Zambia and Sri Lanka need IMF programs—macroeconomic disequilibria are impeding access to orderly foreign finance in both cases, classic IMF program territory.

Zambia’s program has just begun, while that for Sri Lanka is imminent.

The central parameters in the IMF conditionality for both are already known, even though full details are only available for the Zambian program. Zambia must secure a fiscal primary surplus of 3.2 percent of GDP by 2026, and Sri Lanka a primary surplus of 2.3 percent of GDP by then.

Everything else in the IMF conditionality is derived from those two pivotal numbers, including the fiscal revenue and expenditure envelopes, the fiscal balance path from here to those terminal points, and all the specific policy steps required to deliver all that.

And those pivotal numbers are themselves derived from the target external debt service in each case.

However, those primary surplus targets are indefensible and are the product of fundamental flaws in IMF priorities and corresponding work practices.

**Best Peers**

To see how and why, consider the following charts.

They show the average outturns for the primary balances for 2000-19—i.e., across several cycles, and undistorted by covid—for a selection of the trend-fastest-real-PPP-GDP-per-capita growing macroeconomic peers of Zambia and Sri Lanka over that period—a balanced panel, with half the peers with higher PPP GDP/Capita, and half lower than Zambia and Sri Lanka respectively:

**Fastest Trend Growth Peers**

*Average Fiscal Primary Balances, 2000-2019 in Percent of GDP*

<table>
<thead>
<tr>
<th></th>
<th>Zambia</th>
<th>Sri Lanka</th>
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<tbody>
<tr>
<td></td>
<td><img src="chart_zambia.jpg" alt="Chart for Zambia" /></td>
<td><img src="chart_sri_lanka.jpg" alt="Chart for Sri Lanka" /></td>
</tr>
</tbody>
</table>

Source: IMF WEO Spring 2022
The average primary balance of Zambia’s fast trend growing peers is a deficit of 1.3 percent of GDP, and of Sri Lanka’s, a deficit of 2.0 percent of GDP.

So not a single one of their fast growing peers recorded an average surplus across cycles at the level that the IMF now insists is necessary for the medium term for Zambia and Sri Lanka.

And as the following charts show, those target primary surpluses are also far adrift of what the IMF itself regards as appropriate for those same peers looking ahead to 2027—in the same global macroeconomic and post-pandemic environment to which the IMF conditionality for Zambia and Sri Lanka applies.

The average primary surplus the IMF recommends for Zambia’s fast growing peers for 2027 is a deficit of 0.3 percent of GDP, and for Sri Lanka’s high growing peers, a deficit of 1.5 percent of GDP.

And only one of their fast growing peers—Botswana, a precious minerals exporter—is recommended by the IMF to attain a primary fiscal surplus by 2027 anywhere near the levels it demands of Zambia and Sri Lanka.

Thus, the IMF requirements for Zambia and Sri Lanka are substantially deviant both from past best peer practice and from the IMF’s own assessment of best peer practice to 2027—of the order of 4 percentage points of GDP in both country cases.

And that is not all. The IMF target for Sri Lanka also deviates substantially from its pre-disorder record up to 2020—when it was among the strongest growing income per capita countries in the region accompanied by modest primary fiscal deficits. So the IMF fiscal anchor for 2027 is not even congruent with Sri Lanka’s own pre-blowout successful economic record.

Source: IMF WEO Spring 2022
The following table summarizes:

<table>
<thead>
<tr>
<th>Fiscal Primary Balances</th>
<th>IMF targets 2026</th>
<th>Best Peers</th>
<th>IMF target Deviances from Best Peers</th>
</tr>
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<tbody>
<tr>
<td></td>
<td>Outturn</td>
<td>IMF Recommended</td>
<td>From outturn</td>
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<tr>
<td>2000-19</td>
<td>2027</td>
<td>2000-19</td>
<td>2027</td>
</tr>
<tr>
<td>Zambia</td>
<td>3.2</td>
<td>-1.3</td>
<td>-0.3</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>2.3</td>
<td>-2.0</td>
<td>-1.5</td>
</tr>
</tbody>
</table>

Source: IMF

Thus, the concern here is not about errors in multipliers but is with the terminal goals: the primary balance targets for 2026 on which all other IMF program conditionality hangs.

So why does the IMF, even finally with female leadership at its core, impose overall fiscal targets lacking any basis in the behavior of the best peers?

Not because

The answer cannot be “because of their excess public and external debts” because both programs include—indeed are largely motivated by—restructuring their debts. So instead the question is why the extent of restructuring envisaged is so inadequate—as measured by the consequent necessary deviation of each cases’ primary balance target relative to macroeconomic peer best practice.

Nor can the answer be “because they have gone so far wrong—including Sri Lanka recently cutting VAT and overfunding the military—and so are starting from major disequilibria”. The point of IMF programs is to take countries from disequilibria back to sustainability. So the starting imbalances do not determine the sustainable end-point. Structural conditionality en route should also substantially replicate the proven arrangements of best peers rather than one-size-fits-all naive Econ 101 priors.

