The Role of the IMF in Low-Income Countries: Recent Issues[1]

Domenico Lombardi[2]

Forthcoming on *World Economics*, December 2007

Abstract

The question whether the IMF should effectively engage with its low-income member countries has recently generated a wide debate among development economists, policymakers, and advocates from nongovernmental organizations. This note elaborates on the important role that the IMF can play in its low-income member countries, points to some current problems with the Fund's engagement with these countries, and suggests avenues for future improvement.

Keywords: IMF, Development, Poverty.

[1] This note is a revised version of the remarks delivered at the Oxfam Panel on the role of the IMF in low-income countries held at the International Monetary Fund in Washington on September 24, 2007.

[2] The author is president of The Oxford Institute for Economic Policy and a Senior Fellow at the Brookings Institution. He has previously advised the Executive Boards of the International Monetary Fund and the World Bank. His academic research addresses a number of policy-related questions in macroeconomics and international economics. His recent work focuses on the reform of the international financial and monetary system, and the creation of a new aid architecture for low-income countries.

Introduction

The question whether the IMF should effectively engage with its low-income member countries has recently generated a wide debate among development economists, policymakers, and advocates from nongovernmental organizations. The issue remains controversial, as views are split among those who, on the one hand, would have the IMF refrain from working with low-income members and those who, on the other, call for a substantial step up in the quality of the Fund's engagement with these same members. This note elaborates on the important role that the IMF can play in its low-income member countries, points to some current problems with the Fund's engagement with these countries, and suggests avenues for future improvement.

Historical background

Even the founding fathers of the IMF had trouble grappling with the issue of the IMF's role in low-income countries. Convened at the end of the Second World War, the Bretton Woods Conference aimed to establish a universal financial and economic order, with generally applicable solutions to the problems of the world. In light of this goal, the participants in the conference carefully avoided distinguishing between groups of members in drafting the IMF's Articles of Agreement. The Indian delegation proposed that a reference to the role of the IMF in low-income countries be added in the section devoted to the purpose of the Fund in Article I, but this proposal was overruled (James, 2007).

It was only in subsequent years that the developing world defined itself politically, as low-income countries acquired independence from their colonial powers, and economically, as the international community began contemplating the challenges of these countries within the broader framework of development. As the newly independent low-income countries joined the membership of the institution, the Fund gradually found itself drawn into an as yet unresolved debate about its role in relation to its low-income members.

Should the IMF be engaged with low-income countries?

The answer to the question whether the IMF should be *effectively* engaged with low-income member countries is, of course, "yes"—and not simply because low-income countries as a group now account for the largest share of the Fund's clientele. The IMF is a universal institution of 185 members, of which 78 (or 42 percent) are low-income countries. The purposes of the IMF, as set out in Article I of its Articles of Agreement, require it "to contribute . . . to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy." The Fund must fulfill this purpose for its low-income member countries, just as it must for all the other members of the Fund.

Moreover, the IMF exerts an informational role for the benefit of its membership by providing a *bundled* set of activities that include lending, offering policy advice, and assisting with capacity building.[3] Low-income members stand to potentially enjoy the greatest benefits of these activities, given the lack of incentives in the private sector to undertake such costly information-gathering activities in a context of uncertain benefit.

Despite resistance from within and outside the institution to the Fund's acceptance of its responsibilities toward its low-income members, the IMF has now definitely acknowledged that

[3] See Lombardi (2007) and (2005).

it has a role to play vis-à-vis this group of its membership. Yet how the Fund determines to go about playing this role is as important as its acknowledgment of the responsibility's existence. In low-income economies, the policy space is not neatly partitioned between poverty-reducing and "traditional" macroeconomic policies. Macroeconomic policies, for example, tend to affect the efficiency with which economic growth translates into poverty reduction. Operationally, this points to the need for the Fund to display greater awareness of the social impact of key macroeconomic policies and of the trade-offs involved in the various policy mixes embedded in both program design and the IMF's policy advice. Thus, any assessment of the effectiveness of the IMF's role in assisting its low-income members ought to consider the extent to which this dimension has been operationalized in the institution's policy toolkit.

Are the IMF's policies toward low-income countries effective?

Recent evidence points to some tensions between the IMF's policies in regard to low-income countries and the execution of these policies. The Fund's poverty and social impact analysis (PSIA) has not systematically informed distributional aspects in the program design of the Poverty Reduction and Growth Facility (PRGF), the Fund's concessional lending arm in support of low-income members, despite Board-approved resolutions that it should.[4] In 2005, the IMF set up a standalone unit to engage in poverty and social impact analysis. In doing so, it went beyond the advice given by an external panel in 1998 to rely on the World Bank to fulfill this function.[5] Despite the creation of the PSIA unit, however, the Fund's Internal Evaluation Office (IEO) found no apparent evidence that PSIAs are having any material influence on PRGF program design, although the findings of PSIA analysis are duly reported in PRGF documents.

[4] See IEO (2007) and Oxfam (2007).
[5] See External Evaluation of ESAF (1998).

