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November 20, 1987

To: Members of the Executive Board

From: The Secretary

Subject: Monitoring of Structural Adjustment in Fund-Supported
Adjustment Programs

There is attached for consideration by the Executive Directors a paper on monitoring of structural adjustment, which has been scheduled for discussion at an Executive Board meeting on Friday, December 18, 1987.

Mr. G. G. Johnson (ext. 8779) or Mr. Burton (ext. 8781) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)



INTERNATIONAL MONETARY FUND

Monitoring of Structural Adjustment in Fund-Supported
Adjustment Programs

Prepared by the Exchange and Trade Relations Department

(In consultation with other departments) 1/

Approved by L.A. Whittome

November 20, 1987

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1/ This paper has benefited from comments by the World Bank staff.

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I. Introduction

The encouragement of structural reform has long been a feature of the Fund's support for its members' adjustment efforts. During the last two years this subject has received particular attention in the Executive Board because of an awareness that such reforms can be important in overcoming severe external imbalances and fostering better growth performance. At the May 1987 Board discussion of issues in conditionality the general view was that Fund-supported programs should focus more sharply on enhancing economic efficiency and competitiveness, and there was broad agreement that growth-oriented adjustment required stronger and more specific structural measures. ^{1/} However, questions were raised as to the extent to which structural reforms should be subject to conditionality and, in particular, how they should be monitored in arrangements with the Fund. This paper has been prepared in response to these questions.

This paper is one aspect of the Board's ongoing work on the review of adjustment programs and their supporting Fund arrangements that has been called for by the Interim Committee. ^{2/} It is thus to be read in conjunction with other papers, particularly "Issues in the Design of Growth Exercises" (SM/87/267, 11/17/87), which discusses some of the main analytical and empirical issues that arise in the design of growth-oriented external adjustment programs. ^{3/} The present paper focuses on issues that arise at the stage of implementation of structural adjustment, including the role of the Fund in program monitoring.

The paper is organized as follows. Section II briefly reviews the rationale for addressing structural reforms in the context of Fund conditionality, seeking to establish the broad circumstances in which the Fund should undertake to monitor the implementation of structural reforms in the programs it supports. Some key issues that the Fund faces in assisting members in the identification of structural problems and the design of structural reform are set out in Section III. Section IV considers technical issues involved in the actual monitoring of structural reform, including the issue of the choice among alternative monitoring techniques. Section V addresses a number of related concerns, such as Fund-Bank relations, and Section VI suggests some topics for discussion. The role of indicators in identifying structural problems and tracking progress with reform is considered in Appendix I, and Appendix II briefly discusses the characteristics of alternative

^{1/} See "External Adjustment, Financing and Growth--Issues in Conditionality" (EBS/87/40, 2/25/87), and the Chairman's Summing Up issued as Buff 87/79 (5/18/87). See also "Program Design and Performance Criteria" (EBS/86/211, 9/8/86), and the Chairman's Summing Up issued as Buff 86/232 (12/10/86).

^{2/} That review also involves consideration of the proposals on conditionality contained in the recent G-24 report.

^{3/} This is part of a continuing program of studies on the conceptual and empirical underpinnings of growth-oriented adjustment.

monitoring techniques and reviews their application to structural reform in recent arrangements. Two background papers that provide more detailed discussion of the monitoring of structural reforms in a number of specific policy areas will be issued shortly. 1/

II. Structural Reform and Conditionality

Structural adjustment may be defined in a broad sense to include all measures that affect the structure of economic incentives and the efficiency with which the economy operates. In pursuing balance of payments viability, the Fund and its members have needed to be concerned both with policies normally construed as "macroeconomic" and with the question of efficiency, particularly in the external sector. For example, changes in key relative prices, particularly the exchange rate but also interest rates and producer prices, have often figured in Fund-supported adjustment programs.

The Fund has also provided support for more far-reaching reforms in the institutional and regulatory framework of members' economies, particularly with respect to exchange systems. An active role for the Fund in supporting its members' efforts to implement such reforms has posed a variety of special, largely technical issues for program monitoring that are discussed later in this paper. To provide background for that discussion, the present section briefly reviews the objectives of structural reform and the role of the Fund's conditionality.

1. Objectives of structural reform

Structural reforms in Fund-supported programs have two broad types of objectives. Some reforms are aimed primarily at enhancing the efficiency of resource allocation and removing impediments to the growth of aggregate supply ("supply-side" reforms 2/); others have the primary aim of adding to the effectiveness and durability of macroeconomic adjustment; but any particular reform may well contribute to both these objectives. For example, liberalization of the financial system or the

1/ One paper examines issues in the reform of financial systems, public enterprises, producer prices, and agricultural marketing. It also provides details of performance criteria related to structural reform in upper credit tranche stand-by and extended arrangements approved since 1979. The second provides a more comprehensive examination of issues that arise in trade liberalization. Further work is underway on the monitoring of structural reform in other areas, such as fiscal policy and the exchange system.

2/ The role of structural policies in stimulating the level and growth rate of output is discussed in "External Adjustment and Growth in Fund-Supported Programs - Recent Experience" (EBS/87/47, 3/2/87). See also "Issues in the Design of Growth Exercises" (SM/87/267, 11/17/87), and "Theoretical Aspects of the Design of Fund-Supported Adjustment Programs," Occasional Paper No. 55.

removal of fiscal disincentives to investment may have as their primary objective alleviation of distortions that suppress the return to savings or investment, but may also affect the conduct of macroeconomic policy.

Strengthening of external sector performance is often a key objective of policies aimed at enhancing efficiency and the growth of productive capacity. For instance, measures relating to the trade and exchange systems or to producer pricing and marketing can remove an anti-export bias and contribute to the growth and diversification of exports. 1/ Policies such as the restructuring of a public investment program or the deregulation of prices of nontraded goods, on the other hand, may have less direct implications for external performance.

Measures that increase the effectiveness and sustainability of macroeconomic policy also have particular relevance for programs of external adjustment. Such reforms may be aimed at increasing the durability of fiscal adjustment, as through increasing the elasticity of the tax system or restructuring financially troubled public enterprises. Reforms of systems intended to control fiscal expenditure may be needed where expenditure overruns have been a persistent problem. 2/ Strengthened supervision and regulation of the banking system may be important where interest rate liberalization is being undertaken, or where rapid adjustment is likely to place pressure on a fragile financial system. Reforms that increase the flexibility of wages or prices can also contribute to the effectiveness of demand management. 3/

In practice there is a considerable interweaving of measures and objectives. For instance, structural policies that stimulate growth in productive capacity are likely to have an influence on the balance of payments through their impact on the savings-investment balance and foreign financing flows. And policies that contribute to durable growth may also enhance the ability over the medium term to service debt while maintaining acceptable improvements in standards of living.

