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IMF POLICY PAPER

A STRATEGY FOR IMF ENGAGEMENT ON SOCIAL SPENDING

June 2019

IMF staff regularly produces papers proposing new IMF policies, exploring options for reform, or reviewing existing IMF policies and operations. The following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its May 2, 2019 consideration of the staff report.
- The **Staff Report**, prepared by IMF staff and completed on April 5, 2019 for the Executive Board's consideration on May 2, 2019.

The documents listed below have been separately released:

- A Strategy for IMF Engagement on Social Spending—Background Papers
- A Strategy for IMF Engagement on Social Spending—Case Studies

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IMF Executive Board Supports New Strategy for Engagement on Social Spending

On May 2, 2019, the Executive Board of the International Monetary Fund (IMF) discussed a policy paper outlining a strategy to guide IMF engagement on social spending issues to enhance its effectiveness.

The paper **A Strategy for IMF Engagement on Social Spending** outlines the scope, objectives, and boundaries of engagement and provides guidance on *when* and *how* to engage on social spending. The strategy was informed by background analysis, broad consultations, and the Executive Board-endorsed recommendations of the 2017 Independent Evaluation Office (IEO) Report on "The IMF and Social Protection."

The paper notes that interest in social spending issues intensified over recent decades—especially in the aftermath of the global financial crisis—reflecting concerns about rising inequality and the need to support poor and vulnerable households. Social spending is also a key policy lever for meeting the global commitment to support inclusive growth through the 2030 Sustainable Development Goals (SDGs) and for addressing emerging challenges from demographic shifts, technological developments, and climate change.

Against this backdrop, the paper documents the scaling up of the IMF's work on social spending. Analytical work has highlighted the relationship between inequality and growth, the important role of social spending in promoting sustained and inclusive growth, and the resource requirements for achieving the SDGs in education and health. Accordingly, the IMF surveillance and lending operations have increasingly emphasized inclusive growth, including through the use of social spending "floors" in IMF-supported programs. There has also been enhanced engagement on inequality issues in surveillance, as well as increased technical assistance to expand fiscal resources available for social spending.

The paper sets forth a strategy based on best practices for more effective IMF engagement on social spending issues, including: (i) engagement guided by an assessment of the macro-criticality of a specific social spending issue and consideration of that issue in an IMF-supported program context, and by the existence of in-house expertise; (ii) enhanced collaboration with International Development Institutions; (iii) strengthened program design and conditionality; (iv) clearer guidance on the use of targeted and universal transfers in the context of a broader discussion on the effectiveness of the social safety net; and (v) better communications, including by leveraging input from a broad set of stakeholders.

Implementation of the strategy will be accompanied by granular and gradually evolving guidance to staff, reflecting the evolving nature of social spending issues and emerging lessons from cross-country experiences.

Executive Board Assessment[1]

Executive Directors welcomed the proposed strategy to guide Fund engagement on social spending issues. They noted that the Fund has made considerable progress in its treatment of social spending over recent years and that the proposed framework is expected to strengthen the Fund's engagement on social spending issues by making it more systematic and effective in surveillance and Fund-supported programs. Directors welcomed that the strategy reflected consultations with a broad set of stakeholders, including civil society, academics, and international development institutions (IDIs).

Directors observed that social spending issues have become increasingly important for the Fund's membership, reflecting a growing emphasis on inclusive growth, especially in the aftermath of the global financial crisis. They noted that social spending plays an essential role in protecting vulnerable groups, supporting social and political stability, addressing inequalities of both income and opportunity, smoothing consumption over the life cycle, and stabilizing demand in the face of economic shocks. Directors saw social spending as critical to achieving the commitments under the 2030 Sustainable Development Goals (SDGs) and to tackling policy challenges from demographic, technological, and structural changes.

Directors appreciated that the proposed strategy will be guided by an assessment of the macro-criticality of specific social spending issues. They agreed that social spending can become macro-critical through three key channels: fiscal sustainability, spending adequacy, and spending efficiency. In this context, Directors underlined the need for a sufficiently granular framework to assess macro-criticality. Directors emphasized that staff should continue to provide policy advice on sustainable financing of social spending with an increased focus on the quality of such spending for improving social outcomes. Directors also highlighted the importance of underpinning both surveillance and program policy advice on social spending with in-depth analytical work as appropriate and supported by capacity development where necessary. Directors noted the importance of technical assistance to help ensure adequate data availability and quality, and to help create fiscal space—both through

[1] An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

domestic revenue mobilization and improved spending efficiency— to finance increases in social spending where needed. A number of Directors noted that the distributive effects of taxation and other revenue sources should be considered together with the effects of social spending.

Directors welcomed the clarification of the Fund's advice on the use of universal and targeted social benefits, which should be discussed in the context of the overall effectiveness of the social safety net. They noted that the use of universal and targeted transfers should depend on country preferences and circumstances while being consistent with fiscal and administrative constraints.

Directors concurred that the design of Fund-supported programs and conditionality could be strengthened—both in PRGT and GRA-supported programs—through greater focus on measures to offset the adverse effects of adjustment on poor and vulnerable households, and to enhance the political and social sustainability of programs, thereby contributing to program success. They also noted that specific conditionality on social spending may be necessary to ensure its adequacy and underscored the importance of evenhandedness. In this context, Directors also called for appropriately sequencing reforms to cushion the impact on the vulnerable while noting that the nature and extent of conditionality should be informed by a country's macro-fiscal context, political economy considerations, and social objectives.

Directors called for improved collaboration with IDIs, notably with the World Bank. They noted that while staff may need to develop some in-house expertise, the Fund would also need to rely on other development partners to address social spending issues outside of its areas of expertise. Directors called on the Fiscal Affairs Department to act as a hub to help ensure that country teams can effectively draw on IDI and other relevant external resources. They agreed that staff need to engage early with relevant IDIs to align institutional priorities.

Directors noted that communication is an essential element of the strategy on social spending issues. They stressed that good communications would enhance effectiveness of Fund policies by promoting understanding and setting realistic expectations of the institution's role. In this context, they noted that communications should discuss social spending issues in the broader macroeconomic setting, explain policy trade-offs and financing constraints, while emphasizing country ownership.

While Directors noted that staff is expected to strengthen its focus on social spending in line with the agreed strategy, they acknowledged that more granular guidance is necessary to effectively implement the strategy. They looked forward to the forthcoming Staff Guidance Note to be issued by end-2020, which should explain in greater detail how to consistently apply the key concepts, including macro-criticality, in country- and sector-specific settings. Directors noted that consultations with relevant stakeholders would take place in the preparation of the Staff Guidance Note.

June 14, 2019

A STRATEGY FOR IMF ENGAGEMENT ON SOCIAL SPENDING

EXECUTIVE SUMMARY

Interest in social spending issues has intensified over the last decade. This reflects concerns about rising inequality and the need to support vulnerable groups, especially in the aftermath of the global financial crisis. There is also a global commitment to continue support for inclusive growth, as expressed in the 2030 Sustainable Development Goals (SDGs). And ongoing demographic, technological, and climate developments will pose new challenges. Social spending is viewed as a key policy lever for addressing these issues.

The Fund has concomitantly increased its work on social spending. *Analytical work* has cast new light on the relationship between inequality and growth, the important role social spending plays in promoting sustained and inclusive growth, and the resource requirements for achieving the SDGs in education and health. The growing emphasis on inclusive growth is also reflected in *operational activities*, including the use of social spending "floors" in IMF-supported programs. There has been enhanced engagement on inequality issues in surveillance, as well as increased technical assistance to expand fiscal space for social spending.

This paper outlines a strategy to guide IMF engagement on social spending issues. The 2017 Independent Evaluation Office (IEO) Report on "The IMF and Social Protection" recognized that the Fund's engagement has increased over time but found that it has been uneven and there is scope for strengthening. Analysis undertaken for the paper confirms this finding and identifies additional challenges. The strategy is central to IMF management's response to the Board-endorsed recommendations of the IEO. Its purpose is to clarify the scope, objectives, and boundaries of engagement.

The strategy would support a more effective IMF engagement. It is informed by additional background analyses, internal and external consultations, and the 2017 IEO Report:

- ***Engagement would be guided by an assessment of the macro-criticality of a specific social spending issue and consideration of that issue in a program context, and by the existence of in-house expertise.*** The key channels through which social spending can become macro-critical are fiscal sustainability, spending adequacy, and spending efficiency. The strategy encourages early engagement with

the authorities and envisages that staff *continues* developing policy advice on sustainable financing of social spending and *increases* the focus on the quality of such spending for improving social outcomes, drawing on the expertise of IDIs.

- ***Collaboration with IDIs would be improved.*** The IMF's Fiscal Affairs Department (FAD) would act as a hub for facilitating and strengthening engagement between country teams and IDIs, while early engagement of country teams with relevant IDIs would be encouraged. There would also be a stronger engagement with other stakeholders, including Civil Society Organizations.

- ***Program design and conditionality would be strengthened.*** This calls for more consistent emphasis on mitigating the adverse effects of adjustment on the vulnerable in IMF-supported programs, where this is consistent with the primary goals of helping the member correct its balance of payments problem and achieve external viability. Conditionality can also be instrumental in helping to strengthen tax capacity in support of social spending, improving the quality of social spending, and addressing data and information gaps.

- ***Advice on the use of targeted and universal transfers would be discussed in the context of the effectiveness of the social safety net.*** The appropriate design depends on countries' social and political preferences and should be consistent with their fiscal and administrative constraints.

- ***External communication in specific countries would focus on providing a clear explanation of Fund policy advice*** reflecting the overall macro-fiscal context and strategy, while clarifying what the Fund can and cannot do.

Implementation of the strategy will require granular and gradually evolving guidance to Fund staff. A Staff Guidance Note, to be completed by end–2020, will detail the already significant existing support and initiatives for strengthening this support, including further tools for country teams and improved knowledge management. It will aim to help country teams in prioritizing when and how extensively to engage on different social spending issues. The Note will be updated as needed to reflect the evolving nature of social spending issues, and as the Fund acquires more experience. In the interim, country teams would continue their already extensive engagement on social spending drawing on existing resources.

Since IMF engagement on social spending issues is already extensive, the additional resources to implement the strategy are at this point not expected to be significant, beyond some set-up costs.

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Glossary

AEs	Advanced economies
CCT	Conditional cash transfer
CD	Capacity Development
COFOG	Classification of the Functions of Government
COM	Communications Department
CS	Case Studies
CSO	Civil Society Organization
CSR	Comprehensive Surveillance Review
EA	Empirical Analysis
EAT	Expenditure Assessment Tool
EC	External Consultation
EMDCs	Emerging Market and Developing Countries
EME	Emerging Market Economy
FAD	Fiscal Affairs Department
FY	Fiscal Year (May 1, year t-1 to April 30, year t)
GFS	Government Finance Statistics
GFSM	Government Finance Statistics Manual
GRA	General Resource Account
ICD	Institute for Capacity Development
IDI	International Development Institution
IEO	Independent Evaluation Office
ILO	International Labor Organization
IMF	International Monetary Fund
ITs	Indicative targets
ITUC	International Trade Union Confederation
LIDC	Low-Income Developing Country
LOI	Letter of Intent
LSE	London School of Economics
MCS	Mission chiefs' survey
MEFP	Memorandum of Economic and Financial Policies
MTRS	Medium-Term Revenue Strategy
OECD	Organization for Economic Co-operation and Development
PCs	Performance criteria
PCI	Policy Coordination Instrument

PFM	Public financial management
PPPs	Public-Private Partnerships
PRGT	Poverty Reduction and Growth Trust
PSI	Policy Support Instrument
PSIA	Poverty and Social Impact Analysis
QPCs	Quantitative performance criteria
RES	Research Department
ROC	Review of Conditionality
ROC2011	2011 Review of Conditionality
ROC2018	2018 Review of Conditionality
SB	Structural benchmark
SD	Surveillance Decision
SDGs	Sustainable Development Goals
SPIAC-B	Social Protection Inter-Agency Collaboration Board
SPR	Strategy, Policy, and Review Department
SSN	Social Safety Net
SSP2017	2017 Social Safeguards and Program Design
STA	Statistics Department
TA	Technical assistance
TM	Text mining
TSR	Triannual Surveillance Review
UN	United Nations
WHO	World Health Organization

INTRODUCTION

1. Interest in social spending issues has intensified over the last decade. This reflects, in part, growing concerns among the public and policy makers about increasing inequality,[1] especially in the aftermath of the global financial crisis. It also reflects the need to support vulnerable groups, including low-income households and others adversely impacted by adjustment of various kinds, such as from technological change. For instance, international surveys[2] indicate rising public support for redistribution in many countries. There is also a global commitment to continue support for inclusive growth, as expressed in the 2030 Sustainable Development Goals (SDGs).[3] Social spending—defined as social protection, health and education spending (Box 1)—is a key policy lever for promoting inclusive growth, addressing inequality, protecting vulnerable groups during structural change and adjustment, smoothing consumption over the life-cycle, and stabilizing demand during economic shocks.

2. Concomitantly, the Fund has increased its work on inclusive growth and social spending issues.[4] In general, the IMF helps countries achieve inclusive growth by promoting macroeconomic stability and sustainable fiscal policies. More specifically, *policy analysis* by staff[5] has focused on the relationship between inequality and growth, finding that high inequality may undermine the pursuit of sustained growth.[6] The October 2017 *Fiscal Monitor* on "Tackling Inequality" documents the wide cross-country variation in inequality and growth patterns, which indicates that social policies aimed at decreasing inequality can complement growth.[7] The increased emphasis on inclusive growth is also reflected in *operational activities*, with the introduction in 2009 of the Poverty Reduction and Growth Trust (PRGT) which enhanced the focus on social and other priority spending, including through incorporating explicit "targets" (typically social spending "floors") into program design. Along with this increased engagement has come increased external

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[1] Pew Research Center (2014) and World Economic Forum (2014).

[2] These include the World Value Surveys, Regional Barometers, and International Social Surveys.

[3] Other initiatives on social spending to support inclusive growth include: the 2012 ILO's Recommendation No. 202 on Social Protection Floors, which recognized the importance of providing a guaranteed minimum level of social protection for all, and the universal social protection initiative launched by the World Bank and the ILO in 2015. Social spending issues have also been prominent on the G20 agenda, e.g., related to the future of work (in 2018) and to the health sector (in 2019).

[4] The Fund's work on social spending issues is guided by its mandate. Annex 7 of Jobs and Growth—Analytical and Operational Considerations for the Fund (IMF, 2013b) provides a deeper analysis of the Fund's mandate with respect to inclusive growth and domestic stability.

[5] Ostry and Berg (2011) and Ostry, Berg, and Tsangarides (2014).

[6] While some inequality is integral to a market economy, various studies have argued that high and persistent inequality can undermine the sustainability of growth, including by eroding political and economic stability and social cohesion and weakening support for growth-enhancing reforms (Rodrik, 1999; World Bank, 2011; and Stiglitz, 2013). High inequality may also lead to financial fragility and macroeconomic instability (Rancière and Kumhof, 2010; Rajan, 2010; and Reich, 2010).

[7] Other studies have also found that the relationship between inequality and growth varies greatly across countries; see, for example, Ferreira and others (2018).

