

Policy Support Instrument: “Helping hand or more thumb screws?”

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13th Meeting of the CMDSF
Washington, DC
April 9, 2008

PSI: Helping Hand or More Thumb Screws?

- Outline:
 - PSI: Key Aims and Features
 - PSI: A new role for the Fund in LICs, or more of the same?
 - Market Access and the road to MIC-status
 - Conclusions

PSI: Key Aims and Features (1)

- Non-lending instrument to complement PRGF and Exogenous Shock Facility (ESF) (launched at about the same time as MDRI);
- Aims to:
 - Promote close policy dialogue between IMF and MCs;
 - Provide more frequent Fund assessment of economic and financial policies than through regular surveillance;
 - Deliver clear signals on the strength of policies;
- Voluntary, demand-driven to strengthen growth prospects, macroeconomic policy frameworks, institutions, and governance structures;
- To be supported by strong country ownership;
- In one unofficial IMF document there is also reference to: “flexibility to specify policy objectives and design reform strategies that are tailored to their own economic conditions”;
- Eligibility: “Mature Stabilisers”, i.e. post-PRGFs with “reasonable growth performance”, “low underlying inflation”, “adequate level of official international reserves”, “begun to establish external and net domestic DS”;

PSI: Key Aims and Features (2)

■ Features:

- Targets and reforms to be based on country's PRS to ensure country ownership;
- Meet the same high standards (Upper Credit Tranche Conditionalities) as under Fund programme;
- Fixed review schedules to assess implementation (semi-annually); limited flexibility in timing of reviews; review irrespective of status of implementation;
- Provision of timely and accurate information essential; framework in place to safeguard integrity;
- In case of shock, on-track PSI **could** provide rapid access to ESF through PRGF;
- Duration: One to Three Years/could be extended to Four;
- Placed on a 24-month Art. IV consultation cycle;
- Publication of PSI document voluntary but presumed;
- Experience to be reviewed after three years, i.e. 2008.

PSI: Key Aims and Features (3)

- Six on-going PSI-Arrangements (so far?): **Nigeria (05), Uganda (06 and 07), Tanzania (06), Mozambique (07);** also, Cape Verde (06), Senegal (07);
- Potential (imminent?) : **Ghana (why not?), Guyana, Cameroon;**
- Possible (longer-run); **Zambia, Sierra Leone;**
- But **Bangladesh (07):** No thanks!

PSI: A New Role for the Fund in LICs or More of the Same? (1)

- PSI has raised expectations re a new role for the Fund in LIC:
 - 1st Cluster: Signaling & Surveillance (S&S), and “gate-keeping”;
 - 2nd Cluster: conditionality and country ownership;
 - 3rd Cluster: flexibility, policy space /alternative macroeconomic scenarios;

PSI: A New Role for the Fund in LICs or More of the Same? (2)

- 1st Cluster:
 - Although strictly speaking under Art. IX i.e.TA, PSI is seen as the latest in a series of non-lending S&S instruments: ranging from Art.IV consultations, SMPs (Staff-Monitored-Programmes) to Enhanced Monitoring Procedure (EMProc) and “Intensified Surveillance”.
 - Combines strong signal attached to funded programme, with “on/off”-type features, coupled with more “nuanced” staff assessments; simple quantitative/ structural benchmarks, approved and regularly assessed and updated by the IMF Board.
 - Could facilitate access to ESF if need be;
 - Reaffirmation of the Fund’s Gate-keeping role in LICs:
 - Political benefits from kudos;
 - Paucity of analysis from private sector rating agencies;
 - Strong basis for bilateral ODA and BWI engagement.

PSI: A New Role for the Fund in LICs or More of the Same? (3)

- 2nd Cluster:
 - Semi-annual performance review based on (up-dated):
 - Assessment criteria (i.e. strict conditions/requirements subject to waiver if missed) applied to clearly-specified quantitative variables and/or structural measures;
 - Indicative targets and structural benchmarks (i.e. indicators of progress) , also quantitative;
 - Prior Actions, measures to be taken prior to EB's completion of the review;
 - Two NGO studies conclude that, "PSI compares unfavourably to the review of PRGF conditions" (Eurodad (06)), and that "in most cases where quantitative comparisons are possible, the PSI represents a continuation of PRGF standards : targets and ceilings are usually incrementally more ambitious" (ActionAid (07))

PSI: A New Role for the Fund in LICs or More of the Same? (4)

On country ownership, the fact that PSI is based on PRSP is of little comfort to NGOs. Indeed experience shows that PRGF shaped the PRSP not than other way around (see IEO report); in addition, NGO's in Tanzania, Ghana, Kenya and Bangladesh, are very skeptical of PSI on the grounds that country ownership is "very narrowly" defined by the Fund and that MC Governments often formulate PSI with a view to pleasing the Board. Three examples are often cited indicating that not much has changed from PRGF:

- Nigeria: where PSI was a Paris Club precondition for debt write-off;
- Uganda: where the Fund is reported to have raised questions re the Government's Bonna Bagagawale ("prosperity for all"), \$42 mil. programmes to subsidise cheap credit to smallholder farmers;
- Mozambique: where, it is claimed, that wage-bill ceilings and low inflation targets effectively thwarted attempts to significantly increase funding and investment in education, recruit new teachers and thus meet the MDGs.

