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SOCIAL DIMENSIONS OF THE
IMF'S POLICY DIALOGUE

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Edited by Thomas Walter

The term "country," as used in this paper, does not in all cases refer to a territorial entity that is a state as understood by international law and practice; the term also covers some territorial entities that are not states, but for which statistical data are maintained and provided internationally on a separate and independent basis.

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Social Dimensions of the IMF's Policy Dialogue

Summary

The IMF's mandate is to promote international monetary cooperation, balanced growth of international trade, and a stable system of exchange rates; fulfilling this mandate is the IMF's primary contribution to sustainable economic and human development. Since the second half of the 1970s, the importance of social issues for sustainable economic and social development has become increasingly evident. This partly mirrors the changing political and social situation in member countries. The IMF's recognition of the social dimension of structural adjustment has led to greater attention being paid to these issues in the context of surveillance and program design, in close collaboration with other agencies that have important interests and responsibilities in the social area.

Social development requires a strategy of high-quality economic growth, macroeconomic stability, which generates low inflation, and promotion of the agricultural sector, where many of the poor work. A strategy of high-quality growth comprises a comprehensive package of policies encompassing four elements: (i) macroeconomic policies aimed at a stable and sustainable macroeconomic environment; (ii) structural policies aimed at a market-based environment for trade and investment; (iii) sound social policies, including social safety nets to protect the poor during the period of economic reform, cost-effective basic social expenditures, and employment-generating labor market policies; and (iv) good governance through accountable institutions and a transparent legal framework, and participatory development through active involvement of all groups in society. Such a strategy is key to poverty alleviation, employment promotion, and social inte-

gration. While this is a complex and difficult agenda for individual governments and for the international community, the growing consensus on these issues could make their attainment more likely than in the past.

Experience with adjustment in many countries has shown the high costs of delayed or disorderly adjustment; in particular, inflation and overvalued exchange rates hit the poor hardest, as their incomes are nominally fixed or depend on export agriculture. Experience with IMF-supported adjustment programs has shown that attention to a proper mix and phasing of policy instruments is essential to minimize possible adverse effects on the poor. Nevertheless, in many cases, adverse effects still remain, and vulnerable groups need to be protected through well-targeted social safety nets, which, largely in collaboration with other agencies, have been incorporated in a growing number of IMF-supported programs. Furthermore, to ensure sustainable per capita income growth and reduce poverty, IMF-supported programs have also increasingly provided for an increase in the level and quality of public expenditure in social services, including primary education and health, as well as for an improvement of the poor's access to these services and administrative capacities.

The IMF's technical assistance in the context of surveillance and IMF-supported programs has helped strengthen policy design and institutional capacity for implementing economic and social policies. In the fiscal area, technical assistance has focused on the design of sustainable social safety nets, improved management of public expenditure (including social programs), and efficiency and greater equity of tax policy and administration.

The IMF is collaborating closely with the World Bank and other UN agencies in the design, implementation, and monitoring of social policies. In the division of labor, IMF advice to mem-

ber countries focuses on macroeconomic implications, cost-effectiveness, and financial viability of social policy options.

The IMF is continuously seeking to improve policy advice and program design, based on past experience. In the social area, there is in particular a need to help governments to improve the integration of social aspects in their global programs, as well as the composition of their expenditures and revenues; they must also be encouraged to better address structural weaknesses (including the lack of financial institutions) in the rural areas, where most of the poor live; and improve monitoring of social developments.

In several of these areas, there is scope for intensifying the IMF's collaboration with other organizations, particularly regarding advice on the composition of members' public expenditure (with the World Bank) and the monitoring of social policies and social indicators (with the World Bank and UN agencies).

Finally, through policy discussions and technical assistance, the IMF could contribute further to improving governments' capacity to monitor social developments and pursue transparent social policies.

Despite significant progress, social policy implementation has been constrained in many countries by poor data and administrative capacity, weak political commitment, vested interests, and limited foreign assistance. Much remains to be done—including by the IMF in collaboration with others—to improve the design and implementation of social policies and effectively alleviate poverty and promote employment.

Introduction

The work of the IMF has major implications for the three core issues of the World Summit on Social Development (WSSD)—poverty alleviation, pro-

motion of employment, and social integration. 1 The IMF's policy advice to member countries aims at promoting international monetary cooperation, trade, and exchange rate stability and emphasizes the importance of sound economic policies to foster sustainable growth and generate employment. As economic and social developments are mutually reinforcing, these policies are essential for reducing poverty and engendering social integration in the medium term. At the same time, the IMF also recognizes the importance of sound social policies aimed directly at achieving social objectives.

This pamphlet focuses on only one aspect of the IMF's work, namely, its—mainly indirect and limited—role in social policy advice. First, the evolution of the IMF's involvement in social issues is traced. The lessons that can be drawn from this experience, including the policy implications, are then dealt with. This is followed by an elaboration of the social dimensions of IMF policy advice to member countries under its two major activities: surveillance of economic policies and financial support for adjustment programs. The next section discusses how the IMF's technical assistance has addressed social concerns, especially in the context of IMF-supported adjustment programs. The IMF's collaboration on social issues with the World Bank and UN agencies is then examined, and the pamphlet concludes by laying out ways to further strengthen the IMF's contribution to social development.

IMF Involvement in Social Issues

IMF involvement in social issues has to be seen in the context of the IMF's mandate. This mandate, as laid down in its Articles of Agreement, is clear: (i) to promote international monetary cooperation; (ii) to facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and mainte-

nance of high levels of employment and real income; (iii) to promote exchange stability and to maintain orderly exchange arrangements among members; (iv) to assist in the establishment of a multilateral payments system; and (v) to give confidence to members by providing temporary financial resources to help them correct balance of payments disequilibria. Given this essentially macroeconomic mandate, the IMF's contribution to social development is mainly indirect, and its role in social policy advice is necessarily limited. Nevertheless, the IMF's involvement in social issues has evolved over time, drawing not only from its own experience but also from that of member countries and of other agencies (see Box 1).

