently selective, because of the country's systemic or geopolitical importance, or because of the risks of stopping lending to a country with large outstanding debts. In such situations, since agencies are able to use their leeway to grant waivers when ex ante conditions are not met, recipients judge that the credibility of conditionality is weak. It then becomes rational for them to promise more than they expect to deliver in order to secure more financial assistance. Some willingness to lend when the risk of weak ownership is high may be a necessary and on balance a beneficial practice, but if carried too far may undermine ownership as well as credibility.

30. These risks are illustrated by the contrasting experiences of transition economies in the 1990s. The Baltic countries and a few others displayed strong ownership of reforms and were able to implement Fund-supported programs successfully with no more than usual conditionality. In contrast, weak ownership and extensive conditionality seem to have interacted to undermine implementation, especially in structural and institutional reforms, in several other transition countries, including the Kyrgyz Republic (discussed above and in the Annex). While the experience with reforms in transition countries is sufficiently complex to

[18] Frequently, the authorities initially refuse to accept the extent or difficulty of the economic imbalances and insist on implementing a less comprehensive program. Only after that effort fails is it politically possible to take ownership of a sufficiently strong reform agenda.

warrant a separate analysis, some causes—not unique to transition economies—can be briefly identified. One was uncertainty regarding the benefits of some reforms, especially in the beginning of transition when many decision makers were thinking in terms of a different economic model.[19] A second and related factor is low implementation capacity. The early experience with PRSP processes in transition countries indicates that building ownership takes time. Economic education and technical assistance aimed at capacity building, as discussed in Section V, will go a long way toward strengthening both implementation capacity and fostering ownership.[20] A third factor was unclear boundaries of what was covered by structural conditionality, together with discretion in enforcement. Since it was not always clear what actions would stop Fund support, countries may have felt they could violate some conditions included in long lists of structural conditionality without the threat of program interruptions. Fourth, in some cases, the staff may not have had sufficient expertise in specific structural reform areas, and the staff's ability to monitor wide-ranging structural reforms outside the Fund's core areas of responsibility was limited. Fifth, in some transition countries, the Fund was faced with signals of weak ownership, including misreporting, window-dressing of results, lack of support for fiscal targets by sub-national governments, and serious conflicts between the executive branch and parliament. When these problems became manifest, the Fund intensified conditionality—including through prior actions—in an attempt to offset weak ownership. Although this response may have helped safeguard Fund resources, it did not improve implementation as much as had been hoped.

31. To summarize, there is both theoretical and empirical support for compatibility between ownership and conditionality, but conditionality is not an effective substitute for ownership. The literature in this field has identified several possible dangers when conditional financial assistance is offered to governments that are not committed to reform:

- To the extent that governments perceive that policy changes are simply the price they have to pay to receive aid, they may conclude that reforms are not in their self-interest and fail to assume ownership.

- When reform efforts are difficult to observe or assess and external donors and official creditors lack incentives and commitment to cut off aid when reform falters, governments have fewer incentives to sustain reforms for instance, because:

[19] There is, however evidence about a virtuous cycle where policy successes is followed by a recognition of the benefits of reform policies. For example, after relatively successful stabilizations, most central bankers in the CIS countries are now committed to prudent monetary policies. Similarly, ownership of fiscal reforms has clearly increased with stabilization gains.

[20] It should be recognized, however, that in times of crisis the opportunity to building broad-based ownership will necessarily be limited.

  - Withdrawing financing when conditions are not met may lower the probability of repayment of earlier credits, which may lead to defensive lending. Empirical evidence on multilateral development bank lending suggests that disbursement of loans may depend on the recipient's level of indebtedness as well as on adherence to conditionality.

  - Donor discretion over whether to grant waivers when conditions are not met decreases the predictability of aid and creates uncertainty regarding the incentives for carrying out promised reforms.

- If approval of IFI assistance is subject to political influence, the credibility of conditionality will be weakened.

V. NEXT STEPS FORWARD

32. The IMF has taken significant steps in recent years to promote country ownership. First, it has further strengthened its commitment to transparency by encouraging publication of LOIs and other documents explaining programs and conditionality. Second, in the past year the Fund has begun to streamline its conditionality and focus its conditions more clearly on those policies that are critical for the macroeconomic objectives of the program. In addition to making conditionality more efficient and transparent, this shift (by reducing the range of policies covered by conditionality) should increase the scope for flexibility and domestic control in overall program design and policy implementation. Third, the Fund has undertaken a process of external consultations to get a better understanding of the concerns and preferences of officials and other stakeholders in borrowing countries. Fourth, the Fund and the World Bank are taking steps to improve collaboration in their support for country programs. Collaboration in work on low-income countries, where the country-led process for preparation of Poverty Reduction Strategy Papers (PRSPs) is already widely accepted and applied, is now being used as a model for enhanced collaboration more generally, including in those middle-income countries that need ongoing assistance from both institutions over the medium term.[21] An important component of this process is an effort to engage in an earlier and more extended dialogue with the authorities and other domestic stakeholders to promote ownership.

33. Looking forward, the Fund could consider a number of ways to further improve its interactions with members applying to use Fund resources. The most direct, and perhaps the most effective, way to ensure ownership of Fund-supported programs would be for the Fund to be more willing to delay or interrupt lending when doubts about commitment are

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[21] The relationship between the PRSP process and collaboration in middle-income countries is discussed more thoroughly in "Strengthening IMF World Bank Collaboration on Country Programs and Conditionality," SM/01/219, Supplement 1 (July 12, 2001); posted at http://www.imf.org/external/np/pdr/cond/2001/eng/collab/coll.htm.

paramount. Selectivity on the basis of ownership is implicit in the 1979 guidelines on conditionality and has been reaffirmed by the Executive Board, most recently in March 2001.[22] It is not always easy, however, for the Fund, as a cooperative institution with a mandate to treat all members equally, to withhold support from members with urgent financing needs unless the lack of ownership is unambiguous.

34. As a supplement to direct efforts to be appropriately selective, the Fund could take further steps to help develop ownership prior to committing its resources. These process-strengthening measures would involve making adjustments to the way the Fund interacts with borrowing countries, increasing the skill and flexibility with which the staff can respond to individual country circumstances and preferences, improving communications, shifting the allocation of staff resources, and expanding the ex-post review and evaluation processes. Few of these proposals are completely new, and most are already being applied to some extent case-by-case. The issue is the extent to which these practices can be generalized or formalized—where to draw the line—so as to strengthen country ownership of programs without weakening the ability of the Fund to respond to the needs of its member countries.

35. One promising way to promote country ownership in the context of PRGF-supported programs is to deepen the PRSP process. Three aspects of that process, implemented partly in response to the external review of the ESAF, are particularly relevant. First, country officials at the highest political level should be engaged in the process more intensively from the outset. Only when the government has fully committed itself to correct underlying economic imbalances and impediments to progress is it useful for the economic authorities to engage in detailed discussions about specific policies. Second, a transparent and participatory process can help ensure that the program represents the broad interests of society and not just those of powerful interests inside or outside the government.[23] Third, the scheduling of missions and the pace of negotiations should not be dictated by fixed deadlines. Rather, they should be flexible enough to allow for consensus building and domestic preparation of programs.[24] The

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[22] "Since conditionality cannot compensate for a lack of program ownership, Directors agreed that the Fund should seek to limit its financing is such cases." Public Information Notice No. 01/28, March 21, 2001.

[23] For an introduction to the literature on how interest groups contribute to "government failure," see Krueger (1990).

