

CHAPTER 8

Conclusions and Recommendations

1. This chapter summarizes the main conclusions of this study on the extent of prolonged use, on the factors underlying it, and on its effects. We then make a number of specific recommendations designed to counter the ill effects associated with this phenomenon. An important caveat is in order at this stage: since the IEO's mandate is to evaluate the IMF and not the policies followed by its member countries, the emphasis of both our conclusions and recommendations is on the IMF's role. This focus may give the impression that the IMF should be able to solve all problems in its areas of expertise, if only its interventions and modus operandi could be perfected. Clearly this is not the case. There are obvious limits to what any external agency can achieve, and the primary responsibility for the successes and failures of economic policies necessarily lies with the governments of the countries concerned. This point was emphasized by many officials we met during the evaluation and is the essence of ownership.

Major Conclusions

The prevalence of prolonged use and the nature of prolonged users

2. Prolonged use of IMF resources, regardless of how it is defined, has consistently expanded since the 1970s among both low-income and middle-income countries, in terms of number of countries, share of the IMF's membership, and the extent of financial exposure. In terms of the number of prolonged users, most of the expansion is accounted for by those eligible for the concessional facilities; however, in terms of financial exposure, prolonged use of the IMF's general resources is much larger. Furthermore, prolonged use is persistent, with relatively few "graduators." In addition, arrangements with prolonged users now represent half the total number of ongoing IMF-supported programs.

3. Although prolonged users have attracted a substantial share of both the IMF's general and concessional resources, they were not a significant constraint on overall lending since the IMF's liquidity

position remained comfortable. However, since decisions on the size of access to IMF resources and on quota increases are endogenous, it is difficult to tell ex post whether prolonged use led to implicit rationing of resources to other users.

Factors underlying prolonged use

4. The increase in prolonged use is partly a reflection of systemic factors arising from the changed role that the international community expects the IMF to perform but it is also partly related to program design and implementation issues.

Systemic factors associated with the role of the IMF

5. There are three major systemic factors that lead to an increase in prolonged use, though their impact in this respect has not been fully acknowledged.

6. *A broadening of the rationale for IMF program involvement beyond achieving short-term balance of payments adjustment.* The international community increasingly looks to the IMF to help developing countries—particularly the poorest—implement and maintain policies and institutions needed for the achievement of sustainable growth. It looks to the IMF for an assessment of whether policies and institutions are in place that can deliver a sustainable macroeconomic position, and to monitor the situation over time to check that these policies remain on track. In low-income countries, it is also looking for a broader assessment, and subsequent monitoring of progress, on policies to achieve balanced growth over the longer term; many of the aspects of such an assessment go beyond the traditional concept of the IMF as being responsible primarily for short-term stabilization. The fundamental objectives of the IMF, as set out in Article I of the Articles of Agreement, are sufficiently broad that they could encompass such an expanded role. However, this raises the basic question of where a legitimate adaptation of roles ends, and where inappropriate "mission creep" begins. This inevitably involves judgments on the most efficient allocation of responsibilities among institu-

tions and also on whether lending arrangements are the most suitable tools to pursue the above objectives. Many of these questions go beyond the scope of this evaluation, but it is important to consider the potential consequences of the approach that has been adopted for the emergence of prolonged use and its possible adverse impact. We do not believe this has been done sufficiently.

7. *IMF lending as a seal of approval and the boundaries between programs and surveillance.* One of the factors underlying the expansion of prolonged use is that most official creditors/donors insist on an IMF-supported program as a seal of approval, which becomes a precondition for new adjustment loans and grants or for debt relief and restructuring. There is some evidence that such insistence compromises the quality of IMF-supported programs, and therefore the quality of the seal of approval. With so much riding on the decision, there are strong pressures to agree to a program even though the program may be deficient in several respects. The same tension would of course exist with any other form of seal of approval, but, for reasons discussed below, the association of the seal of approval with repeated programs is especially problematic. Moreover, the signal sent by a short- or even medium-term program may not be the type of seal of approval that official creditors and donors—who usually have a medium- to long-term perspective—should be seeking, especially if it does not ensure the strengthening of core institutions needed for good policies to stay in place beyond the term of the program. In whatever manner the seal is provided, it is important that its quality be maintained. This suggests the need to look for a mix of instruments that provide a seal of approval better suited to the needs of the global community.

8. *Choices on where the boundary between programs and surveillance should lie, and on the scope and strength of surveillance processes, will have a major impact on the extent of prolonged use.* The pre-eminence acquired by programs over surveillance in addressing the evolving needs of the international community in a number of circumstances appears to reflect a judgment that only an IMF financing arrangement provides a strong enough vehicle to achieve the desired results.¹ However, the nature of the surveillance process itself can be adapted to meet this need. Some of the recent initiatives go some way in this direction. For example, recent efforts to make surveillance assessments more transparent, to sharpen their diagnosis on vulnerability issues, and to promote

¹As noted in Chapter 6, some donor respondents to the questionnaire suggested that one of the reasons why such an endorsement was taken more seriously was precisely because it involved a financial commitment by the IMF. But such an approach would by its very nature imply prolonged use.

the observance of internationally agreed standards and codes already provide a potentially stronger instrument for monitoring a country's progress than existed for much of the period covered by the evaluation. Such initiatives could be expanded further.

9. The expectations of the international community for some form of “seal of approval” signal by the IMF could be met through different combinations of enhanced surveillance, a series of programs, or precautionary arrangements. For low-income countries, this could also involve building on the PRSP process and the need for a positive joint IMF/World Bank staff assessment of each PRSP and PRSP review. It is for the IMF's members to decide which route they want to take. However, if they wish to continue to rely primarily on a series of programs, then the result is likely to be continued prolonged use of IMF resources for a significant proportion of the membership. This should be acknowledged explicitly and, as discussed below, is likely to have implications for how the IMF organizes its work in such countries. This evaluation also suggests that such an outcome could involve some significant drawbacks. Changes in the nature and modalities of programs can help mitigate these drawbacks, but are unlikely to eliminate them completely.

