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April 11, 1995

To: Members of the Executive Board

From: The Secretary

Subject: Bilateral and Multilateral Aid Flows and Fund-Supported Programs

Attached for consideration by the Executive Directors is an executive summary relating to the paper on bilateral and multilateral aid flows and Fund-supported programs (to be issued shortly), which is tentatively scheduled for discussion on Monday, May 8, 1995.

This paper also provides background information to the paper on possible modalities for continued Fund involvement in low-income countries, including the most heavily indebted countries, through ESAF (EBS/95/60, 3/31/95) and on further consideration of issues and developments in multilateral debt and financing for the heavily indebted poor countries (SM/95/61, 3/31/95), which is tentatively scheduled for discussion tomorrow, Wednesday, April 12, 1995.

Ms. Christensen (ext. 38397) or Mr. R. Brooks (ext. 38315) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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INTERNATIONAL MONETARY FUND

Bilateral and Multilateral Aid Flows
and Fund-Supported Programs

Prepared by the Policy Development and Review Department

Approved by Jack Boorman

April 11, 1995

Executive Summary

This paper focuses on recent trends in concessional assistance from bilateral and multilateral aid agencies and their implications for Fund-supported programs. The recent downward pressure on aid budgets in many donor countries, stemming from fiscal consolidation and a poor public image of aid reported by several donors, has resulted in a decline in overall aid disbursements, particularly in the form of balance of payments support. This trend is likely to continue in the near term with the exception of a few donors. The current outlook is for concessional bilateral balance of payments support to be significantly lower in the next few years compared with the recent past. While concessional multilateral balance of payments support has the potential to increase in the next few years, it is unlikely to offset the expected decline in bilateral support. An important question in this context is how aid in general, and balance of payments support in particular, is likely to be distributed among developing countries and countries in transition.

Following the end of the Cold War, donors are renewing their focus on poverty reduction, particularly in the poorer countries, although it is still uncertain how this renewed focus will be affected by other factors in aid decisions such as strategic concerns and historical ties. If there is a trend away from support for middle-income countries toward greater support for low-income adjusting countries, this could help protect the poorer countries from the impact of an expected decline in the global availability of balance of payments support.

Under current prospects, only limited balance of payments support to the poorer countries in transition is likely to be available directly from bilateral sources, with donors relying primarily on multilaterals (including the European Union in exceptional cases) for support for these countries. This raises questions about whether international support to the poorer countries in transition that pursue Fund-supported programs will be adequate in the future.

Balance of payments support is likely to be concentrated more on those countries pursuing sound macroeconomic and structural policies, with an emphasis on private sector development, which should enhance the catalytic

role of Fund-supported programs. Despite scope for reallocating assistance across countries and potential declines in the needs of successful countries with relatively strong external positions, financing prospects for programs are likely to be more uncertain in the future given the current outlook for the global volume of balance of payments support. This calls for conservatism in medium-term projections of balance of payments support, firmer financing assurances from creditors and donors for the program period, and--recognizing the uncertainties that will nevertheless remain--adequate contingency mechanisms in the event of shortfalls in disbursements. Strong programs--perhaps more ambitious than in the past in terms of promoting domestic savings--will be required to attract support from the limited pool of funds, particularly for balance of payments support. The middle-income and more successful low-income countries may face deeper reductions in balance of payments assistance as donors focus more heavily on the poorer countries; they will have to demonstrate a strong commitment to sound policies to win the confidence of private investors in the context of the heightened uncertainty in international capital markets that is likely to remain in the near term.

Recent trends in the mix of aid flows of bilateral donors suggest a shift away from balance of payments support towards sectoral and project support and technical assistance directed at the social sector. In the context of strong economic programs, the emphasis on direct assistance for social programs--particularly in the areas of basic health and education--could be important in sustaining adjustment and achieving a lasting reduction in poverty. However, there is a danger that too rapid a shift away from balance of payments support could lead to unbalanced adjustment programs with slower structural reforms and economic growth and adverse consequences for poverty reduction and the effectiveness of donor project and technical assistance. Importantly, private inflows cannot be relied upon to fill prospective financing gaps for most of the poorer countries.

For many donors, decisions on the country allocation of aid are likely to take greater account of issues such as good governance and participatory development. The Fund has traditionally had a role in encouraging the economic dimension of good governance, particularly when it influences significantly the macroeconomic framework, but has not taken a direct role in the political dimension. In a number of cases, however, the Fund has faced problems with a lack of financing assurances from donors because of concerns about the political as well as the economic dimension of good governance in a member country. A difficult issue arises in such cases as to whether the authorities can design and the Fund should accept tighter--but still credible--programs that entail greater risks and may not be sustainable beyond the short term in the absence of a resumption of donor support, or withhold its support from such countries until adequate financing assurances can be obtained in support of a more sustainable program.

There is a trend among donors toward providing budgetary support instead of import support and attaching conditionality to specific public expenditures, particularly in the social sector. This raises complex issues

of coordination among donors and the recipient country to ensure consistency with the fiscal framework agreed with the Fund in the context of adjustment programs--an area where greater coordination and exchange of information is needed among all parties involved. The PFP process might be useful in this coordination process. There is also a question whether earmarking of external assistance for certain government expenditures reduces the flexibility of the recipient government in managing the fiscal situation and leads to a lack of support for other priority expenditures.

An increasing share of aid budgets has been devoted to peacekeeping operations and dealing with emergency situations, which has put pressure on other areas of aid budgets, including balance of payments support. There is concern among donors about how to prevent new conflict cases from emerging and how to deal with post-conflict cases. Regarding the latter, there is consensus among donors that international organizations should take the lead and that the Fund should become involved in the macroeconomic and structural policy discussions at an appropriately early stage, partly to ensure that aid decisions made in the context of peace settlements and post-conflict restructuring efforts are consistent with a sustainable fiscal and macroeconomic position.

Policy framework papers (PFPs) have become an important part of aid agencies' planning instruments and are regarded positively, although some donors would prefer greater openness on the part of Fund staff in providing country-specific information and earlier involvement in the PFP process. The PFP has also played a useful catalytic role in mobilizing external financing and providing a formal vehicle for articulating a consistent macroeconomic framework and financing framework in the Fund and the Bank. Given the usefulness of PFPs in low-income countries, it might be considered whether and, if so, under what circumstances, wider use should be made of PFPs for middle-income countries. This has to be weighed against the considerable costs--for the Bank and Fund staffs and the authorities concerned--of preparing a PFP and alternative ways of advancing the main purposes of the PFP, including close Bank-Fund collaboration.

Large shortfalls in external financing were experienced in many Fund-supported programs in recent years. The main factors behind the shortfalls were economic policy slippages; donor concerns about good governance; and administrative weaknesses in project implementation, disbursement of import support and monitoring of external financing. Given the experience and the general outlook for aid in the next few years, future programs will need to be more conservative in projecting external financing over the medium-term and more careful in obtaining financing assurances for the program period than in the past. Projections should be based on the best available information and take account of the complexities of donor conditionality and administrative requirements, particularly given the shift toward budgetary support for specific sectors. There is also a need for more emphasis on improving members' administrative capacity in the areas of project implementation and disbursement of import support in collaboration with the World Bank.