Nor can the answer be “to do even better than the best”. In regard to the primary balance, that means combinations of raising taxes higher than necessary or/and cutting expenditures, including on necessary infrastructure, education, and the other investments in human capital. Both are not only painful but the damage done to trend and potential output by such excessive zeal on the primary balance is manifestly evident in the data and thus has no macroeconomic merit.

And nor can the answer be that “well, we can always take another crack at the conditionality as we go along through the program.” The core case against the IMF demands is already evident. And such misspecification of conditionality at program outset itself affects the economy’s response and imposes
immediate undue burdens on fragile fiscal institutions and political balance. It thus runs counter to the overarching purpose of programs—stabilization—as the Greeks 2010 can attest.

So if the core IMF fiscal conditionality is so ungrounded, why did Zambia and Sri Lanka sign up?

**Debtors’ Prisons**

The practice of debt collection at the expense of output was once embodied in the institution of debtors’ prisons—a seamstress, imprisoned for defaulting, was unable to produce dresses in jail, cutting output, but creditors nevertheless put her there there to pressure others to pay on her behalf.

That institution—though vehemently defended by creditors at the time as necessary on moralistic/punishment/financial stability and “pour encourager les autres” grounds, none of which have been validated post abolition—is now regarded as utterly beyond the pale for individual and corporate debtors. Anyone seriously proposing its reintroduction would be disbarred from polite society.

Yet exactly that practice—sacrificing output to debt collection—persists for Sovereigns via such excessive IMF targets for fiscal primary surpluses—as both these programs and others as I have noted elsewhere illustrate.

And affected authorities sign on because protesting in a Debtors’ Prison will make matters even worse.

**Action**

To correct all this, I proposed earlier that the Debt Sustainability Analyses (DSAs) which are routine in all IMF program staff reports should be subordinated to new Growth Sustainability Analyses (GSAs) rather than as now—implicitly given total absence of GSAs—vice versa.

In particular, those GSAs should constitute at each program outset precisely the balanced panel best peer group analysis that is outlined here for Zambia and Sri Lanka, supplemented by formal estimates of the level of GDP 5 years ahead that is lost to programmed deviations from such peer norms.

Any such deviations from those peer fiscal norms would have to be justified by IMF staff in those GSAs on grounds that the authorities were unwilling to adopt their best-peer policy practices, with each such key issue itemized, or reflecting some other exogenous special factor, such as the terms of trade, which significantly distinguishes the outlook from best peers.

And the aggregate and nature of debt restructuring and the quantum of program financing by the IMF would be calibrated from parameters derived from GSAs, not DSAs. Thus, programs would by default be oriented to sustain growth—the founding purpose of the IMF—rather than to sustain debt.

All that would correct flaws in current IMF priorities and work procedures by obliging it to defend program anchor fiscal targets and debt restructurings which are deviant from peer success cases.

**Zambia and Sri Lanka**

In these two cases, absent individually itemized explanations for deviations from best peers, the appropriate order of magnitude of the primary balance targets for Zambia and Sri Lanka are those the IMF recommends for those peers.
That means balance for Zambia by 2026, not the IMF-required 3.2 percent of GDP surplus, and a
deficit of 1½ percent of GDP for Sri Lanka, not the IMF-required 2.3 percent of GDP surplus.

Debt restructuring and IMF financing should be parameterized off of those corrected numbers—not the surplus targets on which the IMF insists.

That would require Sri Lanka to completely reverse its post 2019 fiscal blowout but no more—as it was broadly on track before. It is more demanding of Zambia because structural private savings rates of its peer group are lower. But in neither case are there any grounds for IMF fiscal overkill.

Inaction

Sadly, no surprise that the IMF has not taken this counsel, either on these balance target numbers for Zambia and Sri Lanka nor on the related broader proposal on its work priorities and practices.

Instead it demands outlandish growth- and stabilization-compromising medium-term primary surplus targets because it has been captured by the principal creditors—both public and private—to Sovereigns and it acts as Debtors’ Jailer on those creditors’ behalf. It does not wish its de facto status in that regard to be obvious from its own routine program documentation.

So the IMF, as captured, chooses in its programs to sustain debt than to sustain growth—even in the midst of concern with global war-related recession—often employing exactly the same combination of discredited moralistic/punishment and "for the best" justifications alongside ostentatious displays of its earnestness and decorum as creditors once advanced in support of Debtors’ Prisons.

And with this backstop assured, creditors—including those in China—are willing to lend into clearly unsustainable situations, which both diminishes the role of the Fund and delays policy correction.

All this underscores the importance of long-standing fundamental critiques of IMF governance.

Unacceptable

Yes, It’s Mostly Fiscal.

But with formal IMF Board assessment of the program for Sri Lanka imminent, no fingers should be pointed at the present Zambian and Sri Lankan authorities by signing up—even, given their predicament, to the shameless IMF assertion that these programs are "home grown".

Instead, imposition by the IMF of outlier fiscal primary balance targets on such Sovereigns should be utterly unacceptable in polite society.

Peter Doyle
Washington DC
September 14, 2022