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A STRATEGY FOR IMF ENGAGEMENT ON SOCIAL SPENDING—CASE STUDIES

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The documents listed below have been separately released:

- A Strategy for IMF Engagement on Social Spending
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A STRATEGY FOR IMF ENGAGEMENT ON SOCIAL SPENDING—CASE STUDIES

EXECUTIVE SUMMARY

This paper uses case studies to explore the nature and extent of past IMF engagement on social spending issues and to draw lessons for future engagement. Countries were chosen to cover a wide spectrum of country circumstances, and type and intensity of engagement. While in all case studies social spending issues were part of the IMF staff dialogue with the authorities, the breadth and depth of engagement varied significantly. Fiscal sustainability has been the main driver of IMF engagement, with fiscal constraints often shaping the dialogue, and spending efficiency and adequacy being less prominent dimensions for engagement.

Internal and external resources have been extensively leveraged enabling better integration of social spending reforms into the macro-fiscal strategy. In many cases, external engagement with International Development Institutions (IDIs) facilitated deeper analysis allowing policy advice to be better tailored to country circumstances and enhancing traction with the authorities. Engagement with Civil Society Organizations (CSOs) was less systematic than with IDIs. For countries with an IMF-supported program, conditionality (both quantitative and structural) on social spending was regularly used.

Two main lessons emerge from the analysis. A key takeaway is that all macro-criticality dimensions (fiscal sustainability, spending efficiency and spending adequacy) may be potentially important for ensuring that social spending systems support inclusive growth and stability, and an a priori narrow focus should be avoided. Also, outreach and communication efforts need to be strengthened to include a broader set of external stakeholders and to be anchored in a broad narrative on the macro-fiscal context of policy advice.

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TABLES

Glossary

ADB	Asian Development Bank
AEs	Advanced Economies
AFR	African Region
ALMPs	Active labor market programs
APD	Asia and Pacific
COCOBOD	Cocoa Board (Ghana)
CMP	Child Money Program
CSOs	Civil Society Organizations
DPF	Development Policy Financing
EC	European Commission
ECB	European Central Bank
ECF	Extended Credit Facility
EFF	Extended Fund Facility
EMs	Emerging Markets
EMEs	Emerging Economies
EU	European Union
EUR	European Region
FAD	Fiscal Affairs Department
GMI	Guaranteed minimum income
GSGDA II	(second) Ghana Shared Growth and Development Agenda
GSIS	General insurance pension scheme
HDF	Human Development Fund
IADB	Inter-American Development Bank
IDIs	International Development Institutions
IEO	Independent Evaluation Office
ILO	International Labour Organization
IMF	International Monetary Fund
INPS	Italian social security institute
IPEP	Infrastructure for Poverty Eradication Program
IT	Indicative Target
LEAP	Livelihood Empowerment Against Poverty
LIDCs	Low-income and Developing Countries
LOI	Letter of Intent
MCD	Middle East and Central Asia

MCS	Mission Chiefs' Survey
MEF	Ministry of Economy and Finance (Italy)
MEFP	Memoranda of Economic and Financial Policies
MOU	Memorandum of Understanding
MTRS	Medium-term revenue strategy
NDC	Notional defined contribution
NDP	National Development Plan
NDPC	National Development Public Commission
NEET	Neither in employment, education nor training
OECD	Organisation for Economic Co-operation and Development
PATH	Programme of Advancement through Health and Education (Jamaica)
PER	Public Expenditure Review
PRGT	Poverty Reduction and Growth Trust
SBs	Structural Benchmarks
SBA	Stand-By Arrangement
SIP	Selected Issues Paper
SMEs	Small and medium-sized enterprises
SPR	Strategy, Policy, and Review Department
SR	Staff report
TA	Technical assistance
UN	United Nations
UNDP	United Nations Development Programme
WHD	Western Hemisphere
WP	Working paper

BACKGROUND AND INTRODUCTION

1. **This paper uses eleven case studies to explore the nature of the IMF's past engagement on social spending and draw lessons for the future.** The 2017 IEO Report on "The IMF and Social Protection" (IEO, 2017) recognized that engagement on social protection issues increased significantly over recent decades, as the IMF expanded its focus on inclusive growth and protection of vulnerable groups. This growing engagement, including on education and health spending issues, is confirmed by the analysis presented in the Main Paper (see in particular the section "The Story So Far") and the findings of a recent mission chiefs' survey (MCS; Background Paper III). However, both the IEO Report and the MCS point to challenges for country teams, which may have contributed to uneven engagement across countries and over time. This paper discusses case studies with the aim of at shedding light on the approach and process of IMF engagement; it is not intended to provide an assessment of the impact of policy advice on social spending issues. Case studies provide an in-depth look, showing that the main challenges include competing priorities, poor data availability and quality, and in some instances lack of specific expertise within the teams. The lessons from the case studies helped to inform the development of the Fund's strategy for engagement on social spending issues.

2. **The case studies presented in this paper were chosen to cover a wide spectrum of country circumstances, and type and intensity of engagement.** They include countries at different stages of development and in different regions (Table 1), and cover both surveillance[1] and Fund-supported programs ("programs" hereafter).[2] A team from the IMF Fiscal Affairs Department (FAD) and Strategy, Policy and Review (SPR) departments conducted desk reviews of country cases. This paper summarizes their findings.

Table 1. Distribution of Country Case Studies by Region and Fund Activity[1]

		IMF Department/Region				
		AFR	APD	EUR	MCD	WHD
Fund Activity Considered	Surveillance	South Africa	Japan	Italy		Bolivia
	IMF-Supported Program	Ghana	Mongolia	Cyprus Ukraine	Egypt Kyrgyz Republic	Jamaica

Note: AFR: African region; APD: Asia and Pacific; EUR: European Region; MCD: Middle East and Central Asia; WHD: Western Hemisphere.

[1] Red=Advanced countries; Green=Emerging economies; Blue=Low-income and developing economies.

[1] Country surveillance is a process that entails consultations with individual member countries. The consultations are known as "Article IV consultations" because they are required by Article IV of the IMF's Articles of Agreement. During an Article IV consultation, an IMF team of economists visits a country to discuss macroeconomic policy with government and central bank officials, and often also meet with parliamentarians and representatives of business, labor unions, and civil society. A report is then prepared and presented to IMF management and then for discussion to the Executive Board. A summary of the Board's views is subsequently transmitted to the country's government and the staff report generally published.

[2] A country in severe financial trouble can turn to the IMF for financing if it has a balance of payments need—that is, if it cannot find sufficient financing on affordable terms in the capital markets to make its international payments and maintain a safe level of reserves. Several types of lending facilities are available, which allows tailoring to specific country needs and circumstances.

SUMMARY OF FINDINGS[3]

A. Context

3. Social spending issues were part of IMF staff dialogue with the authorities in all case studies, although with varying scope and intensity. This is in line with the findings of the Mission Chiefs' Survey (MCS) which found that most country teams engage on social spending issues. In some countries, engagement was based on systematic and long-standing discussions of social spending issues (e.g., Italy and Japan on population aging and pensions). In other cases, short-term developments or shocks motivated deeper engagement on social spending (e.g., Bolivia, Cyprus, Ukraine) with discussions focused on specific or more immediately relevant issues (e.g., on social assistance programs and cash transfers directed to specific segments of the population in Cyprus, or Mongolia). However, in all cases dialogue was persistent over time (e.g. surveillance cycles or program phases). While engagement covered all social spending topics, in most cases it focused on social protection programs (discussed in all ten cases), with social insurance the predominant focus in advanced countries (AEs), such as Italy and Japan, and social assistance in Emerging Market Economies (EMEs) and Low-income and Developing Countries (LIDCs; Table 2). Education and health issues were central only in a minority of cases (five and four out of the ten countries, respectively).

Table 2. Case Studies Summary Table–Context

(tick if yes)

Context	Fund Acvitity	Main Macro-criticaly Channel			Main Social Spending Topic Addressed[1]
	Surveillance/Program	Fiscal sustinability	Spending efficiency	Spending adequacy	
Bolivia	Surveillance	√	√	√	Social Assitance, Health, Education
Cyprus	Program	√	√		Pensions, Social Assistance, Health, Education
Ghana	Program	√	√	√	Social Assistance, Education
Italy	Surveillance	√	√	√	Pensions, Social Assistance, Health, Education
Jamaica	Program	√		√	Social Assistance
Japan	Surveillance	√	√		Pensions, Health
Kyrgyz Republic	Program	√	√		Social Assistance
Mongolia	Program	√	√		Social Assistance
South Africa	Surveillance		√	√	Education, Social Assistance
Ukraine	Program	√	√		Pensions, Social Assistance

Source: IMF staff.

[1] Topics: Health, Education, Social Insurance, Pensions, Social Assistance.

[3] The analysis presented below and in subsequent sections is based on the countries listed in Table 2.

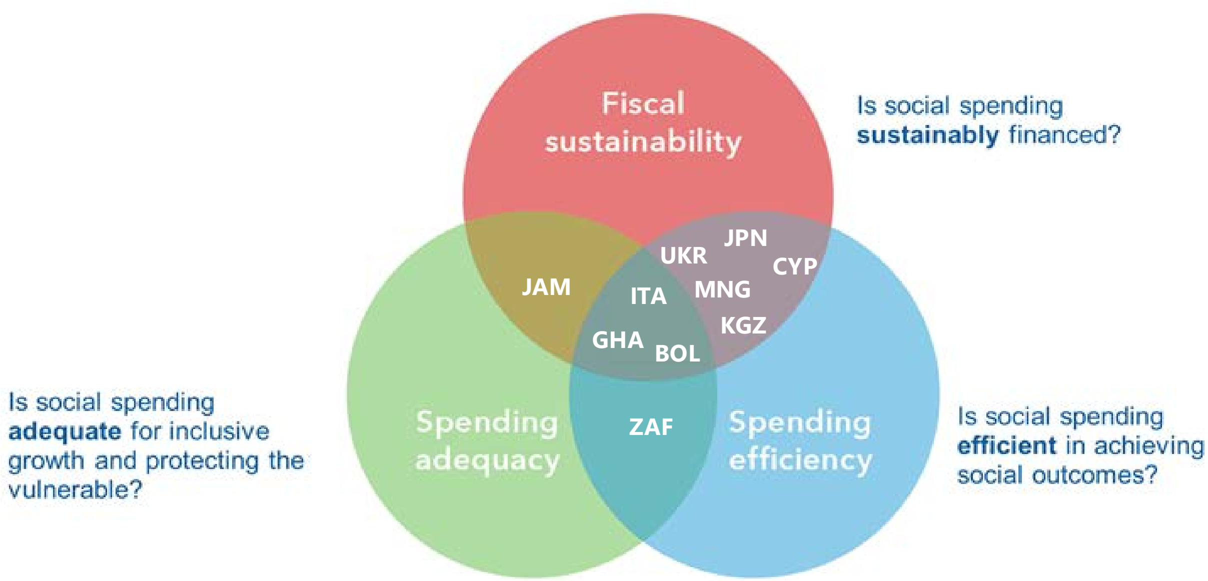
4. Fiscal sustainability was typically the entry point for engagement, with discussions often broadening to spending efficiency and adequacy as engagement deepened (Figure 1).[4]

- *Fiscal sustainability was overwhelmingly the most frequent trigger of IMF engagement* (relevant in 9 countries). Spending levels and dynamics were almost always a concern, particularly in IMF-supported programs.

- *Spending efficiency was also an important focus of IMF staff engagement* (relevant in 9 countries), while spending adequacy played a less important role (relevant in 5 countries).

Consequently, policy advice focused mostly on ensuring fiscal sustainability and to a lesser extent on spending efficiency and adequacy. Fiscal adjustment needs and/or budget constraint considerations were key in shaping the dialogue with authorities and the policy advice on social spending issues in all case studies.

Figure 1. Relevant Macro-Criticality Channels Across Case Studies



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

[4] The Main Paper provides a definition and discussion of the main macro-criticality dimensions (fiscal sustainability, spending efficiency, and spending adequacy) and a visual representation with a Venn diagram. In this paper we use this visual representation for summarizing main engagement dimensions that were observed in the case studies sample.

B. Nature of Interaction

5. Social spending issues featured systematically in policy discussions with country authorities and in published IMF country documents. Consistent with the findings of the text mining analysis (Background Paper V), in most country cases engagement was reflected in published documents, mainly in staff reports and selected issues papers (Table 3).

Table 3. Case Studies Summary Table–Nature of Interaction
(tick if yes)

Nature of Engagement	Output (paragraphs in SR, box, SIP, TA report, WP)						Internal resources leveraged				External resources leveraged					Interaction with CSOs
	Paragraphs in Staff Report	Box/annex in Staff Report	SIP	TA report	Working Paper	Other	Country Team	Expertise from other IMF Dept	Internal tool, template, database, etc.	IMF TA	Bilateral discussion with IDIs or other international institutions (e.g. EC)	IDIs or other institutions' analysis used	IDIs participation in TA	Cooperation with IDIs on project/s	Explicit coordinaton with IDIs	
Bolivia	√	√			√		√	√	√	√	√	√		√		√
Cyprus	√	√	√	√	√		√	√	√	√	√	√	√			√
Ghana	√			√			√			√	√					
Italy	√	√	√		√		√	√	√		√	√		√		
Jamaica	√	√		√			√			√	√	√	√	√		√
Japan	√	√	√		√		√	√								
Kyrgyz Republic	√		√	√			√			√	√	√	√			√
Mongolia	√						√				√				√	
South Africa	√		√		√		√				√	√			√	
Ukraine	√	√	√	√			√	√	√	√	√	√	√			

Source: IMF staff.

6. Engagement relied heavily on country-teams' own resources. Country teams were engaged on social spending issues in all countries. In nine cases, some analytical work was developed in-house to support discussions with the authorities. In-house analysis spanned a variety of approaches, from a more macro-fiscal focused approach (such as long-run social spending projections for population ageing-related issues in Italy and Japan) to micro-based distributional analysis (for Jamaica and Kyrgyz Republic where incidence analysis of spending programs and other measures was developed). This reflected heterogeneity in the specific sectoral issues under consideration at different points in time and country circumstances.

7. **Internal resources have contributed to deepening IMF engagement.** Other IMF departments (mainly the Fiscal Affairs Department) supported country teams in many cases, including by providing expertise (in five cases) and tools, templates and databases (in four countries). Generally, sectoral expertise allowed country teams to conduct more in-depth analysis and formulate a more comprehensive view of social spending reforms and their impact (e.g., Cyprus, Italy, Jamaica, Kyrgyz Republic). This also enabled better integration of social spending reforms into the macro-fiscal strategy and objectives of the programs (Cyprus, Jamaica, Ukraine).

8. **Technical Assistance (TA) on social spending provided key input in many cases, particularly to support the design of social insurance and assistance schemes in programs (Cyprus, Jamaica, Kyrgyz Republic, Ukraine).** In several cases (four out of the six countries receiving IMF TA) International Development Institutions (IDIs) participated in TA delivery (Cyprus, Jamaica, Kyrgyz Republic). In two program countries, Fund TA has been systematically supporting teams over extended periods of time and covering many topics (Cyprus and Ukraine). This enabled very detailed policy advice and better integration into the macro-fiscal strategies and objectives of the programs. Quick mobilization of resources was key in crisis contexts.

9. **Synergies with other workstreams, while not prominent in the case studies, helped strengthened engagement on social spending issues occasionally.** For example, in Bolivia the dialogue on social spending was informed by the work conducted under the "inequality pilot initiative" that the IMF started in 2015 (IMF, 2017). This facilitated detailed analytical work on distributional issues and a broadening of the scope of discussions on social spending issues beyond fiscal sustainability concerns.

10. **While the interaction with IDIs or other international institutions[5] was frequent, cooperation or coordination on specific social spending issues or projects was less common.** In almost all cases, in-house analysis was complemented by discussions with external experts and by drawing on work developed externally. However, explicit coordination with IDIs on specific social spending areas was rarer. This occurred only in the case of South Africa where the World Bank focused on health, poverty and inequality issues and IMF staff on labor markets and minimum wages, and in Mongolia where the IMF team aligned key social spending policy advice to that provided by ADB and World Bank, without any internal analysis. Interaction and dialogue with the World Bank or regional IDIs was more frequent in the case of LIDCs and EMEs, than in AEs. In some AEs close interaction was developed with European institutions which allowed IMF teams to leverage their expertise (e.g., Cyprus on age-related spending). In general, cooperation on specific projects, beyond TA, was not common.

