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Selected Issues in Loan Negotiations with Official Creditors

Essays written following a UNITAR Sub-Regional Workshop on Debt Negotiations for Eastern and Southern African Nations
(Lilongwe, Malawi 2 to 6 August 1999)

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INTRODUCTION

We all know that financial management begins with the decision to enter into negotiations for financial assistance. Therefore the ability of a country to effectively negotiate the terms of a loan agreement is an important determinant of the cost at which it will borrow the funds. However, for a variety of reasons, developing countries often assume they have limited capacity to influence the outcome of financial negotiations. This is a misconception. Once parties are committed to the negotiating process it is the preparation and strategy of negotiation that plays a greater role in determining the outcome. Through adequate preparation and timely utilization of the right mix of expertise, developing countries can improve the outcome to a negotiated loan transaction.

An effective debt management team consists of a multidisciplinary group of professionals with combined expertise in such disciplines as finance, economics, law and accounting. The lawyer's contribution to this team is his/her knowledge of the domestic laws that govern the sovereign borrowing process, the laws and regulations applicable to each of the sovereign borrower's possible sources of funds, and the documentation, contractual and drafting issues that may arise in the negotiation and structuring of transactions with each of these sources of funds.

As part of its training programme in the **Legal Aspects of Debt and Financial Management for Sub-Saharan Africa**, UNITAR brings together African public officials from a range of agencies including the Ministry of Finance, Ministry of Justice, Ministry of Foreign Affairs, the Attorney-General's Chambers, the Central Bank as well as Members of Parliament, parastatals and other agencies involved in borrowing or negotiating international agreements. The primary aim of such workshops- conducted on a regional basis- is to bring together officials with different backgrounds to appreciate the multidisciplinary nature of financial management and negotiation issues and the centrality and importance of the legal aspects in the borrowing process. Participants at these workshops are not only lawyers but also negotiators, decision makers, financial experts, economists and accountants.

As part of a similar initiative, UNITAR conducted a sub-regional workshop on **Debt Negotiations (Lilongwe, 2 to 6 August 1999)** jointly with MEFMI (Macroeconomic and Financial Management Institute, based in Harare). Some 24 participants were drawn from Angola, Botswana, Lesotho, Malawi, Namibia, Swaziland, Tanzania, Uganda, Zambia, and Zimbabwe. The purpose of this workshop was to expose African government officials to multilateral sources of finance and how to negotiate with each source. The primary mandate of UNITAR in such exercises is to deal with the **legal aspects** of financial management and negotiation. Thus, the workshop also dealt, to a great extent, with the legal mechanisms as well as the role of the lawyer in negotiations.

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This document is a logical outcome of the issues discussed at the Lilongwe workshop. It comprises two chapters dealing with some of the practical issues facing African nations in as far as loan negotiation and sources of finance are concerned. Let me however hurry to say that the issues raised in these chapters may also apply to other nations just as much as they apply to African economies.

We hope that this publication is useful to the readers.

Marcel A. Boisard
Executive Director of UNITAR

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THE PROBLEMS OF SUB-SAHARAN AFRICAN DEBT NEGOTIATORS*

by Mr. Bolaji Owasanoye

Introduction

The objective of this paper is to look at the significance of the legal obligation under an international loan agreement vis-à-vis the negotiating constraints faced by African debt negotiators and to examine whether or not bargaining has been at arms length. The purpose is to establish that the problems which hinder the negotiating capability of African negotiators belie the importance of the agreement and its implication for the political and economic future of the borrower. The issues which will be considered are those which have come up at the Debt Management and Loan Negotiations training seminars of the United Nations Institute for Training and Research for senior and middle level managers of English speaking countries in sub-Saharan Africa in 1999.

Although external debt and its management has in the past two decades become a central issue in the development aspiration and progress of third world countries, it is still treated more as an economic and fiscal issue rather than as a subject to be viewed holistically from a multi-faceted angle including economic, legal accounting, management, development and as a governance issue. Of these related factors, the most underplayed by developing countries is the legal aspect of external debt management, whereas, this ought to be one of the most important since the basis for the relationship between lender and borrower is legal even where political considerations play a major role in the execution of the agreement.

External debt management as a legal issue is yet to be fully recognised by developing countries as crucial to the clamor for reprieve from the excruciating pain of external debt burden even though many developing countries have begun to see its relationship with other development parameters. Only recently, leaders of African nations concluded a seminar in South Africa where the Chairman of the seminar Festus Mogae, President of Botswana said that African nations are willing to abide by conditions offered by creditor countries towards the cancellation of Africa's debt but that the conditions should be jointly agreed upon. He said further that changes to be introduced by African states will include trade liberalisation, civil service restructuring, a working judiciary, democratisation, respect for human rights and improved infrastructure. Other conditions for sustained aid from donor countries will include good governance, respect for rule of law and zero tolerance to corruption. These and other fiscal conditions are acceptable by African leaders but they must be jointly negotiated with the creditor nations before they are implemented as part of the debt relief/cancellation programme[1].

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* *This article has been written by Mr. Bolaji Owasanoye (Associate Professor, Nigerian Institute of Advanced Legal Studies, Lagos) for UNITAR following his participation as a resource person in a joint UNITAR/MEFMI Sub-Regional Workshop on Debt Negotiations for Eastern and Southern African Nations (Lilongwe - Malawi, 2 to 6 August 1999).*

[1] "Africa Urges Cancellation of Debt" news report, Guardian Thursday September 2,1999 at p. 10.

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The strident calls for the cancellation of Africa's debt not as a legal issue but as a political move is established on some factors. One is that many debt distressed African nations would prefer to avoid using the detailed provisions of the various agreements under which their debts were incurred. Such provisions include modality for amendment, dispute resolution, supplementing the agreement, etc. By implication, to adopt a legal solution will be to call a dispute to challenge the agreements or clauses under them, or allege breach of the agreements and then leave a court or an arbitral tribunal to make a pronouncement on the claim as the case may be. Such a legal approach implies proving the claim before the adjudicator, a challenge which many developing countries will rather not face except perhaps in a few cases. Apart from the fact that such a process will be long and protracted, a detailed legal inquiry will expose the pitfalls and the corruption which accompany a lot of international agreements including the international loan agreement.

Secondly, an inquiry may reveal that in many cases, the borrower breached its own legal provisions regulating external borrowing or failed, at one time or the other, to comply with laid down rules in the process of external borrowing. A third possible factor is a lack of understanding of the intricate international legal rules which govern the subject of international lending. Many developing countries do not fully understand these rules and have little capacity in the area. A fourth factor is that the lenders are traditional partners with whom the borrower would like to maintain cordial relations. A legal challenge of the type under discussion may deny the borrower of its traditional source of aid, grants and other credit.

In the light of such constraints, borrower countries have adopted the "faster and cheaper" route of political advocacy for the cancellation of all or at least a substantial part of their external debt burden. In the alternative, there have been calls for a relaxation of the rules governing international lending especially where multilaterals are involved. One such area requested for reform is in the recapitalisation of interest payments[2]. Since there is, strictly speaking, no legal basis upon which to hang the request, borrower countries have not been able to insist and the response of the creditor countries has been less than obligatory.

Undoubtedly, a political solution to the debt crisis is the fastest and perhaps least painful as the delightful example of Egypt represents. She was given a total debt reprieve by the creditors in a campaign spearheaded by the United States on account of its support for the coalition of developed countries against Iraq in the Gulf war. The political solution is also anchored on other fundamental factors apart from those listed above, in spite of the fact that its success is too dependent on the whims and caprices of the lenders such that reliance upon it as the ultimate solution to the debt crisis implies perpetual indebtedness or no hope at all. For example, IMF officials said recently that debt cancellation was not good for Nigeria as it will hurt the economy because further credit will not be given on account of the cancellation the basis being that debt cancellation affects credit worthiness[3]. This same sentiment is shared by the World Bank[4].

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[2] See P.J. Obaseki and B.C. Bello "A Framework for Resolving Africa's Debt Crisis" Central Bank of Nigeria Economic and Financial Review, Vol.33, No.3 pp 241 - 254.
[3] Guardian Friday September 7,1999, back page.
[4] ibid.

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The rigidity of this argument, which may be said to be a ploy to ensure that Nigeria and other sub-Saharan African countries remain impoverished in perpetuity, ignores other fundamental factors behind the political agreement. These are clearly well articulated in an editorial of the reputable Guardian newspaper in Nigeria[5] that –

(a) the world economy is now inter-linked and inter-related such that instability somewhere may affect all, more important is that the potentials of the world economy may be undermined if it enters into the new millennium, with a debt burden which stunts the growth of debtor nations[6];

(b) the agreement favours the alleviation of the suffering of millions of African masses who daily bear the brunt of the excruciating debt burden;

(c) the debt is technically, no longer payable having being privately appropriated in certain cases and also because borrowers have paid back several times the amount ever borrowed;

(d) the Africans and the Third World are being made to pay for the joint mis-judgements of both creditors and borrowers in the 70s where the creditors pushed for the loans to be taken and the borrowers without careful appraisal accepted;

(e) it is contradictory to request a liberalised global free trading world economy in which some partners are impoverished and held down by a debt burden.

