INTERNATIONAL MONETARY FUND

April 2024

OPERATIONAL GUIDANCE NOTE FOR IMF ENGAGEMENT ON SOCIAL SPENDING ISSUES

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International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

April 8, 2024

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EXECUTIVE SUMMARY

The Strategy for IMF Engagement on Social Spending was endorsed by the Executive Board in May 2019. Social spending plays a critical role as a key lever for promoting inclusive growth, addressing inequality, protecting vulnerable groups during structural change and adjustment, smoothing consumption over the lifecycle, and stabilizing demand during economic shocks. Social spending policies have also been playing an important role in tackling the structural challenges associated with demographic shifts, gender inequality, technological advances, and climate change.

This note provides operational guidance to staff on when and how to engage on social spending issues. It builds on a series of notes on IMF engagement on specific social spending issues developed since the publication of the 2019 strategy paper and provides guidance on when and how to engage on social spending issues, in the context of surveillance, Fund-supported programs, and capacity development. More specifically, the note:

- Clarifies the scope, identifies the key challenges, and lays out a roadmap to guide staff when engaging on social spending issues;
- Provides practical guidance in assessing the macrocriticality of a specific social spending issue in the surveillance context and determining when to engage and the extent of engagement in surveillance, programs, and capacity development;
- Discusses key considerations in formulating policy advice and designing social spending conditionality, including social spending floors;
- Details capacity development support by the Fund in the area of social spending; and
- Outlines approaches to strengthen and leverage collaboration with external stakeholders and design outreach strategies.

This guidance note will be periodically updated to reflect the evolving nature of social spending issues and the building up of knowledge, including at the Fund.

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Glossary

CD	Capacity Development
COFOG	Classification of the Functions of Government
COM	Communications Department
CSO	Civil Society Organization
ECF	Extended Credit Facility
EFF	Extended Fund Facility
EMDEs	Emerging Market and Developing Economies
EME	Emerging Market Economy
FAD	Fiscal Affairs Department
GFS	Government Finance Statistics
GFSM	Government Finance Statistics Manual
GRA	General Resources Account
IADB	Inter-American Development Bank
IDI	International Development Institution
ILO	International Labor Organization
IMF	International Monetary Fund
IT	Indicative Target
MEFP	Memorandum of Economic and Financial Policies
MTEF	Medium-Term Expenditure Framework
MTFF	Medium-Term Fiscal Framework
OECD	Organization for Economic Co-operation and Development
PA	Prior Action
PATH	Programme of Advancement through Health and Education
PIT	Personal Income Tax
PRGT	Poverty Reduction and Growth Trust
QPC	Quantitative Performance Criteria
RES	Research Department
ResRep	Resident Representative
ROC	Review of Conditionality
SB	Structural Benchmark
SDG	Sustainable Development Goals
SPR	Strategy, Policy, and Review Department
SPRAIIG	Inclusion and Gender Unit of the Strategy, Policy, and Review Department
SSA	Sub-Saharan Africa
SSC	Social Spending Conditionality
SSN	Social Safety Net
STA	Statistics Department
TA	Technical Assistance
TMU	Technical Memorandum of Understanding
TNM	Technical Notes and Manual
UN	United Nations

UNESCO	United Nations Educational, Scientific and Cultural Organization
UNFPA	United Nations Population Fund
UNICEF	United Nations Children's Fund (or originally United Nations International Children's Emergency Fund)
UNSD	United Nations Statistics Division
VAT	Value Added Tax
WFP	World Food Program
WHO	World Health Organization

BACKGROUND

1. **The Strategy for IMF Engagement on Social Spending was endorsed by the Executive Board in May 2019.** The strategy underscores the critical role of social spending—defined as social protection, health and education spending—as a key policy lever for promoting inclusive growth, addressing inequality, protecting vulnerable groups during structural change and adjustment, smoothing consumption over the lifecycle, and stabilizing demand during economic shocks.[1] More recently, social spending policies have played a critical role in mitigating the impact of COVID-19 pandemic, including helping address its long-term scarring. Social spending policies have also been playing an important role in tackling the structural challenges associated with demographic shifts, gender inequality, technological advances, and climate change.

