

IMF Publication

Conclusions of the Task Force
on Prolonged Use of Fund
Resources - Modifications in
Light of Initial Executive Board
Discussion

INTERNATIONAL MONETARY FUND

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Conclusions of the Task Force on Prolonged Use of Fund Resources

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I. INTRODUCTION AND SUMMARY

1. The Independent Evaluation Office of the IMF (IEO) issued its first evaluation report, on the prolonged use of Fund resources, on September 6, 2002.¹ Shortly afterward, the Managing Director issued a statement to the Executive Board welcoming the IEO's report, expressing agreement with many of its findings, and indicating that Management would establish an internal task force to make recommendations on how issues raised in the report could best be addressed, taking account of the views of Executive Directors. The task force was to be asked to look at (i) the best ways to build on current policy initiatives to address the problems identified in the report; (ii) other possibilities for improving program design and achieving a better balance between ambition and realism; and (iii) whether issues not already included in the work program needed to be studied further.² In their initial discussion of the IEO report, Executive Directors welcomed this proposal, and looked forward to following up on the recommendations of the task force early in the next year.³

2. This paper reports the conclusions of the task force on prolonged use of Fund resources ("Task Force").⁴ For the purposes of this report, the Task Force has divided the proposals made by the IEO into seven categories: (i) remedial actions; (ii) preventive measures related to program design, ownership, and conditionality; (iii) proposals to strengthen Fund surveillance; (iv) strengthening "due diligence" in the Fund's relations with prolonged users; (v) alternative mechanisms for signaling the views of the Fund to donors and creditors; (vi) analysis of political issues, and (vii) human resource management. The Task Force has also benefited from comments received by the IEO through its process of external outreach, including seminars in Berlin, Cambridge, London, Manila, and Tokyo.

3. In considering the issues raised in the IEO report, the Task Force took the view that a member country's sustained engagement with the IMF through a succession of Fund financial arrangements may, at times, be appropriate and desirable. In addition, a broader appreciation of the duration and magnitude of the economic challenges facing low-income countries has led to the development of institutional arrangements based on the *expectation* that many, if not most, of these countries would benefit from a succession of Fund-supported programs.

4. However, the Task Force also observed that prolonged use of Fund resources may be associated with inadequate progress in dealing with a country's key economic problems, and risks to the revolving nature of Fund resources. It therefore focused on measures to help

¹ *Evaluation of the Prolonged Use of Fund Resources* (SM/02/87, Volume I, 9/6/02).

² *Statement by the Managing Director on the Evaluation by the Independent Evaluation Office of Prolonged use of Fund resources* (BUFF/02/150, 9/13/02).

³ *Summing Up by the Acting Chair, Evaluation by the Independent Evaluation Office of Prolonged use of Fund resources* (BUFF/02/164, 9/25/02).

⁴ Participants in the Task Force included Timothy Geithner (chair), Michael Deppler, Margaret Kelly, Mohsin Khan, John Odling-Smee, Teresa Ter-Minassian, Ulrich Baumgartner, Carlo Cottarelli, Donal Donovan, R. Anthony Elson, Oleh Havrylyshyn, Richard Hemming, Saleh Nsouli, Scott Brown, Godfrey Kalinga, Eliot Kalter, Timothy Lane, Markus Rodlauer, Miguel Savastano, and Alexandros Mourmouras.

guard against these problems and address them when they emerge. These fall mainly into two categories:

(i) A broad-based effort to improve surveillance, program design, and conditionality, in order to devise better programs that stand a better chance of being implemented, in conjunction with procedures to ensure that the Executive Board has access to the information it needs to perform its responsibilities with regard to the approval of Fund financial arrangements. This effort must include greater emphasis on the political and social context, attention to implementation capacity, promotion of country ownership based on an informed domestic policy debate, selectivity, and *ex post* assessment of program performance.

(ii) The adoption of measures to strengthen “due diligence” for prolonged users of Fund resources, through a systematic process of *ex post* assessment and strategic forward planning. These assessments would be presented to Management, and the conclusions would be provided to the Executive Board at an early opportunity—as a general principle, prior to consideration of any further use of Fund resources and wherever possible in the context of the next Article IV consultation. In many cases an important result of the exercise would be to define better the expected duration of Fund financial support or an “exit strategy.”

5. The IEO report and some external commentators have also expressed concern that the Fund’s expanded role and prolonged engagement in low-income countries has tended to undermine their institutional development and blur the division of labor with the World Bank. These important issues must be addressed in the context of ongoing efforts to streamline and focus conditionality and the development of alternative mechanisms for signaling the Fund’s views on policies to a country’s donors and creditors. They will also form an important part of the context for the forthcoming review of the role of the Fund in low-income countries.

II. THE CONTEXT FOR THE RECOMMENDATIONS: EXPERIENCE WITH PROLONGED USE OF FUND RESOURCES

6. The IEO report identified a number of problems associated with prolonged use of Fund resources. These include:

- risks to the revolving character of Fund resources,
- the possibility that prolonged use may be the result of weak program design and implementation,
- unwarranted intrusion on the development of domestic policies and institutions (particularly in the case of low-income countries), and
- a possible blurring of the Fund’s role and mandate.

7. The potential threat to the revolving nature of Fund resources and the growing problem of overdue obligations to the Fund were the primary concerns motivating a series of Executive Board discussions of prolonged use in 1984-1991. Fund financial support is intended to assist members in overcoming *temporary* balance of payments difficulties and, particularly under stand-by and extended arrangements, a primary objective of Fund-supported programs is the attainment of external viability—after which support from the IMF should no longer be needed. Prolonged use of Fund resources may signal a failure to achieve this key objective—a failure which can impose costs on the member, damage the Fund's credibility, and make it more difficult for the member to meet its external obligations, including its obligations to the Fund. Indeed, most countries with protracted arrears to the Fund were prolonged users of Fund resources in the 1970's and early 1980's. At the same time, Executive Directors have consistently emphasized that a distinction should be made between members that are making adequate progress toward achieving program objectives, and those that have not. The discussions on prolonged use and overdue obligations in 1984-1991 led to initiatives to strengthen debt sustainability analysis, enhance the assessment of program implementation, and establish remedial measures to deal with cases of repeated, poor performance.

8. The Fund's role in the global economy has evolved over time, and some of the attendant changes have had implications for prolonged use of Fund resources. The desire of the international community for the Fund to play a role in cushioning the effects of sharp increases in world oil prices during the 1970's and in the subsequent “recycling” of external surpluses had implications for the scale of Fund involvement in countries with limited debt-servicing capacity, and its ability to reduce its exposure subsequently. Since then, the Fund has also been called upon to expand its activities in low-income countries and to take a major role in guiding the transition to market in former centrally-planned economies. Because these countries faced simultaneous challenges of macroeconomic stabilization, institutional development, and structural reform that were expected to take considerable time, there was a presumption of sustained Fund engagement, including financial support.

9. While many transition countries have by now “graduated” from Fund financial support, most low-income countries remain either current or prospective users of Fund resources. From 1988 onward, the primary channels for Fund financial support to low-income countries have been the Fund's concessional facilities—first the Enhanced Structural Adjustment Facility (ESAF) and, since 1999, the Poverty Reduction and Growth Facility (PRGF). Like the World Bank's Special Program of Assistance for Sub-Saharan Africa, the ESAF was part of a series of initiatives in the mid-to-late 1980's designed to mobilize international support for a more ambitious and comprehensive reform agenda in low-income countries. The ESAF was intended initially as a one-off operation, to provide concessional financing for low-income countries embarking on three-year programs of macroeconomic

and structural adjustment by November 1989.⁵ However, it subsequently became clear both that the adoption of comprehensive programs of macroeconomic and structural adjustment would be a substantial challenge for many eligible countries, and that such programs would typically require more than three years to achieve the intended results. Thus, over time the November 1989 cutoff date was relaxed, provision was made for an additional year of support at the expiration of the initial three-year arrangement, financing became available for successive three-year arrangements, and the explicit limit on the number of ESAF arrangements was eliminated. In 1999 the ESAF was replaced by the PRGF, which maintains the same financial terms and structure of three-year arrangements but differs from the ESAF in other crucial ways—including its support for programs based on a country’s poverty reduction strategy paper (PRSP), which is prepared through a broad consultative process.

