INTERNATIONAL MONETARY FUND

2011 Review of Conditionality

Overview Paper

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In consultation with other Departments

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Boxes

GLOSSARY

ASEAN	Association of Southeast Asian Nations
BOP	Balance of Payments
DSA	Debt Sustainability Analysis
EA	Euro Area
EU	European Union
ECB	European Central Bank
EPA	Ex Post Assessment of Longer-Term Program Engagement
EPE	Ex Post Evaluation of Exceptional Access
FCL	Flexible Credit Line
GRA	General Resources Account
IEO	Independent Evaluation Office
ILO	International Labour Organization
LIC	Low-Income Country
MONA	Monitoring of Fund Arrangements
OECD	Organization for Economic Co-operation and Development
PA	Prior Action
PCL	Precautionary Credit Line
PLL	Precautionary and Liquidity Line
PRGT	Poverty Reduction and Growth Trust
PRSP	Poverty Reduction Strategy Paper
PSI	Policy Support Instrument
RoC	Review of Conditionality
SBA	Stand-By Arrangement
SMP	Staff Monitored Program
TA	Technical Assistance
TSR	Triennial Surveillance Review

EXECUTIVE SUMMARY

This review of conditionality both finds broadly positive results for a substantial majority of Fund-supported programs and highlights challenges in some recent high-debt programs. The review, covering the period 2002 to September 2011, finds that:

- In most programs, the conditionality guidelines were followed appropriately, and programs succeeded in meeting their objectives. Program design adapted flexibly and appropriately to the challenges of the global financial crisis and its aftermath. In response to capital account crises, ample and upfront financing to create policy space was emphasized.
- Program conditionality has generally been appropriately streamlined, even-handed, and tailored to country needs. In a few recent programs in currency unions, where restoring external competitiveness required deep labor and product market reforms, structural conditionality was more extensive.
- The macroeconomic impact of most programs appears to have been generally positive, and social spending has usually been largely protected and, in some cases, has increased. However, in a few cases where large policy adjustment was deemed necessary for medium-term fiscal and external sustainability, it was inevitably associated with output losses, though efforts were made to protect the most vulnerable.
- Program design and coordination in high-debt crisis programs has been challenging. For example, in the Euro Area, policy adjustment has necessarily had to be very ambitious given the scale of fiscal and external sustainability problems and the risk of contagion. Debt sustainability and competitiveness problems required deep and protracted policy adjustment combined with large-scale official financing.

In light of these findings, the review concludes that the conditionality guidelines remain broadly appropriate, while implementation needs to be strengthened by:

- Keeping conditionality parsimonious and focused on macro-critical issues.
- Developing a framework for tailored robustness tests based on enhanced risk diagnostics (including by cross-checking against past crisis cases) and a strengthening of debt sustainability assessments.
- Considering macro-social issues in Fund-supported programs more consistently, through dialogue with authorities and increased analysis of both long-term benefits and short-term costs.
- Enhancing ownership and transparency, through more discussion of alternative policy options, greater clarity in program documents, and new avenues to collect external views.
- Leveraging surveillance, particularly through contingency planning and analysis.
- Improving partnerships with other institutions, including in currency unions, where program success can be linked to union-level policies.

I. INTRODUCTION

1. **The review generally yields positive findings on conditionality and design in Fund-supported programs**.[1,2] Programs in the review period internalized lessons from the past, for example with program design incorporating the lessons of the Asian crisis, and the approach to conditionality being modified to take into account the recommendations made in the 2007 report on structural conditionality by the Fund's Independent Evaluation Office (IEO).[3] (Box 1 also summarizes recommendations from the previous Review of Conditionality and follow-up.) These findings hold for the substantial majority of programs supported under both the Fund's General Resources Account and the Poverty Reduction and Growth Trust (hereafter GRA programs and PRGT programs, respectively).

- In particular, as shown in Box 2, structural conditionality has become increasingly parsimonious and generally well focused on macro-critical areas of core Fund responsibility.
- Program design appears to have been tailored to country circumstances, in particular with higher and more frontloaded access in capital account crisis cases than in other programs. In general, program design and access also seemed appropriate and consistent with guidance. Macroeconomic adjustment and access generally appeared both evenhanded and appropriately tailored to relevant pre-program macroeconomic conditions and characteristics (Box 3).
- Key macroeconomic projections, such as growth, did not display a bias in program countries in the aggregate (contrary to past studies, which found an optimistic bias).
- Program design tended to adapt flexibly to changing macroeconomic circumstances and country authorities' policy preferences (e.g., exchange rate regimes). This approach generally enhanced program implementation despite the severe economic shocks during the review period. Average implementation rates of program conditionality have also improved,

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[11] The Review of Conditionality (RoC) was completed under the supervision of Dominique Desruelle, and by a team led by Ranil Salgado, Marshall Mills, Hans Weisfeld, and Amina Lahreche (all SPR). Other team members comprised Tushara Ekanayake, Katrin Elborgh-Woytek, Lars Engstrom, Richard Harmsen, Christian Henn, Emmanuel Hife, Robert Gregory, Armine Khachatryan, Jean-Baptiste Le Hen, Anton Op de Beke, Christian Saborowski, Mika Saito, Sarah Sanya, Joe Thornton, Jarkko Turunen, and Nick Young (all SPR). Valuable contributions were also provided by: Alexei Kireyev (AFR); Christoph Klingen, Ester Perez Ruiz, and Yan Sun (EUR); Aqib Aslam, Jack Grigg, Izabela Karpowicz, Masahiro Nozaki, Sailendra Pattanayak, Mario Pessoa, and Shamsuddin Tareq (FAD); and Mali Chivakul, Karina Garcia, Gavin Gray, Kai Guo, Linda Kaltani, Sergi Lanau, Yanliang Miao, and Nathan Porter (SPR). This overview paper was drafted by a team led by Marshall Mills and including Katrin Elborgh-Woytek and Robert Gregory. Two external advisers, Professors Randall Stone (University of Rochester) and Shang-Jin Wei (Columbia University), provided inputs and comments on the RoC background papers.

[2] The RoC also comprises four background papers: *Content and Application of Conditionality* (referred to as Background Paper 1); *The Design of Fund-Supported Programs* (referred to as Background Paper 2); *Outcomes of Fund Supported Programs* (referred to as Background Paper 3); and *Technical Appendices* (referred to as Background Paper 4). The issues addressed in these papers are consistent with the *2011 Review of Conditionality and the Design of Fund-Supported Programs-Concept Note* , and the subsequent Board discussion on February 14, 2011.

[3] *An IEO Evaluation of Structural Conditionality in IMF-Supported Programs*.

helped by the shift to review-based structural conditionality in 2009—although this progress stalled in 2011 across a broad range of GRA programs.

- Concerning outcomes, the main macroeconomic variables typically improved in most program countries, and programs have generally safeguarded priority expenditure for social protection and investment (Box 4). While it was difficult to quantify the net impact of Fund-supported programs (i.e., controlling for other factors), the macroeconomic and social effects of programs appear to have been generally positive.

2. **The design of some of the Fund's high-debt crisis programs faced serious challenges**. Most of these programs are ongoing, so it is difficult and premature to assess them fully. The review's observations regarding these programs are thus very preliminary and will need to be revisited in due course.[4] Program design has been complicated where countries faced high debt burdens, sustained loss of market access, low growth, and competitiveness issues, and where the constraints of a currency union limited policy options. Spillovers, macro-financial linkages, and systemic risks also constrained the design of some of these programs. For similar reasons, the Euro Area (EA) programs required access levels that were significantly higher than in other cases—even taking into account the differences in measurable pre-program conditions—complementing the very large share of official support provided by other Euro Area partners (Background Paper 2, Section II). Structural conditionality has been less parsimonious, because the need to improve competitiveness required addressing entrenched product and labor market rigidities in some cases (Background Paper 1, Section II). While coordination with other institutions has generally worked well at the operational level, important issues have arisen in formulating programs with Fund members that are also members of currency unions (Background Paper 1, Section III and Background Paper 4, Appendix 1).

3. **This review focused on the period since the last review of conditionality, which was completed in 2004-05.**[5] A concept note, discussed by the Executive Board in February 2011,

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[4] The analysis of the RoC covers the period 2002-September 2011, and since the EA programs were initiated toward the end of the period, the coverage of these programs is limited in several ways. In particular, the Greece program, as redesigned in the request for a new extended arrangement, was not formally part of the sample covered. This paper does not attempt to conduct in-depth assessments of these or any other individual programs, especially since the programs are ongoing. The assessments in this Overview Paper nevertheless do take into account the broader implications of subsequent developments in these programs for the review's conclusions, keeping in mind the limitations on an assessment of ongoing programs that face evolving challenges and risks.

