



## **Friends of the Earth Comments on the Report by the Independent Evaluation Office: Prolonged Use of IMF Resources**

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Friends of the Earth (FoE) commends the work done by the Independent Evaluation Office (IEO) on this report. The report is extensive, detailed, reveals new information, and offers concrete recommendations. It serves the purpose of both re-raising some issues previously highlighted in past evaluations that have not been sufficiently addressed in subsequent operations, as well as raising new issues for consideration. The report should provide guidance in the design and implementation of ongoing IMF operations; it is also an important contribution to the debate about the appropriate role of the IMF in borrowing countries and is therefore useful in the “big picture” consideration of the future direction of the IMF. **We hope that this report spurs the IMF Board of Directors to evaluate the role of the IMF in the poorest countries.**

It is important to note that many of the issues highlighted in the report have been raised in previous reviews, such as the external review of the Enhanced Structural Adjustment Facility (ESAF), and the recent review of the Poverty Reduction Strategy Papers (PRSPs). As the IEO notes, there have been significant problems in implementing recommendations surfacing from these reviews and in translating best practice into regular operations. To ensure credibility of independent evaluation and accountability of the IMF in general, **the Board must make explicitly clear how it will take action on and implement the review’s findings, including a work plan for implementing recommendations and identifying obstacles, and establishing mechanisms for monitoring.** It is important to demonstrate how action on this review will differ from some past experiences of inaction on implementing the results of external review.

FoE broadly agrees with the recommendations set forth in the evaluation. Rather than comment on each recommendation, we offer additional consideration to points raised in the review.

### *Rationale for IMF Involvement*

An initial recommendation of the review is for greater selectivity in IMF lending. This recommendation echoes the external ESAF review and other studies on aid effectiveness. There is a case for lending to countries that welcome an adjustment program and whose financing needs are related to the Fund's purpose of short-term balance of payments assistance. Selectivity makes sense examined in isolation, though it is likely to spark concern among the many borrowing countries requiring significant assistance from the international community that fear that selectivity will create categories of "favored nations" and pariah states. Stabilized countries that nevertheless require external assistance because of long-term development and poverty needs may also resist selectivity for fear of diminishing overall assistance levels. Addressing the total flow of external resources to a country, where these flows come from and what they are needed for, will need to be considered by IMF member governments if progress is to be made on conforming the IMF's lending to its stated mission. A broader discussion of international assistance is needed to make progress on refining the IMF's role in the poorest countries.

As the review notes, greater selectivity is also hindered by the importance of IMF lending and its associated "seal of approval" to other donor programs, including World Bank policy-based lending, bilateral aid, and HIPC debt relief. **The IMF Board of Directors should take steps to involve the broader donor community into a discussion about alternative "seals of approval" and work with the donor community to develop possible approaches.** With regard to debt relief, we believe that the review provides additional rationale for the delinking of HIPC debt relief from structural adjustment program requirements, and instead linking HIPC debt relief to alternative safeguard mechanisms, such as a transparent and accountable mechanism to record the receipt and track the expenditure of debt relief funds.

### *Program Design and Implementation*

We strongly endorse the recommendation to assess real economy responses to policy proposals. This has been a constant external critique of IMF lending. For example, the recent experiences of countries that have received interim HIPC debt relief reveal how export and growth projections can far exceed actual rates, and the devastating economic consequences that this entails, including the failure of most of these countries to meet debt sustainability targets. The credibility of IMF program design would heighten considerably by including such an assessment, countries would hopefully be better prepared for economic volatility, and the adequacy of financial assistance and programs such as HIPC to meet countries' financing needs would be better assessed.

Real economy assessments could be part of ex ante poverty and social impact analysis, which we believe should be systematic for IMF lending programs. Real economy responses should be integrated into a multiple scenario analysis that would, for example, outline potentialities in the external environment, such as terms of trade or commodity price shocks, or financial crises. The Board should take steps to outline how these real

economy assessments will be done, and the prioritization of analyzing real economy responses vis a vis the IMF's financial programming framework. While the review is not explicitly critical, the review appears to question the degree of utility of the FPF model, which has been a fundamental component of IMF program design. **The Board should therefore explicitly address the FPF model, its contribution to IMF program design, and how it would be part of program analysis that included multiple scenario analysis and real economy responses.**

We agree that IMF staff should work to formulate alternative policy options for discussion by borrowing governments and interested stakeholders. Alternative policy options should be discussed in Article IV consultations, as well as in the PRSP process. This would require greater transparency and disclosure by IMF staff and borrowing governments of possible options, their implications, risks, costs and benefits. We also contend that **greater ownership and domestic policy formulation would be facilitated by amending the PRSP process to include parliamentary endorsement before submission to the Bank and IMF.** Involving parliaments more in economic debate and policymaking has been raised as a goal in many contexts; formalizing it through the PRSP could ensure that aspirations meet reality. The Board should also consider assessing the extent to which greater outreach within the government, including to line ministries and parliamentary bodies, is hindered by Article V of the IMF Articles of Agreement that formally limits the IMF's contact to the government's finance ministry and central bank. The Board could commission a survey of mission teams and borrowing government officials to determine obstacles to outreach.