10. Another source of incentives for prolonged use of Fund resources has been the “signaling” role that Fund-supported programs play for multilateral development banks and other official donors, and their presumed catalytic effects on private capital flows. Official donors and creditors, in particular, often condition some forms of development assistance on the existence of a financial arrangement with the IMF, on the grounds that a sound macroeconomic policy framework is important for the effectiveness of this assistance. The Fund, for its part, has experimented with alternative ways of addressing this objective outside the context of a Fund financial arrangement, but has found that neither member countries nor their external partners considered these to be good substitutes for a Fund-supported program. To a large extent this reflected a judgment that the Fund’s willingness to approve arrangements enhanced the credibility of its advice and underscored the seriousness of the government’s policy intentions. This produced pressures on the Fund to support programs even in cases where the prospects for implementation of credible policies were weak. At times donors and creditors also sought to ensure that the Fund contributed to “burden-sharing” in meeting a country’s external financing requirements.

11. Against this background, the initial Board discussion of the IEO evaluation indicated that most Executive Directors did not consider prolonged use of Fund resources *per se* to be a matter of great concern, or that financial engagement with low-income countries should necessarily be viewed from the same perspective as use of the Fund’s general resources.⁶

⁵ Programs supported by the ESAF were to “involve a substantial effort to strengthen the external payments position in a sustainable manner, and in particular to assure substantial progress during the three-year period toward an overall position and structure of balance of payments that is consistent orderly relations with creditors and a reduction in restrictions on trade and payments.” Chairman’s Summing Up of the Discussion on the Enhancement of the Structural Adjustment Facility—Operational Arrangements (SUR/87/260, 12/17/87).

⁶ “Directors reviewed the circumstances in which long-term Fund involvement can be an appropriate response to help countries sustain strong macroeconomic policies and address, through structural reforms, deep-seated problems that, by their nature, require many years to resolve. Many considered that for low-income and transition economies, the key challenge is to design sound programs and ensure their implementation on the basis of strong ownership and close monitoring, rather than to avoid prolonged use *per se*. For low-income countries relying on concessional financing administered by the Fund, most Directors did not consider the relatively high incidence of prolonged use analyzed in the report as necessarily indicating a problem that needs

(continued...)

These points were also stressed by many external commentators on the IEO report, including participants in outreach events organized by the IEO. This line of reasoning would suggest that the Fund's major concern should be the incidence of repeated program failure, and of cases in which prolonged use is associated with inadequate progress in dealing with a country's key economic problems, heavy indebtedness to the Fund over a long period of time, or difficulties in meeting obligations to external creditors, including the Fund.

12. In addition, however, some external commentators echoed the concern expressed in the IEO report, that the expansion of the Fund's role in low-income countries had led to excessive intrusion in the policy debate and institutional development, a blurring of the division of labor with the World Bank, and inappropriate pressures for sustained financial engagement. In the IEO report, these concerns were characterized as stemming from "a mismatch between [the Fund's] core operational approach ... and some of the tasks it was being asked to perform," perhaps reflecting in part differences of view within the Executive Board on the longer-term role of the Fund in low-income countries.

III. REMEDIAL MEASURES

13. **The IEO report proposed three types of remedial measures** that could be applied to countries identified as prolonged users of Fund resources:

- (i) **obliging prolonged users to pay a higher rate of charge** (interest rate);
- (ii) **the formulation of explicit "exit strategies" for the Fund**; and
- (iii) **greater selectivity in considering future Fund financial support.**

In making its proposal for differentiation in charges, the IEO noted that there is no evidence that the cost of IMF resources has been a significant factor in determining prolonged use. But it suggested that the introduction of differentiated charges could serve as a signal of excessive dependence on the IMF and possibly provide a political incentive to avoid prolonged use.

14. **It is reasonable, in principle, to expect that differentiation in charges would have an effect on the demand for Fund resources. But in practice it seems unlikely that this effect would be significant, given the Fund's central role in crisis management and the tendency of many official donors to associate their assistance on the existence of a Fund-supported program.** Modifications in the system of charges for the Fund's general resources could be adopted by a 70 percent majority vote, and a very rough approximation of the IEO proposal could be achieved through differentiation in charges on the basis of the amount of time that Fund credit is outstanding (perhaps above some threshold level). The PRGF Trust Instrument does not contain any provision for differentiation in PRGF interest rates, but such

to be corrected. A few Directors, however, called for a reassessment of the Fund's strategic role with respect to low-income countries and possible further delineation of the respective mandates of the Fund and World Bank." Summing Up of Executive Board Discussion on the IEO Evaluation of Prolonged Use of IMF Resources (BUFF/02/164, 9/25/02).

a provision could be introduced by a simple majority vote in the Executive Board. When the Board last considered modifications in the Fund's system of charges, in conjunction with the review of Fund facilities in 2000, it agreed that the system of surcharges established at the time of the review should not be changed again for at least four years. More recently, during the Board's initial discussion of the IEO report, there was virtually no support for the proposal for differentiated charges for prolonged users, which most Directors felt would be particularly inappropriate for low-income countries. In view of these considerations, **the Task Force does not recommend reopening the issue at this time.**

15. **Under previous Executive Board decisions relating to prolonged use of Fund resources and prevention of overdue financial obligations to the Fund, provisions are in place regarding selectivity and access to the Fund's general resources.** As specified by the Board in the 1991 review of conditionality, continued Fund financing for countries making slow progress toward external viability may require strong policy justification, and access should continue to be guided by the need to reduce outstanding use of Fund resources over time.⁷ Where a review of experience under Fund-supported programs for a prolonged user suggests that insufficient progress is being made toward external viability, or there is evidence of repeated failure in program implementation, continued access to Fund resources will thus need a stronger justification, and access should be set at levels that would normally result in a reduction in the amount of outstanding credit.

16. In practice, discussions toward a Fund-supported program are typically more prolonged, and Management is generally more selective in recommending consideration of use of the Fund's general resources, in cases where a member has a record of sustained weak program implementation. Recommendations regarding the level of access to the Fund's general resources are based on a range of factors, including the size of the balance of payments need, and the factors underlying the proposed levels of access under individual Fund-supported programs are not typically documented in great detail. However, a recent empirical study of the determinants of access in 70 non-exceptional stand-by and extended arrangements found that, in 1994-1999, a poor track record of policy implementation was associated with a significantly lower level of access.⁸ **The Task Force considers that the existing policies remain appropriate.** It also recommends that their implementation be buttressed by consistent discussion of the justification for proposed levels of access in staff reports for the use of Fund resources.

17. For PRGF-eligible countries, the track record of policy implementation also typically affects the length of policy discussions and the prospects for Management recommendation

⁷ See "Conditionality in Fund-Supported Programs – Issues and Review of Experience – Draft of Acting Chairman's Summing Up and Decision" (EBS/91/101, Supplement 2, 7/29/01); and "Selected Operational Issues Related to Use of Fund Resources" (EBS/91/108, 7/3/91).

⁸ "Review of Access Policy in the Credit Tranches and Under the Extended Fund Facility—Background Paper" (EBS/01/134, 8/10/01), pp. 24-27.

of a request for use of Fund resources, but the effect is often difficult to disentangle from other factors tending toward active and early Fund involvement in low-income countries. Under current policies, the track record is not a factor in decisions on the level of access to PRGF resources. **Factors in the appropriate levels of access under successive PRGF arrangements will be touched upon in the forthcoming review of the role of the Fund in low-income countries.**

18. Regarding **exit strategies**, the Executive Board has stressed in its past discussions of prolonged use that concerns of other donors and creditors about “burden sharing” should not lead to inappropriate lending decisions by the Fund. As noted by a participant in the IEO’s outreach process, insistence on continuous burden sharing among multilateral institutions misses the point that the ultimate source of financing in each case is the taxpayers of member countries. Making best use of the resources entrusted to multilateral institutions requires the recognition of their differing roles and mandates, including the temporary and revolving character of the Fund’s financial assistance. At the same time, it should remain clear that the Fund remains willing to take calculated risks in order to assist members in dealing with external payments imbalances, including those of a particularly difficult and protracted nature. In the words of another external commentator, the Fund should not be too ready to “give up on difficult countries.”

