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**Statement by Ms. Jacklin and Mr. John
on the IEO Evaluation Report on PRSPs and the PRGF
(Preliminary)
Executive Board Meeting 04/71
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Through a comprehensive and objective report on the PRSP process and the PRGF, IEO staff once again have shown the great value of independent in-depth analysis on key challenges facing the Fund.

The IEO Report issues a clear “danger” warning. The PRSP/PRGF process has blurred distinct forms of IMF support and the purposes they serve and merged capacity-building, financing, and informing a wider community of a country’s economic condition into a single function – lending – which is increasingly being made to serve a development role. The Fund’s unique role and therefore special contribution to enhancing growth in low-income countries is in jeopardy.

Summary:

- The PRSP/PRGF process has blurred distinct forms of IMF support – capacity-building, financing, and signaling – into a single function – lending.
- The Fund has a long-term role in low-income countries, but to resolve the mismatch between the lofty ambitions of the PRSP/PRGF approach and what can realistically be achieved, the Fund should focus on capacity-building in the core areas of Fund expertise through surveillance and TA and, as appropriate, lending for short-term balance of payments needs.
- There is a need to clarify the purpose of the Fund’s involvement in each country and ensure that the tools used are suited to the purpose of engagement.
- Non-borrowing programs need to be developed so as to offer an alternative vehicle for countries to develop macroeconomic frameworks in consultation with the Fund without adding to their debt burden.
- Judged against the ambitious original objectives, the PRSP has failed to live up to expectations and has been of limited use for PRGF program design. Nonetheless, there continues to be value in country-led development of poverty reduction strategies. The PRSP’s link to Fund lending should be more flexible and PRSP evaluations needs to be more useful than the JSA.

PRSP/PRGF Objectives and the Role of the Fund in Low-Income Countries

1. Stick to the Fund's Core Functions

The IEO Report rightly concludes that there has been a mismatch between the lofty ambitions of the PRSP/PRGF approach and what could realistically be achieved, especially given the largely unchanged tools at the Fund. How this mismatch is resolved is critically important. We do not believe the Fund should ramp up spending and staffing in a wide-ranging effort to deepen the Fund's role in guiding the formulation and implementation of countries' poverty reduction plans. Instead, the Fund should focus on its core objectives.

The IEO Report provides guidance, saying on page 24 that the approach "should build upon the specific comparative advantage of the IMF" and goes on to cite as key Fund contributions: "analysis and policy advice on macroeconomic and related structural policy issues," a focus on budget constraints and longer-term sustainability issues, technical assistance and capacity building, and a "relatively short-term financing role to help cushion against adverse shocks." These recommendations reflect well the views of the Board during the August 2003 discussion of the Fund's role in low-income countries.

2. Define the Purpose of Each Engagement and Use the Appropriate Tools

Thus, the need for long-term engagement by the Fund in low-income countries is clear. That long-term role is one of capacity-building in the core areas of the Fund's expertise (both through the surveillance process and technical assistance). The Fund also needs to stand ready to meet short-term balance of payments needs with financing linked to policy measures and, in the case of our poorer members, to ensure that Fund lending is on concessional terms. The Fund can also contribute expertise, for example in assessing debt sustainability, that providers of development assistance can utilize to determine if lending is appropriate.

There is a need to clarify with each country the *purpose* of the Fund's involvement – whether it is institution-building, developing a sustainable macroeconomic framework, assessing the sustainability of financial flows, or providing short-term balance of payments financing with related conditionality. *The tools the Fund uses must be suited to the purpose of its engagement.* In all cases, Fund involvement can aim to fit the overall poverty reduction and growth strategy developed by the country.

3. IMF Lending

It is noteworthy that the IEO Report found that experience with the PRGF contradicts the usual criticisms (for example, PRGF programs have allowed for more gradual fiscal adjustment concentrated on increasing revenue rather than cutting spending, not shown a disinflationary bias, and have not been pessimistic about assistance levels). However, that is little consolation. The IEO found that there was very limited improvement in performance under the PRGF (compared to the ESAF), contradicting the hope that the PRSP process would achieve greater ownership and that this would lead to better program implementation. This is a striking and disappointing finding and reinforces our belief that the Fund has not been sufficiently selective in its use of the PRGF, nor effective in its policy engagement.

