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February 13, 1989

To: Members of the Executive Board

From: The Secretary

Subject: Selected Aspects of the Experience with Programs Supported by Stand-By and Extended Arrangements - Issues in Conditionality

There is attached for consideration by the Executive Directors a paper reviewing selected aspects of the experience with adjustment programs supported by stand-by and extended arrangements, which is scheduled for discussion on Wednesday, March 8, 1989. A draft decision appears on page 30.

Mr. Stuart (ext. 4579) or Ms. Puckahtikom (ext. 8780) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

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INTERNATIONAL MONETARY FUND

Selected Aspects of the Experience with Programs Supported by Stand-by and Extended Arrangements--Issues in Conditionality

Prepared by the Exchange and Trade Relations Department

(In consultation with other departments)

Approved by L.A. Whittome

February 13, 1989

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I. Introduction

This paper, together with the background report, reviews the experience with adjustment programs supported by stand-by and extended arrangements called for in Conditionality Guideline 12. 1/ This guideline states "The staff will from time to time prepare, for review by the Executive Board, studies of programs supported by stand-by arrangements in order to evaluate and compare the appropriateness of the programs, the effectiveness of the policy instruments, the observance of the programs, and the results achieved. Such reviews will enable the Executive Board to determine when it may be appropriate to have the next comprehensive review of conditionality."

The decision adopted by the Executive Board at the last review of experience with Fund-supported programs envisaged that, at the time of the next such review, the Fund would also review the provisions of the extended Fund facility. 2/ Given that the Executive Board undertook a comprehensive reconsideration of the extended Fund facility in 1988 3/, it is proposed to conduct the present review of Fund-supported programs without a concomitant review of the provisions of the extended Fund facility, and to review the provisions on the extended Fund facility at the time of the next review of programs supported by stand-by and extended arrangements.

This review is the eighth of such studies undertaken since 1979. The last comprehensive review of conditionality was completed by the Executive Board in April 1988. At that time, the Chairman's Summing Up indicated:

> Directors agreed that the [1979] guidelines [on conditionality] had served [the Fund and its membership] well, but some considered that they needed to be re-examined in the light of the Fund's growing emphasis on structural reform and to take into account new types of Fund arrangements such as those under the SAF and ESAF. Many Directors, however, noted that the guidelines in fact provided latitude for a greater emphasis on structural reform where that was essential to external viability, and did not see an urgent need to revise the guidelines. 4/

1/ The experience with adjustment programs supported by arrangements under the Structural Adjustment Facility and the Enhanced Structural Adjustment Facility is being reviewed separately in a forthcoming staff paper.

2/ Decision No. 8583-(87/72), May 8, 1987, Section 2.

3/ EBM/88/23 (2/22/88); EBM/88/47 (3/24/88); Decision No. 8885-(88/89), adopted June 6, 1988. See also EBS/88/7 (1/20/88).

4/ Summing Up 88/74 "The Chairman's Summing Up of the Discussion on Conditionality--A Survey of Current Issues," Executive Board Meeting 88/60, April 8, 1988.

In response to suggestions by Executive Directors made at the last review on the experience with Fund-supported programs, this paper approaches the subject in a different manner from past reviews. Previous reviews were generally based on a cross-country analysis of the medium-term adjustment experience of countries for which arrangements had gone into effect in a given year. Because of the large number of countries involved, the assessment was inevitably in terms of broad tendencies, and important country-specific aspects of adjustment were not always apparent. The present review seeks to fill this gap and is based primarily on case studies, which are presented in the background report, covering the adjustment experience of nine member countries since the early 1980s.

The plan of this paper is as follows. Section II sets out the approach and the considerations underlying the country selection. Section III examines the overall adjustment record, focusing on the progress made in achieving program objectives. Section IV considers the main factors that have a bearing on economic performance, including external conditions, appropriateness of program design, and strength of implementation. Based on this discussion, Section V raises some issues affecting the Fund's conditionality. Section VI provides a summary of topics for discussion.

II. Sample Countries and Approach

1. Criteria for country selection

The first task in a case studies approach is to ensure that the sample countries are appropriately representative of the group of member countries that have made use of Fund resources. This involves a substantial degree of judgment, and the staff has relied on a number of criteria to guide the choice of countries to be included (Table 1). However, the practical need to limit the number of countries involved makes it unavoidable that there is a degree of arbitrariness in the selection process.

One of the main criteria used in the selection of countries was a high cumulative commitment of Fund resources from the early 1980s. Equally, it was decided to include some members which had delayed seeking the Fund's support, to see if this delay entailed any particular adjustment problems. Another criterion was that the selection be representative of a broad range of member countries, in terms of regional balance and economic and institutional structures. Thus, the objective was to select countries which are diverse in terms of such characteristics as dependence on market or on official sources of external financing, level of income, and structure of production. Finally, the selection needed to be sufficiently broad so as to encompass a range of adjustment strategies and varying degrees of achievement of adjustment objectives. As the typical situation in the 1980s has been one of continuing difficulties in the adjustment process, the selection focused on cases where difficulties had been encountered

Table 1. Selection Criteria for Sample Countries

	Regional	No. of Fund Arrangements		SAF Eligible	Type of Borrower	Heavily Indebted	Progress Toward Viability
		1976-82	1983-87				
Ghana	AFR	1 SBA	3 SBA & 1 EFF	Yes	Official		Mixed
Morocco	AFR	2 EFF & 1 SBA	3 SBA	No	Diversified	X	Mixed
Zambia	AFR	2 SBA & 1 EFF	3 SBA	Yes	Official		Insufficient
Bangladesh	ASD	1 SBA & 1 EFF	2 SBA	Yes	Official		Mixed
Philippines	ASD	2 SBA & 1 EFF	3 SBA	No	Market	X	Mixed
Yugoslavia	EUR	2 SBA	2 SBA	No	Market	X	Mixed
Egypt	MED	1 SBA & 1 EFF	1 SBA	No	Diversified		Insufficient
Chile	WHD	—	2 SBA & 1 EFF	No	Market	X	Substantial
Mexico	WHD	1 EFF	1 SBA & 1 EFF	No	Market	X	Mixed

and where there had been different degrees of success in dealing with them so as to draw lessons for the application of conditionality.

On this basis, countries selected for the case studies were Bangladesh, Chile, Egypt, Ghana, Mexico, Morocco, the Philippines, Yugoslavia, and Zambia. The exercise examined 40 Fund-supported annual adjustment programs, the details of which are provided in the background report. Commitments of Fund resources to these countries during the period 1981-88 amounted to SDR 15.7 billion (31 percent of total commitments by the Fund during the period) and outstanding use of Fund credit for these countries at end-1988 amounted to SDR 9.0 billion (or 36 percent of total outstanding use of Fund credit (Table 2)).

2. Approach

The case studies analyze the adjustment process over a period spanning several years, generally concentrating on the 1982-87 period. They attempt to identify sources of balance of payments difficulties and describe the design of the adjustment programs and their outcome. In accordance with Conditionality Guideline 12, the studies evaluate the appropriateness of the policy packages, the degree of implementation, and the attainment of key program objectives. The basis for evaluation is a broad one, namely the degree of progress made over time toward balance of payments viability with reasonable price stability and sustainable growth.

Where the chances of successful adjustment were particularly dependent on public acceptance and thus the implications for income distribution were very important, program evaluation attempted to take account of these aspects as well. Nevertheless, this paper does not cover in detail the income distribution aspects of Fund-supported adjustment programs, which has been discussed extensively in recent papers. 1/

In reviewing the experiences described in the case studies, it should be borne in mind that programs may suffer from three basic constraints.

1/ See, for example, "The Implications of Adjustment for Poverty--Recent Experiences with Fund-Supported Programs and Lessons," EB/CW/DC/88/6 (8/12/88); "The Implications of Fund-Supported Adjustment Programs for Poverty--Experiences in Selected Countries," EBS/88/6, (1/13/88); "The Implications of Fund-Supported Adjustment Programs for Poverty--Background Analysis of Methodological Issues and Empirical Results," EBS/88/6, Sup. 1 (1/13/88); "Fund-Supported Programs, Fiscal Policy, and Income Distribution," EBS/85/113 and Rev. 1 (1/3/86). See also "The Chairman's Concluding Remarks at the Discussion of the Implications of Fund-Supported Adjustment Programs for Poverty--Experiences in Selected Countries," Buff 88/28 (2/8/88).