IV. PREVENTIVE MEASURES—PROGRAM DESIGN, CONDITIONALITY, AND OWNERSHIP

19. While attention to the risks that may arise from prolonged use of Fund resources, along with appropriate remedial measures in cases where there is inadequate progress in meeting program objectives, are important for safeguarding the Fund’s effectiveness and financial integrity, taking steps to reduce the risk of program failure is clearly better than cleaning up the damage afterward. **The IEO report contained a number of recommendations for improving program design and conditionality, in order to strengthen the prospects for successful Fund-supported programs:**

- **Operational procedures to ensure that program design places greater emphasis on ownership and the nature of the domestic policy formulation process.** Specific suggestions include making the authorities’ proposals the starting point for program negotiations as a normal procedure; subjecting core program elements first to a domestic policy debate; and to facilitate this, discussing alternative policy options and trade-offs in Article IV consultation reports.
- **Greater efforts at judging implementation capacity and, on that basis, increased selectivity in extending financial support.** Also, greater emphasis on fostering key institutional changes and strengthening implementation capacity.

- **More selectivity in program content**, in line with the ongoing effort to streamline Fund conditionality.
- **More explicit discussion of the major uncertainties faced by programs**, and of how policies will be adapted if underlying assumptions do not hold.

20. **The Task Force felt that the IEO's recommendations in this area were consistent with the lessons emerging from experience in recent country cases, and that the implementation and periodic review of the new guidelines on Fund conditionality should provide the appropriate vehicle for putting these recommendations into practice.** The guidelines were recently finalized by the Executive Board, following an intensive two-year period of discussion and experimentation with ways to streamline and focus conditionality and improve the prospects for sustained implementation of Fund-supported programs. Implementation is focusing on procedures to promote country ownership (including those suggested in the IEO report), taking into account particular national characteristics and the preferences of country authorities.

21. **As part of this process, the Board has signaled its desire for greater selectivity in recommending Fund financial support, based in part on assessment of implementation capacity and ownership.** There are no simple recipes for balancing the risks of excessive intrusion in domestic policy formulation and institutional development with the roles that the Fund has been asked to play in policy advice and capacity building.⁹ But this balancing act must recognize that the Fund's advice and assistance are no substitute for a minimum level of political and social consensus, founded on an understanding within a member country of the nature of the problems it faces and the policy options for addressing them.

22. In the intensified cooperation with transition and low-income countries, the Fund, along with the rest of the international community, has faced **difficult challenges in finding the right balance between realism and ambition and in determining the appropriate pace and sequencing of structural and institutional reforms.** The mix of financing and adjustment presents a particularly complex nexus of issues, with the result that many observers (including the IEO) have criticized the Fund both for seeking overly-ambitious adjustment, and for excessively prolonged financial engagement. **The Task Force recommends that ongoing efforts to address these issues in the operational work of the Fund be enriched by the Fund's future work on program design, including the research agenda, focusing on:**

⁹ It is clear that the Fund should not take limits on institutional capacity as a fixed parameter, and be actively engaged in capacity-building in its core areas, through advice and well-targeted technical assistance. But it must also take a view about a country's capacity during the program period, as well as its record of utilizing past technical assistance.

- ways **to ensure greater realism in objectives and underlying assumptions**, including the time-frame over which policies can be expected to attain their full impact; and
- the **linkages between structural reforms and program objectives** (especially those relating to economic growth and external viability), as well as possible **tradeoffs** between macroeconomic and structural policy measures.

In the process, it will be important to bear in mind that the choices and tradeoffs made in individual country cases will also depend on nature of the problems faced by the member (which may be more profound and wide-ranging in the case of low-income countries) and the objectives of its Fund-supported program.

23. The Task Force believes that **the review process within the IMF** fulfills an essential function, by promoting even-handed treatment of members in the application of Fund policies, provision of consistent policy advice, and a rapid response to guidance from Management and the Executive Board in meeting new challenges. Thus, it has a crucial role in ensuring that new orientations emerging from the evaluation of prolonged use of Fund resources take root in the Fund's day-to-day operations. **The Task Force would therefore endorse a systematic effort in the review process to promote the application of preventive measures and ensure that lessons are drawn from the experience in identified cases of prolonged use.**¹⁰

24. In its evaluation report, **the IEO recommended the adoption of procedures to ensure that, when political considerations enter into decisions on use of Fund resources, these are seen to be taken into account in a transparent manner**—with decisions and accountability at the level of the Executive Board, on the basis of a candid technical assessment by staff of the risks and potential trade-offs. **The Task Force considers that there can be no question about the responsibility of Management for recommending, and the Executive Board for considering and approving, all requests for the use of Fund resources.** The staff has an important responsibility for ensuring that Management and Executive Directors have access to a candid technical assessment of the risks and potential trade-offs, and must continue working to improve both the substance and presentation of this material. Proposals for strengthening the analysis of political factors in the work of the Fund are discussed in a later section.

V. STRENGTHENING FUND SURVEILLANCE

¹⁰ To facilitate follow-up monitoring when programs have gone off-track, the IEO also recommended enhancements of the internal MONA database for program monitoring. An improved database system is now at an advanced stage of development and should become operational in the near future.

25. **The IEO recommended a strengthening of surveillance in cases of prolonged use of Fund resources, “going beyond the recent revisions to surveillance guidelines aimed at improving surveillance in program countries.”** Specific suggestions included:

- Clarification of expectations regarding the role of surveillance in program countries, stressing the need for *ex post* assessments
- Greater operational separation between UFR and surveillance missions in prolonged use cases, including appointment of a mission chief for surveillance missions from outside the area department in some cases, provided there are suitable continuity and coordination safeguards.
- Conducting Article IV consultations with program countries at times when a "fresh look" would be most valuable.
- Seeking a second opinion--including from outside the IMF--on key policy issues that appear to be contributing to prolonged use.

26. **The Task Force agrees with the overall thrust of the IEO’s recommendations for strengthening surveillance.** As a practical matter, it also believes that these objectives are **best addressed through continuing implementation and refinement of the conclusions of the recent Biennial Review of Surveillance and the planned follow-up discussions.**

During that review, the Board agreed on ways to strengthen the quality and content of Article IV consultation discussions, and also made several suggestions aimed at enhancing the impact on the domestic policy debate in member countries and promoting ownership. In particular, consultation discussions are expected to complement sound advice on economic policy objectives with discussions of alternative ways to achieve these objectives; to assess more carefully the social and political realities that shape economic policy; to reach out more broadly, for instance to the legislative bodies and a wider range of line ministries in member countries; and to try to ensure that consultations with members take place at times when the Fund’s advice can influence the domestic policy debate (for instance, during the period leading up the presentation of the annual budget).

27. The Board also identified ways to improve the effectiveness of surveillance in a program context. Thus, Directors asked that consultation reports provide a candid discussion of risks and vulnerabilities, even if this calls into question the original program framework; and that consultation discussions be held when at times that are most conducive to a thorough and detached assessment, such as between programs or when a program has moved off track. Building on this guidance, the staff is exploring ways to ensure that Article IV consultations in program countries “step back” from the program, and take a broader perspective on the economic challenges facing a country and the adequacy of current policies to meet those challenges. In recent months the results have been embodied in individual country papers that have been sent to the Board, and Executive Directors will have an opportunity to address these issues in the planned discussion of “Surveillance—Steps Forward,” in late March.

VI. STRENGTHENING “DUE DILIGENCE” FOR PROLONGED USERS

28. **The IEO has proposed that the Executive Board “...adopt an explicit definition of prolonged use, as a trigger for the adoption of automatic due diligence procedures.** The definition could use different criteria for the general and concessional resources.” A major application of this definition was to be in triggering “systematic *ex post* assessments of programs ...with the key messages reported to the Executive Board, as part of a broader effort to disseminate more effectively best practices and lessons learned, and to maximize the effectiveness of the review process.”¹¹

29. **The Task Force believes that the Fund needs to strengthen its mechanisms for systematic *ex post* assessment and strategic planning, targeted especially at cases of prolonged use of Fund resources.** This could be achieved at reasonable cost by building on existing procedures for the preparation of country strategy papers, which are not widely used and do not always deliver the type of analysis that is required.

30. **The Task Force would propose that the preparation of a country strategy paper (CSP) be required for all prolonged users of Fund resources, and that the lessons learned be presented to the Executive Board, generally prior to consideration any proposal for a new Fund financial arrangement.** This approach would include a number of modifications in current procedures. At present, when CSPs are prepared, they are internal exercises involving the staff and Management, intended as a focal point for Management’s guidance on future relations with the country concerned. They are prepared by area departments, usually for countries that have used Fund resources over a number of years, at a time of when a break in the adjustment process has taken place or a natural pause for reflection seems to be in order. Typically this could be near the conclusion of a three-year arrangement under the EFF or PRGF, or of a sustained period under stand-by arrangements. CSPs are to be prepared outside the cycle of mission briefings, with input from the World Bank, and with adequate for thorough discussion and reflection within the Fund prior to any preparations for a future Fund arrangement. In practice, the requirement for a pause in the normal cycle of country work has limited the number of natural opportunities for CSPs, while work pressures in area departments and the difficulty, in some cases, of distinguishing the product from a thorough mission briefing have led to questions about the cost-benefit ratio of preparing one.