[24] In the context of a recent internal review of mission experience conducted by the Office of Internal Audit and Inspection (OIA), some authorities and Executive Directors have questioned the frequency of missions—especially in view of capacity constraints in member countries. The review suggested that the authorities' readiness to receive Fund missions should be assessed more systematically, and it recommended strengthening the approach for assessing and responding to authorities' lack of readiness by: (i) area departments reporting their assessments of members' readiness in briefings and debriefings for management;

(continued…)

PRSP process has necessitated longer missions in some cases and has required a more intensive use of staff resources, but it has already shown signs of leading to increased local participation and commitment. Some of these aspects may also be useful guides for promoting national ownership in non-PRGF cases. However, in many such cases, especially those triggered by financial crises and a loss in investor confidence, time pressures may be greater or the program may be focused on overcoming temporary disequilibria. A period of experimentation would be required to find the right balance between rapid response and foundation building.

36. One way to ***increase response flexibility*** would be to apply more systematically the general presumption that the authorities should have the initial responsibility for proposing a reform program. This expectation would help to ensure that the authorities had an understanding and acceptance of the need for reform and that their proposals would constitute the starting point for negotiations.[25] By the time the staff is ready to brief management on its plans for a program mission, the staff should have been able to ascertain—through its regular surveillance consultations and through preliminary communications on the country's request for assistance—at least a broad outline of the policy changes that the authorities are proposing to undertake to deal with the country's balance of payments problem. The briefing would include those proposals and the staff's initial reactions and would propose a flexible strategy for negotiating a program acceptable to the Fund. In cases where the country is unable or unwilling to develop a viable reform program on its own initiative, or where it would be politically awkward for the authorities to present a program that might be subject to change through negotiation, the staff should be expected to present the authorities with a genuine menu of options.[26] In doing so, it is critical that the policy options are compatible

(ii) mission chiefs taking steps to improve member country preparedness by streamlining country questionnaires, providing adequate time for preparations in member countries, and facilitating members' grasp of policy issues; and (iii) area departments examining opportunities for reducing mission frequency for countries that have readiness problems and receive four or more area department missions annually.

[25] As Drazen (2000) has argued, "When several proposals are up for consideration, the order in which they are considered can determine which gets adopted" (p. 71). Also see Birdsall's (2000) criticism of the "analytic near-monopoly of the [IFIs] on … economic and social reform."

[26] Although Fund staff try to present options, officials in borrowing countries often feel that the choices are much too narrowly circumscribed. In a recent submission (October 15, 2001) in response to the staff's call for external comments on the conditionality review, José Antonio Ocampo (Executive Secretary of the Economic Commission for Latin America and the Caribbean) noted that IMF conditions "severely constrain the choices countries face." He concluded that "it is essential to increase the effort by the IMF to effectively provide alternative policy packages to governments." Similarly, in a keynote address to a seminar on

(continued…)

with the incentives, preferences, and interests of the authorities and other influential stakeholders in the country.[27] The aim of this flexible response would be to ensure that each country assumes the lead role to the fullest extent that is consistent with its own preferences and capabilities.

37. Another proposal for increasing flexibility is to provide members more leeway in the timing of structural reforms. In some cases (as in Pakistan, for example) leeway can be achieved by starting with a stand-by arrangement focused on macroeconomic stabilization and following it with a more structurally oriented EFF or PRGF arrangement when conditions are right. Floating-tranche conditionality might also be helpful in some circumstances, meaning that some disbursements under an arrangement would be linked to implementation or performance but without a specified date. As Khan and Sharma (2001) note, allowing flexibility in timing for implementing structural reforms could enhance local control over the process and thus strengthen ownership. The World Bank has had some success with floating tranches in recent years, and this type of conditionality has been used effectively by the Fund in certain situations (e.g., augmentation of EFF arrangements under the Brady Plan and floating completion points under the HIPC initiative). Similarly, shifting conditionality more toward broad policy objectives rather than specific policy tools would give the authorities more control. In both cases, careful attention would need to be paid to the Fund's ability to provide clear financing assurances to its members, meet the macroeconomic objectives of programs, and restore financial stability in a limited period of time. These issues are examined more thoroughly in a related paper on the modalities of conditionality.

38. If the Fund is to increase the flexibility in its conditionality by enough to make a real difference in country involvement and ownership, it should be open to programs that differ from the staff's preferred options, as long as the core objectives of the program are not compromised.[28] A fully successful result would be that the country-led framework worked as well as, or better than, the program preferred by the staff. But even if such programs were not

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donor conditionality held in Nairobi (October 24-26, 2001) with participation by Fund staff, the Finance Minister of Kenya called on the IMF and the World Bank to "always ensure that a range of options is available from which the authorities can choose."

[27] As noted earlier (see footnote 5), the role of stakeholders outside government may in some instances be to promote narrow interests rather than general welfare. The distinction between "vested interests" and "civil society" is critical but may be ambiguous or controversial; see Dawson and Bhatt (2001).

[28] Conditionality associated with Fund financial support usually reflects compromises reached through negotiation. The question raised here is whether the staff should give greater weight to country-led strategies at the outset of the negotiations.

as effective as hoped, the flexible approach might still be welfare-improving if it increased the likelihood that the agreed program would be fully implemented.

39. To avert misunderstandings and avoid proposing programs that have a low probability of being implemented, the Fund might need to strengthen its capabilities on ***analyzing issues of political economy***.[29] Negotiation of programs that will be effectively owned by the authorities, especially when the programs require structural reforms, may in some cases require a broader range of skills than those that the Fund has always emphasized.[30] In addition to determining what must be done to resolve a country's macroeconomic problems—which remains the *sine qua non* of program design and conditionality—the staff must have a strong sense of what social and political difficulties might limit the feasibility of implementing the program in the required time frame, and how to strengthen feasibility either through program modifications or communication. More intensive integration of political economy considerations into program design would likely require additional resources and training of staff.

40. More specifically, improvements in the area of political economy analysis might take one or more of several forms, including:

- expanding and systematizing the role of resident representatives as evaluators of the feasibility of proposed reforms;

- expanding recruitment of staff with a broad range of social-science skills and interests, beyond (but not substituting for) technical economics training and macroeconomic experience;

- drawing more heavily on consultants with expertise in particular countries or on particular problems;

- increasing the continuity of staffing on country desks and mission teams, in recognition that policy advice on structural issues may be more complex and country-specific than it is for macroeconomics;

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[29] Social safety net measures have been incorporated in some programs partly to secure political support for a wider range of reforms. See IMF Occasional Paper 191. The Fund's Social Development Officers provide assistance in the analysis of social impacts of proposed structural measures. In addition, EXR staff have wide contacts in the press, civil society, and political circles, are in regular communication with these contacts, and assist other departments in keeping abreast of relevant political developments.

[30] See Bird (2001), on political economy issues relevant to the Fund, and Willett (2000a, 2000b), on the need for a framework for IFIs to analyze these issues.

- adjusting the pace and focus of program missions to allow for consensus building and local participation;
- increasing the coverage of such issues in briefings and debriefings for management, and in staff reports;
- training staff more intensively in political economy issues and negotiating skills; and
- strengthening the staff's ability to make objective assessments about the likelihood of success of proposed arrangements, and systematically communicating those judgments to management and the Board.

41. Consideration could also be given to the reprioritization of ***technical assistance*** (TA) activities. Even though TA is a general benefit and privilege of membership, in practice there has been a strong connection between TA and program work. About 60 percent of technical assistance in recent years went to countries with Fund-supported programs, with HIPC/PRGF countries alone accounting for 40 percent of all TA.[31] Lengthy policy matrices derived from TA reports have been incorporated directly into policy programs supported by Fund arrangements, contributing to the impression of greatly expanded structural conditionality.

42. Key lessons of the recent review of technical assistance include the need to enhance country ownership of the reforms supported by TA to adapt assistance to local situations, and to give TA more of a medium- and longer-term focus. Similarly, a common complaint expressed by participants in the 2001 external consultation process on conditionality has been that TA has not been effective in helping countries develop the capacity to design, implement, and take ownership of economic policies. Because ownership depends in part on the country's capacity to implement effective reforms, it could prove beneficial to aim the Fund's TA more at capacity building, not necessarily linked to an existing Fund arrangement.