Table 2. Upper Credit Tranche, SAF and ESAF
Arrangements for Sample Countries, 1981-88 1/

	1981	1982	1983	1984	1985	1986	1987	1988	Total Fund Resources 1981-88 Committed	Total Fund Resources 1981-88 Disbursed	Fund Credit Outstanding end-1988 2/ (In millions of SDRs)	Fund Credit Outstanding end-1988 2/ (In percent of quota)
									(In millions of SDRs)			
Bangladesh	* 3/		SBA		SBA	*	SAF	*	430.3 3/	430.3 3/	605.1 4/	210.5
Chile			SBA	*	EFF	*	*	EFF 5/	1,325.0	1,250.0	982.6	223.1
Egypt							SBA		250.0	116.0	116.0	25.0
Ghana			SBA	SBA	*	SBA	EFF, SAF	ESAF	1,243.7	725.1	564.8 6/	276.2
Mexico			EFF	*	*	SBA	*	*	4,810.6	3,902.7	3,570.3	306.3
Morocco	EFF	SBA	SBA	*	SBA	SBA	*	SBA	2,038.3	957.8	696.0	227.0
Philippines			SBA	SBA	*	SBA	*	*	1,128.0	701.0	791.9	179.8
Yugoslavia	SBA	*	*	SBA	SBA	*		SBA	2,977.3	2,532.0	973.6	158.8
Zambia	EFF		SBA	SBA		SBA			1,466.3	559.0	674.5	249.5

1/ * indicates Fund-supported adjustment program under existing arrangement during at least part of the year.
2/ Includes administrative resources for Bangladesh and Ghana.
3/ A three-year EFF with Bangladesh approved in late 1980, which became inoperative in June 1981. The amount of the arrangement was SDR 800 million, of which SDR 220 million was drawn.
4/ Includes SAF loans outstanding of SDR 182 million.
5/ Lengthening of EFF by one year.
6/ Includes SAF and ESAF loans outstanding of SDR 137.2 million.

First, programs need to be developed with due regard to the domestic, social, and political objectives, the economic priorities, and the circumstances of the members. In framing their economic programs, member country authorities may be faced with important constraints that limit their ability to undertake as bold a program as might be called for on purely economic and technical grounds. In such circumstances, an approach that might be second best in an economic sense may be accepted, provided that it has sufficient focus on external viability.

Second, programs need to be assessed in the light of the international economic context in which they were developed. For example, most programs at the start of the 1980s were formulated with the expectation, widely held at that time, that the external economic environment would be considerably more favorable than it actually turned out to be. Furthermore, many of the programs developed in the period around the onset of the international debt crisis in 1982 were framed under the pressure of the need for a rapid reduction in the external current account deficit and to maintain orderly relations with creditors.

Finally, the assessment in the case studies can be more complete than is possible with any contemporary reviews of programs, as it involves a good deal of hindsight. It also benefits from the existence of more complete data than were available at the time the programs were framed.

III. Adjustment Record

1. Sources of economic imbalances

In the 1970s and early 1980s, most of the countries under review were following strongly expansionary financial policies which proved to be unsustainable. This policy stance had been facilitated by the ready availability of external finance, particularly from rapidly expanding international capital markets, at negative real interest rates. By the early 1980s, countries began to be seriously affected by the rise in world interest rates, the slowdown in growth in export markets and a marked deterioration in the terms of trade, including the effects of the second oil shock. The weakening in the external environment brought to the fore macroeconomic problems, including weak tax bases and unsustainable levels of public expenditure. The changed environment also highlighted deep-seated structural problems, often including overvalued exchange rates, complex trade and payments systems that further reduced incentives for production of tradable goods, and distorted financial and product markets.

The easy availability and terms of external financing enabled the needed adjustment to be postponed in the early 1980s in most of the countries under review. However, foreign borrowing became centered increasingly on the short term as commercial banks began to reassess the creditworthiness of these countries; the increase in short-term debt added to an already serious debt problem. In some cases, tentative adjustment efforts were made under Fund-supported programs, but were not sustained (Bangladesh, Morocco, Yugoslavia, and Zambia).

By 1982-83, there was a generalized loss of confidence by banks in lending to developing countries, and commercial financing to most of these countries was abruptly cut back. In this context, as well as in light of other important factors (such as the change of government in Ghana), several of the countries began to adopt and sustain a more comprehensive approach to adjustment; an exception was Egypt, which was able to obtain financing from official sources to cover large imbalances well into the 1980s.

The countries' adjustment efforts since 1982-83 took place against a background of a world economy that was performing better than in the immediately preceding years, although the improvement was less marked than had been expected in the early 1980s and trade protection intensified. Nominal interest rates fell considerably and growth resumed in the industrial countries, albeit at a moderate pace. Many of the countries also benefited from positive movements in the terms of trade since 1985; major exceptions to this general rule were Egypt and Mexico, which were adversely affected by the prolonged decline of oil prices after 1981 and their sharp drop in 1986, and Zambia, which suffered from a prolonged decline in copper prices until 1987.

2. Progress toward program objectives

The main objective of Fund-supported adjustment programs is to achieve a sustainable balance of payments over the medium term in the context of an open trade and payments system, in accordance with the conditions governing use of the Fund resources. 1/ Achievement of this objective usually requires restoration and maintenance of reasonable price stability and a sustainable rate of economic growth compatible with the country's growth potential. Given the current climate in international capital markets, it may also involve further rescheduling of external debt.

In recent years, the majority of the countries covered by the case studies have made progress toward achieving balance of payments viability with reasonable growth and improved inflation performance (Bangladesh, Chile, Ghana, Morocco, and the Philippines (Appendix Table 3)). This was achieved even though the programs covered by the case studies were developed against the background of a major cutback in

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1/ The Articles of Agreement state that: "The Fund shall adopt policies on the use of its general resources...that will assist members to solve their balance of payments problems in a manner consistent with the provisions of this Agreement and that will establish adequate safeguards for the temporary use of the general resources of the Fund" (Article V, Section 3(a)).

the availability of external finance and needed to cope with a difficult and uncertain external environment. Nevertheless, it is disappointing that in spite of lengthy Fund involvement (ranging from six to nine years in most cases), the countries have yet to achieve fully the objectives of the programs; one case (Zambia) has large overdue obligations to the Fund.

At the present time Chile is assessed to have come close to achieving external viability, though difficult conditions in world financial markets have prevented normalization of relations with external creditors. At the other end of the spectrum, on present indications, the outlook for two cases (Egypt and Zambia) is that the adjustment may be prolonged--certainly in excess of five years--even with strong efforts and substantial external assistance. The remaining six cases have made varying degrees of progress and under current prospects could still achieve external viability in three to five years but this would require maintenance of the adjustment effort and, in a few instances, a major strengthening in policies.

In two cases (Bangladesh and Ghana), the relatively slow progress is an outcome of the gradual approach to adjustment that was adopted. The balance of payments problems in these two cases were seen at the outset as structural and protracted in nature, implying a more lengthy period of adjustment; moreover, a gradual approach to adjustment was seen as feasible, given the availability of external financing on appropriate terms. In another case (Yugoslavia), inflation rose persistently and external viability remained elusive notwithstanding a sizable improvement in the external accounts. Major structural reforms still remain to be undertaken.

In most cases, slower-than-expected progress in achieving adjustment objectives reflected a mixture of weaknesses in both program design and policy implementation. In one case, the slow progress reflected serious adverse exogenous shocks which altered in a major way the medium-term adjustment framework (the sharp fall in oil prices for Mexico in 1986). The lack of progress in the case of Zambia can also be attributed partly to an external environment that deteriorated over the medium term rather than improving as had been expected.

IV. Factors Affecting Economic Performance

A review of the experience points to two common factors that generally tend to underlie positive economic performance, namely a policy package with adequate scope and depth and sustained implementation over time. The focus on adjustment is also better maintained in a broadly favorable external environment.

1. External conditions

a. Exogenous external environment

The experience in the case studies emphasizes the importance of the external environment in the adjustment outcome. A key common factor lying behind the cases that registered relatively better economic performance since the mid-1980s was the relatively favorable external conditions as regards the terms of trade, buoyancy of export markets, and international interest rates (Chile, Morocco, and the Philippines). In these instances, the more favorable external environment was largely anticipated and did not lead to an undue relaxation of the adjustment effort, as had been the case in some earlier periods; instead it served to provide the necessary margin for maneuver. Conversely, in cases where external conditions were adverse, the needed external adjustment had to be achieved with relatively stronger policies. However, in the face of a very adverse external environment, this was achieved in some cases only in the context of lower output and accelerating inflation (Mexico).

As discussed in Section IV below, adverse external developments that were not anticipated at the time programs were framed caused serious difficulties in the implementation of a number of programs.

b. External financial support

Adequacy of external financing has always been considered a critical element in the success of adjustment programs and since 1982 the Fund has actively assisted member countries in their relations with creditors. Programs were formulated on the basis of an assessment of financing prospects after close consultation with the international financial community. Fund arrangements helped to unlock financing from other sources and contributed to some relaxation of the external financing constraint.