31. **Under the Task Force proposal, once a country was identified as a prolonged user of the Fund’s general resources, there would be no discretion about the preparation of a CSP and limited flexibility in its timing. Preparation and discussion of the CSP would be expected to take place before the preparation of the briefing paper for the next Article IV consultation or any request for a new Fund financial arrangement.** The lessons learned would be **presented to the Executive Board** prior to any consideration of a new

¹¹ IEO Evaluation of the Prolonged Use of IMF Resources (SM/02/287, 9/6/02), Volume I, pages 13-15.

Fund financial arrangement—wherever possible, **in connection with the staff report for the next Article IV consultation**. The CSP would be prepared by an inter-departmental team, including representatives from the area department, PDR, and at least one other functional department. **In some cases, the CSP might also draw upon the outside experts**. Coverage would include an analysis of the problems facing the country, a critical and frank review of progress during the period of prolonged use of Fund resources, and a forward-looking assessment that takes account of lessons learned and presents a strategy for future economic policies and Fund engagement (including financial support and technical assistance). CSPs would be expected to reflect a good understanding of the political context and the adequacy of institutional development. But there would be no attempt to use them as detailed blueprints for future negotiations or, even less, as a framework for planning future technical assistance. Rather, these papers would be expected to be as brief and clear as possible in drawing lessons from the experience to date and posing strategic options for economic policy and future Fund interactions with the member country, including whether it would be appropriate to consider additional Fund financial support. Perhaps most importantly, no stigma should be attached to such an exercise, because CSPs would be prepared for successful as well as unsuccessful cases.

32. **Serious consideration was given to proposing, instead, that the requirement to prepare CSPs be targeted** only at cases in which prolonged use of Fund resources had been associated with inadequate progress toward program objectives, heavy indebtedness to the Fund, or a more generalized deterioration in the prospects for external debt sustainability. On balance, however, Task Force members judged that a simple and transparent trigger, based on the length of time spent under Fund financial arrangements, would produce a more credible and even-handed response to the issues raised by the IEO. In addition to its contribution to decision-making in individual country cases, the process proposed by the Task Force would provide important input for future reviews of conditionality and program design, as well as a better basis for assessing the validity of the concerns expressed by the IEO about the effects of prolonged use on institutional development in member countries and proper governance in the Fund.

33. **In its report, the IEO defined prolonged users of Fund resources as countries that had spent at least 7 years out of some 10-year period under Fund-supported programs** with upper credit tranche conditionality, including precautionary arrangements and arrangements under the concessional facilities. In contrast, the Review of Fund Facilities in 2000 defined prolonged users as countries having programs under upper credit tranche arrangements in at least 5 of the previous 15 years, including precautionary arrangements, but *excluding* countries eligible to use the Fund's concessional facilities. Table 1 lists countries defined as prolonged users in the IEO report, and in the 2000 Review of Fund Facilities.

34. The Task Force explored the implications of various definitions of prolonged use, based on the existence of Fund financial arrangements in 5, 6, and 7 of the past 10 years (see Table 2), and concluded that there was no convincing reason for using a different cutoff point from the one adopted by the IEO. It also considered excluding precautionary arrangements,

but rejected this on the grounds that countries with such arrangements retain the right to make purchases and, on occasion, have done so in very sizeable amounts. **For the Fund's general resources, the Task Force therefore recommends that prolonged users of Fund resources be defined as having countries that have spent 7 or more of the last 10 years under stand-by or extended arrangements, including precautionary arrangements.**

35. **In dealing with prolonged use of the Fund's concessional facilities**, the Task Force considered that the Fund should be cautious about adding new requirements—particularly in view of the expectation, at present, that most PRGF-eligible countries will be users of Fund resources over a sustained period. The ability of the Fund to fulfill its role in low-income countries while remaining focused on its core areas of responsibility is a continuing challenge, depending to a considerable extent on the scope for further strengthening the cooperation and division of labor with the World Bank and other international institutions. The role of the Fund in low-income countries, including the appropriate time-frame and modalities for Fund engagement, will be reviewed in a comprehensive paper later this year.

36. Against this background, **the Task Force sees the end of a three-year arrangement under the PRGF as a natural opportunity to reflect on the progress in addressing underlying economic problems under the Fund-supported program and the nature of the Fund's future engagement.** Indeed, such an assessment is increasingly a feature of Article IV consultation reports for countries nearing the end of PRGF arrangements, and in some cases work on such countries has been enriched by the preparation of (internal) CSP. The Task Force recommends that current best practice regarding a “fresh perspective” in the Article IV surveillance process be generalized for such cases.

37. **In addition, the Task Force would propose that a CSP be prepared after a country has gone through two multi-year arrangements under the Fund's concessional facilities (either through completion of the arrangement, expiration without making all purchases, or cancellation).** The content and procedures for preparing these CSPs would be the same as those adopted for users of the Fund's general resources, but in some cases the authorities might be involved in the distillation of lessons from past successes and failures and the initial outline of the future economic strategy, drawing on institutional arrangements developed in conjunction with the PRSP process. The lessons learned would be presented to the Executive Board, generally in connection with an Article IV consultation.

38. The Task Force did not come easily to this recommendation regarding CSPs for PRGF-eligible countries. As indicated in Table 3, some 24 PRGF-eligible countries would presently be included in the proposed requirement to prepare a CSP. Since this would imply a substantial increase in the staff work load, particularly in 1-2 area departments, the Task Force considered various ways to limit the number of countries that might be covered. However, it found that only by restricting the requirement to cases of repeat failure could the list be narrowed significantly—an approach that would contradict the principles of seeking a balanced and representative sample and not stigmatizing countries that are subjects of a CSP. Since there have been only a limited number of CSPs so far for PRGF-eligible countries, and

most of these have been, are, or will later become prolonged users of Fund resources, it is difficult to avoid both a large initial stock of CSPs and a more moderate continued flow, perhaps on the order of 3-4 per year, once that stock has been dealt with.

39. Unlike most other proposals in this paper, the requirements to prepare CSPs would have significant, identifiable resource implications. Tables 2 and 3 identify 35 countries as potential subjects of CSPs.¹² If these were phased in over a period of about two years, this would imply 16 CSPs in 2003, another 16 in 2004, and a continuing flow of perhaps 5 cases a year (mainly PRGF-eligible countries) for the next few years. While much of the work needed to prepare a CSP would be in addition to existing country work, some of it would contribute to the preparation of Article IV staff reports and PRSPs. In addition, in some cases the preparation and consideration of a CSP could delay other mission work, or even lead to a decision not to proceed with previous-planned discussions on use of Fund resources. **On balance, a rough estimate might be that only two-thirds of the staff resources needed to prepare CSPs would be in addition to ongoing country work—implying an additional resource requirement of about \$1 million per year in FY 2004 and 2005, declining to perhaps \$400,000 per year thereafter.¹³ Roughly one-fourth of this requirement would be for work on prolonged users of the Fund’s general resources, and the remainder for CSPs in PRGF-eligible countries.**

40. **If it were considered preferable to prioritize the preparation of CSPs in order to live better within the existing resource envelope, an option which would involve substantial up-front savings would be to phase in CSPs for the initial stock of PRGF-eligible prolonged users by preparing them only during the period after the expiration of a PRGF arrangement and before the approval of a new arrangement.** At present, 16 of the 24 PRGF-eligible countries listed in Table 2 have an active PRGF arrangement and another 6 countries are in the late stages of discussions on a new Fund financial arrangement. This leaves two countries (Djibouti and Mauritania) at a natural point for the preparation of a CSP, with another 11 countries likely to reach this point during the course of FY 2004-FY 2005—in effect, **reducing the number of CSPs that would be prepared for PRGF-eligible countries by about one-half during the first two years.**

41. In order to ensure that the prolonged use of Fund resources can be monitored easily on an ongoing basis, **the Task Force would also recommend that the staff prepare a brief, factual report on the incidence of prolonged use of Fund resources, according to the definition utilized by the IEO.** It would suggest that this report be circulated to Executive Directors for information twice a year.

