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Designing Expenditure Policy Conditionality in IMF-Supported Programs

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Designing Expenditure Policy Conditionality in IMF-Supported Programs

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ABSTRACT: This gap-filling paper provides granular advice on how to design quantitative and structural conditionality of IMF-supported programs in six expenditure policy areas: social assistance, energy subsidies, pension spending, health spending, education spending, and wage bill management. Such granular advice is based on a stocktaking exercise: an analysis of 105 programs approved between 2002 and July 2021 containing c.a. 1400 conditions. Conditions are key to identify outcomes or actions seen as critical for program success or monitoring, and so are essential for financial support countries can receive from the Fund.

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WORKING PAPERS

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I. Introduction and Executive Summary

IMF member countries can receive financial support through IMF-supported programs to address balance of payment crises and provide space for implementing needed macroeconomic adjustment policies. The objectives and adjustment strategies are based on a common understanding between country authorities and the IMF on how to address balance of payments (BOP) difficulties and achieve medium-term external viability. (Quantitative and structural) conditionality are key components intended to identify key outcomes or actions seen as critical for program success or program monitoring.

A review of conditionality since 2002 shows that conditionality on expenditure policy has been dominated by energy sector and social assistance policies[1]. Energy sector conditionalities represent 35 percent of all expenditure policy (EP) conditionalities, social assistance (social spending floors) 24 percent, civil service reforms 17 percent, pension reforms 14 percent and health, education, and water sector policies together 10 percent. In absolute numbers EP conditionality is dominated in Sub-Saharan Africa (SSA) due to the large number of approved programs. However, adjusted for the number of approved programs, EP conditionality is prevalent in all regions. The type of conditionality differs by topic and region. Prior actions are mainly formulated for energy subsidy reforms, typically related to the need to increase energy prices specifically in Middle East North Africa and Pakistan (MENAP). On the other hand, indicative targets (IT) are mainly formulated in social assistance as a floor on social spending, mainly in SSA and low-income and developing countries (LIDC).

In 2018 the IMF conducted a detailed review (2018 Review of Program Design and Conditionality) of both quantitative and structural conditionality in numerous areas. Nonetheless, as a full-spectrum IMF Board paper, it only touched certain expenditure policy areas, but did not explore them in detail. At the same time, a series of Background Papers published recently (IMF, 2022) or upcoming are a deep-dive in certain expenditure policy areas, without focusing on IMF-supported programs, though. This paper fills in a significant gap and provides a bridge between conditionality and expenditure policies, such as social assistance, energy subsidies, pension spending, health spending, education spending, and wage bill management.

In each area, the starting point are the channels through which an area is deemed to be macro-critical. These include fiscal sustainability, spending adequacy, and spending efficiency (IMF, 2019b). In each area we discuss criticality and parsimony, and how conditionality should rely on technical assistance (TA) and Article IV (AIV) findings. Conditionality must be critical to the achievement of program goals or to monitoring implementation, and it should be limited to the minimum necessary (i.e., parsimonious). Since the judgment of criticality depends upon program goals and the strategies adopted to achieve them, these should be set out as clearly as possible. Furthermore, setting ambitious but realistic timetables can help ensure that conditions are actually met. Finally, conditionality should be informed by AIV consultations and technical assistance; the latter is particularly relevant in countries with capacity or political economy constraints.

Conditionality in social assistance can be set in several ways depending on the status of social assistance, policy objectives and institutional capacity. The analysis should start by assessing current social programs which could be included in structural conditionality. Structural conditionality could also be set around measures critical for introducing a new social assistance program such as identifying households, implementing delivery

[1] A review of expenditure policy conditionality is conducted using the “The Monitoring of Fund Arrangements” database.

systems, and designing eligibility criteria and benefit formulae for social assistance. An indicative target could be used to ensure sufficient resources. If an existing social assistance program has the potential to turn into a desired program, conditionality could be set in this area. Given time and capacity constraints, often a combination of measures and hence conditionality should be considered. An IMF-supported adjustment program may be necessary to ensure macro stability but may have significant negative effects for the most vulnerable. Scaling up of current (possibly imperfect) social assistance programs should be complemented with necessary steps to strengthen social assistance over the medium term. Motivation and further explanation of policy measures should be included in the Memorandum of Economic and Financial Policies (MEFP) while technical details including the definition of a floor of social assistance spending should be clearly defined in the Technical Memorandum of Understanding (TMU).

Conditionality in energy subsidy reform should be designed around key measures for energy subsidy. In this context, prior actions and structural benchmarks are often used in IMF-supported programs. Designing a comprehensive energy subsidy reform and quantifying the size of energy subsidies is a key step but often does not require conditionality. Contrary, phased price increases are often critical to program success and could be included in structural benchmarks or prior actions, if upfront implementation is crucial. Depending on the type of energy product (fuel, electricity, or natural gas) and policy priorities, price increases can be formulated in nominal terms, percentage increases or increases relative to cost recovery rate. Mitigating measures are also critical to program success and can be set as structural benchmarks or an indicative target (see also above). Given its nature, reforms to depoliticize energy pricing, implement a communication plan, and improve the efficiency of SOE's lends itself more for structural conditionality. Automatic pricing mechanism can also be set as a continuous structural benchmark. In some critical cases, indicative targets can be set on the size of energy subsidies or on the accumulation of arrears to or from energy companies such as SOE's. Finally, MEFP's and TMU's should be used to motivate and outline measures in more detail.

Public pension spending, one of the largest expenditure items is macro-critical via several channels, and key milestones can be best set as structural benchmarks. According to the 2018 Review of Program Design and Conditionality, 1 out of 10 IMF-supported programs contained pension conditionality in the past. Some countries already have a high level of public pension spending, while others face pressures in the future arising from a need for higher pension coverage, higher level of pensions, or an aging population. Inadequacies and inefficiencies might also warrant critical reforms. Key milestones can be set as structural benchmarks; as pension reforms are usually complex and long reforms, quantitative targets are less appropriate. Conditions can be set not only on pension reforms per se, but related areas (such as labor markets or social assistance). As pension reforms are complex, they might need to be dealt with in subsequent IMF-supported programs. At the same time, their impact could span far beyond public pension spending, such as in the areas of labor markets and capital market development.

Even though health and education are clearly macro-critical, there are far less examples of IMF-supported programs from the past. If public health spending is not adequate and the health indicators worsen, there is a risk of not promoting growth (due to worse labor market and productivity outcomes), or not protecting the vulnerable. Additional fiscal pressures might also arise in the future. There is a considerable risk of fiscal unsustainability given the fact that most non-advanced economies would need to increase public health spending to achieve universal health care goals. In case of education, spending needs can result from rapid population and technological growth, and a fight against low basic skill levels and skill mismatches. Furthermore, after the pandemic, there might be generations lagging on education with long-run impact on human capital accumulation. Interlinkages between health and education are also important: both in terms of

financing needs and competition, and their positive impact on each other (better health contributes to better education, and vice versa). Health and education reforms need to take the form of structural benchmarks or prior actions, while quantitative conditions can help with financing constraints.

Carefully crafted public wage bill reforms can be included as part of structural conditionality. While public sector wage bill is macro-critical through all three channels IMF-supported programs often focus on the fiscal sustainability channel. Conditionality can be set around compensation or employment measures. Measures regarding the public-private wage bill, periodic or in-depth reviews of compensation, streamlining non-wage compensation and increasing transparency on compensation could be included in structural conditionality. Employment-related measures that could be included in structural benchmarks would include limiting new hiring, eliminating ghost workers and double dippers or a functional review. As the public wage bill is not assumed to be a macroeconomic variable, it lends itself less for conditionality in this area. However, some quantitative conditionality have been formulated in IMF-formulated programs before 2015 and most recently in 2021.

The structure of the paper is as follows. In section II we provide a general guidance on conditionality in IMF-supported programs. In section III we take stock of expenditure policy conditionality since 2002. In section IV we talk about our granular advice in each expenditure policy area: social assistance, energy subsidies, pension spending, health spending, education spending, and wage bill management. Finally, in section V we conclude. The annexes provide some useful background material about conditionality and expenditure policies.

II. Conditionality in IMF-supported Programs[2]

A. Lending instruments and conditionality

IMF member countries can receive financial support through IMF-supported programs to address balance of payment crises and provide space for implementing needed macroeconomic adjustment policies. All IMF members are eligible to access the General Resources Account (GRA) on non-concessional terms. Low-income countries can also access funding on concessional terms through the Poverty Reduction and Growth Trust (PRGT). Both lending instruments are tailored to the type of adjustment needed and the expected duration of financial support. As regards non-concessional financial support, Stand-By Arrangements (SBA) typically cover a shorter period of 12-24 months and are frequently used during acute crisis episodes (e.g., the Global Financial Crisis, GFC). Extended Fund Facility (EFF) arrangements support more comprehensive programs, including when policy reforms are needed to correct structural imbalances over an extended period (duration of up to four years). For concessional lending operations, arrangements under the Extended Credit Facility (ECF) serve a similar purpose as EFFs. Both EFF and ECF instruments, designed for addressing structural impediments or slow growth, have become the most common instruments in recent years, and a new instrument which can be key in the future is the Resilience and Sustainability Trust (RST). There is also the

[2] Main sources are IMF (2014b) and IMF (2018a). The glossary provides detailed definition of terminologies used in this section.

"blending" of GRA and PRGT instruments—after reaching a particular level of development, as a first step towards graduation from PRGT, countries are expected to blend, i.e., not rely fully on concessional financing[3].

The objectives and adjustment strategies of IMF-supported programs are based on a common understanding between country authorities and the IMF on how to address BOP difficulties and achieve medium-term external viability. Conditionality, introduced in the 1950s, is a key component of programs and intended to identify key outcomes or actions seen as critical for program success or program monitoring. There are two forms of conditionality: quantitative and structural.

Quantitative conditions include quantitative performance criteria and indicative targets. The definitions of various aggregates included in the QPCs and ITs are set in the technical memorandum of understanding (TMU)[4].

- *Quantitative Performance Criteria*: QPCs are specific and measurable conditions that always relate to macroeconomic variables under the control of the authorities. Such variables include monetary and credit aggregates, international reserves, fiscal balances, and external borrowing. Examples are the need to achieve a minimum level of government primary fiscal balance or a ceiling on government borrowing.
- *Indicative Targets*: ITs may be set for quantitative indicators to assess progress in meeting a program's goals. Sometimes ITs are set on macroeconomic variables instead of QPCs when there is uncertainty about macroeconomic trends—as uncertainty is reduced, these targets may become QPCs, with appropriate modifications. Examples are minimum levels of domestic revenue collection and minimum levels of social assistance spending.

Structural conditions include structural benchmarks (SB) and prior actions (PA). SBs and PAs are reform measures that are often not easily quantifiable.

- *Structural Benchmarks*: In contrast to a QPC or an IT, a SB should include a structural element of a reform. For example, a SB would specify the development of a social registry of vulnerable households rather than specifying an increase in social spending.
- *Prior Actions*: When upfront implementation is essential to achieve program goals or monitor implementation, PAs are measures which a country agrees to take before the IMF Board approves financing, completes a review, or grants a waiver. In certain cases, measures can be amended, including by making them a PA for completing a program review. PAs are also often used when a country has a weak track record of implementation and when there are significant doubts that the measure would be implemented at a later date. However, staff needs to be mindful of the possibility that PAs may be implemented without genuine ownership of the program, and that implementation may be nominal or temporary as a result.

[3] Countries are expected to blend if their per capita income exceeds the prevailing International Development Association operational cutoff, or if per capita income exceeds 80 percent of this threshold and the country has sustained past and prospective market access. However, countries meeting the income or market access thresholds that are also at high risk of debt distress or already in debt distress are not expected to blend, providing them with cheaper funding to reduce their debt service burdens. See IMF (2018b) and IMF (2021) for more information on blending.

[4] The technical memorandum of understanding is not conditionality, but rather sets out the understanding between the country authorities and the IMF regarding definitions of QPCs and ITs, their adjustors, and data reporting.

The scope of conditionality has expanded over recent decades. Until the 1980s, conditionality typically centered on monetary, fiscal, and exchange rate policies, i.e., the Fund's core areas of expertise. Since then, it has also often targeted macro-structural weaknesses in other domains: shared (with other agencies, e.g., labor market reforms) and non-core (e.g., agricultural policies). This shift reflects the recognition that, in a context of intensifying economic integration, various structural weaknesses need to be addressed to avoid future macroeconomic and financial instability. More recently, structural reforms featured heavily during IMF-supported programs in the European monetary union, given that a common currency puts a premium on structural reforms to achieve economic adjustment. The possible economic transformation that could follow today's COVID-19 crisis may well trigger another period of heightened structural reforms.

B. Criticality, parsimony, and program reviews

Conditionality must be critical to the achievement of program goals, to monitoring implementation, or necessary for the implementation of specific provisions under the Articles of Agreement. According to the Guidelines on Conditionality (GN 2002; IMF, 2002) and Revised Operational Guidance to IMF Staff on the 2002 Conditionality Guidelines (Revised 2014 GN; IMF, 2014b), leaving aside conditions necessary for implementation of provisions under the Articles, a judgment that a condition is of critical importance means that if it was not implemented then program goals would not be achieved, or program monitoring would not be possible. Conversely, all critical measures generally must have conditionality associated with them. The criticality criterion applies to all conditions whether in the Fund's core areas of expertise (such as fiscal, monetary, and financial areas) or outside, or whether they are or are not covered by another agency's (e.g., the World Bank's) conditionality[5].

Criticality is strongly linked to parsimony, another major consideration when designing program conditionality. Conditionality should be limited to the minimum necessary to achieve program goals or to monitor program implementation. Parsimony in the use of conditionality requires program objectives to be specific to help identify the most critical reforms needed to achieve them. In the 2018 Review of Program Design and Conditionality (2018 ROC; IMF, 2019a), Directors called for further prioritization of reforms to ensure parsimony of structural conditionality.

Since the judgment of criticality depends upon program goals and the strategies adopted to achieve them, these should be set out as clearly as possible. At the time of approval of a new arrangement, the staff report should lay out the links between program goals and reforms and the corresponding structural conditionality. All staff reports also need to indicate as clearly as possible what is expected in the subsequent reviews. The setting of narrow and specific program objectives can help identify the most critical structural conditions. The level of detail of conditions should also be balanced and formulated in a way that national authorities are clear about the measures on which access to Fund resources depends. However, a high level of detail can run the risk of micro-management in how program objectives are achieved or make it unnecessarily difficult to meet all components. Since structural conditions are used for monitoring program implementation, they should be phrased as precisely as possible to avoid multiple interpretations.

Ambitious but realistic timetables can help ensure conditions are met. While the authorities should be free to set demanding timetables where they consider them helpful in driving their policy agenda forward, staff should not press for overly ambitious timetables to avoid frequent requests for waivers. Recognizing the complexity of

[5] Annex III provides a detailed breakdown of core, shared and non-core structural conditions.

structural reforms, careful sequencing of structural conditions can also improve prospects for successful implementation (2018 ROC).

The required action when failing to meet conditionality depends on the type of conditionality. A failure to meet a SB does not by itself automatically interrupt a purchase or a disbursement, but it serves as an indicator that the program may be off-track. Completion of the review would then require a judgment by the IMF Board that there are other factors giving confidence that program objectives are being achieved. In case of substantial deviations and weak commitment to correct slippages, staff and Management could decide not to propose completion of a review. If a country misses a QPC, the IMF Board may approve a waiver if it is believed that the program will still succeed. This may be because the deviation was minor or temporary, or because national authorities are taking corrective actions. Missed ITs do not require waivers, but – similar to SBs – they are assessed in the context of overall program performance. Consideration of country circumstances when setting conditions is in general crucial to help ensure a realistic program timetable for conditions to be met. Insufficient prioritization or sequencing could also lead to frequent modifications in structural conditions.

