United States General Accounting Office

GAO

Report to the Chairman, Committee on Foreign Relations, U.S. Senate

May 2001

INTERNATIONAL MONETARY FUND

Few Changes Evident in Design of New Lending Program for Poor Countries

GAO

Accountability * Integrity * Reliability

GAO-01-581

Contents

Letter 1

Executive Summary 2

Chapter 1 **Introduction** 12
- Financing of and Eligibility for the IMF's Concessional Loans 12
- The IMF Focuses on Macroeconomic and Structural Issues 14
- The IMF's Increased Focus on Social Issues 15
- Criticisms of the IMF 16
- The New Facility Is to Focus More Explicitly on Poverty Reduction 17
- Objectives, Scope, and Methodology 21

Chapter 2 **The Design of the IMF's New Program Differs Little From Its Previous Program** 24
- Most of the Announced Modifications Represent a Change in Emphasis Rather Than a Change in Philosophy 24
- Widely Accepted Goal of Maintaining Macroeconomic Stability Limits Potential Changes Under the Program 30
- Developing a Nationally Owned Macroeconomic Framework Is Difficult 35

Chapter 3 **Few Changes Evident in Three Countries' Programs** 39
- Inclusion of Some Elements Difficult to Attribute to New Program 39
- Difficulties Establishing National Ownership of Macroeconomic Framework 44

Chapter 4 **The Effects of the New Program on Graduation and the Role of the IMF** 47
- Strong, Sustained Economic Growth Essential to Reach Consideration for Graduation 47
- The IMF Has Been a Long-term Lender to Low-income Countries 52

Appendix I **Identifying the Impact of Different Policy Choices Is Difficult** 55

Appendix II **Key Events and IMF Programs in Albania, Benin, and Honduras** 59

Appendix III **Comments From the Department of the Treasury** 66

Appendix IV **Comments From the International Monetary Fund** 67

Appendix V **GAO Contact and Staff Acknowledgments** 72

Tables

Table 1: The Fund's Stated Focus on Poverty Reduction, Government Leadership, and Civil Society Participation 26
Table 2: Inclusion of PRGF Elements in Three Countries' IMF Programs 40
Table 3: Projected and Previous Annual Growth Rates for 32 PRGF Borrowers 50
Table 4: Number of Years 32 Countries Received IMF Resources 53
Table 5: Key Events in Albania, 1991-2001 60
Table 6: Key Events in Benin, 1960s-2001 62
Table 7: Key Events in Honduras, 1992-2000 64

Figures

Figure 1: Disbursements of IMF Concessional Loans by Region, 1986-2000 14
Figure 2: Elements of a Macroeconomic Framework in Support of the PRGF's Twin Goals of Poverty Reduction and Growth, in a Context of Macroeconomic Stability 32
Figure 3: Complex Linkages Between Increased Spending on Education and Health and Goals 56

Abbreviations

ESAF	Enhanced Structural Adjustment Facility
GDP	Gross domestic product
IDA	International Development Association
IMF	International Monetary Fund
PFP	Policy framework paper
PRGF	Poverty Reduction and Growth Facility
PRSP	Poverty Reduction Strategy Paper

GAO

Accountability * Integrity * Reliability

United States General Accounting Office
Washington, DC 20548

May 8, 2001

The Honorable Jesse Helms
Chairman, Committee on Foreign Relations
United States Senate

Dear Mr. Chairman:

This report responds to your request that we (1) analyze how the International Monetary Fund's new Poverty Reduction and Growth Facility is designed to be different from the Fund's Enhanced Structural Adjustment Facility, (2) assess what has actually changed in recipient countries' programs, and (3) evaluate whether the changes implemented in the new program increase the likelihood of recipient countries graduating from (that is, no longer being eligible for) concessional borrowing in less than 15 years or have contributed to a more short-term lending focus for the Fund.

We are sending copies of the report to the Honorable Paul H. O'Neill, Secretary of the Treasury; the Honorable Colin L. Powell, Secretary of State; the Honorable Horst Köhler, Managing Director of the International Monetary Fund; the Honorable James D. Wolfensohn, President of the World Bank; and other interested parties. Copies will also be made available to others on request.

Please contact me at (202) 512-4128 if you or your staff have any questions concerning the report. An additional GAO contact and staff acknowledgments are listed in appendix V.

Sincerely yours,

Harold J. Johnson
Director, International Affairs and Trade

Executive Summary

Purpose

The effectiveness and appropriateness of the International Monetary Fund's lending programs to poor countries have been widely debated.[1] This debate has centered on whether Fund programs have improved countries' economies and whether the potential negative impacts of its programs on the poor have been sufficiently considered. Some have also argued that the Fund should return to its initial mandate of lending on a short-term basis to countries experiencing crises and end its support of the longer-term reform programs of low-income countries.

In response to some of these concerns, and as part of a concerted international effort to reduce poverty, in September 1999 the Fund expanded the goals of its lending program to its poorest members to include an explicit focus on poverty reduction. In November 1999, to underscore this focus, the Fund renamed its concessional lending program from the Enhanced Structural Adjustment Facility to the Poverty Reduction and Growth Facility. In December 1999, the Fund's Executive Board asked Fund staff to begin implementing the process quickly, recognizing that it would involve a substantial degree of experimentation and innovation.[2]

Under this new focus, the economic and structural measures in Fund-supported programs are to emerge directly from each country's own priorities for reducing poverty, determined through a government-led, broad participatory process that includes representatives of civil society (including the poor),[3] parliament, and donors, based on each country's unique circumstances. In this way, policies aimed at poverty reduction could have a direct impact on the design of the macroeconomic

[1]The International Monetary Fund, supported by its 183 member governments, promotes international monetary cooperation and exchange rate stability and provides lending to member countries that experience balance-of-payments difficulties. The Fund lends money to low-income members on concessional, or below-market, terms in order to support programs to strengthen their balance-of-payments positions and to foster growth. A country's balance-of-payments accounts summarize its financial dealings with the outside world.

[2]The Fund operates under the authority of the Board of Governors, the highest decision-making authority. General operations are delegated to a smaller group of representatives, the Board of Executive Directors, who are responsible for making policy decisions and approving loans. The Board comprises 24 Executive Directors who are appointed or elected by one or more member countries.

[3]"Civil society" refers to the nongovernmental segment of society and includes churches, community groups, trade unions, business associations, and organizations that advocate for specific causes, such as human rights and environmental protection.

framework (that is, economic policies, targets, and structural reforms) that seeks to promote faster, sustainable economic growth.

The Chairman of the Senate Committee on Foreign Relations asked GAO to evaluate what the Fund has changed about its lending program for its poorest members since it announced the Poverty Reduction and Growth Facility; specifically to (1) analyze how this new program is designed to be different from the previous program, (2) assess what has actually changed in recipient countries' programs, and (3) evaluate whether the changes implemented in the new program increase the likelihood of recipient countries graduating from (that is, no longer being eligible for) concessional borrowing in less than 15 years or have contributed to a more short-term lending focus for the Fund.

To address all three issues, GAO analyzed a wide range of documents from the Fund, the World Bank,[4] recipient and donor governments, U.N. organizations, and nongovernmental organizations. GAO also interviewed officials from these organizations in the United States and abroad. To analyze whether the design of the new program differs from the old, GAO examined Fund statements describing the key elements of the new program and compared them to Fund statements and analyses regarding the Fund's previous program. GAO's findings regarding program design derive from this analysis and are not based on individual country experiences. To address the second issue, GAO selected and visited three countries for case studies—Albania, Benin, and Honduras—that met the following criteria as of September 30, 2000: they had a current Fund program and relatively consistent performance under this program, were expected to have full poverty reduction strategies by mid-2001, and had been reviewed by the Fund under their current and previous Fund programs. GAO did not generalize from the experience of these countries to draw conclusions about overall implementation issues. Instead, the case studies are examples of how countries are addressing the design challenges identified in the first objective.

Background

Since 1976, the Fund has provided loans on concessional terms[5] to eligible low-income members in order to strengthen their balance-of-payments

[4]The World Bank, supported by its 182 member governments, promotes economic growth and the development of market economies by providing financing on reasonable terms to countries that have difficulty obtaining capital.

[5]The lending terms include a 5-½ year grace period, 10-year maturity, and annual interest rate of 0.5 percent.

positions and support their reform programs. In order to receive loans, countries agree to implement macroeconomic and structural reforms.[6] These loans have been funded primarily with the profits from the sale of some of the Fund's gold holdings and contributions (loans or grants) from member countries.[7] Eligibility for these concessional loans has been based mainly on a country's per capita income and eligibility for World Bank concessional lending. The terms of the loans have remained the same, while the purpose of the loans has expanded from balance-of-payments assistance to fostering lasting growth that leads to higher living standards and a reduction in poverty.

The Fund provides advice on macroeconomic issues such as achieving and maintaining stability.[8] At the same time, the Fund seeks to integrate social policies into its programs and advice, with the World Bank taking the lead on these issues. As of February 21, 2001, 34 of the 77 countries eligible for the Poverty Reduction and Growth Facility had current loan commitments totaling more than $4 billion. Twenty-two of the 34 countries are in sub-Saharan Africa.

Results in Brief

Although the design of the International Monetary Fund's Poverty Reduction and Growth Facility does not differ significantly from the Fund's previous program, certain elements of the new program are emphasized more now than in the past. GAO observed that most of the changes announced for the new program were also pursued under the previous program. The one major design change—getting countries to take ownership of their macroeconomic framework—is difficult to achieve for three reasons. First, the limited capacity of many recipient governments to

[6]Programs cover a period of 3 years but can be extended to a fourth year. Loans are disbursed either quarterly or semi-annually. The Fund makes the first disbursement after it approves the arrangement. The Fund releases the next disbursements after it completes reviews of the program, determining that the country has satisfactorily met its performance requirements. These requirements generally include macroeconomic indicators and important structural measures.

[7]These resources are separate from the Fund's other resources such as the quota contributions of its members.

[8]Macroeconomic stability exists when key economic relationships are in balance, for example, between domestic demand and output, the balance of payments, fiscal revenues and expenditure, and savings and investment. These relationships need not necessarily be in exact balance. Imbalances such as fiscal and current account deficits or surpluses are perfectly compatible with economic stability provided that they can be financed in a sustainable manner.

independently analyze and effectively negotiate the macroeconomic framework reduces the opportunity for country-specific elements to be addressed. Second, the challenges to effectively engaging civil society in a dialogue on these very complex matters are significant. Finally, a national dialogue on the choice of effective policies is hampered by the limited knowledge of all parties about how different policies actually affect elements of the macroeconomic framework. Considering the above difficulties, civil society may not be able to influence the macroeconomic framework through the initial poverty reduction strategy; however, civil society may help improve the allocation of resources and increase the amount of resources donors are willing to provide by helping establish priorities for poverty reduction. Even if national ownership increases, given the need for poor countries to maintain macroeconomic stability, which is essential for economic growth and poverty reduction, the actual policies and targets within the macroeconomic framework are not likely to be altered substantially from the past.

GAO found few changes in the Fund programs of the three countries reviewed—Albania, Benin, and Honduras—that can be clearly attributed to the changes that the Fund announced in 1999. Most elements of the Fund's new program were also included in countries' previous programs, making it difficult to determine to what extent these elements reflect the announced changes in the Fund's approach rather than the direction the country's program was moving in prior to the new program. Nonetheless, the three countries faced several difficulties in developing a nationally owned macroeconomic framework. First, each government has limited capacity to independently analyze macroeconomic issues. Second, while all three governments have begun a dialogue with civil society, many people that GAO spoke with were unsure how to use this dialogue to address the countries' complex macroeconomic policies and targets, other than the composition and level of spending. Finally, GAO did not see evidence of changes in the three countries' Fund documents that were called for under the new program. These changes include showing that before reforms were implemented, their social impacts were assessed and measures to alleviate any negative impacts were put in place.

If the changes announced by the Fund for its lending program to its poorest members actually improve the overall effectiveness of a country's development program, the likelihood of earlier graduation from the Fund's program could increase. However, the impact of these changes on economic growth is unknown at this time. GAO's analysis shows that most of the current recipients of the Fund's concessional assistance will require strong, sustained economic growth to reach the point of graduation from concessional Fund assistance. To reach this point within 15 years, the 32 countries that borrowed from the Fund's concessional facility in 2000 must average a real per capita income growth in excess of 6 percent annually during that entire period, a growth rate that significantly exceeds the countries' average growth rate of negative 1 percent over the last 15 years. Unlike the Fund's nonconcessional facilities that are to lend resources based on short-term conditions, the concessional facility does not assume that countries will have only a temporary need for assistance. During the past 15 years, the Fund has functioned as a long-term lender that supports countries' reform programs, and indications are that it intends to retain this role.

The Treasury said that GAO's report addresses a number of important issues concerning the Fund's concessional lending to poor countries. The Fund did not disagree with GAO's findings regarding the design of the Poverty Reduction and Growth Facility but stated that GAO's report could have been more positive in its judgments.

Principal Findings

The Design of the Fund's New Program Differs Little From Its Previous Program

Most of the Announced Modifications Represent a Change in Emphasis Rather Than a Change in Philosophy

The design of the Poverty Reduction and Growth Facility does not differ significantly from the Enhanced Structural Adjustment Facility because the new program includes elements that have been pursued under the previous program for a number of years. One change in the new program—that the macroeconomic targets and policies in Fund programs will emerge from a government-led process involving civil society and donors—could be a major departure from how the macroeconomic framework has been traditionally chosen. However, even this builds on features that the Fund has discussed and pursued for some time.

This commonality does not necessarily mean that the new program is identical to the previous program, since the new program envisions consolidating the program elements into a single framework and giving them greater prominence. GAO believes that such a change represents a shift in emphasis rather than a change in the Fund's stated philosophy, with signs of this shift evident over the past few years. Yet the Fund has had difficulties achieving some of these program elements. For example, since at least 1987, ownership by the recipient governments of their Fund programs has been seen as an important element in successful program implementation. However, the main vehicle to achieve this—the policy framework papers—has been generally developed by the staff of the Fund and not by the countries themselves. Under the new program, the governments are to write the new poverty reduction strategies themselves. According to Fund staff, the Fund's Executive Board could endorse strategies that contain elements that the Fund does not agree with. However, the significance of this change is uncertain, since the Board must endorse a country's overall strategy in order for the country to borrow from the Fund.

Widely Accepted Goal of Maintaining Macroeconomic Stability Limits Potential Changes Under the Program

The Fund and the World Bank consider macroeconomic stability to be a necessary prerequisite for economic growth and poverty reduction, although not sufficient on its own to achieve those goals. Countries that experience macroeconomic instability, such as high inflation rates, have tended to have low or even negative economic growth rates. This concern over the negative effects of macroeconomic instability underlies the Fund's continuing goal that a country's macroeconomic framework should work to maintain stability, once achieved. However, policies that are overly concerned with macroeconomic stability may turn out to be too austere, lowering economic growth from its optimal level and impeding progress on poverty reduction. According to Fund and World Bank documents, there is a "substantial gray area" between those policies that may be considered too austere and those that cause macroeconomic instability. Presumably, one goal of including the macroeconomic framework within the national poverty reduction dialogue would be to explore this gray area to establish an effective mix of policies consistent with the medium-term goals of the country.

Based on GAO's analysis of numerous documents and discussions with Fund and World Bank officials, it is difficult to determine whether in fact there is a "substantial" range of macroeconomic policy targets to be discussed and explored within this so-called "gray area." This is due to two factors. First, precise identification of the bounds of the gray area is beyond the current understanding of the economics profession. For example, many economists, including some at the Fund, think that inflation above a 7 to 11 percent range is risky, whereas others think the level can be between 20 and 40 percent before it starts to endanger economic growth. Second, the harsh economic realities confronting these very poor countries also work to limit the choice of policies or the amount that spending can be prudently increased over a short period of time. Both of these factors are strongly influenced by the desire to ensure that whatever macroeconomic framework is agreed to, it does not put the country at greater risk of macroeconomic instability.

Developing a Nationally Owned Macroeconomic Framework Is Difficult

Governments face several challenges in developing a macroeconomic framework for which they are expected to take ownership. First, many governments have limited technical capacity relative to the substantial complexities inherent in establishing macroeconomic policies and targets. For example, governments are expected to more openly discuss the selection, impacts, and trade-offs of various macroeconomic policies (i.e., lower budget deficits versus higher spending on poverty reduction). Yet, there are questions about the extent to which many governments are capable of effectively engaging in such discussions. Second, the challenges in establishing a participatory process and the complexities of macroeconomic issues may limit the extent to which civil society can influence the macroeconomic framework in the near term. This can be especially difficult in countries that lack a democratic or representative tradition and thus have few existing means for getting citizen or nongovernmental organizations' input or for electing representatives. Finally, even if the capacity of the national governments were improved and civil society were effectively engaged in a dialogue on the macroeconomic framework, national ownership would be hampered by the current limitations in economic knowledge on how different policies actually affect elements of the macroeconomic framework. The World Bank and others are attempting to develop models that may help explain the impact of various policies, but the process is slow due to technical complexities and limited country-specific data. Considering the above difficulties, civil society may not be able to influence the macroeconomic framework through the initial poverty reduction strategy; however, civil society may help improve the allocation of resources and increase the amount of resources donors are willing to provide by helping establish priorities for poverty reduction.

