10 FINDINGS, LESSONS, AND RECOMMENDATIONS

This chapter summarizes the main findings of this evaluation, derives some broad lessons, and then recommends specific steps that the Fund could take towards fostering stronger growth-related outcomes in the program context. While the evaluation does not assess the experience during the COVID-19 pandemic, its lessons have become even more relevant as countries now face particularly strong headwinds to growth as they seek IMF support for achieving durable recoveries.

FINDINGS

Increasing attention to the growth consequences of IMF-supported programs seems to have delivered some positive results. The evaluation does not find evidence of a consistent bias towards excessive austerity in IMF-supported programs during the evaluation period (2008–19). IMF-supported programs during this period were in most cases (except in the crisis context) able to sustain output broadly in line with a growth benchmark that corrects for exogenous external factors, while still delivering needed adjustment. Indeed, cross-country evidence suggests that programs have yielded significant growth benefits relative to a counterfactual of no Fund program engagement and that stabilization and reforms implemented in the program context raised post-program growth. Historical data over a longer time horizon suggest a positive role of IMF-supported programs at initiating sustained growth surges.

Analysis of program design and adaptation shows that programmed fiscal policy incorporated both sustainability and growth considerations although less so in initial program design in the case of PRGT programs. In program reviews, fiscal adjustment targets tended to be revised downwards in response to interim growth shortfalls and upwards in response to adjustment slippages in both GRA and PRGT programs. However, very few programs included explicit contingencies for addressing adverse growth shocks.

Notwithstanding these positive findings, growth outcomes consistently fell short of projections incorporated in the program's macroeconomic framework, both during programs and in the post-program period, consistent with the findings of the 2018 ROC. Of the programs covered in the evaluation, around one-half experienced an average growth shortfall during the program period of ½ percentage points or more, while one-fourth had a growth shortfall of over 1.5 percentage points. Growth shortfalls were particularly marked in the first year of GRA programs in the crisis context, but were observed in PRGT projections too, particularly in the post-program period. Macro modeling errors, particularly those related to fiscal multiplier assumptions, seem to have been a significant source of such growth optimism, particularly in GRA programs outside of a crisis context. While fiscal multiplier assumptions seem to have been broadly in line with the "bucket approach" suggested by guidance given to staff, they were not discussed widely in program documents and their adaptation to country circumstances seems to have been limited. At the same time, case study evidence suggests that political economy considerations in program negotiations that encouraged agreement on ambitious growth projections also played a significant role.

Persistent growth optimism raises serious concerns because growth outcomes below program projections in the macroeconomic framework imply slower than intended progress in increasing incomes and strengthening the public balance sheet, undercut program ownership, and fuel rising adjustment fatigue and public opposition to reforms. While greater scrutiny of the realism of program projections as recommended by the 2018 ROC could help to reduce growth optimism, it seems even more relevant to consider whether IMF-supported programs can achieve more robust growth outcomes more in line with the program's macroeconomic framework by paying greater attention to growth-friendly policies in program design and implementation.

To shed light on this question, the evaluation examined to what extent different policy instruments were used to support the program's growth-related outcomes and their impact. It found that fiscal policies typically incorporated growth-friendly measures but with mixed success. Tax mobilization improved in PRGT programs making space for higher capital spending than otherwise, while GRA programs were able to help encourage a more growth-promoting tax structure in the post-program period. However, GRA programs often relied heavily on spending cuts to achieve deficit reduction during the program, and there were no significant increases in health and education spending in either PRGT or GRA programs. A number of case studies raised concerns that growth benefits of higher public investment could be limited by poor project selection and wasteful implementation and that efforts to protect low-income and vulnerable groups often fell short of their goals.

Structural conditionality included in programs played a positive role in promoting structural reforms and growth, but the potential growth benefits of structural reforms were not fully realized. SC implementation was positively associated with independent measures of progress in structural reforms and helped to boost growth within and after the program, with stronger growth impact for higher-quality SCs. However, the bulk of SC was oriented to stabilization rather than promoting growth and the average depth and growth orientation of SCs was relatively low. Fund CD assistance was actively provided to support reforms and associated SCs in the program context and was generally appreciated by country authorities. However, cross-country evidence suggests that CD support does not seem to have been delivered more to countries with weaker capacity nor consistently effective in strengthening SC implementation. Some country officials observed that SCs were often too numerous, going beyond a country's capacity to deliver even with CD support, and embodied unrealistic timetables. Moreover, in their view, Fund teams sometimes paid too little attention to growth-oriented reforms, relying too heavily on partner institutions, even for reforms crucial to program success. Implementation was significantly weaker for SCs in areas outside of Fund expertise and where collaboration with partners was sought.