The IEO's finding that the definition of protracted balance of payments need is "so vague as to be difficult to distinguish from development financing in practice" supports a conclusion that PRGF access definitions be made consistent with the GRA to refocus Fund financial assistance on short-term balance of payments needs. The Report also emphasizes the need for an exit strategy from IMF lending. Finally, the IEO highlights the differences between the Fund's relatively short-term focus and longer-term development objectives, and we look to more appropriate signaling tools than performance under a Fund program to inform donors of the presence of appropriate conditions for development assistance. The unique contribution the IMF can make in helping countries establish sound macroeconomic frameworks is in jeopardy, and alternative forms of engagement need to be considered.

4. Need for Non-Borrowing Programs

Although we envision a division of labor more reflective of the Fund's limited expertise on development issues, we recognize that the Fund will continue to play an important role in advising low-income countries and providing signals of macroeconomic policy performance to MDBs and donors. There is ample room, however, to improve how the Fund fulfills these roles while supporting greater country ownership. PRGF lending programs have been the primary means of engagement and signaling. We have expressed our concern that the Fund has been insufficiently selective in PRGF lending (thus lowering the value of the PRGF itself as a signaling device) and find support for this view in the Report. The Report also makes two additional and important points:

- "the IMF can remain very substantially involved . . . without providing baseline financing over long periods" (p. 23) and
- "At present, programs associated with IMF lending arrangements are so central to the IMF's role in low-income countries that non-program signaling tends to have less credibility. This could change if a different structure, with new signaling and financing instruments were adopted." (pp. 24-25)

These two points, plus consideration of key concerns related to ownership and debt sustainability, and the Report's recognition that the IMF has an essentially unchanged toolkit, help make the argument for a new approach.

In view of the need to customize the tool to the purpose of Fund engagement, we believe that policies for non-borrowing programs need to be developed so as to offer an alternative vehicle for countries to develop macroeconomic frameworks in consultation with the Fund without adding to their debt burden. These programs can also have a duration that meets the country's circumstances (and is not limited by the tenor of IMF balance of payments assistance). Where appropriate, they can provide a basis for informing providers of budgetary support of policy performance. Such an option would fill an important gap between regular surveillance and financial engagement.

We urge the staff to prepare a paper on this option by the time of the Board discussion on the IMF role in low-income countries.

Poverty Reduction Strategies

1. The PRS Process Needs Further Refinement and its Limits Should be Recognized

Judged against the ambitious original objectives, the PRSP has failed to live up to expectations. Commenting on the goals of developing both a roadmap and institutional arrangements for implementing and monitoring the roadmap, the report concludes on page 123 that “To date, no country has both components of such an operational framework.” In addition, it is clear that there has been too much emphasis on the process and documentation to meet IFI requirements – by both countries and the staff – and not enough on improving analysis and the capability of countries to develop and implement strong policies supportive of growth and poverty reduction. More specifically, we believe the work-intensive JSAs generally are not useful to individual countries or the donor community.

PRSPs also have been of limited utility in terms of guiding PRGF program design. Although this was a key objective of the PRSP, we are neither surprised nor especially disappointed since PRSPs have in many cases been particularly weak in their macroeconomic frameworks, prioritization and costing, development of contingency measures, and consideration of difficult tradeoffs. There should be no expectation that IFI lending plans will be built on inadequate strategies. The tensions the IEO Report comes back to time and again – ambition versus realism in PRSPs and ownership versus the quality of policy measures – are not easily resolved and certainly have not been to date.

These criticisms notwithstanding, we think there continues to be significant value in country-led development of poverty reduction strategies and acknowledge their function, and that of the PRGF, under the HIPC initiative. PRSPs have enhanced understanding of the nature of poverty in specific countries and have been especially helpful in promoting consultation and, to a lesser extent, country ownership. Although there is much room for improvement, the consultations spurred by the PRSP process represent a significant step forward in policy formulation. We hope continued progress on this relatively new initiative will be made to foster broader ownership, including among civil society, and better integration of the macroeconomic framework in discussions. Perhaps most important, the dialogue needs to include a discussion of priorities and policy tradeoffs and contingency plans when goals cannot be met. Greater use of PSIA conducted by the Bank and others with relevant expertise could help inform discussions, but we have serious reservations about the Fund conducting or playing a significant role in such analyses.