Few Changes Evident in Three Countries' Programs

Inclusion of Some Elements Difficult to Attribute to New Program

GAO found a few changes in the Fund programs for Albania, Benin, and Honduras that can be clearly attributed to the changes announced by the Fund in 1999. These few changes are (1) Albania's establishment of a participatory approach for preparing a national development strategy and (2) fewer structural conditions in Benin. However, the significance of these changes for the Fund program is not clear, since Albania's participatory process does not describe how Albania will include civil society in discussing the macroeconomic framework, and Benin still has to meet two of the three conditions dropped from the Fund program in order to receive debt relief under the Heavily Indebted Poor Countries Initiative.[9] The absence of clear change is due, in part, to the inclusion of many of the same elements in countries' previous Fund programs. For example, Albania and Benin have focused on poverty reduction since at least 1997.

Difficulties Establishing National Ownership of Macroeconomic Framework

For all three countries, establishing national ownership of their macroeconomic policies and targets has been challenging for several reasons. First, the three governments' ability to analyze macroeconomic issues is limited. For example, according to a government official in Albania, since the departure of an employee of the central bank in 1997, no one has been able to operate and maintain their macroeconomic model. Second, while all three national governments have organized a participatory process for preparing their countries' poverty reduction strategies, they have found it difficult to determine how to include civil society in discussing macroeconomic policies and targets. For example, in Honduras, government and donor officials told GAO that there were no civil society organizations conducting analyses of macroeconomic issues. Finally, while countries' Fund program documents are to include information on the social impact of significant economic adjustments before adjustments are implemented, GAO did not find such information.

[9]The Heavily Indebted Poor Countries Initiative is a comprehensive approach for providing debt relief to the poorest and most indebted countries in the world. For more information on this initiative, see *Developing Countries: Debt Relief Initiative for Poor Countries Faces Challenges* (GAO/NSIAD-00-161, June 29, 2000).

The Effects of the New Program on Graduation and the Role of the Fund

Strong, Sustained Economic Growth Essential to Reach Consideration for Graduation

If the changes announced by the Fund for its lending program to its poorest members, particularly national ownership of the macroeconomic framework, improve the overall effectiveness of a country's development program, the likelihood of earlier graduation from the Fund's program could increase. However, the actual impact of these changes on economic growth is unknown at this time and, as previously discussed, there are many challenges and obstacles to establishing national ownership.

GAO's analysis showed that most of the 32 countries that borrowed concessional resources from the Fund in 2000 will need to achieve strong, sustained economic growth to reach eligibility for graduation within the next 15 years. These countries would have to achieve an annual average growth rate of 6 percent, which is substantially greater than the negative 1 percent growth rate the countries averaged over the previous 15 years. These countries are projected to have an average of 2.5 percent growth over the next 15 years. At those projected growth rates, only four additional countries would reach the eligibility threshold by the end of the 15-year period. Given that the current annual per capita income levels of these countries is generally quite low (an average of $427), the average number of years required for these countries to reach the graduation threshold at their projected per-capita income growth rates is 59, with Niger requiring 366 years.

The Fund Has Been a Long-term Lender to Low-income Countries

Over the last 15 years, the Fund has functioned as a long-term lender to support poor countries' reform programs, and it has indicated that it intends to retain this role. The underlying problems that Fund assistance is designed to help address in poor countries often take a long time to resolve. Unlike the Fund's nonconcessional resources, there is no presumption under the Poverty Reduction and Growth Facility that countries will have only a temporary need for assistance. The Fund has wide latitude to lend to poor countries, given the countries' underlying vulnerabilities and low standards of living. For example, in recent years Benin has had a very stable macroeconomic environment, with low inflation, a balance-of-payments surplus, low budget deficits, and good economic growth. Within this healthy macroeconomic context, in July

2000 the Fund and Benin negotiated another program for an additional 3 years, with the objectives of achieving high and sustainable economic growth and reducing poverty while maintaining macroeconomic stability. The 32 countries that received Fund assistance in 2000 had received assistance from the Fund for an average of 7 of the last 10 years. According to a Fund official, the Fund is likely to continue to provide low-income countries with concessional resources as long as they have a need for those resources, the resources are available to be lent, and the countries pursue effective policies.

Agency Comments and GAO's Evaluation

GAO received written responses on this report from the Department of the Treasury and the International Monetary Fund. The Treasury said that GAO's report addresses a number of important issues concerning the Fund's concessional lending to poor countries. Comments received and GAO's evaluation of them are reprinted in appendixes III and IV. These organizations, along with the World Bank, also separately provided technical comments that GAO discussed with relevant officials and included in the text of the report, where appropriate.

The Fund did not disagree with GAO's findings regarding the design of the Poverty Reduction and Growth Facility but stated that GAO's report could have been more positive in its judgments. The Fund said that GAO's report discounts the process of public involvement in the formulation of key macroeconomic policy choices. GAO disagrees with this characterization of the report. The report recognizes the significance of the participatory process and, in fact, points out that civil society may help improve the allocation of resources and increase the amount of resources donors are willing to provide by helping establish priorities for poverty reduction. The Fund stated that further GAO investigation would have identified actual changes in Poverty Reduction and Growth Facility-supported programs and that the Fund knows change is taking place in many of these programs. However, the Fund provided no evidence to support this assertion nor did it provide any examples of actual changes or identify countries where change is taking place. The Fund said that the GAO analysis could be more tightly focused on whether outcomes are likely to be better under the new program than under the previous program. GAO reports that the impact of the new program on countries' economic growth rates is unknown at this time and that there are many challenges and obstacles to establishing national ownership.

Chapter 1: Introduction

Since 1976, the International Monetary Fund (IMF) has provided loans on concessional (below-market) terms to eligible low-income members of the Fund in order to strengthen their balance-of-payments positions and support their reform programs. In order to receive loans, countries agree to implement reform programs to address their underlying problems. The IMF has primarily focused on macroeconomic and structural issues, such as those intended to promote a market-based economy. In recent years, the role of the IMF in providing long-term assistance to poor countries as well as the appropriateness and effectiveness of its programs have been the subject of considerable debate. In response to some of these criticisms, and as part of a concerted international effort to reduce poverty, in September 1999 the IMF expanded the goals of its lending program to its poorest members to include an explicit focus on poverty reduction. In December 1999, the IMF's Executive Board asked IMF staff to begin implementing the revised program quickly, recognizing that it would involve a substantial degree of experimentation and innovation.[1] The IMF said in September 2000 that it expected to see measurable progress in incorporating the new features of the concessional lending program by September 2001.

Financing of and Eligibility for the IMF's Concessional Loans

The IMF has provided concessional financing through four facilities since 1976.[2] The terms of the IMF's loans have remained the same over this period, while the purpose of the loans has expanded from providing balance-of-payments assistance to now include strengthening a country's balance of payments and fostering durable growth, leading to poverty reduction. The IMF's concessional lending has been financed primarily with the profits from the sale of some of the IMF's gold holdings and contributions (loans or grants) from member countries. These resources

[1]The IMF operates under the authority of the Board of Governors, the highest decision-making authority. General operations are delegated to a smaller group of representatives, the Board of Executive Directors, who are responsible for making policy decisions and approving loans. The Board comprises 24 Executive Directors who are appointed or elected by one or more member countries.

[2]These facilities are the Trust Fund, which operated between 1976 and 1981; the Structural Adjustment Facility, which operated between 1986 and 1994; the Enhanced Structural Adjustment Facility (ESAF), which operated between 1987 and 1999; and the Poverty Reduction and Growth Facility (PRGF), which was established in 1999. The legal authority for the IMF to act as an administrator of such resources derives from its Articles of Agreement, Article V, Section 2(*b*), which empowers it, if requested, to "perform financial and technical services, including the administration of resources contributed by members, that are consistent with the purposes of the Fund."

are separate from the IMF's other resources such as the quota contributions of its members.[3] Eligibility for these concessional loans has been based mainly on a country's per capita income and eligibility to borrow from the World Bank's concessional lending window, the International Development Association, but it can also take into account other considerations such as a country's balance-of-payments and external debt situation.[4] The amount lent under the IMF's concessional facility is based on the member's balance-of-payments needs, the strength of its adjustment program, its outstanding use of IMF credit, and its record of such use in the past. The initial access limit under a 3-year arrangement is 140 percent of the member's quota, or, under exceptional circumstances, up to 185 percent of quota, as of February 21, 2001.

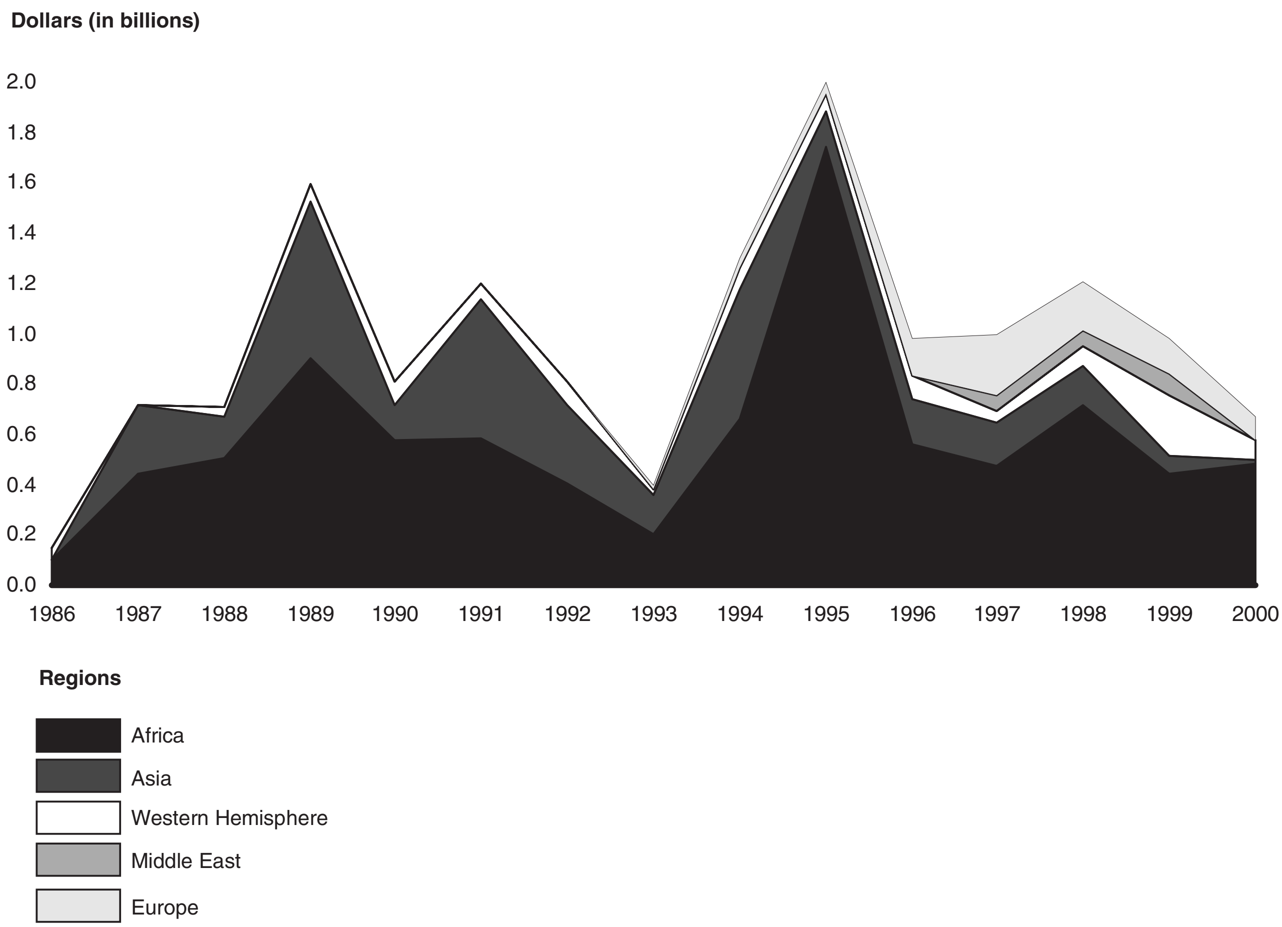
Countries eligible for these concessional loans are among the poorest in the world, with many classified by the United Nations as being in its lowest category of human development, based on life expectancy, literacy, and annual per capita income. Many depend on development assistance from governments, multilateral organizations, and nongovernmental organizations and have significant development needs.

Since 1986, a majority of the IMF's concessional resources have been disbursed to Africa. Over the latter part of this period, Asia reduced its use of IMF concessional resources, while Europe increased its use as part of the transition from centrally planned economies in the early 1990s. (See fig. 1.)

[3]The characterization of the arrangements involving the IMF's concessional resources differs from those involving its nonconcessional resources. Whereas the IMF's concessional resources are considered loans, use of its nonconcessional resources are considered "purchases," with repayments considered "repurchases." Nonconcessional resources are to address short-term balance-of-payments problems, such as those that occurred in Asia in 1997. See *International Monetary Fund: Observations on the IMF's Financial Operations* (GAO/NSIAD/AIMD-99-252, Sept. 30, 1999) for a description of the nature of the IMF's nonconcessional resources, and *International Monetary Fund: Approach Used to Establish and Monitor Conditions for Financial Assistance* (GAO/GGD/NSIAD-99-168, June 22, 1999) for a description of the IMF's lending programs.

[4]This threshold was based on a 1998 per capita income of $895 or less.

Figure 1: Disbursements of IMF Concessional Loans by Region, 1986-2000



Note: The spike in disbursements in 1995 was primarily due to a significant assistance package worth $1.3 billion provided to Zambia. This package was part of an effort by Zambia to clear its arrears to the IMF.

Source: GAO analysis of IMF data. Amounts adjusted to constant 2000 U.S. dollars.

As of February 21, 2001, 34 of the 77 countries eligible for the Poverty Reduction and Growth Facility had current loan commitments totaling more than $4 billion. Twenty-two of the 34 countries are in sub-Saharan Africa.

The IMF Focuses on Macroeconomic and Structural Issues

In its lending programs to low-income countries, the IMF primarily focuses on macroeconomic issues, such as promoting international monetary cooperation, a balanced growth of international trade, and a stable system of exchange rates; and structural measures such as financial sector reform. When countries borrow from the IMF, they agree to implement reform programs as a condition for access to financial assistance.[5] This "conditionality" aims to alleviate the underlying difficulties that led to the countries' economic problems and ensure repayment to the IMF. Not all of a country's policies or reform efforts are necessarily included as conditions of the IMF arrangement. The actions the IMF judges to be particularly important for achieving program objectives will become (1) "performance criteria" that generally must be met for members to qualify for disbursements or (2) "benchmarks" that help to measure progress in meeting objectives but do not generally affect disbursements.

The IMF has focused on advising countries on how to achieve and maintain macroeconomic stability, which is widely viewed as a precondition for, but not a guarantee of, economic growth and poverty reduction. According to IMF and World Bank staff, macroeconomic stability exists when key economic relationships are in balance, for example, between domestic demand and output, the balance of payments, and fiscal revenues and expenditure. To meet the goal of achieving or maintaining macroeconomic stability, IMF programs may target factors such as the rate of inflation, debt sustainability, and the level of international reserves.

The IMF's Increased Focus on Social Issues

The IMF's primary mandate is to focus on macroeconomic issues; however, according to IMF staff papers, the IMF has become more involved in areas where the World Bank has the lead role. For example, the IMF said it has worked to ensure that social policies are integrated into IMF-supported programs and advice, thus fulfilling its primary mandate while also contributing to sustainable economic and human development. In this way, the IMF's contribution to social development is mainly indirect, and its role in social policy advice is limited. Nevertheless, the IMF's involvement in social issues has increased. During the 1950s and 1960s, when the IMF provided financial assistance primarily to industrialized countries, its policy advice focused mainly on macroeconomic policies. With the shift to lending to developing countries since the 1970s and economies in transition since the late 1980s, greater

[5] Programs cover a period of 3 years but can be extended to a fourth year. Loans are disbursed either quarterly or semi-annually. The IMF makes the first disbursement when its Executive Board—its primary decision-making body—approves the arrangement. The IMF releases the next disbursements after it completes reviews of the program, determining that the country has satisfactorily met its performance requirements. These requirements generally include macroeconomic indicators and important structural measures.

consideration has been given to the complementarity of macroeconomic policies and structural reforms and to the formulation of policies in a medium-term context. With this broadening focus, the link between economic and social policies has also increasingly been recognized.

Criticisms of the IMF

The role of the IMF in providing long-term concessional lending and the appropriateness and effectiveness of its concessional loan programs have been the subject of considerable debate. For example, some critics believe the IMF has overstepped its original mission by including conditions related to social development strategies. In response, the IMF says its increasing emphasis on structural issues has reflected a growing understanding that countries' balance-of-payments problems cannot be resolved if a country suffers from deep-seated structural weaknesses. Critics also contend that IMF programs impose undue hardships on the poor. They point out that IMF programs often require that governments cut expenditures and reduce budget deficits in order to meet the IMF's macroeconomic goals. They argue that such cuts often result in reductions in spending on health, education, and other social programs vital to the poor.

The IMF has acknowledged that, in certain cases in the past, programs for the poor have been excessively reduced. To lessen this potential, the IMF said that it now pays more attention to social issues and to social safety nets and, if necessary, requires that countries maintain minimum spending levels for social programs despite the need for a general reduction in government spending. In 1998, the IMF-commissioned external evaluators of ESAF recommended that IMF programs for low-income countries be better integrated with policies to fight poverty and that recipient countries should take more ownership of their program.[6] In response, the IMF began to implement these changes; this policy has continued under the new PRGF.