The strength of these argument is self evident and it ought to be promoted. However, it will be strengthened where the merit of the legal agreement backs it up.

The Significance of Law

Every subsisting debt obligation of developing countries is founded on a loan contract otherwise popularly known as the international loan agreement. This covers commercial, bilateral and multilateral loan agreements irrespective of the political considerations which led to the conclusion of the agreement. For example, prior to the end of the cold war, the superpowers could support a developing country with aid, grant or loan purely for political or ideological motives but this would not obliterate the obligation to pay back the facility at the appropriate time. Similarly, former colonial governments, particularly France and Britain, continue to give financial support to their former colonies under various guises. With the exception of an outright grant, most of the financial support given is repayable in accordance with the

[5] Editorial in the Guardian, September 13,1999.
[6] This is essentially one of the reasons for the advocacy of NGOs like Jubilee 2000 who are canvassing a relief for the year 2000.

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terms of the agreement, thereby emphasising the importance of the arrangement as a legal obligation. It is only the IMF Stand- by Arrangement whose character remains subject to some debate which was provoked by no less important individuals than counsels to the Fund. Whereas, Joseph Gold former counsel to the Fund argues that the stand by arrangement is merely a decision of the Fund and no more, his predecessor, Mr. J. Fawcett argues that the arrangements may be classified as international agreements[7].

With several years of implementing the stand by arrangement behind us, lawyers in developing countries can safely argue that it is tenuous to say that the stand by arrangement is not an international contract. The legal obligations which flow from the arrangement, breach of which portends serious economic and political implications for borrower countries, underscores the importance of the arrangement as a contract which must be carefully appraised by the borrower before execution[8].

Before the execution of any agreement certain preliminary discussions and behind the scene activities would have been done by both parties. One of such important behind the scene moves is an assessment of what is needed by the borrower and where to get it under the most favourable conditions. Such behind the scene moves include appraisal of the potential lending sources and their conditions vis-à-vis the needs of the borrower. Even at this level, the importance of law remains vital. For example, the borrower must have capacity to borrow under its own laws. Secondly, there must be no secondary impediment to its contracting a new loan. If the borrower has bound itself under a previous agreement to limit its borrowing to a certain amount, it cannot in violation of such agreement contract a new facility without the consent of its subsisting creditor. Thirdly, the borrower must ensure that it follows its own procedures with regard to external borrowing so as not to allow an impeachment of the transaction by default.

At the economic and political level, the socio-economic implications of the transaction must have been carefully considered. For example, if servicing the loan will aggravate the social conditions of the citizenry and create new levels of poor people or if it will lead to serious environmental risks for local citizens or if it will lead to a displacement of persons, the borrower must of necessity consider all these. Whereas the borrower may by law enter into the agreement, yet if these matters are left unattended they may foreclose its ability to perform under the contract and such factors may ultimately lead to a breach of the agreement.

In the light of all the above, the lender seeks to cover every conceivable situation which may arise after the agreement is signed especially because performance is not simultaneous. The importance of law in this regard is underscored by the view of one commentator that-

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[7] See Joseph Gold "The Legal Character of the Fund's Stand By Arrangement and Why It Matters" IMF Pamphlet Series No.35 and J.E.S Fawcett "The Place of Law in an International Organisation" (1960) 36 BYIL p 321.
[8] See Ogan C.A. "Some Aspects of the Financial Policies of IMF: Law or Anti-Law." The Advocate Vol.9 p.56 (1983-84).

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"... A contract of loan is an unusual commercial transaction. It is unusual because one party performs at the beginning and leaves the other party to perform at the end. Many other contracts require concurrent performance. Under the loan contract the lender parts with the funds at the start, and they are left with a piece of paper while the borrower has the funds. The piece of paper must remain a good valid claim for the money over many years. But it is only a claim The piece of paper protests because it is nowhere near as strong as the possession of the money which it represents[9]."

This important view of a lender's lawyer underscores the importance which the lender attaches to the loan agreement. This is without prejudice to whether the agreement is on a bilateral or multilateral basis, the concern remains the same.

In the light of such important consideration, the borrower has an obligation to prepare adequately before signing the agreement. It is of no use to argue that a facility is being given by a former colonial government or a very friendly nation such that the legal implication of the arrangement is ignored or underplayed. In fact, it may be safely concluded that the success or failure of the agreement from the point of view of the borrower is determined by the level of preparedness and the effort put into negotiating with the lender.

Problems of African Negotiators

Considering the importance of law to external debt arrangement, it behoves the borrower to adequately prepare before executing any agreement because external debt, simply put, is a taxation on the unearned income of generations yet unborn who are forced to continue paying a debt for which they may not have derived any benefit. Unfortunately, a myriad of factors hinder the ability of developing country negotiators to negotiate adequately and protect their national interests. The following are the most pronounced factors raised by senior and middle level managers from sub-Saharan Africa.

[9] Sovereign Borrowers - Guidelines in Legal Negotiations with Commercial Lenders, (ed.) Lars Kalderen and Qamar S. Siddiqui in cooperation with Francis Chronell and Patricia Watson, (Dag Hammarskjold Foundation and Butterworths London, England) 1984 at page 139.

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1. Standard Clauses

The first major problem of African debt negotiators is that international loan agreements are in standard format with clauses which can hardly be negotiated by the borrower[10]. Some of the reasons given for standard form contracts in international transactions is that they help to avoid long negotiation and the particularisation of provisions. The fear of lenders here is that special terms given to one borrower may lead to a precedent which the lender would wish to avoid. Furthermore, standard formats help to minismise the cost of packaging the loan in the sense that a direction is given to the process by the proposed clauses. Finally, they help to anticipate the process and the cost of enforcement. While these reasons may be salutary and helpful to the lender they are not so favourable to the borrower. In spite of this, some clauses in the international loan agreement may be negotiated.

The few negotiable clauses include the **payment clauses** dealing with draw downs, repayment and interest, among others. Under these clause the following matters are covered - the purpose of the loan and a statement prohibiting its use for unauthorised purposes. Other matters covered are the *"Commitments"* which set out when, where, in what currency and to what extent the Lender has to provide the facility requested.

The *drawdown* provision indicate the times, amounts and currency in which the Borrower can call for the money and the conditions which go with this. The *repayment clause* sets out the places, amounts, currency and times for repayment. Closely allied to this is the *prepayment provision* which describes the penalties for prepayment ahead of schedule and the *indemnification provision* covers the indemnity the Lender will get for losses arising from the Borrower's lateness to either take up money provided or to make repayments due. The *interest clause* which is one of the most important describes the interest calculations for the loan. It covers times, rates, amounts, currency and places at which interest will be charged. Next is the fees clause which transfers to the Borrower the burden of paying the lenders administrative and other fees and taxes which may be applicable in respect of the loan.

This range of provisions can generally be negotiated by the borrower at least to the extent of its economic and political strength, capacity and depending on the source from which it is borrowing. Several other clauses are however generally speaking not negotiable. These include the "Credit Risk Clauses" dealing with the warranties, representations and covenants in the agreements; the "Country Risk Clauses" dealing with the sovereign and currency risks of international financial transactions; "syndication or co-finance clauses" which apply where all of the money to be lent will not come from only one Lender; and the "general contract clauses" which are used to cover outstanding matters like applicable definitions, notices and assignment etc. Sanctions clauses which describe the remedies of the Lender in the event of default also apply.

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[10] See generally Gbolahan Elias "The International Loan Agreement" in Ayua and Owasanoye ed- External Debt and Financial Management in Nigeria Nigerian Institute of Advanced Legal Studies, 1997.

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From the series of training programmes which the United Nations Institute for Training and Research (UNITAR) has been organising in sub-Saharan Africa for English speaking African debt negotiators[11] it has come out that there is a high level of despondence and misgiving about the standard formats of these agreements. There is a prevailing lethargic reaction to the negotiability of the clauses such that hardly do senior government officers thoroughly or critically review them. Furthermore, the fact that lawyers are sometime not allowed into the negotiation process from inception but are later requested to "vet"[12] escalates the frustration. The insights into the negotiating possibilities offered by the UNITAR training programmes represent one ray of hope to eliminate the fear and lethargy.

