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To: Members of the Executive Board

From: The Secretary

Subject: **Evaluation of the Prolonged Use of Fund Resources**

Attached for consideration by the Executive Directors is Volume I of the IEO report on the evaluation of prolonged use of Fund resources, which is tentatively scheduled for discussion on **Friday, September 20, 2002**. The report is unchanged from the version that was previously circulated to the Evaluation Group and other Executive Directors as EG/02/7 on August 12, 2002. Volume I contains the main evaluation report and an executive summary. Volume II contains reports on the three detailed case studies (Pakistan, Philippines, and Senegal) and two narrower country case reviews (Jamaica and Morocco).

It is expected that comments by Fund Management, and any IEO response to those comments, will be circulated later.

The Director of the IEO proposes that after the Executive Board completes its discussion, the paper be posted on the external IEO website together with management comments, any IEO response, and a summary of the Board discussion. It would also be published in hard copy.

Questions may be referred to Mr. Goldsbrough (ext. 34735), Mr. Tsikata (ext. 39601), and Mrs. Mateos y Lago (ext. 37219) in IEO.

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INTERNATIONAL MONETARY FUND

INDEPENDENT EVALUATION OFFICE

**EVALUATION OF THE PROLONGED USE OF
IMF RESOURCES**

VOLUME I: MAIN REPORT¹

September 3, 2002

¹ This report was prepared by a team headed by David Goldsbrough and including Kevin Barnes, Isabelle Mateos y Lago, and Tsidi Tsikata and was approved by Montek S. Ahluwalia, Director of the Independent Evaluation Office (IEO). Sections of the report have also benefited from comments and other inputs from Professor Graham Bird, Professor Jong-Wha Lee, David Peretz, and Professor Andreas Wimmer, but the final judgments are the responsibility of the IEO alone. Research assistance from Mwaffak Taib, Ned Rumpelstin, Yothin Jinjarak, and Sergei Peredriy is gratefully acknowledged.

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Executive Summary¹

Introduction

1. **In this evaluation, which is the first by the Independent Evaluation Office (IEO), we examine the issue of the prolonged use of IMF resources which has been the subject of external criticism and internal concern.** Some critics have argued that prolonged use constitutes a departure from the IMF's traditional mandate of providing temporary balance of payment support and suggests a lack of effectiveness of IMF-supported programs. Others have argued that frequent recourse to IMF arrangements is less of a problem than critics contend that it can take place for good reasons in countries with deep-seated adjustment problems and that it can be fully compatible with the IMF's mandate. We analyze the various reasons that have caused prolonged use to expand over the last three decades, be they related to IMF lending policies, to specific characteristics of the countries concerned, to shortcomings in program design and implementation, or to broader institutional factors. In so doing, we inevitably touch upon some issues that have been at the heart of recent controversies about the effectiveness of IMF-supported programs. Given the IEO's mandate, the focus is on the role of the IMF, but we are not suggesting that the IMF is responsible for all problems that contributed to prolonged adjustment difficulties. Clearly, the governments of the countries themselves bear primary responsibility for their policies.

2. **We used a combination of methodological approaches** in the evaluation, including empirical and econometric analyses of the broader group of prolonged users; three main country case studies (of Pakistan, Philippines and Senegal); two more limited case studies of "graduators" from prolonged use (Jamaica and Morocco); interviews with a wide range of stakeholders in the countries studied and with IMF staff; and a series of questionnaires to prolonged users' authorities, official and private creditors, and IMF mission chiefs.

3. **We find that the increase in prolonged use is partly a reflection of systemic factors** arising from the changed role which the international community expects the IMF to perform—where the implications for the extent of prolonged use have not been fully recognized—and **is also linked to program design and implementation problems**, many of which are not specific to prolonged users.

Definition and scope of prolonged use

4. **There is no single definition of prolonged use and different definitions have been used in earlier studies on the subject. For this evaluation, we have used a definition that treats a country as a prolonged user if it has been under IMF-supported programs for seven or more years in a ten-year period.** (For example, a country would have to be in more than two consecutive three-year arrangements to be classified as a prolonged user). The

¹ This Executive Summary should be read in conjunction with Chapter VIII (Conclusions and Recommendations), which presents a more detailed discussion of the major themes underlying our conclusions and discusses further the rationale for our principal recommendations. Executive summaries of the country case studies are provided in Volume II.

“fixed” version of this definition looks at all countries that met this definition at some point in the period covered by the evaluation. On this basis, 44 countries (29 of them PRGF-eligible) were prolonged users at some point during 1971–2000; a further 7 countries were prolonged users if precautionary arrangements are included. For some purposes, we have also used a “dynamic” definition according to which a country is treated as a prolonged user in a particular year if it has had an arrangement for 7 of the previous 10 years.

5. **Prolonged use has expanded consistently since the 1970s in terms of number of countries, share of the IMF’s membership, and total financial exposure.** This conclusion holds regardless of how prolonged use is defined and also, if the analysis is done separately for low-income countries and middle-income countries. In terms of number of countries, most of the expansion is accounted for by those eligible for the concessional facilities; but in terms of financial exposure, it is predominantly associated with users of the IMF’s general resources. Furthermore, prolonged use is persistent, in the sense that countries are generally slow to “graduate” from such use. In 2001, arrangements with prolonged users represented about half the total number of ongoing IMF-supported programs, with a total exposure of SDRs 24 billion (i.e. about half total outstanding obligations to the IMF).

Evolution of the IMF’s policies with respect to prolonged use

6. **The emergence of the phenomenon of prolonged use is to some extent the consequence of the evolution of IMF policies on the length of use of its resources.** A review of the history of this evolution (in Chapter III) suggests the following broad conclusions:

- Initially, the IMF was expected to provide financing only for a relatively short period, but over time the Executive Board accepted that many balance of payments problems, especially in the case of low-income countries, arose from deep-seated structural problems which required a longer time frame for adjustment. This led to acceptance of IMF financing being provided over a longer period. Even so, the departure was initially viewed as exceptional and access was not expected to be overly prolonged.
- With the establishment of concessional financing facilities in the late 1980s to address deep-seated external problems in low-income countries, policies applied to the use of concessional and general resources began to diverge, especially in the 1990s. There was a gradual relaxation of any implied upper limits on the time spent under IMF-supported programs in the concessional facilities. Simultaneously there was a tightening of the rules governing the length of use of the IMF’s general resources, although not to the point of setting a ceiling on that length.
- **The evolution of these facilities did not fully and explicitly recognize some of the consequences in terms of the extent of prolonged use and its potential adverse impact.** This was in part a consequence of differences of view within the Executive Board over what the longer-term role of the IMF should be in such cases. As a result, the IMF has been left with a mismatch between its core operational approach (which is still focused on promising

and achieving a restoration of sustainability within a relatively short timeframe) and some of the new tasks it is being asked to perform, especially the provision of support for longer-term structural adjustment.

- **The approach to prolonged use as it evolved over time reflected the nature of the financing constraint.** Initially, the limited availability of funding for the IMF's concessional facilities precluded any consideration of a long-term involvement. Subsequently, the reluctance of donors to maintain their aid flows at a level consistent with the intended diminished reliance on IMF lending, implied that the IMF would either have to remain involved through repeated programs until a sustainable external situation could be reached, or withdraw from the countries concerned midway in the process before external viability could be achieved.
- **Over time, a set of guidelines were approved by the Board to reduce the likelihood of prolonged use of IMF resources.** These guidelines called for frontloading the adjustment effort and monitoring implementation closely; calibrating access to IMF resources to ensure a diminishing reliance over time; comprehensive ex-post assessments of previous programs; and the preparation of explicit exit strategies for prolonged users. The evaluation indicates that these guidelines were not implemented consistently. One reason may have been the Board's reluctance to endorse a specific definition of prolonged use which led to ambiguity about the application of the guidelines in individual cases.

Characteristics of prolonged users

7. **Prolonged users appear to face external circumstances and have fiscal characteristics that are less conducive to swift adjustment.** These include lower trend export growth and more volatile terms of trade, as well as a more rigid structure of government expenditure, lower tax revenues, and a higher public debt burden. Although the statistical significance of these differences between prolonged and "temporary" users is limited and directions of causation are hard to disentangle, some of these characteristics have potential implications for program design. For example, they suggest the need for caution against the danger of overambitious projections for exports or tax revenues being built into program targets, since these could cause problems for program implementation. Evidence from the case studies and cross-country analyses—discussed in Chapter V—suggests that such overoptimism often was a problem in program design. However, there are also indications that prolonged users suffered from more serious imbalances than "temporary" users at the start of their prolonged use period, which might account in part for the greater length of their adjustment process.

Effectiveness and design of prolonged users' IMF-supported programs

8. **While it is hard to disentangle the effects of poor implementation from design problems, IMF-supported programs in prolonged use cases achieved much less than projected:**

- Although the methodological problems are considerable, econometric evidence suggests that in cases of prolonged use of general resources, IMF-supported programs tend to be associated with a negative impact on growth—after controlling for the endogeneity of a country’s decision to seek IMF assistance and for other determinants of growth. There is no such negative association for “temporary” users. Prolonged users of concessional resources do not show any negative impact on growth.
- A cross-country analysis of the extent of fiscal adjustment suggests that, in multi-year arrangements, prolonged users adjusted less than “temporary” users over the program period. In stand-by arrangements, prolonged users also appear to have achieved a slightly smaller reduction in the overall public sector deficit than “temporary” users and the shortfalls from the targeted fiscal adjustment seem to have been larger, although lack of a fully consistent database makes such comparisons difficult.
- The case studies show that, during the long period of IMF program involvement, significant progress toward solving these countries’ economic difficulties was eventually achieved in the Philippines and Senegal and even more so in Morocco, although with a mixed record across areas of economic policy and at a much slower pace than originally envisaged. The record in Pakistan and Jamaica was more disappointing. In all cases, substantial challenges remained at the end of the prolonged use period reviewed, especially as regards institutional reforms in tax administration and the broader public sector.

9. A cross section analysis of program design in prolonged use cases reveals interesting differences with “temporary” user cases. Some of these might have contributed to lower program effectiveness:

- Prolonged users’ programs had an optimistic bias as regards projections of real GDP growth and (for users of concessional facilities) export growth.
- In both stand-by and multi-year arrangements, the magnitude of the targeted fiscal adjustment (as measured by the primary fiscal balance) was markedly lower in prolonged use cases. In SBAs, the targeted adjustment of the external current account was also much lower. Contrary to established guidelines the targeted adjustment effort in multi-year arrangements was less frontloaded in prolonged use cases.
- Conditionality in prolonged users’ programs was, on average, less extensive than in other programs and its modalities involved fewer performance criteria and prior actions (as opposed to structural benchmarks and reviews). Moreover, a higher proportion of prolonged users’ performance criteria were waived. However, the evidence from the case studies, discussed below, suggests that it was not so much the magnitude of conditionality as its prioritization and integration into program design that was critical.

- Programs with prolonged users, particularly those supported by general resources were frequently subject to interruptions (both temporary and irreversible), to a greater extent than were “temporary” users’ programs.
- Access to IMF resources in successive prolonged users’ arrangements declined only in a minority of cases, and disbursements were on average somewhat more frontloaded than in arrangements with “temporary” users.
- Staff inputs in programs with prolonged users were smaller than in other programs, although the evidence suggests that this had no significant impact on program outcomes. Staff turnover on country assignments was very high in prolonged user countries, although not worse than in “temporary” users.

10. **The case studies broadly confirm the pattern emerging from the cross section analysis and highlight a number of additional issues that hampered program effectiveness.** We note that not all programs suffered from these problems and there is some evidence of improvement over time. While these problems likely contributed to prolonged use, they were not special to such cases.

- *Discrepancies between the timeframe of programs and the magnitude of their objectives.* There was a tendency to overoptimism about the effectiveness of the structural reform agenda in all three of the country cases. On the macro side, the tendency was most marked in Pakistan. Too little attention was often paid to analyzing how the real economy would respond to key policy measures and to assessing the expected sources of growth leading to overly optimistic forecasts of key magnitudes.
- *The risk to programs of weak ownership and political commitment was often understated,* and not enough attention was paid to assessing and developing implementation capacity. Assessments of such issues in internal documents were variable and, in those relatively few cases where a clear assessment was made, subsequent Board papers were much less candid. There is evidence, however, of a somewhat greater attention to such issues in some more recent programs.
- *Many programs had difficulty in dealing with uncertainty,* in part because program documents often did not analyze the key risks to a program and specify how policies would broadly respond to those risks.
- *Relatively few systematic ex post assessments of programs were undertaken* and (with the exception of the Philippines) there was generally limited discussion of exit strategies from prolonged program involvement.

11. **The three main country cases also provide lessons for approaches to structural conditionality.** Many of these lessons are not specific to prolonged users, but they are especially important in these cases.

- The extent and structure of conditionality was much less important than an underlying political commitment to core policy adjustments. The three country cases illustrate a wide variety of approaches to conditionality, ranging from extensive and detailed in the case of Pakistan to a heavy reliance on reviews in the case of the Philippines; none proved especially effective in periods when ownership was weak. Likewise, very detailed conditionality (e.g. a detailed matrix approach) was not effective in enhancing implementation when political commitment was lacking.
- Structural conditionality was often poorly prioritized, so that compliance with a subset of these conditions did not ensure that the most critical problems were being addressed even though it was often sufficient for continued access to IMF resources.
- Forms of conditionality that focused on policy rules or procedures, rather than one-time discretionary actions, appear to have been ultimately more effective, especially when dealing with deep-seated structural issues.
- Prior actions were not always well integrated into program design and did not always focus on the most critical issues. This might explain in part the general finding that the number of prior actions has little influence on successful program implementation. The history of prior actions in the area of agricultural income taxation in Pakistan is one illustrative example.

Influence of IMF governance and other institutional factors on prolonged use

12. Internal institutional factors have contributed importantly to the program design problems outlined above:

- The approach to structural reforms was, until recently, often characterized by insufficient emphasis on fostering the deep institutional changes needed in critical areas. These problems were compounded by the fact that collaboration between the IMF and the World Bank often did not yield an operationally effective integration of priorities and work programs. The case studies illustrate some of the difficulties that programs encountered in addressing some especially intractable structural problems that were central to the sustainability of adjustment (e.g. effective tax collection procedures in all three countries). Recent initiatives to streamline conditionality should help to address these problems and are welcome.
- The IMF's approach to program design has until now often given insufficient priority to a proper assessment of the implementation capacity constraints that a program might face, be they related to political feasibility or to administrative capacity. In best practice cases, efforts are made to take account of these constraints, but there are insufficient systemic incentives to ensure that such an approach would be followed more generally.

- Some of the case studies (most notably Pakistan) and a survey of IMF mission chiefs suggest that political considerations have been an important factor in program-related decisions on some occasions. While political considerations are bound to enter into decision making for an institution where the ultimate power of approval rests with shareholder governments, it is necessary to ensure that technical judgments and political considerations do not get blurred in these cases. This only dilutes accountability and tends to reduce the credibility of those programs.
- There is evidence that internal incentives in the IMF encourage overpromising in programs. This results from both the relatively short time frame of programs forcing optimistic assumptions about the pace of adjustment and also from a desire to maximize the program's catalytic role. This led to a tendency to downplay risks. Even when, as was often the case, they were well identified during the internal review process, the assessment of risks was not candidly presented to the Executive Board.
- The case studies suggest that, by and large, surveillance failed to play a major independent role in prolonged user cases. In some cases (most notably the Philippines), doubts that surveillance would be a sufficiently strong instrument for some purposes (e.g. to provide a continuing framework for "good" policies and to send a signal to other lenders) appear to have contributed to continued program involvement even when there were questions about the balance of payments need.
- The IMF's ability to learn from experience is hampered by (i) the relative scarcity of systematic *ex post* assessments of programs and (ii) the slow pace at which lessons learned in the context of cross-country policy reviews—which are often insightful—permeate operational practices. Moreover, many of the most candid internal assessments and debates on alternative policy strategies in individual countries were not reflected in subsequent Board papers.

13. **The international community's evolving expectations of the IMF's role contributes in important ways to the expansion of prolonged use.** In particular, official donors and creditors have tended to link increasing parts of their financing flows to the existence of an IMF lending arrangement acting as a "seal of approval" on recipient country policies. While this tendency can be justified by the legitimate desire to ensure aid effectiveness, it is not clear that the "seal of approval" provided by IMF-supported programs, especially as currently designed, suitably addresses all the concerns of donors and creditors—in particular those related to long term sustainable growth and the deep institutional changes that it requires. Furthermore, there is some evidence that "seal of approval" demands are the source of pressures to agree to programs with a low probability of success, which only undermines the seal of approval.

Implications of prolonged UFR for the member country and the IMF

14. **Prolonged use appears to have both positive and negative implications for institutional development in prolonged users.** Most prolonged users' authorities acknowledged that successive programs had been accompanied by a positive transfer of

economic management skills, although views differed regarding the scope of that transfer. However, there was a general sense—both from the case studies and questionnaire responses from a broader group of prolonged users—that throughout its involvement, the IMF had paid insufficient attention to institutional reform and to the development of implementation capacity, even in cases where programs had facilitated access to IMF technical assistance. The views expressed regarding the impact of prolonged use on the policy formulation process were generally negative, in particular because program negotiations were often characterized as proceeding in a way that left too little space for policy debate and the formulation of homegrown policies. While this is a general problem, it is particularly damaging in prolonged use cases because of the extended period involved. However, a number of officials acknowledged that the primary responsibility for any failures in policy implementation had to lie in the countries themselves and that a “blame-the-IMF” approach could, in itself, be detrimental to ownership.

15. Prolonged use may also affect the IMF itself, in two ways: it has a potential impact on its finances, and there are indications that it also affects its credibility. In terms of financial impact, our analysis indicates that, in spite of its expansion, prolonged use does not appear to have been a binding constraint on the IMF’s lending ability, either in the general resources account (GRA) or in concessional trusts. However, since decisions on the size of access to IMF resources and on quota increases are endogenous, it is difficult to determine ex post whether prolonged use led to implicit rationing of resources to other users. Prolonged users’ programs have also contributed significantly to the growing mismatch between the IMF’s staff resources and its lending activities. The impact of prolonged use on the IMF’s credibility cannot be quantified rigorously but there is anecdotal evidence that the willingness of the IMF to maintain or renew its support in the face of uneven implementation weakened the leverage of conditionality. There is also some econometric evidence that, where IMF resources have been found to have a catalytic effect on other financing flows, that effect weakens with prolonged use.

Conclusions and recommendations

16. Prolonged use, even when it takes place for “good” reasons, can have significant adverse implications, both for prolonged users and for the IMF. The expansion of prolonged use reflects both systemic factors and weaknesses in program design. The latter largely arise from a mismatch between the functions taken on by the IMF for systemic reasons and its institutional culture. Implementation weaknesses also played a part. While they largely reflect policy choices in the countries themselves, which are beyond the scope of this evaluation, their prevalence is also related to the systemic and institutional factors mentioned above. The IMF is in a process of change, and many initiatives have been adopted in recent years which, if implemented faithfully to their spirit, should go a long way towards addressing some of the problems highlighted by this report, particularly as regards ownership, the design of conditionality, surveillance in program countries and IMF-World Bank collaboration.

17. The recommendations summarized below have two objectives: to diminish the incentives for prolonged use, including by enhancing program effectiveness, and to

reduce its adverse consequences. Some of these recommendations would be applicable only to actual prolonged users. Others are of more general applicability to the IMF's approach to programs, not just prolonged use cases, but they constitute a preventive strategy which would reduce the likelihood of prolonged use in future. We recognize that some of the recommendations are likely to require some increase in resources, especially in the short term when offsetting resource savings will not yet have materialized. Several of the recommendations are not new, either because they merely give renewed emphasis to existing policies and guidelines which do not appear to be uniformly implemented, or because they constitute an endorsement of recent initiatives, to which they only add specific proposals regarding their implementation.²

I. Recommendations on the Rationale for IMF Involvement

1. The Executive Board should adopt an explicit definition of prolonged use, as a trigger for the adoption of automatic due diligence procedures. The definition could use different criteria for the general and concessional resources.
2. In view of the experience with ineffectively implemented programs, greater efforts should be made at judging when countries are ready to implement programs especially in situations of prolonged use. On this basis, the IMF should be willing to be more selective in extending financial support.
3. The IMF should aim to provide the international community with credible alternatives to the current situation where IMF-supported programs have become a precondition for the provision of many other sources of financing by donors and creditors. This could be done by developing a mix of tools (e.g., strengthened surveillance, PRSP assessments, precautionary arrangements or shadow programs) to deliver seals of approval suited to the varied needs of donors and creditors.
4. An explicit "exit strategy" should be developed for identified prolonged users, although without setting rigid limits on the duration of IMF program involvement.
5. A differentiated rate of charge could be considered for prolonged users. While there is no evidence that cost of IMF resources is a factor in prolonged use, it would serve as a signaling device that could possibly provide at least a political incentive against prolonged use.

² Specifically, recommendations 4 and 9 concern existing procedures, and recommendations 6, 8, 10, and 11 are an elaboration of recent or ongoing initiatives.

II. Recommendations for Program Design and Implementation

6. Since implementation is critically dependent on ownership, it would be desirable to evolve specific operational procedures to ensure that program design places greater emphasis on ownership and the nature of the domestic policy formulation process. This approach is already embedded in initiatives currently underway. The following specific suggestions are offered to operationalize the process.

- The IMF should move toward a situation where the normal procedure, would be for the authorities to have the initial responsibility for proposing a reform program which should be the starting point for negotiations. The speed at which this can be done will vary from country to country, depending on administrative capacity. Such an approach should not be an additional prerequisite for financial support, but countries should be encouraged to adopt it.
- The aim should be to move as soon as possible to a situation in which the core elements of a program are subject first to a domestic policy debate within the member country's own policy-making institutions.
- As is already "best practice", Article IV surveillance reports should actively seek to present alternative policy options and to analyze the trade-offs between them so as to encourage an open debate on alternative policy options.

7. Programs should give much greater emphasis to fostering key institutional changes and to strengthening implementation capacity. Staff reports should include an explicit assessment of key implementation challenges foreseen and ways to address them.

8. There should be greater selectivity in program content, based on a clearer prioritization of conditionality and a better integration of the latter in program design. This is the essence of ongoing efforts to streamline conditionality, which we strongly support. To reach this objective, the following steps would be key:

- A deepening of operational collaboration with the World Bank, to ensure an effective meshing of priorities and timeframes of the two institutions on key issues. Recent initiatives in this area are welcome, but substantial changes in operating approach and sustained emphasis by management will be needed to make collaboration effective.
- Systematically incorporating into program documents more in-depth analyses of real economy responses to the key policy elements of programs and of the sources of growth, while spending proportionately less time fine-tuning traditional financial programming exercises. Such analyses would draw, where appropriate, on the expertise of the World Bank.
- Using conditionality as a means to direct attention to critical reforms and emphasizing substantive rather than formal progress toward the program's objectives both in setting

conditionality and in assessing compliance with it. Greater selectivity in the use of conditionality should be accompanied by less recourse to waivers.

- Making greater efforts to tailor the effective timeframe of program design to the foreseeable length of the reform and adjustment process, not necessarily by lengthening the timeframe of arrangements themselves, but by casting individual arrangements within a longer-term strategic framework and recognizing upfront the need for repeat arrangements where adjustment is expected to be protracted. This approach would build on the existing internal country strategy papers, but with the core elements included in reports to the Executive Board.

9. UFR reports should include more explicit discussions of the major uncertainties faced by the program and of how policies will be adapted if underlying assumptions are not borne out by subsequent developments. To counteract any bias to overoptimism, the reports should discuss explicitly how programs would be adapted if other available forecasts were to prove more accurate.

III. Recommendations for IMF Governance

10. Systematic ex-post assessments of programs should be undertaken, with the key messages reported to the Board, as part of a broader effort to disseminate more effectively “best practices” and lessons learned, and to maximize the effectiveness of the review process. As part of this process, the following points deserve emphasis:

- Staff reports, especially those involving UFR requests by prolonged users, should provide more perspective on the history of the IMF’s program involvement in the country, highlighting what has been achieved and where previous programs have fell short of their objectives.
- More follow-up monitoring should be undertaken when programs go off-track, especially for prolonged users. This will require improvements to the existing (MONA) database.

11. Steps should be taken to strengthen further surveillance in prolonged use cases, going beyond the recent revisions to surveillance guidelines aimed at improving surveillance in program countries. Further steps should include:

- A clarification of the expectations on the role of surveillance in program cases, going further than the simple reassertion of existing, but unevenly implemented guidelines, and stressing the need for ex post assessments of programs’ achievements.

- There is a case for creating greater operational separation between UFR and surveillance missions in prolonged use cases, although implementing this separation raises delicate trade-offs. The appointment of a mission chief chosen from outside the area department for surveillance missions to prolonged users could be considered provided there are suitable continuity and coordination safeguards.
 - 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.
 - The precise frequency of Article IV consultations with program countries is less important than that they take place at times when a “fresh look” would be most valuable.
12. The IMF should strengthen the ability of its staff to analyze political economy issues in order to achieve a better understanding of the forces that are likely to block or enhance reforms and to take these into account in program design.
13. A broad review of explicit and implicit incentives facing IMF staff should be undertaken, in particular with a view to reducing the excessive turnover of staff working on countries and to fostering increased candor in staff reports and greater accountability.
14. The appearance of undue political intervention in the IMF’s decisions to grant a country access to its resources undermines the credibility of programs. Procedures should be evolved so that political considerations, which are inevitably present in these decisions, are seen to be taken into account in a transparent manner, with decisions and accountability clearly at the level of the Executive Board on the basis of a candid technical assessment by staff of the risks and potential tradeoffs.

I. INTRODUCTION

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

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

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

- it contradicts the IMF's mandate as set forth in the Articles of Agreement, which stress that IMF resources should be made available to members "temporarily"² to cope with balance of payments disequilibria.
- it suggests a lack of effectiveness of IMF-supported programs, as the repeated need to make use of IMF resources indicates a persistence of the balance of payment difficulties which such programs are intended to solve (Meltzer (2000) and Vasquez (2000)). In recent years, some critics have argued that lack of ownership, leading to poor program implementation, and program design flaws are key factors underlying the lack of effectiveness of IMF-supported programs and therefore a root cause of prolonged use.
- it may encourage over-indebtedness because a prolonged "IMF seal of approval" encourages overlending in an environment where there is insufficient attention to debt sustainability (Bandow (1994)); in heavily indebted countries it could reflect a

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

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

strategy of “defensive lending” by the IMF and other multilaterals to avoid default (Birdsall (2001)); and

- it may hinder institutional development in the borrowing countries by giving the IMF an overly intrusive presence in their policy-making process, thereby compromising the development of responsible, democratic institutions that correct their own mistakes and respond to changes in external conditions (Meltzer (2000)).

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

- This could be the case for countries subject to frequent external shocks and for countries where external imbalances have deep-seated structural causes, which cannot be overcome over the short term, or only at a great cost to economic prosperity—an outcome IMF-supported programs are specifically intended to avoid. The latter category could include many low income and transition economies.
- Since the mid-1980s, most IMF arrangements intended to tackle the latter kind of balance of payments difficulties for low-income countries have been funded from special accounts, (i.e. the SAF, ESAF, and PRGF) and consequently have not exerted pressure on the revolving nature of general resources.³ Besides, it has been argued that the views of the official international community on the appropriate length of IMF financial involvement have changed over time, at least for the low-income group of countries, and the IMF has been given a mandate to provide support, via the PRGF, for programs intended to foster growth and poverty reduction over a longer time horizon.
- Prolonged use of IMF-supported programs may simply reflect the unwillingness of other lenders (be they private or public) to provide financing without the “seal of approval” they consider an IMF-supported program to be. This raises important questions with regard to the appropriate balance between the IMF’s lending and surveillance activities.

5. This evaluation investigates the issue of prolonged use by addressing three broad sets of questions. First, how extensive is prolonged use and what are its consequences for borrowing countries and the IMF? Second, to what extent is the phenomenon an inevitable consequence of conscious decisions made by the shareholders regarding the IMF’s role in the changed international environment? Third, to what degree can it be accounted for by

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

shortcomings in the design of IMF-supported programs and how could the effectiveness of the programs be improved? We find that both systemic factors associated with the IMF's role and program design and implementation issues have contributed to the extent of prolonged use. In addition, the topic of prolonged use touches upon many aspects of the IMF's operations; in undertaking the evaluation we have identified a number of issues that, while germane to this topic, are of much broader relevance.

6. The evaluation has relied upon a combination of methodological approaches, including (i) empirical and econometric analysis of a wide range of prolonged users, taken both as a whole and in various relevant groupings; (ii) detailed case studies of three country cases (Pakistan, Philippines, and Senegal) that have been among the most prolonged users of IMF resources and illustrate different aspects of prolonged use. These case studies have involved country visits to seek the views of the authorities and a wide range of other stakeholders;⁴ detailed reviews of both internal and publicly available IMF documents; and interviews with relevant IMF staff, management, and Executive Directors; (iii) more limited desk reviews of two countries (Jamaica and Morocco) that appear to have "graduated" from IMF financial support, drawing on IMF documents, interviews with staff and some senior officials; (iv) written submissions by the authorities in a number of prolonged use cases responding to an IEO questionnaire on specific issues; and (v) responses received to IEO questionnaires sent to official donors and creditors, members of the private financial sector, and a broad range of IMF mission chiefs designed to seek their views on a range of issues including the broader institutional framework and incentives that influence decisions on programs. In the empirical work, we have made a distinction, wherever possible, between prolonged use of general and concessional resources, since expectations of the IMF's role are, to some extent, different for the two groups.

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

⁴A list of those with whom the evaluation team had discussions in the case study countries is given in the companion volume on the case studies.

8. The three countries chosen for the detailed case studies illustrate different aspects of prolonged use. Philippines had had the longest involvement with IMF-supported programs, stretching back to the early 1960s, with only relatively brief interruptions until it finally exited from such programs in 2000. It has used only the IMF's general resources. Pakistan had repeated, but discontinuous, use of IMF resources during the period 1970-88 and, since 1988, has had a long series of arrangements—almost all of which suffered from substantial policy slippages and soon went off-track. The only exception was the 2000 stand-by arrangement, which was completed as scheduled. Pakistan has used both general and concessional resources and is currently implementing a PRGF-supported program. Senegal has had an almost continuous succession of IMF arrangements since 1979, except for a nearly two-year period around 1992-93 (i.e. prior to the devaluation of the CFA franc). Periods of strong adjustment have been interspersed with periods of policy slippages, often around electoral cycles. Since 1986, it has used primarily concessional resources, although it has also used a number of stand-by arrangements, either to supplement access levels or as a transition to multi-year arrangements.

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

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

II. WHAT IS PROLONGED USE AND HOW WIDESPREAD IS IT ?

A. What is Prolonged Use of IMF Resources?

1. There is no official or generally agreed definition of prolonged use of IMF resources (UFR). In previous studies, undertaken both within and outside the IMF, prolonged UFR has been characterized in several different ways, focusing either on the number of years spent by a country under IMF-supported programs—in some cases approximated by the number of IMF-supported programs entered into—or on the length of time a country has outstanding obligations to the IMF. Annex I discusses the most commonly used definitions in more detail.

2. In the current project, the definition used is based on the concept of “time under arrangement”: *countries are defined as prolonged users if they have been under arrangements for at least seven years out of any ten.*¹ This concept was preferred to other alternatives mainly because it is more homogeneous across lending instruments (since a single IMF “lending arrangement” can vary in length and repayment period, depending upon the particular facility used). It permits the use of a single threshold for all member countries, regardless of the types of facility used.² Moreover, focusing on “time under arrangement” goes to the heart of issues such as program design, ownership, and conditionality.

3. The threshold of seven years in any ten, which is higher than in previous reviews of the phenomenon, was chosen so that any country with just two three-year arrangements (EFF or ESAF/PRGF) in a decade, or a combination of a few stand-by arrangements with one medium term arrangement, would be classified as a “temporary” user, not as a prolonged user.³ This relatively high threshold means that some countries classified as “temporary” users might have made a relatively frequent and/or protracted use of IMF resources.

¹ This definition is applied in two different ways in the report, depending on the type of analysis undertaken and the nature of the question being addressed: in one case, prolonged users (PUs) are treated as an invariant group that includes all the countries which met the 7 out of 10 years criterion at least once over the 1971-2000 period (i.e. a “fixed” definition); in the other case, the composition of the PU group varies each year, as it includes only the countries which met the criterion in that particular year (i.e. a “dynamic” definition).

² Short-term arrangements (SBAs) typically span 12 to 18 months, with no minimum and a maximum length of three years, whereas medium-term arrangements (under the EFF, SAF and ESAF/PRGF) cover a three-year period. Repayment periods have been markedly differentiated across lending facilities, in order to take account of the different speeds at which various countries can be expected to return to balance of payments viability: from 2½ years for the SRF to 10 years for the EFF and PRGF.

³ However, unlike the definition used in previous IMF reviews, the proposed definition does not impose any threshold on the outstanding use of IMF resources at the end of the period. This is in order not to exclude countries which have repaid all or most of their outstanding obligations to the IMF and in that sense have subsequently “graduated” from IMF support. The terms “prolonged user” and “temporary user” (i.e. all those not counted as prolonged users) are employed as a convenient terminology for purposes of this evaluation. Under the IMF’s Articles of Agreement, all use of IMF resources is supposed to be temporary.

4. The 2000 Review of Fund Facilities made a distinction between “repeat users”—i.e. countries with many programs but where effective use of IMF resources was relatively low because the programs went off-track quickly—and “prolonged users”—i.e. countries which made greater effective use of the IMF resources. The former type are represented in our country case studies by Pakistan and raise the most serious questions about program implementation and ownership. The latter type is, to some extent, closer to the examples of the Philippines and Senegal and raise questions about the appropriate length of IMF program involvement in cases with protracted adjustment difficulties and about the revolving nature of IMF resources. In general, however, the empirical evidence suggests no sharp dividing line between the two types and, for the purposes of this evaluation, the terms “prolonged use” and “repeat use” will be used to mean the same thing.

5. Moreover, neither the choice of concept on which to base the definition of prolonged use, nor the choice of threshold, has a major impact on the general trends observed, either as regards the extent of the phenomenon of prolonged use or its evolution over the last three decades.⁴ Settling on a specific definition was necessary in order to identify a list of countries on which to conduct quantitative analyses, but the general conclusions reached do not seem very sensitive to the precise definition.

B. Extent and Evolution of Prolonged Use over 1971-2000

Trends in prolonged use over 1971-2000

Scope of prolonged use

6. Out of 128 countries which made use of IMF resources during the 1971-2000 period,⁵ 51 countries meet our definition of prolonged use at some time during the period (44 countries if precautionary arrangements are excluded) (Table 1).⁶ Prolonged users are

⁴ We reached this conclusion after mapping out prolonged use based on the alternative concept of number of IMF arrangements entered into, by including or excluding precautionary arrangements within the total for each country, and by raising or decreasing the “time under program” threshold by one year. Chart 1 below as well as the charts presented in Annex I broadly illustrate that point.

⁵ This excludes countries whose UFR consisted exclusively of “outright purchases”, i.e. was not associated with a lending arrangement or program (e.g. first credit tranche purchases).

⁶ So-called “precautionary” arrangements are the same as other IMF arrangements except that the authorities have indicated that they do not intend to draw on the resources made available. Even though that commitment is never binding, to the extent that it is observed, these programs do not reflect any actual balance of payments need nor involve any actual use of IMF resources. However, the program negotiation and Board approval process is identical, and the committed resources can be drawn upon if the authorities so wish, and indicate they have a balance of payments need; therefore the resources are not available for lending to other members. A significant number of precautionary arrangements were eventually drawn upon. Therefore, for completeness, the tables in this chapter identify those countries that would be classified as prolonged users if precautionary arrangements were included in the definition, but not otherwise. Arrangements under the ESAF/PRGF cannot be precautionary.

predominantly—but by no means exclusively—low-income countries with little or no access to private capital markets. For example, in the group of prolonged users excluding precautionary arrangements, 29 of the 44 prolonged users are eligible for the IMF's concessional facility (henceforth, PRGF-eligible) (Chart 1).

7. Nearly 40 percent of prolonged users made an intensive use of the IMF's general resources, in the sense that they had outstanding obligations to the general resources account (GRA) of over 100 percent of their quota for ten years or more (Table 2). When both general and concessional resources are taken into account, more than half the countries had average outstanding liabilities over the thirty year period in excess of 100 percent of their quota, i.e. they made both long and large use of IMF resources.

Table 1. List of Prolonged Users at Some Time During 1971-2000^{1/2/}

Countries that would be classified as prolonged users excluding precautionary arrangements		Countries that would be classified as prolonged users only if precautionary arrangements were included
Argentina	<i>Malawi</i>	Costa Rica
<i>Bangladesh</i>	<i>Mali</i>	Egypt
<i>Benin</i>	<i>Mauritania</i>	El Salvador
<i>Bolivia</i>	Mexico	Korea
Bulgaria	<i>Mongolia</i>	Latvia
<i>Burkina Faso</i>	Morocco	<i>Liberia</i>
<i>Congo D.R.</i>	<i>Mozambique</i>	Uruguay
<i>Cote d'Ivoire</i>	<i>Nicaragua</i>	
Ecuador	<i>Niger</i>	(7)
<i>Equatorial Guinea</i>	<i>Pakistan</i>	
Gabon	Panama	
<i>The Gambia</i>	Peru	
<i>Ghana</i>	Philippines	
<i>Guinea</i>	Romania	
<i>Guyana</i>	<i>Senegal</i>	
<i>Haiti</i>	<i>Somalia</i>	
<i>Honduras</i>	<i>Tanzania</i>	
Jamaica	<i>Togo</i>	
Jordan	Turkey	
<i>Kenya</i>	<i>Uganda</i>	
<i>Kyrgyz Republic</i>	F.S.R. of Yugoslavia	
<i>Madagascar</i>	<i>Zambia</i>	
(44)		

1/ Chart 1 summarizes in graphic form the history of lending arrangements of the countries listed here. The vast majority of these countries were still under program at the end of the period. Of the 13 countries which were not, 4 countries (Congo D.R., Liberia, Somalia, and the F.S.R. of Yugoslavia) were no longer eligible to use IMF resources at the end of the period (the first three because of arrears to the IMF and the fourth because it was dissolved).

2/ Countries in italics are PRGF-eligible. However, a large part of the resources made available to them over that period came from the general resources account (GRA).

Table 2. Intensity of Use of IMF Programs, 1971-2000

Country	Time under program 1/ (years)		First year under program (in period)	Last year under program (in period)	Number of programs			Use of Fund Credit (GRA)		Average outstanding credits and loans 2/	Outstanding credits and loans as of Dec 2000 2/
					GRA	Non -GRA	% of Partially disbursed programs 1/	(years with outstanding obligations)			
	of which precautionary	over 100% of Quota						over 200% of Quota			
Philippines	24.7	1.0	1971	2000	16	0	60	24	4	172	177
Panama	20.8	10.0	1971	2000	17	0	50	13	8	110	24
Pakistan	20.1	0.0	1972	2000	12	3	80	13	4	146	114
Haiti	20.1	5.0	1971	1999	13	2	80	5	0	70	50
Senegal	19.8	0.0	1979	2000	9	4	23	13	1	174	121
Guyana	19.8	4.0	1971	2000	11	3	100	12	7	138	99
Kenya	19.2	1.0	1975	2000	9	4	67	13	6	160	36
Uganda	18.4	0.0	1971	2000	5	4	30	8	5	167	134
Madagascar	18.2	0.0	1978	2000	8	3	64	9	6	114	65
Uruguay	18.2	6.2	1971	2000	16	0	44	3	2	69	37
Jamaica	18.1	0.0	1973	1996	12	0	67	19	11	184	17
Mauritania	17.3	0.0	1977	2000	6	4	36	5	0	116	117
Mali	17.3	0.0	1988	2000	5	4	27	4	0	103	144
Malawi	17.2	0.0	1979	1999	6	3	55	11	7	160	91
Togo	17.2	0.0	1979	1998	7	3	70	5	0	96	73
Argentina	16.4	3.0	1976	2000	10	0	75	19	8	129	193
Bolivia	16.1	0.0	1973	2000	3	5	44	5	0	113	98
Cote d'Ivoire	16.1	0.0	1981	2000	6	2	83	10	8	151	130
Ghana	14.4	0.0	1978	2000	4	4	40	8	5	133	61
Guinea	14.3	1.0	1982	2000	0	3	50	0	0	60	81
Mexico	13.8	0.0	1977	2000	6	0	67	18	13	182	0
Zambia	13.7	0.0	1973	2000	7	3	70	19	15	200	179
Tanzania	13.3	0.0	1976	2000	2	4	57	7	1	106	125
Peru	13.3	1.5	1971	2000	9	0	100	23	4	135	67
Egypt	13.2	6.0	1987	1998	7	0	100	3	0	45	0
Gabon	13.1	2.0	1978	2000	6	0	20	4	0	43	46
Korea	13.1	4.0	1971	2000	12	0	57	16	14	225	273
Bangladesh	12.7	0.0	1974	1993	0	2	75	0	0	133	31
Honduras	12.5	2.0	1971	2000	4	2	17	5	2	78	128
Niger	12.4	0.0	1983	2000	4	2	33	5	1	92	86
Costa Rica	11.9	6.0	1976	1997	10	0	80	9	2	69	0
Romania	11.8	0.0	1975	2000	8	0	75	12	1	82	34
Gambia, The	11.7	0.0	1977	2000	3	3	50	6	1	102	45
Yugoslavia	11.5	0.0	1971	1991	9	0	44	NA	NA	NA	NA
El Salvador	11.5	7.0	1971	2000	10	0	25	0	0	33	0
Equatorial Guinea	11.0	0.0	1988	1996	2	2	60	0	0	40	12
Benin	10.7	0.0	1989	2000	0	4	33	0	0	50	104
Congo, DR	10.7	0.0	1984	1990	9	1	90	13	4	137	103
Liberia	10.3	3.0	1971	1985	11	0	50	20	19	219	315
Jordan	9.9	0.0	1989	2000	5	0	80	6	4	70	208
Morocco	9.9	0.0	1980	1993	10	0	60	16	8	127	0
Burkina Faso	9.8	0.0	1991	2000	0	4	50	0	0	47	143
Turkey	9.7	0.0	1971	2000	8	0	63	14	12	142	333
Ecuador	9.6	0.0	1971	2000	9	0	67	8	3	65	38
Mozambique	9.5	0.0	1987	2000	0	5	40	0	0	59	148
Nicaragua	9.2	0.0	1971	2000	4	2	80	1	0	32	100
Somalia	9.1	0.0	1980	1990	5	1	33	19	18	170	253
Mongolia	7.2	0.0	1991	2000	1	2	100	0	0	25	76
Kyrgyz Rep.	7.1	0.0	1993	2000	1	2	50	0	0	38	163
Latvia	7.1	4.9	1992	2000	6	0	0	2	0	21	21

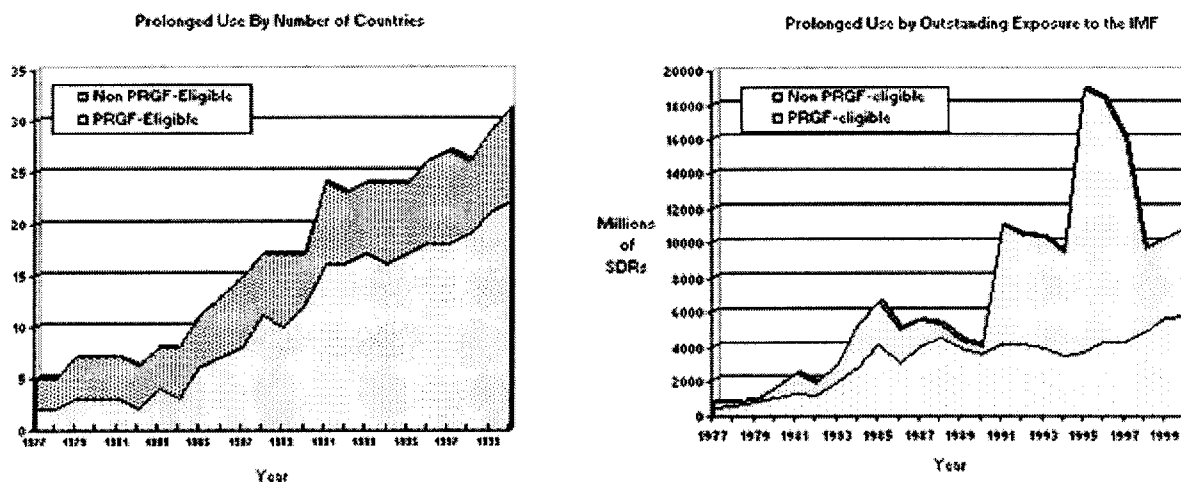
1/ Time spent refers to the actual period covered by arrangements, whether or not a country was eligible to draw under the program. Only programs which were precautionary from the point of approval and were effectively treated as such are represented as precautionary.
2/ As a percentage of quota.