[6]Kwesi Botchwey and others, *Report of the Group of Independent Persons Appointed to Conduct an Evaluation of Certain Aspects of the Enhanced Structural Adjustment Facility* (IMF: Washington, D.C., Jan. 13, 1998).

The New Facility Is to Focus More Explicitly on Poverty Reduction

In response to some of the above criticisms, and as part of a concerted international effort to reduce poverty, in September 1999, the IMF expanded the goals of its lending program to its poorest members to include an explicit focus on poverty reduction. Both the ESAF and PRGF highlight sound macroeconomics and rapid, sustainable economic growth—based on robust private sector activity and investments—as critical to reducing poverty. Under the PRGF, the IMF will continue to advise on and support policies to this end, including prudent macroeconomic management, freer and more open markets, and a stable and predictable environment for private sector activity. According to IMF documents, the new approach also recognizes the increasing evidence that entrenched poverty and severe inequality in economic opportunities and assets can themselves be impediments to growth. According to these documents, growth-oriented policies should be implemented in a framework in which the pressing need to reduce poverty is also a central objective. IMF staff documents highlight the following as the key features of the PRGF.[7]

1. *The IMF program is to emerge from the country's own strategy for growth and poverty reduction.*

- The broadest and most fundamental changes to the IMF's work arise from the fact that the targets and policies embodied in IMF-supported programs will emerge directly from the country's own poverty reduction strategy paper (PRSP). The country and its people will need to take the lead. The government will prepare the poverty reduction strategy based on a process involving the active participation of civil

[7]See IMF, *Poverty Reduction Strategy Papers—Operational Issues* (IMF: Washington, D.C., Dec. 13, 1999); *Poverty Reduction and Growth Facility--Operational Issues* (IMF: Washington, D.C., Dec. 13, 1999); *Concluding Remarks by the Chairman on Poverty Reduction Strategy Papers—Operational Issues* and *Poverty Reduction and Growth Facility--Operational Issues* (IMF: Washington, D.C., Dec. 21, 1999); and *Key Features of IMF Poverty Reduction and Growth Facility (PRGF) Supported Programs* (IMF: Washington, D.C., Aug. 16, 2000).

society, nongovernmental organizations, donors, and international institutions.[8]

- The participatory process is to facilitate open debate on issues such as the social impact of policy measures and the pace and sequencing of reforms. Discussions on the macroeconomic framework are to be more open and iterative.
- Macroeconomic policies will need to be better integrated with social and sectoral objectives to ensure that plans are mutually supportive and consistent with a common set of objectives to spur growth and reduce poverty. To ensure this consistency, the poverty reduction strategy will set out a coherent and comprehensive strategy.
- The bottom-up approach will be reflected in the design of the macroeconomic framework, including the level and composition of government expenditures and the fiscal and external deficits. Key social and sectoral policies, infrastructure projects, institutional reforms, and other measures aimed at reducing poverty will be costed, prioritized, and incorporated within the macroeconomic framework.
- Reconciling macroeconomic stability with spending levels needed to achieve poverty goals will generally be a matter of raising an adequate level of external grants or highly concessional loans. One key component will be to mobilize external support, and IMF staff will need to intensify efforts to identify sustained increases in resources for countries where these can be used most effectively.

[8]The World Bank's *Poverty Reduction Strategy Sourcebook* defines participation as "a process through which stakeholders influence and share control over development initiatives and the decisions and resources that affect them." The major stakeholders involved in poverty reduction include the poor and vulnerable groups, the general public, organized civil society, the private sector, government agencies, representative assemblies, and donors. As the Bank staff reported, participation is not a uniform process. The staff noted that "[Participation] is likely to involve a cycle of participatory dialogue, analysis, actions, and feedback within existing political and governance structures that is designed to bring the views of all levels of civil society, from communities to the private and public sectors, into government policy-making and program implementation, at both the national and local levels." The goals are to reach the maximum level of participation feasible within a particular country and to increase accountability, transparency, and efficiency of governance structures in promoting development and reducing poverty. Participation includes the following continuum of approaches: information sharing, consultation, collaboration, and empowerment.

2. *Budgets are to be more pro-poor and pro-growth.*

- Government spending should shift toward activities that demonstrably benefit the poor, while tax reforms should improve both equity and efficiency.

3. *Appropriate flexibility is to be ensured in fiscal targets.*

- The program should be flexible enough to react to commonly experienced shocks, such as deteriorating terms of trade or poor harvests, or to spend newly available aid when it is clear that it could be used productively.

4. *Analysis of the social impacts of major reforms is to be conducted before the reforms are put in place (normally by the World Bank), and measures to counteract negative impacts should be incorporated in the IMF's program.*[9]

- The IMF should demonstrate that the effects of substantial macro-adjustments or structural reforms on different groups have been considered. The program should also highlight countervailing measures to offset temporary adverse effects on the poor. If a technical impact analysis is needed, the World Bank should lead that effort, but IMF documents should indicate what work was done and how it influenced policies.

5. *Greater emphasis will be accorded to good governance.*

- All government activities should have greater transparency, effective monitoring procedures, anticorruption initiatives, effective public resource management, accountability, and the involvement of all sectors of society in monitoring relevant aspects of the program.

6. *Programs are to contain more selective structural conditionality.*

[9]According to World Bank staff, ideally social impact analysis should be undertaken as an integral part of the government-led preparation of PRSPs. When such analysis has not been adequately done as part of the PRSP process for policy measures supported by the IMF's program, and further technical impact analysis is needed, the World Bank should normally lead that effort.

- Program documents are to discuss only those areas where the IMF had primary responsibility (and in these areas conditionality would be used sparingly). For example, the IMF is to focus on structural conditions that may impact the macroeconomic framework, such as the privatization of significant government entities. Conditionality covering areas within the primary mandate of the World Bank would be the responsibility of the Bank and would not be expected to appear in IMF financial arrangements.

According to IMF documents describing the PRGF, to help ensure that the above key features are addressed in country-specific programs, program documents are specifically to include the following. This information is to provide a benchmark for future progress reviews.

- *Documents should demonstrate that the distributional effects of substantial macroeconomic adjustments or structural reforms have been considered.* For example, privatization of a state-owned utility may impact (positively or negatively) employment levels and the cost and quality of services. Or, tax increases may affect some vulnerable groups more than others. Normally, the World Bank would undertake these analyses, drawing to the extent possible on analysis already conducted during the preparation of the PRSP, but PRGF documents should state what analysis was done and how it influenced the policy choices.
- *Documents should highlight measures designed to ease any temporary adverse impacts.* Negative impacts—such as the loss of jobs—may be discussed along with mitigating actions, such as a job retraining program or temporary social assistance for laid-off workers.
- *Documents should state how fiscal targets would be modified in the event of key shocks, such as a significant drop in the price of a major export.* Where relevant, programs should explicitly indicate how the fiscal objectives have been, or will be, influenced by actual or likely shocks. Several factors need to be weighed in determining the appropriate response to an adverse shock, such as the amount and terms of financing and the impact of higher spending on domestic demand, the real monetary exchange rate, and the country's competitiveness. Inevitably, questions will arise regarding the amount of domestic financing and the appropriate inflation target. IMF and World Bank documents state that since inflationary financing represents a tax whose incidence falls principally on the poor, the risks here need to be weighed carefully. According to the IMF, sacrificing low inflation to finance additional expenditures is not an effective means to reduce poverty, particularly in cases where inflation is above

single-digit levels. All of these issues are to be discussed in the context of the participatory process leading to the PRSP and elaborated in the document itself.

- *Country program documents should present clearer information to signal financing needs.* Programs could be presented in ways that give clearer signals to donors about the connection between financing and the poverty and growth goals. PRSPs may identify (1) additional priorities that could be funded if donors provided more aid and (2) the areas in which spending cuts would be made in the event of financing shortfalls. This change would require better measurement and tracking of government expenditures.
- *Documents should indicate how, in the course of the PRSP preparation process, choices were made regarding the balance between the public and private sectors in the allocation of total credit.* It is generally desirable that governments in low-income countries avoid or strictly limit their use of relatively expensive domestic credit. But there may be situations in which urgent public spending needs exceed the resources available from revenues and external assistance, and a case could be made for drawing on some of the domestic credit that would otherwise flow to the private sector. This is another area in which flexibility can be exercised, depending on how the relative needs of the two sectors are prioritized.

Objectives, Scope, and Methodology

The Chairman of the Senate Committee on Foreign Relations asked us to evaluate what the IMF has changed about its lending program for its poorest members since it announced the PRGF, specifically to (1) analyze how this new program is designed to be different from the previous program, (2) assess what has actually changed in recipient countries' programs, and (3) evaluate whether the changes implemented in the new program increase the likelihood of recipient countries graduating from (that is, no longer being eligible for) concessional borrowing in less than 15 years or have contributed to a more short-term lending focus for the IMF.

For our first objective, we analyzed documents from the IMF describing the design of its concessional lending programs between 1986 and 2001. To describe the key elements of a macroeconomic framework, we studied IMF documents on financial programming and staff research papers (workpapers, discussion papers, and technical papers) and attended a seminar at the IMF on financial programming.[10] Our research also included an analysis of the current state of the development of macroeconomic models. We also read research papers by other experts on this topic. We met with IMF and World Bank officials to discuss the formulation of a country's macroeconomic framework and their understanding of how a broad-based, participatory approach could be expected to influence the macroeconomic framework. We also reviewed research conducted by staff from the IMF, the World Bank, academia, consultant groups, and nongovernmental organizations to identify empirical evidence supporting the extent to which specific policies affect economic growth. To address all three issues, we analyzed a wide range of documents from the Fund, the World Bank,[11] recipient and donor governments, U.N. organizations, and nongovernmental organizations. We also interviewed officials from these organizations in the United States and abroad. Our findings regarding program design derive from this analysis and are not based on individual country experiences.

To address the second issue, we selected and visited three countries for case studies—Albania, Benin, and Honduras. These countries met the following criteria as of September 30, 2000: they had a current Fund program with no significant disruptions; were expected to have full poverty reduction strategy papers by mid-2001; and been reviewed under their current and previous IMF programs, which provided us with documents for comparing the PRGF to the ESAF. We met with and analyzed information on countries' IMF programs and efforts to develop poverty reduction strategies from officials of the IMF, the World Bank, and other multilateral organizations; the recipient governments; the United States and other donor countries; and nongovernmental organizations in the United States and abroad. These officials also provided information on the capacity of governments and civil society to influence the formulation of the country's macroeconomic framework. We did not generalize from the experience of these countries to draw conclusions about overall

[10]Financial programming is the framework used by the IMF to determine a country's macroeconomic program. The framework consists of several basic accounting identities (relationships that are true by definition) and a few behavioral relationships (such as a country's demand for imports). To ensure consistency of the outcome, judgments are made regarding underlying relationships, such as the relationship between investment expenditures and import requirements.

[11]The World Bank, supported by its 182 member governments, promotes economic growth and the development of market economies by providing financing on reasonable terms to countries that have difficulty obtaining capital.

implementation issues. Instead, the case studies are examples of how countries are addressing the design challenges identified in the first objective.

For our third objective, to determine the likelihood of the 32 countries that received PRGF disbursements in 2000 graduating from concessional borrowing in 15 years or less, we utilized two databases. Using the per capita income data from the World Bank's World Development Indicators 2000 CD-ROM, we determined countries' past growth rates and calculated the per capita income growth rate required for them to reach the International Development Association's (IDA) income threshold in 15 years.[12] Using 15-year forecasted growth rates estimated by Standard & Poor's DRI, a leading provider of economic information, for each of the 32 countries, we determined what each country's projected per capita income would be in 15 years and how many years it would take each country, at the DRI-projected growth rate, to reach the IDA threshold.[13] To evaluate whether the PRGF has contributed to a more short-term lending focus for the IMF, we reviewed IMF documents and data on its concessional lending programs.

We performed our work from August 2000 through March 2001 in accordance with generally accepted government auditing standards.

[12]The IDA income threshold is generally used to determine whether a country is eligible for concessional lending.

[13]DRI is a unit of Standard & Poor's, which is a division of The McGraw Hill Companies. It is a leading provider of industry and economic data, forecasting, and consulting services. Its World Forecast Database includes historical and forecast data for 170 countries.

Chapter 2: The Design of the IMF's New Program Differs Little From Its Previous Program

We found that the design of the new PRGF differs little from the IMF's previous program. Although certain elements of the new program have greater emphasis placed on them now than in the past, we observed that most of the announced changes for the new program were pursued under the previous program, and the one major design change—national ownership of effective macroeconomic policies—is difficult to achieve. Given the need for poor countries to maintain macroeconomic stability, which is essential for economic growth and poverty reduction, the policies and targets within the macroeconomic framework are not likely to be altered substantially from the past. Our analysis shows that national ownership of the macroeconomic framework is difficult to achieve for three reasons: (1) the limited capacity of many recipient governments to independently analyze and effectively negotiate the macroeconomic framework reduces the opportunity for country-specific elements to be addressed; (2) the challenges to effectively engaging civil society in a dialogue on these very complex matters are significant; and (3) a national dialogue on the choice of effective policies is hampered by the limited knowledge of all parties, including the IMF, on how different policies actually affect elements of the macroeconomic framework.

Most of the Announced Modifications Represent a Change in Emphasis Rather Than a Change in Philosophy

Our analysis of IMF documents shows that the design of the Fund's new lending program for low-income countries—the PRGF—does not differ significantly from its previous program—the ESAF—because it includes concepts that have been pursued for a number of years. As shown in table 1, according to the IMF, it has focused on key issues such as reducing poverty and increasing the recipient government's role in developing its Fund programs since at least the late 1980s.

[Blank page]

Table 1: The Fund's Stated Focus on Poverty Reduction, Government Leadership, and Civil Society Participation

	1987 [a]	1988 [b]	1989 [b]	1990 [c]
Focus on poverty reduction	The IMF Executive Board said the explicit focus on alleviating structural problems was particularly important, since many countries suffered for many years from low rates of economic growth and declining per capita incomes.	The IMF Executive Board • welcomed the increased attention being paid to the impact of IMF programs on income distribution and the poorest population groups • supported occasional use of measures to ease the impact of reform on these groups.	Essential ingredients for successful structural adjustment programs include integration into program design of • poverty reduction objectives • ways to mitigate adverse effects on the most vulnerable groups, preferably through income-generating programs.	Sizable reduction in the incidence of poverty is the highest priority for the international development community. A broad consensus is emerging on strategies to achieve this goal. Policy framework papers identify policies that help and those that may hurt the poor.
Government leadership in developing strategy	According to the IMF Board • country authorities should play a greater role in developing PFPs. • PFPs should include more discussion of country authorities' priorities. Successful reform and adequate safeguards for IMF resources require the borrower to be fully committed to the reform program.	The IMF Board • stressed that the member country should play the leading role in preparing the PFP, so that the document would be an authentic expression of the country's objectives and policies • emphasized the importance of achieving consensus within the member country's government on the content of an adjustment program. In some cases, additional time might be needed to permit full discussion of major issues before the PFP was drafted.	In a March 1989 review of concessional lending programs, the IMF Board stressed that the involvement of member countries' authorities in program design be intensified. The Board emphasized the importance of allowing sufficient time for political consensus to be reached in borrowing countries.	Governments of developing countries have primary responsibility for achieving goal of poverty reduction. This goal could be most effectively achieved through *national development strategies* that • include sound macroeconomic and structural policies • encourage sustainable growth that increases income earning opportunities for the poor • develop the human resources of the poor, particularly through broad access to education, health, and family planning services.
Civil society participation	IMF programs need to pay due regard to countries' domestic social and political objectives.	The IMF Board said that focusing on programs' impacts on income distribution and the poorest population groups enhanced programs' chances of success by minimizing public resistance to them.	Other essential ingredients for success include well-designed programs with broad public understanding/support that take into account the country's deep-seated structural problems and social, demographic, and political environment.	Developing countries' experience in the 1970s shows that growth founded on inflation and excessive external borrowing and not built on broad-based and creative participation of the largest part of the population is deprived of its essential driving force. Involvement of the poor in designing and executing projects and programs is key to effective poverty reduction efforts.

1992-93[d]	1995[e]	1996[f]
The IMF continued to find ways, commensurate with its mandate as a monetary institution, to contribute to reducing poverty by • emphasizing sound macroeconomic and structural policies, which promote sustainable growth worldwide • discussing impacts of economic policies for poor groups and appropriate policy mix to achieve reform.	The IMF focused more on the social issues of adjustment. Short-term focus: mitigate adverse effects on vulnerable groups. Long-term poverty reduction is best achieved by sustained and broad-based growth and improvements in level and quality of government spending on social services. The IMF focused more on composition and efficiency of public expenditures.	Explicit focus on poverty reduction within a country's overall development strategy. Growth-oriented policies should be implemented in a framework in which the pressing need to reduce poverty is also a central objective.
All IMF programs resulted from stronger collaboration among the governments, the IMF, and the World Bank through the PFP. Political commitment to reform was critical.	Countries, the IMF, and others developed mix of policies in close consultation. The IMF programs have increasingly paid attention to the mix and sequencing of policies, with a view to minimizing adverse effects on the poor. This helps increase the political sustainability of economic reforms. Ultimately, the choice of social and economic policies belongs to the government. It is critical that key players--especially at the grassroots level--have a stake in economic policy-making.	The country and its people will need to take the lead. • The government will prepare the poverty reduction strategy paper based on a process involving the active participation of civil society, nongovernmental organizations, donors, and international institutions. • The most fundamental changes to the IMF's work arise from the fact that the targets and policies in IMF programs will emerge directly from the country's poverty reduction strategy. • Discussions on the macroeconomic framework will be more open and iterative. • The costs of poverty-reduction programs will more directly influence the design of the macroeconomic framework.
Vested interests were often against reforms; ways to ease the impact on these groups and persuade them of the longer-term benefits of reforms were important. Declining terms of trade eroded support of reforms.	Strategy of high-quality economic growth--which is key to poverty alleviation--includes participatory development through active involvement of all groups in society.	Broad participation and greater ownership to ensure that civil society is involved and that country authorities are in the driver's seat.