2. Inadequate Preparation

Inadequate preparation towards debt management is a second major hindrance to successful debt management. Oftentimes, African debt negotiators have not been given sufficient time by their political leaders to prepare for debt negotiation. The observation ranging from West Africa to East and Southern Africa is that the team which negotiates has hardly ever had time to sit and coordinate, analyse and develop a strategy which is in national interest. The team has also hardly had time to study the lender in order to know its strength and weaknesses, or the prevailing market for the current rules and practices. In other situations, senior political representatives of the government sign agreements on their foreign friendly trips without any reference to their advisers. On return the agreements may or may not be deposited with the office of the Attorney-General and the Central Bank for their information.

[11] In 1999 it has held two major training workshops for senior and middle level officers of debt management first from the West African sub-region at Banjul the Gambia from May 2-6, 1999 and later for Eastern and Southern African officers in Lilongwe Malawi from August 2-6,1999.
[12] The expression "vet" has occurred frequently amongst government lawyers. It means to "review" an agreement which is already obligatory. At best most of the officers merely inform government of its obligations or liabilities under the agreement they are unable to make any more meaningful input.

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3. Weak Economy of Borrowers

In those rare situations where there is opportunity to prepare and negotiate with the lender, economic inferiority complex robs the team of the value of the opportunity. The weak economy of sub-Saharan African states continues to be a hindrance to objective appraisal of the facility being offered by the lender. In a 1991 seminar organised by UNITAR on debt management, a senior debt manager from one of the small countries in the West African sub region had argued that African nations are bound to take whatever conditions they are offered because they need the money. In some cases it has been said that where the borrower's representatives were making a good job of cutting a favourable deal for the country, apprehensive lenders had taken the matter over and above the team to their political superiors to report that the team was been "rigid". Such ignorant superiors had been said to reprimand their officers to the intent that they are supposed to conclude a deal with the lender and not make trouble. This has been common in undemocratic and non-representative governments which dot majority of the sub-Saharan African landscape. With the campaign for democratisation and the strengthening of democratic institutions, this type of occurrence will be reduced to the barest minimum. It is also on account of such practices that debt management awareness seminar for politicians and policy makers remains of important consideration[13].

Also on this point is the assumption by African debt negotiators that aid and grant from developed countries cannot be negotiated. This misconception belies the proper understanding of aid. As we have observed elsewhere[14]

"Aid in the context of external finance is a misnomer because it gives the impression that it is free. Economic aid is in fact not free as nationals of developing countries are led to believe both by their own governments and by the "donor"[15]. Most economic aid is repayable to the donor country because the aid is given from taxpayers money in those countries. The donor government usually has statutory power to support a needy country[16] but does not have power not to take back what is given. Because it comes in trickles and from diverse sources it is usually not regarded as a problematic part of the debt problem of third world countries. This aid may come in different forms. It may be provided in the form of finance (grants or loans); technical assistance (the provision of expert personnel and training); food aid; health aid or medical assistance or military aid. It may also come through bilateral or multilateral assistance.

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[13] One of the significant recommendations at the training seminars is that there should be debt management awareness seminars for politicians and members of parliament in sub-Saharan Africa.
[14] Bolaji Owasanoye, National Borrowing Process: The Legal Perspective paper presented at Debt and Financial Management Workshop, Nigerian Institute of Advanced Legal Studies, May 1995.
[15] Note that the word "donor" is also a misnomer because what is donated is sometimes taken back.
[16] See for example the Foreign Assistance Act of 1961 of the United States of America through which Congress prescribed the parameters for foreign economic aid.

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In view of the above, African debt negotiators must, where they have traditional "donors", prepare against each fiscal year by notifying such donor of areas in which they need support. Apart from assisting planning, the "expectation" can at least be negotiated. An example was given at one of the debt management seminars, where Zambia requested food aid for its rural populace from one of the donor countries. Due to the fact that the request was not negotiated, the donor sent in shipload of cheese and other food items to the country. The impoverished people for which the request was made could not benefit from the aid as they found the food totally foreign. It was not made clear in this case whether or not there were strings attached to the aid. But it reflects the problems associated with receiving aid which was not negotiated. There is no reason why aid or grant cannot be negotiated if they are to be meaningful to the recipient.

One final point on the weak economy is that African debt negotiators fear to ostracise themselves from lenders if they negotiated hard but profitable bargains. The experience of Mexico in this area remains fresh in the minds of many developing countries. When Mexico defaulted on its loans and raised some strong arguments in its favour, lenders withdrew from supporting the Mexican economy. African borrowers are scared of this type of experience. Unfortunately, whereas the technocrats and professionals in government are skilled in arguments which could be used to the advantage of the borrower, the politicians, whether in military fatigues or in civilian mufti, are not prepared for the challenge. They prefer to compromise and rely on political and diplomatic non-legal pressure as opposed to sound legal and economic arguments to resolve the contradictions in the international debt trap.

4. Corruption of Lenders and Borrowers

The impact of corruption on the effectiveness of aid and international lending is no longer in doubt. Only recently, the World Bank in a comprehensive report documents its effort in this area[17]. In the report, the World bank defines corruption as "the abuse of public office for private gain". But the definition ignores the pivotal role of the private sector in the systemic corruption in developing countries. The Bank's argument for such a narrow definition is self serving. It acknowledges that there is corruption in the private sector but since the Bank lends to governments and supports government policies and programmes then it should concern itself with public sector corruption only[18]. The argument is lame because government lending is usually for projects executed by the private sector. Furthermore, bribery by government officials is usually with the assistance of private sector collaborators. As the report admits, bribes can be used by private parties to buy many things provided by central governments, or officials may seek bribes to supply those things. With such acknowledgment, it is difficult to appreciate the Bank's narrow definition.

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[17] Helping Countries Combat Corruption: The Role of the World Bank.(September 1997).
[18] op cit at p. 9.

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In a previous paper[19], this writer had tried to show how conditions attached to international credit reduce the ability of the Borrower to pay and also promote corruption directly or indirectly by both lenders and Borrowers. These conditions are the following –

(a) Conditions in loan agreements insisting that machineries or equipment to be procured for a development project must be procured from the lender or from a supplier recommended by the lender. Usually machinery procured from such conditions are obsolete and are supplied at prices far above the market price.

(b) Conditions insisting on the use of foreign consultants to the detriment of the nation and at the expense of local consultants who were usually better placed to understand local needs and sentiments. The commitment, loyalty and competence of the usually over priced consultants helps to fuel the failure of development projects in debtor countries in addition to contributing a substantial part of the total debt profile;

(c) Encouraging the corrupt tendencies of debtor country leaders to siphon their country's money into coded accounts in the lender countries. Usually lenders are aware that a leader has stolen money meant for development of his country. Such corrupt leaders are however propped up by the support of lenders and multinational corporations.

(d) The proliferation of unviable projects several of which are funded through the World Bank. Such World Bank projects were appraised by World Bank consultants who always somehow returned the "invest" recommendation.

One report had this to say on World Bank projects in developing countries. "... more than a third of the bank's development projects completed last year were judged complete failures by its own staff, a 150 per cent rise over the last 10 years. An article in the English Newspaper the Guardian says the figures add weight to charges by bank critics that loans have paid for environmental and social destruction in poor countries. Big money is involved. The request reviewed 1,800 projects in 118 countries covering $138 billion in loans. Among 1991 projects, the report deemed 37.5 per cent failures, up from 15 per cent in 1981 and 30.5 per cent in 1989"[20].

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[19] Bolaji Owasanoye "Development and External Loans: Paradox of the Incompatibles" Nigei Institute of Advanced Legal Studies, Current Law Review, 1995 at p. 110.
[20] Bolaji Owasanoye, "Development and External Loans" op cit quoting the San Francisco Chronicle Report of 13th November, 1992 in ILI News Ref. WB EVLI. NW2-N13.

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Aside from factors listed above, there are other corrupt strategies used by lenders to have their way. One of such is to take a matter above the head of the negotiating team to their political bosses who are more easily compromised than the negotiating team. In one instance, a debt negotiator had reported how its team had matched the presentation of the lenders point for point. When it looked as if the Borrowers would get a better deal, the lenders requested for a recess which was used to contact the political leaders of the Borrower's to call its team to order. The scenario left no one in doubt that the political leader had been compromised. The Borrower's team contrary to its judgement had to conclude what was clearly an unfavourable deal which was bound to put the country in trouble[21].

In other situations, the strategy of the lender is to capitalise on the poverty of the Borrower by offering inducement and incentives to the negotiating team in a manner which hinders the team from discharging its obligations. Government officials from Borrower countries have admitted that the lure of incentive from the lenders at the negotiation have led to turning the blind eye every now and then. All the factors listed above contribute to an eventual failure of the loan facility or the project for which the facility is meant. In the long run, it adds up to the debt problem.