[5] Other international institutions include for example the European Commission.

11. Engagement with Civil Society Organizations (CSOs) was less systematic than interaction with IDIs. Only four countries had some interaction with CSOs, which may reflect teams' traditionally closer collaboration with IDIs, particularly the World Bank.

C. Policy Advice

12. The objectives of staff's policy advice on social spending were clear in most cases, but not necessarily how these fitted into the broader macro-fiscal context. The immediate objective of policy advice was typically stated in both surveillance and program documents (e.g., reduce spending pressure from aging in Italy and Japan or protect vulnerable households from the effects of needed structural reforms or large shocks in Ukraine). However, the broad rationale behind specific policy recommendations was not always fully explained in the staff papers or easy to put together. In particular, the mapping of social spending to the short- and medium-term macro-fiscal context and constraints, and how trade-offs were reconciled (e.g., the need to ensure or preserve fiscal and economic stability while creating the conditions to strengthen social spending systems) were not always clearly communicated. In elaborating their policy advice country teams took mostly a medium-term perspective; a short-term focus was also relevant in all program countries, but only in one of the surveillance countries considered (Table 4).

13. Where fiscal sustainability was a primary concern, IMF policy advice often focused on means-tested programs. In most of the countries the focus on strengthening social spending programs translated into recommendations to introduce or strengthen means-tested programs (e.g., Bolivia, Cyprus, Jamaica, Kyrgyz Republic, Mongolia),[6] though staff reports often did not articulate possible implementation or other challenges. A perceived narrow focus on targeting resulted in some cases in external criticism of policy advice (Kyrgyz Republic and Mongolia), notably by CSOs. In other cases, the focus on targeting of benefits was less controversial, for example in Cyprus where reforms were implemented during a deep crisis but were supported by stronger capacity and ownership of the authorities and a better articulated staff communication strategy and outreach, including to CSOs.

14. Communication on social spending engagement was uneven across the case studies. In some cases, a well-articulated narrative (linking the macro-fiscal context and the broader country reform strategy to the specific policy advice and the communication activities) supported IMF staff's advice (e.g., Cyprus). In other cases, there was less emphasis on communication (e.g., Mongolia). The lack of a communications strategy or outreach to a broad set of stakeholders may have contributed in some cases to the perception of an a priori IMF's bias against "universality" of social spending programs.

15. Interaction with IDIs helped shape IMF policy advice in many cases. In nine countries, policy advice benefitted from systematic interaction with IDIs and other international institutions,

[6] This in line with evidence discussed in IMF (2019b), which suggests emphasis on means-tested programs in IMF policy advice.

and in five cases it drew on IDIs analysis and input. In most cases IMF policy advice was broadly aligned with that of the IDIs.

Table 4. Case Studies Summary Table–Policy Advice[1]
(tick if yes)

Policy Advice	Was narrative of policy advice well explained and embedded in macro-fiscal context?	Was perspective short-term?[2]	Was perspective medium-term?[2]	Did policy advice draw on IDIs analysis/input?	Was policy advice in line with other IDIs?
Bolivia	√		√	√	√
Cyprus	√	√	√	√	√
Ghana		√	√		
Italy	√		√	√	√
Jamaica	√	√	√	√	√
Japan	√	√	√		
Kyrgyz Republic		√	√		√
Mongolia		√	√		√
South Africa			√		√
Ukraine	√	√	√	√	√

Source: IMF staff.
[1] The table reflects the judgment of the team that conducted desk reviews of country cases.
[2] Engagement can have both a short- and medium-term perspective. In this case tick both cells.

16. Conditionality on social spending was used in all case studies with IMF-supported programs (Table 5).[7] In AEs and EMEs, structural benchmarks (SBs) helped promote the implementation of social spending reforms in crisis situations, with an emphasis on enhancing spending efficiency to support sizeable consolidation efforts (e.g., introducing a Guaranteed Minimum Income program in Cyprus or the reform of social assistance programs linked to energy consumption in Ukraine, with both reform efforts being supported by IMF TA). SBs were also used in LIDCs and EMEs to facilitate implementation of key structural reforms (e.g., in Mongolia for promoting a transition from universal to means-tested child benefits; in Ghana to improve resource management in the health and education sectors), even though they were not often met. Spending

[7] On IMF conditionality and the differences between type of conditions, see https://www.imf.org/en/About/Factsheets/Sheets/2016/08/02/21/28/IMF-Conditionality.

floors (e.g., indicative targets on a subset of social spending items) were commonly used in LIDCs in line with guidelines for PRGT program design. This finding is in line with the discussion in IMF 2019a.

17. Traction of policy advice was stronger when supported by country ownership. The case studies confirm that authorities' ownership is important for traction of policy advice.[8] In some cases, traction benefitted from engagement being persistent (e.g. in Cyprus or Bolivia) and was also supported by internal expertise, TA and collaboration with IDIs (e.g. Cyprus and Jamaica). In program countries, conditionality design played an important role. In particular, traction was improved by selective conditionality and appropriate sequencing of reforms and when they were well integrated into the broader policy strategy and program design (e.g. Cyprus).

Table 5. Case Studies Summary Table–Conditionality

(tick if yes)

Conditionality	Was conditionality clearly specified?		Was conditionality generally met?[1]	
	PC/IT (quantitative)	SB	PC/IT (quantitative)	SB
Bolivia	n/a	n/a	n/a	n/a
Cyprus		√		√
Ghana	√	√		√
Italy	n/a	n/a	n/a	n/a
Jamaica	√	√	√	√
Japan	n/a	n/a	n/a	n/a
Kyrgyz Republic	√	√	√	
Mongolia	√	√	√	
South Africa	n/a	n/a	n/a	n/a
Ukraine		√	√	

Source: IMF staff.
Note: n/a=not applicable.
[1] This cell is ticked if conditionality was generally met, e.g. if it was met all the times but in some cases with a delay.

[8] Traction is based on the evidence that emerges from the desk reviews on impact of policy advice on actual reform efforts.

LESSONS AND WAY FORWARD

18. The case studies suggest that at country level all macro-criticality dimensions may potentially be important for ensuring that social spending supports economic growth and stability. A narrow focus should be avoided unless justified by the context or country circumstances. Fiscal sustainability was often the main factor that shaped IMF engagement with the authorities, but the case studies also show that other macro-critical dimensions of social spending can gain prominence. This highlights the merits of maintaining a broad view of the impact of social spending and underscores the risks of adopting a priori a narrow focus from the outset of engagement.

19. In-house analytical work is effective in supporting engagement by deepening its scope. Given resource constraints, efficient use of in-house expertise and resources is key. Options that could be explored include greater reliance on cross-country departmental projects that would provide a basis for country-level engagement on specific issues. The case studies also highlight the importance of mobilizing internal expertise quickly in crisis contexts.

20. The case studies confirm that country ownership is critical for enhancing traction. The case studies reveal a few common factors that can improve traction of policy advice on social spending issues: i) continued rather than sporadic engagement on social spending issues, supported by internal expertise and by in-depth dialogue with IDIs; and ii) effective and selective conditionality that is well integrated into the broader policy strategy and program design and with reforms that are properly sequenced.

21. Collaboration with IDIs (in particular with the World Bank in EMEs and LIDCs) can be conducive to more in-depth engagement and in many cases better traction. Systematically leveraging broad external expertise is most beneficial in areas which complement in-house expertise, for example on implementation of spending schemes such as setting up a conditional cash transfer program, or on education and health systems design.

22. Interaction with a broader set of external stakeholders was not systematic and could be strengthened. Outreach could be strengthened through well-developed communication strategies. This would help enhance the broader understanding of the role of IMF's activities and policy advice in the social spending area.

23. Outreach and communication efforts should focus on the broad narrative of social spending issues, avoiding a narrow focus on selected specific issues. This would enable a clearer understanding of the Fund's engagement on the part of third parties. Synergies and complementarities between measures, as well as constraints and trade-offs of policy measures, should be clearly spelled out. In the context of large fiscal adjustment needs, it is important to communicate the magnitude and timeline of consolidation measures as well as of the proposed actions to mitigate the impact on vulnerable households. Clarifying constraints, interdependence between measures (e.g., revenue mobilization efforts and measures for strengthening spending programs) and trade-offs could play an important role in enhancing the impact of IMF engagement on social spending issues in the future.

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CASE STUDIES

A. Bolivia

Context

24. Bolivia experienced strong economic growth during 2004–14, which helped reduce poverty and inequality. As a commodity exporter, the country benefitted from the commodity boom in the energy, minerals, and agriculture sectors. Soaring tax revenue enabled the government to finance higher social spending, which combined with strong economic growth to create the conditions for poverty reduction and a marked decline in inequality.[9] Social indicators (such as higher life expectancy, a lower infant mortality rate, and higher primary school completion rate) also improved over the period. In just ten years, Bolivia went from being the most unequal country in South America to about average for the region.

25. The end of the commodities boom in 2014 meant that higher social spending had become unsustainable. With the lower commodity prices and a reassessment of prospects for private investment and productivity growth, GDP growth was projected to be lower in line with potential growth revisions. Although accommodative fiscal and monetary policies bolstered growth in 2014, there was still a need for fiscal consolidation to maintain macroeconomic stability and ensure debt sustainability. Because the need for fiscal consolidation would reduce the resources available for social spending, with potentially adverse implications for vulnerable households, the focus of discussions turned to improving the efficiency and adequacy of social spending to preserve the gains made in reducing poverty and inequality.

Nature of Interaction

26. Staff engaged with the authorities on social spending issues in a surveillance context. Policy discussions focused on improving the adequacy and quality of social spending supported by analytical work. In 2013, staff provided an impact evaluation of social transfers and better targeting of fuel subsidies to enhance the effectiveness of social policies and deepen social development gains (IMF 2014). During 2015 and 2016, staff analyzed the determinants of poverty and inequality during the commodity price boom, including the role of social spending policies in improving social outcomes.[10] More recent staff reports focused on policies to improve the quality of social spending, including in the context of low commodity prices and fiscal consolidation needs (IMF 2015, IMF 2016, IMF 2017). In-house expertise on social spending issues, including expert support on

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[9] The poverty rate fell from 63 to 39 percent, with extreme poverty dropping from 45 to 14 percent. At the same time, inequality decreased substantially with the Gini index falling from 0.59 in 2004 to 0.48 in 2014.

[10] These analyses were carried out in the context of the project for piloting the operationalization of analysis of inequality issues in Fund surveillance and program work. Bolivia was included in the first and second waves of pilot countries and, in addition to consideration of distributional issues in staff reports, two working papers (Vargas and Garriga, 2015 and Toscani, 2017) were published.

inequality and distributional impact, helped the team improve the depth of its analysis using empirical modelling.

27. Policy advice benefitted from collaboration with other stakeholders. The World Bank, the Inter-American Development Bank and the ILO all provided input to policy advice based on their shared research. For instance, the working paper on poverty and inequality benefited from various World Bank research papers on inequality in Latin America (Vargas and Garriga, 2015). The coordinated IMF-World Bank work plan on Bolivia was another example of close collaboration (IMF 2015). The work plan covered policies that impact poverty and inequality including access to quality basic education, health, water, and sanitation. Youth unemployment and social protection were also covered. The country team frequently met with academics and CSOs.

Policy Advice

28. During the commodities boom, Fund advice focused on ensuring social spending adequacy and supporting the authorities' policies aimed at reducing poverty and inequality. The National Development Plan (NDP)[11] was underpinned by a national education and health strategy that called for an increase in education and health spending. The NDP also called for improving data quality for appropriate monitoring. Given the strength of public financial cushions and the favorable outlook, staff's advice focused on taking the opportunity to increase physical and human capital investment to ensure adequacy of the social spending levels and address development needs. Staff also encouraged the authorities to weigh the benefits of social spending against other investment and to strengthen fiscal policy response to changing economic conditions with multi-year budgeting and better investment planning.

29. Staff's analytical work supported the understanding of drivers of social progress. This work indicated that the reduction in poverty and inequality was driven mainly by labor income growth at the bottom end of the income distribution (IMF 2015; Vargas and Garriga, 2015). Increases in non-labor income (rents, private transfers, remittances) contributed to poverty reduction for certain groups, but the overall contribution was relatively small. Pro-poor labor policies played a role through marked increases in minimum wages (which supported overall wage growth), as did higher transfers to specific population groups, e.g. for the elderly poor. Staff's analysis suggested that labor income increases were concentrated in the informal, low-skilled service and manufacturing sectors. In more recent work,[12] staff estimated that about two-thirds of the inequality reduction was due to the commodities price boom: one-third directly through its impact on rural incomes, and one-third indirectly through its impact on government revenue that allowed a substantial expansion in social programs.

30. As the commodities boom receded, IMF policy advice turned to fiscal sustainability, with the objective of preserving recent gains in reducing poverty and inequality (Figure 2). For

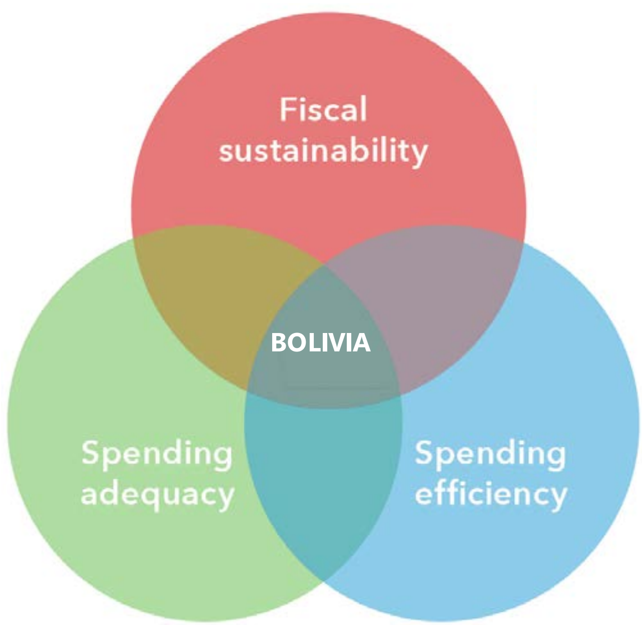
[11] See the Bolivia National Development Plan 2006–2010 (in Spanish).

[12] See the 2016 IMF Article IV Staff Report and Balakrishnan and others, forthcoming.

instance, the baseline scenario of the 2015 Staff Report built on a moderate and gradual fiscal consolidation of the non-hydrocarbons primary deficit over the medium term, with a capital budget execution rate of around 80 percent. Staff also suggested an active policy scenario with a more ambitious but still gradual reduction of the non-hydrocarbons primary deficit and debt, which included revenue measures on income tax and VAT and expenditure measures on investment, energy subsidies, and the wage bill. Staff recommended gradually reducing energy subsidies, while offsetting the impact on the most vulnerable households with targeted social assistance support. Staff also suggested strengthening social safety nets by improving efficiency through measures such as enhancing competition among service providers and strengthening the information system on beneficiaries of all social programs (Table 6). Staff recommended strengthening the pension system by raising the contribution rate and retirement age to boost replacement rates while ensuring fiscal sustainability was maintained.

31. Policy discussions on improving social spending efficiency were based on analytical work that highlighted inefficiencies in the health and education sectors. Despite high levels of health and education spending, the results were relatively poor compared to those in peer countries. Staff analysis indicated that spending efficiency in social protection was low because only a small share of resources reached the poor. Based on these findings, staff recommended the following measures for enhancing spending efficiency in reaching vulnerable households and strengthening the safety net: (i) higher but progressive fees for users of social services; (ii) greater competition in the provision of social services; (iii) better targeting of existing social benefits; and (iv) reform of financing mechanisms for health spending away from a capacity-based remuneration system (where general practitioners were paid fixed salaries and hospitals were financed based on capacity considerations) toward a system that rewards performance to increase incentives for cutting costs.

Figure 2. Bolivia: Key Macro-Criticality Dimensions



Source: IMF staff.