Legend
PFP = Policy framework paper

[a]International Monetary Fund, *Annual Report of the Executive Board for the Financial Year Ended April 30, 1987* (Washington, D.C.: IMF, 1987) and International Monetary Fund, *Annual Report of the Executive Board for the Financial Year Ended April 30, 1988* (Washington, D.C.: IMF, 1988).

[b]International Monetary Fund, *Annual Report of the Executive Board for the Financial Year Ended April 30, 1989* (Washington, D.C.: IMF, 1989) including press communiqués of the Joint Ministerial Committee of the Boards of Governors of the Bank and the Fund on the Transfer of Real Resources to Developing Countries (Development Committee). The Development Committee, which is composed of 24 members who are usually ministers of finance or development, advises the IMF's and the World Bank's Boards of Governors.

[c]International Monetary Fund, *Annual Report of the Executive Board for the Financial Year Ended April 30, 1990* (Washington, D.C.: IMF, 1990); International Monetary Fund and World Bank, *Finance and Development* (Washington, D.C.: IMF and World Bank, Sept. 1990); and International Monetary Fund, *Annual Report of the Executive Board for the Financial Year Ended April 30, 1991* (Washington, D.C.: International Monetary Fund, 1991), including press communiqués of the Joint Ministerial Committee of the Boards of Governors of the Bank and the Fund on the Transfer of Real Resources to Developing Countries (Development Committee).

[d]International Monetary Fund, *Annual Report of the Executive Board for the Financial Year Ended April 30, 1992* (Washington, D.C.: International Monetary Fund, 1992) and International Monetary Fund, *Economic Adjustment in Low-income Countries: Experience Under the Enhanced Structural Adjustment Facility*, Occasional Paper 106 (Washington, D.C.: IMF, Sept. 1993).

[e]International Monetary Fund, *Social Dimensions of the IMF's Policy Dialogue*, Pamphlet Series No. 47 (Washington, D.C.: IMF, Mar. 1995).

[f]*The Poverty Reduction and Growth Facility (PRGF)—Operational Issues* (Washington, D.C.: IMF and World Bank, Dec.13, 1999); *Social Policy Issues in IMF-supported Programs: Follow-up on the 1995 World Summit for Social Development* (Washington, D.C.: IMF, Mar. 16, 2000); *Key Features of IMF Poverty Reduction and Growth Facility (PRGF) Supported Programs* (Washington, D.C.: IMF, Aug. 16, 2000); and International Monetary Fund*, News Brief No. 00/81* (Washington, D.C.: IMF, Sept. 7, 2000).

Sources: IMF documents listed in above table notes.

According to our analysis, one change—that the macroeconomic targets and policies in IMF programs will be the responsibility of the government and emerge from a process involving civil society and donors—could be a significant departure from how targets and policies have been traditionally chosen. However, even this approach builds on and includes features that have been discussed and pursued for some time. As shown in table 1, staff documents indicate that the IMF has focused on the importance of government leadership and domestic public support for reform programs since at least the early 1990s.

The commonality of these concepts over time does not necessarily mean that the new program is identical to the previous program, since the new program envisions consolidating these concepts into one framework and giving them greater prominence. We believe that this represents a continued increase in emphasis rather than a change in the Fund's stated philosophy, with IMF documents placing increased focus on these topics since the external review of the ESAF in January 1998.[1] For instance, under the PRGF, program development is to begin with the country's priorities (as described in the country's poverty reduction strategy paper) instead of the IMF's macroeconomic targets, as was done in the past. While this represents a shift in the IMF's starting point, a similar approach was available under the previous facility—if a country identified needs

[1]Botchwey and others, *Report of the Group of Independent Persons*.

that were greater than its available financing, then the government, the Fund, or others could seek additional donor and creditor support. Furthermore, according to IMF documents, since at least 1998, countries that achieved macroeconomic stability were permitted to increase spending on priority areas over previous program levels, if the spending were financed through donor resources.

The IMF has had difficulties achieving some of the goals listed in table 1 in the past, and it is uncertain whether it will be able to do so in the future. For example, since at least 1987 getting governments to take ownership of their IMF programs has been seen as an important element in the programs' successful implementation. However, the main vehicle to achieve this—the policy framework papers—has been generally developed by the staff of the IMF and not by the countries themselves. According to an external evaluation of the ESAF commissioned by the IMF,

> "although initially the PFP [policy framework paper] had held great promise as an instrument of a genuine three-way dialogue between the government, the Fund, and the Bank, it has become a rather routine process whereby the Fund brings uniform drafts (with spaces to be filled) from Washington, in which even matters of language and form are cast in colorless stone…the general yearning therefore was for the realization of a potential that never was—a truly country-specific PFP, agreed on the basis of a government-led consultation process."[2]

In responding to this evaluation, IMF staff noted that a wider range of initiatives to promote ownership is clearly needed. Under the new program, the governments are to write the PRSP themselves. According to Fund staff, the IMF Executive Board could endorse PRSPs that contain elements that the Fund does not agree with. However, the significance of this change is uncertain since the IMF's Executive Board must endorse a country's overall PRSP in order for the country to borrow from the Fund.

[2] Botchwey and others, *Report of the Group of Independent Persons.*

Widely Accepted Goal of Maintaining Macroeconomic Stability Limits Potential Changes Under the Program

The Importance of Maintaining Macroeconomic Stability

According to the IMF and the World Bank, macroeconomic stability is considered to be a necessary prerequisite for economic growth and poverty reduction, although not sufficient on its own to achieve those goals.[3] Countries that experience macroeconomic instability—such as high inflation, volatile and over-valued exchange rates, or excessive fiscal deficits—have tended to have slow or even negative economic growth rates.[4] According to the IMF and the World Bank, macroeconomic instability can also place a heavy burden on the poor, for example, inflation can place a disproportionate burden on those in the lower income brackets. This concern over the negative effects of macroeconomic instability underlies the continuing goal that a country's macroeconomic framework should work to maintain stability, once achieved.

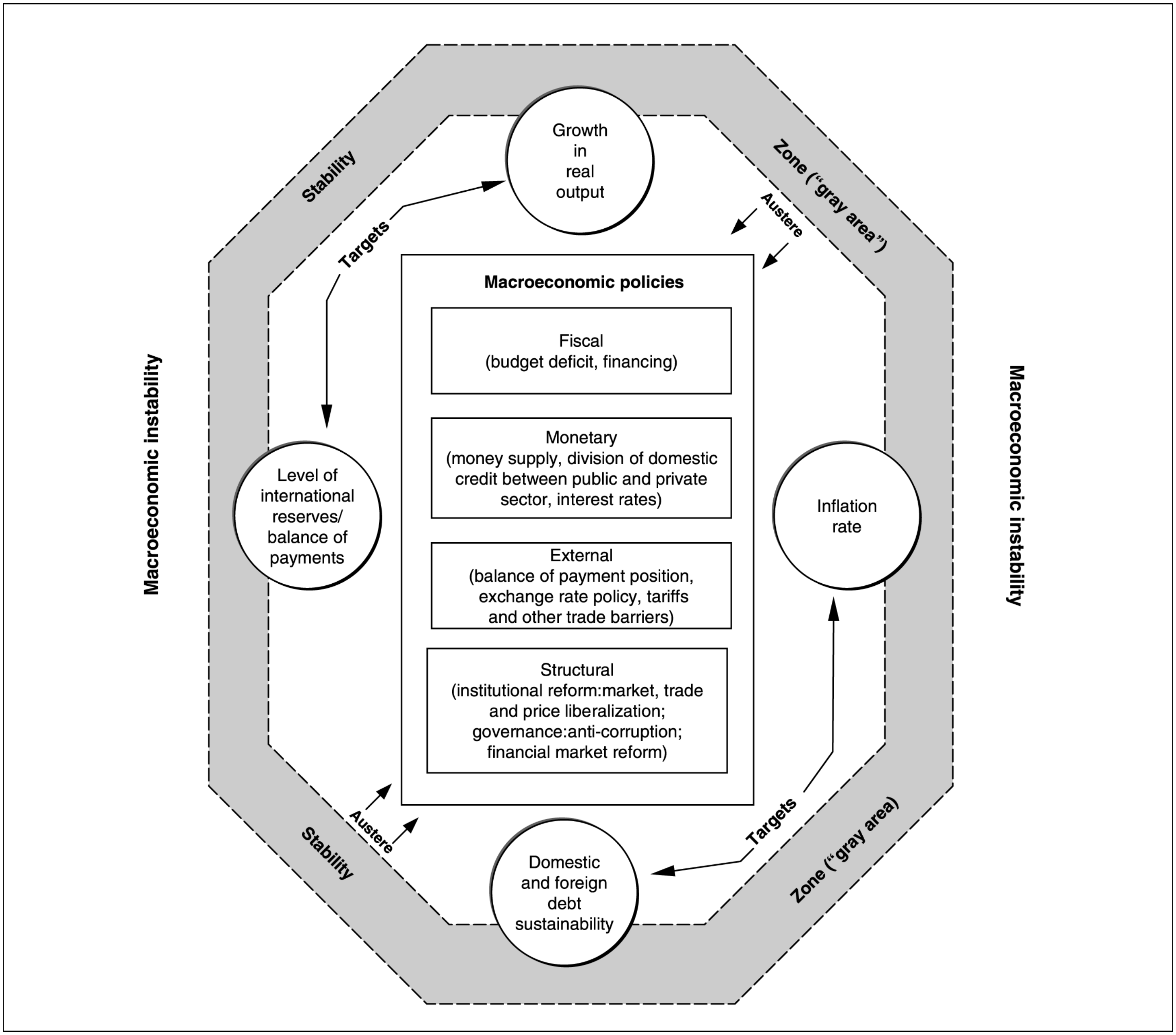
The IMF has been accused in the past of having an overly austere approach to macroeconomic policy, sacrificing potential economic growth and poverty reduction in order to reduce a country's inflation rate and deficit level. The impact of too much austerity would be to lower economic growth from its optimal level and impede progress on poverty reduction. In recent documents, the IMF presents the view that it is now open to alternative approaches, as long as they are consistent with

[3]Macroeconomic stability exists when key economic relationships are in balance, for example, between domestic demand and output, the balance of payments, fiscal revenues and expenditure, and savings and investment. These relationships need not necessarily be in exact balance. Imbalances such as fiscal and current account deficits or surpluses are perfectly compatible with economic stability provided that they can be financed in a sustainable manner.

[4]The IMF and the World Bank *PRSP Sourcebook* identifies macroeconomic instability as a situation in which a country has large current account deficits financed by short-term borrowing, high and rising levels of public debt, double-digit inflation rates, and stagnant or declining output.

macroeconomic stability and growth. In discussing the range of macroeconomic policies available, IMF and World Bank documents refer to a "substantial gray area" between those policies that may be considered too austere and those that cause macroeconomic instability; in other words, the gray area represents the range of optimal policy options. Figure 2 illustrates the macroeconomic framework, with the four key targets that are instrumental in pursuing poverty reduction and growth, in the context of macroeconomic stability.

Figure 2: Elements of a Macroeconomic Framework in Support of the PRGF's Twin Goals of Poverty Reduction and Growth, in a Context of Macroeconomic Stability



Source: GAO analysis of IMF and World Bank documents.

Presumably, one goal of including the macroeconomic framework within the national poverty reduction dialogue would be to explore this gray area to establish an effective mix of policies consistent with the medium-term goals of the country.

The Area Available for Negotiation Is Limited

Based on our analysis of numerous documents and discussions with IMF and World Bank officials, it is difficult to determine how "substantial" or wide is the range of macroeconomic policy targets within this so-called "gray area." This is due to two factors: Precise identification of the bounds of the gray area is beyond the current understanding of the economics profession, and the harsh economic realities confronting these very poor countries also work to limit the choice of policies or amount of spending that can be used effectively. Both of these factors are strongly influenced by the desire to ensure that whatever macroeconomic framework is agreed to, it does not put the country at greater risk of macroeconomic instability.[5]

Although there is general agreement within the economics profession that certain policies will likely lead to macroeconomic instability (such as a rapid increase in the money supply, leading to high inflation), there is little agreement on what constitutes the best approach. For example, many economists, including some at the IMF, think that inflation above a 7 to 11 percent range is risky, whereas others think the level can be between 20 and 40 percent before it starts to endanger economic growth. The uncertainty created by this lack of precision may increase the likelihood that the more conservative approach will be agreed upon to avoid the

[5]The focus of the macroeconomic framework for countries that are experiencing instability has been to reestablish stability. Most of the countries that are current borrowers from the PRGF program are considered to have achieved or nearly achieved macroeconomic stability. The Fund does not explicitly classify countries as macroeconomic stable or unstable, nor does it provide threshold levels or the "gray areas" separating stability from instability for relevant macroeconomic variables. However, the *PRSP Sourcebook* provides country data and criteria and concludes that "many developing countries are presently in a state of macroeconomic stability." Countries are classified over the recent economic period 1994-99 as good performers or poor performers for three macroeconomic variables: real gross domestic product (GDP) average annual growth rate, average annual inflation (GDP deflator), and average annual primary fiscal budget surplus/deficit as a percent of GDP. (The threshold levels for good performance are real GDP growth rate greater than 2 percent, inflation below 20 percent, and primary fiscal surplus/deficit as percent of GDP greater than –3 percent.) Using the same variables and criteria for the 32 countries that received PRGF disbursements in 2000, we found that 69 percent of the countries are classified as good performers for at least two of the variables, and 41 percent for all three variables.

perils of macroeconomic instability. Whereas an overly conservative approach may both lower economic growth and reduce spending on poverty reduction, the negative consequences of macroeconomic instability are much greater and are likely to result in even lower economic growth and require greater austerity to recover from it. For example, policies identified under the poverty reduction strategy may include measures such as a significant increase in spending for primary education and health, beyond what domestic revenue can fund, what the donors are willing to finance, and what could be used effectively given some countries' limited capacity. However, domestic financing of these priority areas would increase the budget deficit, the risk of high inflation, and an unsustainable debt burden in the future. How much of an increase is affordable is difficult to determine, but the fear of macroeconomic instability would limit the amount of new spending in these areas.

These concerns are magnified for the very poorest countries, given the underlying fragility of their economies. In addition to domestic factors that should be considered for maintaining macroeconomic stability, such as the identification of how much spending can be prudently increased over a short period of time, consideration should also account for the vulnerability of these economies to external shocks. This vulnerability is due to many factors, including a reliance on just a few basic commodities for much of their export income, weak revenue-generating capacity, and substantial dependence on imported oil. This tension was evident in the circumstances of Honduras between 1993 and 1994. In the period leading up to the presidential elections of November 1993, domestic spending rapidly increased, more than doubling the fiscal deficit from 4.8 percent of gross domestic product to 10.7 percent. The country then experienced a severe drought in 1994, creating a serious electricity shortage and dramatically lowering the volume of its leading exports—coffee and bananas. The combined effect of the increased domestic spending and drought was to increase inflation from 12.9 percent in 1993 to 28.4 percent in 1994, to lower per capita growth from 6.2 percent in 1993 to negative 1.5 percent in 1994, and to reduce Honduras's international reserve levels to less than 1 month of imports.

Developing a Nationally Owned Macroeconomic Framework Is Difficult

The development of a nationally owned macroeconomic framework faces several constraints. The limited capacity of many recipient governments to independently analyze and effectively negotiate the macroeconomic framework reduces the opportunity for country-specific elements to be brought into the dialogue. The complex nature of this subject matter presents significant challenges to an effective civil society dialogue. Furthermore, even if these challenges were overcome, a national dialogue on the choice of effective policies is complicated by the lack of knowledge by all parties, including the IMF, about how different policies actually affect the macroeconomic framework.

The Importance of Increased Capacity-building for Recipient Governments

Borrower governments are responsible for preparing the poverty reduction strategy, negotiating the IMF program, and deciding among difficult trade-offs. However, the limited technical capacity within the government and the substantial complexities inherent in establishing macroeconomic policies and targets have constrained the involvement of governments in establishing their previous macroeconomic programs, with many macroeconomic policies and targets based on the technical analyses of the Fund and others. The PRGF and PRSP are to increase the role of borrower governments by calling for a nationally owned program developed with civil society participation. Under these programs, governments are expected to (1) more openly discuss the selection, impacts, and trade-offs of various macroeconomic policies with civil society; (2) assess country-specific circumstances that affect economic growth and poverty reduction; and (3) evaluate and respond to the information received from civil society. Yet there are questions as to whether many governments are in a position to engage effectively in such discussions, according to some IMF and World Bank officials. Efforts to increase borrower governments' ability to develop and assess macroeconomic issues have been ongoing since at least the late 1980s.[6] However, these efforts have not increased capacity sufficiently, according to some donors and creditors. This is of particular concern, given the increased emphasis on country ownership and participation. Without such

[6]The objective of the Social Dimensions of Adjustment program was to help participating African countries to integrate poverty and social concerns in the design and implementation of their adjustment programs so as to mitigate the burden on the poor in the process of structural adjustment. Its mandate was to strengthen the capacity of African governments to design appropriate programs and projects in this regard. The World Bank, the African Development Bank, and the U.N. Development Program jointly administered the program.

increased capacity and the willingness of donors and creditors to accept government views, technical analyses will remain outside the governments' hands, and the goal of country-owned macroeconomic programs focused on reducing poverty may not be achieved.