5. Lack of Skilled Manpower in Borrower Countries

Lack of skilled manpower in developing countries is also a serious problem. Many Borrower countries do not have personnel who understand the intricacies of international lending and the linkages between the various professionals. In fact, this is the basis for the series of debt management training programmes of international organisations like UNITAR and regional organisations like the West African Institute for Financial and Economic Management (WAIFEM) in West Africa and the Macroeconomic and Financial Management Institute (MEFMI) in South and Eastern Africa. In spite of their effort, there remains a yawning gap in manpower development. Firstly, because the number of government officials that can be trained within the shortest time by these agencies remain limited whereas the need is urgent. Secondly, because the benefit of training is lost to irrational movement of trained officials to schedules which do not reflect their background and capacities even where such movement is for promotional purposes.

[21] Reported at the training seminal in Banjul the Gambia.

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6. Poor Documentation and Co-ordinating Strategy

Absence of reliable information data bank, legal and administrative machinery within developing countries is a factor which hinders their ability to negotiate. Relevant information in this case is both about the current debt situation of the Borrower, the status of the potential lender and the borrowing powers of the Borrower. It is still the case that many developing countries cannot fully account for the transactions which have led to their current debt profile. Precedent agreements are not well kept and there is hardly a clearing house of all subsisting loan agreements. This is itself a reflection of the absence of a clear cut policy or law on external borrowing. Whereas the office of the Attorney-General or the debt management unit of the Central Bank ought to be the coordinating office for such, this is not the case in many countries. Since external loans may be contracted by government directly or through any of its agencies or parastatals or by regional governments in a federal structure, it behoves the country to institute a structure which allows government officials to keep track of the country's debt profile at any point in time.

A salutary structure used in Zimbabwe lends itself to emulation[22]. There is an External Loans Co-ordination Committee (ELCC) which is used as an integral part of macro-economic management in Zimbabwe. Both public and publicly guaranteed private sector debt are managed and monitored through the Committee. The Committee itself was established under a cabinet mandate in 1985 and is regulated by the Loans and Guarantees Act, the Exchange Control Act and the Reserve Bank Act.

The ELCC is made up of senior officials of the Ministry of Finance, Reserve Bank of Zimbabwe and the Zimbabwe Investment Centre. It is chaired by the Governor of the Reserve Bank of Zimbabwe. Its mandate is-

(a) to implement an effective debt management policy by sanctioning and monitoring all existing and new loan commitments undertaken by all sectors of the economy;
(b) to ensure that external borrowings are within the absorptive capacity of the economy and that the external debt portfolio is optimised;
(c) to create a need for a disciplined process of borrowing;
(d) to ensure that all external borrowing are contracted at the lowest borrowing cost to the country;
(e) to ensure a tolerable structure of debt;
(f) to ensure an adequate spread of maturities;
(g) to ensure the diversification of borrowing sources;
(h) maintenance of an affordable margin of borrowing capacity;
(i) maintenance of the country's credit worthiness in the international capital markets[23].

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[22] As reported at the just concluded debt management seminar for Southern and Eastern African countries organised jointly by UNITAR and MEFMI, August 2-6,1999.
[23] Moris B. Mpofu "Zimbabwe External Debt Strategy Formulation" paper presented at the MEFMI/UNITAR Loan Negotiation Techniques Workshop, Lilongwe, Malawi 2-6 August, 1999.

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Based on its very broad mandate, the ELCC set some benchmarks designed to manage interest rate risk, exchange rate risk, credit risk, liquidity risk and operational risk in external debt management. The Committee makes recommendations to the Parliament of Zimbabwe which as a rule does not go against the Committee's advise. The ELCC enables Zimbabwe to keep track of its debt profile and its debt negotiators are able to use information available from the Committee to advantage.

Conclusion

Streamlining the problems identified above will improve the debt management ability of sub-Saharan Africa debt negotiators especially in an improved economic and governance environment. Majority of the problems are management problems and could be improved with better governance. The impact of a representative and transparent government in this regard cannot be underplayed. This is why one of the surest steps to resolving the debt crisis is by a participatory system of government which democracy offers.

Furthermore, debt crippled countries must boldly approach the problem from both the legal and political angles. Whereas the political approach is faster and cheaper, it evokes no obligation from the other party. It should not be promoted to the detriment of the legal angle especially where there is merit in the claim. A test case in this area is long overdue.

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THE REVIEW OF THE IMF'S ENHANCED STRUCTURAL ADJUSTMENT FACILITY*

by Prof. Daniel D. Bradlow

I. Introduction

In 1986, the International Monetary Fund (IMF) established a new financing facility specifically to deal with the problems confronting low income member countries that were unable to meet their external funding requirements. This facility, was as the Structural Adjustment Facility (SAF). It was established on a temporary basis because this was the first time that the IMF was explicitly creating a financing facility to support structural reform.

After one year, the IMF decided to make some changes in the SAF. The result was that in 1987, the IMF established the Enhanced Structural Adjustment Facility (ESAF) to replace the SAF[1]. Initially the ESAF was established on a temporary basis. In 1996, the IMF's Board of Directors voted to make the ESAF a permanent facility[2]. The ESAF has also become the vehicle through which the IMF participates in the initiative to lower the debt of the heavily indebted poor countries (the HIPC initiative).

From the moment it was established, the ESAF program proved to be controversial. There was debate over the policies that it required its member states to follow and whether or not they had a disproportionately adverse impact on the poor. There was also controversy over their efficacy in solving the problems of the states that utilized ESAF funds. In addition, many critics expressed strong reservations about the intrusive role that the IMF was coming to play in the policy making processes of those countries that made use of ESAF funding.

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[1] During the course of its life from 1986-93, the SAF provided multiyear funding to qualifying member states.
[2] In October 1999, the IMF membership voted to rename the ESAF. Its new name is the Poverty Reduction and Growth Facility. The new name is intended to convey the message that this facility is focused on poverty reduction as well as on the structural adjustments needed to promote growth. Information on this new facility can be found at the IMF website (www.imf.org).

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Partly as a result of these controversies and partly as a result of the experimental nature of ESAF, the IMF decided to undertake a comprehensive review of the ASAF This review, which was completed in 1998, consisted of three parts. The first was an internal review conducted by the IMF staff[3]. The second was a review conducted by a team of independent outside reviewers[4]. This external review was particularly significant because it was the first time that the IMF had formally commissioned an independent review of any of its operations. The third part was the IMF staff report to the Board of Directors of the IMF distilling the lessons learned from the two reviews[5].

This paper discusses the ESAF review process and the issues that arise therefrom relating to the relationship between the IMF and its ESAF-Eligible member states. It is divided into five sections. The first section is a description of how the ESAF operates. The next three sections discuss the internal and external reviews of the ESAF and the IMF staff report to the Board of the IMF on the lessons from the ESAF reviews. In the final section the paper will discuss three issues that arise from the ESAF review process. These three issues are the IMF's negotiating style; the implications of the expansion of the IMF's operation for its relations with other international organizations and the IMF's negative public image.

II. The ESAF and How it Operates

Beginning in the mid-1980's the IMF decided that its standard financing facilities did not adequately meet the needs of the world's poorest countries. The biggest challenges these countries face are structural and relate to their ability to make and effectively implement policy. These problems require long term solutions which are not readily adapted to the short term and non-concessional nature of the standard IMF financing facilities[6]. Consequently, the IMF decided that to adequately assist these countries it would create a facility that offered them financing on concessional terms for relatively long periods of time.

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[3] The ESAF at Ten Years: Economic Adjustment and Reform in Low-Income Countries. IMF Staff (Occasional Papers #156, December 1997) (hereinafter ESAF at Ten).

[4] External Evaluation of the ESAF. Report by a Group of Independent Experts June 1998), available at IMF website (http://www.imf.org/external/pubs/ft/extev/index.htm) (hereinafter External Evaluation).

[5] Distilling the Lessons from the ESAF Reviews, available at IMF website (http://www.imf.org/external/pubs/ft/distill/index.htm) (hereinafter Distilling Lessons).

[6] The standard IMF financing facilities are designed to provide relatively short term funds on a non-concessional basis. See IMF Survey: Special Supplement. September 1999 for a useful description of these and the IMF's other financing facilities. This publication also contains a useful description of all the IMF's activities, how it raises its financing and of the membership structure of the IMF.

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The IMF also realized that, this financing facility could not be funded through its General Resource Account[7]. This was partly due to the concessionality and terms of the financing and partly due to the IMF principal of uniformity. This principle means that any country, regardless of its level of income, should have access to any facility that utilizes the funds in the General Resources Account provided it is experiencing the type of financing problems that the facility is designed to correct. There are many middle-income countries with structural problems which theoretically could qualify for ESAF funding if the principle of uniformity were applicable to ESAF.

The result was that the IMF established a special trust to fund ESAF. The IMF approved total commitments of SDR 0.9 billion for 10 countries in the fiscal year ending June 1999. As of April 1999, a total of SDR 9.0 billion had been disbursed under 79 ESAF and SAF arrangements to 56 ESAF- eligible countries[8].

