The IMF role in low-income countries
Do we need the PRGF?

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24 April 2007

Our key question: ***Should the IMF be providing development finance to low-income countries?***

Background

The IMF commenced concessional (at less than market interest rates) support to low-income countries more than 30 years ago, so this is not a new area of operation. However the mechanisms and the proclaimed goals of IMF activity, including lending, has changed over time. Most are familiar with Structural Adjustment Programmes (SAPs) financed through the Enhanced Structural Adjustment Facility (ESAF) through the 1980s and 1990s.

As a result of much criticism of the ESAF approach, and the hardship it caused to citizens in developing countries, the IMF ended the ESAF in 1999 and began the Poverty Reduction and Growth Facility (PRGF). Michel Camdessus, then managing director of the Bank, declared: "...it is the hard, the demanding, task - it is the honour - of the IMF, even if it is not a development institution, to try continuously to help governments, to be responsive to the cries of the poor. The cries of the poor!"

The PRGF was supposed to have more country ownership (by being based on the participatory PRSP) and supposed to be more focused on poverty reduction (through PSIA and a focus on pro-poor growth). Now 8 years in questions are being raised about the purpose and efficacy of the PRGF and the implementation by IMF staff (detailed below).

But it is important to remember that even before these questions were raised NGOs and some governments were wary about the PRGF and the IMF's role in low-income countries. The IMF's mandate is to: promote international monetary cooperation; facilitate the expansion and balanced growth of trade; promote exchange stability; assist in the establishment of a multilateral payments system; and help members correct maladjustments in their balance of payments through temporary provision of resources.[1] There was a perception that getting involved in concessional lending based on a "protracted balance of payments need" was beyond the mandate of the Fund and that this 'mission creep' would damage the institution.

What role does the IMF play?

IMF operations are generally broken down into three areas: lending, surveillance, and technical assistance. These are not academic distinctions but matter for how the Fund might implement conditionality, how it gives advice and how it funds its operations.

"Surveillance" is the least understood of the terms – it refers to IMF activities to monitor countries' (as well as regional and global) economic performance and encompasses Article IV reports (bi-annual or annual reports on the state of a country's economy) and the Regional and the World Economic Outlook (REOs and WEOs).

In practice though, in LICs surveillance takes on a different function. While in rich countries the information contained in Article IVs may be used by investors, in poor countries, the information provided through surveillance is used as a signal by donors to decide whether and how much to give in aid.[2] Only DFID has an official policy of not strictly following IMF signals, while Norway has an unofficial policy.

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[1] Summarised from Article I of the IMF Articles of Agreement, http://www.imf.org/external/pubs/ft/aa/aa01.htm
[2] For more on this signalling function read Domenico Lombardi's IMF Working Paper, "The IMF's Role in Low-Income Countries: Issues and Challenges", http://www.imf.org/external/pubs/ft/wp/2005/wp05177.pdf

In LICs, surveillance is also carried out more regularly as part of the lending review process. For countries with PRGF loans, they must undergo a review every 6 months, during which time an IMF staff mission visits the country to check on economic, monetary and fiscal indicators. Though officially part of a lending programme, these reviews are the primary information/signalling tools from the IMF that are used by all donors including DFID and Norway to determine the release of aid. The UK and Norway use the information on macroeconomic assessments, but don't strictly follow the IMF's advice on aid absorptive capacity. The reviews also determine the release of IMF resources.

In terms of technical assistance, the IMF provides this in an ongoing fashion that is not reliant on a country having a lending programme. Though usually TA strategies are developed during a PRGF review, they need not necessarily be done on that cycle and could be negotiated during Article IVs or some other such visit. While there may be separate issues with TA provision – monolithic thinking on economic policy and country priorities (to be discussed in the afternoon session on TA/knowledge) – TA should not be used as the reason for continuing IMF lending programmes.