32. The authorities have made some progress in implementing policy reforms. Access to education, health services, water, electricity has greatly increased in the past decade. Some reforms to increase competition among health providers were implemented following the Fund's policy recommendations, though the degree of competition introduced was uncertain. In addition, efforts were started to put in place an information system covering all beneficiaries, although progress has been slow. Implementation of the system will be key for improving the capacity of the administration of social programs.

Table 6. Bolivia: Objectives of IMF Policy Advice

IMF Policy Advice Objectives	Relevant Macro-criticality dimension
Social spending to reduce poverty and inequality, and mitigate the impact of other reforms on the vulnerable	Spending adequacy while ensuring fiscal sustainability
Improve education and health spending efficiency	Spending efficiency
Strengthen social safety nets	Spending efficiency
Strengthen the pension system	Spending adequacy while ensuring fiscal sustainability

Lessons

33. Ownership played an important role in ensuring traction. The authorities were keen on reducing poverty and inequality and achieving better education and health, and positively engaged on these issues with the Fund.

34. Fund advice through different periods of the commodity price cycle provides insights for other commodity exporter countries. During a commodity boom, countries can utilize revenue gains to enhance social spending adequacy, and manage increases during the boom so as to avoid unsustainability of spending during price declines. Improving social spending efficiency during the period of commodity bust and fiscal consolidation can then help to protect social gains achieved during the boom.

35. Policy advice benefited from leveraging internal expertise, including analytical work on inequality and the distributional impact of social spending.

36. Staff's work benefited from the work of IDIs. The coordination with the World Bank provided Fund staff with deeper insight into social programs (quality services in education, health, water, and sanitation) and allowed for coordinated policy advice. The continued involvement with IADB, other IDIs, and think tanks also helped policy discussions.

37. Communication of Fund advice was important and could have been strengthened. Communication of policy recommendations occurred mainly through IMF staff reports and working papers. Going forward, communication could be strengthened by using more diverse channels, such as workshops and roundtables, to reach a broader set of key stakeholders and enhance awareness of the policy trade-offs and impact of social spending policies.

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B. Cyprus

Context

38. Cyprus undertook a major policy adjustment in the aftermath of the global financial crisis. Cyprus' economy fell into a recession in 2009 and weak growth continued through 2012, with the public debt-to-GDP ratio reaching close to 90 percent in 2012. Unemployment increased, property values decreased significantly, and banks faced pressure from an increase in non-performing loans and high exposure to Greek debt. By 2012, the crisis in Greece and downgrades of Cyprus' credit rating to below investment grade that made Cypriot bonds ineligible for being used as ECB collateral, led Cypriot banks to continue declining in value with risk of collapse. In May 2013, a three-year IMF-supported program was approved (about €1 billion, or US$1.3 billion[13]). It included sizeable fiscal consolidation—emphasizing more efficient and more sustainable social spending—debt reduction, deep financial sector restructuring, and a major recapitalization of the banking sector.

Nature of Interaction

39. The IMF engaged with the authorities and other institutions on social spending issues since the early 2000s. The Fund's early engagement on social spending brought to the authorities' attention issues that facilitated reforms before, during, and after the crisis. Prior to the crisis, policy discussions and analytical work by IMF staff focused on the need for pension, health, and social benefit reforms to improve fiscal sustainability and efficiency.[14]

40. Given the severity of the crisis, protection of vulnerable households, including the working poor, was a priority of the program. Reforms also helped generate savings to allow for reallocation within the social protection system toward the most effective programs and mitigation of the employment effects of the crisis. Many of the social spending reform measures were included in the 2013 budget and published in a medium-term framework to signal a clear commitment to fiscal consolidation, which had been elusive in the years preceding the crisis. The authorities' consolidation plans were supported by structural benchmarks (SBs) for social protection reforms, including introducing a guaranteed minimum income (GMI) scheme capable of protecting those adversely affected by the crisis, including the working poor.

41. Timely technical assistance (TA) with World Bank participation provided valuable inputs for the design of the IMF-supported program. A broad public expenditure TA was conducted in February 2013 (right before the start of the program) to inform expenditure consolidation needs. In July 2013, the Fund provided additional TA—with World Bank participation—on specific reforms to protect vulnerable households from falling incomes, including by consolidating and streamlining existing social protection schemes and improving their targeting

[13] Total financing was close to €10 billion with the European Stability Mechanism providing €9 billion.

[14] IMF (2003), IMF (2005), IMF (2007a), IMF (2007b), IMF (2009).

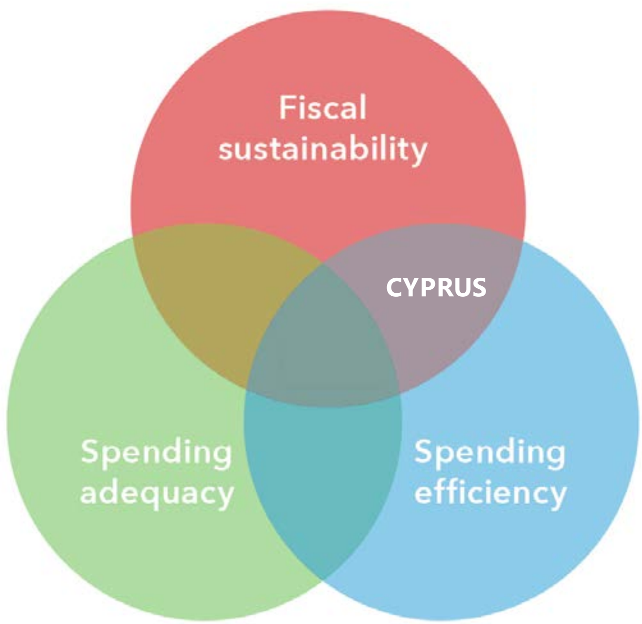
to generate savings for a GMI program, and mitigating the labor market effects of the crisis. Fund experts engaged with a range of ministries and other stakeholders while providing TA.

42. External analysis from the EC and ECB complemented the Fund's work. Pre-crisis 2004 EU Convergence Program recommendations generally aligned with the analysis of Fund staff, which included a focus on social expenditure rationalization and sustainability. The EC's Aging Working Group analysis (including long-term projections of age-related spending) reinforced Fund work on social spending by highlighting fiscal sustainability concerns. EC and ECB staff also participated in TA missions.

Policy Advice

43. Enhancing fiscal sustainability and efficiency were the main objectives of Fund engagement (Figure 3 and Table 7). Initially, policy advice on social spending issues focused on the sustainability of public spending, including social protection spending. In the wake of the crisis, fiscal sustainability became a growing concern. The IMF-supported program sought to rationalize spending, improve equity, protect the unemployed and poor[15]—the latter through a new GMI program. Because much advice was presented earlier, the authorities were able to undertake most reforms during the crisis.

Figure 3. Cyprus: Key Macro-Criticality Dimensions



Source: IMF staff.

[15] Poverty rates increased following the crisis but have now fallen to around pre-crisis levels.

Table 7. Cyprus: Objectives of IMF Policy Advice

IMF Policy Advice Objectives	Relevant Macro-criticality dimension
Reduce spending level to contribute to consolidation needs	Fiscal sustainability
Reduce pension spending over the medium term	Fiscal sustainability
Rationalize public sector wage bill	Fiscal sustainability
Introduce GMI program	Spending efficiency
Strengthen SSN (consolidate programs)	Spending efficiency
Strengthen SSN (increase real value of benefits, while containing total envelope)	Spending efficiency

44. **Fund policy advice on the fiscal sustainability of the pension system dates back to the mid-2000s.** A recognition of the significant pressures on pension spending that would materialize because of demographic developments prompted staff to analyze the macroeconomic and distributional impacts of pension reform.[16,17] In particular, EC aging reports provided long-term pension spending projections indicating large increases of outlays as a share of GDP in future decades. Staff policy advice on pension reform included indexing the retirement age to life expectancy at retirement, switching the indexation of all pension benefits from wages to prices, aligning the (relatively high) public pension benefits to private pension benefits, and lessening reliance on consumption taxes to finance age-related expenditures. Taking these recommendations into account the authorities implemented a pension reform in 2009 that increased contribution rates. Subsequent Fund analysis noted that the increase in pension contribution rates was not sufficient to cover financing needs and could have adverse labor market effects compared to other measures.[18]

45. **During and after the crisis there was renewed attention on pension spending and other social spending measures.** In December 2012, increases in the public pension retirement age were automatically linked to life expectancy at retirement and early retirement penalties were introduced. Further increases in contribution rates were also approved, a measure that the Fund considered less desirable. Fund TA in February 2013 suggested reducing supplementary pension benefits and reducing benefit amounts of the general public pension system. The authorities in their Letter of Intent (LOI) and Memorandum of Economic and Financial Policies (MEFP) under the IMF-supported program stated they would undertake an actuarial analysis projecting through 2060 the

[16] The 2002 AIV noted the unsustainability of pensions, though no specific measures were recommended. The 2006 Article IV and a 2007 Selected Issues Paper looked at the issues in more detail and had policy measures.

[17] Under a no policy change scenario, pension spending as a share of GDP was projected to increase so rapidly that Cyprus would move from being among the lowest spenders in the EU to close to the top in 2050.

[18] 2010 Article IV and a 2011 SIP "The Cypriot Pension System: Issues and Reform Options."

sustainability of the general insurance pension scheme (GSIS) to inform any needed parametric reforms. Prior actions under the program included freezing cost-of-living indexation of pension increases. The EC Memorandum of Understanding—part of the EFF documentation—included more detailed measures that had been implemented or were to be approved.[19] In July 2013, IMF TA advised integrating the low-income pensioner scheme into a GMI and improving its targeting, as well as removing eligibility discretion for the disability pension. The authorities undertook most of the pension measures that the Fund advised.

46. Fund policy advice on the labor market was initially linked to reducing the high public wage bill and then improving labor market policies during the crisis. The February 2013 TA mission advised that lowering the public wage bill—one of the highest in Europe—should be the priority for expenditure rationalization, to free up resources including for improving active labor market programs (ALMPs) and other priority spending. In line with IMF advice, the authorities passed a series of measures to contain public wage increases and also to decrease public employment, particularly in education. A May 2013 Fund TA mission advised having participation in ALMPs mandatory and using in-work benefits, public assistance benefits be conditioned on participation in ALMPs, and the proposed GMI benefit amounts being partially withdrawn for low earning households to mitigate perverse work incentives. The authorities adopted most of the recommended measures.

47. Policy advice on social assistance played a more prominent role once the crisis hit. The Fund suggested a comprehensive reform of the social assistance system to reduce poverty and generate savings via efficiency gains. The February 2013 TA mission found that spending was low, the system fragmented, and targeting weak. Better targeting and rationalization of some schemes, as well as benefit taxation, were recommended. The July 2013 TA report followed up on these recommendations, and advised the authorities to consolidate existing programs, improve targeting mechanisms, and review eligibility criteria, with the objective of strengthening the role of means-tested benefits, for example, introducing a GMI program that would also cover the working poor. The authorities in their MEFP committed to "*implement a new social welfare system to improve the targeting of social assistance, consolidate welfare programs, and streamline administration costs*" (structural conditionality).[20] This overall objective was then followed up by review activities that monitored conditionality implementation and progress toward achieving key steps.[21] The authorities followed up on most recommendations and designed and implemented a GMI.

[19] Measures included targeting the Easter allowance to pensioners with monthly pension income under €500, separating the financial reporting of the contributory and non-contributory benefits, taxing lumpsum payouts, and as noted above auto-indexing the retirement age to life expectancy at retirement and introducing a penalty for early retirement. For the GSIS, measures included extending the minimum contribution period from 10 to 15 years and for the General Employee Pension Scheme closing the scheme to new entrants.

[20] IMF (2013), Cyprus: Letter of Intent, Memorandum of Economic and Financial Policies, Technical Memorandum of Understanding, and Memorandum of Understanding on Specific Economic Policy Conditionality (European Commission), International Monetary Fund, Washington D.C.

[21] For example, preparing plans to consolidate benefits, requiring recipients to declare all benefits received, finalizing assessment of the GMI design, and building a unified social protection database.

48. While less prominent than social protection issues, selected health and education reforms were also discussed under the IMF-supported program. In the health sector, Fund policy advice centered on sustainability and efficiency. The February 2013 TA advised increasing the share of people paying for health services and tightening eligibility criteria for subsidized care. In the medium term, the introduction of a comprehensive health insurance system was suggested. Education was considered under a broad policy reform framework, focusing on the need to streamline and consolidate to lower costs and increase efficiency. TA reports suggested increasing teacher hours, merging schools to address class sizes, reducing teacher compensation, and introducing fees for tertiary education.[22] They also recommended replacing the many fragmented scholarships and grants with a single well-targeted grant, merging administration, and making education benefit levels more progressive. In the medium term, utilizing technical analysis, Fund staff advised merit-based hiring, and reassessing the administrative structure. Many recommendations were followed; for example, a national health insurance system is now being carefully rolled out to ensure sustainability, and the education wage bill was reduced.

49. The IMF approach to social spending reform under the IMF-supported program generally received a positive response from the authorities, though there was some criticism. The Fund undertook proactive communication and outreach. Staff communicated externally via interviews and reports. The team met with CSOs, political parties, and other stakeholders for an open dialogue. However, the initial period of the program lacked full buy-in from the public, though this dynamic changed over time. An example of criticism included from the UN,[23] which asserted that the fiscal consolidation decreased health spending for vulnerable populations and increased wait times.

Lessons

50. Fund advice on social spending gained traction only after the crisis. Crisis and program contexts acted as a catalyst for rapid reforms, which were overdue. Extreme circumstances drove decisive action. To limit deterioration of social outcomes in a weak macro-fiscal context, the reform strategy aimed at ensuring an adequate level of protection to vulnerable households and the efficient use of resources. While noting the likely difficulties of achieving this, this case study suggests that "good times" should have been used to improve the effectiveness of the safety net, which can then become an important and effective stabilization tool in crisis times (whereas in the case of Cyprus the strengthening social assistance and setting up a GMI program gained center stage only during the crisis). Within the social and political context of a country, teams should consider on how they can maximize traction of advice during "good times."

51. Strong ownership by the authorities supported reform implementation, as did adequate administrative capacity and information availability. The government—newly elected in 2013—was reform-minded, which led to a constructive engagement with the Fund and a sense of

[22] This advice drew on research such as from the U.K. Department of Education (2011).

[23] UN (2016).

partnership. Adequate administrative capacity and information availability also supported reform efforts, especially when the timeline for implementation was tight.

52. In the crisis context, long-standing surveillance engagement supported the Fund's quick mobilization of internal and external resources. As the IMF engaged on social spending issues since the early 2000s, the Fund was able and well-prepared to quickly mobilize resources and deepen its engagement (e.g., with TA missions) during the crisis. The long engagement on social spending prior to the crisis supported rapid policy changes given that many issues had already been analyzed.

53. Focused policy advice and parsimonious conditionality under the IMF-supported program were critical for the feasibility and success of reforms. Fund engagement and conditionality were selective, with emphasis on addressing the key social policy issues via the GMI introduction and pension reforms. Wage bill reform also helped free up resources for other priority spending. This approach lowered the likelihood of overwhelming the reform efforts.

54. Effective leveraging of external resources was important to support social spending reforms. Close interaction with the EC and ECB ensured that policy advice was very closely aligned. The continual dialogue on needed reforms, informed by internal and external analysis (including engagement with the World Bank), was useful in quickly diagnosing social spending needs and policy responses.

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C. Ghana

Context

55. Ghana experienced strong and broadly inclusive growth over two decades, before large fiscal and external imbalances started to emerge in 2012.[24] Ghana outperformed regional peers in reducing poverty and improving social indicators for two decades. The overall poverty rate declined from 52.7 percent in 1991 to 21.4 percent in 2012, while the extreme poverty rate declined from 37.6 percent to 9.6 percent during the same period.[25] After 2012, rapidly rising public debt led to significantly higher interest payments,[26] constraining social and development spending. Large fiscal and external imbalances and monetary financing of the budget led to high inflation and a significant depreciation, weighing on growth and real incomes of most households.

