External Evaluation of the ESAF

Report by a Group of Independent Experts

International Monetary Fund

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Part I

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Statement by Bernd Esdar Chairman of the Evaluation Group of Executive Directors, on the Report of the External Evaluation of the ESAF

March 11, 1998

This very interesting and stimulating evaluation report on the Enhanced Structural Adjustment Facility (ESAF) is a first concrete outcome of our newly developed approach to external evaluation agreed upon in 1996. Therefore, I should like to express gratitude to Dr. Botchwey, Prof. Collier, Prof. Gunning, and Prof. Hamada.

The external evaluation instrument was adopted, for an initial period, to build upon and complement our in-house evaluations with a view to obtaining an independent and fresh outside perspective on crucial Fund policies. The Board agreed that it would be enlightening as well as prudent to ask for a view that is not clouded by routine or limited by institutional constraints.

When the Executive Board chose the ESAF for an external evaluation, it was aware that this topic was complex and challenging. While there can be no doubt that the macroeconomic and the structural reform framework agreed upon under ESAF arrangements is *one* important determinant for the success and the progress of the development process in individual countries, it is still only one element. Crucial factors in this regard certainly include the role of the government, its policies, and the political, institutional, and social environment in the countries themselves. But there are also close interactions with the structural reform and development support of the World Bank and the regional development banks and with bilateral development assistance as well as with private, nongovernmental organization–led efforts, not to mention the critical role of private economic agents and investors. It is also not easy to clearly differentiate between the influence of policy design and policy implementation.

Therefore, there can be no doubt that the external evaluators were confronted with extremely complex problems when the Board asked them to review aspects of ESAF programs. The study concentrates on three topics:

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

In line with the request of the Board, the evaluators have based their findings on a sample of individual country studies that adequately reflects that the challenges differ from country to country—or, to put it in their words: "The average experience across all ESAF programs conceals as much as it reveals, while a case study of an individual country is liable to be highly particular."

The study reveals very interesting findings on all three topics. Some of the findings and suggestions blur the established division of institutional responsibilities between the international institutions that envisages for the IMF in particular the role of providing temporary balance of payments support based on macroeconomic and structural reform programs.

The study complements the Fund's latest internal ESAF review, which was discussed in the Executive Board on July 18, 1997, and subsequently published as IMF Occasional Paper No. 156: *The ESAF at Ten Years* (1997). I would also like to thank staff for their comments on the evaluation study that have been circulated for today's discussion. These comments show that the external evaluators and staff agree on the objective to better focus ESAF by improving protections for the poor, by improving the cooperation with other international financial organizations and bilateral donors, and by strengthening "ownership." However, while there is encouraging agreement on the objectives and the overall strategy, there are areas where views divide slightly and where different emphasis is given to certain aspects as could be expected given the different perspectives and experiences of staff and external evaluators. Therefore, we can look forward to very enlightening and stimulating discussions.

Our joint objective continues to be to target the ESAF even better, with the objective of improving the living conditions in the poorest countries, to better integrate them into the world economy based on a viable growth and development process in which all groups of the population can participate. Also, the ESAF is only one instrument within the Fund's overall responsibilities, defined by the three pillars of economic surveillance, policy and technical advice, and lending for balance of payments support.

I would suggest that both the external evaluation report and staff's comments be made public, supplemented by the summing up of today's discussion. This would not only help the public to better understand the role and the functioning of ESAF programs, but it would also contribute to the transparency of this institution.

To conclude, I would like to thank the external evaluators again for their tremendous efforts in presenting this study within the envisaged time frame. I would like to include in this appreciation the cooperation and support of my colleagues of the Evaluation Group for providing and designing the framework of this study and for following up on its implementation. My thanks also go to the Head of the Office of Internal Audit and Inspection, Eduard Brau, and his team, who provided valuable support.

Summing Up by the Chairman of the Executive Board on the External Evaluation of the ESAF

Executive Board Meeting 98/26, March 12, 1998

Executive Directors expressed their appreciation to Dr. Botchwey and to Professors Collier, Gunning, and Hamada for the very stimulating work they had done in evaluating aspects of the ESAF. Their evaluation complements the internal evaluation of the ESAF discussed by the Executive Board on July 18, 1997. Similarly, Directors saw a high degree of complementarity between the report of the evaluation group and the response formulated by the staff. All Directors endorsed the fundamental view underlying the evaluators' findings that the ESAF is a valuable instrument to assist low-income countries, and that the work of the Fund with this instrument could be improved.