1/ Some forms of trade liberalization can result in a temporary worsening of the current account of the balance of payments, although this will depend in part on the nature of accompanying demand-management and exchange rate policies.

3/ Fiscal reform also affects the structure of incentives. For a discussion of the importance of the quality of fiscal adjustment, see V. Tanzi, "Fiscal Policy Growth and the Design of Stabilization Programs," International Monetary Fund, Working Paper No. 87/1.

3/ The phasing out of indexation, for example, can have a role in containing inflation. See "Rapid Disinflation and External Adjustment" (EBS/87/154, 7/9/87), and "High Inflation, Heterodox Stabilization, and Fiscal Policy" (SM/87/141, 6/25/87).

2. The role of the Fund in promoting structural reform

The extent to which structural reforms should be subject to Fund conditionality has been discussed in the Executive Board on a number of occasions, most recently the May 1987 review of the experience with Fund-supported programs. ^{1/} From these discussions a broad consensus has emerged on the considerations that should guide the Fund's approach, though some differences in view remain as to how these considerations should apply in particular instances.

The Articles of Agreement specify 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 this Agreement and that will establish adequate safeguards for the temporary use of the general resources of the Fund." ^{2/} This consideration, which implies a focus on the achievement of balance of payments viability over the medium term, provides considerable latitude for the choice of adjustment policies. While the Fund favors efficient, growth-oriented approaches to external adjustment, the strength with which it advocates such strategies is constrained by the need "to 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." ^{3/} A related consideration is the general aim of limiting the number of policy aspects to which the Fund attaches conditionality. ^{4/}

Thus in considering the approach of the Fund to the question of structural reform, the basic concern is how such reforms relate to the objective of achieving balance of payments viability over the medium term. Measures that enhance the effectiveness and durability of macroeconomic adjustment are clearly important, although the degree of emphasis put on them will depend to some extent on the country's experience with policy implementation. Where a country has been able to adapt its policies flexibly to achieve macroeconomic objectives, the need for reforms of this type is obviously less pressing than in cases where there have been repeated difficulties in sustaining the momentum of adjustment. The magnitude of the macroeconomic adjustment required will, of course, be another consideration.

As to reforms that focus on the efficient allocation of resources and the growth of productive capacity, Fund-supported programs have frequently addressed impediments to the efficient functioning of the external sector through attention to, for example, exchange rate policy

^{1/} See footnote 1, p.1. The issues summarized here are examined in greater detail on pp. 16-20 of EBS/87/40.

^{2/} Article V, Section 3(a).

^{3/} Conditionality Guideline 4 (see Appendix III).

^{4/} See Conditionality Guidelines 7 and 9 (Appendix III).

and the pricing of tradeable goods. 1/ Such reforms may also lead to stronger growth of income and output. In recent years there has been increasing recognition of the problem of "adjustment fatigue"--the difficulty of sustaining adjustment policies when growth performance is weak--which has led to greater emphasis on the need for heavily indebted countries to grow out of their debt problems. In addressing this issue, however, the Fund and its members face hard choices. Sustaining adjustment policies in a slow-growth environment can be very difficult, but structural reform is also difficult, since it goes to the heart of the country's institutional framework, often involving the need to deal with special interest groups and to embark on complex legislative and administrative processes. 2/

While emphasis will typically be placed on reforms that improve the durability of macroeconomic adjustment or influence the external sector directly, there is no a priori basis for general exclusion of particular areas of reform. Rather, the specific areas to be addressed will need to be determined on a case by case basis in light of the country's circumstances, taking account of both the magnitude of the distortions involved and the extent to which they bear on external viability, as well as other considerations such as whether the World Bank is playing a complementary role in assisting the country in its structural reforms (see Section V.2). The comprehensiveness of the reform to be undertaken similarly needs to be determined case by case.

The nature of the Fund's monitoring of individual structural reforms will by and large reflect the degree of importance attached to implementation of the reforms in question, though the technical issues addressed in Section IV will also have a bearing on the choice of monitoring techniques. Thus, where early action is deemed imperative, approval of the arrangement might be delayed until the action is taken--the prior action technique; other critical actions might be covered by performance criteria or by reviews. For less critical reforms, problems in implementation could be addressed through consultation triggered by supplementary monitoring criteria. These and other considerations that form the basis for delineating the role of the Fund in supporting structural adjustment are developed further in the remainder of this paper.

1/ Although the emphasis in Fund-supported programs has been on solving balance of payments problems without resort to new or increased restrictions, a broader question in this area is whether a country that maintains severe pre-existing restrictions on external transactions can be said to have achieved viability. (See EBS/87/40, p. 19).

2/ The hard choices can be mitigated to a degree by the provision of additional external resources, provided their investment yield a rate of return at least commensurate with the cost of funds. (See SM/87/267).

III. The Process of Reform

1. Problem identification

The identification and evaluation of structural problems is the crucial first step in the process of structural reform. Early diagnosis of structural problems may enable corrective action to be taken before distortions have become severe and begun to have serious adverse effects on economic performance. When a serious structural distortion has developed, accurate assessment of the extent of the problem will facilitate formulation of an adequate reform program.

Diagnosis of emerging structural problems requires regular and systematic monitoring, in a broad sense, of structural aspects of members' economies. Tracking structural developments may involve the collection and updating at regular intervals of information about the institutional structure of an economy, including, for instance, details of legislation, administrative rules and regulations governing activities in different sectors, the operations of major state-controlled entities, and the levels of government-controlled prices. ^{1/} The diagnosis of problems and the tracking of measures to deal with them must be primarily the responsibility of the member government, but the Fund through its surveillance functions and in the context of adjustment programs supported by its resources should also be able to contribute.

Some degree of precision can be brought to the tasks of diagnosis and monitoring by use of indicators that seek to measure the magnitude of distortions and their impact. Effective indicators typically summarize information and present it in a form that fits into an established analytical framework, and can be useful for tracking progress with structural adjustment. Indicators that bring out the macroeconomic importance of structural problems may be particularly valuable.

The potential role and the limitations of structural indicators are discussed in Appendix I, which also makes some suggestions as to those that might be useful in individual structural areas. In developing indicators, two points need to be borne in mind. First, the optimal value, or standard, against which the recorded values of structural indicators are judged may vary across countries and over time. Hence a mechanical use of indicators is to be avoided, and indicators should be interpreted carefully on a case-by-case basis. And second, while structural indicators are potentially helpful signposts, particularly for early identification of emerging problems, they are not necessarily

^{1/} In-depth knowledge of the institutional structure of an economy may be particularly important when major changes in the course of policy are to be undertaken, since the institutional framework may have a critical bearing on how the economy responds to policy change. The nature and extent of wage indexation, which is critical for the effect of anti-inflation policies on output and employment, is a clear example.

prerequisites for addressing structural problems. Severe distortions ^{1/} can often be identified without the aid of sophisticated indicators, and measures to address problems need not be delayed until refined indicators are constructed.