2. **The 2019 strategy outlines a framework for a more effective, systematic, and evenhanded engagement on social spending issues.** It provides broad principles and key steps on (i) when and how to engage with members countries on social spending issues, including in the context of surveillance and IMF-supported programs (henceforth "programs"); (ii) enhancing collaboration with International Development Institutions (IDIs); and (iii) improving communications and leveraging input from a broad set of stakeholders.

3. **This guidance note builds on existing work and analyses.** These include the How-To-Notes on IMF Engagement on Social Spending during and in the Aftermath of the COVID-19 Crisis and the Technical Notes and Manuals (TNMs) on IMF Engagement on Pensions, Social Safety Nets, Health, and Education. The guidance note will be periodically updated to reflect the evolving nature of social spending issues and the building up of knowledge, including at the Fund.

4. **This note aims at providing operational guidance to staff on the implementation of the 2019 strategy.**[2] It covers:

- the scope and key challenges (e.g., data) of engaging on social spending issues, including a roadmap to guide such engagement (Section II);
- when to engage (Section III), providing practical guidance in assessing the macrocriticality of a specific social spending issue in the surveillance context and determining when to engage and the extent of engagement in surveillance, programs, and capacity development (CD);
- how to engage (Section IV), discussing (i) key considerations in formulating policy advice—along with a list of typical social spending reform options—in surveillance and programs; (ii) specific

[1] Alternatively, tax expenditures can also be considered in achieving these policy objectives, such as refundable tax credits.

[2] The 2022 Guidance Note for Surveillance under Article IV Consultation and the 2024 Operational Guidance Note on Program Design and Conditionality provide operational guidance in general on surveillance and programs (IMF, 2022d; IMF, 2024b). To limit duplication and confusion, this note focuses on social spending specific issues, while leaving more general considerations that apply similarly to social spending and other issues to the surveillance and program guidance notes (i.e., specification of program objectives; contingency plans if financed by donor support).

issues in program engagement such as the design of social spending conditionality; and (iii) engagement under CD; and

- how to strengthen and leverage collaboration with external stakeholders and design outreach strategies (Section V).

A FRAMEWORK FOR FUND ENGAGEMENT ON SOCIAL SPENDING ISSUES

This section discusses the definition and key challenges of social spending issues and their implications for Fund engagement. It also outlines a roadmap for Fund engagement.

5. The definition of social spending adopted by the 2019 strategy paper specifies both the areas and the scope of Fund engagement. Social spending is broadly defined in the 2019 strategy paper and consists of social protection, health, and education spending. The strategy paper suggests that Fund engagement should focus on both the spending level and the designs of social spending systems (Box 1).

Box 1. Defining Social Spending and the Implications for Fund Engagement

The definition of social spending specifies the areas of focus for Fund engagement on social spending issues. According to the 2019 strategy paper, social spending comprises social protection, education, and health spending. Furthermore, social protection includes both social insurance (e.g., pensions, unemployment insurance, and sickness and maternity leave) and social assistance programs (e.g., universal and targeted transfers, child benefits, and active labor market programs). *Social insurance* aims at protecting households from shocks that can adversely impact their incomes and welfare and is typically financed by contributions or payroll taxes. *Social assistance* aims at protecting households from poverty and is financed by general government revenue. Consistent with practice in other IDIs, the terms *social assistance* and *social safety net* are used interchangeably. The definition sets the areas for Fund engagement, but whether the Fund should engage on any specific social spending issue in a country would depend on a number of factors (see Section III for more details).

The broad definition implies diverse policy challenges. Social spending, as defined here, covers several functional spending categories and sectors. Thus, policy challenges may vary not only by country, given country-specific conditions, but also by type of social spending within the same country. For example, a low-income country may need to strengthen social assistance to protect the most vulnerable, while at the same time, pension benefits, which mostly go to rich households, may be too generous and need to be reduced. Even for the same type of spending, for example on education, too much may be spent on wages while too little on capital spending or too much on tertiary education while too little on basic education such as primary and secondary education.

Fund engagement should focus on public social spending and the designs of social spending schemes to achieve macroeconomic and development objectives. While public social spending often plays a central role in addressing social issues, in some areas and under certain designs, private spending can also have an important role to play, such as in pensions, education and health. Public social spending and the designs of the social spending schemes are two key policy levers to maximize the overall effectiveness and efficiency of such systems, including through incentivizing private behaviors, and ultimately to promote inclusive growth, social cohesion, and achieve macroeconomic stability.