43. In some countries with active Fund-supported programs, a strengthening of administrative capacity may itself be part of conditionality.[32] More generally, however, in program countries TA should complement, not substitute for, structural conditionality.[33] In

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[31] See, IMF, "*FY 2000, Annual Report on Technical Assistance*", p. 3. Available on www.imf.org.

[32] For example, fiscal targets may be missed due to weak public expenditure management systems and despite the good intentions and full ownership of the authorities.

[33] See "*Summing Up by the Acting Chairman, Review of the FY 2000 Annual Technical Assistance Report and Discussion on Alignment of Technical Assistance with the IMF's Policy Priorities, Executive Board Meeting 01/2-January 5, 2001*", BUFF/01/2, January 10, 2001.

addition, the Fund's encouragement to members to adopt voluntary standards and codes aimed at strengthening their financial, fiscal, and statistical systems has been complemented by positive responses to members' requests for targeted TA to implement measures associated with the standards and codes. [34] The ownership of TA in these instances and its contribution to strengthening capacity are not in question, given the desire on the part of member countries to exploit the potential financial benefits of compliance with international standards. The Fund's planned participation in the Partnership for Capacity Building in Africa (PACT) is another example of a home-grown cooperative effort aimed at building capacity. Under this plan, the Fund will set up regional assistance centers offering and following up on capacity-building programs in the Fund's areas of expertise.[35]

44. Ownership might also be strengthened by better ***communication*** by the Fund. Many staff missions are already subject to intense local and even international publicity. Engaging properly trained staff in the domestic debate has in many cases helped inform that process. Generalizing that type of activity could reap dividends, as long as it is a genuine two-way exchange of views that respects the country's circumstances and does not reinforce perceptions of the Fund as overly intrusive or overbearing. A well structured campaign would enable the Fund to explain its views on policy options and the trade-offs involved, its projections of the consequences of acting and not acting in the recommended way, the reasons for any differences in view between the Fund and the authorities or other domestic stakeholders, the nature of the constraints on available financing from the Fund, other creditors, and donors, and how the downside of reform might be handled (unavoidable short-term costs, compensation for those most severely affected, and proposals for handling other risks and vulnerabilities).

45. Finally, consideration could be given to focusing the ***ex-post review and evaluation*** process on ownership problems in cases where negotiations break down or countries fail to implement programs. A prototype might be the occasional aid effectiveness reviews that have been conducted by independent and external ad hoc evaluation bodies; see, for example, Helleiner and others (1995) for a review of donor assistance to Tanzania.

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[34] See *"Ensuring Alignment of Technical Assistance with IMF's Policy Priorities,"* SM/00/284 (December 20, 2000).

[35] The PACT is a collaborative framework between African countries and their international development partners established in 1999. Unlike previous programs that were externally conceived, PACT is an African initiative meant to strengthen human and institutional capacities in sub-Saharan Africa, spur economic growth, reduce poverty, and improve living standards. The initiative is expected to bolster capacity in the public and private sectors and civil society by ensuring better financial and development management, improved legislative, judicial and regulatory frameworks, and strengthened communications and institution-building. See World Bank News Release No. 99/2200/AFR, May 21, 1999.

VI. Issues for Discussion

46. Strengthening ownership does not require new Fund policies, because the importance of ownership is already recognized in the 1979 conditionality guidelines and—more forcefully—in the outcomes of earlier Board meetings in the current conditionality review. Moreover, encouragement of national ownership is already reflected in the institution's best practices. What is now required is more systematic attention to this issue and more specific guidance on how to generalize the best outcomes. Directors' views are requested on the following analysis and strategy.

47. This paper has summarized evidence, based on previous studies done in the Fund and by others and on several recent Fund-supported programs, suggesting that national ownership of programs is a key determinant of success and that intensifying conditionality is not likely to be effective when there is little or no ownership. Conditionality can, however, complement and strengthen ownership, particularly if it is reached through a mutually acceptable and transparent process and if the conditions are compatible with the incentives and preferences of the authorities and other influential stakeholders in the country whose support will be needed for successful implementation of the reform measures.

48. The paper makes a number of recommendations for a more systematic implementation of existing policies that would affect the way the Fund interacts with borrowing countries. The thrust of these recommendations is (a) to provide countries with more flexibility and responsibility in the design of their Fund-supported programs; (b) to clarify and strengthen the role of national commitment as a basis for judgments about when to approve financing arrangements; and (c) to enhance the ability of the staff to analyze and respond to issues of political economy that pertain to effective implementation and ownership of the programs supported by the Fund. Taken together, these three elements could substantially improve the prospects for successful outcomes.

49. A strategy to enhance flexibility and country ownership is already in train under the PRSP approach to the Fund's support for low income countries. Elements of this approach could be used to strengthen country-led frameworks for middle-income countries, in cases where the country itself is prepared to develop such a framework and where the Fund's involvement is not expected to be limited to short-term stabilization. More generally, the Fund can encourage countries to take an earlier and more active role in program design and articulation, including by an expectation that the authorities will draft letters of intent and take a leadership role in communicating the contents of the program within the country. The modalities of conditionality can also be used to reinforce national ownership, including through innovative techniques that might include floating tranches or outcomes-based conditionality under appropriate circumstances(as discussed in a related paper on modalities).

50. Several additional steps could help to further strengthen country ownership. First, it is crucial to ensure the active support and durable commitment to the program by the top political leadership. Second, more effort could be devoted to strengthening the staff's ability to analyze issues of political economy pertaining to the design of Fund-supported programs,

including the analysis of factors that might limit the breadth of support for a program and prevent it from being fully implemented. The role of resident representatives is especially important in this regard. Third, a shift toward a longer-term focus for technical assistance to borrowing countries could contribute to capacity building. Fourth, measures could be taken to intensify or improve the Fund's communication of its views on economic policies, especially within borrowing countries and where there are sharp initial differences between the Fund and domestic stakeholders, but not as a substitute for effective communication by the authorities of their own views on what reforms are needed. And finally, more extensive and independent ex-post evaluation of programs should lead over time to better understanding of what is needed and what is feasible and ultimately to stronger ownership and better program design.

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ANNEX: Ownership Issues in Selected Recent Programs

51. Recent examples of reform programs illustrate how domestic ownership or its absence can either strengthen or impair the likelihood of successful implementation of economic policies, and how in some cases ownership can be enhanced through dialogue and negotiation.

Zimbabwe

52. In the early 1980s, Zimbabwe maintained the extensive system of government controls to support industrial autarky it inherited from the previous government, coupled with a large-scale program of social expenditures. By the end of the decade, following discussions with the Fund, the World Bank and other external creditors and donors, the government had come to regard this development strategy as unsustainable. A new program of fiscal retrenchment and economic liberalization was initiated, supported by an ESAF loan (1992-95).

53. Even though proponents of reform dominated the government position in the first phase (through 1993), the government's commitment to reforms was fragile. From the beginning of the program, forces within government and the political leadership opposed it. The fiscal consolidation, which was partly drought-related, included reductions in social expenditure and civil service retrenchment. But while fiscal adjustment needed strong consensus-building efforts, not enough was done to create broad-based support. The authorities' commitment to the program weakened decisively in 1993, following bread riots, university student unrest, and a general stiffening of opposition within government.

54. Factors contributing to the loss of ownership included (i) agitation among civil servants against retrenchment and other civil service reforms; (ii) the deterioration of the health of the Minister of Finance—the senior official most committed to reforms; and (iii) absence of political backing of reforms by the President and important business groups hurt by the dismantling of trade protection (Botchwey and others, 1998, p. 110). The failure to deepen support for the program within government, the ruling party, and society at large meant that it was not possible to successfully implement the envisaged program reforms.