2. Policy design

a. Approach

The first step in program design is to settle on the approach to be pursued. Where the structure of incentives is at issue, the usual aim will be to seek fundamental reforms in the way the incentive structure is determined. Broadly, members have adopted one of two approaches. One is to move toward greater reliance on market forces. ^{2/} Trade and exchange system liberalization, interest rate deregulation, price liberalization, and privatization of public enterprises are inherently of this character. Alternatively, the principle of government intervention may be retained, but shifted from "discretion" to "rules" in an effort to enhance the efficiency and quality of intervention. Adjustment of regulated interest rates or producer prices according to a formula, or changes in the incentive system for public enterprises provide particular examples.

The choice between these two broad lines of approach will typically depend on a variety of factors, including market structure, the difficulties involved in making adequate adjustments to regulated variables at sufficiently frequent intervals, and the importance of distributional or other social objectives. The considerations involved in specific structural areas are discussed in the background papers.

The choice of approach has implications for monitoring. Where a market-oriented strategy is pursued, monitoring may be able to focus on enactment of the needed legislation or the taking of administrative decisions. Where some degree of intervention continues, monitoring may focus on implementation of the intervention policy.

b. Specificity of reform programs

The World Bank's first review of structural adjustment lending emphasizes the importance of detailed planning of structural reforms. ^{3/} The prospects for effective implementation can be enhanced by a carefully mapped out strategy that specifies in detail, and at a practical level, the sequence of structural policy measures that need to be taken to achieve a well-defined policy objective.

^{1/} For example, major distortions in the exchange and trade system or in the structure of producer prices.

^{2/} In some cases where the structure of incentives is at issue, such as tax reform, this will not be an option.

^{3/} "Structural Adjustment Lending: A First Review of Experience," World Bank Report No. 6409.

Since programs of structural reform are typically complex and often stretch over a period of years, it is not always feasible to draw up a detailed plan at the outset for the entire duration of the reform. Nevertheless, it is important that clear objectives be established within a consistent overall framework and that the measures to be taken are specified in detail over a reasonable planning horizon.

c. Scope of reforms

Given the importance of careful planning and problems of implementation, the administrative capacity of a member to design and implement complex programs of structural reform has to be an important factor in determining the scope of structural adjustment that can feasibly be incorporated in an adjustment program. The World Bank's first review of structural lending concluded that reform packages had often been too complex and ambitious, lacking a clear focus on the most important problems. This general conclusion suggests the need to concentrate on key structural areas where distortions have important implications for external adjustment. 1/

A further consideration is the extent to which reforms in one area may need to be undertaken jointly with measures in other fields. For example, a rationalization of the tariff structure may need to be taken in the context of a more general reform of the tax system. Careful thought has always to be given to the optimal sequence in which structural reforms in different areas should be implemented, as well as to the need to coordinate reforms with demand-management policies, 2/ although the scope that a government has for flexibility in this regard may be limited.

d. Speed of adjustment

Most structural reforms need to be viewed in a medium-term context, since major institutional changes will often stretch out over a period of years. In some instances gradual implementation may be necessary to limit transitional costs in terms of output and employment. It can also take time for shifts in the incentive structure to achieve a reallocation of resources. As noted in "Issues in the Design of Growth

1/ This should not be taken to imply that the Fund should discourage members from undertaking wide-ranging reform programs, but rather that in urging members to undertake structural reform, the Fund should focus its efforts on the most important structural problems.

2/ Some aspects of these issues, including the appropriate sequencing of the liberalization of the capital and current accounts of the balance of payments, were discussed in "External Adjustment and Growth in Fund-Supported Programs--Recent Experience" (EBS/87/47, 3/2/87); see also, S. Edwards, "The Order of Liberalization of the Balance of Payments: Should the Current Account be Opened First?", World Bank Staff Papers, No. 710; and A.M. Choksi and D. Papageorgiou (eds) "Economic Liberalization in Developing Countries," Basil Blackwell, 1986.

Exercises," however, in some circumstances structural measures may produce substantial effects quite rapidly, particularly where excess capacity exists and when the durability of reforms is credible.

With respect to policy implementation, rapid and sizable initial steps can enhance the credibility of an adjustment effort, limit uncertainty, and establish appropriate price signals. 1/ A bold initial move can also help to ensure that a reform program is carried through by ensuring that significant beneficial effects, which can muster support for the reform, are experienced relatively quickly. 2/ In contrast a small first step may arouse equally substantial opposition, but fail to induce sufficient positive effects to rally political support.

e. Flexible approach

Despite careful advanced planning, the complexity of structural issues can lead to unanticipated problems with implementation, and the magnitude and timing of the effects of measures once taken may also be different than expected. This suggests the need for flexibility of response to unanticipated turns of events on the part of both country authorities and the Fund.

IV. Choice of Monitoring Technique 3/

A primary function of monitoring is to facilitate effective policy implementation by providing a member with information about how adjustment is proceeding. Monitoring is part of a logical framework for policy action that encourages the taking of measures at appropriate intervals and facilitates timely course corrections when there are deviations from the intended path of adjustment. Where policy implementation needs to take place on a more or less continuous basis, which is the case with many aspects of monetary or fiscal policy, frequent monitoring may be helpful. In other policy areas, particularly where changes in institutional arrangements are involved, frequent adjustments

1/ This issue is discussed in EBS/87/47 (3/2/87).

2/ Even in the case of trade liberalization, where it is generally accepted that implementation of a major reform should be gradual to limit economic dislocation, preliminary evidence from a World Bank study suggests that major initial steps are more likely to lead to success, and that the adjustment costs in terms of unemployment have generally not been high. See D. Papageorgiou, M. Michaely, and A.M. Choksi, "The Phasing of a Trade Liberalization Policy: Preliminary Evidence," CPD Discussion Paper No. 1986-42.

3/ The properties and roles of the various monitoring techniques--prior actions, performance criteria, etc.--are briefly reviewed in Appendix II, which also provides a brief survey of the application of the different monitoring techniques to structural reform in recent arrangements, and briefly reviews the World Bank's experience with conditionality linked to structural adjustment lending.

may not be necessary or even desirable, and monitoring at longer intervals may be appropriate.

In the context of Fund-supported adjustment programs, monitoring has the further purpose of giving the member assurances of the circumstances under which purchases can be made, while providing the Fund with assurances that purchases will only be requested if a program is on track, thereby helping to safeguard the revolving character of the Fund's resources. To this end, program monitoring needs to be both precise and objective, and to relate as far as possible to policy instruments or intermediate targets that are subject to a member's control, rather than to variables whose link to policy actions is uncertain. Program monitoring also needs to balance the sometimes competing requirements of flexibility of treatment that takes into account individual country circumstances, on the one hand, and uniformity of treatment among members, on the other.