Box 1. Role of the IMF in the World Economy

The IMF—the world's central international monetary institution—has the responsibility for carrying out effective surveillance over its members' exchange rate and macroeconomic policies. Thus, one of the IMF's key tasks is to help countries pursue sound macroeconomic policies aimed at sustained economic growth. It advises members on economic and financial policies and promotes policy coordination among the major industrial countries.

The IMF also provides temporary balance of payments financing to members to help them to correct their external payments difficulties. Financial assistance has been provided to both developing and industrial countries to carry out economic reform and transformation, such as the re-establishment of market economies in the countries of Eastern Europe and the former Soviet Union, and adjustment and structural change in the economies of Africa, Asia, and Latin America. In providing financial support, the IMF pays attention to social aspects of economic adjustment. end
Box 1

During the 1950s and 1960s, when the IMF provided financial assistance mainly to industrial countries, its policy advice focused primarily on macroeconomic policies. With the shift to lending to developing countries since the 1970s and economies in transition since the late 1980s, much greater attention has been given to the complementarity of macroeconomic policies and structural reforms and to the formulation of policies in a medium-term context.² With this broadening of focus, the interrelationships between economic and social issues have also increasingly been recognized. The experience has shown the need for protecting vulnerable groups during the adjustment period by constructing well-targeted social safety nets and by safeguarding their access to basic public services, such as primary health and education. These measures would also serve to enhance the political sustainability of economic reforms.

The broader context for the IMF's policy advice has called for much closer collaboration than in the past among international agencies, with a delineation of responsibilities according to each agency's mandate and expertise. Much of the analysis and policy and technical advice on social issues is undertaken by international agencies other than the IMF, such as the World Bank, regional development banks, the FAO, the ILO, the UNDP, and UNICEF, as well as by bilateral donors and non-governmental organizations. The issues are complex, and analysis and action are often hindered by weaknesses of data and administrative structures; given the difficulties, it has been important that the various parties build not only on their own experience but also on that of members and other agencies.

In its policy advice to member countries, the IMF is constrained not only by resource limitations and its general focus on macroeconomic policies but also, at times, by member countries' dif-

difficulties in developing domestic political support for improving social spending policies and their targeting. Notwithstanding the IMF's role in advising governments on policy design, the choice of social and economic policies belongs ultimately to the member.

The increasing involvement of the IMF in social matters has been discussed by its Executive Board on several occasions. In 1988, for example, the Board stressed the need to assist member countries to evaluate the implications of IMF-supported adjustment programs for income distribution and poverty, to strengthen the staff's understanding of the channels through which adjustment policies affect the poor, and to draw more extensively on the expertise of the World Bank and UN institutions. At the same time, it reaffirmed its decision not to establish conditions on the use of IMF resources related to income distribution. The joint World Bank-IMF Development Committee, which also has discussed social issues, has encouraged both the World Bank and the IMF to further intensify their efforts, working closely together, to help design and implement well-targeted measures to mitigate the costs of adjustment.

Sustained Economic and Social Development: The IMF's Perspective

While economic policies of individual countries can have diverse objectives, there are three key points with—as experience has shown—particular relevance for social development.

Economic growth is required for sustainable social development. In the last few years, a broader concept of high-quality growth has emerged, namely, economic growth that brings lasting employment gains and poverty reduction, provides greater equality of income through greater equality of opportunity, including for women, and

respects human freedom and protects the environment.

Controlling inflation can prevent or mitigate real income losses, against which the poor are least protected since their income is often fixed in nominal terms and they tend to hold much of their assets in the form of currency.

By promoting the agriculture sector, which employs most of the poor, many developing countries can achieve a lasting reduction in poverty.

To achieve progress in these three areas, the main pillars of economic policies include sound macroeconomic and structural policies, with a strong social policy component, and good governance and participatory development.

Macroeconomic Policy. Sound macroeconomic policies—fiscal, monetary and credit, and exchange rate policies—are needed to secure financial stability and external viability with low inflation. In the absence of these conditions, it is difficult for a country to encourage productive investment or to promote the efficient use of scarce resources, both of which are essential for durable growth.

Structural Policy. Structural reforms are often vital to promote a market-based environment with an outward orientation. These include liberal and open systems of prices, exchange, trade, and investment; a fiscal system that emphasizes efficient resource allocation and minimizes adverse effects on incentives; agricultural marketing arrangements that promote competition; a financial system that is free of direct credit allocation and effectively channels financial savings to productive investment; and policies that take into account their impact on the environment.

Social Policy. Social and supplementary structural policies are also needed to strengthen the social dimensions of economic development. These include labor market policies aimed at ensuring high employment through competitive and

flexible wages and at removing other rigidities while adhering to ILO principles; public expenditure programs aimed at protecting and, when possible, increasing cost-effective programs for human development and reducing poverty (such as generally accessible health, education, and social security programs); a tax system that ensures a fair distribution of the tax burden; and well-targeted social safety nets to mitigate negative effects of economic reform on vulnerable groups.

Good Governance and Participatory Development. Effective governance involves such diverse elements as publicly accountable institutions for formulating and executing the budget, efficient tax administration and public expenditure management, prudent banking supervision, a transparent foreign trade and exchange regime, and a fair and transparent legal and regulatory framework. Transparency and checks and balances, at both the political and administrative levels, can help limit the influence of special vested interests.