Accessing ESAF Funding

In order to be eligible for ESAF funding a country must have a per capita GDP that would qualify it for IDA funding. The current cutoff for IDA funding is a 1997 per capita GDP of $925[9]. Currently 80 countries are eligible for ESAF funding[10]. It is important to note that countries that are eligible for ESAF can also qualify for support from the IMF's other financing facilities.

The first step in accessing ESAF funding is for a member country to prepare a Policy Framework Paper (PFP)[11]. The PFP is a document prepared by the country in collaboration with the staff of the IMF and the World Bank. The PFP discusses the country's macroeconomic and structural reform policy objectives and the relative priorities attached to these objectives, the strategy the country plans to follow to achieve these objectives, and the country's external financing requirements. In recent years, the PFP's have also included discussion of social policies designed to protect the most vulnerable parts of the population and the budgetary allocations to support these policies. The paper is drafted to cover a three year period but is updated annually. The PFP serves as the framework paper for the country's relations with the IMF and IDA and influences other agencies and institutions that intend to provide the country with financial or technical support over the period covered by the PFP. Pursuant to the IMF's efforts at enhancing its own transparency, it is encouraging all countries who prepare PFP's to make them publicly available. If the country agrees to make the PFP publicly available, the IMF publishes it at the IMF website[12].

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[7] Id. This account contains the funds the IMF has received from its member states through their subscriptions to the IMF, that is from the contributions all member states make to the IMF.
[8] IMF Survey: Special Supplement. September 1999. p!5.
[9] IMF Concessional Financing Through ESAF. IMF Fact Sheet, (March 1999), available at (http://imf.org/external/np/exr/facts/esaf.htm). The site was last visited August 31,1999.
[10] Id.
[11] Under the new Poverty Reduction and Growth Facility in addition to the PFP, states will need to prepare a paper called a Poverty Reduction Strategy Paper. This paper will also be prepared in conjunction with the World Bank and the IMF.
[12] http://www.imf.org

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Both the IMF and IDA will base their operations in the country on the content of the PFP. The Board of Directors of the IMF bases its specific funding decisions for a country on a Memorandum of Economic Policies. In this Memorandum, the country spells out its policy for the upcoming year. The exact amount of money that the IMF will lend to ESAF-eligible countries is based on the country's quota[13], its balance of payments need, the IMF's perception of the strength of its adjustment program, its current use of other IMF financing facilities and its record in past usage of these facilities. The IMF allows eligible countries to borrow up to a maximum of 140% of their quotas during the three year arrangement. In exceptional circumstances, the IMF will allow countries to borrow up to 185% of quotas.

The IMF charges an interest rate of 0.5%, to be paid semi-annually, on all ESAF loans. The repayments of the loan begin five and a half years and end ten years after the initial disbursement. All repayments are made semi-annually. This means that the terms and conditions attached to the loan, especially IMF monitoring of the borrowing country, may continue for 10 years.

Funding for ESAF - The IMF's ESAF activities are funded through the ESAF Trust. The funds in this Trust were provided in the form of loans and grants by those IMF member states who chose to contribute to the Trust. The IMF acts as the administrator of this Trust. The Trust has three accounts:

- Loan Account: This account is funded through loans that member states make to the Trust and which the Trust then on-lends to ESAF-eligible countries. The total funds in this account amount to about SDR10 billion of which about SDR 6.6 billion were committed by February 1999[14];
- Subsidy Account: This account is funded through grants. It is used to subsidize the interest charged by the IMF on ESAF loans, thereby enabling the IMF to only charge the borrowing country an interest rate of 0.5%. The Subsidy Account's resources are about SDR4 billion, of which the IMF itself has contributed about SDR0.6 billion[15]; and
- Reserve Account: The funds in this account provide security to the creditors of the ESAF Trust.

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[13] Each country, when it joins the IMF, is assigned a quota. The quota is calculated on the basis of the country's size and importance in the global economy. The quota affects the size of the country's vote in the IMF, its financial contribution to the IMF (known as its subscription) and its access to IMF financing. For more information, see IMF Survey: Special Supplement. supra note 5.
[14] IMF Concessional Financing Through ESAF. supra note 7.
[15] Id.

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In 1997, the IMF member states established a second trust, the ESAF-HTPC Trust. This trust is designed to finance both special ESAF operations that are being undertaken under the HIPC initiative and interim ESAF subsidy operations. The HIPC initiative is a joint World Bank and IMF initiative to provide qualifying countries with some relief on their debt obligations to the World Bank and the IMF. In order to qualify, countries must demonstrate a multi-year record of successful adjustment and reform that has been funded, and monitored by the IMF and the World Bank[16].

Interim ESAF subsidy operations are operations that the IMF will undertake during the period 2001-2004. These operations are considered "interim" because, given its current cashflow projections, the ESAF Trust will not have sufficient funds to meet the projected SRD 1 billion that it will need in each of these 4 years. After 2004 the ESAF Trust is expected to become self-sustaining, because the repayments of the outstanding ESAF debts will be sufficient to meet future funding needs. The IMF is hoping to fund ESAF operations during this interim period through contributions from its member states to the ESAF-HIPC Trust and from its own resources[17].

III. The Internal ESAF Evaluation

In 1997, the IMF publicly released a review that its staff had conducted of the ESAF program. This study, which was conducted by a team from the IMF's Policy Development and Review Department, looked at the programs in all countries that had had ESAF or SAP multiyear programs approved by the IMF's Board of Executive Directors before December 31,1994. The study covered 68 multi-year programs in 36 countries. Its purpose was to assess the effect of die ESAF program on economic development and to identify possible changes that could be made in the design of ESAF-supported programs to improve their performance. The IMF study concluded that:

- Most countries that have pursued reform and adjustment policies with ESAF/SAF support "have strengthened their economies materially"[18]. The evidence it cites to support this conclusion is that most countries have reduced their fiscal imbalances; their macroeconomic policies have "eradicated almost all instances of high inflation"[19]; many of the improvements in economic structure that the ESAF/SAF were intended to support "appear to have taken root and to be spreading[20]" and the pace of reform seems to be accelerating.

[16] See, IMF Survey: Special Supplement. September 1999 for an explanation of the HIPC Initiative.
[17] These funds were approved during the 1999 IMF Annual Meeting and member states are now deciding on their individual contributions.
[18] ESAF at Ten, supra note 3, p20.
[19] Id.
[20] Id.

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- The authors of the study also state that these policy gains appear to have improved growth and living standards and strengthened the balance of payments in most countries.
- Progress in reducing intermediate levels of inflation, and creating more outward oriented economic conditions has been uneven.
- The authors of the study also found a mixed record on ESAF/SAF supported countries advancing towards a situation in which they can raise their own external finance.

The study's authors also made some proposals for reorienting and "in some respects redesigning[21]" aspects of ESAF programs so that they are more effective in achieving the ESAF's goals of "sustained higher growth, with an improvement in living standards and progress towards external viability[22]". The proposals focused on more "fiscal adjustments", more decisive effort to reduce inflation, strengthened reforms of public enterprises and banking systems and some modifications in programs to ensure continuity in policy implementation[23].

The findings of the IMF reviewers do not suggest that ESAF is a great success. The reviewers most optimistic conclusion appears to be that there is some evidence that most ESAF-supported countries have experienced some improvements in the worst aspects of their macro-economic conditions. For example, the reviewers found that in almost all cases high levels of inflation have been reduced and most of the countries studied appear to have cut their budget deficits. However, the study was unable to find conclusive evidence that the ESAF programs had been successful in bringing inflation down to low levels or in improving countries economic condition to the point where, through their own efforts, they are able to meet their external financing needs[24]. The latter finding means that despite the often wrenching adjustments required of the countries, the ESAF policies have not succeeded in reducing their dependency on aid and official sources of funding. In addition, the tentative nature of the reviewers conclusions on policy reforms and structural changes, suggests that the ESAF programs have not been particularly successful in promoting structural adjustment. This conclusion should be interpreted in conjunction with the findings of the external reviewers on the importance of ownership to effective reform[25].

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[21] Id.
[22] Id.
[23] Id.
[24] Presumably the IMF reviewers do not discuss the impact of the ESAF policies on the poor and on other social groupings because this fell within the mandate of the external reviewers. The external reviewers findings are discussed in the next section of this paper.
[25] The external reviewers findings are discussed in Section IV of this paper.

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Interestingly, the IMF reviewers proposals for improving the success of ESAF programs were to apply the same policies more rigorously. They did not seem to consider the possibility that the current operating policies and practices and the way in which they have been implemented by the IMF may be contributing to the lack of unequivocal ESAF success. Their lack of attention to this possibility and their resulting failure to suggest any reform in the IMF's own conduct in the ESAF operations, is particularly surprising in light of the external reviewers[26] findings about the IMF's negotiating posture in ESAF negotiations and the negative public perception of the IMF.