This section reviews the technical considerations involved in selecting a monitoring technique when progress with implementation of a particular reform is to be monitored as part of an arrangement with the Fund. The focus is on the roles for prior actions, performance criteria and reviews, the three techniques the Fund employs in linking disbursements to policy implementation in upper credit tranche stand-by and extended arrangements. ^{1/}

1. Policy actions

Most structural reforms can be characterized on one level as a series of discrete policy actions. Trade liberalization, for example, typically consists of a sequence of policy measures, such as the elimination of quantitative restrictions (in some instances to be replaced by tariffs), which may take place in several steps, or a phased reduction in tariffs according to a prespecified schedule. Various techniques can be employed in monitoring such policy actions.

As noted, it is usually desirable for a strong first step in the process of reform to be taken at the outset of an adjustment program. In some instances the alleviation of major distortions before the start of a program may be essential for the success of an adjustment effort. This is particularly likely to be the case where severe distortions exist in the exchange and trade system, the structure of producer prices, or the structure of interest rates. Policy actions that represent a first step in a program of reform, or which represent interim measures to reduce important distortions, may readily be

^{1/} Other forms of monitoring include supplementary monitoring techniques, which can trigger consultations with the Fund--See Appendix II. General issues in the selection and mix of monitoring techniques were reviewed in "Program Design and Performance Criteria" (EBS/86/211, 9/8/86), discussed by the Executive Board in December 1986 (Chairman's Summing Up issued as Buff 86/232 (12/20/86)).

specified as prior actions. In addition to providing strong assurances of commitment to reform and getting an adjustment program off to a strong start, prior actions also offer some flexibility in timing to a member.

Sometimes, the start of a program may not coincide with the natural policymaking cycle, and necessary measures may more appropriately be taken after the start of an arrangement (e.g., steps to reform agricultural marketing or pricing may need to be synchronized with the crop cycle). Under those circumstances, steps that might otherwise be prior actions could be formulated as performance criteria, provided that they can be specified with adequate precision. From a technical standpoint it may also be feasible in some cases to make implementation of subsequent steps in a reform sequence performance criteria, provided that measures have been adequately specified over the required planning horizon. It would then be necessary for the appropriate timing of the measure to be clear and to be synchronized with test dates. In a number of recent arrangements, implementation of specific measures in the areas of trade liberalization and exchange system reform has been a performance criterion (Appendix II). Examples include steps toward the unification of exchange systems, elimination of quantitative restrictions on imports, and scheduled reductions in tariffs. Outside of these broad areas, the use of performance criteria has been limited, although it has included specific tax reform measures and interest rate liberalization.

Reform programs that embody institutional changes will frequently involve substantial steps separated by intervals long enough to provide some degree of stability in the institutional environment. In such cases, particularly where a first step has been taken as a prior action, annual reviews in multiyear arrangements might be a more suitable monitoring technique than performance criteria. If a lag in implementation has affected the outcome of the program, implementation of necessary measures could be required as a prior action for approval of the subsequent annual program. Mid-year or annual reviews might also be the most suitable monitoring technique when the exact date by which particular actions would be completed is difficult to predict, especially if legislation is required, or the policy actions themselves are difficult to describe with the precision required for performance criteria. Indeed, in some instances, a too precise deadline for policy implementation might make satisfactory implementation more difficult. For the review mechanism to be fully effective, however, the expected progress with policy implementation needs to be specified in some detail at the outset of the program.

These considerations suggest that it is not possible to arrive at hard and fast rules about the types of reforms for which policy actions during the program period should be monitored by one technique rather than another. A variety of factors need to be taken into account, including the desirable phasing of policy actions and the uncertainties

involved, and the choice of monitoring technique will need ultimately to be determined in light of the circumstances of the case in question.

2. Intermediate indicators

Where discrete actions take the form of changes in rules or regulations governing an activity, the effectiveness of a reform might depend critically on how the changes were administered on a day to day basis. In such instances, the implementation of discrete actions would be unlikely to provide adequate assurance to the Fund that a reform was being fully implemented, and the monitoring of intermediate indicators of the effectiveness of a reform would assume considerable importance.

For example, in the case of exchange system reform, the spread between exchange rates in official and parallel markets is often an important indicator of policy implementation. Movements in key components in the cash flow of a single public enterprise, or a group of public enterprises, could also provide an important indicator of the effectiveness of rehabilitation programs for public enterprises. ^{1/} Because the link between policy action and the intermediate indicator is seldom direct, such indicators are rarely suitable as performance criteria, but could be used to help evaluate policy implementation at program reviews or to trigger consultation under supplementary monitoring. ^{2/}

When a reform attempts to approximate more closely a competitive market outcome while maintaining government control, policy formulation may sometimes involve a target for an intermediate indicator. An example would be the introduction of a system under which interest rates are adjusted at specified intervals to achieve a particular target for the real interest rate expressed in terms of past inflation. Adjustments to producer prices on a regular basis targeted toward achievement of a specified proportion of the border price could also fall into this category. Intermediate indicators in this second type of case might satisfy more closely the technical requirements of performance criteria since they would generally fall more directly under government control.

V. Other Issues

1. Length of arrangement

Some programs of structural reform, as noted earlier, may need to extend over a period of several years. This is especially likely to be the case where far-reaching changes in the institutional structure of an

^{1/} The overall deficit of the public enterprise sector or its domestic financing might also be covered by the macroeconomic monitoring of a program.

^{2/} A maximum deviation between the exchange rates in the official and parallel markets has been a performance criterion in at least two cases.

economy with implications for the pattern of production are involved. The scope for structural reform to be undertaken in the context of an arrangement will therefore depend on the relationship between the timespan of the reforms in question and the length of the arrangement. In particular, while arrangements of relatively short duration may be able to assist in substantially reducing distortions they may be less suitable than extended arrangements for tackling multi-year reform programs. ^{1/} However, in some instances the first phase or phases of a reform program might be the most crucial in terms of progress toward external viability, and these could be implemented in the context of a one-year stand-by arrangement.

A related problem may arise when a serious structural problem exists, but policies for dealing with it have yet to be fully worked out. In these circumstances there is a danger that if the process of policy planning and formulation is extended, little or no headway may be made with implementation in the life of an arrangement. In most instances, however, it is possible to take steps that go some way toward alleviating a distortion before a complete reform program has been developed. For example, where reform of an agricultural marketing system is judged to be important, adjustments to key producer prices can usually be taken quickly even if the reform strategy is not fully developed. Swift actions will also generally be possible where exchange system reform or financial liberalization is involved. ^{2/} In such cases, however, it will be important to coordinate actions in different structural areas since isolated actions in the presence of widespread distortions can have adverse results. In other cases, it might be necessary to delay the start of an arrangement until the authorities are in a position to make concrete proposals.

