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BACKGROUND PAPER

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Growth and Adjustment in IMF-Supported Programs for Middle East and Central Asia

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ABBREVIATIONS

AML/CFT	Anti-Money Laundering and Combating the Financing of Terrorism
AsDB	Asian Development Bank
BISP	Benazir Income Support Program
BOP	Balance of Payments
CPEC	China Pakistan Economic Corridor
CPI	Consumer Price Index
EBRD	European Bank for Reconstruction and Development
EFF	Extended Fund Facility
EPE	Ex Post Evaluation
FAD	Fiscal Affairs Department (IMF)
FDI	Foreign Direct Investment
FTE	Full Time Equivalent
GCC	Gulf Cooperation Council
GRA	General Resources Account
GST	Goods and Services Tax
IDP	Internally Displaced Persons
IFC	International Finance Corporation
LEG	Legal Department (IMF)
MCD	Middle East and Central Asia Department (IMF)
MCM	Monetary and Capital Markets Department (IMF)
METAC	Middle East Regional Technical Assistance Center
NEPCO	National Electric Power Co. (public electricity company, Jordan)
PPM	Post-Program Monitoring
RFI	Rapid Financing Instrument
ROC	Review of Program Design and Conditionality
SBA	Stand-By Arrangement
SC	Structural Condition
SOE	State-Owned Enterprise
STA	Statistics Department (IMF)
TA	Technical Assistance
UFR	Use of Fund Resources
VAT	Value-Added Tax
WB	World Bank

CHAPTER 1. EGYPT, JORDAN, AND TUNISIA

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EXECUTIVE SUMMARY

This paper discusses the experience with adjustment and growth in recent Fund-supported programs with Jordan, Tunisia, and Egypt, all affected by economic and social disruptions linked to the Arab Spring uprisings and protracted regional conflicts. In all three cases the authorities asked for Fund financial support to attain two key objectives, regaining macroeconomic stability and reinvigorating growth, to address longstanding social problems at the root of the uprisings.

Attaining both objectives proved elusive, with only Egypt achieving success (with some qualifications). The programs with Jordan and Tunisia helped the authorities to regain a measure of macroeconomic and financial stability—in itself a significant result—but in both cases the growth objectives were not attained. In part, this was due to domestic political shocks, security concerns and persistent disruptions linked to regional conflicts. In Egypt's EFF-supported program, the programmed adjustment and growth objectives were both achieved, debt ratios were reduced and there was a sizable reduction of unemployment. Strong ownership, preparation and upfront implementation of important exchange rate and fiscal reforms were key drivers of this success. But even in this case progress on the structural reform agenda was quite limited.

Growth projections proved overoptimistic in all arrangements with Jordan and Tunisia. In part this has to do with the negotiated nature of growth projections. But growth outcomes repeatedly below announcements over time may fuel skepticism and reform fatigue. A more realistic approach may be justified in difficult political and regional settings vulnerable to frequent headwinds and shocks. A second contributing factor may be related to the "independence" of growth and fiscal adjustment projections. A key link in this regard are the program assumptions on fiscal multipliers, which in all cases were unclear in program documents. This is an important omission. Lack of transparency on fiscal multipliers prevents accurate program assessment; and greater clarity in this area would be advisable.

Another important factor behind growth over-optimism concerns the role and nature of structural reforms in program design. In Fund arrangements with Jordan and Tunisia, these reforms were envisaged as a key channel for growth dividends, which turned out much weaker than expected. This is because (i) most reform measures and related program conditions by their nature, depth and growth orientation were only remotely linked to growth outcomes within the program timeframe; (ii) program assumptions on the feasibility of implementing reforms in these complex political and social settings proved unrealistic even with extensive support from technical assistance from the IMF and the World Bank, and (iii) the impact of structural measures on investment and growth was muted by persistent uncertainty linked to political transitions and/or regional conflicts. Greater selectivity in program design, better contingency planning and more cautious assumptions on feasibility and growth dividends of structural reforms may be called for in such complex settings. And Fund arrangements of longer duration may be necessary. Appendix I shows the timeline of Fund engagement in the three country cases.

I. INTRODUCTION

1. This paper discusses the experience with adjustment and growth in recent Fund-supported programs with Jordan, Tunisia, and Egypt. All these countries were affected by the protracted political uprisings that started with Tunisia in January 2011 and spread across North Africa and the Middle East in response to oppressive political regimes, low standards of living, and widespread social and economic disparities (the "Arab Spring").

2. The economic disruptions that occurred as a result of the political upheavals and spillovers from other regional shocks—including the conflicts in Syria, Libya and Iraq—induced the authorities to ask for Fund support to re-establish macroeconomic and financial stability. Following these requests, a three-year Stand-by Arrangement (SBA) with Jordan was approved in August 2012 and a two-year SBA with Tunisia in June 2013. In the case of Egypt, agreement on a Fund-supported program involved several rounds of negotiations amid protracted political changes. In this case, a three-year arrangement under the Extended Fund Facility (EFF) was approved in November 2016.

3. In all three countries, the authorities faced clear stabilization needs, but also the key challenge of achieving the required adjustment of macro-financial policies—the primary goal in IMF-supported programs—while also giving priority to reinvigorating growth and making it more inclusive. This priority was motivated by the need to address longstanding problems of high unemployment, inequality and widespread poverty which were at the root of the Arab Spring uprisings.

4. Jordan, Tunisia, and Egypt had all had previous experience with Fund arrangements. Nonetheless, these arrangements had expired years or decades earlier, and had been fully repaid by the time the arrangements under review were approved. The last arrangement with Jordan (an SBA) had expired in 2004, the last one with Tunisia (an EFF) in 1992; and a precautionary SBA with Egypt was completed in 1998.

5. The rest of this paper is organized as follows. Sections II, III, and IV discuss the program experience for Jordan, Tunisia and Egypt, respectively. Each of these sections covers the following topics: (i) a brief overview of economic developments and the policy context leading to the request for a Fund-supported program; (ii) the design of the program, in terms of adjustment strategy, targets, projections, and factors considered in reaching the balance between adjustment and growth objectives; (iii) the implementation of the program and the associated economic outcomes; and (iv) Fund staff's and the authorities' perspectives on the quality of policy dialogue and effectiveness of the program. Finally, Section V concludes with some observations on the challenge of achieving adjustment and growth based on the experience with the three country cases considered.

II. JORDAN

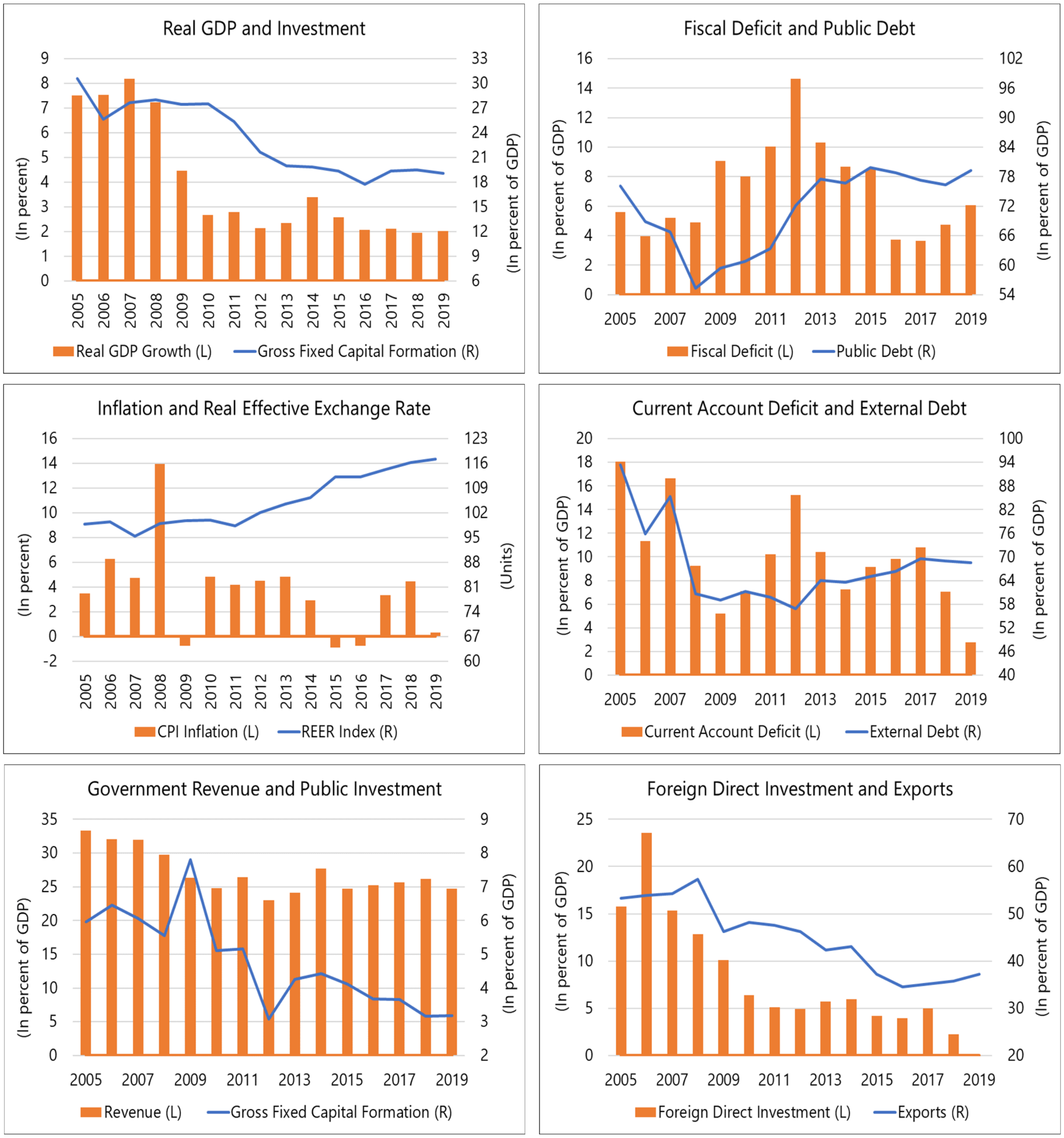
A. Context

6. In the decade preceding the Arab Spring, Jordan became one of the most open economies in the Middle East. Growth averaged about 6 percent a year, supported by strong links with the region and the rest of the world in tourism, exports, remittances and foreign direct investment (FDI) flows (Figure 1). Inflation also remained generally low. However, over time the economy became increasingly dependent on imports of gas from Egypt for electrification and on external grants as well as loans to finance large government deficits. These deficits reflected declining domestic revenue mobilization and low regulated electricity prices, which contributed to losses of the public electricity company (NEPCO) and to relatively high public debt (65 percent of GDP in 2009).

7. The authorities implemented a fiscal consolidation effort in 2010, in line with the Article IV recommendations, but this effort proved temporary. In 2011, Jordan's vulnerabilities came to the fore, exposed by repeated sabotage to the Arab Gas Pipeline in the Sinai Peninsula. These disruptions required increased imports of expensive fuel products for electricity generation and boosted NEPCO losses. In addition, tensions in the region affected tourism, remittances, FDI flows and trade routes—very damaging in view of Jordan's limited port access. The external current account widened sharply (to 12 percent of GDP including grants, up from 7 percent in 2010), putting pressure on international reserves. Investor confidence also weakened on fears that the Arab Spring turmoil in the region could spill over to Jordan, which suffered from longstanding poverty and high youth unemployment (over 30 percent). In this setting, with growth slowing down (to 2.6 percent), the authorities adopted expansionary budgetary policies trying to mitigate the impact of the shocks, financed by large external grants from Saudi Arabia.

8. The 2012 budget again envisaged a fiscal correction. However, the authorities—concerned about social tensions amid ongoing political reforms (revision of the Constitution in 2011 and new electoral law in 2012)—soon reversed the corrective measures. In this uncertain environment, new interruptions to gas inflows triggered another round of expensive imports of fuel products. Moreover, financial pressures continued to intensify, due to a rise in deposit dollarization (despite tighter central bank interest rates), crowding out of private sector credit by large public financing needs, and a further sharp drop in international reserves (by almost 40 percent relative to end-2011). Facing urgent stabilization needs, in mid-2012 the Jordanian authorities requested Fund financial support under an SBA.

Figure 1. Jordan—Macroeconomic Developments

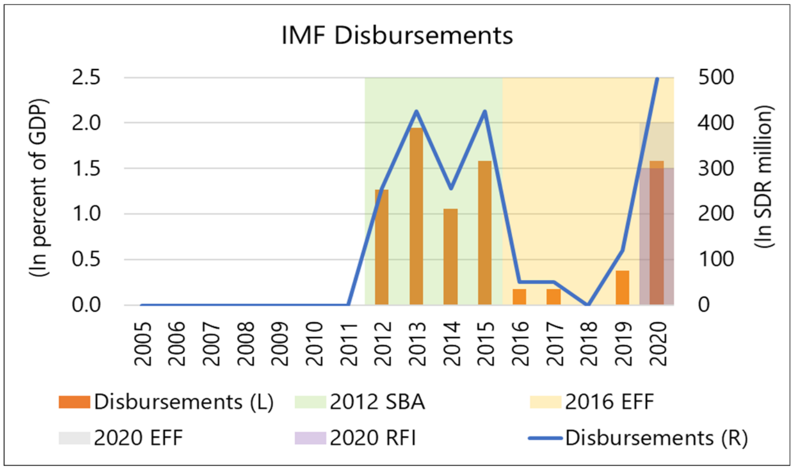


Sources: April 2020 WEO database; INS database; FFA database.
Note: The public debt, in percent of GDP, shown in the above chart differs from amounts quoted in the text due to subsequent data revisions. Numbers quoted in the text are from IMF Country Reports.

B. 2012 SBA—Program Design

9. The 36-month SBA with Jordan was approved in August 2012, with exceptional access at 800 percent of quota (about US$2 billion), front-loaded in view of the difficult reserves situation, and to maximize the program's signaling role (Figure 2).[1]

Figure 2. Jordan—IMF Disbursements



Source: IMF Members' Financial Data.

Adjustment Strategy

10. The program had three main objectives: (i) maintaining macroeconomic stability, by implementing fiscal, monetary and structural policies aimed at reducing external vulnerabilities; (ii) supporting growth and the medium term external position by improving the investment climate; and (iii) making policies more equitable and inclusive.[2]

11. To achieve these objectives, the program involved four key elements: (i) a gradual fiscal consolidation as the program's cornerstone; (ii) monetary policy supporting the peg to the U.S. Dollar as nominal anchor; (iii) structural reforms; and (iv) additional external financing.

12. The gradual fiscal consolidation aimed at reducing the overall fiscal deficit during 2012–15 from 6.5 percent of GDP to 3.5 percent of GDP, and an adjustment in the primary deficit (excluding grants) by almost 5 percent of GDP. In addition, a reduction of NEPCO losses by more than 5 percent of GDP was targeted over the same period. Despite the targeted consolidation, public debt (including NEPCO obligations) was programmed to rise further to 83 percent of GDP

[1] Although the 2012 SBA included front-loaded financing at approval, realized disbursements after rephasing and delays in reviews were less front-loaded.

[2] Memorandum of Economic and Financial Policies, paragraph 4, in IMF Country Report No. 12/243.

in 2015, stabilizing only at the end of the program. Staff nonetheless indicated that public debt would remain sustainable in the medium term.[3]

13. Energy subsidy reforms, revenue mobilization measures and a variety of other spending cuts were the key fiscal instruments. To reform and reduce generalized fuel subsidies, the authorities reinstated a monthly fuel price adjustment for less socially sensitive products in May 2012 and committed to widen the mechanism to all fuel products in 2013. They also planned an electricity tariff reform with significant input from the World Bank in order to gradually achieve cost recovery and reduce NEPCO losses. In terms of revenue measures, the program involved the submission to Parliament of a revised income tax law aimed at boosting tax revenues and reducing exemptions (structural benchmark) and plans to enhance tax administration.

14. The program did not include prior actions, despite the front-loading of exceptional access. As for contingencies, program documents note that the authorities would take corrective measures if downside risks linked to the difficult domestic and regional situation were to materialize, likely through cuts in (non-priority) capital spending with the least impact on growth.

15. Short-term fiscal multiplier assumptions were not discussed in program documents for the SBA request, except for a reference that revenue-based adjustment would have a lesser impact on growth relative to cuts in capital spending. However, an analysis of fiscal spending multipliers was included in the staff report for the first review.[4] The key result was that a reorientation of public expenditure toward capital spending and away from fuel subsidies was expected to be growth enhancing, as capital spending had statistically significant positive short-run and long-run growth multipliers, while for current spending multipliers were positive but not statistically significant.

16. Fiscal consolidation was intended to secure fiscal viability, lower public debt, and ease pressures on reserves. In this regard, the program macro-framework projected the current account deficit to decline by US$2.4 billion, from 14 percent of GDP in 2012 (including grants/official transfers) to 5 percent by 2015. Total external adjustment was thus programmed at 9 percent of GDP over the program period, with international reserves maintained at around four months of imports coverage. IEO estimates point to an annual average contribution of current account adjustment of 6.9 percent of GDP to meeting the annual balance of payments need of 15.6 percent of GDP over the duration of the program (Figure 3).[5]

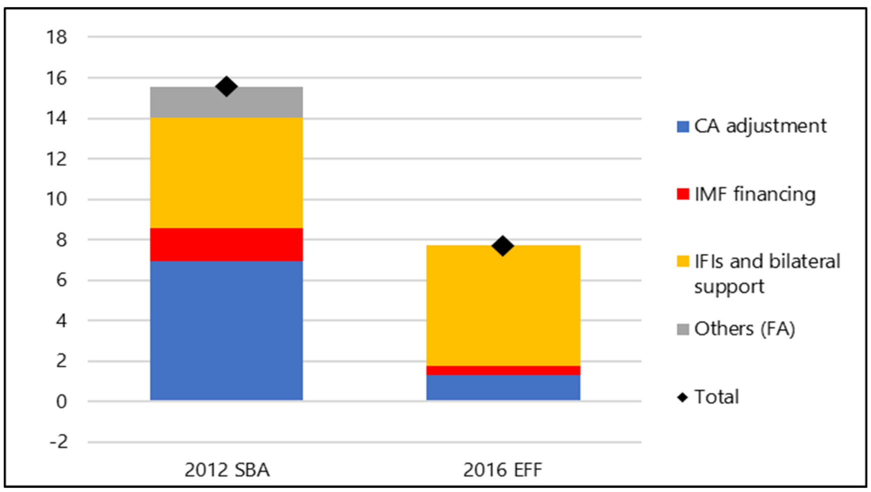
[3] See IMF Country Report No.12/343, page 25.

[4] See Box 4, IMF Country Report No. 13/130, May 2013.

[5] The estimate largely exceeds the average of 4.3 percent of GDP for exceptional access cases. See Kim and others (2021) for further details.

17. According to program documents, the large external adjustment was expected to derive from a strong rebound in export growth and travel receipts; the easing of international fuel and food prices; the emergence over time of alternative sources of energy; and competitiveness gains from structural reforms. Seen from the perspective of projected savings-investment balances, however, the key assumption underlying the external adjustment was a whopping improvement in gross national savings (by 11 percent of GDP), in large part due to a projected increase in private savings (by 6 percent of GDP). However, the realism of these projections raises questions. First, the program design did not include specific policies supporting a significant improvement in private savings as a means to raise national savings. Second, the projected improvement in government savings (5 percent of GDP) cannot be reconciled with the program fiscal tables—involving an increase in domestic revenue of less than one percent of GDP and current spending cuts of about 2 percent of GDP over 2012–15.

Figure 3. Jordan—Balance of Payments Decomposition
Adjustment vs. Financing
(In percent of GDP)



Sources: IEO calculations and Kim and others (2021).
Note: See Kim and others (2021) for a detailed explanation of the methodology.

18. Gross financing requirements were projected at US$21.1 billion at the time of program approval. Assuming a significant increase in FDI inflows (from US$1 billion in 2012 to US$2.3 billion in 2015 (5.8 percent of GDP), as well as a robust sovereign access to international capital markets (US$1.3 billion) and continued inflows of budgetary grants (in the range of 3–4 percent of GDP per year), the residual external financing gap was projected at US$4.1 billion for 2012–15. Fund financing (US$1.9 billion, net of repayments) was expected to play a catalytic role, with official bilateral lending (France, Japan) and multilateral financing (World Bank, IFC, EBRD, and the GCC) contributing more than half of the resources required to cover the projected gap.

Growth Aspects

19. The macro-framework for the SBA projected real growth to increase gradually and monotonically—from 3 percent in 2012 to 3.5 percent in 2013, 4.0 percent in 2014 and 4.5 percent in 2015. The channels through which this growth recovery was envisaged to materialize included stronger investor confidence; the assumed unwinding of regional tensions; and positive effects of structural reforms, particularly on the business environment.

20. However, out of four potential growth-supporting strategies—growth-friendly/inclusive fiscal policies, growth-oriented structural reforms, debt operations, and exchange rate flexibility—the program design for the 2012 SBA with Jordan included only the first and, in limited part, the second component. The latter two components were not part of the SBA program design.[6]

21. In regard to growth-friendly/inclusive fiscal policies, a key concern of the authorities was to balance fiscal consolidation—required to reduce financing needs, lower public debt and ease pressure on reserves—with the risks of recession and social unrest. Accordingly, overall fiscal adjustment was limited to 1 percent of GDP per year and was to be accompanied by other fiscal and other reforms enhancing growth and social protection.[7] Reflecting this priority, the fiscal strategy involved: (i) a projected increase in public investment by 1.6 percent of GDP during the program, which was important as it accounted for almost the entire projected increase in gross domestic investment; (ii) the introduction of targeted transfers to the poor, as protection against higher fuel prices, while eliminating subsidies for those with a higher ability to pay; (iii) the gradual introduction of NEPCO tariffs' reform with a view to making the tariff schedule closer to cost recovery and more progressive, while protecting the more vulnerable households; (iv) a revised income tax law lowering the personal income tax threshold without affecting lowest income households; and (v) plans to enhance tax administration, in particular by reducing tax exemptions and strengthening tax enforcement. Tax administration was identified in World Bank's Enterprise Surveys as a major constraint on business and growth by privileging well connected firms.

22. As to growth-enhancing structural reforms, the SBA emphasized: (i) the authorities' focus on enhancing the business investment framework, leveling the playing field among enterprises, especially on the tax front; and (ii) increased trade openness and integration with other countries,

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[6] The 2012 Article IV Consultation found that Jordan's real effective exchange rate was broadly in line with medium-term fundamentals, and Jordan did not face major competitiveness problems. See IMF Country Report No. 12/119, Box 4. The external debt sustainability analysis at the time of program approval noted that Jordan's external debt was expected to remain relatively low (hovering in the low 20s in percent of GDP) and broadly unchanged over the program period. See IMF Country Report no.12/343, pp. 45–47. Public debt was instead much higher (close to 80 percent of GDP), and, as noted in the text, programmed to increase moderately.

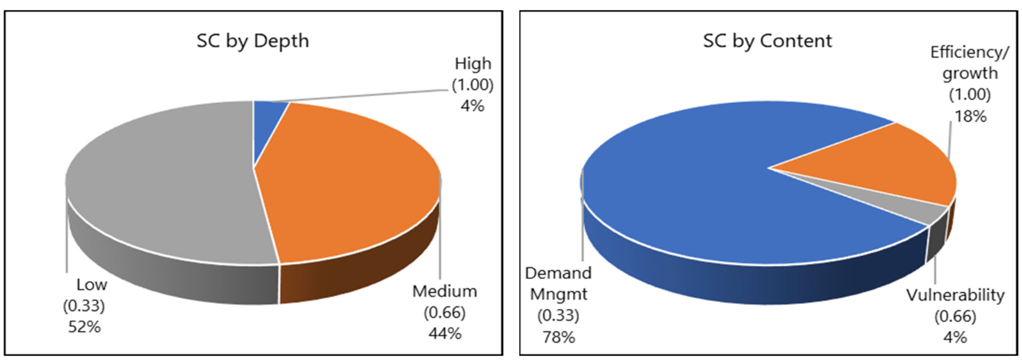
[7] Finding the right balance was however a challenging endeavor, and "staff urged the authorities to opt for a more ambitious adjustment, in light of high vulnerabilities and risks, but the authorities felt that what was done is sufficient and that it was not feasible (to do more) in the current political environment." Country Report No.12/243, December 2012, paragraph 9.

in particular with the Gulf Cooperation Council (GCC), the European Union and Mercosur countries.[8]

23. However, the program's structural conditionality only in minimal part reflected growth-enhancing priorities. Out of the five structural benchmarks included in the original program, none were directly linked to growth and only one related to inclusiveness/social protection—the introduction in early 2013 of targeted transfers to protect the poor from higher oil prices, if the latter increased beyond $100 per barrel. The remaining structural conditions (SCs) covered fiscal and energy reform measures.

