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A NOTE FOR CSO ADVOCACY ON ENGAGING WITH THE IMF ON SOCIAL SPENDING

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People involved in analysis, recommendations and advocacy on social policy should appreciate that the International Monetary Fund (IMF) has released an Operational Guidance Note in April 2024 to help IMF staff decide when and how to engage with member countries on issues related to social spending, which is defined by the Fund as government spending on social protection, health and education. The guidance note is needed because the IMF adopted a Strategy for Engagement on Social Spending, which increases the attention that IMF management wants its staff to give to social spending when dealing with member countries. The guidance note for implementing the new strategy had been planned for soon after the strategy was adopted in 2019, but was overtaken by the Covid-19 pandemic. However, two preliminary implementation notes were issued in 2022 in the IMF's series of Technical Notes and Manuals, one on pensions and the other on budget-financed cash transfers, which the Fund identifies as social safety nets.[1] These notes were meant to inform the operational guidance note that the Fund has now issued. A third technical note was issued in late December 2023 on health spending, and a fourth on education spending is in its final stages of preparation.[2]

The Operational Guidance Note was issued to the IMF Executive Board "for information," meaning that no comment on it was required. But it does signal how the staff is meant to take up social spending issues in the country papers that are presented to the Board for decision. The IMF note also provides an opportunity for additional social advocacy by civil society.

When does IMF engage on social spending?

A starting question is why is the IMF even dealing with social spending. The IMF was assigned international responsibility through its Articles of Agreement for international financial stability and thus is empowered to help member countries avoid crises in their balances of international payments and help them recover from the crises when they do occur. Developed countries can (and often do) disregard what IMF staff tell political leaders in their country surveillance. However, developing countries, whose economies are less robust and susceptible to periods of crisis, need to pay attention to the advice. They

[1] It is well worth appreciating here the contribution by David Coady, former Assistant Director, Fiscal Affairs Department (FAD) of IMF to developing the Fund's strategy on social spending and the notes on pensions and social safety nets. Dave not only led the staff work on the topic until retiring in 2022, but he also substantively engaged throughout with colleagues in other international organizations, academia and civil society, which was genuinely appreciated, even if we did not always agree (especially as we did not always agree).

It should also be noted that the work on the strategy and the technical notes was a joint effort of FAD with the Strategy, Policy and Review Department (SPR), which takes lead responsibility for overall IMF policy advice in its country surveillance and for policy conditionality in its lending programs. Notably, SPR itself issued a "how to" note in September 2020 in the depths of the pandemic on How to Operationalize IMF Engagement on Social Spending during and in the Aftermath of the Covid-19 Crisis.

The present note has benefited from comments on an earlier draft by Rodrigo Cerda, Chief, Expenditure Policy Division, FAD and his team, which are sincerely appreciated.

[2] Your present author wrote a commentary on the two social protection notes for the Global Coalition on Social Protection Floors and a brief on the health spending note for SocDevJustice.

may be required to negotiate a set of agreed monetary, exchange rate and fiscal policy changes (and sometimes policy changes in the financial sector or other sectors affecting macroeconomic stability). Those policy changes or "conditionality" are a quid pro quo for receiving IMF financial assistance (see annex).

As the IMF's focus is on the financial stability of each economy, it is usually called to help resolve a crisis when a country's foreign lenders decline to lend more. The IMF is the one institution that will lend when others will not, but only on condition that the country agrees with the Fund on policy changes for a recovery program. In the cases in which the crisis entails an excessive budget deficit, the fiscal adjustment means curtailing expenditures and/or raising tax revenues. As there is usually little political support to raise taxes and economic arguments against doing it in the worst stages of an economic crisis, some expenditures will have to be cut.

Here, finally, is where the IMF engagement on social spending enters the picture. Annual outlays for social protection, health and education usually loom large in government budgets. In domestic political processes during hard times, some parts of populations can better protect their interests than others. The weakest will tend to have the programs that benefit them cut the most. The IMF has traditionally hesitated to tell governments which programs to cut or protect, focusing instead on ensuring that the overall fiscal deficit meets its projected target during the period of an IMF loan program. Some governments will protect essential social services, but others have been brutal in how they meet the austerity requirement, even to the point of creating political instability and possibly violent repression of protesting people. This is not something for which IMF management and staff want to be held responsible, hence the new focus on social spending.

Moreover, all the governments on the IMF's Executive Board and the Fund's management have embraced the sustainable development goals (SDGs) of the United Nations, some of which pertain to social protection, health and education. So, whether for reasons of political stability or international social accountability, the Fund has a reason to have an improved focus on social spending.