The IMF's medium-term strategy has this to say about the Fund's role in LICs:

> The Fund's strategy for low-income countries requires more work in the following areas: (i) focus and flexibility—the Fund should focus on macrocritical issues tailored to individual country circumstances, broaden its division of labor with the World Bank, and offer more flexible lending facilities; (ii) aid and the MDGs—the Fund needs to assess whether projected aid flows are consistent with macroeconomic stability and the estimated costs of achieving countries' development goals, and also be more forthcoming with donors; and (iii) debt relief—the Fund needs to ensure that the beneficiaries of debt relief do not again accumulate excessive debt. Countries' public expenditure management systems need to be strengthened.[3]

PR or poverty reduction?

One question arises as to the nature of the PRGF – is it really a poverty focused instrument or is it more of the same in terms of structural adjustment and inflexible economic policy. This paper can't cover the evidence on conditionality and its imposition through the ESAF / PRGF. But in terms of PRGF programme design and weighing the potential benefits versus costs, we can ask some important questions.

The IMF's Independent Evaluation Office (IEO) has done two reports of relevance, the 2004 report on the PRGF[4] and the 2007 report on the IMF's role in aid in Sub-Saharan Africa[5]. The latter pointedly raises some concerns about the PRGF not living up to its name. Instead it found that while IMF communications touted the IMF's performance and role in reducing poverty, actual work in the field was more limited to enhanced work on fiscal management. It said the IMF has been following a "business-as-usual" approach and partly blamed this on changes in IMF senior management and a lack of consensus at the board level.

Echoing the findings of the 2004 IEO review, the 2007 IEO report also found serious deficiencies in many aspects of the IMF's analysis and reviews, showing that despite 3 years passing on the first recommendations, still no progress has been made. These are: a lack of use of appropriate PSIA; lack of incorporation of PSIA findings in PRGF design; lack of cross-sectoral analysis on aid absorptive capacity; lack of analysis of cross-sector synergies on long-term growth; poor consultation/participation in PRSPs in relation to macroeconomic tradeoffs; and PRGFs not reflecting what little there is in the PRSPs. The 2007 reports adds poor and non-transparent aid forecasting and incoherence over whether the IMF should be working to mobilise aid. Finally it shows that the IEO does not allow countries to spend aid increases if they are not meeting fairly conservative macroeconomic targets (< 5% inflation and > 2.5 months worth of reserves).

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[3] See the whole strategy at http://www.imf.org/external/np/exr/ib/2006/041806.htm
[4] See BWP summary at: http://www.brettonwoodsproject.org/art.shtml?x=72243; and full report at: http://www.imf.org/External/NP/ieo/2004/prspprgf/eng/index.htm
[5] See BWP briefing attached; and full report at: http://www.ieo-imf.org/eval/complete/eval_03122007.html

One recent debate erupted over the Joint Staff Assessment Notes (JSAN), a programme where the Bank and Fund get together to assess a country's PRSP. The Fund had recently thought it might drop out of the exercise, but this prompted calls of both poor collaboration and a lack of commitment to participation in setting economic policies at the country level. Some NGOs wanted the IMF to stay engaged because they were afraid that the IMF might further marginalise input PRSPs into the PRGF. Still others have wondered why the Fund or Bank should be assessing what are supposed to be "country-owned" documents.

With all these deficiencies in the Fund's work, the questions we might be left with are:
- In cases of LICs with multiple problems and bottlenecks to development, could the IMF be making things worse with their macro-focused conditions?
- With the Fund's lack of expertise and capacity on microeconomic issues are they the right agency to move forward on this?
- Are there other agencies (the Bank, UNDP, UNDESA, etc.) that might be better suited to working on these topics?
- Will the mistrust of the IMF and its seriously deficient governance prevent it from changing to play a positive role in LICs?

Is the IMF providing development finance?

One question is whether the IMF be involved in providing financing to LICs, especially given that their problems are long-term and/or structural in nature and not based on temporary balance of payments needs. In practice though the IMF has continually rolled over loans to LICs through the PRGF, extending repayment times and issues more resources in successive agreements, extending as long as 15 years. While the finance may end up being long-term because of extensions and roll-overs, they are the sort of predictable long-time-horizon financing options that are called for in the Monterrey Consensus.