There is a broad consensus among governments and in the international community on the importance of most of these elements. But translating them into concrete policies and priorities involves difficult choices concerning income distribution, as well as present and future consumption and investment. Consensus building often involves disseminating information, explaining policies to the general public, and, where appropriate, decentralizing the decision-making and implementation process. It is critical that key players—especially people at the grass-roots level—have a stake in economic policymaking, and that the social policies are compatible with the administrative capacity.

Social Dimensions of IMF Policy Advice

Policy Advice: Surveillance and Program Support

The IMF provides policy advice to member countries primarily in the context of its "surveillance" of their economic policies and its financial support for their adjustment programs. IMF surveillance is rooted in its Articles of Agreement and aims at promoting international monetary cooperation, balanced growth of international trade, and a stable system of exchange rates, as well as regional and global coordination of growth-oriented policies. The objective of IMF policy advice to member countries is to contribute to the promotion and maintenance of high levels of employment and real income and to the development of their productive resources. An important element of this advice in the surveillance process is to encourage the initiation of appropriate policy measures before serious macroeconomic imbalances surface. In this way, surveillance helps to identify emerging issues and problems of importance to member countries and the world community to facilitate an early policy response. 3

Whenever a country faces macroeconomic imbalances that arise from lax financial policies or external shocks and requests the IMF's financial support, the IMF's policy advice aims at restoring domestic and external balance and price stability while removing structural rigidities, thereby paving the way for sustained economic growth, gains in employment, and reduction in poverty in the medium term. By catalyzing substantial amounts of external assistance in the form of creditor/donor support and debt relief, IMF-supported programs help attract financing for higher investment and domestic consumption, including consumption by the poor. Experience suggests that failure to adjust to serious macroeconomic imbalances has high social costs in various forms, including through implicit loss in agricultural income, loss from rising inflation, and cuts in social expenditures. The rural poor suffer when attempts are made to repress inflation

through price controls on their agricultural output, or when overvalued exchange rates depress prices of export goods produced by them. In addition, the poor are often left to buy consumer goods at substantially higher prices on parallel markets. Generalized consumer subsidies, ostensibly given to protect the poor, have been found to be of greater benefit to the relatively better-off consumers. High inflation often hurts the poorest the most, as their limited income and financial saving are quickly eroded. And very high inflation can result in a collapse of tax revenues, thereby disrupting governments' ability to provide basic services and particularly hurting the poor. Weak economic policies also tend to reduce foreign financing from both official and private sources.

Social Policy Issues in Surveillance Activities

The IMF's policy advice during Article IV consultation discussions with individual countries has given consideration to social policy issues, taking into account each country's circumstances. The major issues discussed with member countries have included unemployment and various types of social expenditures.

High levels of unemployment have been an important concern in many European countries, since failure to reduce unemployment to acceptable levels, namely, compatible with low inflation, entails large economic and social costs. The IMF has therefore advocated comprehensive labor market reforms to reduce the incidence of high unemployment, together with policies for better education and training to improve skills and productivity. The IMF has also emphasized that labor market reforms have to be accompanied by appropriate adjustments to tax and expenditure policies in order to address social concerns.

In other areas of public expenditures, the IMF has paid increasing attention to health and social security spending, in particular in many industrialized countries where such spending has increased rapidly. While this increase can mainly be explained by a pronounced trend toward population aging and higher levels of service and unit costs, it is often difficult to sustain. Consequently, the IMF has explored with country authorities options for streamlining such expenditure and safeguarding medium-term sustainability (see, for example, Box 2 on Italy).

Box 2. Italy: Reforming the Health Care System

Whereas the level of public health care expenditures in Italy is similar to that of other OECD countries, there has been a widespread perception that the quality of public health care has been declining as costs have increased. Furthermore, the weakness of Italy's fiscal position has raised questions regarding the sustainability of health care and other social security expenditures (notably pensions).

In its discussions with the Italian authorities, the IMF has drawn attention to the importance of controlling entitlement spending, including public health care. The IMF counseled that reforms of health care spending should avoid untargeted across-the-board cuts and should aim for long-lasting savings. The reform strategy should focus on increasing local responsibility for expenditure decisions, reinforcing the managerial authority and financial accountability of local health administrators, and giving patients a greater degree of choice. While much of the financial effects of the reform efforts undertaken since 1992 will only materialize over the next several years, the improved quality of some of the fiscal measures—in terms of their more permanent impact and the planned structural reforms—were welcomed by the IMF. end Box 2

In some developing economies, the task is one of expanding social security arrangements in light of rapid economic growth and increasing urbanization, which undermine traditional, family-based security arrangements. The IMF's policy discussions in such countries have therefore focused on economical ways to retain basic elements of equity in the new social security arrangements within a sustainable fiscal policy framework.

In the IMF's cross-country surveillance—its half-yearly World Economic Outlook exercise—the IMF has drawn attention to a broad range of social policy issues, including, for example, unemployment and labor market issues in industrial countries, the economic benefits of reducing unproductive expenditures, institution building and human capital investment in developing countries, and labor market policies and social safety nets in transition economies. To a large extent, these issues reflect the concerns brought to the IMF's attention in the context of the annual discussions with member countries.

Social Policy Issues in Program Design

Policy Mix

As noted above, achievement of macroeconomic stability is a key objective of IMF-supported programs. The mix of policies incorporated in a member's program that is supported by the IMF is developed in close consultation among the authorities, the IMF, and other agencies. Because various mixes and phasing of policies can be consistent with macroeconomic objectives but have different effects on the poor, programs have increasingly given attention to the issues of mix and phasing of policy instruments, with a view to minimizing possible adverse effects on the poor.

