

INDEPENDENT EVALUATION OFFICE COMMENTS ON MANAGEMENT/STAFF RESPONSES TO THE EVALUATION OF PROLONGED USE OF FUND RESOURCES

Executive Board Meeting
September 20, 2002

1. The statement by the Managing Director and the staff response circulated separately indicate general agreement with many of the report's findings and state that a number of the report's recommendations have been addressed by recent initiatives taken by management. We welcome the broad congruence of views and recognize that the recent strengthening of guidelines on conditionality and surveillance provides a framework for moving forward. However, as the Managing Director has himself noted, changing guidelines is only the beginning of the process and there can be a very long lag between the identification of the changes needed to address a problem and the effective implementation of these changes. Our report recommends a number of additional steps that could be taken to encourage effective implementation. These include some of the systemic issues identified in the evaluation, including changing the nature of the IMF seal of approval, defining the boundaries between programs and surveillance, and evolving more explicit exit strategies, including from the PRGF. All of these require specific consideration and decision by the Executive Board.

2. We have the following comments in some of the specific issues raised, mainly in the staff response. (Para. references are to those of the staff response.)

The nature of prolonged use and degree to which it is a problem (Paras. 5, 6, 7 and 9)

3. The staff argues that the IEO evaluation may give a misleading picture of the incidence of prolonged use and extent to which it is a problem because (i) prolonged use as defined in the report is more heavily concentrated in PRGF-eligible members where the issues raised by the Fund's long-term involvement are different than for the rest of the membership; and (ii) most cases of prolonged use of nonconcessional resources involve members who enter into arrangements that go off-track quickly after their approval and the fundamental issue in these cases is not prolonged use per se but the need for more successful program design and implementation. These arguments underlay the approach taken to prolonged use in the most recent internal review

of the issue, which judged that prolonged use was not a major problem. We have carefully considered this approach and we feel it represents too narrow a view of the issue which risks understating the nature of the problem, thereby also avoiding some fundamental questions about the Fund's role.

4. We fully agree, and have explicitly noted, that there are important distinctions between prolonged use by members that have used primarily the PRGF/ESAF resources and those that use the Fund's general resources. However, a situation in which a large proportion of the Fund's low-income member countries spend very long periods under IMF arrangements raises important questions about the appropriate timeframe of Fund-supported programs, the consistency with the goal of enhanced ownership, and the longer-term impact on domestic policy formulation processes which need to be explicitly addressed. We agree with the staff that improving the effectiveness of Fund-supported programs is a very important part of the challenge. But there are also other systemic issues arising from the present institutional framework that encourages continued prolonged use for a significant number of member countries, which in our view have not been sufficiently recognized and addressed.

5. Turning to prolonged use in the GRA, the staff are correct to emphasize that cases of programs going off track quickly and repeatedly are especially problematic, but this is not the only aspect of prolonged use that warrants attention. As our report shows, the Fund's general resources lent to prolonged users revolve very slowly—with obligations effectively outstanding for several decades in some extreme cases. This raises questions about the consistency with the mandate of providing financing for temporary balance of payments needs. Prolonged use also raises other important issues, such as the credibility of the seal of approval signal and the consistency of long-term program involvement with robust domestic ownership.

Consequences of prolonged use

6. The staff point out (in para. 10) that there are considerable methodological problems in identify-

ing causal links between prolonged use of Fund resources and specific economic outcomes. We agree that identifying causality poses formidable problems, especially those associated with the endogenous nature of the decision to request IMF financial support. The evaluation report therefore does not claim that there is strong statistical evidence associating prolonged use with widespread adverse economic outcomes. Moreover, as the staff notes, some of the most important potential negative effects, such as the impact of successive program negotiations on the process of economic policy formulation, are not amenable to statistical analysis.

7. We agree with the staff's observation (in para. 13) that there will always be questions as to how far conclusions reached from particular case studies can be generalized. Nevertheless, the lessons emerging from the case studies are relevant because they involved countries that had been among the most prolonged users and illustrated four different types of prolonged use: prolonged use of concessional resources (Senegal); prolonged use of general resources with high disbursement rates (Philippines); prolonged use of interrupted programs (Pakistan); graduation from prolonged use (Jamaica and Morocco). Moreover, the questionnaire responses from the broader group of prolonged users suggest that many of the issues that surfaced in the case studies are of broader concern. We would also emphasize that we do not suggest that no progress was achieved in these cases over the long sweep of the Fund's involvement (e.g., in the Philippines, as mentioned in para. 12 of the staff response). The staff also suggests that prolonged involvement in precautionary arrangements may have different (and more beneficial) effects from other types of prolonged use. This may well be true, but it is not an issue that we addressed in the evaluation.