55. In 1998-2001, and in the face of mounting economic and public health crises and internal strife, staff and management strove to remain engaged in Zimbabwe. An agreement was reached in 1999 on a program of reforms to be supported by Fund resources. In the event, the lack of ownership of a reform agenda was too deep-seated and too widespread. The 1999 stand-by arrangement veered sharply off track soon after its inception because of unsustainable fiscal policies, including wage and defense spending overruns, and a deterioration in the application of the rule of law. The economic crisis deepened in 2000, fueled by mounting fiscal imbalances, further erosion of competitiveness, election-related violence (including farm invasions and casualties), and compulsory land acquisitions. The government's mismanagement of the economic and political crisis further undermined

confidence and led to arrears to official creditors, including to the IMF, which then declared Zimbabwe ineligible to use Fund resources.

Kyrgyz Republic

56. Since independence, the Kyrgyz Republic's record in macroeconomic and structural policies has been mixed. In the early 1990s, following the successful introduction of a national currency in 1993, the country was an early reformer and made good strides in macroeconomic stabilization and structural reforms. However, while macroeconomic performance has continued to improve significantly in the second half of the decade, and growth has been good relative to other CIS countries, progress in structural reforms has been uneven. Poverty has increased, some social conditions have worsened, and the external debt burden has reached unsustainable levels.

57. This mixed record of reform is reflected in the outcomes of Fund-supported programs with the Kyrgyz Republic during the 1990s. Of the three programs approved from 1993 to 1998, two—the 1993 SBA and the 1998 ESAF (later PRGF) loan—suffered major, irreversible interruptions, while performance under the 1994-97 ESAF program was more satisfactory. The problems lay primarily in the poor implementation of structural reforms rather than in the conduct of stabilization policies. Divisions within government regarding the advisability of reforms, resistance of certain interest groups as expressed in parliament, lack of coalition-building by the government with parliamentary groups, and weak coordination of economic decision-making were major causes behind the interruptions.

58. Following independence, the Kyrgyz Republic got off to a good start, introducing a national currency and exiting the ruble zone before any other CIS country—a politically difficult move at the time. This created the conditions for successful macroeconomic stabilization that could be supported by the Fund. The first SBA was approved by the Executive Board in May 1993 for SDR 27 million (42 percent of quota) over 11 months. Following two purchases, the program went off track after several performance criteria for end-September 1993 were breached by wide margins. The drive for macroeconomic stabilization and structural reforms had lost its momentum following the emergence of a serious split within the government and pressure from the legislative assembly against reforms. Directed credits to enterprises had resumed, fueling an acceleration of inflation, and structural reforms had ground to a halt. The authorities were sharply divided over the political advisability of reforms. While the president favored continuation of the reform effort, he was unable to act decisively, due to resistance from the prime minister, other reluctant reformers in government, and increased pressure against reforms by parliament.

59. The parliament played a key role in sabotaging the program. All parliamentarians at the time had been appointed before the breakup of the Soviet Union. Their majority were managers of state enterprises or local officials. In May 1993, parliament had made changes to the constitution that weakened the power of the presidency, hindering the president's ability to act as chief executive. Following the approval of the SBA, parliament increasingly put

pressure on the government, as reforms threatened to weaken the power wielded by the enterprise managers and local state officials. Finally, in mid-December 1993, parliament removed the prime minister, and a new government was formed with a makeup that made further progress impossible.[36] To resolve the political deadlock, the president called a national referendum on reforms for early 1994. In the event, the lack of clearly defined budgetary and structural policies precluded any possibility of restoring the program.

60. Lack of experience with the functioning of market-based economies and of macroeconomic linkages also contributed to the initial program failures. By the time of the first review it had become quite apparent that senior government officials had very limited understanding of either what macroeconomic stabilization and transition to a market economy would entail or of the link between monetary expansion and inflation. Influential cabinet ministers in charge of economic portfolios lacked elementary understanding of how market economies solve the production, allocation and distribution problems without central decisions and interference by the government.

61. Conflicting policy advice from donors and multilateral agencies and easy access to foreign credits may also have undermined program implementation in the early years of transition. Even though much of the assistance was on concessional terms, it added up to a serious accumulation of debt and was readily enough available to weaken the incentives for strong policies.

62. Economic performance and the political acceptability of reforms improved during the 1994-97 ESAF, as the economy bounced back from the large output shock of the early 1990s and the structural transformation toward a market system continued. Macroeconomic indicators were among the best in the CIS, fiscal and monetary policy stabilization was consolidated, and progress was made in implementing structural reforms in a number of areas (financial sector, budgetary reforms, privatization, and the introduction of modern accounting standards).

63. Program implementation benefited from a variety of factors. First, the political environment became more conducive to reforms. Key policy makers found the political will to stay the course of reforms aiming to move the country to a market-based system as they gradually came to understand their benefits. Second, as the authorities' understanding of macroeconomic issues improved and their openness and receptivity to the Fund gradually increased, their cooperation with the Fund improved significantly. Third, program implementation benefited from good program design and forceful enforcement of

[36] In late 1993, the speaker of parliament went so far as to threaten to block legislative approval of the 1994 budget unless large sums of money were made available to finance the construction of a new parliament building, to hire support staff, and to provide parliamentarians with apartments and automobiles.

conditionality. Performance criteria and structural benchmarks were clear and precise and the Fund was willing to stop the program when it went off track (e.g., in 1995). Finally, a large and effective technical assistance program contributed to enhancing the authorities' understanding of economic issues and was especially valuable at the early stages of the reform process. However, it was felt that short-term missions were less beneficial than the placement of long-term advisors.

64. Despite the generally good program implementation, there were several weaknesses, in addition to those noted above. First, the government's decision-making process was at times non-transparent, owing to the country's relatively short democratic tradition and ethnic and regional heterogeneity. Internal disagreements in the cabinet and the parliament continued to play a destabilizing role: reform measures were revoked and unwarranted and unenforceable laws were passed which had substantial fiscal impact. When politically expedient, the president departed from his overall commitment to reforms by issuing decrees that undermined program objectives. Some local officials stuck to Soviet-era traditions and refused to implement key fiscal or agricultural reforms. Second, special interest groups exerted influence on key policy makers. Sometimes, this resulted in the government offering sovereign guarantees for foreign nonconcessional project financing, which, when called, contributed further to the accumulation of external debt. Third, the implementation of some laws was inconsistent. Finally, some reforms may have been too ambitious in relation with the country's administrative capacity.

65. Lack of political commitment was also at the root of the interruption, in July 2001, of the program supported by the 1998 ESAF loan. Implementation of financial policies in February-July 2001 had been successful and all prior actions had been implemented in the run-up to the July 2001 Board meeting. However, despite the central bank's partial independence and its commitment to the Fund-supported program, fiscal policy proved again to be the program's Achilles heel. Tax cuts had been enacted which were not accompanied by offsetting fiscal measures and which were inconsistent with the objectives of the ESAF-supported program.

66. The fiscal slippages are partly explained by the fact that 2000 was a year of parliamentary and presidential elections. External shocks, and in particular the 1998 Russian financial crisis, also contributed to program deviations. This incident also underscores a more general problem: the authorities regularly made strong commitments to the program but in more than ten instances after 1995 they did not meet those commitments. The deviations were not always very large or fundamental, and they were often waived—though not without dissent. The cumulative effect of such incidents weakened the authorities' credibility.

Uganda

67. Uganda's experience offers a valuable contrast to that of Zimbabwe. Uganda turned to the Fund in 1987 following a failed experiment with state-directed and inward-looking development and after a thorough national debate. The government of President Museveni,

which came to power in 1986, was initially opposed to much of the Fund's policy advice but requested a SAF loan mainly to attract donor aid (Botchwey and others, 1998, p. 89). Given the lack of government conviction, little progress was made at the outset in structural reforms.