IV. External Review of ESAF

In 1996, the IMF's Board of Directors, responding in part to the ongoing controversy that the ESAF had generated, decided to appoint a team of independent consultants to evaluate ESAF. The decision was an important development for the IMF because it was the first time that the IMF was subjecting any of its activities or operations to independent evaluation.

The IMF selected the following people to conduct the external review: Dr. Kwesi Botchwey, former Ghanaian Minister of Finance and currently with the Harvard Institute for International Development; Professor Paul Collier, Centre for the Study of African Economies, University of Oxford; Professor Jan Willem Gunning, The Free University of Amsterdam; and Professor Koichi Hamada, Economic Growth Center, Yale University. The mandate of these reviewers was to evaluate ESAF in terms of the following three issues:

- developments in the viability of the countries' external position;
- the impact of ESAF on social policies and the composition of government spending; and
- the determinants and importance of national ownership to ESAF-supported programs.

The external evaluators conducted their study of ESAF programs in the second half of 1997 and in March 1998 made their report publicly available[27]. They made six key findings.

The first finding was that the social impact of ESAF varies so greatly from country to country that the average experience across all ESAF programs "conceals as much as it reveals"[28]. In their study, the evaluators looked at the social impact of ESAF through its impact on incomes and social expenditures. They concluded that "on the whole" reform has a positive effect on growth and income distribution because the reforms tend to hit the better off segments of the population more than the poor[29].

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[26] See Section IV of this paper.
[27] External Evaluation, supra note 4.
[28] Id., p 27.
[29] Id.

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However, they found that, in many cases, different members of the same social grouping can be found in the groups of winners and the losers from ESAF-supported programs. In addition, they found that in some cases the effects of ESAF policies on income redistribution worked against certain subgroups of the poor.

Based on this finding, the external evaluators recommended that the IMF should pay closer attention to the differential impact of the ESAF supported policies on the poor and other social groups. Furthermore, they suggested that, when designing ESAF-Programs, the IMF should undertake detailed country-level studies utilizing the household poverty expertise of the World Bank. The external reviewers also proposed that the adverse social impacts of ESAF policies could be reduced if the IMF paid more attention to the sequencing of reforms[30].

The second finding was that the possibility for poverty reduction improves after the economy has stabilized. At that point, government policy should be to encourage investment and growth. However, the evidence indicates that, even after stabilization, the ESAF-eligible countries have only a limited capacity to finance investment through domestic savings. Consequently, the external reviewers recommend that ESAF (i.e. the IMF) should play a continuing role even after the economy has stabilized and that the post-stabilization ESAF-supported program should be oriented towards growth. They also suggested that in post-stabilization countries the IMF should pay closer attention to structural reform targets which can only be achieved over a relatively long period of time than to the short term macroeconomic targets that are typical of stabilization programs. In addition, they suggested that IMF monitoring in these post-stabilization programs should focus more on the actual outcomes of these policies than on targets that are set ex ante as is the typical case in stabilization programs. The evaluators reasoned that these proposed changes would more effectively promote the key function of an ESAF-supported program in post-stabilization countries, which is to help build investor confidence in the policies of the country and in the credibility of the government.

The third finding related to the impact of ESAF on social expenditures. The evaluators found that ESAF affects social services through 4 possible means: the impact on real per capita expenditures on social services; the effect on the share of government expenditures in GDP; its the effect on the composition of government expenditures, and the effect on relative prices and therefore on the amount of services that a given budget allocation will purchase.

The external evaluators recognized that the IMF currently lacked the expertise to properly evaluate the impact of ESAF programs on social services. To fill this gap in the IMF's capacity, the evaluators recommended that the IMF make greater use of World Bank expertise in poverty analysis. In addition, they suggested that the IMF could help mitigate the adverse impacts if, in designing its programs, the IMF more explicitly analyzed the trade offs between the short and long run effects of ESAF programs. Finally, the reviewers proposed that ESAF programs would be improved if there was closer collaboration between the IMF and the World Bank in those areas where their interests overlap, for example fiscal policy.

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[30] Id.

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The fourth conclusion of the external evaluators was that the IMF overemphasizes debt-export ratios in its assessment of external viability. To correct this problem, they recommended that at least equal weight be given to debt-GDP indicators. The evaluators reasoned that, because these latter indicators are less affected by the degree of openness of the economy, they give a clearer indication of the impact of the debt burden on the country's finances. In particular, they recommend that the IMF utilize the Real External Debt Burden (REDB) and the Debt Deepening Index (DDI). The REDB provides an indication of the debt to GDP ratio in the absence of a current account deficit (or surplus). The DDI provides an indication of the debt to GDP ratio given the actual the current account balance.

The external evaluators's fifth conclusion was that "[t]he one common theme that runs through perceptions of ESAF at the country level is a feeling of loss of control over the policy content and the pace of implementation of reform programs[31]". They noted that while there is widespread recognition of the importance of ownership in program implementation, there is little evidence that ownership is being respected in practice. The evaluators suggest that the solution to this situation does not lie in "reducing ownership to simply persuading the country to adopt what ..[the IMF]..wants but in finding a middle ground that enables the country to express its will and build consensus behind a program capable of achieving sustainable growth[32]".

The evaluators note that this will require action at the country level to improve decision making and consensus building processes and by the IMF "to make the negotiation process and conditionality regime more supportive of country ownership[33]". At the county level, the evaluators recommend that the countries should define their medium and long terms visions before they begin negotiations with the IMF. In so doing the country should make full use of all available forms of technical assistance and should seek to build a national consensus behind the national program. In order to foster this process, the evaluators recommend that countries create an economic management team consisting of the key economic and sector ministries and political leaders and that they hold national conferences where alternatives and trade-offs can be openly debated.

They also recommend that the IMF take steps to enhance national ownership in negotiating agreements. In particular, they suggest that the IMF engage in an intensive and informal policy dialogue with each country's political leadership in order to ensure that it fully understands the constraints and possibilities in the system. They also propose that the timing and duration of IMF missions should be arranged so as to allow adequate time for country preparation in advance of negotiations and for consensus building during the course of the negotiations. Furthermore they argue that the IMF should take steps to "relieve widespread concerns about the Fund's perceived inflexibility in negotiations through the introduction of an element of choice in the negotiation of the conditionality regime[34]".

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[31] External Evaluators Report, supra note 3, p20.
[32] Id., p29.
[33] Id.
[34] Id.

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This could be done by, for example, proposing alternative program paths and letting the country choose, or by utilizing a more systematic mechanism for providing ex post support to a country that has chosen to follow a home grown program of adjustment.

The fifth finding relates to the IMF's negative public image. The evaluators noted that the IMF is so negatively perceived that it is often blamed for things with which it has no connection. They recommend that, to counter this situation, the IMF take steps to "humanize and demystify the Fund's image[35]". They suggest, for example, that the IMF should have more systematic and interactive contact with a broad cross section of stakeholders in the countries. They also proposed that the IMF establish resident missions in all ESAF countries and that these resident representative be given greater authority. The evaluators contend that the resident representatives are likely to have a better understanding of the country's situation, and are more likely to be more responsive to local conditions and local concerns than the people in the IMF's headquarters in Washington.

This fifth finding raises an issue that may be of interest to those who are planning for negotiations with the IMF. This issue is explored in the last section of the paper[36].

The evaluators sixth conclusion is that the IMF and the World Bank need to develop better instruments of coordination. The current basis for the relationship between the two organization is the 1989 Framework Agreement (the so-called "Concordat") which seeks to assign areas of primary responsibility to each institution. In brief, the IMF is primarily responsible for macro-economic policy and the World Bank for the structural and medium term aspects of development. Since 1989 both institutions have undergone substantial changes in terms of the scope of their activities and, in case of the Bank, in its operating structures. Consequently, given that the IMF's stated purpose for ESAF is "fixing macro-economic shortcomings and medium term structural problems that underpin macro-economic policy weaknesses[37]" it is not surprising that this topic should become an issue in the ESAF evaluation[38].

[35] Id., p29.
[36] See infra. Section VI.
[37] ESAF at Ten, supra note 3 p. vii. This document in its preface states that ESAF is "intended to back fundamental reform in the structure and institutions of the economies concerned, as well as strong macro-economic policies, with the objectives of promoting higher economic growth and external viability in a balanced manner", Id, p. vii.
[38] This issue is discussed in Section VI, infra.

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V. The IMF Response to the External Evaluation

After the IMF's Board of Directors received the external evaluators report, they request the staff to distill the lessons to be learned from the findings of both the external and internal reviews of ESAF and to develop specific proposals for further action. In executing this assignment the staff first identified nine lessons that could be learned about ESAF program design.