Conditionality should be clearly presented in program documents and be informed by AIV consultations and technical assistance. Specific tables setting out QPCs and ITs are required in program documents. All structural conditionality is also routinely identified in program documents in the form of tables in the Letter of Intent (LOI)/Memorandum of Economic and Financial Policies (MEFP). Both the Revised 2014 GN and the 2018 ROC highlight the need for program objectives, conditionality, and the structural reform agenda to be informed by AIV consultations and TA (both by IMF staff and external TA). Relatedly, in a program context where time and resources are typically constrained, prior outreach with other institutions could help build the knowledge and contacts necessary for success at a later stage. Policy notes should also elaborate on capacity constraints and the needed focus of TA in programs to address these constraints, since capacity (and political) constraints might imply a higher rate of modifying conditions.

Program conditions should be distinguished from other measures in program documents. If the authorities wish to list measures that are not specified as conditionality, these should be listed separately from program conditionality and as part of the authorities' reform agenda. Reform measures that are not critical for achieving program goals or for monitoring program implementation, but which the authorities wish to highlight, can also be addressed in the LOI/MEFP.

III. Stocktaking of Expenditure Policy Conditionality Since 2002

This section reviews the developments in expenditure policy conditionality in IMF-supported programs since 2002 using the Monitoring of Fund Arrangements (MONA) database.[6] It covers prior actions, structural benchmarks, structural performance criteria/structural assessment criteria (SPC/SACs), quantitative performance criteria, and indicative targets.[7][8] The MONA database encompasses IMF-supported programs

[6] See Annex II for an explanation of the methodology. The search was finalized in July 2021.

[7] Structural performance criteria and structural assessment criteria were discontinued after 2009 when structural benchmarks were introduced.

[8] The nature of imbalance and adjustments can differ across countries (e.g., banking and currency crisis) calling for different types of adjustment policies.

since 2002 and, among other things, contains cross-country data on the use of quantitative and structural conditionality. Data for a particular year corresponds to the year of program approval.[9] For our analysis, expenditure policy covers the areas of social assistance, pensions, health and education, energy subsidies, and civil service reform, and water policies (Box 1). Expenditure policy conditionality focuses on spending both from the sectoral (e.g., social assistance/protection, health, and education) and economic (e.g., civil service reform or price subsidies) classifications. For instance, conditionality on civil service reform could cover the health and education sector.

Box 1. Areas of Expenditure Policy

The note focuses on the following areas of expenditure policy: energy subsidies, social assistance, pensions, health and education, and public wage bill.

Energy subsidies cover both fuel subsidies, electricity, gas, and other such utility subsidies. The area of energy subsidies focuses on sustainably reducing the fiscal cost of subsidies, depoliticizing the price setting including designing an automatic pricing mechanism, identifying mitigating measures to protect the most vulnerable, designing a communication plan, and improving the efficiency of state-owned enterprises.

Social assistance programs (social safety net) comprise all expenditure financed from general revenues and aimed at protecting households from poverty (IMF, 2019b). Examples of social assistance expenditure are universal and targeted transfers, child benefits, active labor market policies, food subsidies, near cash benefits such as food vouchers and ration cards, and in-kind transfers such as food assistance and school feeding programs.

Pension policies comprise all policies related to first, second, and third pension “pillars”. The first pillar is a government administered public pension plan that is non-contributory and guarantees a minimum income. The second pillar is an employment-based contributory pension plan. The third pillar is a personal retirement savings plan. The aim of public pension reforms is to restore their financial stability or increase coverage while protecting their underlying equity and poverty alleviation objectives.

Health care includes public health spending except for those that fall under social assistance programs. The precise focus on spending components can also vary by country, e.g., reflecting different perceptions on what constitutes a basic health care package. For advanced countries, basic health includes usually a more comprehensive set of health services than in low-income and emerging market economies.

Education sector covers public spending related to pre-primary, primary, secondary, and tertiary schooling except for those that fall under social assistance programs. The level of public spending varies by country as different countries have different access to schooling. For instance, in one country tertiary education may be public, while in another it may involve significant private financing.

Civil service reform focuses on the size of public wage bill, including compensation and employment measures in line with efficient service delivery and fiscal sustainability.

Mapping to conditionality focuses on policies related to the provision of water utilities.

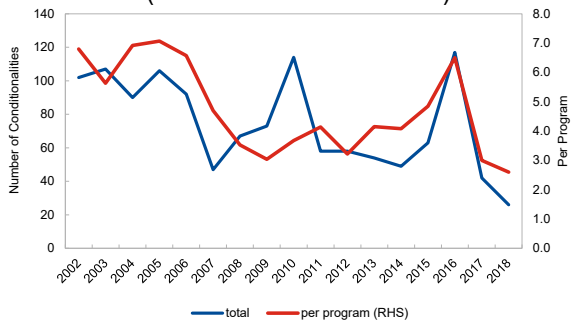
[9] This implies that a conditionality set for an IMF-supported program approved in 2018 will only appear in the data for 2018 even if conditionality is set in subsequent reviews, e.g., in 2019. Therefore, data towards the end of the period will show a decline in conditionality as these programs are still ongoing. As IMF-supported programs last at most three to four years, 2018 is the latest datapoint with full coverage of conditionalities set.

Social spending consists of social assistance, social protection (including pensions), health and education spending[10].

Since 2002, the number of expenditure policy conditionalities has been decreasing. A total of almost 1400 conditionalities have been formulated in expenditure policy in 97 (out of 105 program) countries in the period 2002–July 2021. While this seems to imply that conditionality in expenditure policy is common across all countries, below we will show that most conditionalities are more concentrated in a smaller set of countries. Figure 1 shows both the absolute number of conditionalities and the number of conditionalities per approved program (which gives a better indication of the underlying trend). The decline is mainly driven by a decline in conditionality in pensions and civil service reform. The decline in conditionality in pensions is explained by the decline in programs in Europe and Latin-America. Many of them had more than 1 conditionality per program on pensions. The decline in the wage bill conditionalities is mainly explained by a decline in the number of conditionalities in Sub Saharan Africa. The absolute number of EP conditionalities has decreased by about 35 percent in 2011–19 compared to 2002–10[11]. There are two exceptions to the steady decrease of EP conditionalities, which are the peaks in 2010 and 2016. The peak in 2010 can be partially explained by the increase of approved IMF-supported programs in that year in the aftermath of the global financial crises. The peak in 2016 can be explained by the increase in expenditure policy conditionalities itself (as the average EP conditionality per approved program also increased), mainly in energy subsidy reforms. The dip in the number of conditionalities of programs approved in 2007 coincided with the global financial crisis which crowded out attention to social spending issues (see also IMF, 2019b).

Figure 1. Expenditure Policy Conditionality, 2002–2019

(number of conditionalities)



Source: IMF staff calculations using the MONA database.

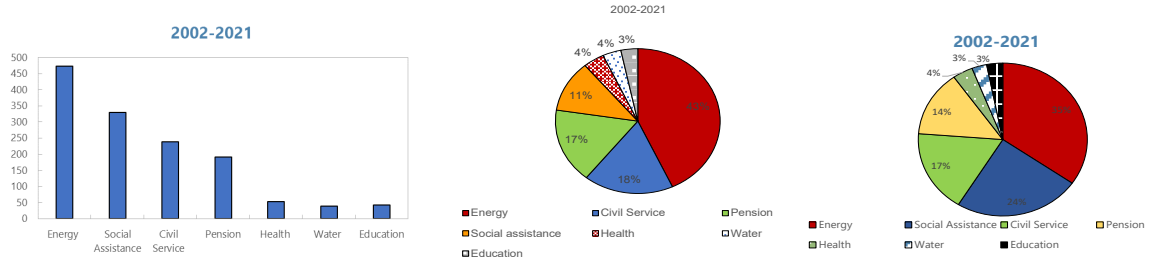
Conditionality on expenditure policy has been dominated by energy sector and social assistance policies. Since 2002, about 475 conditionalities have been set on the energy sector representing 35 percent of all EP conditionalities (Figure 2). This is followed by social assistance with 330 conditionalities (24 percent of the total), civil service reforms with about 240 conditionalities (17 percent), and pension reforms with about

[10] The use of social spending conditionality (ITs) in IMF-supported programs is common. In cases where social spending is not specified, the category "social spending" is included in the category "social assistance" as this is often the focus of the conditionality.

[11] The comparison and figure involve 2019 as programs started in 2020 and 2021 are still ongoing and the number of conditionalities can still increase. Therefore, when assessing trends these data points could be misleading.

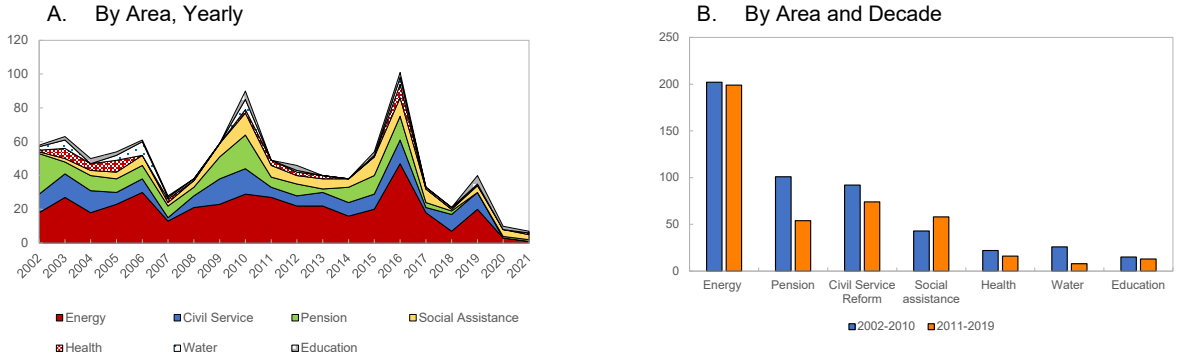
190 conditionalities (14 percent). The total number of conditionalities in health care, education, and water are substantially lower.[12]

Figure 2. Expenditure Policy Conditionality, 2002–2021
(number of conditions)



Source: IMF staff calculations using the MONA database.

Figure 3. Developments in Expenditure Policy Conditionality, 2002–2021
(number of conditions, total)



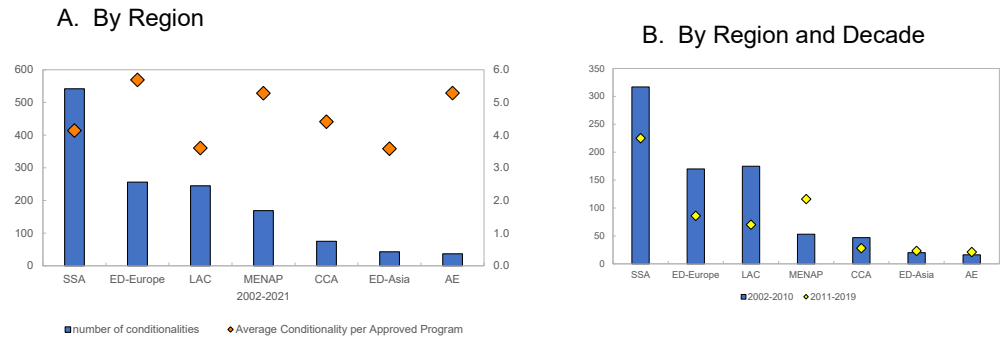
Source: IMF staff calculations using the MONA database.

Since 2002, conditionality on expenditure policy has been gradually declining, not only in absolute numbers, but also in percent of IMF programs (see for latter figure 1). The decline is mainly driven by a decline in conditionality in pensions and civil service reforms which decreased by 60 and 50 percent in 2011–2019 compared to 2002–2010, respectively. The decline in conditionality in pensions can be explained by the decline in programs in Europe and Latin-America. Many of them had more than one conditionality per program on pensions. The decline in wage bill conditionalities is mainly explained by a decline in the number of conditionalities in Sub-Saharan Africa. Conditionality in social assistance and energy subsidy reform has also seen the lowest decrease over time. Conditionality in social assistance increased until 2010, with a dip in 2007 coinciding with programs approved during the global financial crisis and afterwards (Figure 3. A). Comparing

[12] As noted above, in many cases related to ITs, a conditionality is being formulated on social spending without a specification of what it includes. These ITs may include health and education spending.

the period 2002–2010 with 2011–2019, conditionality in social assistance has declined by only 13 percent. Conditionality in the energy sector has also been slowly decreasing during the period 2002–2021, except for a peak in 2016 which was followed by a decrease of 20 percent when comparing the period 2002–2010 with 2011–2019 (Figure 3.B).[13] This in turn also contributed to the peak in the total number of conditionalities in 2016. On health care, conditionality has traditionally been low and decreased even further in the 2010s.[14]

Figure 4. Developments in Expenditure Policy Conditionality



Source: IMF staff calculations using the MONA database.

Notes: SSA=Sub Saharan Africa, ED-Europe=Emerging and Developing Europe, LAC= Latin America and the Caribbean, MENAP= Middle East North Africa and Pakistan, CCA= Caucasus and Central Asia, AE= Advanced Economies, ED-Asia= Emerging and Developing Asia.

With large differences in the number of conditionalities across regions and time, conditionality on expenditure policy has been especially high in the Sub-Saharan African region, given the large number of programs in these countries and the structural measures needed in expenditure policy. Other regions with a high number of conditionality are Emerging and Developing Europe (EDE), Latin America and the Caribbean (LAC), and Middle East and North Africa (Figure 4.A). For the most part, regional variation in the absolute number of expenditure policy conditionalities reflects variation in the number of programs with much less variation in the number of conditionalities per program. The conditionality per approved program is the highest for EDE, followed by MENAP and AEs. Conditionality in Sub-Saharan Africa remained relatively high despite the 40 percent drop in the period 2011–2019 compared with the period 2002–2010 (Figure 4.B). LAC and EDE have seen a substantial decrease of more than 150 percent and 100 percent, respectively, over the same period. In contrast, the MENAP region has seen a tripling of the number of EP conditionalities, albeit from much lower levels. Conditionality in other regions remained low throughout.

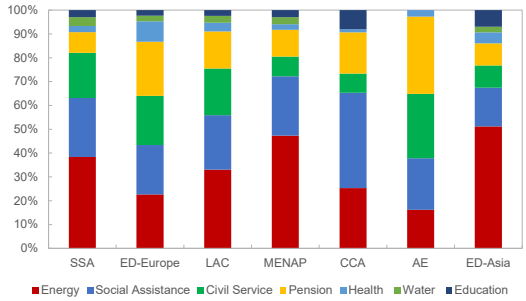
Energy subsidies and social assistance dominate conditionality in most regions. Except for Advanced Economies (AEs) and CCA region, which have a relatively low number of total EP conditionalities, energy subsidies and social assistance account for the dominant share of conditionalities. In SSA, almost 40 percent of EP conditionalities are on energy reforms which is related to the large number of countries that have price subsidies, followed by conditionality on social assistance which can be explained by the lack of resources to

[13] It is key to note that, since the data shown assigns conditionality by the approval year, the end years (2019-2021) may show a lower number in conditionalities as these programs are still ongoing and may add conditionality later.

[14] Most recently during the pandemic, discussion of health issues has increased tremendously in IMF-supported programs, but this has not yet been reflected in conditionality, partially because emergency financing requires no structural conditionality. However, this may change as many programs are ongoing, and may add conditionality after the most urgent macroeconomic needs are addressed. In contrast, conditionality in auditing Covid-19 and health care spending (which is classified under PFM rather than expenditure conditionality) has risen during the pandemic with a total of 12 structural benchmarks and 2 prior actions.

and the existence of adequate social safety nets (25 percent), civil service reforms which is due to the relatively high spending on the wage bill compared to other spending (20 percent), and pensions (10 percent) (Figure 5). Conditionalities in EDE are broadly equal for energy, pensions, social assistance, and civil service reform (all about 21-23 percent). LAC has most conditionalities in the energy sector (33 percent), followed by social assistance (23 percent), and civil service reforms (20 percent). In the MENAP region almost 50 percent of EP conditionalities are in the energy sector which is related to the large number of countries with price subsidies, followed by social assistance which accounts for 25 percent of all EP conditionalities. The absolute number of EP conditionalities are low in Emerging and Developing Asia (ED-Asia) of which 50 percent of all EP conditionalities are in energy, but these conditionalities are far less in absolute numbers as there are far less IMF-supported programs in these countries.