Social issues in annual country surveillance

The IMF carries out its macroeconomic responsibilities through two types of interaction with its member countries. On the one hand, Fund staff will visit a country to assist it out of a macroeconomic crisis with some financing to ease the contraction in the balance-of-payments deficit when the country runs out of other financing options. On the other hand, in "normal" times it will more or less annually send country missions to assess a country's macroeconomic situation and discuss potential policy reforms that might strengthen the macro economy. Social spending issues will now systematically enter into both types of visit.

Sensitive to not having a mandate as such on social spending, the new IMF strategy commits to engage with governments on social spending only when it impacts macroeconomic stability, which is the Fund's mandate. It thus limits its engagement to whenever social spending is "macrocritical." The criterion that the Fund uses to assess macrocriticality is "whether it affects or has the potential to affect domestic or external stability."

The guidance note adds that IMF engagement on social spending may also promote "inclusive growth," as by improving health and education outcomes, and that it may help reduce poverty and inequality, close gender gaps and facilitate climate mitigation reforms (p. 11).[3] These are laudable goals, all warranted by the UN's 2030 Agenda and its SDGs, and if they are side benefits of the IMF's

[3] Page numbers in the text refer to the IMF Guidance Note.

engagement on social spending, more power to the Fund. To this end, the Fund asks its staff to advise governments on what it calls the three channels by which components of social spending can be macrocritical. One is the traditional concern about fiscal sustainability. The other two are "spending adequacy" and "spending efficiency."

Staff readers of the guidance note are referred to the aforementioned technical notes and manuals to learn what adequacy and efficiency mean for the various components of social spending. The overall context of the advice, however, seems more realpolitik than SDG inspired, as staff are directed regarding adequacy to consider "the aggregate spending level/capacity in line with a country's policy objectives in the area, while considering the country's economic, historical, political, and social background." The channel of spending efficiency is meant to "capture any waste, poor allocation of spending, distortions, and design issues and behavior incentives in the social spending area" (pp. 11-12).[4]

Thankfully, the guidance note is pretty eclectic on how staff should arrive at judgements on adequacy, efficiency and sustainability, offering formal (modelling) and informal ways to arrive at the judgements. It also seems that the Fund is less dogmatic than it may have been in the past on certain policy issues, in particular, on whether social protection schemes should be universal or targeted on the poor. The guidance note devotes a box to the issue, noting that "While social assistance benefits tend to be targeted in most countries (though a growing number of countries have adopted universal guaranteed minimum income schemes), education and health benefits are typically universal" (p. 24). Reading between the lines, it does not seem that the Fund is ready to abandon targeting, albeit acknowledging its imperfections. However, it appears that when a government wants a universal system, the Fund will not oppose it and should offer advice on how to afford it.

The IMF's main interlocutor with the government on fiscal issues is the finance ministry and the office of the president or prime minister. It should thus not be surprising that the social content of IMF surveillance seems very much driven in practice by "national goals," which can be progressive or retrogressive from a social perspective. Keeping in mind the original and essential mandate of the Fund, it is up to the government to decide its social spending with its legislature, and for its social ministries and non-governmental stakeholders to seek to influence the decisions on how forcefully to reach for the social SDGs.

If the public can successfully raise the political profile of social spending in a country, then IMF and other international development organizations have some tools to help make that spending efficient and sustainable and—responding to public guidance—adequate. Sometimes, appropriate social policy reforms may be studied and prepared but not be actionable during "normal" times. But then, the hindrances may fall away during a crisis and the reforms may become politically possible. Best is to be prepared ahead of time because a crisis compresses the time available to think and plan. It may be hard for the IMF to put that political consideration into an official publication to guide its staff, but civil society can get the point and advocate for appropriate planning.

In other words, governments should think through their social strategies during "normal" times, so that they can specify to their citizens as well as to the IMF team on a counter-crisis mission just what constitutes essential social spending. The assessment can be informed by the country's development plan, medium-term expenditure frameworks, medium-term revenue strategies, integrated national financing framework, country programs under the Global Accelerator on Jobs and Social Protection for Just Transitions, and other economic and financial planning tools that a country may use. The essential point is

[4] One of the determinants of spending inefficiency noted by the IMF is that "means-tested social assistance may lead to work disincentives" (p. 12); i.e., stay poor to collect the cash transfer, a problem that, say, a universal child benefit need not create because the parent of every child gets the benefit as a right.

that the government needs to have a politically endorsed social policy in effect to help shape the fiscal framework, whose funding will be the focus of so much of the effort spent in arranging the workout from the crisis.