The first lesson was that ESAF programs, to generate investable resources, should establish a substantial increase in national savings over 3 years as an explicit target of the program. In order to achieve this objective, ESAF programs need to pay close attention to improving the financial system, the design and implementation of the tax system, macroeconomic policy, and such other policies as labor, education and health. This lesson therefore implies that the IMF will be more rigorous in its attention to these issues in its ESAF operation. This, in turn means that, de facto, the IMF will involve itself in a more intensive way in policy making and implementation in its ESAF-supported member states.

The second lesson was that the balance in fiscal adjustment between increases in revenues and cuts in recurrent expenditures should be designed to achieve higher savings and to take into account country specific factors. This will require the IMF to more carefully evaluate specific budgetary allocations and revenue decisions. Consequently, the adoption of this lesson is also likely to result in a more intrusive role for the IMF in the member states' policy making and implementation process.

The third lesson was that the program should aim to shift the composition of revenues over time away from trade-based revenue sources, which the staff perceived as having a distorting effect on the allocation of resources in the economy, and toward broad based consumption and income taxes. This lesson raises complex political and social issues that the IMF will need to consider in its program design and in monitoring country performance. Thus once again it will lead to more intensive IMF interaction with the member country.

The fourth lesson was that the quality and composition of public expenditures should be improved so that expenditures on items such as health and education are protected. This implies, once again, that the IMF will need to play a direct role in deciding how government resources are allocated.

The fifth lesson was that a decision on the role that the IMF should play in ESAF-eligible countries that have achieved macroeconomic stability can be postponed because few countries have actually achieved such stability. This lesson suggests that, in fact, there are few countries that have actually experienced successful ESAF programs. This dismal finding raises the troubling issue of how well the IMF, itself, is actually performing in ESAF operations. It would suggest that a more rigorous study to identify the impediments to more effective IMF performance under ESAF may be warranted. It also raises the issue of how the IMF is held accountable for giving flawed policy advice.

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The sixth lesson was that the goal of reducing inflation should be achieved through the utilization of both fiscal and monetary policy. This means that such monetary variables as exchange rates, money supply ceilings or announced inflation targets can be used together with budget cuts to reduce inflation. This lesson again implies a more intrusive role for the IMF in the policy making process because it will require the IMF to carefully assess if the country is choosing the best mix of monetary and fiscal policies. It can only make this evaluation by reviewing the specifics of each policy.

The seventh lesson is that structural reform priorities should be set on a case-by-case basis and should focus on stimulating the private sector. This means, according to the IMF staff, that the program should focus on privatization, developing sound banking systems, and improving the regulatory and legal framework for the private sector. This task will require the IMF to get involved in such complex social phenomena as transforming a country's legal system. It is not clear that the IMF has the expertise or the mandate to undertake this task.

The eight lesson is that trade liberalization should be designed to improve the efficiency with which the economy allocates resources. In many countries trade-liberalization is related to the composition of government revenues because many governments raise much of their revenue through tariffs and other trade duties. Consequently, once again, the adoption of this lesson is likely to result in the IMF becoming engaged more intensively in policymaking in the country.

The ninth lesson is that in measuring external viability the staff should use export-, GDP-, and revenue based indicators. This lesson is drawn directly from the recommendations of the external evaluators.

Based on these lessons, the IMF staff proposed five operational changes in ESAF. The first recommendation is that the IMF should foster greater government ownership of the ESAF-supported program. The staff acknowledge that national ownership means that the country is responsible for creating its own adjustment program. This program is then the subject of the negotiations between the government and the IMF. Clearly, in the course of these negotiations, the two parties will need to pay careful attention to the constraints within which the IMF functions in its ESAF operations.

The staff suggests that national ownership will be promoted if the IMF, in its discussions with the government, is willing to consider alternative policy mixes all of which are consistent with the IMF's objectives for the ESAF-supported program. The staff states that the objectives for the program should be "incorporated into the mission's initial thinking on program design and thus elaborated in a negotiating brief[39]". The IMF staff cautions, however, that the scope for flexibility is constrained by the IMF's principal of uniformity of treatment and by the risk that understandings reached by the IMF mission and the government are subject to revision at IMF headquarters.

[*39] Distilling Lessons, supra note 5, p20.*

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In addition, the staff proposes that the IMF help foster what it refers to as "a national consensus in support of the program.[40]" It warns, however, that this second aspect of ownership is desirable but not always feasible or essential, particularly if the fruits of the reform program only become evident over time[41]. According to the staff the IMF can help promote a national consensus for reform by ensuring that IMF missions meet with representatives of civil society, such as parliamentarians, trade unions and business groups. The staff suggests that such meetings are already "common practice[42]".

It is important to note the emphasis the IMF staff place on the constraints on the IMF's ability to be flexible in its negotiations with ESAF-eligible countries. For example, they highlight the fact that the agreements reached between IMF mission staff and the government are subject to revision by the senior management of the IMF. However, this is not a unique feature of the IMF. Many agreements are negotiated by agents who must remit the proposed agreement to their principals for approval and possible revision. The concerns of the staff on this point, therefore, suggest that they are reluctant to engage in a truly free exchange of ideas with their member states. They also seem to indicate a lack of flexibility in the IMF's current negotiating posture in ESAF negotiations. It is to be hoped that over time the IMF will recognize that undue constraints on their negotiating flexibility is incompatible with their efforts to foster national ownership of ESAF programs.

The second recommendation is that the IMF should be more selective in providing support under ESAF. The staff suggests that the IMF can achieve this objective through requiring the country to complete certain actions before it qualifies for a disbursement of ESAF funding (so-called prior actions). In addition, they propose that the IMF staff reports relating to requests for ESAF support should include a discussion of the government's commitment and capacity to implement reform. These assessments may influence IMF decisions on how much financing to provide the country. The potential significance of this recommendation is clear: countries that the IMF deems insufficiently committed to or incapable of implementing structural change could loose their access to ESAF funding.

It is not clear however how the IMF would make these determinations. Moreover it is far from obvious that a specialized macroeconomic institution like the IMF, has the expertise to assess a government's commitment to or ability to implement policy reforms. Finally, it is unclear how the IMF will be held accountable for incorrect assessments of these issues. Unless these unresolved issues are clarified, this recommendation should be viewed critically. After all, the IMF's record in this regard, as evidenced by its recent performance in Russia and Indonesia, does not inspire confidence.

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[40] Id., p20,
[41] Id.
[42] Id.

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The third recommendation is that the IMF and World Bank staff should formally undertake 5-6 pilot projects. These pilot cases would focus on accelerating public enterprise and financial sector reforms, identifying and addressing the adverse social consequences of ESAF-supported programs; and assessing medium term investment needs and the capacity of the country to attract the necessary resources. These pilot cases would also focus on collaboration between the World Bank and the IMF. The delineation of responsibilities between the Bank and the IMF in these cases would be governed by the 1989 "Concordat" between the two institutions[43].

In order to reduce the high number of interruptions that occur in ESAF-supported programs, the staff's fourth recommendation is to make some changes in the "architecture" of ESAF. In particular, the staff recommends that the existing ESAF Trust documents be amended to allow the staff to conduct quarterly reviews and disbursement. This change, which would conform to the practice under the Extended Fund Facility, is intended to promote more effective staff monitoring of ESAF program implementation. It is also likely to lead to more intensive and intrusive IMF monitoring of ESAF-countries and to greater IMF involvement in policymaking and implementation in these countries.

Finally, the staff examined the feasibility of the IMF playing some role in a country after it has completed an ESAF program. The staff suggests that the regular Article IV consultations, which the IMF conducts with all member states, on their own would not be adequate for the post-ESAF role that the external evaluators (and some Executive Directors) seemed to favor. They propose a precautionary financing arrangement between the IMF and the member, which could be agreed even though the country does not actually need IMF funds. This arrangement, which the member would not actually utilize unless it faced a genuine balance of payments problem, would create a formal monitoring opportunity which the IMF could utilize to signal its approval of and support for a country's adjustment and reform program. The staff expects this arrangement to catalyze financial support from other sources for the country. The staff suggests that ESAF would not be suitable for this precautionary role but that the standard IMF standby and extended arrangements would be suitable[44]. The staff's reasoning is that the concessional nature of ESAF funding would create too strong an incentive for the country to draw down the precautionary ESAF even if it was not experiencing a balance of payments problem.

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[43] See supra Section IV for discussion of this "Concordat".
[44] See IMF Survey: Special Supplement. September 1999 for a description of standby and extended arrangements.

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VI. Three Issues Arising from the ESAF-Review

There are three issues that arise from the review of the ESAF that raise important concerns about the IMF as an institution capable of managing a successful economic adjustment and reform program. These issues are:

- The IMF's negotiating posture towards its ESAF-eligible member states,
- The Relationship between the IMF and other International Organizations, including the World Bank, and
- The Fund's Negative Image.