68. Successive ESAF-supported programs in Uganda were more successful (Boughton, 2001, pp. 679-84). Over the past 12 years, Uganda has implemented wide-ranging macroeconomic and structural reforms supported by the Fund and other donors in a series of programs that did not experienced major interruptions. Trade and exchange rate liberalization were at the core of the first ESAF program (1989-1992). Program ownership was promoted by taking the social impact of the crisis into account, as it was recognized that some vulnerable groups would not benefit in the short run. Ownership was further solidified following a fiscal crisis in 1992, when the president put strong advocates of reform in charge of economic policies. By the time the 1994 ESAF program was approved, the authorities had already stabilized the macroeconomy and structural reforms were at the core of the program's objectives. Uganda's 1994 and 1997 ESAF arrangements were broadly on track. The authorities pursued prudent fiscal and monetary policies, together with structural reforms and increased openness. Consequently, real economic growth was raised and became more broad-based and progress was initiated in reducing poverty. Social expenditures were increased, both in relation to GDP and to total government expenditure, and efforts to reduce the spread of HIV/AIDS were highly effective.

69. Ownership of reforms was assured through a long process of internal debate and consensus-building initiated and nurtured by the president who publicly defended reforms. This public education process culminated in a national conference of social stakeholders, convened in December 1989 to debate exchange rate issues. Ownership gradually took root beyond the president and government technocrats, including in interest groups that benefited from economic liberalization. The Fund helped ownership by agreeing to publish the PFP in 1995. The government's role in setting the policy agenda and authoring major macroeconomic policy documents has been strong since the early 1990s. Although there were continuous Fund-supported programs throughout the period, most of the key decisions were taken by the government on its own initiative. Ownership was weaker as far as the conception of structural reforms is concerned (Botchwey and others, 1998, p. 92), largely because of opposition from civil service officials and staff of state enterprises who were seeing their perks and power decline. Parliament gradually became more involved in reforms to the point that its support was deemed to be crucial for their success.

70. Effective program design, including successful domestic revenue-raising efforts to make up for lost trade taxes and reintegration of demobilized soldiers into civilian life, helped to maintain broad program support and to neutralize the resistance of vested interests to structural reforms. These reforms, and especially the elimination of the state monopolies over the marketing and rail transport of coffee, were key to improving competitiveness. When the size of the civil service and the army were substantially reduced, the government implemented an effective program of assistance to demobilized soldiers. This helped the

former soldiers' reintegration in civilian life and avoided unrest. A privatization program was initiated and expanded, and financial and fiscal sector reforms were implemented. The establishment of an independent revenue authority was key to the effort of raising domestic revenues (including through a VAT), which was needed to make up for the loss of import tariff revenues. Ownership is also being strengthened through the implementation of an anti-corruption action plan through the recently established Ministry of Ethics and Integrity.

Bulgaria

71. In Bulgaria, an initial lack of commitment to structural reform was succeeded by a clear break from the past and a strong and sustained commitment to macroeconomic stabilization and structural reform. Following a severe banking and foreign exchange crisis culminating in near hyperinflation in early 1997, a reform-minded government was elected. Widespread program ownership was cultivated by the authorities, fostered by the Fund, and reinforced by public support for economic reform. This contributed crucially to the successful formulation and implementation of an EFF-supported program and helped put Bulgaria on the path to EU accession.

72. Following the aborted 1994 SBA, the Fund remained cautious about supporting the authorities' economic policies, mainly because of the unwillingness of the authorities to adopt urgently needed structural reform policies and their apparent expectation that they could succeed without support from the international community. While the government enjoyed a parliamentary majority, divisions within the dominant party and entrenched interest groups cast doubt on its ability to marshal support for needed structural reforms. Fund refusal to support the authorities' program continued until mid-1996 when, following lengthy negotiations, a front-loaded program of stabilization and reform held promise of a break from the past. A SBA, approved by the Board in July 1996, included a significant number of prior actions as a way of testing ownership. However, the Bulgarian government's strict adherence to the program and their willingness to press ahead with structural reforms was weakened by intra-party opposition. By October, delays in implementation and an unsettled political situation had pushed the program off-track. The staff proposed to the authorities a more radical approach to macroeconomic stabilization that involved the adoption of a currency board arrangement as a means of abruptly changing expectations and achieving a pattern of interest rates that would be consistent with budgetary and confidence-building requirements.

73. In the midst of crisis, the newly elected president appointed a caretaker government in February 1997, with a mandate to negotiate and conclude loan agreements with IFIs. The president and prime minister consulted with major political parties on commitments undertaken to introduce a currency board in the context of the SBA. As a result of these consultations a "declaration" was attached to the MEFP proclaiming the readiness of the major political parties to cooperate in fulfilling the agreement with the Fund. The widespread political support behind the program was manifested in the authorities' decision to publish the program's prior actions and in their request for the Fund's assistance in nominating the head of the issue department under the currency board.

74. Elections held in April 1997 shifted political power to a new majority but also ushered in a period of national unity. With support across the political spectrum, the new parliament adopted a declaration of national consensus endorsing the introduction of a currency board, anti-corruption measures, EU membership, alleviation of the social costs of reform, and a medium-term program of economic revival. The government vowed to stop "nationalizing losses and privatizing profits" by accelerating privatization, closing loss-making enterprises, reducing state interference in the economy, fighting crime and corruption, and creating a secure and stable economic environment for foreign investment.

75. In preparation for an EFF-supported program, the government organized a workshop to present its economic objectives to the IMF, World Bank, EBRD, EIB and the EU. The purpose of the workshop, held in March 1998, was for the participants (government, international organizations, and official creditors) to reach understandings on the main policy objectives for the next three years and on the broad strategy for achieving those objectives. The workshop was followed by two negotiating missions, which reached agreement on the details of a three-year EFF-supported program that was approved by the Executive Board in September 1998. Between missions, a detailed policy matrix was published locally and debated in parliament.

76. With broad political and public support, the authorities continued their commitment to the strategy and pursued an ambitious program even in the face of adverse external and domestic circumstances. Over the next three years, substantial progress was made in the privatization of assets outside the energy, transport, and infrastructure sectors. However, the restructuring process in preparation of privatization in these sectors (which account for about 34 percent of total long-term state owned assets) fell behind schedule. In March 2001, the Fund approved the completion of the fifth and final review under the extended arrangement.

Korea

77. Korea's experience with the 1997 Fund-supported program illustrates both the dynamic nature of country ownership and the importance of broad, national commitment for successful program implementation. While the leadership vacuum during the presidential election campaign contributed to the initial failure to turn the economy around, the ensuing crisis galvanized the nation. Political, business and labor forces rallied behind the reform effort and created the national consensus needed to ensure good program implementation.

78. Following a long period of strong economic growth and rapid industrialization, by 1997 the Korean economy was running into difficulties, reflecting in part important limitations in the model of state-led, export-oriented development. Government intervention in investment decisions, close relationships between banks and industrial conglomerates (chaebol), weak regulatory and supervisory systems and inappropriate sequencing of capital account liberalization in the context of limited exchange rate flexibility had led to high levels

of short-term debt and severe maturity mismatches.[37] Bankruptcies in a number of highly leveraged chaebol and steep declines in stock prices (amounting to 40 percent between the peak of November 1994 and end-1996) had weakened the financial system. Capital outflows and a rapid withdrawal of credit lines followed later in the year as contagion from the regional crisis set in and international ratings agencies downgraded Korean entities.

79. As its foreign reserves dwindled, Korea was forced to seek support from the Fund on November 21. Using accelerated procedures (established in September 1995 to enable swift responses to crises), the Fund quickly approved a three-year stand-by credit for SDR 15.5 billion on December 4, 1997. The program aimed to tighten monetary and financial policies in order to narrow the external current account deficit, contain inflation, and create the conditions for a resumption in output growth. To restore credibility, the program also aimed to attack long-standing structural weaknesses through comprehensive financial and corporate sector restructuring.