¹² One of these countries, Pakistan, is on both the PRGF list and the list of prolonged users of the Fund’s general resources.

¹³ This additional resource requirement would correspond to about 5 staff years in FY 2004 and 2005, declining to about 2 staff years thereafter.

42. More generally, the Task Force agrees that there are benefits from a process of *ex post* assessment in a variety of circumstances, subject to resource constraints. It would therefore emphasize that any decision to adopt a system of mandatory CSPs for prolonged users should not be seen as limiting the scope for staff or Management to initiate similar country strategy exercises in other cases, on a discretionary basis.

VII. ALTERNATIVE “SIGNALING” MECHANISMS

43. **The IEO has recommended that the IMF “aim to provide the international community with credible alternatives to the current situation where IMF-supported programs have become a precondition for the provision of many other sources of financing by donors and creditors.”** It suggests that this could be done “by developing a mix of tools (e.g., strengthened surveillance, PRSP assessments, precautionary arrangements, or shadow programs) to deliver seals of approval suited to the varied needs of donors and creditors.”

44. **This topic is being taken up in two papers in the Fund’s work program subsequent to the release of the IEO report: the paper on *Signaling Assessments of Members’ Policies* (SM/03/2, 1/8/03), and the forthcoming review of the *Role of the Fund in Low-Income Countries*.** The first paper, which was discussed by the Executive Board on January 29, 2003, considered ways to signal the Fund’s views on members’ economic policies in cases where there is no Fund-supported program. The paper on the role of the Fund in low-income countries would have a broader focus, as noted above, but an important aspect would be further consideration (in cooperation with the World Bank and other donors) of the best ways for the Fund to monitor economic performance and fulfill this type of signaling role in low-income countries. This is a crucial issue, as a small but growing number of PRGF-eligible countries move beyond the stage of macroeconomic stabilization and into a sustained and more gradual process of institutional development.

45. Donors are understandably reluctant to de-link certain forms of assistance from the existence of a Fund-supported program. **An important point of departure for each of these papers is that the Fund is not willing to enter into financial arrangements in support of programs that do not meet reasonable standards of policy content, in order to fulfill the expectations of donors. To help donors in taking their own decisions on how to proceed in cases where a Fund-supported program is not appropriate, the Executive Board stressed in its January 29, 2003 discussion that the Fund should make effective use of Article IV staff reports and the associated Press Information Notices. It also spelled out the procedures under which the staff can provide “assessment letters” to a country’s external donors and creditors.** The Board agreed that the Fund should discontinue the practice of “signaling” staff-monitored programs (SMPs), which are prone to misinterpretation as offering a form of endorsement with many features of Fund-supported programs, but none of the safeguards. In addition, precautionary arrangements (or, for low-income countries, PRGF arrangements with very low access) will continue to provide a framework for monitoring policy performance in countries with policies that meet that

standards for Fund financial support, but which do not have an immediate need for Fund resources.

VIII. STRENGTHENING POLITICAL INFORMATION AND ANALYSIS

46. **The IEO recommended a strengthening of the ability of staff to analyze political economy issues, to get a better understanding of the forces that are likely to block or enhance reforms and to take them into account in program design.**

47. The Task Force agrees that political information and analysis is important for understanding alternative strategies to achieve countries' economic objectives, appropriate design and sequencing of structural reforms, and assessment of the degree of ownership and prospects for successful implementation of policy measures. Some briefings, back-to-office reports, and staff reports already touch upon political and governance issues with a direct impact on program design and implementation, to support Management and the Executive Board in meeting their responsibilities regarding surveillance and the approval of Fund-supported programs.

48. **The Task Force recommends an effort to enhance reporting and analysis of political issues. A critical objective would be to include such information in staff reports for Article IV consultations and requests for use of Fund resources, when it has important implications for the design and implementation of economic policy.** In practice, the Task Force would expect reporting on political issues in staff reports to evolve gradually, as experience is gained. At present, this occurs mainly in countries emerging from conflict, facing severe governance problems, or threatened by imminent social disorder. Enhanced political analysis could, for instance, be part of a deeper probing of the reasons for repeated program failure. Mission teams and resident representatives, who are in a special position to follow political issues in the countries to which they are assigned, would be the backbone of this effort; resident representatives, in particular, would be encouraged to do more to seek the views of local and foreign political analysts in their countries.

49. Like the IEO and many external commentators, **the Task Force feels that more can be done with the political information and analytical capacity already extant in the Fund, and that the staff's capacities in this area could be strengthened appropriately through a modest investment in training.** It also believes that the Fund should continue the practice of drawing on outside experts (including those with both economic and political expertise) from time to time in analyzing national or regional issues. The Task Force agrees that it would be useful to continue experimenting with targeted internal seminars, similar to the ones recently introduced by INS, and coaching, especially for mission chiefs and resident representatives, to strengthen staff skills and awareness in this area. Increased participation in external events could be another way of achieving this.

IX. HUMAN RESOURCE MANAGEMENT

50. **The IEO report also suggested a “review of explicit and implicit incentives facing IMF staff ... in particular with a view to reducing the excessive turnover of staff working on countries and to fostering increased candor in staff reports and greater accountability.”**

51. **In view of the much broader implications of most human resource management issues, the observations of the Task Force in this report are limited to the question of staff mobility.** The Task Force is convinced that excessive mobility among Fund economists and, especially, mission chiefs over the past 10-15 years has created significant managerial problems for departments, posed challenges for the quality and consistency of policy advice and program design—particularly in smaller countries—and in some cases, adversely affected the policy dialogue with member countries. At the same time, neither the staff nor, apparently, the IEO considers it likely that excessive mobility has increased the incidence of prolonged use *per se* (indeed, staff mobility is one way to avoid excessive “coziness” in interactions with country authorities, which has been identified by the IEO as a factor in prolonged use).

52. **Staff mobility is an important means of increasing the breadth of knowledge within the staff and the efficiency of the institution, as well as a key tool for staff development.** Mobility is affected mainly by three factors:

- personnel policies, which require mobility for economists at least once prior to promotion to managerial level and bar interdepartmental transfers by staff who have not spent at least two years in their current assignment;
- the broader institutional culture, in which mobility and wide experience are seen as a positive factors for career progression; and
- the evolution of the Fund’s membership and workload. Over the past 15 years or so, major changes (creation of the SAF and ESAF; breakup of central planning and shift to nearly-universal membership; capital account crises and expansion of Fund work on financial sector issues) have occurred mainly in discrete jumps, with an immediate Fund response through the redeployment of existing staff resources.

53. In considering ways to avoid excessive mobility in the future, **the Task Force did not believe that the Fund’s personnel policies needed to be changed.** However, it does recommend that **guidelines and practices regarding the reassignment of mission chiefs and other economists pay greater attention to the stability of country assignments, reinforced by appropriate incentives. Even more, it considers that the best way to guard against excessive mobility in the future would be the reestablishment of spare capacity to respond to emergencies and new tasks,** so that assignments throughout the institution are not so often subject to sudden and unplanned change.

X. CONCLUSION

54. Prolonged use of Fund resources can raise complex issues, particularly when it is associated with inadequate progress toward addressing a country's economic problems. It is clear that not every case of prolonged use has been associated with poor performance under Fund-supported programs, and that even some cases in which the Fund has provided sustained or repeated support for failed programs may in fact have been based on an informed judgment of the risks and the political context. What is crucial is for the Fund to have policies and procedures that promote sound program design, appropriate use of conditionality, and a good understanding of the country-specific institutional, social, and political context. And, ultimately, it is also crucial to ensure that decisions on whether to provide Fund financial support for a member's adjustment program are taken transparently and with a clear understanding of the risks and constraints. These considerations form the basis for the Task Force's recommendations.