Program-related factors

The evaluation suggests that a number of program-specific factors have also contributed importantly to prolonged use.

10. *Some deep-seated adjustment problems take a long time to fix, even in a perfect world where programs are well designed and implementation is smooth.* There is some evidence that the problems of countries that eventually became prolonged users were more severe at the start of their long program involvement. If the IMF is to continue to seek to help countries tackle these problems over an extended period then the challenge is to design programs that recognize from the outset that a longer time frame—with repeat programs and an appropriate division of labor among the IFIs—may be required to achieve lasting adjustment, while ensuring that such a time frame does not become a device to postpone action. Without such a recognition, our evaluation suggests that the short-term focus required by programs may lead to the adoption of approaches that are likely to be ineffective in tackling deep-seated problems because they are not complemented by effective implementation of core institutional and structural changes.

11. *Some programs have suffered from design and implementation problems.* The country case studies suggest a number of reasons why some programs have been less effective than initially expected in

achieving their longer-term objectives. It is not possible to say definitively how much these problems have contributed to prolonged use, since the cross-country evidence discussed in Chapter 5 suggests that these problems also arise in “temporary” user programs. Nevertheless, they are worth noting because they have implications for program effectiveness.

- Many programs suffer from an overoptimistic time frame—reflecting the difficulty of matching the short-term conditionality of a program to complex, structural and institutional changes that are central to sustained growth-oriented adjustment. There are also institutional incentives to “overpromise” on the speed at which core reforms can be implemented and longer-term sustainability attained.
- A lack of sufficient emphasis, until very recently, on strong domestic ownership leading to the approval of programs to which governments are inadequately committed.
- Structural conditionality that was insufficiently focused on key issues. The issue seems to be one of prioritization, rather than the number of structural conditions per se; indeed, programs with prolonged users were not, in general, more burdened with such conditions.
- Insufficient priority to assessing and improving implementation capacity, and to reforming core institutions so as to ensure that adjustments are sustainable.
- Insufficient assessment of the real economy responses to the program and to the sources of growth (e.g., leading, in a number of cases, to an overestimation of how rapidly private investment or exports would respond).
- Absence of a strategy for responding to inevitable uncertainties about the economic environment, which sometimes led to ad hoc corrections that were inconsistent with longer-term objectives.
- Insufficient opportunities to step back and reconsider the overall strategy pursued by programs while learning lessons from experience.

We are not suggesting that all programs suffered from these problems, or that there was no learning over time. In some of the case studies, IMF-supported programs were associated with significant improvements in the policy environment over time.

Many of the problems listed above have already been recognized within the IMF, and some important initiatives are under way to try to address them. Of particular importance are ongoing efforts to enhance ownership and to “streamline” structural conditionality, so as to concentrate the focus on medium-term,

macro-critical structural issues, and to improve collaboration with the World Bank. For the low-income countries, the PRSP/PRGF process is the key initiative to try to embody genuine government commitment, through a broader consensus building process, into the formulation of a medium-term policy framework. However, the jury is still out on how much these initiatives have changed the way the IMF operates in practice and therefore how well they will address core problems.

Is prolonged use a problem?

12. Our evaluation suggests that prolonged use does present problems that were not sufficiently appreciated when decisions were made that were likely to encourage extended program involvement. These problems broadly fall into two categories: potential costs to the prolonged user countries; and adverse effects on the credibility of the IMF.

- There is some qualitative evidence that prolonged use hinders the development of robust domestic policy formulation processes over time, which partly reflects insufficient attention to country ownership in past programs—although it is not possible to test the counterfactual of how institutions would have developed in the absence of lengthy IMF program involvement.
- There is an inherent tension between the quasi-permanent conditionality implicit in prolonged use, and country “ownership,” in the sense of countries taking responsibility for the conduct of their economic policy, both by being in the driver’s seat and by facing the consequences of their decisions. Recent changes, including the PRSP process, may help mitigate these tensions but are unlikely to eliminate them.
- Some of the case study experiences also suggest that the perception that IMF resources would be available over the long term, despite policy slippages, may have weakened incentives to take decisive action to deal with some problems.
- If, as appears to be the case, prolonged use in some cases has resulted from pressures on the IMF to agree to a series of weak programs—for example, to open the way for donor support or debt rescheduling or because of political pressures—then the effectiveness of these programs will be weakened and the credibility of all IMF-supported programs may be adversely affected.
- Some aspects of the IMF’s independent surveillance functions tend to be crowded out by program activities in the countries concerned, which might reduce the credibility of surveillance.

13. We recognize that some of the adjustment problems faced by IMF member countries, especially the poorest of them, do indeed take a long time to resolve and this justifies somewhat greater acceptance of prolonged use in these cases. Nevertheless, many of the potential costs mentioned above would also be relevant in such cases. Moreover, acceptance of a lengthy program involvement in a significant share of the IMF's membership would have consequences for the IMF's role that, in our view, have not been fully recognized. Widespread prolonged use is to some extent inconsistent with current internal operational procedures that are still largely built around the relatively short-term framework of programs. Consequently, there needs to be a clear understanding of what the IMF's role is expected to be in such cases, so that its operational approach can match that role.

Recommendations

14. In our view, the drawbacks associated with prolonged use are sufficiently serious to warrant a greater effort to reduce its extent; to look for other and better ways to provide the seal of approval that the international community wants; and, where prolonged use still does occur, to look for ways to mitigate its drawbacks since even in cases with “good” reasons for such use, there can be undesirable side effects. Our recommendations seek to address these challenges. Some of them would be applicable only to actual prolonged users. However, any strategy aimed at reducing prolonged use that restricted itself to tackling the problem once it has already materialized would be of limited value. Therefore, many of the recommendations are of more general applicability to the IMF's approach to programs. In that sense, they can be seen as elements of a preventive strategy for improving the effectiveness of the IMF's operations and hence reducing the likelihood of prolonged use.