6. When engaging on social spending issues, staff should carefully consider various constraints and challenges. For example, social spending issues tend to be ***complex and multifaceted***, reflecting a mix of different designs and the involvement of different public and private entities; ***local capacity*** on social spending issues can be limited; and the role of social spending and the designs of social spending systems vary by country, reflecting differences in ***social preferences*** *and* ***available resources***. In particular,

- ***Expertise.*** Given the complexity and breadth of social spending issues, the Fund does not have expertise in all areas of social spending issues. Close collaboration with external stakeholders, particularly the World Bank, should be leveraged for areas that are outside Fund's expertise, such as sector specific analyses and policy designs.[3]

- ***Quality, consistency, and timely availability of data as well as comparability across countries*** are often challenges for in-depth engagement, particularly in low-income countries (LICs) where IMF engagement on social spending issues is especially needed (Annex I). While a wide range of cross-country databases are available for social spending (Annex II), coverage is still incomplete (e.g., for LICs and for certain spending such as education and social assistance), and cross-country comparability remains lacking in certain areas (e.g., test scores in education). For administrative data, the main issue is the lack of consistency in the definition both across countries and over time. Furthermore, functional classification is not always available on a timely basis or sufficiently disaggregated. In addition, data needs typically differ by surveillance and programs, with surveillance relying more on cross-country data and programs administrative data.

7. A well-structured approach with a clear roadmap can help guide Fund engagement with the membership. Main steps of such a roadmap include (Figure 1):

- ***Initiation of discussions on social spending issues***. This can be triggered by authorities' requests and interests or by team's recognition that social spending is an important tool in addressing the macroeconomic challenges a country faces, including through discussions with external stakeholders. Social spending issues can arise in both surveillance and programs in various contexts, including for:

    - tackling existing poverty and income inequality;

    - mitigating the impacts of economic shocks (e.g., the COVID-19 pandemic) or macroeconomic adjustments (e.g., fiscal consolidation);

    - improving access to and quality of education and health services to enhance human capital and growth potential;

[3] See Annex I of the 2019 strategy paper for examples of areas where the Fund can provide policy advice and areas for which external expertise is needed.

  - addressing structural challenges—such as demographic shifts, gender inequality, climate change, and technological advances—which may have important poverty and inequality implications and/or for which social spending is an important policy tool (Box 2).

- ***Preparation work.*** Intense preparation is often needed for engagement on social spending issues, as the teams may not be familiar with the specific social spending issue and/or there is a lack of necessary information and expertise. Key aspects include:

  - involving FAD at an early stage. FAD, as a hub for information and collaboration, can help identify relevant counterparts in other IFIs and facilitate the collection of initial information and background materials.

  - taking stock of existing analyses and collecting any relevant background information, including data. Potential sources include Fund staff reports, FAD tools, and capacity development reports, the World Bank's Public Expenditure Reviews and poverty assessments, and other external policy discussions.

  - having a good understanding of the relevant social spending issue, including key design features of the existing system—such as coverage, benefit levels, modalities of delivery, financing sources, and role of the private sector—and potential concerns such as on adequacy, efficiency, cost, and administrative capacity.

  - understanding the member's needs and priorities, as the role of social spending and the design of social spending issues to an important extent reflect preferences. It is thus important to understand the context of the social spending issues, collect relevant background information, and hear the views of the authorities.

- ***When to engage*** on social spending issues (Section III):

  - ***Assessing macrocriticality in surveillance*** is a key step in determining whether the Fund should engage in surveillance and requires country-specific assessment.

  - ***Determining whether to engage and the extent of engagement***. This differs by surveillance, lending, and CD, depending on various factors including macrocriticality in surveillance, criticality under conditionality guidelines, Fund expertise, and whether requested by the authorities (see Section III for further discussions). In some instances, the Fund may decide not to engage. For example in surveillance, staff may not engage on issues such as the design of school curriculum or whether specific medical treatments should be covered by health benefits, as they, while important for the education and health systems, may not be macrocritical and are outside Fund's expertise.