24. During the course of the SBA arrangement, the number of SCs was increased to 25 in total, of which 7 pertained to raising fiscal revenues, 2 to enhancing fiscal transparency, and 6 to energy and water sector reforms; only 3 related to inclusive growth and they were sequenced not early on but in the midst of the program.[9] Thus, the links between structural conditionality and growth targets was relatively weak. In this regard, based on the 2018 Review of Conditionality, the majority of SCs in the 2012 SBA with Jordan had low depth and only 18 percent of SCs had a growth orientation (Figure 4).[10] Similarly, the 2015 Ex Post Evaluation of the SBA prepared by staff concluded that: "Structural conditionality was parsimonious but narrowly focused. Structural benchmarks covered the energy and financial sectors, but there was a somewhat limited coverage of structural reforms."[11]

Figure 4. Jordan—Structural Benchmarks by Depth and Growth Orientation



Sources: IEO calculations and Kim and Lee (2021).
Note: The numbers in bracket refer to the score (scaled between 0 and 1) assigned to the corresponding category. See Kim and Lee (2021) for a detailed explanation of the methodology.

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[8] Enhancing linkages with GCC countries was identified in the 2012 Article IV Consultation as a priority for growth. See IMF Country Report No.12/119, page 18.

[9] See Table 2 in the staff report for the seventh and final review of the SBA, IMF Country Report No. 15/225, pp. 50–52. The total number of SCs reported (25) is not consistent with the data in the MONA database.

[10] See Kim and Lee (2021) for a detailed analysis of structural conditions in IMF-supported programs over the period of 2008–19.

[11] See "Jordan—Ex Post Evaluation of Exceptional Access under the 2012 Stand-By Arrangement, EBS/15/105, September 11, 2015, page 11.

25. In regard to capacity development and technical assistance (TA) issues related to structural reforms, the 2012 Article IV consultation report noted that extensive TA had been provided to Jordan in years prior to the SBA. During 2010–12, Jordan received 18 TA missions in the fiscal area, 17 in the monetary and financial area, 2 in statistics, and 11 in other areas. In particular, the provision of TA prior to the SBA covered all three SCs which were classified as relating to inclusive growth, namely the licensing of a credit bureau; improved targeting of subsidies; and strengthening the public investment process.[12] The World Bank had long been engaged in Jordan's energy sector and social protection reforms, as well as in efforts to improve the business environment.

C. 2012 SBA—Implementation and Outcomes

26. The three-year SBA with Jordan was completed in early August 2015, with full disbursement of Fund resources.[13] Program implementation was complicated by major exogenous shocks. A massive influx of refugees from Syria, the conflict in Iraq, and persistent shortfalls in the supply of gas from Egypt continued to put pressure on domestic resources and external accounts. These shocks caused high fiscal and social costs related to hosting refugees (estimated at up to 1.3 million, or around 20 percent of Jordan's population); disruptions to trade routes, tourism and fuel imports; and an uncertain investment environment. On the other hand, lower oil prices since late 2014 helped reduce NEPCO losses.

27. In this setting, program modalities and policies had to be repeatedly adapted. Reviews were delayed allowing the authorities more time to implement reform measures, and the phasing of access was modified three times to align it with program developments. The third and fourth reviews were combined, and performance criteria were modified during the program—for instance in the first review to better monitor the central government deficit and NEPCO losses and in the second review to consolidate the two aggregates into a broader measure of the fiscal deficit.[14] On the policy side, the fiscal consolidation path had to be modified, for instance after it became clear during the first review that the 2012 government deficit, originally estimated at 6.5 percent of GDP, had reached almost 9 percent of GDP as a result, inter alia, of the more challenging regional environment and the associated acceleration of influx of refugees.

28. In terms of macroeconomic stabilization, the policies pursued under the SBA helped the authorities to strengthen the external and fiscal positions and maintain stability in a difficult regional environment. Inflation declined, the external current account deficit narrowed, albeit less than programmed—from 15.2 percent of GDP (revised) in 2012 to 9.1 percent in 2015—an

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[12] This effort continued during the SBA. According to the 2017 Article IV consultation report, during the program Jordan received 24 Fund TA mission (10 in fiscal areas; 7 in financial matters; and 7 on statistical issues).

[13] With waivers of nonobservance or applicability of performance criteria in six out of the seven program reviews completed.

[14] See "Jordan—Ex Post Evaluation of Exceptional Access under the 2012 Stand-By Arrangement," EBS/15/105, September 11, 2015.

external adjustment of 6 percent of GDP (see Figure 1). International reserves were rebuilt to US$15.7 billion by 2015 (8.5 month of import coverage), in excess of targets, largely because of higher than programmed external financing from the GCC, and despite lower than programmed FDI.[15] The domestic financial sector also proved resilient.

Table 1. Jordan—Fiscal Balance and Growth: 2012 SBA Program vs. Outturn

Years	Projected GDP Growth	Actual GDP Growth	Target Overall Fiscal Balance	Actual Overall Fiscal Balance
2012	3.0	2.8	-6.5	-8.9
2013	3.5	2.8	-5.5	-11.1
2014	4.0	3.1	-4.5	-10.3
2015	4.5	2.4	-3.5	-5.4
Cumulative Change	1.5	-0.4	3.0	3.5

Source: IMF Country Reports.
Note: Projected GDP growth and target overall fiscal balance refer to original program targets, not those subsequently modified in reviews.

29. Key to maintaining macro stability was the fiscal adjustment achieved with the elimination of fuel subsidies and other power sector reforms. Despite slippages and significant and frequent revisions of both the base and the targeted adjustment path, the overall fiscal deficit was reduced from 8.9 percent of GDP (revised) to 5.4 percent of GDP during the program (Table 1); the primary deficit narrowed from 7.4 percent to 5.2 percent of GDP; and NEPCO losses declined from 5.3 percent to 0.9 percent of GDP. Thus, the combined public sector deficit—defined as the central government's primary deficit plus NEPCO losses—improved from 12.7 percent of GDP in 2012 to 7.2 percent in 2015—a fiscal adjustment of 5.5 percent of GDP. However, this could not stem a further significant rise in public debt from 80 percent of GDP (revised) in 2012 to over 93 percent of GDP in 2015.[16]

30. As to growth performance, the Jordanian economy continued to expand, but at rates well below program projections, which had to be subsequently revised downward. Cumulatively, real GDP increased by 11 percent during 2012–15, compared to 15 percent projected in the original program (see Table 1). The average growth rate—about 2-3/4 percent per year—proved insufficient to reduce the unemployment rate (13 percent by the end of the program). Annual growth also underperformed by 0.5 percent per year the growth benchmark derived from a panel regression which relates growth to external factors alone (Figure 5).[17]

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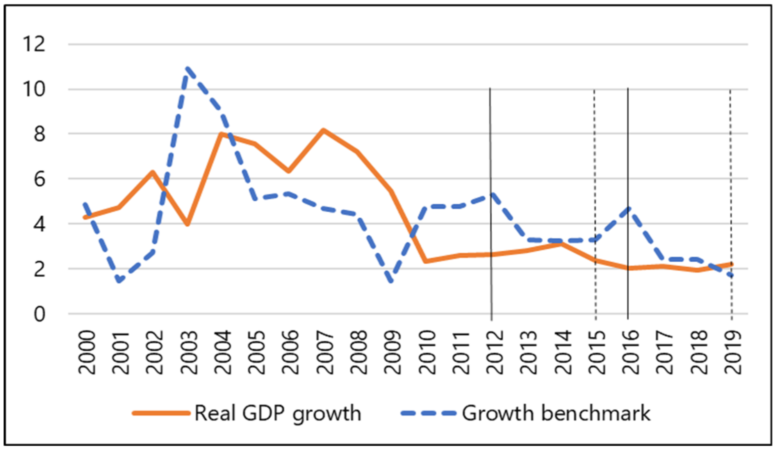
[15] The over-performance of reserves started in 2013 and reflected mainly faster-than-expected de-dollarization, and higher-than programmed external financing from the GCC. See IMF Country Report No.13/368.

[16] The higher-than-programmed debt ratios in part reflected lower levels of nominal GDP.

[17] The growth benchmark is intended to capture the variation in real GDP explained by external factors, including those affecting the demand for the country's exports and availability of external financing. As such, the difference between actual and benchmark growth can be interpreted as primarily reflecting the impact of domestic factors, including policy adjustment and other country-specific supply and idiosyncratic shocks. See Kim and others (2021) for further details.

Figure 5. Jordan—Growth vs. Benchmark



Source: IEO estimates.
Note: See Kim and others (2021) for a detailed explanation of the methodology.

31. The weaker-than-projected growth outcome can be attributed to the combination of various factors. First, the impact of the Syrian crisis and other regional conflicts affecting trade routes was large. The 2014 Article IV consultation estimated a loss of output growth of about 1 percentage point for 2013 deriving from the massive influx of Syrian refugees alone, which fueled social tensions, stretched public services and infrastructure, and required increased current spending and taking limited resources away from public investment. This influx also crowded out Jordanian workers in the informal sector of the economy.[18]

32. Second, and relatedly, investment declined significantly. Gross domestic investment fell by 2.5 percent of GDP during the program, in contrast to a programmed increase by 1.8 percent of GDP. Because of dominant uncertainty, private investment contracted by 1.6 percent of GDP in 2012–15. This was compounded by under-execution of public investment plans, resulting in a sizable decline in public investment during the program.

33. Third, the record of structural reforms implementation was mixed. Despite progress in the areas of public investment management, the establishment of a Public Private Partnership (PPP) unit at the Ministry of Finance, and the parliamentary approval of new investment and PPP laws, program reviews repeatedly underscored reform delays. In terms of compliance, about 60 percent of SCs were either not met or met with a delay.[19]

34. In the area of inclusive growth, the setting up of a national unified registry to improve targeting of subsidies (structural benchmark) was achieved. However, the mechanism introduced to protect the vulnerable from the impact of the automatic fuel price adjustment in practice

[18] See IMF Country Report No. 14/152, June 2014, Box 1.

[19] Of the 25 structural benchmarks included over the course of the program, 10 were met; 4 not met; and 11 met with a delay. See IMF Country Report No. 15/225, Table 2, page 50.

provided cash transfers to a very wide and poorly targeted share of the population (70 percent). The last reviews of the program also highlighted the need for labor market reforms dealing with high structural unemployment, low female participation, and public sector compensation and hiring practices, seeking their inclusion in the government's new medium-term reform plans under preparation. These reforms had been identified as important in supporting inclusive growth in the course of the 2012 Article IV consultation preceding the program but were not included in the SBA program design.[20]

D. 2016 EFF Program Design

35. In view of the unfinished reform agenda in 2015–16, the Jordanian authorities developed a new medium-term program underpinned by "Vision 2025," a 10-year framework for economic and social policies.

36. To support the country's new reform program, a successor three-year EFF arrangement (about US$0.7 billion, or 150 percent of quota) was approved in late August 2016. The new arrangement provided for semi-annual program reviews. Unlike the SBA, several prior actions were used in the fiscal area to signal the authorities' commitment to reform.

Adjustment Strategy

37. In terms of program objectives, the EFF arrangement aimed at advancing fiscal consolidation to lower public debt and structural reforms to enhance conditions for more inclusive growth. From a macro-policy perspective, program design was based on two key elements similar to the previous SBA, namely:

(a) A gradual fiscal consolidation to curb public debt to a sustainable path—from about 94 percent of GDP in 2016 down to 86 percent by 2019 and then to 77 percent beyond the program period.[21] The primary deficit (3.7 percent of GDP in 2016) was to be turned gradually into a surplus (0.9 percent of GDP) by 2019, with a cumulative fiscal adjustment of 4.6 percent of GDP (Table 2). An adjustment of similar magnitude was envisaged for the consolidated public sector balance. Fiscal multipliers' assumptions were not mentioned in program documents.[22]

(b) Monetary policy focused on maintaining the fixed exchange rate with an adequate level of reserves—targeting an increase in import cover to over 8 months or about 125 percent of the reserve adequacy metrics, given Jordan's vulnerability to external shocks.

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[20] See IMF Country Report No. 12/119, page 19.

[21] See IMF Country Report No. 16/295, September 2016.

[22] See IMF Country Report No.16/295.

38. The fiscal strategy was intended to be growth-friendly and inclusive. The authorities and staff agreed that gradual consolidation would preserve space for capital expenditure while protecting the most vulnerable. To shield low-income groups from the impact of fiscal adjustment, the EFF included an indicative floor on social spending for programs targeting health and disability, old age, family support and housing. To enhance the social safety net and improve the targeting of transfers, the authorities committed to establishing an automated data exchange among public agencies involved, with the support of the World Bank. In addition to these elements, the fiscal strategy focused on longstanding weaknesses on the revenue side (by streamlining tax exemptions and broadening the very narrow income tax base); containing current spending; and clearing the stock of outstanding domestic payments' arrears.

39. The program macro-framework anticipated inflation remaining in low single digits and the external current account deficit (including grants) was projected to narrow gradually by 2.8 percent of GDP (3.5 percent of GDP excluding grants), from 9.0 percent of GDP in 2016 to 6.2 percent of GDP in 2019, based this time entirely on improved government savings. IEO staff estimates point to current account adjustment contributing an annual average of 1.3 percent of GDP for the three-year period covered by EFF arrangement (see Figure 3).[23]

40. The projected current account adjustment, IMF repurchases for the previous SBA and amortization of public debt were expected to generate gross external financing requirements during 2016–19 equivalent to US$23.3 billion. Although financing would continue to depend significantly on public grants, restored investor confidence as a result of the program was expected to improve access to FDI and international capital markets, and to increase foreign investors' interest in local debt. Under these assumptions, the external financing gap amounted to US$5.1 billion, in large part covered by official support catalyzed by Fund financing.[24]

41. According to staff, the program faced significant risks, including: (i) difficult socio-economic conditions undermining the government's ability to pursue structural fiscal reforms; (ii) limited reform implementation technical capacity; (iii) shortfalls in public and private financing; and (iv) unfavorable external developments (higher oil prices, worsening refugee crisis, delays in the trade agreement with the EU). The planned strategies to respond to these risks involved instructions at the highest political level for the government to implement structural reforms; technical assistance support from the international community to help improve implementation capacity; commitments from the World Bank, the EU and key bilateral partners to help mitigate pressures from the refugee crisis and risks to program financing; and a commitment by the authorities to maintain reserves at levels adequate to withstand external shocks.

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[23] See Kim and others (2021) for technical details.

[24] Net of repurchases for the previous SBA (US$1.7 billion during 2016–19), IMF financing was actually a negative US$0.9 billion for the EFF arrangement. See IMF Country Report No.16/295, Table 3b, page 35.

Growth Aspects

42. The EFF-supported program's macro-framework projected a gradual increase in real GDP growth—from 2.8 percent for 2016 to 3.3 percent, 3.8 percent, and 4.0 percent, respectively, for 2017, 2018, and 2019. The projected acceleration in growth was premised on an increase in both public investment (by 0.7 percent of GDP) and private investment (by 1.5 percent of GDP); a strengthening of exports toward the EU following the relaxation of EU's rules of origin; and investment and productivity gains from structural reforms. Debt operations or exchange rate flexibility were not included as growth-supporting strategies in the arrangement.

43. Growth-enhancing structural policies focused on strengthening the business environment; promoting export diversification; advancing labor market reforms; enhancing the conditions for more inclusive growth; and facilitating access to finance. Financial reforms also aimed at further advancing the regulatory and supervisory framework and enhancing AML/CFT, in line with IMF TA recommendations.

44. SCs involved a detailed list of 24 structural benchmarks for 2016–17 (15 in the fiscal area, 7 for the financial sector, and 2 related to the business environment). Policy commitments to improve capacity in public investment management—seen as a constraint to growth already in the 2012 Article IV consultation—involved close cooperation with the World Bank and USAID. Other aspects of public financial management and tax administration reforms relied on advice received from IMF TA and on diagnostics from the IMF Fiscal Affairs Department. The preparation of a medium-term debt strategy for 2016–21 (structural benchmark) involved TA provided by the U.S. Treasury in coordination with the IMF and the World Bank.

E. 2016 EFF Arrangement—Implementation and Outcomes

45. The first review, originally planned for late 2016, was completed six months later, together with the 2017 Article IV consultation. There was progress in some areas, with over-performance in budget and utilities management leading to a better than targeted consolidated balance by 1.2 percent of GDP in 2016 (see Table 2). However, the improved fiscal performance also reflected cuts in capital spending, lower repayment of arrears, and a shortfall in social spending relative to target, reflecting continued military and refugee-related spending pressures and a revenue raising shortfall. International reserves also remained below programmed levels, in part reflecting higher deposit dollarization. The record on structural reforms was again mixed, with delays in the amendments to the income tax law.

46. Jordan continued to face a challenging environment, with the refugee crisis compounded by terrorist attacks and ISIS-related border security concerns. Moreover, a slowdown in GCC countries affected exports, tourism and workers' remittances. Thus, in 2016 the current account deficit remained high (9.3 percent of GDP including grants) and growth decelerated to 2.1 percent—below program projection (see Table 2)—with unemployment rising to about 16 percent. Growth projections for the reminder of the program had to be revised downward (to 2.3 percent in 2017, 2.5 percent in 2018, and 2.7 percent in 2019), as the troubled regional environment continued to weigh on investment and tourism.

Table 2. Jordan—Fiscal Balance and Growth: 2016 EFF Program vs. Outturn

Years	Projected GDP Growth	Actual GDP Growth	Projected Primary Fiscal Balance	Actual Primary Fiscal Balance
2016	2.8	2.1	-3.7	-3.2
2017	3.3	2.1	-2.5	-1.7
2018	3.8	1.9	-0.9	-3.0
2019	4.0	2.0	0.9	-3.8

Source: IMF Country Reports.

47. The second review was completed with a long delay, in May 2019, because of slippages in critical reforms and program targets. The progress in fiscal consolidation during 2017 was reversed in 2018, with reform delays stalling public revenue improvement. The primary deficit reverted to 3.0 percent of GDP (exceeding the first review target by 2.4 percent of GDP);[25] the combined public sector deficit widened to 4.3 percent of GDP (against a revised first review target of 1.8 percent of GDP); and public debt was unchanged at over 94 percent of GDP, rather than declining. In an unsettled macroeconomic and policy environment complicated by renewed political protests, private capital outflows led to a significant loss of reserves (down to an import cover of about 6.5 months). The situation eventually stabilized with the formation of a new government, which succeeded in passing key tax reforms by end-2018. In the May 2019 review, the authorities requested an extension of the EFF arrangement to March 2020.

48. However, the combination of stop-and-go economic policies, political uncertainty and unfavorable investor sentiment took a toll on growth (1.9 percent in 2018, after 2.1 percent in 2017). In the end, actual growth during the EFF arrangement (8.1 percent cumulatively for 2016–19) remained significantly lower than original program projections (13.9 percent). Annual growth also underperformed by a sizable amount (0.7 percent per year) the growth benchmark derived from a panel growth regression based on external factors alone (see Figure 5).[26]

49. In the course of the 2019 Article IV consultation mission (November 2019), staff and the authorities concurred that the remaining reform priorities could not be achieved during the few remaining months for the EFF, and agreed to start discussions on a new arrangement. A new 48-month EFF-supported program (about US$1.3 billion, or 270 percent of quota) was approved on March 26, 2020 soon after the onset of the COVID-19 pandemic. The new program aims at reinvigorating growth based on structural reforms tacking unemployment of women and youth and improving the fiscal situation through revenue mobilization efforts. The EFF also included significant TA support and training and was updated to support spending needs related to the COVID-19 pandemic. However, Jordan's economic outlook has since deteriorated considerably,

[25] The program definition of primary central government balance (PC) was defined as excluding grants and net transfers to the National Electric Power Company (NEPCO) and the Water Authority of Jordan (WAJ).

[26] See footnote 16.

due to sharp declines in tourism, remittances, exports and capital inflows linked to the pandemic. On May 21, 2020, the Fund approved Jordan's request for emergency financial assistance under the Rapid Financing Instrument (RFI) for about US$396 million (85 percent of quota).

F. Staff and Authorities' Perspectives

50. Interviews with Jordan's authorities, mission chiefs, senior reviewers and OED representatives focused on country circumstances, quality of policy dialogue, staff expertise on country issues, and growth projections.[27] Highlights were as follows:

51. **Growth objectives.** In discussions with IMF staff regarding Jordan's SBA and EFF growth recovery objectives, staff perceived the authorities as lacking a clear growth strategy, hesitant on pursuing reforms, and hamstrung by fears of Arab Spring contagion and interest groups. Staff also openly recognized its limited expertise regarding the design and calibration of growth-enhancing structural reforms ("we are good at stabilization, but we depend on other institutions on growth, and coordination is not always easy"). This view was shared by the authorities, who noted that staff's expertise on growth strategies was limited, advice in this area was too general and often lacking specificity, and collaboration with the World Bank—good on NEPCO reforms—was unsatisfactory on the design of an overall growth strategy. The authorities also underlined that regaining macroeconomic stability ultimately was the key objective of the IMF programs with Jordan, not growth; In addition, they noted that—complicating attention to growth issues—a continuing difficult external environment contributed to keep the country in "stabilization mode" throughout the two arrangements, with tight macro-financial conditions and constraints—pegged exchange rate, high debt and eroding donors' propensity to provide financing—and subject to continued headwinds and persistent uncertainty, which reduced the impact of any reform on FDI, domestic investment and growth.

52. **Quality of policy dialogue.** The interviews highlighted a rather uneasy relationship between staff and the authorities. While some country officials praised the high quality of the TA support received from the Fund and the policy dialogue, other officials complained about staff's inflexibility and "inability to grasp the country workings," and about discontinuities of policy dialogue that occurred during the EFF arrangement, which did not help maintain the reform momentum. On the other hand, staff felt that poor delivery on reform commitments, frequent delays, and recourse to ad hoc fixes to meet program targets indicated weak ownership. Staff recognized it lacked a good reading of the country's political economy, and recognized its limited ability to assess prospects for success of reform measures. For example, staff

[27] Interviews in Washington included those held with Kristina Kostial (mission chief, SBA, on January 21, 2020): Martin Cerisola (mission chief, EFF, on January 17, 2020); Adnan Mazarei, Mark Flanagan and Vitaliy Kramarenko (senior reviewers in MCD and SPR, respectively, on January 21 and 22, 2020); and Sami Geadah (Alternate Executive Director for Jordan, on January 17, 2020). Video interviews with the authorities included those with Senator Umayya Toukan, former Minister of Finance and former Governor of the Central Bank of Jordan, on July 8, 2020; with Deputy Governor Maher Sheikh Hasan on August 17, 2020; and with Deputy Governor Adel Al-Sharkas on August 21, 2020.

underestimated the strong political resistance to efforts to broaden the income tax base, which involved curtailing widespread exemptions for over 95 percent of the population. Such resistance was a key factor contributing to delayed completion of EFF reviews. The limited staff understanding of Jordan's political economy was possibly associated with the absence of a resident representative office on the ground until recently. Such presence was opposed by the authorities to avoid perceptions of the IMF being in the driver seat in regard to Jordan's economic policy priorities. The authorities also noted that greater presence of staff from the region in the IMF team could have helped.

53. **Geopolitics.** There was widespread recognition of the importance of geopolitical factors in framing Fund relations with Jordan, a country seen as surrounded by instability and conflicts. Maintaining political and economic stability in Jordan was an overarching objective widely supported by Jordan's international supporters—including by the United States, Saudi Arabia and European countries, which saw Jordan as a "gate" in preventing a flood of refugees toward Europe.

54. **Relations with donors.** Jordan's longstanding reliance on donors had generated over time a "strong sense of entitlement" vis-a-vis the international community. On the other hand, perceptions of limited reform achievements fueled donor fatigue. This was seen by staff as a factor reducing the catalytic role of the Fund, and at times complicating financing assurances. For instance, staff noted that the perceived reluctance to implement key taxation reforms during the EFF arrangement created significant difficulties in mobilizing support on terms suitable to Jordan's high debt situation. On the other hand, some country officials disputed the notion of donor fatigue due to weak ownership, noting that it was simply the reflection of increased global demands on limited donor resources ("too many causes to support").

55. **Growth projections.** Given the above conditions, the over-optimistic growth projections lacked a solid foundation. Even with program design carefully tailored to country circumstances and reflecting, as in the EFF arrangement, the lessons from the 2015 Crisis Program Review on avoiding excessive fiscal adjustment, the mixed record of policy implementation and continued uncertainty adversely affected investment and growth outcomes.[28] The massive influx of Syrian refugees also implied important changes in Jordan's economy, widening the informal sector. This may have magnified growth measurement errors, affecting to some extent the accuracy of projections versus outcomes comparisons.

[28] See IMF Crisis Program Review, November 9, 2015.