15. The recommendations concern three aspects of the IMF's operations: (i) the rationale for IMF involvement and the use of its facilities; (ii) program design and implementation; and (iii) IMF internal governance issues.

Recommendations on the rationale for IMF involvement and the design and use of its facilities

16. *We recommend that the Executive Board adopt an operational definition of prolonged use, as an essential requirement for evolving a strategy for reducing the likelihood of such use.* The evaluation shows that although there are current internal guidelines approved by the Board for dealing with prolonged use cases—calling in particular for the sys-

tematic ex post evaluation of programs, for specific justification of IMF involvement, and for a progressive reduction in the size of access in such cases—these guidelines have not always been implemented in a systematic manner. This is partly because there is no formal definition that would identify countries for which prescribed procedures must apply. We fully recognize and strongly endorse the need for flexibility in the decision to provide IMF assistance in individual cases, but the adoption of a formal criterion to identify prolonged users would not eliminate this flexibility. Its purpose would be to trigger automatic due diligence procedures whenever a country meets the prolonged user criterion. The operational definition could be based on the criterion we have used in this study, or indeed some other criterion that is felt to be more useful. The criterion could also distinguish between general and concessional resources, in order to reflect the special circumstances of low-income countries and allow more extended involvement in their case.

17. *We recommend that greater efforts be made at judging whether countries are ready to implement credible programs, and that the IMF should be more selective in extending financial support.* Many countries may be in a position where they need to make adjustments for which financial support is needed, but they may not always be ready, for complex political and social reasons, to implement the necessary adjustment measures. In these circumstances, IMF-supported programs are likely to be unsuccessful, and the IMF may well need to hold back from providing finance until circumstances are more appropriate. A more rigorous approach to assessing the willingness and ability to undertake adjustment measures and associated reforms should help to reduce prolonged use by encouraging a stronger commitment toward implementation and therefore a more effective adjustment process with a higher probability of graduation. Greater selectivity does not mean that the IMF should play no role where the conditions are not yet ready for financial support. It should (i) actively help to create the conditions for an effective domestically owned program through a frank and transparent policy dialogue, through candid surveillance, and through technical assistance; and (ii) be ready to provide financial and technical support in a timely manner when circumstances are conducive to effective implementation.

18. We recognize that a decision to withhold IMF financial support in such circumstances involves very difficult judgments since it may worsen the economic situation for the country concerned, at least in the short term. We are not suggesting that these implications should be disregarded; they involve very difficult trade-offs between undesirable alternatives that need to be weighed carefully in each case. However,

evidence from the case studies shows that there is a strong risk that programs approved under circumstances in which credible action is unlikely, for whatever reason, will only postpone the resolution of problems, perhaps even allowing them to get worse, without offering any good prospect of sustainable adjustment. In such cases, raising the threshold for what is required for IMF support, especially in terms of the probability of implementation, is likely to yield a better outcome in the long run. In calling for greater selectivity, we are not seeking programs that look “tougher” on paper; indeed, an essential counterpart of greater selectivity is that programs focus only on what is essential for longer-term sustainability and have a realistic time frame (see next section).

19. Operationally, this means that UFR proposals to the Board should contain an explicit and frank assessment of the readiness of potential borrowers to implement programs. Current guidelines already call for a judgment by management that the program will be carried out, but the evidence from the case studies indicates that the assessments on which this judgment is based are sometimes done in a perfunctory manner. Few such judgments are likely to be totally clear-cut, but the Board should be provided with a candid assessment of the risks.²

20. *We recommend that the IMF aim to provide the international community with credible alternatives to the current situation where IMF lending arrangements have become a precondition for many other bilateral and multilateral flows.* It is up to each donor and creditor to decide the conditions on which they will provide financing, and all legitimately want assurances that an appropriate policy framework is in place to make their financing effective. However, the requirements for effectiveness of different types of flows are different. For many longer-term flows these requirements could be met without always having an IMF-supported program if suitable alternatives are developed, such as greater use of strengthened surveillance, reliance on joint staff assessments of PRSPs, shadow programs, and precautionary arrangements. More generally, we recommend that the IMF should aim at developing a mix of tools that could serve to deliver a seal of approval in different ways, depending on the member’s circumstances (in particular, its eligibility for the PRGF and for the HIPC Initiative), donor/creditor requirements, and the strength of the member’s policies and institu-

²It is difficult to prespecify exact criteria that the Board should use in making such judgments, but the case studies suggest a number of examples where it would have been better if the IMF had been more restrained in entering into or extending programs—such as the Philippines during much of the Marcos and Estrada administrations (once the extent of governance-related problems become clear) and in Pakistan for parts of the 1990s.

tions.³ Such forms of enhanced surveillance may even have an advantage over lending arrangements since they can have a longer-term and broader focus, covering all elements of a country’s economic strategy.

21. For PRGF-eligible countries, one possible approach could be to design a form of enhanced surveillance (once a degree of macroeconomic stability is restored), in order to provide a clear signal on the appropriateness of the macroeconomic framework and a monitoring of progress over time on both macroeconomic performance and on macro-critical structural reforms outlined in the PRSP. In effect, the IMF would start from the country’s own medium-term program as outlined in the PRSP, and assess it (in cooperation with the World Bank in aspects of policy and institutions that fall outside the IMF’s core areas). Thus, it should be made clear that not every PRSP would be accompanied by an IMF arrangement under the PRGF.⁴ In whatever manner this was done, it would clearly be necessary to incorporate into surveillance reports and Board summings-up an overall judgment that a country’s economic strategy is sustainable and has good prospects of achieving the desired objectives, to give a clear signal to the donor community.