Fiscal policy is a key avenue for dealing with

social aspects of adjustment. On the expenditure side, the fiscal package often includes reducing consumer and public enterprise subsidies, and non-priority and wasteful expenditures. Phasing these reductions over time has allowed consumers and producers time to adjust. And reducing unproductive spending has helped safeguard a certain level of social spending. Moreover, certain elements of incomes policy can be tailored to help the poor. Protecting real incomes of less-well-off groups has been feasible, for example, when government wage increases could be differentiated according to salary level, with higher wage increases for low-salary groups and freezing of nonwage benefits for high-salary groups. However, in many circumstances, a compression of wage scales may be considered undesirable, given the need for appropriate incentives for highly qualified workers. Furthermore, programs have allowed temporary tax reductions or maintenance of subsidies for basic foodstuffs and medicines to protect vulnerable groups (such as in several CFA franc countries).

Programs have also typically included tax reforms aimed at enlarging the revenue base, improving compliance, and reducing distortions and fraud stemming from complex and inefficient tax systems. Besides spreading the tax burden more equitably across different income groups, these reforms have generated additional resources for governments to support social programs targeted to the poor during critical periods of economic adjustment.

Public sector reform is a further area where social implications could be addressed. In IMF-supported programs, civil service reforms are directed at improving administrative capacity and cost-effectiveness, while public enterprise restructuring and privatization aim at exposing management to market principles, thus fostering conditions for sustainable growth and job creation in the medium term. As these measures often imply

layoffs of public sector employees, programs have attempted within their macroeconomic constraints to spread retrenchment over time and to provide severance pay while promoting alternative job opportunities through a more flexible labor market, as well as retraining schemes.

Exchange rate policy also bears directly on social issues. In many developing countries where external imbalances and exchange rate overvaluation made currency depreciation unavoidable, programs have often emphasized the need for improving the agricultural terms of trade (that is, the relationship between agricultural producer prices and consumer prices), on which the livelihood of rural populations depends. For instance, in many sub-Saharan African countries, the large majority of the population and more than 80 percent of the poor live in rural areas. Their incomes are to a large extent based on agricultural exports and are largely spent on domestic goods. Therefore, more realistic exchange rates, if accompanied by tight macroeconomic and incomes policies, tend to improve real output, income, and employment in rural areas, laying the basis for poverty reduction.

To ensure that the potential benefits of currency depreciation reach a broad group of producers, programs in low-income countries have often incorporated comprehensive reforms of the agricultural sector. These reforms have aimed at further stimulating agricultural production through a reduction of implicit and explicit export taxation; producer price increases; improved access to imported inputs; and a liberalization of marketing arrangements, including the eventual elimination of state monopolies in the purchase, transportation, processing, and marketing of export commodities. In several African countries, where state marketing boards were temporarily maintained, agricultural policies included flexible producer-pricing policies in line with world market developments (for example, in C\kote d'Ivoire,

Mali, and Senegal). These policies, *inter alia*, aimed at reducing economic rents from monopolistic marketing boards to the benefit of farmers and the government.

Trade liberalization is widely implemented in IMF-supported programs. In general, these measures entail the removal of trade distortions stemming from quotas, licenses, excessive export and import tariffs, complex administrative procedures, and foreign exchange rationing. Although removal of distortions should free the potential for output and employment in the export sector, the reallocation of resources induced by relative price changes takes time and is often accompanied by employment losses in previously protected sectors. With a view to minimizing transitory adjustment costs, and also to protecting fiscal revenue, IMF-supported programs generally provide for phasing the removal of trade restrictions and reduction of tariffs over a period of several years.

Financial sector reform is another element of IMF-supported programs, which have also recently emphasized improving rural financial institutions. To better channel rural savings to productive uses, programs have included measures to restructure agricultural credit banks and, in some cases, set up new institutions with adequate access for farmers (for example, in Cambodia and in Benin and other CFA franc countries). More generally, the increased access to formal credit at market-determined interest rates envisaged in most programs has helped to reduce reliance on informal credit markets at higher interest rates.

Labor market policy is another important instrument. In many countries, labor market rigidities—and, in some cases, high payroll taxation—have led to high labor costs, which have undermined competitiveness and employment. Programs supported by the IMF have incorporated the revision of labor codes and restrictive practices,

with a view to enhancing labor mobility and employment, in particular in the formal sector (including in several CFA franc countries, the Kyrgyz Republic, and Nicaragua). In Cote d'Ivoire, labor policies sought to reverse the steady decline in private sector employment since the 1980s through a revision of collective bargaining procedures, so that labor contracts reflect branch- and firm-specific circumstances. In Senegal and other countries, programs incorporated the elimination of state-run labor placement and hiring monopolies, which had often curtailed employment.

The mix and phasing of policy instruments have helped insulate the poor against possible adverse effects of reform. Nevertheless, in many cases, such effects were unavoidable, and there was a need for targeted social safety net measures.

Short-Term Social Effects and Social Safety Nets

In the short term, reform policies can affect certain poor groups in several ways. Removal of generalized price subsidies on basic necessities or exchange rate devaluation can cause real incomes of domestic consumers, including the poor, to decline in the short term. A reduction in budgetary subsidies to state-owned enterprises and their restructuring, a lowering of protection following trade liberalization, and a downsizing of the government may result in job losses. Consequently, IMF-supported programs have sought to include social safety net measures to mitigate anticipated adverse short-term effects on vulnerable population groups. In this area, the IMF's policy advice has focused on the cost-effectiveness and financial viability of social policy options.

In practice, it has been difficult, especially in poorer countries, to identify and target the most vulnerable groups affected by adjustment measures because of a lack of household data. Inte-

gration of social safety nets into programs is also constrained by weak administration, particularly at local levels, inadequate political support, shortfalls in expected external financing, and the absence of adequate social protection instruments. Notwithstanding these difficulties, reform programs have increasingly provided for a range of social safety net instruments, depending on a country's mix of reform policies, existing institutions, administrative capacity, the composition of target groups, and available financing. Social safety net measures have comprised targeted subsidies, cash compensation in lieu of subsidies, improved distribution of essentials such as medicines, temporary price controls for essential commodities, severance pay and retraining for retrenched public sector employees, employment through public works, and adaptation of permanent social security arrangements to protect the poorest. Targeted subsidies and cash compensation have allowed reforming countries to shield the consumption of basic food items by the vulnerable groups in the face of rising prices, and at the same time have permitted a strengthened budgetary position (for example, in Mozambique and Zambia; also, see Boxes 3 and 4 on Jordan and the Kyrgyz Republic, respectively).