The limitations on flexibility resulting from the need to maintain macroeconomic stability do not mean that there is no role for country involvement in the process. Although the IMF's financial programming approach has been applied to all member countries, its relevance is improved by using country-specific information. While the iterative approach of the staffs of the IMF and the World Bank attempts to capture these local differences as accurately as possible, there have been instances in the past where they misread a country's underlying circumstances, resulting in mistakes in the macroeconomic framework. For example, according to an expert on economic development in Africa, the IMF made mistakes in the programs of Zambia and Malawi due to not understanding the countries' individual circumstances.[7] Active involvement on the part of technically skilled representatives of each country would presumably help reduce imprecision in the formulation of their macroeconomic framework through greater understanding of the country's unique circumstances.

Civil Society Unlikely to Significantly Affect the Macroeconomic Framework in the Near Term

As discussed previously, the targets and policies of the PRGF program are expected to emerge directly from the country's poverty reduction strategy. The challenges in establishing a participatory process and the complexities of macroeconomic issues may limit the extent to which civil society can influence the macroeconomic framework in the near term. The IMF and the World Bank have urged countries to adopt key concepts such as "ownership" and "civil society participation" in discussing macroeconomic policies. However, neither the Fund nor the World Bank has defined these concepts. Given the desire of the Fund and the World Bank to allow for country-specific interpretations, countries are expected to define these concepts for themselves. As we previously reported, just establishing a participatory process itself is challenging.[8] For example, countries face challenges in determining which groups represent civil

[7]Bruce R. Bolnick, *The Role of Financial Programming in Macroeconomic Policy Management*, Harvard Institute for International Development Discussion Paper No. 720 (Cambridge, MA: Sept. 1999).

[8]See *Developing Countries: Debt Relief Initiative for Poor Countries Faces Challenges* (GAO/NSIAD-00-161, June 29, 2000).

society, since stakeholders include those directly affected by the project or strategy, such as the poor, as well as those who are indirectly affected, such as the borrower governments at the local level, nongovernmental organizations, and private sector organizations. Identifying representatives can be especially difficult in countries that lack a democratic or representative tradition and thus have few existing means for getting citizen or nongovernmental organizations' input or for electing representatives. These concerns are magnified when the process is to involve the poor or groups that have traditionally been excluded, such as women and indigenous populations. There is also concern that government officials will not support a participatory process if it is perceived as diluting their power or alienating influential constituencies.

To effectively involve civil society—however defined—in discussing macroeconomic policies and targets, efforts may be needed to educate them and their representatives about the macroeconomic framework and build their organizational and financial capacity to participate. Specialized information and skills are needed to assess the trade-offs between, for instance, a higher fiscal deficit and a higher rate of inflation or to determine the impact of a floating exchange rate on economic growth. Moreover, as previously discussed, within the academic literature there is limited knowledge about how much flexibility exists in the macroeconomic framework with, for example, uncertainty about how much spending can be increased without jeopardizing macroeconomic stability. Given the complexity of the issues, participation in influencing macroeconomic policy could be limited to a few informed constituencies or experts, such as representatives from academia and the business community and others who can assess trade-offs. Considering the above difficulties, civil society may not be able to influence such macroeconomic targets as inflation or exchange rates through the initial poverty reduction strategy; however, civil society may help improve the allocation of resources and increase the amount of resources donors are willing to provide by helping establish priorities for poverty reduction.

National Dialogue Hampered by Limited Knowledge About the Impact of Policies

Even if the capacity of the national governments were improved and civil society were effectively engaged in a dialogue on the macroeconomic framework, national ownership would be hampered by the current limitations in economic knowledge. An assumption of the PRGF program is that the macroeconomic framework is designed to support the twin goals of sustained economic growth and poverty reduction within the context of stability. National ownership of the macroeconomic framework could then reflect agreement on the broad macroeconomic targets and the policies that support those goals. The expectation of the IMF that countries will assume ownership of their macroeconomic frameworks creates the impression that these countries can hold a meaningful debate on the alternative policy choices that can be implemented, with the policy mix most compatible with national interest embraced. However, a meaningful national dialogue on the range of policies that are available is constrained by the limited knowledge of all parties, including the IMF, about how different policies actually affect elements of the macroeconomic framework. (See app. I for a fuller discussion of how limitations in the existing body of economic knowledge can work to constrain national dialogue.)

The ability to analyze trade-offs among different policy choices requires an underlying model that explains the relationships between these policies and the macroeconomic framework. For example, if as part of the national dialogue the country sought to consider a slowing or even abandonment of its privatization efforts due to concern over lost employment and potential price increases, it would have no way of gauging the impact of this policy on future economic growth. The expectation of the IMF and others is that privatization will lead to increased investment and economic growth. However, there are cases in which the expected growth and investment have not materialized. Attempts to construct models that explain the impact of these various policy choices have not been successful, with the current expectation that such models need to be tailored to each country's individual circumstances in order to be meaningful. The World Bank and others are attempting to develop these models, but the process is slow due to technical complexities and limited, country-specific data.

Chapter 3: Few Changes Evident in Three Countries' Programs

We found a few changes in the IMF programs of the three countries we reviewed—Albania, Benin, and Honduras—that can be clearly attributed to the changes announced by the IMF in 1999. Many elements of the PRGF were also included in the countries' previous programs, making it difficult to determine to what extent their presence reflects the announced changes in the IMF's approach rather than the direction the country's program was moving in anyway. Our review of these countries' efforts highlighted the difficulties countries face in developing a nationally owned macroeconomic framework. First, each government has limited capacity to analyze macroeconomic issues independently. Second, while all three governments have begun to establish a participatory process and promote dialogue with civil society, many people that we spoke with were unsure how to use this dialogue to address a country's complex macroeconomic policies and targets, other than the composition and level of spending. Third, we did not see evidence of changes in country-specific program documents that were called for under the PRGF, such as the inclusion of assessments of the social impacts of reforms and measures to alleviate any negative impacts, which could help facilitate participants' analysis of issues.

Inclusion of Some Elements Difficult to Attribute to New Program

The changes in the IMF programs of the three countries we reviewed that can be clearly attributed to the changes the IMF announced in 1999 are (1) Albania's establishment of a participatory approach for preparing a national development strategy and (2) fewer structural performance criteria in Benin. For example, in Benin, between 1998 and 2000 the number of structural performance criteria decreased from five to two as IMF conditions on the civil service wage scale and privatization of state-owned-enterprises were eliminated.[1] However, the significance of these changes for the IMF program is not clear. For instance, Albania's participatory process does not describe how Albania will include civil society in discussing the macroeconomic framework, and Benin still has to meet two of the three structural performance criteria dropped from the IMF program if it is to receive full debt relief under the Heavily Indebted

[1]Benin met its two remaining performance criteria by the end of August 2000, according to an IMF document.

Poor Countries Initiative.[2] The inclusion of PRGF-type elements in the three countries' current and previous IMF program is illustrated in table 2.

Table 2: Inclusion of PRGF Elements in Three Countries' IMF Programs

Key elements of PRGF (per IMF)	Albania	Benin	Honduras
Greater degree of government ownership and civil society participation	• Under the PRGF/PRSP, Albania established its first participatory process that includes civil society representatives in preparing a national development strategy. • Government officials told us (1) they believe their current IMF program is more of a government-led program than the one negotiated in 1998 because they believe they have increased their capacity to negotiate and (2) the IMF program they hope to negotiate in 2001 will be a country-owned program that is linked to the Growth and Poverty Reduction Strategy (Albania's PRSP).	• Several issues—such as civil service reform and privatization of the cotton industry—have been points of contention in Benin's past and present IMF programs. The first PRGF review notes some of these divergences in views, as well as the agreement between the World Bank and the government of Benin to have consultants assess the impact of the different cotton privatization scenarios. • Broad participatory process is not new for Benin. Benin undertook participatory processes in 1994 and 1998, including one to create a poverty reduction action plan based on full participation of the vulnerable groups. • There has been very little progress in civil society participation in the poverty reduction strategy. No consultations had taken place at year-end 2000, though 12 regional workshops were planned, according to the Interim-PRSP. This is partly due to the presidential elections that took place on March 4, 2001, and were expected to be ongoing through the end of March 2001.	• The government of Honduras has previously worked with civil society to define priorities for the country. After Hurricane Mitch, the government prepared a plan aimed at promoting economic revival and job creation, which involved analysis, discussion, and consultation with representatives of Honduran civil society. • In 2000, the government held 13 regional meetings (including in very remote areas) to present and discuss the draft poverty reduction strategy and met with some nongovernmental organizations in the capital, and members of parliament. Besides resistance toward privatization of electricity distribution, macroeconomic issues that the IMF deals with were not prominent in these discussions. Instead, interest groups generally pushed their sector-specific issues.
Increased focus on poverty reduction	Reducing poverty has been an objective of Albania's IMF program since 1997, when it outlined medium- and short-term strategies for alleviating poverty.	Throughout the 1990s, Benin increased its focus on poverty reduction. To combat widespread poverty, the government undertook national programs and projects at the sector level specifically to address the vulnerable populations.	Since 1995, poverty in Honduras has been discussed more in IMF documents.
Budgets more pro-poor and pro-growth	Since 1998, the government and the IMF have sought to	Budgeted expenditures for education and health in 2000 and 2001 are	Targeted increases in expenditures since 1998 are

[2]The Heavily Indebted Poor Countries Initiative is a comprehensive approach for providing debt relief to the poorest and most indebted countries in the world. For more information on this initiative, see *Developing Countries: Debt Relief Initiative for Poor Countries Faces Challenges.*

Key elements of PRGF (per IMF)	Albania	Benin	Honduras
	• increase social spending, with spending on health and education increasing as a percentage of GDP since 1998. The government projects spending on health and education to increase from 4.7 percent of GDP in 1998 to 7.1 percent in 2003. • reduce the domestically financed deficit to free up credit for private sector. In 1998, credit to the private sector grew by 15 percent. In 2000, it is projected to grow by 39 percent. The government projects public investment expenditures (i.e., infrastructure) to increase from 5.3 percent of GDP in 1998 to 8.7 percent in 2003.	greater than in the recent past but have increased by less than 0.5 percent of GDP. To receive debt relief, Benin must increase basic health expenditures including reproductive health, child immunization, and HIV/AIDS prevention. A key objective of the 1996-99 program was to raise economic growth to 6 percent. The government's main concern was to create growth-enhancing policies that would allow for substantial poverty alleviation. High and sustainable growth rates of 5-6 percent continue to be a goal in the current program.	taking place within the context of efforts to recover from Hurricane Mitch, which makes it difficult to attribute projected increases solely to the PRGF. Pro-poor: More spending for social expenditures (such as rural development and health) and targeting of subsidies to the poor. Social expenditures to increase from about 8 percent in 1999 to about 11 percent of GDP in 2000. Pro-growth: Elimination of remaining export taxes may benefit small banana producers. To support the growth and recovery after Hurricane Mitch, public sector investment is programmed to increase 6.3 percent of GDP in 1999 to 7.9 percent in 2000.
Flexibility in fiscal targets	The overall fiscal deficit as a percent of GDP has remained relatively large during 1997-2000, averaging 11 percent. While the domestically financed budget deficit has declined from 10.7 percent in 1997 to 3.3 percent in 2000, foreign financing rose over this period. Whereas the PRGF document projects a decrease in the overall deficit to 7.1 percent in 2003, the government of Albania projected the overall deficit to be 9.4, according to the Medium Term Expenditure Framework finalized in December 2000. An important reason for the difference between these two projections stems from different expectations on future foreign financing.	Deficits slightly larger than the deficit in 2000 are projected, partly reflecting increased expenditures budgeted for health and education. However, these higher deficit levels may not materialize because of concerns about the government's ability to use additional resources effectively.	For the most part, Honduras has been meeting fiscal targets for the last few years. After Hurricane Mitch struck, the IMF program targeted the central government's 1999 fiscal deficit to increase to 8.6 percent of GDP, but the actual deficit was about 1 percent. For 2000, the IMF programmed a deficit of 6.8 percent of GDP.
Analysis of social impacts of major reforms conducted and countervailing measures included	None mentioned.	Minor anecdotes but no social impact assessments discussed in current or previous IMF program.	No social impact studies cited. April 2000 document said, "The nature and poverty impact of social policies will be reviewed in the process of preparing the final PRSP."
Greater emphasis on good governance	The 1997 program identified the government's limited/weak (but improving) ability to formulate and implement macroeconomic and	Ministries have had difficulties implementing public investment projects, especially those domestically financed. Weak planning, budgeting,	The January 1995 policy framework paper stated that Honduras's public sector has a shortage of technical and

Key elements of PRGF (per IMF)	Albania	Benin	Honduras
	structural measures as the main risk to the program and stated that obtaining future concessional IMF lending depended on improving capacity.	and audit mechanisms, and corruption within the public sector, especially the ministries of health and education, continue to be the major constraints.	managerial staff. The ministries, the public enterprises, and the central bank required institution building and technical assistance in many areas, including project preparation and evaluation, budgetary design and control, and tax policy and administration. To assist the government in these areas, since at least 1994 the IMF has provided technical assistance. Good governance and transparency became major policy issues in Honduras after Hurricane Mitch. IMF documents emphasized the importance of further efforts in those areas.
More selective structural conditionality	Structural performance criteria stayed roughly the same.	Number of structural performance criteria decreased from 5 to 2 between 1998 and 2000 as conditions on civil service reform and cotton privatization were eliminated. After end-August 2000, Benin's program had no structural performance criteria. However, adopting a privatization strategy for the cotton sector is a condition for Benin to receive debt relief.	It appears that the number of structural performance criteria has increased, from two in November 1999 to three in April 2000 to five in October 2000.

Sources: IMF, World Bank, and recipient government documents.

(For additional information on the three countries' programs, see app. II.)

We found that many elements of the PRGF were also included in the three countries' previous IMF programs. In those cases, it is difficult to determine to what extent their continued inclusion reflects the announced changes in the IMF's approach rather than the direction the country's program was moving in anyway. For example, Albania and Benin have focused on reducing poverty for several years.

- One objective of Albania's 1997 program with the IMF was to address the impoverishment of the Albanian population resulting from the collapse of financial pyramid schemes, in which an estimated two-thirds of Albania's population was involved.[3] The program outlined a two-stage strategy for alleviating poverty. In the short term, the government would temporarily expand social safety nets targeted toward the poorest families, including faster disbursements of public assistance and initiation of job-creating public works projects, which were to be funded through cuts in spending in other areas and external assistance. Over the medium term, poverty was to be alleviated through high, sustainable growth driven by private sector development.

- Benin has been moving in the direction of increased attention toward poverty reduction throughout the 1990s. In an effort to combat Benin's widespread poverty, the government has undertaken a number of programs and projects. In 1994, Benin adopted the national program on the Social Dimensions of Development. This program was to explicitly integrate the social dimensions of development with the macroeconomic and sectoral policies, formulate and implement a poverty reduction action plan identified by full participation of the most vulnerable groups, and periodically monitor the population's living conditions to get at the root causes of poverty. In 1998, the National Community Development Program was to supplement the Social Dimensions program using an approach that addressed basic needs identified by the beneficiaries themselves.

Consistent with the goals of the PRGF program, the budgets of all three countries indicate plans to increase spending in priority social areas such as health and education. However, in Albania and Benin, increased government spending in social areas has been an objective of their IMF programs since at least 1998. Importantly, as the IMF notes, the effectiveness of higher spending and deficit targets depends on the governments' ability to use resources well and to obtain financing on reasonable terms, when the governments cannot collect sufficient revenues. In all three countries, IMF program documents have raised concerns about the countries' ability to use resources effectively. In the past, due to the government's weaknesses in effectively planning, executing, and monitoring programs and budgets, Benin has been unable to fully spend available funds, including in priority areas such as primary health and education. Similarly, in December 2000, Albania's Ministry of Finance reported that in all five sectors reviewed—health, education,

[3]In a typical pyramid scheme, a fund or company attracts contributors by offering them very high returns; these returns are paid to the first contributors out of the funds received from those who contribute later. The scheme is insolvent from the day it begins. The scheme flourishes initially as news about the high returns spreads and more contributors are drawn in.

labor and social protection, transport, and public works—insufficient capacities for policy planning and program management constrained the more effective utilization of budgetary resources. The ministry expressed the concern that if the substantial delays that have beset the implementation of many donor-financed projects in recent years were to continue, donor agencies may reduce their planned level of funding.

Difficulties Establishing National Ownership of Macroeconomic Framework

For all three countries, establishing national ownership of their macroeconomic policies and targets has been challenging for several reasons. First, the governments' ability to analyze macroeconomic issues is limited. Second, while all three national governments have organized a participatory process for preparing their countries' poverty reduction strategies, they have found it difficult to determine how to include civil society in discussing macroeconomic policies and targets. Finally, while countries' PRGF program documents are to include information on the social impact of economic adjustment policies, we did not find such information.

