SPEAKING NOTES FOR PRESENTATION AT THE

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'DEVELOPING COUNTRIES,

GLOBAL FINANCE

AND THE ROLE OF THE IMF:

TOWARDS A NEW RELATIONSHIP?"

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*THE ROLE OF THE IMF IN LOW-INCOME COUNTRIES** **Louis Kasekende**

Fund-supported programs in low-income countries have been evolving since mid-1990s, beginning with the shift in emphasis from financial and exchange rate adjustment to the need to ensure long-term growth as a central goal of economic reform. That was the basis of the establishment of the Structural Adjustment Facility in 1996, and its successor the Enhanced Structural Adjustment Facility in 1987, which attempted to focus on medium-term as opposed to short-term interventions of the traditional Stand-by arrangement. Many low income countries receive Fund assistance through these instruments. Of the countries that had arrangements under the SAF/ESAF between 1986-1993, fifteen were Sub-Saharan African countries.

Several reviews have been conducted on the effectiveness of programs supported by these facilities. An external panel commissioned by the Fund in the mid-1990s reviewed the role of ESAF. Fund staff have also done studies on the impact of fund-supported programs in Africa (e.g Fund Occasional Paper No. 106; 139;143). These should have provided lessons for the Poverty Reduction and Growth Facility, which followed the ESAF, the basic goal of which was not only to improve growth performance in low-income countries, but also bring about a more rapid reduction in poverty in a more direct way.

Two papers have been presented at this conference namely, "T he IMF and Poor Countries: Towards a More Fulfilling Relationship" by Graham Bird, and "The Role of the IMF in Low Income Countries" by Mathew Martin and Hannah Bargawi. The two papers are yet another contribution to the debate of the potential role of the IMF in low income countries (LICs). There is an admission in the papers that the relationship has fallen well short of addressing problems faced by LICs and that the perennial issue of the design of Fund-Supported Programs remains critical. Some have adopted an extreme view that the Fund is not suited for addressing the protracted problems faced by LICs while others have focused effort on reforming the instruments and program design to make them more amenable to the challenges facing the LICs especially Africa.

Africa, in particular, presents challenges to the development world. A number of countries in Africa are unlikely to meet the MDGs; a very big proportion of population live on less than one dollar a day and poverty in absolute terms is on the rise; economies remain fragile; very little diversification has taken place; export concentration is mainly in primary commodities; markets are largely dysfunctional; Africa remains highly vulnerable to climatic and terms of trade shocks, and aid shortfalls; and Africa is faced with an AIDS epidemic. It is against these stark realities that we engage in a re-examination of the role of IMF in LICs. Is it realistic to talk about counter-cyclical lending by the IMF to LICs or should focus be more on addressing constraints to growth?

Program Design

I agree with the view in both papers that the circumstances in LICs are complex and it is such complexity that is at the heart of the debate surrounding the IMF's involvement in both developing and emerging markets. What assumptions should be made in program design? What is the appropriate relationship between fiscal deficit and inflation? What is an acceptable level of deficit that can be financed sustainably? Will restraining government in the domestic market free up resources for lending to the private sector? What targets for the monetary anchors are appropriate for inflation control, growth and poverty reduction? What level of inflation is appropriate for sustainable growth? Can we talk about fiscal flexibility when most of the spending is committed to civil service, wages, defence and social spending which are difficult to cut? The list of questions is endless and the answers are largely elusive. The chances of getting it wrong are high, partly explaining the over-optimism reflected in the programs. There is also an element of countries agreeing to a sub-optimal IMF program as a gateway to financial resources from Multilateral Development Banks (MDBs) and bilateral donors. I also recognize that in an effort to present a fully funded programme, staff at times make unrealistic assumptions about export growth, fiscal correction, economic growth and aid delivery.

Both papers call for more realism and flexibility in program design. Martin and Bargawi propose that PRGF should spring from PRSPs and not vice-versa—in terms of holding to the GDP growth and budget spending needed

to attain the MDGs and national goals defined in the PRSPs, and limiting structural conditions to those contained in the PRSP. Bird also recognize the need to strengthen ownership. I strongly support strengthening of country ownership and the PRSPs becoming the basis for design of programs and resources mobilization. Efforts should therefore be made to make PRSPs more realistic and broad enough to encompass the development challenges facing a country. But I have to express doubts to the proposal of basing IMF PRGF on what it takes to attain the MDGs and also the recommendation that macroeconomic forecasts can be improved to avoid shocks. What is more likely is for the IMF to ease on conditions necessary for absorbing external assistance, especially grants and the fiscal space required for stepping up investment in the physical infrastructure. On the latter issue, given the weaknesses of private investments in infrastructure, public investment in infrastructure is necessary for supporting private sector led growth.