80. Although the Fund regarded the program as strong, questions were raised at the time of its approval about the firmness with which it would be implemented because of what was viewed as inadequate program ownership by the authorities. The interest rate policy adopted in the days prior to the program's approval and unfavorable comments by the Minister of Finance had contributed to these doubts. Moreover, in the days following the program's adoption, candidates in the presidential election scheduled for December 19—all of whom had given private assurances to the Fund of their willingness to support the program—had publicly distanced themselves from the program's objectives, casting renewed doubt about the government's commitment to the program.

81. The initial positive market reaction to the announcement of the program proved extremely short-lived. By mid-December, Korean markets were in turmoil after it became known that foreign exchange reserves were lower than previously declared, and concerns mounted about the overhang of Korea's massive short-term external debt and the impact of tight monetary policies on the corporate and financial sectors. Market fears were compounded by concerns that official financing under the program was barely enough to cover maturing short-term debts. Given the fragile situation, individual foreign banks had strong incentives to withdraw credit lines. The rating agencies downgraded Korean entities further, and capital outflows continued. The dollar value of the won dropped by 45 percent, and the stock market suffered big losses. The drain on reserves continued as the Bank of Korea continued to provide foreign exchange to enable commercial banks to meet their external obligations.

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[37] For detailed evaluations of the Fund-supported programs with Korea, Indonesia and Thailand, see Lane et. al., 1999; Boorman et. al., 2000; and Chopra et. al., 2001.

82. These setbacks were a turning point in the crisis as it became clear that a strengthening of the program was needed, which in turn required a national effort to build broad ownership for reforms. This effort, which succeeded in establishing broad consensus in favor of the difficult structural reforms, was the key for the program's subsequent success. On December 24, 1997, the Fund activated additional financial support after the government, in consultation with representatives of the president-elect, decided to intensify and accelerate the program of macroeconomic and structural reforms. The Fund and other IFIs accelerated disbursements, voluntary rollovers increased, and maturing claims by international banks on Korean borrowers were extended. The government also began discussions with international bank creditors on a voluntary and market-based consolidation of Korean short-term debt.

83. The intense, unexpected crisis and market turmoil had galvanized Koreans to put aside their differences and strive for the broader national interest. The authorities and broader political forces moved decisively to win public support for the program. The outgoing president and leading presidential candidates publicly reaffirmed their strong commitment to the program. An interministerial committee was formed to monitor and coordinate program implementation. Broad national ownership was achieved following the election of president Kim Dae-jung. He made acceleration of structural reforms—beyond what was envisaged in the program—a hallmark of his presidency. An open dialogue began, aimed at maintaining social peace, in part by strengthening social safety nets, and creating a tripartite social compact between labor, business, and government. Koreans of all walks of life lined up to donate their gold jewelry to help the government's crisis-fighting efforts. This was a convincing demonstration that Koreans had the determination to overcome this crisis, just as they had overcome other crises in their history.[38]

84. Financial market conditions improved significantly in the early months of 1998 as confidence gradually returned. The balance of payments swung from deficit into surplus; the BOK's foreign exchange reserves were replenished; the won stabilized and started to appreciate; an outburst of inflation was prevented; and interest rates started to come down. GDP bottomed out in the second quarter of 1998. The improvements in financial market conditions were greatly helped by a smooth transition to a new government and the agreement with foreign banks to roll over the short-term debt of Korean banks. However, unemployment increased in 1998, bringing hardships to many people.

85. The Korean experience—and the Asian crisis more generally—has yielded some basic lessons about the role of ownership. [39] First, successful reforms require the commitment

[38] Hubert Neiss, 1998, "Korea One Year After Crisis - Some Personal Reflections: A Commentary", Korea Times (November 30).
[39] Stanley Fischer, 1999, "The Asian Crisis: the Return of Growth". Comments prepared for delivery at a dinner of the Asia Society, Hong Kong (June 17). Available at http://www.imf.org/external/country/KOR>.

of the political leadership of a country. Each of the IMF-supported programs in Asia took hold only when the political leadership changed and the authorities themselves designed or endorsed the policies and sought the backing of the people's representatives in legislatures. Second, broader public support for reforms is also essential. As emphasized by the Managing Director (Michel Camdessus), only participatory decision-making systems can guarantee the needed durable popular support for in-depth reform in a democracy.[40] This requires both consultation and discussion with a wide spectrum of society and adequate social safety nets for the poorest. Key interest groups, especially labor unions, must be involved if a reform program is to be truly participatory. In Korea the Fund actively encouraged the authorities to pursue a tripartite consultative approach with labor unions and employers. Third, adequate social safety nets are a key to maintaining social peace and improve the chances of peaceful implementation of the ambitious programs needed.

86. Fourth, the Fund helped build national commitment to the reform program by reaching out to groups and personalities outside the government, through frequent staff contacts, visits by senior Fund management, and participation in the domestic public debate. The Managing Director played a personal role in encouraging the authorities to pursue a tripartite consultative approach. Fund officials talked to opposition parties, parliamentarians, union leaders, religious leaders, bankers, students, academics, and others. They also reached to the broader population through TV interviews and newspaper articles. The Fund explained the rationale of the program and the constraints on both sides, and responded to criticism. While this did not aim to produce agreement on every detail, it did contribute to economic understanding and education and raised the level of debate, thus helping to establish a broad consensus in favor of the program. Publication of LOIs was a big help in this respect.[41]

87. Fifth, transparency in private or government financial operations and good governance are important in ensuring broad based ownership and international support. In the long run, opaque and excessively close relationships among governments, corporations, and financial institutions only result in unclear accountability and inefficient investment and lending decisions. In the case of Korea, this concealed the extent of the country's problems, so much so that corrective action came too late, forcing the Fund to intervene just days before the central bank would have exhausted its reserves—too late to reverse the initial collapse of

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[40] Michel Camdessus, 1999, "After-crisis thoughts on poverty alleviation and peace for development", Address During the High-Level Segment of the 1999 Substantive Session of the UN Economic and Social Council Geneva (July 5). Available at <http://www.imf.org/external/country/KOR>.

[41] Hubert Neiss, 2001, "Conditionality and Program Ownership", Remarks delivered at the IMF Seminar on Conditionality, Tokyo (July 10). Available at http://www.imf.org/external/country/KOR>.

market confidence.[42] The crisis led to a reconsideration of the tight links among business, government, and the financial sector, and it is leading to more transparency in the economy and in economic policy-making, with wide ranging consequences.[43]

Brazil

88. Brazil's economic history in the years prior to the adoption of the 1994 *Real* plan was characterized by chronically high inflation and failed stabilization plans. The *Real* plan was a home-grown program of macroeconomic and structural reforms based on exchange rate stabilization that succeeded in conquering inflation and jump-starting economic growth. The plan also ended a long period of disagreement with the Fund over the main direction of policies and gave the authorities a real sense of ownership. Despite some temporary setbacks that reflected a complex domestic political process, Brazil has been able to make good progress tackling the fiscal and structural imbalances at the root of its vulnerabilities. As stated by First Deputy Managing Director (Stanley Fischer), Brazil "is potentially in the midst of a structural transformation of enormous historical significance. Structural reforms are taking place that can decisively strengthen the Brazilian economy and integrate it fully into the modern global economy—where Brazil belongs".[44]

89. When contagion from Asia and Russia hit in 1997-98, the Brazilian authorities took the lead in designing the policy response. The Fund staff's role was to verify that the proposed measures would have the expected yields within the existing macroeconomic environment; and make marginal suggestions. Following the Fund staff's positive assessment of the authorities' program, the Fund's role was to concur and provide financing and catalytic support. Achieving broad country ownership of reforms in Brazil was not easy, however. This vast country features heterogeneous constitutional players—the president and his administration, congress, state governments, and the courts. Fund-supported programs are

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[42] Michel Camdessus, 1998, "The IMF and Good Governance", Transparency International (France) Paris, France (January 21). Available at http://www.imf.org/external/ country/ KOR>.