Both the 2004 IEO evaluation of the PRGF and the 2007 independent report by the Malan committee on Bank-Fund collaboration have said: "the criteria for Fund financing in low-income countries based on the concept of 'protracted balance of payments need' is so vague as to be difficult to distinguish from development finance in practice." But the IMF has repeatedly said that it is not a development finance institution.

In fact, a cursory review of PRGF disbursements finds them to be incredibly small compared to the investment needs of LICs. For example the recent PRGF disbursement to Kenya was just about $9 million, hardly a very large sum. Part of the reason is that countries have moved to borrowing less from the IMF but maintaining IMF programmes for the signalling function. This also informed the creating of the Policy Support Instrument (PSI), basically a PRGF that has no money associated with it. The greatest concern there is that the PSI still contains conditionality, including structural and privatisation conditions[6].

There is also a question of who is paying for the PRGF and PSI financing, missions, reviews and expenses. The PRGF Trust, with contributions from donors, actually only finances the interest concessions on the loans, ie the difference between the interest paid by LICs and the interest payments on the money borrowed by the IMF from donors. The administrative expenses of the PRGF were previously paid for by the IMF's general administrative budget. That budget comes from interest payments by middle-income countries to the IMF on the loans given from the IMF's general resources account. Many authors, including the recent independent report from the Crockett committee[7], have criticised these cross-subsidies. Middle-income countries have long complained about the inequities in IMF finance and seem keen to use the Crockett report to finally end the cross-subsidies at the IMF.

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[6] For more discussion of the PSI see the BWP article: "Reading from the Script: the IMF's PSI invades Africa", at http://www.brettonwoodsproject.org/art.shtml?x=548931

[7] For a more thorough review of the Crockett committee's report see the BWP article on it "Putting the cart before the horse", at http://www.brettonwoodsproject.org/art.shtml?x=550974

Potential alternatives

The IMF budget crisis prompted the Crockett report to examine the IMF's income. But feedback we have received from Washington is that the G7 is unanimous that they want to examine income and expenses together – thus the IMF board will be reconsidering the IMF's roles and mandate over the next year. So we have an opportunity to put forward alternatives.

If we believe that the IMF has some role in LICs, how can we envision it? Some key ideas:

- Countries may want IMF advice on monetary and macroeconomic policy;
- But countries do not necessarily need IMF financing, especially with benevolent capital and commodity markets and alternative donors like China;
- Overall resources could be maintained if the PRGF trust's funds was shifted to IDA;
- IMF technical assistance operates separately from the lending programmes and continues regardless of a programme being in place, it should be led by country priorities;
- The IMF's signalling role is problematic because the IMF's economic model may prioritise macroeconomic stability and low inflation over growth, employment and poverty reduction;
- IMF conditionality, while often cited as a useful tool by and for LIC finance ministers to control their budgets in the face of internal demands (unions, line ministries, business lobbies), actually undermines democratic governance and accountability.

Could we not envision the IMF providing advice/surveillance that members can use on a take-it-or-leave-it basis (much as the Article IV reports are treated for rich countries) as well as technical assistance that countries are free to choose to use or not as it fits their priorities?

There are two main counters to these arguments:
(1) that providing finance keeps the IMF engaged (which is presumed to be a good thing) in LICs since the Fund's money is at stake. Some have argued that ordinary surveillance does not elicit as much interest and scrutiny from the Fund and that programmatic interaction (PRGF, PSI etc) are needed for the Fund to give top-quality advice. This seems unconvincing, to both officials and many NGOs; and
(2) the IMF could be used as a tool to promote poverty reduction and to make sure that macroeconomic policy is creating pro-poor growth. Essentially it comes down to the question: Do we think the leopard can change its spots?

We also shouldn't make such policy pronouncements in a vacuum without considering what our partners in low-income countries are saying. One important development is the IMF Sink It or Shrink It campaign, a global platform/campaign against IMF conditionality and economic policy. The campaign calls for an end to the PRGF and the campaign statement carries the signature of more than 80 civil society organisations globally. Though the campaign is nascent in setting targets and objectives, it looks to be kicking off in more active fashion later this year. Will UK NGOs be supporting this effort through advocating an end to the PRGF?