Evolution of prolonged use over time

8. Prolonged use is neither a recent nor a rare phenomenon and contrary to what previous internal reviews, which focused on the use of the IMF general resources, have suggested, it is also not one that is diminishing in importance. As indicated in the 1991 and 2000 reviews, prolonged use started to build up in the second half of the 1970s and accelerated sharply in the first half of the 1980s as a result of the debt crisis. Thereafter, the establishment of concessional facilities resulted in a large shift of prolonged users from the general to the concessional window, so that by 1990 the number of prolonged users of general resources had fallen dramatically. Prolonged use, thus defined, rose again slightly in the 1990s, partly due to the intensive involvement of the IMF in “transition” countries.

9. However, an analysis of prolonged UFR which does not limit itself to the general resources account (GRA) leads to different conclusions. First, the decline in the scope of the phenomenon which occurred in the late 1980s is largely cosmetic, since five of the countries previously characterized as prolonged users fell into arrears and were declared ineligible for further borrowing from the IMF,⁷ and most of the others had become prolonged users of concessional resources. In fact, prolonged use, according to the definition used in this evaluation, has consistently expanded since the late 1970s. In terms of number of countries, most of the expansion was in PRGF-eligible countries, but in terms of financial obligations, the expansion in prolonged use of general resources was greater (Chart 2).⁸

Chart 2. Prolonged Use by Number of Countries and By Outstanding Exposure to the IMF



⁷ These are the four countries mentioned in footnote 1 of page 4, plus Zambia, which has subsequently regained eligibility.

⁸ Outstanding obligations are shown according to whether or not a country is PRGF-eligible, not according to the nature of resources at stake. The charts are based on the “dynamic” definition of prolonged use, so that prolonged users’ outstanding obligations in each year are taken into account only if they qualify as prolonged user in that year. For example, Ecuador’s obligations in 1999 are not taken into account because it did not qualify as a prolonged user in that year.

10. Furthermore, the increase in the overall number of prolonged users exceeded the pace of increase of the number of countries making use of the IMF's resources. As a result, while prolonged users represented a little over 10 percent of users of IMF resources in the late 1970s, that proportion had gone up to over 30 percent in 2000, with an even higher proportion of PRGF-eligible countries (40 percent, against a little over 20 percent for GRA-only borrowers). The share of prolonged users in total resource commitments has also tended to increase over time, reaching 60 percent of PRGF resources and a little over 20 percent of general resources in 2000. (See Charts in Annex I for more details.)

Persistence of prolonged use

11. The persistence of prolonged use is substantial: almost 40 percent of countries which became prolonged users in the second half of the 1980s were still in that group in 2000, and 60 percent of countries which were prolonged users in 2000 had joined that group prior to 1995. Moreover, over 1970-2000, the average length of episodes of prolonged use was ten years, and even this indicator underestimates the eventual length since the majority of countries characterized as prolonged users were still in that category in 2001.⁹

12. Further evidence of the persistence of prolonged use is provided by the small number of "graduators", i.e. prolonged users that have ceased to make use of IMF resources. Of the 51 countries who have been prolonged users at some time between 1971 and 2000, just 12 had less than 25 percent of quota outstanding at the end of May 2002.¹⁰ It is also striking that only 15 of the 51 prolonged users did not have active arrangements with the IMF at some point in 2001-02 and this includes three countries which were in substantial arrears to the Fund and were therefore ineligible for such arrangements.

13. Another indication of the extent of prolonged use is found in Jeanne and Zettelmeyer (2001), who measure the timeframe in which IMF members eliminate outstanding obligations to the Fund—after taking account of new lending.¹¹ They find that, for developing countries, about 40 percent of all the lending cycles initiated since the creation of the IMF were not completed at end-2000, and that the average length of such "incomplete" cycles is 18 years (see Table in Annex I). Not surprisingly, the proportion of uncompleted

⁹ This average is the same in the GRA-only and PRGF eligible groups.

¹⁰ Bangladesh, Costa Rica, Egypt, El Salvador, Equatorial Guinea, Haiti, Jamaica, Korea, Latvia, Morocco, Panama and Mexico. Of these, Costa Rica, Egypt, El Salvador, Korea, and Latvia only qualify as prolonged users if precautionary programs are taken into account.

¹¹ In the absence of subsequent programs, the length of this time frame, which they call a "lending cycle", should be equal to the sum of the program and the repayment period, i.e. a maximum of 13 years for an EFF or an ESAF/PRGF arrangement and 6½ years for an eighteen-month SBA. This concept would not be entirely satisfactory as main basis for the definition of prolonged use, because it does not distinguish the respective contributions of repeat use and of the length of the repayment period (which can and has been increased by policy decisions).

lending cycles and their length is even higher for PRGF-eligible (and HIPC) countries. But they also find that 30 percent of emerging market countries¹² initiated a lending cycle prior to 1991 that was still incomplete at the end of 2000. The average length of time these countries had outstanding obligations to the IMF is about 21 years. Clearly, for these countries, IMF resources are revolving very slowly.

Prolonged use in 2001¹³

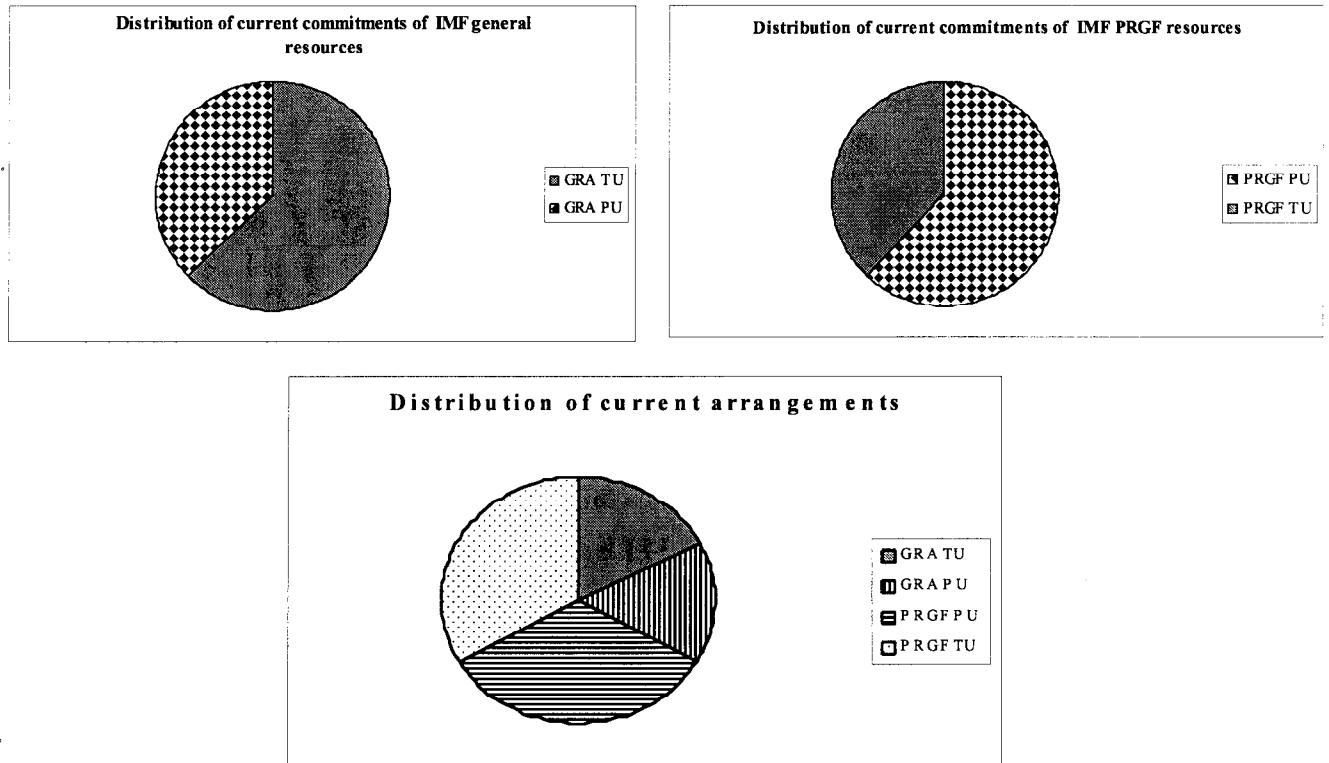
14. A look at the extent of prolonged use in 2001 using the dynamic definition suggests that the incidence of prolonged use is important for both concessional and GRA resources. The largest number of prolonged users (22 out of 31) are accounted for by countries eligible for concessional resources. However, the exposure to prolonged users in the general resources account is much larger than in the PRGF Trust Fund (SDRs 20.6 billion as against SDRs 3.5 billion).¹⁴ Within each resource category, the incidence of prolonged use varies. Prolonged users account for 62 percent of the commitments of concessional resources. The proportion of GRA commitments absorbed by prolonged users in 2001 is lower at 37 percent but this is still substantial (Chart 3).

¹² Defined by countries whose sovereign bonds are tracked in the J.P. Morgan Emerging Market Global Bond Index, which is an indication that they would normally be expected to have access to private market financing.

¹³ Data reported in this section refers to the situation as of December 31, 2001.

¹⁴ Prolonged users in 2001 (i.e. countries that had IMF arrangements for seven or more years during the previous decade) were: (i) Argentina, Bulgaria, Gabon, Jordan, Panama, Peru, Philippines, Romania, Ukraine (GRA-only borrowers); and (ii) Albania, Benin, Bolivia, Burkina Faso, Cameroon, Cote d'Ivoire, Ethiopia, Ghana, Guinea, Guyana, Honduras, Kyrgyz Republic, Malawi, Mali, Mauritania, Mongolia, Mozambique, Nicaragua, Pakistan, Senegal, Tanzania, and Uganda (PRGF-eligible members).

**Chart 3. Distribution of Current Commitments of IMF Resources
and Current Arrangements**



III. THE EVOLUTION OF THE IMF'S POLICIES WITH RESPECT TO PROLONGED USE OF ITS RESOURCES

1. This chapter describes how the IMF's policies with respect to prolonged use have evolved over time. It shows that these policies have moved gradually towards greater acceptance of the need to finance adjustment over a longer time period, especially in low-income countries, and that this has increased the probability of prolonged use. However, the implications of some of these changes both for the extent of prolonged use and possible adverse consequences may not have been fully and explicitly recognized. It also describes how some elements of a strategy for dealing with prolonged use were adopted by the IMF's Executive Board at various times; however, the country case studies and other evidence suggest that these strategies were not fully implemented.¹

A. Evolution of the IMF's View of Prolonged Use

Prolonged use of the IMF's general resources

2. The official interpretation of the mandate of the IMF was initially unambiguous on the temporary nature of its assistance, and policies on the use of Fund resources (UFR) reflected that interpretation. However, in the 1970s, it became clear that even difficulties of a "temporary" nature could require a lengthy period of adjustment and this led in 1974 to the decision to create the Extended Fund Facility (EFF). Although the EFF recognized the need for a longer adjustment period, it was nevertheless expected that the economic program supported by an extended arrangement should be "adequate for the *solution* of the member's problem".² A further step was taken in 1981, with the institution of the enlarged access policy (EAP). This policy was intended to help members address balance of payments problems whose solution required "a relatively long period of adjustment and a maximum period for repurchase longer than the three to five years under the credit tranche policies (...)."³

3. The creation of concessional facilities (the SAF in 1986 and ESAF in 1987) reflected further endorsement of the idea that the adjustment process in low income countries required an even longer timeframe than implied by the EFF. However, the creation of concessional windows for the low-income countries also paved the way for a renewed emphasis on the temporary nature of the IMF's support in other countries. Thus, when the EAP was abandoned in 1992, its features related to the longer program and repayment periods were not retained in the new access policy, unlike those related to the magnitude of access to IMF

¹ Details on the various policies referred to in this chapter are provided in Annex II.

² Decision No. 4377-(74/144). Arrangements under the EFF would be for a period not exceeding three years, to be lengthened to four where appropriate, with a repayment period of 4½ to 10 years.

³ Decision No. 6783, para. 3, 6, and 10. Purchases made under the EAP were to be repaid within seven years. This decision stressed the temporary character of the EAP, hence the requirement of annual reviews of the policy. However, the EAP was not allowed to lapse until 1992.

resources. Subsequently, in 2000, a general review of IMF facilities led to the introduction of repurchase expectations, shorter than repurchase obligations, to signal the importance attached to the temporariness of the IMF's support, along with other incentives to encourage a faster repayment of outstanding credit by members in a position to do so.

Prolonged use of the IMF's concessional resources

4. When the SAF and ESAF were created, both were originally envisaged as one-off operations to support adjustment in low-income countries with protracted balance of payments problems, during a relatively short period and with limited resources.⁴ These facilities were not only concessional but also had a less demanding adjustment requirement than the EFF: specifically, programs supported by these facilities were not required to solve the balance of payments problem fully, but only to assure substantial progress in that direction. The original decisions establishing the facilities precluded the possibility of entering into more than one three-year arrangement with any single country, largely because of the limited availability of resources to fund the facilities and the short timeframe set for the commitment period. This restriction was not entirely consistent with the recognition that the programs might not solve the problem within the timeframe. It was gradually abandoned in several steps taken between 1990 and 1997, as experience showed that the initial estimate of the timeframe needed for effective adjustment in low-income countries had proved overoptimistic, and also as more financing became available. However, the Executive Board consistently stressed that the purpose of these successive extensions *was not to provide a source of continuous financing for individual countries*, but rather to maintain the IMF's ability to respond to members' needs as they arise.⁵

5. A further step was taken in 1999, with the transformation of the ESAF into the PRGF and the close relationship established between the latter and countries' Poverty Reduction Strategy Papers (PRSPs), which are meant to provide a longer-term framework for donor support to low-income countries. This framework does not presume an extended IMF involvement but—unlike the case earlier—it does not rule it out, thus generating some ambiguity.

6. In part, this evolution reflected the understanding that the countries concerned were particularly vulnerable to exogenous shocks and were in need of continued IMF support for their macroeconomic policies. However, another factor was the growing pressure from official creditors and donors for a IMF-supported program with IMF monitoring, as a “seal of approval” for debt relief and donor support (see Chapter VI).

⁴ As under the EFF, resources were to be committed in support of a three-year program, with a repayment period of 4½ to 10 years.

⁵ Cf. Chairman's summing-up of EBM 97/5, 97/8 and 97/10.

B. Evolution of the Strategy vis-à-vis Prolonged Use

7. Each time prolonged UFR was discussed by the IMF Executive Board, Directors expressed concern not so much about prolonged use *per se*, but at the persistence of balance of payments imbalances in spite of protracted financial support from the IMF. This suggests that their primary concern was the ineffectiveness of programs in achieving sustainable BOP adjustment. In each review, various remedial measures of increasing specificity were proposed by the IMF staff and endorsed by the Board. However, the Board consistently opposed imposing fixed limits on the length or extent of reliance of IMF support, out of concern that such limits might prevent the IMF from responding flexibly to members' needs as they arose. The Board also opposed endorsing any specific operational definition of prolonged use, owing to concerns that any definition would be arbitrary and assuming that good judgment would be sufficient to identify problematic cases of prolonged use. However, in practice, very few countries were even identified as prolonged users in staff reports to the Board,⁶ which may account in part for the lack of consistent implementation of the guidelines approved by the Executive Board.

Program design elements

8. All internal reviews of prolonged UFR identified inadequate program design and weak program implementation as key factors underlying prolonged use. The remedies envisaged focused on two aspects: the nature of conditionality and the extent of access.

Conditionality

9. From 1985 onward, successive staff reports endorsed by the Board proposed dealing with prolonged use through (i) greater emphasis on prior actions and frontloading of policy measures, especially those related to past policy failures; (ii) a proactive use of conditionality—in particular, the use of more detailed conditionality covering structural aspects; and (iii) on a case by case basis, a tranching of the IMF financial support such that disbursements would be backloaded. In addition, the 1991 review recommended building policy contingencies into programs, along with IMF contingency financing if appropriate.

10. In fact, actual practice with regard to prolonged users did not correspond to the remedies suggested in the reviews (see Chapter V).⁷ Contrary to the policy directions

⁶ Based on a keyword search in the text of country reports recorded in the IMF's institutional repository, the only countries specifically characterized as prolonged, repeat or long-term users in staff reports to the Board since 1983 are: Argentina (2), Bulgaria (1), Cameroon (1), Cote d'Ivoire (1), Dominica (1), Jamaica (2), Malawi (1), Morocco (3), Pakistan (1), the Philippines (5), Senegal (1) and the FSR of Yugoslavia (1). The figure in parentheses indicates the number of reports in which the terms above are mentioned.

⁷ In assessing compliance with prolonged use guidelines throughout this chapter, for lack of a single officially recognized definition of countries to which these guidelines should be applied, we have used our own definition of prolonged use. Since it tends to be more demanding than the ones suggested by staff at the time of various reviews, it seems fair to expect that the most countries which we define as prolonged users should have been subjected to these guidelines.

endorsed by the Board, prolonged users as a group were actually subject to fewer prior actions and performance criteria, and even had slightly more frontloaded schedules of disbursement, on average, than “temporary” users.⁸ However, as discussed in Chapter V, there is little evidence that the extent of conditionality *per se*—as opposed to ensuring that it is well-prioritized and integrated into program design—was an important determinant of a program’s successful implementation. In that narrow sense, the nonimplementation of these aspects of the guidelines was probably not a major cause of prolonged use. However, that does not mean the design of conditionality is unimportant; we will return to this issue in Chapter V.

Access to IMF resources

11. The general policy on access to IMF resources adopted in 1984 and still applicable today provided that “in determining the case for further Fund support and the amount of access in those cases where members have made repeated use of Fund resources, more careful attention will be given to the past record, the design of adjustment programs and the effectiveness of their implementation.”⁹ In 1991, this policy was reinforced by making explicit that its purpose was to seek a net reduction in prolonged users’ outstanding liabilities to the IMF, through a strengthening of programs and, possibly, a greater use of arrangements involving only limited access to IMF resources, but which could serve as a catalyst in mobilizing resources from other creditors.¹⁰ Later in the 1990s, as UFR policies became more differentiated between the GRA and the ESAF/PRGF Trusts, the need to reduce access over time, even to concessional resources, was confirmed.

12. Our evaluation shows that these guidelines were not applied consistently in practice. In particular, our case studies show that the justification of the level of access proposed in staff reports was treated in a rather perfunctory manner. A broader look at the evolution of

⁸ It was not possible in the context of this study to assess on a large scale to what extent the recommendations related to contingency planning were followed, but evidence from the case studies suggests they were not. Furthermore, like the recommendations related to the use of conditionality, they do not appear to have ever been translated into actual operational guidelines for IMF staff.

⁹ EBS/84/168, Access Limits for 1985, Preliminary Policy Considerations. To some extent, this is only an adaptation to the specific case of repeat users of the general guidelines on access adopted in 1983, according to which “*the amount of the member’s outstanding use of Fund credit and its record in using Fund resources in the past must enter into the judgment on the appropriate scale of further use of the Fund*” (EBS/83/233).

¹⁰ EBS/91/108, Selected Operational Issues Related with the Use of Fund Resources. Similarly, in the 1990 Board discussion on Strengthening the Cooperative Strategy, Executive Directors had said that when there is evidence of repeated failure in program implementation, continued access to Fund resources would need stronger policy justification.

the level of access further indicates that only about one-fifth of prolonged users had a consistently diminishing access to either general or concessional resources.¹¹

Strengthened analytical and assessment efforts

13. The area of greatest consensus in dealing with prolonged users since the first time the Board reviewed the issue was the need to improve the understanding of the factors underlying a country's prolonged need for IMF resource. This was to be achieved through a two-pronged analysis:

- a review of the historical background to a member's problems and an analysis of the factors underlying its prolonged use experience at the time a new request for UFR was introduced;
- candid ex-post assessments of performance under previous programs. The need for such assessments was repeated in successive Board discussions with increasing specificity over time.

However, the case studies show that these recommendations were generally not followed. A noteworthy exception is Morocco, whose entire IMF-supported adjustment experience was reviewed in 1994 as part of that year's Article IV consultation. However, the practice was not followed for most prolonged users during the 1990s, although, as will be discussed later, somewhat more was done internally than was reported to the Board.

Exit strategies

14. As early as 1984, the IMF recognized that "frequently, despite the progress achieved during the period covered by an arrangement or a succession of arrangements with the Fund, *the amount of adjustment remaining to be accomplished at the end of the period was substantial.*"¹² Two remedies were envisaged to prevent such a situation from leading to prolonged UFR which, taken together, outlined an exit strategy from IMF lending.

Ex-ante assessments of time needed to complete the adjustment process

15. In the early 1980s, it became a standard requirement for UFR staff reports to include a medium-term scenario, in order to identify *ex-ante* cases where significant balance of payments gaps could be expected to persist over the foreseeable future. Subsequently, IMF staff was further requested to foresee a timeframe for the disengagement of the Fund,

¹¹ The trend of access broadly reflects that of members' gross financing needs, which also failed to decline consistently in a majority of cases. See Annex II for further evidence on the evolution of access.

¹² EBS/84/227, Review of Upper Credit Tranche Arrangements and some conditionality issues.

particularly when prolonged users were involved.¹³ Evidence from the case studies again suggests that this recommendation was often not followed.

Strengthened surveillance at the post-program stage

16. Surveillance has long been identified as an important instrument for promoting the sustained implementation of adjustment efforts beyond the immediate UFR period.¹⁴ “Continued policy dialogue” was actually put on a par with improved program design to contain prolonged use. This was meant to involve anything between interim article IV consultations and “shadow programs”, almost as detailed as UFR programs, but not linked to any IMF resources. This approach to safeguarding the IMF’s general resources beyond the program period received renewed emphasis in the 2000 Review of IMF Facilities, in the form of “post-program monitoring” (PPM). For concessional resources, the principle of PPM as a means of avoiding prolonged use was formally established in the early 1990s.¹⁵

17. However, few prolonged users have ceased to make use of IMF resources for longer than a simple interruption between programs and, among those that did, few went through any of the envisaged exit strategies.¹⁶

Implications for other creditors

18. A key implication of the exit strategy outlined above was that, if the IMF was not prepared to provide financial support to its members for the entire period required to achieve a sustainable balance of payments situation, other donors and creditors would have to provide the necessary financing beyond the program period. This delicate problem was recognized in 1991, when a staff report noted that: “In cases where external viability is not in reasonable prospect, the Fund will need to carefully limit further provision of its resources (...) Other creditors and sources of funds would then have to assume more of the responsibility for

¹³ EBS/91/108, Selected Operational Issues Related with the Use of Fund Resources, recommended “systematically highlighting, in staff reports accompanying requests for UFR arrangements by prolonged users, the prospects for continued need for Fund resources in the future and, where possible, indicate the time frame and circumstances in which UFR might no longer be needed”.

¹⁴ Cf. EBS/84/227, Review of Upper Credit tranche Arrangements and Some Conditionality Issues and EBS/85/265, Issues in the Implementation of Conditionality: Improving program Design and Dealing with Prolonged Use.

¹⁵ EBS/93/32, Operational Modalities and Funding Alternatives for an ESAF Successor – Preliminary Considerations. Subsequently, it was also envisaged that one option for continued IMF support for the programs of former ESAF users that ceased to have a need for IMF financing would be through precautionary arrangements, but that option was eventually not pursued.

¹⁶ Among prolonged users, the Gambia and Bangladesh went through the “enhanced surveillance” procedure in 1993/94, as did Uruguay and the FSR of Yugoslavia in the late 1980s. Ecuador had a staff monitored program in 1995/96, and the Philippines entered the PPM procedure after their last arrangement expired in 2000. In all these cases, these procedures were applied to the country after a long string of IMF-supported programs. Of these countries, Bangladesh and the Philippines are the only two which, to date, have not made further UFR.

providing appropriate financing.”¹⁷ In the event, although the Executive Board endorsed the staff’s analysis, such a sequencing of IMF and donors’ financing has largely failed to materialize, in part as a result of creditors’ and donors’ continuing to insist on an IMF lending arrangement as a “seal of approval” (see Chapter VI).

19. **In conclusion**, the evolution of IMF policies responding to changing circumstances and perceptions have contributed to the phenomenon of prolonged use of its resources in several ways. First, the evolution of the IMF’s facilities intended to address more deep-seated causes of external problems, especially in low-income member countries, clearly increased the likelihood of prolonged use, though it did not fully and explicitly recognize the potential consequences. This appears to have reflected in part differences of view within the Executive Board over what the longer-term role of the IMF should be in such cases.¹⁸ As a result, the IMF has been left with a mismatch between its core operational approach (which is still focused on promising and achieving a restoration of sustainability within a relatively short timeframe) and some of the tasks it is being asked to perform. As will be seen in subsequent chapters, this question of timeframe lies at the heart of many of the problems associated with prolonged use.

20. Second, although the Board did on various occasions approve the elements of a strategy to reduce prolonged use, this was not been systematically implemented. A contributory factor here is the absence of formal definition of prolonged use, although various proposals have been made by IMF staff. In the absence of a formal definition, there is ambiguity about whether procedures prescribed to deal with prolonged use need to be followed in particular cases.

21. Finally, questions of financing have strongly influenced the approach to prolonged use. Initially, the limited availability of funding for the IMF’s concessional facilities precluded any consideration of a long-term involvement. Subsequently, the fact that the level of aid flows was not always consistent with the intended diminished reliance of SAF/ESAF users on IMF lending implied that the IMF would have to either remain involved until a sustainable external situation could be reached, no matter how long it took; or leave the countries concerned midway in this process, with a high probability of backsliding. Both options involved some departure from the IMF’s original mandate, and the choice taken—to remain involved—while perhaps the only practical one under the circumstances, only deepened the mismatch with the IMF’s operational approach mentioned above.

¹⁷ EBS/91/108, Selected Operational Issues Related with the Use of Fund Resources.

¹⁸ The discussion in Annex II of the evolution of policies on the use of concessional resources provides further illustration of this point.

IV. CHARACTERISTICS OF PROLONGED USERS

1. This chapter describes some of the main characteristics of the prolonged users in terms of performance and key economic indicators and compares them with the characteristics of “temporary” users. Further details are provided in Annex III. Differences in performance between the two groups obviously cannot be attributed in any simplistic way to prolonged use, or vice-versa, since there are many other factors that could have influenced both economic performance and the need for prolonged use of IMF resources. Nevertheless, the comparison is relevant as a basic point of reference and points to structural features which should receive special attention in designing programs for these countries.

A. Econometric Evidence on the Characteristics of Prolonged Users

2. Although there is a growing empirical literature on IMF-supported programs, very few studies have explicitly addressed issues related to prolonged or repeated participation in such programs.¹ One study that examined “recidivism” in the participation of IMF arrangements, *Bird, Hussain, and Joyce (2000)*, found, among other results, that repeated participation was associated with: (1) lower levels of international reserves; (2) larger current account deficits; (3) larger debt service ratios; (4) lower per capita income; (5) lower investment rates; and (6) weaker governance. Another study which modeled the duration of participation in programs, *Joyce (2001)*, found the duration of program “spells” to be inversely related to per capita income, and positively associated with export concentration in primary goods and being landlocked.

3. Drawing on the above literature, we have attempted to isolate possible factors associated with prolonged use by estimating a series of probit regressions using various economic and institutional characteristics as explanatory variables. Two alternative definitions of “prolonged use” were employed in these exercises—one “fixed” and the other “dynamic.”² While some of the results were not statistically significant and they do not prove anything about the direction of causality, the main finding was that prolonged use was associated with lower levels of international reserves and higher debt service ratios (see Annex III for details). To the extent that prolonged use reflects persistent external sector problems, these associations are not surprising. There was also some evidence that a measure of the (higher) quality of the civil service was associated with less prolonged use.

4. There were some notable differences in the results for PRGF-eligible and non-eligible countries. With the fixed definition of prolonged use, the results appeared to be driven entirely by PRGF-eligible countries; within this group, prolonged use also appears to be

¹ Studies that have examined factors that induce countries to seek IMF arrangements have also highlighted variables related to the external sector as well as growth performance. For example, Knight and Santaella (1997), and Barro and Lee (2002).

² As explained in Chapter I, the “fixed” definition classified a country as a prolonged user if it had IMF arrangements in seven out of any ten year period during 1971-2000. The “dynamic” definition which was employed in a panel probit regression framework classified a country as a prolonged user in a particular five year period if it had IMF arrangements in 7 or more years during that and the preceding five-year period.

associated with lower per capita GDP.³ When the analysis was limited to the 35 countries in the sample that were not eligible for the PRGF, none of the explanatory variables used proved to be significant. With the dynamic definition, the differences between countries eligible for the PRGF and those not eligible were not as marked, but the same broad conclusions applied.

B. Some Comparisons Between Prolonged and “Temporary” Users

5. A comparison of starting conditions, underlying characteristics, and economic trends during 1971-2000 between prolonged users (identified on the basis of the fixed definition) and “temporary” users suggests that, as a group, prolonged users had some distinctive features although such differences cannot produce conclusive evidence on causal relationships. Details are provided in Annex III, but the main results are:

- Prolonged users’ economic conditions prior to the start of their prolonged use episode were generally characterized by larger imbalances than the “temporary” users that contemporaneously entered into IMF-supported programs in at least three respects: they had larger external debt stocks relative to GDP, larger current account deficits, and larger overall fiscal deficits.⁴
- Turning to trends in the 1971-2000 period, prolonged users were characterized by:
 - lower export growth (in low-income countries only); more volatile terms of trade; lesser degree of trade openness (particularly for middle-income countries) and a higher concentration of exports on primary commodities (particularly for low-income countries);
 - lower and more rigid government expenditure, owing to the weight of higher defense and interest expenditure (the former characteristic being more marked in middle-income countries and the latter more marked in low-income countries);
 - lower tax revenues relative to GDP (particularly for middle-income countries) and a higher public debt burden;
 - heavier external debt and debt service burden up to the 1990s, leading to a much more frequent recourse to debt rescheduling agreements with creditors—which suggests that creditors’ need for the IMF’s seal of approval may have been a factor contributing to prolonged use;
 - greater political instability;

³ Some of the other characteristics included in the regressions were: real GDP growth, current account balance (in relation to GDP), openness, share of primary exports in total exports, and volatility in the terms of trade.

⁴ The difference between prolonged users and “temporary” users is statistically significant as regards the external debt to GDP ratio, but the other differences were not statistically significant at the 5 percent level.

- in terms of trend macroeconomic performance, there were no major differences in inflation between the two groups over the period. For much of the period, the group of countries defined as prolonged users grew at a slower pace, but there were exceptions (e.g. among the low-income countries, the group of prolonged users appear to have grown faster on average in the 1990s than the group of “temporary” users). However, it is difficult to interpret such results without addressing the issue of the endogeneity of access to IMF resources.⁵ This issue is addressed in Chapter V.

6. Not surprisingly, in light of the greater preponderance of high debt and debt service burdens, Paris Club debt rescheduling agreements were much more frequent for prolonged users: among low-income countries, 93 percent of prolonged users had to negotiate a debt treatment with the Paris Club at some point over 1971-2000, against 61 percent for “temporary” users. Among middle-income countries, these proportions are respectively 100 percent and 28 percent. Moreover, prolonged users typically needed a larger number of debt treatments than “temporary” users (Table 3). Indeed, in many cases, the need for these reschedulings may have been one of the critical factors explaining prolonged use. As the discussion in the case studies illustrates, the evolution of the international community’s approach to the debt crises of the 1980s (in the case of the Philippines) and to the workout of the debt problems of highly indebted poor countries (in the case of Senegal) itself had a major influence on the length of the IMF’s program involvement.

Table 1. Average Number of Paris Club Debt Treatments Per Country Over 1971-2000¹

	1971-80	1981-90	1991-2000	1971-2000
Prolonged users	0.3	3.0	2.4	5.3
“Temporary” users	0.2	1.3	1.5	2.9

1/ For countries with at least one Paris Club debt treatment over 1971-2000.

C. Overview of Characteristics of Case Study Countries

7. Among the three countries chosen as cases studies, Pakistan and Senegal are broadly representative of the group of PRGF-eligible prolonged users, while the Philippines has the main characteristics of prolonged users of the Fund’s general resources.⁶ In particular, all three countries are characterized, like most prolonged users, by (i) relatively low tax revenue to GDP ratios and a rigid structure of expenditure. This was especially true for Pakistan but less so for Senegal, in comparison with other low-income prolonged users; (ii) low trade to exports ratios and a relatively weak growth of exports (except the Philippines), and an

⁵ For example, a number of PRGF-eligible countries were probably “temporary” rather than prolonged users because they encountered periods of severe political disruption and conflict that made it difficult to access IMF resources on a consistent basis. Such factors would also obviously affect their growth performance.

⁶ Detailed statistics comparing the three countries with their respective control groups for the various indicators discussed in the previous sections are provided in Annex III.

initially high concentration of exports on primary products (except in Pakistan), as well as very low international reserves; and (iii) adverse political characteristics, with Pakistan and the Philippines suffering primarily from political instability and a lack of political cohesion, and Senegal primarily affected by ethnic fractionalization.

8. Against this background, a few specific features are worth noting:⁷ (i) in terms of growth and correction of macroeconomic imbalances, Pakistan generally performed better than the group average until the 1990s, after which its performance was worse, while Senegal's stop-go pattern of adjustment is reflected in an above average growth performance with lower adjustment in the 1980s, while the opposite was true in the 1970s and 1990s;⁸ (ii) the Philippines enjoyed a favorable position with respect to trade indicators, but was handicapped by a high external debt to GDP ratio; (iii) overall, Pakistan's structural problems, as revealed by the indicators discussed above, appear to have been among the deepest of the group, whereas they were close to the average of prolonged users in the Philippines, and somewhat milder than average in Senegal.

9. While, technically, it should have been possible to take account of these characteristics in the design of IMF-supported programs in these countries, evidence from the case studies, discussed in more detail in the country notes in the companion volume, suggests that this has not always been the case. For instance, greater attention to the considerable rigidity of expenditure in all three countries, particularly in Pakistan, might have given a hint that as rapid a reduction of the fiscal deficit as was targeted would be very difficult to achieve in a sustainable manner. Moreover, as will be discussed in the next chapter, although programs repeatedly targeted higher tax/GDP ratios, the deeper institutional reforms necessary for sustainable gains in this area proved hard to achieve.

10. Bearing in mind the limited statistical significance of the differences observed between prolonged and temporary users in the cross-section analysis and the difficulties of knowing how representative are the more detailed analyses in the case studies, the characteristics highlighted do suggest some messages for designing programs in prolonged users. For example, the generally weak records of export and tax revenue growth suggest that it is important to be especially careful to avoid building programs around projections of rapid growth in exports and tax revenue, unless a solid case can be made to proceed otherwise. Likewise, when designing a fiscal adjustment package, enhanced due diligence should be applied to the analysis of the structure of expenditure, in particular with a view to assessing its rigidity and ensuring that the targeted reductions can be achieved in a manner that is both sustainable and consistent with long-term growth.

⁷ Data on the evolution of key economic variables for the three countries is provided in Table 1 of Box 1 in Chapter V.

⁸ In the 1990s, however, a distinction must be made between the pre- and post-devaluation period. Growth was significantly higher in the latter period (i.e. from 1994 onwards).

V. PROLONGED USE AND EFFECTIVENESS OF IMF-SUPPORTED PROGRAMS

1. Since UFR policies have been designed at least to contain, if not entirely avoid, prolonged use, the pervasiveness of the phenomenon raises questions about the effectiveness of IMF-supported programs in prolonged user countries. This chapter examines this issue at two levels. In Part A we examine available evidence from cross sections of countries to see whether there are any differences in program design or implementation between prolonged and temporary users and what can be learnt about the impact of IMF-supported programs on growth and adjustment in a prolonged use context.¹ In Part B we focus on lessons that can be drawn from our case studies (Pakistan, Philippines, Senegal, Morocco, and Jamaica) and from responses to IEO questionnaires sent to authorities in prolonged user countries and to IMF staff.² Some of the issues that have surfaced from our investigation, especially from the case studies, are of general relevance for program effectiveness and not exclusive to prolonged users.

A. Results from Cross Sectional Evidence

Cross-country evidence on the effects of prolonged use

2. The empirical literature on the effects of IMF-supported programs (see Haque and Khan, 1998) has produced widely varying results depending upon the time period covered and the methodology for estimation. The more recent studies using the so-called general evaluation estimator all suggest that programs contribute to improvements in the current account balance and the overall balance of payments, but the evidence with respect to the impact on growth is mixed.³ Goldstein and Monteil (1986) and Khan (1990) found negative effects on growth. Conway (1994) finds that initial negative effects on growth are offset by subsequent positive growth rates. However, Przeworski and Vreeland (2000), using a broadly similar approach, find significantly negative and persistent effects on growth. A recent study, Barro and Lee (2002), which used a different (instrumental variable) approach to take account of the endogeneity problem, concluded that while programs do not have a significant contemporaneous effect on growth, they do have a lagged effect which is negative.

3. Not only are the results from the existing literature mixed, as summarized above, they do not distinguish between prolonged and temporary user cases. To explore this distinction we requested Professor Lee, one of the co-authors of Barro and Lee (2002), to extend their

¹ The cross-country results discussed in this section all use the same basic definition of prolonged use set out in Chapter II. Since the time periods covered by the various databases differ, the precise group of countries that are defined as prolonged users varies depending upon that time period. However, because prolonged use is highly persistent over time, the population of prolonged users does not vary greatly over time and the results do not seem very sensitive to this factor.

² The questionnaire sent to prolonged users is shown in Annex V.

³ For a survey of the literature, see Haque and Khan (1998). A significant recent development is Barro and Lee (2002).

analysis so as to consider whether “prolonged use” has an effect on growth that is distinguishable from that associated with “temporary use.”⁴ While the methodological problems are complex and hard to resolve entirely, the results, reported more fully in Annex IV, suggest the following:

- Programs have significant negative contemporaneous and lagged effects on growth in prolonged users, but no significant effect on growth in temporary users.
- Limiting the sample to only GRA arrangements, strongly negative contemporaneous and lagged effects on growth are found in prolonged users but not in temporary users.
- When only concessional facility arrangements are considered, there is a negative contemporaneous effect on growth which is more than offset by a positive lagged effect in the case of prolonged users, but there is no significant lagged effect in the case of temporary users.

4. From these results, it would appear that IMF-supported programs in the case of prolonged users have adverse consequences on growth in the case of programs supported by GRA resources but not programs based on concessional resources. However, as noted above, previous exercises that have attempted to assess the impact of IMF-supported programs on growth have come to very different conclusions and it appears that the results can be sensitive to variations in approach and sample size. The difficulties in identifying the independent impact of prolonged involvement in IMF-supported programs are likely to be even greater.

5. It is useful to consider whether there are any substantial differences between the extent of adjustment achieved in prolonged and “temporary” users’ programs, although similar methodological difficulties apply. We have used the World Economic Outlook database to examine this issue.⁵

6. In stand-by arrangements, prolonged users achieved a somewhat larger adjustment in the current account than “temporary users,” but the extent of adjustment of the overall public sector balance was slightly smaller in the group of prolonged users (Table 1).⁶ However, the results suggest that the shortfalls from the targeted fiscal adjustment—discussed in greater

⁴ We also requested that he expand the coverage of the earlier Barro and Lee (2002) analysis to include arrangements under concessional facilities.