[5] The 2004-05 RoC consisted of two parts. The first part examined key features of Fund-supported programs approved during 1995-2000 (with data through 2003), including their design, their objectives, and the success in achieving these objectives (discussed by the Executive Board on December 17, 2004; http://www.imf.org/external/np/sec/pn/2005/pn0516.htm). The review included the following documents: *The Design of Fund-Supported Programs—Overview*; *Fund-Supported Programs—Objectives and Outcomes*; *Policy Formulation, Analytical Frameworks, and Program Design*); *and* *Macroeconomic and Structural Policies in Fund-Supported Programs: Review of Experience*. The second part (*Review of the 2002 Conditionality Guidelines*) considered the application of the Conditionality Guidelines, which were introduced in 2002, reviewing arrangements approved from 2001 to mid-2004 (discussed by the Executive Board on March 25, 2005: http://www.imf.org/external/np/sec/pn/2005/pn0552.htm). The 2004-05 RoC resulted in the 2006 *Revised Staff*

(continued)

established the scope of the review. The review examines not only the trends in conditionality in Fund-supported programs but also their overall design and outcomes, relative both to objectives and to a control group of non-program countries. Key findings are presented in four background papers. The three main background papers are summarized in Boxes 2-4. This review builds on earlier reviews of conditionality, the *Crisis Program Reviews,* and similar reports undertaken since 2009.[6] Its conclusions draw on qualitative and quantitative analysis; surveys and interviews (Background Paper 4, Appendices 6 and 7); and comments from two external advisors. The review also benefitted from outreach with stakeholders and an online consultation process during its design stage (Background Paper 4, Appendix 5). The review examines 159 Fund-supported programs from 2002 to September 2011 that meet the standard of upper credit tranche conditionality. The sample includes 95 PRGT programs (60 percent of total; including 12 supported under the Policy Support Instrument (PSI)) and 64 GRA programs. The average access level for non-PSI, PRGT programs is SDR 96 million, and for GRA programs is SDR 3.0 billion. The review concentrates on those programs approved during 2006-11, which included 43 PRGT programs (54 percent of 2006-11 programs) and 37 GRA programs (Figures 1 and 2).[7]

4. **Developments during the review period reflect important actions taken since 2004-05**. These actions include:

- Further efforts to streamline and focus conditionality, including following the 2007 IEO evaluation of structural conditionality.
- Discontinuation of structural performance criteria and a shift to review-based monitoring of structural reforms as part of the 2008-09 lending reforms.
- Reforms of the exceptional access policy and the introduction of the Flexible Credit Line (FCL) and Precautionary Credit Line (PCL) in 2009-10, which aimed at facilitating the provision of precautionary finance while tailoring conditionality to the strength of members' fundamentals and policies (e.g., greater reliance on qualification requirements as a form of ex ante conditionality). [8]
- The new lending framework for low-income countries introduced in 2009, which doubled access norms, introduced new facilities (the rapid and stand-by credit facilities), and increased program flexibility.

Statement on Principles Underlying the Guidelines on Conditionality and *Operational Guidance Note on the 2002 Conditionality Guidelines*.

[6] *Review of Recent Crisis Programs* and *Creating Policy Space – Responsive Design and Streamlined Conditionality in Recent Low-Income Country Programs*.

[7] The sample of programs included all programs under the PSI and excluded all Staff Monitored Programs (SMPs).

[8] The FCL and PCL facilities and programs were reviewed by the Board in November 2011, leading to the creation of the Precautionary and Liquidity Line (PLL).

Figure 1. Total Access in GRA Programs, 2002-11

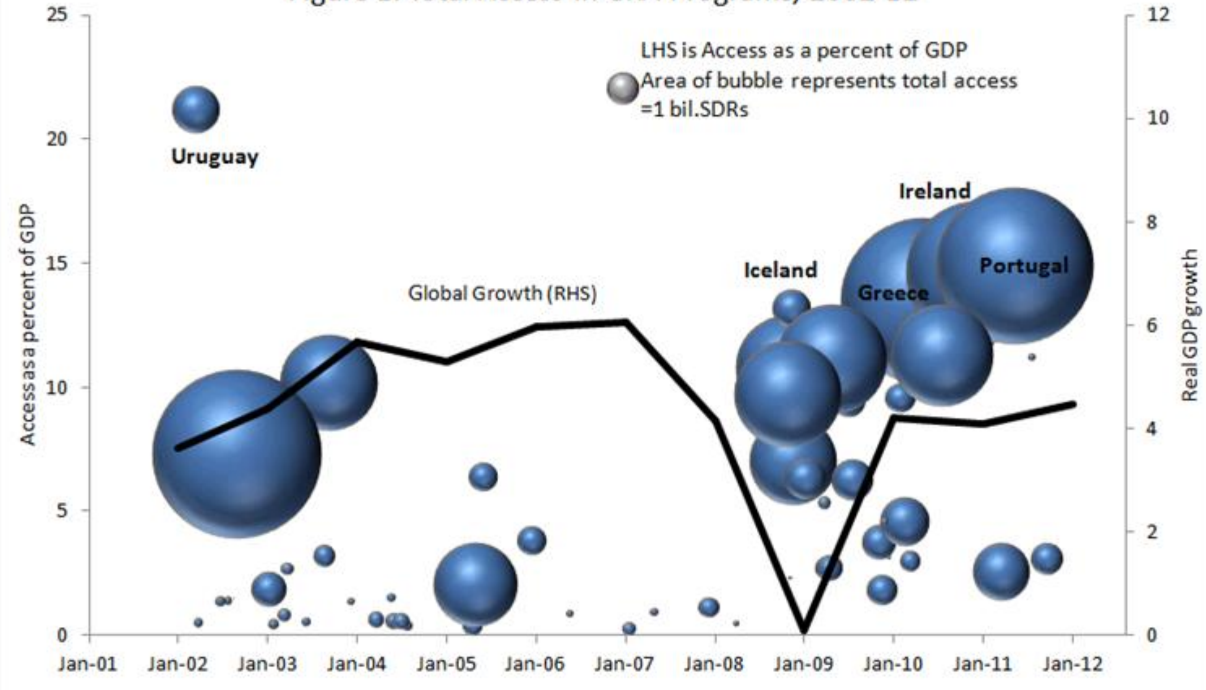
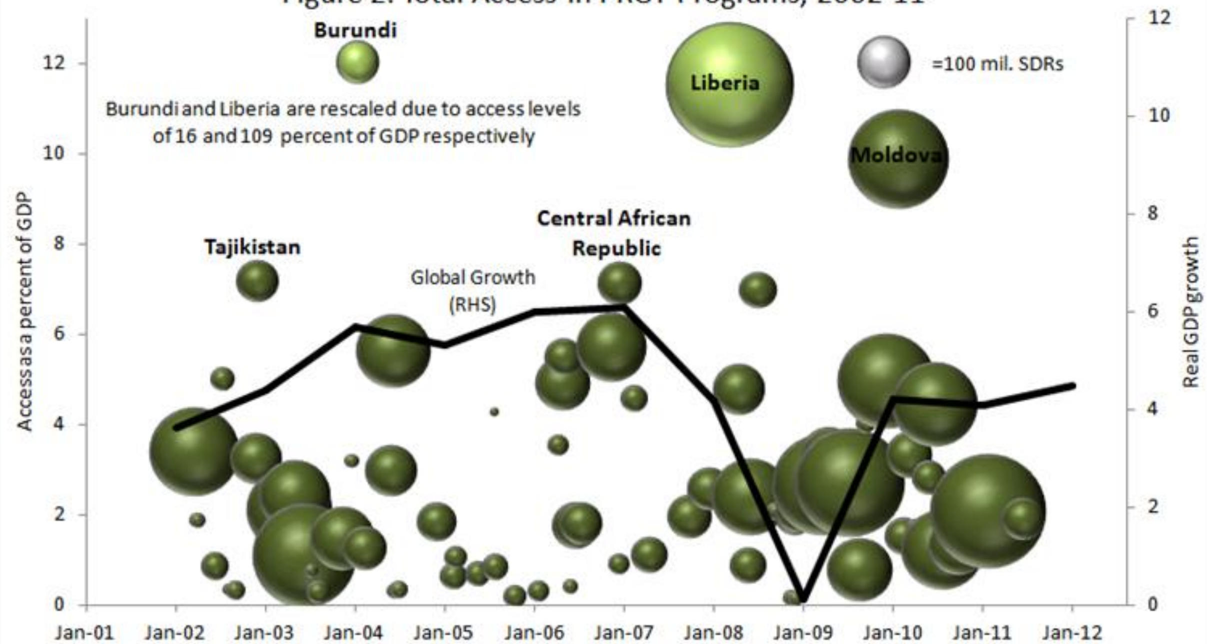


Figure 2. Total Access in PRGT Programs, 2002-11



Note: In both figures 1 and 2, the top five countries in access as a percent of GDP are labeled.

5. **Overall, this review finds that the conditionality guidelines remain broadly appropriate, but implementation of these and other policies needs strengthening**. The paper presents results and recommendations organized around six themes:

- Keeping conditionality focused.

- Enhancing risk diagnostics underpinning program design.
- Considering macro-social issues in Fund-supported programs.
- Enhancing ownership and transparency.
- Leveraging surveillance.
- Improving partnerships with other institutions.

6. **To implement these recommendations, it is envisaged that in some areas the guidance note to staff would be enhanced following the Board discussion.** This action would be complemented by efforts to improve debt sustainability analysis (DSA) and specific proposals on the application of more robust risk diagnostics.[9] This review's conclusions would also feed into new work on the macro-social aspects of Fund policy advice.

