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Enhancing the Credibility of the IMF

Louis Kasekende

I agree with Graham Bird that these issues of the role of the IMF in low-income countries have been with us for a long time. You may recall the shift in the 1970s and 1980s from structural adjustment to the Enhanced Structural Adjustment Facility (ESAF), which was an attempt to focus more on the persistent problems rather than the short-term interventions that where typical for the traditional stand-by arrangements. From 1986 to 1993, 15 countries in Africa had ESAF programmes. Over the years, the IMF has compiled a list of lessons learned. These culminated in placing poverty at the centre of reform programmes in the Poverty Reduction Growth Facility (PRGF).

I believe there is a role for the IMF in the low-income countries. I do not support the extreme view that the problems in developing countries should be dealt with by the World Bank alone. This is partly because of my own experience in Uganda. Our main challenge is finding the proper instruments.

Programme Design: The Chances of Getting it Wrong

Africa presents major challenges to the development world. One is that a number of the African countries are unlikely to meet the Millennium Development Goals. A large proportion of the population lives on less than one dollar a day, and absolute poverty is on the rise. The economies remain very fragile; there is little export diversification, exports remain concentrated on primary commodities, and markets are largely dysfunctional. Africa also remains highly vulnerable to climatic and terms of trade shocks. Then we have issues of aid shortfalls, not to mention AIDS. This is the stark reality that one has to consider when looking at the role

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of the IMF in low-income countries. The question is whether it is realistic to talk of counter-cyclical lending by the IMF, given these stark realities, or is it more realistic to talk about *constraints* to growth.

Let me start with the programme design. I agree with Graham Bird that the circumstances are very complex, and the complexity is at the heart of the debate surrounding IMF's involvement. Given the stark realities I just described, the first issue is what assumptions can one make if we are going to design a programme. What is the appropriate relationship between the fiscal deficit and the rate of inflation? What is the acceptable level of a deficit that can be financed sustainably? Graham says that there is agreement on some of these issues, but my experience working at the central bank suggests that many of these questions have no easy answers.

We are restraining governments in the domestic market, especially the government's borrowing from the domestic markets, without freeing up resources for the private sector. It is assumed that once you restrain the government's expenditures, commercial banks would be awash with the resources and will start lending to the private sector. But the reality in most cases is very different from that.

What targets for the monetary anchors are appropriate for inflation control, economic 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, defense, wages and social spending? When we talk about fiscal flexibility and demand management, how can we expect re-adjustments when most of the expenditure is on priority areas or areas that are difficult to cut? Just as Graham Bird's chapter shows, the list of questions is endless and the answers are largely elusive.

The chances of getting it wrong are quite high. Maybe this explains the over-optimism reflected in the IMF programmes. Graham mentioned that over-optimism might lead to under-financing the programmes, but I think part of the over-optimism results from the extreme difficulty of getting the correct answers to a number of these questions.

There is also the issue of countries agreeing to sub-optimal policies because their objective is just acquiring the resources. They want to reach an agreement quickly with the IMF so that they receive financial resources from the multilateral development banks and the bilateral donors. There are incentives on both sides that make the outcome of programmes highly unpredictable.

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Programme Design: The Need for Realism and Flexibility

I recognise that the IMF makes an effort to present fully funded programmes. The IMF staff attempts to make realistic assumptions about export growth, fiscal expenditures, economic growth and aid delivery. Nonetheless, there is a call for more realism and more flexibility in programme design. In my view, however, the realism should come, first of all, from more commitment to the programmes by the countries themselves.

I support the idea that the PRSPs should be the basis in programme design. I do not think that we shall get to a point where attaining the Millennium Development Goals and all of the objectives as defined in the PRSPs will fully drive the IMF programmes. I think that is stretching our expectations too far. But what I am talking about is making sure that the IMF uses the PRSPs as a way of strengthening ownership by the countries themselves.

If we are going to use the PRSP, efforts should be made to make the PRSP itself more realistic and broad enough to encompass the development challenges facing a country.

This leads me back to the issue of the role the IMF can play if the PRSP is the basis. The IMF could ease the conditions necessary for absorbing external assistance, especially grants, and the fiscal space required for increasing investments in physical infrastructure.

The problem most of the countries face is a tendency to place over-reliance on the private sector to take up investments in physical infrastructure. This rarely happens. Therefore, if you present a very tight programme, you will frustrate the government because the government cannot improve the infrastructure, which is required for supporting private sector-led growth. The IMF could assist governments and provide that fiscal space, so that governments can make investments in the public sector.

There is a debate, mainly in the Latin American countries, where profitable public corporations can be taken out of the budget and can even borrow directly in the market. Instruments like this, which are innovative, may be required for even the low-income countries.

Another big issue in programme design is the tension between short-term stabilisation and medium to long-term growth. I think this issue will continue to bog our minds; it will also be complicated by the tension between the financing needs for Millennium Development Goals and the objective of obtaining debt sustainability. This is one of the issues that we have been talking about in the World Bank. Once you bring in debt sustainability, especially as both the IMF and the World Bank have proposed it, you end up constraining the resource envelope or the type of resources that countries can assume. For those countries with a very low debt-carrying capacity, you start talking about grants as the only source of financing.