In its analysis of the capacity of members to absorb aid, moreover, it is necessary for the Fund to consider sectoral aspects, such as health, education, and infrastructures, by going beyond the use of traditional macroeconomic assessment tools. Currently, in assessing absorptive capacity, the Fund mainly focuses on issues such as “Dutch Disease” and competitiveness, which the IMF’s IEO has found to be of no concern for the levels of aid inflows under discussion (IEO, 2007).

In assessing external financing requirements, the IMF sounds donors before coming up with an aid figure that reflects what is likely to be available. This figure is then fed into medium-term macroeconomic and expenditure planning, as well as donor aid plans. Once this forecast becomes the IMF’s own assessment, it carries significant weight with regard to donor ability and willingness to fulfill commitments. In other words, the very fact that the IMF says that a certain level of aid inflow is likely to materialize affects the likelihood that the aid will be offered. So why should the Fund not fully leverage on this opportunity by highlighting *more ambitious but still feasible* aid scenarios, consistent, of course, with country absorptive capacity? Why not assist member countries in designing macroeconomic frameworks compatible with such alternative assessments? Such an approach would certainly be consistent with the findings of the literature on the catalytic role of the IMF, which offers robust evidence of the Fund’s importance as a catalyst for donor resources in low-income countries.[6]

Finally, in order to serve low-income member countries more effectively, the IMF should make more effective use of the Poverty Reduction Strategy Paper (PRSP) as a basis for PRGF

---

[6] See Lombardi (2007) and (2005). On the role of IMF surveillance in low-income countries, see also Lombardi and Woods (2007).

programs. The most important feature of PRGF program design is that it is meant to promote national ownership of underlying economic policies, which are formulated through an open and broad-based participatory process that results in a PRSP produced by the member country itself. The Fund's IEO reports, however, that only half of the staff surveyed admit to making use of the work and the experience of country authorities in PRGF program design, and only about a third agree that the PRSP provides the basis for PRGF program design (IEO, 2007).

A 2003 publication of the IMF lists contributions made by the IMF to macroeconomic research in low-income countries (IMF, 2003). They include about a thousand research papers in seven analytical categories, including growth and poverty, fiscal and monetary policy, financial market issues and structural reforms. Yet, again, zero percent of operational staff uses the findings of the IMF research department in their operational work, according to the IEO's survey (IEO, 2007).

In sum, in the Fund's operationalization of the poverty and social impact analysis, its treatment of absorptive capacity, and its use of the PRSP or IMF-sponsored research as a basis for PRGF programs, then, it is possible to observe a common pattern: the IMF is definitely doing something, but by its own standards, it is not doing enough.

Looking forward

If the leadership of the IMF desires for the Fund to improve its service to low-income member countries, the Fund ought, first, to fully operationalize its own policies in regard to low-income countries using transparent and internationally agreed-upon benchmarks, for which it should be held accountable. Mixed signals should be avoided, such as the signal that the Fund transmitted by endorsing the Millennium Development Goals without operationalizing their related implications.

The IMF should consider, secondly, how to leverage its coordinating role and *proactively* partner with the World Bank and other donors in highlighting *more ambitious but still feasible* external financial requirements.

Finally, the Fund ought to determine how to frame more effectively its partnership with the World Bank, which will require it to move beyond the usual platitude that cooperation is important and actually develop additional incentives for cooperation. Experience shows that when such incentives to cooperate have been fully institutionalized—as they have been in the case of the Financial Sector Assessment Program, Heavily Indebted Poor Countries Initiative, and the Debt Sustainability Framework—positive results follow.

The institutional and human capital of the IMF is obviously huge, but the Fund's weight has yet to be thrown in service to its low-income member countries.

Bibliography

External Evaluation of the ESAF, 1998, Report by a Group of Independent Experts (Washington: International Monetary Fund).

IEO, 2005, Report on the Evaluation of Poverty Reduction Strategy Papers (PRSPs) and the Poverty Reduction and Growth Facility (PRGF), Evaluation by the Independent Evaluation Office (IEO) of the IMF (Washington: International Monetary Fund).

IEO, 2007, An Evaluation of the IMF and Aid to Sub-Saharan Africa, Evaluation by the Independent Evaluation Office (IEO) of the IMF (Washington: International Monetary Fund).

IMF, 2003, IMF Macroeconomic Research on Low-Income Countries (Washington: International Monetary Fund).

James, Harold, 2007, Bretton Woods and the Debate about Development, in *Finance, Development, and the IMF*, James Boughton and Domenico Lombardi, eds., forthcoming.

Lombardi, Domenico, 2007, The Development Dimension of IMF Lending Policies, *The International Spectator*, 42(1).

Lombardi, Domenico, 2005, The IMF's Role in Low-Income Countries: Issues and Challenges, Working Paper 05/177 (Washington: International Monetary Fund).

Lombardi, Domenico, and Ngaire Woods, 2007, The Political Economy of IMF Surveillance, Working Paper 17 (Waterloo, Canada: CIGI, Centre for International Governance Innovation).

Oxfam, 2007, The Continued Failure of the World Bank and the IMF to Assess the Impact of Their Advice on Poor People, Joint NGO Briefing Note (Oxford, UK: Oxfam).

Woods, Ngaire, and Domenico Lombardi, 2006, Uneven Patterns of Governance: How Developing Countries Are Represented in the IMF, *Review of International Political Economy*, 13(3).