II. KEEPING FOCUSED

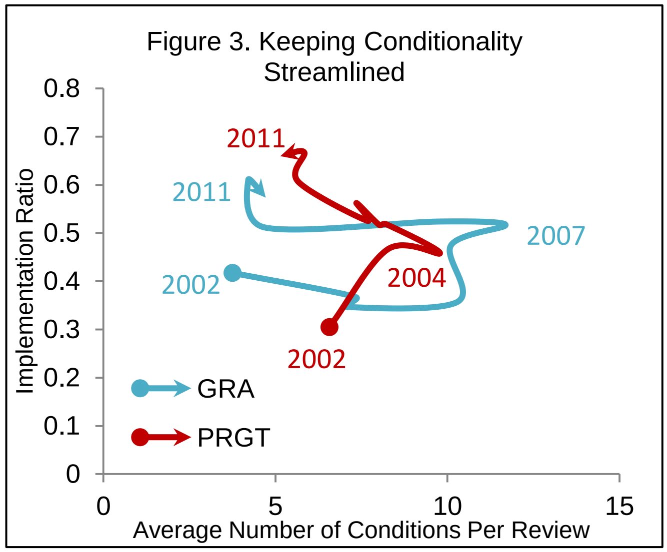
7. **Conditionality in Fund-supported programs aims to help countries solve their balance of payments problems and to safeguard Fund resources.** According to the Conditionality Guidelines, program-related conditions should be (i) of *critical* importance to achieve program goals or to monitor program implementation, or (ii) necessary to implement specific provisions under the Articles of Agreement or policies under them.[10]

8. **Parsimony is a key principle of streamlined conditionality, implying a focus of program conditions on achievable goals and key macroeconomic objectives.** Under streamlining, structural conditionality should be both parsimonious and macro-critical (i.e., conditions should be of critical importance for achieving the goals of the member's program or for monitoring program implementation, and should be limited to the minimum necessary). Streamlining does not preclude individual programs from having substantial conditionality when needed for the success of the program. The Guidelines stress that the criticality criterion applies to all reform measures, whether within or outside the Fund's core areas of responsibility.

[9] The Executive Board reviewed the debt sustainability framework for market-access countries in August 2011 and the debt sustainability framework for low-income countries in February 2012. New guidance notes reflecting the Board's conclusions are expected to be issued in the third and fourth quarters of 2012, respectively.

[10] In 2000-02, the Fund carried out a comprehensive review of its program conditionality, culminating in the adoption of a set of conditionality guidelines by the Executive Board in 2002 (*Guidelines on Conditionality*, September 2002). This was the first major revision of conditionality since 1979.

9. **Streamlining conditionality has been successful, and this progress should be consolidated**. As highlighted in Background Paper 1, section II, structural conditionality has become more parsimonious and focused on core areas of Fund responsibility. The number of structural conditions (per review and per program year) has followed a downward trend in recent years (Figure 3).



10. **Flexibility and parsimony in program conditionality have supported successful program implementation** (Background Paper 1, Section IV). During the review period, programs have generally been successful, reflecting a qualitative rather than quantitative approach to conditionality. Since the early 2000s, all program types and all groups of countries have demonstrated improvements in the implementation of conditionality, with program flexibility, capacity, and ownership being key determinants (as indicated by Ex Post Assessments (EPAs)/Ex Post Evaluations (EPEs); Background Paper 4, Appendix 10). Adaptability in program design through the modification of program targets and built-in adjustors has also improved program implementation. Programs have also recently included more direct budget support than in the past; this development has been consistent with the requirement of a balance of payments need and circumstances identified as warranting direct budget support—i.e., fiscal financing need and an institutional constraint on central bank financing of the government (Background Paper 2, Box 6).

11. **Maintaining the principles of streamlining in recent, higher risk programs will be critical**. As illustrated in Background Paper 1, section II, the number and depth of structural conditions has increased in the Euro Area programs, compared to previous programs, including in areas outside the Fund's core areas of responsibility. While it is difficult to judge whether all the conditions were critical, the increase in the number and depth of conditions warrants scrutiny. Some increase in the scope of conditionality was undoubtedly appropriate given the profound structural reforms required for program success, including in labor and product markets. But it is important to continue to scrutinize the macro-criticality of certain conditions in these programs, particularly given the large number of conditions in non-core areas (e.g., judicial reform and competition policy). Striking the balance between the structural reform needs and macro-criticality of measures has been complicated by collaboration with regional institutions with broader mandates than the Fund. It is also essential to keep in mind that countries often face additional conditions in the context of their relationships with these other institutions.

12. **Improved clarity and transparency will contribute to streamlining and ownership** (Background Paper 1, Section III). With respect to clarity, the presentation of conditionality in program documents has been uneven. While most country documents analyzed program implementation risks, the presentation of critical structural measures, the justification of the criticality of conditionality, and the discussion of policy options presented to the authorities were often more limited. Reports did well in justifying the macro relevance of structural conditionality, but could have done better in linking conditionality clearly to program goals. Efforts will be needed to ensure better implementation of existing guidelines in this area. In addition, to foster transparency and analysis (both inside and outside the Fund), it would be helpful to enhance the collection and publication of information related to structural conditionality and program design. These efforts will benefit from further improvements underway to the Monitoring of Fund Arrangements (MONA) database, with more data on objectives, indicative targets, depth of conditionality, modifications, and financial sector conditionality.

13. **The review also points to possible improvements in the implementation and communication of review-based conditionality**. Background Paper, 1 Section III demonstrates that in some reports, there was a lack of clarity when, despite missed structural benchmarks, staff had come to the view that adequate progress was being made to support completion of a review. Reports need to explain better why staff propose completing the review in light of compliance (or lack thereof) with structural benchmarks, and any additional information relevant to assess progress with structural reforms.

Key recommendations:

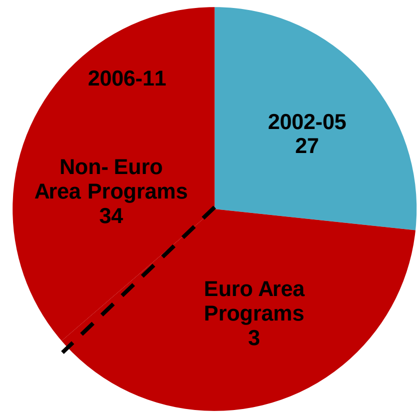
- Consolidate and secure progress made in streamlining and focusing conditionality. Ensure that the macro-criticality criterion is strictly maintained for setting conditionality, with continued scrutiny for conditionality outside core areas of Fund responsibility.
- Enhance clarity on structural conditionality in program documents, particularly regarding macro-criticality, alternative structural measures that were considered (if any), and the adequacy of progress in structural reforms subject to review-based conditionality.

III. Robust Risk Diagnostics

14. **The challenges in some high-debt programs point to the need for more robust risk diagnostics in program design**. The idea would be to develop a framework for better risk diagnostics across a range of dimensions (as described below) and tailor robustness tests according to this assessment. The relevant risks to consider would be those to program success, financial risks to the Fund, and systemic issues. Implementing this approach would involve internally identifying heightened risks through the use, for example, of certain indicators on the initial debt situation or planned adjustment. Such an approach calls for tailoring both the analysis and conditionality to the specific risks of a respective program.

15. **A range of indicators show that program design has on the whole been reasonably tailored to country needs, consistent, flexible, and adaptive**—comparing current programs among themselves as well as with past programs (Background Paper 2, Section III). In particular, the tailoring of both structural and quantitative conditionality has generally reflected program countries' specific characteristics and circumstances (Background Papers 1 and 2). This conditionality often draws from analysis undertaken as part of the Fund's technical assistance (TA) work.[11] At the same time, this review underscores the challenges concerning debt sustainability assessments encountered in some recent crisis programs. While few in number, some of these programs have large-scale financing, with large potential risks to the Fund (Figure 4).

Figure 4. Distribution of Total Access in GRA Programs, 2002-11

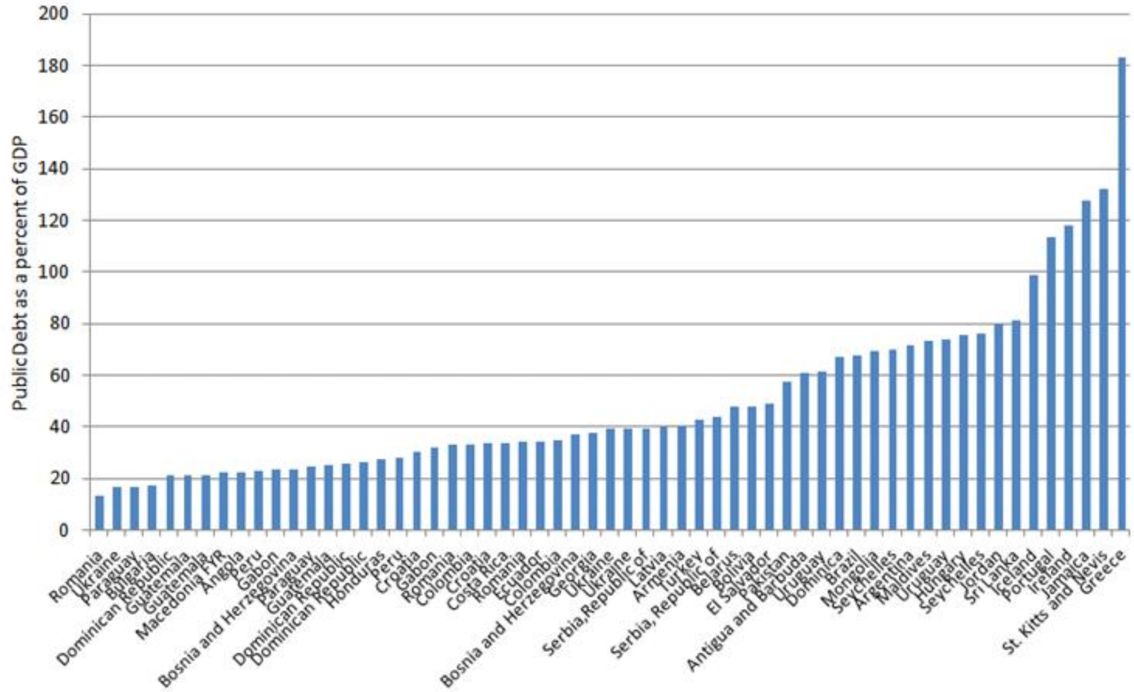


Note: Total Access was 191.6 bil. SDRs
The total number of programs is listed in each section