III. Tunisia

A. Context

56. Prior to the Arab Spring, Tunisia had reached the highest per capita GDP growth among regional oil importers, thanks to a longstanding record of fiscally conservative macro-economic policies.[29] In the decade prior to the 2011 revolution, the country achieved an average growth rate of 4 percent, with very low inflation. Tunisia weathered relatively well the impact of the global financial crisis.

57. However, Tunisia's development model relied heavily on state intervention, price and capital controls, a tightly managed exchange rate, directed bank lending, and a rigid labor market. This state-centered development strategy fostered the expansion of low value-added, export-oriented industries intensive in unskilled labor. For several years, this strategy delivered robust growth and stability, but over time it contributed to high youth unemployment (30 percent in 2010) and widespread regional and social inequalities. These strains triggered the January 2011 political uprising which toppled President Ben Ali, in power since 1987.

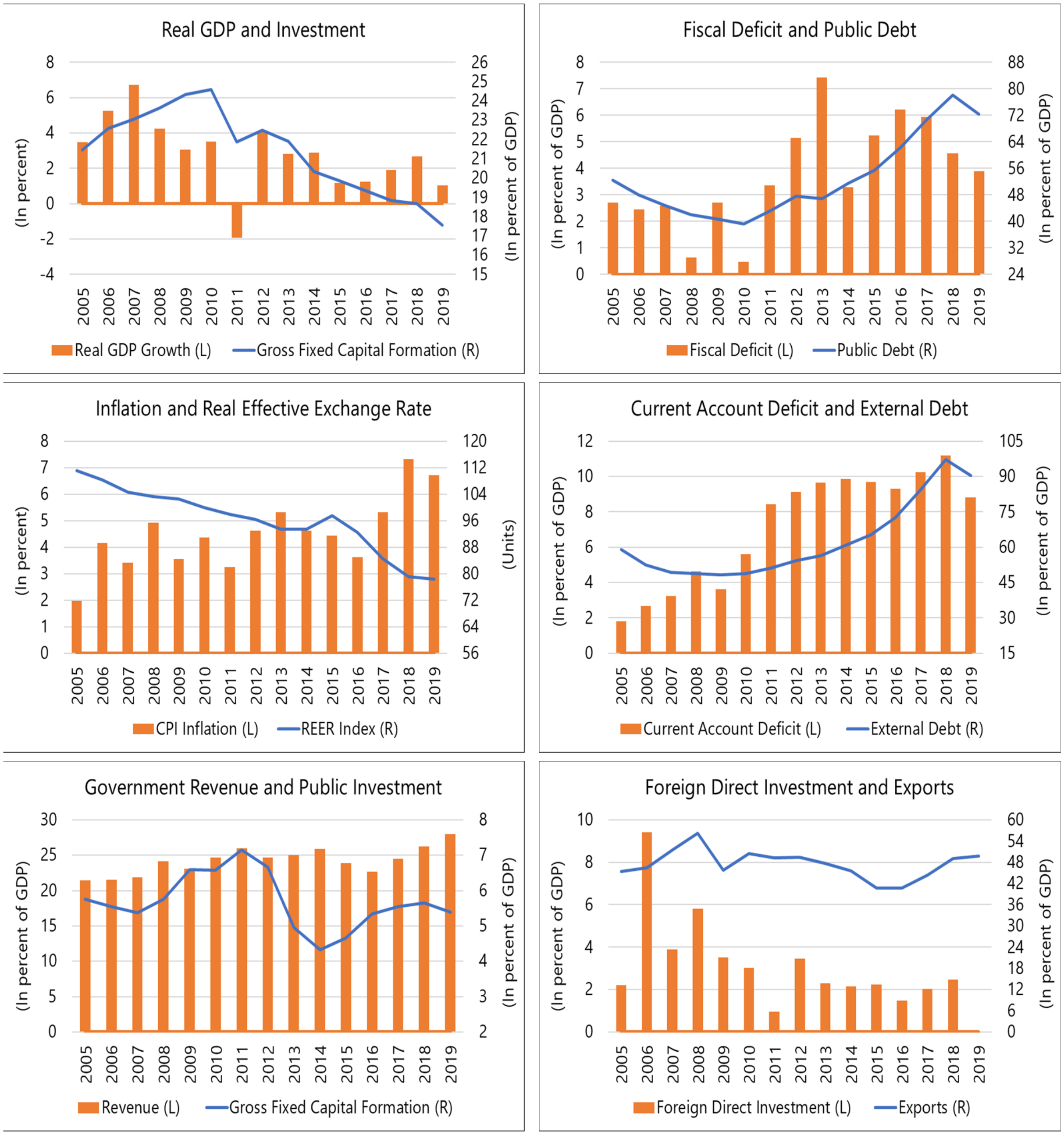
58. The revolution was followed by a political transition to democracy with the first elections for a National Constituent Assembly held in October 2011. The general expectation was that the new Constitution would be quickly followed by parliamentary and presidential elections and the formation of a new government, but this process was long delayed. During the protracted transition, Tunisia had interim coalition governments, which lacked sufficient political authority to take significant reform decisions.

59. Domestic political unrest and spillovers from the conflict in Libya (the main trading partner outside the EU) damaged Tunisia's economy. In 2011, real GDP declined by 2 percent, with a sharp drop of tourism receipts and FDI flows (Figure 6). The downturn and the return of Tunisian workers from Libya pushed unemployment to record levels (19 percent) and weakened the financial condition of the already fragile banking sector.

60. The authorities' first concern was to maintain social peace and mitigate the downturn's effects on living standards. Accordingly, they expanded social transfers and raised public-sector wages, and eased monetary policy to support credit to the economy. However, these policies contributed to deteriorating macroeconomic conditions, with an increase in inflation (to about 6 percent), a significant widening of the government deficit (to 3.2 percent of GDP including grants, up from 0.5 percent in 2010), higher public debt and a widening external current account deficit (7.3 percent of GDP, up from 4.8 percent in 2010) as shown in Figure 6. The deterioration of the external accounts and intervention to defend the exchange rate resulted in a significant loss of reserves (to 3.4 months of next year's imports).

[29] IMF Country Report No. 13/161, June 2013.

Figure 6. Tunisia—Macroeconomic Developments



Sources: April 2020 WEO database; INS database; FFA database.

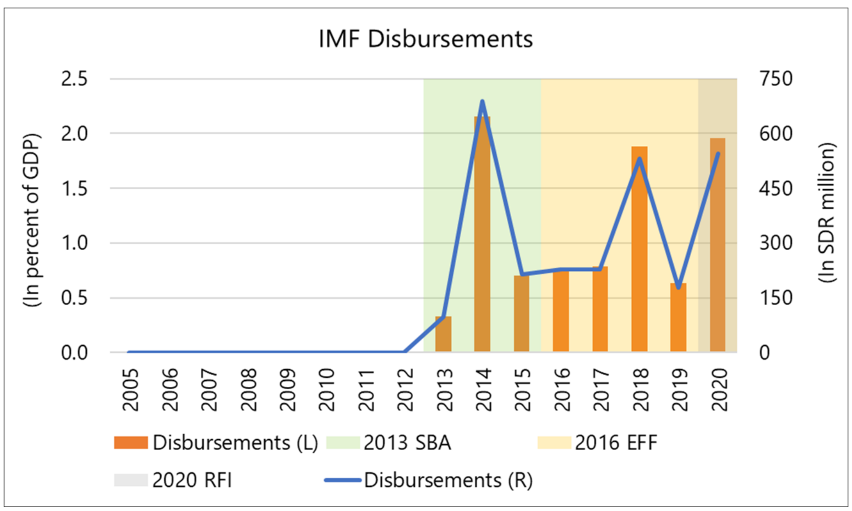
61. Despite these developments, the authorities remained reluctant to ask for Fund financial support. In this setting, the 2012 Article IV consultation called for a rebalancing of the policy mix, with tighter monetary policy to control inflation, greater exchange rate flexibility, fiscal policy supporting growth, and comprehensive structural reforms.

62. Despite some recovery of economic activity in 2012, persistent social and security tensions and weak demand from Europe caused the current account deficit to widen to about 8 percent of GDP, the fiscal deficit rose to about 5-1/2 percent of GDP, with incurrence of domestic arrears on payments of energy subsidies. In May 2012, Tunisia's sovereign rating was downgraded to below investment grade. The authorities then engaged staff on options for precautionary Fund assistance, as a safeguard against a further deterioration of market financing conditions ahead of the elections (scheduled initially for June 2013, subsequently delayed first to October 2013 and then to 2014). Following further policy discussions and requests for technical assistance (bank supervision, central bank capacity and tax policy and administration), the authorities finally reached agreement with staff for a disbursing SBA at the 2013 Spring Meetings.

B. 2013 SBA—Program Design

63. The two-year SBA with Tunisia was approved by the Board in June 2013 for about US$1.7 billion, or 400 percent of quota (Figure 7). It was designed with the objectives of "maintaining macroeconomic stability in support of the political transition and embarking on an ambitious structural reform agenda to sustain higher and more inclusive growth and employment creation, while preserving social cohesion."

Figure 7. Tunisia—IMF Disbursements



Source: IMF Members' Financial Data.

Adjustment Strategy

64. In designing adjustment policies, "staff and the authorities agreed on the need to strike the right balance in the short term between supporting the recovery and improving fiscal and external buffers."[30] The program was framed by the government's medium-term economic

[30] IMF Country Report No.13/161, June 2013, p.11.

agenda which was supported by the World Bank and other partners. Given the concern on market financing prospects, the authorities emphasized the program's signaling role in helping to catalyze official and investor support.

65. Program design was based on three pillars:

(i) strengthening fiscal and external buffers. Fiscal policies sought to create space for the one-off costs of bank recapitalization. Monetary policy focused on controlling inflation. Greater exchange rate flexibility was aimed at preserving reserves against exogenous shocks.

(ii) laying the building blocks for growth, by addressing banking sector vulnerabilities; pursuing medium-term fiscal consolidation allowing for a more growth-oriented composition of expenditure; and a structural reform agenda aimed at promoting private sector development.

(iii) strengthening social assistance and reducing income disparities.

66. In terms of fiscal adjustment, staff held the view that Tunisia had some fiscal space, given the relatively moderate level of public debt (44 percent of GDP in 2012—later revised to 48 percent). Therefore the program accommodated an initial widening of the fiscal deficit (from 5.4 percent of GDP in 2012 to 7.3 percent in 2013, excluding grants), in order to cover public banks' recapitalization needs (0.6 percent of GDP), the settlement of outstanding domestic arrears (0.9 percent of GDP) and higher social spending (0.3 percent of GDP)—in part offset by a modest decline in public investment (0.2 percent of GDP). The fiscal projections for the remainder of the program (2014 and 2015) aimed at a consolidation of the central government deficit (excluding grants) by 3.7 percent of GDP, from 7.3 percent of GDP in 2013 to 3.6 percent of GDP in 2015, leaving space for higher public investment spending (by some 0.7 percent of GDP).

67. The targeted fiscal adjustment (1.8 percent of GDP during the whole SBA, and 3.7 percent after 2013) was premised on a reduction and recomposition of current spending, based on two key measures: (i) the control of the public wage bill—projected to decline by 0.7 percent of GDP during the program—and (ii) the reform of energy subsidies. The fiscal program also included a substantial allocation for bank recapitalization (2 percent of GDP in 2014). Government debt was projected to increase to 49 percent of GDP in 2015.

68. The reform of energy subsidies involved their gradual phasing out with a sequence of fuel price increases and the adoption of a new automatic fuel pricing formula (structural benchmark). The resulting savings were to be used to improve the existing cash transfer scheme for the poor and other social programs—with World Bank TA support—and in part to finance the

targeted increase of public investment.[31] This was seen as having a larger fiscal multiplier, unspecified in program documents, but based on a cross-country study for the MCD Regional Economic Outlook.[32]

69. The program's macroeconomic framework involved an adjustment in the external current account deficit of 2.5 percent of GDP, from 7.5 percent of GDP in 2013 to about 5 percent of GDP in 2015—based on expectations of improving demand from Europe and a resumption of mining production and exports which had been affected by the political uprising. The improvement in the external position also involved an increase in official reserves coverage from 3.8 months to 4.5 months of prospective imports, based also on improving FDI flows (to 3.4 percent of GDP in 2015) and other private capital inflows. Greater exchange rate flexibility was also seen as crucial in preserving reserves from external shocks and mitigating risks from seasonally non-synchronized current account receipts and payments which tended to put pressure on reserves in the first half of the year.[33] The real exchange rate was assessed as modestly overvalued.

70. The program was seen as carrying substantial risks. These included: a growth outlook falling short of projections due to a deteriorating external environment; setbacks to the political transition affecting reform implementation and investors' confidence; renewed bouts of social unrest and security concerns; higher commodity prices; additional losses of public enterprises; and shortfalls in public or private market financing. The program risk mitigation strategy involved the setting up of inter-ministerial committees at the policy and technical level to monitor progress; the authorities' commitment to adjust policies as needed; reliance on quarterly fiscal targets and program reviews to help detect deviations and take remedial actions at an early stage; and TA support from the Fund and other international partners.

71. Total external financing needs were projected at US$28.8 billion during the program. After taking into account significant official financing support for the general government (projected at US$6.9 billion for 2013–15), including financing from bilateral and multilateral donors (the World Bank and African Development Bank) and other external financing for the banking and corporate sectors, the residual financing gap was projected at US$1.7 billion during the program, entirely to be covered by access to Fund financing.[34] IEO estimates for 2013 SBA indicate that the balance of payments need (in the absence of the program) was 3.4 percent of GDP annually, of which 2.0 percent of GDP was to be met by current account adjustment (Figure 8).[35]

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[31] Over the 2013–15 period, the aggregate of transfers and subsidies was to generate savings for 1.5 percent of GDP; other (non-allocated) expenditure was to decline by 1.3 percent of GDP; and capital expenditure to increase by 0.7 percent of GDP.

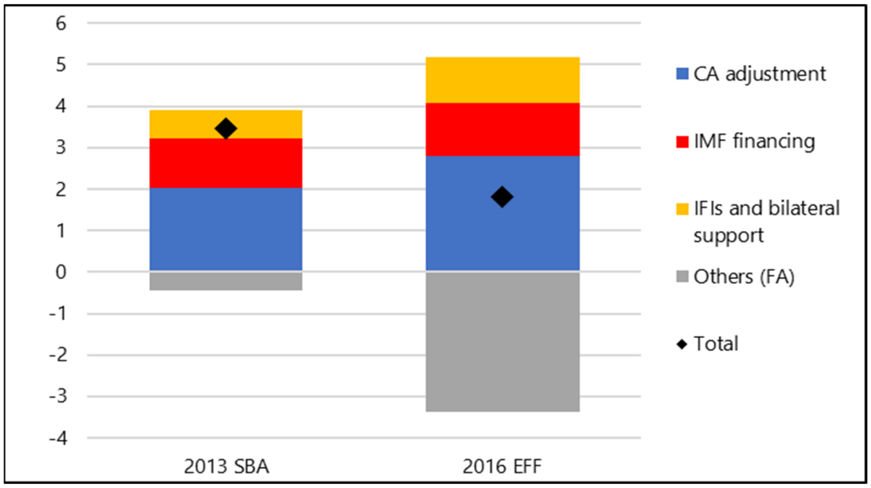
[32] See: MCD Regional Economic Outlook, Fall 2012.

[33] See IMF Country Report No. 13/161, Box 6, page 26.

[34] See IMF Country Report No. 13/161, page 25 and Table 3, page 37.

[35] See Kim and others (2021) for further details about the BOP need decomposition.

Figure 8. Tunisia—Balance of Payments Decomposition
Adjustment vs. Financing
(In percent of GDP)



Sources: IEO calculations and Kim and others (2021).
Note: See Kim and others (2021) for a detailed explanation of the methodology.

Growth Aspects

72. The program's macroeconomic framework was based on projections of a robust growth path. Real GDP growth was to increase monotonically from 3.6 percent in 2012 to 4 percent in 2013, 4.5 percent in 2014 and 5 percent in 2015, above the 10-year average of 4 percent.

73. The channels envisaged for such higher growth included: (i) a recovery of mining and tourism; (ii) a post-election reduction of policy and security uncertainty, expected to boost investors' confidence; (iii) a pickup of FDI and domestic demand; and (iv) in the medium term, a boost to private investment from an improved business environment and financial reforms. That said, the growth projections raise some issues, as the projections made reference to a flat-to-declining path for potential output—seemingly inconsistent with positive effects of reforms—and included a declining path for private investment, from 18.8 percent of GDP in 2012 to 18.1 percent of GDP in 2015, and flat overall investment during the program.[36]

74. The program's key pillars, as noted before, included laying the building blocks for a recovery of growth—by pursuing a moderate medium-term fiscal consolidation allowing for a more growth-oriented composition of public expenditure (see previous section); greater exchange rate flexibility; and a growth-enhancing structural reform agenda—and pursuing more inclusive development by strengthening social assistance and reducing income and internal regional disparities.

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[36] See IMF Country Report N0. 13/161, Table 7, page 43.

75. Growth-enhancing structural reforms involved addressing key growth constraints in two main areas: (i) financial sector reforms aimed at tackling longstanding vulnerabilities of the Tunisian banking system; and (ii) measures strengthening the foundations for private sector growth. A third element, the removal of labor market rigidities and constraints to the efficient functioning of the labor market, was recognized as in need of a clearer diagnostic at the time of program approval, and would be addressed at a later stage. The above constraints to growth were highlighted in Article IV surveillance activities preceding the program.[37]

76. The agenda for financial sector reforms involved some basic regulatory architecture elements, reflected in structural conditionality.[38] In addition, it involved addressing vulnerabilities of the three public banks (together, about 40 percent of banking system assets), with a financial audit (prior action) as the basis for deciding on recapitalization needs and the strategy on the role of the state in banking (structural benchmark). These measures were important for longer-term development, but by their nature were unlikely to involve a direct growth payoff within the two-year SBA timeframe.

77. The second area for growth-enhancing structural reforms was based on an analysis of key constraints to development of the Tunisian economy, and factors exacerbating inequalities. These constraints were identified as: (i) lack of transparency, complex regulations and cronyism discouraging private investment; and (ii) internal regional disparities and distortions due to the dichotomy between the offshore sector (located in the coastal areas and benefitting from a zero-tax regime attracting assembly lines in low-value added industries employing unskilled workers) and the onshore sector (located in the less developed interior of the country and subject to 30 percent tax and heavy labor regulations), a situation which was seen as penalizing educated youth's employment.[39]

78. To address these constraints, the authorities' program envisaged: (i) the adoption of a new Investment Code leveling the playing field, in conjunction with a reform of the corporate tax system seeking convergent tax rates—and thus addressing the noted regional disparities—in a revenue neutral fashion, with the help of World Bank and Fund TA; (ii) a review of existing tax, custom and business regulations aimed at streamlining procedures, again with the help of the World Bank TA; and (iii) the reform of the existing competition law.

79. The authorities also focused on improving social assistance programs to protect the most vulnerable. Specifically, the government committed to create a unified registry for cash transfers to the poor and to submit to the Council of Ministers a new targeted household support system

[37] See key structural issues discussed in the 2012 Article IV consultation—IMF Country Report No.12/255.

[38] These elements included improving data quality and provision through a new data reporting system; strengthening bank supervision through onsite and offsite inspections, based on the 2012 FSSA recommendations and Fund technical assistance (TA); and the setting up of a banking resolution mechanism, again with the help of Fund TA.

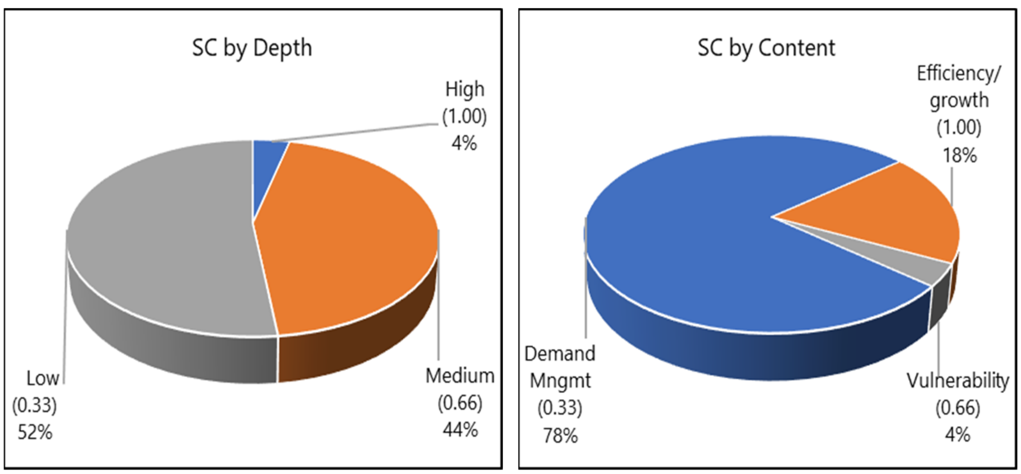
[39] See IMF Country Report No. 13/161, page 20–22.

accompanying the reform of energy subsidies (structural benchmark). These measures were seen as key to move toward an effective social safety net, since the World Bank had assessed the existing cash transfer system as subject to significant leakages.

80. In terms of structural conditionality, the structural reform agenda was reflected in 14 SCs at program approval—4 for the financial sector, 5 for fiscal policy, 4 for monetary and exchange rate policy, and 1 for private sector development, involving the early adoption (by July 2013) of a new Investment Code. Most SCs addressed financial sector stability, monetary transmission mechanism or fiscal issues. Only 3 out of the 14 SCs were oriented either at enhancing private sector development, social protection/inclusion or a growth-supporting strategy such as greater exchange rate flexibility.[40]

81. During the course of the SBA arrangement, the number of SCs was increased to 46 in total.[41] Of these, 18 pertained to the financial sector, 16 to the fiscal area, 9 to monetary and exchange rate policy, and 3 to private sector development—suggesting a relatively weak link between SCs and growth targets. The large majority of SCs in the 2012 SBA with Tunisia (69 percent) had low depth, and only 13 percent of SCs had strong growth orientation (Figure 9).[42]

Figure 9. Tunisia—Structural Benchmarks by Depth and Growth Orientation



Sources: IEO calculations and Kim and Lee (2021).
Note: The numbers in bracket refer to the score (scaled between 0 and 1) assigned to the corresponding category. See Kim and Lee (2021) for a detailed explanation of the methodology.

[40] See Kim and Lee (2021) for technical details on SC analysis.

[41] The total number of SCs reported in the MONA database does not match the data mentioned in the text above, derived from IMF Country Report No.16/138, Annex Table 1, pp. 49–50. These SCs were introduced as interim steps to reach a few key benchmarks but accumulated as authorities did not implement them.

[42] See IEO calculations and Kim and Lee (2021).

82. In regard to capacity development issues related to structural reforms, the 2012 and 2015 Article IV consultation reports noted that TA provided to Tunisia prior to the SBA covered some of the key issues reflected in SCs, including foreign exchange market and central bank operations, banking supervision, a 2012 Financial Sector Assessment Program update, the provision of a resident expert in banking supervision, and an assessment of training needs of the central bank. Significant TA support from the Fund continued during the program (see below).[43]

C. 2013 SBA—Implementation and Outcomes

83. The 2013 SBA was completed at end-December 2015, after a 7-month extension allowing the authorities more time to implement policy commitments. In the event, six reviews were completed (out of eight reviews originally planned in the program) and 90 percent of program access was drawn (US$1.6 billion out of US$1.75 billion).

84. Program implementation was "complicated by a more protracted political transition process than expected, with frequent changes in governments, delayed elections and a strong legislative focus on the constitutional and political process."[44] The new Constitution was finally approved in January 2014, and legislative and presidential elections held in October 2014, more than a year later than expected. Policy making was also hampered by continued social tensions, security problems, spillovers from Libya and, in 2015, repeated terrorist attacks. Persistent weak growth in Europe, Tunisia's main trading partner, and the decline in global oil prices in late 2014 also affected outcomes.

85. In this environment, program modalities had to be repeatedly adapted. Monitoring was based on quarterly reviews, with frequent use of prior actions and modifications of performance criteria. Delays in implementing reform commitments led to combining the first and second program reviews; halving the disbursement associated with the fifth review and re-phasing access; a long delay in completing the sixth review; a program extension to allow the authorities more time to advance the structural reform agenda; and finally the cancellation of the seventh and eight reviews.

86. In terms of macroeconomic and policy outcomes, the SBA succeeded in helping the authorities maintain relatively stable macroeconomic conditions and initiate reforms in a difficult political and external environment. The monetary policy framework was improved with the introduction of a Monetary Policy Committee and inflation remained broadly in line with projections. However, the external position did not improve as programmed. The level of international reserves (US$7.6 billion at end-2015) remained well below the SBA program target (US$11.9 billion), despite strong multilateral support with sizable World Bank disbursements in 2015 and renewed international market access.

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[43] See IMF Country Reports No. 12/255, Annex 1, and No. 15/285, Informational Annex.