2. Fund-Bank collaboration

Fund involvement with structural reform raises questions about the division of responsibilities between the Fund and the Bank. It was emphasized at the last Board discussion on Fund-Bank collaboration that the two institutions have different mandates, different functions and different areas of expertise. The Bank is traditionally recognized as having primary responsibility for the composition of development programs and project evaluation, while the Fund has primary responsibility for policies directly related to balance of payments adjustment, including the exchange system. ^{3/} In between there have always

^{1/} In the case of Turkey, major structural reforms were undertaken under a three-year stand-by arrangement.

^{2/} A further example is provided by trade liberalization, where steps to liberalize restrictions on key imported inputs can be taken quickly even if the details of a more comprehensive program remain to be worked out.

^{3/} See "Fund-Bank Collaboration and the Adjustment Process--Issues for Consideration" (SM/84/242, 10/30/84), and the Chairman's Summing Up issued as Buff 84/195 (12/6/84).

been broad areas of common concern, but with increased emphasis on the need for structural reform for the achievement of external viability, and the Bank's greater involvement with policy-based lending, the overlap has become more pronounced.

On occasion structural reform in areas traditionally the responsibility of the Bank has been judged by the Fund to be essential for external viability. In such cases problems have sometimes been encountered in meshing the timing of the Bank's discussions with the member's timetable for an arrangement with the Fund. In other instances overlapping monitoring has occurred. For example, in some SAF programs, benchmarks, particularly when broadly defined, have covered measures that have also been covered by understandings specified in certain Bank loans. ^{1/} Similarly, in stand-by and extended arrangements, prior actions, or program reviews have covered progress with structural reforms that were also part of Bank lending programs.

Concern about the potential difficulties that overlapping interests might raise, ^{2/} as well as recognition of the essential complementarity between Fund and Bank activities, has led to increased collaboration between the two institutions. This has been most intense on the SAF, where Fund and Bank work jointly with the authorities in developing the Policy Framework Paper. Collaboration has resulted in the involvement of the two institutions with structural reforms being handled in a pragmatic way on a case by case basis. While occasional problems in coordinating timing and monitoring are likely to continue to occur, Fund-Bank collaboration is working increasingly well and should be capable of dealing with any potential problems that might arise from a more intensive, focused approach to structural reform in Fund programs.

3. Surveillance

Conditionality Guideline 1 states that: "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." Careful appraisal of structural aspects of members' economies as part of Article IV consultations is essential if structural problems are to be identified at an early stage. As noted above, there may be scope for

^{1/} See "Structural Adjustment Facility (SAF)--Review of Experience" (EBS/87/46, 2/27/87).

^{2/} In particular, cross-conditionality--financial support by one organization made contingent on a decision of the other as to the appropriateness of policies--needs to be avoided (see SM/84/272, 10/30/84, pp. 8-10).

greater use of quantitative indicators and for generally more systematic monitoring in structural areas.

4. Technical assistance

Given the complexity of structural reforms, and the importance of carefully mapping out a reform strategy, and specifying steps at a practical level, technical assistance may sometimes need to play a significant role in the process of structural reform. This is particularly the case in the areas of fiscal, financial sector and exchange system reform where the Fund has considerable expertise. In other areas, however, the Fund may need to draw heavily on the experience of the World Bank. Efforts are being made to improve the coordination of the technical assistance provided by the two institutions. Ideally, technical assistance would be provided before the start of an arrangement so that those policy recommendations accepted by the authorities could be incorporated in an adjustment program.

Increased emphasis on structural adjustment and its monitoring is likely to have implications for the Fund's technical assistance program. Those consequences will be examined in the forthcoming review of technical assistance in the Fund.

5. Guidelines on conditionality

Increasing Fund involvement with structural reform may raise issues for the Guidelines on Conditionality, which are reproduced in Appendix III. As noted, Guideline 1, which refers to the role of Article IV consultations, has particular relevance to structural adjustment. Structural adjustment clearly may go to the heart of the domestic, social and political objectives of members, referred to in Guideline 4. In addition, monitoring through prior actions, performance criteria and reviews are respectively referred to in Guidelines 7, 9 and 10. Although the current guidelines offer considerable flexibility, especially when structural reforms are viewed as critical to the achievement of balance of payments viability, they were formulated at a time when the Fund was not so intensively involved with structural reform. Consideration of the continuing appropriateness of the Guidelines is one of the issues to be addressed in coming months in the ongoing process of reviewing conditionality.

VI. Topics for Discussion

Directors may wish to address the following interrelated topics.

1. The circumstances in which it is appropriate for conditionality to be attached to structural reform in arrangements with the Fund, and the scope of the reforms that might be covered, given the need to provide adequate protection for the revolving character of the Fund's

resources and the importance of durable macroeconomic adjustment and growth-oriented policies for external viability.

2. The possible implications for the Guidelines on Conditionality of the Fund's growing involvement with structural reforms. For example, what issues are raised for the implementation of Guideline 4, which refers to the need to pay due regard to the domestic social and political objectives of members? Given the contribution that many types of structural reform can make to growth-oriented external adjustment, should the Fund staff take greater initiative in emphasizing to country authorities the implications of the policies they follow in pursuing their domestic objectives?

3. The extent to which the techniques for designing and monitoring structural reform need to vary with the type of reform being implemented. A specific question in this regard is the suitability of alternative techniques (prior actions, performance criteria, and program reviews) for linking disbursement of Fund resources to the implementation of structural reforms. Relevant considerations include the importance of a bold start to the reform process, the appropriate phasing of structural policy actions, the role of intermediate indicators, and the uncertainties involved in structural adjustment.

4. The contribution to successful implementation of a carefully worked out reform strategy that specifies in detail the measures to be taken. In this connection, Directors may also wish to consider the role of technical assistance in areas of Fund expertise, and the constraints imposed on the optimal scope of structural reform by administrative capacity.

5. The issues that Fund involvement with structural adjustment may raise for Fund-Bank collaboration.

6. The importance of early identification of structural problems and the scope for improved tracking of structural aspects of members' economies, particularly in the context of Article IV consultations.

The Role of Indicators in Monitoring Structural Adjustment

Indicators play an indispensable role in monitoring and quantifying economic performance. Effective indicators typically summarize information that would otherwise be difficult to interpret, and present it in a form that corresponds to a key element in an established analytical framework. They also often represent analytically helpful relationships between key variables.