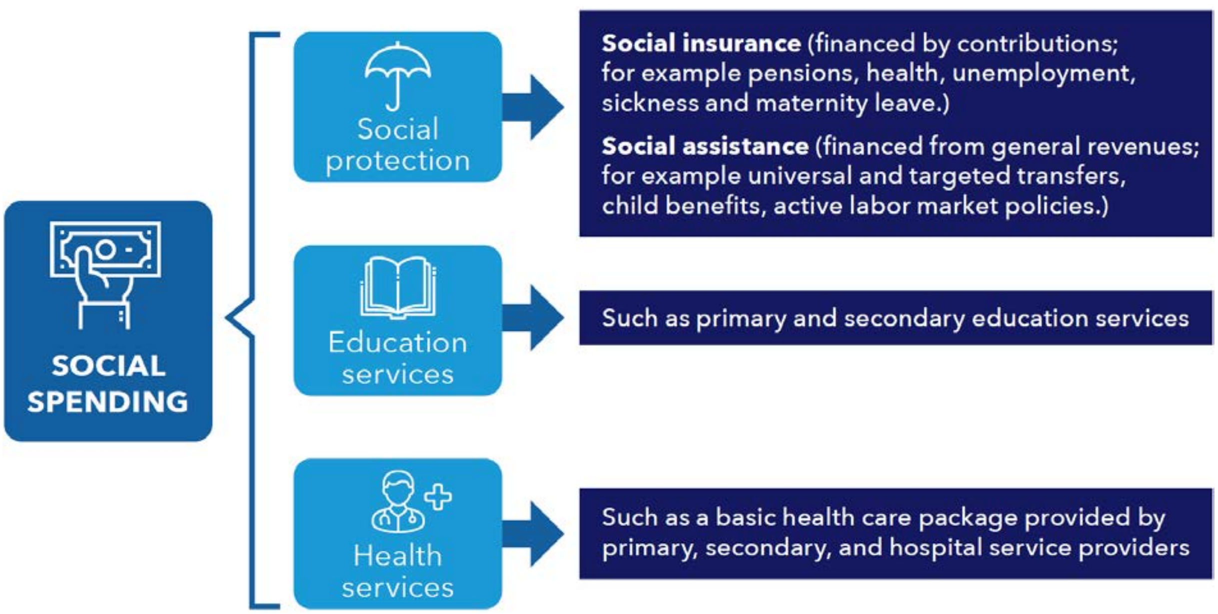
scrutiny of IMF policies on social spending by civil society organizations (CSOs) and the academic community, especially in program contexts.

Box 1. Definition of Social Spending

The strategy focuses on a broad concept of social spending.[1] In addition to *social protection* spending, which was the focus of the 2017 IEO Report, social spending is defined to comprise *education and health spending*. This reflects the critical importance of such spending for promoting inclusive growth, the wider scope of current engagement by the IMF, and the complementary nature of these three spending components. This definition is consistent with past IMF analysis[2] and prevailing practices of international institutions;[3] the Classification of the Functions of Government (COFOG) provides details on the spending items typically included in social spending (Box 5). In the context of inclusive growth, particular emphasis should be placed on increasing access to *basic* education and health spending.

Social protection is defined to comprise social insurance and social assistance programs. *Social insurance* aims at protecting households from shocks that can adversely impact their incomes and welfare and is typically financed by contributions or payroll taxes. *Social assistance* aims at protecting households from poverty and is financed by general government revenue. Consistent with practice in other IDIs, the terms *social assistance* and *social safety net* are used interchangeably.

The appropriate definition of *basic* education and health spending is country specific. It will vary by level of development and existing level of access. For example, for Low-Income Developing Countries (LIDCs), *basic education* may include primary and secondary education, while *basic health* often refers to a nationally defined basic health care package. For Advanced Economies (AEs), basic may include further training and a more comprehensive package of health services.



Note: International Development Institutions (IDIs) include the World Bank, regional development banks, the OECD, the ILO, and relevant UN organizations.

[1] Governments can pursue social objectives withough affecting social spending; for example, through regulations requiring individuals to contribute to private pension systems. Also, other public spending can have a strong impact on social outcomes, e.g., infrastructure, water and sanitation.

[2] April 2014 *Fiscal Monitor* on "Public Expenditure Reform: Making Difficult Choices," p. 21, footnote 1.

[3] Acosta and others (2017).

3. Ongoing trends are likely to increase social spending pressures, present new policy challenges, and reinforce existing ones.[8]

- *Ageing populations*. Most advanced economies (AEs) are facing rapid ageing of their populations. Although less immediate in emerging market and developing countries (EMDCs), in the coming decades some of these will experience even more rapid ageing than in AEs. Countries may therefore need to strengthen their health and pension systems to enhance spending efficiency and ensure adequate coverage of the population.

- *Labor markets*. Women's labor force participation has significantly increased, and this trend can be expected to continue as countries continue to develop. Many EMDCs also face growing youth populations. Successful absorption of women and youth into employment will require supporting social and economic policies. Social benefit systems (and their financing) therefore need to be designed to support, rather than disincentivize, increased female and youth employment. Education and training systems may need to be reformed to ensure these groups have the skills to be productively employed.

- *Technological change*. This is transforming labor markets by increasing mobility of labor across sectors and the use of flexible work arrangements (e.g., part-time and temporary work, and self-employment), which can result in discontinuous careers and volatile income streams. In particular, technologies like artificial intelligence (AI) and robotics have the potential to render a broad range of current skills redundant resulting in significant labor market disruption. Education and training will need to adapt to a growing demand for skilled labor, including by continuously upgrading skills over an individual's life cycle and complemented by policies to enhance labor market matching. Maintaining or expanding social protection coverage may require less reliance on eligibility linked to employment status and contributory financing, and greater reliance on financing from general government revenue.

- *Climate change*. Global warming is expected to increase risks from extreme weather events and natural disasters, with the most severe impacts expected for low-income and small island states. This could push many households into poverty and will require enhancing the capacity of social safety nets.

Tight budget constraints in many countries will mean that the spending pressures arising from these trends and other factors (e.g., from conflicts or displaced persons) compete with other priority spending. How these competing claims on the budget are resolved will depend both on country-specific circumstances and social preferences. Addressing these challenges through the pursuit of universal access to key social services and significant expansion of safety net coverage would require many countries to strengthen their tax capacity.

[8] See the December 2018 Finance & Development.

4. This paper proposes a strategy to provide broad guidance on the Fund's engagement on social spending. The strategy is central to Fund management's response to the Board-endorsed recommendations of the 2017 IEO Report on "The IMF and Social Protection," which found that the Fund's engagement was uneven and identified areas in which further strengthening was required.[9] It focuses on a broader concept of social spending—social protection, health and education—given its importance for inclusive growth, and the wider scope of the policy debate and of existing IMF engagement. The strategy recognizes that strengthening social spending can be a complex, long-term process requiring sustained engagement on addressing fiscal and implementation constraints, and critically depends on a country's capacity and support from International Development Institutions (IDIs).[10] Accordingly, it provides broad guidance to staff on when and how it should engage with member countries on social spending issues across Fund activities, ensuring that Fund policy advice is given in a transparent and evenhanded manner. While the strategy does not set out specific Fund policy advice on social spending, it identifies the resources available to staff to develop such advice, including through engagement with IDIs that have deeper expertise. Given its prominence in discussions with stakeholders and in the 2017 IEO Report and the subsequent Management Implementation Plan, the strategy clarifies Fund advice on the appropriate use of targeted and universal transfers. Finally, it provides a basis for developing effective communication on the scope and boundaries of IMF engagement on social spending issues.

5. Fully implementing the strategy will require additional guidance for staff. A Guidance Note, to be completed by end–2020, will aim to help country teams in prioritizing when and how extensively to engage on different social spending issues in light of trade-offs, policy options, and traction in countries, as well as internal expertise constraints. It will detail the already significant existing resources and initiatives for further strengthening support, including in different country contexts and in the different areas of social spending. The Note will be updated as needed to reflect the evolving nature of social spending issues and Fund's policy advice, and as the Fund acquires more experience in engaging on social spending issues. The paper also includes an estimate of the resource costs of implementing the strategy, which may be updated as experience with the implementation is gained. In the meantime, country teams would continue their already extensive engagement on social spending drawing on existing resources; there is also scope for cross-country departmental papers as a vehicle for developing and operationalizing this guidance.

6. The paper complements other Fund initiatives. It draws on recent and ongoing policy work covering related issues, including *Social Safeguards and Program Design in PRGT and PSI-supported Programs (*SSP2017), the *Review of Conditionality* (ROC2018), and the *Comprehensive Surveillance Review (CSR)*. It also builds on the recent initiative on How to Operationalize Inequality Issues in Country Work.

[9] IEO (2017a) and IMF (2018a).

[10] International Development Institutions (IDIs) include the World Bank, regional development banks, the OECD, the ILO, and relevant UN organizations.

7. The paper draws on extensive analysis and consultations, which are described in background papers:

- *Stakeholder consultations* were held with various groups to discuss the scope of the paper, including IMF Executive Directors, IMF area departments, IDIs, and CSOs, trade unions and academics (for instance through seminars during the 2018 Spring and Annual Meetings, an International Trade Union Confederation (ITUC) social protection conference, and a workshop at the London School of Economics (LSE)). A dedicated consultative group consisting of participants from the CSO and academic community, as well as an open online consultation, also provided input.

- *Text-mining analysis* of surveillance and IMF-supported program documents helped determine the evolution of Fund engagement on social spending issues.

- *A mission chiefs' survey* (MCS) provided information on the extent, nature, and challenges of country-team engagement with authorities and IDIs. A separate survey of randomly selected country teams was conducted to estimate the resource implications of this strategy.

- *A cross-country data and econometric analysis* assessed whether social spending has been protected in IMF-supported programs. This was based on a newly constructed database on education and health spending.

- *A note on the appropriate use of universal and targeted transfers* discussed the trade-offs involved and emphasized the need to consider both the tax and transfer side when evaluating and designing fiscal redistribution systems.

- *Case studies* on eleven countries provided granular information on the nature of engagement on social spending issues in surveillance and program contexts, and the challenges faced by staff in ensuring effective engagement.

8. The paper is structured as follows. The second section reviews *past and ongoing IMF engagement* on social spending and evidence on its effectiveness. The third section summarizes the key challenges to be addressed and sets out a *strategy* to guide *when* and *how* the IMF should engage on social spending issues with members, including how to assess the macro-criticality of social spending and how to engage in a program context. The fourth section identifies the *resources available and needed* to support this engagement. The fifth section identifies the implications for *engagement with IDIs* that have deeper expertise and the next section outlines the *implications of the above for communications* with broader stakeholder groups, including CSOs and academics. The seventh section discusses resource implications, the eighth section concludes, and the final section presents issues for discussion.

THE STORY SO FAR

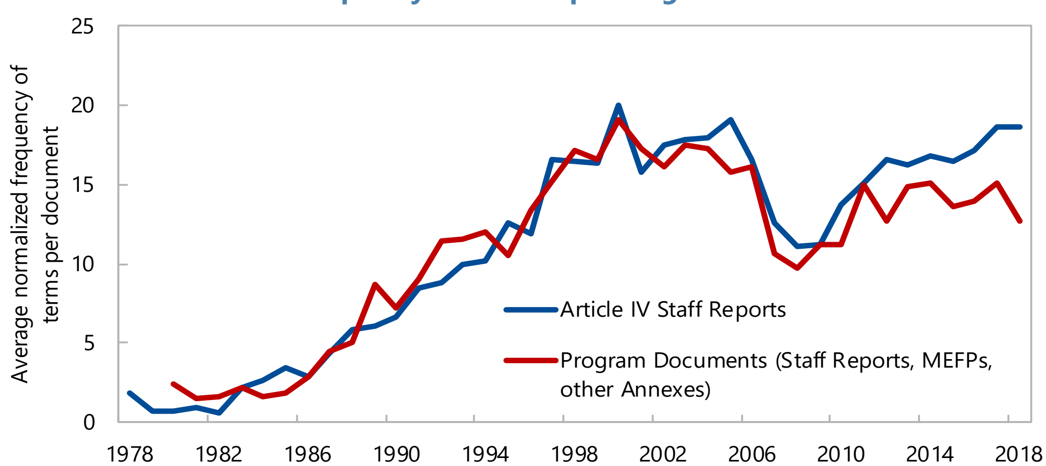
9. IMF engagement on social spending issues has been increasing. This trend was especially pronounced over the 1990s, across both surveillance and program activities (Box 2), and supported by capacity development work. The MCS and country case studies confirm that engagement on social spending issues is high.

Box 2. IMF Engagement on Social Spending: A Text-Mining Analysis

Staff conducted a text mining exercise to explore how IMF engagement on social spending issues has evolved over time. The exercise considered all bilateral surveillance (Article IV Staff Reports) and program documents (Staff Reports, Memoranda of Economic and Financial Policies (MEFPs), Letters of Intent (LOIs), and Annexes) over four decades. The figure below shows how frequently social spending-related terms appear in these documents; the indicator used is the average frequency count per document, normalized by number of words (x10,000) to control for varying document length—alternative normalization methods show a similar pattern.

The observed pattern is similar for surveillance and IMF-supported program documents. After increasing significantly over the 1980s and 1990s, the frequency of social spending terms remained stable until the mid-2000s. The frequency dropped sharply around 2008 and then recovered to the levels observed at the beginning of the 2000s. This drop coincided with the global financial crisis and the 2007 Surveillance Decision (SD).[1] The recovery in the frequency of social spending terms after the late 2000s was also accompanied by increased research by the IMF on social spending issues and its link with inclusive growth.

Frequency of Social Spending Terms



Source: IMF staff calculations.

[1] The SD stated that bilateral surveillance would always cover the macroeconomic and macroeconomically relevant structural aspects of fiscal, monetary, and financial sector policies. Other domestic policies (including social spending policies) would be covered in particular cases, but their material bearing on external stability would need to be explained.

Box 3. Social Spending and Inclusive Growth

Many studies find that public investment in education and health has been a significant driver of inclusive growth (Rossi, 2018; Coady and Dizioli, 2018). Expansion of access to quality basic education and health services increases the human capital stock and decreases inequality in education and health outcomes. This, in turn, increases productivity and growth and reduces inequality of opportunity and income (IMF, 2017b). As reflected in the SDGs, most countries aim at achieving universal access to quality basic education and health services.

Social protection spending is also important for achieving inclusive growth (Ostry, Berg, and Tsangarides, 2014; Clements and others, 2015; Atkinson, 2015; IMF, 2017b). By redistributing income from higher-income to lower-income groups it *directly decreases income inequality*. For example, most of the differences in income inequality across countries are explained by differences in the extent of fiscal redistribution. In AEs with the lowest income inequality and the highest fiscal redistribution from direct taxes and transfers, about two-thirds of this redistribution is achieved through transfers. While there is evidence that fiscal redistribution does not necessarily harm growth, redistributive fiscal policies need to be carefully designed to minimize the efficiency costs associated with redistributive tax and transfer policies (e.g., disincentives for labor supply and investment). Social protection can also contribute directly to inclusive growth through making lower-income groups more resilient to economic shocks and promoting investments through addressing liquidity constraints. For example, there is evidence that conditional cash transfer (CCT) programs can simultaneously help to address current poverty and break the intergenerational transmission of poverty through enhancing investment in human and physical capital (Fiszbein and Schady, 2009). In addition, social protection can be *instrumental in promoting growth*, helping to build public support for macroeconomic and growth-enhancing structural reforms by protecting vulnerable groups from any adverse short-term impacts of such reforms.