While Directors did not endorse all of the views expressed by the external evaluators, they found that the report provided an opportunity to broaden the debate by offering a fresh and different perspective, and to promote a better understanding of the Fund's work.

Regarding social developments under ESAF-supported programs, Directors agreed with the evaluators' view that economic reforms, while "generally having positive effects on growth and income distribution," do entail temporary costs for certain segments of the population: this calls for appropriate compensatory measures to be built into program design. Everything possible should be done in program design to protect such groups, including the provision of well-targeted assistance to the more vulnerable groups and the allocation of adequate resources for social sectors. Also, the sequencing of fiscal and other structural reforms should be further analyzed to minimize any adverse social impact. As the evaluators point out, these actions would help policymakers to build a domestic consensus in favor of important but difficult reform measures.

Directors did consider that important efforts were already being made by the Fund to advise countries to protect poor groups from the impact of adjustment measures and to safeguard social expenditures during fiscal consolidation. They welcomed the proposals by the evaluators to draw more extensively on the expertise and data of the World Bank for a more refined ex ante assessment of the likely impact of adjustment measures on poor groups. They also agreed that it would be desirable to review the effects of the adjustment measures on poor groups as part of the regular ESAF program reviews. Directors asked management and staff to explore the feasibility of these suggestions, including the availability of the necessary data, with the World Bank, to assess the ability of the World Bank to provide the envisaged services, and to come back to the Board with operational proposals.

Directors agreed that an assessment of progress toward external viability required a broad range of indicators, and they continued to see considerable merit in the traditional export-based indicators of external viability.

On other external aspects, Directors did not share the view of the evaluators that the ESAF constituted an inadvertent tax on exports by virtue of most ESAF funds being disbursed to central banks. They endorsed the staff view that the macroeconomic effects of ESAF disbursements did not depend on the initial recipient of ESAF resources, and noted that the evaluators were not suggesting that the currencies of ESAF-supported countries were generally overvalued.

On fiscal issues, Directors agreed that short-term revenue objectives should be pursued with sensitivity to the important longer-term implications of the tax system for economic efficiency. Directors were not persuaded by the evaluators' view that the Fund systematically exaggerates the size of fiscal deficits. They noted that where the line was drawn in presenting the fiscal balance did not materially affect the setting of fiscal targets, which was always based on considerations of the availability of noninflationary financing and the evolution of the debt and debt-servicing burden. What was essential was transparency and clarity of the breakdown, and Directors were generally satisfied with staff presentations on fiscal positions.

On national ownership of Fund-supported programs, Directors noted with concern the evaluators' assessment—which they saw as a key contribution of the evaluators' report—that a common perception at the country level was "a feeling of loss of control over the policy content and the pace of implementation of reform programs." Directors therefore welcomed the proposals by the evaluators as to the steps that should be taken by national authorities to build a greater policy consensus within society. They agreed that it was, first and foremost, the obligation of national governments to ensure transparency in policymaking and to promote wide public debate of policy issues. They therefore recommended for serious consideration by governments the suggestions of the evaluators concerning national conferences and regular meetings with academics, business, and labor groups. It was important that policy alternatives and trade-offs be openly debated, and that economic management teams made up of the economic and social sector ministries and political leaders—already a practice in some countries—be established in all countries to oversee the reform process.

Directors agreed with the evaluators that the Fund staff should take into consideration the political constraints faced by the authorities when making recommendations on the policy mix—although this should not lead to an overall weakening of the programs. Indeed, Fund staff should not be put in a position of having to judge what was and was not politically feasible. Directors supported the recent trend toward a greater variety of contacts between staff and representatives of civil society and noted that the Fund could thereby play a role in easing political constraints.

Directors noted that some of the recommended measures to ensure ownership might prolong the initial stages of negotiations, but considered that investment would be compensated for over the period of implementation. Some Directors emphasized that ownership was a dynamic concept: even when ownership was not as strong as the ideal initially, early success with reforms could feed stronger commitment. Directors also recognized the importance of striking the right balance between ownership and securing a strong program. Directors observed that, unless a government was committed to pursuing the program objectives, the program would have little chance of success, and therefore would not merit ESAF support. Directors agreed with the evaluators' recommendation that the Fund should be more cautious in providing ESAF support where the authorities' commitment was in question. They believed that that view might call for greater selectivity in the use of Fund resources.