The linkage between the adequacy of financing and the strength and sustainability of adjustment can be complex. In cases that were not entirely dependent on bank financing and that received adequate support from official and multilateral creditors, the steady flow of external financing contributed to the maintenance of adjustment momentum (Bangladesh and Morocco). Beyond that, it is clear from the experience that program performance can be seriously affected by shortfalls in the programmed amount of financing (e.g., Ghana 1983-85 and Zambia 1986). In the case of Egypt 1987, the inability to achieve program targets during the program period was related in part to shortfalls from projected financing.

In some instances, the loss of creditor confidence and abrupt curtailment of financing was a factor in the member's decision to undertake strong and rapid adjustment. For example, in the cases of Mexico 1983-84 and Chile 1983, the adjustment effort led to a strong improvement in the balance of payments. Initially, there was a weakening in economic activity, but in both cases the economy began to turnaround fairly quickly. Unfortunately, after the recovery had begun policies were relaxed in search of more rapid growth, and the momentum for adjustment was lost.

In a number of cases, the adjustment process turned out to be longer than initially envisaged, reflecting a downward assessment of the availability of external financing in the long run and the desirability of reducing the heavy external debt burden. This reassessment led both to a larger adjustment need over time and a stretching out of the adjustment period, as it proved difficult to adapt the strength and mix of adjustment policies.

2. Program design

The case studies review country experiences within the general framework that programs generally need to restrain domestic absorption, raise national savings to allow higher productive investment, and improve efficiency in the use of domestic and foreign resources. Policies must also be seen as interrelated and mutually supportive. Demand-management policies are necessary as a means to correct underlying macroeconomic imbalances in the short-run, and typically these policies center on the fiscal and monetary areas. Exchange rate policy is also relied on to enhance competitiveness and strengthen the supply response of the economy. Structural measures, such as in the areas of interest rate and pricing policies, are intended to enhance domestic savings, and promote efficiency of investment and resource allocation through greater price flexibility and reduction in cost-price distortions. The experience in the case studies suggests that this general framework is appropriate.

Within it, adjustment programs had to be tailored to the circumstances of the countries involved, given the understandings of the problems at the time and the constraints facing the authorities. Furthermore, even with a well-designed program, economic results will depend on the strength and continuity of policy implementation.

Even though the case studies approach permits a detailed examination of various design issues, it should be noted that the range of issues raised in the experience cannot be exhaustive. The experience also has shed little light on such design questions as the appropriate sequencing of structural measures, beyond confirming conclusions that have become generally accepted (for example, the need to remove severe cost-price distortions at an early stage).

a. Assessment of the adjustment problems

A well designed program must begin with an accurate assessment of the nature, size, and sources of the problems to be addressed, and clear agreement on these aspects between the authorities and the staff is essential. In some of the cases under review, serious difficulties that were encountered in the adjustment process could be traced to shortcomings in the initial stages of problem assessment. In these cases, the chief shortcomings were an initial underestimation of the nature and seriousness of the problems and the consequent need for adjustment.

At times, underestimation of the size of the problem was caused by overoptimistic projections of key exogenous variables over the medium term (copper prices for most programs for Zambia). In other instances, underestimation of the problems reflected assessments of external financing prospects which proved to be too optimistic (Bangladesh 1980, Egypt 1987, Ghana 1983-84, Morocco 1980, and Zambia 1980). This suggests the need for greater rigor in such assessments and the need to strengthen program design to deal with these kinds of uncertainty.

In some other instances, design problems stemmed from the complex linkages between instruments and program objectives; this was a particular complication in economies with widespread administered prices and relatively low factor mobility (e.g., Yugoslavia and Zambia). In cases where problems are in wide-ranging areas, diagnosis of the problem needs to be particularly comprehensive. This would raise the question of whether the degree of involvement of the World Bank was adequate and sufficiently timely to assist in the various areas of its expertise.

Assessment turned out to be weak in cases where the problem areas were not of primary Fund focus at the time (e.g., the soundness of the financial system in Chile 1982 and the financial viability of selected public enterprises and the quality of the investment program in the Philippines 1983). In many of these areas, an adequate database was not available. In other cases, assessment of administrative capacity to implement the program turned out to be optimistic and program implementation suffered from limited administrative capacity to carry out a wide range of measures (e.g., management of credit policy in Ghana 1986, and budgetary control in Morocco and Zambia).

In general, assessment of the problems and design of policy elements improved over time. For example, the programs for Chile, the Philippines, Yugoslavia, and Zambia became increasingly comprehensive as the weaknesses of the assessment in earlier programs became apparent. In this connection, assessment of the nature of the problems and program design can be expected to be more complex for economies with a relatively complicated institutional framework and a highly administered structure of the economy. Given this, a lack of continuity in the Fund staff involved has been a weakness in the operations with certain countries with especially complex economies. This consideration would need to be balanced against other considerations in the management of staff resources.

b. Scope and balance of adjustment policies

Overall adjustment results hinge critically on there being a carefully mapped out policy approach that is followed consistently over the medium term. For example, in the case of Chile after 1985, adjustment policies were implemented under a medium-term framework that clearly set out the direction of main policies, and these policies were adhered to even though the external environment turned out to be more favorable than expected. Similarly, the approach to adjustment in the case of Morocco was clearly identified at an early stage, and although there were slippages in implementation, the basic policy direction was maintained.

Experience suggests that progress toward external viability is better sustained if it is made in the context of reasonable growth and low inflation. This implied a need for more comprehensive policy packages, including structural measures in key areas. Many of the structural reforms were politically sensitive, e.g., trade liberalization and tax reforms. This, along with the larger number of policy areas that needed to be tackled at the same time, called for a strong commitment to the adjustment process on the part of the authorities.

The experience suggests that the appropriate sequencing of macroeconomic and structural reforms varied from case to case. In a few cases, key reforms moved in tandem with macroeconomic adjustment. For example, in the cases of Morocco (1983-84) and the Philippines (1984-85), trade liberalization in the early stage of adjustment was instrumental in giving the adjustment effort an outward looking orientation. In the case of Ghana, the shift to more flexible exchange rate management was essential in securing fiscal adjustment and was also important in improving the efficiency of resource use and the growth performance.

In some other cases, inadequate progress or reversals in key structural areas reduced the efficacy of macroeconomic adjustment and complicated the adjustment effort (Bangladesh, Mexico 1984, Yugoslavia, and Zambia). 1/ In these instances, the programs were generally recognized to have involved a second-best approach in that the external improvement might be less durable. However, the programs as designed were also judged to entail significant progress in reducing financial imbalances and strengthening the external position. At the same time,

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1/ In the case of Bangladesh, the adjustment process was prolonged by inadequate progress in domestic resource mobilization, particularly in the area of tax reform. For Yugoslavia, the disappointing growth and inflation performance was linked to inadequate progress on a broad range of structural reforms, including improving financial discipline in the enterprise sector and interest rate policy. For Mexico, growth is likely to have been adversely affected in 1983 and 1984 by strict import controls (including on intermediate inputs).

the programs were judged to have more political acceptance and offered better chances of being successfully implemented. It is a separate matter of judgment as to whether, especially with the benefit of hindsight, the Fund should have sought to insist on stronger structural measures. In two other cases (Egypt and Zambia) the scope of the initial policies included in the programs was inadequate for the task, which meant that progress in external adjustment was very limited. 1/

The experience also points to the importance of an adequate balancing of interrelated policy instruments. For instance, the failure to complement fiscal policies with an appropriate exchange rate policy in Zambia's earlier programs meant that too great a burden was imposed on fiscal adjustment; this degree of fiscal adjustment turned out to be either not feasible (1981) or not sustainable (1983). Conversely, inadequate fiscal and pricing policies to support flexible exchange rate policy meant that the exchange rate auction system established in October 1985 was shortlived. More generally, in a number of cases flexible exchange rate policy without adequate support of fiscal and monetary policy led to accelerating inflation (Ghana 1986, Mexico 1987, and Yugoslavia 1985).

c. Program content

Progress in the various policy areas covered by the programs was the result of both the quality of the technical design and persistence in implementation. This section sets out in more detail specific lessons drawn from the case studies on possible ways of improving policy design.

(i) Fiscal policy and fiscal reforms

The experience of the case studies suggests that there was a close relationship between progress in fiscal adjustment and achievement of program objectives, particularly as regards the balance of payments and inflation. This relationship was particularly marked in the cases of Chile, Mexico, Morocco, and the Philippines.