In the macroeconomic sphere monitoring techniques are highly developed. ^{1/} Over a long period the economics profession in general and the Fund in particular have developed a large number of useful indicators that track the intermediate targets and final objectives of policy, and that typically correspond to important elements in the theoretical framework of macroeconomics. ^{2/} Information on a broad range of such indicators is routinely collected by member countries and systematically reported in staff papers.

The tracking of structural aspects of members' economies, particularly through the use of indicators, is generally less well developed and less systematic than the monitoring of macroeconomic developments. To some extent this may reflect the Fund's traditional emphasis on macroeconomic concerns, but there may also be difficulties inherent in developing simple but useful indicators of structural distortions in some policy areas. For instance, the overall efficiency of public investment programs or of tax systems may be difficult to characterize by single-valued indicators. Nevertheless, in most structural areas there is scope to supplement detailed institutional knowledge with the monitoring of carefully selected indicators. An important distinction is between indicators that measure the magnitude of distortions and those that provide a guide to their effects. It needs to be emphasized that the link between structural policy actions and indicators of their effects is typically uncertain and operates with a considerable lag.

Theoretical analysis of structural issues can be helpful in selecting useful indicators. However, in many cases the data necessary for the most suitable indicators will not be available and may be difficult and costly to collect. The choice of variables to monitor in individual cases will therefore typically involve a trade-off between information content and the cost of monitoring. Decisions about the frequency with which an indicator is reported will also need to balance the costs of reporting and calculation against the needs of policy monitoring. Setting up useful structural indicators may be a time

^{1/} For a discussion of the role of indicators in multilateral surveillance, see "Indicators Relating to Policy Actions and Economic Performance" (EBS/86/127, 6/12/86).

^{2/} The development of indicators and the provision of technical assistance to members to improve the quality of their statistics in these areas have been major contributions of the Fund.

consuming and costly process, and it will be important to establish clear priorities based on individual circumstances.

The following discussion tentatively suggests for selected policy areas some measures of distortion that might be useful in assessing structural problems. 1/ Some of these indicators may also be helpful in monitoring progress with policy implementation. It is important to stress, however, that work in many of the areas covered is at an early stage of development.

In some structural areas, particularly those where structural and demand management policies merge, such as the exchange system and the financial system, indicators of structural distortions are readily available and widely reported. Various measures of the real interest rate have been used to gauge distortions in the level and structure of interest rates. Indicators of the real exchange rate in the official market, and the deviation between exchange rates in official and parallel or secondary markets have been employed to track distortions in the exchange system. However, there remains scope for refinement of existing and the development of new indicators in these areas. For example, indicators of the dispersion of lending rates across sectors can be helpful in evaluating distortions in credit markets. Improved monitoring of the soundness of the financial system and the adequacy of regulation, particularly where liberalization is contemplated or in progress, may also be of considerable importance--instability in the financial system has been linked in some cases to inadequate regulation of financial institutions (e.g., Chile and Turkey).

Routine assessment of the financial performance of major public enterprises is essential for early identification of emerging problems in this sector. Cash flow data for major public enterprises on the same basis as the government budget, as well as profit and loss accounts would be required. The former information would enable the preparation of consolidated public sector accounts. While this information is available for many countries, its absence in others may seriously impede assessment of the macroeconomic importance of structural problems in the public enterprise sector.

In the area of agricultural producer pricing and marketing, the relationship between producer prices and border prices for major commodities is a key indicator. 2/ The appropriate level for producer prices in relation to border prices depends on a number of factors such as internal transportation, storage and processing costs, and would need to be evaluated carefully on a case by case basis. Substantial deviation from this level would signal the existence of a serious distortion. The relationships between domestic and border prices for

1/ A number of the indicators mentioned are examined in more detail in the background papers.

2/ Where distortions in the exchange system exist, border prices need to be calculated at an appropriate shadow exchange rate.

key inputs, particularly fertilizer, also need to be tracked since distortions in markets for inputs may have significant offsetting or compounding effects on distortions in output markets. ^{1/} Monitoring the financial positions of major marketing agencies is also important since inefficient marketing may be a major source of price distortions, and because the financing of such agencies may have substantial macroeconomic implications.

The trade system and tariff structure is an area where distortions are particularly difficult to gauge accurately, partly because they may take many forms. Reliable indicators are also often difficult to construct. ^{2/} In the case of the tariff structure, this applies particularly to levels of effective protection by industry, which are the best guide to the distortions involved. However, knowledge of nominal tariff levels together with measures of average nominal tariffs, particularly by commodity group, should be sufficient to initiate reform and track implementation.

For quantitative restrictions, although various ratios such as the percentage of items subject to restrictions or the ratio of state-traded to total imports may convey some information, the size of distortions is difficult to measure. ^{3/} The direction of change of import penetration ratios may provide an indication of whether restrictions are being tightened or liberalized. A comparison between domestic and international prices is also a potentially useful indicator.

Reduction of impediments to exporting is likely to be a top priority of most trade system reforms. Broad measures such as the ratio of the average effective exchange rate for exports to that for imports, where the relevant rates include all tax payments specific to imports and additional net subsidies to exports, may be helpful in assessing anti-export distortions and tracking progress in their reduction.

^{1/} Price distortions in markets for individual commodities also need to be viewed in relation to prices in related commodity markets.

^{2/} This issue is discussed in detail in N. Halevi, "Trade Liberalization in Developing Countries: Suggestive Guidelines for Implementation and Monitoring," forthcoming.

^{3/} Replacement of quantitative restrictions by tariffs at an early stage in trade liberalization is important because it increases the transparency of the trade system; it also enables quota profits to be absorbed by budget revenues.

Monitoring Techniques and Experience with
Their Application to Structural Reform

1. Role of alternative monitoring techniques
in Fund arrangements

Since the roles of alternative monitoring techniques have been recently reviewed at length elsewhere, 1/ the discussion here is relatively brief and focuses on issues relevant to the monitoring of structural adjustment.

a. Upper credit tranche stand-by
and extended arrangements

Four forms of program monitoring have been employed in upper credit tranche stand-by and extended arrangements: prior actions, performance criteria, program reviews and supplementary monitoring.

Performance criteria provide a direct link between program implementation and the disbursement of the Fund's resources and are intended to provide clear assurance of the circumstances under which a member will be able to make purchases under an arrangement. Even more than other monitoring techniques, they need to be objective and precisely formulated. It is also important that the data necessary for determining compliance be available promptly. 2/

Prior actions are policy measures critical for the effectiveness of an adjustment program that are taken before an arrangement goes into effect and monitored as preconditions for program approval. Such actions are particularly important where severe imbalances exist, or in cases where the record of policy implementation has been weak. Prior actions can also be preconditions for approval of second- or third-year programs in multiyear arrangements, particularly where policy implementation has been weaker than anticipated in preceding annual programs, as well as at the outset of arrangements.