16. **The core issue in the design and conditionality of recent programs has been how to achieve robust sustainability**. This point is well illustrated by the public debt dynamics of a few programs, particularly some in the Euro Area and the Caribbean, which were projected to leave countries with high debt levels (Figure 5 and Background Paper 3, Section II). Some of these programs also stand out because of their need for strong (sometimes unprecedented) fiscal adjustment; need to rollover significant amounts of sovereign debt in the face of sustained loss of market financing; banking stress; and absence of independent monetary and exchange rate policies in currency unions, all accompanied by competitiveness issues. The levels of financing in Euro Area programs were very large (especially relative to quota) and were supported by even larger bilateral official sector financing for several reasons: the need to meet extraordinarily large financing needs; program design choices, including the initially limited efforts to bail in the private sector; and systemic contagion risks (Background Paper 2, Section II). Throughout the history of the Fund, extraordinary access relative to quota or GDP has periodically been granted as member countries have faced new types of crises (Figure 6).

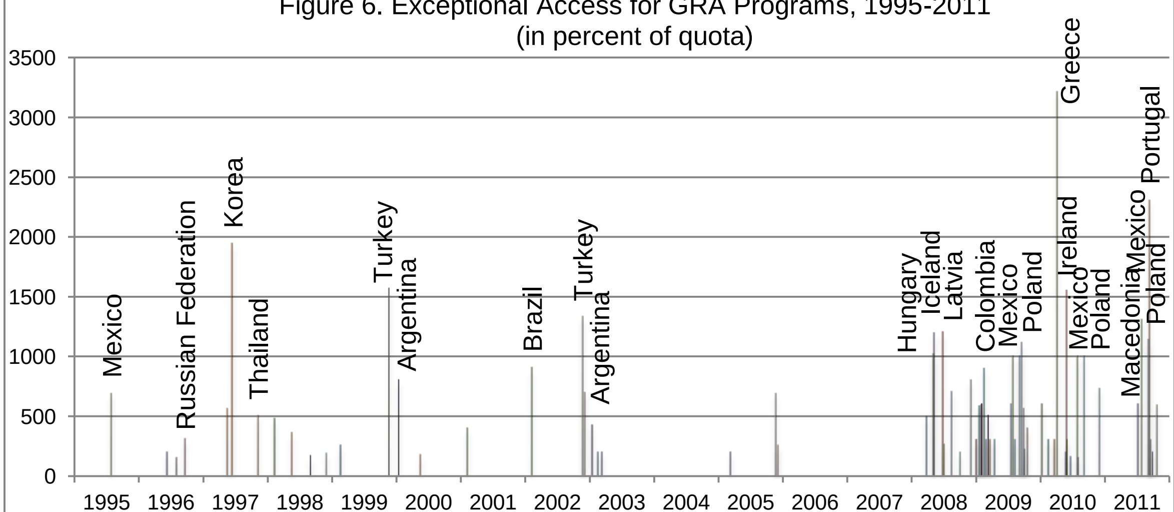
[11] The recent "*Report of the Task Force on the Fund's Technical Assistance Strategy*" noted that further efforts should be made to integrate TA with the Fund's surveillance and program responsibilities.

Figure 5. Post-program Public Debt Levels in GRA Programs, 2002-11



Note: Post-program refers to the average public debt level at t+3 and t+4 where t is the year of program initialization. Post-program public debt levels include projections for programs initiated after 2009.

Figure 6. Exceptional Access for GRA Programs, 1995-2011
(in percent of quota)



N.B. Computed using initial program design and projections (see BP3 for methodology)

17. **Deeper analysis of risks in recent programs over time has facilitated better informed decisions.** As risks evolved and became more prominent during the implementation of programs, the analysis and presentation of risks were expanded in subsequent program documents. This increased coverage should be emulated in future exceptional access cases at program inception. Key risk factors in such cases include: assumptions underlying the macroeconomic framework; macro-financial linkages; policies to achieve debt sustainability

(size and pace of fiscal consolidation and privatization); spillovers; and institutional and political capacity to implement program policies. Extraordinary levels of scrutiny were warranted in the Euro Area programs for a range of reasons, including: the severity of the planned macroeconomic adjustment (in relation to both country history and cross-country experience); the fact that the impact of large fiscal adjustment on growth could not be compensated by a fall in domestic interest rates, a surge in external demand, or the short term impact of structural reforms; the high initial levels of public and private debt; the large share of public debt held by financial institutions (at home and abroad); the mixed international experience with domestic-policy-focused strategies to restore external competitiveness; and the financial risks to the Fund.

18. **The discussion of systemic risks in these exceptional access programs can be similarly strengthened, although this is a difficult area**. The debt sustainability criterion under the exceptional access policy was adapted at the time of Greece's Stand-By Arrangement (SBA) program approval by lowering the evidentiary bar on debt sustainability where there were risks of systemic spillovers. However, the analysis of systemic risks and contagion, which is a complex challenge, was not fully developed and quantified.[12] Since systemic risk was used to justify the approval of the high access programs in the Euro Area, clear means of assessing the risk are important for perceptions of even-handedness, as well as program design.[13] It would thus be desirable to refine analytical tools to evaluate contagion risk.

19. **These recent program cases highlight the need to tailor robustness tests according to risk assessments based on enhanced diagnostics**. To do so, higher risks—those related to program success, financial risks to the Fund, and/or that have systemic implications—would first need to be identified during the program design process based on relevant indicators. Some of these indicators could be benchmarked against the country's past or a set of comparator countries. Other indicators would be related to the country's conditions at the inception of the program—such as the level of external or public debt, data weaknesses in the program country, or extraordinary policy measures (e.g., fiscal adjustment or privatization proceeds). This approach echoes the proposals made in the recent paper *"Modernizing the Framework for Fiscal Policy and Public Debt Sustainability Analysis,"* which proposed a move to a risk-based approach to DSAs for all market-access countries.[14] In cases where quantitative and other relevant information points to higher risks, program design would be enhanced with tailored robustness tests; the purpose would be to understand and help mitigate risks. These tests could be pre-established in guidance notes (e.g., debt sustainability frameworks). Greater

[12] The staff report on Greece's 2010 request for a SBA included a discussion of the exceptional access criteria.

[13] The uniformity of treatment principle requires consistent and even-handed treatment of similarly situated countries (but does not require members in different circumstances to be subjected to the same treatment). Higher access for Euro area programs, therefore, would be consistent with uniformity of treatment if justified by special circumstances present in those countries (e.g., higher balance of payments needs as a result of systemic risks).

[14] These proposals are now being developed into specific guidance.

understanding of risks from these tests would better inform decisions on program design, avoiding unrealistic assumptions without ruling out ambitious, even unprecedented policy measures (as long as capacity and political constraints were adequately incorporated). Admittedly, the urgency of the design of some crisis programs could limit the time available for more in-depth analysis; this problem can be offset to some degree through leveraging surveillance (as discussed in Section VI) and concentrating resources earlier in relevant cases. Identifying risks and responses could also benefit, where possible, from processes that ensure that staff adequately consider external, independent insights.

20. **A more risk-based approach to program design would draw on, and parallel, a more risk-based approach to surveillance in several ways**. Section VI describes recent steps toward a more explicit discussion of risks in Article IV consultations. This enhanced risk focus in surveillance should improve the design of Fund-supported programs by focusing attention on key risks and providing the opportunity for a more thorough analysis before the urgency of a crisis hits. In general, this review finds that flexibility in program design—both during implementation and built into design—has contributed to the success of Fund-supported programs.