- ***How to engage*** on social spending issues (Section IV): This typically includes analyses of social spending issues and providing policy advice in surveillance and programs, drawing on expertise of external partners; specifically for programs involves incorporating social spending issues in program design including the design of conditionalities; and engagement under CD includes how Fund's CD can complement and support the engagement in surveillance and programs.

- ***External collaboration and outreach*** (Section V). Collaboration with external partners should typically be maintained throughout the engagement process, as many of them tend to have more experiences and expertise on social spending issues. It is also important to reach out to Civil Society Organizations (CSOs) and the public on Fund's engagement.

Box 2. Social Spending and Gender Inequality

Gender inequality is macrocritical and the Fund has developed a gender strategy to mainstream gender issues in its core activities (IMF, 2022a). An interim guidance note has been issued (IMF, 2024a).[1] Social spending is an important policy tool to close gender gaps and reduce gender inequality, and this highlights the importance of having a gender lens in the design of social protection schemes.

Targeted social spending measures can help close gender gaps and reduce gender inequality and ultimately support macroeconomic outcomes. Typical measures include (un)conditional cash transfers to girls previously dropped out of school, targeted cash transfers to poor women, paid maternity leave, and programs to improve women's education and health outcomes. In addition, directing social assistance payments to women is not only more effective in reducing poverty, but also helps reduce gender inequality.

Nongender targeted social spending measures can also help address gender inequality. These include (un)conditional cash transfers, measures to improve access to and quality of education and health services, and public spending on childcare and active labor market programs, as women and girls are often disproportionately represented in the vulnerable populations. Paid parental leave can improve health and development outcomes for children through increased earnings for mothers, higher female labor force participation, and a more equitable division of labor at home.

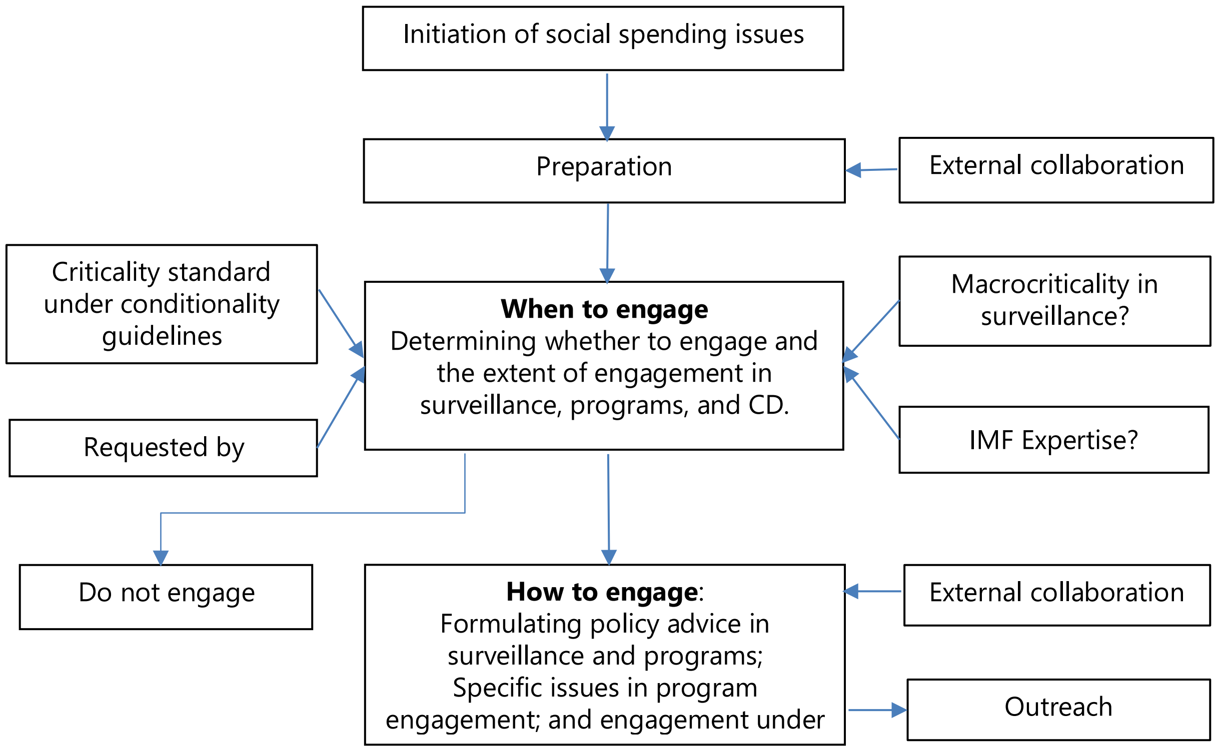
The choice between gender targeted measures and nongender targeted measures involves various tradeoffs. Conceptually, gender targeted policies are less efficient as they exclude males who may be better suited for the opportunities. That said, with the presence of gender inequality, nongender targeted policies can also be inefficient in the sense that preference may be given to less qualified males (Shang, 2022). The exact tradeoffs in the effectiveness and efficiency of the two types of policies likely vary by policy areas and country contexts (Evans and Yuan, 2022).