On the point of the perceived inflexibility by Fund staff, many Directors felt that the evaluators may have inadvertently conveyed an inconsistent message. While criticizing perceived inflexibility, the evaluators were also very clear that "the failure to frontload structural reforms with long gestational lags may well be the most serious defect of structural adjustment as currently designed." Often that failure reflected the willingness of the Fund to accommodate government resistance to specific reforms. Some Directors embraced the suggestion that, wherever feasible, the Fund staff should seek to identify, with the national economic authorities, alternative options for economic programs, each capable of achieving the needed economic results. Those alternative options could be presented to national decision makers for their consideration.

Directors also considered that finding the proper balance between negotiating flexibility and supporting only programs that adequately addressed economic problems was indeed a delicate matter. Those trade-offs and the sequencing of reform issues would continue to be at the center of future discussions of ESAF programs by the Executive Board. On the sequencing of reform measures, Directors agreed with the staff that member countries often needed to take advantage of windows of opportunity, without being overly constrained by strict sequencing considerations. Directors also felt that, in several cases, what appeared to be sequencing problems were in reality problems of a lack of implementation of agreed policy measures.

Directors agreed that further efforts were needed to improve public understanding of the Fund in countries receiving ESAF support, including through public explanations of the purpose and benefits of economic reform programs by the governments. As one Director observed, it was important that having a program with the Fund should be seen by members not as a stigma, but as an enviable badge of excellence. Directors agreed with the observations of evaluators concerning the very helpful role of Fund resident representatives in ESAF countries in this regard. They felt that the steps currently being taken to strengthen the role of resident representatives in external relations and to enhance collaboration with national authorities and civil society were very much in line with the evaluators' views.

Directors agreed that there were many cases in which the Fund had to stay engaged in ESAF-eligible countries after the initial macroeconomic stabilization had been achieved. They stressed that that was indeed the essence of the intent of the ESAF, which was to address, in a medium-term context, the structural weaknesses that might threaten the maintenance of financial stability and the achievement of sustained growth and external viability. As the evaluators had suggested, Directors saw a window of opportunity in several African economies that had stabilized and were currently approaching high rates of growth as a result of policy reform. However, investment rates in those economies remained far too low for those growth rates to continue over the longer term, and significant external capital needed to be attracted to supplement only slowly rising domestic savings rates. To attract external savings from public and private sources in an environment perceived by markets to be risky, a Fund signal of policy adequacy was often essential to help reduce uncertainty.

Commenting on the scope for ESAF financing in the poststabilization phase, several Directors emphasized that the ESAF provided exceptional—and temporary—balance of payments support on concessional terms to low-income members, but that the ESAF was not a long-term aid transfer mechanism, as the evaluators seemed to imply. Therefore, disbursements of ESAF support could not be provided over the long term through a "tapering-in" mechanism coupled with ex post ESAF support for programs that aimed at little, if any, further reform. Directors expressed interest in more extensive use of precautionary arrangements with the Fund. That could have the advantage of conferring the Fund's stamp of approval for a country's reform efforts, to catalyze financial support from other sources. For that purpose, the Fund should also take a close look at the effectiveness of its Article IV consultation process. Directors also saw the need for a greater role for the World Bank and other donors in supporting the reform efforts of ESAF countries in the post-stabilization period.

Directors noted the evaluators' recommendation that the Fund develop more systematic mechanisms for providing ex post support in situations in which stabilization had been achieved but in which agreement between the government and the Fund was delayed or the government felt unable to agree on a conventional Fund arrangement for mainly political reasons. The evaluators sought a move from negotiation to certification. While a few Directors considered that this suggestion deserved attentive consideration, many other Directors were concerned that Fund support for such programs might not be workable. In particular, the absence of ex ante agreement on a framework for policies might mean that any ex post judgment and disbursement of ESAF resources would pose difficulties, as the Fund had to avoid arbitrary judgments and unequal treatment of member countries.

Directors noted the indications by the evaluators that Bank and Fund cooperation could be improved in some country cases and noted the importance of seeking ways to strengthen that collaboration. Those issues had also surfaced in the internal evaluation of the ESAF and on other recent occasions. A few Directors called for early Board review of specific proposals by management to address these issues. Some other Directors, however, considered that it may not be useful to establish further formal rules on coordination. They recommended that priority be given to promoting an open and free flow of information between the Fund and the Bank. For this reason, it has been particularly valuable to have the participation of a World Bank representative in this discussion.