The use of the exchange rate as a policy tool to support growth and external adjustment during programs was quite limited. Exchange rate regime transition was infrequent during the evaluation period, and more often toward greater fixity. Where more flexible regimes were introduced, progress was often at least partly reversed, in part because of volatile markets in the context of insufficiently supportive macroeconomic policies. Efforts were typically made to correct clear cases of overvaluation and were generally successful, although more generally the impact of nominal exchange rate movements on the REER were partially muted by pass-through to prices. There was also a tendency towards a loss of competitiveness in PRGT programs that relied on a heavily managed exchange rate as an anchor for inflation. Nevertheless, where significant REER depreciation did occur, it seems to have supported external adjustment and growth, particularly in PRGT programs, although there were also disappointments, particularly in the face of supply-side impediments to the export response.

In a number of cases, market debt operations were useful to restore debt sustainability and provide the basis for renewed market access, supporting a return to growth. However, the overall record was mixed, and there were examples in which debt operations were too little and too late, and thus had only limited impact in strengthening debt sustainability and improving growth prospects. Debt operations with principal haircuts and upfront fiscal adjustment were more successful than those with just debt reprofiling and lower coupons.

LESSONS

While this evaluation acknowledges increased attention to growth in IMF-supported programs and finds that such programs have generally played a positive role in promoting growth, the fact that growth outcomes have typically not met growth projections embodied in program macroeconomic frameworks suggests a need for increased attention to growth-related aspects of program design and implementation. The aim should be to strengthen growth-related outcomes, both during programs and in the post-program period, while ensuring that needed external adjustment takes place to correct balance of payments problems.

The diverse experience in the case studies underlines that there is no simple recipe for delivering better growth-related outcomes in IMF-supported programs given the variety in country circumstances and preferences, the underlying causes and contexts of the BOP problems, and the potential scope for policy action. Moreover, the need for careful tailoring is underlined by clear experience that it is essential that the adjustment and growth strategy be fully owned by the government and broadly supported. Particularly in the context of a BOP crisis, ambitious upfront adjustment and reforms may quickly restore growth after an initial downturn by restoring confidence and market access. However, in other cases, more gradual adjustment and reform paths may be better suited to a country's limited capacity and fragile social tolerance for short-term economic stress. In some circumstances, stabilization may by itself be sufficient to restore a satisfactory growth path, while in other situations there may be greater need for deep reforms to raise a country's medium-term growth potential. Moreover, the approach taken to address social and distributional concerns, particularly to ensure adequate protection for the vulnerable and growth benefits for low-income groups will depend on country capabilities and national preferences.

In developing growth strategies, particular care should be paid to ensuring that macroeconomic frameworks used in program design incorporate realistic program assumptions and that program design pays more consistent attention to contingencies for growth shortfalls. Continued efforts should be made to developing and applying a suite of tractable models suitable for use in different country circumstances to analyze the growth impact of adjustment and reform policies. At a minimum, more attention is needed to ensure that fiscal multipliers are carefully tuned for country circumstances and that expectations for the pace and impact of reforms are not excessively sanguine. More explicit analysis of short-term fiscal multipliers in staff reports would enable a more realistic understanding of short-term growth consequences of fiscal adjustment and could help reduce optimism bias. Moreover, greater attention should be paid to program contingencies at the initial program design stage as well as during program reviews, particularly on how to respond to unexpected growth shortfalls. This early attention will help to not only guide subsequent program adaptation in a timely way but also promote country ownership and alleviate negative perception of the Fund's austerity bias.

The evaluation also provides lessons for how a broad spectrum of policy tools—fiscal policy, structural reforms, exchange rate policy, and debt operations—can be used to foster stronger growth outcomes in the program context.