A range of internal and external toolkits and data sources are available to assess the cost and impact of social spending measures that directly or indirectly affect gender gaps.

- The IMF's modeling work allows to quantify the impact of different social spending measures on gender gaps and key macroeconomic outcomes. Applications include: cash transfers to women in poverty (**Senegal**)**,** family allowances and social security contributions (**Argentina**), paid maternity leave (**United States**), subsidized childcare (**Mexico**, **United States**); investment in education to close gender gaps (**Niger**, **Nigeria**, **Sierra Leone**).
- The IMF's analytical work can help quantify the impact of **active labor market programs, public childcare, unemployment benefits, and pension spending** on female labor force participation.
- **Impact 40 tool** by United Nations Population Fund (UNFPA) estimates the cost and impact of different categories of health spending targeted at women.
- The **ILO Care Policy Investment Simulator** highlights the investment requirements for different care policy areas and related employment and gender equality benefits for 82 countries.

[1] For more information, staff can contact the SPR Inclusion and Gender Unit (SPRAIIG) or visit the gender KE site.

Figure 1. A Roadmap on Fund Engagement



Source: IMF staff formulation.

WHEN TO ENGAGE ON SOCIAL SPENDING ISSUES

This section provides specific guidance on how to assess the macrocriticality of a social spending issue in surveillance and how to determine whether to engage and the extent of engagement in surveillance, programs, and CD.

A. Assessing Macrocriticality in Surveillance

Conceptual Considerations

8. **The macrocriticality of a social spending issue ultimately rests on whether it affects or has the potential to affect domestic or external stability.** Social spending is a key policy lever, for example, in promoting inclusive growth including through better education and health outcomes, reducing poverty and inequality, closing gender gaps, or facilitating climate mitigation reforms. This implies that when assessing the macrocriticality of social spending, special attention should be paid to the macrocriticality of the policy objectives.

9. **The 2019 strategy paper identifies three channels to assess the macrocriticality of a social spending issue.**

- *Spending adequacy.* The general question is whether social spending is adequate for achieving the policy objectives such as inclusive growth and protecting the vulnerable. The TNMs on

Pensions, Social Safety Nets, Health, and Education provide operational definitions in their specific context, typically referring to 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.

- *Spending efficiency*. The general question is whether social spending is efficient in achieving social outcomes. More concrete and informative questions are: can the same social outcomes be achieved with less social spending? Or can better social outcomes be achieved with the same level of social spending? These questions capture any waste, poor allocation of spending, distortions, and design issues and behavior incentives in the social spending area. The assessment should also consider any spillovers, positive or negative, to other areas or any unintended consequences. For example, means-tested social assistance may lead to work disincentives, maternity leave schemes that cover an extended period of time can lead to skill losses and miss career opportunities and widen gender gaps in labor force participation, and tax-financed pension and health insurance schemes may lead to informality, which should be incorporated into the overall assessment of spending efficiency.

- *Fiscal sustainability*. The general question is whether social spending is sustainably financed, without undermining macroeconomic stability, including through increasing fiscal deficits and debt, or crowding out other critical expenditures. The assessment may need to be based on whether spending is (or will be) too high, relative to revenues and fiscal space, and thus put undue pressures on public finances. Where the private sector plays an important role in financing and providing benefits, the assessment needs to consider any contingent liabilities from private spending in the social spending areas, for example, unfunded liabilities from employment-based pension or health schemes.