The cases also emphasize issues in the design of the fiscal program that have a bearing on the success of implementation and on the durability of fiscal adjustment. These include the need for appropriate balance in revenue raising and expenditure reducing measures, and the desirability of paying attention to the structure of expenditure. The experience would tend to suggest that fiscal adjustment needs to provide for an adequate and sustainable revenue effort instead of one-time revenue measures, a realistic level of current expenditure (including wages), an adequate level of productive investment, and reductions in subsidies. Most of these aspects were featured in varying degrees in

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1/ In the case of Zambia (1981-84), this reflected the underestimation of the size and nature of the problems.

the fiscal adjustment effort of Chile, Ghana, and the Philippines. 1/ At the other end of the spectrum, it proved difficult to sustain fiscal adjustment that was obtained through ad hoc revenue measures, sharp reductions in wages, and deep cuts in investment expenditure (Zambia 1983).

In cases where fiscal adjustment was slower than expected, the experience also suggests that key fiscal reforms might have been essential and should have been expedited. This applies for instance to tax reforms in the cases of Morocco and Bangladesh. 2/ In some of the instances where progress has been limited, design of fiscal programs could have been strengthened by giving more attention to improvements in budgetary process and controls (e.g., capital expenditure budgeting in Morocco 3/ and budgetary controls in Egypt and Zambia) and to the financial performance of public enterprises (the Philippines 1983, and Yugoslavia).

(ii) Monetary and interest rate policies

The experience indicates that the management of monetary policy on the basis of the targets for the expansion of credit or net domestic assets incorporated in the programs was generally effective in achieving the balance of payments and inflation objectives of the programs. However, the experience of some countries raises a number of

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1/ In the case of Chile (1985-88), the control of subsidies and other current expenditure (including through the privatization of some public enterprises) permitted a maintenance of capital expenditure as well as reduction of corporate and personal income tax rates. In Ghana (1984-86), the realignment of relative prices associated with the early correction of the exchange rate, in addition to the introduction of new taxes and an improvement in tax administration, permitted a substantial increase in public investment and a restoration of public sector wages to a reasonable level. Similarly, in the Philippines the tax reform of 1987-88 permitted an increase in public investment and a restoration of real wages in the public sector.

2/ The need for tax reform in Morocco was identified in 1981, but the first stages were delayed until 1986 and the process is still ongoing. Slippages in the implementation of tax reforms also slowed progress in external reforms, as planned reductions in import duty rates needed to be delayed. In the case of the programs for Bangladesh, fiscal adjustment was to be based on increased tax effort; however, there were recurring shortfalls in revenues, and the burden of adjustment often fell on the investment program. Technical studies on tax reform were initiated only in 1986.

3/ The budgetary process in Morocco provided for authorization of capital expenditures at levels above amounts that could be financed, and relied on administrative means to keep such spending within program limits. Unspent authorizations carried over from earlier years also added to the difficulties of budgetary control.

issues with regard to the management of credit policy in a high inflation environment, especially in conjunction with a policy of targeting the real effective exchange rate.

In Yugoslavia in 1985 and Mexico in 1987, substantially higher-than-targeted inflation was accompanied by both a stronger-than-programmed performance in the balance of payments and higher-than-expected increases in the monetary aggregates. In the case of Yugoslavia, the problem was compounded by the existence of a relatively large stock of foreign exchange deposits; high inflation and maintenance of real effective exchange rates had large valuation effects on the foreign currency component of the money supply. In instances where reduction in inflation is a prime objective, supplementary monitoring of monetary aggregates might be adopted to trigger a review of the full range of policies, including financial and exchange rate policies, if monetary developments are substantially different than planned.

In its 1984 program, the Philippines adopted a floating exchange rate policy and given the prime importance attached to the objective of inflation reduction, monetary management focused on control of the monetary base. Under this program, an unexpectedly strong balance of payments performance was reflected in a real appreciation of the peso, and the targeted sharp drop in money growth was achieved. Concern developed about the effect of the real appreciation of the peso on the future viability of the balance of payments, and once inflation was brought to a low level, partial adjustments to the base money targets were incorporated to limit the extent of any future appreciation.

In general, Fund-supported adjustment programs aimed at achieving positive real interest rates, and this objective was usually met in instances where the inflation rate was relatively low and stable, or declining. In cases where inflation was high and variable, this objective proved to be more elusive. For instance, interest rates were substantially negative in Mexico during part of 1983-84 prior to the introduction of an auction system for government securities, in Yugoslavia except for a brief period in 1985, and in Ghana beginning in late 1985 as inflation reaccelerated.

In the two countries that raised interest rates to real positive levels (Ghana 1984-85 and Morocco since 1984), the experience suggests that domestic savings of the private sector responded quickly to the higher rates. At the same time, the lesser need for credit rationing made possible a higher level of private investment. Where worker remittances were important, appropriate interest rate and exchange rate policies were effective in encouraging the inflow of such remittances and raising national savings (Bangladesh and Morocco). In some of the cases under review, appropriate interest rate policy helped at times to reduce capital flight (Mexico 1986, the Philippines 1985, and Yugoslavia 1984).

This overall record suggests that an important issue in program design is how best to ensure positive real interest rates. In instances where the financial system is competitive, has adequate depth, and is subject to appropriate supervision, interest rate liberalization might be an effective way to secure positive real interest rates. In other instances, there might be a need to continue to manage interest rates and adjust rates periodically to achieve this objective. Where the financial system is weak, interest rate policy needs to be accompanied by measures to strengthen the system. This might involve measures to recapitalize the system (Chile 1983) or to improve loan recovery rates (Bangladesh 1986-87). In the case of Yugoslavia, where there are substantial rigidities such as fragmentation of the financial system and weak financial discipline in enterprises, these rigidities need to be reduced so as to increase the effectiveness of interest rate policy.

(iii) Exchange rate and trade policies

At one time or another, flexible exchange rate management was featured in varying degrees in virtually all the cases under review. This ranged from a system where the rate was adjusted periodically in line with some indicators to a freely floating system. The cases point uniformly to the responsiveness of the balance of payments to real exchange rate adjustments, when supported by appropriate financial policies. Response of nontraditional exports to improved competitiveness was particularly strong for Bangladesh since 1985, Chile since 1985, Ghana since 1984, Mexico 1983 and 1986-87, and Morocco 1984-87. Export performance in Yugoslavia in 1984-85 also responded favorably to the downward adjustment of the value of the currency in 1983 and 1984.

In instances of large external imbalances or sharp shifts in the external environment, the experience points to the need for early and decisive exchange rate adjustment as was done in the cases of Chile 1982, Mexico 1982-83 and Ghana 1983. More generally, the experience also underscores the need to keep exchange rate policy under close review, and avoid policy reversals and ensure consistent signals to producers. Reversals in the direction of exchange rate policy in the cases of Chile 1983 and Mexico 1984-85 were followed by a weakening in the external position and led to the need for substantial one-step adjustments.

The experience underlines the important complementary nature of exchange rate policy and financial policies. An active exchange rate policy that was not adequately supported by appropriate financial or wage policies gave rise to difficulties (e.g., an acceleration in inflation in Yugoslavia in 1985 and Mexico in 1987 and the breakdown of the exchange rate auction system and a return to a rigid exchange rate regime in Zambia 1986). At the same time, the realignment in relative prices associated with exchange rate adjustments provided strong support to fiscal adjustment in the cases of Mexico (1983) and Ghana.

In a number of cases, major steps were taken toward the liberalization of the exchange and trade system (e.g., Bangladesh since 1985, Ghana in 1983, Morocco in 1983-85, Mexico in 1985-87, and the Philippines beginning in 1984). It is difficult to be precise as to the effect of these actions on efficiency and growth as their effectiveness depends also on interaction with policies in other areas. Nevertheless, it may be noted that virtually all of these cases have experienced a reasonable growth performance which might be associated at least in part with the efficacy of these measures.

In most of these cases, trade liberalization took place in the context of flexible exchange rate management and relative financial stability. The reforms to be adopted were clearly specified, often with the assistance of the World Bank in areas of its expertise, and timetables for individual actions were set out.

(iv) Pricing and wages policies

Pricing policies, relating to both producer and consumer prices, were important policy elements in a number of cases (e.g. Ghana, Morocco, Yugoslavia, and Zambia). These steps were taken to ensure an efficient allocation of resources in association with exchange rate adjustment, and also to improve the fiscal position. Typically, the policies involved periodic and sometimes large adjustments in prices. The experience indicates that when there is a recurring need for price adjustments, semiautomatic mechanisms or decontrol of prices would ensure more timely and politically less visible adjustments. 1/

The experience with the two countries that recorded high inflation in much of the period under review (Mexico and Yugoslavia) illustrates the special considerations regarding wage and price policies that may need to be borne in mind in designing and implementing policies in a high inflation environment or in an environment of less transparent price/wage determination mechanisms. It may be very difficult to control nominal variables through financial policies alone, as this might involve too high a cost in terms of output and employment. 2/

1/ This was most apparent in the case of Zambia where repeated efforts to adjust prices of maize proved inadequate. However, the manner in which the decontrol of maize marketing in 1986 was managed caused serious difficulties, suggesting the need for very careful design in this area.