Social spending needs to be efficient and sustainably financed. Numerous studies find substantial inefficiencies in different components of social spending (Dutu and Sicari, 2016; Jin, Jirasavetakul and Shang, 2019), highlighting significant room for enhancing social outcomes within current budget allocations in most countries. Spending efficiency requires effective public financial management (PFM) systems that ensure good governance through appropriate budget formulation, execution, and monitoring. Increased spending should therefore be supported (and ideally preceded) by measures for enhancing PFM systems and spending design. Sustainable financing requires an appropriate balance between financing, revenue mobilization, and spending across social protection transfers and investments in education, health, and physical infrastructure. This is particularly important in EMDCs with relatively large human and physical capital needs, low tax capacity, and rising debt. But it is also important in AEs, many of which need to reduce high public debt.

A. Surveillance

10. The increased Fund engagement on social spending has accompanied the growing emphasis on inclusive growth and the need to protect the vulnerable. Since the 1990s, IMF policy advice has increasingly recognized that there need not always be a trade-off between growth and distributional objectives, and the key role of social spending in achieving inclusive growth (Box 3). While short-term fiscal constraints can create tensions between the objective of protecting the vulnerable and policies to expand coverage of the safety net to middle-income groups to promote inclusion, reforms to increase fiscal space in an efficient and progressive manner can reduce these tensions in the longer term. Sound macroeconomic and structural policies can also be designed to promote poverty reduction through supporting growth and helping to reduce inequality. Policy analysis[11] has underpinned the renewed emphasis on "inclusive growth" in IMF work over recent years, more recently complemented by an initiative launched in 2015 to ensure that inequality issues are routinely addressed in IMF surveillance. Since the latter's inception, studies have been undertaken for 42 countries, with analysis for another 3 countries ongoing.[12] These studies cover a broad range of issues including the design and performance of social safety nets, price subsidies, and pensions systems, and evaluation of the poverty and inequality impact of proposed policy measures. More recent work on gender inequality discusses the significant macroeconomic benefits that could be reaped by improving gender equity.[13]

B. IMF-Supported Programs

11. Fund-supported programs ("programs" hereafter) have increasingly attempted to address the potential adverse effects of adjustment on poverty and inequality. PRGT-supported programs are designed to safeguard social and other priority spending and, whenever appropriate, to increase it. Both these and GRA-supported[14] programs often include *quantitative spending targets* (typically referred to as "spending floors") on social and other priority spending, and *specific reform measures* designed to protect vulnerable groups, sometimes established as prior actions or structural benchmarks (SBs).[15] Staff analysis for the ROC2018 found that the share of programs with SBs on social spending declined during 2012–17, compared to 2002–2011 (Figure 1). In contrast, the use of quantitative conditionality (performance criteria (PCs) and indicative targets (ITs)) related to social spending increased significantly. The ROC2018 also noted that there was limited focus on the quality of social spending and inequality.

- **Quantitative conditionality.** Over sixty percent of programs since 2012 included quantitative targets on social and other priority spending, more than double the share during 2002–2011.[16] This reflects a marked increase in the prevalence of social spending floors to over 90 percent of PRGT-supported programs following the 2009 Reform of the Fund's Facilities and Financing Framework for Low-income and Developing Countries, which required that such programs include specific targets to safeguard social and other priority spending, whenever possible. Across all lending facilities, the vast majority of social spending floors were in the form of ITs, with about 5 percent involving quantitative PCs. Observance of PCs and ITs on social spending

[11] See IMF's Work on Income Inequality.

[12] IMF (2018b).

[13] Kochhar, Jain-Chandra, and Newiak (2017).

[14] Whereas PRGT programs are typically focused on enhancing growth and reducing poverty, General Resource Account (GRA) programs are often associated with crisis prevention or mitigation and tend to require significant fiscal consolidation.

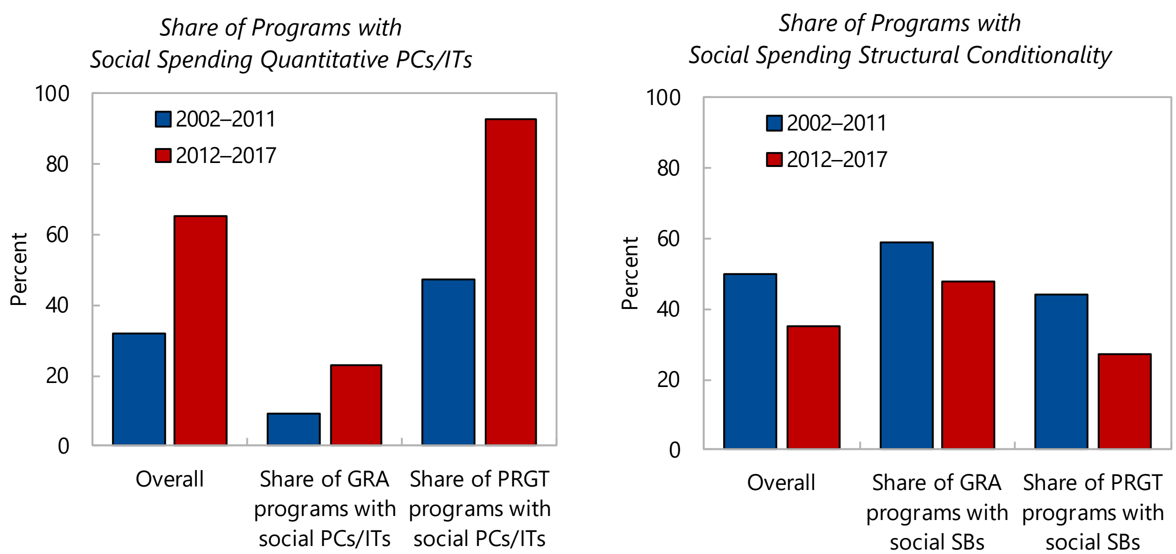
[15] IMF (2014a).

[16] The coverage of quantitative targets differed across countries, from narrow coverage of targeted cash transfers for the most vulnerable to a broad coverage of wages, and goods and services spending of ministries of education and health and other priority spending.

was broadly satisfactory, at about 70 percent during 2012–17, and comparable to compliance levels for other types of quantitative targets. These findings are confirmed by the MCS.[17]

- **Structural conditionality.** The decline in the share of programs with SBs on social spending during the last decade likely relates to reforms of the IMF's lending framework in 2009,[18] which introduced a review-based approach to structural conditionality. Where SBs on social spending were included in programs, they were met about 70 percent of the time, slightly better than the overall performance of SBs. The use of structural conditionality was somewhat lower in PRGT-supported programs, though spanning a wider range of social sector reforms.[19] Yet staff analysis of the ROC2018 found that few SBs focused on improving the quality of social spending.

Figure 1. Social Conditionality in IMF-supported Programs[1]



Source: 2018 Review of Conditionality.

[1] The ROC2018 sample includes all 133 programs between September 2011 and December 2017: 70 PRGT (Standby Credit Facility, Extended Credit Facility), and 11 Policy Support Instrument (PSIs; note that PSIs are included among PRGT for the purposes of the analysis in this paper); 51 GRA (Stand-By Arrangement, Extended Fund Facility, and Precautionary and Liquidity Line), and 1 Policy Coordination Instrument (PCI). The ROC2011 covered all 159 programs from 2002 to September 2011 (95 PRGT and 64 GRA), including the first wave of post-global financial crisis programs.

[17] Almost all mission chiefs (90 percent) indicated that social spending was protected in the program, mainly through the use of ITs (70 percent), and that conditionality was met most of the time. Most mission chiefs for program countries indicated that social spending was either maintained (53 percent) or increased (38 percent) despite the fact that nearly 80 percent indicated that the program involved fiscal consolidation. These results are in line with the SSP2017, which found that 90 percent of PRGT programs included a social spending floor, and that in two-thirds of these programs social spending ITs were met.

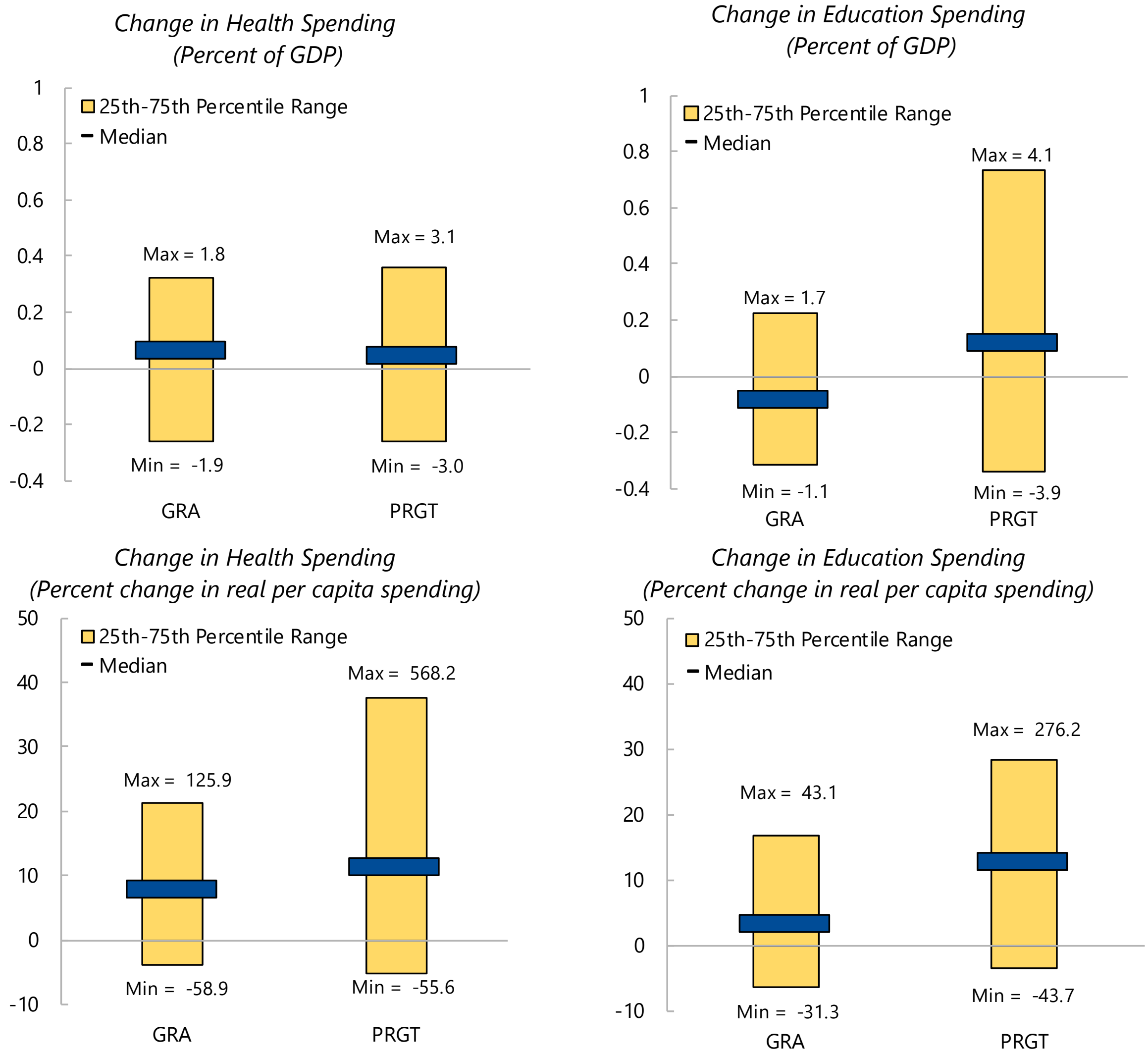
[18] The 2009 Reform of the IMF Lending Framework followed the IEO *Evaluation of Structural Conditionality in IMF-Supported Programs* (2007). The 2007 IEO Evaluation focused on the scope for streamlining structural conditionality, inclusing restricting conditionality to Fund core areas of expertise and raising standards of criticality and parsimony.

[19] Structural conditionality in PRGT programs ranged from cash transfer programs to expenditure frameworks on health and education, and from enhancing data reporting to improving quality of social spending (such as strengthening the existing social assistance system or implementing a unified registry for targeting of transfers).

Figure 2. Public Education and Health Spending in IMF-Supported Program Countries

Change in Spending after Program Approval

(each year after program approval – year before program approval; by program type)

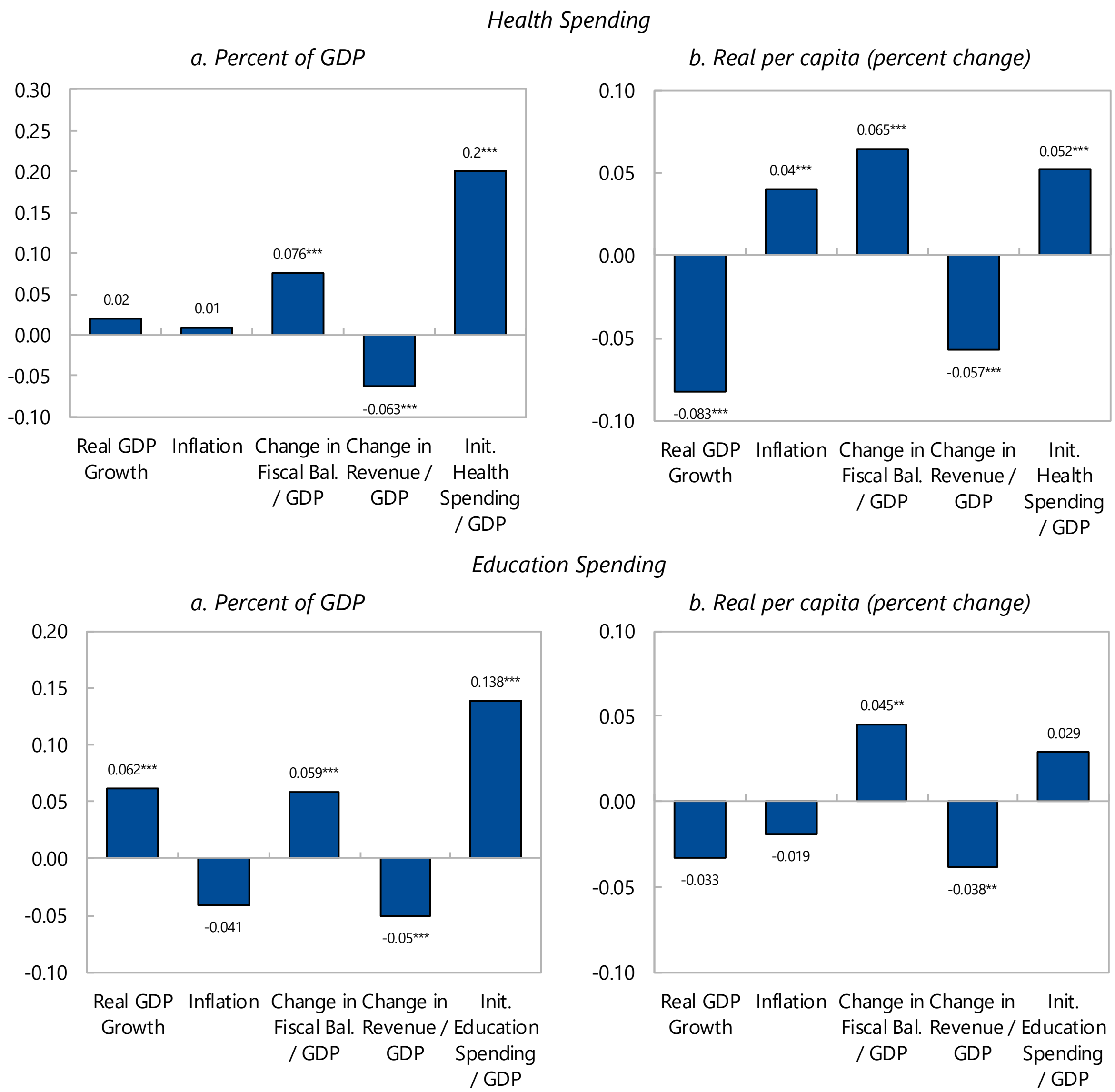


Source: IMF staff calculations.
Note: Bars represent cross-country interquartile ranges of changes in spending in each program year after the program approval relative to spending in the year prior to the approval date. Only countries with observations in the year before approval and during program years are included.