In the area of fiscal policy, greater attention is warranted to ensure that fiscal adjustment and reforms are indeed growth friendly and inclusive. The apparent lack of progress on raising social spending, especially on education and health care, is disappointing and the limited monitoring of distributional impact limits the ability to make mid-course corrections. More granular approaches to conditionality and monitoring in this area could help to ensure that social spending to support low-income and vulnerable groups is at least protected during adjustment and raised in a durable manner over time. While it is encouraging that public investment has been boosted in a number of programs, the case studies demonstrate clearly that more attention is needed to maximize the growth impact of such investment and limit the risk of acquiring new debt without significantly raising debt-servicing capacity. This will require addressing transparency and governance issues especially to ensure a productive allocation of investment resources and limit leakages and corruption, building on the staff's continuing work in providing technical support on public financial management and applying the new governance framework introduced in 2018.

Greater focus on growth-enhancing structural reforms in IMF-supported programs would help to raise medium-term growth prospects given the clear evidence for the importance of the depth and growth orientation of SCs in determining the growth impact of reforms. At the same time, too many low-quality SCs should be avoided following the principle of parsimony and macro-criticality. Recognizing that higher quality SCs take more time to implement, Fund arrangements of longer duration could allow for a more realistic time frame for reform implementation. In addition, steps could be taken to foster more effective integration of CD support with program implementation, including to target more Fund CD resources at countries with limited capacity and giving CD experts more of a role in setting and monitoring program structural conditionality. More effective collaboration with partner institutions could produce greater synergy and traction in supporting reforms in areas with high growth impact that lie outside IMF core expertise

The limited use of exchange rate adjustment as a tool in the program context suggests that there could be greater scope to use exchange rate policy as a means to facilitate adjustment while supporting growth and resilience to adverse shocks, subject to the principle that the exchange rate regime choice is ultimately the authorities' decision. Cross-country evidence suggests that, depending on a country's economic structure, significant depreciation of the REER can help to boost exports and restrain imports, helping to shift the trade-off between external adjustment and growth. The case studies show that such depreciation can be achieved within different exchange rate regimes (including through internal devaluation under a currency union or peg) depending on country circumstances. The greatest and most effective route will be an upfront currency adjustment, although care will be needed to limit exchange rate pass through to inflation and ensure that any depreciation is consistent with members' obligations under Article IV to avoid manipulating exchange rates to prevent effective BOP adjustment or to gain an unfair competitive advantage. Use of the exchange rate as a policy tool would need to take due account of country circumstances, respect the member's right to choose their exchange rate regime, and address the concerns giving rise to a "fear of floating." Doing so will require assisting countries to build a supporting policy framework, including to securely anchor inflation expectations, to develop foreign exchange markets with adequate depth and liquidity, to address foreign currency balance sheet mismatches and distributional consequences of exchange rate depreciation, and to alleviate supply-side impediments to export growth.

The experience of IMF-supported programs with debt operations suggests that the Fund should seek to make sure that where restructuring is needed to address debt sustainability concerns to qualify for access to IMF financing, it is not "too little and too late." While respecting the neutrality principle, applying a consistently careful approach to debt sustainability assessment would help ensure that where debt restructuring is needed, it is achieved in a timely and growth-friendly manner with adequate depth. Recent modifications to the LIC-DSF and MAC DSA should help in this respect. In addition, the potential growth and market access consequences of debt operations, including their specific design features, could receive more attention in analyzing the consequences of debt operations. Creative design may help facilitate debt negotiation and secure high creditor participation in debt exchanges, thus allowing for more rapid restoration of market access to new financing. However, it could also backfire if restructuring terms are too generous to creditors and discourage debtors' policy effort to grow out of debt if growth dividends to creditors are too great.

Finally, two more general lessons are worth emphasizing. First, in order to ensure that program design is well tailored to country needs and circumstances, the groundwork for a successful policy response to cushion the output and distributional consequences of an adverse exogenous shock should ideally be laid well in advance through surveillance and CD work. The case studies repeatedly show that meaningful reforms to strengthen such growth resilience take many years to put in place and become effective, even with strong capacity development support. In this respect, areas for attention include building an institutional structure for an effective social safety net, strengthening governance over public investment, establishing a workable framework for effective exchange rate management, and identifying structural impediments to investment, productivity and export gains.