[44] See Annex I of IMF Country Report no.16/138.

87. The reserve shortfall was not due to external financing issues but to continued central bank intervention to support the exchange rate. The Tunisian dinar was assessed at the time of the SBA 6th and last review/2015 Article IV consultation as being a "de facto crawl-like" within a narrow margin (2 percent) around a statistical trend, and overvalued by some 5–15 percent, in part reflecting the appreciation of the currency as a result of the stronger US dollar vis-à-vis the euro.[45] In addition, external current account deficits remained high and deteriorated to about 9 percent of GDP in 2014 and 2015—rather than narrowing as programmed to 5 percent of GDP—leading to increasing external debt ratios (see Figure 6). The high deficit was due to low oil and phosphate exports and a significant decline in tourism revenues, damaged by terrorist attacks and security concerns.

Table 3. Tunisia—Fiscal Balance and Growth: 2013 SBA Program vs. Outturn

Years	Projected GDP Growth	Actual GDP Growth	Projected Fiscal Balance	Actual Fiscal Balance
2013	4.0	2.4	-7.3	-7.5
2014	4.5	2.3	-6.4	-4.3
2015	5.0	0.8	-3.6	-5.5

Source: IMF Country Reports.

89. In regard to fiscal policy adjustment, progress was made in reducing energy subsidies and, with delays, in adopting a new automatic pricing formula. Nonetheless, despite faster than expected reduction of subsidies due to the decline in oil prices in late 2014 and 2015, the central government deficit (excluding grants) was reduced by only 2 percent of GDP (from 7.5 percent of GDP in 2013 to 5.5 percent of GDP in 2015), nearly half the programmed consolidation of 3.7 percent of GDP for that period (Table 3).[46] The composition of public expenditure also deteriorated, as the envisaged control of public wages and salaries failed to materialize and public investment actually declined—to 4.6 percent of GDP in 2015, rather than increasing as programmed to 7.1 percent of GDP. Government debt reached 53 percent of GDP (2015), above program projections.

90. Structural reforms implementation proved challenging in the midst of a protracted political transition complicated by security risks. In fact, only about 59 percent of the 46 structural benchmarks included in the program were met.[47] This mixed result was despite the significant technical assistance support provided by the Fund during the program. This effort included 29 TA missions from various Fund departments (9 from FAD, 2 from LEG, 13 from MCM and 5 from STA) in the two and a half years of the program.[48]

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[45] See IMF Country Report No. 15/285, page 20 and Annex I.

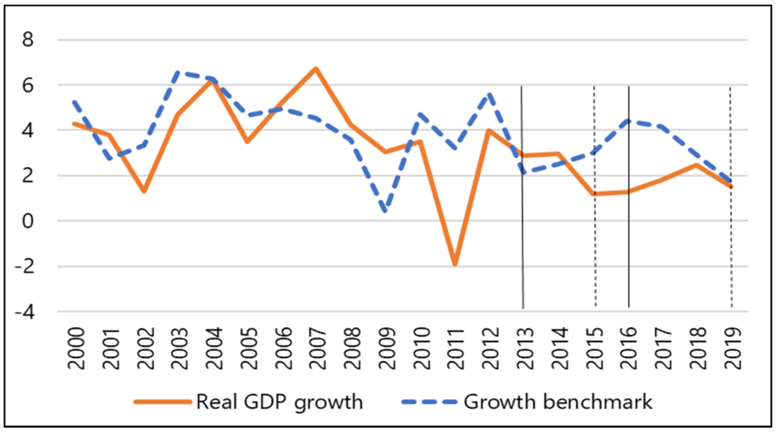
[46] See IMF Country Report No. 16/138, Table 1.

[47] See IMF Country Report No. 16/138, Annex Table 1, pp. 49–50.

[48] See the 2017 Article IV consolation report, IMF Country Report No. 18/120, Informational Annex.

91. In regard to key reform priorities for the banking sector, progress was made in completing the audits; recapitalizing two public banks; unifying rules for public and private banks; and strengthening regulations on loan classification and provisioning. However, the operational restructuring of public banks did not start and supervision remained in need of considerable strengthening. In the area of business environment reforms, SCs related to implementation of a new Investment Code were not met and the new laws on competition and bankruptcy were adopted by Parliament only in late 2015 and early 2016, respectively. In the area of social protection, there was progress. A new targeted household compensation system was introduced together with the reform of generalized energy subsidies. Cash transfers were increased and coverage expanded to reach close to 60 percent of poor households.

Figure 10. Tunisia—Actual and Benchmark Growth



Source: IEO estimates.
Note: See Kim and others (2021) for a detailed explanation of the methodology.

92. The program objective of growth recovery was not attained. Real GDP growth remained significantly below program projections, reaching a cumulative growth rate during 2013–15 of 5.5 percent, sharply below the programmed cumulative rate of 13.5 percent (see Table 3). Annual growth also underperformed, albeit modestly, the growth benchmark derived from the IEO panel regression which explains growth based on external factors alone (Figure 10).[49] The weak growth outcome despite lower than programmed adjustment was mainly due to persistent political uncertainty, and security-related concerns and external factors. However, lack of progress with reforms to improve the business environment and the failure to expand public investment also played a contributing role.

93. In late 2015, in view of further expected delays in completing key elements of the SBA structural reform agenda, the authorities decided against trying to complete the seventh review of the SBA, in order to start negotiations for a new program.

[49] The difference between actual and benchmark growth can be interpreted as reflecting the impact of domestic factors, including policy adjustment, and other country-specific factors not included in the panel regression specification. See Kim and others (2021) for further details.

D. 2016 EFF Arrangement—Program Design

94. A 48-month EFF arrangement (about US$2.9 billion, or 375 percent of quota) was approved by the Board in May 2016 to support Tunisia's reform program framed by the authorities' new five-year economic strategy, broadly endorsed by the new government of national unity that took office in August 2016. The new EFF arrangement had as key objectives addressing remaining macroeconomic vulnerabilities and pursuing more inclusive growth. Program monitoring was subject to semi-annual reviews.

95. Program design was similar to the SBA, and was centered around four pillars: (i) consolidating macroeconomic stability, with fiscal policies designed to place public debt on a downward path while creating space for priority public investment; monetary policy geared at containing inflation; and greater exchange rate flexibility protecting reserves; (ii) reforming public institutions; (iii) promoting financial intermediation; and (iv) improving the business environment. Based on these pillars, the macro-framework involved a gradual rebound in growth, stable inflation, and a gradual improvement of the fiscal and external accounts.

Adjustment Strategy

96. In terms of fiscal adjustment, the EFF arrangement aimed at a moderate consolidation of the central government deficit (excluding grants) by 2.2 percent of GDP, from 4.6 percent of GDP in 2016 to 2.4 percent in 2019, and of the structural deficit (from 4.0 percent to 2.1 percent), consistent with a declining debt ratio from around 54.6 percent to about 51 percent of GDP. Most deficit reduction was to come from containing the wage bill (from 14 percent to 12.7 percent of GDP)—including through civil service reform—and an increase in tax revenues (by 1.2 percent of GDP, to about 23 percent of GDP), through a comprehensive tax reform.

97. In terms of phasing and composition, fiscal adjustment was expected to proceed gradually, "anchored by wide consensus on tax and civil service reforms which are essential to improve budget composition."[50] With the wage bill accounting for 63 percent of tax revenues, containing it had become an "immediate priority." The envisaged consolidation left room for an increase in public investment (from 5 percent of GDP in 2016 to 6.5 percent in 2019) and in social spending, including for unemployment support and higher pension transfers. To protect social spending, the EFF included an indicative floor. Fiscal multipliers assumptions were not explicit in program documents.

98. Regarding external adjustment, the program projected an improvement in the current account balance by some US$0.7 billion or 2.2 percent of GDP, from 7.7 percent in 2016 to 5.5 percent in 2019. International reserves' coverage was to remain constant at 4.6 months of imports. Access to Fund financing (about US$2.9 billion) was expected to have a significant catalytic impact, with the African Development Bank, the Arab Monetary Fund, the World Bank

[50] IMF Country Report No.16/138, page 12.

and the European Union providing substantial resources (about US$2.2 billion) to meet the financing needs for the first year of the program, and commitments for subsequent years linked to progress on reforms.[51] IEO staff calculations point to a contribution of current account adjustment of 2.8 percent of GDP to meeting the average annual BOP need of 1.8 percent of GDP for the arrangement period (see Figure 8). With the 2013 SBA's mixed record of structural reform implementation, the EFF arrangement treated key measures in financial and taxation areas as prior actions. These measures included: the approval by the three public banks' boards of updated business plans for operational restructuring; the approval by Parliament of the central bank law, the banking law and of the bankruptcy law; and, the adoption by the Council of Ministers of a comprehensive tax reform strategy.[52] Eleven additional SCs at program approval related to fiscal and financial reforms.

99. Staff noted that the EFF-supported program carried considerable risks, mainly related to increased security tensions diverting policymakers' attention from economic reforms; weakened social and political support for reforms, which could also imply reduced donor support; and a rebound in oil prices or other external development that could put pressure on growth and the external and fiscal accounts. The program strategy to mitigate these risks included building an early momentum for key economic reforms in program design and the creation of a high-level reform implementation committee at the Prime Minister's office. In addition, six-monthly reviews with interim staff visits would provide a monitoring mechanism allowing for early remedial action in case of program slippages, for instance linked to the risk of increasing security tensions.[53]

Growth Aspects

100. The EFF's growth projections and the program's macro-framework were premised on relatively optimistic assumptions of receding security risks; a stabilization of the situation in Libya; and a recovery of tourism and demand from Europe. Growth projections were informed by a staff analysis of Tunisia's growth constraints.[54] The projections were based on a gradual increase of growth potential (to a 4–4.5 percent range) driven by a return of investor confidence associated with the implementation of program reforms.

101. Growth was expected to gradually converge to medium-term potential—closing the output gap by the end of the program—with projected growth rates of 2.0 percent in 2016 and 3.0 percent, 3.7 percent, and 4.3 percent, respectively in 2017, 2018, and 2019. Supporting the

[51] See IMF Country Report No. 16/138, page 25.

[52] The comprehensive tax reform strategy included: (i) broadening the VAT tax base by removing exemptions and simplifying rates; (ii) improving the progressivity of the personal income tax; (iii) reduce the difference between on-shore and off-shore corporate taxation; (iv) simplifying the taxation of small enterprises; and (v) reducing earmarked taxation. In addition, tax administration was to be strengthened, starting with a Large Taxpayer Unit as a priority.

[53] See IMF Country Report No.16/138, page 27.

[54] See: "*Tunisia's Growth Potential: Recent Trends, Constraints, and Opportunities for the Future*," IMF Country Report No.16/47, September 2015.

gradual growth recovery, gross investment was projected to increase from 21.8 percent of GDP in 2016 to 23.5 percent in 2019, reflecting the programmed strengthening of public investment (1.5 percent of GDP) and a more cautious recovery of private investment (0.3 percent of GDP).

102. Growth-enhancing structural reforms focused on modernizing the public administration and public financial management; promoting financial intermediation, with progress on public bank restructuring and strengthening supervision; and improving the business climate with the adoption of a new Investment Code and streamlining of tax and administrative procedures.

103. The cornerstone of the authorities' strategy to boost inclusive growth was the reform of public institutions. This was aimed at increasing efficiency in the provision of public services and improving revenue mobilization and the composition of the budget in order to increase growth-oriented expenditures and provide resources for a better-targeted social safety net. The latter was to be improved with the introduction of a unique identification number and a new database of vulnerable households, in addition to the existing cash transfer schemes.

E. 2016 EFF—Implementation and Outcomes

104. The experience with the first review demonstrated at the outset the challenge of keeping the program on track in a fragile socio-political setting. The review was eventually completed after a long delay, in June 2017. The authorities had to request waivers of nonobservance for all performance criteria at end-December 2016. All structural benchmarks through March 2017 were subject to delays.

105. The new government of national unity that had been formed in August 2016 tried to recover ground on the fiscal slippages it had inherited, and in the end succeeded in making progress on most structural benchmarks that had been subject to delays, including the approval of laws and implementing decrees on competition, public-private partnerships and the investment code performance contracts for public banks, the approval of the civil service reform strategy and the organization of the large taxpayer unit. Fund TA on tax policy and administration was instrumental in supporting reform plans.

106. Nonetheless, macroeconomic conditions diverged significantly from the program framework (Table 4). Growth in 2016 (1.2 percent) was below program projection (2 percent); the public wage bill kept increasing; the central government deficit (6.1 percent of GDP excluding grants, subsequently revised to 6.4 percent of GDP) exceeded the program target (4.6 percent of GDP); public debt reached 63 percent of GDP (almost 8 percent of GDP above program).[55] The external current account deficit widened to 9.0 percent of GDP; and international reserves declined to US$5.9 billion, or 3.4 months of imports coverage.

[55] The increase in public debt ratio in part reflected revisions as a result of Fund STA guidance.

Table 4. Tunisia—Fiscal Balance and Growth: 2016 EFF Program vs. Outturn

Years	Projected GDP Growth	Actual GDP Growth	Projected Fiscal Balance	Actual Fiscal Balance
2016	2.0	1.2	-4.6	-6.4
2017	3.0	1.9	-3.9	-6.1
2018	3.7	2.7	-3.7	-4.8
2019	4.3	1.0	-2.4	-4.1

Source: IMF Country Reports.

107. A similar situation emerged during the second review, completed in late March 2018. Despite a modest growth recovery in 2017 (1.9 percent, below the original program's and the first review projection), macroeconomic conditions deteriorated, with rising inflation, a fiscal balance larger than the original program target (6.1 percent versus 3.9 percent of GDP), a higher current account deficit (10 percent of GDP) fueling exchange rate depreciation, declining international reserves (US$5.7 billion, or 3.1 months of imports), and public and external debt ratios rising to 71 percent and 80 percent of GDP, respectively. Gross fixed capital formation continued to decline, and FDI (about 2 percent of GDP) remained well below historical standards (see Figure 6).

108. The record of program performance remained weak, despite continued strong support by the Fund on capacity development.[56] All quantitative performance criteria for December 2017 were missed and only 2 out of 14 structural benchmarks were met. Staff recognized that "program risks are exceptionally high."[57] In concluding the review, Directors issued a strongly worded statement urging stronger commitment to the program and approved intensified program monitoring through quarterly reviews.[58] After this change in program monitoring arrangements, three additional reviews were completed, the last in June 2019, bringing total Fund disbursements to about US$1.6 billion (less than 60 percent of access upon approval).

109. After the second review, macroeconomic conditions remained characterized by persistent vulnerabilities, amid social pressures and political uncertainty linked to new parliamentary and presidential elections. A subdued recovery in 2018 (2.7 percent) was followed by low growth in 2019 (1 percent)—insufficient to reduce high unemployment (above 15 percent)—and a continued decline in gross capital formation. Annual growth in 2016–19 also underperformed by a large amount (about 1.9 percentage points) the growth benchmark derived from a large panel

[56] The 2017 Article IV consultation report discussed at the Board in March 2018 highlights that during the EFF period up to the completion of the second review Tunisia received seven TA missions from FAD, one from LEG, six from MCM, five from STA, and nine from the Middle East Regional Technical Assistance Center. See the Informational Annex in IMF Country Report No.18/120.

[57] See IMF Country Report No. 18/120, March 2018, Executive Summary.

[58] *"Noting weak program implementation and high risks to the program, Directors urged the authorities to strengthen their commitment to the program and take urgent and decisive action to put public finances on a more sustainable path, address rising inflation and falling reserves, and ensure macroeconomic stability. Directors generally agreed that moving to quarterly reviews would facilitate implementation of the Fund-supported program."*

regression (see Figure 10). On the back of higher oil prices, inflation rose to over 7 percent in 2018 (6 percent in 2019, after a hike in the policy rate) and the current account deficit widened to a record level above 11 percent.

110. The fiscal deficit fell to about 4 percent of GDP in 2019, following the adoption of measures to strengthen tax administration; eliminate the preferential tax regime for offshore companies; pension reforms and energy price adjustments. The deficit reduction occurred despite the setback on civil service reforms linked to the authorities' decision to grant further civil service wage increases against staff advice, the cost of which offset the impact of other measures such as the adoption of limits to new recruits and of voluntary separation and retirement schemes to contain the size of the civil service. All in all, central government and external debt remained elevated at 72 percent and 90 percent of GDP, respectively, at end-2019.

111. In April 2020, the IMF Board approved emergency financing (US$745 million, equivalent to 2 percent of GDP) under the RFI to support the authorities' efforts to contain the spread of the COVID-19 pandemic and mitigate its human, social and economic toll. The emergency financing aims at ensuring an adequate reserve buffer amidst unprecedented uncertainty and provides resources for increasing health related spending; strengthening social safety nets for low-income families and the unemployed; and supporting small and medium-size firms hit by the pandemic crisis.

F. Staff and Authorities' Perspectives

112. Interviews with Tunisia's authorities, mission chiefs and senior reviewers focused on country circumstances, realism of growth projections, and quality of adjustment and policy dialogue.[59] The key points emerging from these interviews were as follows:

113. **Unrealistic expectations.** Staff underscored that "looking from the prism of growth, there was too much lack of realism." The SBA design reflected clear stabilization needs due to deteriorating macroeconomic conditions and the financial sector weakness. However, staff underestimated the complexity of the political transition and the duration of the impact intervening political, security-related and regional shocks. As a result, staff had unrealistic expectations regarding the feasibility and growth payoff of reforms included in the program design. The consequence was a disconnect between optimistic growth projections—reflecting "the need to show hope"—and the adverse effects on investment and growth of persistent uncertainty and other shocks. The authorities agreed with the gist of these observations and praised the quality of policy dialogue with staff and the TA support received by the Fund.

[59] Interviews in Washington included those held with Amine Mati (mission chief, SBA and EFF, on January 14, 2020): Bjorn Rother (mission chief, EFF, on January 14, 2020); Taline Koranchelian (senior reviewer in SPR and then MCD, on January15, 2020); and Daniela Gressani (senior reviewer, MCD, on January 21, 2020). Video interviews with the Tunisian authorities took place on July 20, 2020 with Mr. Moez Labidi, Economic Advisor to the Prime Minister and former Minister of Finance; and on July 23, 2020 with Mr. Taoufik Rajhi, former Advisor to the Prime Minister in charge of supervising the Economic Analysis Council, and former Minister of the Government of Tunisia in charge of major reforms.

However, they also underscored that staff failed to understand the fragility of the political situation and to integrate appropriately the difficult constraints faced by the government during Tunisia's transition to democracy. In this regard, it may be noted that the 2013 SBA identified possible setbacks to the political transition as a risk for the implementation of program reforms.[60] Adaptations to the program during quarterly reviews were envisaged as the key instrument for adjusting the program framework and take remedial actions.[61]

114. **Ownership and geopolitics.** The protracted political transition also affected ownership and implementation because it crowded out the authorities' attention for and commitment to economic reforms and, as noted before, it required repeated program adaptations. In addition, in the context of frequent government changes, the continuing lack of a constitution and persistent security concerns, governments lacked sufficient legitimacy, strength and cohesion to take decisions and enact major reforms, and withstand pressure from important vested interests such as public sector labor unions. Nonetheless, the country's transition to democracy was widely supported in the Board ("nobody wanted Tunisia to fail"), which may have resulted in some forbearance for partial or delayed implementation of reform commitments. As in the case of Jordan, however, perceptions of weak ownership induced donors' fatigue.

115. **Sustainability of reforms.** The authorities and staff noted that Tunisia's transition to democracy involved difficult issues in consensus building in a pluralistic society, and a more complex political situation relative to the top-down decision-making prevailing in Jordan and Egypt. In this situation, some program measures fueled opposition to reform, because of the failure to communicate effectively to the population the rationale for the economic reforms included in the programs, and because of an imbalance between winners and losers. For instance, the reform of fuel subsidies hit widely the urban middle class, who were politically organized and well represented, while the compensating measures targeting the more vulnerable favored a narrower and politically silent part of the population. The tradeoff between economic and social stability weighed on reform implementation, for instance with the decision to retract planned energy price hikes in the fall of 2018.

116. **Recurrent over-optimism.** According to staff, three assumptions underlying the 2016 EFF-supported program proved incorrect. These were, first, that the political transition had been completed by the time the EFF was approved, while in fact socio-political conditions remained fragile. Second, that the impact on growth of the 2015 terrorist attacks and the conflict in Libya would be short-lived, which proved unrealistic. And third, that policy implementation capacity—reinforced by significant IMF and WB TA support—was commensurate to Tunisia's emerging market status, which again proved unrealistic in a fragile political environment. Together these assumptions led staff to believe that a detailed reform agenda could be implemented during the EFF arrangement, and that growth would bounce back to historical levels, which proved incorrect. The authorities concurred on these observations.

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[60] See IMF Country Report No.13/161 p. 27.

[61] See earlier paragraph 81 for details on program adaptation.

117. **Budget composition and growth.** The control of public wages faced very strong and organized opposition, particularly in view of the political strength of the trade unions in Tunisia's young democracy. This measure was considered important as public wages absorbed almost two thirds of tax revenues; public wage levels were double those prevailing in the private sector; and the public sector was the key player in job creation. In the event, however, the control of wages failed to materialize, and program assumptions on civil service reform proved unrealistic, despite the provision of Fund TA. The authorities again underscored a problem of ineffective communication in this regard.[62] In turn, the failure to control public wages crowded out resources for public investment and created pressure on public debt. According to staff, the policy response—improving tax administration and tax collection—ended up trading higher taxation for higher current spending and low public investment, resulting in a budget composition problematic for growth ("the budget went in the wrong direction"). The authorities agreed on this observation, recognized the importance of implementation constraints on public investment, and noted that the fragility of the political situation left no alternative in view of the need to preserve macroeconomic stability.

IV. EGYPT

A. Context

118. The Egyptian economy experienced buoyant growth prior to the global financial crisis (GFC), reaching growth rates above 7 percent (Figure 11). Egypt weathered the GFC relatively well, despite a pullout of foreign investors, and growth held up at 4.7 percent in 2008/09. Prompt counter-cyclical fiscal and monetary responses—additional infrastructure spending, interest rate cuts and use of international reserves to meet capital outflows—helped mitigate the impact of weak external demand.

119. However, the strong growth record was insufficient to generate enough jobs to absorb the fast-growing Egyptian population. Popular dissatisfaction with chronic high unemployment (especially for the youth) and economic inequalities eventually burst into dramatic civil unrest in January 2011.

120. Egypt entered then a prolonged period of political turmoil. President Mubarak was forced to step down in February 2011 and new parliamentary and presidential elections were held in 2012, with President Morsi coming to power. However, renewed protests broke out in 2013, calling for the removal of the President, who was arrested after a new military takeover. A new Constitution was approved in 2014, and General Sissi was elected as President. After repeated terrorist attacks in 2015, a new Parliament was elected in January 2016.

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[62] Fund staff tried to communicate the need for public wage bill reform, including through a departmental paper on the subject, however the authorities often discouraged such communication efforts.

121. The Egyptian authorities expressed interest in Fund financial assistance already in April 2011, after a sharp bout of reserves losses. The policy dialogue between the authorities and Fund staff continued during the long period of political turmoil, albeit intermittently due to shifting political circumstances. Several rounds of program negotiations took place during 2012 and early 2013, and technical assistance activities continued in the fiscal area, monetary policy and bank supervision.[63] Nonetheless, agreement on appropriate adjustment policies could not be reached, notably because of divergent positions on exchange rate policies as the IMF pressed for a shift to a more flexible regime and in regard to the challenge of controlling fuel subsidies. After a long pause in relations during 2013–14, the 2014 Article IV consultation (the first after 2010) played a key role in deepening the policy dialogue, and the authorities initiated important fuel subsidy reforms in the 2014/15 budget.