Box 3. Jordan: Subsidy Targeting Through a Coupon Scheme

Under the IMF-supported program, fiscal adjustment has entailed, inter alia, enhancing the efficiency of expenditures through a better targeting of generalized consumer subsidies for basic food items. The subsidy for selected food items was retained, but targeting was improved through a food coupon scheme. This scheme, introduced in September 1990, allowed coupon recipients to purchase fixed quantities of subsidized sugar, rice, and powdered milk, equal to quantities consumed, on average, by the poorest 10 percent of the pop-

ulation. Consumers were allowed to purchase additional quantities at higher liberalized prices but were no longer able to buy unlimited subsidized quantities. The budgetary subsidy costs declined from 3.4 percent of GDP in 1990 to 1 percent of GDP in 1994, while the real consumption of the poor was shielded. A large decline in world market prices of grains also contributed to the fall in budgetary costs. However, the generalized subsidy on wheat, and therefore bread, was maintained. end Box 3

Box 4. The Kyrgyz Republic: Replacing Generalized Subsidies with Cash Compensation

Before initiation of the IMF-supported program in May 1993, untargeted consumer subsidies and cash benefits to households constituted a significant burden on the budget. As part of the objective to reduce the fiscal deficit, the Government developed a schedule for phased increases in bread prices and replaced the consumer subsidy for bread with targeted cash transfers to pensioners and families with three or more children under the age of 16.

Until 1992, all families with children were eligible for child allowances irrespective of income. Means testing for determining child allowance eligibility was introduced in January 1993. In 1994, outlays on cash benefits were projected to decline, reflecting mainly reduced benefits to the better-off. Under the 1995 budget, a single, better-targeted cash benefit is to replace the current system of support.end Box 4

Different options have been adopted in different countries. One option has been to limit the amount of subsidized commodities to the quantity consumed by the lowest income group; another has been to provide full or partial cash compensation in lieu of the subsidy to selected population groups. The composition of vulnerable groups has

been an important consideration in targeting subsidies or cash compensation (for instance, families with three or more children and pensioners in the Kyrgyz Republic). Social safety nets have included severance payments to workers who lost jobs as a consequence of public sector downsizing, trade policy reforms, and public enterprise reforms (see Boxes 5 and 6 on Ghana and Sri Lanka, respectively). In many instances, severance payments have been combined with the retraining of unemployed workers and initiation of targeted public works programs to provide income support to jobless individuals.

Box 5. Ghana: Severance Payments to Retrenched Workers

During 1983-91, Ghana pursued a comprehensive program of economic and structural reforms supported by the IMF. One aim of this program was to remove structural weaknesses in the budget by rationalizing civil service employment. Consequently, between 1987 and 1991, the size of the civil service was reduced by 10 percent, or 32,000 positions.

To alleviate the impact of income loss on retrenched civil servants and their dependents, this program included (i) severance payments to departing workers of two months of salary for every year of service; (ii) employment counseling, retraining, and courses in entrepreneurial development; (iii) credit facilities; and (iv) food-for-work programs for those unable to secure alternative employment opportunities. The take-up rate for (ii) and (iii) was low in the initial years. Recent evidence indicates that retrenched workers invested a large proportion of their severance payments, thereby contributing to the establishment of small businesses and farms. However, because of severance payments and the need to raise wages for skilled civil servants, the net budgetary savings from the civil service reform

have been negligible in the short term. Nevertheless, budgetary savings are anticipated in the medium term with concomitant improvement in government efficiency.end Box 5

Box 6. Sri Lanka: Rationalization of Poverty Alleviation Programs and Civil Service Reform

The successive programs supported by the IMF and the World Bank during 1989-94 were aimed, inter alia, at restructuring government expenditures through a rationalization of poverty alleviation programs and civil service reform.

The main poverty alleviation programs in Sri Lanka are the JanaSaviya, the Midday Meal, and the Food Stamp Programs. These programs were poorly targeted, and they cost some 3 percent of GDP in 1989. After reform, and without reducing assistance to the vulnerable, government expenditures on these three programs were projected to decline to 1.9 percent of GDP in 1994.

The JanaSaviya Program, which was introduced in 1989, aims at assisting near-subsistence households in establishing a permanent earning potential. Since 1990, the Government has sought to improve the targeting for this program, for example, through community screening, inspections, community meetings, and a check of ownership, such as of consumer durables, and through participation in productive activities, such as public works programs and self-employment projects.

The Midday Meal Program was also established in 1989 with the objective of improving nutrition among children and increasing the returns to education. The program covered the entire population until 1994 when the program was to be restricted mostly to food stamp program recipients with school-age children and to those who applied.

The Food Stamp Program was introduced in 1979 to improve the nutrition of poor households. Since then, it has been restructured twice in order to remove ineligible households and add newly eli-

gible households, and to use the savings to raise the nominal benefits, which were being eroded by inflation.