⁵ Since the IMF’s internal (MONA) database on programs has incomplete information on outcomes and the coverage of the WEO database is different in several respects, it is not possible to make a systematic direct comparison of outcomes and program targets, as discussed below.

⁶ None of the differences reported in this section are statistically significant. The usual caveats about inferring causality apply.

detail below—were greater in the case of the group of prolonged users. Fiscal adjustment in prolonged user countries, on average, does not appear to have involved any reduction in government expenditure as a percentage of GDP.

7. In medium-term arrangements, prolonged users achieved a markedly smaller adjustment of both their current account and fiscal balances over the three-year period. Once again, the differences in the extent of fiscal adjustment are accounted for by a much lower reduction in government expenditure in the group of prolonged users. These differences are largely at odds with those found between adjustment targets (see below), except for the relative sizes of fiscal adjustment.

Table 1: Actual Change in Key Variables¹
(Average annual changes in percent of GDP)

	Prolonged users		Temporary users	
	SBA	Multi-year arrangements	SBA	Multi-year arrangements
	(T-1) to (T+1)	(T-1) to (T+3)	(T-1) to (T+1)	(T-1) to (T+3)
Overall public sector	0.75	1.43	1.07	2.36
Balance				
Central government	1.43	0.79	0.38	0.12
Revenues				
Central government	0.34	-0.70	-0.58	-2.52
expenditures				
Current account balance	0.97	1.21	-0.30	3.56

1/ T refers to the year of approval of the arrangement. Because the data on outcomes is drawn from the WEO database, definitions and sample size differ from those used in Table 4, making direct comparisons difficult.

Cross-country evidence on program design and implementation

8. We begin with documenting whether IMF-supported programs with prolonged users differ from those with “temporary” users with respect to five characteristics: the extent of overoptimism of growth targets; the extent of targeted adjustment and outcomes; the nature of conditionality; degree of implementation; and size of “Fund effort”.⁷ A variety of databases, covering different time periods, are used.

⁷ It should be borne in mind that whatever specificities of prolonged users this analysis reveals may reflect a variety of factors and that there is no proven causal relationship with prolonged UFR.

Projections for exports and real GDP growth⁸

9. A comparison of medium-term program projections and outcomes in ESAF-supported programs is presented in Table 2. It shows that projections for exports were greatly overoptimistic for prolonged users but not for temporary users.⁹ Projections for real GDP growth were generally too optimistic for both prolonged users and temporary users. A comparison of the year-by-year differences suggests that the errors in projections for prolonged users' real GDP growth are greater in later years of multi-year programs than in the first year.

Table 2. Optimism of Real GDP and Export Projections in ESAF Programs 1/

	Prolonged Users		Temporary Users	
	Mean	Median	Mean	Median
Merchandise export growth				
Outturn	7.4	5.8	17.2	13.6
Projected	10.5	9.9	12.5	12.5
Real GDP growth				
Outturn	3.5	3.7	4.2	5.4
Projected	4.1	4.0	5.0	4.7

1/ Average annual growth in percent for years t to t+4, where t is the year in which the program started.

10. Programs supported by arrangements using general resources (GRA) typically include projections for a much shorter period. A comparison was only possible for real GDP growth projections covering the initial program year, drawing upon the database used by Musso and Phillips (2002).¹⁰ Again, the results suggest short-term projections of real GDP growth were optimistic for both prolonged and "temporary" users but the overoptimism was

⁸ The analyses of ESAF-supported programs in this section is based on the database on medium-term program targets and outcomes prepared by PDR for the 1997 ESAF Review. More recent data were not available on a consistent basis for use by the IEO. The analysis of GRA-supported programs is based on the database used by Musso and Phillips (2002), which draws on the MONA database and covers 69 programs in 47 countries during 1993-97. The latter database excludes precautionary and SAF/ESAF programs. For purposes of the analysis, countries are defined as prolonged users if they met the definition used in this evaluation either at the beginning of the program included in the database, or if the program in question subsequently contributed to their classification as a prolonged user.

⁹ In neither case, however, is the bias statistically significant, given the large variability of both projections and outturns for exports.

¹⁰ The study looks at projections for the current calendar year when a program is approved more than three months before the end of the year, otherwise for the following year. Thus, the effective length of projections varies between three and fifteen months.

actually greater in the latter case (Table 3).¹¹ The substantial differences between the median and mean errors suggests that a few, relatively large errors on the downside affected both temporary and prolonged users.¹² The Musso and Phillips data base does not include export growth, making it difficult to compare projections with outcomes in this dimension in GRA cases.

Table 3. Accuracy of Short-Term Projections for Users of General Resources¹

	Prolonged Users		Temporary Users	
	Mean	Median	Mean	Median
Real GDP growth				
Outturns	1.7	3.9	-0.9	0.2
Projected	2.4	3.4	0.2	-1.0
Difference 1/	-0.7	0.0	-1.1	-0.4

1/ The median of the differences is not necessarily equal to the difference of the respective medians.

These results suggest that programs with prolonged users under concessional facilities do have a tendency to be overoptimistic about medium-term export growth, which may have implications for program design. There also appears to be some overoptimism in projections of real GDP growth in programs under both GRA and concessional facilities, but in this case the overoptimism does not appear to be systematically related to the phenomenon of prolonged use.

The magnitude of targeted adjustment

11. The strategy for dealing with prolonged use set out by the IMF's Executive Board called for more "frontloaded" adjustment in such cases. It is, therefore, relevant to ask whether programs with prolonged users targeted greater adjustment in the external current account or fiscal deficit than other cases and whether they were more frontloaded. Because of limitations in the available IMF databases on programs, it is only possible to answer this question for the period since 1993.¹³

12. There are marked differences between prolonged and "temporary" users' programs concerning the extent of targeted fiscal adjustment and the current account adjustment but the

¹¹ This result contrasts somewhat with the evidence from the Musso and Phillips study that "follow-up" programs have a larger bias in growth projections than other programs in their sample. "Follow-up" programs are defined as new programs for which there was some form of IMF arrangement active in the preceding year. This is because in the Musso-Phillips sample, a large number of countries that had one (immediate) follow-up program did not go on to be "prolonged users" under the definition used for this study.

¹² Among prolonged users, the programs with substantial overoptimism about GDP growth included Mexico (1995), Bulgaria (1996), and Romania (1997).

¹³ The analysis in this section draws upon the IMF's MONA database which has comprehensive data on program targets only for the period since 1993 and has incomplete data on outcomes. Therefore, the group of prolonged users for the purposes of the analysis of this subsection refers to those countries that either were prolonged users in 1993 or became prolonged users subsequently.

pattern differs between stand-by and multi-year arrangements.¹⁴ In stand-by arrangements, prolonged users' programs targeted a somewhat larger average adjustment of the overall public sector deficit than temporary users' programs (2½ percentage points of GDP compared to 2 percentage points) (Table 4). However, if we focus on the change in the primary balance of the central government as the relevant measure of adjustment effort, the targeted fiscal adjustment in prolonged users on average (1.8 percent of GDP) was much lower than that in the case of temporary users (3.3 percent). Prolonged users' programs supported by SBAs were also characterized by a higher share of the targeted fiscal adjustment expected to come from increased revenues, with much lower cuts in primary (i.e. non-interest) expenditure. While the data on outcomes, discussed earlier, is not strictly comparable, it suggests that prolonged users actually achieved less fiscal adjustment, with no expenditure reduction. The external current account adjustment required of prolonged users in SBAs was also much lower than in the case of temporary users.

Table 4: Targeted Change in Key Variables
(Average annual changes in percent of GDP)

	Prolonged users				Temporary users			
	SBAs	Multi-year arrangements			SBAs	Multi-year arrangements		
	(T-1) to (T+1)	(T-1) to (T+1)	(T-1) to (T+3)	Share of frontloading ¹	(T-1) to (T+1)	(T-1) to (T+1)	(T-1) to (T+3)	Share of frontloading ¹
Overall public sector balance ²	2.5	1.59	2.92	54	2.0	1.95	3.57	55
Central govt. revenues	1.55	0.28	0.68	42	1.2	0.92	1.3	71
Central govt. total expenditure	-0.78	-0.93	-2.02	46	-2.05	-1.13	-2.02	56
Primary central govt. balance ²	1.79	0.81	1.92	42	3.29	1.85	2.49	74
External current account ²	0.09	1.07	3.18	34	0.62	1.25	3.31	38

T refers to the year of approval of the arrangement.

1/ Targeted adjustment in the period T-1 to T+1 as a proportion of the targeted adjustment over the period T-1 to T+3.

2/ Positive number implies an improvement in the balance.

13. In the case of multi-year arrangements, the magnitude of fiscal adjustment required from "temporary" users was higher than from prolonged users whether one looks at the overall balance or the primary balance.¹⁵ In both cases the primary expenditure contraction expected was similar but the magnitude of the revenue effort from temporary users was much larger. Unlike in SBAs, the extent of current account adjustment in the multi-year programs was of the same order for prolonged users as for temporary users. In effect, the fiscal

¹⁴ None of the differences discussed here are statistically significant at the 5 percent level, due to very large variations within each group.

¹⁵ As noted earlier, the actual fiscal adjustment achieved by prolonged users in multi-year arrangements was also smaller.

adjustment was targeted to play a much larger role in bringing about adjustment in the temporary users than in the case of prolonged users.

14. An important difference between prolonged and “temporary users” in multi-year arrangements is that the targeted adjustment in all the variables was **more** frontloaded in programs with “temporary” users, particularly as regards revenue increases and primary expenditure cuts. This is contrary to what might have been expected given the guidelines on prolonged use.

*The extent and nature of conditionality*¹⁶

15. For the purposes of this study, conditionality can be classified into two types: “hard” and “soft”.¹⁷ Hard conditionality consists of prior actions (PA) and performance criteria (PC) both of which are conditions which the country must meet in order to have access to the IMF resources under a program.¹⁸ “Soft” conditionality consists of all the elements which are taken into account by the IMF in forming a judgment about whether or not to “complete” a review, which triggers the release of a financing tranche. It might include structural benchmarks, indicative targets, or general undertakings in the authorities’ letter of intent,¹⁹ sometimes expressly identified as elements that will be subject to reviews.

16. Available cross-country data summarized in Table 5 indicates that, on average, conditionality in arrangements with prolonged users typically had fewer formal structural conditions than arrangements with “temporary” users, regardless of the type of arrangement.²⁰ Moreover, most of the cases with very heavy use of structural conditionality

¹⁶ The findings of this section are based on two databases: one, assembled by PDR for the 2001 Review of Fund Conditionality, is focused on structural conditionality and covers all IMF-supported programs over 1987-2000. The other database was assembled for an internal research project on the determinants of the effectiveness of IMF-supported programs, whose findings are reported in Ivanova et al (2001). It covers all conditionality contained in the approximately 170 arrangements approved between 1992 and 1998. The two datasets yield broadly similar conclusions even though they cover different periods.

¹⁷ This classification of “hard” and “soft” conditionality is not one used formally by the IMF and it refers only to the form of conditionality, not to the strength of the underlying measure.

¹⁸ However, they differ in the sense that prior actions are often imposed before the approval of an arrangement, whereas PCs are specified in the arrangement itself and only apply to subsequent disbursements. Prior actions linked to subsequent reviews rather than the program’s initial approval, are sometimes referred to as “conditions for the completion of a review.” Until 2000, PAs were generally not specified in the text of Executive Board’s decisions, which gave them a certain degree of informality (along with a lack of transparency). In both cases, the country may be granted access to the IMF’s resources even though not all conditions have been met, but in the case of PCs, this will require a decision by the Executive Board granting a waiver, whereas for PAs, a judgment from management that a critical mass of measures has been taken would suffice.

¹⁹ However, not all general undertakings in the authorities’ letter of intent qualify as conditionality strictly speaking.

²⁰ When transition countries are excluded from the sample, all the means reported in the table decline, and differences between prolonged and “temporary” users became somewhat smaller. However, the thrust of the

(continued)

did not involve prolonged users; many involved the transition economies. For example, only four of the seventeen programs which had more than ten prior actions per program-year in the 1990s involved prolonged users—although Pakistan was one of these cases.

Table 5: Average Number of Structural Conditions per Program-Year (1987-2000)

	Total conditions ¹		Benchmarks		Prior actions		Performance criteria	
	Prol. Users	Temp. users	Prol. users	Temp. users	Prol. users	Temp. users	Prol. users	Temp. users
All arrangements	6.5**	9**	3.6	4.8	1.6*	3.1*	1.0	0.8
ESAF / PRGF	8.4	10.1	5.5	5.8	1.0*	2.8*	1.7	1.5
SBA and EFF	4.9**	8.5**	1.8**	4.4**	2.1	3.3	0.5	0.6
Memorandum items								
Pakistan		10.4		4.9		0.8		4.7
Philippines		2.2		0		0.8		0.2
Senegal		7.1		4.7		0.1		2.3

Source: MONA database. ** indicates that the difference between both means is statistically significant at the 1 percent level and * at the 5 percent level.

1/ Differences between total conditions and the sum of the other three categories are accounted for by “review” conditionality. The difference is particularly large in the case of the Philippines.

17. Not only was structural conditionality less extensive in prolonged users, but the evidence also suggests that it was “softer”—at least in the narrow sense discussed above.²¹ In both prolonged and temporary users’ arrangements, the largest part of structural conditionality was of the “soft” kind (mostly structural benchmarks). However, arrangements with prolonged users had fewer prior actions, especially in the case of arrangements under concessional facilities.

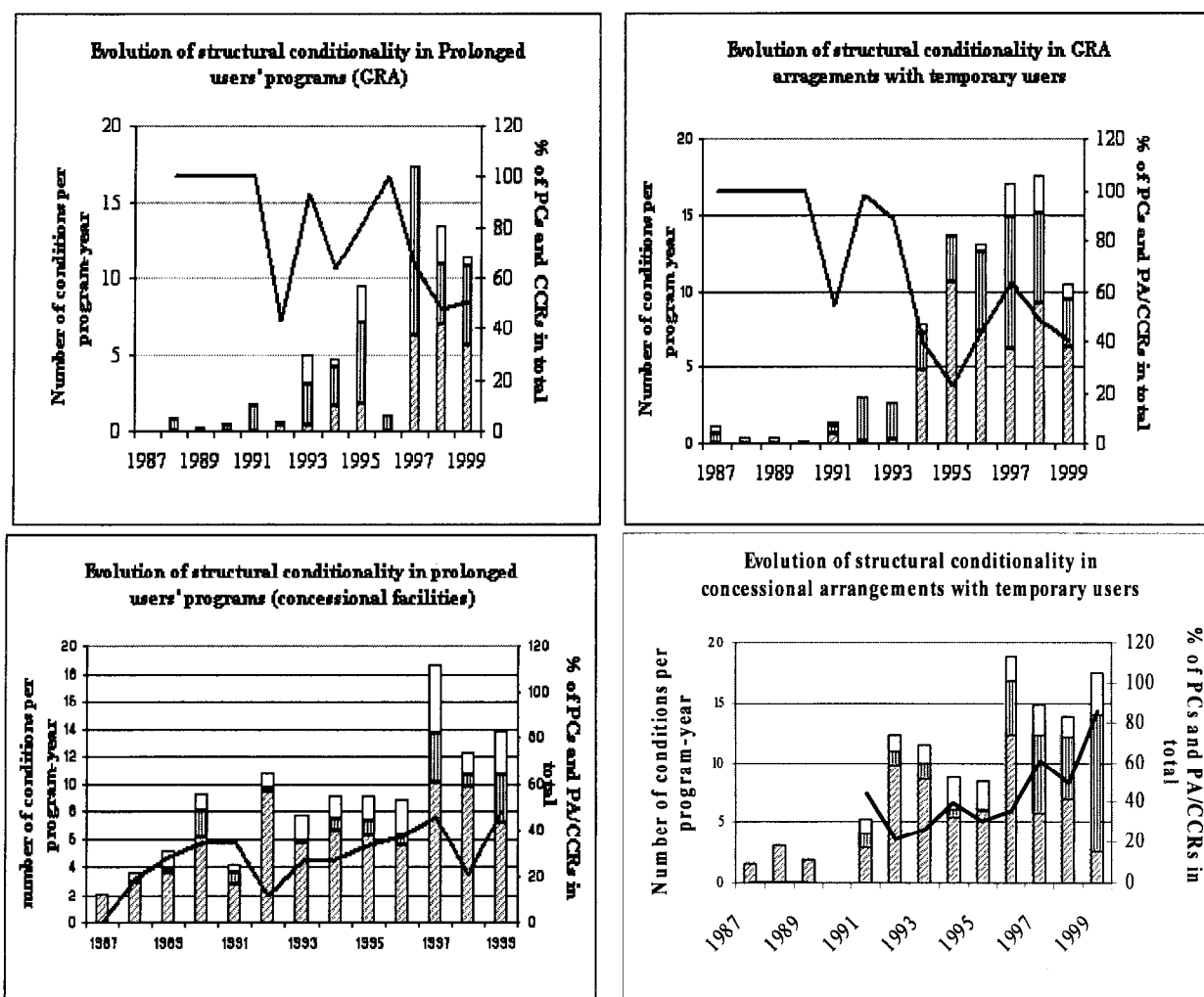
18. A distinctive feature of GRA arrangements with prolonged users was the comparatively large share of conditions to be appraised by program reviews in total conditionality (10 percent against 5 percent or less in all other cases), which gave the IMF more room for discretion in assessing the progress in structural reforms than other forms of conditionality. For example, the Philippines’ programs came to rely almost exclusively on reviews in implementing structural conditionality because the political system made it hard for the government to commit to a specific timetable for passing measures through Congress. As the discussion in the Philippines case study illustrates, the tradeoff for the greater flexibility and discretion of reviews was less certainty about the timing of disbursements, the content of policies, and pressures to “renegotiate the program at each review”.

comparison remains the same, with the exception of total conditionality in ESAF/PRGF arrangements, which was marginally higher for PUs than for TUs.

²¹ Among the case study countries, Pakistan was an exception.

19. Structural conditionality also tended to get heavier and more constraining over time, but that tendency affected both prolonged and temporary users' programs, and there are no indications that the trend was stronger in the case of the former (cf. Chart 1 below).

Chart 1. Evolution of Structural Conditionality in IMF-Supported Programs



20. The evidence suggests that macroeconomic conditionality was also more abundant in arrangements with “temporary” users than in those with prolonged users.²² In GRA arrangements, there were on average 31 macroeconomic conditions per program-year for prolonged users, and 35 for “temporary” users, probably reflecting a higher frequency of reviews in the latter arrangements. In ESAF arrangements, these numbers were respectively 10 and 13. Both results suggest that there was not closer monitoring of performance under programs with prolonged users.

Differences in program implementation

21. Assessing performance in terms of implementation presents problems since any single measure is inherently arbitrary. Table 6 presents six different measures of the extent of implementation. They show that, taking all arrangements together, prolonged users’ programs are more subject to interruptions, both “minor” and irreversible. However, disaggregating into programs supported by GRA resources and those supported by concessional resources, we found that prolonged users as a group suffer from such interruptions more frequently than “temporary” users only for GRA-supported programs. Prolonged users score somewhat better than temporary users in terms of overall implementation while the program is on track,²³ which in the case of GRA-supported program might suggest greater difficulties to sustain their efforts.

22. In theory, these two findings could reflect either a higher propensity of prolonged users to encounter serious policy slippages, or a more rigid stance of the IMF in appraising whether a given slippage can be corrected (and thus whether a waiver of the missed PC is warranted). However, the data indicates that prolonged users, particularly in GRA programs, were granted waivers on a slightly larger proportion of their structural PCs than “temporary” users, whereas there is almost no difference between the two groups as regards waivers of quantitative PCs (Table 7).²⁴

²² Data on macroeconomic conditionality suffers from various availability and reliability problems, which limits the robustness of any conclusions. While initial observations by PDR, based on a small sample of arrangements, suggested that the total number of macroeconomic conditions (i.e. target values for key macroeconomic aggregates presumed to be under the control of the authorities) per test date varied little from program to program, the data collected for the Ivanova paper, which is reported here, does shows significant variations, perhaps capturing differences in the frequency of test dates (this is because a macroeconomic indicator monitored, for instance, on a quarterly basis will count as four conditions during a year).

²³ Existing data resources do not allow to track conditionality implementation in programs that go off-track and the indices reported here do not incorporate any measure of actual completion of programs. To that extent, they are biased towards overstating actual policy implementation.

²⁴ However, when the Ivanova et.al. (2001) database is used to determine the percentage of macro PCs waived, a noteworthy difference surfaces in ESAF/PRGF arrangements, where 17 percent of PCs were waived for prolonged users, against 12 percent for temporary users. It may be recalled that the Ivanova database, unlike the one used in Table 7, reports the actual number of macro PCs in programs instead of approximating them based on the number of test dates.

Table 6. Selected Data on Program Implementation (1992-1998)

	Percent of arrangements with at least one minor interruption ¹	Percent of arrangements seriously interrupted ²	Percent of committed funds disbursed ³	Average macro implementation index ⁴	Average structural implemen- tation index ⁴	Average overall implemen- tation index ⁴
All arrangement types						
Prolonged users	72	47	77	81	68	77
“Temporary” users	68	39	76	82	67	75
ESAF arrangements						
Prolonged users	66	44	80	77	73	74
“Temporary” users	88	46	82	78	69	72
GRA arrangements						
Prolonged users	77	49	74	84	62	80
“Temporary” users	61	36	74	83	67	77
Memorandum items						
Pakistan	100	83	47	88	79	83
Philippines	100	50	77	88	68	86
Senegal	100	33	88	90	71	85

Source: Ivanova et al (2001) database.

1/ A minor interruption is defined as a delay of over 3 months for the completion of an SBA review or noncompletion; or a delay of over 6 months for the completion of an ESAF/PRGF review or non completion; or an interval of more than 6 months between two annual arrangements in a multiyear program; or the nonapproval of at least one annual arrangement in a multi-year program.

2/ An irreversible interruption occurs if either (i) the last schedule program review was not completed (all program types); or (ii) all scheduled reviews were completed but the subsequent annual arrangement was not approved (ESAF/PRGF arrangements only).

3/ Not including precautionary arrangements.

4/ The implementation index is equal to 100 if the condition is met or met after modification, 50 if met after a substantial delay (for structural conditions only) and 0 if not met, waived, or not met after modification.

Table 7. Use of Waivers (1987-2000)*

	Number of waivers granted per program-year					Percentage of PC waived	
	Total	QPC+SPC	QPC	SPC	CPC	SPC/tot	QPC/tot
“Temporary” users	1.3	1.0	0.7	0.3	0.3	25	2.7
PRGF-eligible average	1.6	1.4	0.9	0.5	0.2	25	4.5
GRA-only average	1.1	0.8	0.6	0.2	0.3	25	2.1
Prolonged users	1.2	1.1	0.7	0.4	0.1	29	2.9
PRGF-eligible average	1.3	1.2	0.7	0.5	0.1	27	4.4
GRA-only average	0.9	0.8	0.6	0.2	0.1	33	2.1
Memorandum items							
Pakistan	1.4	1.2	0.6	0.6	0.2	10	NA
Philippines	0.8	0.7	0.7	0.0	0.1	0	3
Senegal	1.2	0.7	0.5	0.2	0.5	6	NA

Source: PDR database on waivers.

QPC: quantitative performance criteria; SPC: structural performance criteria; CPC: continuous performance criteria

* not including waivers of applicability

23. According to IMF internal guidelines, waivers are to be used to deal with minor deviations from agreed targets, considered to be of a temporary or reversible nature. The fact that prolonged users had more of both program interruptions and waivers suggests that, in their case, waivers were more often followed by program interruptions, which might indicate that a higher proportion of waivers granted to prolonged users turned out, in hindsight, to be unwarranted.²⁵ This could be either because the IMF had a higher tolerance threshold regarding the magnitude of deviations waived for prolonged users or because the corrective actions implemented were more frequently insufficient.

²⁵ This is only a conjecture, since it is possible that program interruptions were caused by factors totally unrelated with the waived conditions. Only a case by case analysis would allow firm conclusions to be drawn. However, the case studies suggest that the waivers were often related to significant policy slippages. For example, according to the decisions, none of the waivers granted to Pakistan or the Philippines since 1983 were motivated by exogenous shocks or technical reasons. By contrast, two of the three waivers on QPCs granted to Senegal were motivated by exogenous shocks. This contrast is consistent with the differences noted between GRA and ESAF arrangements in this respect. The five waivers on QPCs (along with two others on SPCs) granted to Pakistan at the second review of its SBA in December 1996 are an example of waivers granted in the face of major policy slippages. The program fell apart soon after.

24. Even though prolonged users of ordinary resources were more prone to serious program interruptions, a similar proportion of funds committed got disbursed in their arrangements. This reflected a somewhat more frontloaded pattern of disbursements for prolonged users—which was not consistent with the strategy for prolonged use established by the Board.²⁶

25. These findings are broadly consistent with recent internal reviews of the modalities of conditionality, which concluded that (i) there was no clear relation between the volume or modalities of conditionality (in particular the quantity of prior actions) and the probability of success of an IMF-supported program and (ii) waivers had been predominantly used to address significant policy slippages, not—as they were originally intended—minor/technical factors or exogenous developments. They also suggest that the IMF’s practice with respect to prolonged users has not been wholly consistent with the guidelines calling for more intensive monitoring of programs in prolonged use cases (see Chapter III).

Differences with respect to IMF staff inputs²⁷

26. We find that arrangements with prolonged users were less resource intensive than those with “temporary” users, but staff turnover was high for both groups. Details are provided in Annex VI.

27. Arrangements with “temporary” users were actually more mission intensive than arrangements with prolonged users, especially when the negotiation period is taken into account.²⁸ Most of the difference appears to stem from the implementation/supervision phase rather than from the design phase. These findings are difficult to interpret. One cannot conclude that greater staff input could have helped to avoid prolonged use because causality is elusive. It may be that the greater intensity of inputs into “temporary use” cases reflects the operation of other factors.²⁹

²⁶ On average, since 1993, the share of total program commitments disbursed in the first tranche has been 26 percent higher for prolonged users than for “temporary” users, suggesting more frontloaded disbursements in the former case.

²⁷ Comparisons of IMF financial effort were also undertaken, based on the ratio of gross IMF financing to gross financing requirements over the program period, for which available data covers the 1990-2001 period. The differences found between prolonged and “temporary” users were small and statistically insignificant.

²⁸ These conclusions are consistent with those suggested by data compiled by the Office of Internal Audit and Inspection (OIA) of the IMF in the course of one of its recent reviews and provided to the IEO, which confirms that prolonged users receive, overall, fewer missions than “temporary” users and also revealed that, for non PRGF-eligible countries, this difference is compounded by a smaller average mission size. In PRGF-eligible countries, by contrast, mission size has generally been larger for prolonged than for “temporary” users (except in FY2001). A large part of the difference in mission size was accounted for by staff from functional departments.

²⁹ For example; because (i) programs with temporary users are less likely to have been immediately preceded by another arrangement, more preparatory work and consultations with the authorities and other stakeholders
(continued)

28. Both “temporary” and prolonged users suffer from high staff turnover.³⁰ On average, program countries had four different mission chiefs over the last five years with very little difference between the two groups.³¹ Turnover among other mission members was also high for both groups. These findings are consistent with comments received from prolonged users’ authorities as well as from IMF staff. Both groups identified excessive staff turnover as a significant problem. Although the evidence suggests that the problem is not specific to prolonged users, such a high turnover risks undue disruptions to the quality of country work and of the relationship with the authorities. These detrimental effects could be more costly in the case of prolonged users, owing to the importance of track record and learning curve issues in their case.

B. Evidence from the Case Studies and Responses to Questionnaires

29. In this section, we present some evidence related to program design and implementation arising from the three detailed country case studies and the more limited case studies of two “graduators” from prolonged use. In all three of the countries that are the subject of full case studies, some progress toward the resolution of their economic problems was eventually achieved under IMF-supported programs, but this progress was uneven across areas, often took much longer to achieve than initially expected, and generally fell short of what was targeted when the programs were agreed upon (see Box 1).

30. Drawing upon the evidence from the case studies and on the questionnaire responses from a broader group of prolonged users, we identify a series of problems which appear to have combined to limit the effectiveness of IMF-supported programs in these prolonged use countries. These are: a discrepancy between the timeframe of programs and the magnitude of their objectives; insufficient attention to program ownership and implementation capacity; issues related to the design of conditionality, especially in dealing with core institutional changes; issues related to the financial programming framework; and issues related to the IMF’s exit strategy for prolonged users. Most of these program design issues

are needed to design the program; or (ii) programs with “temporary users” suffer from fewer fatal interruptions which means that, on average, more reviews get completed, with the associated mission work; or (iii) they have more conditions, thus requiring a more intensive monitoring process. Econometric tests on the determinants of success of adjustment programs (cf. for instance Ivanova et. al (2001) and Dollar-Svensson (2000)) found that, once the endogeneity of institutional effort was taken into account, it did not have a significant impact on the probability of success of a program. Interestingly, this conclusion held regardless of the sign of the correlation: Ivanova et. al. (2001), found that the IMF seemed to invest more resources into successful than failed programs, while Dollar-Svensson (2000) found that the World Bank invested more efforts in operations that were eventually unsuccessful.

³⁰ Based on an analysis of mission travel data compiled by the OIA, as an extension of their previously mentioned work on mission organization and management. The data analyzed covers the period FY 1996-2001.

³¹ This count does not take into account cases where the permanent mission chief was outranked by a member of the area department front office as *ad hoc* head of mission.

appear to have resulted less from weaknesses in the staff's technical analyses than from a variety of institutional factors, which are discussed in Chapter VI.

31. Before turning to these issues, we should emphasize several points:

- There are obvious limits to how far any conclusions can be generalized from a small number of country cases—especially ones that, by selection, have encountered difficult and protracted adjustment processes. We are not suggesting that all, or even most, programs supported by the IMF suffer from the range of problems identified here, not even among programs with prolonged users. We do not have sufficient evidence to make such a determination. Even among the case study countries, experiences have varied significantly. Nevertheless, many of the questionnaire responses suggest that the issues identified do not just reflect isolated occurrences.
- A number of the issues discussed are not particular to cases of prolonged use—or even more especially prevalent in such cases than others. But the problems identified do seem to have lengthened the IMF's program involvement in these specific country cases, and they suggest a number of lessons that are worth emphasizing.
- We were not able to quantify the specific contribution of program design issues to prolonged use, as opposed to other factors, including those which are beyond the IMF's control—such as the authorities' actions. However, based on all the evidence analyzed, our judgment is that these issues were significant.
- Finally, some of the problems identified are already well known, since they have been discussed in various previous assessments. For some, important initiatives are already under way to try to address them, as will be discussed in Chapter VIII.

Timeframe of programs

32. The case studies highlight many instances in which programs tended to “overpromise,” both on the speed of restoration of macroeconomic sustainability and on the pace at which structural reforms could be implemented. On the macro side, the tendency was most marked in the case of Pakistan, but was also present in expectations about Senegal's graduation from reliance on debt relief. It is interesting to ask whether the overoptimism observed ex-post was only because policies agreed under the program were not always implemented (see Box 2). Weaknesses in implementation clearly played an important part, as the detailed discussion in the country notes illustrates; and it is no coincidence that the “overoptimism” was least in Morocco, which had the best track record on implementation. However, repeated underestimation of the obstacles to policy implementation is, in itself, a program design problem. Moreover, some programs—especially those with Pakistan in the 1990s—relied on projections for exports and tax revenue that would have been optimistic even with full implementation. On the structural side, the overoptimism—about both the length and diversity of the reform agenda embedded in programs—occurred in all three cases.

Box 1. Overview of What Was Achieved Under IMF-Supported Programs in the Country Cases

In Pakistan, little or no lasting progress was achieved on the macroeconomic front, except as regards inflation, which was halved to 4 percent over the 1990s. Both the fiscal and the current account deficits remained high throughout the period and stood respectively at 5 and 4 percent of GDP in 2000, while international reserves remained critically low (Table 8). Meanwhile, growth declined to an average of 4 percent per year over 1988-2000 and poverty rose steadily, with 30 percent of the population living below the poverty line in 2000.

Progress in structural reforms was mixed. There was substantial change in some of the core areas of the IMF's mandate, e.g. liberalization of trade and external payments, public debt management and the conduct of monetary policy, including independence of the central bank. Progress in tax reforms and administered prices (including utilities) and in financial sector supervision was more protracted; but it was eventually significant, although by no means complete. In other critical areas, such as tax administration or public enterprises, only small improvements had begun to materialize at the very end of the decade. Furthermore, the quality of economic governance generally deteriorated during the period of intensive UFR, though for reasons largely unrelated to IMF-supported programs.

In the Philippines, a long series of programs in the 1960s and 1970s were associated with a period of quite strong growth but heavy external borrowing. They achieved little lasting adjustment and failed to prevent a debt crisis in 1982-83. A large part of the problem appears to have been the difficulty of promoting lasting adjustment in the face of deep governance problems and a lack of political commitment to reform at the highest level, although—reflecting the general approach at the time—program documents tended not to discuss such issues. The eventual crisis was exacerbated by adverse global developments. Subsequently, a considerable degree of adjustment and structural transformation was eventually achieved in the second half of the 1980s and the 1990s under successive programs, although progress took place in spurts and was slower overall than anticipated. Regarding macroeconomic developments, a rapid turnaround of the current account was achieved in the first half of the 1980s but only at the cost of a sharp output decline. Tight monetary policy was also instrumental in preventing a take-off in inflation, which remained moderate subsequently. A substantial current account deficit re-emerged, however, in the late 1980s and for most of the 1990s, despite rapid export growth facilitated by a realignment of the incentives structure. Substantial debt restructuring combined with export growth was, however, instrumental in the gradual resolution of the Philippines' external debt problem. The debt to GNP ratio was halved to 50 percent between 1985 and 1995. There was also considerable fiscal adjustment, with the consolidated public sector deficit reduced significantly from over 7 percent of GNP in 1984-85 to just 0.6 percent of GNP in 1993-97, before rising again to 3.7 percent of GNP in 1998-2000.

In the area of structural reforms, the programs of the 1980s achieved substantial progress in liberalizing the trade and exchange system, the abolition of marketing monopolies in the agricultural sector, public enterprise privatization and financial sector reform. However, there was also a large unfinished agenda. These reforms were advanced further in the 1990s, with additional trade liberalization, the recapitalization of the central bank, the opening of critical sectors to new competition and foreign participation, and acceleration of the privatization program. There was also progress—although slower than desirable—in strengthening the prudential framework of the financial sector. However, despite these gains, a few long-standing and critical weaknesses, notably a low saving rate, problems with tax collection, and an inefficient public sector remained unresolved. For example, tax/GDP ratios improved substantially in the mid-1990s, but collapsed again after 1998 as collection problems and other weaknesses re-emerged. Moreover, despite some progress, the incidence of poverty remained high and widespread corruption concerns lingered.

Senegal's adjustment process has been of a stop-and-go variety. After a severe financial crisis in the early 1980s, a period during which implementation of IMF-supported programs was weak, there was a period of improved implementation during 1984-88 which contributed to a marked decrease in fiscal and external current imbalances as well as to much reduced inflation. However, that period saw the emergence of a banking crisis. In the early 1990s, growth slowed down, as "internal" adjustment measures implemented by the authorities did not succeed in addressing competitiveness problems. A nearly two-year period of interruption in IMF arrangements occurred in 1992-93. The devaluation of the CFA franc in 1994 and accompanying measures gave new impetus to the authorities' adjustment effort. A surge in inflation was rapidly contained, fiscal and external imbalances were reduced, and real GDP growth has been at a steady 5-6 percent per annum. During the later part of that period, Senegal's debt problem was also significantly reduced, mainly by debt relief (after the debt was officially recognized as unsustainable in 2000). Since 2000, however, financial imbalances have re-emerged, suggesting that the stop-and-go pattern has yet to be eliminated.

Box 1. Overview of What Was Achieved Under IMF-Supported Programs in the Country Cases (continued)

In the area of structural reforms, substantial progress was eventually made—broadly following the same stop-go pattern—in the areas of price liberalization, trade liberalization and simplification of the tax system. Generally speaking, the role of the state in the economy has been significantly reduced and the economy has become more resilient to terms of trade shocks, in part thanks to a markedly reduced share of groundnuts and phosphates in total exports. By contrast, in spite of repeated attempts to tackle them over the last twenty years, the problems of the groundnut sector, the petroleum and power sectors and tax collection remain largely unsolved. Besides, with virtually no growth in per capita GDP in the 1980s and the first half of the 1990s, poverty has remained widespread.

Morocco faced very large domestic and external imbalances and a heavy debt burden in 1980 when it entered a long series of IMF-supported programs. It also faced major structural weaknesses, with heavy government regulation of the economy, including on consumer prices and credit allocation, and a strong inward economic orientation. Programs in the early 1980s had only a moderate impact in reducing these imbalances. Fiscal adjustment was initially achieved mainly through expenditure reduction, but substantial domestic arrears occurred. At first, progress on structural reforms was slower than planned, in part due to concerns over their social acceptability.

In the second half of the 1980s, financial adjustment policies and structural reforms became more mutually reinforcing, although progress was not smooth: there were a number of setbacks in the face of exogenous shocks and slippages in the timetable of policy implementation. Nevertheless, reinforced by a strong political backing for the broad direction of key reforms and an effective civil service, substantial progress was eventually achieved. Programs were successful in raising national saving (from an average of 16 percent of GDP during 1980-82 to almost 23 percent during 1990-92), with an improved tax effort contributing to these gains. Debt and debt service ratios were reduced substantially, with the aid of significant debt restructuring. Significant structural change was also eventually achieved, including the liberalization of most foreign transactions and consumer prices; reform of public enterprises; and tax and public expenditure reform. Although significant challenges remained, including the need to generate faster growth, Morocco was able to “graduate” from IMF-supported programs in 1993.

The case of **Jamaica** was examined not to analyze in-depth the effects of its IMF-supported programs, but to illustrate the importance of domestic ownership of policies and the potential benefits of considering alternative policy options. Jamaica had a long series of arrangements with the IMF stretching from the 1960s until the last EFF expired in March 1996, after which the Jamaican government announced its “independence from the IMF”, indicating that it would not borrow again. At this time, Jamaica still faced large adjustment challenges. Public debt was high (over 100 percent of GDP, with over two thirds external); inflation was over 20 percent; the real effective exchange rate was appreciating; growth remained weak; and the first stages of a major financial sector crisis was under way.¹ The authorities rejected the IMF’s policy advice on several key aspects (notably on a substantial depreciation of the exchange rate and the closure of weak financial institutions) in favor of a “homegrown” macroeconomic program that included running very large primary fiscal surpluses and tight monetary policy to reduce gradually inflation and inflationary expectations. The IMF staff initially doubted that, in the likely protracted low-growth environment that such a stabilization strategy would involve, the authorities would be able to maintain the sizable fiscal effort necessary to avoid unsustainable public debt dynamics.

In the event, the government did manage to generate and maintain large primary fiscal surpluses and, as the authorities’ “homegrown” policy strategy was seen to be implemented quite forcefully, the IMF backed away in subsequent Article IV surveillance reports from its previous insistence on an initial large depreciation, although differences of view remained on the appropriate degree of exchange rate flexibility. In July 2000, it was agreed that there would be IMF staff monitoring of the government’s economic program—an option the authorities pursued in order to obtain an IMF “seal of approval” and consequent access to adjustment lending from the multilateral development banks. The authorities’ program achieved some important results, although Jamaica’s problems are far from resolved. High primary surpluses prevented the public sector debt dynamics from deteriorating further, although it still remains vulnerably high; real interest rates, although still very high, have declined moderately; and the cushion of external reserves has improved. Growth has only recently begun to recovery moderately, after a number of years of stagnation.

Whatever the relative merits of the two different policy strategies—and, it is not obvious that the one favored by the IMF was better—the Jamaican experience illustrates that, once the strong political commitment to the “homegrown” strategy was taken into account, its prospects for success were definitely higher.

¹ See the companion paper on the case studies for further details.

**Table 8. An Overview of Economic Performance in the Three Country Cases
(Period averages in percent, unless otherwise indicated)**

	Country	71-75	76-80	81-85	86-90	91-95	96-00
GDP growth 1/							
	Pakistan	3.2	6.2	6.8	5.8	4.8	3.1
	Philippines	6.1	6.1	-2.0	5.4	2.8	4.2
	Senegal	2.4	1.0	3.0	3.2	1.5	5.3
Inflation							
	Pakistan	15.7	8.7	7.1	6.8	11.2	7.3
	Philippines	17.0	12.3	18.6	7.8	10.0	7.1
	Senegal	13.5	6.8	11.9	0.1	6.8	1.4
Overall budget deficit (percent of GDP) 1/							
	Pakistan	-7.6	-8.0	-6.1	-7.3	-7.6	-6.5
	Philippines 2/	0.6	-1.3	-2.8	-3.3	-0.7	-1.7
	Philippines 3/	NA	NA	-5.6	-4.0	-2.5	-2.6
	Senegal	NA	-8.2	-6.0	-1.6	-1.3	-0.3
Tax revenues (percent of GDP) 1/							
	Pakistan	10.3	12.3	10.6	12.4	15.6	16.0
	Philippines	10.3	12.1	10.1	12.3	15.2	14.8
	Senegal 4/	NA	21.1	19.5	17.7	17.1	17.1
Government expenditure (percent of GDP) 1/							
	Pakistan	16.9	17.4	19.0	23.3	23.6	22.2
	Philippines	13.9	13.8	13.1	17.2	18.4	18.2
	Senegal	NA	30.1	26.4	20.7	20.8	20.2
Public debt (percent of GDP) 1/							
	Pakistan	66.9	56.8	54.4	73.8	76.5	79.1
	Philippines	43.6	30.5	32.1	53.2	56.6	57.5
	Senegal	18.2	30.9	72.5	63.8	67.5	75.9
Exports growth							
	Pakistan	11.0	17.0	3.0	14.0	6.0	0.0
	Philippines	15.9 5/	20.7 5/	-2.4	9.9	9.4	3.3
	Senegal	1.2	-4.0	3.1	5.9	0.8	5.0
Current account balance (percent of GDP) 1/							
	Pakistan	-4.7	-4.6	-2.7	-2.6	-3.6	-4.8
	Philippines	-1.9	-6.9	-2.7	-0.8	-3.3	2.6
	Senegal	-4.6	-8.3	-13.4	-8.2	-6.4	-4.2
External debt (percent of GDP) 1/							
	Pakistan	52.2	47.0	40.0	47.8	50.3	51.5
	Philippines	29.2	45.4	73.6	80.5	61.4	59.8
	Senegal	17.0	36.7	61.0	59.7	66.2	75.4
Gross international reserves (months of imports)							
	Pakistan	0.5	1.0	1.8	1.3	2.2	0.2
	Philippines	1.0	2.5	1.5	2.3	6.1	4.9
	Senegal	0.0	0.0	0.0	0.0	0.1	0.0
Gross international reserves (percent of external debt)							
	Pakistan	9.9	11.5	15.1	7.5	8.3	5.6
	Philippines	32.8	23.0	6.3	7.9	17.0	25.8
	Senegal	11.5	3.9	1.0	0.7	2.8	10.6

1/ GNP, rather than GDP in the case of Philippines

2/ National government balance.