Civil society should encourage governments to develop such a strategy, not only to provide adequate, efficient and sustainable social spending during normal times, but also because a crisis will come someday, and they should be ready for it. It is also a topic Fund staff could emphasize in annual country surveillance missions and in conjunction with specialized international organization partners.

Social spending conditionality

When a country is in crisis and it becomes necessary to agree with the IMF on a program of policy changes and temporary financing to rebalance the fiscal situation, an especially sensitive question is whether or what parts of social spending will be rolled back. Will teachers' salaries be cut? Will nurses' pension funds be raided? Will hospital maintenance be delayed? Will cash payments to offset increased public transportation fares suddenly end? These are policy decisions that the government may have to face.

IMF staff are told to be guided in their negotiations with the country's authorities over policy changes by four principles: realism, granularity, gradualism and parsimony (p. 26). The problem in country programs is these principles may well conflict with each other in application. How the principles are applied is in part a function of whether countries decide their social imperatives in advance and force them into the early steps in the design of the country recovery program. Advocacy to maintain programs during a crisis is an easier win politically than starting new programs.

Long ago the IMF devised packages of policy reforms to require of borrowing countries—what it calls "conditionality"—and the criteria by which to measure their implementation. The criteria have been applied to social spending in some cases, but that is likely to expand under the new IMF policy on social spending. Some of the criteria are quite powerful and others less so. The guidance note says that the Fund is not averse to setting its most powerful "quantitative performance criteria" (QPCs) on social spending when "social spending is critical to achieve program objectives" (p. 26). The Fund may also agree to set "indicative targets" (ITs), which are quantitative but on which the country is held to a less rigorous standard of implementation. The Fund can further set "structural benchmarks" (SBs) for non-quantitative reforms that may take time to implement, such as adopting legislation to increase contributions or delay or reduce benefits of unsustainable public pensions to render them sustainable for some time period. And it may require "prior actions" (PAs), which are usually "structural" in the social context (e.g., revise the budget law to move exceptional social expenditures to the normal budget process).

PAs need to be achieved before the IMF will approve a country recovery loan and QPCs that are not met can stop the disbursement of the next tranche of the IMF loan (and for that reason they need to depend on reliable data). ITs are "flexible numerical trackers" that may be useful when there is "heightened uncertainty and limited capacity" and can be converted into QPCs "with appropriate modifications" when conditions permit (p. 26n). Clearly, QPCs are the toughest spending conditionality as not meeting them has potentially very serious consequences, as are PAs which can delay approval of a loan program. QPCs are also seen as helping to "enhance commitments and ownership of the authorities" (p. 27). Conversely, PAs can be required when there is reason to be concerned about the government's commitment to relevant reforms.

One way in which the IMF for many years has set quantitative social conditionality is as a "social spending floor" during the recovery period of the Fund program. The "floor" has been seen as a way to limit the impact of austerity on the very poor. It usually sets a minimum expenditure level on certain

categories of spending, but it can also exclude "key social programs from fiscal adjustment" or ensure "a steady increase in their spending levels" (p. 28). The Fund notes there is a tradeoff between specifying the floor narrowly, as by individual program categories, as opposed to specifying it broadly, such as a specified share of the budget or of gross domestic product. A narrow definition, as of service delivery on a set of specific programs, may be monitored more easily than a broad indicator of total money spent on heterogeneous programs. A narrow specification, naming particular social programs, may also lend itself more to QPC monitoring, although IT monitoring can also be selected. The principle of "granularity" calls for narrowly defining the floor. Perhaps the principle of "realism" points to taking the broader approach in some cases. Civil society can be expected to press for holding the government to its social commitments through QPCs on delivery of identifiable programs, especially when a broad measure of money disbursed for social programs as a whole need not link directly to services received.

In any event, the IMF concept of the social spending floor is far from the specification of a set of minimum social protections to which governments should commit year in and year out as has been recommended by the International Labor Organization (ILO). Civil society might well advocate to move the IMF concept of the social spending floor closer to that agreed at the ILO.

Openness to external outreach

When IMF staff go on country missions, they typically need more time than they have to prepare for the mission and less time than they need to do the most thorough assessment. If the staff are to give greater attention to social issues without reducing their attention to the standard macroeconomic and financial issues, they will need to draw on additional expertise outside as well as inside the Fund. One can see in the guidance note a welcome sign of humility in this regard and openness to outside views.

In particular, while the guidance note acknowledges Fund expertise in some social policy areas, it calls for "close engagement" with other international development institutions (IDIs), naming the World Bank, the ILO and the World Food Program (p. 34). Other partners, such as UNICEF, could have been added to the list of external partners with which the Fund collaborates. Who will the Fund call first? One indicator is in an introductory part of the guidance note: "Close collaboration with external stakeholders, particularly the World Bank, should be leveraged for areas that are outside [the] Fund's expertise, such as sector specific analyses and policy designs" (p. 8). While fully appreciating the expertise of the World Bank on social issues, its perspective has traditionally been close to that of the IMF. It is also perhaps the easiest source for the Fund to tap, as their headquarters are across the street from each other.