12. **Although programs have protected education and health spending on average, spending declined in a large share of instances reflecting a range of factors.**[20] Most studies found that, on average, education and health spending in program countries either increased by more than, or at the same rate as, spending in non-program countries. New analysis of spending

[20] While the studies discussed below focus on the level of education and health spending, their quality (or efficiency) is also crucial. The absence of relevant studies focusing on quality reflects, in part, the absence of sufficient data. Data limitations prevent a similar analysis on social protection spending.

Figure 3. Average Marginal Effects on Probability of Large Declines in Public Education and Health Spending



Sources: WHO; UNESCO; and IMF staff calculations.
Note: Bars represent average marginal effect estimates from a probit model of large negative changes in spending during a program, raising each explanatory variable from its 25th to 75th percentile value.

trends since 2000 undertaken for this paper, which addresses various methodological and data challenges, confirms these findings (see Background Paper II). However, the analysis also finds a significant number of instances in which education and health spending decreased in program countries (whether spending is measured as a share of GDP or in real per-capita terms; Figure 2). An analysis of the factors explaining instances of *large* spending decline (i.e., those greater than the median negative changes) shows that high GDP growth increases the probability of a decline in spending as a share of GDP but lowers the probability of a decline in real per-capita spending

(Figure 3). The probability of a decline in spending (both as a share of GDP and in real per-capita terms) is also greater where short-term fiscal consolidation is high; this effect is attenuated the more fiscal consolidation is achieved through revenue mobilization rather than expenditure consolidation.[21] Therefore, measures that reinforce growth and revenue mobilization can help to avoid short-term declines in social spending. Finally, declines in spending are more likely where initial spending is high, which in some cases may reflect inefficiencies (such as excessively high wages).

C. Technical Assistance

13. Technical assistance (TA) in support of social spending has increased significantly. Many EMDCs need to create fiscal space to finance increases in social spending. Recent research finds that countries seem to move to a higher growth path once tax revenue reaches around 15 percent of GDP (Gaspar and others, 2016)—this could in part reflect the creation of fiscal space for higher social spending. About half of low-income and developing countries (LIDCs) and a third of EMEs, have tax ratios below this threshold. Therefore, TA on improving tax policy and strengthening revenue administration, where the IMF traditionally takes a lead role, has about doubled since 2010 (Figure 4). TA on PFM has also increased significantly over this period, focusing on enhancing spending efficiency and governance through strengthening budget formulation, execution, and monitoring.[22] While the scale of expenditure policy TA is relatively low, mainly reflecting the lead role played by other IDIs with greater expertise (particularly the World Bank),[23] the scope of spending issues covered is broad. In countries where fiscal consolidation is needed, including in AEs, TA also focuses on enhancing spending efficiency while protecting the vulnerable (e.g., containing the public wage bill or pension spending where relatively high, or decreasing energy subsidies with appropriate compensating measures). TA directly linked to social spending is mainly provided to EMDCs.[24] Recent work on estimating the cost of achieving the SDGs has laid the foundation for increasing TA (and policy) engagement on social spending in these economies, including in collaboration with other IDIs (Gaspar and others, 2019).

[21] The results are similar when focusing on all (and not just large) instances of social spending decreases.

[22] Gupta and others (2018) find that structural PFM conditionality in programs has proven effective at boosting long-term social spending, and Crivelli and Gupta (2010) find that it effectively supports revenue collection.

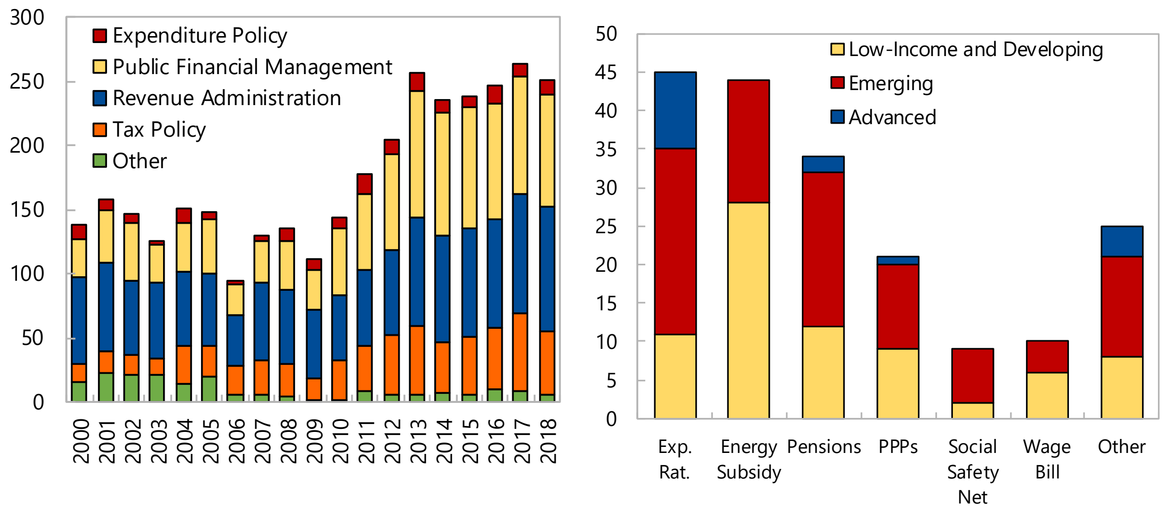
[23] The lead role played by the World Bank in developing sectoral policy advice on public expenditures is recognized in the 1989 IMF-World Bank Concordat and the 2007 Joint Management Action Plan (JMAP). See footnote 46 below for more details.

[24] Over 2000–2018, all TA on social safety nets, and 94 percent on pensions, was provided to EMDCs, which also accounted for 78 percent of TA on expenditure rationalization that often includes health and education.

Figure 4. Fiscal Technical Assistance

FAD Technical Assistance (Number of missions)

Expenditure Policy TA Missions by Topic and Country Group (Number of missions; 2000–2018)



Source: IMF staff calculations.

Notes: *Exp. Rat.* refers to Expenditure Rationalization, *PPPs* refers to Public Private Partnerships.

A STRATEGY FOR ENGAGEMENT ON SOCIAL SPENDING

14. The above analysis indicates a significant increase in Fund engagement on social spending over recent decades, but also that the level and effectiveness of engagement remain uneven. The findings of the background papers confirm and expand on those of the 2017 IEO Report and help identify additional challenges, including the need for:

- A common ***definition of social spending*** to provide more clarity;
- Better explaining the ***rationale for IMF engagement*** (i.e. when to engage) and identifying ***steps for effective engagement*** (i.e. how to engage) to improve consistency;
- Strengthening ***in-house analytical work and expertise*** to improve the quality of policy advice;
- Greater attention to some ***specific policy issues***, including (i) the (perceived) Fund bias in favor of narrowly targeted transfers and against more universal types of transfer systems, and (ii) encouraging and assisting a member to pursue its own objectives related to protection of vulnerable groups and social spending during adjustment (if these objectives are consistent with the primary goal of helping the member correct its balance of payments problem and achieve external viability);

- A focus on enhancing the ***quality*** and ***efficiency of social spending*** to maximize its impact and improve social outcomes;

- Enhancing ***engagement with external stakeholders*** (IDIs, CSOs, external experts) through making it more systematic and broader while preventing duplication;

- ***Better communication*** on Fund engagement on social spending issues to help enhance understanding and develop stronger country ownership of reforms; and

- Being mindful of ***constrained Fund's resources*** to avoid crowding out core activities, and the importance of not duplicating the activities of other IDIs with greater social spending expertise.

15. The strategy set out below would help make engagement more consistent (Table 1). It provides clarification on *when* and *how* to engage, including how to strengthen engagement in program contexts. Subsequent sections identify internal resources available to support engagement and measures to strengthen external engagement and communications.

Table 1. IMF Engagement on Social Spending: Challenges and Architecture of Strategy

Broad trends and takeaways	**The strategy's objective**
Engagement increased, but is uneven (EA, TM, IEO)	Define *when* and *how* to engage to ensure even-handedness
Challenges and areas for strengthening	**The strategy architecture**
• Social spending definition (EC, IEO)	• Provide a social spending definition
• Rationale of IMF involvement/when to engage/boundaries and modalities of engagement (CS, EC, IEO)	• Provide guidance on when/how to engage, guided by macro-criticality principle and steps for effective engagement
• In-house expertise and analysis (CS, IEO, MCS)	• Discuss enhancing support for in-house analysis
• Policy design issues: ➢ (perceived) narrow focus on selected design issues, e.g. means-testing (CS, EC, IEO, MCS) ➢ Program design/issues and conditionality (CS, EA, EC, IEO, ROC)	• Addressing selected policy design issues: ➢ Discussion of targeted and universal approaches to social transfers ➢ Program considerations
• Focus on quality and efficiency of spending to improve social outcomes (EC, ROC)	• Strengthening focus on structural reforms
• Leveraging external expertise/cooperation with IDIs (CS, EC, IEO, MCS)	• Engagement with IDIs and other stakeholders
• Narrative of policy advice/communication (CS, IEO)	• Communication considerations
• Resource needs (IEO and internal stakeholders)	• Resources implications of new strategy

Note: CS=Case Studies, EA=Empirical Analysis, EC=External Consultation, IEO=IEO Report, MCS=Mission Chiefs' Survey, ROC=Review of Conditionality, TM=Text mining.

A. WHEN to Engage

Macro-criticality

16. Macro-criticality is an important guiding principle for when to engage on social spending issues. The Fund has long recognized that it should take relevant structural issues into account. To this end, the Fund's engagement with members on these issues has been guided by the principle of "macro-criticality" to ensure consistency with its mandate. Specifically, a structural issue has been deemed *macro-critical if it affects, or has the potential to affect, domestic (e.g., growth and inflation) or external stability*.[25] At the same time, it is recognized that the Fund should avoid duplicating the efforts of IDIs that often have greater expertise in these areas (Box 4). Consideration should also be given to macro-critical social spending issues in the context of programs.[26]

17. Social spending issues are viewed as macro-critical in most countries. Mission chiefs indicated that social spending was macro-critical in nearly 80 percent of countries, with 70 percent reporting that policy advice was provided in this area. The ratio was higher for EMDCs and program countries. This finding is also borne out by the case studies. The reasons given for macro-criticality of social spending were diverse, going beyond traditional fiscal sustainability considerations, and varied by countries' income level (Figure 5):[27]

- For *AEs*, expected social spending pressures (especially from population ageing) and achieving authorities' distributional objectives;
- For *EMEs*, achieving the authorities' distributional objectives, risks to social or political stability

[25] For purposes of bilateral surveillance in Article IV consultations, the Fund's engagement on social protection issues has been guided by the principles set forth in the Integrated Surveillance Decision, which establish that policies other than exchange rate, monetary, fiscal, and financial sector policies are also examined in the context of surveillance only to the extent that they significantly influence present or prospective balance of payments or domestic stability. This principle, referred to as "macro-criticality," corresponds to issues or policies that affect, or have the potential to affect, domestic or external stability (2015 Guidance Note for Surveillance under Article IV, IMF 2015c).

[26] In the Use of Fund Resources (UFR) context, while IMF staff routinely discusses with member authorities issues that are considered to be macro-critical, the establishment of program conditionality is subject to specific standards that do not refer to "macro-criticality." These standards are set forth in the Guidelines on Conditionality and state that conditionality should only be set on measures that are (i) critical for meeting program objectives or for monitoring the program's implementation, or (ii) necessary for implementing specific provisions of the Fund's Articles of Agreement or policies adopted under them. This means that even in cases where an issue or policy is not macro-critical, these will still be discussed if they are the subject to program conditionality or they are otherwise part of the member's program. In the specific case of PRGT-supported programs, under current policy, all PRGT facilities, should safeguard and, whenever appropriate, increase social and other priority spending. This should be monitored through explicit program targets, wherever possible. The definition of priority spending should be established by the member, in accordance with the country's poverty reduction and growth strategy, and hence can be expected to vary from country to country. More generally, PRGT facilities are designed to support economic policies rooted in country-owned strategies that aim to support poverty reduction and economic growth (IMF, 2009a, 2009b).

[27] These findings are consistent with the IEO staff survey, according to which three quarters of surveyed staff considered macro-implications as the key reasons for working on social protection issues, while a similar ratio considered social and distributional concerns as the key reasons (IEO Report, 2017b).

posed by insufficient spending levels, and large social protection gaps; and

- For *LIDCs*, large coverage gaps in education and health as well as risks to social or political stability.

Box 4. Macro-criticality and In-house Expertise

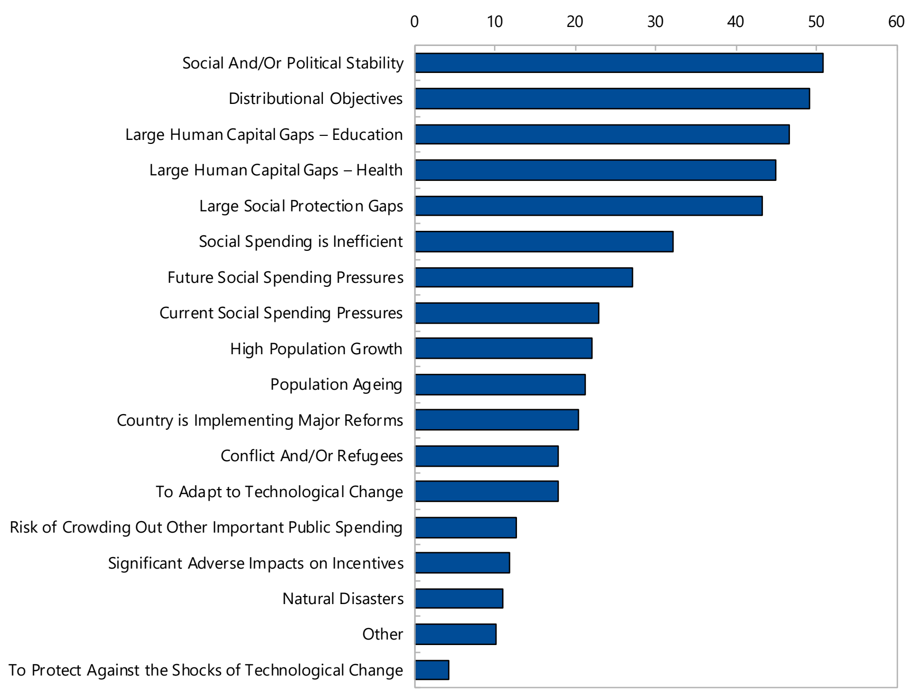
For engagement on structural issues in surveillance, the Fund has been guided by macro-criticality and expertise, defined in the 2014 Triannual Surveillance Review (TSR) and the 2015 Guidance Note for Surveillance under Article IV Consultations.