2. Apply the Link Between PRSP and Fund Lending with Flexibility

Considering these strengths and weaknesses, it would be appropriate to be more flexible in the PRSP’s link to Fund lending. In particular, a PRSP evaluation needs to be more useful than the JSA. More honest, focused, and relevant assessments should be able to be made, perhaps in Article IV or program documents. Keeping in mind the need for a focused and effective Fund role, however, we do not support the suggestion in the paper reviewing Fund surveillance to enhance greatly Article IV treatment of MDGs as it would be especially resource-intensive, overlap with the World Bank, and not have a clear benefit. As a simple step to improve economic policy debate, we urge all countries to publish their Article IV reports.

While we do not envisage a significant role for IMF staff in domestic policy debates, we do not think ownership concerns preclude the IEO suggestion on page 18 of preparing “a short note on key macroeconomic issues that need to be addressed in the broader growth and poverty reduction strategy,” which if shared, could increase civil society knowledge of economic tradeoffs. Nor does better defining the Fund’s role preclude resident representatives from assisting the authorities in their efforts to educate society on the process of establishing a macroeconomic framework embodying trade-offs and choices. The Fund and the Bank should be available to answer questions and during the PRSP development process. Early engagement, especially by the Bank, could lead to a better participatory process and help countries build the capacity to remedy analytical gaps regarding the poverty impact of potential policies.

Specific Recommendations of the IEO Report

Regarding the specific recommendations made in the IEO Report –

- (1) *Introduce greater flexibility in the implementation of the Poverty Reduction Strategy (PRS) approach to better fit the needs of countries at different stages of the process and with different capacities and political and administrative systems.*

We support a more country-specific approach with respect to objectives, timing, and documentation, but expect that some further work will be needed to determine how progress will be assessed.

- (2) *Shift the emphasis of the initiative from the production of documents to the development of sound domestic policy formulation and implementation processes.*

We strongly favor reducing paperwork requirements, consistent with our long-standing emphasis on results and ownership.

- (3) *Clarify the purpose of the JSA and redefine the vehicle accordingly.*

As noted above, we believe the evaluation of PRSPs needs to be more useful than the JSA.

- (4) *Clarify what the PRS approach implies for the IMF’s own operations and strengthen the implementation of the agreed role.*

We believe the Fund should refocus its efforts on its core mandate. This implies defining the purpose of Fund engagement in each case, using the tools appropriate to that engagement, deferring to the World Bank on many issues such as social policy advice, and limiting Fund financial support to short-term balance of payments needs with the current approach of streamlined conditionality.

- (5) *Strengthen prioritization and accountability on what the IMF itself is supposed to deliver within the broader partnership framework, built around the priorities emerging from the PRS process, and ensure resources match commitments.*

As noted above, we do not believe the IMF should increase administrative resources devoted to improving the poverty reduction aspects of the PRSP, but should instead focus its efforts on its core mandate and strive to improve the quality of the macroeconomic and financial advice it provides. It should provide its support in the context of the country's developmental strategy.

(6) The IMF should encourage a strengthening of the framework for establishing the external resources envelope as part of the PRS approach.

We agree with the recommendation that countries should take the lead in seeking aid and providing assistance estimates to the Fund. The Fund should also provide analyses to the financial community of the sustainability of financial flows given a country's institutional capacity and macroeconomic framework.

The Broader Challenge

This Report provides further impetus for a much-needed broad look at policies for low-income country engagement – at the Fund and in conjunction with bilateral and other multilateral participants. As the IEO Report suggests, we cannot decide how to improve the PRSP process unless we clarify the role the IMF should play in low-income countries, the policies needed by developing countries to foster sustainable growth and financial stability and the sources of financing for that effort, and how longer-term development financing (whether bilateral or multilateral, grants, loans, or increased debt forgiveness) is best coordinated. The creation of the Committee on Low-Income Country Work is a welcome step to stand back and assess how the Fund can best support sustainable growth in the low-income countries. We trust the Committee will address the issues raised in paragraphs 42-44 of the Report. We look forward to the Board's further discussion of these issues.