Limited Government Capacity

The three governments' ability to analyze macroeconomic issues is limited. For example, although government officials in Albania told us that their capacity to negotiate with the IMF has increased, this capacity is still limited. A recent World Bank report concluded that the Ministry of Finance needs to strengthen its expenditure policy and analytical capacities in order to enhance the policy debate on public spending and the formulation of economic policies.[4] The report further stated that the current framework was largely based on the parameters guiding Albania's PRGF arrangement and that "in the future it is expected that this framework will increasingly reflect the government's own forecasts and analysis." A central bank official in Albania told us that in 1997 a former employee developed a model to analyze macroeconomic policies, but since his departure no one has been able to operate or maintain the model. As for Benin, based on our discussions with government and donor officials there, it was not evident that the government is attempting to develop alternative macroeconomic scenarios based on different policy options. Finally, the January 1995 policy framework paper for Honduras stated that the central bank required assistance in financial programming,

[4]See *Albania Public Expenditure and Institutional Review: A Briefing Note*, World Bank/Europe and Central Asia Region (Washington, D.C.: World Bank, Mar. 1, 2001).

open market, and foreign exchange market operations; and the strengthening of balance-of-payments, money, banking, and national accounts statistics. According to IMF staff, there are Honduran government officials who are capable of devising a macroeconomic framework and discussing macroeconomic policies and trade-offs; however, due to limited budgets and lack of specialists, they sometimes need external technical assistance.

Unclear How to Involve Civil Society in Discussing Many Macroeconomic Issues

All three countries we reviewed have taken initial steps to implement the most significant change resulting from the PRGF—that macroeconomic targets and policies will be nationally owned based on a participatory process. All three national governments have organized a participatory process and initiated a dialogue with civil society for preparing their countries' poverty reduction strategies. However, many people said that they were unsure how to use this dialogue to address the country's macroeconomic targets and policies other than in discussions involving the budget. Determining how, in practice, to include civil society in discussing macroeconomic policies and targets has been challenging due to the following.

- Significant time and resources are needed to establish a participatory process for addressing the numerous elements of the poverty reduction strategy. For example, in Albania, identifying civil society representatives involved significant effort, because civil society does not have a history of being organized and, according to many people we spoke with, remains fractured. Yet, with the help of the Carter Center, civil society has begun to organize itself by sector, provide input to working groups in four key sectors—agriculture/rural, education, health, and labor and social affairs—and assist government working groups in developing and writing sector-specific strategies that will prioritize needs and feed into the government's budget.[5]
- Limited capacity exists in-country for addressing complex macroeconomic issues. Although there is ample donor assistance in Benin, we were not told of any research organizations that are assisting Benin in the development of its macroeconomic framework. Donors in Benin indicated that they prefer to stand back and let the government and the people

[5]In 1982, former U.S. President Jimmy Carter and Rosalynn Carter founded the Carter Center, a nonprofit nongovernmental organization that seeks to promote peace and health worldwide.

decide for themselves how to integrate the sectoral priority areas, such as health and education, into the overall poverty reduction strategy. Government and donor officials in Honduras told us that there are no independent think tanks analyzing macroeconomic issues.[6]

In practice, civil society participation in the three countries has focused on discussing poverty reduction goals and priorities for the composition and level of spending—particularly within specific sectors—to achieve those goals. However, despite the importance of these discussions, they only impact one element of the macroeconomic framework.

Lack of Information on the Social Impact of Adjustment Limits Discussion

Under the PRGF, countries' program documents are to include information on the social impact of adjustment; however, we did not find such information. Such information is to help inform the range of policies considered and the measures designed to ease any temporary adverse impacts. In 1989, the IMF and the World Bank considered inclusion of measures for mitigating adverse effects on the most vulnerable groups to be an essential ingredient for successful structural adjustment. Unlike the lack of knowledge on trade-offs and linkages discussed in chapter 2, such an analysis is doable and, according to the IMF, the IMF and the World Bank have been undertaking such analyses for some time and including this information in country-specific programs. Although we found limited evidence of such analyses in pre-PRGF program documents, we did not find such information in the documents for the three countries' current programs. This information is not difficult to include in program documents relatively quickly, since it does not require the preparation of the poverty reduction strategy and was called for under the IMF's previous program. Despite the limited technical capacities of member governments and civil society, such information is valuable in helping to inform the discussion on the effects of certain policies, especially on the poor

[6]In commenting on a draft of this report, IMF headquarters staff said that there is at least one independent, donor-funded entity in Benin (Cellule d'analyse politique économique) and two groups in Honduras (the economics school at the public university and the Chamber of Commerce) that engage in macroeconomic analysis.

Chapter 4: The Effects of the New Program on Graduation and the Role of the IMF

If the changes the IMF announced for its lending program to its poorest members work to actually improve the overall effectiveness of a country's development program, the likelihood of earlier graduation from the Fund's program could increase. However, the actual impact of these changes on economic growth is unknown at this time and, as previously discussed, there are many challenges to achieving national ownership of effective macroeconomic policies. Nonetheless, our analysis shows that most of the current recipients of the IMF's concessional assistance will require strong, sustained economic growth to reach the point where they would be considered for graduation from concessional Fund assistance. To reach this point within 15 years, we found that the 32 countries that borrowed from the IMF's concessional facility in 2000 must average a real per capita income growth rate in excess of 6 percent annually during that entire period. This significantly exceeds the countries' average growth rate of negative 1 percent over the last 15 years. Unlike the IMF's nonconcessional facilities that are to lend resources based on short-term conditions, the concessional facility does not assume that countries will have only a temporary need for concessional assistance. During the last 15 years, the IMF has functioned as a long-term lender that supports countries' reform programs, and indications are that it intends to retain this role.

Strong, Sustained Economic Growth Essential to Reach Consideration for Graduation

Graduation Eligibility Influenced by a Country's Income Level

Since the beginning of the IMF's Structural Adjustment Facility in 1986, six countries have graduated from program eligibility. Three of those countries (the Dominican Republic, the Philippines, and St. Kitts and Nevis) were graduated from eligibility for concessional lending in 1995. According to IMF documents, this decision was based on three factors: (1) the countries were no longer eligible for IDA funds; (2) their balance-of-payments and debt positions had improved substantially; and (3) they had not used, nor were they expected to use, PRGF resources in the near future. In 2000, China, Egypt, and Equatorial Guinea also graduated from PRGF eligibility, with similar considerations given for that decision. In the case of China, although its per capita income was still below the IDA threshold (its per capita income equaled $750 in 1999), it graduated from both IDA and PRGF eligibility because it was considered creditworthy, with a substantial foreign exchange reserve and a sustainable external debt obligation. Some countries, such as Bolivia and Macedonia, have remained eligible for borrowing under the IDA and PRGF even after their per capita income exceeded this threshold because they were determined to lack creditworthiness under the World Bank's market-based lending facility.[1] Macedonia is considered a candidate for future graduation from both IDA and PRGF eligibility, according to the Fund.

Countries that are only eligible for IMF nonconcessional resources can be added to the PRGF eligibility list if their economic situations worsen. According to IMF documents, as of December 2000, two countries (Uzbekistan and Turkmenistan) had per capita income levels below the IDA threshold and were under consideration for IDA eligibility and could potentially be made PRGF-eligible in due course. Indonesia's per capita income has also fallen substantially over the last several years, and Indonesia is now deemed eligible for IDA resources. However, according to IMF documents, Indonesia is not considered eligible for PRGF resources at this time.

Most Current Borrowers Require Strong, Sustained Economic Growth to Become Eligible for Graduation Within 15 Years

If the changes announced by the IMF for its lending program to its poorest members work to improve the overall effectiveness of a country's development program, the likelihood of earlier graduation could increase. According to an IMF official, the poverty reduction strategy is likely to improve a country's overall economic growth rate by having the country's national dialogue focus increased attention on ways to accelerate its growth rate and through increased coordination among the donors. However, the actual impact of these changes on economic growth is unknown at this time and, as previously discussed, there are many challenges to achieving national ownership of effective macroeconomic policies.

To better understand the likelihood that current borrowers will graduate from eligibility from the IMF's concessional lending facility, we analyzed borrowers' per capita income growth rates in the previous 15 years and

[1]This facility is the World Bank's International Bank for Reconstruction and Development loan facility.

the impact of projected economic growth over the next 15 years.[2] We estimated per capita income growth rates based on forecasts provided by Standard & Poor's DRI for each of the 32 countries that received assistance from the PRGF in 2000.[3] As is demonstrated in table 3, the DRI-projected growth rates are considerably greater than the growth rates that most of these countries experienced over the previous 15 years.

[2]We focused on countries that received PRGF disbursements in calendar year 2000. Our analysis focused only on per capita income in our consideration of graduation. This was due to three reasons: (1) per capita income is the primary factor in determining eligibility; (2) forecasts of creditworthiness and balance-of-payment positions would be very speculative and difficult to implement; and (3) as discussed previously, although some countries graduate prior to reaching that threshold, others do not graduate until they have exceeded that level for some time. Thus, we consider the IDA per capita income threshold to be a reasonable proxy for graduation eligibility. We used the 1998 IDA threshold of per capita income of $895 or less, which corresponds to the 1998 per capita income levels used in the analysis.

[3]DRI is a unit of Standard & Poor's, which is a division of The McGraw Hill Companies. It is a leading provider of industry and economic data, forecasting, and consulting services. Its World Forecast Database includes historical and forecast data for 170 countries.

Table 3: Projected and Previous Annual Growth Rates for 32 PRGF Borrowers

Country name	1998 per capita GNP	Forecasted real per capita GDP growth rates, 2001-2015[a] (in percent)	Projected per capita GNP in 15 years, using forecasted real per capita GDP growth rates (in 1998 U.S. dollars)	Number of years required to reach IDA threshold of $895, using forecasted real per capita GDP growth rates	Rate of growth required to reach IDA threshold of $895 per capita GNP in 15 years (in percent)	Real per capita GNP growth rates over past 15 years (in percent)	Real per capita GNP growth rates over past 5 years (in percent)
Albania	$810	4.57%	$1,582.5	2	0.67%	2.69%	4.67%
Benin	380	2.26	531.2	38	5.88	0.22	2.38
Bolivia	1,010	3.31	1,645.0	-4	-0.80	1.61	2.23
Burkina Faso	240	2.19	332.3	61	9.17	0.85	2.15
Cambodia	260	4.14	477.5	30	8.59	1.96	1.52
Cameroon	610	1.88	806.3	21	2.59	-4.02	0.81
Chad	230	2.19	318.4	63	9.48	0.17	1.40
Djibouti	789	0.91	904.2	14	0.84	-4.12	-3.36
Gambia, The	340	1.87	448.7	52	6.67	-0.57	-0.71
Ghana	390	2.94	601.9	29	5.69	1.49	1.51
Guinea-Bissau	160	1.61	203.3	108	12.16	0.44	-3.15
Guyana	780	3.12	1,237.3	4	0.92	2.82	7.44
Honduras	740	1.78	964.0	11	1.28	0.55	0.91
Kenya	350	2.73	524.0	35	6.46	0.16	1.82
Kyrgyz Republic	380	3.20	609.9	27	5.88	-5.71	-1.44
Macedonia, FYR	1,290	4.28	2,417.8	-9	-2.41	-1.40	1.10
Madagascar	260	1.29	315.3	96	8.59	-1.28	-0.24
Malawi	210	2.92	323.2	50	10.15	0.25	2.80
Mali	250	2.18	345.4	59	8.87	-0.10	1.55
Mauritania	410	1.96	548.6	40	5.34	0.11	2.19
Moldova	380	3.50	636.8	25	5.88	-8.29	-7.28
Mongolia	380	3.44	631.4	25	5.88	-1.20	2.18
Mozambique	210	4.68	417.0	32	10.15	2.39	6.42
Nicaragua	370	2.96	573.2	30	6.07	-2.45	5.70
Niger	200	0.41	212.6	366	10.51	-1.69	0.60
Rwanda	230	-0.63	209.3	∞[b]	9.48	-3.62	0.96
Sâo Tomé and Principe	270	0.87	307.4	138	8.32	-1.19	-0.69
Senegal	520	2.78	785.1	20	3.69	-0.09	2.64
Tajikistan	370	2.67	549.4	34	6.07	-11.89	-6.78
Tanzania	220	3.02	343.6	47	9.81	0.27	1.22
Uganda	310	2.71	463.2	40	7.32	2.70	4.92
Zambia	330	2.32	465.7	44	6.88	-1.07	-1.04
Average	$427	2.50%	$648	59	6.13%	-0.94%	1.08%
Median	$360	2.69%	$528	34	6.26%	.01%	1.45%

Legend

FYR = Former Yugoslav Republic
GNP = Gross national product

Note: Data from World Bank's World Development Indicators 2000, CD-ROM. The past 15-year growth rate is based on real per capita GNP from 1983 to 1998, except for the following countries for which the data were available for only the following years; Albania – last 8 years; Bolivia – last 10 years; Cambodia – last 11 years; Djibouti – based on DRI GDP data, not GNP; Kyrgyz Republic– last 12 years; Macedonia – last 6 years; Moldova – last 6 years; Sâo Tomé and Principe – last 12 years; Tajikistan – last 12 years; and Tanzania – last 10 years.

[a]Forecasted real per capita GDP growth rates are calculated from Standard & Poor's DRI's forecasted real GDP and population growth rates.

[b]Given the projected negative growth rate for Rwanda over the next 15 years, its projected GNP per capita does not converge toward the IDA threshold. For the purpose of calculating an average duration until graduation, we assigned Rwanda the same value (366) as the next highest estimate.

Source: GAO analysis using data from the World Bank and Standard & Poor's DRI.

Although the DRI-projected country growth rates are generally higher than prior growth rates, they are only sufficient to bring four countries—Albania, Djibouti, Guyana, and Honduras—to per capita income levels that would exceed the IDA eligibility threshold by the end of the 15-year period.[4] An additional 26 countries would still have per capita income levels that were below the graduation threshold. Given that the current per capita income levels of these countries is generally quite low (an average of $427), the average number of years required for these countries to reach the graduation threshold at their projected per capita income growth rates is 59, with Niger requiring 366 years.

To reach the eligibility threshold within 15 years, these countries must average a real per capita gross national product growth rate in excess of 6 percent annually over that entire period. The poorest country, Guinea-Bissau, must average a real growth rate in excess of 12 percent a year to reach the threshold for graduation within 15 years. Such high, sustained

[4]As of the end of 2000, the per capita income level of Bolivia and Macedonia already exceeded the IDA eligibility threshold.

growth levels would greatly exceed the rates projected by DRI and those that have prevailed in the past.[5]

The IMF Has Been a Long-term Lender to Low-income Countries

The underlying problems that IMF assistance is designed to help address in poor countries often take a long time to resolve. In an August 2000 speech, the Managing Director of the IMF said that the efforts to combat poverty "will inevitably be an arduous and often lengthy process." According to an IMF official, the IMF is likely to continue to provide a low-income country with resources as long as it has a need for such resources, resources are available to be lent, and the country pursues effective policies.

Unlike the IMF's nonconcessional resources, there is no presumption under the PRGF that countries will have only a temporary need for concessional assistance. Each program under the PRGF is scheduled to last for 3 years, but countries can receive follow-on programs over time, if needed. The purpose of PRGF assistance is to strengthen a country's balance-of-payments position and foster lasting economic growth. This purpose extends beyond temporary balance-of-payments difficulties, which are the focus of IMF nonconcessional assistance. They also allow the IMF wide latitude to lend to poor countries, given the countries' underlying vulnerabilities and low standards of living. For example, in recent years Benin has had a very stable macroeconomic environment, with low inflation, a balance-of-payments surplus, low budget deficits, and good economic growth. Within this healthy macroeconomic context, in July 2000 the IMF and Benin negotiated another program for an additional 3 years, with the objectives of achieving high and sustainable economic

[5]It should be noted that this average projected level of growth is actually lower than the levels called for by the World Bank and the IMF for many of these countries over the next 15-20 years. For example, in a speech given in February 2001, the Managing Director of the IMF endorsed a plan proposed by African leaders that called for a sustained growth rate in Africa of at least 7 percent. Such high growth levels are needed to achieve the reductions in poverty called for by the donors in Copenhagen in 1995. To the extent that such high growth rates are achieved, graduation from PRGF eligibility would be realized sooner.

growth and reducing poverty while maintaining macroeconomic stability during 2000-03.[6]

As shown in table 4, the 32 countries that received IMF concessional assistance in 2000 also received assistance for about 9 years since the inception of the Structural Adjustment Facility in 1986 and for about 7 of the last 10 years.[7]

Table 4: Number of Years 32 Countries Received IMF Resources

Country	Number of years countries received IMF resources, 1986-2000	Number of years countries received IMF resources, 1991-2000
Albania	8	8
Benin	9	8
Bolivia	13	9
Burkina Faso	9	9
Cambodia	5	5
Cameroon	10	8
Chad	10	7
Djibouti	6	6
Gambia, The	9	4
Ghana	12	7
Guinea-Bissau	8	6
Guyana	11	10
Honduras	8	7
Kenya	8	5
Kyrgyz Republic	8	8
Macedonia, Former Yugoslav Republic	7	7
Madagascar	10	5
Malawi	11	8
Mali	13	9
Mauritania	13	8
Moldova	7	7
Mongolia	8	8

[6]According to IMF staff, the new PRGF arrangement was necessary for Benin to benefit from full debt relief. In addition, given the vulnerability of the macroeconomic framework to frequent internal and external shocks, an IMF-supported program was considered necessary to consolidate the achieved macroeconomic stability and for the Fund to play its catalytic role in securing other donors' assistance.