3/ Underlying consolidated public sector balance.

4/ Government revenue excluding grants

5/ Exports of goods 1971-1980 for Philippines.

33. As the discussion in Chapter VI will illustrate, these factors seem to have stemmed in considerable part from institutional pressures to produce substantial visible progress within the relatively short timeframe of the program. Interestingly, these pressures were present even in those cases, such as the Philippines, where staff reports were relatively candid from an early stage (i.e. following the 1982-83 debt crisis) that adjustment was going to take considerable time. In other words, recognition that IMF program involvement was likely to be lengthy does not appear to have changed fundamentally the approach to program design.

34. The relatively short timeframe of program design also meant that, in some cases, less priority was given initially to those elements of the structural reform agenda that were inevitably going to take a significant amount of time, even though they were important for long term sustainability or when their nonimplementation caused adverse side-effects and ex-post sequencing problems. For instance, in Pakistan, early programs envisaged a simultaneous cut in trade taxes and creation of a broad based general sales tax. While the former reform was implemented broadly on schedule, the latter took over ten years to be fully effective, giving rise to large revenue shortfalls in the interim. In all three of the main country cases, the strengthening of regulatory and supervisory systems lagged too far behind financial liberalization with adverse consequences for the banking system.

The extent and nature of conditionality

35. The cross-section evidence discussed earlier suggests that—although there were wide variations from country to country—prolonged users as a group had less structural conditionality and relied upon conditionality that was “softer”, in the sense of being less directly monitorable (i.e. fewer prior actions and performance criteria). We use the case studies to examine, in a more qualitative manner, whether these factors influenced program effectiveness and hence prolonged use.

Box 2. Were Program Projections Overoptimistic? Lessons from the Case Studies

An examination of initial projections underlying all programs since 1983 for the three country cases as well as Morocco confirms the earlier cross-section evidence that there has been a strong tendency to overestimate export projections in all cases (see table below and attached charts). Real GDP growth was also overestimated, on average, in all four countries. Projections of government revenue were markedly optimistic in Pakistan and the Philippines, but not in Morocco or Senegal. Projections of national saving also proved too high in all countries other than Morocco. In general, the extent of overoptimism embedded in programs was greatest in Pakistan and least in Morocco, which is not surprising given the respective track records on program implementation. It is not possible to ascertain from these comparisons whether it was unrealistic *ex ante* program projections that contributed to weak implementation or vice versa, and it is not possible to estimate precisely the counterfactual of what would have happened if all the programs had been implemented as agreed. Nevertheless, the more extensive discussion in the country studies suggests that, in the case of Pakistan in particular, both the authorities and staff recognized that programs were often built on very optimistic projections.

Realism of Program Projections: Average Projections less Outturns¹ (Percentage points per year)

	<u>Pakistan</u>	<u>Philippines²</u>	<u>Senegal</u>	<u>Morocco³</u>
Real GDP growth	1.4	2.1	1.7	1.2
Export growth (in U.S. dollar terms)	5.7	2.5	2.8	0.9
Fiscal balance (in percent of GDP)	1.9	1.6	1.9	1.8
Government revenue (in percent of GDP)	1.3	1.1 ⁴	--	--
National saving (in percent of GDP)	2.3	0.5 ⁵	2.8	-0.8

1/ Average of all initial projections for programs since 1983, for the year in which the program started and the two succeeding years.

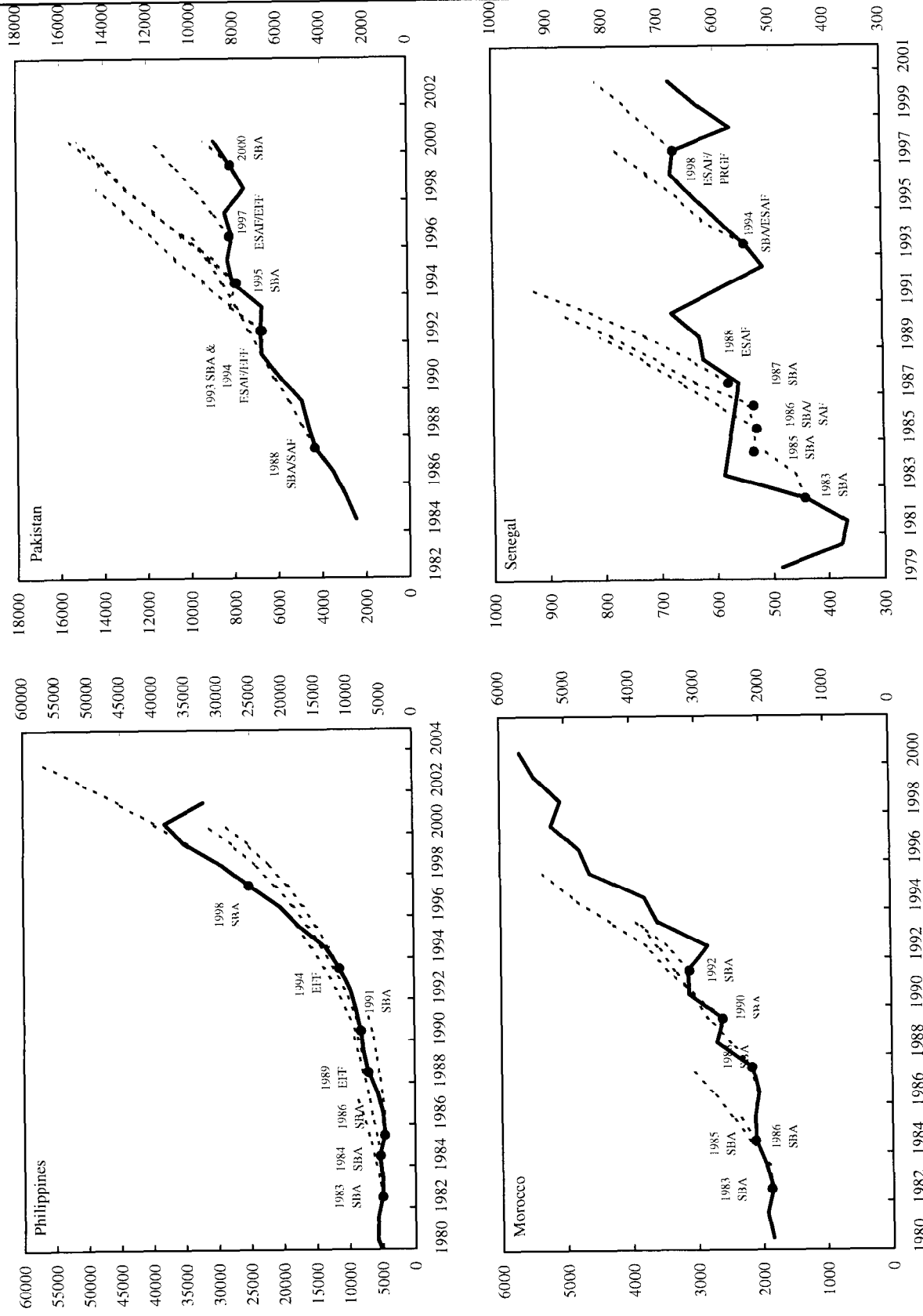
2/ Growth and ratios expressed in relation to GNP, rather than GDP.

3/ For Morocco, except for export growth, projections are for the year in which the program started and the immediately succeeding year, due to the limited time horizon of projections in program documents.

4/ National government tax revenue as percent of GNP.

5/ The apparent rise in the saving rate in the late 1990s and early 2000s may be overstated as a result of statistical weaknesses.

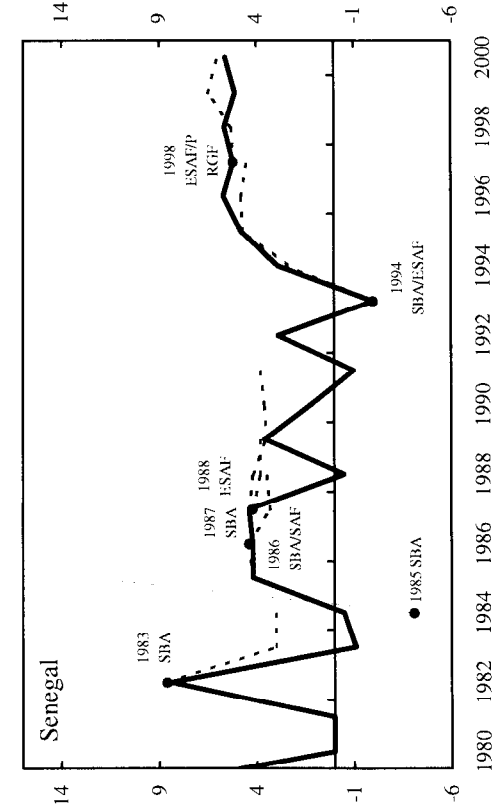
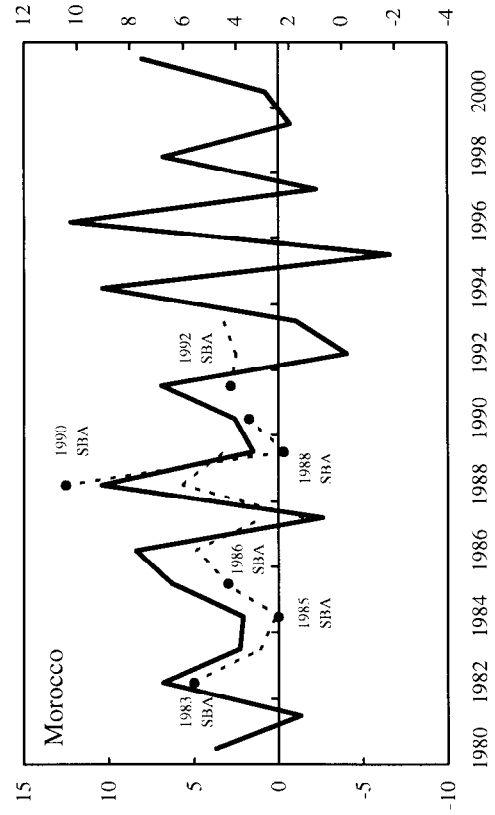
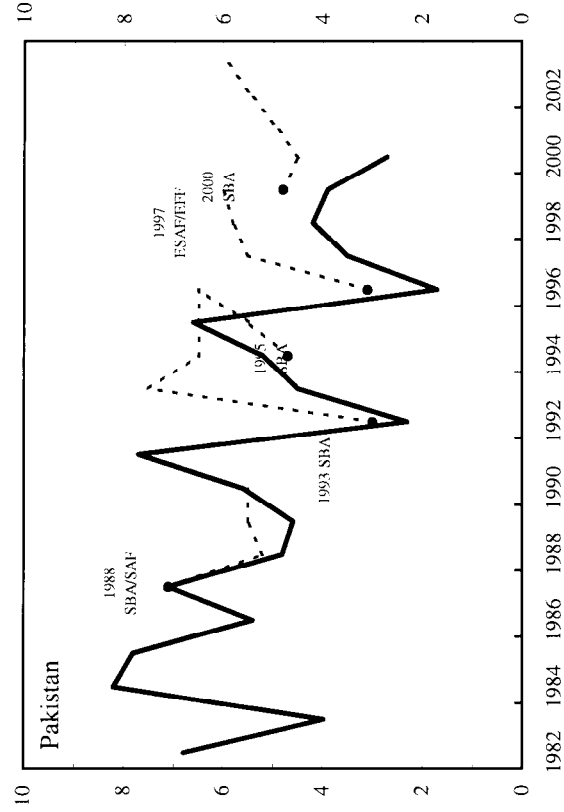
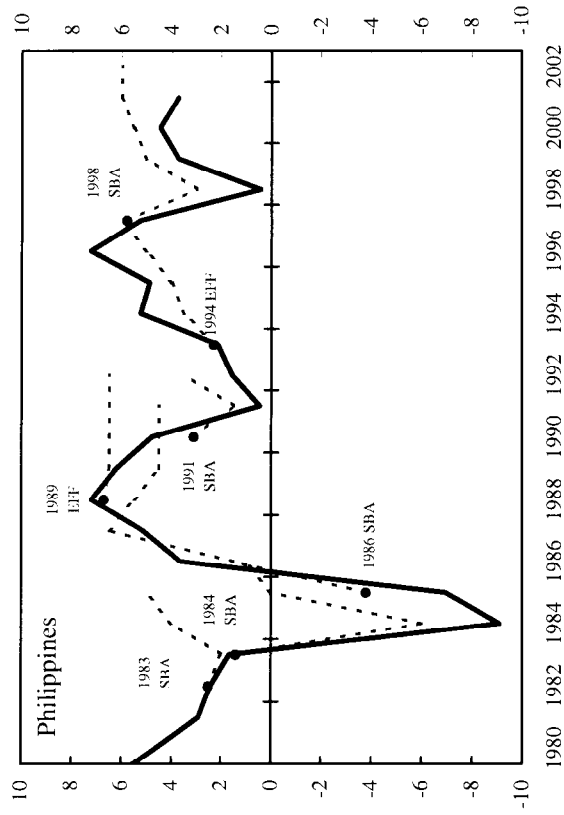
Chart 1: Prolonged Users Exports



All data are expressed in billions of US dollars.

Source: Data provided by the national authorities; and IMF staff estimates.

Chart 2: Prolonged Users GDP Growth



Source: Data provided by the national authorities; and IMF staff estimates.

All data is expressed in percent of change.

36. The three case studies illustrate rather different approaches to conditionality. In Pakistan, structural conditionality was extensive and very detailed, with a total number of conditions per program-year well above the average of other programs whether with “temporary” or prolonged users (see Table 5). These conditions overwhelmingly took the form of benchmarks and performance criteria. In the Philippines, by contrast, conditionality relied primarily on reviews, with practically no benchmarks and a minimal number of performance criteria (0.2 per program year on average). Total formal conditions per program-year were less than half as many as the GRA prolonged users’ average. In Senegal, the approach adopted was broadly consistent with ESAF/PRGF prolonged users’ average, with a heavy reliance on structural benchmarks and a somewhat above average recourse to performance criteria. However, all three countries share a below average use of prior actions. Interestingly, in spite of these differences in the overall approach to conditionality, all three countries had similar and significantly above average implementation indices—as measured by the degree and timeliness of compliance with program conditionality as long as programs are on track (Table 6).³²

37. Our analysis of the nature of conditionality in the three cases—details are provided in the country studies—suggests a number of lessons. We are not implying that these lessons are germane only to prolonged use cases, or that their full adoption would have prevented prolonged use. Many are now well-recognized within the IMF. Nevertheless, they are important for program effectiveness and are worth reiterating here.

(i) The specific structure of conditionality is much less important than an underlying domestic political commitment to core policy adjustments. Conditionality can be potentially useful as a device to signal that commitment and as a device for monitoring progress, but it does not appear to have been effective at enforcing changes in the cases where the necessary political commitment was absent. In that sense, the critical factor contributing to prolonged use was not that the guidelines calling for different approaches to conditionality in such cases were not followed—which, the cross-country evidence discussed earlier shows was often so—but that the IMF often proved reluctant to be more selective in its involvement when political commitment to implement necessary changes was lacking. The case of Pakistan is one example. The Philippines case also suggests that the modalities of conditionality were not the critical factor explaining the relative lack of success in strengthening tax administration—since a variety of approaches were tried without lasting success, including prior actions, benchmarks, reviews, and detailed commitments summarized in a policy matrix.³³ In Senegal, restructuring of the groundnuts sector remains incomplete in spite of various forms and types of conditions contained in programs since the early 1980s, in part reflecting policy reversals associated with social and political sensitivities.

³² As noted earlier, the fact that implementation is not recorded systematically in the MONA database once a program is off-track biases this measure upwards, especially in the case of Pakistan.

³³ However, owing to the strong and consistent resistance of the authorities, almost no “hard” conditionality was used, in particular no quantitative PCs on tax revenues or indicative targets creating a presumption of corrective action when breached, such as were used in Senegal and Morocco for instance

(ii) Excessively detailed conditionality—whether resorted to because of a weak track record, doubts about ownership, or to support reform-minded groups within government—does not appear to have been effective in enhancing implementation.³⁴ One example is the effort to implement tax administration reforms in the Philippines under the 1998 SBA.³⁵ The Memorandum of Economic Policies contained an extremely detailed matrix of commitments, but this was agreed primarily with officials of the outgoing Ramos administration, and the incoming officials were not committed to it. In the event, the “matrix approach” proved ineffective, including as a monitoring device, because it was relatively easy to find superficial ways to meet the commitments. In Senegal, in response to weak implementation, there was a sharp increase in the number of structural conditions and an escalation from “soft” to “hard” conditions during the second and third annual arrangements under the 1998 ESAF/PRGF. This was only partially effective as some measures were implemented with significant delays or in ways that did not meet program objectives (e.g., the withdrawal of the state from the collection and transport of groundnuts did not lead to the liberalization envisaged in the program, as the authorities continued to set indicative margins rather than allow the market to determine transportation and collection costs).

(iii) This is not to say that the form taken by conditionality is irrelevant. In particular, there is some evidence from the case studies that conditionality that focused on policy rules or procedures, rather than discretionary, one-time actions, was ultimately more effective.³⁶ For example, in Pakistan this approach was eventually adopted with some success in the area of tax exemptions as well as in the area of utilities price adjustments. However, the Senegal case study shows that reversals can occur even with policy rules, as happened with an automatic pass-through mechanism for the retail prices of petroleum products which was suspended prior to presidential elections in 2000.

(iv) The evidence is mixed as regards the effectiveness of prior actions. Historically, as noted in Chapter III, staff reports and Board meetings discussing strategies to deal with prolonged use had supported front-loading the adjustment and reform effort with a greater use of prior actions, while backloading disbursements to provide an extra incentive to sustain the reform effort over the span of the program. In practice, most of the programs in Pakistan and the Philippines featured neither frontloaded structural reforms nor backloaded disbursements—which is consistent with the cross-country evidence discussed earlier. The one program which most clearly did both (i.e. the 2000 Pakistan SBA) was implemented well, but it unfolded in an environment characterized by strong political commitment, which makes it hard to disentangle the independent impact of frontloading of reforms. In Senegal,

³⁴ This is not to suggest that overly detailed structural conditionality was especially prevalent in prolonged cases; indeed, the broader cross-country evidence discussed earlier suggests it was not, with the exception of a few countries, including Pakistan.

³⁵ Cf. Section IV C of the Philippines note.

³⁶ Elborgh-Woytek and Lewis (2002) provide a detailed assessment of how IMF conditionality has operated in the case of privatization of state enterprises in Ukraine and come to a similar conclusion.

disbursements were generally not backloaded, but some programs did frontload the policy effort, including through prior actions—largely when the political circumstances, including the electoral cycle, were favorable—and these tended to be more successfully implemented.

(v) A closer analysis of some prior actions used in the three country cases casts light on the somewhat counterintuitive conclusion of several recent studies, according to which the number of prior actions has not had a significant influence on program implementation.³⁷ A large part of the problem was that the prior actions chosen were not always well-integrated into the program design. The discussion in the Pakistan country note of the prior actions related to agricultural taxation in the 1993 SBA and 1994 ESAF is especially informative:³⁸ both prior actions were judged to be met and yet neither resulted in meaningful taxation of agricultural incomes. Agricultural taxation became the focus of prior actions because conditionality in previous programs had been ineffective (i.e. there was a weak track record on the issue) and because it was highly desirable on equity grounds. But the prior actions specified were not critical to achieving the programs' macroeconomic objectives, since the revenues they would have raised, even if effectively implemented, were small. Moreover, other potential prior actions, that were more macro-critical, appear to have been dropped during the process of negotiation (e.g. extension of the GST base or reintroduction of the petroleum price adjustment mechanism). This example illustrates two lessons: (i) prior actions, like any other conditionality, can be subject to superficial or temporary observance if domestic ownership/political commitment is weak; and (ii) prior actions imposed for "symbolic" reasons, rather than in view of their criticality for the achievement of program objectives, do not enhance program effectiveness.³⁹

(vi) Conditionality is especially difficult to apply to complex regulatory and institutional issues that are often critical to achieving longer-term sustainability and avoiding prolonged use. In these circumstances, use of reviews based on an assessment of outcomes is probably a better approach, rather than attempting to split the reforms into a detailed timetable of discrete, intermediate steps that are then subject to conditionality. But the Philippines experience also suggests that while a use of reviews and a focus on broad outcomes is the best way of monitoring progress with complex reforms, even this approach has its drawbacks, since there was often a lack of clarity over the "bottom line" of conditionality. Each review became an occasion for "recontracting" the underlying commitments, which

³⁷ See for instance *Modalities of Conditionality, Further Considerations*, IMF (2002) or Thomas (2002).

³⁸ See Section B.2 of the Pakistan note for further discussion.

³⁹ Prior actions can also turn out to be counterproductive when they force the hasty adoption of a measure, through procedures which subsequently put its implementation at risk. This happened in the Philippines with a prior action for the 1994 EFF on expanding the VAT base, which although formally passed in 1994 was not implemented until 1996 because of a judicial challenge that might have been avoided had a different, but lengthier, procedure been followed by the authorities for its adoption.

weakened their credibility. In retrospect, greater specificity in identifying a small number of critical outcomes, with progress assessed through reviews, may have been desirable.

(vii) The case studies provide some evidence that the credibility of conditionality can be eroded by many repeated programs. According to many Pakistan officials, the expectation that the IMF would eventually provide financing—by agreeing either to waivers or to new arrangement shortly after program interruptions—weakened incentives to tackle the fiscal deficit forcefully. Similarly, in the Philippines repeated programs appear to have fostered the view that policy commitments could be readily renegotiated. In Senegal, the views expressed on this question by various stakeholders were mixed.

Dealing with core institutional and structural changes

38. As discussed earlier, part of the explanation for prolonged use in all three countries was that a number of intractable issues took a very long time to correct and some have still not been resolved. This reflects the fact that attempts to fit complex reforms into the timeframe and conditionality framework of IMF-supported programs sometimes caused priority to be given to easily measurable actions over more complex and more important institutional changes. For example, in all three countries, tax administration reforms were recognized as centrally important to achieving longer-term revenue improvements, but were often given less explicit focus in programs than more visible tax policy changes, even when technical assistance was offered in parallel to programs to address them. This was in part because the impact and timing on revenues was less easily measurable or could result in an initial revenue loss that would have complicated program design in the short run. The choice to pursue these reforms through means other than program conditionality appears to have sent a signal—or created an incentive—to treat them as secondary priorities. While this may be appropriate in a near crisis context, it is not effective in a *de facto* long term relationship between the IMF and the member.

39. Other areas where a stronger early emphasis on institutional reforms in macro-critical areas, might have mitigated subsequent problems were in the banking sector (in particular risk management practices and prudential regulations, especially in Pakistan and Philippines) and public enterprises (in all three countries). For example, in Pakistan, public enterprise adjustment in programs was not addressed from a broader institutional reform perspective until the end of the 1990s. Because earlier programs did not effectively come to grips with the broader reform needs of these enterprises, they tended to focus on tariff adjustments which, although warranted from a purely fiscal perspective, implied an acceptance of low efficiency levels in these enterprises leading to a higher cost structure for Pakistan's industry. As discussed in the Pakistan note, these problems reflected, in part, a failure of Bank-Fund collaboration to focus on such issues in an operationally effective manner at an early stage.

Ownership and assessments of feasibility

40. In each of the three main country cases, the risks to the programs of weak political commitments was often understated. For example, reports to the Executive Board on

Pakistan generally downplayed the effects of the considerable political instability which prevailed throughout 1988-2000 on governments' willingness and ability to implement far-reaching reforms—although there was more discussion of such issues in internal documents. Similarly, in the Philippines, programs tended to underestimate the difficulties of pushing reforms through Congress—although staff did make significant efforts to interact with key congressional committees in an effort to enhance domestic commitment. Coverage of such issues in internal documents was variable and only a few (e.g. an internal ex-post assessment of the Philippines 1989-91 EFF) provided a candid assessment of such constraints. Even in these cases, subsequent Board papers were less candid. In general, most Board papers on the programs had no significant assessments of ownership. This is not surprising since this only became an operational concern very recently, but it points to areas where future policies should be different (see Chapter VI).⁴⁰

41. There was also relatively little presentation in internal briefing papers—and even less in Board papers—of the tradeoffs between potential alternative strategies, including in cases where there were substantial divergences of views between the staff and the authorities.⁴¹ Furthermore, only limited attention was often paid to assessing and developing implementation capacity, both in a technical and political sense.

Issues related to the IMF's "financial programming" framework⁴²

42. There was broad recognition—both in the country cases and in the responses to the questionnaire sent to other prolonged users—that one of the most valuable contributions of programs has been in focusing attention on a sound macroeconomic framework and in providing a consistency check on the key components of that framework. However, several weaknesses in the approach, as it is implemented in practice, occurred frequently. Once again, these issues are of broader relevance and not just for the prolonged users.

(i) Too little attention was often paid to analyzing the real economy dynamics and the expected sources of growth. In some cases (e.g. most of the Pakistan programs during the 1990s), overoptimistic growth and revenue projections in effect "squared the circle", allowing projected fiscal deficits to appear consistent *ex ante* with other macroeconomic objectives, and thereby avoiding some difficult fiscal choices. The result was to force *ad hoc* policy adjustments that were inconsistent with the medium-term strategy and were generally

⁴⁰ Cordella and Dell'Ariccia (2002) also suggest a number of reasons why *ex ante* knowledge of a country's degree of commitment to a program can help reduce the costs associated with the imposition of suboptimal levels of conditionality.

⁴¹ A notable exception in Senegal relates to the 1992 Article IV staff report and (especially) briefing papers for possible UFR in 1993 which contrasted the authorities' purely "internal" adjustment strategy with a more "comprehensive" approach—including exchange rate action—favored by the staff.

⁴² See Mussa and Savastano (1999) and Khan and Knight (1985) for a discussion of this framework.

not sustainable. Similarly, overoptimism about the speed of recovery in private investment, in the face of a continuing debt overhang, was a problem with the 1989 Philippines EFF.⁴³

(ii) Many programs had difficulty in dealing with uncertainty. As in all macroeconomic policy-making, program design faced enormous uncertainties—including about the nature of behavioral relationships, key international prices, supply conditions, and the pace of implementation of reforms. But many program documents did not spell out the key risks facing the program, nor did they conduct suitable stress testing exercises. While the actual adaptation of programs to unanticipated events has to be left largely to reviews,⁴⁴ the limited *ex ante* discussion of the major risks and of how policies and targets could respond to deviations from program assumptions meant that there was generally too little mid-course reconsideration of the logic of program design until programs were already close to being off-track. As a result, policy adjustments were often too slow and risked being inconsistent with the long term strategic objectives of the program (e.g. short-term expenditure squeezes or ad hoc revenue measures).⁴⁵ In this respect, a large proportion of responses to the questionnaire noted that programs paid insufficient attention to how policies would respond to external shocks. However, a number of the more recent programs mark some improvement in that respect—for example, the 2000 SBA of Pakistan contained a candid discussion of risks and uncertainties. The guidelines and framework for assessments of external sustainability endorsed by the Executive Board in June 2002, which are meant to be applied in priority to program countries, are a further step in that direction and, if implemented consistently, could bring about significant improvements.

(iii) Many officials as well as many staff also noted that too much of the time available for program negotiations (as well as the authorities' subsequent monitoring efforts) was spent on "fine-tuning" the details of the financial programming exercise—by more than was justified given the inevitable uncertainties about the underlying behavioral relationships and economic environment. As one response to the questionnaire put it, there was "too much focus on fine-tuning of technical issues with not enough attention to higher quality conditionality".

⁴³ Such overoptimism about the pace of response of private investment does appear to be a significant problem in the design of many programs. See, for example, Goldsborough et al (1996) *"Reinvigorating Growth in Developing Countries: Lessons from Adjustment Policies in Eight Economies"*.

⁴⁴ The one example in the case studies where a program attempted to pre-specify, in a fairly rigid quantitative manner, how the mix of adjustment and financing would respond to various exogenous shocks was the Philippines use of the Compensatory and Contingency Financing Facility (CCFF) along with the 1989 EFF. It proved cumbersome and ineffective. See the Philippines case study.

⁴⁵ Senegal's 1994 SBA and the 1994-97 ESAF arrangements contained understandings that in the event that world prices for groundnut products and cotton turned out to be lower than projected, any associated fiscal shortfalls would be corrected by revenue raising or expenditure-reducing measures. However, this approach appears to rule out the possibility of allowing an increase in the fiscal deficit to accommodate a temporary terms of trade shock. Moreover, the nature of the revenue and expenditure measures are not discussed, which increases the risk of ad hoc measures that are not consistent with the medium-term growth objectives.

Lack of well-defined exit strategies

43. The problems discussed above were sometimes accompanied by too broad a rationale for the IMF's involvement through a program relationship which inevitably encouraged prolonged use. This appears to have been the case in the Philippines for parts of the 1990s. Such an approach appears to have reflected, from the authorities' perspective, uncertainties as to the effects that putting an end to the thirty-year program relationship would have on markets. From the standpoint of the IMF, it reflected a belief that a continued involvement would foster "good" policies, including by enhancing the leverage of domestic reformers, or (in 1998) would help to sustain earlier gains by avoiding backsliding during a change of administration. Indeed, a comparison of the situation of the Philippines and Morocco in the early 1990s does not suggest any clear reasons why different approaches to an "exit" from IMF resources was taken (Box 3).⁴⁶ Similarly, there appears to have been little discussion of a possible exit strategy in the case of Senegal.

44. This experience suggests that, as more PRGF-eligible countries move toward having eliminated their structural balance of payments imbalances, the lack of a well-defined exit strategy—or criteria to guide such a strategy—could contribute to a more prolonged use of IMF resources.

⁴⁶ Clearly, the onset of the Asian crisis in 1997 justified renewed IMF financial support, but this was not a factor in deciding on the nature of IMF involvement in 1994.

Box 3. Exits from IMF-Supported Programs: A Comparison of Morocco and the Philippines

Morocco "graduated" from the use of IMF resources in 1993 and the Philippines in 2000. A review of various economic indicators suggests that their positions were not that different in the early 1990s: the Philippines had a higher current account deficit and lower, albeit still comfortable reserves, but had lower debt and debt service ratios. The fact that the Philippines had almost fully liberalized its capital account, while Morocco still had a more restrictive system, could have implied the need for a higher reserve cushion, but the Philippines also had a more flexible exchange rate regime.

	Philippines			Morocco		
	1982-1984	1992-94	2000	1982-1984	1992-94	2000
Current account balance (in percent of GNP or GDP) 1/	-7.0	-4.0	11.5 2/	-8.7	-2.0	-1.7
External debt to GNP or GDP ratio 3/	73.4	62.1	63.1	100.2	89.0	48.3
Debt service ratio (before rescheduling) 3/	48.1	24.0	14.6	49.7	38.1	19.3
(after rescheduling)	44.3	19.7	14.6	33.9	38.1	19.3
Fiscal deficit (percent of GNP or GDP) 4/	8.2	2.7	4.6	12.1	2.8	6.5
Gross national saving (percent of GNP or GDP) 1/	21.4	20.0	28.3 2/	18.6	20.4	23
Reserves (in months of imports)	1.3	3.2	4.6	0.9	4.8	5.5
Inflation (in percent)	20.7	8.5	4.3	9.7	5.3	1.9
Growth rate in real GNP or GDP (in percent)	-1.8	3.0	4.5	3.7	1.6	0.8
Per capita income (US\$)	663	860	1,039	737	1,110	1,159

1/ Ratios and growth rates are in terms of GNP for Philippines and GDP for Morocco.

2/ Maybe overstated as a result of statistical weaknesses (see Philippines case study for details).

3/ Public and publicly guaranteed debt for Morocco.

4/ Underlying consolidated public sector deficit for Philippines; central government overall deficit (payments basis) for Morocco, excluding privatization receipts.

VI. INFLUENCE OF IMF GOVERNANCE AND OTHER INSTITUTIONAL FACTORS ON PROLONGED USE

1. In this chapter, we examine governance issues which are relevant to the phenomenon of prolonged use. These include institutional biases that can affect program design and contribute to prolonged use, including the issue of whether program activities have “crowded out” surveillance in these countries, and the implications of the IMF’s role in providing a “seal of approval” on policies.¹

A. Impact of the IMF’s Institutional Culture on Program Design

2. Some of the problems of program design identified in the previous chapter as contributing to prolonged use have their roots in the institutional culture of the IMF. These institutional characteristics are obviously not specific to prolonged users: they constitute the background to all IMF-supported programs and there is no straightforward and probably no unique explanation of why these institutional features led to prolonged use in some cases and not in others. However, any discussion of the causes of prolonged use which ignored these factors would be incomplete. We note, however, that recent initiatives have begun to address a number of the problems discussed below, and their success would help to reduce the occurrence of prolonged use in the future.

The treatment of institutional reforms in program design

3. Two factors that are critical to the sustainability of any adjustment effort, namely institutional change and good governance, have received too little attention until recently. The approach towards structural reforms adopted from the late 1980s onward often led to an overload of the reform agenda—a phenomenon observed in the country case studies—which resulted in a de facto failure to focus on the reforms that were most critical from the perspective of long term sustainable adjustment and that often depended critically upon institutional development. (See Chapter V for a more extensive discussion of this point.) Governance problems, which were also important in all three case studies, were not discussed openly until the late 1990s, when the Board adopted guidelines setting out the role of the IMF in governance issues. The case of the Philippines toward the end of the Marcos era, when governance issues were explicitly raised, was an exception.²

¹ In addition to the country case studies and the questionnaire sent to the authorities of all prolonged users, the discussion draws upon a survey of IMF mission chiefs. The questionnaire sent to prolonged users is reproduced in Annex V. The main components of the mission chiefs’ questionnaire and its results are shown in this chapter. We would like to thank the IMF’s Office of Internal Audit and Inspection (OIA) for the help they provided in implementing the latter survey.

² Even though these guidelines were adopted following a declaration of the IMF’s Interim Committee on 9/26/1996 which attached particular importance to “promoting good governance in all its aspects”, their adoption was controversial enough for the Fund’s Legal Department to be asked to ascertain their consistency with the Articles of Agreement. The conclusion of consistency was reached based primarily on the fact that the guidelines did not assert that the IMF had a general mandate to promote good governance, but rather identified certain areas of IMF involvement that were referred to as governance. In practice, the guidelines limit the IMF’s

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4. Mindful of these problems, the IMF in 2001 launched a review of conditionality.³ Although the review is still under way at the time of this evaluation, it has already led to a strong drive toward streamlining conditionality, in particular through a stricter application of the macroeconomic criticality test. By narrowing the scope of structural conditionality, this initiative should pave the way for programs that incorporate a greater prioritization of structural reforms. We would, however, emphasize that streamlining by itself is no guarantee that the few reforms pursued in each program will truly be the most critical ones, nor that they will be tackled in sufficient depth. Meeting these two challenges requires a strengthening of the treatment in program design of the key structural reforms, and a much closer and more effective collaboration with the World Bank than has generally been the case until now.

5. All three case studies reveal that one factor contributing to prolonged use was the presence of a few seemingly intractable structural problems, including in the areas of tax administration, public enterprises and administered prices, that hampered adjustment. The IMF frequently approached those issues from the narrow angle of their direct—often just fiscal—macroeconomic implications, while the World Bank concerned itself with the design and implementation of the broader structural reform.⁴ In practice, this joint involvement sometimes gave rise to coordination problems which in turn led to weaknesses in program design. Such problems included overlapping—and on occasion conflicting—policy advice, *ex post* inadequate sequencing of reforms, or *de facto* cross-conditionality all of which contributed to the ineffectiveness of the reform process in these areas. For example, in Pakistan, at one point the World Bank and the IMF had different targets for power prices, the Bank's target being geared to achieving a specific rate of return on investment, while that of the IMF was motivated by fiscal considerations. In Senegal, progress in the disengagement of the state from the groundnut sector, which was pursued in successive IMF-supported programs for fiscal reasons, was long hindered by the lack of progress of reforms targeted at the reorganization of the sector, even under World Bank sector and adjustment lending operations.

6. The different timeframes on which the two institutions operate has often been blamed for these recurrent difficulties, along with various procedural differences. However, in the case of prolonged users, both the World Bank and the IMF have had *de facto* a long-term involvement, which makes timeframe conflicts a not fully convincing explanation. While a full assessment of the causes of these problems is beyond the scope of the current evaluation, they appear to lie much deeper than a mere failure of the two staffs to coordinate adequately;

involvement to the economic aspects of governance that could have a significant macroeconomic impact. They were reviewed and left unchanged by the Executive Board in early 2001.

³ See, for example, IMF (2002), *Streamlining IMF Structural Conditionality: Review of Initial Experience* and IMF (2002), *The Modalities of Conditionality—Further Considerations*. Both are available on the IMF's website.

⁴ However, there were important exceptions. For example, in the Philippines, IMF-supported programs took the lead in the dismantling of sugar, coconut and other monopolies that were part of the "crony capitalism" legacy of the Marcos era.

they reflect different institutional cultures, program modalities, and objectives—and hence will be harder to resolve. Indeed, a number of the difficulties in tackling structural problems in a coordinated manner occurred in cases where the staff of both institutions characterized the working relationship as good.⁵

7. Several steps have been taken in the recent past to clarify further the division of labor between the two institutions and devise concrete mechanisms and procedures which should foster a more efficient collaboration, in particular the designation of a “lead agency” in each policy area of common interest, with close interactions and accountability built-in.⁶ Most of the prolonged users surveyed as part of the evaluation recognized that there had been some improvement, because of the streamlining initiative and the PRSP process, but they emphasized that much more was needed. Looking ahead, the key challenge, in order to achieve sustainable adjustment earlier and thereby minimize prolonged use, is to ensure that the two institutions and the authorities will be able, jointly, to identify the limited number of structural reforms which are key to long-term macroeconomic sustainability and sustainable growth; to collaborate effectively in designing the most appropriate strategy for implementing such reforms; and to monitor their implementation through appropriate, but parsimonious conditionality. This will require a much more effective meshing of the priorities and work programs of the IMF and the World Bank than in the past.

Insufficient attention to assessments of political feasibility

8. The case studies make clear that ownership and implementation capacity were often the Achilles’ heel of IMF-supported programs in these countries. These were also the reasons most frequently cited by IMF mission chiefs participating in the IEO survey when asked to rank the reasons why the programs they had negotiated or overseen had been unsuccessful. Many country authorities in prolonged user countries also expressed the view that the underestimation by the IMF of the technical and political limits to implementation capacity, and the consequent overoptimism about the speed of success, was an important reason for their prolonged use of IMF resources.

9. Political feasibility is clearly closely related to ownership but is not identical to it, and in principle one could argue that the IMF should make a realistic assessment of political feasibility of any program as an essential aspect of ensuring credibility, whatever the level of ownership.⁷ It is certainly possible to envisage situations where programs are owned by the government but are not politically feasible.

⁵ The history of cooperation between the IMF and the World Bank is reviewed in more detail in an annex of “Strengthening IMF-World-Bank Collaboration on Country Programs and Conditionality”, IMF, August 2001.

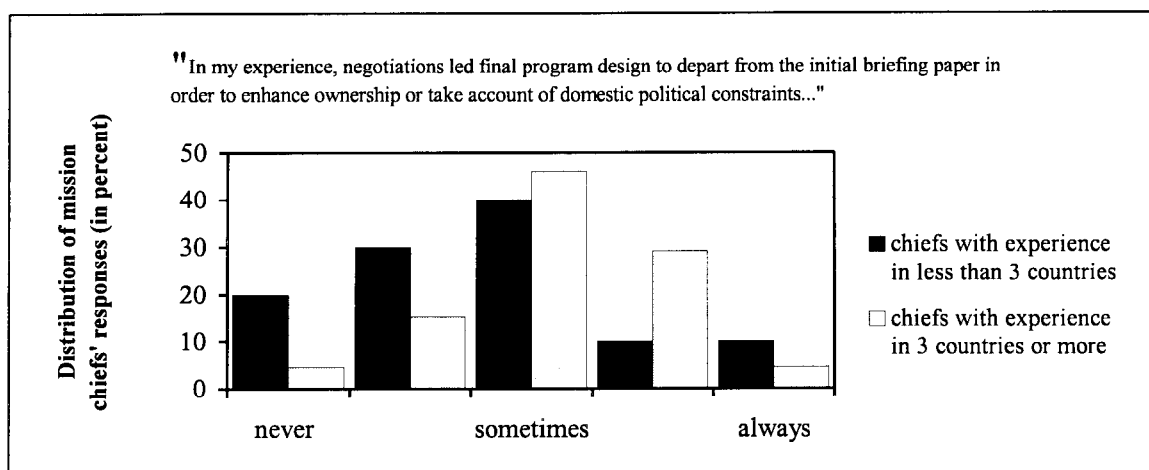
⁶ Additional initiatives are the creation in 1999 of joint Bank-Fund “products”, such as the FSAP and joint staff assessments of members’ PRSPs, along with the adoption of policies and operational guidelines to strengthen Bank-Fund collaboration in country programs and conditionality in 2001 and 2002.