21. **Program design could also be better tailored to country-specific types of risks, in capital account crisis cases and, to some extent, in engagement with fragile states**. In capital account crises, access has been higher than—and fiscal adjustment similar to—other programs, drawing on lessons from the past. Nevertheless, stabilization has been successfully achieved despite often narrowly missing initial fiscal targets (Background 2, Section III). These outcomes suggest that fiscal targets in certain capital account crisis programs should be thoroughly examined to assess whether a modest further relaxation is possible without jeopardizing program success. In PRGT programs, the programmed fiscal adjustment has been larger in fragile states than in other countries on average (Background 2, Section III), but program implementation in some fragile states has often been plagued by sizeable slippages. This raises questions about how best to design country-specific programs (and use the panoply of Fund instruments) to achieve a sustained and productive engagement with countries in fragile situations.[15] In particular, the magnitude and timing of macroeconomic adjustment should be carefully designed to ensure that it is adapted to the specific conditions in these countries.

22. **At the same time, the lower risks evident in many other programs may indicate space for more flexibility in program design and monitoring**. Overall, programs had high rates of success in meeting targets and achieving objectives. Many GRA programs that were successful immediately following the global financial crisis involved "crisis bystanders," i.e.,

[15] A recent review of the Fund's engagement with fragile states can be found in the paper *Macroeconomic and Operational Challenges in Countries in Fragile Situations*, and *The Chairman's Summing Up— Macroeconomic and Operational Challenges in Countries in Fragile Situations—July 7, 2011*. A new guidance note was issued in April 2012.

countries hit by very large and unforeseen external shocks.[16] Increased flexibility can both improve ownership—a key ingredient in program success—and possibly reduce stigma—which can encourage more countries to seek Fund-supported programs early on in stressful times.

Key recommendations:

- Develop procedures for conducting tailored robustness tests during program design.
- Closely analyze and monitor the fiscal adjustment/growth nexus in programs where policy space has shrunk. This is particularly important with respect to debt sustainability assessments in high debt cases, which should be based on realistic macroeconomic assumptions that are cross-checked against past crisis cases.
- Refine analytical tools to evaluate systemic and contagion risk.
- Analyze systemic risks, spillovers, and macro-financial linkages more systematically to ensure that they are adequately reflected in the design of programs for which these risks and linkages are particularly high.

IV. Macro-Social Aspects

23. **Fund-supported programs are increasingly emphasizing social aspects**.[17] This attention has grown in response to mounting concerns about a lack of employment opportunities and rising inequality—highlighted by the events in the Arab transition countries and persistent high unemployment in some advanced countries. There is also a growing recognition that social stability has a large impact on macroeconomic stability and growth, and thereby on a member's balance of payments (BOP) and external viability. This focus also aims to help build the foundations for growth through investment in human capital (education and health). Conditionality to protect the most vulnerable segments of the population has contributed to enhanced ownership and improved quality of spending in a number of program countries. Several programs addressed the need for better social safety nets and reforms to enhance sustainability of the social insurance systems. Policies in these areas have often been pursued in collaboration with the World Bank and other development institutions.

24. **Social spending has been largely safeguarded under most Fund-supported programs and has even tended to increase in PRGT programs**.[18] Background Paper 3,

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[16] As discussed in the 2011 Fund paper *Analytics of Systemic Crises and the Role of Global Financial Safety Nets*, these are countries with relatively strong fundamentals for which likelihood of an idiosyncratic crisis is normally low.

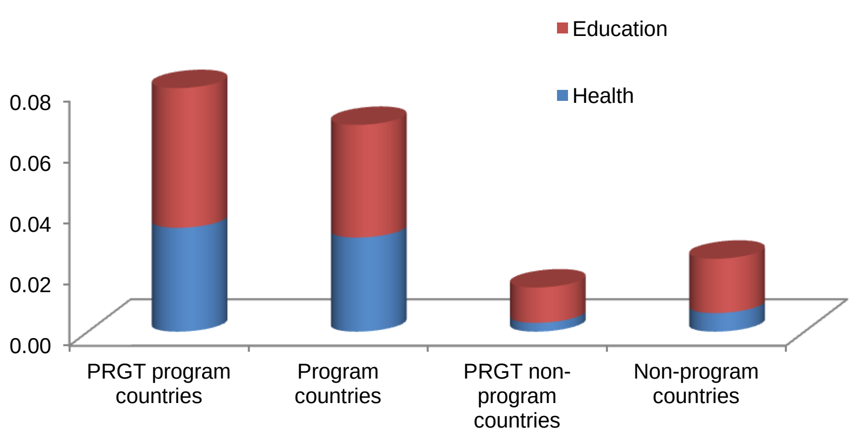
[17] See Box 4 in Background Paper 1; Background Paper 2, Section III; and Background Paper 3, Section V. The Guidelines on Conditionality (Paragraph 4) recognize that "in helping members to devise economic and financial programs, the Fund will pay due regard to the domestic social and political objectives, the economic priorities, and the circumstances of members."

[18] The findings on social spending are drawn from the recent *What Happens to Social Spending in IMF-Supported Programs?* (IMF Staff Discussion Note, No. 11/15 and its associated database).

Section V highlights that under PRGT programs, social expenditure increased significantly as a share of total expenditure and GDP. The results of econometric analyses suggest that in the first year of Fund-supported programs with low-income countries, education and health spending rose by, respectively, 0.22 percent of GDP and 0.27 percent of GDP (Figure 7). This result benefitted from the establishment of indicative targets for social spending in a majority of PRGT programs, as well as the emphasis on using the savings from debt relief under the Heavily Indebted Poor Countries and Multilateral Debt Relief Initiatives for social and other purposes.

25. **Nevertheless, in certain programs, successful crisis resolution has required significant cuts in expenditures, including in social sectors, and in real wages** (the Greece program is a leading example).[19] These cuts, while necessary for economic stability and a return to sustained growth, have undoubtedly been painful for many in the concerned countries. Even within the constraints of these cases, the Fund has supported designing measures to target social protection better on the most vulnerable segments of the population and to promote a broad distribution of the negative impact of adjustment—although this could be done more consistently across programs (Background Paper 2, Section III). These cases also highlight the need to pay attention to the strength of political ownership of programs that rely on difficult adjustment for success.

Figure 7. Median Annual Change in Social Spending, 1985-2009
(in percent of GDP)



Source: IMF staff calculations

[19] For countries that maintain fixed exchange rates or are members of a currency union, addressing competitiveness problems requires an "internal devaluation" to lower production costs, which usually includes a reduction in real wages.

26. **The analysis of the social impact of policy measures in programs, while growing, needs to be strengthened**. For example, an examination of case studies described in Background Paper 2, Box 3 found that social impact analysis was conducted in only half of programs involving increases in fuel or electricity price increases. Staff could provide additional analysis.[20] On the basis of understandings reached with the authorities and consistent with the primary goals of helping members correct their BOP problems and achieve external viability, program design could incorporate the expansion of existing social safety nets and improved targeting of social benefits to the poor when appropriate, including temporary, targeted transfers to offset the impact of price increases on the most vulnerable. In addition, Fund technical assistance often analyzed the equity dimension of tax policy, fuel pricing, and utility tariff reforms, with a view to avoid increased regressivity. Due to potential political sensitivities, this type of work should proceed only with the support of the country authorities. Offering to conduct this analysis and utilize it to develop policy options more systematically and even-handedly could improve program design, motivating the recommendations below. Surveillance can help lay the groundwork for some of this analysis, much of which can take longer than is often available for designing programs, especially in crisis situations. For PRGT cases, the Poverty Reduction Strategy Papers (PRSPs) and associated analytical work can support consideration of these issues.

27. **The social aspects of policy measures in program design need to be considered in a broader context**. Reforms often involve near-term costs yielding significant long-term benefits, which should not be neglected in the analysis. Net costs can often be over-estimated if dynamic effects, such as contributions to growth, are not fully considered. Finally, the general equilibrium implications of reforms, such as the positive contributions to fiscal sustainability of fiscal reforms, should not be neglected. Balancing these considerations with concerns related to employment, equality, and inclusiveness will require close reflection.

28. **Recent experience in the Middle East, Northern Africa, and Europe highlights the need for analysis to be cognizant of employment issues and inclusive growth strategies**. In this regard, teams should collaborate closely with organizations that have specific expertise in the area (the World Bank, the OECD, and other international organizations) and as much as possible draw from their analysis and expertise. While there is probably room to make better use of existing analysis and resources, it may also be necessary to consider further the need for in-house analysis of macro-social impacts of policies in the program context. A staff working group on jobs and growth is examining how to integrate macro-social aspects better in the Fund's work, including program design. The working group is also developing a number of tools that will help country teams analyze macro-social aspects.

[20] For example, between 2006 and 2010, nine of the 18 countries in the case study sample for this review were subject to program conditionality affecting the prices of products consumed by the poor.