Second, growth and reform strategies envisaged in program design should pay adequate attention to social and distributional consequences in line with country circumstances and national objectives. While the focus in this evaluation has been largely on aggregate outcomes, fair distribution of the burden of adjustment and the rewards of recovery are important in their own right to meet national goals and to ensure continued public support for program implementation. Towards this end, there is a need to strengthen the analysis, monitoring and reporting of the social impact of the overall program and of the specific policies to protect vulnerable groups. The lack of a capacity to track effectiveness made it hard to track progress made in achieving inclusive growth, to identify emerging risks, and to assess the need for further reinforcing actions.

RECOMMENDATIONS

This section suggests specific actions that could be considered to strengthen growth-related outcomes in the program context both during the program period and in the medium term, while ensuring needed external adjustment. These actions are grouped into three umbrella recommendations: first, to increase the overall attention to growth-related implications in designing and implementing Fund-supported programs; second, to encourage deeper and more growth-oriented structural reforms; and third, to further develop the tools needed to support greater attention to sustainable and inclusive growth in program work.

Recommendation 1—Attention to growth implications of IMF-supported programs should become more thorough, systematic, realistic, and sensitive to social and distributional consequences.

- Board papers supporting GRA as well as PRGT programs should clearly explain the program's growth implications, both during the program and over the medium term. They should discuss how program design reflects the country's growth strategy, including whether and how the program will help to protect activity during the program and help the country achieve sustainable medium-term growth while solving its balance of payments problems in a manner consistent with the Articles of Agreement. The relevant considerations will vary depending on country circumstances and national preferences, including the country's social and distributional goals.
- The discussion of growth implications in Board documents should provide a more thorough analysis of how growth has been taken into account in the design of the underlying macroeconomic framework of the program, including the interaction of different policy tools, ideally based on a well-calibrated country-specific model. Documents should provide more systematic coverage of the quality dimensions of growth, including distributional consequences of adjustment and reform policies, such as how low-income and vulnerable groups are affected during the program period and how they would share in growth over time.
- In discussing the macroeconomic framework, particular attention should be paid in program documents to discussion of fiscal multiplier assumptions, especially where available country-specific modeling is limited. While the bucket approach could continue to provide a useful starting point for fiscal multiplier discussion, multiplier assumptions should be further fine-tuned to country circumstances based on available evidence and informed judgement.
- Program design should pay more consistent attention to contingencies for growth shortfalls, based on scenario analysis, which should help better prepare to deal with adverse shocks and help fend off negative perceptions of the Fund's austerity bias. The appropriate approach would be determined case by case. In some situations, inclusion of explicit growth contingencies in the program may be helpful. In others, program adjustments may be best determined in the context of reviews but discussion of growth contingencies with authorities at the program design stage would still be desirable to foster ownership and preparedness to deal with adverse developments.
- Efforts to pay greater attention to distributional aspects related to growth may require more granular approaches to conditionality and monitoring. Conditionality could focus more on policies needed to achieve distributional outcomes

where they are of critical importance for achieving program goals, while strengthened monitoring of key social and distributional metrics would help to measure progress and signal emerging issues to be addressed in program reviews. This work would need to be adapted to data availability, which is likely to be quite limited in the context of many LICs.

- Revisions to the 2002 Guidelines on Conditionality and the 2014 Operational Guidance Note on Conditionality should be considered to give further guidance on the role of Fund-supported programs in fostering favorable growth outcomes while solving the member's balance of payments problems in a manner consistent with the Articles of Agreement. These revisions could elaborate further on the appropriate treatment in Fund-supported programs of a country's growth-related objectives and of considerations related to the quality of growth, including protecting vulnerable groups during the program period and encouraging inclusive and sustainable growth over the medium term, tailored to country circumstances and national preferences. They could also provide updated guidance on the use of contingencies for growth shortfalls and the application of structural conditionality (consistent with Recommendation 2). The update to the Guidance Note in response to the 2018 ROC now under way can provide an opportunity to advance this work. Revisions to the Guidelines on Conditionality could be considered in the next Review of Program Design and Conditionality, which would involve broad consultation and require eventual approval by the Executive Board.