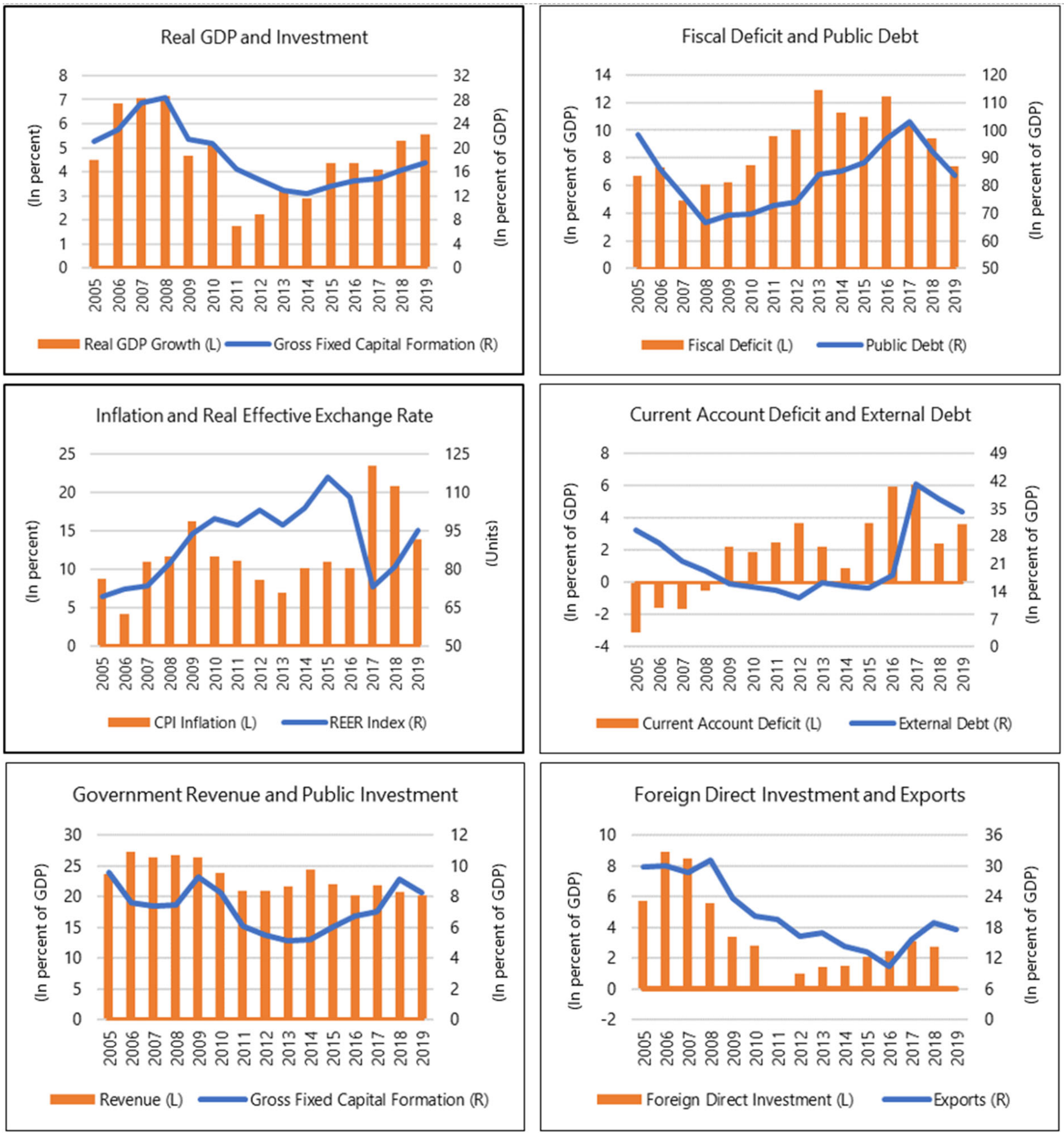
122. Years of political instability took a significant toll on economic activity, investment, tourism, and the fiscal and external positions. As noted during the 2014 Article IV consultation, "amidst political turmoil, chronic problems were left unaddressed and new problems became acute."[64] The result was a deep slowdown in growth, to an average close to 2 percent for 2011–14 and increasing macroeconomic imbalances. Foreign exchange earnings and fiscal revenues collapsed, causing an acute deterioration of the balance of payments, with a significant loss of international reserves (by some 50 percent between 2009/10 and 2015/16). Chronic and large budget deficits stood for years at double-digit levels, peaking at around 17 percent of GDP, excluding grants, in 2013/14. These deficits reflected poorly targeted subsidies, an increasing public sector wage bill, and sizable interest payments on a rising level of public debt (89 percent of GDP in 2014/15, up from 70 percent in 2009/10).

123. Macro-financial conditions further deteriorated in 2015/16 and foreign exchange shortages became a severe constraint on economic activity. A widening current account deficit (5.5 percent of GDP) as a result of a significant fall in tourism due to the 2015 terrorist attacks compounded the foreign exchange shortage. In March 2016, the authorities devalued the official exchange rate against the U.S. dollar by 13 percent, but the erosion of international reserves continued (down to 3.1 months of imports by June 2016), and the parallel market premium rose above 30 percent. Faced with these critical conditions and with dwindling donor support, in mid-2016 the authorities turned again to the Fund to seek financial support.

[63] See IMF Country Report No.15/33, Informational Annex.

[64] IMF Country Report No.15/33, page 4.

Figure 11. Egypt—Macroeconomic Developments



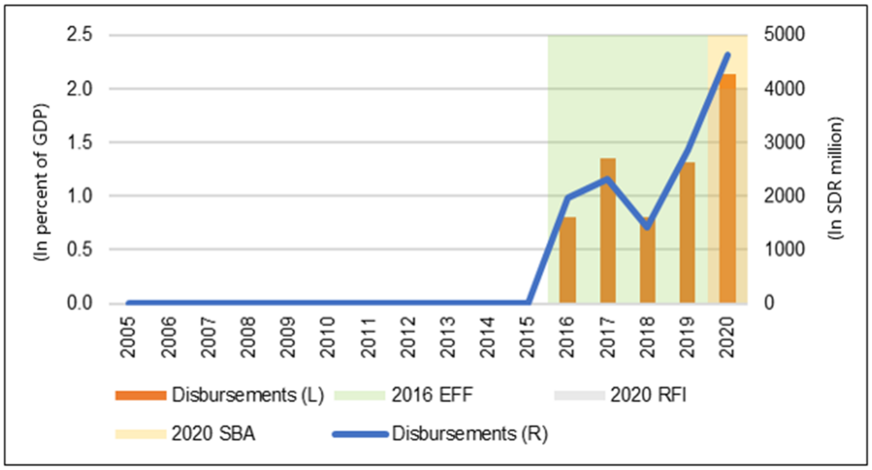
Source: April 2020 WEO database; INS database; FFA database.

B. 2016 EFF Arrangement—Program Design

124. The three-year EFF arrangement approved in November 2016 (around US$12 billion, or 422 percent of quota) had the following objectives: *"achieving and maintaining macroeconomic stability, promoting inclusive growth and employment creation, supporting private sector development, and protecting vulnerable groups. (The program) seeks to bolster market confidence*

by reducing fiscal and external imbalances, addressing structural impediments to growth, and fostering human and infrastructure development" (Figure 12).[65]

Figure 12. Egypt—IMF Disbursements



Source: IMF Members' Financial Data.

125. The authorities had two overarching concerns. First, they strongly affirmed their ownership of program design to allay perceptions of IMF imposition. The Letter of Intent indeed stated upfront that: "most of the pillars and measures of our program were announced by the government and were presented and endorsed by the parliament ahead of discussions held with the IMF." Second, they emphasized safeguarding social cohesion, as the program involved difficult adjustment measures. Hence the imperative, underscored at the highest political level, of protecting low-income groups while undertaking the necessary reforms.

Adjustment Strategy

126. At the start of the EFF arrangement, Egypt was confronted with critical macroeconomic imbalances and price distortions: an urgent balance of payments problem with widespread foreign exchange shortages; a pronounced overvaluation; costly universal fuel subsidies; rising public debt at risk of becoming unsustainable; and high unemployment.

127. The design of the program aimed at addressing these imbalances rested on four key pillars:

(i) significant macroeconomic policy adjustment including unifying the foreign exchange market under a new floating regime; tightening monetary policy to control inflation and rebuild reserves; and implementing a strong fiscal adjustment to ensure public debt sustainability.

[65] Authorities' Letter of Intent dated 11/7/2016, in IMF Country Report No. 17/17, p.49.

(ii) strengthening social safety nets with increased food subsidies and cash transfers.

(iii) implementing wide-ranging structural reforms to promote higher and inclusive growth.

(iv) seeking fresh financing to close the external financing gap, in large part associated with the need to rebuild international reserves.

Table 5. Egypt—Fiscal Balance and Growth: 2016 EFF Program vs. Outturn

Years	Programmed Primary Fiscal Balance	Actual Primary Fiscal Balance	Projected GDP Growth	Actual GDP Growth
2015/16	-3.9	-3.7	3.8	4.3
2016/17	-1.4	-2.4	4.0	4.1
2017/18	0.5	-0.2	4.8	5.3
2018/19	1.6	1.6	5.5	5.6

Source: IMF Country Reports.

128. Staff and the authorities agreed that at current policies public debt would risk becoming unsustainable. Therefore, restoring debt sustainability through fiscal adjustment was central to the program.[66] Accordingly, the program targeted a large adjustment in the primary balance of the general government by 5.5 percent of GDP over three years, from a (preliminary) deficit of 3.9 percent in 2015/16 to a surplus of 1.6 percent of GDP in 2018/19 (Table 5).

129. In terms of phasing, the adjustment was front-loaded (2.5 percentage points the first year, about 2 in the second, and about 1 in the third year of the program). Consistent with the significantly front-loaded pace of adjustment, especially during the first program year, key policy measures on subsidies, taxation and the exchange rate were to be adopted upfront as prior actions. The consolidation path was consistent with placing the general government debt on a downward trajectory, from about 95 percent of GDP to 86 percent by 2018/19, and lower in outer projections. The overall deficit was projected to narrow by 6 percentage points of GDP over the program period helped by a reduction in interest payments as a result of declining public debt.

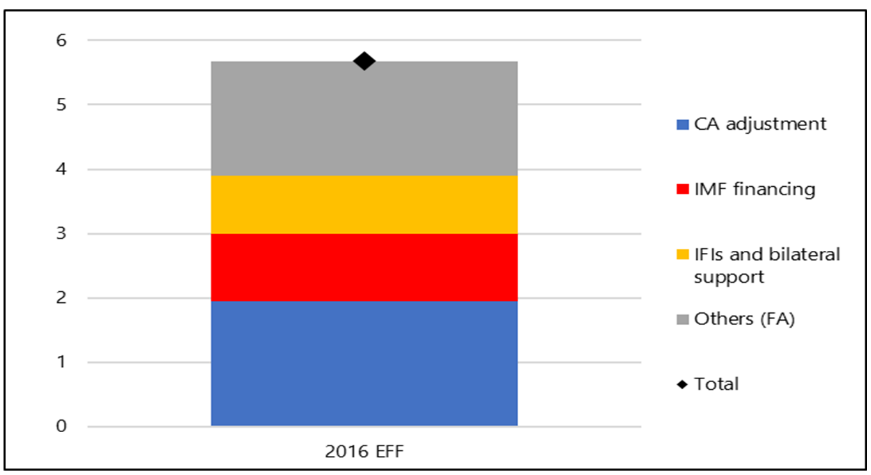
130. As to the composition of fiscal adjustment, tax revenues were projected to increase by 2.5 percent of GDP during the program—mainly due to the upfront introduction of VAT as a prior action—and primary expenditure was to decline by about 3 percent of GDP, with a reduction of fuel subsidies and public wages. Public investment was projected to remain flat at about 2.5 percent of GDP. To ease the burden of adjustment, the program directed about 1 percent of GDP in fiscal savings at programs protecting vulnerable groups—additional food subsidies, cash transfers to the elderly and poor families, and other targeted social programs. The goal was to replace poorly targeted energy subsidies with direct support for poor households.

[66] Debt operations would have carried major risks of collateral damage due to the elevated exposure to the sovereign in balance sheets of large (public) banks.

131. The program also included contingencies against risks to fiscal targets, which were identified as the impact of lower economic growth on revenue, weaker than anticipated VAT receipts, higher interest rates, wage bill overruns and higher obligations to non-performing state enterprises. To safeguard fiscal targets, the authorities committed to respond by better targeting food subsidies, accelerating energy subsidy reforms, revisiting tax exemptions, and reducing non-priority spending as needed.[67]

132. In regard to external adjustment, the program's macro-framework projected the current account deficit to gradually narrow by about US$8.6 billion, from 5.5 percent of GDP in 2015/16 to 3 percent of GDP in 2018/19. Key factors underlying the external adjustment by 2.5 percent of GDP included the impact of a more competitive exchange rate on exports and new gas fields on line, as well as import restraint effects from tighter macro policies. IEO staff calculations estimate that the current account reduction's contribution (both net of grants/official transfers) to closing the financing gap was projected as equivalent to 2 percent of GDP per year or a cumulative 7.8 percent of GDP over the program period (Figure 13).[68] FDI flows (rising to 3.4 percent of GDP in 2018/19) and portfolio investment would contribute to the targeted rebuilding of international reserves, from US$17 billion in 2015/16 to US$33 billion in 2018/19 or from about three to five months of imports' coverage.[69, 70]

Figure 13. Egypt—Balance of Payments Decomposition
Adjustment vs. Financing
(In percent of GDP)



Sources: IEO calculations and Kim and others (2021).
Note: See Kim and others (2021) for a detailed explanation of the methodology.

[67] See IMF Country Report No.17/17, paragraph 28, page 13.

[68] See Kim and others (2021) for further details on the estimation of the BOP need relative to a counterfactual in the absence of the program.

[69] See IMF Country Report No. 17/17, Table 2 and 3, pp. 25–26.

[70] See Kim and others (2021) for further details.

133. On this basis, gross financing requirements were projected at US$54.4 billion for the program period. Assuming a significant increase in FDI inflows and increased access to international capital markets, the residual external financing gap was projected at US$35 billion. Fund financing (US$12 billion, net) was expected to play a catalytic role, with other IFIs financing (World Bank, African Development Bank, and African Export Import Bank), bilateral financing (in particular from China and the UAE, and in minor part from Germany, UK, France, and Japan), a planned Eurobond and transactions with international commercial banks securing financing assurances at program approval.

Growth Aspects

134. The foundations for the growth-enhancing aspects of the program were set in the diagnostic analysis of growth constraints prepared during the 2014 Article IV consultation.[71] The most binding constraints to growth and job creation in Egypt were identified in fiscal and external vulnerabilities that affected confidence and investment; microeconomic distortions stemming from high subsidies, inefficient labor markets, weak governance and corruption, poor enforcement of contracts, and dominant public sector presence in key sectors of the economy;[72] low human capital, access to finance and infrastructure; and weak external competitiveness. Longstanding structural weaknesses also included persistent inflation; a significant overvaluation of the pegged exchange rate; low non-oil exports; declining foreign capital inflows; an unfavorable business environment; and high vulnerability to security concerns affecting, inter alia, tourism activities.

135. The program's structural agenda was relatively light at the start of the EFF but became much more extensive later on. In 2016, the country was facing an imminent balance of payments and debt crisis, so the objective was to achieve macro stability first. The reform agenda was expanded considerably at the time of the second review when macro stability had started to take hold, informed by the 2017 Article IV consultation. The program's strategy envisaged growth-enhancing effects through a variety of channels:

(i) Fiscal consolidation would crowd in private sector access to finance, and regained fiscal stability would boost investors' confidence and attract FDI.[73] The emphasis was on creating space for private investment, while maintaining a constant public investment to GDP ratio.[74] On the other hand, the fiscal adjustment path envisaged in the program was also designed to strike a balance between restoring fiscal sustainability and political feasibility. The authorities and staff discussed more ambitious adjustment options but agreed that further fiscal adjustment would not be advisable "due to its contractionary

[71] See IMF Country Report No. 15/33, Box 1, page 5.

[72] The share of public sector employment in total was around 30 percent; the state owned most land for industrial investment; and there was a large number of state-owned enterprises (SOEs) operating in many sectors, subsidized and not subject to transparency standards as private enterprises.

[73] Fiscal multipliers' assumptions were not discussed in program documents.

[74] See paragraph no. 120.

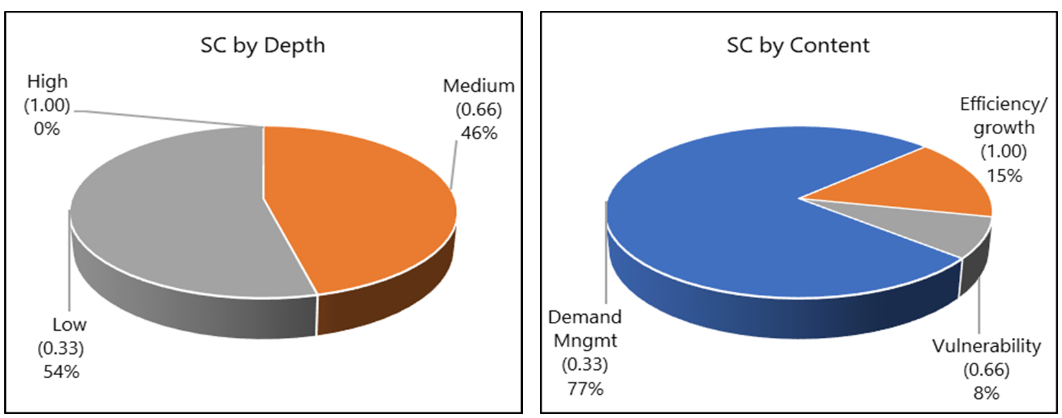
impact and potentially negative social implications."[75] However, fiscal multipliers' assumptions were not discussed in program documents.

(ii) Energy subsidy reforms would create space for higher spending in social programs—enhancing the social safety net and improving targeting of assistance to poor households—and provide incentives for investment in less capital and energy intensive initiatives, fostering job creation.

(iii) The move to a floating exchange rate regime and the resulting greater flexibility would improve competitiveness, eliminate shortages and overvaluation (estimated at 25 percent prior to the EFF approval), encourage investment and exports, and act as buffer against external shocks.[76]

(iv) Structural measures focused on improving the business environment and public finance management, reforming the energy sector, and strengthening governance would contribute to remove identified impediments to growth— excessive regulations and licensing requirements and barriers to trade—and help promote private sector development. In particular, 2 out of the 12 SCs at program approval involved adopting a new industrial licensing law and spending to remove obstacles to labor force participation for women. The remaining 10 SCs related to exchange rate and financial sector policies (4), fiscal policy and public financial management (4) and energy sector reforms (2). About 46 percent of SCs had medium depth, and 15 percent had a growth orientation (Figure 14).[77]

Figure 14. Egypt—Structural Benchmarks by Depth and Growth Orientation



Sources: IEO calculations and Kim and Lee (2021).
Note: The numbers in bracket refer to the score (scaled between 0 and 1) assigned to the corresponding category. See Kim and Lee (2021) for a detailed explanation of the methodology.

[75] IMF Country Report No. 17/17, p.12.

[76] See IMF Country Report No. 17/17, page 7.

[77] See Kim and Lee (2021) for technical details.

136. The program was supported through significant provision of Fund TA. For instance, the planned upfront introduction of the VAT culminated a longstanding TA provision by FAD, which continued to provide TA support during the program on a variety of fiscal areas. MCM TA prior and during the program focused primarily on financial stability and liquidity management, while METAC focused on bank supervision and regulation. STA provided TA in balance of payments and government statistics.[78] In addition, the World Bank provided Egypt with sustained support for social protection reforms, private sector financing, modernization of the oil and gas sector and procurement legislation.

137. Growth projections recognized that in 2016/17, the first year of the program, growth would be inevitably constrained by the combination of monetary tightening and fiscal consolidation, while structural reforms would require time to bear fruit. On the other hand, the liberalization of the foreign exchange market was expected to remove crippling foreign exchange shortages and overvaluation—key constraints to growth—and contribute to boost exports, tourism and investment. On balance, growth in 2016/17 was projected to remain broadly constant at about 4 percent.

138. The growth payoff from program measures was reflected in projections of a gradual acceleration in growth in the medium term to 4.8 percent in 2017/18, 5.5 percent in 2018/19 and 6 percent in outer years (above the 10-year average of 4.3 percent). Investment was projected to increase from 14.5 percent of GDP prior to the program in 2015/16 to 16.7 percent in 2018/19.

C. 2016 EFF Arrangement—Implementation and Outcomes

139. The Egyptian authorities took early and decisive policy measures, centered on fiscal consolidation and the liberalization of the foreign exchange market. The prior actions under the program included the approval by Parliament of the VAT law in August 2016; a large adjustment of pump prices for fuels (35 percent); an upfront devaluation of the exchange rate by 32.5 percent in early November 2016, prior to the move to a floating rate; and an increase in central bank policy rates (300 basis points). These measures were key to restore credibility and confidence in the economy and represented an important break with the past.

140. Furthermore, by sustaining the adjustment effort—all reviews were completed (with waivers) and the approved Fund financing was fully disbursed—Egypt's reform program succeeded in attaining the goals of stabilizing the economy, placing public debt on a declining path, and promoting a strong recovery of growth and employment.

141. In terms of macroeconomic stabilization, with some mid-course corrections during the second and third reviews to allow for a smoother adjustment path, the fiscal adjustment effort succeeded in turning the primary deficit of the general government into a surplus of 1.6 percent of GDP by 2018/19, reaching the three-year adjustment target while recording a slight rise in

[78] See IMF Country Report No.18/14, Informational Annex.

public investment (2.7 percent of GDP, above program projections). This adjustment contributed to a decline in general government debt from 97 percent of GDP in 2015/16 (revised) to 85 percent of GDP in 2018/19 (see Figure 11).

142. Key to these important achievements were the upfront introduction of the VAT and the completion of fuel subsidies' reform, with the gradual increase of fuel prices to full cost recovery for most products and the introduction of price indexation protecting the budget from unexpected exchange rate and oil prices changes. Savings from the elimination of fuel subsidies were used in part to strengthen social programs aimed mitigating the impact of reforms on the most vulnerable.

143. External imbalances were also corrected. The current account deficit, equivalent to 6 percent of GDP (revised) in 2015/16, was reduced to 2.6 percent of GDP by 2018/19. This improvement—and significant portfolio inflows attracted by the return of confidence and interest rate differentials—contributed to a rise in international reserves well in excess of program targets, from US$17.1 billion (3.1 months of prospective imports) in 2015/16 to US$43.9 billion (5.9 months) in 2018/19.

144. Nonetheless, the implementation of the floating exchange rate regime raised concerns that triggered several discussions between staff and the authorities. In terms of developments, at the start of the program the exchange rate jumped to over 19.6 pounds/US$ (up from close to 9 pounds/US$ in October 2016, prior to the EFF), and fluctuated in the limited range of 17.6–18.2 pounds until early 2019, when it appreciated by some 8 percent against the dollar (Figure 15).

145. The sharp initial exchange rate movement was related to difficulties in gauging the size of the existing foreign exchange backlog and to excess liquidity conditions. The subsequent limited flexibility of the exchange rate in the context of significant portfolio inflows in 2016/17 and 2017/18 reflected in part the continued operation of the so called "repatriation mechanism." This was an arrangement put in place by the Egyptian authorities well before the EFF arrangement to shield reserves and the exchange rate from the vagaries of "*hot money,*" and to provide insurance to portfolio investors in case they wanted to withdraw their funds. The Fund argued for the removal of the mechanism starting from the first review, because it considered it a form of intervention that diverted portfolio flows from the interbank market, thereby preventing its deepening and damaging the credibility of the newly established floating regime. The result—in a situation of significant portfolio inflows—was a relatively stable exchange rate at a relatively depreciated level which *inter alia* may have contributed to the observed inflation inertia and the consequent gradual appreciation of the real exchange rate (see Figure 15). The nominal appreciation during 2019 reflected a rise in portfolio flows through the interbank market after the repatriation mechanism was cancelled in late 2018, after a protracted transition period.[79]

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[79] See IMF Country Report No. 19/311, page 8.

Figure 15. Egypt—Exchange Rates and Inflation: 2016–19

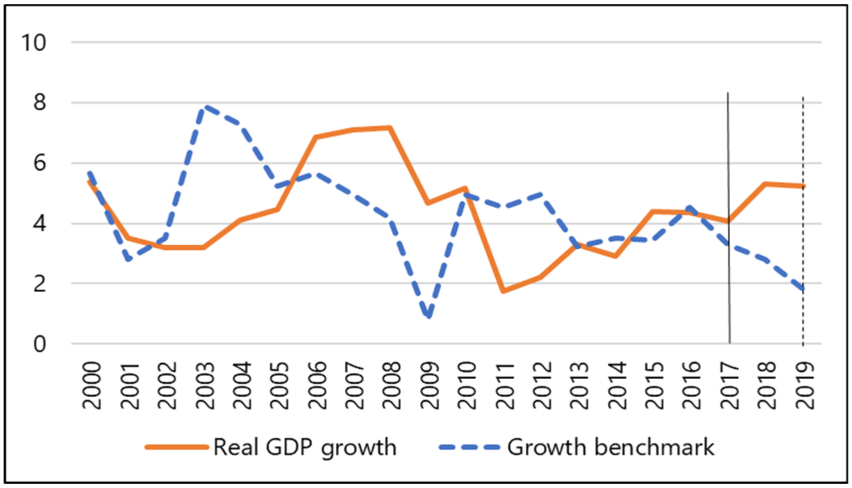
Sources: Central Bank of Egypt and Darvas (2012).