The point in the guidance note, however, is that expertise comes wrapped in overall policy preferences and those of IMF and the World Bank can differ appreciably from those of the other UN agencies (e.g., on targeted versus universal social protection programs). The guidance note makes a point that IMF staff should take account of "differences in institutional focus" from the IMF's own, which is to say different from that of the World Bank as well. As the guidance note states,

> "It is thus important to exchange views—better understanding each other's policy objectives and line of thinking—and look for common grounds. Consistent policy messages from the Fund and IDIs send a more powerful signal to the authorities and the public and can help improve policy traction. The opposite, on the other hand, can lead to confusions and policy inaction.
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> "Many IDIs have deep knowledge and experiences in certain social spending issues, particularly related to detailed designs and implementation of social spending schemes. In addition, IDIs also have been engaging on social spending issues for many decades, much longer than the Fund, have greater presence in the field, and thus have a better

> understanding of country-specific institutional settings, past experiences and contexts of social spending issues, have a closer relationship with country authorities, and often have better access to the data" (pp. 34-5).

It seems worth monitoring how this works out in practice.

The guidance note goes further and asks the Fiscal Affairs Department to identify relevant counterparts and also "help country teams identify relevant experts" and "facilitate collaboration at the country level." This is a monitorable quantitative indicator.

Importantly, the guidance note also recommends outreach to civil society. This includes the semi-annual and other discussions at headquarters where the Fund can explain its views and "counter any unfounded and unfair criticism of Fund engagement." But more important is the recommendation that country teams engage with civil society organizations, academics, labor unions and local experts, not only to explain Fund thinking, but also to "gather information to better understand social needs and the political economy" (p. 36).[5] This too can be monitored externally and both positive and disappointing experiences can be brought to the attention of IMF authorities. In any event, the Fund is making an open invitation to civil society to engage with the Fund in their countries.

In conclusion

In sum, the guidance note to IMF staff for engaging on social spending has a number of encouraging points for civil society advocacy, including for universal as well as adequate social spending in member countries. To take best advantage of these opportunities, governments need to be willing to give sufficient attention to social spending in their planning and policy making, not only to assure adequate programs during normal times, but also to set a firm benchmark for spending to be maintained when it comes time for the country to work with the IMF in preparing a country program for crisis recovery. By the same token, social spending obligations should substantively inform the budget balance constraint in the debt sustainability analysis. IMF seems ready to encourage as well as facilitate ways to make social spending adequate and efficient, as well as sustainable during normal times, including through an openness to engaging with other international agencies and civil society, including those employing a human rights approach to social spending. What is most hopeful is that the guidance note can help raise the profile of social spending issues when finance ministries and IMF staff sit down to discuss a country's economic situation.

Annex. A primer on why a social spending focus belongs in IMF recovery programs

In the typical economic crisis that the IMF is called upon to help resolve, a country may be suffering from accelerating inflation and/or see its economic activity and employment plummet. This is the symptom, but the cause is usually that for one reason or another, including for reasons beyond the country's responsibility or ability to control, the country is producing substantially less than it is spending. We can know that a country is producing less than it is spending because it finds itself importing more goods and services than it is exporting. This much is arithmetic.

The way that the country as a whole covers the deficit in its balance of international payments for goods and services is by borrowing abroad and/or spending down its foreign assets, notably, those that the

[5] Since the pandemic, many Article IV consultations have apparently been undertaken virtually rather than in person. They could include online discussion with civil society and other stakeholders in the "visited" country when in-person consultations are not feasible. Indeed, on-line consultations could be organized well before country visits on a periodic basis.

government or central bank maintains in the form of official foreign exchange reserves. The crisis that leads to the call to the IMF comes when the external deficit becomes large and persistent, and the foreign creditors get nervous about being repaid. Then they raise the cost of funds or just stop providing them, leaving the country to run down its reserves. The speed of decline can be exacerbated by nervous foreign investors and citizens who take their money out of the country, making the overall balance-of-payments deficit even worse than the negative balance on goods and services, until reaching a sudden stop.