⁷ The concept of “ownership” and its possible operational implications were rarely discussed until the last few years. This situation has changed dramatically since 2001, and no fewer than six staff papers directly concerned with that subject have been issued, of which two are research papers and four policy papers discussed by the

(continued)

10. Surveys of authorities in prolonged users and IMF mission chiefs indicate that the latter are not insensitive to domestic feasibility constraints. Seventy percent of mission chiefs surveyed reported that, in their experience, the frequency with which final program design departed from the initial briefing in order to enhance ownership or take account of political constraints was more than occasional. Furthermore, most mission chiefs reported that they did not consider their performance assessments to be adversely affected when program negotiations departed from their brief. But the frequency of such departures seems to be positively correlated with the experience level of mission chiefs. About three quarters of mission chiefs with experience in three or more countries reported such departures “sometimes” or “frequently”, compared to less than half of chiefs with experience in less than 3 countries (see Chart 1 below).

Chart 1. Consideration Given to Ownership in Program Design



11. Many officials and other stakeholders from the prolonged user countries acknowledged that there were wide variations in approaches and that the most effective mission chiefs did invest considerable time in understanding the political situation and consulting with a broad range of participants, but they said that in general too little attention was paid to such issues. Discussions with IMF staff and reviews of internal documents (e.g. back to office reports routinely prepared following missions) also suggest that much more mission time is now devoted to discussions with various political and social groups in an effort to gauge, and enhance, the degree of consensus behind particular reform agendas. Any meaningful reforms will always attract some opposition and, as a number of staff stressed in our discussions, it is important to distinguish between genuine concerns about political feasibility and narrower considerations of short-term political inconvenience which may lead governments to delay reforms when the prospective benefits are only likely over the long term. Several internal documents reviewed by the IEO in the context of case studies suggest

that IMF staff often has a good understanding of the political economy of program implementation and the potential risks. However, these considerations often did not surface in staff reports to the Executive Board.

12. The extent to which the IMF could or should analyze political factors in a more explicit and systematic way as part of its decision-making procedures on programs is an important but difficult question to address. A paper prepared at the request of the IEO by a team of political scientists illustrates some of the tools that might, in principle, be used in such political feasibility assessments, although incomplete information obviously limits how much such tools could be applied ex ante in highly complex situations. Nevertheless, the paper suggests that the application of some of these analytical tools to the Pakistan programs of 1993/94 and 1997 would have raised significant doubts about the government's ability to implement them.⁸ It is impossible to say with certainty whether such analyses would have led to different decisions regarding the IMF's involvement or program design, especially since there was a strong and understandable tendency to give new governments the benefit of the doubt. However, such analysis might have enabled staff, management and ultimately the Board to make better-informed judgments and could have influenced the content of programs. Chapter VIII discusses further how the IMF's handling of political feasibility in its decision-making process might be improved in the future.

Political influences on IMF decision-making

13. Another factor that may affect IMF decisions and underlie the phenomenon of prolonged use is "political" pressure from influential shareholders. Pakistan may be the clearest example of a case where the decision-making process of the IMF has come to be perceived as politically driven by many stakeholders in Pakistan.⁹ Such perceptions were also present (although to a lesser extent) in other country case studies. More generally, political pressures were the third most frequent factor cited by mission chiefs participating in the IEO survey in explaining less than successful outcomes in the programs they negotiated or oversaw.

14. The impact of political considerations in the IMF decision-making process can not be measured rigorously, but the survey of mission chiefs suggests that they are neither rare nor widespread. Only seven percent of mission chiefs surveyed reported that their technical judgment regarding support for a UFR request had been overridden by political pressures

⁸ "Political Science Tools for Assessing Feasibility and Sustainability of Reforms", by Professor Andreas Wimmer, Director of the Department of Political and Cultural Change at the Center for Development Research, University of Bonn, with Indra de Soysa and Christian Wagner. The purpose of the paper is to illustrate the analytical tools that are available to address such issues, not to undertake a full-fledged political economy analysis of particular cases. The paper will be made available on the IEO's website at www.imf.org/ieo (pending publication, the paper can be accessed internally in EDMS, document no. 1445171). Its main points are summarized in an appendix to the Pakistan case study.

⁹ Many of the staff members interviewed concurred that many of the decisions on the IMF's involvement in Pakistan since the 1980s had been politically driven to a large extent.

“frequently” or “always”. However, as many as 48 percent reported that they had experienced such strong pressures “occasionally” or “sometimes.”

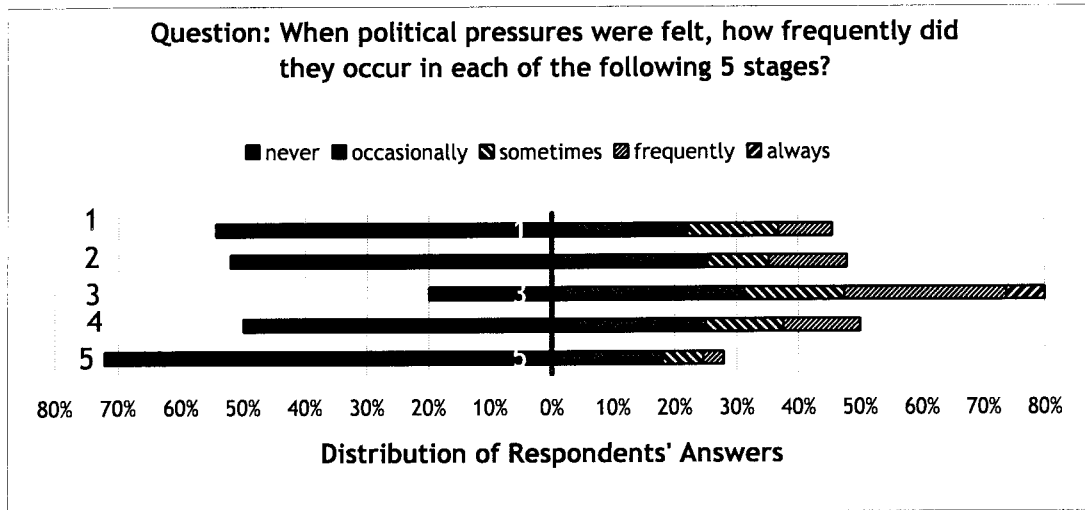
15. It is neither practicable nor desirable to expect that political considerations could be completely removed in an institution whose decisions have to reflect the views of its shareholder governments. However, a problem arises if political considerations are seen to overwhelm technical considerations, leading the IMF to support programs that have a low probability of success. This would inevitably raise concerns that the principle of uniformity of treatment across countries may not be upheld and it could also encourage a lax approach to implementation by the borrowing country. In our view, the focus of action should be on introducing greater clarity and transparency about the nature of the judgments that need to be made and who should make them. The existing guidelines state that the Managing Director of the IMF will recommend that the Executive Board approve a member’s request for Fund resources “when it is his judgment that the program ... will be carried out”.¹⁰ This presumes that an absolute judgment can be made on technical grounds. In practice, however, all such judgments—about the likelihood that a program will be implemented and whether it will achieve its objectives if implemented—can only be made in a probabilistic sense, based on a clear assessment of the risks and trade-offs for both the member country and the world community. The present procedure does not make a sufficiently sharp distinction between the technical assessment of the risks and the judgments involved in weighing those risks, which is where any political considerations should presumably enter. This situation has important drawbacks. First, there is no formal and transparent channel through which political judgments on this balancing of risks can be suitably fed into the process before the final stage of Board approval even though it is at earlier stages that political pressures may be greater.¹¹ This was confirmed by the survey of mission chiefs, significantly more of whom indicated that political pressures occur at key times *before* the Board discussion rather than at the Board itself (see Chart 2 below). Second, the line of accountability between staff, management, and the Board becomes blurred. Moreover, the lack of transparency can give rise to exaggerated perceptions of political pressures, which are likely to weaken the effectiveness of IMF-supported programs.¹²

¹⁰ 1979 Guidelines on Conditionality; guideline No. 7. The revised guidelines which were under discussion by the Executive Board at the time of writing of this report contain identical language. Guideline No. 8 further entrusts the Managing Director with a responsibility to ensure the non discriminatory treatment of members in the application of UFR policies.

¹¹ The only such process at present takes the form of “informal” Board discussions, convened in the most sensitive and high profile cases. But since there is no official record of these discussions, they have little value-added in terms of transparency and accountability.

¹² If only by providing a convenient excuse to all parties involved in the negotiation for the shortcomings of program design, and by blurring the signals sent by the program to economic agents, both within and outside the country.

Chart 2. Timing of Political Pressure



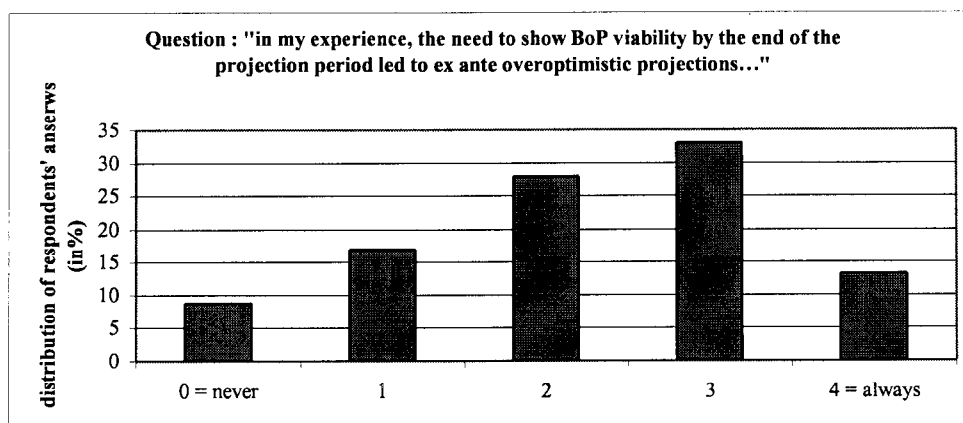
1. drafting mission brief 2. clearing brief; 3. negotiating program; 4. preparing Board meeting; 5. Board meeting

16. We discuss in Chapter VIII what might be done to deal with this problem. The aim should be to ensure that such political judgments—which are an inevitable part of decisions on whether or not to proceed with programs whose outcomes are uncertain—should be clearly distinguished from technical judgments and should be made in a transparent manner at the level of the Managing Director and the Executive Board, who are accountable for them.

Incentives to overpromise in programs

17. The IEO survey of mission chiefs suggests that internal incentives create a tendency to overpromise. As discussed in Chapter III, until the late 1990s, the rules governing the use of IMF resources implied that all programs submitted to the Board's approval had to show at least substantial progress toward viability within the program period, along with net repayments by the member after the expiration of the program. In practice, the IMF was often placed in a situation where it found it desirable to enter into an arrangement with a member even though there were good reasons to doubt that these viability requirements would be met. In a number of cases, this appears to have led to projections of a return to external viability over the medium term that were overoptimistic not just ex post, as discussed in Chapter V but also ex ante. About 45 percent of mission chiefs surveyed by the IEO reported that the need to show balance of payments viability by the end of the medium term projection period had led to ex ante overoptimistic projections or overambitious program objectives "frequently" or "always" with another 28 percent reporting the same phenomenon "sometimes". In contrast, only about a quarter reported this practice occurring "never" or only "occasionally" (cf. Chart 3 below).

Chart 3: Incentives toward Overoptimism

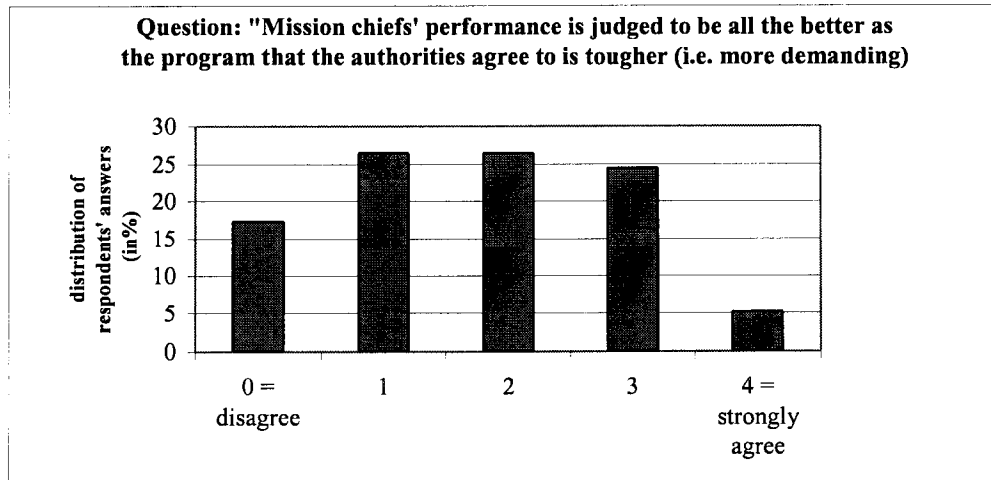


18. While optimistic forecasts may appear to be supportive of borrowing countries in need of assistance in the short run, since they enable a program to be approved, their long term effect is likely to be adverse. As the case of Pakistan illustrates, they create conditions in which programs are virtually certain to go off track when the optimistic projections do not materialize, leading to new programs which often meet the same fate. This creates a cumulative impression of poor implementation on the part of borrowing countries and also poor program design on the part of the IMF, eroding the credibility of both. More realistic projections would help to identify financing needs more accurately, both in terms of the volume of assistance needed and the length of time for which support may be necessary. If assistance on the scale required is not feasible it would at least lead to more realistic assessments of likely outcomes in terms of performance, which would enable the international community to determine whether these are indeed acceptable or whether additional support can be mobilized.

19. A significant proportion of staff members interviewed in the course of the country studies were also of the view that the internal review process gives a premium to "toughness" over realism in the setting of program targets, leading to targets that were more likely to be missed. The survey of mission chiefs further indicated that close to thirty percent of survey participants felt somewhat strongly that their individual performance appraisal would be better if they were "tougher" in negotiations with the authorities, with only 17 percent in clear disagreement with that view (see Chart 4 below).¹³

¹³ There were no marked differences across responses according to mission chiefs' exposure to prolonged users.

Chart 4: Incentives Towards “Toughness” in Program Design



20. The primary purpose of IMF-supported programs, as stated in the Articles of Agreement, is to “give confidence to members” and this objective probably contributed to the tendency to underemphasize downside risks in documents presenting a UFR request or a program review to the Board. The case studies—especially Pakistan—show that even when those downside risks were identified at the stage of the interdepartmental review process, which was frequently the case, they were subsequently toned down in the final Board documents, as were any disagreements between functional and area departments on the appropriate adjustment path or program design. While the ability of the IMF to “speak with one voice” is one of the strengths of the institution, it should not be at the expense of full presentations of the risks to a program, an exploration of policy alternatives, and a frank assessment of implementation capabilities.

21. On the authorities’ side, the case studies suggest that there can be tactical incentives for knowingly agreeing to a program that overpromises in order to achieve a release of external financing. For example, in the particular case of fiscal revenue targets, ex-ante overoptimism sometimes made it easier to reach a domestic consensus on the magnitude and design of fiscal adjustment (since overoptimistic revenue targets postponed difficult decisions on expenditure cuts).

The role of surveillance

22. In theory, the exercise of surveillance in program countries should provide an opportunity for a “reality check” to compensate the incentives discussed above. However, the evidence from the case studies suggests that some important aspects of surveillance have been weakened in prolonged use cases. Since the early 1980s, Article IV consultations in program countries have generally been conducted jointly with UFR related discussions. The case studies suggest that, compared to current guidelines, there was often less in-depth medium-term sensitivity and vulnerability analysis, less exploration of the possible trade-offs between different policy options, and a less candid discussion of divergences of views

between the staff and the authorities (see Box 1).¹⁴ This appears to stem from in-built concerns not to “rock the boat” by including any analysis that might undermine the credibility of the program and its desired catalytic effects.

23. In countries where programs are occasional events, the combination of Article IV consultations and UFR discussions may also reduce the quality of surveillance, but the impact is temporary. It is potentially much more significant for countries that have a long series of IMF-supported programs, as a weakening of surveillance in such cases could allow vulnerabilities to build-up without appropriate warning signals being sent. The build-up of a large uncovered foreign exchange exposure through foreign currency deposits in Pakistan, which culminated with a deposit freeze in 1998, is one illustration of this risk.

The IMF’s learning culture could be improved, including through more systematic program assessments

24. Despite various policy requirements and frequent calls by the Board for more “stock-taking” opportunities, there are too few occasions when the institution steps back on country programs to reconsider its overall strategy. One attempt at creating systematic opportunities for staff to step back from routine program work and think strategically about the IMF’s involvement in the member country was made by Management in 1992, with the creation of internal “country strategy papers” (CSPs). However, experience with that instrument proved unsatisfactory.¹⁵ In response, a revamped CSP strategy was prepared in 1997, which called for such papers to provide essentially two elements: (i) a critical and frank review of the latest arrangements, covering not only whether program targets were met, but also the appropriateness of program design; reasons for the success of, or problems in, program implementation; the progress made relative to the ultimate objectives of the country; the remaining issues to be tackled; and an assessment of the effectiveness of the collaboration with World Bank staff; and (ii) a forward-looking strategy for future IMF involvement, taking account of the lessons drawn in part (i) and focusing on the broad pattern of macroeconomic adjustment and key areas of structural reform (including a discussion of the rationale for their choice, phasing, and prioritization).

¹⁴ The 2002 Review of Surveillance, which looked at the implementation of surveillance in program countries during 2000-2001 came to similar conclusions. See “Biennial Review of the Implementation of the Fund’s Surveillance and of the 1977 Surveillance Decision: Surveillance in a Program Environment” (SM/02/82, Supplement 2, 3/15/2002).

¹⁵ Memorandum from the then Director of PDR to IMF Management. The memorandum indicated that, by mid-1997, only 31 CSPs had been produced (of which only 12 concerned prolonged users), and noted that “it is not clear that a number of the CSPs generated value added commensurate with the efforts involved. In addition, several were lengthy and heavy on detail, providing little assessment of operational relevance or guidance in terms of priorities”.

Box 1: Factors Used to Assess the Quality of Surveillance in Prolonged Use Cases

To assess the quality of surveillance in the country case studies, we rated the performance of each surveillance report for nine functions viewed by the IEO as “key elements” of surveillance in a program context.¹ These nine functions are: (i) provision of realistic medium term and alternative scenarios; (ii) provision of meaningful sensitivity analyses; (iii) discussion of risks to the assumptions and projections; (iv) discussion of the risks and impact of policy slippages and of vulnerabilities; (v) balanced reporting of the authorities’ views, including any significant differences with staff; (vi) cogent presentation of proposed policy course; (vii) discussion of policy alternatives and trade-offs; (viii) critical and frank review of previous UFR performance; and (ix) presentation of collaboration/interaction with the World Bank.

It must be recognized that, to some extent, such a comparison does involve judging previous surveillance exercises by current standards. More specifically, whereas all the functions highlighted above have been part of surveillance requirements since at least the early 1990s, and often earlier, the emphasis they have received has tended to increase overtime. For instance, discussions of risks and vulnerabilities received a much stronger emphasis after the 1995 Mexican crisis, and an even stronger one since the 1997/98 Asian crisis. In contrast, the requirement that staff prepare an analysis and assessment of performance under IMF-supported programs in connection with article IV reports, adopted in 1979, was never emphasized in subsequent surveillance guidelines.

As noted in the main text, the overall assessment is that many of these key functions of surveillance were not fully implemented in the prolonged use case studies. However, there is some indication that the quality of surveillance in the case study countries did improve over time—most clearly in the Philippines—with respect to some of the key functions identified here, particularly as regards the identification of vulnerabilities. Nevertheless, the key conclusions that some key surveillance functions have not been fully implemented in prolonged use cases remains valid.

1/ These nine functions draw on the “minimum requirements” of Article IV reports as identified on PDR’s website (which reflects the guidance given by the Executive Board in successive biennial reviews of surveillance up to the 2000 exercise as well as in ad hoc discussions of specific aspects of surveillance policy), as complemented by three other sets of internal guidelines of particular relevance for program countries (the 1979 Conditionality Guidelines—especially guideline 11; the 1990 note on Assessments of a Member’s ability to repay the Fund; and the 1997 note on Country Strategy Papers, both issued by PDR) and the 1998 instruction note on Report Writing by the First Deputy Managing Director. These internal instructions add a qualitative dimension to the general guidelines, which themselves are primarily concerned with coverage.

25. The documents reviewed as part of the country case studies suggest that the quality of CSPs produced since this revamped approach did improve significantly. However, relatively few were produced (in total 24 full CSPs and 3 partial ones between mid-1997 and end 2001—i.e., less than six a year on average), primarily due to workload constraints. Thus, most programs still do not benefit from any stock taking exercise when they expire, and those that do are not necessarily the ones for which there would be the greatest need to learn from experience (i.e. in particular, programs which went irretrievably off-track). Moreover, those prepared for the case study countries suggest that the judgments in CSPs were often not fully reflected in subsequent program or surveillance documents.

26. In contrast with specific country programs, experience with IMF general policies has been subject to quite intensive and usually high-quality reviews. Many of these reviews have drawn clear lessons from their analyses that are of relevance to program design in general,

including for prolonged users.¹⁶ However, the process often stopped at the diagnostic stage and some of the lessons identified subsequently took a long time to be actually incorporated into program practices. For instance, several staff papers from the mid/late 1980s identified the lesson that the authorities' commitment was key to the success of any program and that, if it was lacking, efforts to optimize the program design were bound to be of limited effectiveness.¹⁷ Similarly, most of the ingredients of robust and realistic sustainability assessments mentioned in a paper discussed by the Executive Board in June 2002 that proposed a formal framework for mainstreaming "best practices" in that area, were actually identified and circulated as guidelines to area department staff as early as 1990, with a view "to avoid well-known traps—such as scenarios which seek to establish viability by the use of optimistic assumptions. There is a need to be open about the possible dangers."¹⁸ Many of these reviews also drew useful lessons for program design that have yet to be fully operationalized—for example, the importance of an early focus on institutional reforms, particularly for sustainable fiscal adjustment.¹⁹

¹⁶ There have been 58 such policy reviews since 1979, covering the entire spectrum of UFR-related issues, from theoretical and operational aspects of program design, to access policies, external financing and the design of various facilities.

¹⁷ See for instance EBS/86/211, *Program Design and Performance Criteria*, noted that "it is important to bear in mind the fundamental limit to the efficacy of program monitoring imposed by the degree of commitment of the member to the policies that make up the program. The commitment of members to their program is essential to their success. While the Fund's role in providing policy advice is important to the formulation and design of the program, it can only be effective if the member is committed to it and implements it with the consequent resolve".... Also, EBS/87/40, *External Adjustment, Financing and Growth—Issues in Conditionality*, which noted that "the politics of adjustment is often as important as the economics. With benefits of hindsight, it appears that in some particularly difficult situations the capacity to implement adjustment policies was not sufficient. In some instances time may be required for a strategy to emerge that is consistent with domestic political realities".

¹⁸ Cf. *Assessments of Member's capacity to Service its Financial Obligations to the Fund*, memorandum from the Head of PDR to area departments; July 5, 1990: "[Medium-term] scenarios should prove useful in identifying cases where external viability would be ensured only if strong policy actions continued in the post-program period, only if the external environment remained particularly favorable (say, relative to developments in the past), or if creditors were to provide large amounts of exceptional financing through the projection period. It is important that these scenarios not be presented in a way that fails to warn of potential dangers... When an improved policy stance in the post-program period is mainly an extrapolation of progress expected to be made under the program, or if further major improvements are expected in the post-program period without specific policy underpinnings, these limitations should be made explicit. Similarly, an attempts should be made to assess the quality of the adjustment effort, in particular from the point of view of the sustainability of the program. Temporary or cyclical factors should be identified in evaluating the underlying strength of the adjustment." The note further stressed "the importance of evaluating the risks of policy slippages and the implications of such slippages for the medium-term prospects of the balance of payments and the member's capacity to repay the Fund. These evaluations could be based on an assessment of those key policy areas where the authorities have had difficulties with program implementation in the past. Also, if key policy elements have been proposed but have yet to be legislated or implemented, the analysis would assess the implication of a failure to adopt the required measures in a timely fashion. Whenever possible, specific contingency measures should be outlined for cases when legislatures fail to act on key policy elements in the program".

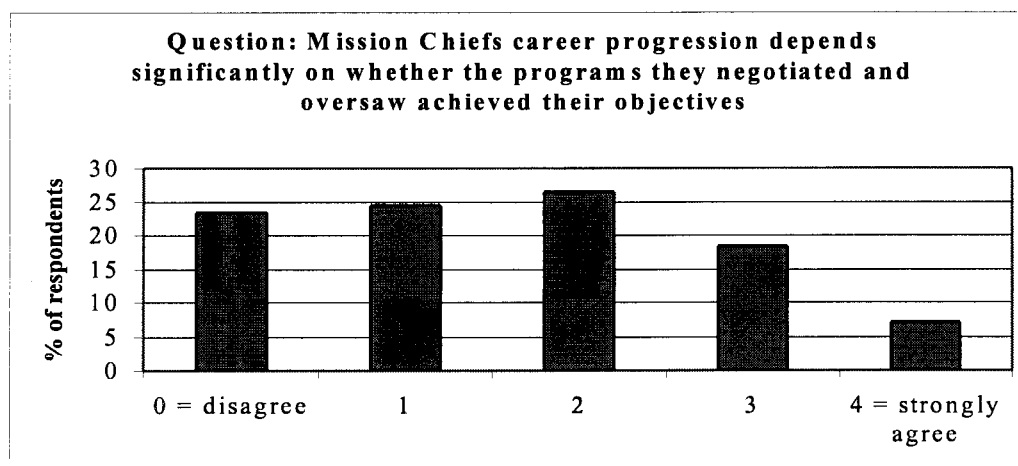
¹⁹ See *The Composition of Fiscal Adjustment and Growth, Lessons from Fiscal Reforms in Eight Economies*, IMF Occasional Paper, March 1997: "One basic lesson for successful growth-oriented fiscal adjustment is that,

(continued)

27. **Thus, the IMF often seems to have been quite good at identifying lessons, but less effective at ensuring that they were fully absorbed into its everyday operations.** The experience of the country case studies suggests that this slow absorption of lessons and broader policy guidance into actual operations on a systematic basis contributed to weaknesses in program effectiveness and hence to prolonged use. However, it is clearly not a phenomenon that is special to prolonged use cases.

28. These shortcomings in the IMF's learning culture are compounded by two human resource management issues. First, as noted in Chapter IV, the internal turnover on country assignments is high. While not specific to prolonged users, this is a significant impediment to the development of an adequate learning culture, not least because many of the lessons to be learned from experience are country specific. Thus, even if the lessons from policy review were fully and swiftly incorporated into the IMF's operational practices, an important gap would remain. Second, high staff mobility limits the accountability of mission chiefs: when mission chiefs have a shorter tenure, on average, than the time span of most programs, their contribution to the outcome of a given program becomes harder to assess. Clearly, program success depends to a very large extent on factors beyond the mission chief's control, but an effective mission chief should make a difference. Yet, results of the IEO survey indicate that most mission chiefs do not feel that their career progression depends significantly on whether the programs they negotiate and oversee achieve their objectives (see Chart 5).

Chart 5. Mission Chiefs' Career Progression and Program Outcomes



to the extent possible, it should emphasize administrative reforms right at the outset. [Experience] suggests that early reform is more likely to be substantial reform.”

B. The “Gatekeeper” Role Assigned to the IMF with Respect to Many Other Sources of Official Financing Also Contributed to Prolonged Use²⁰

29. In addition to the internal factors affecting program design which lead to ineffective programs and thus encourage prolonged use, there is a systemic factor which has the same effect: the gatekeeper role of the IMF in providing a signal for other resource flows. There is considerable empirical evidence that aid is most effective when a sound economic policy framework, including a sound macroeconomic environment, is in place. The IMF is the international institution most suited to providing certification regarding the soundness of macroeconomic policies, and the main multilateral lenders and most major bilateral donors have come to rely upon the IMF to give this signal when making decisions about their program and adjustment lending. However, the expectation seems to be that the signal will be conveyed in the form of an IMF lending arrangement. Since many countries expect to rely upon bilateral and multilateral flows for an extended period, the requirement that there should be an IMF-supported program in such cases is a recipe for perpetuating prolonged use.

Is IMF financing necessary for a seal of approval?

30. It is appropriate to question whether creditors/donors should insist on an IMF-supported program as the only credible seal of approval on whether the same objective could be achieved in some other way, e.g. through the surveillance process or staff’s assessments of countries’ PRSPs. In their responses to the IEO, official donors and creditors often justified their preference for a program on the grounds that a lending arrangement provides a clearer and more reliable assessment.²¹ For creditors—especially the Paris Club and the private sector—“burden sharing” issues may also be important: some of these groups have been reluctant to provide additional financing if large net repayments are being made to the IMF or if the absence of new IMF financing implies that other new sources of financing will not be forthcoming.²²

31. These considerations are reinforced by the fact that, historically, the Executive Board has been rather reluctant to generalize the recourse to intermediate signaling tools, such as “enhanced surveillance” in the 1980s, staff-monitored programs (SMPs) and other “shadow

²⁰ The following sections draw upon a series of questionnaires to and interviews with the main bilateral donors and creditors, with the Paris Club Secretariat, and with a range of international banks and asset managers engaged in emerging market investments.

²¹ The latter point, in some cases, appeared to stem from the perception that the IMF would conduct its assessments more seriously if its resources were involved than otherwise.

²² In the case of the Paris Club, relying on the IMF has the added advantage of providing an objective framework to determine which countries should benefit from debt restructuring and on what terms. The multilateral and informal nature of the Paris Club also makes its reliance on the judgments of the IMF with regard to debt service capabilities and the macro framework natural.

programs”.²³ It is also possible that the various instruments of “strengthened surveillance” were not regarded as providing sufficient assurances to donors because of the lack of clearly defined standards for such instruments. In some cases, these instruments were resorted to when the member’s program fell short of what could be supported by a lending arrangement; in other cases, the member’s program met or even exceeded UFR standards, but the member did not want to be perceived as being in need of IMF resources.

32. It is worth noting that unlike the official sector, private creditors have become less dependent on IMF-supported programs as a “seal of approval”. Such a signal was needed to enable a debtor country to negotiate rescheduling or restructurings agreements with its private creditors in the decade or so after the debt crisis of the early 1980s and this contributed to prolonged use at the time, e.g. in the Philippines. However, this factor has been much less important recently, owing to less widespread debt servicing difficulties, together with an increasing tendency on the part of the private sector towards one-time restructurings of the debt stock or debt exchanges, rather than a succession of annual arrangements.

33. Nearly all the private financial institutions surveyed as part of this evaluation considered an IMF-supported program to be highly desirable for a debt restructuring or a coordinated debt rollover, but not absolutely necessary.²⁴ They observed that, historically, a number of debt restructurings had been completed where an IMF-supported program was not possible. Examples include the reschedulings for a number of East European economies and for South Africa in the 1980s, and for Iran in the early 1990s. In the view of some of the respondents, these reschedulings were “among the most successful”. Respondents also noted that the timing of restructurings by private creditors need not be tied as closely to IMF-supported programs as, for example, Paris Club reschedulings typically are. There are many examples of debt restructurings by private creditors that were completed when IMF-supported programs had gone off-track.²⁵

34. For countries that are not facing immediate debt-servicing difficulties, many private investors and lenders take the country’s relationship with the IMF into account, directly or indirectly, in their investment and risk management decisions but IMF financial involvement is not a necessary signal.²⁶ Several alternative mechanisms are available for that purpose, e.g. precautionary arrangements, staff-monitored programs, and IMF surveillance through

²³ This reluctance was based on varied reasons including a fear that making IMF assessments too public or explicit might turn the institution into a universal credit rating agency and concerns about marginalizing the catalytic role of the IMF’s resources.

²⁴ In most cases this was because they viewed agreement on an IMF-supported program as providing some assurance that realistic economic policies and reforms would be implemented, eventually leading to the restoration of external viability and so enhancing the value of the debt to be restructured. In many cases the direct financing implications of IMF involvement were also considered important.

²⁵ For example, Pakistan’s 1999 debt rescheduling agreements with private creditors were concluded as the EFF/ESAF arrangement was off-track, with little prospect of renewed IMF support in the near future.

²⁶ In a few cases, the relationship is even explicitly taken into account in quantitative risk management systems.

Article IV consultations—whose signaling role has been enhanced in recent years as a result of improvements in transparency, with many such reports now being published. These alternatives vary in the degree to which they imply formal IMF approval of policies. The Executive Board has traditionally emphasized that, unlike the so-called enhanced surveillance procedure or precautionary arrangements, staff-monitored programs do not constitute IMF endorsement of the country's policies. Internal reviews of experience have shown that these distinctions may not always be clear to private market participants. Other factors mentioned as limiting the usefulness of surveillance reports to the private sector include the considerable variability from country to country in terms of disclosure and publication of reports, a lack of timeliness, and limited frequency. In this respect, staff-monitored programs or precautionary arrangements can add value by providing more frequent assessments of developments, at the time of periodic program reviews. In general, most respondents to the IEO survey found IMF surveillance to be a useful input into their risk management assessments.

35. Jamaica's experience—discussed in more detail in the companion paper on the case studies—is interesting since it was able to maintain access to private markets on relatively good terms despite publicly ruling out new lending arrangements with the IMF. Senior Jamaican officials interviewed indicated that a commitment to transparency—including publishing the IMF surveillance reports, even when they did not fully share the assessment, and explaining the reason for their different approach—had helped maintain good private market access.²⁷

36. The key reason why considerations of an IMF “seal of approval” for the private sector is rarely the determining factor behind prolonged UFR is that most investors and lenders ultimately rely on their own judgments, for which the assessments and analyses of the IMF are only one source of information. The views of other institutions—including credit rating agencies—often also play an important role. Some institutions also expressed reservations about relying too much on the IMF's judgment, in part because of misgivings about its impartiality, noting its vested interest in helping its members.

37. An important question is whether a prolonged IMF program involvement weakens the credibility of the signals provided by lending arrangements and hence reduces its catalytic effect. It was not possible, in the context of this project, to test rigorously this question, partly because available cross-country evidence on the existence of any catalytic effect is inconclusive.²⁸ However, among the studies which found a positive correlation between

²⁷ One senior Jamaican official said that, in his experience, sending appropriate signals to private financial markets did not require an IMF-supported program, but it did require that the authorities not be “fighting with the IMF.”

²⁸ Several studies covering the 1970s and 1980 found evidence of a negative relationship between IMF involvement and the subsequent supply of new loans. Bird et al. (2000) find that the relationship is unstable but, when significant, strongly negative as far as private capital flows are concerned. Conway (2000) and Eichengreen and Moody (2001) find a positive relationship under particular specifications. Evidence is more consistent as regards official capital flows, for which there does appear to be a positive relationship between the

(continued)

IMF-supported programs and market access, those which tested for the impact of prolonged use found that the beneficial effect of IMF involvement declined in size with the length of past IMF involvement and that continuing IMF presence was associated with higher spreads.²⁹

Consequences of the gatekeeper role for lending arrangements and surveillance

38. There is some evidence from the case studies that insistence on having the IMF's seal of approval delivered exclusively in the form of a lending arrangement can compromise the quality of IMF-supported programs, and therefore the quality of the seal of approval. This is because the potential consequences for the member country, in terms of loss of financing, are so serious that pressures build—on both the authorities and the IMF—to agree to programs with a low probability of success.³⁰ There are similar pressures to keep the programs formally on-track as long as possible, often through unsustainable efforts, even when several PCs are not met, under the assumption that officially calling the program off-track would trigger adverse donor responses. Such factors contributed to the problems with a number of Pakistan's programs and have also been an issue in Senegal and the Philippines.

39. Whatever signaling device is used, it is clearly important to resist pressures to compromise quality. But there is a case for considering vehicles other than an IMF lending arrangement in some circumstances. Private sector creditors have already acknowledged this in their approach to lending to developing countries. Official donors surveyed by the IEO generally took a cautious stance, pointing out in particular that requiring an IMF "seal of approval" to target some of their aid flows had been instrumental in improving the effectiveness of their aid, so that any departure from this—sometimes hard-won—policy rule would imply a step backward in this respect. This premise notwithstanding, most acknowledged the above-discussed dangers of an exclusive reliance on IMF lending arrangements to deliver the requested seal of approval. Most were therefore open to considering alternatives, provided that: (i) they suitably addressed the information needs of the donor community; (ii) they delivered sound and candid analyses of economic conditions and prospects; and (iii) they provided a clear assessment that the member's policies are sufficiently strong to be supported. Some possibilities in this regard are explored in the final Chapter.

presence of an IMF-supported program and those flows. However, the sustainability of aid flows in the past program period is not established.

²⁹ C.f. Eichengreen and Mody (2001) and Mody and Saravia (2002).

³⁰ To be sure, countries with market access retain, to some extent, the flexibility of dispensing with an IMF lending arrangement if they feel the steps required from them to be granted the IMF's seal of approval are not in their best interests. The case of Jamaica, discussed in the companion paper on the case studies, is a good illustration of that situation. On the other hand, countries which do not have access to private capital markets, either permanently or temporarily, have strong incentives to accept the IMF's conditions even when they have misgivings about their feasibility or likely impact.

VII. THE IMPLICATIONS OF PROLONGED USE FOR THE MEMBER COUNTRY AND THE IMF

1. In this chapter, we examine the effects of prolonged use on institutional development within the borrowing countries and on the IMF's financial and human resources.

A. Implications for the Borrower: Impact on Institutional Development¹

2. There are two possible channels through which prolonged use of IMF resources could have an impact on a country's institutional development: (i) it may help, or hinder, the development of technical skills within the departments involved in the negotiation of IMF programs; and (ii) it may foster or undermine the country's policy formulation process; including the process of policy closure, i.e. the way in which the political and bureaucratic system reaches consensus on a final strategy. The second channel is closely linked to the issue of ownership of IMF-supported programs.

Impact of prolonged UFR on the build-up of economic management skills

3. Government officials in all three country case studies and in most other prolonged user countries generally agreed that the prolonged involvement of the IMF had resulted in some positive transfer of technical economic management skills. However, views differed as to the extent of that transfer.² In a few cases, including Morocco and the Philippines, the prolonged time spent under IMF-supported programs was deemed to have made a major contribution to the development of technical and analytical skills. However, in several others, in particular Pakistan and Senegal, it was felt that the knowledge being transferred by prolonged exposure to IMF missions was too narrow and specialized to be of much use outside the context of IMF programs and that the ready availability of IMF models and methodologies weakened the incentives for local technicians to develop their own tools. The potential build-up of technical skills was also limited by the relatively low retention rate of technocrats having benefited from the Fund's training.

4. Notwithstanding the perception that there was some transfer of technical skills, officials in all three country case studies, as well as a number of respondents to the questionnaire, commented that programs had paid insufficient attention to institutional reform and to the development of adequate implementation capacity. Perhaps this is not surprising given the relatively short time span of individual IMF-supported programs. Even in cases where there has been a succession of programs following on one from another, the

¹ This section draws on the relevant findings of country case studies and on the responses to a questionnaire sent to the authorities of all prolonged users.

² In one case, the authorities commented that it was still too early to judge whether the prolonged use of IMF resources had had a positive institutional impact, suggesting that the capacity building effect of programs, if any, had been limited thus far. In another case, the authorities were of the view that the prolonged involvement of the IMF had had "a debilitating effect on economic institutions", particularly due to a "collapse of the long-term economic planning function". A similar view with respect to long-term planning was expressed by the Senegalese authorities.

short term horizon of each individual program naturally limits the extent of attention paid to capacity building. Respondents acknowledged the potential role of technical assistance (TA) and also recognized that IMF-supported programs made access to IMF TA easier, but they felt that in general IMF-provided TA was too transitory to have a sustained capacity building impact, in particular due to the lack of implementation follow-up. A general recommendation often made was that IMF TA should have a more direct focus on the ways and means of policy implementation.³

5. Finally, in several countries, including the three case studies, many commentators within and outside government were of the view that the nature of the IMF's involvement and its leverage could have given it scope for dealing with governance issues more than it did (for instance in relation with connected lending practices in Pakistan's banking sector, or with tax evasion in all three countries).

Impact of prolonged UFR on the policy formulation and closure process

6. With a few exceptions, comments received from country authorities regarding the impact of prolonged UFR on the policy formulation process were generally quite negative, primarily because prolonged use was not conducive to the development of a capacity to generate "homegrown" policies. Instead, it tended to create a situation where the policy formulation process revolved around negotiations with the Fund, locking domestic policy makers into a reactive rather than a proactive role. A typical comment was that IMF missions' briefing paper instructions become the framework of reference for negotiations, thereby giving too little scope for the discussion of alternative policy options and trade-offs. However, many country authorities acknowledged that the transformation of the ESAF into the PRGF and the creation of the PRSP process had begun to change the mode of relations with the Fund in a positive way, though it remained to be seen how this would evolve over time.

7. In several countries, including Pakistan and Senegal, it was also pointed out that the monitoring of program implementation—required not only by the Fund's own procedures but also by those of other donors whose financing was linked to the IMF program in some way—was a significant strain on limited administrative resources. As a result, local civil servants often simply did not have enough time left to focus on developing policies on aspects not covered by the program itself, or even to think through the implementation of the policies adopted under the program.