22. *We recommend that programs for identified prolonged users should include an explicit “exit strategy.”* This is already called for in current guidelines, but is often not implemented, possibly because of the lack of a specific definition of prolonged use. The details of the exit strategy would vary from country to country—and especially between PRGF-eligible countries and others. An important feature of any exit strategy would be for the IMF to reduce progressively its own resource contribution (which again is already a feature of current guidelines) while remaining actively engaged, along the lines discussed above, in providing the “seal of approval”

³One recent example of a development in this direction is the agreement concluded in July 2002 between Jordan and the Paris Club: in effect, Paris Club creditors agreed to a consolidation period more than twice as long as Jordan’s SBA and decided to rely on Executive Board discussions on post-program monitoring and Article IV consultations to assess Jordan’s performance after the expiration of the SBA as a basis for deciding on the entry-into-force of the annual phases of the debt rescheduling agreement. This example, along with donors’ responses to the IEO questionnaire on the topic (see Chapter 6), suggest that the scope for flexibility in the mix of tools to deliver the seal of approval should be explored further.

⁴Joint IMF–World Bank staff assessments of PRSPs are typically concluded by an assessment of whether or not the PRSP in question constitutes an adequate basis for IMF and World Bank concessional lending. These assessments could conceivably be tailored to donors’ concerns in such a way as to allow them to extend the concluding judgment to concessional lending from other sources, thereby making an IMF lending arrangement redundant for seal of approval purposes.

that may be needed for other donors and creditors to maintain their flows. Such an approach would enable the Board to be more proactive in identifying cases where a scaling back of IMF program involvement would be appropriate.⁵

23. *We recommend the introduction of a differentiated rate of charge for prolonged users as a signaling device.* We do not support formal restrictions on the duration of prolonged use because all member countries should have the ability to access IMF resources if the need is justified, and formal time limits would ignore both this right and the variability of country circumstances. However, there is a case for a differentiated rate of charge for prolonged use exceeding some limits. We recognize that there is no evidence that the cost of IMF resources has been a significant factor in determining prolonged use, but the introduction of such a charge could serve as a signal of excessive dependence on the IMF and possibly provide a political incentive to avoid such prolonged use.

Recommendations for program design and implementation

24. Program design and implementation issues have been extensively discussed in the Executive Board on many occasions, and several of the recommendations in this section essentially consist of a reaffirmation of what are supposed to be existing guidelines or “best practices,” but which our evaluation suggests have not always been implemented on a consistent basis. In the recommendations on internal governance processes in the subsequent section, we make a number of suggestions on how internal incentives and procedures could be improved to encourage improved implementation and strengthened learning processes. Many of the issues discussed here have also been the subject of recent initiatives by the IMF; in these cases, we make a number of additional suggestions that could help increase their effectiveness.

25. *We recommend that specific operational procedures be developed that will ensure that program design places greater emphasis on the nature of the domestic policy formulation process, in order to maximize ownership.* The IMF has already recognized the importance of promoting ownership,⁶ most notably in the PRSP process and in the ongoing review of conditionality, and this is the right direction in which to move. A number of steps could be taken to fulfill this objective:

(i) *The IMF should modify its procedures to move toward a situation in which the authorities have the initial responsibility for proposing a reform program.* Ideally, this could be done by having the initial request seeking an IMF arrangement take the form of a letter of transmittal of a domestic policy document outlining the broad approach of the authorities. This should be the starting point for negotiations. We are not suggesting that such an approach be an additional prerequisite for an arrangement, since differences in administrative capacity will affect the pace at which countries are able to take the lead in formulating programs. We understand that some countries already adopt an approach close to what is being proposed, whereas in many others the IMF staff takes the lead. Technical assistance could be provided to help build the capacity for policy formulation where needed.⁷ Clearly, the submission of a domestic policy document would only initiate the process. It would still be the IMF’s responsibility to assess the proposed program to determine whether it has a good chance of achieving its objectives and to negotiate strengthening the program where needed. The specific structure of conditionality would emerge from the negotiations but could then be viewed as concrete commitments undertaken within the broad framework proposed by the authorities. Such an approach would help to ensure greater ownership of the broad directions of the program. We recognize that it would require greater flexibility in scheduling missions, which should be tailored to the timetable of national policy agendas, and may mean that negotiations take longer to complete. If a balance of payments crisis is imminent, there may be less time for detailed policy formulation in advance of a mission, but most program missions for medium-term programs—especially in the prolonged users—do not take place in such an environment.

(ii) *The IMF should, wherever possible, encourage a process whereby the core elements of a program are subject first to a domestic policy debate within the member country’s own poli-*

⁵The discussion that took place in the Executive Board at the time of the fifth review of the Philippines’ 1998 SBA—which triggered a wide-ranging internal discussion of future strategy—is one good example of such a proactive approach.

⁶See, for example, IMF (2001d), available on the IMF’s website.

⁷Many officials from the three country case studies and the questionnaire responses emphasized that IMF technical assistance had generally not been very effective in helping countries develop the capacity to design and, especially, implement economic policies—which are essential elements of ownership. Participants in the 2001 external consultation process on conditionality made a similar point.

*cymaking institutions.*⁸ While the nature of this policy debate will vary with the particular institutional circumstances of each country, two general messages are relevant: (a) high levels of political authority need to be fully engaged; and (b) the more transparent and participatory the process the better.

- (iii) *High-quality surveillance should help to create a better understanding of what would be expected of the authorities should a program become necessary.* This would contribute to the perceived transparency of IMF policies in the design of programs.⁹ Surveillance reports should, therefore, actively seek to present alternative policy options and to analyze the trade-offs between them: this is already “best practice” but it is not general practice.