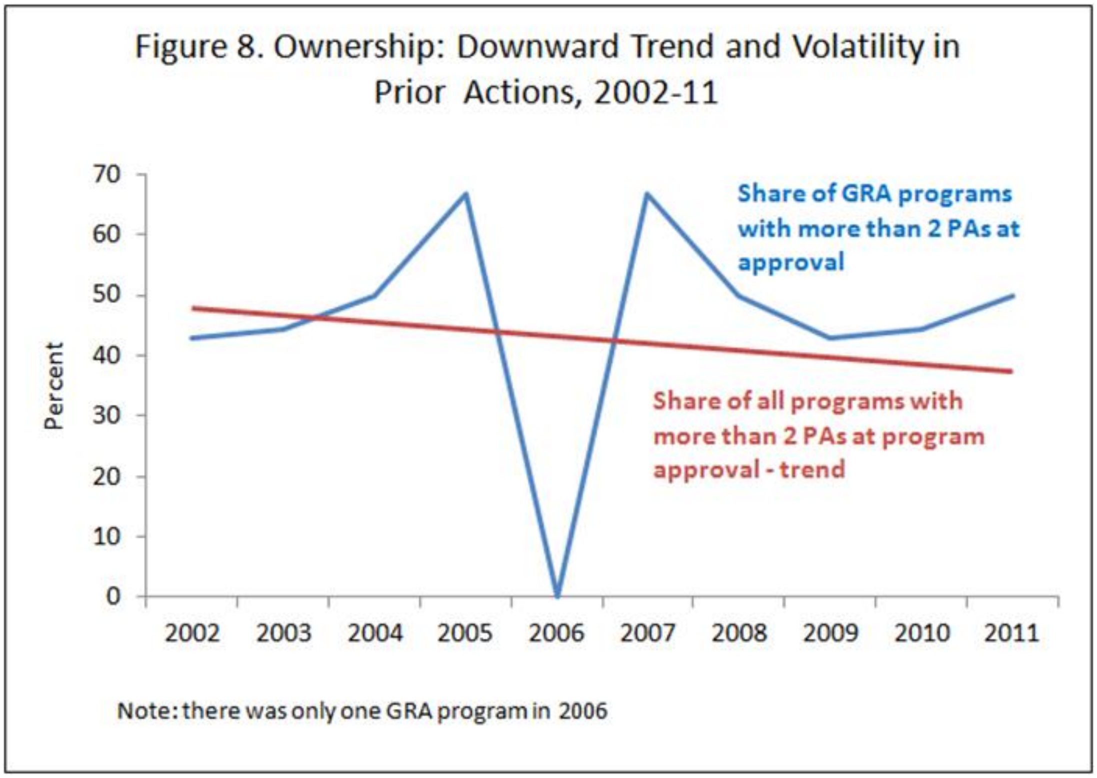
Key Recommendations:

- Leverage surveillance and technical assistance better so that teams have analysis and advice on macro-social issues available to draw on in the event of a program.
- Conduct additional analysis of macro-social issues, in close cooperation with the authorities, with the aim of further promoting sustainable inclusive growth, evaluating additional policy options, and fostering dialogue. Consider the social aspects of policy measures in a broader context, including implications for growth and fiscal sustainability, and thereby members' BOP and external viability.
- Enhance discussion of macro-social issues in program documents, including the trade-offs between short-term costs and the overall benefits of adjustments, along with a discussion of efforts to mitigate the costs on jobs and inequality.
- Ensure inclusion in program design, where feasible and appropriate, of policy measures to mitigate adverse short-term impacts on the most vulnerable, such as adequate safety nets and possible temporary targeted transfers, particularly in programs with higher risks (see Section III).

V. Enhancing Ownership and Transparency

29. **Ownership has been critical to program success, reflecting member countries' primary responsibility for the design and implementation of their economic policies**. Some EPEs and EPAs suggested that extensive outreach efforts, in combination with focused conditionality and flexible implementation, helped achieve a higher degree of ownership (Background Paper 4, Appendix 10). Moreover, the review of country cases indicates that outreach served to facilitate some program negotiations (Background Paper 1, Section III). Given the importance of ownership—even though it is largely subject to factors beyond the control of the Fund—the Fund should continue to promote ownership as much as possible in the way it approaches program conditionality and design. This principle is a strong motivating factor behind many of the recommendations discussed above for risk diagnostics underpinning program design, streamlining conditionality, and enhancing consideration of macro-social issues.

30. **Country authorities were fairly positive on ownership in survey results, while other stakeholders were less positive in countries with recent high risk programs**. Consistent with the concerns on some recent programs, prior actions (PAs) for program approval— as explained in Background Paper 1, Section III, these can be used as a screening device, but not a substitute for ownership—have been on a downward trend, but the improvement stalled in 2011 (Figure 8).



31. **Ownership can benefit from further and more systematic outreach, communication, and transparency involving both the authorities and other stakeholders**. A broader discussion of alternative policy options with country authorities (as well as other stakeholders, such as donors, in some cases) at the program design stage can boost ownership—the review found that this approach was increasingly common but not yet universal (Background Paper I, Section III). Securing broad-based political buy-in at the outset of programs can also strengthen ownership, especially in high-risk cases. In coordination with the authorities and while maintaining the Fund's role as confidential advisor, there is a need to reaffirm the presumption of two-way, in-country communication with stakeholders (e.g., civil society organizations, private sector, parliamentarians, labor unions, and academics), to promote understanding of program objectives and measures. Views expressed by external experts on program conditionality and design issues can serve to inform the staff's advice, to validate difficult choices, and to develop broader "buy-in." The online consultation process for this review has supported this objective, and developing additional new avenues to seek these views, while safeguarding confidentiality requirements, would be beneficial.

32. **Ownership might also be enhanced by better provision of cross-country information on program design**.[21] The survey of stakeholders in program countries often reflected a shortage of information about other programs—for instance, in-country perceptions of evenhandedness, while not negative, were often neutral due to a lack of comparative

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[21] Recent IMF fact sheets provide information on key cross-country issues. See, for example, http://www.imf.org/external/np/exr/facts/protect.htm .

knowledge (Background Paper 4, Appendix 7). More frequent and accessible analysis of program design in a cross-country perspective could improve this situation, as would—to the extent feasible—transparency that would allow stakeholders, such as academics, journalists, and market analysts, in program countries to express informed views on program design and conditionality issues. Currently, the Annual Report on Structural Conditionality is merely descriptive, and analysis in the review of conditionality has become less frequent due to its substantial scale and costs. Furthermore, staff intends to make the data from this conditionality review publicly available, nurturing well-informed public and academic discussion.

Key recommendations:

- Ensure that in all cases there is a broad discussion of alternative policy options at the design stage, in dialogue with authorities, and in program documents.
- Develop standard processes for staff to collect, and reflect on, external views in the internal Fund discussions of program design.
- Replace the current Annual Report on Structural Conditionality with a short, periodic analytical report (e.g., annual), in order to share regular analysis of program conditionality and design with a wider audience.

VI. LEVERAGING SURVEILLANCE

33. **The review points to the need to leverage Fund surveillance better in support of program conditionality and design**. While surveillance recommendations have provided some basis from which to draw program conditions, case studies of 34 countries undertaken for this review (Background Paper 1, Box 7 and Appendix 3) show that only about 48 percent of initial program measures were foreshadowed in preceding Article IV consultation reports. In a number of instances, the link between program conditionality and the main recommendations of recent surveillance appeared weak. In other cases, surveillance recommendations were not initially incorporated in the program, but were added during subsequent reviews. As highlighted earlier in this paper, there is often little time or resources to conduct sophisticated, in-depth analysis when putting together programs during crises. Thus, where relevant, and recognizing that some shocks cannot be anticipated, surveillance should strive to provide sufficient background information and analysis from which teams can draw.

34. **Increased contingency planning by Fund staff for countries at risk can help boost the value of surveillance for later program design**. This planning can lay the analytical groundwork in advance when time is less constrained than during the design of a crisis program. Such planning would naturally need to be conducted under strict confidentiality. The emphasis of the recent Triennial Surveillance Review (TSR) on an explicit discussion of risks in surveillance could support its leveraging for program design. This discussion can be supported by a Risk Assessment Matrix; though not required, these matrices can help assess the probabilities and potential impacts of specific risks and serve as a focal point for considering potential measures that can mitigate their impact. On an operational level, and in line with the

decisions made in the recent TSR, surveillance in near program or high-risk countries should include preparation of the analytical underpinnings of a program.

35. **Outreach with regional and other bodies not used to working with the Fund can pave the way for later cooperation during Fund-supported programs**. Standing dialogues with these bodies in "quiet times" can help build mutual understanding prior to coordination in a program context in which time and resources are constrained. The success of the Vienna Initiative, for example, in limiting financing pressures in certain European program countries suggests one benefit of coordination efforts with regional bodies and the private sector during programs (Background Paper 2, Box 7). Staff could identify the potential for such efforts during surveillance and build the knowledge and contacts necessary for their success should they become needed at a later stage.