2/ In circumstances of very high and variable inflation, financial policies might require the support of other measures that enable a concerted approach to inflation reduction. The issues involved in this approach were discussed in an Executive Board seminar 87/3, October 23, 1987, on the basis of staff papers: "Rapid Disinflation and External Adjustment," EBS/87/154 and "High Inflation, Heterodox Stabilization and Fiscal Policy," (SM/87/141).

3. Policy implementation

The experience in the case studies points to the clear link between sustained implementation of policies and progress toward external viability with reasonable growth and price performance. In particular, in Ghana since 1983 and Chile since 1985, maintenance of the broad thrust of policies was an important factor in the considerable progress toward program objectives. In the cases of Yugoslavia and Zambia, weaknesses in policy implementation contributed in part to the disappointing economic results.

The case studies point to the difficulty of implementing a sustained adjustment effort in a changing world environment, and provide evidence that external developments that differ from those assumed when framing an economic program can affect program implementation. Often, adverse external developments are anticipated in designing economic programs--for example, in the case of Mexico in 1986, the large drop in oil prices was incorporated into the program and, in fact, the partial recovery of oil prices in the latter part of the year meant that the external environment was actually somewhat more favorable than anticipated. In some other cases, external exogenous events were substantially less favorable than projected in programs. Without adequate adaptation in policies to meet unexpected shocks, adjustment results were adversely affected (Chile 1984, Morocco 1984, Philippines 1983, and Zambia 1986). This raises a design question of whether adequate policy margins have been built into programs, or whether additional financing, including from the Fund, might have helped to keep programs on track.

In some instances, unanticipated favorable domestic developments caused difficulties in adhering to the programmed credit and fiscal targets. For example, bumper crops in Ghana (1984 and 1985) gave rise to unanticipated large crop financing requirements. In the case of Bangladesh, favorable harvests led to a reduction in food imports and associated import duties, causing difficulties in meeting fiscal targets. These examples raise design questions of how best to specify programs and targets to prevent unexpected favorable developments from moving financial policies off track.

Rapid progress toward achievement of program objectives could be expected to sustain policy implementation, which is particularly important if the imbalances are large (Ghana 1983). Similarly, a policy effort that is too gradual at the initial stages might increase the risk that implementation will not be sustained, since progress may not be tangible. However, the experience suggests that it is important not to overestimate the speed at which policies may achieve program objectives. For example, in some instances, growth and inflation targets that were publicly announced may have been too optimistic (growth for Chile 1983, inflation and growth for Mexico 1983, growth in the Philippines 1985, and inflation in Yugoslavia 1985). In the event, the announcement of objectives that could not be met might have contributed to premature relaxation of adjustment policies and disenchantment with or weakened support for adjustment efforts. However, from the point of view of the authorities, somewhat optimistic forecasts may well be a price worth paying if it leads to greater domestic support. This classic problem of needing to speak to two audiences will doubtless continue to be difficult to resolve.

Success in policy implementation depends on clearly specified policies. As noted above, the cases of successful import liberalization involved carefully laid out objectives and plans for action. In addition, in the case of the Philippines, a program for deregulation of the marketing of key export products was specified in detail under the 1984-85 stand-by arrangement, and was implemented under the subsequent arrangement. Similarly, the fiscal costs associated with the financial reform in Chile were quantified and monitored at the time of reviews under the 1985 extended arrangement.

Conversely, difficulties in program implementation resulted in some cases from weaknesses in the design of measures. For example, slippages in fiscal policy were often linked to inadequate specification of measures necessary to achieve the targets (Egypt, Morocco, and Zambia). 1/ Similar difficulties emerged in the case of the specification of exchange rate policy (e.g., Mexico 1984) and interest rate policy (Yugoslavia 1985). 2/

Slow progress in implementation of structural reforms was linked in some cases to inadequate specification of the measures to be taken and the timetables for the adoption of the measures (trade liberalization in Mexico 1983-84, tax reform in Bangladesh, agricultural marketing reform in Zambia, improvement in financial discipline in Yugoslavia). The main reason behind ineffective specification in these cases appeared to be the complexity of the reforms involved and, in varying degrees,

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1/ In the cases of Morocco and Zambia, recurring revenue shortfalls suggest the need for more clearly specified revenue measures, and the need to improve estimates of the yield of specific measures. In the case of Egypt, the program was approved with the understanding that additional measures would be decided at the time of the first review of the arrangement.

2/ In the case of Mexico, the 1984 program provided for maintenance of competitiveness; in the event there was a substantial real appreciation of the currency during 1984 and detailed understanding of the indicators guiding exchange rate policy might have helped to avoid this. The interest rate formula for the 1985 program for Yugoslavia involved adjusting the interest rate on three-month deposits on the basis of three months of actual price data and two months of projected inflation; the projections of inflation generally proved to be overly optimistic and the objective of real positive interest rates was generally not achieved.

responded to the authorities' wish to maintain a degree of flexibility in policy implementation.

More generally, strong political commitment is needed to implement and sustain reforms in sensitive areas. This applies, for instance, to financial system reforms in Chile, the trade liberalization effort in Morocco 1983-84 and Mexico 1985-87, and deregulation of marketing for key exports in the Philippines 1986-88. In contrast, in the case of Egypt 1987, the necessary political commitment to a wide range of structural reform measures weakened during the program period.

4. Experience with program monitoring

From the case studies, the experience with program monitoring confirms in key respects the conclusions of previous Board considerations of this topic. 1/ It also points to areas where greater attention might be paid.

As noted above, in a number of instances program results have been disappointing, reflecting both weaknesses in program design and difficulties in policy implementation. Close program monitoring cannot substitute for a well-designed program. However, it remains an essential instrument to provide the Fund with adequate safeguards for the use of its resources by permitting purchases only when policy implementation proceeds in accordance with understandings under the arrangement.

As would be expected, monitoring practices varied from case to case, depending on the policy areas that were judged to be critical to the success of the programs. Overall, the experience emphasizes the contribution of prior actions in ensuring a strong beginning for the adjustment process and establishing the domestic and international credibility of the member's program (e.g., Ghana 1983, Mexico 1983, Yugoslavia 1983 and 1984, the Philippines 1984, Chile 1985, and Zambia 1986). The experience also suggests that beyond appropriate prior actions, there is need for comprehensive and well-defined performance criteria to keep track of developments and to ensure policy adaptations on a timely basis

With respect to performance criteria, the experience illustrates:

- The need to specify performance criteria to cover a sufficient period of policy planning. Criteria that were established for only

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1/ See, for example, "Relationship Between Performance Criteria and Phasing of Purchase Under Fund Arrangements," EBM/84/117 (12/6/84) and EBM/85/38 (3/8/85); "Program Design and Performance Criteria," EBM/86/190 and EBM/86/91 (12/3/86); "Monitoring of Structural Adjustment in Fund-Supported Adjustment Programs," EBM/87/176 (12/18/87); and "Conditionality--A Survey of Current Issues," EBM/88/60 (4/1/88).

a few months may not provide adequate assurance of a clear delineation of policy action (for example, Ghana 1984-86, Morocco and Zambia through most arrangements). Also, there is need for the arrangement period and performance criteria to cover the whole of the member's basic policy period, generally the fiscal year. In several instances where this was not the case (e.g., Bangladesh 1986/87, Chile 1983, Mexico 1984), policy slippages occurred during the uncovered period.

- The importance of comprehensive definitions for the policy variables being monitored, for instance, a comprehensive fiscal test that covers an appropriate definition of the public sector and sources of financing. In instances where this was not done, the linkage between fiscal adjustment and observance of performance criteria was weak (Bangladesh, Morocco 1981-85, the Philippines 1983, and Zambia 1983-84). In some cases, this may require supplementary performance criteria when comprehensive data are not readily available (e.g., the monitoring of certain indicators of domestic arrears of the public sector).

The experience also highlights the important role of program reviews, particularly when the policy environment is uncertain. The growing emphasis on structural measures, some of which might not be readily amenable to monitoring through quantitative performance criteria, gives additional importance to reviews. However, the record also emphasizes the need to confine the scope of reviews to ensure that programs provide both the member and the Fund with a clear understanding of the nature and the direction envisaged for adjustment policies.