[7]During 1986-2000, 28 of these countries received nonconcessional IMF assistance in addition to concessional assistance.

Country	Number of years countries received IMF resources, 1986-2000	Number of years countries received IMF resources, 1991-2000
Mozambique	13	9
Nicaragua	5	5
Niger	10	5
Rwanda	6	6
Sâo Tomé and Principe	2	1
Senegal	13	8
Tajikistan	5	5
Tanzania	11	7
Uganda	13	9
Zambia	5	4
Average	8.9	6.8
Median	9	7

Source: GAO analysis of IMF data.

Fourteen of these countries received IMF assistance for 10 or more of the last 15 years, with Guyana receiving assistance continually over the last 10 years. In August 2000, the Managing Director of the IMF stated the institution's commitment to remain engaged in the world's poorest countries. Over the last 15 years, the IMF has functioned as a long-term lender to these countries to support their reform programs, and indications are that it intends to continue to do so.

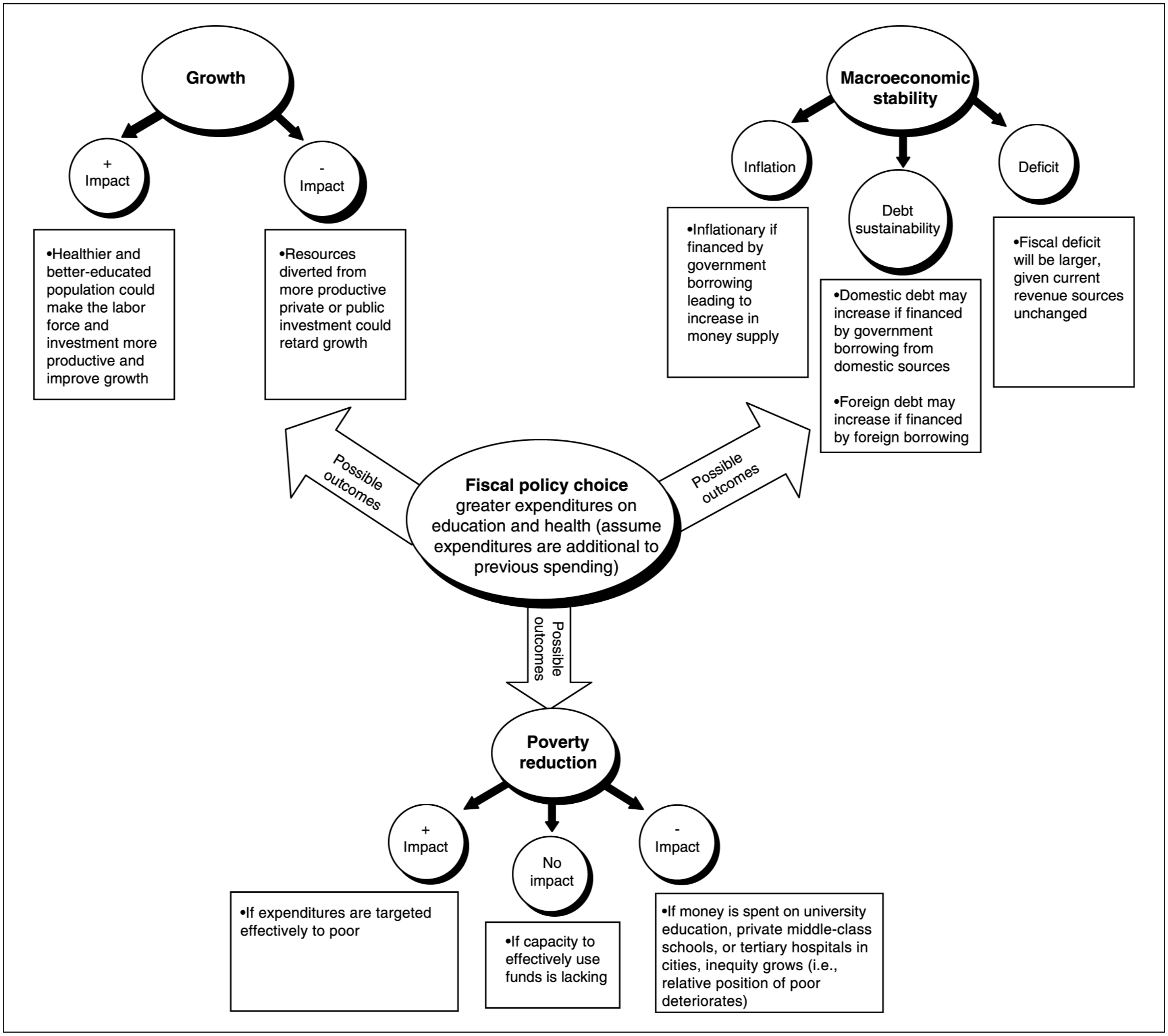
Appendix I: Identifying the Impact of Different Policy Choices Is Difficult

As part of the goal of establishing national ownership of the macroeconomic framework, the government and civil society may seek to discuss the impact of different policy options, to help establish a consensus for reform. However, as discussed in chapter 2, meaningful national dialogue on the range of policies that are available is constrained by the limited knowledge of all parties, including the International Monetary Fund (IMF), on how different policies actually affect elements of the macroeconomic framework. To help illustrate these complexities, we describe the possible impacts of a policy that has been prominently mentioned—increased spending on education and health—on the goals of economic growth and poverty reduction in the context of maintaining macroeconomic stability.

The Impact of Increased Spending on Education and Health Is Uncertain

As part of the change from the Enhanced Structural Adjustment Facility (ESAF) to the Poverty Reduction and Growth Facility (PRGF), the IMF called for budgets of countries to be more “pro-poor.” However, it is difficult to evaluate the impact of this strategy, according to the IMF, because of the limited knowledge of the relationship between expenditures and actual results. In addition, for the policy to be effective, it often requires supporting structural and governance reforms that should also be taken into account. One example of increased pro-poor budgets that has been discussed is a greater allocation of spending to the education and health sectors. While such a policy choice may be appropriate for a country to pursue, the actual impact on economic growth, poverty reduction, and macroeconomic stability is uncertain, as demonstrated in figure 3.

Figure 3: Complex Linkages Between Increased Spending on Education and Health and Goals



Source: GAO analysis of IMF, World Bank, and academic documents.

The impact of increased education and health spending on poverty reduction depends chiefly on two factors: the effectiveness of the increased spending and its allocation. As discussed in chapter 3, poor countries have had difficulties in recent years in effectively utilizing resources, including those provided by donors. If the money is not well spent or not spent at all, the impact on poverty reduction will be negligible. For example, if the money is used to build new schools and clinics, but there are not enough teachers and doctors to fill them, then the improvement of health and education will likely be small. In addition, despite the stated goal of increased expenditures to the poor, the increased expenditures could be allocated instead to services primarily used by the middle class and the wealthy. In such a case, relative poverty may in fact rise as income inequality worsens. However, if the concerns over effectiveness and allocation are sufficiently addressed, the increased spending could work successfully to influence indicators of poverty, such as educational attainment and child mortality. Poor countries have confronted these concerns for some time, and the actual impact of increased spending on poverty reduction remains difficult to determine.

Impact on Economic Growth

The impact of increased spending on economic growth is even more difficult to determine. Whereas a healthier and better-educated population may contribute to increased economic growth, the actual benefit is uncertain, since this reallocation of resources may divert spending away from other uses that would have a clearer and more immediate impact on productivity. The benefits of increased health and education spending may take years to materialize and require complementary resources (such as land and capital) to achieve the greatest impact on productivity. In simple terms, a country is not likely to benefit much from greatly increasing the productivity of its labor force if there is a scarcity of opportunity for laborers to utilize their skills effectively. As shown in chapter 4, most PRGF countries have had little or no growth in the previous 15 years. Thus, the identification of investments that would be most productive for these economies has proven very challenging.

Impact on Macroeconomic Stability

As discussed in chapter 2, the consideration of policy choices should also account for their impact on macroeconomic stability. Countries that experience macroeconomic instability have tended to have low or even negative economic growth, which also negatively impacts their effort to reduce poverty. In assessing the increased expenditures on education and health, the issue is whether this budgetary allocation is consistent with maintaining macroeconomic stability. However, as discussed in chapter 2, it is not possible to establish a definitive boundary between macroeconomic stability and instability.

The increased expenditure on education and health could raise the risk of macroeconomic instability if it negatively impacts the inflation rate, debt sustainability, and the deficit. If these increased expenditures represent borrowed resources, then all three factors could be negatively impacted. We found in a recent report that the efforts to reallocate Heavily Indebted Poor Country debt relief to poverty spending could only increase spending if the countries borrowed these resources.[1] Efforts to finance this increased spending through donor-financed concessional borrowing are likely to present the least threat to macroeconomic stability in the short run. However, as we found in the recent report, unless countries achieve strong, sustained economic growth, they are likely to have problems with debt sustainability in the future. Thus, these macroeconomic stability concerns have to be integrated into the trade-offs when assessing the choice of the best policy.

The Need for Improved Economic Models

Given the challenges that confront government and civil society in choosing the correct policies to achieve the country's goals, it is not clear "how" or "if" a specific macro policy instrument, such as targeted expenditures on the poor, will lead to the ultimate goals–growth and poverty reduction in the context of macroeconomic stability. The difficulty of specifying imperfectly understood linkages, the numerous possible outcomes, and the challenges in assessing the trade-offs involved make it difficult to choose the appropriate macro policy stance (e.g., a larger fiscal deficit) and to select the specific macro policy instrument (e.g., targeted expenditures on the poor). Given the complexity of the links between macroeconomic policies and poverty, the IMF and the World Bank have suggested that to assist countries in assessing these trade-offs and the distributional implications of their macroeconomic policies, it would be particularly useful for them to have a quantitative model that identifies the critical relationships. These models, however, are presently only at a nascent stage of development.

[1] See *Developing Countries: Debt Relief Initiative for Poor Countries Faces Challenges* (GAO/NSIAD-00-161, June 29, 2000).

Appendix II: Key Events and IMF Programs in Albania, Benin, and Honduras

Albania, Benin, and Honduras have borrowed from the IMF's concessional lending facilities since at least the early 1990s. They each have experienced internal or external shocks such as civil unrest, declines in the world price of a major export, and natural disasters. Tables 5-7 provide information on key events and the IMF-supported programs in Albania, Benin, and Honduras.

Table 5: Key Events in Albania, 1991-2001

	1991	1992	1993-95	1996
Key social, economic, and political events	Collapse of Albania's Communist regime was accompanied by economic and political chaos. Deteriorating living conditions and growing awareness of political alternatives contributed to widespread social unrest, public disorder, and severe disruptions in government functions and institutions. Albania became dependent on emergency food aid.	Democratically elected government took office, moved quickly to restore civil order, and embarked on an ambitious economic reform program.	Steep macroeconomic recovery. Average GDP growth neared double digits, inflation fell to single digits, and external imbalances fell sharply. Impressive economic performance reflected reforms such as privatization of agriculture and financial discipline. Yet, limited progress was made in reforming the banking sector and building the government's institutional capacities.	Signs of an impending crisis: About two-thirds of Albania's population contributed to pyramid schemes, totaling almost half of the country's GDP.[a] Albania made little progress in structural reforms. Growth remained rapid. However, it was supported by pyramid schemes and election-driven loose fiscal policy that permitted a near tripling of annual inflation.
IMF program	Albania joined the IMF and the World Bank.	IMF Board approved a 1-year stand-by (nonconcessional) arrangement of about $28.2 million.	IMF Board approved new, 3-year ESAF arrangement of about $59.2 million in July 1993. IMF staff said Albania's performance was impressive during the first 2 years but deteriorated subsequently so that an agreement on the third annual arrangement could not be reached.	

1997	1998	1999	2000-01
Collapse of pyramid schemes triggered deep economic and social crisis, bringing the economy to a standstill. Albania descended into near civil war in which about 2,000 people were killed. The government resigned. The interim government made impressive progress in restoring order and stabilizing the economy. New government elected in July.	20,000 refugees fled escalating conflict in Kosovo for northern Albania. Civil unrest occurred in September after a prominent opposition politician was shot; the Prime Minister resigned. New government reaffirmed the economic policies of the IMF-supported program.	Crisis in Kosovo erupted when the NATO campaign against Yugoslavia began. Refugees poured into Albania; by mid-May about 430,000 largely destitute refugees had flooded into Albania. In the fall, an internal power struggle forced the Prime Minister to resign; the transfer of power was smooth.	In May 2000, the government completed its interim poverty reduction strategy. In November, the government launched a participatory process for developing its poverty reduction strategy. Local elections in October were relatively peaceful but remain contested by opposition party.
IMF approved emergency post-conflict assistance totaling about $12.1 million under a 6-month program. *Immediate priorities*: restore security, achieve macroeconomic stabilization, and rebuild institutional capacity to help resume growth. Resuming sustainable, job-creating growth was a key priority. Pyramid-scheme crisis impoverished the population; government developed short-term and medium-term poverty alleviation strategies. *Risks to program*: Authorities' limited capacity to formulate and implement macroeconomic and structural measures and the difficulty of projecting key economic variables in uncertain circumstances.	IMF approved new, 3-year ESAF arrangement of about $47.9 million. *Main objectives*: restart rapid growth and reduce inflation further--to generate employment and reduce poverty--and reduce the current account deficit to levels consistent with medium-term viability. Reforms in 1999 to allow for increased spending on government priorities—infrastructure and social services, especially health and education. Government reaffirmed short- and medium-term poverty alleviation strategies.	Despite disturbances, Albania generally met the macroeconomic targets, although progress on structural reforms was delayed. Refugees stretched the already thin administrative capacity of the government, risking a breakdown in law and order and social stability. Refugees placed considerable strain on the social and economic infrastructure, budget, and balance of payments. In response, the IMF increased ESAF resources by about $13.3 million. Fiscal deficit remained on track, with disappointing tax collection (partly due to continued problems in customs administration) offset by significant underspending, particularly on public investment.	Albania met all performance criteria between January 2000 and January 2001. Cautious policies and generous external assistance allowed the economy to weather the Kosovo refugee crisis. Economy still suffers from acute structural weaknesses (i.e., no reliable electricity); poor governance; and problems enforcing law and order, with graft reportedly remaining widespread. Significant progress made in improving tax collection and implementing structural reforms, including two major privatizations, in 2000.

Legend
GDP = Gross domestic product
NATO = North Atlantic Treaty Organization

[a]According to IMF staff, in a typical pyramid scheme, a fund or company attracts contributors by offering them very high returns; these returns are paid to the first contributors out of the funds received from those who contribute later. The scheme is insolvent from the day it begins. The scheme flourishes initially as news about the high returns spreads and more contributors are drawn in.

Source: GAO review of IMF and Albanian government documents.

Table 6: Key Events in Benin, 1960s-2001

	1960s-70s	1980s	1990-93	1994-95
Key social, economic, and political events	Benin became a leading innovator in primary health care, designing--without outside help--a primary health care system involving rural populations and covering the entire country, according to a World Bank report.	During this period, under President Kérékou, Benin was a Marxist-Leninist state. Policies pursued in the 1980s led to economic stagnation characterized by significant imbalances, debt, and a severe financial crisis. By 1986, Benin's health care system ranked among the poorest in Africa. The banking system collapsed in 1988. Fundamental political changes occurred as Benin abandoned Marxist policies by the end of 1989, becoming a multiparty democracy in the following year.	GDP growth resumed in 1990, the inflation rate was low, the fiscal balance was in surplus, confidence in the banking system was restored, and reserves increased. Peaceful transfer of power in 1991 presidential elections. Significant effort to contain the wage bill through voluntary departure from civil service.	Adjustment strategy--strengthened by currency devaluation--increased the profitability of cotton but also led initially to slowdown in economic activity and jump in the inflation rate to 54 percent. Country remained one of the poorest in the world on a per capita income basis. Management deficiencies cited in ministries of education and health. Insurance and cotton ginning sectors opened to private sector investment.
IMF program	Benin joined the IMF and World Bank in 1963.	IMF Board approved a 3-year structural adjustment loan in 1989 of about $28.1 million.	IMF Board approved a 3-year ESAF arrangement of about $72.5 million in 1993. Thrust of adjustment programs was to develop a market-based economy: reduce public sector, promote private sector, improve public finances, reform taxes,reform regulatory system, liberalize prices, and privatize state-owned entities.	IMF approved annual loan under ESAF.