8. Some country authorities noted that the perceived need to consult the IMF on every single initiative in areas falling under the program's purview led to an inhibition of local policy formulation and into the attrition of policy development capabilities. This is a problem that could potentially arise in all IMF-supported programs, but it obviously becomes much

³ The effectiveness of IMF-provided technical assistance is a larger issue that goes beyond the scope of this evaluation. It is one of the items on the agenda for future evaluation by the IEO.

more serious in a prolonged use situation, where the effect of attrition over time and the development of a culture of deferring to the IMF can be substantial. However, there were exceptions where the domestic policy formulation process was more center-stage, usually with beneficial results. For example, Pakistan was able to develop, largely on its own and outside the context of a program, a very far-reaching tax administration plan in 2000. This example illustrates that where there is sufficient political will, the inhibition of local initiative can be rapidly overcome, even after more than a decade of use of IMF resources. Likewise, authorities in a couple of other countries noted that the policy formulation process had been largely country-driven, with policies implemented under IMF-supported programs being only part of their own, “homegrown” agenda. This suggests that even in situations where prolonged use is unavoidable, it is possible to ensure that policies are more home grown and therefore more likely to be owned.

9. Similarly, it was mentioned, most notably in Pakistan, that once several successive governments had made a habit of justifying their policy decisions to the public by invoking the exigencies of IMF-supported programs, it was very difficult to reestablish a sense of ownership even for those policies which were genuinely “homegrown”: as soon as they were incorporated into an IMF-program letter of intent (LOI), they became perceived as IMF-imposed. The practice of trying to include a country’s entire reform agenda in the IMF’s LOI, rather than relying more on the country’s own policy documents, exacerbates these perceptions.

10. More generally, the absence of a broad public debate on core policy “planks” resulted in giving policy decisions a flavor of “fait-accompli” to many stakeholders, even when there was, in fact, flexibility in the negotiations. Once again, this perception tended to undermine ownership. For example, in the Philippines under the Ramos administration in the early 1990s, considerable progress was made on a range of structural reforms which emerged from the domestic political process and may have been more politically acceptable since they did not feature prominently in Fund conditionality. These included an extensive privatization program; the opening of certain sectors to foreign participation; and improvements in customs administration. The long-delayed decision to restructure and recapitalize the Central Bank was also implemented in 1993, in between programs. In contrast, some of the structural measures central to IMF conditionality in the period, including reform of the oil pricing system and tax reform, encountered serious political difficulties, probably in part due to a lack of ownership.

11. Many officials interviewed in Senegal and Pakistan pointed to the overly exclusive nature of the dialogue established by the IMF with the Finance Ministry and the Central Bank as a negative feature. In their view, this process *de facto* gave these agencies excessive power to make decisions and undertake commitments which have implications in areas which are the responsibility of other ministries and departments, without sufficient consultation, which led to lack of ownership of some parts of the government and possible problems in implementation. While this problem arises in all IMF-supported programs, it becomes especially acute in situations of prolonged use because the process is seen to marginalize a number of agencies over an extended period of time.

12. It is interesting to note that IMF staff members involved in the negotiations in the three country cases have commented that they made every effort to associate line ministries in matters related to decisions affecting their field of competence. They also noted that initiatives to keep the negotiating circle small often came from the authorities' side. However, associating line ministries is not enough if these ministries are effectively excluded at critical decision making points. We recognize that the perception of powerlessness of the line ministries and the resulting lack of broad ownership may have stemmed primarily from shortcomings in the domestic policy closure process, which may be unfairly blamed on the IMF and its procedures. However, the end result is clearly negative and the problem is not just one of perception, since it can compromise implementation.

13. In fairness, it should be noted that perceptions were not universally negative. In Morocco and a few other countries, the authorities noted that the formulation of IMF-supported programs had generally involved a relatively large group of stakeholders, even though negotiations *per se* were held strictly with the Finance Ministry and the Central Bank. This had contributed to educating managers across economic institutions about the benefits of prudent macroeconomic management and openness to the world economy. The Philippines authorities likewise credited the IMF's prolonged involvement with the strengthening of the cohesion of the economic team and said the IMF had played a useful role in interacting with a broader set of policy makers, including in Congress on the rationale for the IMF's prescriptions, even though they felt that this function had been underused. This suggests that efforts to broaden consultations, especially with line ministries but also with other agencies, should receive more attention and the IMF should work with the authorities to evolve country-specific modalities towards this end.

14. Yet another mechanism whereby IMF programs have an impact on policy closure is when they are used by some parts of the political establishment in an attempt to "tie the hands" of the incoming government with a program negotiated by the previous administration. Examples include Pakistan in 1988—in the transition from a military regime to an elected government—and also the Philippines in 1998—in the transition to the Estrada administration. While some argue that, in those cases, the presence of IMF-supported programs had a stabilizing influence, the overall result seems to have been that the resulting program was not strongly "owned" by the incoming government, which led to weak implementation and ultimately a failure to meet program objectives.

15. In a few countries, including Senegal and the Philippines, it was pointed out that the IMF was not always sufficiently sensitive to the role of Parliaments in the decision-making process. For instance, in Senegal, the *ad hoc* measures adopted in the course of a program under the IMF's pressure, particularly in the taxation area, often rendered meaningless the role of Parliament in the budgetary process. This was a source of resentment from Parliamentarians, potentially leading to difficulties in implementing other parts of the program at a subsequent stage. In other cases, such as the Philippines, Congress generally had the ultimate decision-making power in the approval of key reforms prescribed by the IMF, making it difficult to comply with program conditionality within the time constraints set by the program. As pointed out in the Philippines country study, the IMF team did

interact informally with Congress on the rationale for the IMF's recommendations, but the problem was not necessarily overcome. Ultimately, it is the responsibility of country authorities to determine how Parliaments should be associated with the government's negotiations with the IMF, but a greater mutual awareness by Fund missions and Parliamentarians of their respective roles and objectives would help smooth program implementation.

16. Many of the problems mentioned above would arise in any IMF-supported program, but they become more serious in the case of prolonged use because the process of policy formulation and closure is seen to be affected over a much longer period. In principle, these problems should be reduced for PRGF countries with the introduction of the PRSP process, though it was too soon to judge in the cases of Pakistan and Senegal, or in the responses from other prolonged users, how much difference this was making in practice.

B. Implications of Prolonged Use for the IMF

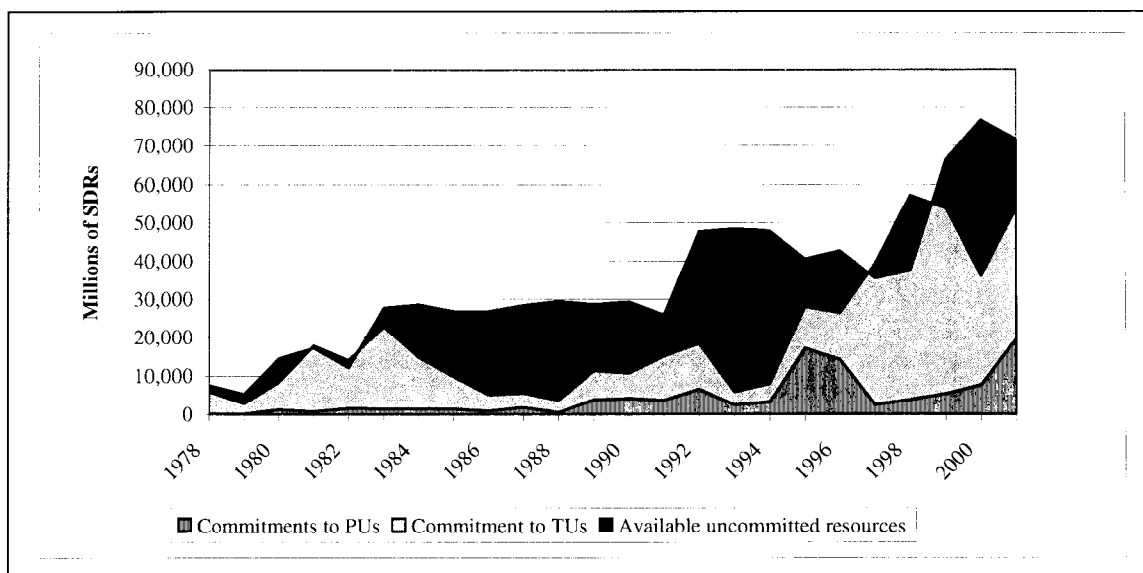
Impact on IMF finances

In the General Resources Account (GRA)

17. As noted in Chapter II, over the last thirty years, prolonged users have attracted a substantial share of IMF's GRA resources: over 20 percent of commitments per year on average (and close to one-third in the last ten years). These substantial commitments to prolonged users do not appear to have significantly constrained the ability of the IMF to extend loans to its members in need, as total commitments only rarely came close to the ceiling of available resources, and even then only for brief periods of time. Of course, since the IMF manages its liquidity position in part by decisions on the level of financing provided to particular countries, as well as through periodic reviews of its resource base, the fact that commitments only rarely reached the ceiling does not mean that the extent of financing to prolonged users did not affect the access level of other users or decisions on the magnitude of quota increases. Nevertheless, periods of resource scarcity were not associated with a sharp increase in commitments to prolonged users (see Chart 1 below).⁴

⁴ The concept of ceiling of available resources referred to here is defined on the basis of a liquidity ratio of 25 percent (i.e. a 25 percent coverage of liquid liabilities by adjusted uncommitted usable resources, excluding borrowed resources). While the IMF does not have a mandatory minimum liquidity ratio, 25 percent is the lower end of the range historically observed for the minimum. A definition of available resources based on a more conservative liquidity ratio would reduce the amount of available resources. When its liquidity position becomes tight, the IMF has the recourse to activate its borrowing arrangements from creditor countries, which can temporarily increase available resources by about SDR 34 billion.

Chart 1 : Available IMF General Resources and Commitments



Source: IMF Treasurer's department data.

18. Although prolonged use did not pre-empt resources on a scale which constrained total lending, it did have a significant effect on the revolving character of the IMF resources. This impact can be measured indirectly⁵ by comparing the average length of lending cycles between prolonged and "temporary" users, taken as fixed groups, the latter being used as a proxy for standard lending cycle length (hence for standard revolution speed of IMF general resources): resources lent to prolonged users took, on average, almost twice as long as resources lent to "temporary" users (15 years against 8 years, respectively) to become fully available again to other members.

In concessional Trusts

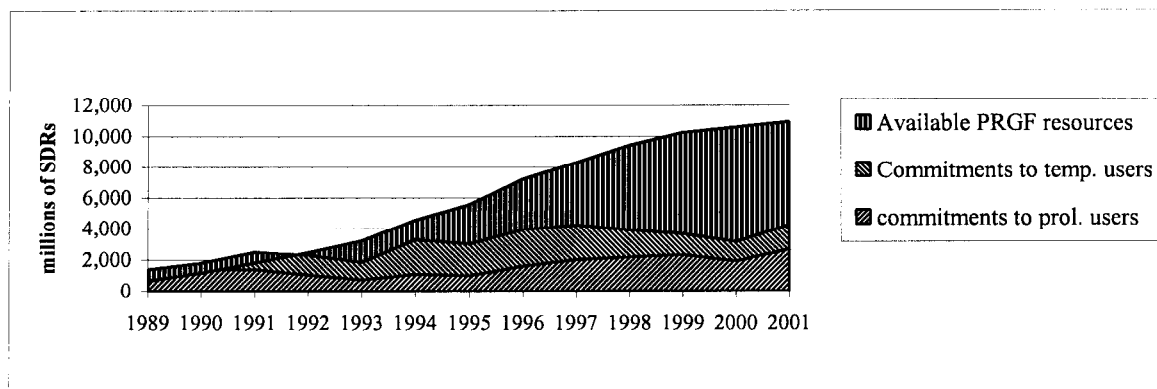
19. The resources of the ESAF/PRGF Trust are also intended to have a revolving character, albeit over a longer timeframe than the GRA. For the reasons already discussed, that timeframe could not be defined authoritatively, and instead was approximated by the average lending cycle length of "temporary" PRGF-eligible users. The comparison with prolonged users shows, once again, that the latter take much longer to make the IMF

⁵ Ideally, this impact would be measured directly by: (i) determining a notional "standard" speed of turnover of IMF resources; (ii) comparing it with the actual speed of turnover observed over a given period. However, the first step involves a number of judgments and assumptions on "normal" frequency or length of UFR and the blend of facilities in use at any given time, which it was not found practical to make in the context of this study.

resources they use available again for other members: 21 years on average, against 14 years for “temporary” users (over 1971-2000).⁶

20. As in the GRA, the scale of commitments to prolonged users in relation to total resources available for lending rarely came close to representing a significant constraint on overall lending. Nonetheless, commitments to prolonged users averaged just under half of total commitments of ESAF/PRGF resources since 1989 (see Chart 2 below).⁷

Chart 2. Use of PRGF Resources¹



Source: IMF Treasurer's Department data.

1/ “Available resources” is the difference between the total amounts provided to the trust funds and commitments.

Costs imposed on the membership through the accumulation of protracted arrears⁸

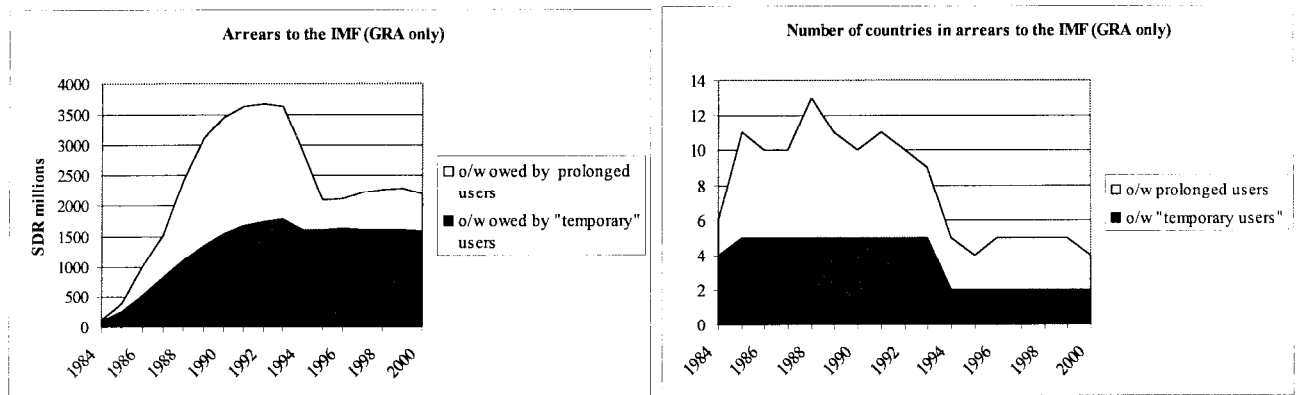
21. The problem of arrears to the IMF is much broader than prolonged use, and there is no obvious direct relationship between the two issues. However, close to 70 percent of countries which, at some point over the last thirty years, incurred protracted arrears to the IMF are prolonged users, and about one-third of the countries identified as prolonged users in this study incurred protracted arrears to the IMF at some time. In most cases, arrears were accumulated after a period of prolonged use. However, in a number of cases, prolonged use began after the clearance of arrears; for these cases, prolonged use might have been part of a “defensive lending” strategy, aimed at preventing the appearance of new arrears.

⁶ As before, these figures understate the actual average lending cycle length owing to cycles that remained uncompleted in 2000.

⁷ In each year, only commitments to countries that were prolonged users in that year were taken into account.

⁸ Protracted arrears are defined as overdue obligations for six months or more.

Chart 3. Evolution of Arrears to the IMF



NB: In these two charts, prolonged users are treated as a fixed group.⁹ Arrears include both overdue repurchases and unpaid charges.

Source: IMF Treasurer's Department.

22. The sharp reduction of the volume of arrears in recent years and of the weight of prolonged users within the total implies that the costs imposed on the membership as a whole through these channels are small.¹⁰ However, the experience of the early 1990s shows that this was not always the case. Thus, enhanced attention to prolonged users' ability to service their obligations to the IMF is warranted and this has indeed been prescribed by operational guidelines since 1990. Evidence from the case studies suggests, however, that sections of reports addressing these issues were often perfunctory, giving little idea of the potential risks in the event of markedly worse, but still possible, outcomes.

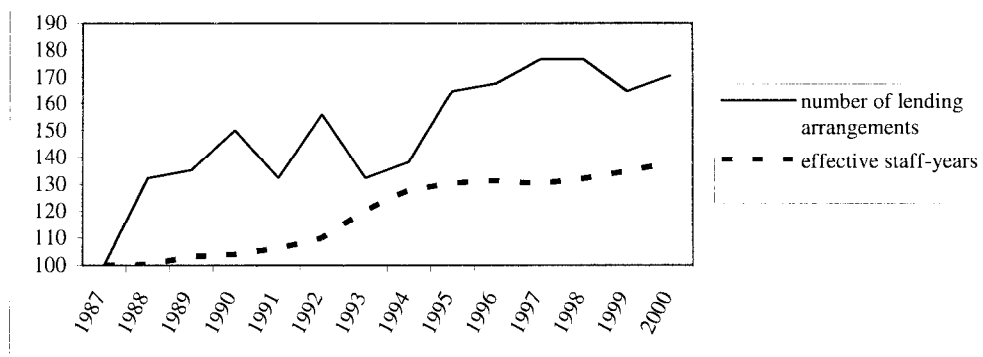
⁹ Otherwise, by definition, few countries in arrears would qualify as prolonged users except in the year where the arrears are first incurred, since their arrears make them ineligible to make further use IMF resources.

¹⁰ Arrears impose costs on the IMF membership through two distinct channels, which have been designed to ensure symmetric treatment of creditors and debtors to the Fund. First, since 1986, the rate of charge (remuneration) is adjusted upward (downward) to cover the loss of income due to overdue charges on outstanding liabilities to the IMF. This burden-sharing mechanism replaced an earlier asymmetric mechanism under which the entire burden of arrears fell on borrowing members through an upward pressure on the rate of charge. Between 1987 and 2000, the adjustment averaged a little under 80 basis points per annum both ways. However, it has been much smaller in recent years (around or below 20 basis points) and only a fraction of it is attributable to prolonged users. It reached a peak of over 160 basis points (83 points on the rate of charge and 79 points on the rate of remuneration) in 1991, at a time when prolonged users represented the bulk of overdue obligations. Second, the IMF's precautionary balances, which according to general guidelines should fully cover credit outstanding to members in protracted arrears, must receive higher allocations when the latter increase, implying a higher net income target and/or larger allocations to the SCA-1, which are financed by symmetrical adjustment to the rates of charge and remuneration.

Pressures on the IMF human resources

23. The number of lending arrangements in effect each year has increased markedly since the late 1980s, from 34 in 1987 to 58 in 2000. As was explained above, that increase was, to a significant extent, due to an increase in prolonged use by certain countries (along with an expansion of the IMF membership in the wake of the collapse of the Soviet Union). Moreover, the share of arrangements under concessional facilities—which are typically more resource intensive than GRA arrangements, and among which prolonged users are over-represented—also rose significantly: from 30 percent in 1987 to over 50 percent in 2000. However, staff resources did not increase commensurately (see Chart 4 below). This contributed to a rising work overload, especially from the mid-1990s onward.¹¹

Chart 4. UFR Activity and Staffing Indicators, 1987-2000
(1987=100)



¹¹ According to the internal Budget Reporting System (BRS), in 2000, the shortfall in effective staff-years (compared to the level needed to match the increase in UFR activity) exceeded 700 effective staff years. Over the last five years, prolonged users absorbed on average close to 130 staff years just for UFR-related work.

VIII. 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.

A. 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 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 Fund'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 which 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 which 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 conception 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 institutions 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 which 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 preeminence 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 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 or 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 timeframe—with repeat programs and an appropriate division of labor between the IFIs—may be required to achieve lasting adjustment, while ensuring that such a timeframe 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.

¹ As noted in Chapter VI, 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.

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 V 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 timeframe—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 which 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.

B. 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/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 systematic 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 towards 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 tradeoffs 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 timeframe (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**

² It 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.

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 institutions.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

³ One 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 VI) suggest that the scope for flexibility in the mix of tools to deliver the seal of approval should be explored further.

⁴ Joint IMF-WB staff assessments of PRSP are typically concluded by an assessment of whether or not the PRSP in question constitute an adequate basis for IMF and WB 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.

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” which 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 evolved which 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 operationalize this objective:

⁵ The 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.

⁶ See, for example, **Strengthening Country Ownership of IMF-Supported Programs**, (SM/01/340, Revision 1, December 6, 2001) available on the IMF’s website.

(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 pre-requisite 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 policy-making institutions.***⁸ While the nature of this policy debate will vary with the particular institutional circumstances of each country, two general messages are relevant: (i) high levels of political authority need to be fully engaged; and (ii) 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

⁷ Many 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.

⁸ A 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.

⁹ We 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.

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 timeframe 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 prioritization 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 which are critical for sustainable adjustment, but it is equally important

¹⁰ Indeed, the data discussed in Chapter V indicates 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.

¹¹ At 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 conditionality guidelines adopted in 1979.

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 substance 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 towards 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 timeframe of program design to the foreseeable length of the reform and adjustment process.** This does not necessarily imply that the timeframe 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, timeframe. 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

¹² For 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 timeframe. Any measure that does not meet either of these criteria would be more effectively dealt with through other forms 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 frontloading of the adjustment effort and the backloading of disbursement could serve to mitigate implementation risks without jeopardizing ownership. (Data reported in Chapter V suggests that these guidelines were often not followed.)

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

- 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 timeframes 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 institutions—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

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

¹⁴ Since 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.

¹⁵ When 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.

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 implementation) 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 VI also suggested that in a number of areas the IMF has been quite good at identifying lessons, but less effective at ensuring 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

¹⁶ This 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.

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 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

¹⁷ Apparently, 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.

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

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 surveillance 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 IMFC 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

¹⁹ Cf. 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 VI constitute a good description of what “stepping back” should aim to achieve.

²⁰ Indeed, 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).

²¹ Thus, within PDR, the surveillance policy division should have the primary role not—as is currently the case—divisions in charge of reviewing programs.

relevant area department.²² We recognize, however, that 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—i.e. 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 in program design.**²⁵ Although it is widely

²² Implementing 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 towards addressing the most critical issues in that respect.

²³ One 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.

²⁴ This 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—i.e., 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.

²⁵ It 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 VI, 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

(continued)

recognized that ownership and political and social feasibility is 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 which 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 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 VI, revealed that existing incentives, as perceived by mission chiefs, do not sufficiently

expressing the view that they should be provided with greater scope to provide input on the feasibility of particular proposals—an approach which is already supposed to be “best practice.”

²⁶ See Annex I to the Pakistan country note for a further discussion.

²⁷ The only formal personnel requirement for intra-departmental 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 Personal Management in the Fund, OIA, February 2000).

²⁸ The internal “Economist Development Guide” recently prepared by the IMF’s Human Resource Department is a step in this direction.

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 VI, 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 tradeoffs 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 accountability 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 tradeoffs 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

²⁹ In 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.

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.

POSSIBLE DEFINITIONS OF PROLONGED USE

This annex describes various approaches to defining prolonged use that have been used previously in the IMF or elsewhere and presents more details on the evolution and persistence of prolonged use.

The precise definition resulting from each approach can be made more or less restrictive by varying the threshold which separates prolonged users from “temporary” users of Fund resources.

- (i) prolonged effective use of the IMF general resources¹ (IMF, 2000)

This concept focuses on resources borrowed under standby and extended arrangements and excludes programs financed from concessional trust funds (SAF, ESAF, PRGF) for low-income countries, as well as programs in which the financing approved is not fully disbursed, either because they are off-track (i.e. the country is not eligible to borrow) or because they are treated as “precautionary” by the country’s authorities. This is the narrowest of the possible approaches and risks excluding important issues, such as the implications of failed/interrupted programs and the IMF’s role in low-income countries.

- (ii) prolonged time spent under IMF-supported programs (IMF 1984, 1991)

This concept encompasses both programs funded from the general resources account and from concessional trusts. It also includes programs which are only partially drawn upon. It may or may not include precautionary arrangements. It does not include drawings on Fund resources not backed by programs (such as first credit tranche purchases).²

A slightly different version of this concept is used by Bird *et al* (2000) to characterize frequent users of IMF resources. Their definition is based on the number of programs adopted by a country during a particular period, regardless of the type of arrangement at stake, its treatment (i.e. precautionary or not), its duration or its degree of completion. However, because many programs have a multi-year timeframe, particularly those under the EFF and PRGF, such a definition does not measure the time spent under IMF arrangements.

¹ I.e. purchases from the general resources account (GRA), which are typically associated with a stand-by arrangement (SBA) or an Extended Fund Arrangement (EFF). The specific operational definition used in the 2000 review of prolonged UFR characterized as prolonged users countries with an outstanding use of Fund credit over 100 percent of quota and either nine years or more of effective UFR in the previous 30 years, or five years of effective use in the previous 15 years.

² The thresholds used in internal IMF definitions have varied overtime: in 1984, it was set at four or more programs with purchases in the previous 10 years ; in 1986 and 1991, it was raised to five annual arrangements in the previous ten years. In all cases, an additional criterion was an outstanding Fund credit of over 100 percent of quota at the end of the period under review.

(iii) prolonged indebtedness to the IMF (IMF (1986); Meltzer (2000); Jeanne and Zettelmeyer (2001))

This concept focuses on the length of periods of indebtedness to the IMF, regardless of the origin of the outstanding obligations.³ However, because IMF facilities have repayment periods varying from 2½ to 10 years, this definition does not distinguish between countries which had only a few arrangements with relatively long repayment periods and those which had a large number of arrangements with shorter maturities. An interesting application of this approach was used by Jeanne and Zettelmeyer (2001) to derive estimates of the length of “lending cycles” to particular countries (see Table 1).

As noted in the main text, the current evaluation project uses a definition based on the amount of time spent under IMF arrangements, whether or not a country was eligible to draw. In principle, a distinction could be made between continuous “prolonged” use and more episodic “repeat” use. These episodic users may have interludes when their balance of payments situation improves and they begin to repay the IMF, but such episodes are followed—perhaps as a result of intervening policy slippages—by further BOP problems and recourse to IMF financing. Prolonged users would encounter few such episodes of IMF “abstinence”, perhaps reflecting incomplete adjustment within the life of a program or longer term debt sustainability problems that were not adequately addressed up front. In practice, however, it is not possible to make such a clear-cut distinction: all such countries appear to have experienced interludes when their external position improved, followed by renewed difficulties.

The attached table and charts provide further details of the intensity of prolonged use and its evolution to supplement the discussion in Chapter II.

³ This concept was used to define prolonged users in a 1986 internal IMF review, with a threshold of “continuously outstanding credit tranche positions in excess of 25% of normal maximum for six years or more” in the previous 10 years.

Table 1. Completed and Incomplete Debt Cycles for Borrowers from the IMF, 1947-2000

	Number of countries	Incomplete Debt Cycles	Average duration of cycles (years)	
			Completed	Incomplete
All countries	186	88	7.1	17.9
Industrial countries	25	0	4.7	n.a.
Developing countries	161	88	7.6	17.9
Africa	52	38	6.1	22.7
Asia	29	13	9	21.2
Europe	28	21	10.2	7.9
Middle East	14	2	6.5	9.5
Western Hemisphere	37	14	7.6	18.1
HIPC countries 1/	42	38	6.1	23.5
Non-HIPC developing countries	119	50	8	13.6
PRGF countries 2/	80	58	9.3	20.6
Non-PRGF developing countries	81	30	8.2	12.7
Prolonged users (PU) 3/	44	41	7.3	22.3
Non-PU developing countries	117	47	9	14.1
EMBIG countries 4/	27	15	7.8	13.8
Non-EMBIG developing countries	134	73	7.6	18.8
Memorandum Item: excluding cycles initiated after 1991				
HIPC countries 1/	42	35	6.1	24.9
Non-HIPC developing countries	119	22	8.2	23.3
PRGF countries 2/	80	43	9.3	25.6
Non-PRGF developing countries	81	14	8.6	20.4
Prolonged users (PU)	44	35	7.3	24.7
Non-PU developing countries	117	22	9.5	23.7
EMBIG countries 3/	27	8	7.9	20.6
Non-EMBIG developing countries	134	49	7.8	24.9

1/ Highly Indebted Poor Countries.

2/ Low income countries eligible for IMF lending on concessional terms (as of December 31, 1998).

3/ Excluding countries that meet the PU criterion owing to a large number of precautionary arrangements.

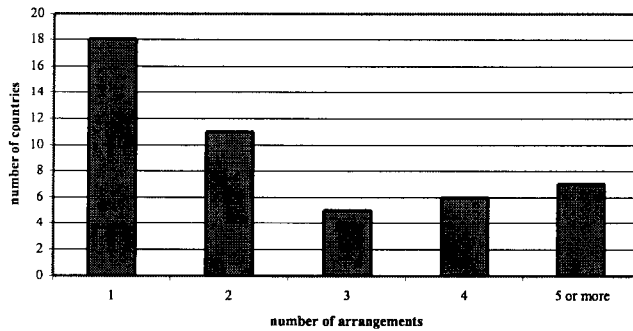
4/ Countries whose bond spreads are tracked by J.P. Morgan's "EMBI Global" Index.

Note: This table is an adapted and expanded version of one shown in Jeanne and Zettelmeyer (2001).

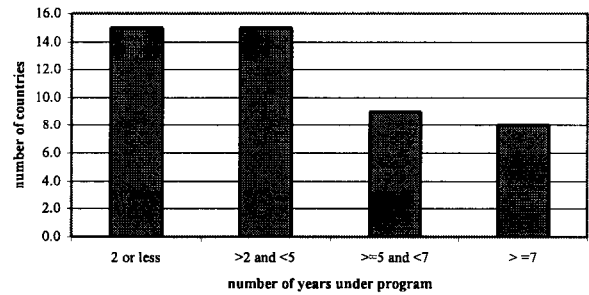
"Complete" and incomplete debt cycles refers to cases where a member has borrowed from the IMF and where the subsequent obligation to the IMF has eventually fallen to zero ("complete" cycle) or where further borrowing meant that the obligations to the IMF have not yet fallen to zero ("incomplete" cycle). The sum of complete and incomplete cycles exceeds the number of countries because each country may experience several lending cycles. The sum of HIPC, PRGF, PU and EMBIG countries exceeds the total number of countries because these categories overlap in part.

Frequency and Duration of Recourse to IMF-Supported Programs Across the Membership Over the Last Ten Years

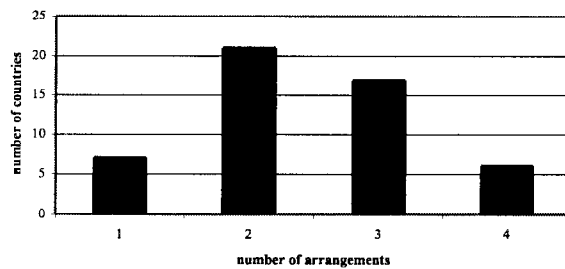
Distribution of GRA-only borrowers according to UFR frequency over 1992-2001



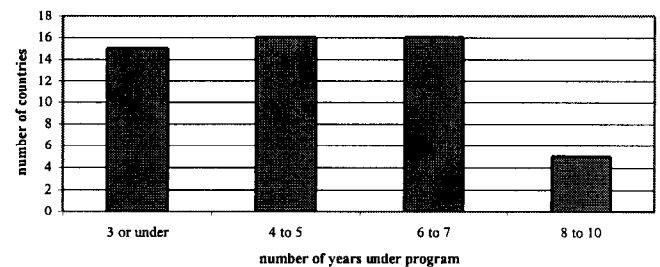
Distribution of GRA-only borrowers according to time under program over 1992-2001



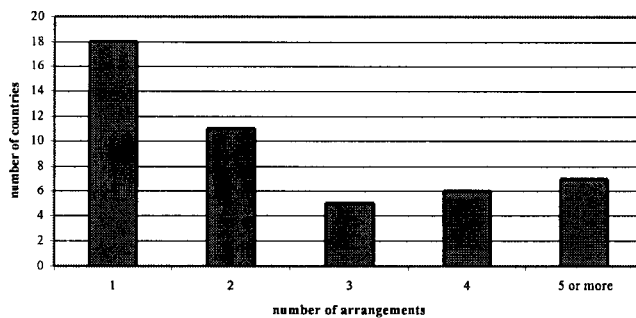
Distribution of PRGF-eligible countries according to UFR frequency over 1992-2001



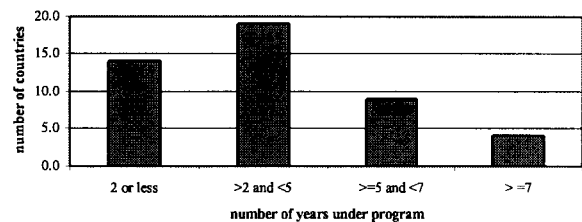
Distribution of PRGF-eligible borrowers according to time under program over 1992-2001



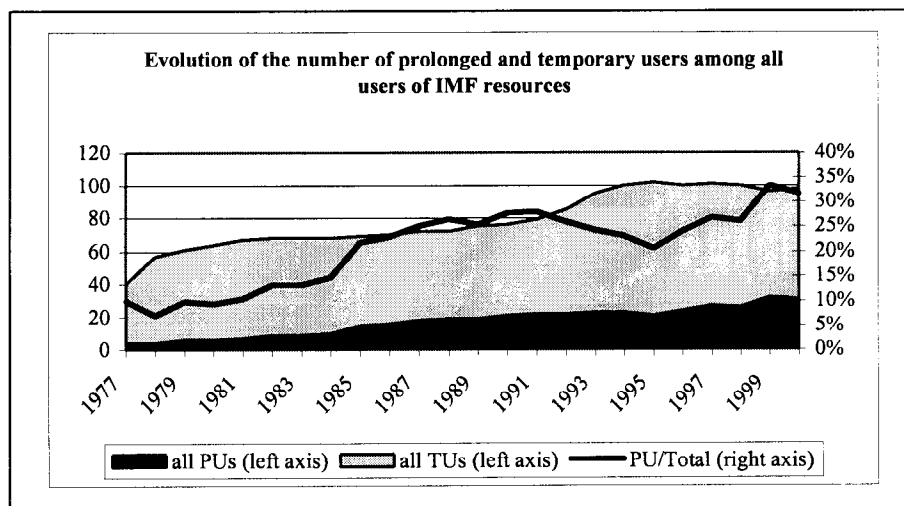
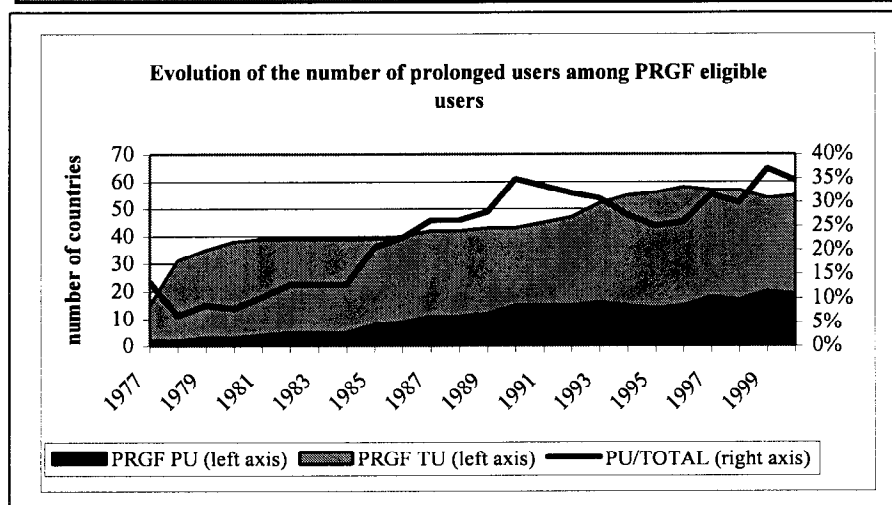
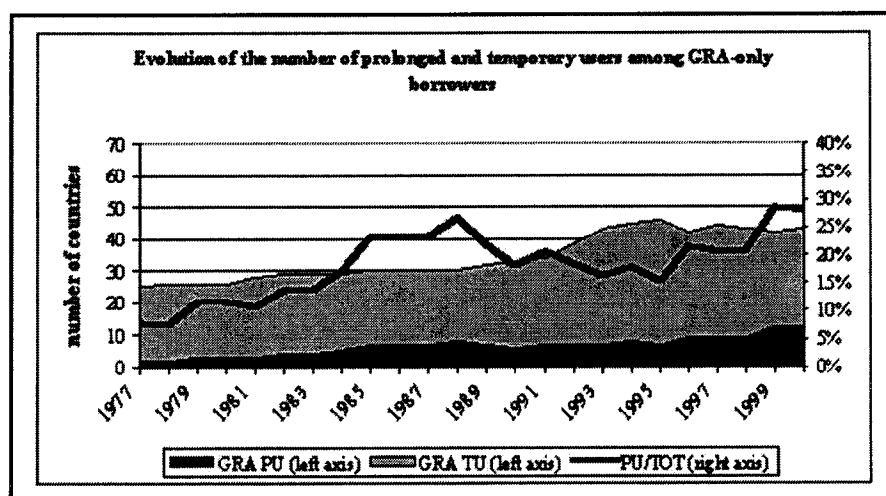
Distribution of GRA-only borrowers according to UFR frequency over 1992-2001



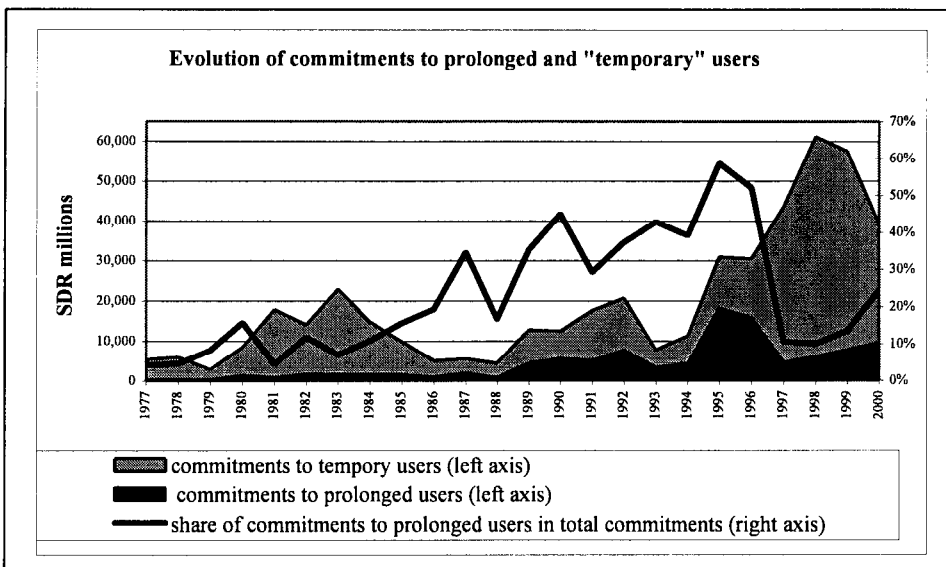
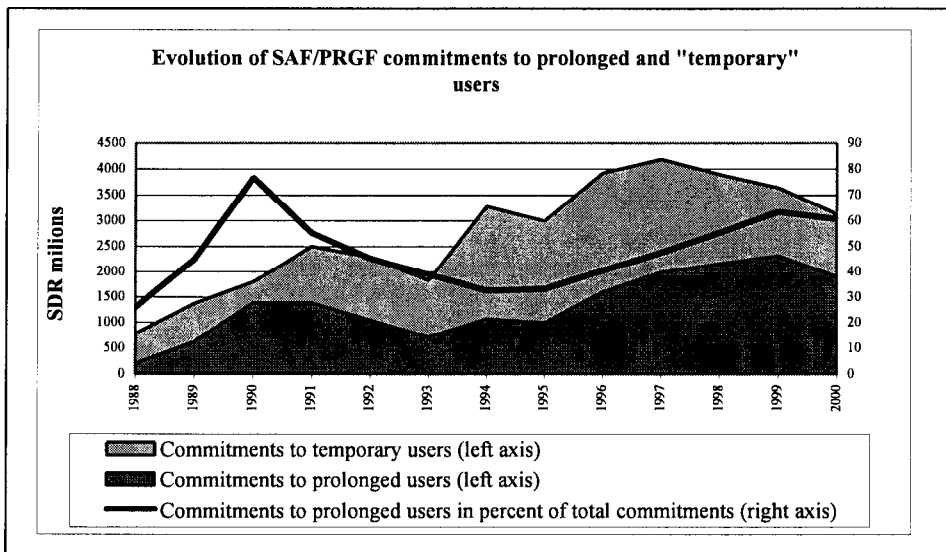
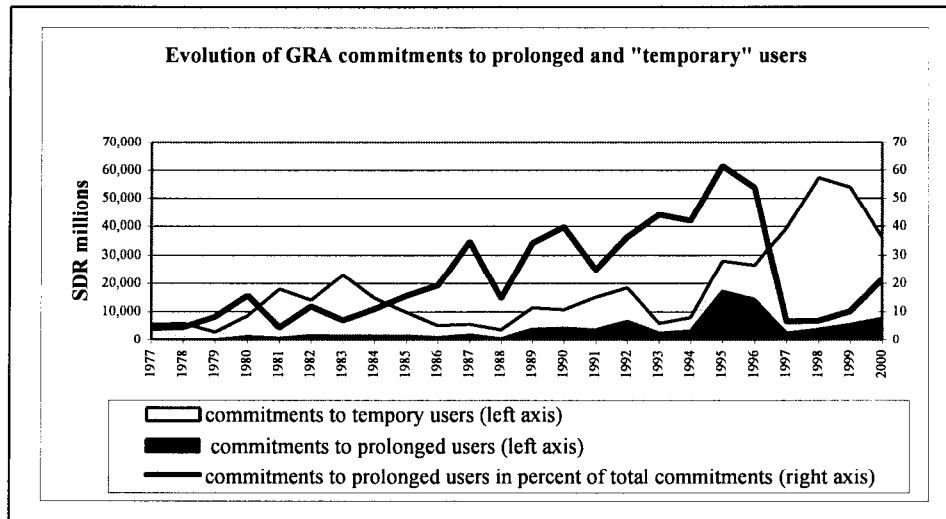
Distribution of GRA-only borrowers according to time under program over 1992-2001, not including arrangements precautionary on approval



Note: IMF members that did not enter into an arrangement with the IMF over the period are not represented in these charts.