In response, (at a meeting with Action Aid), the Fund hinted at a 2nd PSI for Nigeria; on Bonna Bagagawale, R. Nord (AD) said: "Frankly, the IMF has never challenged this"; on wage bill ceilings, he said that "education spending in Mozambique ...has increased from 4.5% to 6.5% of GDP over the last three years" and, if this is not enough, he advised CSOs "to make powerful arguments" with the Government of Mozambique.

PSI: A New Role for the Fund in LICs or More of the Same? (5)

■ 3rd Cluster

Although some evidence (see REO, SSA, Oct. 07) that the Fund is ready to be “more accommodating”, observers note that the IMF:

- Must acknowledge that policy space in LICs, is not neatly partitioned between poverty-reducing and “traditional” macro policies; and that macro policies affect the efficiency with which economic growth translates into poverty reduction, and vice versa!
- Needs to be more sensitive to the social impact of key macro policies and the trade-off involved in the various policy mixes embedded in the PSI;
- Its own PSIA should inform more the design of the PSI;

Market Access and the Road to MIC status (1)

- Intended recipients of “nuanced signals”: bilateral & multilateral donors, as well as the private capital markets;
- So far, no direct evidence of improved market access as a result of PSI; rather development partners (multilateral and bilateral (mainly G7)) seem more receptive to these signals:
 - E.g. Nigeria’s experience with G7;
 - More likely to attract TA for PFM and capacity for DSA;
 - On the other hand, Ghana, although not PSI, in Sept. 07 issued \$750 mil. bonds which were 4x oversubscribed (bids: \$3.2 billion!);
 - So, PSI not a necessary condition for access, but is it sufficient?

Market Access and the Road to MIC status (2)

- Not directly! We know that the sovereign's ability to access markets (i.e. issue bonds) depends both on its "**willingness**" (incentive: high cost of default due to damage to reputation & threat of sanctions) and "**ability**" (i. e. long-term solvency & short term liquidity) **to repay**.
- IMF study (Gelos et al. (04) on sovereign borrowing by **DCs** (EMs & LICs) , shows that access is influenced by: Perceived quality of policies & institutions (CPIA) & Institutional Investor Index (+); vulnerability to (external) shocks (-); inflation (-); PRGF Programme (-). It is **not** influenced by: liquidity indicators (reserve coverage) + other standard indicators of macro policy; links with the RoW (FDI/trade openness); IMF's SBA or EFF; default in the previous year. More by "willingness" rather than "ability".
- But, another IMF study (Zanforlin (07) of **EMs**, shows that when seeking to **re-enter** the sovereign bond market, although "willingness to pay" (i.e. sound domestic policy & IMF programmes) matters, what matters most is the "ability" to pay (i.e. current account deficit) and international investor demand (i.e. the global liquidity cycle). However, note that , if the borrower defaulted (by restructuring their debt), then what matters to creditors is the "willingness" to pay (i.e. long term debt sustainability), whereas for those who avoided default (i.e. negotiated exceptional liquidity support), what matter most in the ability-to-pay (i.e. external soundness).

Market Access and the Road to MIC status (3)

A more recent IMF (empirical) study on “Financial Market Turbulence” (GFSR, Oct. 07) this time for DE&EM, shows that over the medium term, in addition to strong macro fundamentals, total capital inflows and volatility depend on:

- Growth and growth prospects;
- Financial market (i.e. equity market) liquidity/ depth and openness;
- (Partly driven) by external factors (global liquidity);
- “Institutional quality”: i.e. Corporate governance; accounting standards; regulatory quality; the rule of law;
- “Transparency” in relation to both macro policy and financial data (incl. sound Risk Man. Systems);

Market Access and the Road to MIC status (4)

- In the same vein, the road to MIC-status depends on three factors (T. Bernes (IEO) speech in Accra for Ghana):
 - Increase in the quality and quantity of investment to increase productivity, real wages, incomes and growth: the role of the financial sector and financial policies;
 - The effective management of aid: how to manage scaling up and eventually, scaling down!
 - Effective management of transition to MI status: i.e. exchange rate and capital accounts policies to promote competitiveness and avoid the risks of volatility.

Conclusions (1)

- Fund dampens expectations raised for a new role, “best to think of PSI as a way to credibly commit to good policies” (R. Nord) , i.e. just a signal:
 - By anchoring fiscal policy and structural reform in a medium term framework;
 - As a mechanism of internal discipline;
 - A framework of targeted TA.
- For Radelet (CGD), PSI should NOT be seen (by MCs and Fund) in isolation, but as part of a continuum of IMF interventions in LICs, ranging from the less flexible/funded interventions to the fully flexible/S+M role:
 - Pre-stabilisers : to be offered PRGF, i.e. a stringent funded program, focusing on Macro stability;
 - Early-stabilisers: should move to a Low-Access (i.e. small amounts of funding) PRGF;

Conclusions (2)

- Mature-stabilisation: should be placed in a non-funded PSI-type programme, aimed at consolidating stability and building capacity to deal with policy trade-offs in a non-ODA framework;
- Pre-MIC status: Continued “non-dominant” Fund engagement with flexible, pure S+M programme, i.e. “intensified surveillance” + assessment letters+ advice to Gs+ “graduated signals” (LIC-rating in the context of PRSPs), to attract FDI and facilitate access to private capital markets;

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- So the answer to the question is simple: a helping hand as a signal (only to donors)- and not much else, and still (too) many thumb screws!
- **Which begs another question: Is it really worth it? i.e. has the Fund moved sufficiently to make it an attractive enough “signal”? For you to answer , and this year’s review is the time to raise this question.**
- **THANK YOU FOR YOUR ATTENTION**