

# Macroeconomic Performance: Stabilization, Recovery, and Growth

Over the past decade, the average GDP growth rate of IDA countries more than tripled. Thanks to better economic policies, additional resources and favorable external conditions, well over 30 IDA countries are now growing faster than 5 percent a year.

For low-income countries with macroeconomic difficulties and limited access to capital markets, IDA and the International Monetary Fund (IMF) have provided continuous support, even when other sources of development finance have thinned. Advice and financial assistance has contributed to stabilization, recovery and strong growth by:

- **Providing a framework of mutual accountability to stabilize economies and ensure new foreign aid and debt relief.** Country-owned poverty reduction strategies (PRSs) and improved financial management systems led to a doubling of foreign aid to strong reformers such as Tanzania. In addition, the Highly Indebted Poor Country (HIPC) debt relief program and the more recent Multilateral Debt Relief Initiative will result in a reduction in the debt of 29 HIPC countries by almost 90 percent. Pakistan's 1999 reform program was supported by IDA technical advice and financial assistance from IDA and other donors and creditors. This helped reduce the country's public debt from 100 percent of GDP to 55 percent.
- **Facilitating structural reforms and private-sector growth.** In Rwanda, following the reconstruction after the 1994 genocide, IDA supported a widespread reform program that included rationalizing power tariffs, contracting out health services and private management of drinking water supplies. Rwanda is one of the IDA countries growing by more than 5 percent a year. In Tanzania, IDA support for the privatization of telecommunications led to a significant expansion of services.
- **Helping stabilize the macroeconomic situation in difficult environments.** In Indonesia, following the 1998 crisis, and in Sierra Leone, even before the declaration of peace in 2002, IDA provided quick-disbursing funds to maintain economic stability and accelerate growth.

While low-income countries are experiencing robust growth and IDA has played a prominent role in their recovery, there are significant challenges ahead. They include the need to support “second-generation” reforms necessary for shared growth in such areas as public expenditure management, improving the investment climate, and civil-service reform and governance.



## MACROECONOMIC PERFORMANCE OF IDA COUNTRIES

The macroeconomic performance of IDA<sup>1</sup> countries improved dramatically over the past decade. The average GDP growth rate more than tripled—from a meager 1.2 percent a year during 1985-94 to 4.4 percent a year during 1995-2004 and approaching 5 percent in 2005 (see table).

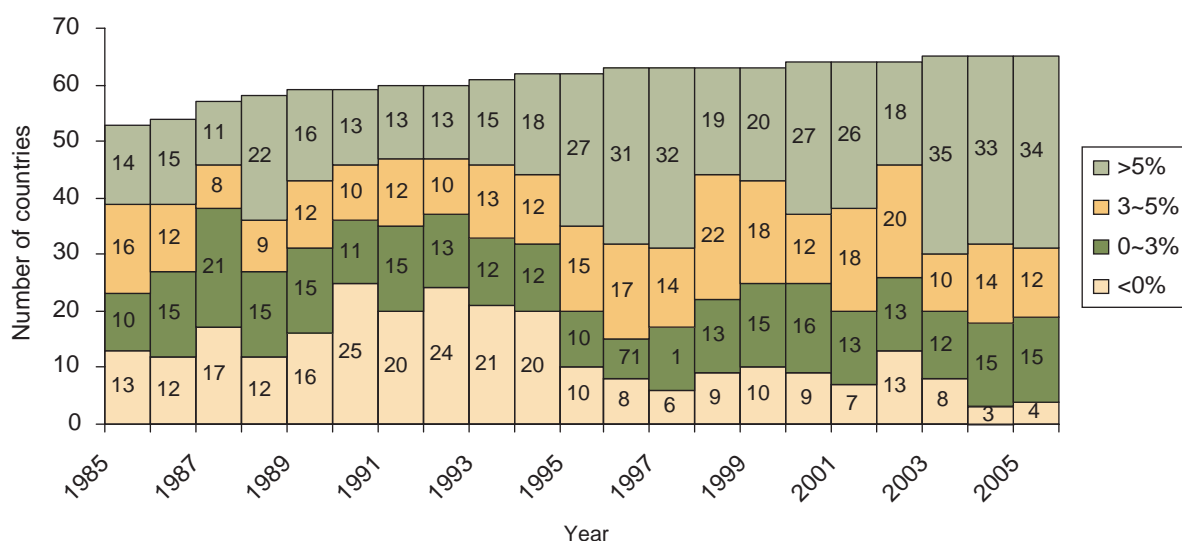
Average GDP Growth of IDA Countries			
Region	1985–1994	1995–2004	2005
All IDA	1.2	4.4	5.0
Sub Saharan Africa	1.5	4.5	5.0
Other IDA	0.8	4.3	4.9

Source: World Development Indicators database.

