Chapter I

Introduction

Fiscal policy is central to macroeconomic management and is, therefore, the subject of considerable attention in the course of Article IV surveillance and in the design of IMF-supported programs. In fact, it is often the centerpiece of program design, with quantified targets included as key elements of conditionality. Fiscal adjustment is also among the most controversial elements in IMF-supported programs. Critics complain that the scale of the adjustment is often unduly harsh and likely to impart a contractionary impulse at a time when economic activity is depressed in any case, thereby leading to unnecessary loss of output and employment, with adverse effects on the poor.[1] Apart from aggregate output and employment effects, fiscal adjustment is also controversial because of its potential distributional effects. Policies for reducing or constraining spending to meet fiscal targets are often criticized on the grounds that they squeeze socially beneficial spending such as health and education or withdraw subsidies on items of essential consumption, thus placing a disproportionate burden of the adjustment on those least able to bear it. Efforts to mobilize higher tax revenue are also sometimes criticized because many of the tax measures which can be introduced in practice in the short term, such as an increase in the rate of general sales taxes or VAT, are viewed as regressive.

This evaluation aims at examining the experience with fiscal adjustment in IMF-supported programs to shed light on these issues and make recommendations for surveillance and program design in the future.

The evaluation is based on analyses at two levels. Part of the evaluation relies on cross-section analysis using two large samples: the Monitoring of Fund Arrangements (MONA) database, which provides information on both program targets and actual outcomes for 169 programs approved during 1993–2001, and a database obtained from the Fiscal Affairs Department (FAD), which provides information on health and education spending covering 146 countries over the period 1985–2000. The cross-section analysis is supplemented by a more detailed examination of two smaller samples. We have examined program and associated surveillance documents for 15 programs in a mixture of low-income, transition, and middle-income countries to evaluate the internal mechanisms and processes through which fiscal targets are set and program performance reviewed. In 4 programs, we complemented the information with work by local experts.[2] We also examined 20 programs in sub-Saharan Africa to consider the specific issue of whether aid availability projections are unduly pessimistic, forcing an unnecessary contractionary stance in programs.

The databases used cover a variety of programs including ESAF and PRGF arrangements and SBA/EFF arrangements in both transition and nontransition countries, some of which represent programs in the context of capital account crises. These categories are separately identified in the analysis where necessary. Since the IEO has recently completed a report dealing with the role of the IMF in capital account crises[3] and a detailed study of PRGF countries is currently under way, this evaluation focuses less on these cases and more on the implications for fiscal adjustment in middle-income countries. This report is organized as follows:

- Chapter 2 examines patterns in the way IMF-supported programs set fiscal targets.
- Chapter 3 examines how well Board documents explain the rationale for such targets and their

[1]See for example, Center of Concern (1998); European Network on Debt and Development (2001); International Financial Institution Advisory Commission (2000); Oxfam (1995, 2001a, and 2001b); World Development Movement (2000a and 2000b); Watkins (1999); Kanbur (2000); Collier (1999); Collier and Gunning (1999); Stiglitz and Furman (1998); and Feldstein (2002).

[2]The programs included are Algeria SBA 1994, Bulgaria EFF 1998, Costa Rica SBA 1995, Ecuador SBA 2000, Egypt SBA 1996, Jordan EFF 1999, Pakistan SBA 2000, Peru EFF 1996, Philippines SBA 1998, Romania SBA 1999, Senegal PRGF 1998, Tanzania ESAF/PRGF 1996, Ukraine EFF 1998, Uruguay SBA 2000, and Venezuela SBA 1996. It was complemented by work by local experts in the case of Ecuador, Philippines, Romania, and Tanzania.

[3]See IEO (2003).

links to the rest of the program. The internal review process at different stages of the program is also examined.

- Chapter 4 analyzes actual fiscal performance and compares it with targets. It looks at the sources of shortfalls and how program reviews under implementation revise fiscal targets.
- Chapter 5 examines the experience with economic recovery under programs and the degree of optimism in program projections. It then looks at possible sources of contractionary bias in typical SBA/EFF arrangements.
- Chapter 6 examines several concerns regarding social spending in IMF-supported programs: whether there is a downward bias in projecting donor aid that may compress social spending, what has been the impact of programs on social spending, and how programs are taking into account social issues in program design.
- Chapter 7 analyzes the process of reform in the fiscal area in the 15 sample programs, including progress in implementation and how well surveillance is supporting the process.