Figure 5. Expenditure Policy Conditionality by Region and Area
(share of total)



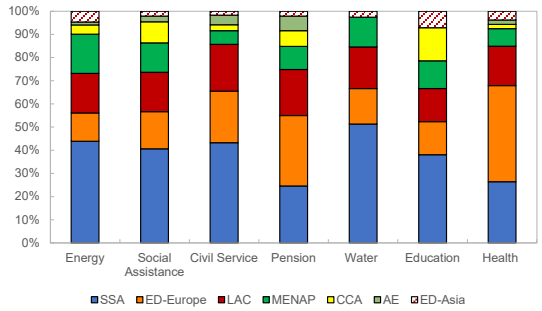
Source: IMF staff calculations using the MONA database.

Notes: SSA=Sub Saharan Africa, ED-Europe=Emerging and Developing Europe, LAC= Latin America and the Caribbean, MENAP= Middle East North Africa and Pakistan, CCA= Caucasus and Central Asia, AE= Advanced Economies, ED-Asia= Emerging and Developing Asia.

The large number of conditionalities in SSA also dominates the number of conditionalities formulated in various expenditure policy areas. More than 40 percent of the energy sector conditionalities are set in SSA followed by almost 20 percent for LAC and MENAP (Figure 6). More than 40 percent of the conditionalities in social assistance are set for SSA, followed by LAC and EDE (both almost 20 percent) and MENAP (about 10 percent). Again, more than 40 percent of the civil service reform conditionalities are set in SSA followed by about 20 percent for EDE and LAC – the latter mainly in the period 2002–11. Almost one third of all conditionalities in the pension area are formulated for EDE followed by SSA and LAC (25 and 20 percent respectively). In health care more than 40 percent of conditionalities are formulated in EDE followed by SSA and LAC. SSA also accounts for most of the conditionalities in education (29 percent), followed by LAC, EDE and MENAP (each ranging from 13 to 18 percent). More than half of the conditionalities in water are set in SSA programs. Finally, a minimum number of conditionalities in civil service reform, education, health, and water is set for AEs, the CCA and EDEs.

Figure 6. Expenditure Policy Conditionality

(number of conditions, by area and region, percent of total)



Source: IMF staff calculations using the MONA database. Notes: SSA=Sub Saharan Africa, ED-Europe=Emerging and Developing Europe, LAC= Latin America and the Caribbean, MENAP= Middle East North Africa and Pakistan, CCA= Caucasus and Central Asia, AE= Advanced Economies, ED-Asia= Emerging and Developing Asia.

Conditionality have been mainly formulated using structural benchmarks which reflects the fact that for most expenditure policy reforms structural measures are needed instead of numerical targets SBs represent about 50 percent of the total number of conditionalities, followed by prior actions (18 percent), ITs (15 percent), SPC/SACs (12 percent), and QPCs (5 percent) (Figure 7). SBs dominate also in almost all individual expenditure policy areas except for social assistance where almost half of the conditionalities are formulated as a floor on some definition of social assistance or social spending. This is due to the importance of the ITs for social assistance starting in the 2000's. Prior actions are mainly formulated for energy subsidy reforms, typically related to the need to increase energy prices. This can be explained both by the fact that energy price increases are often challenging to implement while it is often critical to the program for having it implemented before approval of a program or a review. QPCs are less common, and only formulated in a few areas such as civil service reforms and social assistance.

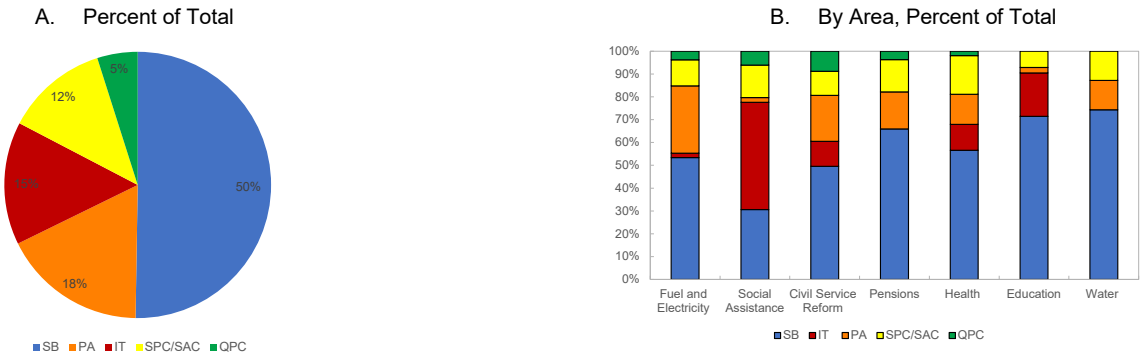
While SBs are the most common conditionality, the use of other conditionalities is mainly explained by the income level of a country. ITs (in social spending) are more commonly used in LIDCs and to some extent Ems as the need to increase social spending is more urgent in these countries (Figure 8). AEs use more prior actions than LIDCs and Ems.[15] Trends in the use of the type of conditionality are broadly equal across regions except for advanced economies as explained above.[16] The relatively high share of PAs in MENAP can be mainly explained by conditionality in energy sector reforms, while the large share of PAs in EDE is explained by a combination of prior actions in energy subsidy reforms, pension reforms, and civil service reforms, mostly in the 2002–2010 period. Finally, the larger number of ITs in the SSA region can be again explained by the number of ITs on social spending.

While expenditure policy conditionalities are broadly equally important in PRGT, GRA, and blended programs, the type of conditionality differs slightly. EFF, blended, and PRGT programs have the highest number of expenditure policy conditionalities in percent of the approved programs (see Figure 9.A). At the same time, SBA and ECF programs have a smaller number of expenditure policy conditionality per approved program. The nature of conditionality differs slightly by the program type (see Figure 9.B). For instance, ITs (mainly on a

[15] It should be noted that the number of conditionalities in expenditure policy in AEs are very small compared to LIDCs and EMs.
[16] Both the income and regional classification of the IMF include the category "AE".

floor on social spending) are the highest in blended programs (of which EFF blended programs) followed by PRGT financed programs as both programs have an explicit objective to reduce poverty. Prior actions are the highest among GRA financed programs, of which about half relate to energy subsidy reforms followed by pension and public wage bill reforms. Structural benchmarks are broadly equal among the different types of programs.

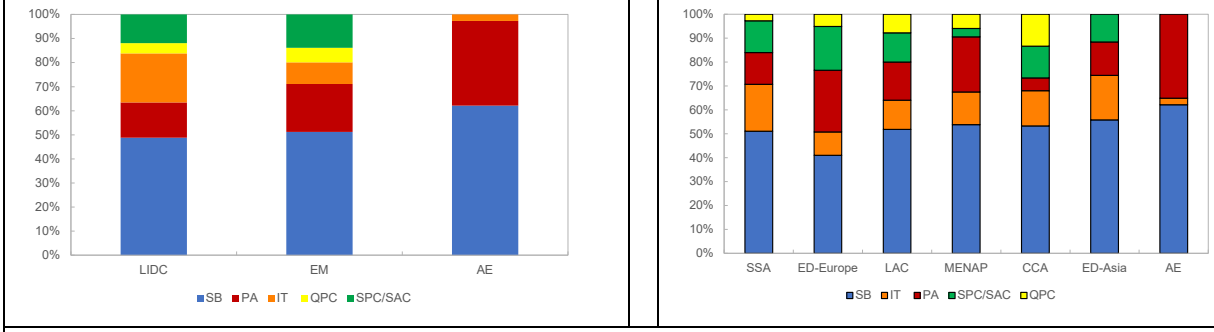
Figure 7. Expenditure Policy Conditionality by Type of Conditionality



Source: IMF staff calculations using the MONA database.

Notes: SB= structural benchmark, PA= prior action, IT= indicative target, SPC/SAC= structural performance criteria/structural assessment criteria, QPC= quantitative performance criteria.

Figure 8. Expenditure Policy Conditionality by Type of Conditionality and Income/Region



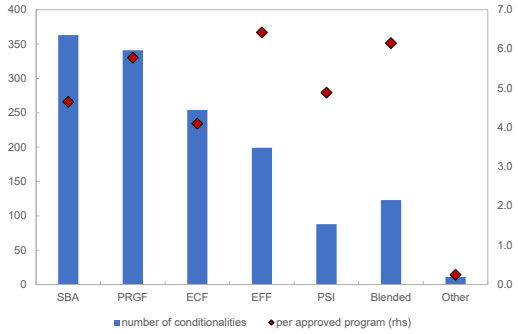
Source: IMF staff calculations using the MONA database. Notes: SSA=Sub Saharan Africa, ED-Europe=Emerging and Developing Europe, LAC= Latin America and the Caribbean, MENAP= Middle East North Africa and Pakistan, CCA= Caucasus and Central Asia, AE= Advanced Economies, ED-Asia= Emerging and Developing Asia, SB= structural benchmark, PA= prior action, IT= indicative target, SPC/SAC= structural performance criteria/structural assessment criteria, QPC= quantitative performance criteria.

Expenditure policy conditionalities are concentrated in a small number of countries which reveals interesting issues regarding parsimony. While there are many countries (97 countries) with 1 or more expenditure policy conditionalities formulated in one or more of their IMF-supported programs since 2002, within this group expenditure policy is concentrated in a small number of countries. More than 60 percent of the conditionalities in all countries with some expenditure policy conditionality is formulated in about 25 percent of these countries. For instance, countries like Cote d'Ivoire, Ghana, Uganda, Burkina Faso (all SSA region), Ukraine, Romania, Moldova (all ED-Europe region) and Honduras (LAC region) have more than 30 conditionalities in expenditure

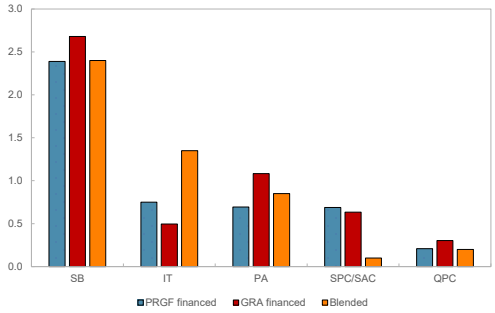
policy (Figure 10). Other examples of countries with a high number of expenditure policy conditionalities (more than 20) are Armenia, Iraq, Pakistan, Tunisia, Jordan, and Albania. Regarding parsimony per program, Cote d'Ivoire had 25 conditionalities in expenditure policy formulated in a single program (2011, ECF), of which 16 were formulated about energy subsidy reforms. While an in-depth assessment of the quantity of EP conditionalities for each program goes beyond the scope of this paper, it should be noted that the high number is not explained by the same conditionality that is being re-set in terms of the date because the conditionality is not met in the previous review.[17] Most conditionalities are new conditionalities that are being added with each review. Of the 37 expenditure policy conditionalities in Ukraine, 18 were formulated in one program (2015, EFF).[18] In contrast to the previous example, half of these conditionalities are related to the same conditionality that was not met and was re-set with a different date. Finally, Greece had 3 prior actions and 2 structural benchmarks on pension reforms in the 2010 SBA.

Figure 9. Expenditure Policy Conditionality by Type of Program

A. By Program



B. By Program and Type of Conditionality

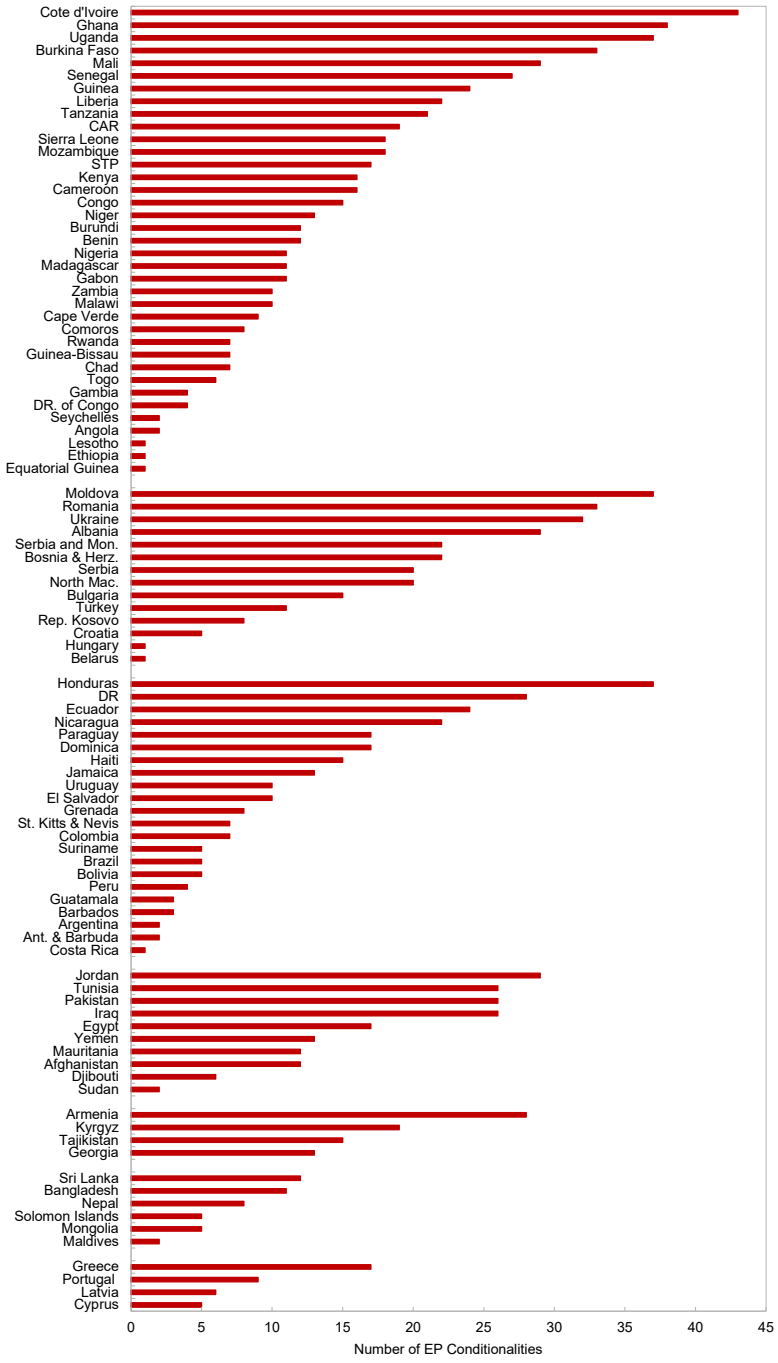


Source: IMF staff calculations using the MONA database.
Note: Blended programs are: ECF-EFF, SBA-SCF, SBA-ESF, PRGF-EFF.

[17] In the MONA database, a conditionality that is not met and included again in the next review with a different date, will appear as two conditionalities.

[18] In line with this, looking at it from the expenditure policy area, conditionalities in the period 2012-2021 for the energy sector for EDEs are in addition to Ukraine, driven by Moldova, and Serbia. In SSA, Burkina Faso and Liberia account for more than 60 percent of all civil service conditionalities in the period 2012-2021.

Figure 10. Expenditure Policy Conditionality by Country
(number of conditionalities, by country)



Source: IMF staff calculations using the MONA database.