1. The list of IDA-only countries is fixed at the year 2005 in order to have consistency in the comparison. Hence the approach is conservative as it would exclude countries that have graduated from the IDA list or reached Blend status by 2005 but would include those that have reverted back to IDA only (because of crisis, conflicts, etc.).

This improvement was across the board. The number of countries with GDP growth rates of over 5 percent a year roughly doubled from about 15 countries during 1985-94 to about 27 during 1995-2006 (see Figure 1). In

**Figure 1: Growth Pattern of IDA countries (number of countries by different range of GDP growth rate)**



more recent years (2003-05), that number has reached 33-35 countries. Significantly, the number of countries with negative GDP growth rates declined by half, from about 17 during 1985-94 to about 8 countries in the last 10 years. That number has further dwindled to less than 5 during 2004-05.

## CONTRIBUTING FACTORS

At least three factors contributed to this improved economic performance: better macroeconomic outcomes, additional external resources and a benign global economy.

**Better macroeconomic outcomes.** Key macroeconomic indicators across a growing number of countries improved significantly. Inflation among IDA countries came down dramatically during the past 10 years. The average number of countries able to keep inflation below 10 percent a year increased from about 21 during 1985-94 to about 35 during 1995-2004.<sup>2</sup> Only 1 to 3 countries experienced hyper inflation (greater than 50 percent a year) from 1995-2004, while as many as 9 countries a year did during 1985-94. This performance is all the more remarkable in view of the significant increase in oil prices that started in 1999.

Another indicator of macroeconomic stabilization, the fiscal balance, also improved.<sup>3</sup> As

2. Since average inflation for IDA countries can be greatly influenced by a few instances of hyper inflation (such as inflation rates of several hundred or thousand percent in Angola (93-01), Armenia (94-95) or Nicaragua (85-91)), it is not meaningful to show and compare period averages. Nonetheless, it should be noted that for the more recent period 2000-05, where instances of hyper inflation have almost disappeared, the average inflation rate has declined to single digits: all IDA countries, 8.6 percent; Sub-Saharan African IDA countries, 9.3 percent; and other IDA countries, 7.6 percent.

3. IDA countries are generally constrained from borrowing in international capital markets. Hence, for many poor countries, the other significant macro balance—the current account

a percent of GDP, the average fiscal deficit in IDA countries declined from 7.2 percent during 1985-94 to 5 percent or less in more recent years. The average number of IDA countries with a fiscal surplus or moderate fiscal deficit (less than 5 percent of GDP) is also rising—from about 28 countries during 1985-94 to 36 countries during 1995-2006 and close to 40 for the more recent period 2000-06.<sup>4</sup>

**Increased Aid Flows and Debt Relief.** A second beneficial factor is the volume of net IDA aid flows in constant US dollars, which have slowly recovered from their nadir in 2000 to reach the high point of the early 1990s (Figure 2). Most of this aid goes to the low-income countries of Sub-Saharan Africa. As a percentage of GDP in partner countries, it has not yet fully kept pace (in part due to the countries relatively strong growth performance) and has yet to increase significantly in line with the 2005 Gleneagles' Commitments. Official Development Assistance as a share of African GDP also reflects the same pattern. These figures do not include the significant debt relief that some IDA countries have received.

balance—is not a policy-dependent variable. Imports adjust to export revenues and aid inflows. The forced current account balance in such circumstances is therefore not a meaningful indicator of macroeconomic management or stabilization policy and is not reported and analyzed here.

4. Underpinning this generalized improvement in macroeconomic indicators was an overall improvement in countries' policy framework. One measure of this evolution is the Bank's own Country Policy and Institutional Assessment (CPIA), which evaluates the quality of country policies related to economic management, structural reforms, social inclusion/equity and public sector management and institutions. The rating system of the CPIA has been changing over time (the last overhaul was in 2004), making comparisons over time difficult. Nonetheless, the positive trend in the CPIA scores is unmistakable: from a scale of 1 to 6, the average CPIA rating of IDA countries has increased from 3.1 in 2001 to 3.3 in 2005.