Macro-criticality. The TSR underscored that, given the Fund's mandate, surveillance should always identify all macro-critical structural issues, and discuss their macroeconomic implications. Yet, the Fund need not be the expert in all areas, especially since the macro-criticality filter could imply a massive expansion of the Fund's advice on specific structural issues, some of which fall beyond its expertise. Thus, *macro-criticality is a necessary but not sufficient condition for determining when the Fund's involvement should go beyond acknowledging the macroeconomic implications to providing specific policy advice.*

In-house expertise: For structural issues that are macro-critical and where the Fund *has in-house expertise* (e.g., fiscal and financial reforms), analysis and policy advice are required for surveillance, and staff should leverage as much as possible Fund TA and cross-country experience, particularly with respect to policy lessons. Where structural issues are macro-critical and the Fund *lacks in-house expertise*, the Fund should typically rely on external institutions to inform its surveillance, rather than "reinventing the wheel." Staff should analyze the issue, drawing on outside expertise, but staff is then not expected to provide specific policy advice (see Section B). Where a critical mass of members finds a particular structural issue to be of macro-critical importance, there could be merit in building in-house expertise.

Figure 5. Mission Chiefs' Survey: Why is Social Spending Macro-critical?

(Percent, multiple responses allowed)

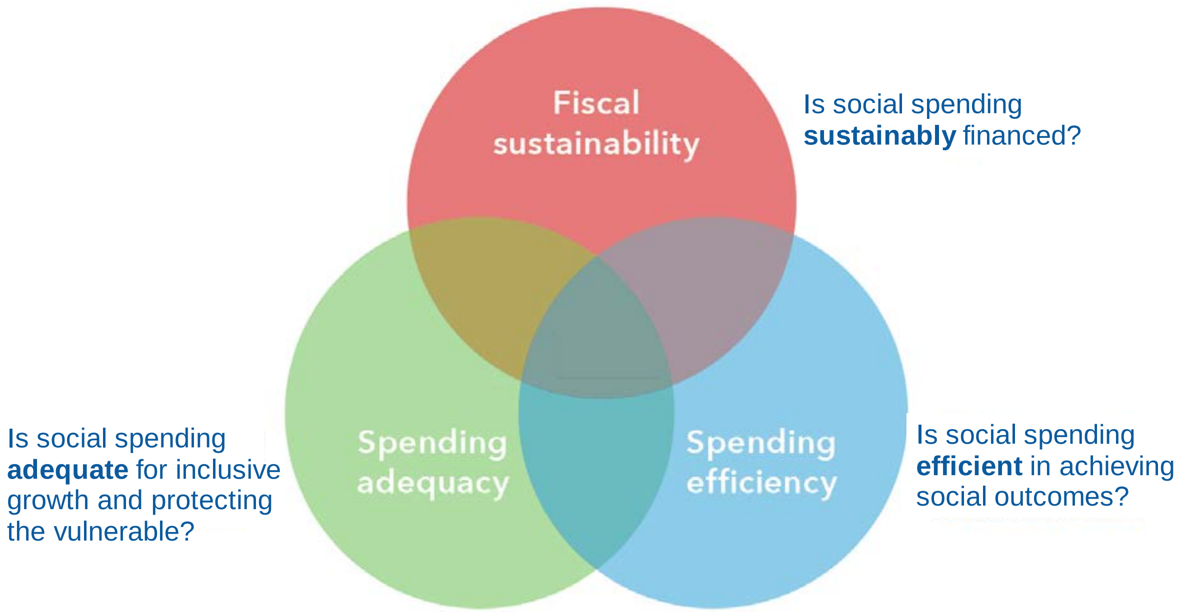


Source: Mission Chiefs' Survey on IMF Engagement on Social Spending.

Macro-criticality Channels of Social Spending

18. The channels through which social spending may be macro-critical can be grouped into three, often interrelated, channels: Is social spending *sustainably financed?* Is it *adequate?* Is it *efficient?* A particular social spending issue is considered macrocritical if one, or any combination, of these channels is a policy concern. Or, in other words, social spending is unlikely to be considered macrocritical if it is sustainable, adequate, and efficient under current policies. Assessment of macrocriticality often requires joint consideration of multiple channels and possible trade-offs. For instance, if social spending is inadequate and needs to be increased, it may need to be accompanied by measures to ensure spending efficiency and fiscal sustainability.[28] These channels, illustrated in Figure 6, can help guide staff in determining if a social spending issue is macro-critical, and capture the underlying motivations for staff engagement. Case Studies (see related paper) help further illustrate how macro-criticality is applied in individual countries.

Figure 6. Macro-criticality Channels of Social Spending



Note: A social spending issue can be macro-critical if any one, or any combination, of these channels is a policy concern.

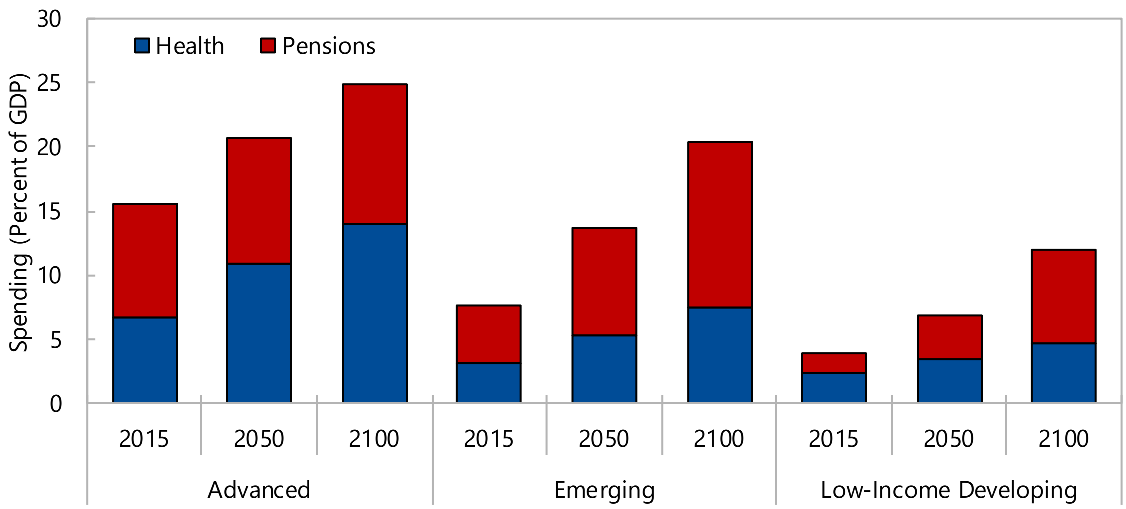
19. Social spending pressures may pose sustainability risks if not appropriately financed. *Fiscal sustainability* is probably the most common channel of macrocriticality, as illustrated by the case studies. Most AEs face significant health and pension spending pressures arising from ageing populations (Figure 7, and Italy and Japan case studies), while many EMDCs face age-related pressures linked to population growth putting pressure on education and health systems. Conflicts, refugee crises, and natural disasters can also create social spending pressures. Or an exogenous

[28] While IDIs are typically better placed to assist authorities in delivering adequate and efficient social services, IMF engagement can play a catalytic role in elevating these issues in the policy debate.

economic shock, such as a collapse of commodity prices, can reduce fiscal resources, and create pressures for reducing outlays, particularly if a prior social spending expansion was predominantly financed by windfall revenue (as illustrated by the Bolivia and Mongolia case studies). Ensuring fiscal sustainability and avoiding disruptive and damaging outcomes require policy reforms that create fiscal space or contain spending increases. Countries may therefore need to increase tax revenue or reduce other spending or increase social spending efficiency. The distributional impact of such adjustment will depend not only on the composition of social spending measures (e.g., social sector wage bill versus social benefit measures) but also the composition of tax measures (e.g., increasing consumption taxes or progressive income taxes).

Figure 7. Fiscal Sustainability

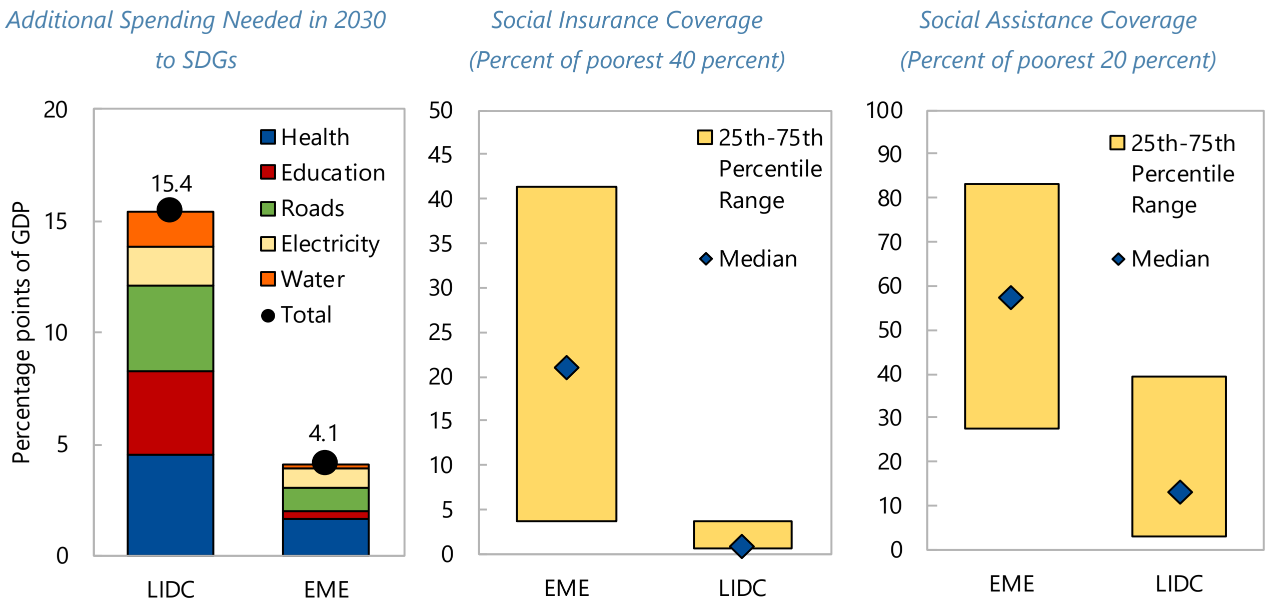
Age-Related Spending Projections



Source: IMF staff calculations.

20. Spending adequacy reflects the importance of social spending for achieving inclusive and sustainable growth. For example, in many EMDCs, increased social spending is required to fill gaps in basic education, health, and social protection coverage (Figure 8) as recognized in the SDGs. In the case of LIDCs, closing health and education gaps to achieve SDGs would require additional spending of 8 percentage points of GDP on average by 2030. Social spending adequacy issues can also arise during crises or periods of large adjustment (as in the Egypt case study), when social protection spending may need to be temporarily scaled up to protect the vulnerable and to ensure a successful transition to more normal times. Staff needs to be cognizant that spending adequacy in a specific country context may depend on a wide range of historical, political, and social factors. The role of the private sector or non-governmental institutions in social protection, health, and education also varies across countries, and social spending needs to be designed to avoid crowding out effective private spending, which can be an important complement.

Figure 8. Spending Adequacy



Notes: *Additional spending* is average GDP-weighted spending in percentage points of GDP. *Coverage* is the percentage of poorest 40 (20) percent of population receiving social insurance (assistance) transfers. Sample sizes by region are: EMEs {n = 37-39}, LIDCs {n = 40-43}.

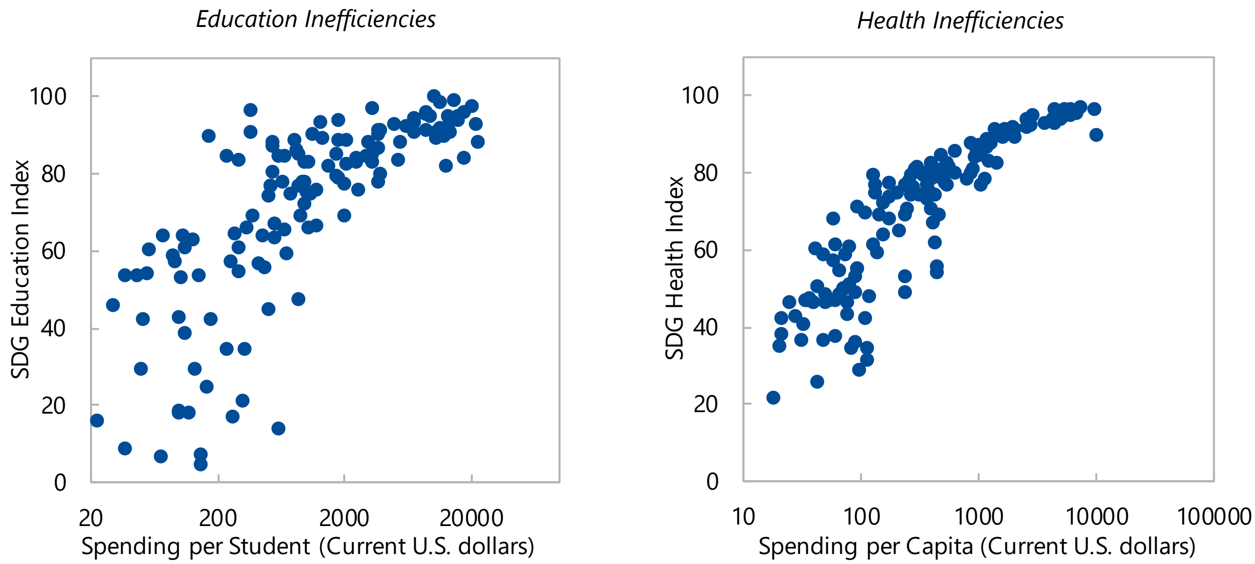
Source: IMF staff calculations based on World Bank ASPIRE data.

21. **Where social spending is inefficient, it can result in poor social outcomes or unnecessarily high levels of spending that crowd out other priority spending or lead to higher taxation.** For example, relatively high education and health spending is not always reflected in commensurately high social outcomes , suggesting substantial room for improving spending efficiency (Figure 9 and South Africa case study). This may require improved governance informed by, for example, functional expenditure reviews and reviews of procurement systems.[29] In addition, while many AEs have comprehensive social protection systems in terms of spending and coverage levels, if poorly designed, these systems can create significant work disincentives resulting in unnecessarily high unemployment and spending.[30] Similarly, the efficiency of social safety nets in EMDCs is often undermined by duplicating small programs spread across numerous ministries, which increases administrative costs. Nonetheless, high spending levels in themselves are not necessarily indicative of inefficiencies. Finally, social spending needs to adapt to the challenges posed by demographic and technological developments, including changing labor relationships.

[29] Closing inefficiency gaps would lower additional spending needed to achieve SDG commitments by about 4 percent of GDP in LIDCs and 2 percent of GDP in EMEs (Gaspar and others, 2019). In OECD economies, where social spending tends to be much higher, addressing inefficiencies could reduce costs by 40–50 percent (Dutu and Sicari, 2016).

[30] Work disincentives could arise from high marginal tax rates due to the combination of progressive taxes and high benefit withdrawal rates (see for example, Brewer et al. 2010; and Immervol et al., 2007).

Figure 9. Education and Health Spending Inefficiency



Source: IMF staff analysis based on Sachs and others (2018) for SDG indices; World Bank Edstats for education spending; and World Health Organization Global Health Expenditure Database for health spending.