With regard to the monitoring of structural measures that are key to the success of the program, prior actions were often useful. There may also be instances when it would be useful to specify the key structural measures in advance, establish timetables for their implementation and, where feasible, incorporate them as performance criteria. The critical role that the World Bank can and has played in the design and monitoring of structural adjustment was highlighted in the case studies. The experience also indicates, however, that greater attention to the design and adequate monitoring of structural reform will place increasing demands on staff resources. It would also be crucial that the authorities fully share the belief that greater specificity in the design of structural reforms is important, to avoid that programs appear to be overly directed by the Fund.

Special issues in monitoring were raised by the experience of high inflation cases. In such an environment, the public sector borrowing requirement could be supplemented by other indicators of the fiscal stance which take into account the fact that nominal interest payments on domestic debt include a large component of debt amortization. In cases where the public domestic debt is large and where there are erratic short-term movements in the rate of inflation, it could be useful to monitor fiscal operations more directly under the control of the authorities in the short run. The operational deficit, which excludes the inflation component of interest payments, appears to provide an important supplementary indicator of the impact of fiscal operations on the economy. Fiscal adjustment as measured by this indicator has also shown a strong relationship with external current account developments (e.g., Mexico).

The experience also indicates the complications of managing monetary policy in a high inflation environment. As noted above, in the cases of Mexico and Yugoslavia, credit ceilings were generally ineffective in helping to achieve the targeted inflation. In these circumstances, there might be a role for supplementary monitoring of monetary aggregates that would trigger a review of all aspects of policies to ensure achievement of program objectives. Alternatively, credit or net domestic asset limits might be adjusted to compensate at least in part for a stronger-than-expected balance of payments performance.

In cases where serious difficulties were encountered in program implementation, there is a need to:

- ensure an appropriate phasing of purchases under Fund arrangements and the need to coordinate this phasing with amounts provided under other Fund facilities (e.g., the relatively heavy frontloading of resources under tranche policies in the 1981 arrangement for Zambia and the compensatory financing facility may have contributed to an inappropriate bunching of repurchases to the Fund); and

- define understandings in key policy areas at the start of programs (e.g., the arrangements for Egypt and Zambia suggest the difficulties that can arise if the reaching of key understandings is left to reviews). The experience also suggests that it might be counterproductive to attempt to keep programs operative primarily with the objective of maintaining the confidence of the international community or to provide greater likelihood of continued flows of resources to avoid the accumulation of large external arrears, including to the Fund (Zambia 1984).

In some cases, difficulties in program design and implementation reflected in part weaknesses in the staff's understanding of the specific workings of the economy and problems in the database (Yugoslavia and Egypt). In such cases, and where a wide range of policy action is envisaged, it might be useful if staff contacts were more intensive, which could be achieved through steps to strengthen the role of the resident representative and through the technical assistance of the Fund and other agencies.

5. The role of other creditors

a. The World Bank

The experience in the case studies points to a number of instances where Bank-Fund collaboration was effective in assisting member countries to design and carry out successfully certain structural reforms. These include, for example, comprehensive Bank involvement in various structural areas in the case of Bangladesh, Chile, Morocco, and the Philippines since 1986; trade liberalization in Mexico beginning in 1985, and reform of the cocoa sector in Ghana. The Bank's technical expertise and financial assistance has been an important factor in the progress achieved in these areas.

In addition, in two cases of serious structural weaknesses, the lack of early and strong support from the World Bank perhaps should have been taken as an indication that the basis for needed policy actions in the structural areas was not in place. For Zambia, the absence of agreement between the Government and the World Bank over a period of several years up to 1985 suggested that needed reforms might not be adopted. Similarly, in the case of Egypt in 1987, the reluctance of the World Bank to step up its lending operations until understandings were reached along the lines to be included as part of the first review under the 1987 stand-by arrangement from the Fund, could have been taken as an additional sign of the risks involved in the program.

b. Other creditors

Since 1982, external assistance from official creditors and donors and bank creditors has been linked more formally to Fund arrangements. This assistance took varying forms, ranging from debt rescheduling to new credits and grants. Through this process of close collaboration with creditors, it was generally possible to design programs with firmer assurances of financing prospects and larger financing than would otherwise have been available.

Shortfalls in disbursements from donors and the World Bank caused difficulties in program implementation in some cases (Ghana). This would suggest the need for greater care in assessing the amounts, composition and timing of such flows, and for stepped up monitoring of them. In other cases, such shortfalls were in part policy-linked, and were directly related to program slippages (Morocco and Zambia). It may be noted that the policy framework paper procedure developed in connection with the Structural Adjustment and Enhanced Structural Adjustment Facilities can play a useful role in coordinating donor assistance.

V. Issues in Conditionality

In the individual case studies, an attempt has been made to assess the appropriateness of the conditions attached to the use of Fund resources. It is difficult to summarize the experience from these individual cases in terms of the overall appropriateness of the Fund's conditionality for all the cases taken together. However, as noted earlier, a majority of cases have made considerable progress toward balance of payments viability. Furthermore, slower-than-expected progress can be attributed in part to an external environment that was less favorable than hoped for, and to uneven policy implementation. Program monitoring has generally been effective in helping to ensure that Fund disbursements were in line with progress in program implementation. Where slippages in policy occurred, Fund purchases were typically interrupted. Based on this overall record, it might be concluded that the conditions attached to the use of Fund resources for the cases under review seem in retrospect to have been broadly appropriate and to have contributed to an improvement in the member's economic situation.

However, in a number of specific cases, conditionality might not have been appropriate and progress toward external viability might have been too slow. In two instances, this was the result of an underestimation of the problems affecting the economy (i.e., Zambia 1981-84 and Yugoslavia 1981-82). In the early 1980s, three programs turned out to be too weak, in part because the expectations concerning financing prospects were overoptimistic (i.e., the extended arrangements for Morocco 1980, Bangladesh 1980, and Zambia 1981). In two other instances, policy slippages may have been unduly accommodated through the granting of waivers (Yugoslavia 1984-85) and through review completion after lengthy delays (Morocco 1983-84). In some cases of close collaboration with creditors, particular emphasis on members' cash flow or systemic implications may have influenced the programs (i.e., Egypt 1987, Mexico 1987, Yugoslavia 1985). In these cases, the programs were known to have been second best. 1/ In two cases (Zambia 1984 and Morocco 1985), the conditionality may not have been entirely

1/ In the case of Mexico 1987, the program recognized that policies might not be adequate to meet the inflation objectives and it was envisaged that the authorities would take additional measures at the time of the second review if inflation remained higher than targeted. In the case of Egypt 1987, special assurances from other creditors were secured, and the staff appraisal noted that a number of important policy areas, including exchange rate, interest rate, and domestic pricing policies, were not being addressed adequately at the start of the program. When the 1985 arrangement for Yugoslavia was approved, Executive Directors noted policies went only part of the way toward improving the responsiveness of the economy. They pointed to a lack of specificity in the Government's short-term policy program with regard to structural policies.

appropriate, reflecting the need to maintain the confidence of the international community and to avoid the accumulation of external arrears, including to the Fund.

In the staff's view, the main lessons that can be drawn from the case studies include the following:

1. Program design

The record points to the need for programs with broad scope and adequate balancing of policies. This would generally require strong financial and exchange rate policies to ensure macroeconomic stability. Where there are major structural weaknesses, this approach would also imply the need for carefully targeted structural measures to be implemented at an early stage to complement demand-management policies.

Despite the general appropriateness of a comprehensive policy package, countries sometimes prefer to limit their programs to traditional macroeconomic adjustment even at the risk that it may not be sustainable. Fund insistence on rapid progress in the structural areas when macroeconomic management is proceeding on track could in some cases imply no Fund involvement, and could result in slower overall progress in adjustment. However, inadequate attention to the structural areas could endanger the achievement of macroeconomic adjustment and extend the adjustment period. In these circumstances, consideration might be given to whether there should be more explicit references in staff appraisals of the risks involved in second-best adjustment paths. More generally, the question arises as to how far the Fund should go in making key structural adjustment a prerequisite for granting an arrangement, or for interrupting purchases when agreed understandings on structural reform are not implemented as envisaged.

With regard to policy instruments in various areas, the experience points to the effectiveness of financial, exchange and trade, and interest rate and pricing policies in the achievement of external adjustment. In a number of these areas, there is scope for improving the design of policies so as to encourage sustained implementation. This might require that greater attention be paid to the measures underlying the fiscal program, ways to liberalize interest rates or secure positive real interest rates, financial and wage policies in a high inflation environment, and more detailed specification in most structural policy areas.

In special cases of single commodity exporters (e.g., Zambia) the experience points to the need for strong policies that would promote export diversification to reduce the country's vulnerability to external shocks. At the same time, the program could be better protected if contingency policy packages are developed at its outset. The buildup of a stabilization fund in times of favorable developments would help cushion the economy against future adverse shocks. For countries that are particularly vulnerable to external shocks, staff papers could present a more systematic and transparent appraisal of the downside risks.