56. In March 2015 the authorities requested an ECF-supported program. The program was to support policy adjustment, restore debt sustainability and market confidence, rebuild external buffers, and revive Ghana's transformation agenda.[27] It envisaged a sizeable fiscal adjustment. The primary balance was projected to be improved by 6¾ percent of GDP over about 3 years on a commitment basis, and the adjustment was designed to be roughly three-quarters primary spending and one-quarter revenue. The authorities committed to safeguard social and other priority spending under the program, including expanding targeted social schemes—such as the flagship cash transfer program Livelihood Empowerment Against Poverty (LEAP) intended to benefit the most vulnerable households and protect basic health care coverage.[28]

Nature of Interaction

57. In 2014, in the context of annual surveillance, staff analyzed the issue of social inclusion—one of the objectives of the authorities' transformation agenda. In this context, staff recommended swift implementation of a strong package of policy measures to restore confidence and address large imbalances to provide the needed fiscal space for infrastructure and priority social spending.[29] This analysis provided useful inputs for policy discussions for the program that followed.

[24] See staff reports for the 2014 Article IV (IMF, 2014) and the Request for a Three-Year Arrangement under the ECF (IMF, 2015a).

[25] See *Poverty Reduction in Ghana: Progress and Challenges* (Molini and Paci, 2015).

[26] Public debt was assessed to be at high risk of debt distress at the time of the program request and the public debt-to-GDP ratio reached over 70 percent in 2015. See Debt Sustainability Assessment for the Request for a Three-Year Arrangement under the ECF (IMF, 2015a).

[27] The second Ghana Shared Growth and Development Agenda (GSGDA II, NDPC 2014). The GSGDA II provides a consistent set of policy objectives and strategies to guide the preparation and implementation of medium-term and annual development plans to facilitate broad economic growth and create more and better jobs. See Staff Report for the Request for a Three-Year Arrangement under the ECF (IMF, 2015a).

[28] LEAP focuses on alleviating poverty and improving human capital by providing cash transfers to the most vulnerable.

[29] See Staff Report for the 2014 Article IV (IMF, 2014).

58. The 2015 ECF-supported program aimed to strengthen the social safety net to restore real incomes of the poor, and to mitigate possible adverse distributional impacts of the fiscal consolidation. An indicative target (IT) was set on a social spending floor to protect priority spending. The coverage of this IT, which was slightly adjusted throughout the program, included specific social safety net programs and selected education and health programs— reflecting the authorities' evolving social priorities and budget constraints. There were also structural benchmarks on improving human resource management in the health and education sectors—mostly to improve spending efficiency in these two key sectors.

59. Technical assistance (TA) on public sector wage bill rationalization and price subsidy reforms provided useful inputs to the authorities' policy formation and the program design. Following the April 2015 TA mission, the authorities started a consultation process to develop a strategy for civil service reform to contain wage bill spending and increase accountability and productivity in the public sector.[30] Among other measures, the TA recommended a hiring freeze for the civil service (excluding education and health) and streamlining civil service allowances,[31] as well as eliminating fuel subsidies by implementing an automatic pricing formula.

60. Staff relied to a large extent on the World Bank, which was directly engaged with the authorities on social spending issues. In November 2016, it released a report titled "Social Protection Assessment and Public Expenditure Review (PER)." The report assessed the existing social assistance programs, as well as specific education and health programs, and more generally expenditure allocations to evaluate whether resources were used in the most cost-effective and pro-poor manner.[32] The analysis identified areas for strengthening social spending, including by better targeting social assistance, education and health programs; and expanding coverage of the well targeted schemes. This report was a useful resource for preparing the authorities' social agenda, with specific measures that were subsequently integrated into the Memorandum of Economic and Financial Policies (MEFP) of the IMF-supported program.

Policy Advice

61. The program aimed at a sizeable and front-loaded fiscal adjustment while creating fiscal space for social and other priority spending. This was to be achieved by expanding revenue collection, restraining the public wage bill through strict limits on net hiring (except for the education and health care sectors) and on other primary expenditures, in addition to energy subsidy reform (Figure 5). Following Fund TA advice, the government liberalized petroleum prices on July 1, 2015, and designed a civil service reform strategy aimed at rationalizing the size of the civil service to reduce the wage bill-to-revenue ratio, while improving public services.

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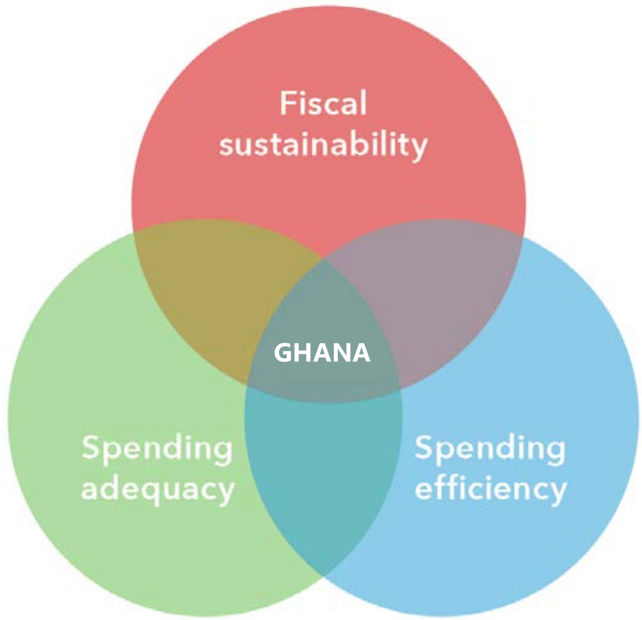
[30] See the MEFP for the First Review under the ECF arrangement (IMF, 2015b).

[31] See staff reports for the Second and Third Reviews under the ECF arrangement (IMF, 2016 and 2017a).

[32] The social programs analyzed in the WB report include mostly core social assistance programs, active labor market programs, social insurance schemes including the National Health Insurance Scheme. The report also analyzed fuel and electricity subsidies.

Figure 4. Ghana: Key Macro-Criticality Dimensions



Source: IMF staff.

62. Fiscal space generated from these reforms was partly used to safeguard social and other priority spending, including expanding the well targeted LEAP cash transfer program. The social objectives under the program were based on the Ghana Shared Growth and Development Agenda (2014–17), which included strengthening social safety nets via the National Health Insurance Scheme, LEAP, Labor-Intensive Public Works,[33]and the school feeding program. In 2015, the National Household Registry was established to improve targeting of the social safety net.[34] Through the Ghana Social Opportunities Project, the government worked to improve targeting in social protection spending by revising the targeting approach with support from the World Bank,[35] increase access to conditional cash transfers nationwide and access to cash-earning opportunities for the rural poor, and improve infrastructure in poor districts. The expanded safety net helped mitigate possible adverse impacts of the fiscal consolidation and protect the real incomes of the poor.

63. The government continued to expand social spending as fiscal space increased. In 2017, Ghana's government launched a number of new social programs to enhance growth and productivity, create jobs, and reduce poverty, including: (i) Free Senior High School intended to

[33] This program provides beneficiaries with employment and income-generating opportunities, particularly during periods when there is a shortage of labor demand and in response to external shocks.

[34] See Staff Report for the Fifth and Sixth Reviews (combined) under the ECF arrangement (IMF, 2018).

[35] For example, to help improve targeting, a proxy means test (together with geographical targeting) was introduced for LEAP, which initially was based on geographical and community targeting methodologies. The World Bank also provided TA to national ministries in targeting, management, coordination, and policy oversight for social protection programs. See *Ghana-Social Opportunities Project* (World Bank, 2018).

boost nationwide school enrollment while giving opportunities to the most vulnerable to access school; (ii) Planting for Jobs and Food, which aims at improving agriculture productivity by introducing improved seeds and subsidized fertilizers; and (iii) Infrastructure for Poverty Eradication Program (IPEP), which aims to provide solar power water systems, prefabricated warehouses, community toilets, and small dams in the northern regions. More than 50 percent of the targets established under IPEP has been met as of June 2018.[36]

64. Despite some set-backs, the authorities continued to make efforts toward achieving their social objectives. The social spending ITs were met about half of the time. Lack of fiscal space was a key factor in the failure to meet ITs, which was compounded by the lack of timely data on social spending developments which made monitoring of protected spending difficult. The structural benchmarks on improving human resource management in the health and education sectors were met with delay, reflecting mostly weakness in implementation capacity. Indeed, a recurrent theme in the program review discussions was how to allocate limited resources among competing priorities, as well as improving efficiency by bringing off-budget social spending onto the budget.[37] While recognizing that addressing capacity and limited space require longer-term efforts supported by additional TA, the authorities continued to make efforts to achieve fiscal consolidation in line with program targets, and reiterated their commitment to creating fiscal space for social and infrastructure spending. There were also some quick wins, for example the student enrollment ratio increased by over 30 percent in the year following the launch of the free Senior High School program.

65. While CSOs mostly supported the program's focus on achieving macroeconomic stability, some felt that the Fund should have been more involved in strengthening social spending. Against the background of the program objectives, CSOs broadly concurred with the policies on social spending under the program but focused more on achieving macroeconomic stability and debt sustainability, which in their view was a precondition for better social outcomes. But some CSOs, for example Development Pathways, thought that the Fund was not putting enough emphasis on getting the government to place greater priority on social protection programs.[38]

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[36] The authorities also pursued other growth-enhancing policy initiatives to improve the business environment to secure a better future for its citizens, especially the youth. This includes the National Industrial Revitalization Program, which provides technical and financial support to companies facing operational challenges, but are viable to benefit from the stimulus package; and the National Entrepreneurship and Innovation Plan, which focuses on the provision of business development services, business incubators, and funding for youth-owned businesses (see Staff Report for the 2017 Article IV Consultation and Fourth Review under the ECF arrangement, IMF, 2017b).

[37] Cocoa is one of the largest export goods in Ghana. The producer price of cocoa is set by Cocoa Board (COCOBOD), a government-owned organization, to guarantee a floor for the price received by the farmers who are generally poor. This implicit income support is currently paid for by COCOBOD. Staff argued that such support should be provided directly through government transfers and included in the budget to improve efficiency and transparency.

[38] Development Pathways noted that "the Fund has ticked all of the boxes in terms of requiring a social spending floor in its loan agreement with the Government of Ghana and listing a diverse array of program as being important in that context. But, in practice it has done virtually nothing to ensure that social protection is taken seriously by the Government."

Table 8. Ghana: Objectives of IMF Policy Advice

IMF Policy Advice Objectives	Relevant Macro-criticality dimension
Create fiscal space for sustainable financing for social programs	Fiscal sustainability
Expand enrollment rate in primary and secondary education	Spending adequacy
Expand basic health services	Spending adequacy
Improve targeting of the social assistance programs	Spending efficiency and adequacy

Lessons

66. **Engagement with the authorities during surveillance allowed staff to gain knowledge and expertise that became crucial in a program context.** In particular, the 2014 AIV Consultation staff report recommended a more ambitious adjustment scenario to set off a virtuous cycle, where lower fiscal deficits and falling interest rates would create room for higher social and infrastructure spending and a crowding-in of private sector activity, while safeguarding existing gains in social indicators. This helped in the program design.

67. **The emphasis on creating fiscal space under the IMF-supported program helped generate resources for the authorities to implement their social agenda.** Fund-supported programs, with important inputs from TA (including a PER from the World Bank), can help governments take informed decisions about expanding fiscal space via expenditure consolidation and revenue mobilization, in turn supporting spending adequacy. Program design should take into account that creating fiscal space takes time.

68. **Transparency is important for monitoring social objectives.** Moving off-budget spending into the budget helps improve the efficiency of resource allocation.

69. **Good data are crucial for effectively monitoring an IT on social spending.** Social spending data rely on a functional classification and program level data, while in general fiscal data are provided on an economic classification. Therefore, data provision can be challenging and this needs to be recognized early on to address such challenges.

70. **More public communication on the social objectives of IMF-supported programs could help bolster the reform momentum through a more inclusive and transparent policy dialogue.** This requires IMF engagement on broader social issues in addition to core macroeconomic and fiscal issues.

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D. Italy

Context

71. Italy's persistently low growth, declining real per-capita income, and poor social outcomes have increased the need for social spending. Real per capita incomes have fallen to the level of the late 1990s, unemployment rates have averaged 10 percent for more than 20 years, and over 20 percent of households are at risk of poverty. In addition to low productivity and competitiveness, fiscal space is constrained: public debt stood over 130 percent of GDP in 2018, the second highest in the EU, and annual gross financing needs are around 25 percent of GDP. Taxes, especially on labor, remain high and social policy is focused on the elderly.

72. Social spending represents over half of primary spending in Italy, with the bulk allocated to pensions.[39] At 16 percent of GDP in 2017, pension expenditures are the second highest (after Greece) in the EU. Pension expenditures are driven not only by demographics—due to low fertility rates and improving life expectancy—but also by early retirement rules and generous benefits that were grandfathered after the 1995 reform.[40] They are projected to increase in the next 2–3 decades.

73. Other types of social spending are relatively low. Social assistance and education are low compared to euro area peers. Italy is the only country in the euro area that lacked a modern, guaranteed minimum income scheme targeted to the poor—one that avoids welfare dependence and disincentives to work and is not time bound. Health expenditures were reined in over the last decade, reflecting a series of measures for improving monitoring and control over outlays.

Nature of Interaction

74. Extensive analytical work by IMF staff supported policy recommendations on social spending. In 2014 and 2017, IMF staff analyzed social spending issues, including pension reform options,[41] and provided policy recommendations at various levels of granularity. IMF fiscal experts identified and quantified the impact of the authorities' assumptions on social spending projections and provided sensitivity analyses based on more conservative assumptions. This work was later reflected in publications by the Italian Fiscal Council.

75. Policy discussions benefitted from close collaboration between IMF staff and the authorities. Technical and policy discussions with the Ministry of Economy and Finance (MEF) and with INPS (the Italian social security institute) took place regularly; data, assumptions, and documents were shared by the State Accountant General of the MEF for the work on pensions as well as by the Ministry of Public Administration and Simplification for its work on the size of public

[39] Selected Issues Paper, 2017.

[40] Due to the slow attrition of pension entitlements, recent reforms only make themselves felt slowly while the stock of entitlements remain dominant.

[41] See Andrle, Hebous, Kangur, and Raissi, 2018.

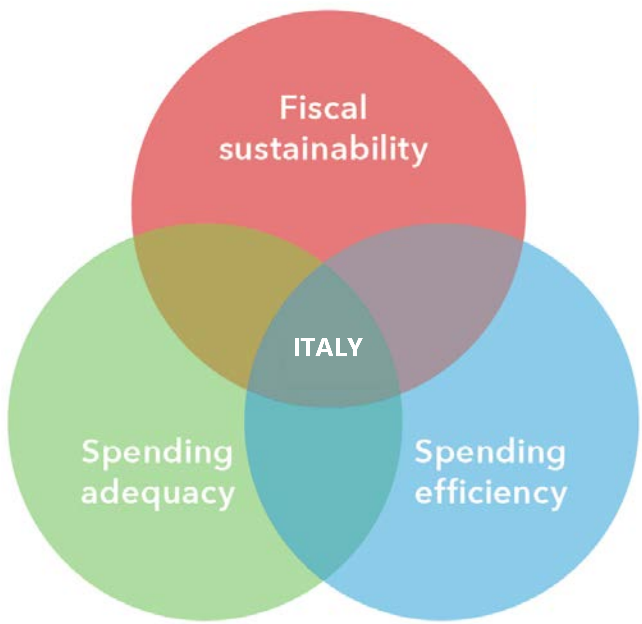
administration. An IMF working paper on pensions[42] was also discussed in a Focus paper by the Fiscal Council after close consultation with IMF staff. And the team discussed the results of a Selected Issues Paper on Italy's tax and transfer system with INPS as well as with the Ministry of Labor during the 2018 Article IV consultations with Italy.

76. IMF staff cooperated closely with EC counterparts on social spending issues. In 2018, the EC granted IMF staff access to data and codes of a microsimulation model of the EU/EUROSTAT to analyze Italy's tax and transfer system. The collaboration also worked in reverse. For example, IMF staff analysis showed how the authorities' pension system sustainability analysis depended critically on optimistic assumptions about demographics, employment, and productivity. These points were picked up by the EC in its work on the 2018 Ageing Working Group that adjusted these assumptions to be more realistic.