This has been a rich and useful discussion, bringing out worthwhile suggestions for follow-up. We have started a constructive process and dialogue here, and Directors invited the external evaluators and the staff to make themselves available to discuss the findings of the internal and external evaluations with interested parties. This, together with the earlier Board consideration of the internal review of the ESAF, will lead to the formulation of specific proposals for the Executive Board to consider on operational lessons from these evaluations for the future work of the Fund in assisting low-income countries.

Terms of Reference

1. Purpose of the Evaluation

The Executive Board of the International Monetary Fund has decided to request independent external experts to conduct an evaluation of certain aspects of ESAF with the purpose of assessing its operation to date and making recommendations for improving the ESAF instrument and the design and implementation of ESAF-supported programs in a manner consistent with the overall purposes of the IMF.

2. Structure and Focus of the Evaluation

There will be one external evaluation with three topics as well as unified conclusions for the design and implementation of ESAF-supported programs and the ESAF instrument:

The three focus topics are:

(i) Developments in countries' external position during ESAF-supported programs.

(ii) Social policies and the composition of government spending during ESAF-supported programs.

(iii) The determinants and influence of differing degrees of national ownership of ESAF-supported programs.

These topics will be evaluated on the basis of case studies by independent external experts, as indicated in Section 3, below, who will be responsible for a section of the final report, after consultation with the other evaluators. The purpose of each evaluation is to objectively assess developments during ESAF-supported programs and draw operational conclusions for future programs. At their full discretion, the evaluators may wish to take into account the views of concerned country authorities and social partners; of parliamentarians; of representatives of multilateral development banks, bilateral donors, and nongovernmental organizations; of academic experts; and of Fund Executive Directors and staff. Unified conclusions will be prepared jointly by the evaluators, drawing on their three studies, as well as on the results of the internal evaluation of experience with ESAF-supported programs to be completed in the spring of 1997 by the Policy Development and Review Department.

The three evaluations should include, but not necessarily be limited to, consideration of the following issues:

(i) Developments in countries' external position during ESAF-supported programs

- How, and based on what indicators, should vulnerability and viability in a country's external position be assessed?
- To what extent has external vulnerability increased or diminished in the countries under study over the specified period? What are the main factors that explain the different outcomes across the sample?
- Has the evolution of the countries' external positions diverged from what was expected in successive ESAF-supported programs? If so, what explains the divergences?
- Has the evolution of countries' external position been consistent with progress toward sustainable economic growth?
- To what extent were other developments, and policies pursued outside the context of Fund-supported programs, responsible for holding back, or contributing to, the achievement of external viability?
- What lessons can be drawn from the design of Fund-supported programs, and more generally for countries' external sector policies?

(ii) Social policies and the composition of government spending during ESAF-supported programs

- How have social indicators evolved in countries undertaking ESAF-supported programs,

Note: The terms of reference were approved by the Executive Board on October 30, 1996, and amended on March 28, 1997.

and can one identify what impact adjustment policies have had on these social indicators? If possible, comparisons should be made with the trends of social indicators in the years before the ESAF-supported programs and a judgment made about how social indicators would have evolved in a nonadjustment scenario. What social indicators did Fund staff use in assessing priorities and progress?

- To what extent have social conditions been enhanced by strengthened external viability (where applicable) and improved conditions for noninflationary growth?
- To what extent and how has the social impact of ESAF-supported adjustment policies and reforms influenced the use and design of social safety nets, the level of public spending on social services like education, health, and rural development, and the design of the adjustment and reform measures themselves? How effective have the safety nets been in mitigating the effects of macroeconomic adjustment on the poorest members of society?
- How appropriate was the Fund advice on social safety nets, social indicators, and social policies? To what extent has staff advice and government policy conformed to the guidance provided by the Executive Board?
- To what extent have government social expenditures been cut in ESAF-supported programs to achieve fiscal adjustment objectives, and how did outcomes in this regard differ from program plans? How were decisions on the level of social spending influenced by judgments about the overall balance between expenditure and revenue measures in programs?
- Is there any evidence on changes in social conditions or other economic outcomes in countries that have persevered with adjustment under ESAF-supported programs?
- What have been the main constraints in addressing social issues?
- To what extent have Fund staff collaborated with other institutions that have expertise on social issues? Has such collaboration been fruitful and how can it be enhanced?
- Given the purpose of Fund-supported programs to promote external viability and thereby facilitate economic growth, should such programs take into account a broader range of social issues than the current policy would dictate? Have programs been moving in this direction?