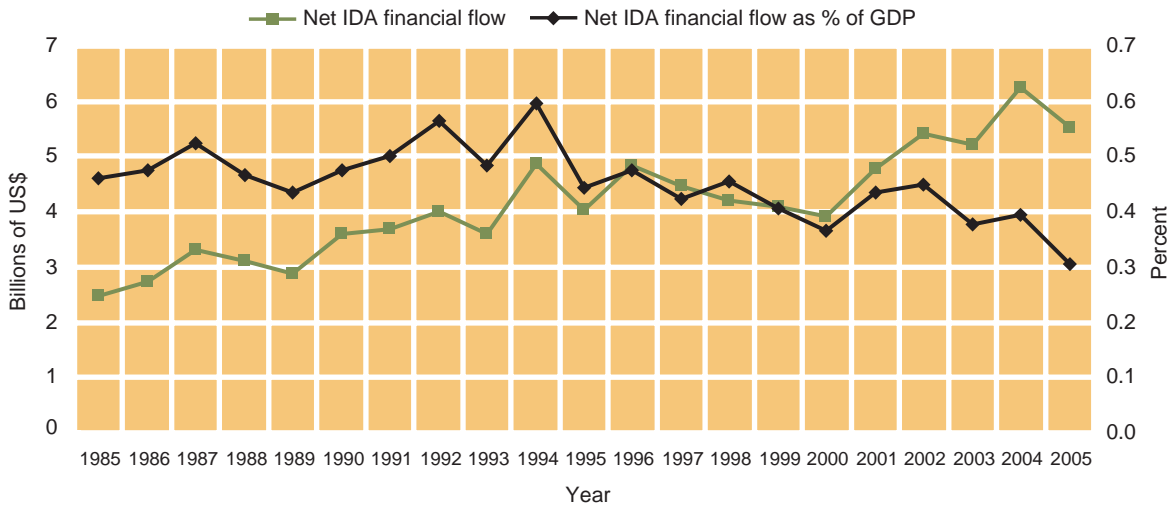
## Debt Relief for Poor Countries

In addition to the Highly Indebted Poor Country (HIPC) debt relief program, the World Bank and the International Monetary Fund recently approved the financing and implementation of the Multilateral Debt Relief Initiative (MDRI). Starting on July 1, 2006, this provides completion point HIPCs with 100 percent debt relief on debts owed to the IMF, the ADF and IDA.

The impact of both HIPC and MDRI is an expected reduction by almost 90 percent in the debt stocks of the 29 HIPCs that are already receiving debt relief. Thanks to HIPC, debt service paid by these countries had already halved between 1999 and 2005 and is expected to decline further as a result of MDRI. In part because of the budgetary headroom created by the reduction of debt service payments, poverty-reducing spending by HIPCs has increased by almost 3 percent of GDP between 1999 and 2005.

All told, the total cost of the HIPC Initiative for the 40 HIPCs is estimated at US\$63.6 billion in end-2005 NPV terms. Moreover, the cost of MDRI debt relief to the 40 HIPCs is estimated at US\$24.6 billion in end-2005 net present value (NPV) terms (equivalent to US\$48.4 billion in nominal terms) of which almost 70 percent will be borne by IDA and 16 percent by the IMF. Of this, US\$13.3 billion and US\$3.0 billion, respectively, have already been delivered by IDA and the IMF to the 20 post-completion-point countries.

Figure 2: Net IDA flows (in billions of US\$ and as % of GDP of IDA countries)



Sources: Global Development Finance Online and World Development Indicators Online.

**External Conditions.** A benign international environment has also contributed to improved growth performance, although its impact has differed. In particular, exports from some African countries like Ghana and Zambia have benefited from higher non-oil commodity prices for metal and minerals such as gold and copper. At the same time, many IDA countries remain vulnerable to external shocks including sudden commodity price declines, drought, or natural disasters which can have a significant impact on growth and poverty reduction. Coffee-exporting countries, for example, lose 2 percent of GDP about once every 5 years to adverse price movements.<sup>5</sup> A recent study of low-income countries in Sub-Saharan Africa found that as their growth performance improved in the late 1990s and early 2000s, the contribution of commodity price shocks to output volatility increased and other factors such as policy failures declined.<sup>6</sup>

While the recent oil price increases have hurt many low-income countries, the ratio of oil to non-oil commodity prices has not risen as sharply as it did during the previous oil shock of 1973–1980. Moreover, higher oil prices now benefit about 10 oil-exporting countries in Sub-Saharan Africa, including Nigeria, Angola, Equatorial Guinea, Gabon, Congo, Sudan, Chad, Cameroon, Cote d’Ivoire, plus a few others in the near future. The situation is different for other IDA countries, especially the oil-importing countries of South Asia, whose terms-of-trade continued to deteriorate during the first half of this decade.<sup>7</sup> Finally, growing remittances also contributed to the improved balance of payments and macrostability in many countries.