146. The performance of the real economy was strong. Growth in each of the three years of the program exceeded original program projections, reaching a cumulative GDP growth of 15 percent, compared with 14.3 percent projected in the program. Annual growth during the program also overperformed by a large amount (about 2.4 percent) the growth benchmark derived from the IEO's panel regression estimated based on external factors alone (Figure 16).[80]

147. The impressive growth performance in part reflected the strong recovery of tourism and increased natural gas production. The Zohr gas field was a major discovery, the largest gas field in the Mediterranean, and natural gas production rose sharply as this new field came on-stream in FY 2017/18. Tourism had fallen precipitously because of security concerns following the terrorist attacks in 2015 but experienced a rapid recovery from FY2017/18 as the domestic political situation stabilized and international perceptions of security conditions improved. Investment also increased from 15 percent of GDP (revised) in 2015/16 to 17.3 percent of GDP in 2018/19, again exceeding program projections. The increase is in part related to large investments by state-owned enterprises in prestige projects outside the perimeter of the general government, and the development of the Zohr gas field. These favorable developments helped mitigate the contractionary impact of the large fiscal adjustment on growth.

[80] See Kim and others (2021) for further details.

Figure 16. Egypt—Actual and Benchmark Growth



Source: IEO estimates.
Note: See Kim and others (2021) for a detailed explanation of the methodology.

148. Particularly important, unemployment declined from 12.7 percent on average for 2015/16 to 8.8 percent in 2018/19, the lowest level in two decades and below program projection. Core inflation was reduced to single-digit, although headline inflation remained relatively high (12.4 percent, CPI end-of-period 2018/19), in part reflecting volatile food prices. In turn, as noted, persistently, high domestic inflation combined with limited exchange rate flexibility after the initial depreciation led to a gradual real appreciation, eroding part of the gains in competitiveness after 2016.

149. In regard to the objective of preserving social cohesion by mitigating the impact of adjustment on the poor and scaling up social protection, the authorities had put in place several initiatives to strengthen social protection before discussions on the 2016 EFF. Programs included inter alia: (i) conditional and unconditional cash transfers;[81] (ii) free school meals and new gas connections in poor districts; (iii) increased pension benefits for lower categories and expanding social solidarity pensions to include medical coverage; and (iv) high inflation compensation for public employees. Notwithstanding these efforts, the 2017 Article IV consultation noted that "despite significant progress made in reducing leakages…the food subsidy program remains poorly targeted and inefficient. Improving targeting could free up resources and reduce poverty."[82] Concerns over lack of inclusive growth indeed persist, with survey data showing that Egypt's poverty rate increased from 27.8 percent in 2015 to 32.5 percent in 2017/18, before falling back down to 29.7 percent in 2019/20.

[81] Conditional and unconditional cash transfers included the so-called Takaful, aimed at increasing food consumption and reducing poverty while encouraging families to keep children in school and providing them with health care, and Karama, aimed at protecting poor elderly and orphans.

[82] See IMF Country Report No.18/14, page 18.

150. As to structural measures, significant reform steps were taken on a variety of fronts. In terms of sequencing, in the early stages of the program Parliament passed the Industrial Licensing Act and the Investment Act, addressing some of the identified barriers to entry and development of private activities. As macroeconomic stabilization took hold, the structural reform agenda was expanded to strengthen public procurement and the institutional and operational independence of the Egyptian Competition Authority; prepare plans to modernize the land allocation process; improve governance and divestiture of SOEs; and better integrate women and the youth in the labor market.

151. The record of SCs' compliance overall was relatively high (over 75 percent). Nonetheless, in the latter reviews of the EFF, progress in implementing structural measures became rather uneven—with a number of SCs missed or delayed—and key obstacles to private sector development persisted. As the program ended in late 2019, further deepening of growth-enhancing structural reforms remained a priority, particularly in reducing the role of the state in the economy, removing non-tariff barriers, and enhancing non-oil exports.[83]

152. In May 2020, the Board approved Egypt's request for emergency financial assistance under the RFI, US$2.8 billion or 100 percent of quota) to limit the decline in international reserves due to the standstill in tourism, capital flight and the slowdown in remittances stemming from the outbreak of COVID-19. Given the worsened economic outlook due to the domestic and global disruptions from the pandemic, the RFI emergency aid was followed by the approval of a new one-year exceptional access SBA (US$5.2 billion) in late June 2020 to support spending on health and social services, mitigate the expected decline in economic growth, and preserve Egypt's hard-won progress in macroeconomic stability.

D. Staff and Authorities' Perspectives

153. Interviews with the Egyptian authorities and Egypt's mission chiefs and senior reviewers focused on ownership, evenhandedness and access to Fund resources, tailoring to country circumstances, and issues related to program implementation and drivers of growth.[84] The key points emerging from these interviews were as follows:

154. **Ownership.** Staff and the authorities noted that strong ownership at the highest level was an important element in explaining the EFF's overall relative success. Egypt's President was an early and committed supporter of the program, reform plans were conceived domestically and focused on key measures, ministers were prepared to act, and there was improved

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[83] See IMF Country Report No.19/311.

[84] Interviews in Washington included those held with Chris Jarvis (mission chief, EFF, on January 15, 2020); Subir Lall (mission chief, EFF, on January 22, 2020); Juha Kahkonen (senior reviewer in MCD, on January14, 2020); Sanjaya Panth (senior reviewer, SPR, on January 14, 2020); and Ms. Abdelati (OED), on January 15, 2020. Video interviews took place with CBE Sub-Governors Zakeya Ibrahim and Yasmine Abbas on June 29, 2020; Vice Minister of Finance Ahmed Kouchouk on July 1, 2020 ; former Minister of Finance Amp El-Garhy on July 9; CBE Deputy Governor Gamal Negm on August 17, 2020; and former Minister of Finance Hani Dimian on August 18, 2020.

coordination between the Central Bank and the Ministry of Finance. In addition, the importance attached at the highest political level to strengthening the social safety net helped to reduce stigma. The "test of ownership" came through decisive policy measures adopted upfront as prior actions, which proved important in breaking with the past and renewing confidence.

155. **Drivers of growth.** Staff observed that strong growth during the program period benefitted from developments that were to a large extent outside the scope of the program. At the same time, they pointed to the role of the exchange rate as the program design's distinctive element in supporting Egypt's growth performance, because it propelled some components of activity while fiscal adjustment was taking place. The move to a floating regime was unavoidable, given the much-reduced level of reserves and the strained relations with donors. But it also removed the queuing and foreign exchange shortages that had long crippled the economy's ability to import and contributed to a rebound in tourism and related activities carrying a high growth and employment multiplier. The authorities also pointed to the resilient banking sector as a significant factor in supporting growth. In contrast, the role of structural reforms was seen by staff as relatively marginal, except for the reform of industrial licensing procedures, in the past a channel of graft and corruption. Staff was of the view that structural reforms were not deep enough and "*it was extremely difficult to quantify the growth impact of structural reforms.*" The authorities on the other hand noted that staff had limited expertise and provided "*not very high quality advice*" in regard to structural reforms outside the core Fund areas of central banking and fiscal issues. Some authorities saw room for improved coordination and engagement with the World Bank, other international financial institutions and experts in non-core structural reform areas.

156. **Capacity development.** Another factor in the success of Egypt's EFF arrangement was that the ground for the program was well prepared by technical assistance and advisory and diagnostic support by the Fund and the World Bank during the period of protracted negotiations before the program was finally agreed. This capacity development effort continued during the EFF and covered a broad range of key reform areas spanning VAT implementation; tax and custom administration; fiscal risk management and medium-term budget planning; social safety net; energy subsidies' reform; financial stability and stress testing; and bank supervision and regulation. The authorities praised the very high quality of TA in most core areas of Fund expertise, in particular on fiscal matters. However, some country officials pointed to the tendency by staff to "*transform TA advice into conditionality*" as inducing reluctance to ask for help in areas where they felt TA was needed. The authorities also noted the limited expertise of the staff team in bank supervision issues during the earlier stages of the program.

157. **Access, evenhandedness and tailoring to country circumstances.** The authorities would have preferred higher access under the EFF arrangement. They noted that access under normal limits provided in the arrangement (422 percent of quota, below the 430 percent exceptional access threshold) created problems and was not commensurable with the strength of the program. In their view, staff had failed to take sufficiently into account the large size of the

existing foreign exchange backlog in estimating the external financing gap. The low level of access was seen by the authorities as a cause for the initial exchange rate overshooting, which had inflationary and social effects that complicated reform efforts. Staff held instead the view that access was appropriately tailored to country circumstances, given the sustainability concerns linked to Egypt's high public debt (95 percent of GDP). Other factors (see below) accounted for the persistent weakness of the exchange rate after the initial overshooting, which was triggered by excess liquidity conditions and the uncertain size of the foreign exchange backlog.

158. **Fear of floating.** Staff noted that there were "teething problems" with the move to a floating exchange rate regime. The EFF's Letter of Intent (LOI) had laid out the expectation that capital inflows would increase with renewed confidence and program policies.[85] But during the first review, it became clear to staff that the central bank had been accumulating foreign exchange from portfolio inflows under a "repatriation mechanism" initially booked outside international reserves. Staff also noted that there had been forbearance on open foreign exchange position limits of commercial banks, allowing them to "*intervene instead of the central bank*" in absorbing the inflows. The authorities clarified that this had occurred only in one specific instance, documented and limited in duration. Staff was of the view that these actions had the effect of diverting foreign exchange from the interbank market, keeping the exchange rate stable at a relatively depreciated level, and discouraging market deepening. Following the second review, the authorities agreed to wind down this mechanism in order to enhance exchange rate flexibility and the effectiveness of monetary policy in confronting inflation. However, they negotiated an extended transition period, necessary in their view to allow for sufficient development of the foreign exchange interbank market. They also made the point that the repatriation mechanism should be considered a capital flow management measure whose design should be left to the country authorities' knowledge of local conditions.

159. **Modalities of fiscal adjustment.** Staff noted that a number of specific factors contributed to limit the contractionary effects of the large fiscal adjustment achieved in the program (5.3 percent of GDP for the primary balance). In addition to the broad benefits of clearing the foreign exchange backlog and the improved confidence, the control of the public wage bill was implemented gradually, by attrition rather than by reducing public wages or employment; reaching the cost recovery target in fuel subsidies reform was facilitated by the low level of oil and gas extraction costs; and important public investment projects (*"prestige projects"*) implemented outside the budget framework, which had limited long-term growth potential but added to aggregate demand.

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[85] See the LOI in IMF Country Report No. 17/17, paragraph 10.

160. **Remaining challenges.** Despite the reform effort during the EFF arrangement, Egypt remains an economy with relatively limited private sector development and a still important role for the state and the military.[86] The growth recovery observed during the program was therefore viewed by staff as mainly a cyclical rebound in nature, rather than a secular increase driven by a deep structural transformation. The structural reform effort during the EFF-supported program "is a start, but a lot remains to be done to create self-sustaining sources of growth." Country officials recognized that improving the environment for domestic and foreign private sector investment remains an important challenge.

V. ASSESSMENT AND LESSONS

161. This paper reviewed the experience with adjustment and growth in recent Fund-supported programs with Jordan, Tunisia and Egypt. These countries were affected by severe social and economic disruptions arising from the Arab Spring uprisings, protracted political transitions, and the conflicts in Syria, Iraq, and Libya.

162. In all three cases the authorities asked for Fund financial support in order to attain two key objectives: regaining macroeconomic stability and reinvigorating growth—in a more inclusive direction—to address longstanding problems at the root of the Arab Spring. Attaining both objectives proved elusive, with only Egypt achieving significant success (albeit with some qualifications).

163. The two SBAs with Jordan and Tunisia succeeded in helping the authorities to regain a measure of stability—in itself a significant result—but in both cases the programs' growth objectives were not attained. The successor EFF arrangements also failed to achieve growth targets, in the midst of significant reform implementation problems. Only in the case of Egypt's EFF arrangement were the programmed adjustment and growth objectives achieved; debt ratios were curbed; growth targets were exceeded; and there was a sizable reduction of unemployment. But even in this relatively successful case, progress on the structural reform agenda was quite limited.

164. While the small sample of cases and the specific country circumstances prevent any generalization of conclusions, the experience under review suggests the following observations:

(i) Domestic political economy considerations are a critical factor in program implementation and impact. Strong ownership of the program played an important role in Egypt's ability to implement difficult fiscal measures and follow through on fuel subsidy reform which led to stabilization and growth dividends. In contrast, Jordan and Tunisia's programs were less successful, as the political transition In Tunisia, strength of domestic opposition, and regional security concerns (particularly in Jordan) hampered program implementation and contributed to uncertainty.

[86] For further details on the role of the military in Egypt's economy see the 2017 IIF report by George Abed, Chun Jin and Boban Markovic "Egypt: Good Progress to Date, but Sustainability Requires Deep, Transformational Change."

(ii) Growth projections proved overoptimistic in all arrangements with Jordan and Tunisia. The projections implied a monotonic acceleration in growth during the program timeframe, based on assumptions of reduced domestic and regional uncertainty, confidence effects and growth dividends from structural reforms. With the benefit of hindsight, these assumptions turned out rather unrealistic. In part, growth shortfalls reflected the impact of continued challenges in regional security conditions and domestic political factors. However, the persistent over-optimism can also be related to program design issues. One source of over-optimism reflects the nature of growth projections. While these projections are subject to scrutiny based on historical record, cross-country comparisons and internal consistency, they are also the result of negotiations with the authorities—who have the incentive to provide the public with prospects of a robust payoff to adjustment and reform. Staff also tended to accommodate the view that "there is the need to show hope." In a repeated game, though, this approach may backfire, as growth outcomes below announcements tend to fuel skepticism, opposition to reform and eventually reform fatigue. A more cautious and realistic approach may be justified, particularly in difficult political and regional settings vulnerable to frequent headwinds and shocks.

(iii) A second reason for over-optimism may be related to the lack of clear connection between growth and fiscal projections. In all cases under review, including Egypt as well as Jordan and Tunisia, there was lack of clarity in program documents regarding assumptions on fiscal multipliers. This is an important omission which affects program assessment. In this regard, the 2015 Crisis Program Review and the 2018 Review of Conditionality (ROC) concluded that, owing to larger than expected fiscal multipliers, short-term output effects of deficit reductions were greater than envisaged in programs featuring significant fiscal consolidation, with the consequence of a counterproductive increase in debt-to-GDP ratios. Indeed, Jordan's SBA may be a case in point—given the fiscal adjustment above the significant consolidation threshold of 1–1/2 percent per year identified in the ROC, program outcomes included lower than projected output growth and the higher-than-programmed debt ratios. But in the absence of information on fiscal multipliers, we cannot determine whether these assumptions made in program design were a contributing factor to these outcomes. Lack of transparency on fiscal multipliers prevents a clear diagnosis and an accurate program assessment, and greater clarity in this area would be advisable.

(iv) A third factor behind the prevailing growth over-optimism concerns the role and nature of structural reforms in program design. In Jordan and Tunisia, these were envisaged as a key channel for growth dividends, which turned out weaker than expected for three reasons. First, most reform measures and related program conditions were by their nature, depth and growth orientation only remotely linked to growth outcomes within the program timeframe. Second, while the programs were supported by the provision of technical assistance, the difficulty of implementing reforms in these complex political settings was underestimated, reflecting limited staff expertise in the design and implementation of non-core areas of structural reform, and limited staff capacity to read the "political tea leaves" and gauge the feasibility of these reforms. In the case of Jordan, this may have been linked in part to the absence of a resident representative office. Third, any impact of structural measures on investment and growth was muted by the dominant uncertainty associated with complex domestic political issues, security concerns and regional conflicts. Greater selectivity in program design, better coordination with structural outside sources of expertise, better contingency planning and more prudent assumptions on the feasibility and growth dividends of structural reforms may be called for in such complex settings.

165. A corollary to these observations may be that longer Fund arrangements (say, five years) may be required in this type of situations, in view of likely headwinds and political constraints. This suggestion—made in the 2018 ROC—could allow for a more realistic pace of structural reform implementation and a more gradual phasing in of measures consistent with existing political constraints.

166. A final point concerns the reasons for Egypt's EFF arrangement's relative success in attaining both stabilization and growth objectives. While caution is in order— given the unfinished reform agenda—three factors appear to have played a key role. First, program measures were supported at the highest political level, were well focused on key reform areas and their implementation was strengthened by valuable preparatory work, a capacity development effort and close coordination between the Central Bank and the Ministry of Finance. Second, the decisive, upfront implementation of a package of measures breaking with the past and addressing Egypt's longstanding problems contributed to rebuild confidence and shift investors' expectations. Third, despite teething problems, upfront exchange rate reforms addressed two important constraints to growth: the significant overvaluation of the exchange rate and the disruptive shortages of foreign exchange that had crippled the economy. This contributed directly to a rebound of tourism and economic activity that supported local incomes and employment, thereby providing a direct impulse to growth within the program timeframe.

APPENDIX I. TIMELINE OF FUND ENGAGEMENT IN THE THREE COUNTRY CASES

Jordan

3-year SBA:
APPROVAL: August 3, 2012
I REVIEW: April 10, 2013
II REVIEW: November 8, 2013
III and IV REVIEWS: April 28, 2014
V REVIEW: November 10, 2014
VI REVIEW: April 24, 2015
VII REVIEW: July 31, 2015

3-year EFF:
APPROVAL: August 24, 2016
I REVIEW: June 21, 2017
II REVIEW: May 6, 2019

Tunisia

(2-year SBA):
APPROVAL: June 7, 2013
I and II REVIEWS: January 29, 2014
III REVIEW: April 25, 2014
IV REVIEW: August 29, 2014
V REVIEW: December 12, 2014
VI REVIEW: September 30, 2015

3-year EFF:
APPROVAL: May 20, 2016
I REVIEW: June 12, 2017
II REVIEW: March 23, 2018
III REVIEW: July 6, 2018
IV REVIEW: September 28, 2018
V REVIEW: June 12, 2019

Egypt

3-year EFF:
APPROVAL: November 11, 2016
I. REVIEW: July 13, 2017
II. REVIEW: December 20, 2017
III. REVIEW: June 29, 2018
IV. REVIEW: February 4, 2019
V. REVIEW: July 24, 2019

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CHAPTER 2. PAKISTAN

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EXECUTIVE SUMMARY

At end-2019, Pakistan was one of five Fund members with the largest outstanding Fund credit. It has been a prolonged user of Fund resources since the 1980s. During 2008–19, Pakistan had three Fund-supported programs (2008 SBA, 2013 EFF, and 2019 EFF) covering a little over half this period with a combined access of 1,335 percent of quota.

This evaluation focuses on the 2008 SBA and 2013 EFF while providing factual information on the 2019 EFF that is still ongoing. The first two Fund-supported programs had to address balance of payments crises in their initial year before transitioning to efforts to achieve higher, inclusive real growth. These stabilization efforts were largely successful, although not sustained after the programs ended. For the 2013 EFF arrangement, questions exist whether its macroeconomic program was sufficiently ambitious because the current account adjustment was meager compared with other GRA-supported programs in the IEO sample. In addition, the targeted current account deficit for the final year of the 2013 EFF-program was wider than the estimated current account norm for Pakistan. On the other hand, more progress was made on the structural front during the 2013 EFF than was made under the 2008 SBA. In particular, under the 2013 EFF, revenue mobilization improved, energy shortages were reduced, and the operational independence of the central bank was enhanced.

Notwithstanding these policy achievements, Pakistan's growth record over this period continued to be disappointing—well behind that of its South Asian neighbors. Real growth rates during these program periods were not statistically different from the pace predicted by external factors and trend alone. This finding implies that domestic policies had only a limited impact on real growth. That said, real growth during the period of the 2008 SBA was markedly below its growth benchmark, suggesting an adverse impact from those policies. Insufficiently detailed national income accounts in the staff report and limited information on fiscal multipliers and monetary sacrifice ratios assumed by these programs rule out a full ex post analysis of factors that explain deviations. Such data could easily be added to macroeconomic framework tables. That said, interviewees opined that adjustment efforts were frontloaded with little, or no, regard for the growth consequences; staff's main preoccupation appeared to be "gap filling, closing budget and external financing gaps.

Program experience with Pakistan underlines the deep-rooted constraints to more rapid, inclusive real GDP growth in the country. While all program reviews under the 2013 EFF were completed, the implemented structural reforms—most notably revenue mobilization, energy pricing and central bank operational independence—were not sufficient to allow a major step-up in real growth potential. This outcome suggests a need for further careful diagnostic work to relate the reform agenda to growth benefits and to build political consensus for more fundamental reforms.

I. INTRODUCTION

1. Pakistan was hit in 2008 by the ramifications from the global financial crisis coupled with adverse internal security developments, which caused it to seek a Stand-By Arrangement (SBA) with exceptional access from the IMF, using its emergency financing mechanism. Pakistan had two subsequent arrangements supported by the Extended Fund Facility (EFF), approved in 2013 and 2019, focusing on structural reforms to enhance sustainable growth. In total, these IMF-supported programs covered seven years during 2008–19. (The second EFF is ongoing and so it is not evaluated in this case study.) Access under these programs was substantial; indeed, Pakistan in 2019 was one of the five Fund members with the largest outstanding Fund credit.

II. CONTEXTUAL BACKGROUND AND PROGRAM OVERVIEW

2. Pakistan has been one of the most prolonged users of IMF resources, having been under IMF-supported programs almost continuously since the late 1980s. Past assessments by the IEO and Fund staff have pointed to several reasons for this repeated use, including inadequate political ownership in a fragile and fragmented political environment, poor economic governance, weak technical capacity, and insufficiently prioritized structural reforms. Domestic and regional security instability have also been contributing factors.

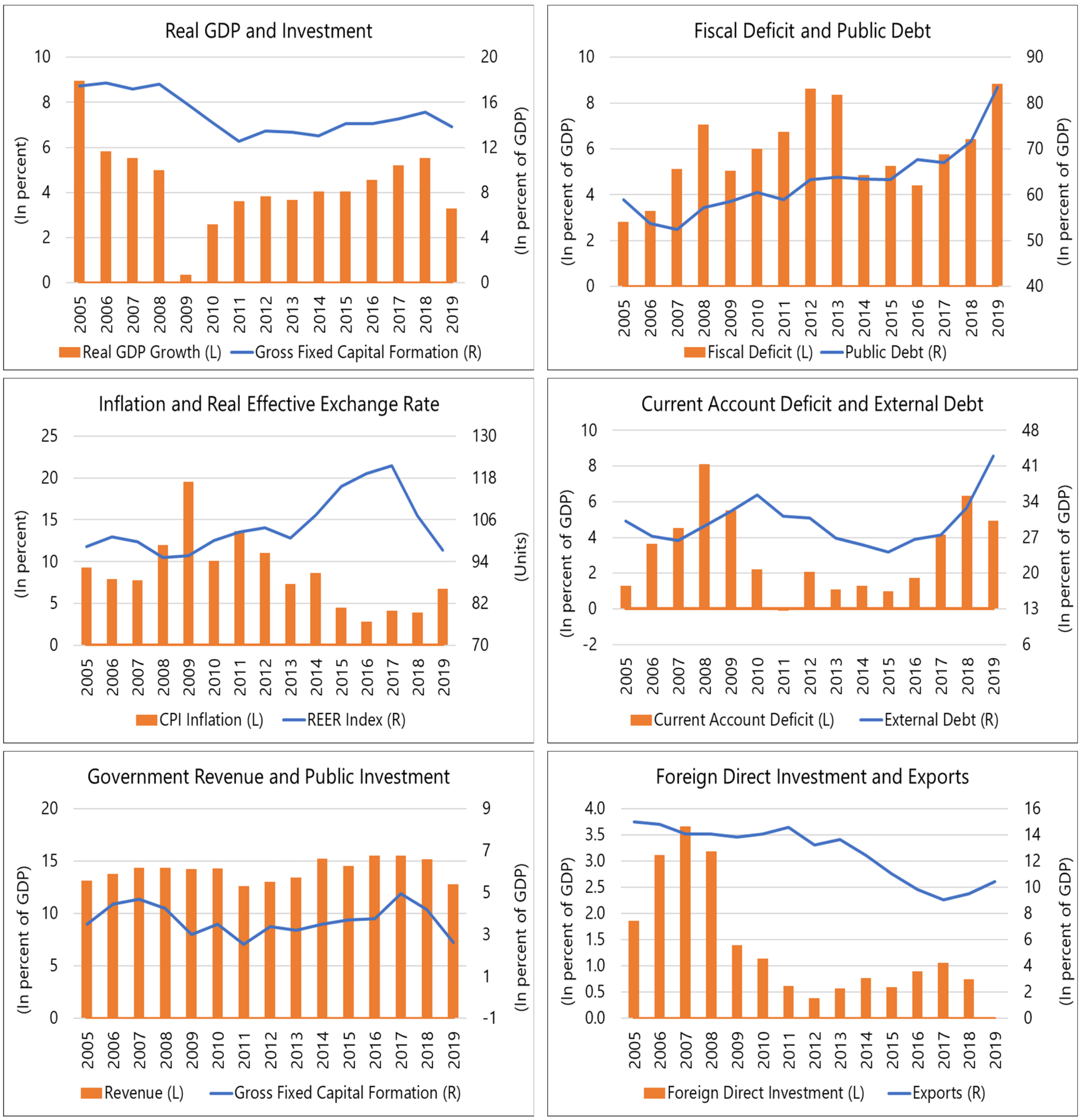
3. Nearly all of these Fund arrangements suffered from substantial policy slippages. Partly as a consequence, real GDP growth averaged only a little under 4 percent a year over 1988–2000 compared to almost 6 percent per annum during the two previous decades. The 1990s has been characterized as an era of "institutional decay," partly due to an erosion of independent policy formulation capacity under protracted IMF programs (see IEO, 2002). These IMF-supported programs had overoptimistic projections for real growth, insufficiently prioritized structural reforms, and inadequate political ownership.