1996	1997-98	1999	2000-01
Mathieu Kérékou elected President. His main concern was to devise growth-enhancing policies to allow for a substantial and visible poverty alleviation and improvement in basic services. Petroleum-distributing sectors opened to private sector. Given its heavy reliance on cotton production and exports, Benin was vulnerable to trade risks and environmental deterioration.	Government adopted national plan for combating poverty, 1998-2002. Government unable to fully spend budget appropriations. Opposition encountered for civil service reform and privatization of the cotton sector and utilities. Severe drought in early 1998 impaired cotton production and resulted in power shortages, which negatively impacted economic performance in 1998.	Legislative elections in March 1999 resulted in opposition parties gaining a slight majority. Deterioration in cotton sector due to drop in international prices, compounded by a fall in production and weak management. Banking system remained heavily exposed to cotton sector; thus, vulnerable to adverse developments in cotton sectors. PRSP process launched in November 1999 with IMF and World Bank workshop for government officials.	In June 2000, the government completed its interim poverty reduction strategy paper and was declared eligible for debt relief of $265 million (net present value) under the HIPC Initiative. Low absorptive capacity continued to lead to social and public investment underspending. Government partially reformed cotton sector, but progress on privatization was slow. Concerns about grave financial problems and mismanagement related to petroleum privatization uncovered by audits in two banks.
IMF Board approved 3-year ESAF arrangement of about $39.5 million. *Key objectives*: raise economic growth to 5.5 percent, limit inflation to 3 percent, attain sustainable balance of payments, and alleviate poverty. According to IMF staff, Benin made progress in several areas including a reduction in domestic and external financial imbalances, the acceleration of growth, and increased private and public investment	In December 1998, the IMF concluded that Benin had satisfactorily implemented the program despite protracted discussions due to disagreement on key reforms and delays in implementing structural reforms, notably in the liberalization of the cotton sector and the divestiture program. *1998-99 program*: emphasis continued from previous program, which aimed at increased spending in social sectors and public investment. Structural policies focused on strengthening public resource management, civil service wage reform, privatization, expanding social programs, and reducing poverty.	Progress made in implementing structural measures, but there were delays. Fall in cotton production and export price, lack of market flexibility, and weak management capacity were expected to have broad repercussions for rest of economy, including expected reduction in GDP growth. *Policies*: Fiscal still on track. Liberalize cotton ginning enterprise, complete civil service reform, and continue to reduce public sector involvement in utility companies and the main port. Focus on poverty alleviation and social policies by increasing spending for health and education.	Presidential elections held March, 2001. Benin's economic and financial performance remained satisfactory. Surplus in overall balance of payments due to a high level of external financial assistance. IMF approved 3-year PRGF arrangement for about $35.7 million in July 2000. *Key objectives*: medium-term program aimed at achieving high and sustainable economic growth of 5-6 percent, maintaining financial stability, and reducing poverty. First review under the PRGF in December 2000 noted that structural reforms were delayed.

Legend
GDP = Gross domestic product
HIPC = Heavily Indebted Poor Countries
PRSP = Poverty Reduction Strategy Paper

Source: GAO review of IMF and Benin government documents.

Table 7: Key Events in Honduras, 1992-2000

	1992	1993-94	1995	1996
Key social, economic, and political events	Government authorities introduced a medium-term economic program for 1992-95 that aimed to consolidate the stabilization effort and deepen structural reforms initiated in 1990. Remaining interest subsidies were eliminated, and the liberalization of price, import, and export controls in agriculture and forestry improved resource allocation in these sectors. Economic activity recovered (real GDP rose by 5.6 percent), with inflation declining sharply to 6.5 percent, and structural reform efforts continued. Fiscal position weakened, however.	Economic activity expanded with a growth of real GDP of 6 percent, but the overall financial situation deteriorated sharply in the run-up to the presidential elections in November. Financial imbalances widened sharply, resulting in the fiscal deficit reaching 10.7 percent of GDP. Volume of coffee and banana exports (Honduras's main export crops) declined. The inflation rate grew to 10.3 percent by June 1993. Economic situation deteriorated further in 1994. Economic activity was affected adversely by major electricity shortages (partly related to a drought) and a reduction in construction activity. Plunging world coffee prices and a severe drought that damaged agriculture also contributed to decline in economic activity.	Economic situation improved with growth rate of about 4.5 percent, but the inflation rate declined only slightly to 27 percent.	Key structural policies, including progress toward the privatization of public utilities, recapitalization of the central bank, and strengthening the finances of the social security system, were delayed or deferred. Real GDP growth remained at 3.7 percent, while the annual inflation rate was 26 percent in December.
IMF program	IMF Board approved new, 3-year ESAF program of about $57 million and disbursed about $9.6 million.	IMF Board approved second ESAF disbursement of $9.5 million in July 1993.	IMF Board approved second annual ESAF arrangement for about $30.9 million in January, increased the total access under the 3-year arrangement to about $82.4 million, and extended the ESAF program through July 1997.	Negotiations on a third annual arrangement were not concluded, because government authorities were not prepared to enter into commitments that would extend into the presidential primaries in late 1996.

1997	1998	1999	2000
Macroeconomic performance improved, but there was little progress in carrying out structural reforms, including privatization of electricity distribution and issuance of bids for half of shares of HONDUTEL (the state-owned telecommunications company). Real GDP growth was 5.1 percent. The annual inflation rate declined to 13 percent in December.	New President took office in January and declared that the government's main objective was to reduce poverty through policies aimed at achieving faster economic growth and providing broader and more effective social services. Hurricane Mitch hit in October, causing the deaths of close to 7,000 people, displacing nearly 2 million people, destroying several towns and villages, and damaging infrastructure and the economy. Estimates of the damage to the economy indicate that direct losses of inventories and fixed assets amounted to about 100 percent of annual GDP.	Reconstruction efforts and improvements in external environment helped bring about a recovery in economic activity during the second half of the year, containing the decline in real GDP to 1.9 percent for the year as a whole. The end-year inflation rate fell to 10.9 percent, the lowest since 1992. In December, Honduras was declared eligible for debt relief under the Heavily Indebted Poor Countries Initiative. The government initiated work on its poverty reduction strategy.	Recovery from the hurricane continued. A pick-up in key exports (bananas, coffee, and maquila) and agricultural production, especially during the second quarter, helped lift real GDP growth to nearly 5 percent in 2000. The government completed its interim poverty reduction strategy in March and began a participatory process for developing a full poverty reduction strategy.
Commitment period for ESAF arrangement expired in July. The government authorities' economic program for 1997 was monitored by IMF staff.	In December the IMF Board approved Honduras's request for emergency financial assistance of about $66 million to support the government's economic recovery program and associated relief and reconstruction efforts in the aftermath of Hurricane Mitch.	IMF Board approved a new, 3-year arrangement under ESAF for about $215 million in March. IMF Board completed first PRGF review and approved $22.5 million disbursement in December.	IMF completed second review under the PRGF and approved a $21 million disbursement in June.

Legend
GDP = Gross domestic product

Source: GAO review of IMF and Honduras government documents.

Appendix III: Comments From the Department of the Treasury

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

ASSISTANT SECRETARY

April 25, 2001

Mr. Harold J. Johnson
Director, International Affairs and Trade
General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Johnson:

Thank you for your letter of April 12, 2001, and the GAO's draft report on the International Monetary Fund's Poverty Reduction and Growth Facility ("Few Changes Evident in Design of New Lending Program for Poor Countries").

The GAO's report addresses a number of important issues concerning IMF concessional lending to poor countries. The new administration is examining these and other issues related to the international financial institutions. We will carefully study the GAO's report over the coming weeks in this broader context. We look forward to working with you.

Sincerely,

Mark Sobel

Mark Sobel
Acting Assistant Secretary
International Affairs

Appendix IV: Comments From the International Monetary Fund

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

INTERNATIONAL MONETARY FUND
WASHINGTON, D.C. 20431

CABLE ADDRESS
INTERFUND

April 24, 2001

Mr. Harold J. Johnson
Director, International Affairs
United States General Accounting Office
441 G Street, N.W.
Washington, DC 20548

Dear Mr. Johnson:

See comment 1.

Thank you for giving us the opportunity to comment on the draft report of the General Accounting Office (GAO) on the Poverty Reduction and Growth Facility (PRGF). The contrast between the GAO's report and the more positive assessment of member governments and non-governmental organizations—including some who have been critical of previous IMF-supported programs in low-income countries—suggests that the report could be more measured in its judgments. Other groups have recognized that the new approach to nationally developed and owned poverty reduction and growth strategies indeed represents a fundamental change in the design of IMF-supported programs and a major and welcome advance on past practice. While some have raised issues regarding the challenges to be overcome in its implementation, they have also accepted that it would be premature to reach a judgment on implementation until more programs have been reformulated in accordance with the new strategy. We believe that, in a number of areas, further investigation by the GAO team might have resulted in judgments more in line with that of other assessors.

See comment 1.

First, we believe the report understates the extent to which the Poverty Reduction Strategy Paper (PRSP) approach influences the design of PRGF-supported programs. Under this approach, PRGF-supported programs are to be based on a nationally developed and openly discussed poverty reduction strategy, as embodied in a PRSP. The national development and control of the document and the involvement of civil society in the formulation of policies are essential requirements for a PRSP. Where the process of bringing about such transparent public discussion and civil society involvement has not yet been sufficiently developed, the PRGF requires an interim document (the I-PRSP) in which the government lays out its existing poverty reduction strategy and commits to developing and modifying that strategy on the basis of an open and transparent participatory process. This represents a major change from the way in which concessional assistance was previously provided by the international financial institutions – including under the IMF's ESAF arrangements.

See comment 2.

While involving civil society in the preparation of a poverty reduction strategy will be difficult and time consuming, it is now widely considered to be an essential ingredient for

See comment 3.

program ownership. The GAO report discounts the process of public (and to some extent even government) involvement in the formulation of key macroeconomic policy choices, on the grounds that it is impossible for the poorer countries to develop national professional capacity to debate the issues. Creating the *opportunity* for a more open and inclusive policy dialog is surely a prerequisite (and incentive) for the development over time of the necessary *capacity*. In our view, the prospect of greater public involvement in policy discussions does have the potential to improve strategies for poverty reduction and increase national ownership of economic reform in all countries.

See comment 4.

The PRSP now forms the underpinnings not only of the IMF's PRGF, but also of the World Bank's concessional lending programs, and it is also being adopted as a common framework by a number of important bilateral aid agencies. This should ensure more effective coordination and a better division of labor between the two Bretton Woods institutions, and it holds the promise of greater coherence with bilateral donors' operations. These innovations respond directly to the independent external evaluation of the ESAF/PFP regime, and should result in support for low-income countries that is both more effective and less burdensome than before. This is a significant difference from the Policy Framework Paper (PFP), which directly influenced only the ESAF operations of the IMF, and might have been acknowledged in the report.

See comment 5.

In addition, there is substantial diversity in macroeconomic frameworks in published PRGF-supported programs. We consider this to be evidence of the range of policy objectives the Fund is willing to support, and hence indicative of the scope for debate in the PRSP process. The report's conclusions about the lack of scope for macroeconomic flexibility in PRGF-supported programs could be usefully reconsidered, based on an assessment of actual PRGF arrangements.

See comment 6.

See comment 7.

The second area where further investigation might have been fruitful is the examination of actual changes in PRGF-supported programs as a result of the new initiative. We know change is taking place in many PRGF-supported programs. Time will tell how successfully the process of involving civil society will translate into the content of PRSPs that underpin future PRGF–supported programs. But by focusing on only three country studies, each of which is built on an interim PRSP (two of which pre-dated the creation of the PRGF and are therefore based on the original ESAF-supported program), the report overlooks important parts of the story. In spite of being at this interim stage, each case is assessed against the standards of full PRSPs—for instance, that there should have been public input into policy choices, including the macroeconomic framework, together with social impact assessments of the policies supported by the PRGF. Not surprisingly, the study concludes that little has changed in these cases. We believe this judgment would have been different had the authors looked at a broader range of countries, or come to these three cases at a later stage. We ourselves have acknowledged the many challenges involved. However, the potential is real, and should not be dismissed before it has been given a chance.

Finally, poor countries' future growth prospects will be determined in large part by the policies they adopt and the help they receive. Those policies, and the results for growth, See comment 8.

- 3 -

improved markedly over the past decade with ESAF support. The report seeks to assess whether the PRGF increases the probability of recipient countries graduating from use of concessional resources within 15 years, by examining the likelihood that the per capita income of low-income countries will rise to the level of middle income countries by 2015. We agree that this outcome, as desirable as it may be, is not realistic for many users of the PRGF. But the GAO analysis could be more tightly focused on whether outcomes are likely to be better in this respect under the PRGF than under the ESAF, let alone under no support from the Fund at all. We are confident that the PRSP approach, as it helps to build broader political support for reforms and greater public accountability for results, can only reinforce the positive trend established under the ESAF.

Sincerely yours,

Jack Boorman
Director
Policy Development and Review Department

The following are GAO's comments on the International Monetary Fund's letter dated April 24, 2001.

GAO Comments

1. The IMF said that we understate the extent to which the Poverty Reduction Strategy Paper (PRSP) approach influences the design of PRGF-supported programs and that other groups have recognized that the new approach represents a fundamental change in the design of PRGF-supported programs. We disagree with the IMF's characterization. We do recognize the extent to which PRSPs could potentially affect the IMF program by getting countries to take ownership of their macroeconomic policies and targets. Our report clearly states that this change could be a major departure from how the macroeconomic framework has traditionally been chosen.

2. The IMF stated that the requirement for borrowers to prepare an interim-PRSP represents a major change from the way in which concessional assistance was previously provided by the international financial institutions, including the IMF. However, IMF guidance documents do not indicate how, or if, the interim PRSP is to influence the PRGF policies and targets. Therefore, our review focused on how the full PRSP—rather than the interim PRSP—is designed to influence the PRGF.

3. The IMF said our report discounts the process of public involvement in the formulation of key macroeconomic policy choices on the grounds that it is "impossible for the poorer countries to develop national professional capacity to debate the issues." We disagree with the IMF's characterization of our report. We do not discount the significance of the participatory process. Although our report finds that national ownership of the macroeconomic framework will be difficult to achieve, we recognize that civil society may help improve the allocation of resources and increase the amount of resources donors are willing to provide by helping establish priorities for poverty reduction. Furthermore, we state that given the complexity of the issues, civil society participation in influencing macroeconomic policy could be limited to a few informed constituencies or experts, such as representatives from academia and the business community and others who can assess trade-offs.

4. The IMF said that the PRSP now forms the underpinnings not only of the PRGF, but also of the World Bank's concessional lending programs, and is also being adopted as a common framework by a number of important bilateral agencies. The IMF concludes that this is a significant difference from the policy framework paper (PFP), which directly influenced only the ESAF operations of the IMF. IMF and World Bank documents show, however, that the PFP was intended to

underpin the World Bank's and bilaterals' programs, as well as the IMF's. For example, according to *The World Bank Annual Report 1987*, the PFPs were to serve as an overall framework for countries' adjustment programs that were supported by the World Bank's adjustment-lending operations. Also, in 1991, the World Bank's *Operational Manual* directed that PFPs should indicate how the Bank's assistance strategy supports and complements the country's own approach to reducing poverty. Moreover, in February 1988 the Fund and the World Bank convened a seminar for senior officials of major bilateral and multilateral agencies to discuss issues related to enhancing the usefulness of the PFPs in coordinating aid and mobilizing resources for low-income countries.

5. The IMF said that there is substantial diversity in macroeconomic frameworks in PRGF-supported programs and that the report's conclusion about the lack of scope for macroeconomic flexibility should be reconsidered. Based on our analysis, we found that it is difficult to determine whether there is a substantial range of macroeconomic policy targets that are acceptable within the context of macroeconomic stability. Furthermore, in our discussions with IMF staff on acceptable inflation rates, we were told that the IMF expects countries to strive for single-digit rates.

6. The IMF stated that further GAO investigation would have identified actual changes in PRGF-supported programs and that they "know change is taking place in many PRGF-supported programs." However, the IMF's response to our report provided no evidence to support this assertion, nor did it provide any examples of actual changes or identify countries where change is taking place.

7. The IMF said that we assessed two of our three country case studies against final rather than the more relevant interim standards and implied that we dismissed the potential of the PRGF changes. Our report did not dismiss the potential of the PRGF but instead described some of the challenges countries face in reaching that potential. We reported countries' progress toward meeting the final standards and noted that certain changes announced by the IMF—such as social impact assessments—were also called for under the IMF's previous concessional lending program.

8. The IMF said that the GAO analysis could be more tightly focused on whether outcomes are likely to be better under the PRGF than under the ESAF. We reported that the impact of the PRGF on countries' economic growth rates is unknown at this time and that there are many challenges and obstacles to establishing national ownership.

Appendix V: GAO Contact and Staff Acknowledgments

GAO Contact

Thomas Melito, (202) 512-9601

Staff Acknowledgments

Cheryl Goodman, Bruce Kutnick, R.G. Steinman, Lee Kaukas, and Rona Mendelsohn made key contributions to this report.

Ordering Information

The first copy of each GAO report is free. Additional copies of reports are $2 each. A check or money order should be made out to the Superintendent of Documents. VISA and MasterCard credit cards are also accepted.

Orders for 100 or more copies to be mailed to a single address are discounted 25 percent.

Orders by mail:
U.S. General Accounting Office
P.O. Box 37050
Washington, DC 20013

Orders by visiting:
Room 1100
700 4th St., NW (corner of 4th and G Sts. NW)
Washington, DC 20013

Orders by phone:
(202) 512-6000
fax: (202) 512-6061
TDD (202) 512-2537

Each day, GAO issues a list of newly available reports and testimony. To receive facsimile copies of the daily list or any list from the past 30 days, please call (202) 512-6000 using a touchtone phone. A recorded menu will provide information on how to obtain these lists.

Orders by Internet
For information on how to access GAO reports on the Internet, send an e-mail message with "info" in the body to:

Info@www.gao.gov

or visit GAO's World Wide Web home page at:

http://www.gao.gov

To Report Fraud, Waste, and Abuse in Federal Programs

Contact one:

- Web site: http://www.gao.gov/fraudnet/fraudnet.htm
- E-mail: fraudnet@gao.gov
- 1-800-424-5454 (automated answering system)

PRINTED ON RECYCLED PAPER