Policy Advice

77. Fund policy advice focused on a package of spending and revenue side measures to underpin fiscal sustainability while supporting growth and inclusion (Figure 6 and Table 10). Fund advice was specific and detailed in several areas to achieve the authorities' objectives of securing stability in a pro-growth and inclusive manner, including to lower the labor tax wedge that is high in international comparison.

Figure 5. Italy: Key Macro-Criticality Dimensions



Source: IMF staff.

[42] Andrle, Kangur, and Raissi (2018).

78. On pensions, the largest single social spending item, policy recommendations included both short and medium-term measures. These included (i) discontinuing the 14th pension payment; (ii) tightening survivor pension eligibility criteria; (iii) harmonizing self-employed contribution rates with those of other workers; (iv) re-calibrating the benefit formula using more realistic and conservative assumptions;[43] (v) strengthening the design of the phased-in notional defined contribution (NDC) system; and (vi) avoiding a reversal of past pension reforms to allow for an early retirement scheme (see the 2018 Article IV Staff Report).

Table 9. Italy: Objectives of IMF Policy Advice

IMF Policy Advice Objectives	Relevant Macro-criticality dimension
Improving the public pension system's financial position	Fiscal sustainability
Maintaining the level of public health expenditures while protecting quality and access to service	Fiscal sustainability
Increased education spending, focusing on improved outcomes.	Spending adequacy and efficiency
More efficient and adequate spending on social assistance, within a newly designed guaranteed minimum income (GMI)	Spending adequacy and efficiency

79. On health expenditures, the Fund's advice has focused on protecting current public health outcomes (as measured by mortality and morbidity) while containing spending. Policy discussions also drew attention to addressing regional differences in spending efficiency and quality of service.

80. Fund policy recommendations on education considered the need to improve productivity and competitiveness. IMF staff consistently called for increasing education spending, as Italy has the lowest education spending among OECD countries at 4 percent of GDP versus an average of 5.2 percent of GDP. This was to address weak upper secondary completion rates, low tertiary participation ratios, and quality concerns (Italy has a poorer record of PISA test scores than the EU average). Regional differences were also repeatedly mentioned, as well as the need to introduce outcome-based policy reforms including revised funding rules and evaluation systems.

81. The adequacy and design of social assistance schemes were also discussed. IMF staff called for adopting a modern, guaranteed minimum income scheme targeted to the poor—one that avoids welfare dependence and disincentives to work and is not time bound. IMF staff has recommended capping benefits at 40–70 percent of the relative poverty level, including gradual

[43] Selected Issues Paper accompanying the 2017 Article IV Staff Report.

benefit phase-outs and conditional in-work benefits to incentivize regular work and for preventing abuse through adequate controls and local administrative capacity. The authorities recently adopted a new means-tested, poverty relief program (the Citizenship Income Program) that will replace the current inclusion income program. Staff's assessment of the new program can be found in the 2018 Article IV Staff Report.

Lessons

82. **Close engagement with various domestic agencies and IDIs enriched the analysis of social spending issues.** This case study is an example of how this engagement resulted in improved analyses of all collaborators.

83. **Even in countries with significant administrative and technical capacity, the Fund can play a role in providing impartial technical assessments of social spending issues that can potentially help build public support for needed reforms.** Italy is a high-income euro area country facing no capacity constraints related to policy design or implementation. Technical expertise is ample and there is an effective understanding of policy issues. Even so, the Fund contributed effectively to the policy debate by highlighting key challenges and tradeoffs (e.g., gaps in policy frameworks, optimism of assumptions), bringing international experience to bear (e.g., design of safety nets), and delivering a consistent message. Ultimately, reform proposals were only partially successful and may be subject to reversals due to the difficult political economy context of the country. Critical in such assessments is taking into account political economy factors.

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E. Jamaica

Context

84. Against a background of stalling growth during 2008–12, high public debt and important development challenges, Jamaica requested assistance from the Fund in 2013. A Stand-By Arrangement approved by the Fund Board in February 2010 went off-track mid-program, eroding confidence, lowering economic growth, and resulting in acute balance of payments pressures. During 2012–13, the authorities began to tighten fiscal policy, prepared a comprehensive economic reform program, and again requested IMF support. Under the 2013 program (IMF 2013), the government targeted an increase in the central government primary fiscal surplus from 5.2 percent of GDP in 2013 to 7.5 percent to help reduce high debt levels. This was to be achieved through important structural reforms, a multiyear decrease of the public wage bill, and a tax package closing loopholes and shifting emphasis from direct toward indirect taxation.

85. Social spending has been at the core of the Fund-supported program since 2013. Strengthening the social safety net to better protect the vulnerable during adjustment was seen as an essential condition for program success in a tense social context, especially given the regressive nature of the shift from direct toward indirect taxation.[44] This was to be achieved through improving the generosity and delivery of safety net benefits to the poor. To this end, the 2013 four-year extended arrangement included a spending floor on identified social schemes and the 2016 IMF-supported program maintained this floor.[45]

Nature of Interaction

86. The Fund quickly engaged on social spending issues with various government agencies (i.e., the Ministry of Finance and Public Service, the Planning Institute of Jamaica, as well as line-ministries for education, health, labor and social security). To assist the authorities in their reforms, IMF staff promptly leveraged in-house expertise to analyze the impact of reforms on the most vulnerable households and discussed specific measures to improve assistance to these households.

87. Technical assistance (TA) was instrumental in informing policy measures implemented under the program. In 2012, the IMF provided TA on expenditure rationalization to help create fiscal space in support of fiscal consolidation and strengthening of the social protection system. In 2016, the authorities asked for a comprehensive assessment of existing social programs to identify those to be improved and expanded. The IMF and the World Bank jointly provided TA in the summer of 2016, designing reform options to offset the negative welfare effects of the regressive tax reform—in particular, boosting the PATH (Programme of Advancement through Health and

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[44] Jamaica had high unemployment and poverty headcount rates at around 14 and 20 percent in 2012, respectively, as well as high incidence of violence.

[45] IMF (2016a and 2016b).

Education) program—and reforming pensions. The authorities drew heavily on the findings of the TA mission in designing their reform measures.[46]

88. There continues to be joint monitoring of progress by the Fund, the World Bank, and the IADB. For instance, the IADB and World Bank already completed a review of benefit adequacy. Ongoing work includes: (i) a plan to regularly reassess the effectiveness of eligibility rules for PATH following World Bank recommendations (on track), and (ii) the extension of coverage of selected active labor market programs (on track).

89. Engagement with national stakeholders helped increase public awareness of the necessity of reforms through a targeted communication strategy. To support reform traction, IMF staff regularly interacted with a range of stakeholders, including the Jamaica Confederation of Trade Unions, the Private Sector Organization of Jamaica, the media, as well as the opposition political party.

Policy advice

90. Policy advice focused on creating fiscal space through tax and spending measures aimed at achieving fiscal adjustment targets and strengthening the social safety net to mitigate the negative impact of adjustment (Figure 7 and Table 11). The main focus was on reducing wage bill spending. In 2016, staff emphasized the need to reform public pensions, including by raising contributions and the retirement age (to 65), lowering the accrual rate, and adjusting the benefit formula. Drawing on previous TA analysis the authorities eventually took steps during 2016–18 to contain wage bill pressures and made some progress in pension reform.[47] To support further containment of wage bill spending, a centralized database for monitoring allowances is being developed. Staff have underscored the need for deeper structural public wage bill reforms that go beyond temporary remedies like wage freezes and adjustments to non-wage benefits. However, measures in this direction (e.g., a reduction in the size of the public workforce) have met with limited progress.

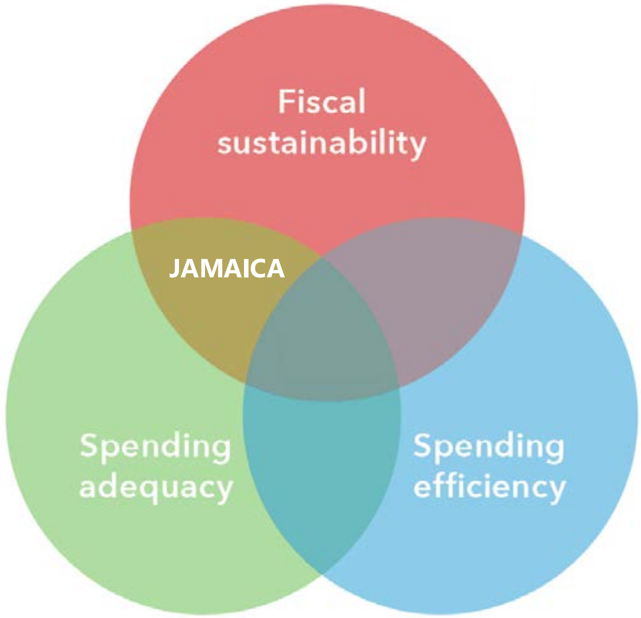
91. Regarding the need to strengthen the social safety net, Fund policy advice was seen as key to the public acceptance of tax reforms, and therefore to fiscal sustainability. Based on TA analysis, staff recommended: (i) increasing the generosity of selected benefits to improve their adequacy and mitigate the impact of weak economic conditions and adjustment; (ii) improving the identification and selection of beneficiaries and exit mechanisms to ensure adequate coverage of households most in need (with World Bank support); and (iii) strengthening capacity to effectively administer social programs (with IADB support). In 2014, the government launched a comprehensive social protection strategy encompassing a monitoring and evaluation framework. This included increasing benefit levels, initiating recertification of existing beneficiaries to improve targeting, and addressing program overlap. The authorities also committed to maintaining the real value of social

[46] IMF (2016b).

[47] IMF (2018).

protection spending for three years.[48] In 2018, spending on social programs increased by 16 percent, especially PATH and the school feeding program.

Figure 6. Jamaica: Key Macro-Criticality Dimensions



Source: IMF staff.

Table 10. Jamaica: Objectives of IMF Policy Advice

IMF Policy Advice Objectives	Relevant Macro-criticality dimension
Mitigate adverse impact of tax and spending reforms on the poor in a budget-neutral manner	Fiscal sustainability and spending adequacy
Strengthen the social safety net (SSN), in particular PATH (improve coverage at the bottom of the income distribution)	Spending adequacy
Strengthen SSN, in particular PATH (increase real value of benefits)	Spending adequacy

[48] IMF 2014. The MEFP included several social protection measures (none of which were structural benchmarks): (i) establishing a national identification system; (ii) reviewing targeting mechanisms, benefit amounts, and regularly assessing the eligibility of recipients of the PATH program; (iii) increasing spending on school feeding; and (iv) redesigning PATH to maximize school attendance.

Lessons

92. Effective and timely mobilization of a range of expertise within the Fund was important to support the country team in maintaining the authorities' reform momentum. In Jamaica, this took the form of TA on both spending and tax reforms as well as a detailed evaluation of the social assistance system. Continued technical and policy support was also provided from headquarters.

93. Close cooperation with development partners can enhance Fund engagement on social spending issues. TA engagement extensively leveraged the expertise of development partners, which in turn facilitated more detailed engagement on the design and implementation of the social assistance system as well as needed follow up. Such collaboration could be further promoted through a more systematic framework for inter-institutional engagement on social spending issues.

94. Continued communication and outreach are critical for the success of reforms. A key part of a communication strategy is to know the audience and relevant counterparts and spokespersons. Successive governments were able to link together difficult structural fiscal reforms (e.g., the broadening of the general consumption tax) and the improvement of the social safety net, thus ensuring sustained progress and winning public support for necessary reforms. However, many eligible households are still not enrolled in social assistance programs, highlighting the importance of continued effective communication of the reform components by the authorities.

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F. Japan

Context

95. Japan is facing spending pressures related to population aging. Japan has one of oldest populations in the world, with a life expectancy of over 84 years in 2018. Consequently, age-related public spending is putting significant pressure on government finances. Public health spending increased from 5.8 percent of GDP in 2000 to 9.0 percent in 2017, and public pension spending from 7.3 percent of GDP in 2000 to 10.2 percent in 2013.[49] Both public health spending and public pension spending are among the highest in the OECD.

96. Recognizing the gravity of the problem, Japan initiated a series of public pension and health reforms over the past two decades, mainly aiming to contain the fiscal pressure from age-related spending. Reform efforts were also intended to increase the coverage and improve the quality of spending.

97. Examples of public pension reforms included:

- In 2004, Japan introduced a macroeconomic indexation scheme, an adjustment mechanism for pension benefits based on changes in the number of contributors and gains in life expectancy. The government did not apply the scheme when inflation was negative.
- In 2016, deflation periods were included in the indexation rules through a carry-over system—any unrealized benefit reduction because of a deflationary environment will be delayed to later years when the unused reduction can be applied with consumer price inflation (to become effective from April 2018). Furthermore, the wage-price indexation mechanism was revised. Pension benefits would be adjusted downward when wage growth is negative from April 2021.
- The mandatory pension contribution rate has been gradually raised from 13.9 percent in 2004 to 17.8 percent in 2015, and to 18.3 percent in 2017.

98. Examples of recent public health reforms include:[50]

- Long-term care insurance has been facing escalating costs because of the aging population, and recent reforms have focused on cost containment, while maintaining the quality and quantity of long-term care services. The latest reform was conducted in 2015, including by increasing out-of-pocket spending from 10 percent to 20 percent, with reduced payments for those living

[49] The health expenditure data are from the OECD Health Statistics, 2018. Health expenditure includes only current expenditure, and for Japan there is a structural break in the data series from 2010 to 2011 where total current expenditure increased by 1.4 percent of GDP. Pension spending data are drawn from the OECD Social Expenditure Database.

[50] The examples are primarily from Sakamoto and others (2018).

below the poverty line and excluding those with less severe conditions from long-term care insurance (their care is instead covered by local governments).

- The Social Security System Reform Promotion Act mandated the maintenance of universal insurance coverage, stabilization of health care financing, equalization of public insurance premiums across plans, and re-evaluation of benefit coverage. To this effect, the consumption tax rate was raised from 5 to 8 percent in April 2014. It was originally planned to reach 10 percent in October 2015, but the timeline was extended to October 2019. Some of the additional revenue was earmarked for medical care and long-term care.

- In 2015, the "*Amendment of the National Health Insurance Act to consolidate municipal public insurers with the prefecture authority*" mandated prefectural governments to coordinate financial management, set prefecture-specific standard premium rates, and provide re-insurance to municipalities with a higher financial risk. Before 2015, the municipal (or city) governments were local insurers that set a municipality specific premium rate under a nationwide standardized benefit packages. This led to unstable and unequal premium rates across municipalities because of the large variations in the financial status of local insurers.

99. The reforms have met with some success. For example, public spending on pensions is projected to decline slightly by 2050 as a result of the many pension reforms over recent decades (OECD, 2017). However, challenges remain and further reforms in both health and pensions are needed to ensure fiscal sustainability of the systems and adequate protection of the beneficiaries (Miake and others, 2018; Arbatli and others, 2016).

Nature of Interaction

100. The IMF's engagement with the authorities on age-related spending has been primarily through the annual Article IV consultation, and the topics were selected based on discussions with the authorities:

- In 2012, the Article IV consultation highlighted the need to contain public pension spending and analyzed the impacts of various reform options. The analysis was discussed extensively in the main text of the staff report as part of fiscal adjustment package, presented as a chapter in the Selected Issues, and eventually published as a working paper (Kashiwase, Nozaki and Tokuoka, 2012b).

- In 2013, Fund staff engaged the authorities on the fiscal risks of rising public health spending (including long-term care spending) and analyzed the impacts of various reform options. The analysis was discussed in the main text of the staff report in a box, and as part of the fiscal adjustment package presented as a chapter in the Selected Issues and then published as a working paper (Nozaki, Kashiwase and Saito, 2014).

- In 2018, staff engagement focused on the macroeconomic effects of demographic changes. Staff discussed many of the policy recommendations made in 2012 and 2013 in the context of the fiscal adjustment package and analyzed their macroeconomic and welfare impacts. The analyses were presented in two Selected Issues papers—one on healthcare reform (Miake and others, 2018) and the other on the macroeconomic and welfare effects of policy options to finance age-related spending (Miyachi and Peralta-Alva, 2018), which was also published as a working paper (McGrattan and others, 2018). Moreover, staff studied the effects of demographics on the natural rate of interest and conducted a general equilibrium analysis on whether structural reforms can offset the macroeconomic effects of demographic changes (IMF, 2018a; Han, 2019; Colacelli and Fernández Corugedo, 2018). Staff also engaged the authorities on inequality in Japan, highlighting intergenerational inequality arising from social spending on the elderly (Colacelli and Le, 2018).