26. *We recommend that programs give much greater emphasis to fostering key institutional changes and to strengthening implementation capacity.* Our assessment based on the case studies and questionnaire responses from prolonged users’ authorities suggests that strengthening the institutional base for implementing reform is a much more important determinant of the long-term success of programs than the detailed structure of conditionality. Staff program documents should include an explicit assessment of the key institutional requirements for effective implementation and how these can be strengthened. As already called for in the most recent procedures, they should also be clear about the division of institutional responsibilities between the IMF and the World Bank (see below), and reporting the Bank’s assessment of institutional constraints in those areas where it is in the lead.

27. *We recommend greater selectivity in program content along with further improvement of collaboration with the World Bank, a more differentiated use of conditionality, and a broadening of the time frame of program design.* This recommendation is in line with ongoing initiatives to streamline conditionality, which we strongly welcome. In our view, the thrust of streamlining should not be primarily on the quantity of conditionality per se but on improving its pri-

oritization and integration with program design, which should then be reflected in a more parsimonious recourse to waivers at the stage of implementation—in other words, picking the battles better and fighting them well.¹⁰ The experience of the case studies indicates that, if the overall volume of conditions exceeds implementation capacity, some conditions—not necessarily the most important ones—may be effectively implemented, but others will not. In keeping with the spirit of the draft revised guidelines on conditionality, the IMF should identify those issues that are truly critical to sustainable macroeconomic adjustment and then focus on them in depth.¹¹ In our view, effective implementation of these principles would require a number of operational changes:

- (i) *Making a more differentiated use of the various modalities of conditionality.* Conditionality should be seen primarily as a tool to help focus on critical areas that need concentrated attention, as well as an instrument of mutual accountability between the IMF and the authorities. Structural conditions should focus on aspects of the program that are critical for sustainable adjustment, but it is equally important that all such aspects be addressed by the program. This was not always so in the programs examined in the case studies. The mix of various modalities of conditionality should reflect the order of priority attached to each measure by the authorities and the IMF as well as the planned sequencing of reforms, both of which should be explained in staff reports to the Board.¹² Furthermore, our analyses, especially in the case studies, also suggest that the sub-

⁸A robust domestic policy formulation process does not necessarily mean near-universal consensus or a requirement to consult nongovernmental groups in a particular way; it just means that the main policy elements of a program would carry sufficient support in the core political institutions, including parliaments. The extent to which this is possible will depend, inter alia, on how urgent is the need for IMF financial support.

⁹We recognize of course that in the event of unexpected developments leading to crises, programs may need to introduce measures not envisaged in surveillance. Nor should programs necessarily undertake to fix every single problem diagnosed in the surveillance process if there are higher priorities.

¹⁰Indeed, the data discussed in Chapter 5 indicate that prolonged users’ programs on average had less extensive conditionality than “temporary” users. Yet they also had a higher proportion of waivers, which were often followed by serious program interruptions. Thus quantity is not the critical issue.

¹¹At the time this evaluation was completed, the Executive Board was in the process of completing the review of conditionality initiated in 2001, by approving a revised version of the “Guidelines on Conditionality” adopted in 1979.

¹²For example, prior actions should generally be limited to measures whose absence at the start of the program would jeopardize its chances of success, and that can effectively be put in place in a short time frame. Any measure that does not meet either of these criteria would be more effectively dealt with through otherforms of conditionality. In particular, prior actions on measures that are meant primarily as tests of the authorities’ ownership but the adoption of which, in and of itself, has little macroeconomic impact, should be avoided. If there are serious doubts about ownership, it is better to wait until some credible track record is established rather than devise tests through prior actions that are not critical to success. In intermediate situations, the actual implementations of existing guidelines on prolonged use related to the front-loading of the adjustment effort and the back-loading of disbursement could serve to mitigate implementation risks without jeopardizing ownership. (Data reported in Chapter 5 suggest that these guidelines were often not followed.)

stance of conditionality matters more than its formal structure. Particular efforts should be made, when negotiating conditionality with the authorities and when assessing compliance, to put the emphasis on actions that will ensure substantive progress toward meeting the program's objectives rather than on formal compliance with narrowly defined conditions on a checklist. We recognize that this would require greater flexibility and judgment.

- (ii) *Making greater efforts to tailor the effective time frame of program design to the foreseeable length of the reform and adjustment process.* This does not necessarily imply that the time frame of IMF arrangements should be further lengthened. Indeed, experience suggests that country authorities themselves are often reluctant to commit themselves firmly for long periods—partly reflecting political uncertainties. However, our study has shown that where a long-haul adjustment effort is required, it is at best ineffective and at worst counterproductive to try to force adjustment within a shorter, and essentially arbitrary, time frame. One way to proceed would be to design a medium-term strategy for IMF involvement, covering the full length of the required reform and adjustment process. The strategy would build on domestic documents (i.e., PRSPs where they exist, planning documents, programmatic laws, “lois cadres,” etc.) and indicate the nature of IMF involvement, including through successive programs, in different stages. The strategy should lay out several key elements: what the objectives of this involvement are; what combination of lending, including possible repeat programs, policy advice, and technical assistance are envisaged to achieve them; and also what exit strategy would be followed. Whether individual arrangements are signed and funds disbursed would continue to be guided by the same policies as before. We do not propose preparation of separate Board documents outlining the strategy: UFR request reports should be used to set out the proposed strategic framework, while surveillance reports or program reviews should update and monitor progress against them. Our proposal is therefore essentially a further strengthening of the approach that is supposed to be used with internal country strategy papers, but with the central elements of the proposed strategy—and subsequent assessments and possible reappraisals—conveyed to the Executive Board.¹³

¹³See Chapter 6 for a discussion of the role of the country strategy papers.