[43] As stated by Kim Dae-jung and James D. Wolfenshon, "Finally, people are demanding change. Financial crises are really human crises. Politicians can no longer ignore the manifest urgency of building economic development in parallel with an environment of social and human justice. This has profound implications." (International Herald Tribune, February 26, 1999).

[44] Stanley Fischer, "The Asian Crisis and Implications for Other Economies", Address prepared for delivery at the seminar on The Brazilian and the World Economic Outlook organized by Internews, Sao Paulo, Brazil, June 19, 1998. Available at <http://www.imf.org/external/ country/BRA>.

negotiated between the Fund and the federal government, but they need congressional approval and/or state and municipal governments' action to be enacted. Possible risks to program objectives arise from court challenges to fiscal measures and the relative autonomy from the federal government which the states and municipalities enjoy in running their financial affairs.[45]

90. When the *Real* was attacked in October 1997, the authorities defended the currency decisively. Interest rates were doubled[46] and a strong fiscal package was proposed by the government and enacted by congress. The timely policy action helped restore confidence and averted a full-blown crisis, helped by a relatively healthy banking system, growing volumes of FDI and large foreign exchange reserves.[47] These actions had systemic consequences. As noted by the First Deputy Managing Director (Stanley Fischer) in the summer of 1998, if Brazil had not defended the *Real*, the crisis would most likely have spread to other countries in Latin America.[48] The authorities' demonstration that they could stick to their firm post-1994 policy approach in a crisis strengthened their credibility significantly. Their efforts in this regard were helped by the constant and extensive policy dialogue they maintained with the Fund throughout this period. But while the Fund supported the authorities' response to the crisis and stood ready to provide assistance, it was the authorities who were in the driver's seat, not the Fund.[49]

91. Achieving broad-based program ownership had to overcome a complicated domestic political economy. While implementation of home-grown policies was strong at the federal government level prior to 1999, other key players were not as committed to fiscal reforms. After an initial decline in 1994, the overall fiscal deficit had increased. Fiscal weaknesses had become more evident as the inflation tax had gradually disappeared. The real exchange rate had appreciated significantly and the external current account deficit had widened. The post-1994 fiscal expansion and loss in competitiveness had fueled a spending boom that was driven primarily by domestic consumption (aided by the recovery of the purchasing power of lower income groups with the end of hyperinflation), while investment and net exports had stagnated in relation to GDP.

92. The authorities' commitment to reforms was tested again as these vulnerabilities came to the fore in the fall of 1998. Capital outflows were triggered by contagion from

[45] IMF Public Information Notice (PIN) No. 99/82.

[46] Nominal interest rate were raised to over 40 percent in an economy where inflation was running at an annual rate of 4 percent.

[47] Brazil's private banking system had been largely restructured already before the crisis hit.

[48] Stanley Fischer, *Ibid*.

[49] IMF News Brief 97/24, November 10, 1997.

Russia, a substantial current account deficit, and doubts about the authorities' commitment to tackle their fiscal woes. Although fiscal and monetary policies were tightened in response, the drain on reserves continued. The authorities approached the Fund in November 1998 with a home-grown approach to responding to the crisis, and the Board approved financial support for Brazil quickly. A stand-by arrangement was put in place on December 2, 1998 for about SDR 13 billion over three years, part of a much large official financing package from multilateral and bilateral sources. The Fund's financing package was large, front-loaded and flexibly tranched. The program signaled the authorities' commitment to sustain their adjustment and reform efforts over the medium-term. It was premised on the notion that confidence would return—and the fixed exchange rate regime could be maintained—through ample official financing and a strong policy response. In view of the imbalances in the public finances, the program envisaged fiscal adjustment designed to forestall unsustainable debt dynamics. Monetary policies were tightened in order to support the crawling peg exchange rate. Substantial and gradual improvement in competitiveness was also envisaged, as well as major financial sector reform.

93. The agreement's calming effect proved short-lived, as markets doubted the commitment of congress and state governments to the program. In December 1998 the central bank reduced overnight interest rates. At the same time, congress failed to pass an important component of the fiscal package. And in early 1999, the state of Minas Gerais threatened to suspend servicing its debt to the federal government. Market concerns over the ability of the authorities to implement the program were aggravated, outflows continued, and the currency was subject to intense pressure. After a two-day experiment with a wider band for the currency, the central bank floated the *Real* on January 18, 1999 and sought to renegotiate and reinforce the program. Tensions eased as the floating of the currency was accepted fairly well by markets.

94. The authorities' decisive policy actions in the weeks following the floating of the *Real* demonstrated their strong ownership of the program. In March, they reached agreement with the Fund on a revised program that included further fiscal adjustment. An inflation targeting regime became the new nominal anchor, and the de facto operational independence of the central bank was strengthened. A respected financial manager was appointed chairman of the central bank. He promptly raised overnight interest rates to 45 percent on March 4. In mid-March international commercial banks agreed to maintain their inter-bank credit lines with Brazilian banks. The strengthened program was successful in restoring confidence quickly. The Brazilian economy performed significantly better in 1999 than was originally expected. The authorities completed by mid-April 2000, partly ahead of schedule, the repayment of their purchases under the SRF.

95. The Brazilian experience offers several lessons that highlight the importance of program ownership. First, achieving the program's fiscal targets, which was key to its success, was only possible because the authorities showed complete and unwavering

commitment to fiscal adjustment, taking corrective and prompt actions to counteract risks as they emerged.[50] They also pressed the structural reform agenda through congress, making progress with difficult structural fiscal reforms. The adoption of a fiscal responsibility law and debt agreements with states and municipalities imposed greater discipline on all levels of government. Congress approved a constitutional amendment on social security reform. Additional efforts were undertaken to deepen the reform, put the social security finances on sound footing, increase the equity of the system and broaden individual choice.

96. A second lesson is the importance of building trust between the Fund and its members, which enables the authorities—supported by the Fund—to take quick and successful action in a crisis. Trust was built gradually through a continuous and frank dialogue between the Fund and the authorities at the highest level. The president and the minister of finance were personally and intimately involved in surveillance and program discussions, supported by Fund management and high level staff. The Fund's and the authorities' public statements were coordinated, mutually supportive, and reinforcing. The good working relationship between the authorities and the Fund staff and management enabled the Fund to act quickly and decisively to provide financial assistance when the crisis intensified. This trust provided, in effect, implicit assurances to the authorities that the Fund would be forthcoming with support quickly in the event of crisis.

97. Third, the president's active and full backing of the program was instrumental in ensuring good implementation. His leadership, which was critical throughout the program period, was especially important for instilling confidence during critical stages in the crisis. On February 3, 1999, in the tense days following the floating of the exchange rate, the president publicly reaffirmed the need to "do whatever it takes" to protect the main achievement of the Real plan—the conquest of inflation.[51] The president's commitment strengthened the authorities' resolve to persevere with reforms and protected the momentum of reforms from complacent or recidivist elements.[52] All this was not lost on the markets.

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[50] Public Information Notice (PIN) No. 99/82, August 23, 1999

[51] IMF News Brief No. 99/5, February 4, 1999, Joint Statement of the Ministry of Finance of Brazil and the IMF Team.

[52] As stated by the Managing Director (Michel Camdessus) following Brazil's remarkable turnaround in 1999, the country needed to avoid complacency: "Brazil must be satisfied by the remarkable turnaround created by this program, which was so difficult to assemble, but it's time for perseverance if Brazil is to stabilize itself, grow more rapidly, and start addressing its fundamental issues which are, as you know, of a social nature, basically the very bad distribution of resources in the country." See "Transcript of a Press Conference given on the eve of the 1999 Annual Meetings", September 23, 1999. Available at <http://www.imf.org/external/country/BRA>.

Expectations were calmed and the credibility of the new inflation targeting regime was established.

