

CHAPTER 1

Introduction

1. In recent years, the IMF has been at the center of an array of criticism concerning the adverse side effects of its interventions in the countries that it supports financially, the effectiveness of the economic programs that form the basis for this support, and even its very role in today's international financial system, with the fiercest critics arguing that it has outlived the mission for which it was created. While the criticism is extensive, it is not unanimous and there are many who recognize that the IMF has an important role to play in promoting stability in the international financial system and especially in helping member countries manage balance of payments problems in a manner consistent with the pursuit of other economic objectives.

2. The purpose of the Independent Evaluation Office is to undertake independent studies, which will further the objectives of strengthening the learning culture of the IMF and contribute to transparency by providing objective assessment of the effectiveness of IMF activities in various fields. This study, which is the first report of the IEO, focuses on the phenomenon of prolonged use of IMF resources by a number of countries. It is an issue that is closely related to the broader debate about the IMF's role and has been the subject of external criticism and also internal concern.

3. External observers have criticized prolonged use from a number of perspectives, suggesting that:¹

- It contradicts the IMF's mandate as set forth in the Articles of Agreement, which stress that IMF resources should be made available to members "temporarily"² to cope with balance of payments disequilibria.

¹Both the main criticisms and their counterarguments have been presented in more detail in the terms of reference of this paper, published on the IEO's website (www.imf.org/ieo) on March 15, 2002. In this report, the terms "prolonged use" and "repeat use" will be interpreted to mean the same thing. (See Chapter 2.)

²Such temporariness is dictated by the need to ensure the revolving nature of IMF resources.

- It suggests a lack of effectiveness of IMF-supported programs, as the repeated need to make use of IMF resources indicates a persistence of the balance of payments difficulties which such programs are intended to solve (Meltzer and others, 2000; and Vásquez, 1999). In recent years, some critics have argued that lack of ownership, leading to poor program implementation, and program design flaws are key factors underlying the lack of effectiveness of IMF-supported programs and therefore a root cause of prolonged use.
- It may encourage overindebtedness because a prolonged "IMF seal of approval" encourages overlending in an environment where there is insufficient attention to debt sustainability (Bandow and Vásquez, 1994); in heavily indebted countries it could reflect a strategy of "defensive lending" by the IMF and other multilaterals to avoid default (Birdsall and others, 2001); and
- It may hinder institutional development in the borrowing countries by giving the IMF an overly intrusive presence in their policymaking process, thereby compromising the development of responsible, democratic institutions that correct their own mistakes and respond to changes in external conditions (Meltzer and others, 2000).

4. The issue of prolonged use has been discussed in the Executive Board on several occasions. These discussions have brought out several arguments suggesting that frequent recourse to IMF arrangements is less of a problem than critics contend and in any case it may take place for good reasons and be fully compatible with both the IMF's mandate and a broadly defined sense of economic efficiency:

- This could be the case for countries subject to frequent external shocks and for countries where external imbalances have deep-seated structural causes, which cannot be overcome over the short term, or only at a great cost to economic prosperity—an outcome IMF-supported programs are specifically intended to avoid. The

latter category could include many low-income and transition economies.

- Since the mid-1980s, most IMF arrangements intended to tackle the latter kind of balance of payments difficulties for low-income countries have been funded from special accounts (i.e., the SAF, ESAF, and PRGF) and consequently have not exerted pressure on the revolving nature of general resources.³ Besides, it has been argued that the views of the official international community on the appropriate length of IMF financial involvement have changed over time, at least for the low-income group of countries, and the IMF has been given a mandate to provide support, via the PRGF, for programs intended to foster growth and poverty reduction over a longer time horizon.
- Prolonged use of IMF-supported programs may simply reflect the unwillingness of other lenders (be they private or public) to provide financing without the “seal of approval” they consider an IMF-supported program to be. This raises important questions with regard to the appropriate balance between the IMF’s lending and surveillance activities.

5. This evaluation investigates the issue of prolonged use by addressing three broad sets of questions. First, how extensive is prolonged use and what are its consequences for borrowing countries and the IMF? Second, to what extent is the phenomenon an inevitable consequence of conscious decisions made by the shareholders regarding the IMF’s role in the changed international environment? Third, to what degree can it be accounted for by shortcomings in the design of IMF-supported programs and how could the effectiveness of the programs be improved? We find that both systemic factors associated with the IMF’s role and program design and implementation issues have contributed to the extent of prolonged use. In addition, the topic of prolonged use touches upon many aspects of the IMF’s operations; in undertaking the evaluation we have identified a number of issues that, while germane to this topic, are of much broader relevance.