It is not surprising that the IEO recommends further strengthening of IMF-World Bank collaboration. The report itself notes that "since 1989, there have been approximately ten reviews or progress reports on IMF-World Bank collaboration, all of which diagnosed room for improvement and put forward remedies." (p. 121, footnote 14) We agree that greater clarity and candor is important, and a "lead agency" is an important accountability tool. The lead agency on specific reforms should also be clearly identified in loan documents as well as in staff reports. However, as improved collaboration has been sought for over a decade, and continues to be a challenge, the Board should specify as clearly as possible what if any additional changes it proposes to adopt and how these will be integrated into ongoing collaboration work.

### *IMF Governance*

From FoE's perspective as an outside observer of the IMF, **one of the most important contributions of this IEO report is the revelation that the Board has not been provided with full information regarding the design of IMF programs.** We find this profoundly disturbing. The IEO further comments that staff reports have become less candid over time, suggesting that initial staff candor is discouraged and redacted by higher-level management. Disputes between area departments and functional departments are not reflected in papers presented to the Board, and consideration of alternative policies is not conveyed to the Board. We believe that this calls for an

**immediate examination of internal incentive structures.** While the IMF is to be commended for its improving record on transparency, this progress is meaningless if the final documents that are actually disclosed reveal little of how the IMF comes to decisions. The Board should take steps to ensure that the range of policies that were considered by IMF staff, why some were rejected and others accepted, and country climate to implement policies, should be presented to the Board.

The review also pointed to internal changes needed with regard to IMF missions. The Board should commission a study on internal incentive structures, including the structure of missions. Mission schedules should be altered to adapt to domestic planning processes, and missions should be extended in duration to allow mission teams more time to meet with a wider representation of government officials, civil society and other domestic stakeholders. The performance of mission chiefs should be judged to include the extent to which missions consult, foster ownership, and build capacity in country to formulate economic policy.

A review of internal incentive structures should also include incentives to “overpromise” and downplay risks. We find it disturbing that “the internal review process gives a premium to toughness over realism” (IEO report p. 90), and that almost one third of survey respondents felt that their performance appraisal would be better if they were tougher in negotiations. This finding is particularly illuminating as the August 2002 progress report “Strengthening IMF-World Bank Collaboration on Country Programs and Conditionality” is fairly dismissive of differing perceptions on the part of the Bank and Fund regarding conditionality. The progress report notes that 40% of IMF respondents feel that key reforms in Bank-supported programs could be implemented faster, while 30% of Bank respondents consider the IMF timetable too ambitious to be realistic. The progress report dismisses such differences as reflecting “the diverse mandates and lending instruments- as well as the different cultures- of the two institutions.” (Progress Report p. 13)

We agree that the IMF should expand its external consultation regarding program design to seek “second opinions” in certain cases. We note that the IMF has done this in select cases, such as Argentina and Indonesia. However, these are extraordinarily complex and politically loaded cases, and the seeking of a second opinion came after considerable external criticism. The IMF should consider expanding the cases where it seeks a second opinion and initiate such a consultation much earlier in the design of programs.

More collaboration with outside parties could also be explored with regard to ex post analysis of programs. We strongly agree that greater ex post assessment is needed to determine which policies were and were not effective, and possible reasons for policy success and failure. External commentators have noted that IMF conditionality has tended to carry over from program to program when conditions have not been met without assessing possible reasons for failure to comply. To address the need to conduct ex post analysis yet consider the resource constraint, the IMF should consider engaging or collaborating more with other international organizations, think tanks, and academic institutions to initiate ex post assessments of IMF programs in prolonged use cases.

Finally, we agree that the Board should be more explicit about how political considerations factor in its decision-making. It is naïve to assume that whatever its intentions and bylaws, the Fund can remain immune from political influence. After all, Executive Directors are appointed to represent country interests, or selected to represent a constituency. The Group of Seven is allocated almost one half of the voting power; this too translates into inevitable political orientation by the Fund at times. A report on political risks and political economy factors should be included in staff reports. Resident Representatives should write these submissions since they are tasked with understanding the broad country context. This should be part of a general process of increasing the authority and seniority of Resident Representatives.