B. HOW to Engage

General Principle

22. The strategy provides a systematic approach for staff engagement in both surveillance and program contexts. The objective of the Fund's policy advice should be to help members resolve the underlying macro-critical policy challenges associated with social spending. While social spending issues have been increasingly covered in country policy dialogues, the extent and nature of this engagement have varied across countries and time. The strategy: (i) sets out a systematic approach to social spending, including guidance on the breadth and depth of engagement; and (ii) provides guidance on how to better leverage external expertise, in addition to in-house resources. In doing so, the strategy strikes a balance between uniformity of treatment and the flexibility to tailor engagement and policy advice to country-specific circumstances, taking into consideration the full set of country-specific macro-critical issues, level of development, economic cycles, institutional capacity, social and political preferences, and other relevant socio-economic factors.

23. Engagement on social spending issues would systematically follow the following steps (Figure 10):

- **Identify social spending issues that are macro-critical.** Country teams should apply the macro-criticality assessment discussed above to identify such issues and also consider them in a program context. Teams should seek to understand the key macroeconomic and social challenges, including possible interlinkages. The presence of large social spending in itself does not warrant Fund engagement, unless sustainability, adequacy, or efficiency concerns endanger macro stability.

- **Understand the member's needs and priorities** with regard to the role of social spending, by drawing on previous or initiating new discussions, while recognizing the competing demands for limited public resources. Early engagement can help gain traction and support from the authorities, and help staff prioritize specific social spending issues. Where adjustment is needed, early discussions of social spending issues can help ensure that social safety nets adequately protect the vulnerable.

- **Take stock of existing analysis,** including country-specific or cross-country analyses (Table 2). Such analysis may be available within the Fund from staff reports, selected issues papers, working papers, TA reports, and other relevant policy or research papers. Staff should also engage with country authorities, IDIs, academics, CSOs, and the private sector in stocktaking.

- **Identify and close any analytical and data gaps.** If the existing analysis is sufficient, comprehensive, and up to date, it can provide the basis for formulating policy recommendations. If not, staff should identify questions and data gaps that need to be addressed before providing policy recommendations. Staff should approach IDIs that have deeper expertise on the relevant social spending issue, ideally early in the process. If staffing and availability of in-house expertise permit, staff can also conduct its own analyses and use tools provided by the Fiscal Affairs Department (FAD). If the issue pertains to a broader set of countries, area departments (possibly with FAD support) may consider conducting cross-country analysis. TA, in-house analytical work, and collaboration with IDIs can help provide an in-depth assessment to identify policy options.

- **Formulate policy recommendations**. This can be undertaken with FAD support and should reflect discussions with IDIs where relevant. The recommendations should be formulated within the broader macroeconomic context, reflecting financing constraints and appropriate sequencing of policies measures. Policy advice should be effectively communicated to broader stakeholders and discussed in staff reports, which should also provide updates on progress in policy implementation as appropriate.

- **Revisit and repeat the steps.** To account for changing economic situations, the above sequence should be periodically revisited, and the list of macro-critical issues updated as needed. For instance, a social spending item could become macro-critical when financing falls short and becomes unsustainable. Similarly, a social spending issue can exit from the list of priorities if it has been addressed through reforms, or if other macro-critical issues are more important.

Figure 10. Engagement on Social Spending Issues—Key Steps

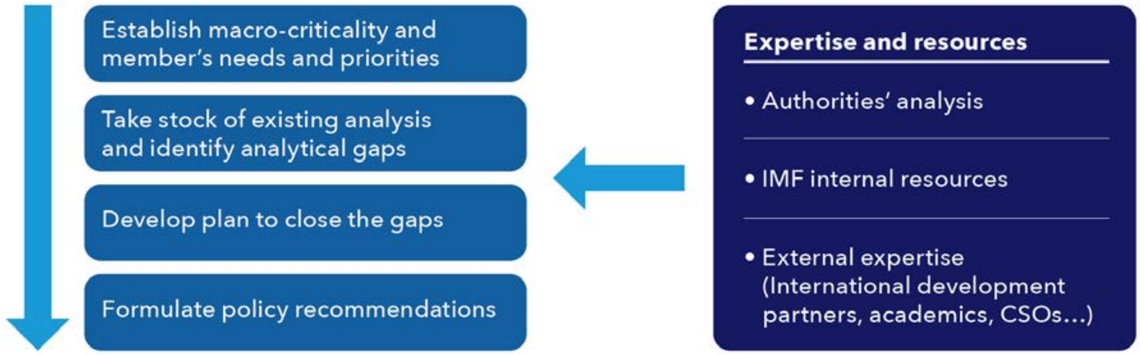


Table 2. Type of Analysis and Sources

	External	Internal	
Country-specific	• Analysis done by authorities, IDIs, academics, CSOs, private sectors, etc.	• IMF's own analysis (Selected Issues Paper, IMF Working Paper, Policy paper, etc.)	Technical Assistance
Cross-Country	• Tools developed by external experts	• IMF in-house tools	

Breadth and Depth of Engagement

24. The *breadth* of analysis and policy advice should cover relevant social spending components. Not all spending sub-components need to be considered (Annex 1). For example, where primary education coverage is near universal, macro-critical fiscal pressures may arise from plans to expand secondary education. Similarly, social protection spending pressures may reflect high pensions, but not high social assistance spending (see the Ukraine case study).

25. The *depth* of policy advice and analysis should consider various factors. Not every issue needs to be covered in-depth in every staff report, and issues can be prioritized and analyzed over multiple surveillance cycles. The depth of the policy advice should reflect:

- **Urgency of the issue,** taking into consideration available staffing and resources. Other immediate policy priorities also need to be considered—for example, the onset of an acute banking crisis may delay the focus on education reform. In some instances, there may be a trade-off between urgency and depth.

- **The authorities' policy agenda and capacity** to implement the needed policies, including the potential to improve their capacity in the near term. TA from the Fund and other IDIs may be important in this regard. The complexity of social spending challenges may require a longer-term approach and continued TA.

- **The Fund's comparative advantage and in-house expertise** to provide *specific* policy advice. For example, staff may identify inefficiencies in the health sector as macro-critical, may recommend the need for their reform, and may—in coordination with IDIs—evaluate the macroeconomic benefit and fiscal cost of such reforms (Annex 1). However, more granular recommendations on how to reform the sector would likely be left to IDIs with relevant expertise and capacity, although the macroeconomic implications of those recommendations should be consistent with Fund advice.

26. The depth of the analysis underpinning the policy advice may differ in surveillance and program contexts. On the one hand, staff may have the opportunity to conduct in-depth analysis and formulate policy recommendations during surveillance, while programs would ideally focus on implementing already developed policy advice. On the other hand, while specific policy advice on social spending issues may be deferred to the next Article IV cycle, in a program context conditionality on an issue might be needed if it is critical to the program's success. The authorities' interest, as reflected in the extent and nature of their TA requests, may similarly impact the depth of policy advice (see, for example, the Cyprus, Jamaica, and Ukraine cases).

27. Addressing social spending issues typically requires a medium-term focus. For example, sustainable financing of spending may necessitate significant strengthening of revenue administration and tax policy reforms. Similarly, improving spending efficiency may hinge on bolstering PFM systems, tackling corruption, and enhancing service delivery capacity, as well as spending reforms. Country teams should consider how TA and engagement with IDIs can contribute to capacity development, which should also influence the sequencing of reforms.

Specific Policy Issues

28. Staff should continue to provide *policy advice on sustainable financing of social spending*. Where the level of social spending is inadequate, creating fiscal space for increased social spending may be important—this has been a frequent focus of Fund engagement, particularly in LIDCs, including by designing efficient and progressive tax systems. Where social spending needs to be contained, improving spending efficiency may help achieve social objectives.

29. There is a need for *increased* focus on the *quality* and *efficiency* of social spending to improve social outcomes. Such focus is also one of the staff's proposed recommendations in the ROC2018. Countries undergoing consolidation or where the quality of spending is low, should find ways to improve spending efficiency—such as by reallocating it within social spending items, streamlining duplicative programs, or eliminating ghost beneficiaries or vacant public positions—and this may warrant more collaboration with IDIs (see the case studies on Cyprus, Jamaica, and Ukraine).

30. Effective implementation of the strategy will require *better data*. Good quality and timely data, disaggregated by key components, are crucial for evaluating policies and spending pressures, formulating policy advice, and monitoring spending outcomes. Consultations highlighted the need to improve data quality, especially in EMDCs and LIDCs where significant gaps exist, including high levels of non-reporting and a narrow focus on central government. Existing statistical standards provide a useful conceptual and operational framework for enhancing data quality (Box 5). Consideration could also be given to the IMF leading an initiative to strengthen adherence to GFS reporting of social spending, but could involve considerable costs.

Box 5. Social Spending Data and the IMF

While other international bodies lead in setting guidelines on how to compile, report, and disseminate social spending data, the IMF helps operationalizing these guidelines:

- The internationally agreed statistical standards for the production of government finance statistics (GFS), including government spending, are described in the Government Finance Statistics Manual prepared by the IMF (GFSM2014) in collaboration with other international bodies and selected countries. About 80 countries report GFS data to the IMF (including almost all AEs and a number EMDCs) based on a standardized annual questionnaire.
- The COFOG classification of government spending (developed by the OECD and published by the UN in 1999) is the international framework for reporting government spending at the functional (sectoral) level. COFOG includes spending on social benefits (both cash and in-kind social protection and health benefits) and on education (GFSM2014). Consistent with the practice of other IDIs, universal price subsidies are not included in the definition of social protection.

31. Policy advice on *universal and targeted social assistance benefits* should be discussed in the context of the adequacy and efficiency of social safety nets (Box 6). IMF policy advice on social spending often centers on targeting mechanisms based on means testing, rather than alternative approaches such as targeting based on the presence of children or elderly in a household.[31] The appropriate use of targeted and universal transfers depends on country preferences and circumstances and should be consistent with fiscal and administrative constraints (see for example the Kyrgyz Republic and Mongolia case studies). When countries expand coverage of their social safety nets and increase fiscal cost, it becomes important that this is accompanied by progressive and efficient financing.

[31] According to the MCS, the introduction or expansion of means-tested schemes is recommended in the majority of cases (64 percent) and the downsizing of schemes that do not require a means est is suggested in 18 percent. The expansion of social programs not based on a means test is recommended in only about 18 percent. Under programs, the share of mission chiefs that indicated they recommended the introduction or expansion of means-tested social safety nets is even larger (about 80 percent).

Box 6. Targeted and Universal Transfers

Countries wishing to strengthen their safety nets face the challenge of how to best ensure full coverage of lower-income groups ("the poor") using means testing of social assistance transfers. Whereas many AEs have broad coverage based on sophisticated *means testing*, this is typically not feasible in countries with large "informal" sectors (characterized by self-employment and multiple and volatile sources of income) and limited administrative capacity, especially LIDCs (see Background Paper IV). An alternative is to use *proxy-means testing*, which estimates income using information on household characteristics highly correlated with low income to target transfers to the poor. Despite its growing use, this method of targeting can result in large errors related to the exclusion of the poor (undercoverage) and inclusion of the non-poor (leakage). Even in AEs, stigma and information gaps can lead to incomplete take-up of means-tested benefits.

Countries often rely on *categorical targeting*. This approach gives transfers to groups that have a greater probability of being poor, such as children or the elderly. However, it also results in targeting errors since not all children or elderly are poor and many poor households do not have children or elderly; and therefore reduces the poverty impact of the transfer budget. Expanding coverage by including more age groups—a form of *progressive universalism*—while keeping transfer levels fixed would require creating fiscal space.

The appropriate mix of universal and targeted transfers depends on country preferences and circumstances, including administrative, financing, social, and political constraints. For instance, administrative constraints and a desire to build middle-class policy support may make targeting of transfers just to the poor undesirable. The appropriate policy mix may change over time; for instance, technological developments, including the use of biometrics, is helping to address administrative constraints. Country strategies for expanding coverage of transfers need to be carefully designed to avoid potentially large costs associated with the distortionary impact of taxes or crowding out other spending (including education, health and physical infrastructure) that is crucial for promoting inclusive growth. This is a particular challenge in LIDCs with limited tax capacity and large development needs.

What ultimately matters is the combined distributional impact of transfer policies and the taxes that finance them. For instance, even the use of regressive taxes to finance progressive transfers can achieve significant redistribution and poverty reduction. Key components of an efficient and progressive financing strategy are: (1) effective strategies to improve tax compliance,[1] (2) progressive personal income taxes for higher-income groups; (3) effective taxation of corporate income; (4) a broad-based consumption tax; (5) efficient taxation of goods associated with negative consumption externalities such as fossil fuels, tobacco, and alcohol; and (6) fighting tax evasion and avoidance. Strengthening these dimensions of the tax system is a key component of strategies promoting progressive universalism. In addition, expanded safety net coverage of the poor is needed to adequately protect them from the potentially adverse impact of broader consumption taxation.

[1] As discussed for instance in IMF (2015b).

Program Considerations

32. **Program objectives and design related to social spending should be tailored to country-specific circumstances.** While following the principle of uniformity of treatment, the social spending objectives of each program should be consistent with the specific macroeconomic context, such as the intensity of short-term macro-fiscal pressures, the pace and size of adjustment needed, and longer-term structural challenges. This is illustrated in the case studies, including Jamaica (tax reform and scaling up the safety net), Ukraine (subsidy reform and scaling up an energy compensation mechanism), and Egypt (strengthening social spending while addressing long-standing imbalances). Programs can therefore aim at one or a combination of the following objectives:

- **Programs should aim to mitigate the adverse effects of adjustment measures on the vulnerable, and conditionality should support social objectives where critical for the program's success.**[32] In line with the staff's recommendations of ROC2018, there is a case to increase the focus on the quality of social spending, in addition to the level, underpinned by more analysis of the program's impact on the poor and vulnerable groups. The principle of reducing poverty and protecting the vulnerable has been well established in PRGT-supported programs, including through appropriate conditionality (social safeguards), given that these programs are intended to advance a country's poverty reduction objectives. Under Fund policies for GRA financing there is no similar general focus, but there is already extensive engagement on social spending issues in the context of GRA programs.[33] Based on existing good practice, in the context of GRA-supported programs, staff should analyze and, as appropriate, document the social impact of adjustment and measures to protect the vulnerable. This may be important in order to build public support and political ownership of the program for the adjustment measures required to address the underlying balance of payments problem. While PRGT-supported programs are expected to explicitly incorporate measures, possibly as conditionality, to protect the vulnerable and generate public support for adjustment, GRA programs would do so where critical for achieving program success in addressing the underlying balance of payments problem and may require the introduction or expansion of social safety nets.

- **Where relevant, programs should aim at identifying fiscal space to address the *adequacy* of macro-critical social spending.** This is particularly, but not exclusively, germane to PRGT-supported programs, whose core objective is to foster sustainable and inclusive growth. Fiscal space can be created through increasing domestic revenue or donor grants, expenditure rationalization, and better PFM systems.

- **Where relevant, programs should aim at improving the *efficiency* of social spending to cost-effectively achieve social objectives.** For example, improving spending efficiency through streamlining administratively costly social programs and enhancing PFM systems, could help in further strengthening the social safety net. IDIs would be expected to lead in issues concerning the design and implementation of social spending aimed at promoting spending efficiency. As illustrated in the case studies, promoting policies to improve spending efficiency can be an important component of IMF engagement (e.g., in the Cyprus and South Africa case studies).

[32] The authorities' responses to the survey conducted for ROC2018 suggest that there is scope for significant improvement in assessing the social and welfare impact of program policies. Section 1 of the ROC2018's background supplement shows details of the survey results on social protection and inequality issues.

[33] See the Mission Chiefs' Survey (Background Paper III) which found that in 92 percent of GRA countries staff assessed social spending to be macro-critical and in 96 percent staff recommended social spending reforms.