Given the weaknesses in the economic relationships that I have pointed out, the IMF should be more flexible in programme design and react as problems reveal themselves, as opposed to setting unrealistic monetary and inflation targets as a means to deliver short-term stabilisation. This will push the IMF in the direction of designing programmes on a case-by-case basis. Even though this is something we always talk about, I am bringing it back again: the need for a case-by-case approach.

Programmes should recognise ownership and political realities. Many times governments delay programmes, especially in areas of privatisation and the opening to foreign participation, because of politics. If you do not recognise this in the design, you might include items in the programme that the countries will never implement.

Then there are cases where governments want to use the IMF as a scapegoat, I think the IMF should exploit that because it is the government that wants to go ahead and implement a certain policy.

The Signaling Role of the IMF

Let me turn to low-income countries under stress, and post-conflict countries. I see a strong role for the IMF in these countries because in most cases, they lack credibility. Take those countries that are just getting out of a war: Liberia, Angola, and Uganda in 1986. There is a need for some sort of seal of approval for these countries to re-engage with the international community. There is a need to reassure the creditors that external financing or debt relief will be used productively.

This takes me to the issue of the signaling role. I have to sound a word of caution on this particular issue because there are times when bilateral donors end up withholding assistance during programme implementation because of protracted negotiations of a country with the IMF. Malawi comes to mind, as does Zambia where aid was suspended. It tends to introduce unwelcome volatility in aid delivery, especially if derailment is on short-term benchmarks. Aid that is supposed to support a country in the medium and longer-term projects is withheld. It complicates macroeconomic management given that there is little fiscal

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flexibility in most of these countries. They cannot cut wages; they cannot cut defense, and they cannot cut social spending. Therefore, you end up with countries accumulating a huge domestic debt and by the time you re-engage, you have an additional problem of a huge domestic debt. That is one of the issues that we are dealing with in some countries, specifically in Malawi.

This is not to say that we should weaken selectivity between the good and the poor performers or between poor and sound economic policies. But I would encourage bilateral donors to make more independent judgment as to whether to withdraw aid, especially during programme implementation. Something serious must occur before aid is withdrawn. Countries need more predictable aid rather than suspension of donor disbursements as soon as the IMF signals that that there are problems in the negotiations.

Signaling also plays a role for two other categories of countries. First, you have the countries that are prolonged users of Fund resources, who wish to graduate from the PRGF and still require some signaling role by the IMF. We can find ways of using enhanced surveillance for such countries. The monitoring of the performance of such countries again starts with setting benchmarks plus providing an endorsement that may be required by the market or the creditors. Second, there are countries that are not in the category of prolonged users of Fund resources, like Nigeria, who wish to design their own programme but need an endorsement by the IMF to be able to proceed with debt rescheduling in the Paris Club. The Paris Club should accept such an endorsement and proceed with debt restructuring.

Conditionality and Improving Programme Consistency

Streamlining conditionality and improving programme consistency among donors has been talked about a lot and it is therefore disappointing that it has not yet fully materialised. The proliferation of conditions in recent years in areas of governance, transparency and anticorruption measures is equally disappointing. In view of my earlier argument in favour of PRSPs as a central document to inform programmes, I support those who argue that Fund recommendations should not be performance criteria. Client countries should be allowed to design benchmarks that can be used to monitor the implementation of PRSPs. Such benchmarks would then be a sort of performance criteria for agreed programmes and surveillance.

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The last set of issues has to do with programme consistency. A large number of distortions and tensions emerge during the implementation of programmes. There are tensions between short-term stabilisation, on the one hand, and debt sustainability in the medium and long-term development requirements, on the other. In an effort to reach the HIPC completion point, some countries forgo access to the much-needed long-term resources, including concessional resources. This is the case of Ethiopia and Rwanda. There are also countries that have fully liberalised their financial sector but have yet to enjoy benefits in the form of competitive pricing of financial instruments, i.e. Uganda and Tanzania. Real interest rates in double-digit figures are common in Africa in general and constrain access to long-term resources by the private sector. Moreover, there is the complex issue of the domestic debt problem, which is undermining fiscal sustainability. So there are quite a number of problems and the IMF and the World Bank should jointly apply their intellectual capacity to analyse these tensions and distortions in terms of their role in developing countries.

I appeal to the IMF and the World Bank to work together to analyse the tensions and distortions in the macroeconomic framework as PRSPs are implemented. One important issue is exchange rates because countries that have been recipients of aid are now faced with appreciating currencies that constrain export diversification.

Equally important is the guidance to client countries in dealing with booms and busts. I was in the research department of the central bank of Uganda when we had a boom, a coffee boom, in 1994, and we received conflicting advice from the World Bank and the IMF. The World Bank wanted us to pass all of the benefits to the farmers since they are good managers of these windfall receipts, while the IMF wanted us to build up reserves during this period by maintaining a very tight budget. To enhance their credibility, the IMF and the World Bank should develop one common view on how to deal with booms and busts. Client countries have limited intellectual capacity to process such conflicting information from the two institutions.

There is one point in Graham's chapter that I disagree with. He says that insurance is a luxury good that poor countries may not be able to afford. I disagree. There is room for insurance to deal with terms of trade shocks. Work has been done on this issue, especially by the World Bank, and the results of the pilot projects need to be shared more widely with the countries.

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