55. **Summary of Task Force conclusions:**

- (i) A major concern for the Fund should be to **reduce the risk of failure of Fund-supported programs, especially repeated program failure**. Wholehearted implementation of the new **conditionality guidelines**, aimed at streamlining and focusing conditionality and promoting country ownership, is crucial for improving the prospects for sustained implementation of Fund-supported programs.
- (ii) It is necessary to continue striving for **greater realism about the objectives and assumptions underlying Fund-supported programs**. The Task Force recommends that this be backed up by **the Fund's future work on program design**.
- (iii) Efforts to improve program design and conditionality should be accompanied by **greater selectivity in extending Fund financial support, based in part on the assessment of implementation capacity and ownership**.
- (iv) The Fund needs to make **better use of Article IV consultations to obtain a "fresh perspective" in program countries**, by assessing experience under the program, the implications for future economic policies, and options for future Fund involvement. Briefs and draft staff reports for such consultations should be subject to a high standard of interdepartmental and Management review, to ensure a thorough discussion and distillation of lessons.
- (v) **Procedures should be instituted to strengthen "due diligence" for prolonged users of Fund resources, through a systematic process of *ex post* assessment and strategic forward planning**. This would focus on the preparation of country strategy papers and presentation to the Board of the lessons learned, whenever possible in connection with an Article IV consultation—and in general, prior to any consideration of proposal for a new Fund financial arrangement. To back up this

approach, **the staff should provide a periodic factual report on the incidence of prolonged use of Fund resources.**

(vi) **The Fund should have effective ways to signal its views on policies to a country's donors and creditors**, outside the context of a Fund-supported program. Article IV staff reports, PINs, and "assessment letters" (under the new guidelines) provide important vehicles, and this topic will also be taken up further in the forthcoming review of the role of the Fund in low-income countries. **The Fund should continue to be clear that it will not enter into financial arrangements in support of programs that fail to meet reasonable standards of policy content**, in order to fulfill the expectations of donors.

(vii) In the case of prolonged users of Fund resources that are making insufficient progress toward program objectives, or experiencing repeated program failure, the staff should **apply consistently the existing guidelines relating to access to Fund financing**. Questions relating to levels of access to the PRGF will be taken up in the forthcoming paper on the role of the Fund in low-income countries. The Task Force would not recommend imposing higher rates of charge for prolonged users of Fund resources.

(viii) The Task Force would endorse **a systematic effort in the Fund's internal review process to promote the application of preventive measures and ensure that lessons are drawn from the experience in identified cases of prolonged use.**

(ix) **The Task Force also recommends an effort to enhance reporting and analysis of political issues with an impact on program design and implementation**, to support Management and the Executive Board in meeting their responsibilities regarding surveillance and the approval of Fund-supported programs.

(x) The Task Force would propose that Management consider **guidelines and incentives to reduce excessive mobility in country teams**. Ultimately, however, it believes that the key to reducing excessive mobility would be the reestablishment of **capacity to respond to emergencies and new tasks**.

56. **Resource implications.** Most of the recommendations in this paper represent a further evolution of the Fund's core work program and are not expected to result in significant new pressures on staff resources. However, the proposal to prepare country strategy papers for all prolonged users of Fund resources would have significant resource implications, due especially to the large initial stock of CSPs during the first two years. These resource costs are tentatively estimated at about \$1 million per year in FY 2004 and 2005, declining to perhaps \$400,000 per year thereafter, with about three-fourths of the total attributable to the preparation of CSPs in PRGF-eligible countries. If this proposal were adopted, it would be necessary to identify additional resources for this purpose, or offsetting

reductions in other activities. Alternatively, a more gradual phasing-in of CSPs for PRGF-eligible countries (along the lines described in paragraph 40) would make it easier for the staff to live within the existing resource envelope.

57. The members of the Task Force would like to express their appreciation to the IEO for its wide-ranging and helpful insights into the issue of prolonged use of Fund resources, as well as its advice in considering how to follow up the evaluation report. We would also like to take this opportunity to reaffirm the staff's commitment to cooperate with the IEO in its future evaluation activities.

Table 1. Countries Identified by the IEO as Prolonged Users of Fund Resources
(countries in *italics* were also identified as prolonged users in the Facilities Review;
countries with an asterisk (*) were largely under precautionary arrangements)

<u>GRA-only</u>	<u>PRGF-eligible</u>	<u>PRGF-eligible</u>
<i>Argentina</i>	Bangladesh	Mongolia
<i>Bulgaria</i>	Benin	Mozambique
<i>Costa Rica</i> *	Bolivia	Nicaragua
<i>Ecuador</i>	Burkina Faso	Niger
<i>Egypt</i> *	DR Congo	<i>Pakistan (blend)</i>
<i>El Salvador</i> *	Côte d'Ivoire	Senegal
<i>Gabon</i>	Equatorial Guinea	Somalia
<i>Jamaica</i>	The Gambia	Tanzania
<i>Jordan</i>	Ghana	Togo
<i>Korea</i> *	Guinea	Uganda
<i>Latvia</i> *	Guyana	Zambia
<i>Mexico</i>	Haiti	
<i>Morocco</i>	Honduras	
<i>Panama</i>	Kenya	
<i>Peru</i>	Kyrgyz Republic	
<i>Philippines</i>	Liberia *	
<i>Romania</i>	Madagascar	
<i>Turkey</i>	Malawi	
<i>Uruguay</i> *	Mali	
FR Yugoslavia	Mauritania	

Additional Countries Identified as Prolonged Users in the 2000 Facilities Review¹⁴

Estonia *	Lithuania *	Russia
Hungary	Moldova	Tunisia
Kazakhstan *	Poland	Zimbabwe

¹⁴ The Facilities Review used a different definition of prolonged use of Fund resources: countries having programs supported by upper credit tranche arrangements in at least 5 of the previous 15 years, excluding countries eligible to use the Fund's concessional facilities.

Table 2. Prolonged Users of Fund Resources for the Period 1993-2002
 (Users of the Fund's general resources are in bold type;
 Countries with an asterisk (*) were largely under precautionary arrangements)

Countries with Upper-Credit Tranche SBAs, EFF, ESAF, or PRGF Arrangements in:

(1) 7 out of 10 years	(2) 6 out of 10 years (Countries in Column 1 plus:)	(3) 5 out of 10 years (Countries in Column 2 plus:)
Albania	Armenia	Azerbaijan
Argentina	Cambodia	Egypt *
Benin	Djibouti	El Salvador *
Bolivia	Gabon	Guinea-Bissau
Bulgaria	Georgia	Indonesia
Burkina Faso	Kenya	Lao PDR
Cameroon	Lesotho (blend) *	Macedonia FYR
Chad	Niger	Madagascar
Côte d'Ivoire	Philippines	Russian Federation
Estonia *	Zambia	Rwanda
Ethiopia		Sierra Leone
Ghana		Togo
Guinea		Vietnam
Guyana		Yemen
Honduras		Zimbabwe
Jordan		
Kazakhstan *		
Kyrgyz Republic		
Latvia *		
Lithuania *		
Malawi		
Mali		
Mauritania		
Moldova		
Mongolia		
Mozambique		
Nicaragua		
Pakistan (blend)		
Panama *		
Peru *		
Romania		
Senegal		
Tanzania		
Uganda		
Ukraine		
Total: 35	45	60
GRA users: 12	15	20

**Table 3. Countries with Two Completed or Expired Multi-Year Arrangements
Under the Fund's Concessional Facilities, 1990-2002**

Albania
Benin
Bolivia
Burkina Faso
Côte d'Ivoire
Djibouti
Ethiopia
Ghana
Guinea
Guyana
Honduras
Kyrgyz Republic
Macedonia FYR
Malawi
Mali
Mauritania
Moldova
Mongolia
Mozambique
Nicaragua
Pakistan
Senegal
Tanzania
Uganda

Recommendations of IEO Evaluation Report on Prolonged Use of IMF Resources¹⁵

I. Recommendations on the Rationale for IMF Involvement

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

II. Recommendations for Program Design and Implementation

6. Since implementation is critically dependent on ownership, it would be desirable to evolve specific operational procedures to ensure that program design places greater emphasis on ownership and the nature of the domestic policy formulation process. This approach is already embedded in initiatives currently under way. The following specific suggestions are offered to operationalize the process.
 - The IMF should move toward a situation where the normal procedure would be for the authorities to have the initial responsibility for proposing a reform program, which should be the starting point for negotiations. The speed at which this can be done will vary from

¹⁵ Quote from *Evaluation of the Prolonged Use of Fund Resources* (SM/02/87, Volume I, 9/6/02), pp. 13-16.

country to country, depending on administrative capacity. Such an approach should not be an additional prerequisite for financial support, but countries should be encouraged to adopt it.

- The aim should be to move as soon as possible to a situation in which the core elements of a program are subject first to a domestic policy debate within the member country's own policymaking institutions.