Note: In these charts, the number of prolonged and temporary users correspond to the cumulative number of programs over a rolling 10-year timeframe.



Background Material on the Evolution of IMF Policies on Prolonged Use

This Annex provides additional information to support the discussion in Chapter III.

A. Evolution of the IMF's Attitude to Prolonged Use

On several occasions in past decades, the Executive Board recognized that adjustment often required a longer timeframe than implied by existing UFR policies¹ and, in response, instituted new modalities of UFR. These new policies were initially conceived as short-term and temporary, out of concern to preserve the monetary nature of the IMF and the revolving character of its resources, but they ended up being renewed year after year. Until the early 1990s, these guiding principles were thought to apply equally to the use of the IMF's general and concessional resources.² Thereafter, the policies applied to the two groups diverged, and there was a gradual acceptance of a greater degree of prolonged use of concessional resources while giving renewed emphasis to the revolving character of the IMF general resources.³

Prolonged use of the IMF's general resources

The official interpretation of the IMF's mandate initially emphasized the temporary nature of the support that the Fund could provide to its members: "The authority to use the resources of the Fund is limited to use in accordance with its purposes to give temporary assistance in financing balance of payments deficits" and "...the task of the Fund is to help members that need temporary help ... The Fund's attitude toward the position of each member should turn on whether the problem to be met is of temporary nature and whether the policies the member will pursue will be adequate to overcome the problem within such a period."⁴

The creation of the EFF in the wake of the first oil shock marked the first important departure from the original conception. However, the wording of the decision made it clear that this departure was intended to be the exception, not the rule: the EFF was to be used in special circumstances,

¹ Initially, Fund financing in the upper credit tranches was typically provided under a stand-by arrangement, whose normal period is one year. It may extend up to but not beyond three years in appropriate cases (cf. Decision No 6056 of March 2, 1979). Since 1978, obligations incurred under a stand-by arrangement must be repaid within a period of 3¼ to 5 years.

² For example, FBS/91/108, *Selected Operational Issues Related with the Use of Fund Resources* explicitly notes that the principle of the revolving character of the Fund's resources must be applied consistently to general and concessional resources, and does not distinguish between the two in the remedial actions it suggests to deal with prolonged use.

³ The Executive Board reviewed prolonged use on several occasions during the 1980s, starting in 1984. The last comprehensive review of prolonged UFR was discussed by the Board in 1991. Thereafter, the issue was not put on the Board's agenda until 2000, where prolonged use was discussed only as a background issue to the review of IMF facilities.

⁴ Decisions of the Executive Board No. 71-2 of Sep. 26, 1946 and No. 102-(52/11) of Feb. 13, 1952, respectively. The Conditionality Guidelines adopted in 1979 further stated that: "*The normal period for a stand-by arrangement will be one year. If, however, a longer period is requested by a member and considered necessary by the Fund to enable the member to implement its adjustment program successfully, the stand-by arrangement may extend beyond the period of one year. This period in appropriate cases may extend up to but not beyond three years.*" (Decision 6056-(79/38) of March 2, 1979).

including where a member suffered serious payments imbalances relating to structural maladjustments and where it was expected that the needed improvement in the balance of payments could only be achieved over an extended period. Subsequent developments, which included an increasing use of series of one-year SBAs and the institution and prorogation until 1992 of the enlarged access policy, ensured that the use of the EFF indeed remained exceptional, although not the recourse to IMF resources for a more prolonged period of time than implied by the original interpretation of the IMF's mandate.

The 2000 Executive Board discussion of the Review of Fund Facilities marked a sharp reversal of attitudes towards prolonged UFR. On this occasion, a number of Board members expressed concern "that some members may rely unduly on Fund financial assistance in place of seeking market financing, and saw a need to review the Fund's policies in this connection."⁵ These concerns led to the introduction of repurchase expectations⁶ and of surcharges on outstanding obligations to the IMF in excess of normal access (i.e. 100 percent and 300 percent of a member's quota). While primarily aimed at providing an incentive against large use of IMF resources, these measure was also presented as an indirect incentive to avoid prolonged use, to the extent that it is associated with rising outstanding obligations.

Prolonged use of the IMF's concessional resources

Beyond the concessionality of the loans attached to it, the main innovation brought about by the ESAF was the relaxation of the requirement that lending arrangements should solve entirely members' balance of payments problems. Instead, programs supported by the ESAF were required only to "assure substantial progress during the three-year period toward an overall position and structure of the balance of payments that is consistent with orderly relations with creditors and a reduction in restrictions on trade and payments, while permitting the timely servicing of obligations to the Fund" (EBM/87/171). The ESAF being initially conceived as a one-off operation, the decision was ambiguous, to say the least, as to how the unfinished agenda should be tackled in the post-ESAF period.

Between 1990 and 1997, the ESAF was gradually transformed through a series of steps into a permanent facility without any restrictions on the number of arrangements that an eligible member could enter into. In late 1990, the ESAF Trust Instrument was amended so as to allow *one additional annual arrangement* at the expiration of the initial three-year ESAF arrangement, although only where performance had been satisfactory and within unchanged overall access limits. In 1992, the Board opened the possibility of renewing ESAF support through *a single one or two-year arrangement*, when the three-year commitment period had expired with undrawn amounts. Then, in 1993 the Instrument was amended again to allow for a second three-year arrangement, which could itself be followed by a single annual arrangement. This option was to be available only for good performers with appropriately strong adjustment programs. In 1995, the ESAF became a self-sustaining facility, offering eligible members indefinite access to concessional resources, though each

⁵ Cf. Chairman's summing up (BUFF/00/41).

⁶ For purchases in the credit tranches and under the CFF, the expectation schedule starts one year in advance of the obligation schedule, beginning 2¼ years after a purchase and ending after 4 years. For the EFF, the expectation schedule begins after 4½ years, as with the obligation schedule, but repurchases are to be doubled, such that the expectation schedule will end after 7 years rather than 10 years under the obligation schedule.

member would remain bound by the limits set in 1993 regarding the number of arrangements and the “good performance” test. In 1997, these last limits were lifted.

These successive extensions were agreed upon only after protracted negotiations, due to the reluctance of a minority of Directors to legitimize prolonged use of the IMF resources, even concessional ones. The need to reflect these different perspectives led the Board as a whole to emphasize that the purpose of these successive extensions *was not to provide a source of continuous financing for individual countries*, but rather to maintain the Fund’s ability to respond to members’ needs as they arise.⁷ Apart from the factors mentioned in Chapter III, this decision also reflected a third, “defensive lending” motivation: ensuring a smooth repayment by the countries with the heaviest debt service ratios to the IMF.⁸

B. Evolution of the Strategy vis-à-vis Prolonged Use

Program design elements

From 1984 to 1991, reviews of prolonged use put a strong emphasis on improvements in program design and implementation to address prolonged use, each of the reviews essentially building on the previous ones and increasing the specificity of its recommendations. By contrast, the 2000 review, which tended to downplayed the importance of prolonged use, did not suggest any specific remedy related to program design, nor did it recall or call for the implementation the measures endorsed in previous reviews.

Access to IMF resources

The majority view of the Executive Board regarding access has consistently been that it would not be appropriate to introduce strict rules limiting access based on the frequency or length of UFR, because even perfect implementation might fail to deliver the desired balance of payments outcome. However, the policies adopted in 1983/84 on the use of general resources made it clear that access should be reduced over time and that past performance in using the IMF’s resources should be taken into account in the determination of further access.

While these policies were not applicable ipso facto to concessional resources, the decisions adopted by the Board from 1990 onward left little doubt that the guiding principles of access policy were similar for both categories of resources. In 1993, the Board decided that “for repeat users, access would take into account the amount of the member’s outstanding use of Fund credit and its record in using Fund resources. (...) This would signal the need to phase out the reliance on exceptional balance of payments financing” and “ensure that even with continued availability of the

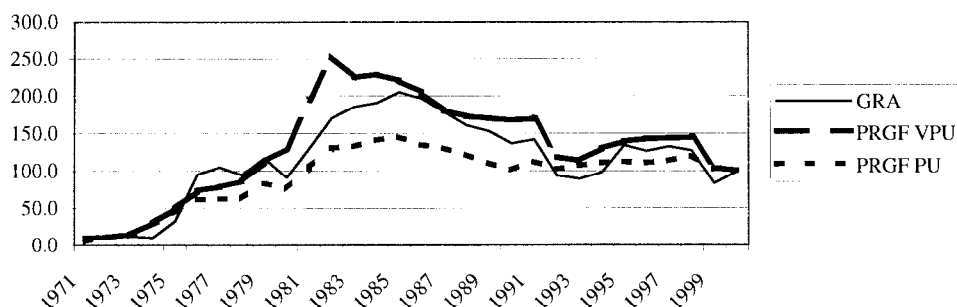
⁷ Cf. Chairman’s summing-up of EBM 97/5, 97/8 and 97/10.

⁸ The then Managing Director put the case in the following terms :“I would suggest that these few cases could appropriately be addressed through the continued availability of concessional ESAF resources on present terms” [as opposed to extending to them one further round of ESAF arrangements with a twenty year maturity, as proposed by the UK Chancellor of the Exchequer]. “Through this instrument, the Fund would have the possibility of tailoring its financing to the individual situation of each member, *extending for the period needed-- in a few cases through several successive ESAF arrangements—the concessional financing required (...), while avoiding significant humps in net transfers from the member to the Fund.*”(BUFF/95/31).

ESAF, individual members would, over time, phase out their reliance on ESAF support.”⁹ In 1995, the Board further specified that “lower (or no) access may be appropriate in the case of (...) countries that have relatively weak track records and are not able to implement sufficiently strong policies...”

Our case studies suggest that the justification of the level of access proposed in staff reports was treated in a rather perfunctory manner. This eventually caused the Executive Board in July 2000 to ask for a revision of the operational guidelines calling on staff to provide more detailed justifications of access proposals. As regards the evolution of the level of access, only about one-fifth of prolonged users with more than one three-year ESAF/PRGF arrangement had a consistently diminishing access. A similar proportion had access that actually increased over time. The remainder had access that either was stable over time or diminished only between the first and second three-year arrangement, and remained broadly stable thereafter. Among GRA arrangements, since 1990, 43 percent of prolonged users had higher annual access in their most recent (or last) arrangement than in their first, and just over a fifth had a consistently diminishing annual access. Another way to capture the lack of consistent implementation of access guidelines is to look at the evolution of prolonged users’ outstanding obligations to the IMF over time (see Chart 1 below). The general trend is fairly consistent both within and across groups: outstanding UFR declined sharply in the second half of the 1980s, but then remained fairly steady during the 1990s.¹⁰

Chart 1. Average Outstanding Obligations of Prolonged Users to the IMF (Percent of quota)



N.B.: In this chart, prolonged users are treated as a fixed group, consisting of the countries listed in Chapter II.¹¹ However, the broad trends are not very sensitive to the precise composition.

⁹ EBS/93/32, Operational Modalities and Funding Alternatives for an ESAF and EBS/95/130, Continued Financing and Adaptation of the ESAF.

¹⁰ The step declines observed in 1981, 1993, and 1999 partly reflect the impact of general quota increases. It should be noted that if access is reduced very gradually, disbursements may exceed repayments for a relatively long period, especially under concessional facilities, thus causing outstanding obligations to increase for a while even though access itself is being reduced.

¹¹ This means that not every country in this sample was a prolonged user in each year. The choice of the fixed rather than the dynamic definition in this case was dictated by concerns not to understate the decline in outstanding obligations of the group of prolonged users.

Strengthened analytical and assessment efforts

In 1990, the Board approved the proposal to include in any new UFR request a systematic review of experience under preceding arrangements. In 1995, the Board went a step further by recommending stock-taking, on a case-by-case basis, toward the end of the three-year arrangement, to reflect on what has been achieved and how to ensure strong performance in a subsequent arrangement (i.e. without necessarily waiting for a new UFR request to arise).¹²

Exit strategies

Evidence from the case studies again suggests that the recommendation that staff reports should provide medium term balance of payments projections and attempt to foresee a reasonable timetable for the disengagement of the IMF was often not followed. For example, medium-term projections for the Philippines in the 1994 EFF projected financing gaps even after market access had been restored. Part of the problem was the lack of clear criteria for a balance of payments financing gap in cases where countries had access to private financial markets. By contrast, in Pakistan and Senegal, most medium-term projections showed no financing gap beyond the program period, but such projections proved unrealistic.

As concerns the use of strengthened surveillance in the post-program period, the emphasis put by the 2000 Review of Fund Facilities on post-program monitoring essentially just formalized a pre-existing disposition. While all GRA arrangements have a consultation clause stating that, under certain conditions, members shall consult with the IMF after the expiry of the arrangement “at the request of the Managing Director”, the facilities review instituted a presumption that countries with obligations to the IMF exceeding 100 percent of their quota at the expiration of the program would undergo this procedure for as long as their outstanding liabilities to the IMF exceeded the threshold.

For users of concessional resources, the principle of post-program monitoring as a means of avoiding prolonged use of ESAF resources was formally established in the early 1990s. In considering operational details for an ESAF successor, the Board endorsed the suggestion of “post-ESAF enhanced consultations and program monitoring (...) on a limited transitional basis, in cases where the macroeconomic situation remains vulnerable and the authorities perceive benefits in a continued close policy dialogue with the IMF.”¹³ Subsequently, it was also envisaged that one option for continued IMF support for the programs of former ESAF users that ceased to have a need for IMF financing would be through precautionary arrangements: “Directors considered that (...) a precautionary arrangement would signal the Fund’s approval of the country’s adjustment program, thereby catalyzing financial support from other sources, while providing assurances that Fund resources would be available should the country’s circumstances change. Directors were persuaded, however, by the arguments against granting precautionary ESAF arrangements. They broadly agreed that ESAF-eligible countries without a recurrent or prospective balance of payments need could

¹² Cf. BUFF/90/37 and BUFF/95/95 for the acting Chairman’s summing-up of the relevant Board discussions.

¹³ EBS/93/32, Operational Modalities and Funding Alternatives for an ESAF Successor – Preliminary Considerations.

instead request a precautionary extended arrangement, which could be replaced or supplemented by an ESAF arrangement in the event that a balance of payments need emerged.”¹⁴

The implications of this exit strategy for other creditors were spelled out rather bluntly in 1991, when a staff report noted that: “In cases where external viability is not in reasonable prospect (...) the Fund could provide support in the early stages of the adjustment process (...) to help ensure the establishment of an appropriate macroeconomic framework. However, other creditors may have to continue their contributions, in part to facilitate repayments to the Fund, and there would need to be a clear acknowledgement by creditors of the revolving character of the Fund’s resources.”¹⁵

¹⁴ Chairman’s Summing-up of EBM 98/73 on *Distilling the Lessons from the ESAF Reviews*.

¹⁵ EBS/91/108, Selected Operational Issues Related with the Use of Fund Resources.

Characteristics of Prolonged Users: Further Details on the Evidence

This Annex provides more details of the analyses discussed in Chapter IV.

A. Econometric Evidence on the Characteristics of Prolonged Users

We estimated a series of probit regressions to examine whether prolonged users had economic and institutional characteristics that were different from temporary users. The characteristics considered, which were drawn from the recent empirical literature on participation in IMF arrangements,¹ were: (i) per capita GDP; (ii) real GDP growth; (iii) current account balance (in relation to GDP); (iv) international reserves (in months of imports); (v) debt service ratio (measured in relation to exports); (vi) openness of the economy (measured as the ratio of the sum of exports and imports to GDP); (vii) primary exports (as a share of total exports); and (viii) volatility in the terms of trade (standard deviation of the terms of trade index).

Two definitions of “prolonged use” were employed in these exercises—one “fixed” over time, and the other “dynamic” (i.e., time-specific).² Using the “fixed” definition, which classified a country as a prolonged user if it had IMF arrangements in seven out of any ten year period during 1971-2000, and entire sample period average data, we found prolonged use to be associated with lower levels of international reserves, with higher debt service ratios, and with lower real GDP growth. There was no statistically significant difference between prolonged and temporary users with respect to the other characteristics considered (equation 1 in Table 1).³ When the sample was limited to PRGF-eligible countries only, prolonged use was found to be associated with higher debt service ratios and lower GDP per capita (equation 2 in Table 1).⁴

¹ See, for example, Bird, Hussain and Joyce (2000), Joyce (2001), and Barro and Lee (2002).

² Due to data limitations for several users of IMF resources during the period covered by the evaluation (1971-2000), a maximum of only 83 countries were covered in the regressions. Also, because data for 1971-75 and for 2000 were missing for many variables for many countries, the annual time series data used spanned 1976-1999. Among users of IMF resources that were excluded were countries that either did not exist in 1976, or had missing data for several variables during most of 1976-1999.

³ The list of distinguishing characteristics here is much shorter than that reported in Bird, Hussain, and Joyce (2000), in which the authors found that repeated participation in programs (“recidivism”) was associated with: (1) lower levels of international reserves; (2) larger current account deficits; (3) lower and less volatile terms of trade; (4) larger debt service ratios; (5) larger capital outflows; (6) lower per capita income; (7) lower investment rates; and (8) weaker governance. Differences in methodology may account for the different results. Bird *et al* do not pre-define a threshold for “recidivism”; rather they regress the number of arrangements and the number of program years on a range of variables using Poisson and negative binomial models.

⁴ These estimates do not take account of the likely strong endogeneity between growth and the likelihood that a country will request an IMF arrangement—e.g., because exogenous shocks that worsen the BoP also harm growth. In Annex IV, when this endogeneity is taken into account, the negative association between growth on prolonged use disappears for PRGF-eligible countries.

Table 1. Characteristics of Prolonged Users of IMF Resources ^{1/}

(Marginal Probabilities)	Fixed definition Sample Averages				Dynamic definition 5-year Averages			
	All (1)	PRGF (2)	nonPRGF (3)	All (4)	All (5)	PRGF (6)	nonPRGF (7)	All (8)
GDP per Capita	-0.048 (1.09)	-0.545 (1.73)*	-0.039 (0.66)	0.014 (0.26)	0.012 (0.08)	1.184 (1.47)	-0.057 (0.33)	-0.078 (0.31)
Real GDP growth	-0.058 (1.72)*	-0.020 (0.42)	-0.077 (1.45)	-0.031 (0.84)	-0.020 (1.29)	-0.039 (1.33)	-0.021 (0.95)	-0.025 (0.93)
Current account balance	0.006 (0.45)	0.024 (1.29)	-0.028 (0.71)	0.013 (0.77)	-0.008 (0.93)	-0.021 (1.50)	-0.020 (1.35)	-0.045 (2.19)**
Foreign reserves	-0.070 (1.80)*	-0.084 (1.43)	-0.025 (0.42)	-0.063 (1.50)	0.056 (2.07)**	0.136 (2.75)***	-0.004 (0.10)	0.072 (1.44)
Debt service ratio	0.015 (2.16)**	0.024 (2.10)**	-0.000 (0.03)	0.011 (1.28)	-0.004 (0.96)	-0.006 (0.72)	-0.008 (1.56)	-0.003 (0.35)
Openness	-0.001 (0.34)	0.005 (1.20)	-0.006 (1.28)	0.002 (0.76)	0.001 (0.40)	-0.003 (0.57)	0.007 (1.42)	0.008 (1.53)
Primary exports	-0.001 (0.42)	0.001 (0.20)	-0.007 (1.23)	-0.001 (0.34)	0.003 (0.63)	-0.003 (0.43)	0.008 (1.36)	0.008 (1.09)
Term of trade Volatility	-0.004 (0.72)	-0.005 (0.70)	-0.006 (0.30)	-0.003 (0.66)	-0.009 (1.44)	-0.008 (0.84)	-0.015 (1.54)	0.005 (0.40)
Lagged GDP per Capita					-0.000 (0.25)	-0.002 (1.83)*	0.000 (0.50)	0.000 (0.48)
Lagged Real GDP growth					-0.015 (1.10)	-0.040 (1.75)*	0.000 (0.02)	0.025 (1.05)
Lagged Current account balance					-0.020 (2.07)**	0.002 (0.18)	-0.064 (3.58)***	-0.076 (3.36)***
Lagged Foreign reserves					-0.070 (2.57)**	-0.153 (2.79)***	-0.031 (0.98)	-0.146 (2.54)**
Lagged Debt service ratio					0.012 (2.91)***	0.018 (2.18)**	0.010 (2.20)**	0.015 (2.25)**
Lagged Openness					-0.003 (0.81)	0.004 (0.72)	-0.010 (1.96)*	-0.008 (1.41)
Lagged Primary exports					-0.002 (0.43)	0.006 (0.87)	-0.009 (1.40)	-0.008 (0.98)
Lagged Terms of Trade Volatility					-0.000 (0.08)	-0.001 (0.26)	0.001 (0.22)	-0.004 (0.54)
Bureaucracy Quality				-0.231 (2.06)**				-0.077 (1.03)
Observations	83	48	35	65	218	105	113	124
Pseudo R-squared	0.14	0.26	0.18	0.13	0.18	0.32	0.29	0.32
p-value	0.0378	0.0302	0.3642	0.2603	0.0000	0.0001	0.0011	0.0000

1/ **Bold** number indicates that the coefficient on the variable is statistically different from zero at the following significance level: 10 percent (*), 5 percent (**), and 1 percent (***).

For countries not eligible for the PRGF (i.e., middle- and high-income users of IMF resources), we found no statistically significant differences between prolonged users and temporary users for any of the variables (equation 3 in Table 1).

Introduction of an institutional variable—quality of government bureaucracy⁵—suggested that prolonged use was associated with lower quality of government bureaucracy, and that once this factor was taken into account, the differences in economic characteristics (i.e., growth, international reserves, and debt service ratio) were no longer significantly different between prolonged and temporary users (equation 4 in Table 1).

In order to allow for some dynamics, a second set of exercises used a period-specific definition of “prolonged use,” based on five-year average panel data (equations 5-8 in Table 1). A country was defined to be a prolonged user in a particular five-year period if it had IMF arrangements in 7 or more years during that and the preceding five-year period. Prolonged use was found to be strongly associated with: (i) lower international reserves in the preceding five-year period but higher reserves in the current five-year period; (ii) lower current account balances in the preceding five-year period; and (iii) higher debt service in the preceding five-year period. No statistically significant difference was found in the quality of bureaucracy.

When the sample was limited to only PRGF-eligible countries, prolonged use was again associated with lower levels of reserves in the previous period but higher levels in the current period; and with higher debt service ratios in the preceding period. Prolonged use was also associated with lower GDP growth for this group of countries.⁴ For countries not eligible for the PRGF, taking account of both contemporaneous and lagged effects, prolonged use was found to be associated with larger current account deficits, larger debt service ratios, and less open economies.

B. Cross Section Evidence on Comparison Between Prolonged and “Temporary” Users

Starting conditions

To compare the “starting conditions” of prolonged users at the beginning of their episode of prolonged use with those of contemporaneous “temporary” users, we identified two sub-periods (1976-79 and 1988-91) during which a large proportion of the episodes of prolonged use that we studied were initiated and looked at economic conditions in the three years preceding the first program of the prolonged use series for the two groups of prolonged users thus identified. We then identified two control groups of “temporary” users, consisting of all the countries that entered into an IMF arrangement during the same periods. Starting conditions were appraised by looking at five measures of potential macro imbalances: public debt, external debt, current account balance, overall fiscal balance and inflation. The results of the comparison are shown in Table 2.

⁵ The institutional variable used is the “Bureaucracy Quality” index calculated by the International Country Risk Guide. It is designed to provide an indication of the policy environment, especially the extent to which policy formulation and day to day administrative functions are able to withstand political changes.

Table 2. Comparison of Starting Conditions for Groups of Prolonged and “Temporary” Users
(In percent of GDP, unless otherwise indicated)

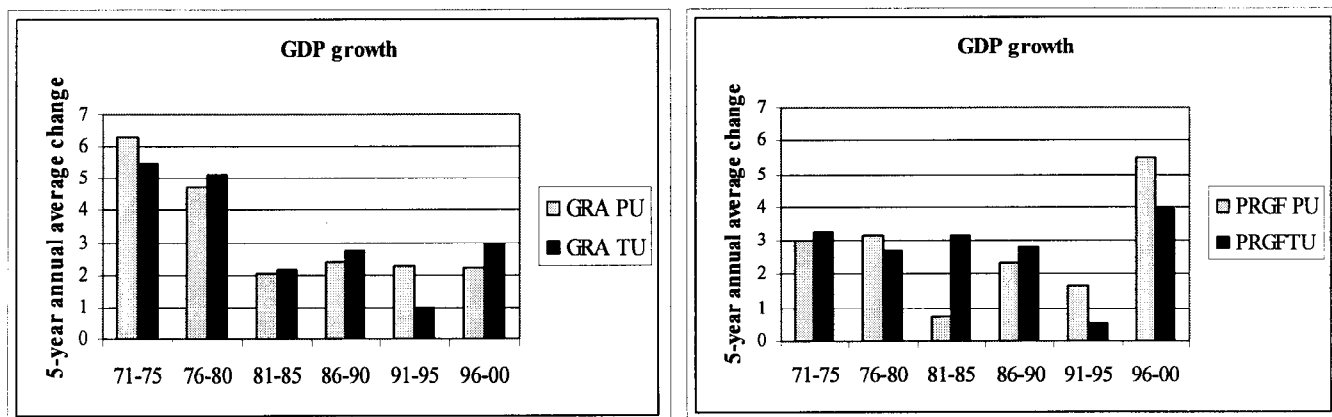
	Public debt	External debt	Current account balance	Overall budget balance	Inflation (in percent)
1976-1979					
Prolonged users	31.9	37.7	-6.6	-6.7	23.7
Temporary users	58.9	15.2	-3.8	-6.0	19.0
Stat. significance	ns	**	ns	ns	ns
1988-1991					
Prolonged users	116.1	157.1	-4.8	-10.1	9.8
Temporary users	45.3	57.1	-2.8	-5.3	24.5
Stat. significance	ns	*	ns	ns	ns

NB: ** indicates stat. significance at the 1 percent level; * indicates stat. significance at the 10 percent level.

Economic performance and macroeconomic adjustment⁶

As concerns GDP growth, a comparison between prolonged and “temporary” users of IMF resources over the last three decades suggests that, in most periods, prolonged users grew at a slower pace than temporary users, the exceptions being the early 1970s and early 1990s for middle-income countries (i.e. the times when there were few debt crises) and the 1990s for low-income countries (Chart 1).

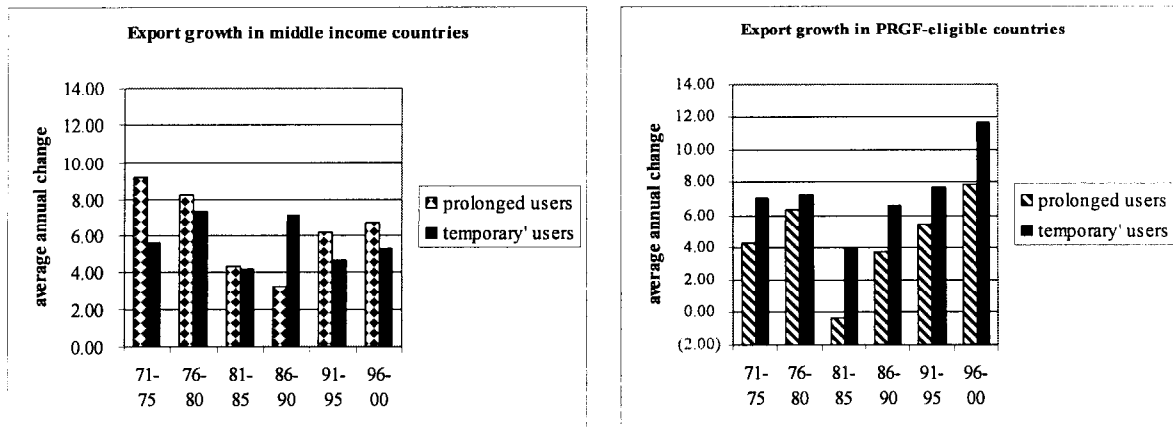
Chart 1. Growth of GDP and Exports
(In percent)



⁶ See Table 4 for detailed figures and statistical significance of the comparisons. In the results presented here, the groups “prolonged users” and “temporary users” are both fixed populations (the former group consisting of the countries listed in Chapter II), i.e. we are looking at the characteristics of a broad group of countries that, at some point in the overall period encountered episodes of prolonged use against other countries which, at some point in the same period, entered into an IMF-supported program, but which did not become prolonged users. However, because the population of prolonged users does not change much over time, the results would not be substantially altered if a “dynamic” definition of prolonged use were used.

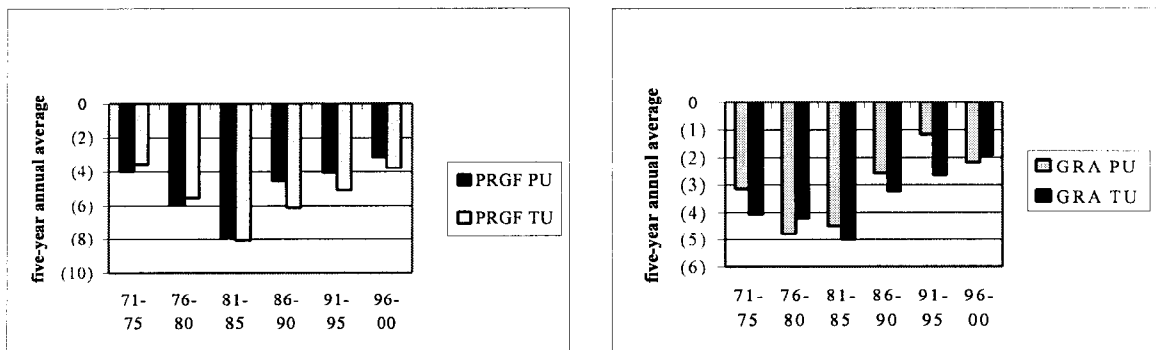
Export growth was generally much weaker, on average, in the group of prolonged users than in the “temporary users” group as far as low-income countries are concerned. For middle-income countries, the opposite was generally true, but differences were less pronounced (Chart 2).⁷

Chart 2. Export Growth



The analysis of adjustment performance, as measured by trends in inflation and reductions in current account deficits, does not show any clear or consistent differences between the two groups, although there are large variations within each group.⁸ As regards fiscal deficits, in both middle and low-income countries, prolonged users had higher deficits in the late 1970s, but they adjusted faster thereafter and thus had lower deficits than “temporary” users in subsequent periods (cf. Chart 3).

**Chart 3. Evolution of Overall Fiscal Deficit
(In percent of GDP)**



⁷ These results are statistically significant only for the PRGF-eligible group over the 1980s.

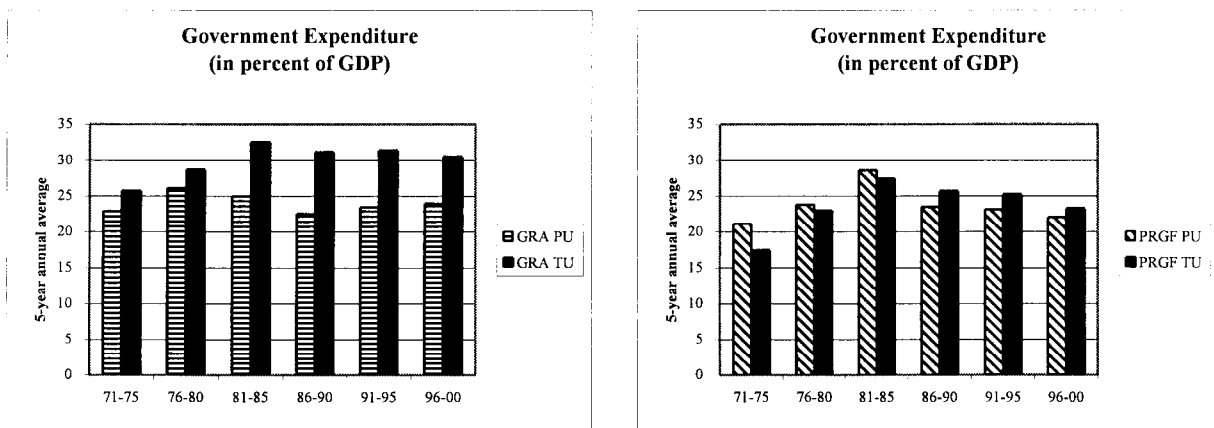
⁸ cf. Table 3.

Key fiscal characteristics

Prolonged users have lower and more rigid government expenditure

Among middle-income countries, the expenditure to GDP ratio of prolonged users was consistently and markedly lower than for “temporary” users over 1971-2000. In other words, the prolonged users are not necessarily those with a tendency toward “big” government—indeed the reverse; as will be seen below, the most obvious distinguishing characteristic appears to be a weak tax base. The differences were less marked for the PRGF-eligible countries.

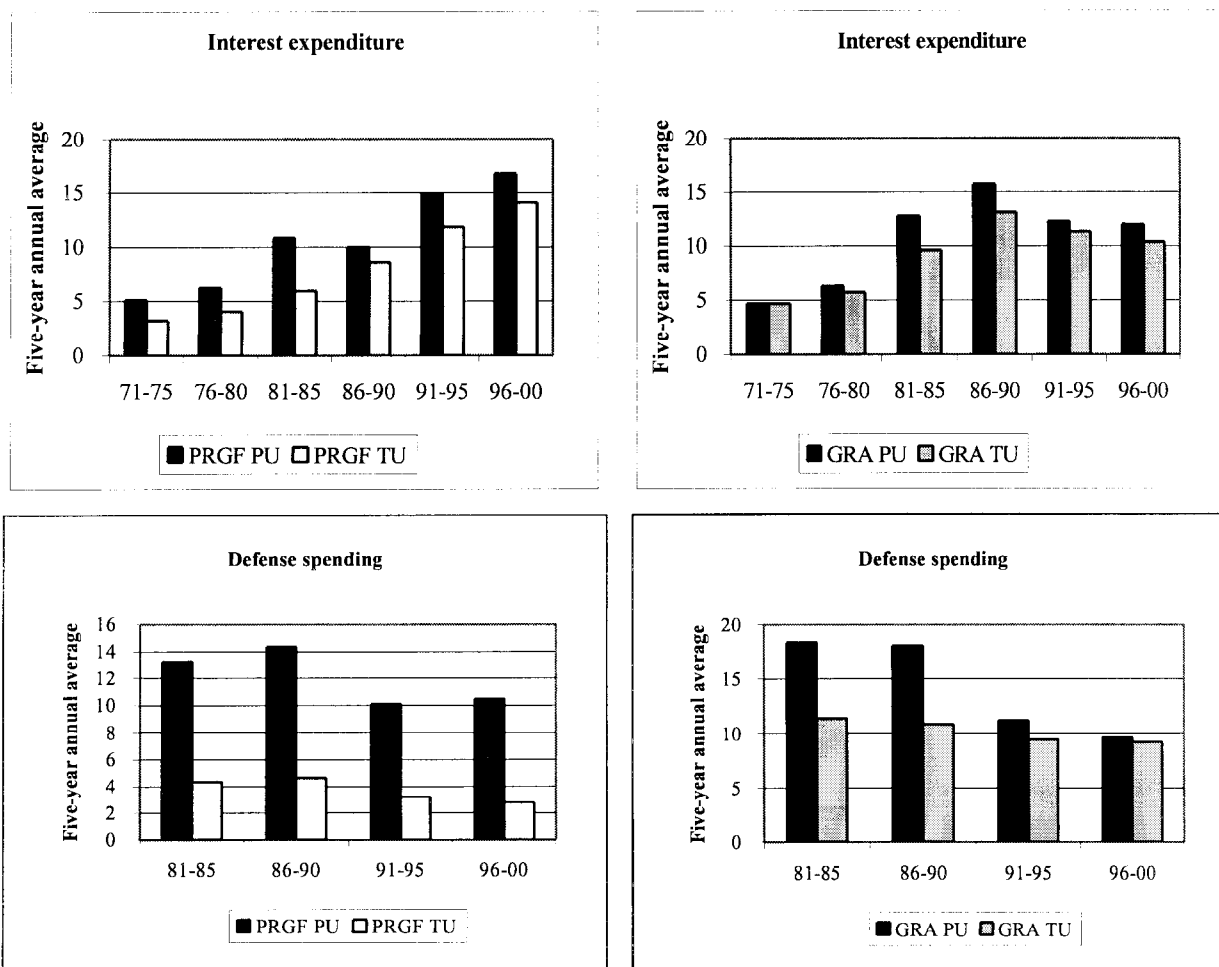
Chart 4. Government Expenditure
(In percent of GDP)



In both low-income and middle-income countries, the government expenditure to GDP ratio expanded significantly less over the last three decades in prolonged user countries than in “temporary” user countries, which might reflect either the fiscal discipline imposed by the successive IMF-supported programs entered into by prolonged users, or simply their generally poor ability to increase revenue collection, or some combination of the two (see below). The likely impact of IMF-supported programs is suggested by the pattern of government expenditure in low-income countries, which exhibits a clear downside break in the mid-1980s, when most of these countries started making extensive use of IMF resources, under newly created concessional facilities (Chart 4).

The analysis of the composition of government expenditure further reveals that, regardless of the income group, *prolonged users had higher interest and defense expenditure* (as a proportion of total expenditure) in all periods since 1970, and especially in the 1980s, largely reflecting a build-up in debt problems (see below). Other things equal, these differences would result in a more rigid structure of expenditure in prolonged user countries, which might account for a more protracted adjustment process (Chart 5).

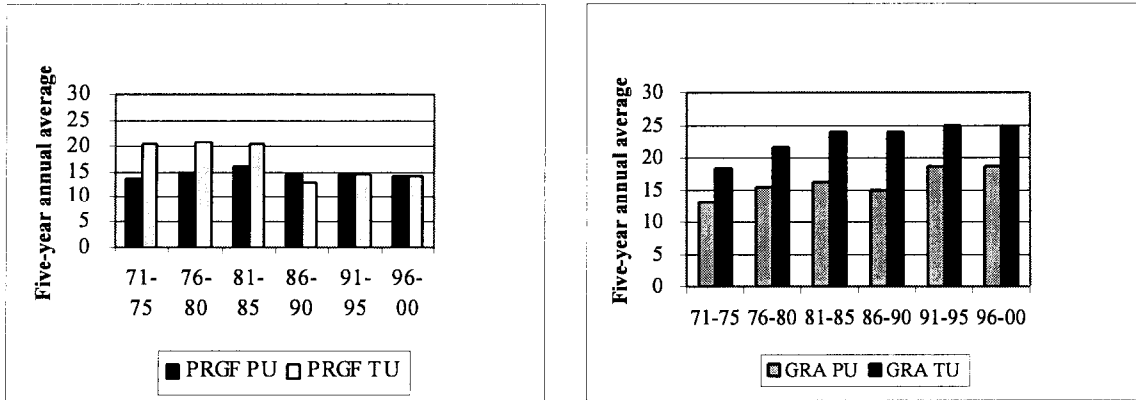
**Charts 5. Interest and Defense Expenditure
(In percent of total government expenditure)**



Middle-income prolonged users collect less tax revenue

Differences related to the tax revenue to GDP ratio are particularly pronounced among middle-income countries: over 1971-2000, prolonged users in that category have consistently had lower tax to GDP ratios than “temporary” users. Both prolonged and “temporary” users have registered increases in that ratio over time, but that increase was faster for “temporary” users up to the 1990s. By contrast, among low income countries, there was no sustained increase in the tax revenue to GDP ratio over time, and the gap between prolonged and “temporary users” which prevailed until the mid-1980s was eliminated in later periods only owing to a decline in “temporary” users’ tax revenues (Chart 6).

Chart 6. Tax Revenues to GDP Ratio

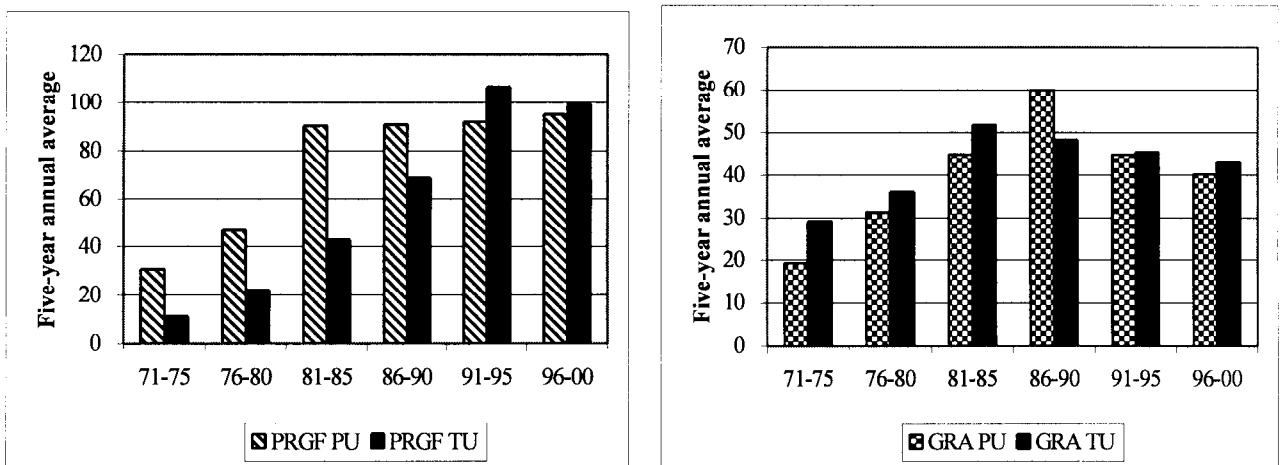


Prolonged users faced a higher public debt burden for most of the period

Among PRGF-eligible countries, prolonged users' stock of public debt (relative to GDP) was three times as large as that of "temporary" users at the beginning of the period. However, differences rapidly diminished from the mid-1980s onward, as the "temporary" users borrowed at a much faster pace than the prolonged users, perhaps reflecting the fact that many prolonged users had already entered into debt problems.