Whether the country invites the IMF to help resolve the difficulty or not, there are essentially three policy tools with which to bring domestic spending more in line with domestic production: a) devalue the currency, which makes imports more expensive and exporting more profitable, but also raises the cost of living and the budgetary cost of external debt servicing in local currency; b) raise interest rates to entice investors to bring their funds back, which also reduces investment and consumption spending owing to the higher cost of credit; and c) reduce the government's contribution to total spending through austerity reductions in the government's budget. The short-term result will be to reduce spending toward the level of production. The medium-term result should be for increased production to contribute more to closing the gap with spending. In many cases, the medium-term result is disappointing.

Countries call on the IMF to help work out of the crisis because the Fund will lend when no one else will, allowing more time than otherwise to close the production/spending gap. It is willing to lend because that is its mandate as an official international institution, but also because the quid pro quo for its loans is that the government of the country agrees to a set of policy changes that the Fund assesses will rebalance the economy's spending and production over the program period, giving the Fund confidence that it will be repaid. Other official institutions may also lend to the government, assured by the government's agreement with the Fund.

The policy reform package will usually have a combination of monetary, exchange rate and fiscal policy changes, as well as address structural financial sector or other impediments to macroeconomic stability. The government budget need not be a primary reason for the production/spending imbalance and an austerity budget is not a necessary feature of the recovery program in such cases. However, if the government has built up an unsustainably large public debt, it is a sign that a budget adjustment is required.

The key fiscal target that addresses the borrowing challenge is the "primary" balance, which is the difference between government expenditure excluding interest on the debt, on the one hand, and revenue from taxes plus any grants in aid the government receives from abroad, on the other hand. The primary balance thus groups the government's relations with its lenders together on one side of the balance and the government's spending and revenue raising activities on the other side.

Viewed from the financial side, if the primary balance is zero, the government will only borrow enough to cover its interest obligations and to roll over any maturing debt with new borrowing. If the government runs a primary surplus, it will pay at least some of its interest obligations out of tax revenues. If the primary surplus is large, the government can also pay down some of its debt (or build a reserve for the next rainy day). If the primary balance is in deficit, the government has to borrow just to pay interest. Setting the primary deficit target and the path to it is a way to specify what level and prospective growth of the public debt would be deemed sustainable post crisis. That depends on the size of the debt at the start, the rate of growth (or contraction) of the economy, the interest rate on the debt, and the government's borrowing during the period of budget correction and beyond.

Viewed from the government spending side, the target for the primary balance entails the government's targets for spending and mobilizing non-debt revenue. In principle, the budget will contain a number of mandatory outlays, as for entitlement programs in which the government promises to provide

a service or cash to everyone qualifying for a program. Other outlays will be discretionary, approved annually, and generally will be more vulnerable to the budget ax. That is the theory, but in reality, all expenditures are vulnerable, depending on the amount of spending reduction and revenue increase programmed to reach the primary balance target.

The primary balance must satisfy both the spending and financing imperatives. To a degree, spending imperatives seem to be sacrificed to the financing imperatives. However, in cases in which a government is heavily indebted, there may be no politically acceptable path of expenditure contraction and new financing to get to the target primary balance. In such cases, the government will need a measure of debt relief to get to a feasible financing envelope. This relief can take the form of a temporary postponement of payments falling due. If the debt is "unsustainable," a permanent reduction is required in the financial burden of the debt, most directly through a negotiated reduction in the stock of debt (preferred by bondholders), but also through agreement with creditors for some combination of temporarily postponed interest payments, reduced interest charges when payments resume, and delayed repayment of the principal of the loan (preferred by government lenders). This will need to be decided with the country's different classes of creditors in separate sets of negotiations, albeit with the overall payment obligations preserving the agreed path of the primary balance in the recovery program.

What are the implications for social spending? If the precipitating balance-of-payments crisis does not involve an unsustainable fiscal situation, there should be no negative consequences for social spending. Indeed, with a crisis like the Covid-19 pandemic, IMF crisis lending should help finance social spending beyond what is normally budgeted, which for many countries it has, and with virtually no conditionality attached to the emergency loans.[6] However, if the balance-of-payments crisis does entail correcting an unsustainable fiscal situation, the targeted primary balance should build in an appropriate level of essential social spending as inviolate. If that requires a smaller primary surplus or larger primary deficit than was typical in IMF programs than in the past and thus greater international institution funding, it is warranted by the SDG commitments of the international development institutions. If it requires deeper debt relief for heavily indebted countries, so be it. Creditors understand (or should understand) that there is a measure of risk in international lending and not expect poor and dependent populations to make them whole when events sour.

[6] This includes loans from the Rapid Financing Instrument for middle income countries; for low-income countries, it includes loans from the Rapid Credit Facility and payment of debt servicing falling due to the IMF that are paid by the Catastrophe Containment and Relief Trust. All other IMF facilities have conditionality requirements.