In some cases, there were weaknesses in the assessment of the nature and size of the problems to be addressed, in part because of data inadequacies and complexities of the economy. Weaknesses of this type could be minimized in the future with a sharper focus on in-depth country studies of key structural aspects, and a general attempt to improve data. In this context, there might be a useful role for Fund technical assistance in areas of Fund expertise as well as closer collaboration with the World Bank in its areas of expertise. More specifically, in cases that involve complex and deep-seated structural problems, Bank assistance in program design may be crucial and should be sought at an early stage. Furthermore, consideration might be given to greater continuity of staff involved in operations with particularly complex cases. Similarly, some thought might be given to strengthening the role of resident representatives.

There will, of course, often be a tradeoff between allowing sufficient time for careful program design, and the need to provide timely Fund assistance. Moreover, the need for a careful and thorough study of the problems should not lead to an undue postponement of needed corrective actions.

2. Program implementation

The experience again points to the critical importance of sustained implementation in the achievement of program objectives. In some instances, external shocks were a factor in the weakening of policy implementation, and the new contingency and compensatory financing facility was developed to help keep programs on track in the face of adverse shocks.

The experience also indicates instances where design might be enhanced to facilitate sustained implementation, in particular, where there is a need for careful and detailed understandings on critical structural measures to ensure adequate progress in implementation. The experience also points to the need for realistic expectations by all parties involved regarding program results, so as to avoid premature relaxation of the adjustment effort.

The record demonstrates that persistence in program implementation requires a strong commitment to the program on the part of the authorities. Where difficult policy measures are involved, there is a need for careful assessment of the commitment to adjustment, keeping in mind the track record and the political context within which adjustment will take place.

3. Program monitoring

On the basis of the experience, monitoring of programs in accordance with current practices was generally effective in helping to ensure that Fund purchases were made only when programs were proceeding on track. In some instances, prior actions were of crucial importance in ensuring that programs had a strong start, while in a number of cases where program implementation was weak, inadequate prior actions were a contributing factor. In most cases, clearly specified performance criteria and appropriate scope of reviews helped to ensure an adequate tracking of progress under the programs.

Further to these current practices, the experience suggests the desirability of careful monitoring of structural reforms that are key to the success of the programs. Such monitoring might take the form of prior actions for policy measures that involve discrete steps, say at annual or semiannual intervals. Monitoring might also be enhanced in some cases, for example in the form of timetables for clearly specified policy steps or, to the extent possible, in the form of benchmarks or performance criteria for quantified policy measures. Such advance specification would help to reduce the burden of monitoring at review time. Of course, care needs to be followed in adopting such a course. The greater the degree of specificity, the more the program may appear to be directed by the Fund and to constitute an unacceptable degree of interference in a member's domestic affairs. These dangers make it particularly important that the desirability of increased specificity and monitoring is fully shared by the authorities of the member concerned.

4. Timeframe for the use of Fund resources

In a number of cases, particularly in low-income countries, as well as in middle-income countries with high external debt, there appears to be a need for a more drawn out adjustment period to provide time to deal with deep-seated imbalances. Against this background, SAF and ESAF were developed to respond to the needs of low-income countries.

For non-SAF eligible countries, the issue for the Fund is how to make the possible need for a lengthier adjustment process compatible with the 3-5 year repurchase period currently in effect for ordinary credit tranche resources. In these circumstances, financial assistance from the Fund could continue in the form of a series of successive stand-by arrangements. One alternative might be to encourage greater use of extended arrangements, provided that there is an adequate commitment to the longer adjustment period.

Under both these alternatives, there could be a lengthier period of Fund involvement in assisting its members in their adjustment efforts than has been traditionally expected. This could be seen as a temporary shift until the international debt situation improves. However, a more protracted use of the Fund's regular facilities would involve a risk to the Fund's monetary character. Moreover, it might weaken the supported member's commitment to the implementation of Fund programs.

VI. Topics for Discussion

This review of the experience with Fund-supported adjustment programs has focused on the experience of nine countries. These programs were developed against the background of a major cutback in the willingness of creditors to extend external finance to developing countries after the debt crisis of 1982, and needed to deal with a difficult and uncertain environment for external adjustment. In this context, it is encouraging that considerable progress has been made in the majority of cases. However, despite extensive Fund involvement in most of the countries, they have yet to achieve full external viability and one country has substantial overdue obligations to the Fund.

This paper has attempted to examine the factors underlying the adjustment results of the selected countries. It has also attempted to draw lessons from the experience in the case studies on the way in which the Fund might better support the adjustment efforts of its members. The large balance of payments difficulties facing several members has required increasing attention to the correction of structural impediments to growth and, in part, because of often slower results on the supply side, also longer periods of implementation.

Executive Directors may wish to comment first on the case studies approach underlying this review and on the criteria that were used in selecting the countries covered in this study. In this connection, Directors may wish to consider whether there would be an advantage on the occasion of the next review in more narrowly focusing the case studies so as to illustrate selected issues in greater depth.

With respect to the lessons drawn from the experience, Executive Directors may wish to discuss the topics set out in Section V.

1. Regarding aspects of program design, the case studies point to the need for programs with broad scope, which in many instances implies the need for carefully targeted structural measures to complement strong financial and exchange rate policies. An issue is the extent to which the Fund's conditionality should focus on structural adjustment. Directors may also wish to consider the constraints that administrative capacity in member countries might impose on structural reforms and possible ways of lessening those constraints.

The experience raises several design issues in a number of policy areas and also for single commodity exporters, and suggests possible ways to strengthen the staff's assessment of the size and nature of the problems to be addressed. In this connection, Directors may wish to consider the role of technical assistance in areas of Fund expertise, and a strengthened role for resident representatives. In cases where closer cooperation between the authorities and the Fund is required, consideration might be given to the posting of a resident representative as part of the Fund's support to member countries.

2. Regarding program implementation, the experience suggests the need to strengthen design so as to encourage sustained implementation. Some aspects of how this might be achieved were discussed in Section IV. Persistence in policy implementation requires the member's strong commitment to the program and Directors may wish to comment on approaches which might strengthen the staff's assessment of this commitment, and the weight to be given to the track record and the political context within which the adjustment will take place. Directors may also wish to comment on the implications of these considerations for issues such as the need for the Fund to pay "due regard" to members' domestic, social, and political objectives.

3. Regarding aspects of program monitoring, Directors may wish to discuss the appropriateness of current monitoring practices and how they might be adapted to ensure more rapid progress in structural adjustment.

4. Regarding the possibility of a more drawn out process of external adjustment in the current circumstances, Directors may wish to comment on the implications of prolonged use of Fund resources for the role of the Fund and for the revolving character of the Fund's resources.

Finally, this review is conducted under Conditionality Guideline 12 which calls for such a review to be prepared from time to time; in practice this review has taken place on average every 16 months. Directors may wish to consider the appropriate periodicity of such reviews. Consideration might be given to reviews at less frequent intervals and when there is a basis for substantive decisions by the Board.

The following draft decision is proposed for adoption by the Executive Board:

1. Pursuant to Decision No. 8583 (87/72) adopted May 8, 1987, the Fund has reviewed the experience with recent programs supported by stand-by and extended arrangements, and decides that the guidelines on conditionality will remain in force in the present circumstances.

2. In view of the comprehensive reconsideration of the extended Fund facility undertaken in 1988, the Fund decides to postpone the review of the provisions of the extended Fund facility envisaged in Section 2 of Decision No. 8583 (87/72).

3. The Fund will again review the experience relating to programs supported by stand-by and extended arrangements at an appropriate time pursuant to paragraph 12 of the guidelines on conditionality. At that time, the Fund will also review the provisions of the extended Fund facility.

Executive Board Decisions following the 1968 and 1978-79 Reviews of Conditionality

1. Use of Fund's Resources and Stand-By Arrangements

The Executive Board has reviewed the Fund's policy with respect to the use of its resources under stand-by arrangements (SM/68/128 and Supplements 1-4, SM/68/141) and agrees that the Fund shall be guided by the approach in the conclusions set forth in SM/68/128, Supplement 4 as revised.

Decision No. 2603-(68/132)
September 20, 1968

Conclusions

In the light of experience over the past years and taking into consideration the necessity of adequate safeguards for the Fund and the need for flexibility while ensuring uniform and equitable treatment of all members, it is proposed that Fund policies and practices on the use of its resources, including tranche policies, shall continue to apply subject to the following:

1. Appropriate consultation clauses will be incorporated in all stand-by arrangements.

2. Provision will be made for consultation, from time to time, with a member during the whole period in which the member is making use of the Fund's resources beyond the first credit tranche whether or not the use results from a stand-by arrangement.