The tension between short term stabilization and medium to long term growth will continue bogging our minds. It will also be complicated by the tension between financing needs for MDGs and the objectives of attaining debt sustainability. Given the weaknesses in economic relationships pointed out above, the IMF should be more flexible in program design and react as problems reveal themselves as opposed to setting unrealistic monetary and inflation targets as a means to delivering on short term stabilization requirements. This will push the IMF in the direction of designing programs on a case by case basis. Such programs should be cognizant of ownership and political realities. Many times governments delay programs especially in areas of privatization and opening up to foreign participation because of political expediency. There are also times government prefer labeling a sensitive reform as "IMF inspired" as a means to restraining political opposition. The Fund has also a critical and beneficial role to play in post conflict countries and Low-Income Countries Under Stress (LICUS) as efforts are made to restart growth, for example in the case of Uganda in 1986. This role could involve strengthening the hand of the pro-reformers against opposition to adjustment. There is also a signaling role for the IMF especially to re-assure creditors that external financing or debt relief will be used productively. But there is need for caution; Bilateral donors could withhold aid during program implementation for reasons associated with under-performance on short term indicators. This will

introduce unwelcome volatility in aid delivery. What is required is predictability in aid flows and not disbursements based on progress in negotiations or failure to fulfill certain benchmarks. I hasten to add that this is not intended to weaken selectivity between good and poor performers or between poor and sound policies. It is intended to provide for more protracted engagement before aid is withdrawn and judgment by bilateral donors independent of the IMF.

This brings me to the case of prolonged users of Fund resources wishing to graduate from PRGF. It should be possible for the Fund, under its surveillance, to monitor performance of such countries against an agreed set of benchmarks plus providing an endorsement which may be required by the market or creditors. Similarly, there are LICs that do not fall in the category of prolonged users of Fund resources and are not interested in entering into negotiations for a PRGF. Such countries would wish to design and implement a sound macroeconomic framework. Again, the IMF could under its surveillance provide endorsement of the macroeconomic framework without providing for drawing of resources.

Conditionality

Donors have expressed a desire to reduce and harmonize conditions as means to promoting ownership and program effectiveness plus reducing transaction costs on the client countries. It is therefore disappointing that donor harmonization and streamlining of conditionalities has not fully materialized. It is equally disappointing to learn that there is a proliferation of conditions in recent years in areas of governance, transparency and anti-corruption measures (Martin and Bargawi). In view of my earlier argument in favour of PRSP as the central document to inform programs, I lend support to those who argue that "Fund recommendations should NOT be performance criteria unless if alternative policies chosen by government had been shown not to work" (Bird). Client countries should be allowed to design benchmarks that can be used to monitor implementation of the PRSP. Such benchmarks would then be a source of performance criteria for agreed programmes and surveillance.

Programme Consistency

As indicated above, there are tensions and distortions that emerge during programme implementation. There are tensions between short term stabilization on one hand and debt sustainability and medium and long term development requirements on the other. Some countries in an effort to reach the HIPC completion point forego access to much needed loan resources, including concessional resources, required to support the implementation of PRSP. There are also countries that have fully liberalized their financial sector but are yet to enjoy benefits in form of more competitive pricing of financial instruments (Uganda, Tanzania) and enhanced access to loan products by the private sector. Real interest rates in double digit figures are common in Africa and constrain access to loan resources by the private sector.

The domestic debt problem is undermining fiscal sustainability in a number of countries. The problem is in part associated to mopping up efforts of the local currency injections by central banks as aid resources are spent. There have also been cases where countries end up with a domestic debt problem due to limited fiscal flexibility in face of withdraw of aid resources. Equally challenging is the widening of the budget and current account deficits (excluding grants) as donor dependency increases. There is the associated Dutch disease effects (Martin and Bargawi, and Bird) that is threatening export diversification. The IMF and the World Bank should jointly apply their intellectual capacity to analyze the tensions and distortions in the macroeconomic framework as the PRSPs are implemented. Equally important, is guidance to client countries in dealing with booms and busts. On this note of external shocks, I do not agree with the statement by Bird that "insurance is a luxury good that poor countries may not be able to afford". In light of the vulnerability to external shocks, countries should be encouraged to buy insurance against shocks. The Bank and fund should share more widely the results of the pilots in the area of insurance against shocks.