5. See, for example, a draft mid-term review paper, World Bank (2006). “IDA Countries and Exogenous Shocks.”

6. Raddatz (2006). “Exploring the Impact of Oil Price and External Shocks in African Countries.”

7. Devarajan and Ghani (2006), “Oil Price Shocks, Fiscal Adjustment and Poverty Reduction in South Asia.”

## IDA’S ROLE

For low-income countries with very limited opportunities to borrow in commercial financial markets, IDA (operating in tandem with the International Monetary Fund) has been the main source of policy advice and financial assistance for macroeconomic stabilization and growth. Between 1990 and 2006, 102 IDA countries have received at least one—and in some cases about 10—policy-based loans aimed at stabilizing the economy and restoring economic growth. IDA’s contribution has been significant and distinctive for several reasons.

**Crowding-in aid and debt relief.** For low-income countries facing short-term macroeconomic distress or persistent fragile economic environments, the IMF and IDA are often the only source of technical advice and financial assistance.

In 1999, Pakistan’s debt-to-GDP ratio was almost 100 percent, interest payments consumed half the country’s tax revenues and growth had come to a halt. Following the country’s May 1998 nuclear test, foreign capital flows dried up, triggering a foreign exchange crisis. IDA and the IMF worked with the government and creditors to restructure existing debt, mobilize concessional loans, and restructure public expenditures to create fiscal space for education, health, and other poverty-related spending. The improved policy framework enabled IDA to lend Pakistan US\$500 million a year over the last six years. Other donors followed suit and foreign direct investment quadrupled to US\$3.4 billion.

**A framework for mutual accountability.** Since 2002, country-owned poverty reduction strategies (PRSs) have provided a framework around which IDA and other donors can scale

up aid and debt relief. The PRS approach, introduced by the Fund and the Bank in 1999, helps countries articulate development priorities to accelerate poverty reduction and specify the policies, programs, and resources needed to meet their goals. In recent years, countries, often benefiting from public financial management support from IDA, have strengthened budgetary institutions to reflect PRS priorities in budgetary allocations and subsequently monitor progress and results. This has helped craft an accountability framework for improved efficiency in public spending as well as increased levels of budget support and scaled up aid.

- IDA has made a major contribution to the budget-making process in Tanzania, which has helped create trust and accountability among various public and private stakeholders and significantly improved the quality and transparency of fiscal management and crowding in of aid. Following IDA's shift to general budget support to Tanzania in the mid-1990s, total foreign aid to the country doubled by 2002. About 36 percent of aid to Tanzania is general budget support, which has enabled a shift in public expenditures towards growth and poverty-reducing sectors such as water, health, education, and transport.<sup>8</sup>
- In Rwanda, IDA has supported specific measures to put in place key budget institutions and regulations. An Institutional Reform Credit of US\$85 million supported the government in implementing its first PRS and adopting a medium-term expenditure framework to budget planning and execution, which was later deepened by a PRS credits and grants (PRSC/G) series that

supported results-based budgeting, fiscal decentralization and modernization of financial management and procurement.

**Facilitating structural reforms and private-sector growth.** In addition to helping countries in macroeconomic distress stabilize their economies, IDA, because of its long-term engagement, analytical work and wide scope, has helped many low-income countries embark upon structural reforms critical for sustained growth.

In Tanzania, IDA support for privatization of the telecommunications sector led to a significant expansion of services and privatization of tourism and mining has been linked to a doubling of foreign direct investment. In Vietnam, the policy dialogue combined with an extensive lending program (five poverty reduction support credits) led to major reforms in trade integration, financial and non-financial enterprise reform, infrastructure, social sector spending and natural resources management. In Mozambique, IDA played a key role in leveraging private capital inflows by supporting an investor-friendly business climate and providing IDA/IBRD and Multilateral Investment Guarantee Agency (MIGA) guarantees for private sector investments.