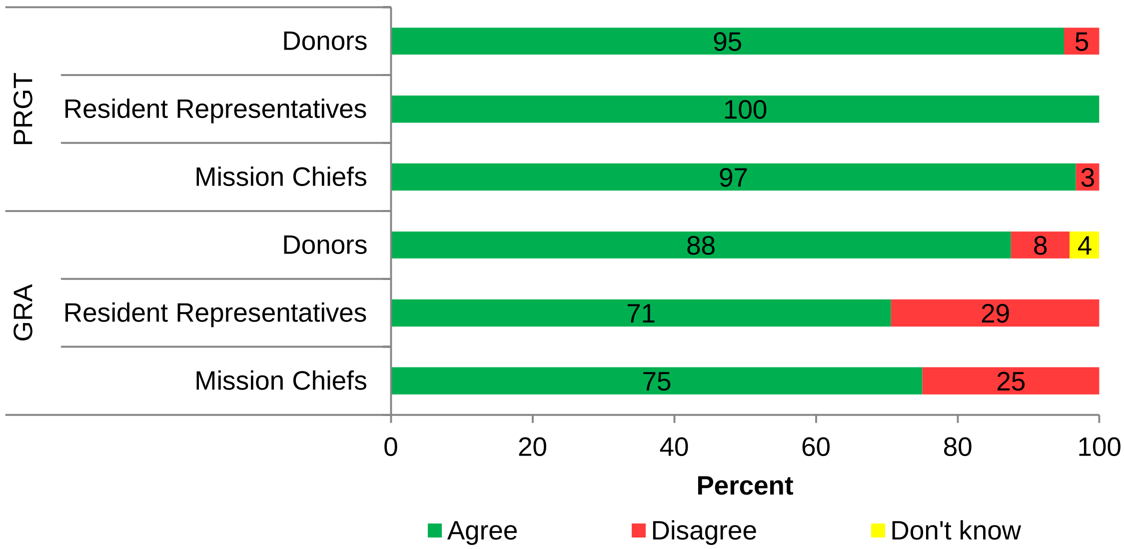
Key recommendations:

- Increase confidential contingency planning for potential programs, linked to risk-based surveillance (as deemed necessary by risks), in order to identify at an early stage key structural reforms, systemic risks, spillovers, macro-financial linkages, and relevant regional/private-sector players.
- Establish closer link to risk-based surveillance, where possible utilizing the risk assessment matrices compiled during Article IV consultations.

VII. STRONGER PARTNERSHIPS

36. **Coordination and collaboration with other institutions has become increasingly important to program design, leveraging financing, and streamlining conditionality**. Background Paper 1, Section III explains that collaboration with the World Bank and other institutions has aided successful implementation of conditionality in macro-critical areas of structural reform beyond the core areas of responsibility of the Fund, such as decentralization, energy sector reform, and pension reform. Collaboration with other international institutions is the norm, especially for PRGT programs (Figure 9). It has usually worked fairly well at the operational level. For example, in African program countries, coordination with the World Bank and other agencies supported streamlining efforts on the side of the Fund, while avoiding duplication of conditionality (Background Paper 4, Appendix 1). This said, efforts need to continue to strengthen coordination with partners (World Bank, regional development banks, OECD, ILO, and others where needed), particularly on macro-critical structural policies outside the Fund's core areas of responsibility. Ensuring timely coverage of these areas requires sustained and intensive engagement.

Figure 9. Survey Results on Coordination
Whether the "Program Involved Intensive Coordination with Bilateral and/or Multilateral Donors."



37. **The Fund operates in an institutional landscape that has changed significantly in recent years, bringing new opportunities and challenges in its wake**. The global financial crisis highlighted the need to work closely not only with official stakeholders, but also with the private sector. As the recent TSR stressed, it has become increasingly clear that the Fund also needs to engage more with supranational groupings, including for example the European Commission and ASEAN+3. For program design, key measures by the regional banking supervisor in the Eastern Caribbean Currency Union have been included as program conditionality, with letters of assurances from the regional authority.

38. **In recent programs with European countries, coordination between the Fund and European Union/Euro Area (EU/EA) institutions was essential but complex**. Supranational regional entities like the EU institutions or the ECB often play critical roles in program success. For example, EU/EA counterparts provided a large share of financing packages on increasingly more supportive terms. The ECB also played a crucial role as a liquidity backstop for banks in program countries. Coordination with EU/EA agencies through early consultation, joint missions, and continuous exchange of information has functioned well operationally and improved over time, but it nevertheless added an additional layer of complexity to conditionality design and decision-taking processes (Background Paper 4, Appendix 1). Institutional constraints in the EA occasionally limited alternative policy options that could otherwise have been considered—notably, debt restructuring to strengthen debt sustainability (particularly for bank debt in Ireland and sovereign debt in Greece). These difficulties illustrate the value of building relationships and mutual understanding with regional institutions with which the Fund may collaborate more closely and systematically in future financial arrangements. They also highlight the importance of clearly communicating the Fund's financing principles when joining in co-financing operations.

Key Recommendation:

- Maintain a standing dialogue with regional financial agencies on policies and procedures regarding program conditionality and design, including a discussion of approaches for dealing with recurrent problems.

VIII. Resource Implications

39. **The recommendations made in this Review of Conditionality are likely to have some budgetary implications**. The further analysis envisaged under a tailored risk diagnostic approach and under leveraging surveillance could have net resource costs, while implementing the recommendations regarding increased outreach and coordination efforts highlighted in sections V and VII would not be cost neutral. The recommendations to keep conditionality focused should, however, be broadly cost neutral in the aggregate, with re-allocation of resources within activities and countries as per evolving circumstances.

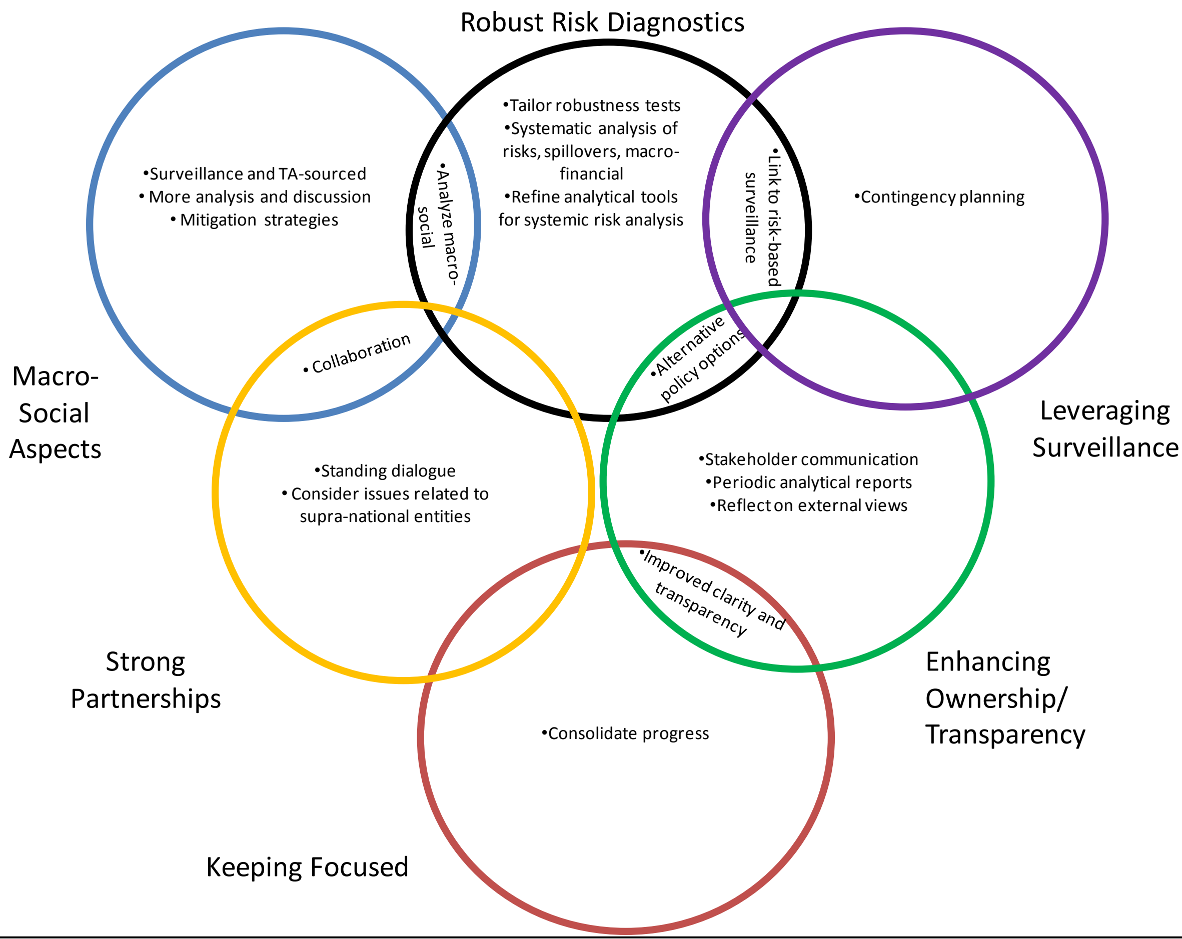
40. **Conducting additional analysis of macro-social issues in program design would also imply increased net costs, although the extent would depend on implementation**. In some cases, Fund technical assistance already analyzes many of these issues (Background Paper 2, Boxes 2 and 3), and in these cases, the recommendation requires merely that existing work should be leveraged more effectively for program design. However, to the extent that additional expertise and analytical capacity are needed for macro-social aspects, there would be new resource needs. These issues are being examined by the staff working group on jobs and growth, which is also drawing on outside expertise. Following the Board discussion and conclusion of the working group's work, staff would need to follow up on those recommendations endorsed by Directors and present a fully-costed proposal in the context of budget discussions.

IX. Issues for Discussion

Do Directors agree with the general findings of the review of conditionality?

What are Directors' views on staff's key recommendations above (as illustrated in Figure 10)?