98. Fourth, enlisting the support of the leadership in congress and other stakeholders was essential in seeing fiscal reforms through. In the days following the change in the exchange rate regime, the president met with the presidents of the senate and the house and discussed with them ways to accelerate the schedule of votes in congress. Congress delivered: it passed the majority of the proposals submitted by the executive branch, including an important but far from consensual social security reform, approved measures to compensate for delays in revenues, and made other adjustments as needed to safeguard program objectives.[53] The president also met with the national privatization council with a view to accelerating the privatization program, especially in the areas of electricity, water supply, and sanitation. Brazil also intensified its dialogue with its multilateral creditors and established new and more intensive procedures of continuous consultation with them.

99. Fifth, the narrower the ownership of a reform program in a democracy, the more likely domestic conflict between competing stakeholders or vested interests is going to be, and the more expensive a country's financing becomes. In a democracy, narrow ownership implies a greater likelihood of policy conflicts, reversals of reforms, or inaction. Ceteris paribus, this will be reflected in higher bond spreads that raise financing costs for the country. The Managing Director (Michel Camdessus) worried about the possibility for such backtracking in the fall of 1999, when the program had already started to yield fruits.[54] Although he was cognizant that some structural reforms were difficult to reverse, he was concerned that Brazil could go back to business as usual. He cautioned political leaders to guard against premature relaxation of the program and warned that this would be penalized by the markets. This eventuality was not merely hypothetical. In the previous summer, amidst indications that the budgetary stance might be relaxed and weakening support in the congress for the fiscal program, the markets had become nervous and financial conditions had began to deteriorate, which had raised Brazil's financing costs.

100. Sixth, it pays for the Fund and the member to explain to the markets and the general public the full content of the programs and to allow greater flexibility in program design. Both were better done in the Brazilian case than in the Fund-supported programs in Asia.[55] Fund management spoke publicly and forcefully about the need to safeguard progress and to

[53] IMF News Brief No. 99/5, February 4, 1999, Joint Statement of the Ministry of Finance of Brazil and the IMF Team. Available at <http://www.imf.org/external/country/BRA>.

[54] Michel Camdessus, *op.cit.*

[55] Stanley Fischer, "Transcript of a Press Conference on the 1999 Annual Report of the IMF". September 09, 1999. Available at <http://www.imf.org/external/country/BRA>.

improve implementation of some difficult reforms such as spending cuts.[56] Likewise, it is important for programs to be fully financed and to be flexible and adaptable to uncertain capital market developments. In the program with Brazil, the large volume and flexibility of the Fund's financial assistance, together with the introduction of inflation targeting, made a difference. From its experience in the Asian crises, the Fund had concluded that the second lines of defense provided by bilateral pledges of support were problematic because they did not provide sufficient assurance to the markets of the terms and conditions under which they would be provided. This led to a change in the Fund's operations in the case of Brazil, where the Fund very heavily front-loaded its financing and also floated its second tranche. There was a mechanism in the program where the authorities could request the second tranche earlier than programmed so that markets could see that the substantial resources were not just committed but also potentially available.[57]

101. Finally, programs need to help countries strengthen their social safety nets to cushion the adverse impact of crises and adjustment on the poor. The Brazilian authorities recognized that well-targeted and efficient social expenditures played a vital role in the alleviation of poverty and the development of human capital. The program made a very significant effort to protect and strengthen social spending, especially education and health. To make social spending more cost effective, efforts were undertaken to increase the efficient use and financing of health and education--particularly at the higher levels--and to better target social expenditures for the poor. Fund management also publicly discussed the need to do more to promote the welfare of the poorest, which could also help reduce Brazil's very unequal income distribution.[58] Efforts to keep an adequate social safety net and to safeguard well-targeted and cost-effective social spending were important in their own right, and also in ensuring continued broad support for the authorities' adjustment program as many social indicators begun to show clear improvements.

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[56] As stated by Stanley Fischer in the summer of 1998, "a central lesson from the 1997 crisis is the need for vigilance and a readiness to act quickly and on occasions preemptively. Monetary policy has to be alert to the possible re-emergence of pressures on the currency. The fiscal reforms…should be implemented in full—and more would be better. At the same time, the momentum for structural reform must not abate." See Fischer, *Ibid*.

[57] Jack Boorman, "Transcript of a video Conference with Asian Journalists on the IMF's Review of IMF-Supported Programs in Indonesia, Korea, and Thailand", January 19, 1999. Available at <http://www.imf.org/external/country/BRA>.

[58] Michel Camdessus, "Transcript of a Press Conference given at the conclusion of the 1999 Annual Meetings", September 30, 1999. Available at <http://www.imf.org/external/country/BRA>.

Table 1. Program Implementation by Type of Arrangement*

Type of Arrangement	Number of Programs*	Number of Programs* excluding precautionary arrangements, cancelled and on-going programs 8/	Share of programs having Interruptions 1/ 6/	Share of programs having Irreversible Interruptions 2/ 6/	Average Macro Implementation Index 3/ 6/ 7/	Average Structural Implementation Index 4/ 6/7/	Average Overall Implementation Index 5/ 6/7/	Average share of committed funds disbursed 8/
			(In percent)					
EFF	25	13	68	40	87.0	75.4	83.3	72.1
PRGF/ESAF	64	51	73.4	45.3	77.1	71.3	72.9	77.2
SBA	81	41	67.9	43.2	81.0	60.8	76.0	63.7
Total	170	105	70.0	43.5	80.3	67.4	75.8	71.3

* Multiyear arrangements are treated as one program. This is a sample of programs approved between 1992 and 1998 and available from the MONA database maintained by PDR. Our sample is missing 16 SBAs, one ESAF and one EFF program approved in 1992. These programs are not covered in MONA. The sample of EFF programs is small, which makes it difficult to obtain reliable conclusions regarding the relative performance of EFFs compared to ESAFs and SBAs.

1/ An interruption occurs if an SBA program review was delayed by more than 3 months or not completed at all; if a program review for EFF or ESAF/PRGF programs was delayed by more than 6 months or not completed at all; if there was an interval of more than 6 months between two subsequent years of a multiyear arrangement; or if at least one of the annual arrangements was not approved (exceptions are programs which were cancelled and replaced by another program, in which case noncompleted reviews and nonapproved annual arrangements are not counted as interruptions).

2/ An irreversible interruption occurs if either: (i) the last scheduled program review was not completed (all programs); or (ii) all scheduled reviews were completed but the subsequent annual arrangement was not approved (ESAF/PRGF arrangements).

3/ The Macro Implementation Index for a given macro performance criterion is equal to 100 percent if macro performance criterion was met or met after modification and it is equal to zero if macro performance criterion was not met, not met after modification, waived or waived after modification. The Macro Implementation Index for a program then is computed as the average of Macro Implementation Indices across all macro performance criteria for this program.

4/ The Structural Implementation Index for a given structural condition is equal to 100 percent if the structural condition was met or met with a small delay (for structural benchmarks); it is equal to 50 percent if the structural condition was partially met or delayed (performance criteria); it is equal to zero if structural condition was not met. The Structural Implementation Index for a program is the average of the Structural Implementation Indices across all structural conditions for this program.

5/ The Average Overall Implementation Index for a given program is the average of Macro and Structural Implementation indices over all conditions in this program.

6/ The Macro and Structural implementation indices were computed from information available in MONA. Since MONA questionnaires are sent only for programs for which Board meetings are scheduled, implementation information is missing on many conditions for programs with noncompleted reviews. Since these were typically unsuccessful programs, the macro and structural indices overstate program implementation. Interruption indices were constructed using additional information from country documents and other sources.

7/ The sample size used in calculating the implementation indices was smaller (150 programs). This corresponds to the sample constructed for the paper "Structural Conditionality in Fund-Supported Programs."

8/ The average share of disbursed funds was computed across a sample of programs that excludes arrangements that were precautionary on approval or later turned precautionary, as well as cancelled and on-going programs.