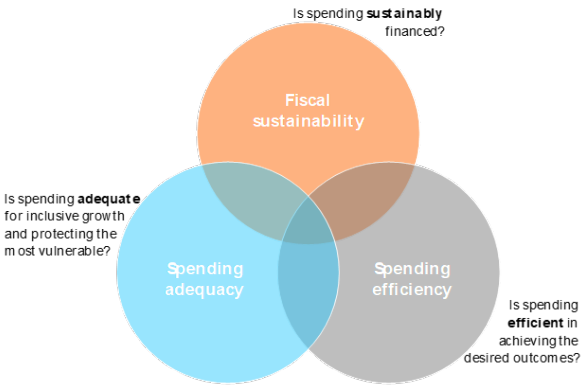
Notes: ED-Europe=Emerging and Developing Europe, LAC= Latin America and the Caribbean, MENAP= Middle East North Africa and Pakistan, CCA=Caucasus and Central Asia, ED-Asia= Emerging and Developing Asia.

IV. Granular Advice for Expenditure Policy Conditionality

A. Main Principles

Engagement on expenditure policy issues is guided by an assessment of the macro-criticality; one needs to determine if it affects, or has the potential to affect, domestic, external, or global stability (IMF, 2015). The main channels are fiscal sustainability, spending adequacy, and spending efficiency (see IMF, 2019b; Figure 11). Fiscal sustainability requires that spending is sustainably financed. Fiscal sustainability issues can arise, for instance, when energy subsidies are crowding out other priority spending, or when the pension system is not on a sustainable financial footing. Spending adequacy requires that spending is adequate for achieving underlying policy objectives, such as delivering efficient and equitable public services (including education and health services) or protecting populations from poverty. In some cases, spending needs required to meet the Sustainable Development Goals (SDGs) could serve as a useful benchmark (IMF 2024). Spending efficiency requires that countries achieve outcomes commensurate with their level of spending. For instance, higher public education and health spending are not always reflected in better outcomes, which suggests ample room for improving spending efficiency. For instance, health outcomes (infant mortality rates, or the immunization level of different population segments) may be low compared to how much the country spends (absolutely or related to peer countries) on public health.

Figure 11. Channels of Expenditure Policy



Source: IMF (2019b).

Note: Spending can be macro-critical if any, or any combination, of these channels are a policy concern.

Once macro-criticality is established, the following framework to think about conditionality on expenditure policy issues could prove useful (Figure 12):

- *Assessment of the current situation*: one needs to assess key policy gaps or challenges that need to be addressed. For instance, it could be that there is no social assistance program in place, or that energy subsidies are high. One should also take capacity constraints into account.

- *Design of a reform plan:*
  - *Objectives and policy measures*: One needs to determine the objectives of the reform plan and what policy measures are required to address the identified policy challenge. This should be informed by the literature on how to design reforms for various expenditure policy areas. One should also rely on issues identified during CD activities, Article IVs and other international development partners, stakeholders, and the government. Then an analysis of existing policies and their deficiencies should be undertaken. For example, an analysis of energy subsidies should examine the approach to energy pricing, how fiscal pressures have evolved over time, and what price reforms are required to reduce or eliminate subsidies and protect the most vulnerable. Or an analysis on social spending should determine whether achieving social objectives requires an increase in spending levels, an improvement in spending efficiency, or both.
  - *Timing, packaging, sequencing, and complementary measures*: What is the appropriate timing, packaging and sequencing of required policy measures? The design and implementation of policy reforms often requires investment of time and resources to: (i) undertake the reform, and possible complementing and mitigating measures; (ii) undertake the needed consultation with important stakeholders (e.g., across government, parliament, and external stakeholders) to ensure reforms are politically and socially sustainable; (iii) ensure development and passing of needed supporting legislation; and (iv) strengthen the institutions required to implement policy reforms.
- *Mapping to conditionality:* Once it's known which measures needs to be implemented, one will need to map this to the existing toolkit of conditionality as laid out in several guidance notes[19]. This means that one considers the required measures and timing and assess which conditionality would serve this purpose the best. Complementarity between various conditionalities within Expenditure Policy but also other areas (such as Public Financial Management) should also be assessed. It is key to understand how critical the reform is for program success as it makes a difference in which type of conditionality should be set, for instance a prior action versus a structural benchmark or a quantitative performance criterion versus an indicative target. It is also important to understand whether a quantitative condition is needed or structural conditionalities, or in some cases both.

Program conditionality can be focused on addressing one, or a combination of issues. For example, when focusing on establishing macro-criticality and its channels, SBs can be used to require an analysis of these channels. Similarly, SBs can be used to require the development of a policy reform strategy to address identified policy challenges within a credible macro-fiscal framework. SBs can also play an important role in assessing data availability and quality issues and identifying data gaps and actions needed to fill these gaps. Once a reform strategy has been agreed, these can be mapped to various types of conditionalities, e.g., SBs, QPCs and ITs. SBs can be set to implement measures that have a structural component to it. QPCs and ITs can specify the implications for levels of related public expenditures, including spending floors and reflected as program commitments in MEFPs and LOIs. The choice between SBs, QPCs, and ITs should also reflect the criticality, urgency, and type of policy reforms as well as the capacity of the authorities to undertake the needed analyses and required actions. During this process, country teams should draw on analytical work undertaken by the IMF (e.g., in core and shared areas during a previous AIV cycle), development partners (e.g., in shared and non-core areas), or governments and policy experts (in all areas). Country teams should also assess the authorities' capacity to implement the recommendations and, where needed, technical assistance (either from

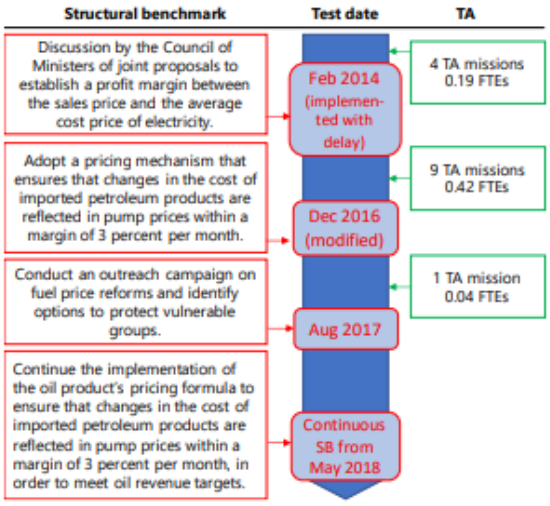
[19] As discussed in section I these refer to the Guidelines on Conditionality (GN 2002; IMF, 2002) and Revised Operational Guidance to IMF Staff on the 2002 Conditionality Guidelines (Revised 2014 GN; IMF, 2014b).

the IMF or other International Development Institutions, IDIs) should support the reform plan and conditionalities. Box 2 provides insights on the relevance of utilizing AIV findings when designing conditionality, while Figure 13 shows a good practice example of relying on technical assistance in a program context. The next sections provide granular advice on the different expenditure policy areas discussed in section III[20].

Figure 12. Framework to Assess Conditionality in Expenditure Policy

Source: Authors.

Figure 13. Energy Subsidies in Mali's 2013 ECF - Conditionality and Technical Assistance



Source: IMF (2019a).

[20] The paper provides granular advice on social assistance, energy subsidy reform, public pension spending, public health spending, public education spending and civil service reforms. The paper does not provide granular advice on water sector reforms.

Box 2. Conditionality Relying on Surveillance

IMF-supported programs should be informed by AIV consultations, i.e., program objectives and conditionality should draw on macro-structural gaps identified in prior surveillance (section II; Revised 2014 GN; 2018 ROC; Andritzky and others, 2021). The distribution of surveillance gaps and structural conditions is very different, though: about half of the surveillance gaps are in shared and non-core areas, less than 30 percent of structural conditions fall into these areas. Relatedly, of those gaps covered by structural conditions, about two thirds fell into core areas, while most gaps not covered by structural conditions tended to be in shared or non-core areas. The areas of social, gender, inequality and poverty were underrepresented, while pensions and civil service reforms over-represented in programs compared to surveillance. Capacity constraints and the need for parsimony might explain some of the discrepancies, but certainly not all.

The aggregate results hide significant country variations. The 2013 Article IV report of Georgia noted a need for reforming the social system (universal health care, pension, targeted social assistance, and education). It also discussed higher private savings through developing local capital markets and creating a contributory pension system. Then, the 2017 EFF program aimed at enhancing the sustainability of the pension system in light of an aging population and shrinking labor force, together with capital market development. Other examples of countries with a higher-than-average share of surveillance gaps covered by structural conditions of the follow-up program (in the area of expenditure policies) are Greece's 2010 SBA (pension reforms), Cote d'Ivoire's 2011 ECF (energy reforms), Kyrgyz Republic's 2011 ECF (energy reforms), and Sri Lanka's 2009 SBA (energy reforms).

In the area of social assistance there were only limited examples of structural conditionality based on preceding surveillance findings. In the 2018 ROC Directors concurred that the design of IMF-supported programs and conditionality could be further strengthened through greater focus on measures to offset the adverse effects of adjustment on poor and vulnerable households. It was also noted that specific conditionality on social spending may be necessary to ensure its adequacy. Measures can aim, for instance, to strengthen existing social spending schemes (e.g., by removing inefficiencies), or to introduce new schemes.

Note: Based on Andritzky, Munkacsi, and Wang (2021).

B. Social Safety Nets

The channels through which social safety net spending is deemed macro-critical can vary according to country circumstances.

- *Spending adequacy:* A key policy challenge in many emerging and most developing economies is that spending on the SSNs and population coverage are inadequate for achieving poverty alleviation objectives and for protecting vulnerable households from the adverse impacts of economic reforms (e.g., energy subsidies and consumption tax reforms). In such circumstances, there is an expectation (indeed a requirement in PRGT programs) that program design addresses this policy challenge.

- *Fiscal sustainability*: In developing countries, the higher spending associated with policies for strengthening the SSN through, for example, increasing population coverage or benefit generosity, needs to be sustainably financed. Since fiscal space is often limited and administrative capacity constraints often preclude the use of means-testing to contain spending increases, higher spending needs to be financed through enhancing tax capacity to avoid undermining fiscal sustainability. In advanced economies, the fiscal cost of SSN spending may require reforms to contain SSN spending.

- *Spending efficiency:* In developing economies, spending inefficiencies typically arise from the fragmentation and duplication of SSN programs across line ministries, which can unnecessarily increase administrative costs. These countries may also wish to strengthen the targeting of transfers to improve spending efficiency, which may require up-front investment in information systems (e.g., benefit registries integrated with other databases on household socio-economic conditions). In advanced countries policy reforms focus on enhancing the targeting of spending to reduce leakage to higher-income groups while avoiding work disincentives.

The analysis should start by assessing the current social programs, including the poverty strategy and existing social assistance programs[21]. If the country does not have a poverty strategy in place that is comprehensive, adequate, and up-to-date (see IMF 2019b), a structural benchmark could be set in this area (Cameroon 2017, St. Kitts and Nevis 2011, see Box 3). The structural benchmark could refer to designing, adopting, or implementing a poverty strategy. In case of many duplicating, opaque, small programs spread among numerous ministries, a stocktaking exercise whereby the incidence of the current social safety net is assessed (possibly with technical assistance from IDIs) could be set as a structural benchmark (Mongolia 2009).

Conditionality could be set around introducing a new social assistance program (Ukraine 2014). As most of the measures contain a structural element, it lends itself very well for structural benchmarks if macro-critical. A few issues are relevant:

- *Identifying households (registry)*: In particular, in low-income developing countries and emerging market economies putting in place a (new) social assistance program requires assessing whether there is a social registry in place to identify households (see IMF 2018a). Many IMF-supported programs included a structural benchmark for setting up a social registry, or strengthening an existing social registry (see Ukraine 2015, Pakistan 2020, Ecuador 2020, Senegal 2021). If targeting is desirable, the targeting mechanism should be part of the social registry (Jordan 2012)[22].

- *Implementing a delivery mechanism*: In addition to the social registry, a delivery mechanism should be introduced or in place to deliver the benefits to the population. Benefits could be delivered as (conditional) cash, semi-cash, or in natura. Depending on the level of financial inclusion, percentage of households with access to mobile money, or the capacity of the authorities to implement a card system where households could receive their benefits through point-of-sale devices, a structural benchmark could be set in this area. Consultation with other IDIs in setting this conditionality is key given their expertise. Depending on the country's capacity setting up a social registry or a delivery mechanism

[21] The design of the SSN should be considered in relation to the design of social insurance and labor market programs (IMD 2024).

[22] The appropriate use of targeted and universal transfers to protect vulnerable groups depends on country preferences and circumstances (see IMF (2017a)).

may take several years which should be reflected in the realism and timeline of the structural benchmark.

- *Designing the social assistance program*: Implementing a social assistance program will include formulating policies regarding eligibility criteria, the type and benefit level and whether the program will be conditional or non-conditional. The details of the design lend itself less for conditionality as this could be perceived as micro-managing (see also section II). Where appropriate, a structural benchmark could be formulated that includes reference to discussions with IMF staff or technical assistance from other IDIs.

If there is a social assistance program that has the potential to become a desired social assistance program, conditionality could be set in this area. In addition to the issues of coverage, generosity and efficiency, the availability of resources should be considered in which case an indicative target could be set.[23]

- *Low generosity and lack of resources*: If the social assistance program has sufficient coverage and is efficient, but resources are limited and the benefit level is not high enough, an indicative target could be set (data and data quality permitting) on the resources for this program. A floor on social spending (and hence social assistance programs) is very common (see Argentina 2018, Armenia 2019, Barbados 2018, Benin 2017, Ecuador 2019, Kenya 2021, Mali 2019, Senegal 2020, Uganda 2021, and Ukraine 2020). The level of the indicative target should be set based on the current number of beneficiaries, and the desired benefit level per beneficiary/household. To avoid that resources may be spent on other costs related to the program than the benefit level, a commitment in the MEFP could be included to increase the benefit level of the program. Alternatively, a structural benchmark could also be set in this area.

- *Low coverage and benefit level*: In emerging markets and low-income developing countries programs often have limited coverage and a low benefit level. The limited coverage is mainly explained by capacity constraints as eligible individuals do not receive benefits to which they are entitled. A low benefit level is often caused by financing constraints. To address these issues, a structural benchmark on increasing the number of households by a particular number could be set (see Ecuador, 2020, Madagascar 2021, Senegal 2021). Given that measures to increase coverage include several reforms in itself and other IDIs have a comparative advantage in this, staff should discuss the structural benchmark with other IDIs and assess the need for TA. The benefit level could be increased along the line above.

- *Inefficiency*: If leakage is high, but vulnerable households sufficiently covered by the program, several measures and conditionalities could be considered to improve targeting. For instance, structural conditionality could be set on eliminating ghost beneficiaries or double-dippers from a program, or re-assessing eligibility criteria.

- *Inefficiency and low coverage*: Often high levels of leakage are accompanied by not the desired level of coverage at the bottom of the income distribution. A structural benchmark as above on reducing inefficiencies could be then complemented by a structural benchmark to increase coverage of the poor households. Depending on country specifics this could be also combined in one structural benchmark

[23] Staff should discuss the potential of programs to become a desired program with relevant IDIs such as the World Bank.

that re-certifies households using the current or strengthened registry and a new targeting mechanism (see Bosnia 2016, Cyprus 2013, Mongolia, 2017).

In practice, any combination of the above could occur. Therefore, staff should assess current issues, prioritize and set conditionality accordingly.

Given time and capacity constraints, often a combination of measures and hence conditionality should be considered. For instance, an IMF-supported program may be necessary to ensure macro and fiscal stability but may have significant negative effects for the most vulnerable. In the lack of an effective social assistance program, current (possibly imperfect) social assistance programs could be scaled up. Conditionality in the form of an indicative target or a structural benchmark could be used depending on the need (see above). Simultaneously, a conditionality could be set around redesigning the current program into a more effective program, introducing a new program, or developing a strategy for social assistance which involves steps as outlined above (see Egypt 2016).