The civil service reform of 1990-91 led to an employment reduction of about 44,000 employees, or 13 percent of the total civil service. The restructuring effort in the civil service is continuing—although with mixed results—and included the planned elimination in 1994 of 60,000 vacant positions. The departing civil servants received generous severance payments from the Government.end Box 6

Existing permanent social security arrangements (such as pensions and unemployment insurance) have been adapted to shield two groups usually considered vulnerable: the pensioners and the unemployed. The adaptation has meant a tightening of eligibility and restructuring of pensions and unemployment benefits to ensure that the average benefit is not only fiscally sustainable but also fair and adequate (for example, in Latvia). IMF-supported programs have also sought to improve the cost-effectiveness of existing poverty alleviation programs (see Box 6 on Sri Lanka).

The available financing is critical in the actual coverage of social safety nets and in the choice of instruments used to shield the vulnerable. In this context, IMF-supported programs have emphasized the importance of reducing or eliminating unproductive expenditures to generate financing for safety nets and other social expenditures. In some low-income countries, temporary financing for safety nets from external donors has also been helpful and has been included in the external financing assurances that the IMF has helped countries obtain. In such instances, the target for the fiscal deficit is set so as to ensure that the pattern of fiscal adjustment in the medium term is consistent with a sustainable level of external debt.

Longer-Term Social Policy Measures

While social safety net measures help alleviate possible adverse effects during the adjustment period, long-term poverty reduction is best achieved by sustained and broad-based economic growth, coupled with improvements in the level and quality of government spending on social services. Consequently, the IMF—in collaboration with the World Bank and other institutions—has paid increasing attention to the composition of public expenditure and the need for improving the efficiency of different expenditure programs to generate savings for well-targeted social spending. While significant progress has been achieved, more needs to be done in this area.

In recent years, IMF-supported programs in low-income countries have increasingly sought to achieve significant real growth in social expenditures, including primary education and health, since such expenditures often were cut by the authorities in the past when budgets came under pressure (see Boxes 7, 8, and 9 on the CFA franc zone, Peru, and Uganda, respectively). In other cases, programs have sought to protect social sectors from the deep expenditure cuts that were made elsewhere and to improve the cost-effectiveness of social programs.

Box 7. CFA Franc Zone: Promoting Economic Growth and Shielding the Poor Through Appropriate Program Design

After the devaluation of January 12, 1994, each of the 14 CFA franc countries initiated adjustment programs supported by the IMF and the World Bank. These programs aim at striking an appropriate balance between fiscal adjustment, financing, and structural reform, but special measures were also incorporated to protect the poor against possibly adverse effects from adjustment,

including reduction of producer subsidies and public sector retrenchment. At the same time, substantial increases in agricultural producer prices—for example, of cocoa, coffee, and cotton—facilitated by the exchange rate devaluation benefited the majority of the poor living in rural areas.

All programs aim at limiting price increases—through temporary subsidies and tax or tariff reductions—for goods essential to the poor, in particular rice, sugar, flour, kerosene, and generic drugs. Moreover, shortly after the devaluation, most countries imposed selected price controls to avoid panic and excessive profit margins on stocks. As inflationary pressures abated in the first half year after the devaluation, most of these controls were removed. In the meantime, minimum wages and salaries of low-income public sector workers have been increased, with a view to partially compensating income earners for devaluation-induced price increases (for example, in Burkina Faso and C\kote d'Ivoire).

In addition, many programs include severance payments under voluntary departure schemes. Moreover, budgetary allocations provide for social funds aimed at creating employment through public works, such as in Burkina Faso, Cameroon, C\kote d'Ivoire, Gabon, and Togo; public housing, such as in Benin; and the promotion of small businesses, such as in Benin, Cameroon, and Niger. Finally, all programs envisage increased real expenditures for primary health and education, in some cases with quantified targets—for example, in Cameroon, Mali, Niger, and Senegal—and in others through earmarked donor financing, such as in Benin. end box 7

Box 8. Uganda: Peace Dividend in a Stable Macroeconomic Environment

After almost a decade of war and civil strife, Uganda found its infrastructure devastated, agri-

cultural lands widely abandoned, public services paralyzed, and its population largely impoverished. Real GDP fell by 8 percent between 1983 and 1986, external financing declined, and inflation rates were very high. A series of IMF-supported adjustment programs starting in 1987 restored economic stability and reduced inflation to single-digit levels in 1993. Since the onset of the reform in 1987, economic growth has averaged over 5 percent per annum.

The adjustment strategy also focused on structural reform. For example, the liberalization of the foreign trade and exchange system and marketing of coffee and tea fostered an expansion of agricultural value added by more than 23 percent since the onset of reforms, largely to the benefit of the rural poor. Most farmers directly receive the fruits of cultivation, as there is little wage labor, and smallholder production is prevalent.

The Government's fiscal adjustment has focused on improving expenditure composition. More than 40,000 ghost workers have been eliminated from public payrolls, while public sector reorganization, combined with a system of mainly donor-financed severance payments, allowed the retrenchment of more than 66,000 temporary public employees and 14,000 civil servants. Moreover, more than 23,000 soldiers have been reintegrated into civilian life through the provision of a support package including a six-month subsistence allowance, construction materials and agricultural inputs, labor-intensive public works, and training programs. This has helped to halve the share of military expenditure in GDP during 1990-93 (to 1.9 percent of GDP). The peace dividend, in combination with the efficiency gains from public sector reorganization, has set free resources to effectively double the share of health expenditure and moderately increase the share of education in current government expenditure during the reform

period, with further increases envisaged under the current IMF-supported program.end box 8

Box 9. Peru: Securing Macroeconomic Stability to Increase Pro-Poor Spending

As part of its efforts to stabilize and liberalize the economy, Peru entered into a series of programs supported by the IMF and the World Bank. The programs have been successful in reducing annual inflation to 16 percent by end-1994 from an annual average of 3,800 percent during 1988-90, and economic growth of 11 percent was estimated for 1994.