Negotiating with the IMF

Making the IMF more flexible in its negotiations with member states will require a significant change in the IMF's approach to its member states. In its initial response to the external review, the IMF staff sought to justify their lack of flexibility by pointing to their responsibility for ensuring that the IMF's negotiating positions are within the "limits dictated by the need to ensure that problems are adequately addressed". It is arrogant to imply that this responsibility rests solely on the IMF. Any government or society that takes seriously its obligation to deal with the economic crisis/situation existing in its own country must develop its negotiating position within the "limits dictated by the need to ensure that problems are adequately addressed". The real difference between the IMF and the country arises from their differing perceptions about the limits dictated by the situation and about the technical and political capacities of the country. The IMF can facilitate more "user-friendly" negotiations by taking time to listen to the country's perceptions of these limits and by taking its perceptions into account in designing its negotiating positions.

During the course of the review, a number of useful suggestions for making the negotiation process more "user friendly" were made. These include having higher level pre-negotiation discussions; lengthening the time and duration of negotiations; increasing the flexibility of the Fund's negotiating position so that countries have more than one option regarding the contents of the ESAF-supported reform program; broadening the IMF's range of contacts in the member state; demonstrating a sincere interest in learning from these contacts; and appointing a resident representative who understands the local situation and is willing to reach out to all elements of the society and who has some independent negotiating authority.

These suggestions are interesting because they indicate that the IMF's current negotiating posture exacerbates the inherent bias in favor of the IMF that exists in all negotiations for IMF funding. The cause of the bias is the country's urgent need for the ESAF funds and the influence the IMF has over the country's other external funding sources.

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It is important for the ESAF-eligible country negotiators to recognize that, despite this inherent bias, they do have some bargaining power. This arises from the fact that the IMF also has a keen interest in reaching an agreement. It needs to show those countries that contributed to the ESAF Trust Fund that it is capable of utilizing these funds. For obvious reasons, the IMF's interest in reaching an agreement, however, is not quite as urgent as the country's interest.

The country negotiators should also recognize that the IMF does have to operate within some genuine constraints,. For example, it needs to treat all ESAF-eligible countries in a relatively uniform manner, and the IMF needs to respect the objectives that have been established for the ESAF program in the ESAF Trust documentation. Despite the IMF's interest in emphasizing these limits, they should not be interpreted as meaning that the IMF is precluded from accommodating a well reasoned position of the country negotiators or from agreeing to special treatment for the unique aspects of a country's situation. In this regard, country negotiators should note that the objectives established for ESAF are the general objectives of promoting economic growth and reducing poverty. There may be many ways to achieve these objectives in a particular country situation. Consequently, it is reasonable for the country to expect that its proposals for structural reform, provided they are consistent with the ESAF program objectives, will be treated with due consideration by the IMF's negotiators.

One important way in which a country can enhance its negotiating position with the IMF, as was suggested by the external reviewers, is to demonstrate that it has taken the time to develop national support for its proposed reform program. Convincing the IMF that this support exists and must be respected is not necessarily easy. It requires convincing the IMF that the support has been achieved through a genuine process of consultation.

An important related issue is the ability of the IMF to engage in political analysis of its member countries. This issue relates not only the question of ownership, but also to the ability of the IMF to evaluate social and poverty alleviation policies. This raises the question of denning the limits on the IMF's mandate. These limits arise from the IMF's specialized mandate, as expressed in its Articles of Agreements, and its practice of not intervening in the political affairs of the member country. The problem is a particularly challenging one for the IMF because it does not have the explicit political prohibition that the World Bank has in its charter[45]. The IMF's Articles only require the IMF to "respect" the social and political policies of its member countries and to pay "due regard" to the circumstances of its members in its Article IV consultations and in its conditionality. However, prudence, respect for sovereignty and the recognized benefits of ownership all suggest that some sort of "political prohibition" makes good operational sense. Defining this prohibition, is not easy, but is essential if the IMF is to legitimately perform its function as a specialized international macroeconomic organization.

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[45] The Articles of Agreement of each of the members of the World Bank Group contain an explicit political prohibition. The members of the World Bank Group are the International Bank for Reconstruction and Development, the International Development Association, the International Finance Corporation, and the Multilateral Investment Guarantee Agency.

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IMF Relations with Other International Organizations

Both the external evaluators report and the staff distillation of lessons propose that the IMF utilize the World Bank's expertise in poverty analysis in addressing issues related to social policy and the composition of government expenditures in ESAF-supported programs. However, it is not immediately clear why the IMF should rely only on the World Bank in this regard. There are other specialized agencies - for example, WHO, UNICEF - which have the legal mandates and expertise to deal with some of these issues. In addition, other actors, including NGOs, may have relevant expertise and knowledge which, if drawn upon, could considerably enhance the IMF's policies.

This suggests that in order to improve its ESAF-related performance, the IMF should review its interactions with the World Bank, other international organizations and with NGOs, particularly those with technical or field expertise. One approach would be for the IMF to establish formal and transparent mechanisms for coordination and dialogue with these other actors and for incorporating their work into its own. These mechanisms could include: formal exchanges of information, staff exchanges, joint training programs, regular joint meetings, joint missions, and joint studies.

The importance of this issue is further emphasized by the IMF's position at the top of the donor hierarchy and as the coordinator of external support for ESAF-eligible countries.

The IMF's Negative Image

Unsurprisingly, only the external evaluators discuss the public perception of the IMF. Even though they emphasize that the IMF's negative image is not always justified, and that it is often blamed for the deeds of other donors, international organization or even for the policies of the government, they make clear there is good reason for the IMF's negative image. This is attributable, in part, to its secretive negotiating style, its inflexible negotiating postures, and its interactions with civil society that leave the non-IMF participants feeling that there was not genuine IMF interest in consultation. The report might also have mentioned the IMF's efforts to portray a monolithic view to the outside world, and the IMF's refusal to admit lack of knowledge or error.

The evaluators discussion of this issue does not go far enough. They do not, for example, state that the same principles of transparency and accountability that apply to IMF member states also apply to the Fund. Now that the IMF plays such an active and intrusive role in the policy making process of its ESAF-supported countries, it is hard to see why it should be trusted to effectively implement its mandate if it does not practice what it preaches to its member state about transparency and accountability.

To its credit, the Fund has begun to move tentatively to address this issue. It has begun to release more information, and to reach out to a broader range of stakeholders. It has also made efforts to begin a process efforts are limited, and often ad hoc. Furthermore, the IMF has not made much effort to create mechanisms through which interested parties can communicate with it or seek to hold it accountable.

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It is regrettable that the evaluators did not discuss this issue in more detail. As the discussion above suggests, this issue is directly relevant to the question of national ownership of Fund programs and to the efficacy with which the IMF conducts its ESAF operations. There are a number of suggestions that can be made for how the Fund can begin addressing these issues. They include the IMF establishing an ombudsman's office, a permanent independent evaluation process, and providing clearer explanations to the public on its modus operandi and activities[46].

VII. Conclusion

he ESAF review process raises important issues relating to the relationship between the IMF and its member states. These issues can help the governments in these member states develop more effective strategies for negotiating with the IMF. In particular, the results of the ESAF review suggest that government preparation for negotiations with the IMF should involve both efforts to consider all alternative paths to adjustment and reform and widespread consultations on these alternatives with stakeholders both inside and outside government. In addition, the government's negotiators should carefully assess the possible areas of flexibility in the IMF's negotiating posture and should capitalize on the opportunities this flexibility offers to advance their own reform proposals. Provided the negotiators can make informed and well reasoned arguments in support of its reform proposals, it may be able to convince the IMF to support their proposals.

In this regard, it is useful to remember that, given that the IMF now acknowledges the importance of ownership to the success of ESAF-supported programs, it needs, if it is to be creditable, to become more flexible in its negotiating position. The reason is that the IMF now needs to demonstrate sufficient indicators of ownership to justify its commitment of ESAF resources to a program. A shrewd negotiating team can use this dynamic to enhance its bargaining power.

The utilization of external evaluators in the ESAF review process was an important step for the IMF. As is to be expected with an institution that has not experienced any external evaluation for 50 years, the external evaluators findings raise important institutional and operational challenges for the IMF. In the coming years the IMF will have to address these challenges. Informed member states and citizens can help ensure that the IMF meets these challenges in a constructive manner that leads to a more responsive IMF and to more "user-friendly" negotiations between the IMF and ESAF-eligible countries.

[46] In this regard, see report of IMF Study Group: Transparency and Evaluation, available from Center of Concern, Washington D.C.

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- Creating awareness among senior government officials of the importance of the legal aspects in the borrowing process and of putting together a multidisciplinary team for loan management and public administration;
- Providing in-depth training and skills development for accountants, economists, financial experts and lawyers coming from government ministries and departments involved in negotiation, financial management and public administration; and
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