**Promoting macro stability in difficult environments.** IDA, together with the IMF, provides financial and technical support to countries confronting macro instability due to conflict, financial crises and natural disasters.

- In Sierra Leone in 1999, even before the formal declaration of peace was signed, IDA provided quick-disbursing funds and non-lending services to support the Government maintain economic stability and accelerate growth. Between 1999

8. Lawson et al. (2006), "Does General Budget Support Work? Evidence from Tanzania."

and 2005, IDA provided US\$135 million to finance four economic rehabilitation and recovery operations that provided not only much-needed foreign exchange, but also initiated structural reforms in mining and telecommunications that encouraged private sector investment.

- Ethiopia has experienced numerous shocks (mainly from war and drought) in recent years and IDA has played a major role in

mitigating their impact on development. After the change of government in May 1991, IDA coordinated a program of multi-donor support totaling US\$650 million that helped jump-start the economy, rebuild war-damaged infrastructure, provide essential medicines and begin the transition to a market economy. More recently IDA has been supporting an innovative program to support local development in this challenging environment.

### Rwanda – IDA's Support for Policy Reforms with PRSC/G Series 2004–06

Following a period of reconstruction after the 1994 genocide, IDA has been supporting Rwanda to secure its broad-based economic recovery by implementing a wide-ranging policy agenda that includes reforms in public financial management, transparency and accountability, monitoring and increasing social service delivery and private sector development. A Poverty Reduction Strategy Paper (PRSP) was put in place in 2002 by the government and since 2004, IDA assistance has moved towards budget support in the form of Poverty Reduction Support Credit/Grants (PRSC/G): US\$15 million credit and US\$50 million grant in 2004; US\$55 million grant in 2005; and a US\$50 million grant approved in 2006.

**Results.** Rwanda is one of the IDA countries growing by more than 5 percent a year - the initial rebound led to a 10 percent GDP growth a year from 1995–2005, but recent growth during 2000–05 is still 5.3 percent a year. Likewise, inflation in these two periods has been maintained at 6 to 6.5 percent a year. The experience of the PRSC/G series indicates that outcomes have been most remarkable in the area of service delivery, particularly in health, education, water and energy:

- Net primary school enrollment reached 92 percent in 2004 and 2005, exceeding the PRSP target for 2008; the primary completion rate increased from 51 percent in 2004 to 55 percent in 2005 (but fell short of the target).
- In health, the contractual approach for community health centers, piloted in Cyangugu and Butare in 2004 and expanded to all health centers in the country, transferred about US\$0.50 per capita in 2006 (to be increased to US\$1 per capita in 2007). Various health services improved: utilization of insecticide treated nets increased from 4 percent in 2005 to 30 percent in 2006; utilization of assisted deliveries increased to 39 percent of the population, from 29 percent in 2000; coverage by *mutuelles* (community insurance schemes) increased from 27 percent in 2004 to 41 percent in 2005.
- Access to potable water increased between 2001 and 2005 from 41 percent to 55 percent in rural areas and from 66 percent to 69 percent in urban areas. In 2005, an additional 598,000 persons living in rural areas gained access to potable water against 167,000 in 2004. Functionality of the rural water systems increased to 75 percent and 8 percent of the 830 piped water systems are privately managed.
- In energy, a revised electricity tariff balanced protection of industrial consumers and cost recovery requirements. Power failures have been significantly reduced with procurement of diesel generators (with topping up from PRSG funds) to supplement generation capacity, and rapid progress on the Lake Kivu methane gas development is being made.

## EMERGING ISSUES

While IDA support has enabled low-income countries to stabilize their economies and resume growth, there remains a huge, unfinished agenda of structural reforms for accelerating and sustaining growth. The challenge for the future is to build on the success of IDA in achieving stability and growth, to support the “second-generation” reforms of public expenditure management, improving the investment climate, civil-service reform and governance and to reach the ultimate goal of a world free of poverty.

In addition, many of the IDA countries face significant institutional and governance challenges making it difficult to scale up development finance for faster results. The case of Rwanda described above shows that much progress can be made to bring about macro stability, growth, significant structural reforms, as well as social outcomes. But it also shows the magnitude of the challenge ahead, a challenge that IDA can help low-income countries meet in the way it has helped them achieve macroeconomic stability and growth.

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<http://www.worldbank.org/ida>