Fiscal policy has been a focus of these programs, with important consequences for the social sector of Peru. Hyperinflation had led to the virtual collapse of revenues and, consequently, real wages of civil servants and other critical public expenditures had declined dramatically. Thus, one of the cornerstones of the program was to increase tax yield. As a result, current revenues have climbed from 7 percent of GDP in 1989 to a projected 12 percent in 1994. This has allowed a gradual recovery in social and other expenditures, and has stopped the erosion of public sector wages, which had contributed to a sharp deterioration in the quality of public services.

The Government also stepped up its efforts to combat poverty. A social investment fund, FONCODES, was established in 1991 to finance community-based projects and improve the access of the poor to social services and infrastructure. A basic social program was launched in 1994 to coordinate efforts in five priority areas (education, health services, nutrition, justice, and employment generation). Social spending was increased, partly through the use of proceeds from the privatization of public enterprises. The effectiveness of social spending is also being improved, including through enhanced budgetary and expenditure management, and better targeting

mechanisms. end box 9

Programs have also aimed at enhancing the poor's access to these services. Measures incorporated in adjustment programs supported by the World Bank and the IMF have included increasing the number of school teachers and health personnel; redeploying staff from urban to rural institutions; increasing access of women to health, education, and population-planning services; enhancing the availability of teaching materials through textbook-lending schemes; and improving the supply of medicines through demonopolization and other regulatory reform. Infrastructure programs have in several cases emphasized improved transportation and access to markets for the poor and the provision of irrigation facilities to small landholders (including in Cote d'Ivoire, Mali, and Cambodia).

In addition, social policies in some cases have sought a better targeting of the most vulnerable by shifting resources away from university education or advanced medical care, accessible only to privileged groups, to primary education and health care (such as in Burkina Faso, Cambodia, Honduras, Jamaica, Lesotho, Mali, and Senegal). In some cases, resources have been made available to sustain the public provision of services by introducing appropriate user fees, which also induced their efficient use. Reorganization of ministries and decentralization of administrative responsibilities to improve targeting has appeared frequently in IMF-supported programs (for example, in Burkina Faso, Ghana, and Guyana). With World Bank support, many programs have included administrative reforms to facilitate monitoring of social expenditures and services, as well as their impact on key social indicators. In many cases, however, the cost-effectiveness, targeting, and monitoring need further strengthening.

Technical Assistance Technical Assistance

Since the IMF's inception, an important aspect of its relationship with member countries has been the provision of technical assistance to strengthen their economic and financial management. The focus of technical assistance has been on areas in which the IMF has a comparative advantage—public finance, central banking, exchange systems, and economic and financial statistics. Assistance has also extended to capacity building by developing and strengthening institutions and training local officials in new work practices, such as computerization of tax administration, improved systems for monitoring budgetary policies, compilation of statistics for economic policy, and new monetary policy instruments. In recent years, increasing efforts have been made to integrate technical assistance in program design, and through medium-term planning the IMF seeks to make this assistance available to member countries in a timely manner.

In the fiscal area, technical assistance has been provided principally in the areas of tax policy and administration, public expenditure management, and the design of social safety nets. Technical assistance in social safety nets has usually been provided in connection with IMF-supported adjustment programs to integrate fiscally sustainable social safety nets into those programs to counter adverse short-term effects of certain adjustment measures on the poor.

Technical assistance has been provided to several transition economies experiencing large changes in prices and employment (such as Armenia, Kazakhstan, the Kyrgyz Republic, Moldova, and the Russian Federation) to improve the targeting of subsidies and to restructure pensions, unemployment compensation, and other social benefits. In the Lao People's Democratic Republic, the author-

ities were advised on social safety net options in the context of public sector retrenchment, and, in Romania, the objective was to devise appropriate means of mitigating the short-term impact of the devaluation on specific population groups and to provide for the contingency of higher outlays on unemployment benefits. The scope of assistance has been extended to encompass the strengthening of the delivery of poverty alleviation programs, including enhanced management of social expenditures (such as in Peru). Advice has also been provided on enhancing the cost-effectiveness of social expenditures (such as in Algeria and the former Yugoslav Republic of Macedonia) and social security systems, while ensuring that the latter's role in redistributing incomes toward the poor is maintained (including in Brazil and Thailand).

To help improve the effectiveness of public projects and programs, including social programs, the IMF has provided extensive technical assistance on public expenditure management to both developing and transition economies (including Albania, The Gambia, Hungary, Lebanon, Malawi, the Russian Federation, Turkmenistan, and Ukraine). In the case of Guatemala and Peru, the assistance was provided explicitly within the context of the design of a medium-term poverty reduction strategy. The assistance has sought to establish institutions and procedures to monitor, control, and evaluate public expenditures. This should increase transparency and accountability in decision making, improve the cost-effectiveness and targeting of social and other spending, and strengthen the conduct of macroeconomic management.

In the area of tax policy and administration, advice has focused on reform of the tax system, specific taxes (such as value-added taxes or global income taxes), tax rate structures, and improved collection procedures. Improvements in tax administration have been stressed because they

promote compliance and enforcement and help distribute the tax burden more equitably.

Central banking assistance has been provided on new currency issue and reform, foreign exchange management and operations, the development of a money market and payments and settlement system, and banking regulation and supervision. Improvements of institutional capacity have assisted member countries in conducting macroeconomic policies for sustained noninflationary economic growth. These improvements have also led to a deepening of financial markets, thereby increasing access to credit for different groups in society.

Advice on improving macroeconomic statistics is given with the aim of facilitating economic analysis, policy formulation and monitoring, and international comparisons. The independence and integrity of official statistics and their wide dissemination are essential for the functioning of a market economy and the promotion of good governance.

Collaboration with Other Institutions in Program Design and Monitoring

Given the IMF's mandate and own limited resources, the IMF draws in program design and monitoring on the expertise of other institutions, including the World Bank, the UNDP, the ILO, other UN agencies, and regional development banks. The IMF assists member countries in integrating social policies in the macroeconomic framework developed in close collaboration with these institutions, so as to ensure that they are consistent with sustainable macroeconomic policies over the medium term.