33. There is room to strengthen *quantitative conditionality* on social spending.[34] Mitigating the adverse effects of adjustment on vulnerable groups and improving spending adequacy can usually be addressed by including quantitative conditionality—social spending floors—typically relying on existing social spending schemes. The following factors should be considered when designing program targets to strengthen the use of quantitative conditionality:[35]

- **Quantitative targets for social spending ("floors") should be carefully defined.**[36] The program objectives for social spending may be expressed, for example, as a share of public spending, as a share of GDP, or in real per-capita terms. These objectives are then translated into program targets, which are set in nominal terms. Where relevant, floors should be specified at the sectoral or social program level and tied to a specific program objective and projected financing. The coverage of social spending floors will therefore vary across countries depending on program objectives and data availability (discussed further below), and should be explained in program documents and linked to program objectives and predictable financing.

- **Social spending with the greatest impact on the vulnerable should be prioritized.** Staff should exercise judgment in defining the perimeter of the targets. A more narrowly defined target (e.g., spending on specific programs that cost-effectively protect vulnerable groups or enhance their human capital) may be desirable, particularly when resources are limited or where many components of social spending are badly designed and inefficient. A broader target (e.g., covering all education and health spending) may be needed when disaggregated data on social spending are not available, and could be supported by SBs to improve data quality supported by capacity development.

- **Financing sources need to be carefully considered.** The authorities should ideally have adequate control over their financing sources to avoid unexpected shortfalls. If the spending targets are designed to be met in part through financing that is outside their control, such as donor support, contingency plans should be considered. When social spending is directly financed by donors, the availability and size of such off-budget spending should be discussed and documented in program documents.

- **Availability and quality of social spending data need to be reviewed.** Country teams can choose to set quantitative targets as PCs or ITs, depending on their criticality to program objectives. Using PCs should be avoided if there are concerns about the quality of data; in this

[34] Quantitative conditionality includes performance criteria (PCs) and indicative targets (ITs)—see ¶11(b) and ¶11(d) of the 2002 Conditionality Guidelines (IMF 2002). A PC is a variable or measure whose observance or implementation is established as a formal condition for the making of purchases or disbursements under a Fund arrangement. Variables may be established as ITs for the part of an arrangement for which they cannot be established as performance criteria because of substantial uncertainty about economic trends.

[35] Some of these considerations were outlined in the SSP2017 and Guidance Note (IMF 2018d).

[36] Spending floors may include other types of priority spending, depending on country circumstances.

case, programs can incorporate structural measures to improve the quality and timeliness of data.

34. Where relevant, programs should consider *structural measures* to strengthen social safety nets and improve the quality and efficiency of social spending and outcomes in the medium-term.[37] These measures can aim to strengthen existing social spending schemes (e.g. by removing inefficiencies) or to introduce new schemes. Structural measures, such as plans for strengthening social safety nets, can take time to design and implement; they can be incorporated as conditionality in a program if they are critical to the program's success.[38] Such reforms may also contribute to creating fiscal space over time. Factors to consider when designing structural measures include:

- **Criticality.** Whether a specific measure is set as structural conditionality depends on its criticality for the program's success and would typically apply to reform milestones. Program design needs to abide by the principle of parsimony, particularly in fragile states. Other measures can be established as commitments in the MEFP, including their implementation timelines.
- **Type.** Measures may include introducing new social assistance schemes, or redesigning existing ones. Wherever feasible, programs should also include measures to enhance the efficiency of social spending (such as a road map for implementing identified measures to increase value for money in the education sector). The use of such measures will typically require leveraging advice from IDIs.
- **Appropriate sequencing and timeline.** Design of structural measures should consider the appropriate phasing and sequencing of reform measures,[39] as well as the economic cycle, and factor in the fiscal implications. Structural measures should also take a realistic approach when assessing the time needed for effective implementation.
- **Capacity constraints.** The successful implementation of structural measures may require training or redeployment of staff, or hiring additional staff, by the authorities.

35. Social spending-related issues need to be thoroughly discussed with the authorities and conditionality consistently documented in staff reports. Program documents need to

[37] This is consistent with the staff's recommendations of the ROC2018.

[38] Program-related conditions (including structural conditionality) should be of critical importance for achieving the goals of the member's program or for monitoring program implementation, or necessary for the implementation of specific provisions of the Articles of Agreement. See ¶17 of the Guidelines on Conditionality and ¶39 of 2018ROC. As set out in the Guidelines on Conditionality, the Fund remains fully responsible for establishing and monitoring conditions attached to the use of its resources (i.e. there should not be any cross-conditionality under which the use of the Fund's resources would be directly subjected to the rules or decisions of other organizations). When establishing and monitoring conditions based on variables and measures that are not within its core areas of responsibility, the Fund will, to the fullest extent possible, draw on the advice of other multilateral institutions, particularly the World Bank.

[39] For example, mitigating measures should ideally be in place before phasing out energy subsidies.

explain the criticality of a specific measure for the program's objectives. This is particularly important in PRGT and PSI programs,[40] given the critical importance of poverty reduction. If a country cannot effectively monitor social spending or faces other obstacles in designing and implementing social spending measures, the program documents should discuss such challenges and ideally present plans or measures to build capacity.[41]

SUPPORT FOR COUNTRY TEAMS

36. Functional departments already provide significant support to country teams on social spending (Box 7). Such support will be crucial for a successful implementation of the proposed strategy, given the complexities of social spending policies and the need to ensure that analysis and recommendations reflect country circumstances. This calls for strengthening both internal expertise and effective leveraging external resources. Several IMF departments (ICD, RES, SPR, STA) are involved, with FAD leading in many of these efforts:

- **Policies** are set out in Board papers on various social spending issues (pensions, health, social protection, and food and energy subsidies), as well as on governance and creating fiscal space through improved tax design and administration.
- **Technical assistance** helps to develop country capacity to evaluate and formulate fiscal policies, including enhancing revenue systems to create fiscal space and strengthening institutions and policies to enhance the management and efficiency of social spending. TA recommendations inform the design and implementation of program conditionality, while training supports the design and implementation of nationally-owned strategies to achieve social spending objectives. There is also considerable TA on the functional classification of spending (COFOG) in GFS.
- **Diagnostic tools and databases** support country policy dialogue. For example, information on country-level spending pressures related to ageing are regularly published in the *Fiscal Monitor*, and templates for assessing social spending efficiency in countries have enabled a significant increase in analytical work on public spending that informs country dialogue.
- **Analytical work** on social spending issues (such as Staff Discussion Notes, Selected Issues Papers, How-to-Notes, and Technical Notes and Manuals), undertaken by Fund staff (sometimes in collaboration with external scholars) contributes to the evolution of internal thinking and to external dialogue.
- When social spending issues are considered in IMF country documents and papers, review departments **provide feedback** on policy discussions and consistency of policy messages, as

[40] This is also relevant for LICs that engage with the Fund through the Policy Coordination Instrument (PCI), and for any member for which poverty reduction is a program objective.

[41] For details on documentation guidelines see IMF (2018c).

well as evenhandedness. Departments also provide support to operationalize inequality work through Article IV consultations.[42]

- Engagement on social spending issues has benefitted from **synergies with other workstreams**. For instance, there are significant positive spillovers between engagement on social spending issues and the mainstreaming of inequality in surveillance, which have strengthened the policy dialogue on inequality and distributional issues with many authorities. Similarly, recent estimates of the cost of achieving the SDGs are being integrated into country work and into TA focused on developing and implementing Medium-Term Revenue Strategies.

- **Seminars and training** on social spending issues (including on energy subsidy reform, food and other subsidies, safety nets, wage bill spending, and PFM) help develop internal and country capacity.

- **Access to external resources** is promoted by making relevant information available on IMF-internal websites. This is facilitated through regular interaction with IDIs, including participation in SPIAC-B,[43] conferences, and seminars.

Box 7. IMF Resources to Inform Policy Advice on Social Spending

Country teams have access to substantial resources in the IMF to develop analytical work and inform the formulation of policy advice. These resources can typically be accessed through external and internal websites. A (non-exhaustive) list of the key IMF resources includes:

General

Papers:

Fiscal Policy and Development: Human, Social, and Physical Investment for the SDGs (2019 Staff Discussion Note);
How To Operationalize Inequality Issues in Country Work (2018 Policy Paper);
Tackling Inequality (October 2017 *Fiscal Monitor*);
Macro-structural Policies and Income Inequality in Low-Income Developing Countries (2017 Staff Discussion Note);
Inequality and Fiscal Policy (2015 Book);
Redistribution, Inequality, and Growth (2014 Staff Discussion Note);
Fiscal Policy and Income Inequality (2014 Board Paper);
Poverty and Social Impact Analysis by the IMF: Review of Methodology and Selected Evidence (2008 Book).

Templates (IMF internal use):

Expenditure Assessment Tool (EAT) template for benchmarking sectoral (social protection, health and education) spending efficiency in advanced, emerging, and developing economies;
SDG template for estimating cost of achieving SDGs.

42 IMF (2018b).

43 The Social Protection Inter-Agency Collaboration Board (SPIAC-B), co-chaired by the ILO and the World Bank, is composed of representatives of international organizations and bilateral institutions with the goal of enhancing global coordination and advocacy on social protection issues, including international cooperation in country demand-driven actions.

Box 7. IMF Resources to Inform Policy Advice on Social Spending (Concluded)

Datasets (IMF internal use):
Gini Income Inequality Indices;
Historical country social spending data;
Expenditures by Function of Government (COFOG) in the Annual GFS Database.

Pension Spending
Papers:
Growing Pains: Is Latin America Prepared for Population Ageing (2018 Departmental Paper);
Automatic Adjustment Mechanisms in Asian Pension Systems (2016 Working Paper);
The Fiscal Consequences of Shrinking Populations (2015 Staff Discussion Note);
Equitable and Sustainable Pensions (2014 Book);
The Challenge of Public Pension Reform in Advanced and Emerging Economies (2011 Board Paper).
Templates (IMF internal use):
Pension template to evaluate sustainability of pension systems.
Datasets (IMF internal use):
Country-level long-term spending projections (regularly published in the *Fiscal Monitor*).

Social Assistance Spending
***Papers*:**
Universal Basic Income: Debate and Impact Assessment (2018 Working Paper);
Inequality and Poverty Across Generations in the European Union (2018 Staff Discussion Note);
Energy Subsidy Reform: Lessons and Implications (2013 Book);
Fiscal Policy and Employment in Advanced and Emerging Economies (2012 Board Paper);
Fuel and Food Price Subsidies: Issues and Reform Options (2008 Board Paper).
Templates (IMF internal use):
Distributional Analysis of Fuel Subsidy Reform (external);
Interactive tool to assess energy taxes and country-level energy subsidy estimates.

Health Spending
Papers:
The Efficiency Imperative (2014 Finance & Development Article);
The Economics of Public Health Care Reform in Advanced and Emerging Economies (2012 Book);
Macro-Fiscal Implications of Health Care Reforms in Advanced and Emerging Economies (2010 Board Paper).
Datasets (IMF internal use):
Country-level historical health spending; and long-term spending projections (regularly published in the *Fiscal Monitor*).

Education Spending
Papers:
Improving the Efficiency and Equity of Public Education Spending: The Case of Moldova (2019 Working Paper).
Datasets (IMF internal use):
EAT - Country-level historical education spending.

Creating Fiscal Space
Papers:
Corporate Taxation in the Global Economy (2019 Board Paper);
Building Fiscal Capacity in Fragile States (2017 Board Paper);
Current Challenges in Revenue Mobilization: Improving Tax Compliance (2015 Board Paper);
Spillovers in International Corporate Taxation (2014 Board Paper);
Taxing Times (October 2013 *Fiscal Monitor*);
Revenue Mobilization in Developing Countries (2011 Board Paper).

37. FAD could further strengthen support for country teams, resources permitting, through:

- **New dedicated tools.** Building on existing initiatives, and in collaboration with IDIs, FAD could develop new diagnostic and policy tools to: 1) assess the fiscal impact of age-related spending (pensions and health) and evaluate alternative policy options; 2) cost the spending required to achieve the SDGs in EMDCs; and 3) evaluate the performance of social safety net systems in EMDCs, including identifying coverage gaps.

- **Seminars.** Seminars and courses for staff could be expanded in collaboration with ICD, leveraging also the external expertise of academics and IDIs.

- **New internal Knowledge Exchange website.** FAD could review existing knowledge sharing platforms with the objective of facilitating access to social spending data and information.[44] This would enhance the capacity of country teams to leverage available and new resources, expertise, and analytical products. The website would also provide guidance on how to engage on social spending issues such as a list of key IDI country contact persons on social spending and a series of How-to-Notes on different components of social spending.

COUNTRY-LEVEL ENGAGEMENT WITH IDIs AND OTHER STAKEHOLDERS

38. Close engagement with IDIs can be very valuable. While country teams rely mostly on their own resources to support their engagement on social spending issues, in some cases there is also significant leveraging of external expertise.[45] Engagement varies by country, reflecting the focus and role of IDIs and heterogeneity in the capacity of country teams. While most interactions have been with the World Bank, they also span a range of institutions and social spending issues. Ultimately, however, IMF staff is responsible for its policy advice.

39. To address challenges in the cooperation with IDIs, and the proposed strategy aims at strengthening engagement at both the country and institutional levels.

- *At the country level*, mission chiefs noted that an important factor weighing on enhanced cooperation are differences in institutional focus, i.e., the Fund's traditional focus on short-term stabilization versus the longer-term development focus of IDIs, as well as different institutional

[44] Examples of such information include: good practice on social safeguards in surveillance; links to relevant analytical work, blogs, and other relevant websites; quantitative tools; and IDI country and expert contacts.

[45] This was confirmed in the MCS and case studies (see, for example, the cases of Cyprus and Ukraine) and is in line with the findings of the 2017 IEO Report and the SSP2017.

priorities for individual countries.[46] This strategy, therefore, emphasizes early dialogue with IDIs, particularly when a country strategy is being developed, to align institutional priorities and foster effective collaboration. This can help ensure that IDI expertise on social spending issues in individual countries supports the work of IMF country teams, which is a particular concern in programs where there is a need to strengthen social protection systems that may require both a short-term and medium-term plan for protecting the vulnerable. Mission chiefs also noted that lack of information on IDIs' organizational set up, misalignment of work plans, and uneven country engagement are obstacles for effective collaboration across institutions. Recognizing this challenge, and to facilitate the dialogue with a broader range of IDIs, FAD would act as a hub for identifying relevant counterparts and provide guidance on where IDIs take the lead or provide complementary support (Annex I). Drawing on IMF Resident Representatives' knowledge and contacts would also be important. Where support from IDIs is not available, and the social spending issue is macro-critical or critical to the program success, staff may need to develop internal expertise.

- *At the institutional level*, since early 2018, the Fund participates in SPIAC-B and in the WHO-World Bank-led Technical Working Group on Health Financing. This engagement would continue to be complemented by ongoing interaction with academic experts (such as the joint IMF-LSE Workshop in November 2018) and coordination between the IMF and multilateral development banks on policy-based lending. Strengthening the high-level dialogue with IDIs (including on improving collaboration in specific countries) and institutional participation in international fora could also mitigate obstacles to external cooperation of IMF teams and help align institutional priorities. Finally, enhanced engagement of IDI experts in developing technical analysis could be explored.