101. Challenges and reform experiences related to age-related spending around the globe as well as issues specific to Japan have been regularly discussed in the annual Tokyo Fiscal Forum (for example, in 2015, 2016, 2017). The forum was jointly organized by the Policy Research Institute of Japan Ministry of Finance, the Fiscal Affairs Department of the IMF, and the Asian Development Bank Institute. This provided an excellent forum for Japanese officials, IMF staff, and researchers from Japan and other countries to discuss broad issues in the areas of age-related spending. Staff took the opportunity to disseminate IMF analytical work—for example, the IMF work on the macro-fiscal implications of health care reform in advanced and emerging economies—which could help the Japanese authorities in formulating their health and pension reforms. In the context of Japan's G20 Presidency, there was a symposium in January 2019 on demographic changes and macroeconomic challenges; staff is preparing a G-20 note on the Macroeconomic and Fiscal Implications of Aging.

Policy Advice

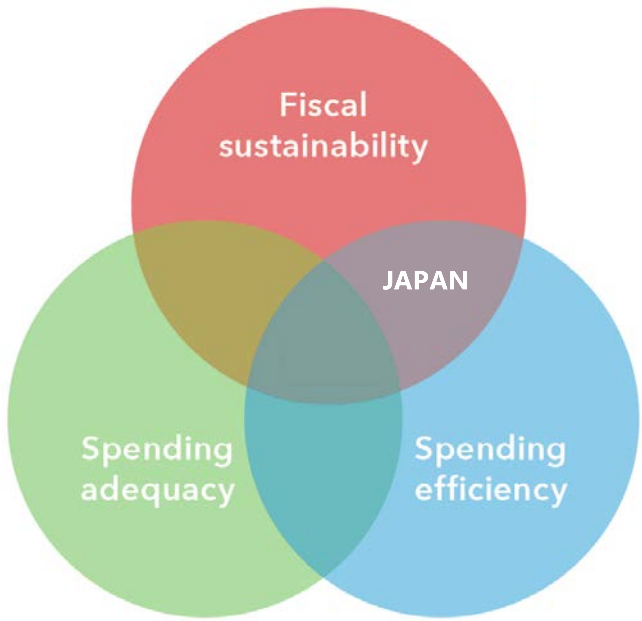
102. IMF staff work on age-related spending highlighted the fiscal risks from rising public health and pension spending (Figure 8). In all three instances (2012, 2013 and 2018), the discussions started by emphasizing the fiscal pressures from the demographic changes in Japan—rising age-related government spending and a shrinking tax base—and the need to contain age-related spending. While pension spending was not projected to increase in the long term, it should contribute to the needed fiscal adjustment and could also help reduce intergenerational inequality and strengthen growth potential (IMF, 2012; Kashiwase and others, 2012a and 2012b). Public health spending was projected to increase substantially with large uncertainties over the next decades and posed a major fiscal risk for public finances (IMF, 2013; IMF, 2018b; Nozaki and others, 2013; Nozaki and others, 2014; Miake and others, 2018).

103. Staff also proposed reform options to contain the fiscal pressures from health and pension spending while protecting the most vulnerable (Table 12).

- On health spending, the main recommendations included: (1) rationalizing health care services; (2) improving the efficiency of health care services; and (3) increasing copayments and premium contributions with measures to mitigate impacts on the most vulnerable (IMF, 2013; Nozaki and others, 2013; Nozaki and others, 2014; Miake and others, 2018).

- On pension spending, the main recommendations included: (1) raising the basic pension eligibility age to 67; (2) reducing benefits for wealthy retirees; (3) eliminating preferential tax treatment for pension benefit income; and (4) collecting contributions from dependent spouses. The preferred option was to raise the retirement age and the accompanying reform to strengthen social safety net was also discussed (IMF, 2012; Kashiwase and others, 2012a and 2012b).

Figure 7. Japan: Key Macro-Criticality Dimensions



Source: IMF staff.

Table 11. Japan: Objectives of IMF Policy Advice

IMF Policy Advice Objectives	Relevant Macro-criticality dimension
Containing the growth of public health spending over the medium term	Fiscal sustainability
Reducing pension spending over the medium term	Fiscal sustainability
Increasing revenues through, for example, raising consumption tax rate, copayments and premium contributions	Fiscal sustainability
Improving the efficiency of health care services	Spending efficiency

- Using a dynamic general equilibrium overlapping generations model, IMF analysis found that financing the costs of aging through gradual increases in the consumption tax rate delivered a better macroeconomic performance and higher welfare for most individuals than other financing options, including those of raising social security contributions, debt financing, and a uniform increase in health and long-term care copayments (IMF, 2018a; Miyachi and Peralta-Alva, 2018; McGrattan and others, 2018).

Lessons

104. In a surveillance context, policy traction was helped by staff providing various perspectives. Reforming age-related spending is clearly a policy priority for the Japanese government. IMF staff has devoted significant analytical resources to its Japan Article IV consultations on age-related spending in recent years. This has helped to reinforce and inform the government's commitment to reform. Continued support is important to sustain reform efforts such as raising retirement ages as recommended by staff since the retirement age in Japan remains relatively low in comparison with other advanced economies.

105. Close engagement and follow-up with the authorities can improve the traction of IMF policy advice. It is often the case that the IMF initiates analytical work in consultation with the authorities, but follow-up attempts to refine the analytical work and reengage with the authorities are sometimes lacking. Fund staff examined a range of macroeconomic issues—fiscal sustainability, growth impacts, and welfare implications—to illustrate the need and impact of health and pension reforms. This helped in the engagement with the authorities and follow up, which in turn improved traction.

106. IMF engagement on social spending should be tailored to countries' needs. In advanced economies, where social spending is often adequate and administrative capacity is high, the focus may not be so much on protecting social spending, but instead, for example, on addressing the long-term fiscal pressures from population aging and improving spending efficiency while protecting the most vulnerable.

107. IMF engagement can greatly benefit from a multiyear research agenda. This is particularly relevant for engagement with advanced economies where the issues tend to be more complex and there is little low-hanging fruit for policy reforms. When engaging in such a context, providing valuable inputs often requires analytical work on cutting-edge issues. In this regard, a multiyear research plan can help build up expertise, leverage external knowledge, and ensure in-depth analytical work that fully takes into account country-specific factors.

108. IMF policy advice could be further strengthened if combined with more detailed sectoral insights provided by other development partners with the appropriate expertise. By focusing on its areas of comparative advantage, IMF engagement was very effective in gaining traction on the need to keep reform momentum. Further progress in improving the quality of reforms (e.g., greater reliance on increases in retirement ages and spending efficiency generally) would benefit from stronger engagement with development partners with significant sectoral expertise and facilitate consistency of policy messaging supported by more in-depth analysis and more tailored policy advice.

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G. Kyrgyz Republic

Context

109. In the Spring of 2015, the Kyrgyz authorities embarked on an ambitious medium-term fiscal adjustment to ensure public debt sustainability.[51] The adjustment was to take place in a challenging macroeconomic environment characterized by adverse short-term developments, including a slowdown in the region that weighed on growth and pushed inflation to double digits. Pressures on the public budget were expected to come from the impact of low growth on revenue, planned investment projects, and upcoming parliamentary elections. Sizeable investment plans were expected to significantly weigh on the debt trajectory.

110. Under the fiscal adjustment plan that was supported by an IMF program, the authorities focused on reducing current spending. The reduction in current spending was expected to be 2.3 percentage points of GDP over 2016–17. This more than compensated for a projected decline in revenue and an increase in investment over the same period. The overall fiscal deficit was to be reduced by 0.8 percentage points of GDP during 2016–17. Including on-lending, the adjustment in the fiscal balance was expected to be even sharper (3.7 percentage points of GDP). Planned spending reforms included reductions in purchases of goods and services and in the public wage bill as a share of GDP.[52] The authorities also committed to an analysis and review of subsidies, in particular in the energy sector, to reduce their fiscal cost.

Nature of Interaction

111. During the program, the Fund engaged on social spending with the authorities since an increase in social assistance was necessary to protect vulnerable households from the effects of the planned energy subsidy reform and the economic adjustment. The commitment to increase social assistance was explicitly recognized in the authorities' plans as laid out in the Memorandum of Economic and Financial Policies for 2015-2018 (see MEFP, p. 68, ¶14)[53] and the accompanying 2015 Staff Report (see "*Request for a Three-Year Arrangement under the Extended Credit Facility – Staff Report*", p. 12, ¶25). The program also included an Indicative Target (floor) on

[51] Following faster and higher than anticipated public investments since the expiration of an IMF-supported program in July 2014, debt had become a source of concern (IMF 2015, p. 5).

[52] The reduction expected in 2016 was 0.3 and 0.4 percentage points of GDP for the compensation of employees and purchases of goods and services, respectively. As regards the wage bill this was high in international comparison.

[53] The MEFP, ¶14, second bullet states that: "The government intends to: (i) streamline spending on goods and services; (ii) conduct a cost benefit analysis of subsidies, especially in the electricity sector and propose an action plan for reducing their fiscal impact; (iii) streamline untargeted social spending by reviewing the existing programs; and (iv) improving forecasting and procurement of social spending. While reforming the subsidy programs we will also carry out measures to mitigate the impact of reforms on the vulnerable, which will gradually increase social spending over the course of the program."

social assistance spending.[54] At the time of the first review in February 2016, staff provided in the staff report a detailed analysis of distributional issues.[55] The analysis presented trends in poverty and inequality indicators and discussed obstacles to improve distributional outcomes. The discussion also pointed at policies, including reform of social spending programs, for reducing inequality and promoting inclusive growth. Suggested policies included consolidating and streamlining social assistance programs, improving targeting, expanding cash-transfers programs and improving poor households' access to education and health services.

112. Program conditionality designed to support reform implementation during the program was delayed. Besides the Indicative Target mentioned above, the authorities planned to conduct a review of subsidies and draw up an action plan to reduce them by end-June 2016 (structural benchmark). The timeline for conducting the review and preparing the action plan was postponed in subsequent reviews and the benchmark only met with a delay in the context of deteriorating macroeconomic prospects and fiscal balances and limited progress in containing the wage bill.[56] The delay in implementing the benchmark and lack of follow up with specific policy measures also reflected limited capacity and political economy challenges in reforming subsidized energy prices.

113. The Fund supported the authorities, including by providing technical assistance (TA) with support from the World Bank. In light of the authorities' difficulties in proceeding with agreed reforms, the Fund deepened its engagement. In Spring 2017, in providing TA in the areas of energy subsidy and social assistance, the Fund worked with the World Bank (two World Bank staff members were part of the IMF mission team and others were extensively consulted both in the field and at headquarters). This reflected the intense engagement of the World Bank with the Kyrgyz authorities in particular on energy subsidy reform[57] and poverty and social protection issues.[58] Cooperation and discussion between Fund and World Bank staff have been on-going throughout the program. The Fund also engaged with UNICEF, in particular on issues related to child benefits. On the latter issue, the Fund also engaged with CSOs (see next section).

[54] The Indicative Target included spending on two social assistance programs (the Unified Monthly Benefit and the Monthly Social Benefit), see *"Request for a Three-Year Arrangement under the Extended Credit Facility–Staff Report"*, p. 176, Table 2.

[55] Analysis was conducted in the context of the pilot on operationalization of analysis of inequality issues in Fund surveillance and program work. The Kyrgyz Republic was included in the first wave of pilot countries and a Selected Issues Paper on *"Income Inequality in the Kyrgyz Republic"* was published in February 2016.

[56] The completion of the structural benchmark was postponed to end-September 2016 in the second review (June 2016) and to end-July 2017 in the third review (the review was concluded by the IMF executive Board in December 2016). The structural benchmark was met in the Summer of 2017 (see fourth and fifth reviews, p. 52).

[57] See World Bank (2017), *Analysis of the Kyrgyz Republic's Energy Sector*.

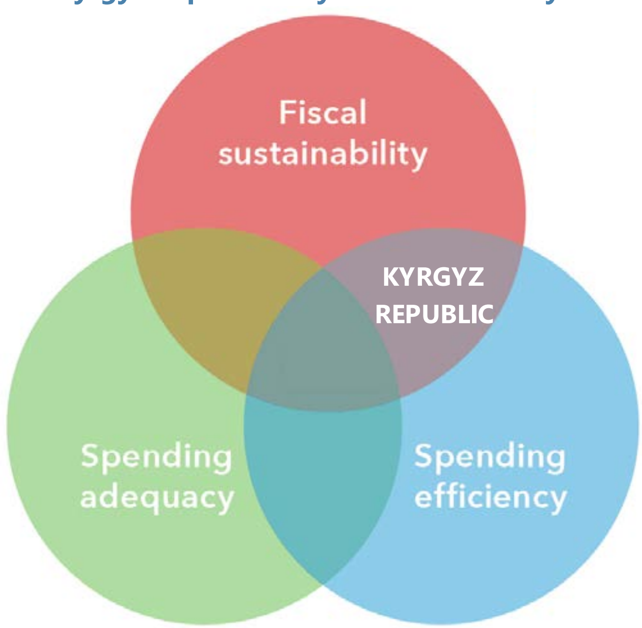
[58] See World Bank (2014), *Kyrgyz Republic Public Expenditure Review*.

Policy Advice

114. In providing analysis and policy advice on social spending issues, the Fund concentrated on fiscal sustainability and efficiency of spending (Figure 9). On social spending issues, the advice focused mainly on social assistance programs (Table 13) and on two main aspects: (i) the need to streamline, strengthen and expand programs prior to and in parallel with the recommended progress on energy subsidy reform to improve both efficiency and distributional outcomes (given that energy subsidies were inefficient and regressive); and (ii) improve the generosity and coverage of social assistance benefits in particular for households in the lower part of the income distribution.

115. Given tight resource constraints, Fund policy advice called for an expansion of the resources for means-tested social assistance programs. Evidence indicated that spending on social assistance was at the high end of the distribution of comparator countries. But low coverage of vulnerable households, limited generosity and low progressivity of social spending reflected extensive use of categorical programs. The largest, and only means-tested, social assistance scheme was designed to provide income support to poor households with children; it scored better than the other programs in terms of coverage and of channeling resources to vulnerable households. Expanding social assistance programs required creating fiscal space by phasing out inefficient and inequitable spending. To this end, energy subsidy reform was seen as key to financing a strengthening of the social safety net.

Figure 8. Kyrgyz Republic: Key Macro-Criticality Dimensions



Source: IMF staff.

Table 12. Kyrgyz Republic: Objectives of IMF Policy Advice

IMF Policy Advice Objectives	Relevant Macro-criticality dimension
Spending composition: phase out energy subsidy to contribute to fiscal consolidation and free resources for social assistance	Fiscal sustainability and spending efficiency
Streamline and strengthen social assistance programs to expand coverage of vulnerable households	Spending efficiency
Re-introduce elements of means-testing in child benefits program	Fiscal sustainability and spending efficiency

116. In the Summer of 2017, the authorities decided to reform the means-tested social assistance scheme, and in the following months moved to universal child benefits; afterwards the Fund emphasized the need for some elements of targeting. The shift toward universal child benefits would have resulted in a substantial reduction of the size of the child benefits for existing means-tested recipients owing to financing constraints, resulting in lower benefits for lower-income households. In 2018, IMF staff recommended the introduction of some elements of targeting to the newly adopted child allowance. The recommendation was then included in program documents and supported by a structural benchmark introduced in the fourth and fifth reviews (February 2018)[59]. The recommendation was aimed at providing sufficient assistance for those most in need while ensuring that the fiscal targets remained consistent with fiscal sustainability. Staff also advised reforms to support the creation of fiscal space (e.g., a reduction in the public wage bill, tax exemptions and energy subsidy), but this advice did not get traction. The advice reflected financing constraints (in the absence of a plan to sustainably finance a universal child benefit program), challenges in domestic revenue mobilization in the short term, and competing demands on fiscal resources for other priority spending (including health, education and transport) for inclusive growth and poverty reduction over the medium term.