Traditionally, collaboration has been particularly close between the World Bank and the IMF. In the social area, the IMF's comparative advantage is to advise member governments on the macro-

economic and budgetary implications of policy options, in particular the financial viability of such options. The World Bank advice centers on long-term poverty reduction and broad-based human resource development, in particular, through improving the level of, and access to, basic social services, administrative capacities, and the cost-effectiveness of social expenditure, including social safety nets. IMF-supported structural adjustment programs rely largely on World Bank expertise with regard to human resource development, public sector reform, and design of social safety nets and social security arrangements.

Social policy implementation is monitored mainly by the World Bank. Except in the selected cases where the IMF has provided its own technical advice, the IMF staff concentrates on macroeconomic and budgetary developments, including social spending developments. In tandem, the World Bank monitors social policy and project implementation, often by means of on-site inspections and social indicators.

In the case of low-income countries, collaboration between the IMF and the World Bank is formalized in the policy framework papers (PFPs), which set out macroeconomic and structural adjustment policies of countries in a medium-term framework. They are prepared by the governments borrowing from the IMF under the ESAF and in certain other cases, and from the World Bank under Structural Adjustment Credits in collaboration with the World Bank and IMF staffs. All recent PFPs examine the social impact of the adjustment program and often also describe human resource developments. Through their distribution to the participants of Consultative Group meetings, PFPs facilitate consistency in policy advice and financing with other bilateral and multilateral donors on all aspects of structural adjustment policies, including the social impact.

Collaboration with UN agencies and other in-

stitutions involved in social policies is an on-going process. The Managing Director of the IMF participates in meetings of the UN's Administrative Council Committee, and the IMF staff regularly comments on reports prepared by UN agencies and benefits from access to the data bases of several UN agencies. The contribution and support of UN agencies and other institutions have been very important in helping the IMF in its approach to the social dimensions of structural adjustment, poverty reduction, and social safety nets. In addition, there have been close interagency staff contacts on several specific countries, including with the ILO and the UNDP. Close collaboration with UN agencies is particularly essential in countries that are in, or in the period immediately following, domestic or international conflict, when fully functioning governments might not yet be in place and destruction of social and other infrastructure has taken place.

While collaboration with other agencies has been fruitful in the past, there is still a need for further improving coordination of technical advice on the design of social safety measures in the context of adjustment operations, since such assistance has not always been available on a timely basis. Given the IMF's limited resources, it is highly dependent on the responsiveness of other institutions in terms of both technical and financial assistance for social programs.

Improving the IMF's Contribution

Against the background of the IMF's mandate and in the context of a country's overall macro-economic framework, the IMF also advises on social issues, while fully recognizing that such issues lie basically in each member government's domain. The IMF is continuously making efforts to learn from its and others' experience, with the aim of improving its policy advice. At present, the staff

is examining the pace of recovery of investment and output following the adoption of structural adjustment programs as the most effective way to raise per capita income growth in many developing countries, notably in sub-Saharan Africa. The experience suggests that greater attention needs to be given to the impact of fiscal policy on growth in a medium-term context, as well as to the analysis of distributional implications of expenditure and revenue. There is also scope for improving further the experience with incorporating social aspects in general program design, including the design of key policy instruments, such as pricing policies and tax and tariff systems. This also involves deepening the understanding of the constraints on policy implementation and their implications for improving the design of social policies.

The composition of government expenditure reflects social priorities. The IMF staff is in the process of intensifying collaboration with the World Bank on public expenditure, with a view to improving its policy advice to member governments. Member governments review their own public expenditure policies as part of their sovereign decision making on social priorities. The advice from the IMF (and other organizations) can nevertheless be a technical input to governments seeking to improve the basis for establishing and addressing such priorities.

Through policy discussions and technical assistance, the IMF contributes to improving transparency in governments' decision making and their capacity to monitor social developments. The IMF staff seeks to report on social indicators in country reports and also to increase transparency and accountability in budgetary expenditure, including spending on social services and the poor's access to these services.

Improvement of monitoring of social policies and social indicators in the context of IMF-sup-

ported programs is being pursued as central to the achievement of sustainable high-quality growth. Improving collaboration with the World Bank, UN agencies, and others, with the objective that each institution focus on areas of comparative advantage, is the best way to achieve—without duplication of work—a better follow-up on the implementation of social policies in programs.

Since in low-income countries the great majority of the poor live in the rural areas, policy reforms that address structural weaknesses in these areas need more emphasis. One area where there is scope for major improvements is developing widely accessible financial institutions and savings and lending instruments in the rural areas, in close collaboration with the World Bank.

1 Social integration—as defined in UN documents for the Social Summit—concerns the ability of different groups in society to live together in productive and cooperative harmony and to accommodate differences within a framework of common interest to the benefit of all. Social integration implies justice for the individual and harmony among different social groups and countries. It means integration of disadvantaged and vulnerable groups by making all institutions of society more accessible to them.

2 The IMF created new facilities that emphasized structural reforms set in a medium-term context: the extended Fund facility in 1974, and two concessional lending facilities—the structural adjustment facility (SAF) in 1986, and the enhanced structural adjustment facility (ESAF) in 1987—for the benefit of low-income countries. The latter facility was extended and enlarged in 1993.

3 The IMF carries out its surveillance role mainly through the regular Article IV consultation discussions with all member countries. IMF surveillance over the exchange rate policies of members includes analyses of all policies affecting exchange rates and is based on principles for the guidance of members' exchange rate policies that respect the domestic social and political policies of members (The IMF's Articles of Agreement, Article IV, Section 3(b)).