Main recommendations

8. The Managing Director notes in his statement that the Executive Board will need to take a view on whether specific policies need to be evolved for dealing with prolonged users or whether a broader, preventive approach will suffice. The IEO sees the two approaches not as alternatives but as complements. One of the messages that has emerged from the evaluation is that in the past, strategies explicitly approved by the Board for addressing the issue of prolonged use have not been implemented consistently. In the IEO's view, the lack of a clear definition of what constitutes prolonged use was an important contributing factor because it created ambiguity on whether the procedures prescribed were necessarily applicable in particular cases. It is for this reason that we have recommended the adoption of a defini-

tion of prolonged use, distinguishing suitably between low income countries and others, which would help to identify cases where special procedures would be automatically triggered. We wish to emphasize that these procedures do not necessarily imply greater restrictiveness in lending—only greater clarity and due diligence on the appropriate strategy to deal with prolonged use.

9. In connection with the need for greater selectivity in extending financial support, we agree with the staff (para. 16 of staff comments) that weighing the consequences of not extending support involves very difficult judgments. But we would emphasize two points. First, the Executive Board needs to be given candid assessments of risks, including nonimplementation risks, and of the implications of withholding Fund support, to make such judgments. Second, the long-term interest of member countries is not well-served by having a series of programs with a high probability of nonimplementation.

10. With regard to the "seal of approval" function, the staff notes (in para. 18) that there is a general perception that the credibility of the Fund's seal of approval has been greater when the Fund commits its resources and that the quality of the seal of approval provided by some alternatives (such as staff-monitored programs) has been questionable. We agree that there is indeed such a general perception but the thrust of our recommendation is that this is not immutable. The boundaries between surveillance, other instruments (e.g., the Joint Staff Assessment in the case of PRSPs) and IMF lending arrangements could be changed by further modifications of existing instruments and/or the creation of new ones. Such efforts are desirable if, as the IEO report suggests, the insistence on lending arrangements leads to prolonged uses which has significant adverse effects. However, IMF lending arrangements may in fact not always be the instrument best suited to the varied needs of the donor community.

11. The staff statement (in para. 19) seems to suggest that two related conclusions of the evaluation: (i) the reform agenda in many countries was overloaded; and (ii) the Fund was too accommodative of program slippages are somewhat inconsistent. We would like to stress that these two messages are entirely consistent: the fundamental issue is one of prioritizing conditionality and ensuring that streamlined conditions (including, where appropriate, prior actions) are well-integrated with the core program design and lead to effective monitoring. Examples from the case studies suggest that it was weaknesses in these latter areas, rather than the volume or precise form of the conditionality, that lead to most problems. Indeed, such an approach is the essence of the ongoing efforts to streamline conditionality.

12. Finally, we do not believe, as the staff claims, that the evaluation report glosses over the difficulty of achieving and sustaining national ownership (para. 21). We recognize that this is an extremely difficult area where the Fund will need to learn through experience. The report makes a number of specific suggestions for adapting Fund procedures to enhance the prospects for ownership, including steps to embed the program formulation process more deeply in domestic policy-making institutions (see paras. 25 and 26 of Chapter 8 of the main report). The staff response concludes with the concern that “nationally-owned programs should not mean weaker, but better, programs.” There can be no disagreement with this general statement, but it hides considerable ambiguity about what an increased emphasis on ownership (and an associated greater se-

lectivity) implies in practice. One of the messages emerging from the case studies was that the Fund’s internal review procedures, including Board discussions, tended to focus mainly on enhancing the strength of the policy measures contained in programs, with less attention to assessing the feasibility of implementation, whereas in practice it was problems in the latter area that typically led to program failures. The evaluation report calls for much greater attention to issues of ownership and political feasibility as part of the program formulation and review process. In our view, greater focus on ownership and more selectivity is not about raising or lowering the threshold on the content of programs per se; it is primarily about ensuring agreement on a set of policies that have a good chance of both being implemented and achieving their objectives.