- (iii) *Further strengthening collaboration with the World Bank.* Initiatives such as the agreement on the “lead agency” concept are useful first steps, but ensuring that the new approach works effectively is likely to require deeper operational changes and sustained emphasis by management.¹⁴ Where the World Bank does not appear to be in a position to deliver the necessary complement to the program, staff reports should be candid about the issue and let the Board decide to what extent the IMF should concern itself with those issues. To encourage such candor, the traditional appendix to staff reports describing the country's relations with the World Bank—which at present is typically pro forma and adds little of substance—could be replaced by a more substantive discussion of the World Bank's strategy in the country, showing how it complements that of the IMF and flagging any significant differences of view or areas where the two institutions' strategies are not fully integrated. However, the case studies suggest that meshing the approaches and time frames of the two institutions will be an enormous challenge.

- (iv) *Systematically incorporating more in-depth analysis of real economy responses to the key policy elements of programs, and the sources of growth* and devoting proportionately less attention—and staff time—to the fine-tuning of the financial programming exercises.¹⁵ Ideally, such analyses should be conducted regularly in the context of the IMF's surveillance activities—drawing where appropriate, on the expertise of the World Bank and other institu-

¹⁴Since 1989, there have been approximately ten reviews and progress reports on IMF–World Bank collaboration, all of which diagnosed room for improvement and put forward remedies. This record suggests that the underlying problems are complex and deeply rooted.

¹⁵When we refer to the excessive amount of time devoted to the excessive fine-tuning of the financial programming exercise, we are not implying that IMF staff does this out of a misplaced sense of priorities, or that simple exhortation will correct the problem. Indeed, it is the staff themselves who have most emphasized this issue during our discussions. Rather, this issue is another example of the tensions between the short-term framework of a program and the more important, but often less precisely defined, longer-term goals. For example, the rather rigid formal framework for quantitative performance criteria—which requires Board approval of waivers whenever a deviation occurs, no matter how small—tends to raise the stakes for even minor deviations, since countries are often reluctant to be seen to request waivers. The recent heavy focus on cases of misreporting has added to these pressures. There is no easy solution to such problems, since a quantitative monitoring framework is justified, but it would help if Board papers were franker about the margins of uncertainty surrounding the details of program design.

tions—and the accumulated knowledge should be used at the time of programs involving UFR. This will help to avoid building programs around unrealistic expectations, especially as regards exports and tax revenue growth. Moreover, using the surveillance process to flag candidly weaknesses in the statistical base would help reduce the enormous amount of time that negotiating missions spend addressing data problems.¹⁶

28. *We recommend that programs include more explicit discussion of the major uncertainties they face and of how policies will be adapted if underlying assumptions turn out differently.* These problems are not new and are also not exclusive to prolonged use cases, but they are specially relevant for these cases as they would help to reduce the risks of programs being repeatedly blown off-track by the materialization of downside risks. It is not possible to pre-specify ways of dealing with all contingencies. However, the program review process needs to be sufficiently flexible to adapt the program in a timely manner when circumstances change, and an early understanding on the major uncertainties and proposed responses, even in general terms, can help this process. For example, in cases where other forecasts (e.g., private sector “consensus” forecasts) of growth or of exports differ significantly from those assumed in the program, staff reports should discuss in concrete terms how program design would be modified should these other forecasts prove to be more accurate. Such a requirement would also help reduce the risks to programs caused by overoptimistic forecasts.

Recommendations for internal IMF governance processes

29. *We recommend that systematic ex post assessments of programs be undertaken, with priority given to identified prolonged users, and the key messages reported to the Board. Such assessments should be part of a broader effort to disseminate more effectively “best practices” and lessons learned, and to maximize the effectiveness of the review process.* Internal assessments of each program that is completed or permanently interrupted would help to ensure that the lessons for program design are absorbed more quickly and systematically. The country case studies highlighted a number of occasions where potential problems with program design (or its implementa-

tion) that contributed to prolonged use were identified, but where the lessons were not fully absorbed in the design of subsequent programs. Indeed, as is the case for several of our other recommendations, this is another example where existing guidelines require such action but they have not been implemented. The discussion in Chapter 6 also suggested that in a number of areas the IMF has been quite good at identifying lessons, but less effective at ensuring that they were absorbed into everyday operations. Building the review process around systematic ex post assessments will foster better implementation of “best practices” and provide clear opportunities for reconsidering the overall strategy.

30. One of the reasons why previous calls for more systematic assessments of programs have not been implemented was excess work pressure, and we recognize that implementation of this recommendation will require some additional resources. If necessary, the requirement for such ex post assessments could be phased in, with priority given to existing prolonged use cases. We also think it is important that the key elements of any debate on program design options that takes place during this process is conveyed to the Executive Board. Clearly, care must be taken not to hamper the ability to deliver a consistent message to the authorities, but the credibility of that message will ultimately be strengthened if it is seen to be derived from a process that considers different options and is designed to learn from experience. In this regard, we also recommend that:

- (i) *Staff reports—especially those involving requests for new arrangements for prolonged users—should provide more of a perspective of the history of the IMF’s program involvement with a country.* This should highlight what has been achieved and where previous strategies have fallen short of their objectives and why.
- (ii) *The MONA database, which is the key internal information system for tracking performance under programs, should be made more comprehensive, accurate, and up to date.* At present, the MONA database does not include information on programs that go off-track—even though these are the very ones that should be followed most carefully.¹⁷ During the course of the evaluation, substantial errors and gaps in the database were also discovered, especially with regard to data on outcomes. Existing

¹⁶This is already supposed to be current practice. Area departments are expected to work closely with the IMF’s Statistics Department in developing strategies to remedy data deficiencies and to enhance statistical capacity, including through a prioritized use of technical assistance.