117. Fund policy advice on child benefits reflected extensive interactions with the authorities, development partners and CSOs, but was subject to criticism. The design of the structural benchmark (see the earlier paragraph) was a result of extensive dialogue with the Ministry of Labor and Social Affairs and UNICEF, which spearheaded support for universal child allowances on behalf of CSOs and also supported the authorities in the drafting of the legislation. Nonetheless, the Fund's position on reintroducing elements of targeting came under criticism by some commentators for having a narrow focus on targeting (i.e., means testing). A few months after the introduction of universal child benefits, a coalition of CSOs and members of Parliament succeeded in suspending the universal child allowance, given the extent of the benefit reduction suffered by low-income households. The criticism of the Fund policy advice might have reflected less than full clarity in IMF staff reports on the broad strategy underpinning the program. While reports presented all

[59] See Table 11 (p. 28) included in the fourth and fifth reviews Staff Report.

elements of the strategy, the inter-dependence of the components and the policy trade-offs were more challenging to communicate and not fully explained, e.g. that lack of progress in tackling structural issues (e.g. subsidy reform) and creating fiscal space would have undermined any plan for expanding social assistance spending. Throughout the criticism, the IMF continued to engage in dialogue with experts and CSOs to explain the context and rationale of its policy advice.

Lessons

118. **Leveraging internal and external expertise offered clear benefits.** In its analysis and policy advice, the Fund relied both on internal and external resources to complement the work of the Fund's country team. This was beneficial not only because internal specialized resources were not sufficient to meet all demands but more importantly because other development partners (in this case the World Bank and UNICEF) had deep engagement with the authorities. Fund technical assistance provided a useful framework for leveraging the expertise and the analysis of the World Bank.

119. **Focus on supporting efforts for creating fiscal space, also by strengthening assistance to improve capacity, is key for enabling social spending reforms.** Limited progress in other structural reforms weighed negatively on resource mobilization and efforts to create fiscal space for social assistance. While Fund advice supported the authorities' policy objectives (and was in line with the views of other development partners), the limited progress in mobilizing resources (by not removing energy subsidies or tax exemptions and slippages in achieving revenue and expenditure targets) was the main obstacle to creating sustainable financing for expanding social assistance programs. This suggests that an even greater focus on strengthening capacity by the IMF and development partners might have been warranted, in particular to ensuring follow-up on technical assistance.

120. **Communication is critical to explaining the basis and framework for IMF policy advice and highlighting trade-offs in policy choices within the macro-fiscal context and the authorities' objectives.** This case study highlights the importance of clearly communicating to the public and other stakeholders the feasibility of measures, trade-offs, and linkages between policy alternatives to inform better policymaking, as well as clarifying the role and limitations of Fund engagement. Besides IMF communication, the authorities' communication plans are also important for enhancing traction on resource mobilization efforts. To this end, development partners could help the authorities design their communication strategies, as for example well-articulated plans have been shown to be a key component of successful energy subsidy reform strategies (Clements et al. 2013).

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H. Mongolia

Context

121. The Mongolian economy is largely dependent on mineral exports—mainly copper, coal, and gold—and extremely vulnerable to terms of trade shocks. The boom-bust cycle, primarily driven by commodity prices, has been a key factor determining Mongolia's economic and social protection policies. Driven by the strong uptick in mining revenues that started in 2005, the governments expanded fiscal spending beyond sustainable levels, with nominal wage increases of about 70 percent in 2007—resulting in a wage bill increase of 2½ percent of GDP. Similarly, transfers to households were raised and new, universal transfers were introduced at an estimated cost of 3½ percent of GDP. This pro-cyclical fiscal policy has weakened the country's position to mitigate the negative impact of the economic bust that started with the collapse in global mineral prices at the end of 2008.

122. The global financial crisis, through a substantial drop in copper prices, severely impacted export revenue and prompted macroeconomic adjustment. In March 2009, the government requested an 18-months IMF-supported SBA program to restore fiscal balance and ensure a smooth adjustment following the large terms of trade shock.[60] The program focused on substantial fiscal adjustment, supported by reduced capital spending, a wage and hiring freeze, and cuts in some untargeted social allowances and goods and services, aimed at reducing non-interest spending by 4 percentage points of GDP in 2009. Protecting vulnerable households from the impact of the needed fiscal adjustment was an important program objective. This was to be achieved through rationalizing untargeted social protection spending to allow more resources to be directed to the most vulnerable households. The program included a structural benchmark on conducting "a comprehensive review of social transfer programs", which was done in cooperation with the World Bank and Asian Development Bank.

123. Worsening economic conditions and declining commodity prices during 2012–16 led a newly elected government to request another EFF-supported program in 2017.[61] Given high public debt, this program focused on fiscal consolidation (of more than 11 percent of GDP over the medium term), including through cutting capital spending, streamlining and better targeting of social transfers and reforming public pensions, and freezing nominal wages (amounting to about 9 percent of GDP in spending cuts), a move to progressive taxation and other income measures, as well as implementation of public financial management reforms. Given the tight fiscal constraints, protecting vulnerable households through better targeting of the social safety net during this period of adjustment was a key objective. To this end, the program included a structural benchmark on strengthening the social safety net: "the Child Money Program will be targeted to the poorest 40 percent of Mongolian households and the savings redirected toward the better-targeted Food

[60] IMF (2009a).

[61] IMF (2017a).

Stamps program" (IMF, 2017a). During the fourth program review, IMF staff agreed with the authorities to introduce an indicative target (floor) on social assistance spending.[62]

124. Mongolia's social protection policies have been greatly influenced by commodity price fluctuations and the political environment.[63] Mongolia has more than 70 social transfer programs, many of which serve overlapping groups, yet about one-third of the population lives below the poverty line. The Child Money Program (CMP) is one of the country's flagship programs and an essential part of its social safety net. It was introduced in 2005, in a context of buoyant copper prices and tax revenue and prospects of a fiscal surplus, with the objective of providing targeted assistance to alleviate poverty through cash transfers. In 2006, on the back of rising copper and gold prices and fiscal revenue, the government converted the program into a universal scheme providing a benefit to all households with children under the age of 18.

Nature of Interaction

125. During both IMF-supported programs, staff had extensive discussions with both the authorities and other international development institutions (IDIs) on social spending. These supported the formulation of IMF policy advice and assisted the authorities in developing a strategy for social safety net reform.

126. Staff relied mainly on the expertise of the World Bank and ADB for engaging on social spending issues, with limited discussions with other stakeholders, including UNDP or civil society organizations.

- **The 2009 18-months SBA-supported program focused on rationalizing untargeted social spending in view of a tight budget constraint.** Given the complex nature of transitioning from a universal system to a more targeted transfer system (as it was difficult to disentangle which programs were more effective in reaching the poor and to institute a reliable targeting mechanism), the authorities agreed to undertake a study of the existing social protection system to identify inefficiencies, which was done in cooperation with development partners. At the end of the program, after reviewing the universal child transfer program, the government introduced a new entitlement system in 2010 with higher universal cash benefits (to each citizen) through the creation of a Human Development Fund (HDF) financed with earmarked mineral revenue.[64]

- **The 2017 IMF-supported program refocused on the CMP.** Discussions centered on improving the targeting of the social safety net, by reducing the coverage of the CMP to the 40 percent poorest households and using the savings from the CMP to scale up spending on the better-targeted food stamp program. Program conditionality on social safety net reform was set to support the programs of other IDIs; in particular, the ADB included conditionality (triggers) in

[62] IMF (2018b) and IMF (2018c).

[63] Yeung and Howes (2015).

[64] IMF (2010) and IMF (2011).

its financial support program to reduce the coverage of the CMP to the 40 percent of poorest households.

127. In 2017–18, policy discussions focused on the authorities' desire to return to a broader coverage of the CMP.[65] Although deviating from the original program objective of more targeted assistance was assessed not to have significant fiscal implications, Fund staff noted that the change toward broader coverage could derail financial assistance from the ADB and, as a consequence, put at risk the financing assurances under the IMF-supported program. After extensive discussions, the ADB agreed to continue its financial support with the understanding that the CMP would be broadened to the 60 percent poorest households and the authorities would increase the financing of other poverty-targeted programs. In the end, the authorities decided to reduce coverage of the CMP to the poorest 80 percent of children and reversed much of the planned increase in other targeted programs to finance the cost of achieving this higher coverage. Although not in line with the agreement, ADB did not oppose to this change.

128. Policy discussions also aimed at addressing large income inequality by introducing a progressive income tax system. However, the authorities also moved away from this program commitment, by reversing progressive income taxation reform a few months after it was introduced in early 2018.[66]

Policy Advice

129. Policy advice on social spending during the last two IMF-supported programs focused on protecting the most vulnerable households while implementing the needed large fiscal adjustment. Discussions centered on the coverage of social assistance schemes. The aim was to channel CMP benefits only to most vulnerable households and to use the resulting savings to scale up spending on the better-targeted food stamp program (Table 14 and Figure 10). Considering the numerous social transfer programs in place in Mongolia, the Fund has also advised the government to consolidate these programs (without cuts in benefits) to improve the efficiency of these programs and generate some net administrative savings.

130. Fund advice did not gain traction. The authorities reversed or did not implement staff's policy advice both due to political pressure and improving economic conditions due to an uptick in commodity prices improving fiscal revenue. In particular, the authorities considered the universal child benefit program necessary for social cohesion and easier to administer. As the deviation was not considered macro-critical by staff—due to the marginal fiscal impact of the deviation—it did not affect the continuation of the IMF-supported program.

131. The Fund approach and policy advice on social protection have also been criticized in the media, notably by CSOs. This reflected, in part, that the broader macro-fiscal context of policy advice could have been more clearly communicated; instead there was a narrower focus on

[65] IMF (2017b) and IMF (2018a).

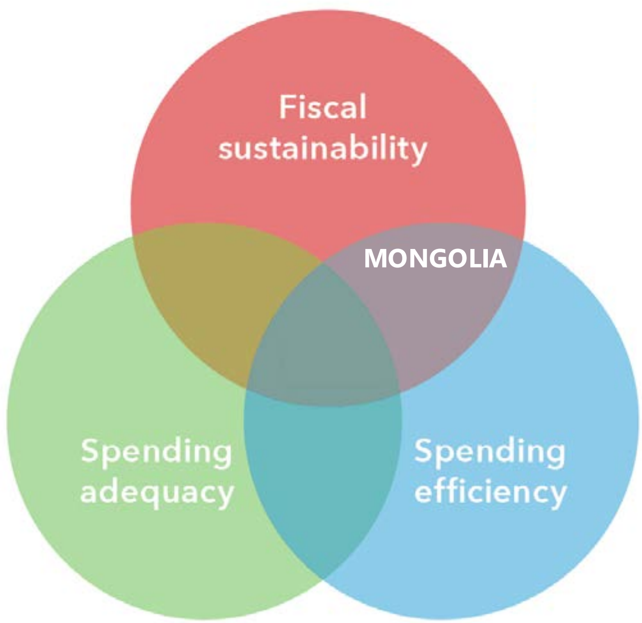
[66] IMF (2018a) and IMF (2018b).

targeting issues in communications. Some stakeholders emphasized the importance of maintaining the universality of the CMP and reinforcing both its legal framework and adequacy of benefits, as being the most effective response to tackle poverty, especially rural poverty.

Table 13. Mongolia: Objectives of IMF Policy Advice

IMF Policy Advice Objectives	Relevant Macro-criticality dimension
Review the social assistance programs by making the Child Money Program more targeted (to the 40 percent poorest households)	Fiscal sustainability and spending efficiency
Direct the resulting savings from the CMP to scale up spending on the better-targeted food stamp program	Spending efficiency
Rationalize the numerous social transfer programs, by consolidating them (without cuts in benefits)	Spending efficiency

Figure 9. Mongolia: Key Macro-Criticality Dimensions



Source: IMF staff.

Lessons

132. Consideration of authorities' objectives and preferences is paramount for traction. Notwithstanding in-depth and extensive discussions with the authorities, differing views on key components of the reform strategy appear to have persisted. The authorities preferred a social safety net based on universal coverage and were also concerned about the higher administrative requirements for implementing targeted schemes. In this context, deepening the understanding of the equity and efficiency impact of the existing system may have increased the chances of gaining traction for the IMF's policy advice.

133. Complementing the country team's skills early on with technical expertise could have helped avoid an unnecessarily narrow focus on targeting issues. Additional analytical work and/or earlier engagement in the program design phase with the Fund's internal experts (including TA) complemented by external expertise could have better equipped staff to design a broader reform strategy for strengthening social safety nets anchored in the macro-fiscal adjustment framework, not centered so much around the narrower issue of making the CMP more targeted.

134. Enhancements and broadening of the tools and expertise for commodity exporters could be considered. The discussion on the coverage of the CMP (universal or partial) took place against a backdrop of the boom-bust cycles of commodity prices feeding into fiscal revenue. This illustrates the need for discussions to be based on sustainably financed social safety net, not susceptible to commodity price swings. There is scope for further analytical work in this area, leveraging efforts (analysis, tools and expertise) on structural fiscal issues and revenue mobilization.

135. A broader engagement with stakeholders in the early stages of program design can contribute to broad-based support for the reform strategy. Although staff did coordinate policy advice with the WB and ADB on the reform of Mongolia's social safety net, there is a case for broader coordination with other stakeholders (such as other agencies) as well as CSOs operating in the country. Differences in views and objectives may not be removed entirely,[67] but the rationale and (importantly) the constraints shaping policy advice and choices would be better understood helping to build a broader platform for strengthening social protection spending.

136. A broad-based communication strategy focused on clearly explaining the objectives and rationale of the IMF-supported program would have been beneficial. It is important for country teams to early on involve the Fund's Communications Department to design a communication strategy that engages most stakeholders on the objectives of the program and explains the role of the Fund. The communication strategy must also explain how social spending advice is integrated in the broader macro-fiscal policy strategy, including fiscal constraints and the interdependence between different measures.

[67] For example, the ILO policy advice is in contradiction with the Fund's advice on CMP. The ILO emphasizes the importance of maintaining the universality of the CMP, seeking to reinforce its legal framework and adequacy of benefits as the most effective way to tackle poverty (ILO, 2017).

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I. South Africa

Context

137. South Africa achieved noteworthy social progress since the end of apartheid, including a reduction in poverty, broader access to health and education, and expansion in social housing, water, and electricity coverage. Redistribution through fiscal policy and especially the system of "social grants" have been long recognized as a cornerstone for this change. Nevertheless, South Africa remains one of the most unequal societies. The Gini coefficient is 0.63 and the national poverty rate stands at 40 percent as of 2015 (latest available).

138. Despite progress, large social gaps remain, and the growth environment has deteriorated. GDP growth decreased to on average 1.7 percent in 2015–17, compared to 2.9 percent in the previous two decades, excluding the crisis year of 2009. GDP per-capita growth turned negative to -0.9 percent on average in 2015–17. The slowdown reflects structural issues, including weakened governance and elevated policy uncertainty. The economy has been unable to generate enough jobs and the national unemployment rate stood at 27 percent at in 2017. Half of the youth population is unemployed, and 1 in 3 is neither in employment, education nor training (NEET). The labor market suffers from a variety of rigidities including a centralized wage negotiation and settlement process that results in wage levels that are not consistent with what small and medium-sized enterprises (SMEs) could afford based on productivity. Insufficient competition in the domestic economy inhibits private investment and inclusive growth.

139. South Africa suffers from low education quality by almost any metric. While education spending is comparable to that of the OECD countries and exceeds that of most peer countries, outcomes are very poor with profound negative social and economic consequences.

140. A permanent increase in government expenditure (by 4 percentage points of GDP) since the global financial crisis led to a doubling of public debt (from 26 to 53 percent of GDP). The wage bill accounted for most of the increase (64 percent) followed by the interest bill (23 percent). Public debt is still assessed as sustainable, albeit vulnerable to growth shocks as well as risks from state-owned enterprises. According to staff estimates, a countercyclical fiscal policy likely helped mitigate the impact of subdued economic activity, but growth gains would have been higher if spending had been directed to more productive outlays. Since 2018, to address rising debt levels, staff has recommended public wage bill consolidation over the medium term, however the authorities have found this difficult due to political reasons.

