



January 8, 2004

Dear Mr. Kohler:

I am writing to applaud the work of the still-new Independent Evaluation Office, and to encourage your more active endorsement of two of the proposals for IMF management and staff implementation in one of the IEO's recent reports.

I and many of my colleagues in the independent policy research and development advocacy community continue to believe that the objectives of the IMF would be best served by some mechanism of completely external evaluation that would complement the work of the current internal unit, including by the periodic commissioning of completely independent and external assessments for review by the International Monetary and Financial Committee. (This was the recommendation of the Task Force of the Overseas Development Council, in its report of April 2000. At the same time, there is no question that the new office's output has demonstrated its own value already, and that is to be roundly applauded.

Regarding specific recommendations that need your support, I refer to the recent report entitled *Fiscal Adjustment in IMF-Supported Programs*. One of the less visible but potentially most important recommendations of that report has to do with the longstanding and highly contentious issue of how IMF programs affect countries' ability to minimize any tradeoff between fiscal adjustment and maintenance of adequate spending on critical social programs. Recommendation #5 says "The IMF should clearly delineate the operational framework in which social issues will be addressed. . . ." A specific proposal then follows:

The IMF could invite the authorities regularly during Article IV consultations to suggest what are the existing critical social programs and social services they would like to see protected in the event of adverse shocks. Participation on the part of the authorities would clearly be voluntary.

Surveillance with routine reporting on this initiative is also proposed as part of a new operational framework.

This potentially important proposal is admirably careful and subtle. But that very care and subtlety leaves it hiding in the shadows. Without a strong message from you and others at the highest levels inside the IMF, it seems unlikely that IMF operational staff in the country and regional departments will be systematic and thoughtful in implementing it. Indeed, the comments of staff on the proposal that were published in the IEO report seem oddly lukewarm. Staff

agreed that they "should be open to discussing with the authorities how their existing social protection systems, or those to be designed, would operate under conditions of financial stringency." This is not responsive to the particular recommendation, which is not that staff should be passively open, but that staff should "invite" the authorities. The staff response seems to reflect a perverse reluctance to take the recommendation as is, with its highly limited but purposefully routine requirement to raise the issue in the context of Article IV consultations. The staff response then refers to the role of the World Bank, and in the usual agreeable words, notes the longstanding commitment of IMF staff (no doubt sometimes honored in the breach, but that is not the point here) to "collaborate effectively with the Bank on these issues." This reminder to the world that social programs are World Bank, not IMF business, also elides completely the point of the recommendation, which is not to judge, design or in any way comment on programs or on social policy, but to consistently and regularly signal to the authorities the IMF's view that good fiscal policy includes advance consideration of what specific social or other spending should be insulated from budget cutbacks.

In the middle-income countries, particularly those in Latin America in which democratic deepening has not been complemented by economic growth in the last decade, the great challenge in the next few years is for economic policymakers and political leaders to avoid sacrificing structural reform because of political pressure, misguided as it might be, to spend too much and spend badly. This is a point you yourself have made.

We now have useful examples of tremendously effective social transfer programs (including Oportunidades, formerly Progresa in Mexico, and Bolsa Familia, an extension of the former program entitled Bolsa Escola in Brazil), that are reaching a large proportion of poor households while spending less than 1 percent of GDP. These programs represent effective public investment, including human capital formation, at the same time that they protect the poorest families from destitution in the worst economic times.

There may also be high quality public investments that governments ought to plan to protect, such as carefully targeted investments in rural school and roads. Inviting authorities to suggest whether and what programs they would want to see protected is fully consistent with the IMF's longstanding role in encouraging sound medium-term fiscal programming, including the logic of fiscal restraint today to permit countercyclical spending tomorrow. The IMF would not only be helping countries protect fiscal adjustment from untoward political pressures; it would be rescuing itself from the widespread perception, ultimately harmful to its effectiveness, that its support for fiscal discipline mindlessly and callously pushes spending reductions that hurt the poor.

The second proposal to which I want to call your attention has to do with tax reform. Chapter 7 of the report notes that IMF support for tax reform has focused heavily on introducing or expanding the VAT and reducing trade taxes, with less attention (has there been any attention at all, anywhere?) to income and property taxes; and to the lack of attention to tax exemptions and evasion. Again the staff response is not encouraging. It invokes the technical assistance work of the IMF on taxes, seeming to willfully ignore the point that there has been little policy or program action in these areas. Again, I believe that the IMF and its borrowing members could benefit from both the reality and the perception of support for modest moves in middle-income

countries to make their tax systems more progressive, by introducing income and property taxes and by greater effort to reduce the exemptions and evasion which in absolute terms imply greater losses to the public purse from better-off households.

I am taking the liberty of copying this letter to Anne Krueger, who is a member of the Advisory Group of the Center for Global Development (but she should not be implicated in any way in these views!) and to Montek Ahluwalia.

Sincerely,

A handwritten signature in cursive script that reads "Nancy Birdsall".

Nancy Birdsall