Virtually all recent arrangements have made satisfactory completion of a midyear review a condition for purchase. Reviews can assess implementation of policies not amenable to monitoring through performance criteria, because policy performance cannot be easily quantified

1/ In the case of upper credit tranche stand-by and extended arrangements, see "Program Design and Performance Criteria" (EBS/86/211, 9/8/86), Supplement 1 (9/11/86), and "Chairman's Summing Up," Buff 86/232 (12/10/86). For a discussion of monitoring under SAFs see "Structural Adjustment Facility (SAF)--Review of Experience" (EBS/87/46, 2/27/87), Supplements 1, 2, and 3, and "Chairman's Summing Up," Buff 87/128 (6/23/87).

2/ The general standard is that data related to performance criteria should be subject to a reporting lag of no more than two months--Executive Board Decision No. 7925-(85/38), 3/8/85.

or specified with adequate precision. In such instances, the need for a precise specification of review clauses to restrict the extent to which purchases are based on discretionary judgment, and hence to limit the uncertainty for a member about what has to be achieved before a purchase can be made, must be balanced against the need for flexibility given the uncertainties involved. Reviews also provide an opportunity for the broad evaluation of performance that is necessary for assessing whether modifications need to be made to program design, or for establishing performance criteria for subsequent periods.

A divergence from indicative targets set for variables subject to supplementary monitoring triggers a consultation with Fund staff and management but does not automatically interrupt the right to make purchases. Supplementary monitoring may be appropriate, in particular, for variables whose linkage to program objectives is indirect or for which data is subject to delay or of limited quality, but which nevertheless are important for assessing progress in policy implementation.

b. Monitoring of structural adjustment arrangements

Monitoring of structural policies under the SAF primarily takes the form of benchmarks that are intended to delineate the expected path of structural reform and to facilitate the evaluation of progress under SAF arrangements, but which do not have the character of performance criteria and are not directly linked to purchases. At the June 1987 Board discussion of experience with the SAF, it was reaffirmed that structural benchmarks need to be formulated in specific terms to provide a clear understanding of the expected path of program implementation. It was also emphasized that benchmarks in general should be confined to those few variables that are considered most important for program monitoring. In addition, a role was seen for prior actions where it was crucial that an important first step need to be implemented, or where past performance had been difficult.

2. Application to structural adjustment
in recent Fund arrangements

a. Upper credit tranche stand-by and extended arrangements

Although upper credit tranche stand-by arrangements, and to a greater extent extended arrangements, have typically incorporated structural policies in a number of areas, ^{1/} formal monitoring of structural policies has been comparatively limited and has been concentrated in areas of traditional Fund concern.

This is particularly true of performance criteria, which have been largely confined to the exchange and trade system (Table 1). This

^{1/} Policies are judged to be part of a program where they are referred to in a letter of intent or an attached memorandum of economic policies.

Table 1. Upper Credit Tranche Stand-By and Extended Arrangements with Structural Performance Criteria, 1979-87 1/

Country	Effective Date	Exchange System	Trade System	Tariff Structure	Financial Sector	Pricing Policy	Fiscal Policy
Sudan	05/04/79		X				
Nicaragua	05/14/79	X	X				
Turkey	07/19/79	X					
Peru	08/10/79		X				
Turkey	06/18/80	X					
Pakistan	11/24/80		X				
Romania	06/15/81	X					
Kenya	01/08/82		X				
Sudan	02/22/82					X	X
Uganda	08/11/82	X					
Chile	01/10/83	X					
Dominican Republic	01/21/83						X
Argentina	01/24/83		X				
Sudan	02/23/83						X
Brazil	02/28/83	X	X				
Turkey	06/24/83	X	X				
Ghana	08/03/83	X					
Guatemala	08/31/83	X					
Sri Lanka	09/14/83	X					
Uganda	09/16/83	X					
Portugal	10/07/83			X			
Zaire	12/27/83	X					
Turkey	04/04/84	X	X				
Yugoslavia	04/18/84	X			X	X	
Argentina	12/28/84	X	X		X		
Ecuador	03/11/85	X	X				
Mauritania	04/12/85	X					
Zaire	04/24/85		X				
Yugoslavia	05/16/85	X			X		
Chile	08/15/85	X		X			
Bolivia	06/19/86	X					
Ecuador	08/15/86				X		
Egypt	05/15/87	X					
Somalia	06/29/87	X				X	
Argentina	07/23/87	X			X		
Total number of arrangements		<u>24</u>	<u>12</u>	<u>2</u>	<u>5</u>	<u>3</u>	<u>3</u>
(In percent)							
Proportion of total arrangements 1979-87 <u>1/</u>		11.7	5.9	1.0	2.4	1.5	1.5

1/ Up to end September, 1987

emphasis reflects both the Fund's special mandate in this area and also the direct and potentially major influence of distortions in the exchange and trade system for external adjustment. Exchange rate policy, typically specified in terms of achieving a target for the real exchange rate, has been subject to a performance criterion in many arrangements. ^{1/} Performance criteria have also related to steps toward unification of official and parallel exchange markets or to the elimination of restrictions on current payments. Specific trade liberalization measures, such as the removal of quantitative restrictions for specified items, sometimes accompanied by tariff adjustments, or the removal of import guarantee deposits, have also been subject to performance criteria in a number of cases.

Performance criteria have also been applied to interest rate policies to ensure greater flexibility in a limited number of instances. In a few cases, the achievement of a particular real interest target has been required. In at least one case, however, the performance criterion required liberalization of specified deposit and lending interest rates. In the areas of fiscal reform and price liberalization, specific measures have also been performance criteria in a small number of instances.

The range of structural policies monitored through program reviews has widened since the early 1980s beyond the traditional areas of exchange and trade system and interest rate policies (Table 2). In particular, progress with public enterprise reform has often been subject to review. Reforms affecting the tax system, the civil service, agricultural pricing and marketing, and public investment program reform have also in some cases been monitored through reviews. Arrangements have varied widely in the specificity of structural review clauses. In some instances, specific steps to be taken have been clearly identified, but in other instances expected progress has been less well defined. Particularly for public enterprises, trade system and agricultural marketing reform, the required policy implementation has tended to be specified in greater detail when there has been substantial World Bank involvement. Where policy formulation was at an early stage, completion of studies or announcement of proposals has been in some cases subject to review.

Policy measures related to the exchange and trade system and pricing policy have been taken as prior actions in a number of cases. ^{2/} In particular, implementation of at least the first stage of a reform of the exchange system at the outset has been viewed as essential for the success of an adjustment program in several instances. Prior actions have also been required in other structural fields,

^{1/} The adequacy of exchange rate policy is also often monitored through a balance of payments test.