4. During 2000–07, Pakistan had two Fund arrangements—a one-year SBA and a three-year concessional arrangement under the Poverty Reduction and Growth Trust (PRGT). In contrast to earlier programs, these two arrangements were successfully completed—all drawings made—with no extensions (IMF, 2005a). Pakistan exited program engagement with the IMF in 2005, owing to an improved external environment, more favorable domestic conditions, and improved economic management. Social spending relative to GDP was lifted significantly, notwithstanding fiscal consolidation, which benefited from debt relief. The major disappointments related to the lack of progress in raising tax revenues, redressing quasi-fiscal deficits in the energy sector, and addressing poor economic governance, including perceived widespread corruption.

5. After expanding robustly during 2006–08 (Figure 1), real GDP growth virtually stalled in 2009, owing to a balance of payments (BOP) crisis with its roots in persistent, overly large current account deficits, but was triggered by fallout from the global financial crisis (GFC). Political instability and adverse security developments added to these economic problems. In late 2007,

President Musharraf declared a state of emergency and former Prime Minister Benazir Bhutto was assassinated in December 2007. A new president (President Zardari) was elected in September 2008.

Figure 1. Pakistan—Selected Economic Indicators



Sources: April 2020 WEO database; INS database; FFA database. Data is presented on a fiscal year basis (which runs from July 1 through June 30), hence 2019 shows FY2018/19.

6. In December 2008, the Pakistani authorities requested, using the emergency financing mechanism, a 23-month SBA—equivalent to 500 percent to quota, which constituted exceptional access—to restore quickly macroeconomic stability via a sharp fiscal consolidation, while protecting the poor and vulnerable. The latter was to be accomplished primarily via the newly introduced Benazir Income Support Program (BISP) and a "lifeline" electricity tariff system to shield low-income households from steep tariff increases. This program was heavily front-loaded in order to shore up Pakistan's weak international reserves position (Table 1 and Figure 2). At the time of the second program review in mid-2009 and notwithstanding mixed program performance, the Board approved an augmentation (200 percent of quota) and extension of the arrangement to end-2010. Almost half of this augmentation would temporarily finance government spending, pending arrival of pledged donor financial support. Two more program reviews were completed by mid-2010, but political and security issues weighed on program implementation, particularly related to fiscal adjustment and structural reforms, notably the failure to introduce a value-added tax (VAT). In the end, the last three program reviews were not completed.[1] In January 2012, the Board completed the 2011 Article IV consultation and initiated Post-Program Monitoring (PPM) (IMF, 2012a).

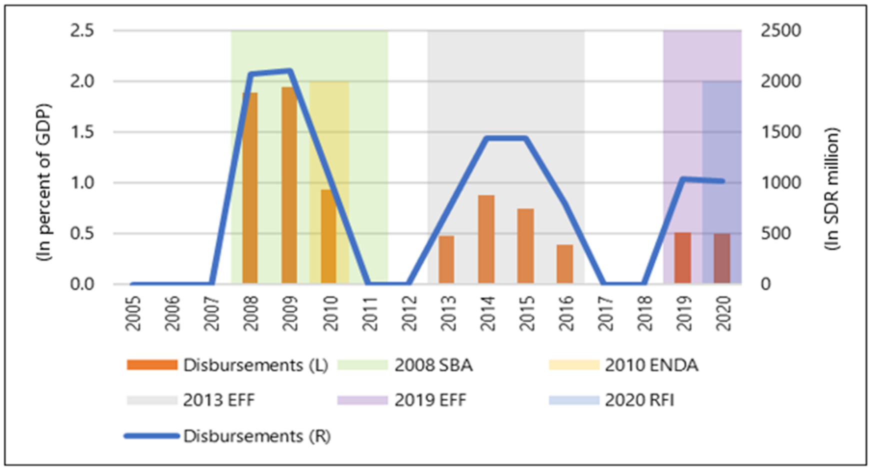
Table 1. Pakistan—Use of Fund Resources, 2008–21

Year	Duration (In months)	Type	Amount		Initial Purchase SDRs/Percent	Number of Reviews Completed/Planned
			SDRs	Quota		
2008–10	23/35[1]	SBA*	5.17[2]	500*/700**	2.07/40.0	4/7
2013–16	36/37[3]	EFF	4.39	425	0.36/8.3	12/12
2019–22	39	EFF	4.27	210	0.72/16.8	5***/8
2020	…	RFI	1.02	50	1.02/100	…

Source: IMF Staff Reports.
* Use of the Emergency Financing Mechanism.
** Exceptional access.
*** EFF is ongoing and completed reviews reflects status as of 6/2021. Four reviews were completed altogether in March 2021.
[1] The SBA was extended at the 2nd Review by a little more than two months to end 2010. In December 2010, the arrangement was further extended to mid-September 2011. With extensions, the arrangement had a duration of nearly 35 months.
[2] Augmented at 2nd Review (August 2009) by SDR 2.07 billion or 200 percent of quota.
[3] The EFF was extended by one month to permit time to report performance criteria and make the final purchase.

[1] In the wake of massive floods, the Board granted Pakistan in September 2010, emergency natural disaster assistance (nearly 29 percent of quota). The SBA-supported program's macroeconomic framework was to be re-evaluated once the flood-damage assessment was completed (IMF, 2010). However, suitable policies were not forthcoming and in late 2010, the SBA period was extended to September 2011 in give more time to bring the program back on track.

Figure 2. Pakistan—IMF Disbursements



Source: IMF Members' Financial Data.

7. In 2013, a sweeping electoral victory by the party of Prime Minister Nawaz provided the new government with a strong mandate to lift Pakistan's growth performance by addressing long-standing institutional impediments, in particular energy bottlenecks. In August, the authorities requested a three-year EFF arrangement (425 percent of quota). The tax-GDP ratio would be raised significantly to allow for needed social and investment spending, while lowering substantially the fiscal deficit. Monetary and exchange rate policies were geared to rebuilding external buffers and achieving price stability. Programmed structural reforms centered on alleviating the growth constraints caused by the energy sector and inefficient state-owned enterprises (SOEs). Protecting the vulnerable from the impact of fiscal and price adjustments received high priority. The major program objectives were achieved, progress was made with structural reforms, and all twelve reviews were completed. With faster growth and larger external buffers, the authorities did not request a follow-up Fund arrangement and PPM was proposed in September 2016.

8. Real GDP growth slowly regained momentum from 2010 to 2018, rising to the pace recorded during 2006–08, before dipping in 2019 in the wake of a new BOP crisis. However, gross fixed investment fell by about a third from its 2006–08 level in the wake of the 2009 BOP crisis and only slowly recovered subsequently due in large part to continued low foreign direct investment (see Figure 1). Foreign direct investment was depressed by security worries and weaker external competitiveness following an appreciation of the real effective exchange rate until 2018. Meanwhile, fiscal fundamentals worsened; public debt rose to 83 percent of GDP in 2019 from 52 percent in 2007, while the fiscal deficit rose to almost 9 percent of GDP. Exchange rate policy was utilized to lower inflation, but at the cost of contributing to episodic BOP crises.

9. When the authorities' gradual approach to policy adjustments did not bear the expected fruits, a new government led by Prime Minister Imran Khan requested a 39-month EFF arrangement (210 percent of quota) in July 2019. This EFF-supported program was anchored on three pillars: (i) macroeconomic stabilization coupled with protection for the most vulnerable; (ii) governance and structural reforms to strengthen institutional frameworks and foster faster growth; and (iii) significant financial support from official and bilateral partners. The first program review was completed by the Board in December 2019. In the wake of the global COVID-19 pandemic, Pakistan requested in April 2020, emergency IMF financing under the Rapid Financing Instrument (RFI) for SDR 1.0 billion (50 percent of quota). The second to fifth reviews of the EFF-supported program were completed altogether by the Board in March 2021 (IMF, 2021).

III. Program Design, Implementation, and Outcomes

A. 2008 SBA

10. In late 2008, the authorities requested an SBA-supported program with exceptional access that envisaged a tightening of fiscal and monetary policies to bring down inflation and reduce the external current account deficit to more sustainable levels.

Program Design

11. Programmed fiscal adjustment was primarily to be achieved through expenditure cuts, including energy subsidies, which accounted for nearly 85 percent of the planned fiscal retrenchment. While the first program year (2008/09)[2] was focused on stabilization by tightening fiscal and monetary policies, the second program year (2009/10) was expected to generate significant new government revenues, primarily through the introduction of a VAT, which would allow additional fiscal spending for development and social needs as well as further reduction in the fiscal deficit to sustainable levels.

12. Staff believed that there were "reasonable prospects for [program] success," but that risks to the program and financial stability were high. These risks arose from security uncertainties, possible policy reversals, a more severe-than-anticipated trading-partner slowdown, and lower-than-projected net capital inflows. Measures to strengthen the social safety net and reduce inflation were seen as essential to address political and security risks, while the mobilization of additional concessional donor assistance was expected to mitigate risks associated with more adverse BOP developments.

13. Structural reform policies under the SBA-supported program were focused on introducing a comprehensive VAT, which would provide a significant revenue boost (about 3 percent of GDP) to permit more development spending, and on alleviating supply constraints and distortions posed by the energy sector. In total, the 2008 SBA had 19 structural conditions (SCs), which were overwhelmingly (nearly 80 percent) centered on economic sectors in the IMF's

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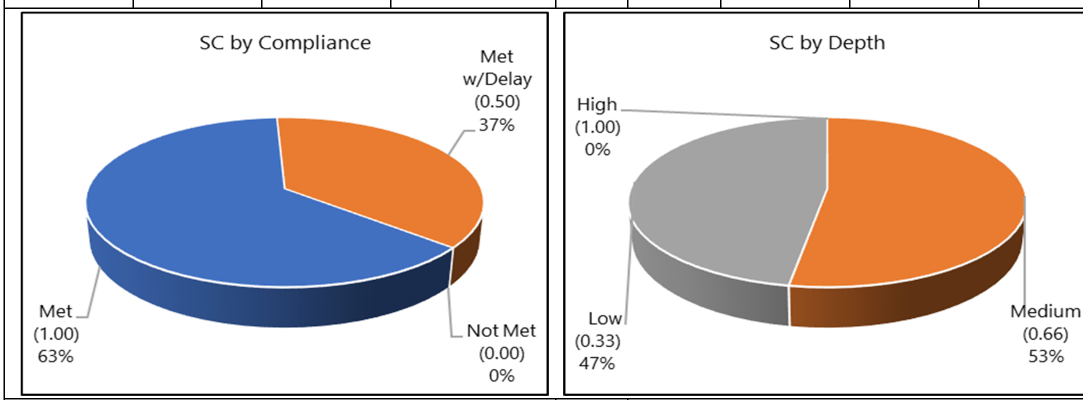
[2] Program years ran from July 1 to June 30.

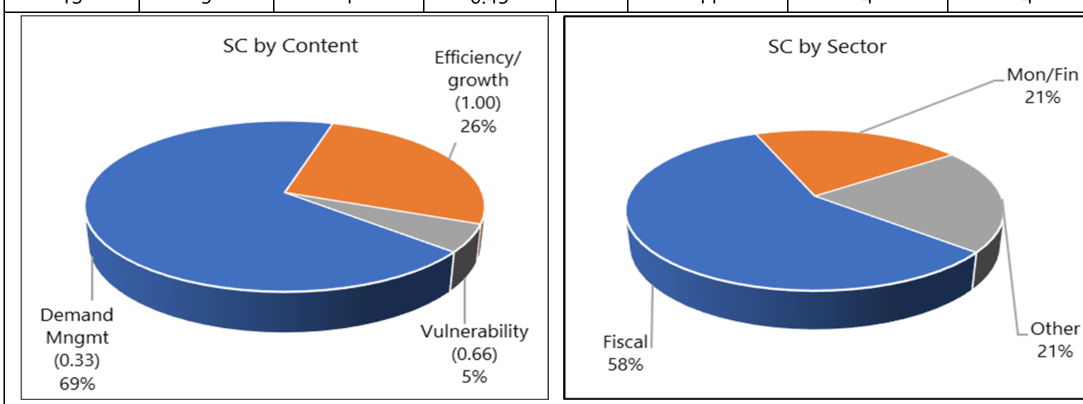
core areas of expertise (Figure 3). SCs were assessed to have a medium growth-orientation (0.45), or somewhat below the mean (0.48) for all GRA-supported programs. About one-quarter of the SCs were aimed at growth/efficiency, including adjusting electricity tariffs, restructurings/ privatizations, and strengthening the social safety net. The structural depth of SCs (0.50) was below the average for all GRA-supported programs in the IEO sample, although well above the threshold for the 25th percentile.

Figure 3. Pakistan—Structural Conditions (SCs) for 2008 SBA Program

SC by Compliance (Implementation)					SC by Depth			
Met (1.00)	Met w/Delay (0.50)	Not Met (0.00)	Avg Score		High (1.00)	Medium (0.66)	Low (0.33)	Avg Score
12	7	0	0.82		0	10	9	0.50



SC by Content (Growth Orientation)					SC by Economic Sector		
Demand Mngmt (0.33)	Efficiency/ Growth (1.00)	Vulnerability (0.66)	Avg Score		Fiscal	Monetary/ Financial	Other
13	5	1	0.45		11	4	4



Sources: IEO calculations and Kim and Lee (2021).
Note: The numbers in bracket refer to the score (scaled between 0 and 1) assigned to the corresponding category. See Kim and Lee (2021) for a detailed explanation of the methodology.

14. The program defined a series of intermediate actions (with lower structural depth) to lay the technical foundation for a VAT, which was supported by extensive technical assistance supplied by the IMF and World Bank. Outreach and efforts to build a political consensus were

recognized as critical because previous attempts to broaden the tax base had failed owing to opposition from vested interests, particularly in agriculture and services. However, security developments constrained such activities and may have contributed to an incomplete understanding of emerging political opposition (IMF, 2012a).[3]

15. Real GDP growth was projected to slow to 3.4 percent in 2008/09 (Table 2), while the current account deficit was expected to narrow by nearly 2 percentage points of GDP to 6½ percent of GDP. Although slower real GDP growth was attributed in part to weaker domestic demand, the impact of macroeconomic policies was not discussed in the staff report. Specifically, the fiscal multipliers for expenditures and revenues employed in designing the program were not presented[4] nor was the sacrifice ratio pertaining to monetary policy.[5]

Table 2. Pakistan—Selected Program Targets for 2008 SBA

Program	Real GDP Growth (In percent)	Current Account Balance (In percent of GDP)	Fiscal Balance (In percent of GDP)
2008/09			
Request[1]	3.4	-6.5	-4.0
1st Review	2.5	-5.9	-4.2
Outturn	**2.0**	**-5.1**	**-5.2**
2009/10			
2nd Review	3.0	-4.7	-4.2
3rd Review	3.0	-4.2	-4.3
4th Review	3.0	-3.8	-5.1
Outturn	**3.8**	**-2.2**	**-5.9**

Source: IMF Staff Reports.

Implementation and Outcomes

16. At the first program review, staff recognized that domestic activity was weaker than expected, attributing the shortfall to a variety of domestic and external factors; high interest rates were the only policy instrument cited. The current account balance was projected to narrow more than originally programmed. Little room was deemed to exist for countercyclical fiscal policy so the target for the nominal fiscal deficit was retained, implying a higher deficit relative to GDP. It was also considered premature to reduce policy interest rates. In the end, real growth for 2008/09 turned out to be even lower (2.0 percent) and the current account deficit narrower (-5.1 percent of GDP) than envisaged.

[3] The security situation prohibited necessary outreach to explain reforms. No staff from the Communication Department (COM) of the Fund was able to visit Pakistan for several years.

[4] The absence of fiscal multipliers is not unusual amongst program staff reports; the 2018 Review of Conditionality (IMF, 2019a) observed that only 15 percent of such staff reports provided multiplier information.

[5] The sacrifice ratio is typically defined as the ratio of the percentage loss in real GDP to the percent reduction in inflation achieved. Several empirical analyses on the sacrifice ratio have been undertaken for the case of Pakistan (Bhatti and Qayyum, 2016; Hassan and others, 2013; Hussain and others, 2017; Memo and Chumro, 2014).

17. Extensive technical assistance related to VAT preparations was provided by the IMF and World Bank, including efforts to build political consensus. At the same time, the World Bank and Asian Development Bank (AsDB) assisted the authorities to ease supply constraints posed by the electricity sector and to restore its financial health by eliminating inter-enterprise arrears ("circular debt"), and its dependency on fiscal subsidies (IMF, 2012b). Social assistance programs for vulnerable groups received additional funding, while low-income households were also shielded from increases in electricity tariffs. The World Bank (WB) was highly involved in efforts to improve the BISP's targeting.

18. Fighting between the Taliban and Pakistani military in the Swat District in early 2009 resulted in an estimated nearly 3 million internally displaced persons (IDPs). Increased spending meant that the fiscal deficit target for 2008/09 was missed by a significant margin. The difficult security and policy-making environment delayed completion of program reviews. While additional donor funds were pledged to help Pakistan, the Fund arrangement was augmented (200 percent of quota) in August 2009 (at the time of the second program review) to provide bridge finance to allow priority government spending.[6] Moreover, the target for the fiscal deficit in 2009/10 was lifted by 1 percentage point of GDP, which still represented a contraction of more than ¾ percentage point of GDP from the previous year's estimated outcome. This contraction was to be achieved entirely by greater revenue effort helped by the expected VAT introduction. It was also considered premature to ease monetary policy. A modest recovery in growth was expected in 2009/10 aided by improved supply conditions, while the current account deficit would narrow further, reflecting slower expansion in non-oil imports.

19. At the fourth program review, the 2009/10 target for the fiscal deficit was raised again to allow for additional security spending. Meanwhile to combat stubborn inflation, monetary policy adopted a tightening bias. The real GDP growth projection was maintained.

20. The 2009/10 outturn was quite different than programmed. The fiscal deficit expanded by about ¾ percentage point of GDP (to nearly 6 percent), or about 1 percentage of GDP wider than targeted, contributing to faster than expected real GDP growth (3.8 percent).

21. Implementation rate for the 19 SCs was assigned a score of 0.82 (see Figure 3), or slightly below the sample average (0.86) for GRA-supported programs. Several reforms were successfully implemented, particularly those related to enhanced central bank supervision over the financial sector and greater central bank operational independence for interest and exchange rate management. The social safety net (i.e., the BISP) was also expanded and became better targeted.

22. With respect to the energy sector, efforts by the WB and AsDB to rehabilitate the electricity sector encountered delays and back tracking related to tariff increases, inter-enterprise arrears, and budget subsidies, while program conditionality related to elimination of differential

[6] In retrospect, this augmentation and its insufficiently secured bridge financing, was viewed as problematic—contributing to a weakening of financing assurances and capacity to repay the Fund—by staff who conducted the ex post evaluation (IMF, 2012).

subsidies in electrical tariffs and inter-enterprise circular debt. Although the absence of Fund technical expertise in critical structural reforms areas posed a continuing challenge, the problem in the energy sector appears to have been one more of the insufficient political will than inadequate technical preparations.

23. The fourth program review was the last one completed, owing to a lack of progress on structural reforms related to introduction of a VAT. While VAT legislation was introduced in both the lower and upper houses of Parliament—satisfying a prior action—that legislation was subsequently withdrawn because while this reform was strongly owned by the federal-level policymakers, it lacked broad political support at the national/provincial levels, and notably from the agricultural sector and civil society. To allow more to time to unlock the VAT reform, the Fund arrangement was extended twice but to no avail. Placing all of one's policy eggs in one (VAT) basket meant that fallback policy options were not adequately developed. Moreover, the challenges presented to deficit management by the general government from increased federal revenue-sharing with the provinces with unchanged spending responsibilities were not sufficiently addressed. With the overshooting of the 2009/10 fiscal deficit, agreement was not reached between staff and the authorities on the appropriate target for 2010/11 fiscal deficit. The SBA expired in September 2011.

B. 2013 EFF Arrangement

24. The 2013 EFF arrangement sought initially to achieve short-term stabilization to reduce crisis dangers and restore fiscal and BOP sustainability, thus creating the pre-conditions to boost potential growth. Staff presented two scenarios—baseline and reform—showing that while real growth would initially be slower in the reform scenario, it would higher than under the baseline scenario by the third year (2015/16), placing the economy on a sustainably higher growth path and reducing the unemployment rate significantly. In the reform scenario, structural measures were projected to boost real growth to nearly 5 percent (staff) to 7 percent (the authorities).

Program Design

25. To address the short-term crisis risks, the program targeted a reduction in the fiscal deficit of 3 percentage points of GDP in the first year (2013/14) of the EFF-supported program to 5½ percent (Table 3). Staff indicated that they had used econometric analysis to estimate fiscal multipliers for total revenues and expenditures, which were about one for Pakistan, albeit over an unspecified time horizon.[7] With the revenue effort low by international standards, taxes were programmed to increase by 1¼ percentage points of GDP. As VAT introduction remained

[7] These results are consistent with the findings of other researchers (Khaled and others, 2007; Shaheen and Turner, 2010; Hayat and Qadeer, 2016; and Munir and Riaz, 2019). These researchers also reported that expenditure multipliers started out near 0.4 in the first year before rising to near 1 by year 5 and they were statistically significant in each year. On the other hand, the reported tax multipliers were near zero every year and were not statistically significant. These results imply that raising taxes are a more growth friendly way to achieve fiscal consolidation than is spending restraint. See also Gupta (2021) for additional discussion on fiscal multipliers.

politically infeasible, greater revenue mobilization was to be achieved by a combination of scaling back of tax exemptions, broadening the tax net, improving the GST, and improving tax administration. Energy subsidies were to be cut by ¾ percentage point of GDP (or nearly in half) through tariff increases that were phased and sequenced differently across energy products. Net lending to the provinces and state-owned enterprises were to scaled back by nearly 1½ percentage point of GDP. The BISP would be expanded further to protect the most vulnerable groups. Monetary and exchange rate policies were focused on rebuilding foreign exchange reserves, while also slowing money growth to fight inflation. Again, there was no empirical investigation by Fund staff into the real growth implications of monetary policy in the staff reports on Pakistan.

Table 3. Pakistan—Selected Program Targets for 2013 EFF

Program	Real GDP Growth (In percent)	Current Account Balance (In percent of GDP)	Fiscal Balance (In percent of GDP)
2013/14			
Request	2.5	-0.6	-5.5
1st Review	2.8	-1.0	-5.2
2nd Review	3.1	-0.9	-5.3
Outturn	**4.1**	**-1.2**	**4.4**
2014/15			
3rd Review	4.0	-1.2	-4.6
4th/5thReviews	4.3	-1.5	-4.5
6th Review	4.3	-1.2	-4.6
Outturn	**4.1**	**-0.8**	**-4.7**
2015/16			
7th Review	4.5	-0.4	-3.9
8th Review	4.5	-0.5	-4.2
9th Review	4.5	-0.9	-4.2
10th Review	4.5	-1.1	-4.1
11th Review	4.7	-1.0	-4.3
12th Review	4.7	-0.9	-4.3
Outturn	**4.6**	**-1.7**	**-4.4**

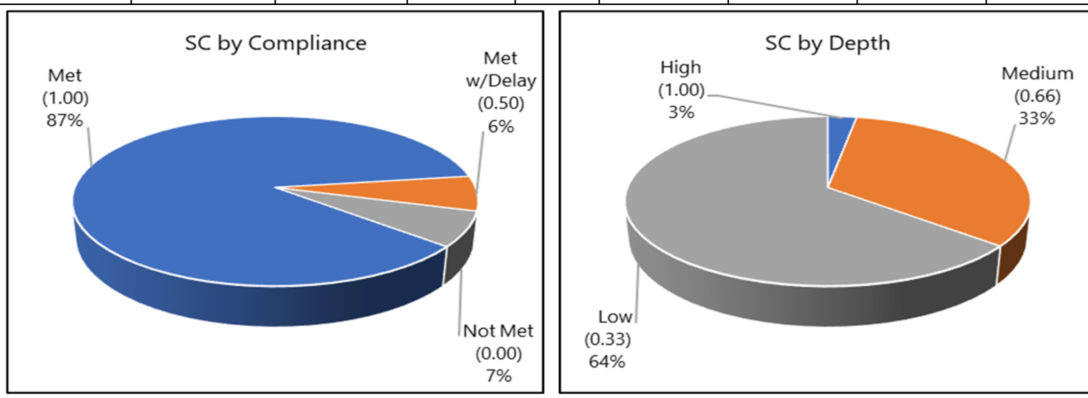
Source: IMF Staff Reports.