¹⁷Apparently, the reason why “off-track” programs are not monitored comprehensively in MONA is because it is the completion of the review that triggers the administrative process to update the database. No action is taken until the review is completed, so programs that are permanently interrupted cease to have their database updated.

weaknesses in data on how programs have performed are an impediment to efforts to enhance the IMF's ability to learn from experience and to monitor the implementation and impact of its own policies. We have discussed this issue with PDR staff and we understand that efforts along these lines have now been initiated. We also recommend that the MONA database be made accessible to outside researchers, in order to encourage further analysis and feedback on program successes and failures.¹⁸

31. *We recommend that steps be taken to further strengthen surveillance in prolonged use cases.* Evidence from the case studies suggests that some important aspects of surveillance have been weakened when undertaken in a prolonged program context. In countries where programs are temporary events, such a “crowding out” of surveillance by program activities could be less important, but its consequences are potentially more significant for countries that have a long series of IMF arrangements. We recommend the following steps:

- (i) *The surveillance guidelines should be modified to clarify the expectations on the role of surveillance in program cases.* The draft guidance note discussed by the Executive Board in July 2002 already takes a step in that direction by highlighting the need, in program countries, for surveillance to bring a fresh perspective by providing: “(i) a comprehensive assessment of economic developments, beyond the narrow focus of program targets; (ii) a candid analysis of short and medium-term prospects, including a thorough discussion of risks and vulnerabilities; (iii) a stock-taking of the policy strategy to date and the effectiveness of the measures implemented in pursuit of that strategy; and (iv) a candid account of the dialogue between the staff and the authorities on the key policy issues and the strategy looking ahead.”¹⁹ As part of the discussion of risks and vulnerabilities, a useful addition to these requirements, in prolonged use cases, would be the presentation of a policy slippage scenario, to illustrate what implications the country and the IMF would be faced with should the current program go off-track. Furthermore, as discussed above, the sur-

veillance reports for prolonged users should be used as an opportunity to encourage a frank and open debate on the IMF's overall strategy in a country. Surveillance reports in program countries should also make a special effort to incorporate the views of the World Bank on those segments of the policy agenda where it is in the lead, and to report candidly about the quality of Bank-Fund collaboration in the country.

- (ii) *There is a case for creating some greater institutional separation between programs and surveillance, especially in the context of prolonged use.* The International Monetary and Financial Committee in its April 2002 communiqué called for a “fresh perspective and appropriate distance” in the conduct of surveillance. This is particularly important in prolonged use cases. Giving these expectations more emphasis in surveillance guidelines and, as discussed in the previous recommendation, embedding them in a systematic ex post assessment process, would go a considerable way in this direction.²⁰ One additional step that has been suggested would be to have entirely separate teams to conduct the two activities, but this would involve substantial resource and coordination costs for both the IMF and the authorities, and signals on policies might also become confused. However, there is merit in taking some institutional initiatives to achieve greater separation between surveillance and program activities for prolonged users. At a minimum, surveillance reports should not be treated as offshoots of program activities. For instance, the internal review process should deal with surveillance reports for countries under program in exactly the same way as other surveillance reports, which is not the case at present.²¹ An option that might be considered in a limited number of cases, such as the most prolonged users, is for the chief of the surveillance mission to be chosen from outside the relevant area department.²² We recognize, however, that

¹⁸We understand some researchers have already been given access to the database, on a case-by-case basis, with safeguards to protect confidential data.

¹⁹See SM/02/184 of June 14, 2002, “Biennial Review of the Implementation of the Fund's Surveillance and of the 1977 Surveillance Review—Follow-up.” As regards stock-taking, the 1997 guidelines on country strategy papers discussed in Chapter 6 constitute a good description of what “stepping back” should aim to achieve.

²⁰Indeed, a few examples from the country case studies suggest that the country teams under the existing arrangement do have the ability to step back and take a frank look when circumstances permit (e.g., when there is not a strong incentive to avoid “rocking the boat” on an already agreed program).

²¹Thus, within PDR, the Surveillance Policy Division should have the primary role, not—as is currently the case—divisions in charge of reviewing programs.

²²Implementing this recommendation would require particular precautions to ensure the adequate preparation and follow-up of Article IV consultation missions, allowing a suitable feedback to program discussion. The suggestions made by the OIA in its 2001 report on the organization and management of country missions, if implemented in these cases, would go a long way toward addressing the most critical issues in that respect.

making the greater separation operational in practice involves delicate trade-offs, in particular in terms of continuity of the policy dialogue and country knowledge management. These trade-offs would have to be appropriately managed.

- (iii) *In the same spirit, there is merit in seeking a second opinion—including from outside the IMF—on key policy issues that appear to be contributing to prolonged use.* Discussions with the staff and internal documents reviewed by IEO make clear that there can be considerable debate within the IMF (as well as between the staff and the authorities) on key policy options, and that this debate often draws upon outside analysis, including through informal contacts and seminars. However, the analysis presented in final reports submitted to the Board is often designed to support the final, agreed position at the expense of understating the extent of trade-offs between different strategies. One possible approach to improve on current practices would be to experiment with including “second opinion” analysis from outside sources in the selected issues paper prepared for Article IV consultations, along with any staff response. The focus of such analysis would be on critical issues where there is a wide divergence of views on the appropriate approach.²³
- (iv) *The precise frequency of Article IV consultations with program countries is less important than that they take place at an appropriate time—that is, when a “fresh look” would be most valuable. It is especially important to have timely consultations when programs are faced with unexpected challenges, when they go off-track, or before a new program is negotiated.*²⁴

32. *We recommend strengthening the ability of IMF staff to analyze political economy issues so that a better understanding of the forces that are likely to block or enhance reforms can be taken into account*

²³One example of where such an approach might have been fruitful is the debate between the Jamaican authorities and the staff on the appropriate exchange rate and monetary framework in the late 1990s.

²⁴This is the spirit of the decision approved by the Executive Board in July 2002, which shifts countries under program to a 24-month Article IV consultation cycle instead of the standard 12-month cycle. It is important that this decision be implemented faithfully to its spirit—that is, to ensure that surveillance takes place in a timely manner when needed—and not mechanically, as the latter might result in a further weakening of surveillance in program countries.

