Foreword

Fiscal adjustment is widely regarded as one of the core elements of macroeconomic design in IMF-supported programs, and has often been the source of controversy and criticism. The IMF has been criticized in various quarters for adopting a standard "one-size-fits-all" approach to determining the desired level of fiscal adjustment without taking into account country-specific constraints and circumstances. Concern has also been expressed that there is an excessive focus on fiscal austerity, which hurts the poor and may also produce a contractionary bias in IMF-supported programs.

This report examines these and other aspects of fiscal adjustment in IMF-supported programs based on analysis of a cross-section database covering 133 programs in 70 countries, supplemented by a more in-depth examination of program-related documents for 15 programs. The evaluation throws valuable light on many of the issues which have been the subject of controversy. The report finds that there is much more variation in the pattern of fiscal adjustment across programs than is generally assumed. For example, contrary to the general perception that IMF-supported programs invariably enforce austerity, it finds many instances where fiscal deficits were actually projected to widen and expenditures to increase as a percentage of GDP. The report also does not find evidence of a general contractionary bias leading to a slowdown in growth compared with precrises averages.

The report also finds evidence of weaknesses in program design in certain areas. There is a tendency to adopt fiscal targets based on overoptimistic assumptions about the pace of economic recovery leading inevitably to fiscal underperformance and frequent revisions of targets. The optimism about growth recovery in the short term is itself often the consequence of overoptimistic assumptions about the pace of revival of private investment when a more realistic assessment in certain circumstances could have justified the adoption of a more relaxed fiscal stance on contracyclical grounds.

The report also deals with the issue of the impact of fiscal adjustment in social sector expenditures, which are critical for the welfare of the poor. Cross-section analysis at the level of aggregate social sector expenditures does not find that these expenditures are lower than they would have been in the absence of an IMF-supported program. However, the in-depth country studies show that even when aggregate social sector expenditures are maintained, critical areas of expenditure most relevant from the point of view of the poor may be crowded out by certain components of expenditure such as wages and salaries. These adverse effects could be avoided at relatively small cost if ways could be found of protecting these critical expenditures during times of crisis.

The report makes specific recommendations on how to deal with these problems in the future, both in surveillance activity and in program design. The findings of the report and the recommendations were discussed in the Executive Board on August 29, 2003, and the reactions of the Board are summarized in the Acting Chair's summary, which is published along with the report.

The issues examined in the report are complex and often call for more data than were available in program documents. There is clearly a need for more detailed studies based on in-depth examination of individual cases. On its part, the IEO hopes to build on the results presented in this report in future evaluations where the same issues may arise. Hopefully, independent research by others will also contribute to a fuller assessment.

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