Box 3. Examples of Social Assistance Conditionality

Prior Actions

- Tunisia, 2016: Social protection. Public announcements of an increase in social transfers for vulnerable households.
- Ukraine, 2014: To protect vulnerable households not covered by the existing scheme, Government will approve a decision to introduce a new social assistance scheme, as described in ¶23.

Structural Benchmarks

- Bosnia and Herzegovina, 2016: Federation government to prepare a report and plan to improve the targeting of social transfers based on the centralized database of beneficiaries.
- Cameroon, 2017: Develop a national social protection strategy (or policy) to be implemented starting with the 2018 budget law.
- Cyprus, 2013: Implement a new social welfare system to improve the targeting of social assistance, consolidate welfare programs, and streamline administration costs.
- Dominican Republic, 2019: Increase the permanent coverage of the conditional cash transfer program (Solidaridad) by 60,000 additional families to 590,000 families.
- Egypt, 2016: Increase social spending on programs such as cash transfers, social pension, school meals, health insurance and free medicine for the poor, etc. by at least EGP 25 billion.
- Madagascar, 2021: Increase the number of beneficiaries of cash transfer programs from 483,428 in December 2020 to 540,000 in September 2021.
- Mongolia, 2009: A comprehensive review of transfer programs resulting in a revision of the relevant laws to streamline transfer programs and safeguard the social safety.
- Mongolia, 2017: The Child Money Program will be targeted to the poorest 40 percent of Mongolian households and the savings redirected toward the better-targeted Food Stamps program.
- Jordan, 2012: Implement a national unified registry for targeting of subsidies.

- Ecuador, 2020: Complete the upgrade of the social registry and expand the coverage of the social assistance program to at least 80 percent of families in the bottom three deciles of the income distribution.
- Senegal, 2021: Update and extend the existing single national registry (RNU) by identifying vulnerable households above and beyond the 558,000 households already surveyed, to include at least 1 million households by end-2021.
- St. Kitts and Nevis, 2011: Submit social safety net reform strategy to Cabinet.
- Ukraine, 2015: Establish a centralized database in the MoF of recipients of social assistance.

Quantitative Performance Criteria

- Argentina, 2018: Social assistance spending (floor).
- Ecuador, 2019: Floor on social assistance spending of central government.
- Senegal, 2020: Floor on social expenditures (percent of total spending).

Indicative Targets

- Armenia, 2019: Social spending of the government (flow, floor).
- Barbados, 2018: Floor on social spending.
- Benin, 2017: Priority social expenditure (floor).
- Egypt, 2020: Social spending of the budget sector (floor).
- Kenya, 2021: Priority social expenditures of the national government (floor).
- Uganda, 2021: Social spending (floor, billions of USh).
- Ukraine, 2020: Ceiling on primary expenditure of the state budget and social funds.

Note: The indicated year refers to the year in which the IMF-supported program is approved.

C. Energy Subsidy Reforms

The macro-criticality of energy subsidy reforms typically arises through concerns for fiscal sustainability and spending efficiency. Energy subsidies comprise consumer and producer subsidies. The most important energy subsidies typically comprise subsidies for fuel products, electricity, natural gas, and coal.

- *Fiscal sustainability:* In many emerging and developing economies, the cost of energy subsidies puts a significant strain on the budget and can crowd out other spending that is crucial for promoting inclusive growth.

- *Spending efficiency:* Energy subsidies are inefficient from three perspectives. First, universal energy subsidies are a very inefficient approach to protecting households since they involve significant leakage of subsidy benefits to higher-income households. Second, low prices encourage excessive energy intensity in consumption and production. Third, where the cost of subsidies is borne by energy

producers, this often crowds out needed investments in generating and distributing energy, resulting in high technical losses and supply shortages.

When designing conditionality, it is important to consider the main elements underpinning successful energy subsidy reforms. International experience shows that a successful energy subsidy reform relies on six key ingredients (see IMF, 2013):

- First, successful reforms are comprehensive, well-planned and include clear objectives with a timeline.
- Second, a comprehensive and far-reaching communication strategy with increased transparency is key to inform the public about the size of the subsidies and who benefit from them.
- Third, appropriately phased price increases and sequencing it across energy products is desirable. The appropriate speed of phasing out energy subsidies depends on issues as the current price gap[24], the current price level[25], the poverty rate in the country, the size and coverage of mitigating measures, the overall economic situation, and the fiscal stance.
- Fourth, mitigating measures are key and should have sufficient coverage and generosity and implemented (at least) at the same time of the price increase.
- Fifth, depoliticizing energy subsidies by adopting an automatic pricing mechanism and having an independent body in charge of it can help prevent reform reversal.
- Finally, improving the efficiency of SOEs can reduce inefficiencies and producer subsidies (if any), and hence the fiscal burden of the energy sector. Sectoral reform could also include measures to diversify the energy mix and move away from fossil fuels to investments in renewable energy.

Designing a comprehensive energy subsidy reform and quantifying the size of energy subsidies is a key step but does not necessarily require conditionality. The current stage of the reform and if available the adequacy of the energy subsidy reform plan should be assessed. An energy subsidy reform plan should have clearly articulated short, medium- and long-term objectives, a description of the type of energy subsidies that will be considered, the timeline for eliminating energy subsidies, the current price gap, and the size and incidence of energy subsidies. Quantifying energy subsidies and the price gap are also vital. While designing a comprehensive plan and quantifying energy subsidies is key, given parsimony, criticality, and the risk of micro-management, it does not imply that these actions should be necessarily part of conditionality. An intention and possibly a request for technical assistance regarding these actions could be included in the MEFP. Even though this is strictly not conditionality, it lays out the authorities' intentions regarding the reform plan, and is a welcome addition, especially when the plan itself is not critical to the IMF-supported program, but the measures are[26]. Then the implementation of the measures itself could be part of conditionality, as explained below. However, many elements of the reform plan will be critical to program design and outcome such as the phase of price increases which is a key input in the macro fiscal framework and/or the implementation of mitigating

[24] The price gap refers to the price of energy products that would prevail if there were no subsidies relative to the current price of the energy product.

[25] The current price level of the energy product is relevant as in some cases a high percentage increase could imply a relatively low price increase in nominal terms.

[26] Technical assistance could be useful when energy subsidies are opaque and not explicitly included in the budget.

measures for the most vulnerable. Therefore, even if not part of conditionality, these issues require close coordination with IMF staff. If in a particular case the design of the plan or the quantification of subsidies is critical for program success, these elements could be part of a structural benchmark (see Honduras 2019, see Box 4).

As part of the reform plan, it is key to decide on the appropriate phasing of price increases and the associated conditionality.

- *Price Increases for Petroleum Products*: The required price increases could be set as part of a structural benchmark or as a prior action. Both type of conditionalities is commonly used (see Côte d'Ivoire 2011, Egypt 2016, Madagascar 2016, Tunisia 2016, Yemen 2014). A price increase can be formulated as i. a percentage increase (for instance increase the price of energy products by 10 percent by [date], ii. a local currency unit increase (increase the price of energy products x by 10 LCU by [date]) or iii. as a percent of the cost recovery price (increase the price of petroleum product x in order to achieve 90 percent of cost recovery price). Another option is unspecified price increases.

- *Unit or Percent Increase*: A percent increase is the most used in conditionality. Both a unit increase as a percent increase set a limit on the maximum price increase required for the structural benchmark. If during the review period, the international oil price and/or the exchange rate change the size of the subsidies change as well and the originally set price increase (in percent of LCU) may not achieve the same fiscal results.

- *In Percent of Cost Recovery Rate*: Setting a price increase in percent of the cost recovery price will limit the impact on the fiscal balance by requiring a price increase considering movements in the macro variables. The downside is, however, that a larger price increase than originally intended can be the result if international oil prices increase more than projected or the exchange rate depreciates more than projected whereby international oil prices are not under control of the authorities.

- *Residual Price Increases*: Although less common, if containing fuel subsidies is very critical to the program, a stricter conditionality could be to include a QPC or IT on the size of fuel subsidies. (Albania 2014, Egypt 2016). The benefit is that energy subsidies are contained as originally intended as the authorities need to increase prices in line with the IT/QPC. The downside is that this may require more frequent and higher price increases than in the previous examples as the price increase is not limited to a percent/LCU or time in moment[27]. It also creates more uncertainty for volatility in retail prices as changes and frequency in retail prices are a residual. Another disadvantage is that this may increase the risk of arrears to energy suppliers (which often then are part of additional conditionality).

- *Price Increases for Electricity and Other Utilities*: Electricity or utility subsidies have usually different prices for different groups of consumers (households, enterprises) and different usage (life-line tariffs). Using the options described above (percent increase, nominal increase, or percentage of cost recovery ratio increase), the structural benchmark can contain average price increases for a group (Honduras 2019) or group of consumers or adjusting the subsidies in such a way to redirect to the most vulnerable (Jordan 2020, Madagascar 2016, Suriname 2016, Ukraine 2015). Two additional

[27] For instance, even if the price increase is conditioned on a percent of the cost recovery ratio, depending on the timing of the structural benchmark and developments of the exchange rate and international price the desired level of energy subsidies may not be achieved.

issues are relevant when designing these conditionalities. First, a formulation that implies an average increase in electricity or utility tariffs could be implemented in many different (and sometimes undesirable) individual block tariff increases with reform reversal as a consequence if the design does not sufficiently take into account equity or political economy considerations (Suriname 2016). On the other hand, too detailed conditions regarding tariff increases may in some cases also not desirable as it could be perceived as micro-management. Second, a conditionality that redirect electricity or utilities subsidies to the most vulnerable can lead to multiple interpretations. For instance, is the bottom 20 percent of the households considered as the most vulnerable or the bottom 30 percent? In some cases, price increases will be determined simultaneously with the reform plan that considers the incidence of electricity and utilities. Based on criticality to the program, for both situations, a balance should be found between too detailed conditionalities and the risk for undesirable outcomes. In addition to the description of the structural benchmark, the MEFP can also provide more clarification on the interpretation of the structural benchmark.

Mitigating measures can be set as structural benchmarks, or an indicative target. The distributional impact of energy subsidy reforms should be assessed which should inform the implementation of mitigating measures. If there is already a program or social safety net with sufficient coverage, this could be scaled up and an indicative target on the size of this program could be set. If a program with sufficient coverage is not in place, a structural benchmark could be introduced that requires the authorities to implement such a program or to scale up current programs while strengthening capacity to implement a new program (see also section IV.2). In this case, an appropriate social program should be first in place (and hence conditionality met) before energy price increases could materialize. In case of electricity subsidies, to some extent, a revision of life-line tariffs can also be considered to protect the most vulnerable or reform utility-related social assistance (Ukraine 2015).

Given its nature, reforms to depoliticize energy pricing, implementing a communication plan, and improve the efficiency of SOE's lends itself well for structural conditionality.

- *Depoliticizing energy subsidies*: Introducing an automatic pricing mechanism and setting up an independent body could be (possibly with technical assistance) set as a structural benchmark. Depending on its criticality, implementing an automatic pricing mechanism could be also introduced as a prior action (Haiti 2015, Pakistan 2019, Jordan 2016, Ukraine 2018).

- *Communication plan*: Depending on the criticality, a structural benchmark on designing and/or implementing a communication plan could be set (or even a prior action (Burkina Faso 2018)), or, if not critical, included in the MEFP. The MEFP or the structural benchmark could lay out the elements that are relevant for a communication plan such as determining the objectives of the communication plan, the governance of the communication plan, stakeholder analysis, the media and the type of messages and information that will be shared. The conditionality should allow for sufficient time to develop and implement the communication plan as this requires an extensive process including many stakeholders. The communication plan should allow for an interactive dialogue with stakeholders.

- *Efficiency of SOEs*: Sectoral policies to improve the efficiency (and hence costs) of SOEs and the energy sector in general (including measures to invest in renewable energy) could be set through structural benchmarks or depending on the criticality included as an intention in the MEFP. Where in-depth sectoral expertise is needed in on-core areas, other IDIs should be consulted. In cases where bringing the SOE on a financially sustainable footing, requires public financial management measures,

public financial management experts should be consulted in designing conditionality. Additionally, measures could be needed to prevent fiscal risks building up through SOEs and leading eventually to transfers from the budget (either above or below the line through capital injection, on-lending, guarantees). In some cases, the use of numerical targets such as an IT could be useful. For instance, an IT on debt or arrear accumulation could be set (see Egypt 2016, Pakistan 2019). The IT's and structural benchmarks could also be complemented with commitments for broader sectoral policies which are necessary but not critical to the IMF-supported program (see Egypt 2016).

Box 4. Examples of Energy Subsidies Conditionality

Prior Actions

- Burkina Faso, 2018: Begin implementation of the communication plan for a flexible fuel price mechanism by publishing an article on the costs of fuel subsidies. Also, conduct two outreach sessions with stakeholders.
- Egypt, 2016: Increase gasoline and diesel prices at the pump by an average of 35 percent to achieve pre-tax price to-cost ratios of 56 percent and the projected fiscal savings.
- Egypt, 2016: Issue and publish in the official gazette a Prime Ministerial decree. to implement fuel price indexation mechanism for all fuel products except gasoline Octane 95 (a decree was already issued in December 2018), LPG and fuel oil used in bakeries and electricity generation.
- Haiti, 2015: Adoption of an automatic price mechanism for refined oil products (gasoline 95, diesel, and kerosene products); TMU ¶34.
- Honduras, 2019: Present a plan to secure a reduction in electricity losses, starting in 2019, with a floor of 3 percent per year from 2020 onwards.
- Honduras, 2019: Approve new tariff scheme that secures the recovery of electricity generation and ENEE's operational costs.
- Madagascar, 2016: Increase fuel pump prices by MGA 50 per liter in June 2018.
- Madagascar 2016: Increase in the weighted-average electricity tariffs by 15 percent compared to April 2016.
- Pakistan, 2019: Adopt a package of measures in the energy sector: (i) Implement a quarterly automatic tariff adjustment in the electricity sector by about 10 percent to generate Rs 150 billion in additional revenues and (ii) notify by government the FY 2020 gas tariff adjustment as proposed by the regulator to become effective on July 1st, 2019.
- Serbia, 2015: Submission to the Energy Agency of the Republic of Serbia a request to increase the regulated electricity tariff by 4.5 percent, to be effective from August 1 (MEFP ¶33).
- Suriname, 2016: Electricity tariffs rise to cover 60 percent of the production cost.

  Tunisia, 2016: Fuel prices. Implementation of a price increase of an average of at least 5 percent at least for the main fuels.

Structural Benchmarks

- Cote d'Ivoire, 2011: Increase the prices of liquid petroleum products by a maximum of CFAF 15 per liter to contribute to financing the butane stabilizer.
- Cote d'Ivoire, 2016: Apply the retail fuel price mechanism to preserve fuel tax revenue at a level envisaged in the budget law.
- Egypt, 2016: Increase fuel prices to raise price-to-cost ratios to 100 percent.
- Jordan, 2020: Adopt a multi-year plan – budget neutral for NEPCO – to reduce electricity tariffs of key sectors so that average electricity tariffs on corporates aligns with the average supply cost per kWh, and household subsidies are re-directed to only those who need it by end-2024.
- Jordan, 2020: Adopt and announce a three-year plan, with evenly-phased implementation starting in 2021, that (a) redirects electricity subsidies only to those who most need them; and (b) uses part of the achieved savings to reduce electricity tariffs for key business sectors, while containing NEPCO losses.
- Yemen, 2014: Cabinet to increase the domestic price of gasoline, diesel, and Kerosene by 50 Yrls per liter and Yrls 800 per gas cylinder (to Yrls 175, Yrls 150, Yrls 150, and Yrls 2000, respectively). Increase SWF monthly allocations per beneficiary by 50 percent.
- Ukraine, 2015: Reform utility-related social assistance by (i) reducing the scope of energy privilege programs to cover only households that remain exempt from income testing according to Law 76-VIII/2014; (ii) converging the associated benefits to the levels in the HUS program; and (iii) revising the benefit formula of the expanded HUS program in consultation with IMF staff to channel benefits to vulnerable households and provide incentives for energy efficiency. The overall fiscal envelope for all energy-related social assistance programs (privileges and HUS) will be set at UAH 43 billion (July MEFP ¶24).
- Ukraine, 2018: Reduce consumption norms from 5.5 to 5.0 cm per m2 for gas for individual heating, from 65 to 51 kwh per m2 for electricity used for individual heating, and from 0.0548 to 0.0431 Gcal per m2 for centralized heating effective May 1, 2017 (as specified in ¶23).