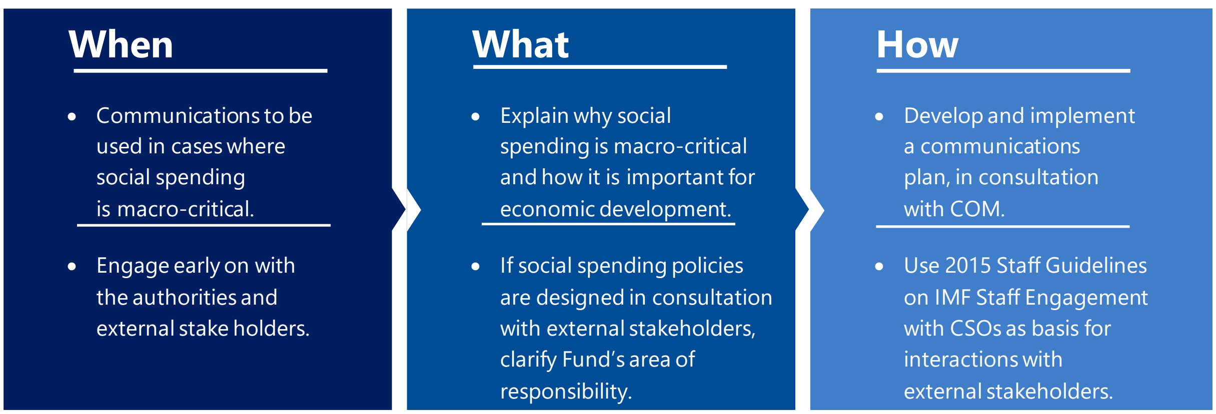
40. Engagement with other stakeholders is also important (e.g., CSOs, academics, think tanks, labor unions, business, and local experts). Early engagement with third parties would enrich staff's understanding of country circumstances, help gauge the economic significance of social spending, improve the design of policy advice, increase ownership, and strengthen traction and understanding of IMF policy advice. In its interactions, staff should follow the general principles and best practices laid out in the 2015 Staff Guidelines on IMF Staff Engagement with CSOs.

[46] The division of labor between the IMF and the World Bank is laid out in the 1989 IMF-World Bank Concordat, which states that the Bank has primary responsibility for policy advice related to the efficient allocation of government spending. This is spelled out in more detail in the 2007 Joint Management Action Plan (JMAP) and the 2010 Implementation of the JMAP on Bank-Fund Collaboration, which states that "Since the Bank has responsibility for analyzing sectoral aspects of public expenditure, and the Fund should have regard to the quality of public expenditure when considering fiscal aggregates, it is essential that the Bank is in a position to provide the Fund with timely advice, for example, through undertaking Public Expenditure Reviews." The latter identified the "early sharing of country documents" as crucial for improving collaboration.

COMMUNICATING IMF ADVICE EXTERNALLY

41. External communication builds awareness of the Fund's engagement and can make its policy advice more impactful. The strategy would guide the content of IMF communications (Figure 11). It would ensure that the Fund explains its approach clearly, within a specific country context, and sets realistic expectations about what it can and cannot do given its mandate, resources, and expertise.[47] In particular, communication should articulate IMF policy advice where this is likely to be a contentious issue for the public, the authorities, or IDIs. For example, sequencing of reforms aimed at up-front strengthening of social safety nets to adequately protect the vulnerable from the adverse impact of planned energy subsidy reforms should be clearly communicated. Communication should also seek to underscore the long-standing and significant engagement of the Fund on social spending issues and reinforce the Fund's commitment to ensuring evenhandedness.

Figure 11. Externally Communicating Policy Advice on Social Spending



42. Collaboration between country teams and the Communications Department (COM) should begin early on during the surveillance cycle and the early stages of program design, based on a *communications plan*. Where relevant, teams would explain why the Fund is concerned about social spending issues, how social spending is considered in the formulation of policy advice and program design, and how this helps the country achieve inclusive growth and its macroeconomic and development objectives. If macro-critical social spending is not covered in country documents, teams should be able to explain the rationale for excluding it. Specific policy recommendations should be made in a broader policy context and synergies and complementarities between measures, as well as constraints and trade-offs of policy measures, should be spelled out.

[47] The case studies suggest that outreach and communication efforts should clearly explain the broader macro-fiscal environment underlying policy advice on social spending issues, avoiding an overly narrow focus on selected specific issues (such as the choice of targeting for social safety nets). See, for example, the Kyrgyz Republic and Mongolia case studies.

RESOURCE IMPLICATIONS AND RISKS

43. Since IMF engagement on social spending issues is already extensive, the additional resource burden of implementing the strategy is expected to be modest. Cost estimates will be updated as experience is gained (Table 3). In the past 2 years, an estimated 8 in 10 country teams discussed social spending in their staff reports and 5 in 10 produced a box, selected issues paper or working paper (at an estimated annual cost of US$3 million). Country teams' estimates of the additional resources required to implement the strategy varied widely; 18 of 44 country teams surveyed anticipated needing more resources in FY20, while 26 of 44 country teams anticipated the same or less resources would be needed. This reflects varying policy priorities across time and countries and the flexibility inherent in the strategy, but also points to uncertainty about the estimates. In total, the proposed strategy is estimated to add additional recurring costs from increased country team engagement and functional department support (US$0.7 million based on a random sample survey and split equally across area and functional departments). Reflecting the uncertainty underlying these estimates, the estimate for additional costs for area department engagement (US$0.36 million) would increase to about US$1 million if resource needs increase more rapidly (as seen in some of the sample countries) than in the baseline (see footnote to Table 3 for details on the assumptions). One-off costs are estimated at US$1.3 million during FY20 and FY21 to develop tools and databases (largely in FAD), prepare How-to Notes, and conduct in-reach. These costs will be financed through internal reallocation. These estimates will be updated as experience is gained, and as functional departments gradually increase their support to country teams.

Table 3. Estimated Additional Resources for Implementing the Proposed Strategy

a. Time spent on social spending issues by IMF country teams

(Person-weeks, per country)[1]	FY18	FY19	FY20
Average	2.3	3.3	3.8
Median	2	2	3
Max	13	14	13
Min	0	0	0.5

b. Expected additional costs of engagement on social spending issues

(Millions of FY19 U.S. dollars)	Transitional and one-off costs FY20-FY21[2]	Steady state per year[3]
Total	1.3	0.72
Area departments		0.36
Functional departments	1.3	0.35

[1] The estimates reflect a survey of a randomly selected sample of 44 country teams across all area departments. The estimates reflect time spent engaging on social spending issues. On average, teams spent 3.3 person-weeks in fiscal year 2019. It should be noted that in a few cases teams spent much more than that (up to 14 person-weeks; one country with 31 person-weeks was excluded from the summary statistics above). Teams estimated that they will spend 1 additional person-week per year in FY20 if the proposed strategy was implemented (difference between average during FY18–19 and FY20 estimate).

[2] Transitional, one-off costs (financed through internal reallocation) are estimated to arise from developing new tools, preparing How-to Notes and conducting internal training (including for staff with review responsibilities). Most of the additional cost for functional departments relates to FAD.

[3] The cost estimate based on the survey of country teams assumes that engagement will deepen in 60 countries per year in implementing the strategy (at a marginal cost of 1 person-week). A reasonable upper-end estimate based on more extensive engagement in 20 countries per year (calibrated based on the average of the 5 countries with the highest estimated additional needs in FY20) points to marginal cost for area departments of up to 2.8 person-weeks or US$1 million. This level of engagement would also significantly increase demand for functional departments support (related to maintaining databases, tools and How-to Notes), from US$0.35 million to US$0.45 million.

44. If successfully implemented, this strategy should reduce risks to both surveillance and lending operations, and to the Fund more generally. The recommendations for engagement on social spending issues where they are macro-critical, or relevant in a program context, would mitigate risks to surveillance and lending operations by improving consistency. Strengthened program design and conditionality would, through greater attention to the adverse effects of adjustment on vulnerable households and improving the quality of spending, also reduce risks in lending by raising traction and sustainability. Proposed steps to support country teams and deepen engagement with IDIs would contain budget and human capital risks, while strong communication would mitigate reputational risks.

CONCLUSIONS

45. Social spending issues have become increasingly important for Fund members. This coincides with increasing emphasis in countries on the need for an inclusive growth process, especially in the aftermath of the global financial crisis, and the central role played by social spending in addressing inequalities of opportunity and income, protecting vulnerable groups, smoothing consumption over the life cycle, and stabilizing demand in the face of economic shocks. Increasing social spending will also be key to achieving country commitments in the context of the 2030 SDGs. And ongoing trends such as from technological change will pose additional challenges.

46. Fund engagement on social spending increased significantly over the last decade, but there is room for further strengthening. The MCS provides evidence of the extensive engagement on social spending issues in surveillance and program activities drawing on team resources and in-house expertise, including TA. Although country teams also regularly drew on IDI expertise, they noted barriers to more effective engagement, including lack of knowledge of counterparts and IDIs' longer-term development focus. Analysis of trends in social spending in program countries finds that although spending has on average been protected, there is a sizeable number of instances where it declined, reflecting various factors. There has also often been an overly narrow focus on means-tested targeting and insufficient focus on the quality of spending.

47. The proposed strategy intends to make engagement more systematic and effective:

- *Engagement would be guided by an assessment of the macro-criticality of a specific social spending issue and consideration of that issue in a program context, as well as by the existence of in-house expertise.* Key channels through which social spending can become macro-critical are fiscal sustainability, spending adequacy, and spending efficiency.

- *Staff would continue to provide policy advice on sustainable financing of social spending and increase the focus on the quality of such spending* for improving social outcomes, while relying more on the expertise of IDIs.

- *Program design and conditionality would be strengthened* through greater focus on the need to mitigate the adverse effects of adjustment on the vulnerable, and address data and information gaps. The nature and extent of conditionality should be informed by the country's macro-fiscal context and social objectives as well its impact on program's success. A medium-term focus would guide the sequencing of conditionality.

- *Support for country teams would be strengthened*. A Staff Guidance Note by end–2020 will present the already significant existing support and initiatives for strengthening this support. The Note will be periodically updated to reflect the evolving nature of social spending issues and as the Fund acquires more experience.

- *Collaboration with IDIs would be improved.* FAD would act as a hub for strengthening engagement between country teams and IDIs to ensure that country teams can draw on IDI resources. Early engagement with relevant IDIs would be encouraged to help align institutional priorities in light of the longer-term nature of social spending reforms. The strategy would also seek closer engagement with other stakeholders.

- *Advice on universal and targeted social benefits would be discussed in the context of the effectiveness of the social safety net.* The appropriate use of targeted and universal transfers to protect vulnerable groups during adjustment depends on country preferences and circumstances. Policies aimed at strengthening the social safety net should be consistent with fiscal and administrative constraints as well as social and political preferences. As countries expand coverage, it is important that this is accompanied by progressive and efficient financing.

- *External communication on IMF engagement in individual countries would be focused on providing a clear explanation of Fund policy advice.* Communication should emphasize how IMF engagement integrates with the overall medium-term macro-fiscal context and policy strategy and help to build up country ownership of policy measures. It should also clarify what the Fund can and cannot do.

ISSUES FOR DISCUSSION

- Do Directors agree that the proposed strategy provides appropriate guidance to staff on the Fund's engagement on social spending issues?

- Do Directors concur that macro-criticality is an important guiding principle for when to engage on social spending issues?

- Do Directors support the continued provision of policy advice by staff on sustainable financing of social spending as well as an increased focus on the quality of such spending?

- Based on existing good practice, do Directors agree that GRA-supported programs should analyze and, as appropriate, document the social impact of adjustment and measures to protect the vulnerable?

- Do Directors agree that advice on the use of targeted and universal transfers would be discussed in the context of the overall effectiveness of the social safety net, administrative constraints, the broader macro-fiscal environment, and countries' social and political preferences?

- Do Directors agree to strengthen collaboration with IDIs with greater expertise in social spending issues?
- Do Directors support improving the clarity of communicating social spending issues, including by embedding them into a broader policy context?
- Do Directors agree that the nature of social spending issues is evolving and that the Fund should update its engagement as it acquires more experience?

Annex I. Examples of Social Spending Policy Issues and Support

Social Spending	Policy Issues[1]	IMF Policy Analysis (Areas where Fund teams can provide specific policy advice)[2]	External Expertise (Areas where Fund teams do not typically provide specific policy advice)
Pensions	Is pension spending projected to increase significantly under current policies (sustainability)?	Is pension spending high in comparison to peers? If so does this reflect demographics, low retirement ages, or generous pension benefits, in-payment and accrual of rights? Is the pension system running deficits? Is it sustainable?	What are the distributional implications of the current pension system? What are the distributional implications of alternative reform options for containing pension spending?
	Does the government have plans to expand pension coverage over the medium term (adequacy, efficiency)?	What are the efficiency and equity implications of reform options? Are there currently large gaps in the pension system? Should gaps be filled with contributory (earnings related) or non-contributory (social) pension systems? What are the spending implications of policy options over the short and medium terms?	How can new contributory schemes be designed and implemented, or existing ones be scaled up? How can pension systems be expanded to cover difficult-to-reach groups?
Social Safety Net (SSN)	Is SSN spending high/low compared to peers (efficiency; adequacy)?	Is high/low spending due to high/low coverage or high/low generosity?	Does the country have the appropriate mix of programs?
	Is SSN spending effective at achieving social objectives (efficiency)?	Is spending progressive and coverage of vulnerable groups high?	Can the administrative system be improved to consolidate and streamline programs and administrative costs?
	Does the SSN create strong disincentives to work (efficiency)?	Are means-tested benefits quickly withdrawn as income increases? Does an adequate tax registry exist, and is it effectively integrated with complementary databases?	How can a beneficiary registry be developed and integrated into the implementation of the SSN?
	Does the government have plans to expand the coverage or generosity	What options is the government considering for strengthening the SSN, and what are the fiscal implications?	How can the targeting mechanisms be designed to ensure adequate coverage of the vulnerable and

	of the SSN (sustainability; adequacy)?	Does the government have the fiscal space and administrative capacity to strengthen the SSN?	minimal leakage to higher-income group?
Health	Is health spending projected to increase significantly under current policies (sustainability, efficiency)? Does the government have plans to expand health coverage over the medium term (adequacy)?	Is health spending high in comparison to peers? If so does this reflect demographics, generous benefits, or spending inefficiency? What are the efficiency and equity implications of reform options? Are there currently large gaps in health coverage? Do plans exist to scale up access, consistent with achievement of the SDGs? Should gaps be filled with expansion of health insurance coverage or general revenue financing? What would be the spending and distributional implications of policy options over the short and medium terms?	How can the primary health care system and hospital system be better integrated to increase efficiency? Can the system for paying providers be reformed to better incentivize efficiency? Can the system for purchasing drugs be reformed to cut costs? How can the insurance system be reformed to enhance coverage among lower-income and middle-income groups?
Education	Has spending declined in line with population ageing? (efficiency; sustainability)? Does the government have plans to expand coverage and increase spending (adequacy)?	Is spending high compared to peers? Is spending efficient? Are teachers' wages too high or too low? Are there currently large gaps in education access? Do plans exist to scale up access, consistent with achievement of the SDGs? What are the fiscal implications of expansion plans? Has the government the administrative capacity to deliver high quality education?	Is the education system capable of delivering quality education? How can schools be consolidated to increase spending efficiency? What complementary policies are needed to reduce excessive inconvenience? Is the system capable of ensuring quality education while expanding access?

1/ For each example the relevant macro-criticality dimension(s) is added in brackets.

2/ While the IMF may have some expertise in the area of social protection (such as pensions and social safety nets), this tends to be limited so that close collaboration with IDIs is still warranted.

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