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Statement by Mr. Moser and Mr. Lanz on
Fiscal Policy Response to Scaled-Up Aid; Aid Inflows—The Role of the Fund and Operational Issues for Program Design
(Preliminary)
Executive Board Meeting 07/57
July 6, 2007

1. We welcome this discussion and the effort to review and clarify the Fund's role in low-income countries (LICs), as suggested by the medium-term strategy and the IEO report on the IMF and Aid to Sub-Saharan Africa. We broadly agree with the thrust of the staff papers, but see a need for more precise guidelines in some instances. Also, in some cases, particularly where collaboration with other institutions is important, the papers identify the issues that have to be addressed but fall short of explaining how it will be done.

2. By way of general comments, we would like to sound a note of caution on the following points:

- First, the Fund should exercise prudence and avoid raising unrealistic expectations with regard to aid flows. OECD statistics cited by staff show little evidence of a substantial scaling up. The Fund provides most added value by basing program design and policy advice on realistic aid projections; we do not see an active role for the Fund in aid mobilization.
- Second, absorptive capacity is key and needs to be carefully assessed to ensure that additional aid can be used effectively. Particularly, the importance of administrative capacity to deal with higher aid flows and greater aid fragmentation should not be underestimated.
- Third, the problem of aid dependency is a serious concern that has not received sufficient attention in the present set of papers. The staff emphasizes problems of aid volatility without discussing underlying issues of aid dependency and insufficient mobilization of domestic revenue. Given the Fund's expertise and authority in the area of tax policy, we would have expected the FAD paper to dwell on this issue. Particularly, we would have

appreciated operational guidance not only on the expenditure/PFM side, but also on the revenue side. We encourage further work on this issue.

3. Given our agreement with the thrust of the staff papers, our following comments focus on issues that require further clarifications and on issues where we disagree:

4. On aid projections, we would like the staff to elaborate on the statement that baseline projections "should *not* be restricted to firm donor commitments" (SM/07/210, para 16). Also, we understand that the rational for alternative scenarios will be further discussed in the forthcoming paper on the Fund's role in the PRS process, but we see a need for further guidance on the use of such scenarios: On what assumptions should such calculations be based? What are the criteria for calculating such scenarios? How many scenarios should be calculated? How do such scenarios address the issue of administrative absorptive capacity?

5. We agree on the importance of protecting priority spending, but we do not agree that the Fund should assume responsibility to alert donors to the need of additional financing (SM/07/210, para 51). This should be the authorities' responsibility. At the same time, we call upon donors to increase their efforts to improve aid predictability by following best practice principles, i.e., by entering multi-year commitments, setting transparent disbursement guidelines, and aligning disbursements with the budget cycle.

6. On debt sustainability and the use of the Debt Sustainability Framework: We do not agree that debt relief has created room for *substantial* new borrowing, as stated in paragraph 57 of SM/07/210. In our view, this gives the wrong message and invites another debt cycle. Moreover, while the Fund has an important role in disseminating the results of debt sustainability analyses and in supporting debt sustainability with appropriate program conditionality as laid out in Box 5 of SM//07/210, the negotiation of appropriate levels of concessionality should be the sole responsibility of the recipient country authorities and not of the Fund (para 18).

7. On safeguarding competitiveness, we note that current research suggests that the risk of Dutch disease should not be overestimated. However, with respect to the guiding principles proposed by staff we would prefer a more cautious stance. Exchange rate surveillance and balance of payments issues are the Fund's core area of expertise and we need our advice in this area to be solid.

8. On public financial management (PFM) diagnostics and assessment tools, and subsequent action plans, there is an urgent need to clarify the role of these tools and avoid overlap. Specifically, what is the IMF's involvement in the PEFA Framework? What is the role of fiscal transparency ROSCs? What is the framework for follow-up to these assessments needs? The staff papers clarify the Fund's expertise in the area of PFM and thus the areas of collaboration with other TA providers, but they do not spell out how such collaboration is executed. Is there a clear division of labor between the Fund and the Bank?

9. On budgetary flexibility regarding wage bills: We agree that wage bill ceilings do not necessarily have to be part of program conditionality, but such ceilings should also not be ruled out. They can be relevant and helpful in accompanying more comprehensive public sector reforms. In any case, the use of wage bill ceilings must be well justified and appropriate time horizons defined. More generally, we wholeheartedly agree that program documents should provide better explanations of program design, and we fear that the recent trend to shorter program documents is counterproductive in this sense.

10. On the use of Poverty and Social Impact Analysis (PSIA), we ask the staff to clarify the policy proposed in paragraph 65 of SM/07/210. We assume that "not being responsible for" means that the Fund will not conduct PSIAs, and we agree. However, what exactly does being "proactive in discussing PSIA needs" mean?

11. On monitoring resource use: We do not think that Fund staff should endeavor to undertake periodic systematic assessments of poverty-reducing expenditures. This should be done by development partners that carry fiduciary risks.

12. On fiscal policy design and growth, the staff notes in para 70 of SM/07/210 that an "explicit development of growth-oriented fiscal policy scenarios to inform the design of an overall macroeconomic policy package is desirable." We would like to know what this implies for Fund program design? Again, collaborative efforts in this respect are in order, but we need to have a clearer understanding about the division of labor and purpose of such efforts.

13. Finally, an area that should be further discussed is fiscal decentralization and sub-national government spending. Fiscal decentralization can lead to greater spending effectiveness but it also greatly complicates the coordination of fiscal and monetary policies and raises additional issues of absorptive capacity. Further work on this topic would be useful.