Quantitative Performance Criteria

- Egypt, 2016, Quantitative Performance Criteria: *Cumulative ceiling on fuel subsidies*

Indicative Targets

- Albania, 2014: Ceiling on subsidies to the energy sector.
- Egypt, 2016: Accumulation of EGPC Arrears ($ million; cumulative ceiling, IT)
- Pakistan, 2019: Indicative Target: Ceiling on power sector payment arrears (cumulative flow, billions of Pakistani rupees)

Note: The indicated year refers to the year in which the IMF-supported program is approved.

D. Public Pension Spending

Public pension spending, one of the largest public expenditure items, is macro-critical via several channels: fiscal sustainability, spending adequacy, and spending efficiency.

- *Fiscal sustainability:* Countries with high public pension spending, a need for increasing pension coverage and/or higher level of pensions, or an aging population might experience spending pressures, and face the unsustainability of the system in the medium- to long term. Most advanced economies (e.g., Portugal, Japan) are already experiencing a rapid aging due to lower fertility rates and / or longer life expectancies. Although the process started later, it is faster in emerging Asia than in most advanced economies (for instance in South-Korea).

- *Spending adequacy:* Public pensions serve as one of the most important sources of income for the elderly (IMF, 2022). They are inadequate if they are not sufficient to achieve social goals. Main social goals include poverty alleviation, and consumption smoothing over the life cycle.

- *Spending efficiency:* Public pension spending is inefficient if pension generosity implies unnecessary large negative macroeconomic, or distributional impacts. Hence, such impacts should be considered along with budgetary consequences of pension reforms.

Conditionality on pension spending is warranted when pension reforms are critical for program success. In the past, usually half of the programs with conditionality aimed at reforming the pension system as a whole, while other half at modifying some parameters of it, with a small portion of aiming at both (Andritzky, Munkacsi, Wang, 2021). In some cases spending policies with a rather immediate impact could help: for instance, in Greece's 2010 SBA one structural benchmark aimed at reducing pension bonuses. In other countries parametric changes in the system as a whole could be warranted to deal with spending pressures: for instance, in Georgia's 2017 EFF there was a need for a new rule-based mechanism to index pensions. Sometimes more fundamental changes would be essential, though, like the establishment of a new second pillar in Georgia (see the 2017 EFF for an SB). In any country, several challenges could be prevalent at once, and also dealing with one aspect might have an impact on the others. So, the timing, packaging and sequencing reforms needs to be carefully designed. Key milestones can be set as structural benchmarks which are non-quantifiable measures, or prior actions when upfront implementation is needed (for example because of a weak track record, or when there are doubts about implementation). As pension reforms are usually complex and long reforms, quantitative targets are less appropriate. Nonetheless, if there are concerns, for instance, they might be used to help protect spending adequacy in adjacent social areas. Public pension spending can also be included in total social spending. Further examples of programs with pension conditionality are available in Box 6, while Box 11 provides insights on QPCs.

In addition to setting structural conditions on pension reforms per se, structural conditions on related areas could help implement, or monitor the implementation of pension reforms. Some examples are as follows:[28]

[28] Please also see IMF (2022) for further details on some of the examples.

- Procedural and substantive fiscal rules to ensure that pension-related regulatory proposals are accompanied by long-term fiscal and welfare impact analyses.

- Regular preparation and submission to legislature of long-term projections concerning the government's pension, health, and long-term care obligations. For instance, in Armenia's 2010 ECF-EFF completing the first set of estimates of the fiscal cost of the pension reform was set as a structural benchmark.

- Labor market reforms to initiate the transfer (back) to labor markets of workers in case of pension reforms (e.g., when the official retirement age is increased, or early retirement is cut back on). For example, in Ukraine's 2010 SBA (Box 5), to motivate workers to stay in the labor force, the authorities increased by 10 years the qualification period for receiving full pension benefits.

Scaling up existing social assistance programs or introducing new programs if needed to mitigate the negative consequences of pension reforms on the most vulnerable groups. E.g., in Greece's 2012 EFF pensions were adjusted with protections for low-income pensioners, and in Ukraine's 2015 EFF (Box 5) the authorities intended to gradually adjust the statutory retirement age, and further reduce the scope for early retirement.

Feasibility is key when designing conditionality on pension reforms. Most pension reforms take a considerable amount of time both to be implemented and impact. Distributional and political economy considerations point to a gradual phase-in of reforms to give people time to adjust. Proper sequencing of reforms can also bring about implementation. For example, in case of Armenia's 2010 program there was first a structural benchmark to identify the fiscal space needed for the reform ("Complete first set of estimates of the fiscal cost of the pension reform."). Or, in case of Georgia's 2017 program, the reform sequence was already set at program initiation, and conditions added during subsequent reviews followed that logic. Another consideration should be the authorities' institutional capacity to make the implementation schedule realistic. Time and resources are typically constrained in a program context, so reliance on gaps identified during prior surveillance or technical assistance, and early outreach with other institutions can help build the knowledge and contacts necessary for success at a later stage. Even if structural conditions are based on prior AIV or TA findings, reform fatigue can happen (Georgia, 2017).

Box 5. An Example of Programs with Pension Conditionality — Ukraine

One example of how such a complex and long reform as a pension reform could be designed in a program context is Ukraine. Similarly, to other countries, due to the complex nature of the reforms, they spanned over more than one IMF-supported program. Another sign of complexity was the brevity of the structural conditions themselves, with references to the MEFP where details about the actual reforms were provided. In the 2010 SBA, first, with the objective of putting the pension system on a sound financial footing, the authorities aimed at reducing the deficit transfers to the pension fund. As a first step, they enacted legislation that requires both legal persons and physical entities participating in the Simplified Taxation System to pay contributions to the pension fund corresponding to the minimum wage surcharges. Then, they enacted changes to the base for calculating the additional 1 percent pension benefits accrued for each year of service above 20/25 for women/men. Furthermore, the authorities also intended to address longer-term structural problems by adopting deeper reforms:

- To increase system enrollment, they increased the minimum required insurance period from 5 to 15 years;
- With the aim to equalize the pension age for all workers, starting in 2010, they gradually increased the pension age for women from 55 to 60 years;

To motivate workers to stay in the labor force, they increased by 10 years the qualification period for receiving full pension benefits.

- Then, in the 2015 EFF the authorities intended to continue with the structural reforms:
- To gradually adjust the statutory retirement age and further reduced the scope for early retirement.
- To tighten the eligibility criteria for the minimum pension.
- To consolidate pension legislation, previously spread across about two dozen laws, and ensure a single principle for providing pensions without privileges for any occupation (with the exception of the military).
- To expand the base for social security contributions.
- To ensure equitable tax treatment of pensions.
- To better link benefits to contributions, also to encourage the declaration of actual incomes.
- Finally, to separate various categorical pension supplements from the labor pensions, bring their financing from the pension fund to the state budget and improve their targeting starting from 2017.

Box 6. Examples of Pension Structural Conditionality

Prior Actions

- Bosnia and Herzegovina, 2012: Adopt a new law on privileged pensions in the Federation in line with IMF staff recommendations.
- Central African Republic, 2016: Suspension of expatriation benefits to diplomats who have completed their assignments.
- Greece, 2010: Reduce public wage bill by cutting bonuses/allowances; and pension bonuses (except minimum pensions).; Government to enact spending reductions (including pensions and earmarked spending and advanced removal of the heating fuel subsidy); revenue measures (including reducing PIT thresholds and reductions) as described in MEFP paragraph 6.; Government to enact legislation in the context of MTFS implementation (phase II) to: (i) introduce pension adjustment bill stipulating freezes through 2015, introducing individual social security numbers, caps, means testing, and rationalizing benefits of pension funds; (ii) introduce single public pay scale bill, temporarily freeze automatic progression, and halve productivity allowance; and (iii) close 40 small public entities, merge 25 more small entities, and close an additional 10 large entities under line ministries and in the social security sector.
- Portugal, 2011: Submit to Parliament a legislative proposal that increases the statutory retirement age to 66 years.; Submit to Parliament a supplementary budget to enact the necessary changes to the existing extraordinary solidarity contribution on pensions (CES), consistent with the general government deficit target of 4 percent of GDP (MEFP ¶5).
- Ukraine, 2015: Adopt a Cabinet of Ministers decree reducing the lists 1 and 2 of occupations eligible for early retirement by at least 40 percent in terms of eligible persons (¶29a).

Structural Benchmarks

- Albania, 2014: Establish a Pension Reform Commission to devise a reform strategy of the pension system.; Council of Ministers to approve a pension reform strategy.
- Armenia, 2010: Complete first set of estimates of the fiscal cost of the pension reform.; Submit by government to Cabinet two pension reform decrees to establish: (i) procedures for managing the guarantee fund for mandatory, funded contributions; and (ii) quantitative and currency restrictions on investing mandatory funded pension assets in financial instruments.; Maintain support for the Pension System Awareness Center and the pension reform outreach campaign in the 2017 budget.
- Barbados, 2018: Government to table a revised public pension law to enhance the sustainability of the public sector pension scheme; Government to conduct an actuarial review of the civil service pension system with a view to reform it as discussed in MEFP paragraph 21.
- Bosnia and Herzegovina, 2012: Refrain from introducing new privileged or special rights for retirement.; Pay obligations accrued through May 2012 arising from early retirement provisions under the Law on Service in the Armed Forces of BiH.; Submit to the Federation parliament the amendments to the relevant legislation to implement the Federation pension reform strategy.; Adopt a new law on privileged pensions in the Federation in line with IMF staff recommendations.

- Bosnia and Herzegovina, 2016: Federation government to complete Phase III of the audit process for all categories of war veterans' benefits, including privileged pensions.
- Georgia, 2017: Submission of a pension law establishing a 2nd pillar pension system; Establishing an independent pension agency; Submit to Parliament legislation proposing a rule-based mechanism to index basic pensions.
- Greece, 2010: Adopt a comprehensive pension reform that reduces the projected increase in public spending on pensions over the period 2010-60 to 2½ percent of GDP.; Government to enact legislation in the context of MTFS implementation (phase II) to: (i) introduce pension adjustment bill stipulating freezes through 2015, introducing individual social security numbers, caps, means testing, and rationalizing benefits of pension funds; (ii) introduce single public pay scale bill, temporarily freeze automatic progression, and halve productivity allowance; and (iii) close 40 small public entities, merge 25 more small entities, and close an additional 10 large entities under line ministries and in the social security sector.
- Greece, 2012: Government to adjust pensions, with protections for low-income pensioners, and the social security contribution base, to permit a fully funded reduction in rates (cumulatively 5 percent from January 1, 2012).; Adopt pension reform package based on actuarial studies completed in September on the whole pension system including supplementary and lump-sum funds (¶6).
- Guinea-Bissau, 2010: Submit to the Council of Ministers an action plan for the public administration reform, with a medium-term schedule to downsize the civil service through retirement and removing redundant workers beginning in 2011.
- Jamaica, 2016: Institute rules prohibiting the rehiring of participants in the early retirement program into the public sector for at least 5 years unless the person returns the incentive.; Submit to the Governor General through Cabinet rules and standards for the Public Service Commission for limiting the approval of continued employment after retirement age, including as contract officers.
- Moldova, 2010: Parliament will adopt legislation to phase out early retirement privileges of civil servants, judges and prosecutors.
- Moldova, 2020: Amended the Law on Social Insurance and the Law on Pension System to: (i) replace double indexation of pensions below subsistence minimum with semi-annual (April and October) indexation based on previous six-month CPI inflation starting in October 2020, (ii) exclude the possibility to recalculate pensions of prosecutors and judges based on average wage growth of their sitting peers, and (iii) redesign the 5-year guarantee of pension payment to surviving spouses to limit its eligibility only to vulnerable households with pensions below 1.5 times of pension subsistence level. (MEFP ¶22).
- Portugal, 2011: Submit to Parliament a legislative proposal that increases the statutory retirement age to 66 years (MEFP ¶8).; Submit to Parliament a legislative proposal that aligns the rules and benefits of the public sector pension fund, CGA, to the general pension regime (MEFP ¶8).
- Uganda, 2010: Submit the Retirement Benefits Authorities Bill to parliament.
- Ukraine, 2015: Parliamentary approval of legislation to: (i) gradually adjust the statutory retirement age and further reduce the scope for early retirement; (ii) tighten the eligibility criteria for the minimum pension; (iii) consolidate pension legislation, which is now spread across about two dozen

laws, and ensure a single principle for providing pensions without privileges for any occupation (with the exception of the military); (iv) expand the base for social security contributions; (v) ensure equitable tax treatment of pensions; and (vi) better link benefits to contributions, also to encourage the declaration of actual incomes. In addition, we will separate various categorical pension supplements from the labor pensions, bring their financing from the pension fund to the state budget and improve their targeting starting from 2017 (¶29a).

- St. Kitts and Nevis, 2011: Draft proposal for a comprehensive pension reform.

Note: The indicated year refers to the year in which the IMF-supported program was approved.

E. Public Health Spending

Health, a key expenditure policy area, is macro-critical via numerous channels.

- *Spending adequacy:* If public health spending is not adequate and the health indicators worsen, there is a risk of not promoting growth, or not protecting the vulnerable (IMF, 2017b; IMF, 2019b; WB, 2004). Additional fiscal pressures might also arise in the future.
    - Better adult health affects the size of labor force and is positively associated with improvements in productivity which can in turn promote higher and more inclusive growth.
    - A child's health has a significant impact on the ability to learn, which over time will increase both labor force and productivity.
    - Unlike redistributive fiscal policies, which seek to lower disposable income inequality through taxes and transfers, public health spending can directly reduce market income inequality (IMF, 2017a).
- *Fiscal sustainability:* Similarly, to other spending items, public health spending needs to be sustainably financed. Most non-advanced economies would need to increase public health spending to achieve universal health care goals (see Box 8). As fiscal space is often limited, spending reprioritization and enhancing revenue generation could prove useful.
- *Spending efficiency:* Inefficiencies can arise because of numerous reasons (see Box 7 for further information). Examples include lifestyle, weak rule of law, corruption, costly or unmotivated staff, and the composition of health spending (primary vs. preventive care).

Conditionality in the area of health should be added if deemed critical for program success or monitoring. Good health in general helps increase growth and decrease inequality, however, an IMF-supported program should focus on areas which are the most critical for program success or monitoring program implementation. There might be several areas in need of reforms, in which case those should be prioritized which are the most critical, and the number of conditions should be limited to the minimum necessary in line with the principle of parsimony. Conditions which are not critical for program success, but the authorities still wish to pursue them, should be described in the LOI or the MEFP.

Although IMF-supported programs usually aim at protecting public health spending (IMF, 2019b), there are only a few examples with structural conditionality from the past. Among them, programs often focused on restoring the financial sustainability of the health care system (see Box 8). For instance, in Bosnia and Herzegovina's 2016 program, the Republika Srpska aimed at adopting a plan to restore financial sustainability of health care institutions, in line with IMF and World Bank advice. Other examples include the adoption of medium-term expenditure frameworks for the health sector (Chad, 2005; Madagascar, 2016), and the enhancing of the quality and efficiency of health spending (Ecuador, 2019; Romania, 2011). In a handful of programs, indicative targets (usually floors on health spending) were added to support program goals (see Box 11).