Among middle-income countries, prolonged users initially had a substantially lower public debt stock (relative to GDP) but debt levels for the group built up rapidly during the 1980s (Chart 7).

**Chart 7. Public Debt Stock
(In percent of GDP)**



External sector

Trade

For both low- and middle-income countries, but particularly for the latter, terms of trade shocks⁹ were, on average, of greater magnitude in prolonged user countries.

As regards trade openness, there is a marked difference among middle-income countries: prolonged users were continuously less open than “temporary” users, in the sense that their trade to GDP ratio was consistently lower –by 10 to 15 percentage points– over 1971-2000, even though for both groups that ratio increased over the period (see chart below). By contrast, there is no significant difference between temporary and prolonged users as far as PRGF-eligible countries are concerned (Chart 8).

With respect to the composition of exports, *prolonged users* in both PRGF-eligible and non PRGF-eligible groups had a higher share of primary exports than “temporary users”, and that gap tended to increase over time. The concentration of exports on primary commodities also declined faster in “temporary” users, which may be related to their greater openness to trade (Chart 8).

In keeping with the findings of previous studies on the determinants of repeat UFR,¹⁰ both groups of prolonged users on average had markedly lower gross reserves (in relation to their external debt) than temporary users. However, data on imports coverage by gross international reserves unexpectedly indicate that prolonged users have had a slightly higher coverage of imports than “temporary users” throughout the 1971-2000 period, and the difference, although small, is statistically significant (Table 3). Once again, this may reflect the generally lower trade openness of the prolonged users.

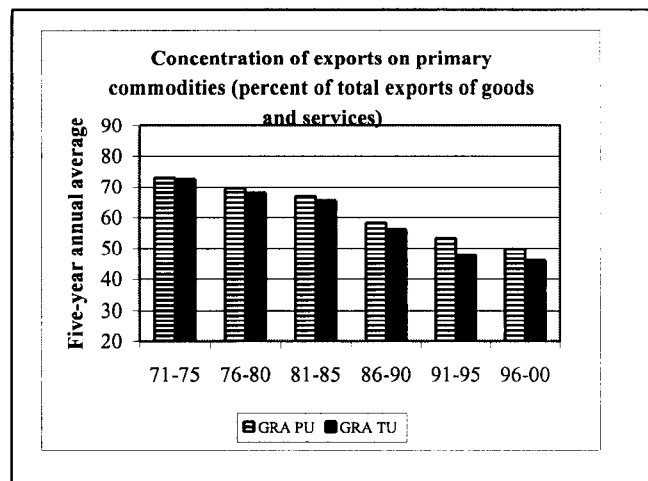
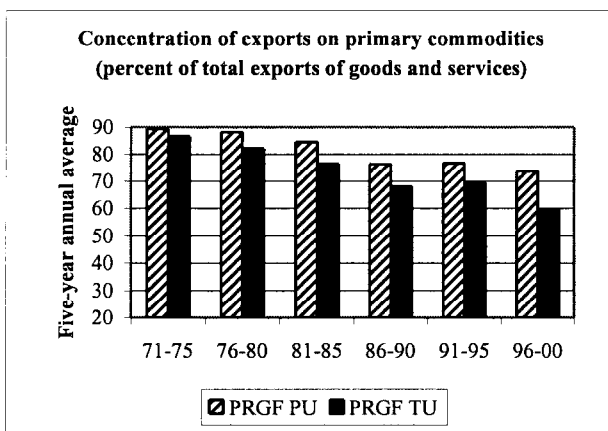
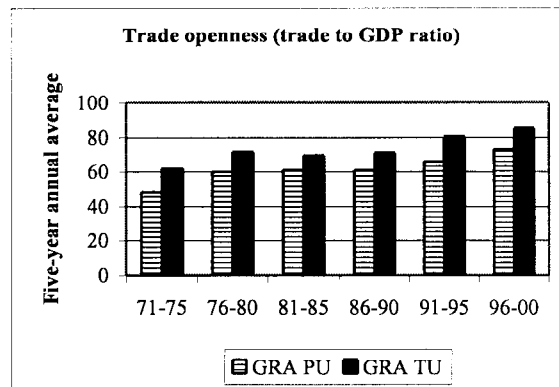
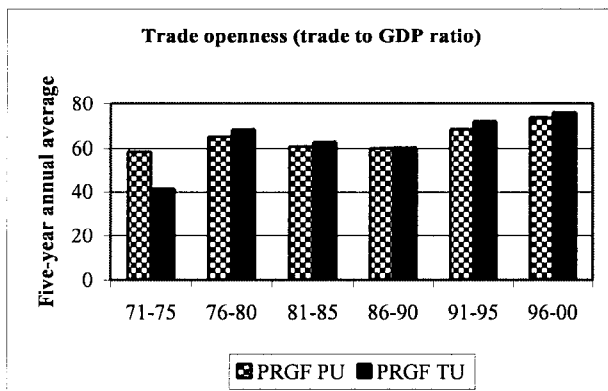
Prolonged users generally faced a heavier external debt and debt service burden

As far as the stock of external debt is concerned, prolonged users had a significantly larger debt/GDP ratio than “temporary users” until the late 1980s, after which the relationship reversed itself, even though the external debt of PRGF-eligible prolonged users kept rising in relation to their GDP. However, the debt service burden, as measured by the external debt service to exports ratio, was significantly higher for prolonged users than for “temporary” users throughout 1975-2000.

⁹ The definition of terms of trade shocks used here is the same as in Ivanova et. al. (2001) and Dollar-Svensson (2000), namely the difference between the change in the price of exports weighed by the share of exports in GDP and the change in the price of imports weighed by the share of imports in GDP (cf. Table 3).

¹⁰ E.g. Bird *et al.* (2000).

Chart 8. Trade Openness and Concentration



Political characteristics

The literature on the effectiveness of structural adjustment programs has emphasized the importance of political economy variables in determining the outcome of these programs.¹¹ It was not possible in the context of this project to collect data on the relevant variables over the entire period under review. However, based on the database used by Ivanova et. al.,¹² there appear to be few consistent differences between prolonged and temporary users as far as political characteristics are concerned.

¹¹ See, for instance, Ivanova et. al. (2001) or Dollar-Svensson (2000).

¹² This database covers the countries that entered into the approximately 170 arrangements with the IMF between 1992 and 1998.

The one important exception is the measure of political instability, which appears to be higher among prolonged than among temporary users for both middle- and low-income countries.¹³ Prolonged users as a whole also appear to suffer from ethnic fractionalization to a greater extent than temporary users, but this is true only for middle-income countries.

Finally, while several authors have found a relationship between IMF-supported programs (related either to their presence or to their design) and the closeness of the relationship between the member country and the IMF's major shareholders, the comparison between prolonged users and temporary users in terms of their closeness to G7 countries found no major differences.¹⁴

¹³ In contrast, measures of political cohesion and of quality of the bureaucracy suggest that prolonged users have a higher degree of political cohesion and a better bureaucracy than temporary users. Interestingly, the power of vested interests appears to be identical, on average, in all four country groupings.

¹⁴ See for instance Bird and Rowlands (2001), Thacker (1999), Barro and Lee (2001) and Ivanova et al. (2001). The variable used here to test for the influence of proximity to G-7 countries was the share of G-7 bilateral aid.

Table 3: Comparison of Prolonged and “Temporary” Users¹
(In percent; unless otherwise specified)

ECONOMIC PERFORMANCE		71-75	76-80	81-85	86-90	91-95	96-00	71-80	81-90	91-00
GDP growth		(period geometric mean)								
	PRGF-eligible Users									
	prolonged	3.0	3.2	0.7	2.3	1.6	5.5	3.1	1.5	3.5
	temporary	3.3	2.7	3.2	2.8	0.5	3.9	3.2	3.0	1.7
	t test significance 1/	ns	ns	**	ns	ns	ns	ns	*	ns
	Non PRGF-eligible Users									
	prolonged	6.3	4.7	2.0	2.4	2.3	2.2	5.0	2.2	2.2
	temporary	5.5	5.1	2.2	2.7	1.0	3.0	5.2	2.7	1.6
	t test significance	ns	ns	ns	ns	ns	ns	ns	ns	ns
	<u>Memorandum</u>									
	Pakistan	3.2	6.2	6.8	5.8	4.8	2.8	4.7	6.3	3.9
	Philippines	5.8	6.1	-1.3	4.7	2.2	3.3	5.9	1.7	2.7
	Senegal	2.4	1.0	3.0	3.2	1.5	5.3	1.7	3.1	3.2
Per capita GDP growth										
	PRGF-eligible Users									
	prolonged	0.5	0.4	-1.4	0.0	-0.9	2.7	0.4	-0.7	0.7
	temporary	2.3	1.9	-0.3	0.6	-2.7	1.5	2.1	-0.2	-0.6
	t test significance	**	*	ns	ns	ns	ns	**	ns	ns
	Non PRGF-eligible Users									
	prolonged	3.1	2.2	-0.5	1.3	0.9	1.2	2.6	0.4	1.1
	temporary	4.1	2.9	1.0	2.3	-0.3	2.1	3.4	1.7	1.1
	t test significance	ns	ns	ns	ns	ns	ns	ns	ns	ns
	<u>Memorandum</u>									
	Pakistan	0.0	4.2	3.5	3.4	2.2	0.6	1.5	3.5	1.4
	Philippines	2.9	1.9	-3.5	0.8	-0.1	1.5	3.1	-0.7	0.7
	Senegal	-0.6	-0.3	-0.8	-0.7	-1.0	2.5	-1.2	0.3	0.7
Inflation										
	PRGF-eligible Users									
	prolonged	12.0	19.2	55.2	167.7	158.0	77.1	15.3	64.5	15.7
	temporary	10.7	11.1	13.2	13.6	18.6	33.4	10.7	14.1	23.3
	t test significance	ns	ns	ns	ns	ns	ns	ns	ns	ns
	Non PRGF-eligible Users									
	prolonged	19.5	18.9	27.8	55.1	77.6	48.3	21.1	32.1	22.4
	temporary	19.5	17.2	23.0	42.8	58.4	47.3	18.3	26.4	18.6
	t test significance	ns	ns	ns	ns	ns	ns	ns	ns	ns
	<u>Memorandum</u>									
	Pakistan	15.7	8.8	5.2	9.4	11.2	7.3	12.2	7.0	9.2
	Philippines	17.0	12.9	14.3	12.7	10.0	7.1	14.7	13.0	8.5
	Senegal	13.5	8.9	7.5	-0.6	6.8	1.4	10.1	5.8	4.1
Growth of exports										
	PRGF-eligible Users									
	prolonged	3.2	5.7	-1.3	2.9	4.6	7.4	4.4	1.4	6.2
	temporary	4.9	4.7	2.4	4.6	4.1	9.1	4.3	3.2	4.4
	t test significance	ns	ns	ns	ns	ns	ns	ns	ns	ns
	Non PRGF-eligible Users									
	prolonged	8.3	7.3	4.2	5.5	7.2	6.8	7.7	4.8	7.0
	temporary	5.1	6.7	3.2	7.1	3.6	4.8	5.1	5.2	4.3
	t test significance	ns	ns	ns	ns	ns	ns	ns	ns	ns
	<u>Memorandum</u>									
	Pakistan	-4.0	11.2	12.2	10.8	9.0	0.3	1.6	8.1	4.5
	Philippines	4.4	8.6	2.4	7.2	9.4	3.3	9.7	3.6	6.3
	Senegal	1.2	-2.7	0.5	1.2	0.8	5.0	-1.4	4.5	2.9

FISCAL CHARACTERISTICS

	71-75	76-80	81-85	86-90	91-95	96-00	71-80	81-90	91-00
	(period average)								
Overall budget deficit (%GDP)									
PRGF-eligible Users									
prolonged	-4.0	-6.0	-7.9	-4.5	-4.1	-3.1	-5.2	-6.8	-3.4
temporary	-3.5	-5.6	-8.1	-6.1	-5.1	-3.8	-4.4	-4.3	-7.2
t test significance	ns	ns	ns	ns	ns	ns	ns	ns	**
Non PRGF-eligible Users									
prolonged	-3.1	-4.8	-4.5	-2.6	-1.2	-2.2	-4.1	-3.8	-1.5
temporary	-4.1	-4.2	-5.0	-3.2	-2.7	-1.9	-3.9	-4.0	-2.3
t test significance	ns	ns	ns	ns	ns	ns	ns	ns	ns
<u>Memorandum</u>									
Pakistan	-7.6	-8.0	-6.1	-7.3	-7.6	-6.5	-7.9	-6.7	-7.1
Philippines	-1.0	-1.3	-2.9	-3.2	-0.6	-1.3	-1.2	-3.1	-0.9
Senegal	-1.1	-0.7	-5.9	NA	NA	NA	-0.9	-5.9	NA
Tax revenues (% of GDP)									
PRGF-eligible Users									
prolonged	13.8	14.9	16.0	14.3	14.3	14.1	16.1	15.2	15.3
temporary	20.2	20.5	20.5	13.0	14.6	13.9	20.3	17.6	13.8
t test significance	ns	ns	ns	ns	ns	ns	ns	ns	ns
Non PRGF-eligible Users									
prolonged	13.1	15.6	16.3	15.0	18.7	18.7	14.3	16.3	18.5
temporary	18.4	21.6	24.1	24.0	25.1	25.0	20.2	24.2	24.9
t test significance	**	**	**	**	**	**	**	**	**
<u>Memorandum</u>									
Pakistan	10.3	12.3	10.6	12.4	15.6	16.0	11.4	11.5	15.8
Philippines	15.0	18.7	18.1	NA	NA	NA	16.9	18.1	NA
Senegal	11.0	11.8	12.9	13.4	12.7	13.1	11.5	13.1	12.9
Government expenditure (% of GDP)									
PRGF-eligible Users									
prolonged	21.1	23.8	28.5	23.5	23.2	22.1	21.5	26.0	23.1
temporary	17.4	23.0	27.5	25.7	25.2	23.2	21.3	26.0	23.9
t test significance	ns	ns	ns	ns	ns	ns	ns	ns	ns
Non PRGF-eligible Users									
prolonged	22.9	26.1	25.0	22.5	23.5	24.0	24.1	24.5	23.6
temporary	25.8	28.6	32.6	31.2	31.4	30.5	27.3	31.6	30.9
t test significance	ns	ns	**	**	**	**	ns	**	**
<u>Memorandum</u>									
Pakistan	16.9	17.4	19.0	23.3	23.6	22.2	17.2	21.2	23.0
Philippines	13.9	13.8	12.0	16.6	18.7	19.1	13.8	14.3	18.9
Senegal	18.2	20.3	27.1	NA 2/	NA	NA	19.2	27.1	NA
of which interest (% of expenditure)									
PRGF-eligible Users									
prolonged	5.1	6.2	10.8	10.0	14.9	16.8	5.2	10.3	14.7
temporary	3.2	4.1	5.9	8.6	11.8	14.1	3.7	6.6	11.9
t test significance	**	**	**	ns	ns	ns	ns	**	ns
Non PRGF-eligible Users									
prolonged	4.7	6.3	12.7	15.7	12.2	11.9	5.3	14.9	12.0
temporary	4.7	5.7	9.6	13.0	11.3	10.3	5.1	11.5	10.9
t test significance	ns	ns	ns	ns	ns	ns	ns	ns	ns
<u>Memorandum</u>									
Pakistan	9.8	10.7	14.4	19.9	23.9	29.1	10.4	16.9	26.2
Philippines	3.7	5.6	13.8	32.4	27.2	18.4	4.8	23.1	23.3
Senegal	2.3	6.2	7.5	NA	NA	NA	4.3	7.5	NA

FISCAL CHARACTERISTICS (continued)

	71-75	76-80	81-85	86-90	91-95	96-00	71-80	81-90	91-00
	(period average)								
of which defense (% of expenditure)									
PRGF-eligible Users									
prolonged	NA	NA	NA	14.4	10.1	10.5	NA	14.5	9.9
temporary	NA	NA	NA	20.6	16.4	17.1	NA	20.5	16.5
t test significance	NA	NA	NA	ns	**	**	NA	ns	**
Non PRGF-eligible Users									
prolonged	NA	NA	NA	18.1	11.2	9.7	NA	17.2	11.2
temporary	NA	NA	NA	10.5	9.3	9.0	NA	10.5	9.1
t test significance	NA	NA	NA	**	ns	ns	NA	**	ns
<u>Memorandum</u>									
Pakistan	NA	NA	28.1	27.6	26.6	24.0	NA	27.7	25.9
Philippines	NA	NA	9.5	11.2	10.1	8.4	NA	10.9	9.6
Senegal	NA	NA	8.8	6.6	10.3	8.7	NA	7.1	9.8
Public debt stock (% of GDP)									
PRGF-eligible Users									
prolonged	30.6	46.7	90.2	90.8	92.0	94.9	38.6	86.2	81.9
temporary	44.4	21.0	47.1	56.0	81.3	95.0	42.4	53.9	84.8
t test significance	ns	**	**	**	ns	ns	ns	**	ns
Non PRGF-eligible Users									
prolonged	43.4	37.9	45.7	55.2	44.1	40.5	40.5	54.5	42.1
temporary	29.2	36.1	51.7	48.4	45.4	43.3	32.6	47.6	43.3
t test significance	ns	ns	ns	ns	ns	ns	ns	ns	ns
<u>Memorandum</u>									
Pakistan	66.9	56.8	54.4	73.8	76.5	79.1	61.8	64.1	77.2
Philippines	43.5	30.2	29.6	51.9	58.1	60.3	36.8	40.8	58.9
Senegal	13.9	NA	60.0	NA	NA	NA	8.0	60.0	NA
Public debt service (% of GDP)									
PRGF-eligible Users									
prolonged	10.0	14.2	22.6	26.2	22.1	17.0	13.6	24.2	19.8
temporary	8.1	7.7	15.6	19.3	12.4	12.5	7.7	17.1	12.6
t test significance	ns	**	ns	ns	**	ns	**	**	**
Non PRGF-eligible Users									
prolonged	5.4	25.1	28.4	26.1	18.6	19.8	24.5	27.3	19.1
temporary	14.3	15.5	21.9	23.4	14.0	15.5	15.0	22.7	14.8
t test significance	**	**	**	**	**	**	**	**	**
<u>Memorandum</u>									
Pakistan	20.9	19.9	19.4	24.9	26.2	27.9	20.4	22.2	26.9
Philippines	NA	23.4	35.5	30.6	21.6	12.2	23.4	33.1	17.4
Senegal	6.2	14.6	15.8	27.7	15.5	18.4	12.2	21.8	16.8
PPG debt service (% revenue)									
PRGF-eligible Users									
prolonged	14.2	15.5	19.7	23.2	24.6	19.4	14.8	21.0	23.5
temporary	6.9	6.1	10.6	14.3	15.6	18.4	6.3	12.2	17.3
t test significance	ns	**	**	**	**	**	**	**	**
Non PRGF-eligible Users									
prolonged	14.8	22.6	32.0	27.5	20.2	22.3	19.1	29.4	21.4
temporary	8.4	10.3	15.7	23.8	15.5	14.5	9.4	19.2	15.0
t test significance	**	**	**	ns	ns	**	**	**	**
<u>Memorandum</u>									
Pakistan	19.1	15.9	18.0	18.8	23.6	21.3	17.1	18.4	22.6
Philippines	13.0	14.9	28.0	43.2	35.7	30.9	14.1	35.6	33.6
Senegal	10.0	24.1	18.1	NA	NA	NA	17.0	18.1	NA

FISCAL CHARACTERISTICS (concluded)

	71-75	76-80	81-85	86-90	91-95	96-00	71-80	81-90	91-00
	(period average)								
Stock of external debt (% of GDP)									
PRGF-eligible Users									
prolonged	29.0	31.1	35.6	40.7	46.0	51.9	56.7	63.0	70.2
temporary	12.4	27.3	45.1	78.3	109.8	98.7	19.9	59.4	111.1
t test significance	**	ns	ns	**	**	**	**	ns	ns
Non PRGF-eligible Users									
prolonged	28.7	41.7	63.9	78.7	61.7	53.1	35.2	71.3	58.3
temporary	20.0	28.1	43.0	54.1	47.0	42.5	24.1	49.7	47.6
t test significance	ns	ns	ns	ns	ns	ns	ns	ns	ns
Memorandum									
Pakistan	52.2	47.0	40.0	47.8	50.3	51.5	48.5	43.9	50.8
Philippines	29.1	45.3	72.1	79.4	62.5	61.2	37.2	75.8	61.9
Senegal	17.0	36.7	61.0	59.7	66.2	75.4	30.5	70.8	61.2

BALANCE OF PAYMENTS CHARACTERISTICS

	71-75	76-80	81-85	86-90	91-95	96-00	71-80	81-90	91-00
	(period average)								
Current account deficit (% of GDP)									
PRGF-eligible Users									
prolonged	-4.4	-3.2	-7.4	-5.7	-7.7	-9.0	-3.5	-6.1	-8.3
temporary	-4.2	-4.5	-7.4	-6.0	-7.9	-9.1	-4.7	-6.4	-8.6
t test significance	ns	**	ns	ns	ns	ns	**	ns	ns
Non PRGF-eligible Users									
prolonged	-2.8	-3.4	-3.9	-2.3	-2.8	-2.7	-3.4	-2.9	-2.8
temporary	4.5	2.6	-5.6	-1.8	-1.9	3.0	2.9	-3.5	-2.3
t test significance	ns	ns	ns	ns	ns	ns	ns	ns	ns
Memorandum									
Pakistan	-4.7	-4.6	-2.7	-2.6	-3.6	-4.8	-4.6	-2.6	-4.1
Philippines	NA	-5.0	-5.4	-1.7	-3.4	0.7	-5.0	-3.6	-1.6
Senegal	-4.6	-8.3	-13.4	-8.2	-6.4	-4.2	-7.2	-10.8	-5.4
Gross international reserves (months of imports)									
PRGF-eligible Users									
prolonged	4.3	4.7	4.5	4.7	5.8	6.6	4.7	4.7	6.2
temporary	5.0	3.4	2.6	2.5	2.7	3.4	3.4	2.5	3.1
t test significance	ns	ns	ns	ns	ns	ns	ns	ns	ns
Non PRGF-eligible Users									
prolonged	5.5	8.5	7.4	7.8	8.5	8.8	8.5	7.5	8.6
temporary	4.3	4.7	3.1	3.2	3.3	3.5	4.5	3.2	3.3
t test significance	ns	ns	ns	ns	ns	ns	ns	ns	ns
Memorandum									
Pakistan	3.6	2.9	3.0	1.8	2.0	1.3	3.2	2.4	1.7
Philippines	NA	4.3	1.7	2.4	3.1	3.2	4.3	2.0	3.1
Senegal	0.3	0.3	0.2	0.2	0.7	2.6	0.3	0.2	1.6
Gross international reserves (billions of US\$)									
PRGF-eligible Users									
prolonged	0.1	0.2	0.2	0.3	0.7	0.1	0.2	0.3	0.8
temporary	0.1	0.4	0.8	0.9	1.7	4.8	0.3	0.8	3.0
t test significance	ns	ns	ns	ns	ns	ns	ns	ns	ns
Non PRGF-eligible Users									
prolonged	0.6	1.5	1.5	2.5	5.1	4.2	1.0	2.0	7.0
temporary	0.1	2.4	2.5	2.9	5.7	8.3	1.7	2.7	6.9
t test significance	**	ns	ns	ns	ns	**	ns	ns	ns
Memorandum									
Pakistan	0.5	1.0	1.8	1.3	2.2	0.2	0.7	1.5	1.9
Philippines	1.0	2.5	1.5	2.3	6.1	4.9	1.8	1.9	8.3
Senegal	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.2

BALANCE OF PAYMENTS CHARACTERISTICS (continued)

	71-75	76-80	81-85	86-90	91-95	96-00	71-80	81-90	91-00
	(period average)								
Gross international reserves (% external debt)									
PRGF-eligible Users									
prolonged	35.9	14.1	6.2	6.0	9.1	11.5	24.8	6.1	10.2
temporary	103.3	64.0	33.6	20.4	18.2	23.9	84.7	25.2	21.0
t test significance	ns	**	**	**	**	**	**	**	**
Non PRGF-eligible Users									
prolonged	60.4	33.3	14.7	17.2	28.8	25.4	44.1	15.9	26.3
temporary	93.6	77.8	30.1	24.7	46.8	39.9	84.7	27.4	43.2
t test significance	ns	ns	**	ns	ns	**	**	**	**
<u>Memorandum</u>									
Pakistan	9.9	11.5	15.1	7.5	8.3	5.6	10.7	11.3	7.0
Philippines	32.8	23.0	6.3	7.9	17.0	25.8	27.9	7.1	21.4
Senegal	11.5	3.9	1.0	0.7	2.8	10.6	7.7	0.8	6.7
Terms of trade									
PRGF-eligible Users									
prolonged	141.7	146.6	119.9	113.0	96.6	105.3	144.1	116.5	100.9
temporary	137.0	146.9	143.1	134.9	115.4	118.8	142.0	139.0	117.1
t test significance	ns	ns	ns	ns	ns	ns	ns	ns	ns
Non PRGF-eligible Users									
prolonged	97.7	105.3	102.1	97.0	97.5	96.9	101.5	99.5	97.5
temporary	99.5	103.7	106.1	103.6	99.5	100.2	101.6	104.8	99.8
t test significance	ns	ns	ns	ns	ns	ns	ns	ns	**
<u>Memorandum</u>									
Pakistan	132.5	133.6	124.2	120.2	97.1	118.7	133.0	122.2	107.9
Philippines	124.9	96.8	92.8	106.7	105.3	92.0	110.9	99.8	100.5
Senegal	100.6	105.3	103.6	112.7	100.7	100.3	102.9	108.1	100.5
Trade (% of GDP)									
PRGF-eligible Users									
prolonged	58.6	65.2	60.8	60.1	68.4	73.7	61.5	61.1	70.7
temporary	41.2	68.3	62.7	60.3	71.9	75.8	65.6	60.6	74.7
t test significance	**	ns	ns	ns	ns	ns	ns	ns	ns
Non PRGF-eligible Users									
prolonged	48.2	59.8	61.0	60.8	66.4	73.4	58.9	61.9	69.5
temporary	61.9	72.0	69.9	71.1	80.7	85.2	69.5	70.9	82.7
t test significance	**	**	ns	**	**	**	**	**	**
<u>Memorandum</u>									
Pakistan	29.2	31.2	33.8	35.7	39.0	37.8	30.2	34.7	38.5
Philippines	45.0	47.1	48.5	55.3	70.2	102.4	46.1	51.9	84.5
Senegal	69.5	76.3	79.7	56.1	62.9	72.8	72.9	67.9	67.3
Share of primary exports (% of merchandise exports)									
PRGF-eligible Users									
prolonged	89.3	88.2	84.5	76.3	76.8	73.7	88.2	83.6	77.7
temporary	86.5	82.1	76.5	68.0	69.4	59.5	84.8	75.6	67.1
t test significance	ns	ns	ns	ns	ns	**	ns	ns	ns
Non PRGF-eligible Users									
prolonged	73.1	69.3	66.7	58.2	53.3	49.9	71.2	61.0	51.2
temporary	72.5	67.8	65.4	56.2	47.8	45.9	69.7	61.5	47.0
t test significance	ns	ns	ns	ns	ns	ns	ns	ns	ns
<u>Memorandum</u>									
Pakistan	44.1	44.8	39.8	29.5	17.6	15.5	44.4	34.6	16.7
Philippines	90.2	81.0	75.5	65.9	52.4	24.5	85.6	70.7	40.0
Senegal	81.9	88.0	87.2	75.9	65.6	49.0	84.6	80.7	58.3

1/ ns indicates the compared means are not statistically significant while * and ** indicates statistical significance at 95 and 99 percent confidence levels, respectively according to t student test.

2/ NA denotes data are not available.

Effects of Prolonged Use on Growth: Details of the Econometric Results

This Annex provides details of the econometric results discussed in Chapter V.

Based on empirical analysis of a panel data set spanning five five-year periods (1975-1999) for 130 countries, Barro and Lee (2002) found that when they did not control for endogeneity, their results suggested that participation in IMF arrangements was associated with contemporaneously lower per capita growth. However, after controlling for endogeneity of participation in IMF arrangements and for other determinants of growth, IMF arrangements had no statistically significant contemporaneous impact on per capita GDP growth, but rather a lagged negative effect. The authors employed an instrumental variables approach to control for endogeneity of participation in IMF arrangements.¹ Specifically, they used the following as instruments for participation: (i) size of quota; (ii) political and economic proximity to IMF major shareholders (the United States, France, and the United Kingdom);² and (iii) national staff (economists) at the IMF.

For the purposes of this evaluation, one of the co-authors of Barro and Lee (2002), Professor Jong-Wha Lee, extended the analysis in that study to consider whether “prolonged use” has an effect on growth that is distinguishable from that associated with “temporary use.” The rest of this section reports on the findings of several exercises undertaken by Professor Lee, using panel data for 82 users of IMF resources (GRA and concessional) over five 5-year periods (1975-79, 1980-84, 1985-89, 1990-94, and 1995-99). The determinants of long-run per capita income growth used encompassed: (1) initial income; (2) human resources (educational attainment, life expectancy, and fertility); (3) investment rate; (4) exogenous shocks (changes in the terms of trade); and (5) policy and institutional variables (government consumption, rule of law, openness, and inflation). Participation in IMF arrangements was measured by loan size.³

A first set of exercises estimated the effects of participation in IMF arrangements, without controlling for the endogeneity of such participation. The results suggested that after controlling for other determinants of growth, IMF arrangements were associated with lower growth contemporaneously and with a lag (equation 1, Table 1). Incorporation of contemporaneous and lagged interactive terms to distinguish between temporary and

¹ The authors argue that the Generalized Evaluation Estimator approach, characterized by Haque and Khan (1998) as the “estimator of choice” for evaluating the effects of IMF-supported programs, does not adequately correct for selection bias (e.g. by reliance on fragile assumptions about the distribution of error terms for identification). They propose a set of political and institutional variables for use as instruments to control for the endogeneity of participation in IMF arrangements.

² Political proximity is measured by voting record at the United Nations, and economic proximity by the ratio of bilateral trade to GDP.

³ In the broader sample used by Barro and Lee (2002), other measures such as program approval, or program participation (the fraction of time that a country operated under an IMF program during the five-year period) do not seem to have a significant impact on growth independently of loan size.

prolonged participants in IMF arrangements yielded statistically significant coefficients on the interactive terms, suggesting significantly more adverse effects on growth for prolonged users than for temporary users (equation 2, Table 1).⁴

A second set of exercises controlled for the endogeneity of participation in IMF arrangements, using the set of instrumental variables employed in Barro and Lee (2002). There was little difference in results when no distinction was made between prolonged and temporary users (compare equations 3 and 1 in Table 1); the effects of IMF lending on growth were found to be still negative and significant.⁵ This result contrasts with the finding in Barro and Lee (2002) that after controlling for endogeneity of participation in IMF arrangements, the contemporaneous effect on growth becomes insignificant. A likely source of the difference in results is the difference in coverage of IMF arrangements, demonstrating the sensitivity of findings of such cross-country regression exercises to sample coverage and size.

When a distinction was made between prolonged and temporary users, the main change in results was with respect to the estimated coefficient on the contemporaneous IMF loan size. The estimated coefficient was no longer significantly different from zero. The coefficients on lagged IMF lending and the interactive terms between IMF lending and the prolonged use dummy did not change much.

A third set of exercises examined whether the effects of IMF arrangements on growth differed between arrangements supported by general resources (i.e., SBAs and EFFs) and those supported by concessional resources (SAF/ESAF/PRGF). The results indicate significant differences (Table 2). When the sample was limited to only SBAs and EFFs, strongly negative contemporaneous and lagged effects on growth were found in prolonged users but not in temporary users. When only concessional facility arrangements were considered, there was a negative contemporaneous effect on growth which was more than offset by a positive lagged effect in prolonged users, and no significant effect on temporary users.

Sample size limitations imposed by available data constrained the scope of the exercises undertaken by Professor Lee. As noted above, the results from such cross-country

⁴ The definition of “prolonged users” was the same as that used in the “dynamic” definition in Annex IIIA. An alternative approach to exploring distinctions between prolonged and temporary users would have been to separate the data into two samples and estimate separate regressions for each group. The sample size for prolonged users was too small to implement this approach.

⁵ Barro and Lee (2002) considered only stand by (SBA) and Extended Fund Facility (EFF) arrangements, while the current exercise also includes arrangements under the IMF’s concessional facilities (i.e., Structural Adjustment (SAF), Enhanced Structural Adjustment (ESAF), and Poverty Reduction and Growth Facility (PRGF) arrangements).

regression exercises can be sensitive to changes in the composition and size of the sample being studied. Bearing in mind these inevitable limitations the main findings were:

- After controlling for endogeneity of participation in IMF arrangements, IMF lending was found to have negative effects on growth, over the contemporaneous as well as subsequent five-year period, in prolonged users.
- For temporary users, the effects on growth of contemporaneous and lagged IMF lending are statistically insignificant.
- The adverse consequences for growth of prolonged use appear to be concentrated in programs supported under general resources, and not in those under concessional facilities.

Table 1. Effects of “Prolonged Use” of IMF Programs on Economic Growth

	(1)	(2)	(3)	(4)
Instruments for IMF loan	Actual values of IMF loan size		IMF quotas and staff, political and economic proximity to the U.S. and Europe	
Log(per capita GDP)	-0.0271 (5.988)***	-0.0260 (6.037)***	-0.0269 (6.042)***	-0.0279 (6.469)***
Male upper-level schooling	0.0036 (1.875)*	0.0030 (1.653)*	0.0035 (1.877)*	0.0034 (1.896)*
Log(life expectancy)	0.036 (1.841)*	0.040 (2.148)**	0.042 (2.171)**	0.054 (2.807)***
Log(total fertility rate)	-0.0281 (4.372)***	-0.0300 (4.891)***	-0.0273 (4.300)***	-0.0303 (4.918)***
Investment/GDP	0.0001 (0.004)	0.0128 (0.406)	-0.0084 (0.260)	0.0122 (0.398)
Government consumption/GDP	-0.092 (3.528)***	-0.069 (2.735)***	-0.068 (2.655)***	-0.049 (2.057)**
Rule-of-law index	0.0111 (1.374)	0.0023 (0.300)	0.0130 (1.638)	0.0064 (0.822)
Openness measure	0.0136 (3.046)***	0.0149 (3.500)***	0.0141 (3.266)***	0.0159 (3.771)***
Inflation rate	-0.0212 (2.644)***	-0.0263 (3.641)***	-0.0191 (2.838)***	-0.0192 (3.406)***
Growth rate of terms of trade	0.069 (2.594)***	0.052 (1.998)**	0.072 (2.706)***	0.062 (2.410)**
Contemporaneous IMF loan	-0.185 (3.000)***	-0.183 (2.846)***	-0.178 (2.008)**	-0.071 (0.789)
Lagged IMF loan	-0.117 (1.715)*	0.099 (1.323)	-0.214 (2.027)**	0.074 (0.818)
Contemporaneous IMF loan * prolonged user		-0.328 (2.899)***		-0.390 (3.062)***
Lagged IMF loan * Prolonged user	--	-0.528 (4.663)***		-0.517 (4.416)***
p-value (a)	0.002	0.011	0.007	0.536
(b)	--	0.000	--	0.000

* significant at the 10 percent, ** significant at the 5 percent, *** significant at the 1 percent.

Table 2. Alternative Specifications of Equation (4) in Table 1

	(1)	(2)
	SBAs and EFFs	SAFs, ESAFs, and PRGFs
Contemporaneous IMF loan	0.043 (0.326)	-0.043 (0.415)
Lagged IMF loan	0.082 (0.888)	0.328 (1.116)
Contemporaneous IMF loan * prolonged user	-0.542 (3.250)***	-0.677 (1.913)*
Lagged IMF loan * Prolonged user	-0.584 (4.761)***	0.853 (1.760)*
p-value (a)	0.856	0.497
(b)	0.000	0.086

* significant at the 10 percent, ** significant at the 5 percent, *** significant at the 1 percent.

Note: The estimation is based on the basic specification of equation (4) of Table 1 with the specific change indicated in each column.

QUESTIONNAIRE SENT TO AUTHORITIES OF PROLONGED USER COUNTRIES

To check how representative of the broader group of prolonged users the findings of the country case studies were, the IEO sent a questionnaire to the authorities of all the countries identified as prolonged users in this study, as listed in Chapter II.

Responses were received from the following 21 countries: Bulgaria, Costa Rica, Egypt, Ghana, Jamaica, Jordan, Kyrgyz Republic, Malawi, Mali, Mexico, Mongolia, Morocco, Nicaragua, Pakistan, Peru, Philippines, Senegal, Tanzania, Turkey, Uganda, Zambia.

A copy of the questionnaire is reproduced below. Most respondents indicated that they did not want to be quoted directly, but the thrust of the views expressed are reflected in the main report, especially in Chapter V.

Overview

1. What is your general assessment of your country's relations with the IMF over the long term?
2. What do you see as the major factors that explain why your country made extended use of IMF resources? Could or should this have been avoided? What should the IMF have done differently? What has your country learnt from the experience of repeated programs?
3. To what extent were IMF-supported programs for your country motivated by the need for a "seal of approval" in order to mobilize funds from other sources, rather than a need for IMF financing, *per se*? Would it have been feasible or preferable to provide such a "seal of approval" in some other way?

Program formulation and negotiation

4. Did the IMF pay sufficient attention to the concerns of the authorities and other groups in the formulation and negotiation of programs? Were any disagreements on policies generally concerned with their substance, or on the pace and sequencing of measures or to potential difficulties in implementing programs?
5. Was the IMF realistic about the political and social environment of programs and the constraints involved?
6. How did the IMF's prolonged involvement affect the development of economic institutions—including those involved in policy formulation and technical analysis—in the country?

Program design

7. What, in your view, were the major strengths and weaknesses in the design of IMF-supported programs? Were IMF-supported programs too ambitious or overoptimistic? Did IMF-supported programs have an appropriate time-horizon? Did they pay sufficient attention to debt sustainability issues? Did programs make sufficient allowance for exogenous shocks?
8. Did IMF-supported programs put the emphasis on the right structural reforms and prioritize appropriately? Was there an appropriate division of labor between IMF and the World Bank with regard to structural reform?
9. Did the IMF learn from experience in designing successive programs?

Post-program experience

10. In those cases where countries no longer use IMF resources, has the internal political dynamic altered since there has been no lending arrangement? Has the process of policy-making and related technical analysis process altered?
11. For those countries that have made repeated use of precautionary arrangements, what are the main reasons for such an approach? What advantages do you see for a precautionary lending arrangement over regular IMF surveillance?
12. Are there any other issues you would like to bring to our attention?

Data on Staff Inputs and Staff Turnover in Prolonged and “Temporary” Users

This Annex provides additional information to support the discussion in Chapter V, Section A.2.

Table 1 provides details of the extent of staff inputs, as measured by the number of missions and mission days, in program countries. The results indicate such inputs were actually higher for “temporary” users. The difference is particularly marked for ESAF arrangements, which involved on average 51 mission days (41 percent) more for “temporary” users than for prolonged users. Likewise, the total staff resources invested by the IMF in programs with prolonged users were, on average, smaller than in “temporary” users’ programs: in both ESAF and GRA arrangements, the Fund’s effort, measured by the personnel costs of its UFR and TA missions, was over 40 percent higher in programs with “temporary” users.

Table 1. Data on IMF Effort 1/

	Number of Mission days		Number of missions		Administrative costs (in millions of USD)	
	During program	incl. 3 mths before prog. approval	During program	incl. 3 mths before prog. approval	During program	incl. 3 mths before prog. approval
All arrangements						
prolonged users	126	144	9	11	1.5	1.6
non-prolonged users	163	186	12	14	1.9	2.1
ESAF arrangements						
prolonged users	122	140	9	10	1.5	1.7
non-prolonged users	173	189	14	15	2.2	2.5
GRA arrangements						
prolonged users	117	138	9	10	1.2	1.4
non-prolonged users	160	185	12	14	1.7	2.0

Source: Ivanova et al (2001).

1/ In this table, data on the number of missions and mission days do not take account of the size of missions.

Excessive turnover of mission chiefs appears to be a problem for many program countries, but has not been worse among the prolonged users (Table 2).

Table 2. Mission Chiefs per Member Country, FY 1996-FY 2001

	No UFR	TU / PRGF	TU GRA	PU / PRGF	PU /GRA
Mission Chiefs per Member Country	(Number of mission chiefs)				
Average	3.4	4.2	4.1	3.9	4.2
High	6	7	10	7	8
Low	1	2	2	2	1
Share of member countries with 5 or more mission chiefs during six-year period (in percent)	13	34	32	19	31

Source: Internal data kindly compiled by OIA at the IEO's request, based on data collected for their review of mission organization and management.

As regards mission team staffing, continuity has also been low across all country groups—in most cases, less than half of mission members were involved in the same country in the two previous years—but it has been slightly better in prolonged user countries than in “temporary” user countries (Table 3).

Table 3. Mission Staff Continuity, FY 1996-FY 2001

(In percentage of total mission staffing)

	current FY area staff active in prior 2 Fys				current FY FAD staff active in prior 2 Fys				% current FY PDR staff active in prior 2 FYs			
	1998	1999	2000	2001	1998	1999	2000	2001	1998	1999	2000	2001
No UFR	41	46	39	40	0	0	25	20	33	0	67	33
TU / PRGF	47	44	39	42	31	40	33	39	36	46	48	28
PU / PRGF	52	55	48	47	47	42	41	39	23	32	40	41
TU / GRA	50	43	51	45	47	40	47	40	25	40	40	42
PU / GRA	49	52	59	55	50	33	50	57	23	36	50	36
All countries	48	47	47	45	43	38	41	41	27	38	45	36

FAD: Fiscal Affairs Department. PDR: Policy Development and Review Department.

Source: Same as above.

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