3. Phasing and performance clauses will be omitted in stand-by arrangements that do not go beyond the first credit tranche.

4. Appropriate phasing and performance clauses will be used in all stand-by arrangements other than those referred to in paragraph 3, but these clauses will be applicable only to purchases beyond the first credit tranche.

5. Notwithstanding paragraph 4, in exceptional cases phasing need not be used in stand-by arrangements that go beyond the first credit tranche when the Fund considers it essential that the full amount of the stand-by arrangement be promptly available. In these stand-by arrangements, the performance clauses will be so drafted as to require the member to consult the Fund in order to reach understandings, if needed, on new or amended performance criteria even if there is no amount that could still be purchased under the stand-by arrangements. This consultation will include a discussion by the Executive Directors

which could culminate in a communication of their views to the member under Article XII, Section 8.

6. Performance clauses will cover those performance criteria necessary to evaluate implementation of the program with a view to ensuring the achievement of its objectives, but no others. No general rule as to the number and content of performance criteria can be adopted in view of the diversity of problems and institutional arrangements of members.

7. In view of the character of stand-by arrangements, language having a contractual flavor will be avoided in the stand-by documents.

2. Guidelines on Conditionality

The Executive Board agrees to the text of the guidelines on conditionality for the use of the Fund's resources and for stand-by arrangements as set forth [below].

Decision No. 6056-(79/38)
March 2, 1979

Use of Fund's General Resources and Stand-By Arrangements

1. Members should be encouraged to adopt corrective measures, which could be supported by use of the Fund's general resources in accordance with the Fund's policies, at an early stage of their balance of payments difficulties or as a precaution against the emergence of such difficulties. The Article IV consultations are among the occasions on which the Fund would be able to discuss with members adjustment programs, including corrective measures, that would enable the Fund to approve a stand-by arrangement.

2. 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.

3. Stand-by arrangements are not international agreements and therefore language having a contractual connotation will be avoided in stand-by arrangements and letters of intent.

4. In helping members to devise adjustment programs, the Fund will pay due regard to the domestic social and political objectives, the economic priorities, and the circumstances of members, including the causes of their balance of payments problems.

5. Appropriate consultation clauses will be incorporated in all stand-by arrangements. Such clauses will include provision for consultation from time to time during the whole period in which the member has outstanding purchases in the upper credit tranches. This provision will apply whether the outstanding purchases were made under a stand-by arrangement or in other transactions in the upper credit tranches.

6. Phasing and performance clauses will be omitted in stand-by arrangements that do not go beyond the first credit tranche. They will be included in all other stand-by arrangements but these clauses will be applicable only to purchases beyond the first credit tranche.

7. The Managing Director will recommend that the Executive Board approve a member's request for the use of the Fund's general resources in the credit tranches when it is his judgment that the program is consistent with the Fund's provisions and policies and that it will be carried out. A member may be expected to adopt some corrective measures before a stand-by arrangement is approved by the Fund, but only if necessary to enable the member to adopt and carry out a program consistent with the Fund's provisions and policies. In these cases the Managing Director will keep Executive Directors informed in an appropriate manner of the progress of discussions with the member.

8. The Managing Director will ensure adequate coordination in the application of policies relating to the use of the Fund's general resources with a view to maintaining the nondiscriminatory treatment of members.

9. The number and content of performance criteria may vary because of the diversity of problems and institutional arrangements of members. Performance criteria will be limited to those that are necessary to evaluate implementation of the program with a view to ensuring the achievement of its objectives. Performance criteria will normally be confined to (i) macroeconomic variables, and (ii) those necessary to implement specific provisions of the Articles or policies adopted under them. Performance criteria may relate to other variables only in exceptional cases when they are essential for the effectiveness of the member's program because of their macroeconomic impact.

10. In programs extending beyond one year, or in circumstances where a member is unable to establish in advance one or more performance criteria for all or part of the program period, provision will be made for a review in order to reach the necessary understandings with the member for the remaining period. In addition, in those exceptional cases in which an essential feature of a program cannot be formulated as a performance criterion at the beginning of a program year because of substantial uncertainties concerning major economic trends, provision will be made for a review by the Fund to evaluate the current macroeconomic policies of the member, and to reach new understandings if necessary. In these exceptional cases the Managing Director will inform

Executive Directors in an appropriate manner of the subject matter of a review.

11. The staff will prepare an analysis and assessment of the performance under programs supported by use of the Fund's general resources in the credit tranches in connection with Article IV consultations and as appropriate in connection with further requests for use of the Fund's resources.

12. The staff will from time to time prepare, for review by the Executive Board, studies of programs supported by stand-by arrangements in order to evaluate and compare the appropriateness of the programs, the effectiveness of the policy instruments, the observance of the programs, and the results achieved. Such reviews will enable the Executive Board to determine when it may be appropriate to have the next comprehensive review of conditionality.

Table 3. Summary Indicators for Sample Countries

	1981	1982	1983	1984	1985	1986	1987	1988 Prel.
(External current account as ratio to GDP; growth, annual percentage change in real GDP; and inflation, 12-month change in CPI, end of period)								
Bangladesh 1/	**		**		**	**	**	**
External CA/GDP (-deficit)	-11.5	-8.4	-6.8	-8.2	-7.0	-5.5	-5.7	-7.6
Growth in percent	0.8	3.5	4.2	3.7	4.8	4.0	3.0	2.0
Inflation	17.1	7.5	13.9	12.3	7.7	12.9	5.5	13.0
Chile			**	**	**	**	**	**
External CA/GDP (-deficit)	-14.5	-9.5	-5.4	-10.7	-8.3	-6.8	-4.3	-1.5
Growth in percent	5.5	-14.1	-0.7	6.3	2.4	5.7	5.7	6.7
Inflation	9.5	20.7	23.1	23.0	26.4	17.4	21.5	12.3
Egypt 1/							**	
External CA/GDP (-deficit)		-8.0	-9.8	-14.8	-20.0	-12.2	-11.3	-11.9
Growth in percent		9.9	8.0	7.4	4.8	-1.5	0.6	-1.0
Inflation, average		15.2	18.0	14.6	15.9	25.2	30.0	30.0
Ghana			**	**	**	**	**	**
External CA/GDP (-deficit)	-1.6	-0.3	-0.3	-1.0	-2.5	-1.6	-2.3	-2.4
Growth in percent	-3.4	-6.9	-4.7	8.6	5.1	5.2	4.8	5.5
Inflation	...	...	143.1	6.0	19.5	33.3	34.2	25.0
Mexico			**	**	**	**	**	**
External CA/GDP (-deficit)	-6.7	-3.3	3.6	2.4	0.4	-0.9	2.8	1.8
Growth in percent	8.0	-0.5	-5.3	3.6	2.6	-4.0	1.4	0.9
Inflation	28.7	98.9	80.8	59.2	63.7	105.7	159.2	48.6
Morocco	**	**	**	**	**	**	**	**
External CA/GDP (-deficit)	-12.5	-13.3	-8.0	-11.0	-7.9	-2.5	-1.0	0.5
Growth in percent	-1.3	6.8	2.3	2.1	4.4	5.8	-2.9	8.0
Inflation		6.7	12.5	7.5	10.0	4.4	2.4	1.5
Philippines		**	**	**	**	**	**	**
External CA/GNP (-deficit)	-5.4	-8.1	-8.1	-4.0	-0.1	3.0	-1.6	-2.0
Growth in percent 2/	3.4	1.9	1.1	-6.8	-4.2	2.0	5.7	7.0
Inflation	10.7	8.5	26.1	50.8	5.7	-0.3	7.5	8.5
Yugoslavia 3/	**	**	**	**	**			**
External CA/GSP (-deficit) 4/	-3.0	-3.0	0.5	2.0	0.8	0.5	1.5	3.0
Growth in percent	1.5	1.0	-2.5	3.0	0.5	2.8	-0.5	-1.0
Inflation	39.0	32.5	60.0	46.0	85.0	90.5	170.0	240.6
Zambia	**		**	**		**		
External CA/GDP (-deficit) 5/	-20.9	-17.0	-6.7	-18.5	-22.3	-26.3	-22.1	...
Growth in percent	6.2	-2.8	-2.0	-1.3	-3.4	-0.5	-0.1	...
Inflation, average	14.0	12.5	19.6	20.0	27.5	57.0	43.0	...

Source: Background report on the case studies.

** Indicates Fund arrangement in place for at least part of year. Data show trends in key macroeconomic variables within countries but are generally not comparable across countries owing to differing definitions and coverage of data.

1/ Fiscal year basis.
2/ GNP.
3/ GSP (gross social próduct).
4/ Convertible area current account.
5/ Including grants.