Nature of Interaction

141. In its surveillance, the Fund focused on analysis of distributional and inequality issues in recent years, given high income inequality. IMF engagement on social spending included:

- *Staff analysis showed that fiscal policy plays an important role in addressing poverty and inequality in South Africa.* Comparative analysis presented in a 2018 Selected Issues Paper found that cash transfers are larger than in comparator countries and tax revenue relies more on progressive direct taxes. Fiscal incidence analysis suggested that both the tax system and social spending are progressive, with a higher impact from the latter especially through social protection spending. Also, targeted transfers were found to be more cost effective in reducing income inequality than in other emerging market economies.

- *In the 2017 Article IV Staff Report, the team focused on the causes and consequences of poor educational outcomes.* It found that the factors contributing to South Africa's underperformance in education were related to the legacy of apartheid. It furthermore documented that underperformance has profound social and economic consequences by contributing to income disparities, unemployment, and the intergenerational transmission of poverty. Underperformance is also a severe constraint on growth. The 2017 and 2018 staff reports gave specific recommendations on improving educational outcomes which leveraged the results of IMF as well as OECD and World Bank research.

- *The 2018 Article IV Staff Report Annex discussed the distributional impact of inflation.* It showed that low and stable inflation tends to benefit the poor proportionally more than the better-off and could help reduce expenditure inequality.

- *A 2016 IMF Working Paper on labor market dynamics and inequality in South Africa explored the determinants of high unemployment using individual level data*. It found that prior experience and being a male increased the probability of finding a job, while lower-educated and black people had higher labor market exit rates. The analysis also estimated that a 10 percentage point reduction in the unemployment rate would reduce the Gini coefficient by 3 percent. Achieving a similar inequality reduction solely through transfers would require a 40 percent increase in government transfers.

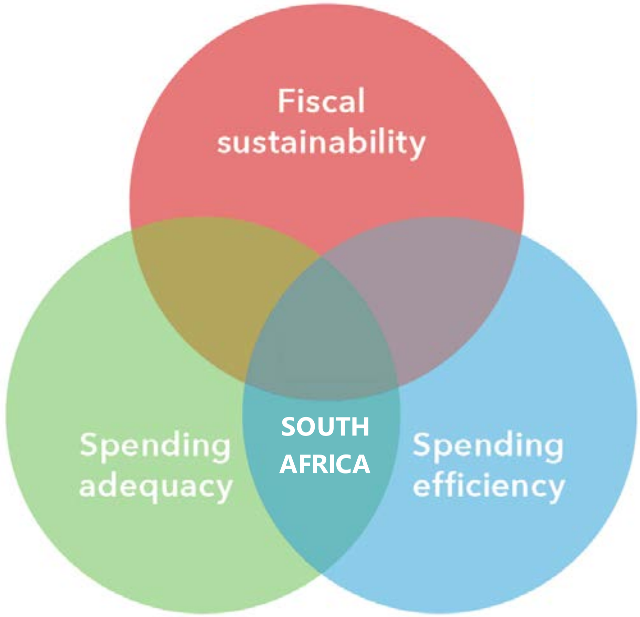
142. The Fund coordinated with the World Bank on advice on macro-critical social issues.[68] This coordination and exchange of information included: (i) technical assistance on the national health insurance system, the TB and HIV/AIDS program, and a poverty and inequality assessment all of which was provided by the World Bank; and (ii) analysis on the National Minimum Wage reform by the IMF.

Policy Advice

143. The main objective of fiscal policy advice has been maintaining debt sustainability while prioritizing pro-growth and pro-poor spending. Staff noted that there is significant scope to improve public spending efficiency (Figure 11). Spending inefficiency in education is especially serious, with very weak educational outcomes. The authorities generally agree with the need to improve the efficiency of health and education spending. They have committed to maintain the system of "social grants" as a key tool to achieving poverty reduction and redistribution.

[68] See also the informational annexes to staff reports.

Figure 10. South Africa: Key Macro-Criticality Dimensions



Source: IMF staff.

144. The 2018 Article IV Staff Report included specific policy advice to improve the administration of social protection (Table 15). Evidence suggested that the mode of cash transfer delivery was eroding the benefits from an otherwise effective social protection system. In particular, the system involved an intermediary (Cash Paymaster Services) who often prompted beneficiaries to get costly contracts for other financial services. Staff supported introducing new service providers to reduce intermediation costs and enhancing financial literacy to improve spending decisions. The authorities have made progress in addressing this issue.

Table 14. South Africa: Objectives of IMF Policy Advice

IMF Policy Advice Objectives	Relevant Macro-criticality dimension
Maintain debt sustainability while prioritizing pro-growth and pro-poor spending	Spending adequacy (while being careful not to compromise fiscal sustainability)
Improve basic education	Spending adequacy
Improve spending efficiency, especially in education	Spending efficiency
Improve administration of social protection	Spending efficiency

145. Improving basic education was identified as one of the key reforms to reignite strong and inclusive growth. Policy recommendations, derived both from the IMF team's own and others' research,[69] focused on strengthening the training and accountability of teachers, improving the targeting of education resources between urban and rural areas, making national assessments mandatory and externally monitored, providing every learner with textbooks, and assigning frequent homework. In addition, staff questioned the recent shift in education spending toward tertiary education subsidies, arguing that consistent with international evidence from many EMs, tertiary educations subsidies in South Africa disproportionally benefit the better off. Staff leveraged analysis by the World Bank, complemented by in-house analytical work to provide granular policy advice.

Lessons

146. Political economy factors can be an important impediment to the traction of policy advice. While the authorities broadly agreed with staff advice, traction on wage bill management was often difficult due to political constraints. This requires continuous engagement on this issue through Fund's surveillance work.

147. Clearly making the case for macro-criticality is key for effective engagement. For South-Africa, the case for macro-criticality of social spending for promoting inclusive growth was made convincingly in surveillance documents, especially in the 2018 Article IV consultation. The Staff Report clearly explained why and how the issues were relevant for macroeconomic outcomes and the overall policy advice was cohesive.

148. In-depth analytical work leveraging other institution supports engagement. Increased engagement on social spending was facilitated by leveraging the expertise of other IDIs, which allowed for granular policy advice. This helped increase the credibility of policy advice.

[69] Mlachila and Moeletsi (2019). This paper contains an extensive literature review, including work done by the World Bank.

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J. Ukraine

Context

149. Ukraine has been facing large structural imbalances amidst increasing inequality. The macroeconomic consequences of these imbalances were repeated balance of payments, high debt, and financial sector crises—as well as the failure to mitigate poverty. Addressing the above issues was much hindered by Ukraine's involvement in the conflict in the eastern part of Ukraine. These conflicts repeatedly curtailed the governments' room for political maneuver and demanded increased defense spending.

150. Progress was achieved in the past decade in addressing these imbalances under a series of IMF-supported programs.[70] Ukraine's fiscal and current account deficits were reduced thanks to the introduction of a flexible exchange rate regime, strict income policies through wage control, and fiscal consolidation. The fiscal deficit declined from 9 percent to 4.5 percent of GDP between 2012 and 2014 and by another 2.5 percent (to about 2 percent of GDP) between 2014 and 2018. The adjustment relied mostly on expenditure cuts—by not increasing public wages and pensions in line with inflation—which were large enough to deliver a reduction in the fiscal deficit despite a sharp reduction in social security contribution rates and the increase in the subsidies required by Naftogaz, the state-owned natural gas company. Public debt as a share of GDP also contracted from 80 percent in 2014 to below 70 percent of GDP in 2018.

Nature of Interaction

151. The collaboration between the Fund and Ukrainian governments has been intense over the past decade. The IMF-supported programs clearly articulated the objectives of social spending reform as improving the sustainability and equity of the public pension system and replacing untargeted and regressive utility subsidies with targeted subsidies. The programs also supported unifying and monetizing various social assistance schemes and improving controls over health expenditure, especially in the areas of pharmaceutical subsidies and the gradual separation of a basic, publicly financed package of health services from other, privately financed ones.

152. Technical Assistance (TA) informed Fund policy advice on social spending. IMF-program engagement was supported by various TA missions focusing on both broad expenditure rationalization and more in-depth sectoral analysis, in particular on pension, energy subsidy, and social assistance reforms. Between 2014 and 2016, several TA missions visited Ukraine, all of them partially or fully focusing on social spending issues. Intensive inter-departmental cooperation with the country team contributed to an in-depth understanding and to granular advice. On occasion, expert staff participated in area department missions to provide detailed technical advice. At

[70] The 2008 and 2010 Stand-By Arrangements (SBAs) both went off-track before they could be completed, due to limited ownership and lack of reform momentum. A new SBA was agreed to in 2014 which was later superseded by an Extended Fund Facility (EFF) arrangement in 2015. In December 2018 the EFF was replaced by a 14 months SBA.

headquarters, experts reviewed proposed reforms, draft laws, and their quantitative impact assessments.

153. Fund advice was closely coordinated with development partners, especially the World Bank. The World Bank has been providing pension policy advice since the early 2000s, accumulating not only factual knowledge but also a good understanding of why earlier reform efforts failed and how certain measures—such as differentiated benefit cuts, indexation regimes, and the politically sensitive but fiscally crucial issue of retirement age increases—may be best tabled to garner social acceptance. Bank-Fund cooperation included joint workshops and frequent discussions aiming to develop a joint stance on reforms; this cooperation was particularly strong when both institutions provided budget support to Ukraine. Consultation with the World Bank extended to energy subsidy and social assistance reform—areas in which the Bank also had a well-established engagement with the authorities.

Policy Advice

154. Advice provided in the context of IMF-supported programs focused on addressing structural weaknesses in social spending. The overarching concerns regarding social spending were fiscal sustainability and spending efficiency (Figure 12 and Table 16). As a result of IMF technical advice and responding to program conditionality, parametric reforms reduced pension expenditures, improving the pension system's fiscal sustainability. The system of social assistance benefits, including household utility subsidies were redesigned, improving its targeting and simplifying schemes' administration, leading to better spending efficiency. In the short term, fiscal adjustment also relied on measures curtailing the wage bill (such as temporary freezing of public sector wages). Revenue measures for creating fiscal space over the medium term mostly focused on improving compliance and collection efficiency of corporate income tax, customs and excises (revenue administration), and on reducing the scope of exemptions and special tax schedules (tax policy; IMF, 2019). In the event, against the advice of the IMF and the World Bank, the government reduced social insurance contribution rates from 43 to 22 percent in 2017 with the aim of improving compliance. As compliance did not significantly improve, the government has had to substantially increase the budget subsidies to the Pension Fund.

155. On pensions, the Fund promoted measures to gradually reduce the Pension Fund's deficit. Both spending and the deficit were high in international comparison. Policy advice focused on increasing the effective retirement age: raising the statutory retirement age (from 60 and 55 for men and women, respectively to 65 and 60), and to make general and occupational early retirement rules stricter. The Fund's policy advice also supported measures designed to support pensioners at the lower end of the benefit distribution, whose pensions were around or below the subsistence minimum. Under the program, parametric pension reforms were implemented in line with this advice: the retirement age is gradually increasing by five years, linking the earliest permissible retirement age to contribution histories; most special pensions are being gradually discontinued; the required contribution history for both full and partial pensions have increased; and benefit indexation has become rule-based and fiscally conservative (IMF, 2017a).

Figure 11. Ukraine: Key Macro-Criticality Dimensions

Source: IMF staff.

156. In the area of social assistance, the IMF advised improving the transparency, targeting and progressivity of a number of social assistance programs. This was to be achieved by moving energy subsidies on-budget and phasing them out via periodical increases in tariffs, reviewing eligibility criteria and the benefit formula of energy related social assistance benefits, and streamlining and consolidating programs with similar objectives (IMF, 2017b). Reforming energy subsidies was particularly important for creating fiscal space for expanding social assistance programs and improving the equity of social protection spending. In terms of fiscal and welfare impacts, energy subsidy reform was the most important measure; strengthening energy-related social assistance was essential to mitigate the impact of tariff increases on the most vulnerable households in a challenging economic environment. With the sharp increase of gas tariffs, the authorities also increased the envelope for energy-related benefits from around 1 percent of GDP in 2015 to 1.8 percent of GDP in 2016, 2.3 percent in 2017 and 2.1 percent in 2018. Over the years, the authorities have implemented reforms to improve the targeting of this support to vulnerable households and ensured that these programs did not jeopardize fiscal sustainability. Besides revising eligibility criteria and the benefit formula (bringing it more in line with IMF advice), consumption norms (which determined the level of subsidy, or energy bill discount, a household received) were updated to bring them closer to actual consumption levels. There remains a need for further reform, such as the establishment of a centralized social assistance beneficiary database and the revision of the parameters applied to utility subsidies. A full monetization of subsidies is now expected by March 2019, as initially recommended by IMF TA.[71]

[71] The recommendation to monetize the energy subsidy program by IMF TA was not initially supported by the World Bank. However, as the fiscal cost of the assistance program increased, and its targeting deteriorated, the government decided to eventually adopt this recommendation.

Table 15. Ukraine: Objectives of IMF Policy Advice

IMF Policy Advice Objectives	Relevant Macro-criticality dimension
Reduce pension spending and Pension Fund deficits through retirement age increases, tighter entitlement criteria, lower accrual rates	Fiscal sustainability
Differentially increase pension benefits, on a temporary basis, to protect low-income pensioners	Spending efficiency
Discontinue special pensions	Fiscal sustainability and spending efficiency
Replace universal energy subsidies with fully monetized, targeted benefit	Spending efficiency
Create a unified social beneficiary database	Spending efficiency
Rationalize pharmaceutical procurement	Fiscal sustainability
Reduce hospital beds	Fiscal sustainability
Rationalize school system, by merging and closing schools in line with declining student numbers	Fiscal sustainability
Improve targeting of school lunch program	Spending efficiency

157. **Fund staff also provided advice on health and education spending that led to reforms that were implemented during the program:**

- **In healthcare**: pharmaceutical procurement was outsourced to international organizations, per-capita hospital bed numbers were reduced, and a new concept of health care financing (financing primary health care through a newly established National Health Service) was approved in late 2017. Implementation of these measures began in 2018.

- **In education**, the closure of smaller schools began in 2015 and the targeting of the school lunch program was improved (from December 2015); further rationalization of the school network is planned through 2020.

Lessons

158. **Lessons should be looked at in the context of a difficult environment for reform (e.g., political economy factors, conflict).** A number of factors—particularly the lack of broad political support and the conflict in Eastern Ukraine—made policy reform in Ukraine particularly difficult. Subsequent governments' parliamentary support was rarely strong enough to support policy reform to remove benefits still anchored to a set-up that was designed in the pre-transition era. As a result,

even high-level commitment to agreed policies could not ensure timely implementation: for instance, gradually introducing an increase in the retirement age took almost 20 years to legislate.

159. The ability to identify key issues promoted a meaningful engagement and increased the effectiveness of policy advice in an extremely challenging economic and political environment. Within the broader area of social spending, there was a multitude of issues to be addressed. However, the political economy of reforms and the government's absorption capacity demanded selectivity. Negotiations helped focus on issues with the greatest short- and medium-term fiscal impact. The combination of selectivity and persistence in promoting reforms in a small number of expenditure areas likely contributed to better results than covering a wider range of issues in less depth.

160. Milestones and patience helped. The almost continuous involvement of the Fund over the past 10 years and, in particular, the consistency of program conditionality was a major factor in achieving policy reforms—even if in some cases they were much delayed and incomplete. The continuous involvement of the IMF facilitated an in-depth understanding of social spending issues that allowed the Fund to have a clear policy framework and specific measures ready to deploy when the crisis struck.

161. Intensive cooperation between the area department and functional departments is important to mobilize the relevant expertise and effectively use it to design policies and conditionality in an IMF-supported program. Advice from fiscal experts both at headquarters (between missions) and in the field allowed for continuous and close cooperation.

162. Strategic interaction with the World Bank allowed the IMF to focus its work and increase the effectiveness of its engagement on social spending issues. The World Bank has a long-standing engagement with the Ukrainian authorities, also deploying significant resources in the field. For example, frequent (at least monthly) visits by the Bank's pension specialist ensured that the Bank and the Fund could present a joint vision of the necessary pension reform measures and enabled effective monitoring and consultation between the two institutions and the government.

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