As health care is not a core area of Fund responsibility, to increase the feasibility of reforms, it is even more important to rely on technical assistance. The World Bank and other development partners' involvement can prove particularly useful. Assistance from the World Bank was requested in several cases, including Chad (2015), Bosnia and Herzegovina (2016), and Ecuador (2019). Reaching out to international partners prior to a program context is important as health care reforms are complex, and time and resources are limited during program negotiations. Delays in implementation can be avoided by a realistic timeline and appropriate order of reforms, and by taking capacity and political constraints into account. Colombia's 2003 program is a good example of utilizing sequencing: first, the preparation of a plan which also identifies the fiscal effect, then the implementation phase, and finally a financial evaluation of the reform.

Mainly structural conditions are needed for program success, but quantitative conditions can help. Health sector reforms need to take the form of structural benchmarks or prior actions; the latter are necessary in case of a requirement of upfront implementation, the presence of weak track record, or when there are doubts about implementation. Quantitative conditions, such as QPCs and ITs, can help if there are financing constraints. Higher economic growth alone would not be sufficient to finance the reforms (see Box 8), and most countries in need of reforms have a high debt and / or high tax levels. Revenue mobilization could prove useful, and the most growth-friendly mix should be preferred. Additionally, as a general rule, higher public health spending should not crowd out other social spending (IMF, 2019b), and QPCs or ITs could be set to make sure that this rule is being respected. (Structural and quantitative) conditions not critical for program success, but desired by the authorities, could be listed in the MEFP or the LOI. Regional distribution of hospitals, doctors and nurses should be of further consideration, especially in countries with high inequality and rural-urban discrepancies. Finally, as public health spending is largely determined by wages and employment in this sector, granular advice about public wage bill management conditionality (see section IV.G) can prove useful.

Box 7. Health Inefficiency and Inequality

Inefficiencies in health are substantial across a wide range of countries (Gupta and Verhoeven, 2001; Afonso and St. Aubyn, 2005; Grigoli, 2015; Grigoli and Kapsoli, 2018), which results in poor health outcomes and higher-than-necessary health spending. WHO (2010) suggests that 20 to 40 percent of public and private health spending does little to improve health outcomes. Andre and others (2010) report that health spending inefficiency lowers life expectancy by about 2 years, while IMF (2014a) claim that it might be even more than that. Potential gains from improving health efficiency are estimated to be 0.4-5 percent of GDP in terms of savings or increases in life expectancy by 2-8 years (Jayasuriya and Wodon, 2003; Greene, 2005; Kim and Lee, 2018; Grigoli and Kapsoli, 2018; Garcia-Escribano and others, 2022).

Health is also relevant in the context of aging and pensions (IMF, 2019); higher life expectancy might facilitate an increase in the retirement age as it would raise the number of after-retirement years.

There are many causes for health inefficiency: lifestyle such as obesity or smoking (Perez-Carceles and others, 2018); weak rule of law, corruption, waste and fraud (Adenauer and others, 2007; Rayp and Van de Sijpe, 2007; WHO, 2010; Garcia-Escribano and others, 2022); inequality (Greene, 2004; Ravallion, 2003; Herrera and Pang, 2005; Garcia-Escribano and others, 2022); costly or unmotivated staff (WHO, 2010); composition of health spending such as public vs. private, primary vs. non-essential (Rayp and Van de Sijpe, 2007); immunization (Alexander, Busch and Stringer, 2003); and education (Afonso and others, 2010). As regards the composition of health spending, primary and preventive care are in general more cost effective than hospital care, while the cost-effectiveness of different treatments also significantly differs (Coady and others, 2014). WHO (2010) also highlight the overuse of expensive hospital treatments, inappropriate hospital size, and the underuse of generics and unnecessarily expensive medicines. Other considerations include competition and macro-level controls. Increasing competition for patients among insurers, and dissemination of information about prices and quality can be positively associated with better health outcomes (Gaynor and others, 2013). Macro-level controls, such as budget caps on subsectors can have an impact, but supply constraints (positive lists for drugs, delisting certain treatments) or price controls (pharmaceutical products, treatments) have a modest effect only (IMF, 2010). Regarding the sub-national level, if central oversight is maintained, greater involvement of sub-national governments is key (IMF, 2010); at the same time, poor execution at the sub-national level can lead to budget under-execution (Bloch, 2020). Finally, improving provider payment systems, adopting health information technology, and improving public financial management could help (Coady and others, 2014; World Bank, 2017).

Given the limited fiscal space, competing social and other spending demands, one way beyond increasing the resources for health to achieve better outcomes is enhancing health efficiency. Countries with similar levels of health spending can have very different performance as regards health services and their financing (Bloch, 2020). For example, Sri Lanka achieved outstanding health indicators with lower spending than countries such as Maldives and Bhutan. Furthermore, in countries where health coverage is already broad (such as emerging Europe), the focus should be on containing current levels and enhancing efficiency (Clements and others, 2012). Increasing health efficiency might also be more politically feasible than lowering spending in other areas (Coady and others, 2014).

Health inequality is also sizeable across the globe. Health disparities—measured by the ratio of the infant mortality rate of the top to the bottom quintile in the population—are substantial, even more, they increased in about half of the non-advanced economies over the last decade (IMF, 2017a). Relatedly, large gaps in health coverage exist between the rich and the poor in most countries. Quality of health care received by the poor is also substantially lower than that received by the rich (Houweling and others, 2007). Eliminating inequalities in basic health coverage could raise life expectancy, on average, by 1.3 years in low- and middle-income countries (IMF, 2017a) which would have several advantages discussed earlier.

Box 8. Financing the Path towards Universal Health Care

As part of the SDGs, the United Nations aim at achieving universal health coverage (UHC) which has two important aspects. Indicator 3.8.1 of the SDGs discusses the coverage of essential health services, medicines and vaccines for all, based on tracer interventions that include reproductive, maternal, newborn and child health, infectious diseases, non-communicable diseases and service capacity and access, among the general and the most disadvantaged population. Indicator 3.8.2 concerns the financial protection dimension of universal health coverage. It captures the impact of health spending paid "out-of-pocket" (OOP) on household's budget which could imply for some families choosing between health and other essentials like food and education. The question is how to find fiscal space for achieving UHC – defined as "the availability of budgetary room that allows a government to provide resources for a given desired purpose without any prejudice to the sustainability of a government's financial position" (Heller, 2006).

Health financing gaps are sizable in numerous countries. Country differences in current public health spending are huge: the health share of government expenditure varies between 1 percent (Myanmar) and 28 percent (Costa Rica) (Fleisher and others, 2014). It is no doubt that reaching, or at least approaching UHC will be a costly exercise for most countries, particularly those with lower public health spending and GDP levels. There are several targets for achieving UHC: absolute targets (expressed in per capita US$ amounts) and relative targets (as a share of public expenditure, or as a share of GDP). The so-called Abuja target says that countries should spend 15 percent of their public expenditure on health (OAU, 2001). As Njora (2010) explains, though, only a few countries reached it so far as it could undermine the autonomy of Ministries of Finance to make sectoral budget decisions. In addition, reaching it might also mean that a smaller share of spending can be spent on other social areas which could be counterproductive (as health is affected by them). Specifying a target of public health spending relative to GDP does not argue for higher health spending at the expensive of lower spending in other areas, and it also takes account of the country's affordability (McIntyre and others, 2017). Additional health spending needs to meet the SDGs by 2030 are almost 5 and 4.6 percent of GDP in LIDCs and 2 and 1.5 percent of GDP in EMEs, respectively (IMF, 2019b; Amaglobeli and others, 2019). The burden is particularly high in low-income countries of Central and Western Asia, Northern Africa and Sub-Saharan Africa (ILO, 2020). McIntyre and others (2017) propose a public health expenditure-to-GDP ratio of at least 5 percent of GDP. They also suggest an absolute target of per capita US$86 because in less-developed countries spending 5 percent of GDP on health would be such a small absolute amount that they would hardly get closer to UHC. There are also a few country-specific studies available which provide similar estimates:

- In South Africa, McIntyre and Ataguba (2012) find that even the least costly universal health coverage scenario would require public health spending to reach 6.4 percent of GDP.
- In Tanzania, Ally, Borghi and Mtei (2012) estimate that to achieve UHC 4.3 percent of GDP should be spent on health publicly.

In addition to expanding basic health coverage to the people, WHO (2010) and Evans and others (2003), in line with the SDGs, stress that the share of OOP financing should be reduced to provide financial protection to people.

Economic growth alone will not be sufficient to raise the funds needed to ensure access to basic health services in most countries (Elovainio and Evans, 2017). Many point out that it is public, compulsory, pre-paid financing (including taxes, health insurance contributions and other government revenues) that helps countries move towards UHC (WHO, 2010; Bitran and others, 2012; Jowett and Kutzin, 2015; Kutzin, 2012; Barroy and others, 2018). It is challenging to raise public revenues, though. IMF (2017a) highlight that in addition to high debt, many advanced economies already have high tax and spending levels. An additional circumstance in most advanced economies is that they are facing aging (Clements, Coady and Gupta, 2012) which has consequences for budget revenues, and so health financing, too. The biggest challenge in non-advanced economies is that health financing gaps are very large compared to their tax revenue levels; in low-income countries, for instance, they represent about 45 percent (ILO, 2020). Low revenue-generating capacity, especially in low-income countries, also implies a high share of out-of-packet financing (Cashin and Tandon, 2010). Inadequate domestic revenue mobilization might be a consequence of several factors, such as low formal employment, widespread tax evasion and weak tax administration (Bloch, 2020).

Even though in the longer term, partly because of fiscal sustainability reasons, domestic funding is preferred, some countries will need to seek for international sources, at least in the short-to-medium term (Farag and others, 2009; Elovainio and Evans, 2017; ILO, 2020). Nonetheless, Moon and Omole (2017) describe several challenges related to external funds which include the level of funds, their volatility and uncertainty, the issue of additionality, and the share of funds actually reaching recipient countries. Another challenge is finding a role for middle-income countries (Moon and others, 2017). Regarding additionality, Farag and others (2009) stress that even though many low-income countries will require external funding, it should be additional to domestic sources.

A key drawback of prioritization for the health sector is that it can adversely impact other social services, and so economic development. Such a policy can negatively affect GDP in a direct way, but also via other social services as they, e.g., education, are key determinants of health, too. In general, crowding out of other social spending is not suggested (IMF, 2019b).

There are several ways to raise funds domestically. Chowdhury and others (2019) list, among others, the following strategies: expanding social security contributory revenues, increasing tax revenues, using fiscal and central bank foreign exchange reserves, improving debt management, reallocating public expenditures, and increasing official development assistance and transfers. According to some stream of the literature, increasing social sector contributions and tax revenues might be carried out by increasing rates. However, as Meheus and McIntyre (2017) say, better tax compliance and efficiency in revenue collection are also ways to consider. In addition, maximizing revenues from natural resources and taxing tobacco, alcohol or sugar products are other potential tools.

Regarding taxes in more detail, a mix should be preferred which is the least harmful to inclusive economic growth. Distortionary taxes should be neglected, and the focus should be on the most progressive means (Meheus and McIntyre, 2017). Basu and others (2015), using data on 89 low-income and middle-income countries, find that each US$100 per capita per year of additional tax revenues corresponds to a yearly increase in government health spending of US$9.86. This association is strong for taxes on capital gains, profits and income, but not for consumption taxes. At the same time, consumption taxes were associated with higher rates of mortality which was not experienced in case of other taxes, and that consumption taxes might reduce the ability of the poor to afford essential goods.

Lifestyle, such as obesity or smoking have a considerable negative impact on health outcomes, however, excise taxes on products with negative health internalities could also contribute to higher domestic revenues, while increasing disincentives for unhealthy consumption patterns. By taxing them more one would raise revenues and improve the health of the population. For instance, in two recent case studies of Ivory Coast and Morocco, the authors pointed out that even though there were taxes in place on tobacco, alcohol and sugar-sweetened beverages, there is a significant capacity to increase them further (OECD, 2020a and 2020b).

Box 9. Examples of Health Structural Conditionality

Prior Actions

- Croatia, 2004: Government to approve and submit to Parliament a package of draft laws on health reform that require co-payments for drugs not included on the main (basic) list, discontinue HZZO's (state health insurance company) provision of supplementary insurance for drugs, and open supplementary insurance for other health services to the private sector.
- Ghana, 2003: Introduce a legislative instrument in parliament to ensure the effective implementation of the National Health Insurance Levy on August 1, 2004.
- North Macedonia, 2005: Government submission to Parliament of amendments to the Health Insurance Law and Law on Health Care and adoption of the necessary by-laws to tighten selection of HIF Board and implement transparent budget procedures.

Structural Benchmarks

- Bosnia and Herzegovina, 2016: RS cabinet to adopt a plan to restore financial sustainability of health institutions, in line with IMF and World Bank advice.
- Bulgaria, 2004: Approval by parliament of an amendment to the Health Insurance Law.
- Chad, 2005: Adoption by the Council of Ministers of the medium-term expenditure framework for all priority sectors (health, education, rural development, basic infrastructure, and environment) for 2006–08, prepared in consultation with the Fund and the World Bank, and consistent with the Poverty Reduction Strategy Paper.
- Colombia, 2003:
  - Approval by CONPES (Consejo Nacional de Politica Economica y Social) of the Social Security Institute's financial sustainability plan for its health service. The plan will clearly identify the fiscal effect of each of its elements and be consistent with eliminating the deficit of the ISS health system by 2007.
  - Full implementation of National Development Planning Authority (CONPES) plan to eliminate the deficit of the ISS health system by 2007.
  - A financial evaluation of ISS health will be undertaken, in order to determine whether additional actions beyond those established in Decree 1750 of June 2003 are required.
- Croatia, 2004:

- Government to submit to Parliament for approval the draft law on the reform of supplementary health insurance.
- Parliament to approve a package of draft laws on health reform that require co-payments for drugs not included on the main (basic) list, discontinue HZZO's (state health insurance company) provision of supplementary insurance for drugs, and open supplementary insurance for other health services to the private sector.

- Ecuador, 2019: Publication of an action plan, in coordination with World Bank technical assistance, to strengthen the efficiency and quality of primary education and health spending.
- Gabon, 2007: Prepare an action plan and a cost estimate for implementing the health insurance and social security system.
- Georgia, 2022: Include in the 2022 Fiscal Risk Statement a quantification of fiscal risks from climate change and legal claims, and a long-term sustainability assessment for health and aging-related spending.
- Madagascar, 2016: Integrate health and education sectoral spending plans into a medium-term budget framework.
- Romania, 2011: Prepare comprehensive amendments to the health care legislation to address the persistent budgetary shortfalls and to ensure high quality health care services.
- Romania, 2013: Prepare the basic health package within the existing spending envelope which will also define the scope of the private sector in the health care system in the future.

Note: The indicated year refers to the year in which the IMF-supported program was approved.

F. Public Education Spending

Education is under pressure in several countries due to numerous reasons.

- *Fiscal sustainability:* The education sector must be sustainably financed; if not, a reform is warranted.
- *Spending adequacy:* If education spending is not adequate for promoting growth and protecting the vulnerable, the sector must be reformed.
- *Spending efficiency:* Especially with a scarce fiscal space, spending inefficiencies hurt the public budget.

Spending pressures can be a result of a rapid population growth (see emerging market economies), while a fast technological change is affecting almost all countries around the world (IMF, 2019b). According to Hanushek and Woessmann (2022), in a vast majority of countries, the youth do not even acquire basic skill levels, while reaching the goal of global universal basic skills would raise future world GDP by $700 trillion over the remainder of the century. Enhancing education could diminish skill mismatches which could further increase the (relative) size of the labor force. Furthermore, after the pandemic, there might be generations lagging on education with a long-run impact on human capital accumulation. Interlinkages between health and

education are also important: both in terms of financing needs and competition, and their positive impact on each other (better health contributes to better education, and vice versa).