26. Structural reforms under the EFF to achieve sustained economic growth spanned a broad scope. Financial markets were to be deepened and developed to increase access to financial services. Fiscal reforms were intended to secure consolidation efforts by enhanced tax administration for sales tax, excises, and customs and a balance budget requirement on provinces, and to distribute the burden to wider groups of taxpayers. Electricity tariff adjustments would improve resource allocation and user efficiency, allowing for more efficient electricity generation, reduced power outages, reduction in circular debt, and greater investment. Improved governance and restructuring/privatization of public sector enterprises was also seen as helping to lift real growth. Trade policy reforms would stimulate exports via increased competition, while enhancing the business climate would likely promote foreign and domestic investment. The World Bank was identified as contributing policy advice in the areas of the energy sector, and trade and business climate reforms.

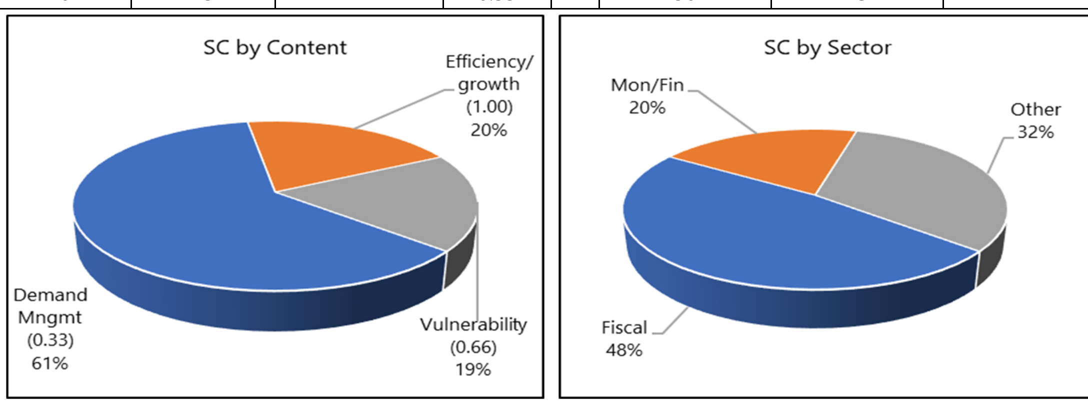
27. In total, the 2013 EFF had 75 SCs assessed at program reviews (Figure 4). Their specific contributions to faster real GDP growth were not quantified and their precise linkage was not described. A roadmap for structural reforms over the entire 3-year program period was not laid out. About two-thirds of these SCs were in the IMF's core areas of fiscal and monetary policies to underpin stabilization efforts. The growth-orientation of these SCs were somewhat higher than their respective mean for 25 GRA-supported programs in the sample (0.53 v 0.48), while their structural depth was below the 25th percentile for those GRA-supported programs.

Figure 4. Pakistan—Structural Conditions (SCs) for the 2013 EFF Arrangement

SC by Compliance (Implementation)					SC by Depth			
Met (1.00)	Met w/Delay (0.50)	Not Met (0.00)	Avg Score		High (1.00)	Medium (0.66)	Low (0.33)	Avg Score
65	5	5	0.90		2	25	48	0.46



SC by Content (Growth Orientation)					SC by Economic Sector		
Demand Mngmt (0.33)	Efficiency/ Growth (1.00)	Vulnerability (0.66)	Avg Score		Fiscal	Monetary/ Financial	Other
46	15	14	0.53		36	15	24



Sources: IEO calculations and Kim and Lee (2021).
Note: The numbers in bracket refer to the score (scaled between 0 and 1) assigned to the corresponding category. See Kim and Lee (2021) for a detailed explanation of the methodology.

28. Staff assessed that risks to the medium-term outlook were tilted to the downside, owing to energy shortages, security issues, vulnerabilities in the banking sector, and uncertainties related to the external environment. Implementation of the EFF-program was expected to substantially address these risks. But risks to program implementation were seen as high, given Pakistan's poor track report, political constraints, and limited technical capacity to undertake structural reforms across a wide range of activities. Upfront actions and the strong electoral mandate were judged to mitigate the first two risks, while external technical assistance was expected to tackle weaknesses in technical capacity.

Implementation and Outcomes

29. Program implementation was hindered by a number of adverse shocks. New security operations by the Pakistani military against the Taliban created large numbers of IDPs, while floods adversely affected agricultural activity and heightened pressures to relax adjustment policies. Structural reforms were also delayed as a result.

30. Notwithstanding these challenges, the authorities persevered with the program, which was modified to reflect the more difficult circumstances. The fourth and fifth program reviews were combined. Under the revised macro-framework for 2014/15, the fiscal deficit was to narrow only slightly (by ¼ percent of GDP to 4½ percent of GDP) from its estimated 2013/14 outcome, owing entirely to expenditure restraint. Monetary policy continued to be oriented toward the accumulation of gross international reserves to achieve a level more consistent with the Fund's metric for gross international reserve adequacy. Notwithstanding headwinds from various sources, real GDP growth was projected to rise to 4¼ percent.

31. From a macroeconomic perspective, the 2014/15 program year met with mixed success. Real GDP growth turned out nearly as projected, while inflation dropped more than expected to 4 percent. The current account deficit (at -¾ percent of GDP) also was somewhat smaller than programmed; gross international reserves rose to US$17.1 billion, slightly exceeding its target. The fiscal deficit was marginally above its target (to 4¾ percent of GDP), owing almost entirely to revenue under performance. Public debt continued to hover above 60 percent.

32. Against this background at the 7th program review, the deficit target for 2015/16 was set at 3.9 percent of GDP, implying a fiscal consolidation of slightly more than ¾ percentage point of GDP compared to the estimated 2014/15 outcome. Strong efforts to boost revenue mobilization meant that only one-quarter of this fiscal consolidation stemmed from the expenditure side, consisting solely of savings on interest payments due to lower domestic interest rates. However, owing to spending pressures, subsequent program reviews revised the target for the fiscal deficit to 4.3 percent of GDP. As regards monetary policy, real interest rates were maintained in an effort to anchor inflation expectations and to support further reserve accumulation (US$3.9 billion).

33. Implementation of structural reforms supported macroeconomic outcomes. The SC implementation rate for the EFF-supported program with Pakistan was slightly higher than the median score for the GRA-supported programs in the sample (0.90 vs 0.86). These reforms increased the tax-GDP ratio (by 2½ percent of GDP), reduced energy subsidies (1½ percent of GDP) and power outages (by 8 hours per day for industrial users) and narrowed the annual losses of SOEs (by ¼ percent of GDP). These accomplishments mainly redressed fiscal and quasi-fiscal deficits.

34. Real GDP growth accelerated to 4½ percent or above target for 2015/16, thanks to construction related to the China Pakistan Economic Corridor (CPEC) and improved energy supply. Inflation was successfully kept low (3 percent). But the fiscal deficit outturn was a little above its target, while the current account deficit was wider than projected. Nevertheless, gross international reserves increased by US$4.8 billion exceeding its target. This EFF expired at end-September 2016 and was fully drawn upon. No follow-on Fund arrangement was requested at that time.

C. 2019 EFF Arrangement and 2020 RFI Purchase

35. Following the expiration of the 2013 EFF arrangement, real GDP growth accelerated to around 5½ percent per year during 2016/17 and 2017/18, while annual average consumer price index (CPI) inflation remained low (4 percent). However, growth was propped up by unsustainable domestic policies, and the current account deficit rose to 6¼ percent of GDP in 2017/18. Over this same period, the fiscal deficit widened to 6½ percent of GDP and public debt rose to 75 percent of GDP. Increased foreign exchange intervention to stabilize the currency caused gross reserves to decline by about US$10 billion.

36. With real growth slowing sharply in early 2018/19 and a sharp currency depreciation driven by market forces that returned the REER index to its 2013 level, the Pakistani authorities requested a new EFF arrangement in July 2019 (IMF, 2019b).[8] This EFF (for 210 percent of quota) covers 39 months extending until October 2022. The program sought to restore fiscal and external sustainability and lay the foundation for balanced growth. Major fiscal consolidation (4½ percentage points of GDP) over the program period was to be achieved wholly by equivalent tax mobilization efforts. These mobilization efforts would be supported by removal of GST exemptions and preferential rates, strengthened real estate taxation, and focused tax administration including risk-based audits and higher legal penalties for noncompliance. Structural reforms would also seek to boost potential growth by improving the business climate, heightened efforts to fight corruption, and improved SOE governance, especially in the energy sector. Real growth was projected at nearly 2½ percent in FY 2019/20, while the current account deficit was expected to narrow by 2 percent of GDP to a little over 2½ percent.

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[8] The authorities first announced their intention to seek a new program in October 2018.

37. The impact of the COVID-19 pandemic led Pakistan to request RFI financing (US$1.4 billion) in April 2020, in view of the difficulty "in recalibrating the existing EFF to ensure that it remains on track to meet its objectives" (IMF, 2020). Amid the evolving COVID-19 shock, the economic policy mix supported by the EFF was recalibrated to strike a balance between supporting the economy, ensuring debt sustainability, advancing structural reforms, and maintaining social cohesion.

D. Cross-Program Comparisons

38. The magnitude of total annual BOP need (as a percent of GDP) estimated based on program projections at the time of program approval was broadly similar between the 2008 SBA and 2013 EFF (Figure 5).[9] For both programs, calculated BOP need was considerably smaller than their respective averages for GRA-supported program in the IEO sample (14 percent and 7 percent of GDP for exceptional and regular access). Nearly half of the BOP need was to be met by current account adjustment under the 2008 SBA, but less than 3 percent under the 2013 EFF. These contributions were also small compared to the average of about 30 percent for GRA-supported programs in the IEO sample. Notably, the target for the current account deficit for the final year of the 2013 EFF was wider than its current account norm, suggesting incomplete external adjustment.

39. Actual real GDP growth during the 2008 SBA and 2013 EFF arrangement underperformed the IEO's estimated growth benchmark based on external and trend factors alone (Figure 6),[10] albeit growth during the 2013 EFF did so only marginally. The wider deviation for the 2008 SBA reflected both policy adjustments and the difficult domestic political/security conditions. By contrast, real growth exceeded the benchmark in years without an IMF-supported program. This finding is consistent with the observation made by several former officials interviewed for this study that real GDP growth accelerated after IMF-supported programs as macroeconomic policies were eased.

40. Comparing initial program targets and outcomes for their respective final program year, the 2013 EFF appears to have been more successful than the 2008 SBA (Table 4). The two-year 2008 SBA fell short on real growth and three fiscal targets, while meeting its targets for inflation, current account deficit, and external reserves. External adjustment was achieved, internal adjustment was not. Also, the SBA-supported program went off-track, so the final three review were not completed. By contrast, under the EFF-supported program, targets were successfully met for real growth, inflation, revenues, and gross international reserves; however, the EFF program fell short of meeting its targets for the fiscal deficit, public debt, and the current account deficit. Program implementation also was much better for the 2013 EFF than the 2008 SBA. all 12 program reviews were completed for the 2013 EFF.

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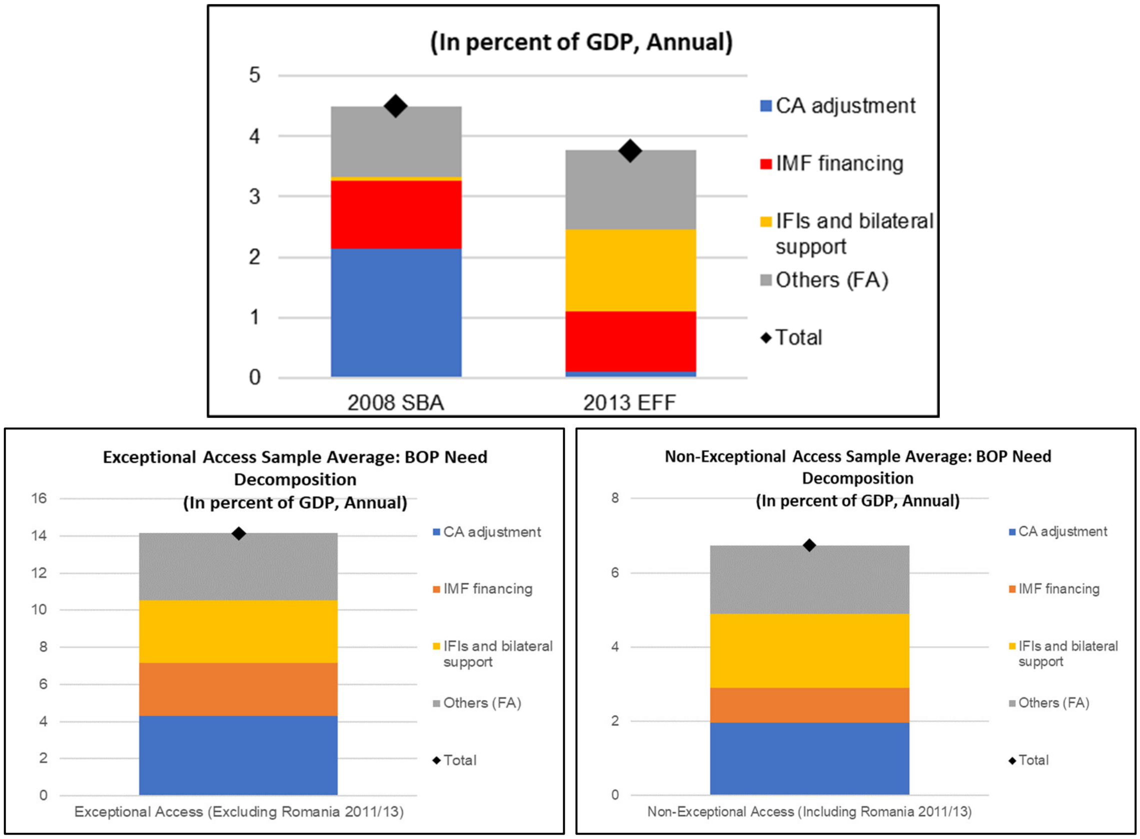
[9] BOP and the contributions of current account adjustment and various types of financing were defined relative to the counterfactual of no IMF-supported program (for details see Kim and others, 2021).

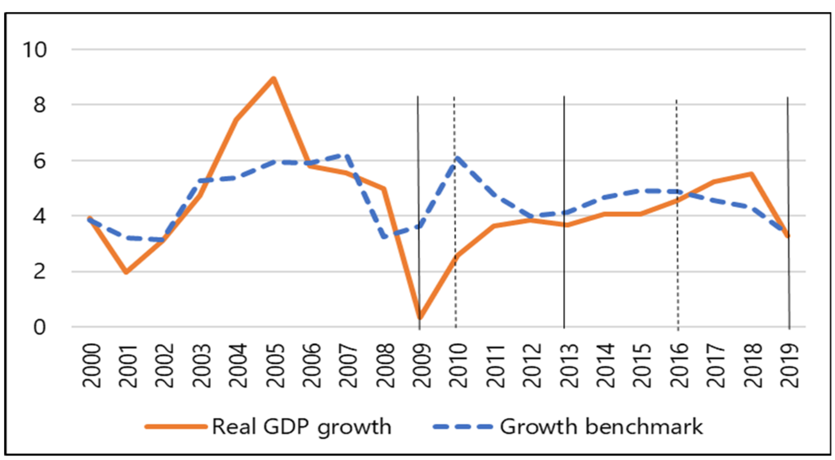
[10] For details on the estimation of growth benchmarks see Kim and others (2021).

Figure 5. Pakistan—BOP Need Decomposition



Sources: IEO calculations and Kim and Lee (2021).
Note: Sample average is for the sample of programs covered by the 17 country case studies (with 40 programs in total) for the evaluation. See Kim and others (2021) for a detailed explanation of the sample and methodology.

Figure 6. Pakistan—Actual Annual Growth and Benchmark



Sources: IEO calculations and Kim and others (2021).
Note: See Kim and others (2021) for a detailed explanation of the methodology.

Table 4. Pakistan—Key Program Targets and Outcomes

	Real Growth	Inflation	Budget Balance	Revenues[1]	Public Debt	Current Account Balance	Gross Official Reserves
	(In percent)		(In percent of GDP)			(In percent of GDP)	(Months of imports)
2008 SBA							
Target 2009/10[2]	5.0	13.0	-3.1	16.1	52.4	-5.7	2.6
Actual 2009/10	2.6	10.1	-5.9	14.3	61.5	-2.2	3.6
2013 EFF							
Target[2] 2015/16	3.7	7.0	-3.6	15.3	60.5	-1.1	3.6
Actual 2015/16	4.6	2.9	-4.4	15.5	67.6	-1.7	3.7

Source: IMF staff reports.
[1] Includes grants.
[2] At time of request.

41. As regards external goals, the 2013 EFF-supported program envisaged that the current account deficit would widen over the program period to 1.1 percent in 2015/16 and was projected to widen further thereafter (to 1.9 percent of GDP in 2017/18). Curiously, these projections moved the external balance further away from the concurrent staff assessment of the current account balance consistent with medium-term fundamentals and desired policies (IMF, 2013a). Indeed, staff assessed that the real effective exchange rate was modestly overvalued at the start of the EFF-supported program, although other external considerations, including a weak foreign asset position, pointed “to a more significant problem with external stability.” Notwithstanding this assessment, the real effective exchange rate appreciated by about 20 percent over the program period (2013 to 2017), even though staff continued to raise concerns about the need to allow greater downward exchange rate flexibility in program reviews.

42. In the area of structural reforms, the 2013 EFF arrangement made considerably more progress than the 2008 SBA. Specifically, tax mobilization efforts succeeded in boosting revenues; power sector measures reduced distortions, improved power supply, and narrowed operating losses; and governance of state-owned enterprises was enhanced. This greater success reflected aspirations and timetables that were better attuned to political ownership as evidenced by the bringing of the EFF-supported program to full completion. However, the depth of SCs contained in the 2013 EFF were very low and significantly lower than in the 2008 SBA, and despite high compliance, Pakistan’s measures of structural reform position slipped during these years (see paragraph, 48).

IV. AUTHORITIES AND STAFF’S PERSPECTIVES

43. According to the staff’s ex post evaluation of the 2008 SBA (IMF, 2012b), this Fund-supported program successfully and quickly restored macroeconomic stability in the wake of the immediate crisis. The targets for fiscal consolidation were considered appropriately ambitious and tempered by emphasis on social spending to protect vulnerable groups (BISP).

However, the implementation of the strategy to enhance sustainable growth was viewed as mixed due to inadequate political support. This lack of support undermined efforts to increase tax revenues (via the VAT) and to reform the electricity sector. The "all-or-nothing" approach on VAT introduction was seen as "a calculated risk" that fell short, while the risks posed by fiscal decentralization were under-appreciated. With severe power shortages hampering growth and imposing fiscal costs, the WB and AsDB took the lead—a "hands-off" approach by Fund staff—in designing reforms owing to their comparative expertise. This reliance exposed the Fund-supported program to risks that were in the hands of the WB and AsDB to manage. The EPE concluded that "The failure of the initial plans for eliminating power sector subsidies also highlighted the importance of having a strong counterpart team on the side of the authorities."

44. In commenting on the ex post evaluation (EPE), the Pakistani authorities expressed the view that the fiscal targets were too tough and the timeline for structural reforms was impractical. Moreover, the centrality of VAT legislation was "highly onerous." The GST reforms produced much the same results as the VAT in their view. They also felt that fiscal consolidation efforts should have focused more on reducing subsidies and containing losses of state-owned enterprises. As regards the power sector, the Pakistani authorities criticized the "hands-off' approach adopted by Fund staff and overreliance upon others (e.g., WB and AsDB), in light of the importance of alleviating the supply-side constraints on real growth. They suggested that the Fund should advise based on best international practices rather than adopting a "hands-off" approach. Indeed, they added that achieving higher real growth—constrained by the energy sector—may be the "answer to Pakistan's continuing stabilization difficulties."

45. The relative success of the 2013 EFF compared to the 2008 SBA as regards implementation of structural reforms was viewed by interviewees as reflecting a more realistic assessment by staff of what was politically feasible in Pakistan, especially related to taxes and SOEs. As regards taxes, the focused shifted to improvements to the GST system and other tax reforms from introduction of the VAT, while SOE reforms moved to enhanced governance measures and away from SOE privatization. Some interviewees, however, noted that legislative loopholes undermined the impact of tax and governance reforms as did enforcement practices. On the other hand, clear progress had been made in enhancing the analytical capacity of the central bank and its operational independence and in the energy sector where electrical shortages had been virtually eliminated, pricing distortions curtailed, and financial viability enhanced, although electricity generated was still too costly and dirty.

46. Current and former officials interviewed for this IEO evaluation consistently expressed the view that fiscal and monetary policies were tightened with little, or no, regard for the growth consequences. In their opinion, Fund staff were pre-occupied with "gap-filling"—closing budget and external financing gaps. They also felt that IMF teams spent too little time in the country and staff turnover was excessive. One consequence was the IMF teams did not sufficiently understand the key distinguishing features of the Pakistani economy, such as implications of the large informal sector, of food and energy pricing for inflation, and of the relatively closed capital

account. On a more positive note, structural reforms had achieved a more operationally independent central bank and energy outages had been virtually eliminated. But a lengthy reform agenda still remained in the view of interviewees. However, in their opinion, IMF arrangements were too short to be effective in tackling this reform agenda, given its breadth, the need for extensive technical assistance, and the critical importance of building consensus.

V. ASSESSMENTS AND LESSONS

47. Given that the estimated BOP need for the 2008 SBA was smaller than the average for exceptional access cases and the current account adjustment was larger than average, the design of the 2008 SBA seems heavily tilted toward adjustment, indicating that more financing may have been warranted. The relatively meager current account adjustment called for under the 2013 EFF and BOP need compared to the sample average for regular access programs suggests that this program may have, on the other hand, tilted away from adjustment. In addition, Pakistan exited the EFF-supported program with a current account deficit wider than consistent with Pakistan's medium-term fundamentals and with an overly appreciated real effective exchange rate despite staff concerns about the need for greater downward flexibility in exchange rate management. This less ambitious external adjustment effort may have contributed to the greater domestic political support for the 2013 EFF than the 2008 SBA, allowing the former to be completed, while the SBA went off track, but did have consequences for Pakistan's external competitiveness.

48. Actual real GDP growth rates during the program periods for the 2008 SBA and 2013 EFF were not statistically different from the IEO's estimated benchmark pace (Kim and Lee, 2021). Nonetheless during the SBA program period, actual growth was noticeably lower than that predicted by external factors alone, leaving some scope for an adverse impact from domestic policies. The lack of disaggregated national accounts in the staff reports makes it impossible to perform a suitable ex post analysis. Moreover, staff reports typically did not examine explicitly the feedback of domestic policies on real growth by including, for example, footnotes giving the assumed fiscal multipliers or monetary sacrifice ratio. Such information could easily be added to a macroeconomic framework table.

49. Notwithstanding reform efforts supported by extensive technical assistance, little progress seems to have been made, in the end, to lift potential growth. In fact, Pakistan's reform standing has apparently slipped over the past decade. According to the structural reform index developed by the IMF's Research Department, Pakistan's score reached a peak in 2006 (0.60) before moderating (at 0.55) from 2010 to 2014—the last available year. Finally, the annual growth rate of potential real GDP averaged 4.7 percent for the three years preceding the 2008 SBA (according to the WEO database), while for the three years following the 2013 EFF (2016–18), the average pace was 4.1 percent. Not only was this pace slower than the pace that prevailed earlier, it was nearly 1 percentage point lower than the EFF target. Thus, while implemented structural reforms during this evaluation period were certainly necessary and beneficial, they have not yet resulted in the desired major step-up in growth potential.

50. On the structural reform front, Pakistan's mixed performance provides a number of lessons. One, reform agendas need to be realistic in terms of implementation capacity and political support. Two, it is very risky to pursue a "big bang" approach to reforms, such as the VAT introduction, because it can be derailed by entrenched opposition from vested interests. Three, in reform areas outside the Fund's expertise, such as the energy sector, close collaboration with international partners is more effective than a "hands-off" approach. Four, reforms that build institutional capacity, like at the central bank, paid lasting dividends and should be extended to other areas, such as tax administration. Five, more careful diagnostic analysis is needed to identify and, if possible, quantify the costs of growth constraints. Such work would help lay the foundation to design better-targeted measures to redress the deep-rooted constraints to more rapid real GDP growth.

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