- As is already "best practice," Article IV surveillance reports should actively seek to present alternative policy options and to analyze the trade-offs between them so as to encourage an open debate on alternative policy options.

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

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

- A deepening of operational collaboration with the World Bank, to ensure an effective meshing of priorities and time frames of the two institutions on key issues. Recent initiatives in this area are welcome, but substantial changes in operating approach and sustained emphasis by management will be needed to make collaboration effective.

- Systematically incorporating into program documents more in-depth analyses of real economy responses to the key policy elements of programs and of the sources of growth, while spending proportionately less time fine-tuning traditional financial programming exercises. Such analyses would draw, where appropriate, on the expertise of the World Bank.

- Using conditionality as a means to direct attention to critical reforms and emphasizing substantive rather than formal progress toward the program's objectives both in selling conditionality and in assessing compliance with it. Greater selectivity in the use of conditionality should be accompanied by less recourse to waivers.

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

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

III. Recommendations for IMF Governance

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

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

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

- A clarification of the expectations on the role of surveillance in program cases, going further than the simple reassertion of existing, but unevenly implemented guidelines and stressing the need for *ex post* assessments of programs' achievements.
- There is a case for creating greater operational separation between UFR and surveillance missions in prolonged use cases, although implementing this separation raises delicate trade-offs. The appointment of a mission chief chosen from outside the area department for surveillance missions to prolonged users could be considered provided there are suitable continuity and coordination safeguards.
- There is merit in seeking a second opinion--including from outside the IMF--on key policy issues that appear to be contributing to prolonged use.
- The precise frequency of Article IV consultations with program countries is less important than that they take place at times when a "fresh look" would be most valuable.

12. The IMF should strengthen the ability of its staff to analyze political economy issues in order to achieve a better understanding of the forces that are likely to block or enhance reforms and to take these into account in program design.

13. A broad review of explicit and implicit incentives facing IMF staff should be undertaken, in particular with a view to reducing the excessive turnover of staff working on countries and to fostering increased candor in staff reports and greater accountability.

14. The appearance of undue political intervention in the IMF's decisions to grant a country access to its resources undermines the credibility of programs. Procedures should be evolved so that political considerations, which are inevitably present in these decisions, are seen to be taken into account in a transparent manner, with decisions and accountability clearly at the level of the Executive Board on the basis of a candid technical assessment by staff of the risks and potential trade-offs.



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IMF Concludes Discussion on Prolonged Use of Fund Resources

On March 24, 2003, the Executive Board of the International Monetary Fund (IMF) concluded its discussions on prolonged use of Fund resources, based on the report of the IMF's Independent Evaluation Office (IEO) and the conclusions of a staff task force.

Background

The IEO issued its first evaluation report on the prolonged use of Fund resources on September 6, 2002. Shortly afterward Managing Director Horst Köhler issued a statement to the Executive Board welcoming the IEO's report, agreeing with many of its findings, and indicating that Management would establish a staff task force to make recommendations on how issues raised in the report could best be addressed. Executive Directors welcomed this proposal, and looked forward to following up on the recommendations of the task force early in the next year.

The IEO report identified a number of problems associated with prolonged use of Fund resources. These included:

- risks to the revolving character of Fund resources,
- the possibility that prolonged use may be the result of weak program design and implementation,
- unwarranted intrusion on the development of domestic policies and institutions (particularly in the case of low-income countries), and
- a possible blurring of the Fund's role and mandate, especially in relation to the work of the World Bank and other development institutions.

Financial support from the IMF is intended to assist members in overcoming temporary balance of payments difficulties. Particularly under stand-by and extended arrangements, a primary objective of Fund-supported programs is the attainment of external viability, after which the IMF's financial support should no longer be needed. At times, prolonged use of Fund resources may signal a failure to achieve this key objective—which can impose costs on the member country, damage the IMF's credibility, and make it more difficult for the member to meet its external obligations (including its obligations to the Fund). In past discussions of prolonged use,

the Executive Board has stressed the importance of distinguishing between countries that are making adequate progress toward achieving their program objectives, and those that are not.

The IMF's role in the global economy has evolved over time, and some of the attendant changes have contributed to prolonged use of Fund resources. For example, the Fund's role in cushioning the effects of sharp increases in world oil prices during the 1970's, and in the subsequent "recycling" of external surpluses, had implications for the scale of its involvement in countries with limited debt-servicing capacity and ability to reduce its exposure subsequently. Since then, the Fund has also been called upon to expand its activities in low-income countries and to play a major part in guiding the transition to market in former centrally-planned economies. Because these countries faced simultaneous challenges of macroeconomic stabilization, institutional development, and structural reform that were expected to take considerable time, there was a presumption of sustained Fund engagement, including financial support. While many transition countries have by now "graduated" from Fund financial support, there is still a presumption that most low-income countries will make use of IMF financing for an extended period, mainly under the Fund's concessional lending window, the Poverty Reduction and Growth Facility (PRGF).

Another source of incentives for prolonged use of Fund resources is the "signaling" role that Fund-supported programs play for a country's external donors and creditors. Official donors and creditors often condition some forms of development assistance on the existence of a financial arrangement with the IMF, on the grounds that a sound macroeconomic policy framework is important for the effectiveness of this assistance. This signaling role has also been important at times with regard to private creditors. The IMF has experimented with alternative ways of addressing this objective, but has found that neither member countries nor their external partners considered these to be complete substitutes for a Fund-supported program. To a large extent this reflected a judgment that the Fund's willingness to approve arrangements enhanced the credibility of its advice and underscored the seriousness of the government's policy intentions. However, this also created pressures on the Fund to support programs even in cases where the prospects for implementation of credible policies were weak.

In considering a strategy for following up the IEO's report, the staff task force focused both on measures aimed specifically at cases of prolonged use, and measures aimed more broadly at enhancing the prospects for success of all Fund-support programs. The latter included a strengthening of the Fund's work on surveillance, program design, and conditionality, to devise better programs that stand a better chance of being implemented, in conjunction with procedures to ensure that the Executive Board decisions on proposed Fund financial arrangements are taken transparently and with a full understanding of the risks and constraints. To help reinforce this process and strengthen "due diligence" in dealing with cases of prolonged use of Fund resources, the task force also proposed a systematic process of assessment and strategic forward planning, whose results would be incorporated into Article IV consultation discussions and staff reports. It proposed that this process be applied for all countries identified as prolonged users of Fund resources—including those with relatively successful programs and, in line with the IEO's recommendation, countries with precautionary arrangements.

In its work, the staff task force benefited not only from the IEO report, but also from comments received by the IEO through a process of external outreach, including seminars in Berlin, Cambridge, London, Manila, and Tokyo.

Executive Board Assessment

Executive Directors welcomed the opportunity to discuss the conclusions of the task force on prolonged use of Fund resources, which the Managing Director had convened to consider the recommendations of the Independent Evaluation Office (IEO) on this topic. They appreciated the work of the task force as a key step in following up on the IEO's candid and comprehensive analysis. Directors stressed that thorough implementation and review of the measures proposed by the task force—along with timely attention to the IEO's future reports—will be critical to ensure that the work of the IEO makes its maximum contribution to enhancing the listening and learning culture within the Fund.

Directors generally reaffirmed their observations during the Board's discussion of the IEO report, last September, regarding the extent and nature of problems posed by the prolonged use of Fund resources. Most Directors agreed that, under proper circumstances, long-term Fund financial engagement can be an appropriate response to help member countries address deep-seated problems that, by their nature, require many years to resolve. These problems have been particularly prevalent in low-income countries and countries in transition. Directors also observed, however, that at times prolonged use can be associated with inadequate progress in dealing with a country's key economic problems, and that, in some cases, prolonged use and the associated policy conditionality can hinder the development of domestic institutions. The financial implications of prolonged use for the Fund's regular resources and for PRGF resources also were a possible concern. Directors broadly endorsed a number of measures aimed specifically at cases of prolonged use, while stressing that attention should also focus on improving the prospects for successful implementation of all Fund-supported programs. This will be achieved through the adoption of policies and procedures that promote better program design and strong local ownership, along with accountability for outcomes. In that context, Directors also supported the recommendation that Board decisions on the provision of Fund financial support be transparently based on candid assessments by the staff of the risks and constraints involved.

Directors were in broad agreement with the strategy outlined by the task force. This will entail the rigorous implementation of IEO recommendations to improve surveillance, conditionality, and program design (including those already internalized in the Fund's work program); additional measures to strengthen "due diligence" for prolonged users and enhance information for decision-making; and further substantive consideration of a number of IEO recommendations in the period ahead. They stressed the importance of systematically monitoring the timely implementation of the various elements of this strategy.