(iii) The determinants and influence of differing degrees of national ownership of ESAF-supported programs

- On what criteria can national ownership of an ESAF-supported program be assessed?
- What evidence is there in the cases being studied that programs were "owned" by the country concerned? Was ownership confined to the national government or did it extend to other social partners?
- What efforts have been made by Fund staff and/or the national authorities to promote ownership of programs, and how successful have these efforts been? In what circumstances is the active involvement of Fund staff in this area most constructive, and are there instances where it is unhelpful?
- To what extent have other aspects of the Fund's operational practices inhibited the development of a sense of ownership by the countries concerned?
- What have been the consequences for the implementation and sustainability of policies of strong or weak ownership?
- From the cases reviewed, what lessons can be drawn for the importance of ownership and the approach the Fund should take to promote it further?

3. Evaluators and Their Independence

The following independent experts have agreed to conduct the evaluation:

Professor Koichi Hamada, with focus on the topic: "Developments in countries' external position during ESAF-supported programs."

Professor Paul Collier and Professor Jan Willem Gunning, with focus on the topic: "Social policies and the composition of government spending during ESAF-supported programs."

Dr. Kwesi Botchwey, with focus on the topic: "The determinants and influence of differing degrees of national ownership of ESAF-supported programs."

Dr. Botchwey has agreed to act as "convenor" for discussions among the evaluators concerning an appropriate degree of coordination in the selection of countries for the case studies, the contacts with country authorities, the design of work programs, and the drafting of the unified conclusions.

The evaluators shall conduct their work freely and objectively and shall render impartial judgment to the best of their professional abilities.

4. Selection of Countries for the Case Studies

The selection of country cases for each topic will be the responsibility of the evaluator(s) for each of the three topics in consultation with the other evaluators and with concerned country authorities, subject to the following guidelines: (i) the number of countries for each topic should be in the range of 4 to 7, with as much overlap as feasible in the choice of countries for the three topics; (ii) the groups of countries should be geographically diverse; and (iii) the sample should contain both strong and weak performing countries.

5. Access to Confidential Information and Protection of Confidentiality

(i) Each evaluator shall have access to any information in possession of the Fund as needed for carrying out the evaluation. This may include, but will not necessarily be limited to, access to staff reports, internal memoranda and studies, existing databases, briefing papers and debriefing reports and other communications with management, as well as minutes of Executive Board proceedings. The Chairman of the Evaluation Group of Executive Directors (Evaluation Group) shall make all necessary arrangements to facilitate and assist the procurement by the evaluators of relevant information in possession of the Fund. The evaluators shall be invited to attend Executive Board consideration of the internal evaluation of ESAF-supported programs to be concluded in the spring of 1997 by the Policy Development and Review Department, as referenced in Section 2, above.

(ii) Each evaluator undertakes not to disclose, deliver, or use for personal gain or for the benefit of any person or entity without the consent of the IMF, any restricted or confidential information in possession of the Fund that he receives in the course of the evaluation. The Chairman of the Evaluation Group will ensure that the draft evaluation report will be reviewed at an early stage by an appropriate officer of the Fund with the express purpose of ensuring that restricted or confidential information will not be disclosed inadvertently.

(iii) Each evaluator is free to request information from country authorities and other sources outside the Fund as he deems appropriate.

6. Evaluation Report: Publication, Executive Board Consideration, and Comments

(i) The evaluators are invited to prepare their report on the assumption that it would be published by the Fund. The Executive Board will decide at a later stage whether or not the evaluation report will be made public. The Fund reserves the exclusive right to publish the report, and the evaluators undertake, individually and collectively, not to publish any part of the report separately.

(ii) In accordance with generally accepted practices for the conduct of audits and evaluations, the Chairman of the Evaluation Group will ensure that those whose actions and advice are the subject of evaluation shall have the opportunity to respond to relevant parts of the evaluation report in draft form, as well as in final form. The evaluators are free to take account of, or ignore, any comments on their draft evaluation report.

(iii) Comments on the final evaluation report shall be considered part of the official record. If the Executive Board decides to make public the final evaluation report, it may also decide to make public the comments thereon, including the conclusions of the Executive Board consideration of the report.