6. The evaluation has relied upon a combination of methodological approaches, including (i) empirical and econometric analysis of a wide range of prolonged users, taken both as a whole and in various relevant groupings; (ii) detailed case studies of three country cases (Pakistan, the Philippines, and Senegal) that have been among the most prolonged users

³To the extent that the PRGF Trust is expected to be self-sustaining at some point, concessional resources would also need to be revolving.

of IMF resources and illustrate different aspects of prolonged use. These case studies have involved country visits to seek the views of the authorities and a wide range of other stakeholders;⁴ detailed reviews of both internal and publicly available IMF documents; and interviews with relevant IMF staff, management, and Executive Directors; (iii) more limited desk reviews of two countries (Jamaica and Morocco) that appear to have “graduated” from IMF financial support, drawing on IMF documents and interviews with staff and some senior officials; (iv) written submissions by the authorities in a number of prolonged use cases responding to an IEO questionnaire on specific issues; and (v) responses received to IEO questionnaires sent to official donors and creditors, members of the private financial sector, and a broad range of IMF mission chiefs designed to seek their views on a range of issues including the broader institutional framework and incentives that influence decisions on programs. In the empirical work, we have made a distinction, wherever possible, between prolonged use of general and concessional resources, since expectations of the IMF’s role are, to some extent, different for the two groups.

7. We relied heavily upon existing databases for all our quantitative analyses. In addition to general databases on economic indicators (including that maintained for the World Economic Outlook), we used internal IMF databases on programs (e.g., the database on the monitoring of arrangements—MONA—and those on IMF arrangements and financial transactions), as well as those set up on an ad hoc basis for policy reviews or working papers (e.g., databases on waivers and structural conditionality, both created in early 2001). We faced a number of difficulties in using these databases: in addition to time frame limitations, we found a number of gaps and inconsistencies between databases compiled from different sources as well as, occasionally, between the databases and program documentation. Whenever possible, we corrected these inconsistencies. However, it is clear that a further strengthening of the MONA database in particular is needed to help improve the basis for internal and external ex post assessments. We make a recommendation to this effect in Chapter 8.

8. The three countries chosen for the detailed case studies illustrate different aspects of prolonged use. The Philippines had had the longest involvement with IMF-supported programs, stretching back to the early 1960s, with only relatively brief interruptions until it finally exited from such programs in 2000. It

⁴A list of those with whom the evaluation team had discussions in the case study countries is given in Part II.

has used only the IMF's general resources. Pakistan had repeated, but discontinuous, use of IMF resources during the period 1970–88 and, since 1988, has had a long series of arrangements—almost all of which suffered from substantial policy slippages and soon went off-track. The only exception was the 2000 Stand-By Arrangement, which was completed as scheduled. Pakistan has used both general and concessional resources and is currently implementing a PRGF-supported program. Senegal has had an almost continuous succession of IMF arrangements since 1979, except for a nearly two-year period around 1992–93 (i.e., prior to the devaluation of the CFA franc). Periods of strong adjustment have been interspersed with periods of policy slippages, often around electoral cycles. Since 1986, it has used primarily concessional resources, although it has also used a number of Stand-By Arrangements, either to supplement access levels or as a transition to multi-year arrangements.

9. The mandate of the IEO is to evaluate the operations of the IMF, not the policies or actions of country authorities. Hence, the focus of this paper is on the former. This does not mean that we believe all of the reasons for prolonged use lie within the IMF, or that full implementation of our recommendations would eliminate all of the problems in the countries themselves that have contributed to a sometimes prolonged and difficult adjustment process. But

these issues are clearly the responsibility of the countries concerned.

10. The organization of the report is as follows. Chapter 2 proposes a definition of prolonged use and discusses its extent; Chapter 3 summarizes the policy discussions that have taken place within the IMF with respect to prolonged use and the strategy that evolved for dealing with it. Chapter 4 examines the characteristics of the prolonged users. Chapter 5 discusses the lessons from the prolonged users for the effectiveness of IMF-supported programs, drawing on both cross-country evidence and the country case studies. Chapter 6 discusses a number of issues concerning IMF governance raised by the phenomenon of prolonged use, including the appropriate balance between IMF surveillance and lending arrangements. Chapter 7 discusses a number of other implications of prolonged use for the borrowing countries and for the IMF. Chapter 8 summarizes the main conclusions of the report and makes recommendations geared to limiting the scope of prolonged use and reducing its drawbacks as well as for improving the overall effectiveness of IMF operations. Supplementary material to several of the chapters is provided in the appendixes. The detailed country case studies for Pakistan, the Philippines, and Senegal, as well as the shorter case studies of Jamaica and Morocco, are presented in Part II.