*in program design.*²⁵ Although it is widely recognized that ownership and political and social feasibility are crucial for effective implementation and sustainability of reform, too little attention is often paid to these aspects in program design. This is a complex area, and it would be unrealistic to expect the IMF, or for that matter any external agency, to do too much, since it is ultimately for governments to determine what sets of policies would be acceptable to their societies and to increase the acceptability of desirable reforms. Excessive involvement of external agencies in this area would itself be contrary to the whole idea of domestic ownership. The paper prepared as background to this evaluation sets out, by way of an illustration, a number of tools and proposes a series of basic questions that could be asked in trying to judge the political feasibility of a program.²⁶ To a large extent, using such questions to guide a basic assessment before supporting a program would only bring discipline and consistency to analyses that are already carried out in best practice cases, though their conclusions are not always reported to the Executive Board. More systematic assessments might also be commissioned in cases where political feasibility has been a major obstacle to program implementation. If more in-depth assessments were undertaken, priority should be given to the most prolonged use cases.

33. Finally, there are two other internal governance issues that surfaced in the context of this study and, although not exclusive to prolonged users, deserve some consideration in view of their seriousness and potential aggravating effects on prolonged use.

- *We recommend that a review of (explicit and implicit) internal incentives facing staff be undertaken with a view to minimizing turnover of staff working on countries and to fostering increased candor and accountability.* Excessive staff turnover—between departments but also between different country assignments within the same department—appears to be a widespread problem. Although not peculiar to prolonged

²⁵It has been suggested that the IMF should hire full-time political scientists to undertake such tasks, but a potential problem with such an approach is that a few such specialists would not be integrated into the negotiating process and would risk being marginalized. As a minimum, efforts should be made to enhance the training of IMF staff on the various political science tools that can be used to analyze the feasibility of policy reforms. In addition, as noted in Chapter 6, the views expressed in our interviews in the case study countries on the role of the resident representatives was very positive, with many officials and other stakeholders expressing the view that they should be provided with greater scope to provide input on the feasibility of particular proposals—an approach that is already supposed to be “best practice.”

²⁶See Appendix 1 to the Pakistan country study (Chapter 9) for a further discussion.

users, such excessive turnover is particularly detrimental in their case. A revamping of internal personnel incentives to encourage greater stability is needed.²⁷ The focus of these incentives should be tilted toward encouraging the development of a deeper familiarity with the problems of individual countries, and correspondingly increasing responsibility, through longer country assignments rather than just acquiring the minimum necessary experience and moving on.²⁸ Furthermore, the questionnaire of mission chiefs, whose results have been discussed in Chapter 6, revealed that existing incentives, as perceived by mission chiefs, do not sufficiently encourage realism and candor, nor do they foster accountability. Efforts should be made to identify the source of these perceptions and, to the extent possible, correct them.

- *We recommend that procedures be evolved that will help avoid the appearance of political intervention in the IMF's determination of whether programs are deserving of support.* Political considerations are unavoidable in an institution governed by the votes of its shareholder governments. However, these considerations should be taken into account in a transparent manner—with decisions and accountability clearly at the level of the Executive Board. As discussed in Chapter 6, the process by which political considerations are currently handled in the IMF's decision-making process is inadequate, and this could affect the credibility of programs and thereby occasionally contribute to prolonged use. While it is reasonable for the Managing Director to take account of shareholder concerns about systemic trade-offs when deciding what risks are acceptable, the present approach has two problems. First, there is no formal—hence no transparent—channel through which political judgments can be fed into the process before the final approval stage. Second, the line of ac-

countability between staff, management, and the Board can, in practice, become blurred. The problems can be mitigated through greater transparency, to which two operational changes could contribute: (i) requiring all program presentations to the Executive Board to be prefaced by an explicit assessment of implementation risks and (ii) when management judged these risks to be high, giving the Board an opportunity to express—on the record—its own judgment on the trade-offs involved before the program was presented for approval, based on a candid assessment of these risks and of the implications of withholding IMF support.

34. Implementation of some of the recommendations would itself raise significant organizational issues. Where our evaluation has provided some insights as to how these implementation issues might be addressed, we make specific recommendations to that effect. However, we have not attempted to spell out operational details in all areas, and we recognize that further work would be needed to translate some of the recommendations into fully operational solutions.²⁹

35. Several of the recommendations have resource implications. Some will clearly involve greater staff inputs, most notably those involving ex ante assessments of ownership and implementation capacity, ex post assessments of programs, and the provision of technical assistance. Others mostly involve a rationalization of current practices which, through greater focus and selectivity, should contribute to staff resource savings. In addition, to the extent that all these recommendations succeed in reducing the scope of prolonged use, the ensuing decline in the size of UFR activities would also eventually reduce the current excess demands on IMF staff time. Although it is difficult to quantify the overall impact of the recommendations, we anticipate that they would probably involve an overall resource increase in the short term, with some reduction possible in the longer term as the scope of the IMF's involvement in a number of prolonged users is reduced. But the most critical question from the perspective of long-term resource implications will be intensity of the IMF's involvement in those countries where achievement of sustainable, growth-oriented adjustment is inevitably going to be a protracted process.

²⁷The only formal personnel requirement for intradepartmental mobility is that, to be promoted to the B-level (i.e., grades with greater management and supervisory responsibilities), an economist should have worked in at least two departments; otherwise, she or he can only be promoted to a B-level position outside their current department. However, there is ample anecdotal evidence that internal incentives strongly encourage mobility for IMF economists (see, for instance, "Review of Personnel Management in the Fund," OIA, February 2000).

²⁸The internal "Economist Development Guide" recently prepared by the IMF's Human Resources Department is a step in this direction.

²⁹In a few areas, recent reports by the IMF's Office of Internal Audit and Inspection (OIA) touch upon some of these organizational issues and we have made reference to these reports where they appear relevant.