Directors considered that wholehearted observance of the new guidelines on Fund conditionality will improve considerably the prospects for sustained implementation of Fund-supported programs. They highlighted, in particular, the emphasis of the guidelines on the

institutional, social, and political contexts; the improved prioritization of reforms and collaboration with the World Bank and other donors; the promotion of local ownership of reforms; and the focus on strengthening institutional capacity in member countries. Directors also agreed that improvements in conditionality will need to be accompanied by greater selectivity in recommending and approving Fund financial support, based on a careful assessment of the member's implementation capacity and ownership. A number of Directors suggested that an explicit and structured assessment of various dimensions of ownership should be included in all staff reports on use of Fund resources. It was recognized that such assessments would need to be based on careful judgment. Directors emphasized that appropriate program design and technical assistance should help members overcome the capacity constraints that may limit their ability to implement reforms successfully.

Directors stressed the importance of continued efforts to improve the design of Fund-supported programs. They noted that combining realism with the necessary ambitiousness, and determining the appropriate pace and sequencing of reforms in individual cases, remains a challenging but essential task. In general, there is a need for greater realism in program objectives and assumptions. Directors therefore looked forward to further work by the staff on the relationship between external financing, adjustment, and sustainability; on the analytical framework for program design; on the tradeoffs between macroeconomic and structural policies; and on the parameters for assessing program success.

Most Directors underscored the importance of consistently applying the existing policies on access that relate to Fund financing for prolonged users that fail to make sufficient progress toward program objectives. As specified by the Executive Board at its discussion on the review of conditionality on July 22, 1991, continued Fund financing for countries with slow progress toward external viability might require strong policy justification, and access should continue to be guided by the need to reduce their outstanding use of Fund resources over time. Directors also agreed that, more generally, staff reports on requests for the use of Fund resources should consistently discuss the justification for the proposed levels of access. There was virtually no support for the IEO's proposal to levy higher rates of charge or interest rates for prolonged users of Fund resources.

Directors concurred with the priority accorded by the IEO and the task force to increasing the effectiveness of Fund surveillance. Diligent implementation of the conclusions of the recent surveillance review will be key to identifying economic weaknesses and vulnerabilities and building domestic support for the adoption of sound policies. Directors stressed the need for the staff to combine clarity and candor with a recognition of the social and political realities that shape economic policy; to complement sound advice on economic objectives with discussions of alternative ways to achieve those objectives; and to reach out more broadly, including to legislative bodies.

Directors highlighted the importance of ongoing efforts to ensure that Article IV consultations in program countries "step back" from the program context. This will allow the Fund to take account of a broader perspective on the economic challenges facing a country and on the adequacy of current policies to meet those challenges. Directors welcomed the recent progress

in this direction. Some Directors, however, saw a need to complement these ongoing efforts with steps toward a greater operational separation of surveillance missions from discussions on the use of Fund resources. Seeking opinions from outside the Fund on key policy issues can, in some program countries, also be a useful input to the surveillance process. Directors looked forward to discussing progress in strengthening surveillance and priorities for further work in the coming weeks.

Directors supported a strengthening of the IMF's "due diligence" in cases of prolonged use, through systematic *ex post* assessment and strategic forward planning in the context of Article IV surveillance. An interdepartmental staff team will prepare such an assessment and planning exercise prior to the Article IV consultation mission to a country identified as a prolonged user. The assessment will reflect input from the World Bank and, in some cases, might also draw on outside experts. The exercise will cover an analysis of the economic problems facing the country, a critical and frank review of progress during the period of Fund-supported programs, and a forward-looking assessment that takes into account lessons learned and presents a strategy for future Fund engagement. Where appropriate, the assessment will present an explicit "exit strategy;" some Directors expected this to be the normal procedure. This strategy may include, in some cases, an approach to help countries identify the steps to be taken to widen their options for external financing, for example by fostering access to foreign direct investment or to international capital markets. Following the consultation discussions with the authorities, the results of this exercise will be presented to the Executive Board in the Article IV staff report. Directors considered that such an approach could also prove useful in the case of some countries that were not identified as prolonged users. In addition, the staff report for the final review under any Fund-supported program will include a concise description of the degree to which the program has achieved its initial objectives. A few Directors also called for further consideration of how best to ensure effective Board discussions of country cases where programs appear to be off-track and an Article IV Consultation is not scheduled.

Most Directors saw the definition of prolonged use proposed by the task force and building on the IEO's recommendations as an appropriate way to identify countries for the process of *ex post* assessments and strategic planning. A country will be considered a prolonged user when it has spent 7 or more of the last 10 years under upper credit tranche stand-by or extended arrangements, including precautionary arrangements, or a mix of GRA and PRGF or ESAF resources. Most Directors also supported the proposal that, for countries using the Fund's concessional resources, the new assessment process be triggered when a country has gone through two or more multi-year arrangements under the PRGF or ESAF (through either completion of the arrangements, or expiration without making all of the scheduled purchases, or cancellation). Some Directors would have preferred to come back to this issue on the occasion of the forthcoming discussion of the Fund's role in low-income countries. Directors emphasized that the inclusion of a country in this new process should not be viewed as an indication of program failure, and that, in each case, the staff will need to be clear about its assessment of program implementation and achievements. A number of Directors considered that precautionary arrangements should be excluded from the definition of prolonged use. Directors agreed to a gradual phasing in of the new assessment process in line with the existing staff resource envelope, particularly in the case of low-income countries.

Several Directors highlighted the conclusion of the task force that excessive staff mobility has at times posed challenges for policy advice and program design and, in some cases, adversely affected the Fund's dialogue with members. Management will pay greater attention to continuity and stability in mission chief and other economist assignments, reinforced by appropriate incentives. At the same time, however, Directors noted that human resource management needs to be framed more broadly than in the context of prolonged use.

Most Directors, while underscoring the complexity of political economy issues, agreed that awareness and knowledge of these issues can be an important channel for better understanding and taking into account the forces shaping the success and sustainability of reforms. They encouraged the staff to enhance its analysis and reporting of political economy issues in staff reports. Some Directors cautioned, however, that the Fund should be extremely careful in venturing into this area, given the staff's comparative advantage in providing technical analysis and the need to avoid intruding on internal political matters. Enhanced reporting on political issues in staff reports will need to evolve gradually, as experience is gained. Mission teams and resident representatives will be the backbone of this effort, and the staff's capacities in this area will be strengthened through appropriate training. From time to time the Fund will draw on outside experts in analyzing national or regional issues.

Directors noted that the linkage of some forms of donor assistance to the existence of a Fund-supported program, and the Fund's catalytic role with respect to private financing sources, can result in pressures for Fund lending decisions that contribute to prolonged use of Fund resources. In that context, Directors confirmed the conclusions of their recent discussion on mechanisms for signaling the Fund's assessment of members' policies. This discussion reiterated that the Fund should not enter into financial arrangements in support of programs that fail to meet reasonable standards of policy content in order to fulfill the expectations of donors. It will therefore be important to consider carefully, on a case-by-case basis, how best to use Article IV consultation reports, Public Information Notices (PINs), PRSP assessments, and other devices for signaling the Fund's views on policies to a broader audience, including donors and creditors. In the case of low-income countries, where the Fund's signaling role and the linkage of external assistance to Fund programs is a particularly important issue, Directors encouraged the staff to continue to explore the scope for alternative signaling mechanisms, in consultation with member countries, donors, and other creditors, including the Paris Club and World Bank. They looked forward to further discussing these issues in the context of the forthcoming review of the Fund's role in low-income countries.

Directors underscored that systematic follow-up will be key to ensuring that the measures endorsed by the Board in response to the work of the IEO and the task force are effectively implemented and achieve their intended results. They agreed to the following actions (i) the circulation of additional guidelines for the staff, accompanied by a systematic internal review effort to promote the implementation of agreed measures and ensure that lessons are drawn from experience; (ii) the circulation of factual, semiannual reports on the incidence of prolonged use of Fund resources; and (iii) regular assessment of progress in the context of the Fund's periodic reviews of conditionality. In addition, a number of key issues relating to prolonged use of Fund resources will be further considered in the context of upcoming discussions on

surveillance and on the role of the Fund in low-income countries, and of future work on program design issues.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board.