In spite of the gains of better education, there are only a handful of IMF-supported programs with structural conditions in the area of education. This could be explained by the fact that an IMF-supported program has many critical urgent reforms to maintain macro-stability and investments in education may not be of immediate urgency. Some of those focus on formulating a medium-term expenditure framework (see Box 10). Conditions which aim at increasing the quality of public education spending are even more limited. Armenia's 2019 Stand-by Arrangement (with three main program goals, one of them being better education) is an exception with several and detailed structural benchmarks. In the program better education was linked to better health care, and there was a reference to skill mismatches which hinder job placements and private sector job creation, particularly in high-productivity sectors. With assistance from the World Bank, the authorities intended to (i) restructure and modernize the tertiary education system, and (ii) develop a comprehensive education reform strategy to increase equitable access to pre-school education. Another example is Ecuador's 2019 Extended Fund Facility Arrangement: an action plan was prepared, with World Bank technical assistance, to strengthen the efficiency and quality of primary education and health spending. So once again, a link between education and health was emphasized. The Georgia authorities also aim at focusing on education in their new 2022 Stand-by Arrangement with the aim to tackle high unemployment and labor market mismatches. Furthermore, to facilitate the financing of education reforms, they highlighted the priority of enhancing tax administration and reviewing tax expenditure. Quantitative targets are even more rare (see Box 11), and they are usually floors on total education spending.

Structural reforms are the most appropriate form of conditionality in the education sector. The main reason is that education reforms are usually complex and long reforms, with numerous structural elements. One topic to be explored is spending and targeting at different education levels; action plans could be drafted, or laws would need to be implemented to change the prevalence of primary, secondary, tertiary, or vocational levels. The targeted shares could originate from aligning education with labor market needs: consulting with private sector employers could prove useful in this regard. In addition to aligning specific occupations, the training of teachers could be better positioned as well. Furthermore, on-the-job trainings might help in certain areas. Regional distribution of schools and teachers should be of further consideration, especially in countries with high inequality and rural-urban discrepancies. Finally, as public education spending is largely determined by wages and employment in this sector, granular advice about public wage bill management conditionality (see section IV.G) is relevant as well. Quantitative targets to help protect education (social) spending can take the form of QPCs or ITs (the latter if there is a concern about data quality, or uncertainty around the economic trend).

Given the complex and long nature of education reforms, careful consideration should be given to their feasibility. On the one hand, sufficient time is required for implementation, on the other hand, the reform impact might only materialize over a longer period of time. Reform realism can be further enhanced by considering the country's capacity and political constraints, and by relying on prior AIV and TA findings. Education is not a core area of Fund responsibility, thus work carried out during prior surveillance and technical assistance are (with the exception of SDG goals) are not typical. Hence, relying on international partners (e.g., the World Bank) is inevitable. In general, time and resources during program engagement are scarce, so reaching out to IDIs before the program phase can be particularly useful.

Box 10. Examples of Education Structural Benchmarks

- Armenia, 2019:
  - Operationalize the tertiary education management system.
  - Develop a comprehensive education reform strategy.
  - Submit to the National Assembly a draft law on Higher Education and Science which sets the legal ground for (i) reforming the tertiary education management system; (ii) upgrading licensing and accreditation requirements, state financing principles, supervision mechanisms for quality of education services.
- Bulgaria, 2004: Approval by the Council of Ministers of the system of school financing based on the unified per student standards.
- Chad, 2005: Adoption by the Council of Ministers of the medium-term expenditure framework for all priority sectors (health, education, rural development, basic infrastructure, and environment) for 2006-08, prepared in consultation with the Fund and the World Bank, and consistent with the Poverty Reduction Strategy Paper.
- Côte d'Ivoire, 2009: Formulation of medium-term expenditure frameworks for education and health ministries.
- Ecuador, 2019: Publication of an action plan, in coordination with World Bank technical assistance, to strengthen the efficiency and quality of primary education and health spending.
- Gabon, 2004: Preparation of a study with recommendations to prioritize the university scholarship system.
- Moldova, 2010: Parliamentary approval of legal amendments to continue the reform in the education sector.
- Nicaragua, 2007: Initiate the bi-annual publication of the principal social indicators for health, education, and water and sanitation.
- Senegal, 2020: Prepare a study to identify policy measures to improve secondary school enrollment and attendance.
- Solomon Islands, 2012: Review the policies on tertiary education and ensure an adequate balance of spending between primary and tertiary education.

Note: The indicated year refers to the year in which the IMF-supported program was approved.

Box 11. Quantitative Conditions for Pension, Health and Education Spending

Quantitative Performance Criteria

- Honduras, 2019: Lending minus repayments from public pension funds (ceiling).
- Iraq, 2005: Government wage and pension bill (ceiling).
- Iraq, 2007: Government wage and pension bill.
- Nicaragua, 2007: Floor on Social Security Institute (INSS) overall balance, after grants.
- Turkey, 2005:
  - Floor on the cumulative overall balance (before transfers) of the social security institutions (SSK, BK & ES).
  - Ceiling on consolidated primary spending of central government budget and social security institutions (SSK, BK, and ES).

Indicative Targets

- Liberia, 2008: Floor on primary education and primary healthcare spending (percent of total budgeted expenditure, excluding contingencies).
- Pakistan, 2019: Cumulative floor on general government budgetary health and education spending.
- Solomon Islands, 2011 and 2012: Government funded recurrent spending on health and education.
- Tajikistan, 2012: Floor on health and education spending.
- Uganda, 2006 and 2010: Minimum expenditures under the Poverty Action Fund (including the Universal Primary Education component of development expenditure).

Note: The indicated year refers to the year in which the IMF-supported program was approved.

G. Civil Service Reforms

The main channels through which public wage bill can be macro-critical are fiscal sustainability, spending adequacy, and spending efficiency (IMF, 2016):

- *Fiscal sustainability:* In both advanced economies as emerging market economies and low-income and developing countries, increases in the public wage bill have been on average associated with deterioration of the fiscal balance as these measures were only partially compensated with increases in revenues (IMF, 2016).

- *Spending efficiency:* Spending efficiency requires that public service delivery objectives are achieved in a cost-effective manner for all sectors which in turn depends on managing government compensation and employment. A positive public-private wage premium arises when there is a wage premium in the government sector that is not justified by relative skill levels or other characteristics.

- *Spending adequacy:* Spending adequacy issues arise when governments do not provide a competitive pay to attract high-skilled personnel, or do not have resources to attract sufficient personnel. In LIDCs and many emerging economies, the key challenge is to improve service delivery and expand employment in an affordable way.

Government's institutional arrangements are an important determinant of government wages and employment, and should be carefully assessed in reform strategies in IMF-supported programs (IMF, 2016):

- *Fiscal planning*: Integrating decision-making on the wage bill in the budgetary and fiscal frameworks, and a ceiling on wages and/or employment help ensure consistency with overall fiscal objectives. More than sixty percent of countries impose a ceiling on the wage bill.[29] However, using a ceiling as an indicative target or quantitative performance criterium can be interpreted as micromanaging, and should only be used if containing the wage bill is macro-critical. In addition, addressing underlying issues is more important. Examples of IMF-supported programs are limited (Moldova, Sudan, Democratic Republic of Congo, Ghana, Latvia). Automatic indexation to inflation or other variables can increase the wage bill in an inconsistent manner. Budget execution rules and payroll controls can help ensure the budget is executed as planned. These reforms can be part of a broader public financial management strategy and support wage bill containment, and they can be part of structural conditionality. Finally, wage bargaining systems can impact the fiscal objectives and competitiveness (Honduras's 2019 program). However, from a legal perspective, IMF-supported programs should not intervene in authorities' private contracts.

- *Competitive compensation*: The competitiveness of government wages can be influenced by legal rights to organize into trade unions, to allow collective bargaining, and to strike, and to give government employees the capacity to negotiate wages and employment conditions. The individualization of wage determination allows governments to have flexibility in pay, to differentiate scales, and to provide additional allowances to attract and retain staff, especially in areas with skill shortages. Comparisons between public- and private-sector wages can provide governments with information to compete with the private sector, and they can inform wage negotiations.

- *Flexibility and efficiency*: Flexibility to manage the workforce and promote efficient, performance-oriented service delivery is key. Flexibility in adjusting employment is impacted by rules and procedures for hiring, reallocating, and making staff redundant, and the degree of employment protection. Merit-based recruitment and promotion allows governments to employ qualified staff to deliver government services.

Carefully crafted compensation reforms can be included as part of structural conditionality. When there is a public-private wage premium, controlling wages by nominal or real wage freezes, or limiting the wage increase can help contain the wage bill. However, these measures are often implemented ad-hoc and across-the-board which may impact the ability of the government to retain high-skilled staff, especially in critical sectors, or sectors where the public-private wage premium was initially relatively small. While there were some examples in the past (Ecuador 2003, Serbia 2009, Bosnia 2016), recently these types of measures are not reflected in conditionality. Streamlining non-wage compensation and a periodic review improves transparency and fairness

[29] In AEs and EMs these ceilings are often combined with other approaches. EMs rely more on fiscal rules limiting the growth in the wage bill, while AEs rely more on fiscal frameworks.

of government pay which can be reflected in structural conditionality, or it can be included in the MEFP as part of reform intentions. Increasing transparency on salaries and broader PFM reforms and systems (Jamaica 2016, Sierra Leone 2006, Mozambique 2013) could also be included in structural conditionality. In-depth structural reforms of the compensation structure can help sustainably contain the wage bill while promoting a competitive and equitable pay. An in-depth study of reform agenda can be included as a structural conditionality as well (Kyrgyz Republic 2015, Ghana 2015, Tunisia 2016).

Employment-related measures could be embedded in broader PFM reforms and structural conditionality. Measures that explicitly limit new hiring should be used with caution, and only included in structural conditionality if they are macro-critical and underpinned with an in-depth assessment (Burkina Faso 2018, Tunisia 2016). Measures to increase transparency in the number of public servants, and eliminate ghost workers and double dippers are key, and could be structural conditionality (Yemen 2014, Liberia 2019, Ghana 2009, Iraq 2016, Chad 2017). Measures to limit new hiring can help reduce government employment (and so the wage bill) in the short term, but flexible frameworks are required to ensure service delivery. Public-sector restructuring can reduce government employment permanently, while improving service delivery, however, significant savings only materialize over the medium term, and more time is needed to prepare. Nevertheless, the development of such a strategy could be usefully included in structural conditionality (Tunisia 2016, Moldova 2006).

Box 12. Examples of Public Wage Bill Conditionality

Prior Actions

- Greece, 2010: Reduce public wage bill by cutting bonuses/allowances; and pension bonuses (except minimum pensions).
- Portugal, 2011: Submit to Parliament a draft Law or a budget provision to implement the single wage scale PER measure.
- Serbia, 2015: Adoption by the government of a new job catalog to support implementation of the Law on Public Sector Employees Wage System (MEFP ¶12, fourth bullet).
- Bosnia Herzegovina, 2018: RS government to adopt a strategic plan to restrain wages and reduce overall employment in public sector.
- Burkina Faso, 2018: Public statement of the government on its commitment and strategy to gradually reduce the ratio of the wage bill to tax revenue starting in 2020.
- Liberia, 2019: Restructure the civil service wage bill such that: (i) the wage bill is limited to US$297 million in FY2020; (ii) General and specific allowances are eliminated as forms of compensation, and every employee's civil service salary is their sole source of government-derived wage income; (iii) All employees will have been assigned a registered job title, official pay grade, and registered salary.

Structural Benchmarks

- Kenya, 2003: Reaching an understanding with staff on new wage setting mechanisms for public employees designed to reduce the share of the wage bill in total expenditure.

- Gabon, 2004: Completion of assessment of stock of wage arrears.
- Latvia, 2008: Wages: prepare a comprehensive report on proposed revisions to the public sector wage grid and the relative wage adjustment across public institutions since end-December 2008.
- Jamaica, 2016: Complete an employee verification exercise. Island-wide pilots at the Ministry of Finance and the Public Service, the civilian population of the police department, the NIS, and the non-teaching personnel at the Ministry of Education are ongoing. The verification for all entities in the central government wage bill will be finalized by March 2017.
- Tunisia, 2016: Completion of the functional review of four ministries (Health, Education, Finance, and Infrastructure).
- Burkina Faso, 2018: Adopt salary and indemnity scales which are consistent with the medium-term objective to contain the overall wage bill within the WAMEU convergence criterion of 35 percent of tax revenues.
- Honduras, 2019: Establish a centralized wage bargaining mechanism, in line with the FRL.
- Liberia, 2019: Improve and clean the civil service payroll registry by: (i) no government worker will be paid without biometric ID; and (ii) the MFDP to provide a detailed report to IMF staff—with format and content outlined in the TMU—on the scope and impact of the salary suspension.
- Mali, 2019: Undertake a comprehensive study of the wage bill policy with technical support from international partners.

Quantitative Performance Criteria

- Central African Republic, 2006: Accumulation of new government domestic arrears on wages and goods and services.
- Iraq, 2007: Government wage and pension bill.
- Tajikistan, 2009: Ceiling on general government wage and pension arrears (continuous quantitative performance criterion).
- Ghana, 2015: Wage bill (ceiling).

Indicative Targets

- Latvia, 2008: Ceiling on the general government wage bill.
- Honduras, 2014: Wage bill of the central government (ceiling).
- Moldova, 2021: Ceiling on the general government wage bill.
- Democratic Republic of Congo, 2021: Accumulation of wage arrears.
- Sudan, 2021: Zero accumulation of central government wage arrears.

Note: The indicated year refers to the year in which the IMF-supported program is approved.

Annex I: Methodology of MONA Data Extraction

To review the developments in expenditure policy conditionality, a keyword search was carried out based on the Monitoring of Fund Arrangements (MONA) database. The MONA database contains annual comparable information on all quantitative and structural conditionality of all IMF-supported programs from year 2002 onward. The results were manually filtered afterwards to ensure that all the captured conditionalities are in the area of expenditure policy.

Keywords used in the analysis by expenditure policy area:

- Social assistance: social, transfer(s), assistance, food, child, target(s), targeting, database, registry, household(s), poor, poorest
- Pension: pension, retirement, parametric
- Health: health, Covid, Covid-19
- Education: education, school, enrollment
- Water: water
- Energy subsidies: fuel, energy, gasoline, diesel, kerosene, petroleum, indexation mechanism, automatic pricing mechanism, electricity
- Wage bill: wage, wage bill, civil service, salary, public servant

Annex III: Definitions of Core, Shared and Non-Core Conditions

Structural conditions are classified by category and area of Fund responsibility. The categories are distinguished as areas of the Fund's core (or traditional) responsibility, areas where responsibility is shared with other institutions, and non-core areas.

Table A2: Categories of Structural Conditions

Category	Description
Fiscal	Revenue administration (incl. customs)
	Expenditure measures (incl. arrears clearance)
	Debt management
PFM/RA	Revenue measures
	Budget preparations
	Expenditure auditing
	Fiscal transparency
	Inter-governmental relations
Central bank	Central bank operations, auditing, transparency, and financial controls
	Exchange systems and restrictions
Financial sector	Financial sector legal reforms, regulation, and supervision
	Restructuring and privatization of financial institutions
Pension & civil service reform	Pension reform
	Health and education sector reforms
	Civil service and public employment reforms, including wages
	PRSP development and implementation
SOE reform	Public enterprise reform (excl. financial sector)
	Public enterprise pricing and subsidies
	Privatization
Social	Other social sector reforms
Other macro-structural	Labor Market Reforms (excl. public sector)
	Product Market Reforms (excl. financial sector)
	International trade policy (excl. customs)
	Statistics
	Governance, incl. corruption
	Natural resource and agricultural policies (excl. public enterprises and pricing)

Source: Andritzky, Munkacsi and Wang (2021).

Note: Font color indicates area of expertise: core, shared, non-core.

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