Recommendation 2—IMF-supported programs should pay greater attention to supporting deep, more growth-oriented structural reforms with more effective capacity development support and more effective collaboration with partners in areas outside the Fund's core mandate and expertise.

- The program's structural reform strategy should be geared to what is important and not what is most easy to agree on or monitor or where the IMF has core expertise, subject to careful consideration of the country's implementation capacity and the program's adjustment and growth-related goals.

- Structural conditionality should be parsimonious enough to avoid overtaxing country capacity but also more focused on correcting underlying distortions and removing structural impediments critical to achieving sustained and inclusive growth even though this may require greater attention to areas outside the IMF's core competencies. Under such an approach, there would be less dependence on structural benchmarks that are relatively shallow and greater reliance on a review-based approach to assessing progress towards reforms critical to achieving the program's growth-related goals.

- Recognizing the limits on IMF expertise outside core areas, the Fund should seek ways to strengthen collaboration with the World Bank and other relevant partners in design and implementation of structural reforms in shared and non-core areas to foster an increased focus on and more effective delivery of growth-oriented reforms. These efforts would need to avoid cross-conditionality consistent with the principle that the Fund be fully responsible for setting and monitoring all conditions attached to use of its resources and protect against undue delays in completing reviews and making disbursements. A useful step could be preparation of a Board paper reviewing experience with Bank-Fund collaboration in Fund-supported programs.

- The Fund should revisit how CD support is integrated with program design and implementation, aimed at promoting deeper and more successful reform efforts in the program context.

For this purpose, CD experts could be involved more in program implementation and monitoring, which may be facilitated by greater use of virtual or hybrid meetings. The ongoing IEO evaluation of IMF capacity development can contribute to a reassessment in this area, ahead of the next strategic review of IMF CD work in 2023.

Recommendation 3—The Fund should continue to invest in building a toolkit of models and monitors that can be applied as a basis for analysis of the adjustment-growth relationship and assessing growth-related developments in the program context.

- Functional departments could continue to take the lead in developing a suite of models suitable for analyzing the adjustment-growth relationship that are tractable and easily accessible for use by country desks to calibrate and apply in their country context. Particular attention should be paid to developing small-scale, easy-to-adapt macro/growth models for LICs where data are limited.

- Country teams should be encouraged to apply the models now being developed to achieve greater realism in program projections, to explore trade-offs between alternative policy mixes, and explain baseline projections and associated risks to authorities, which should help promote country ownership and mitigate the tendency towards growth optimism. Teams would determine case by case the models best suited to country circumstances and needs. Area departments could also contribute by undertaking in-depth case studies on program successes and failures.

- The Fund should increase efforts to keep track of whether structural reforms included in programs were sustained after the program concludes. This initiative could involve investing more in the new Research Department structural reform database.

- Further attention should be given to developing and deploying monitors to help support country desks' capacity to track developments in key distributional indicators such as median incomes and poverty rates, to provide more current and granular information to gauge program impact on key social distributional dimensions of growth, as suggested under Recommendation 1. This work could be done in close collaboration with the World Bank and other agencies.

Budgetary Implications

It should be recognized that full implementation of these recommendations would have significant resource costs. Most significantly, the recommendations to take a fuller and more rigorous approach to analyzing and supporting program growth strategies with greater attention in program documents could add considerably to the time needed for program work (including for effective collaboration with the World Bank and other partners). More extensive coverage of reforms that are important for growth but not in the core of IMF expertise would require additional efforts at strengthening collaboration with development partners and additional specialized resources in-house (including to support effective collaboration). The research work to build a set of useful macroeconomic models to underpin these efforts would require substantial continued investment. And greater efforts at monitoring and reporting on the social and distributional consequences of policies would require a sustained effort across multiple agencies in which the IMF would be just one player.

At the same time, much of this work is already well under way or at least anticipated in the Fund's work program. New tools have been developed for use in debt sustainability assessment and to guide work on social spending and governance issues. Considerable efforts are already underway to develop models that could be used in the program context, which will help deliver on the commitment to improve the realism of program projections as part of the follow-up to the 2018 ROC. Taking on the additional commitments required would depend on a broader strategic decision to increase attention in the program context to ensure that IMF-supported programs not only deliver sufficient adjustment but also contribute in a more thorough way to sustainable and inclusive growth.