Figure 10. Review of Conditionality: Summary of Themes and Recommendations



Box 1. Recommendations and Follow-Up from the 2004-05 Review of Conditionality

The 2004-05 Review of Conditionality (RoC) examined key features of Fund-supported programs approved during 1995-2000, including design, objectives, and implementation, as well as the application of the 2002 Conditionality Guidelines, based on the review of programs approved from 2001 to mid 2004. This box summarizes the recommendations of that review and main follow-up.

More careful analysis of program design in capital account crises: Programs' policy mixes became better tailored to capital account crises, with increased financing. There may still be room for marginal further relaxation of fiscal adjustment in certain cases. The Fund is conducting intensive analysis of determinants of capital flows, their impacts, and policy responses.

Further streamlining of structural conditionality: Over time, structural conditionality became more parsimonious and more focused on core areas of Fund responsibility.

More clarity in Fund conditionality: While achieving some progress, implementation of greater clarity has been uneven. The criticality of conditionality was usually but not always explained in staff reports, while presentation guidelines for staff reports were not always followed. Following the shift to review-based conditionality (assessing structural reform progress based on benchmarks), the level of progress considered adequate to meet program goals has not been always been clear.

Stronger debt sustainability analysis to reduce vulnerability to future crises: The Board approved a modernized risk-based and flexible DSA framework for advanced and emerging market economies that is better geared to capture debt vulnerabilities. Reforms to the low-income country (LIC) debt sustainability framework were also introduced to better align it with the needs of the membership. The quality and sustainability of fiscal consolidation has also been a focus in more recent programs, as recommended in the earlier RoC.

More assessment of poverty implications of policies under LIC programs: The poverty reduction focus of LIC programs has been progressively strengthened. The 2009 reform of LIC facilities ensured an enhanced focus on poverty reduction and growth, with programs including specific targets to safeguard social and other priority spending, wherever possible. Social spending increased faster in program than in non-program countries. Analysis of the social and poverty impact of policy measures grew but remains far from comprehensive.

Better tailor programs to reflect implementation capacity: Country-specific capacity constraints were increasingly taken into consideration in the design and phasing of structural conditionality. Fragile states posed special challenges, and in some cases, program goals appeared to have exceeded capacity.

Foster more country ownership: There has been some success with initiatives to foster ownership, which remains critical to program implementation.

More collaboration with other organizations: Intense coordination with donors and other international organizations, especially the World Bank, was the norm. Programs in currency unions posed new, special challenges to which standard practice was not fully adapted.

Improved medium-term growth projections to enhance credibility of programs: Macroeconomic projections were generally unbiased in 2006-11, in contrast to past findings, but accuracy fell, likely due to hard to predict shocks related to the global financial crisis.

Further analysis of key issues: Following the specific recommendations in the 2004-05 RoC, the current RoC conducts deeper analysis on: (i) economic outcomes of programs; (ii) the correlation between the implementation of structural conditionality and macroeconomic outcomes; (iii) the level of access and Fund financing in program design; (iv) the role of ownership; (v) large samples of program cases and in-depth case studies of disaggregated and homogenous groups; and (vi) findings of ex post assessments and evaluations.

Box 2. Content and Application of Conditionality: Key Messages

Conditionality has become more focused and more closely aligned with program goals, in line with the Fund's principles on conditionality (Background Paper 1).[1] Conditionality was generally well-tailored to country and program characteristics, as well as to initial macroeconomic conditions. The review specifically finds that:

- In recent years, the number of conditions in programs has declined. Program execution was supported by parsimony of conditionality and flexible timelines for program implementation. Conditionality has focused increasingly on core areas of Fund responsibility, notably fiscal measures.

- Ownership was critical to program success. There is some evidence that ownership—while abstract and unobservable—has on balance improved.

- The balance between tailoring and evenhandedness was mostly appropriate. In particular, the design of conditionality tended to match country capacity, as well as access granted under the program.

- Coordination was critical for program success and generally viewed favorably. Coordination with other institutions supported parsimony and made conditionality more effective by avoiding duplicate measures.

The review also finds concerns in some areas:

- The focus and parsimony of conditionality came under pressure in GRA programs in 2011, as the number and depth of structural conditions increased slightly. This may be justifiable, reflecting more deep-rooted structural challenges and adjustment needs. The implementation record deteriorated somewhat across a number of GRA program types in 2011.

- In some recent crisis programs, the need to address urgent crisis issues deferred longer-term structural reforms to lower levels of priority in the early part of the program period.

- Coordination with European institutions on GRA programs faced challenges. In the midst of a crisis, EU partners needed to develop crisis-fighting tools and build up crisis management capacity.

- In some cases, the clarity of conditionality, and in particular the presentation of critical structural measures and discussion of policy options, could have been improved.

[1] Principles guiding conditionality are *national ownership* of programs, *parsimony* in program-related conditions, *tailoring* to country circumstances, effective *coordination* with other multilateral institutions, and *clarity* in the specification of conditions.

Box 3. Design of Fund-Supported Programs: Key Messages

Program design appeared generally even-handed, tailored to country needs, based on unbiased projections, and flexible (Background Paper 2). These generally positive conclusions hold when comparing among programs and with past periods, and assessing the economic logic of program design.

- Macroeconomic adjustment and access to Fund financing can be explained by a limited number of initial conditions. The good fit of regressions for GRA programs points to program design taking differing initial conditions into account in a consistent manner, supporting the notion of even-handedness. The fit for PRGT programs, although somewhat weaker, likely reflects the heterogeneity of these countries, suggesting consistency. In surveys, stakeholders also perceive program conditionality and design to be even-handed.

- Specific initial conditions explained both the extent of adjustment by sector and access levels. This indicates that programs were generally well-tailored to country needs and characteristics.

- The macroeconomic projections underpinning program design did not exhibit a systematic pattern of error (i.e., bias). The optimistic bias identified in the past was not evident during 2006-11.

- Flexibility in design has increased compared to earlier programs, especially in terms of modification of conditionality and levels of access. This has helped to maintain high implementation rates despite the global recession.

However, there were some important exceptions and caveats to the generally positive findings, some but not all of which involved more recent programs.

- With respect to evenhandedness, access in the Euro Area programs was extraordinarily high, even considering measurable initial conditions. However, the access levels were justified as necessary given the systemic risks and high debt rollover needs.

- Projection errors for GRA cases were higher than in the past; although the shocks associated with the global financial crisis helped explain this outcome, room for improvement exists.

- Certain individual programs have exhibited some design flaws, as highlighted by the review of EPAs/EPEs (presented in Background Paper 4), but these were not found to be systematic. For example, the importance of lending under government programs was underestimated in Belarus.

- The fiscal adjustment in PRGT programs in fragile states was tougher than in other PRGT cases, suggesting some scope to examine relaxing macroeconomic adjustment in some of these cases.

- While program design in capital account crisis cases has drawn on the lessons of the past (including increased access), there may be some room for further relaxing initial fiscal targets in some of these cases, since stabilization in the medium term was better than expected despite narrowly missing fiscal targets in the initial program period.

Box 4. Outcomes of Fund-Supported Programs: Key Messages

Evidence suggests that most Fund-supported programs in the sample helped member countries improve macroeconomic and social conditions (Background Paper 3). While it was difficult to quantify program impact, the macroeconomic and social effects of programs appear to have been generally positive.

- Appropriate stabilization was achieved and specific pre-existing difficulties were resolved in the majority of GRA and PRGT programs, as determined by comparing inflation, growth, and fiscal balances at program end against simple uniform thresholds.
- GRA programs appear to have had a favorable effect on inflation, fiscal balances, and reserves, while largely safeguarding social spending. Analysis of debt dynamics suggests that in general these programs appropriately aim at helping countries reduce high levels of debt over time and at having more highly indebted countries reduce their debt more quickly than other countries.
- Effects of PRGT programs are particularly difficult to establish over the duration of each individual program. Nevertheless, previous staff analysis suggests that sustained program engagement by LICs with the Fund is associated with improved macroeconomic outcomes.[1] Analysis of debt dynamics suggests that debt burdens in LICs declined, often through debt relief, lessening the need for fiscal adjustment. Further, over the longer period 1985-2009, PRGT programs led to an increase in social spending and may thereby have supported improvements in health and education outcomes.
- Fiscal and external accommodation in many program countries during the recent global economic crisis was somewhat larger than in previous crisis periods, particularly during the early phase of the crisis, and this may well have helped these countries get through the crisis better. For example, the overshooting compression of the current account seen in previous crisis programs was avoided this time around. The reform of the GRA and PRGT lending facilities in 2009 helped the Fund provide substantial parts of the financing needed for this larger accommodation.

However, some program countries are facing weak growth and challenging public debt dynamics, including in the Euro Area.

- During 2009-10, fiscal space vanished rapidly in Greece, Portugal, and Ireland because debt levels were already fairly high at the start of the crisis, because output contraction lowered fiscal revenue, and/or because bank restructuring added to debt.
- Fund-supported programs for Euro Area countries initiated in 2010-11 aimed at fiscal consolidation to both boost confidence and reverse the unfavorable debt dynamics, but in at least one case, economic activity fell and the debt burden rose substantially more than projected.
- Public debt in some programs is projected to remain high for a number of years.

[1] *The Fund's Facilities and Financing Framework for Low-Income Countries*.