^{2/} Pricing actions have mostly involved specific increases in regulated prices, particularly in agriculture, but have also included price liberalization.

Table 2. Structural Policies in Upper Credit Tranche
Stand-by and Extended Arrangements Covered by Mid-Year Reviews, 1979-87 1/

(In percent of total number of arrangements)

	Exchange rate policy	Interest rate policy	Pricing	Trade/ Tariff system	Exchange system	Fiscal policy	Public enterprises	Financial sector	Other
1979	30	--	--	--	5	--	--	--	--
1980	9	4	--	4	4	--	--	--	4
1981	7	--	4	--	7	--	--	--	--
1982	32	18	5	5	18	5	--	--	5
1983	25	17	14	11	23	3	9	--	3
1984	29	14	--	10	19	10	14	5	5
1985	19	12	12	4	15	8	23	4	4
1986	15	14	27	18	14	45	36	18	5
1987 <u>1/</u>	11	11	11	--	22	11	22	11	22
1979-87 <u>1/</u>	23	10	8	6	14	8	11	3	5

1/ Up to end-September, 1987.

including fiscal, agricultural, marketing and public enterprise reform. Prior actions have typically involved quite precisely specified policy measures. 1/

Supplementary monitoring techniques have been little used to track progress in implementing structural reform in upper credit tranche arrangements apart from monitoring of components of government expenditure as a check on the effectiveness of revised procedures for budgetary control.

b. Structural Adjustment Facility

Annual programs under the SAF have typically included structural benchmarks in a range of policy areas (Table 3). 2/ Fiscal reform, broadly defined to cover reforms of the tax system, the civil service and expenditure control mechanisms, has been the area where benchmarks have been most frequently incorporated in annual programs. Benchmarks concerning public enterprise, financial sector and producer pricing and agricultural marketing reforms have also been incorporated in quite a large number of cases. Programs have varied widely in the number of structural benchmarks included, but as noted in EBS/87/46, 3/ straight comparison of the number of benchmarks may be misleading since in some cases a single benchmark has referred to a program of reform covering several policy actions. However, there was also considerable variation in the number of structural areas subject to monitoring through benchmarks, which ranged from one (CAR) to six (Haiti and Somalia). 4/

Benchmarks, like review clauses, have varied considerably in specificity, both across programs and between different areas in the same program. In some cases where policy formulation was not very far advanced, benchmarks called for the completion of studies or the development of policy proposals by specified dates. In most cases, however, policy implementation was required, although the precise steps to be taken have not always been spelled out.

Where an annual SAF program and a stand-by arrangement were negotiated jointly, it is difficult to attribute any prior actions to one arrangement rather than the other. Structural prior actions, however, have been required in some SAF-only cases.

1/ Prior actions in the strict sense of measures that are preconditions for approval of arrangements cannot in practice be distinguished in many cases from other actions taken shortly before approval of an arrangement.

2/ Details of individual benchmarks are provided in the background paper.

3/ "Structural Adjustment Facility (SAF)--Review of Experience" (EBS/87/46, 2/27/87).

4/ This excludes Mozambique where all actions in the policy matrix related to the first-year program were given the status of benchmarks.

Table 3. Structural Benchmarks in Annual SAF Programs 1/

	Effective date	Exchange system	Trade Liberalization/ tariff reform	Public enterprises	Fiscal reform <u>2/</u>	Financial sector reform	Producer pricing/ agricultural marketing	Public Sector investment program	Other	Total
Bangladesh	2/6/87	1			4	7				12
Bolivia	12/15/86			1	1			1		3
Burundi	8/8/86	1	4	2						7
CAR	6/1/87			3						3
Dominica	11/26/86			3	3		1			7
The Gambia	9/17/86			1	3			1	1	6
Guinea	7/29/87				3	2			2	7
Haiti	12/17/86		3	1	1	2	1	1		9
Madagascar	8/31/87		2		1		2		1	6
Mauritania	9/22/86			2	1	4	1		1	9
Mozambique	6/8/87 <u>3/</u>	2	2	1	1	1	5		3	15
Niger	11/17/86			1 <u>4/</u>	2	1	1		1	6
Senegal	11/10/86		1				2	1		4
Sierre Leone	11/14/86			2	3		1		1	7
Somalia	6/29/87	1		1	3		3		2	10
Uganda	6/15/87		1		2					3
Zaire	5/15/87	1	2		1	1			1	6
Total		<u>6</u>	<u>15</u>	<u>18</u>	<u>29</u>	<u>18</u>	<u>17</u>	<u>4</u>	<u>13</u>	<u>120</u>

1/ Covers programs approved through end-September 1987.2/ Includes reforms of the tax system, expenditure control mechanisms, subsidies and the civil service.3/ All structural policy actions in the policy matrix relating to 1987 were given the status of benchmarks.4/ Covers a number of specified measures.

3. World Bank structural adjustment lending:
experience with conditionality 1/

Structural adjustment loans have in most cases been tranced, 2/ with the release of the second tranche based on an overall review of progress and compliance with specific conditions. They have varied widely in the extent to which the policy actions supported have been taken in advance ("ex ante" conditionality).

The World Bank's first SAL review concluded that the process of structural reform was most likely to be sustained when a SAL was offered in support of actions already taken rather than of future measures. Prior initiation of the reforms was also viewed as reducing the vulnerability of governments to charges of yielding to Bank-imposed prescriptions. Of the 15 cases covered by the review, the 2 deemed to have achieved the most (Thailand and Turkey) were ones where key reforms had been implemented before Board approval. By contrast, SALs that placed greater emphasis on future actions (e.g., Philippines and Kenya) experienced significant delays in implementation. The need for assistance in the development of reform programs during implementation, however, was seen as limiting the extent to which "ex ante" conditionality could be applied.

Where measures were to be taken after approval, tranching was viewed as a useful device for keeping implementation on track. The approach toward the conditionality attached to release of the second tranche has evolved since structural adjustment lending was first introduced. One difficulty encountered with early SALs was that disbursement of the second tranche was sometimes held up by failure to comply with a specific condition even though overall progress with implementation had been satisfactory. Examples include cases where there were delays in the enactment of legislation and in the completion of work by consultants. As a consequence, there has been a tendency for tranche conditions to be interpreted using judgment regarding the significance of the slippages in an agreed program and the reasons for them. A number of tranche releases continue to be delayed, sometimes for as long as a year, because progress in significant areas is not considered to be satisfactory.

1/ This section is based on "Structural Adjustment Lending: A First Review of Experience," World Bank Report No. 6409. The report covers 15 SALs in 10 countries.

2/ The SALs for Thailand have been the only exceptions.

Guidelines on Conditionality

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.

Adopted by the Executive Board on March 2, 1979
(Decision No. 6056-79/38)

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