10. The assessment should be based on the macrocriticality of a specific social spending issue and the associated component of social spending. The key question for macrocriticality is whether the specific social spending component is adequate, efficiently designed, or fiscally sustainable to achieve its intended objectives. Assessments therefore require clearly defined spending level, policy objectives, and outcomes, and thus it is generally advisable to examine spending components separately. The typical social spending component for such assessments is a functional-level spending (e.g., on education, health, pensions, or social assistance) which can be linked to relatively self-contained government priorities and objectives and be associated with clearly defined and measurable outcomes (e.g., test scores, health outcomes, and poverty level). In some cases, assessments can also be done at sublevels of functional spending, such as primary education, secondary education, and tertiary education. While assessing each spending component separately is sufficient in determining macrocriticality, the interlinkages between different channels (e.g., spending adequacy, spending efficiency, and fiscal sustainability) for the same spending component and across different spending components need to be carefully considered in formulating policy options (see Section IV for further discussions).

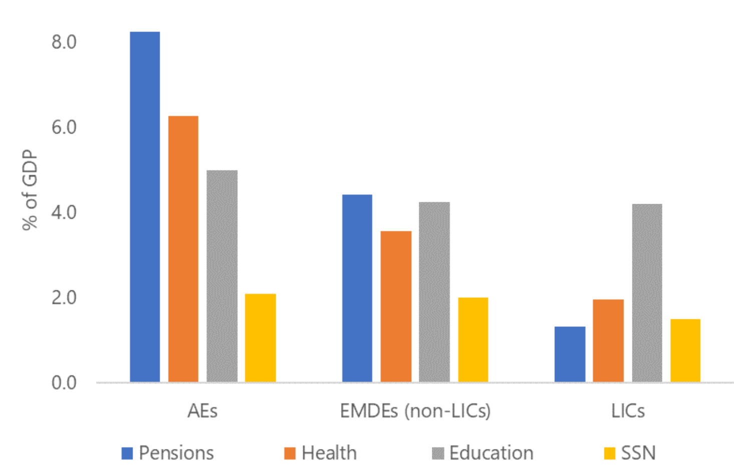
Practical Considerations

11. While the conceptual discussions provide the guiding principles to assess macrocriticality, actual assessments are often based on suggestive evidence and staff judgement is typically required. For example, adequately answering the questions on spending adequacy, spending efficiency, and fiscal sustainability often requires macroeconomic modeling, which can provide important insights on the macroeconomic impacts of social spending. Even so, various assumptions underlying model design may still leave some question marks on the results. To be more practical, the assessments can be based on simpler approaches such as cross-country comparisons, combined with findings from the literature and staff judgement (Annex II provides a summary of the main indicators that can be potentially used to assess spending adequacy, spending efficiency, and fiscal sustainability of social spending). Teams can refer to the Technical Notes and Manuals on IMF Engagement on Pensions, Social Safety Nets, Health, and Education for guidance on specific issues in each of these areas.

How to Assess Spending Adequacy

12. Spending levels are a starting point for assessing spending adequacy. While recognizing that adequate social spending level likely varies by country, the level of spending relative to peer countries at a similar level of development can provide an initial assessment on whether spending is particularly low or high. Typically, advanced economies spend more on health and pensions, while LICs spend more on education (as a share of government spending) (Figure 2). Additional adjustments can be made to account for other drivers of social spending level, such as social preference, demographics (leading to different health and education needs), geography (e.g., service delivery in remote areas), and the design of the social spending schemes (which can lead to different private financing to complement public financing).

Figure 2. Government Spending in Health, Education, Social Safety Net and Pensions by Country Group



Source: Expenditure Assessment Tool and IMF Technical Note on Social Safety Nets.

13. Social spending related inputs, outputs, and outcomes can also help inform spending adequacy. Examples of social spending inputs include the number of medical professionals and hospital beds per capita and student-teacher ratios. Social spending related output may include, for example, the coverage of the poor by social assistance programs and access to education and health services. Social spending related outcomes include poverty level, and education and health outcomes (e.g., test scores, literacy rate, mortality rate, and life expectancy) of particularly the vulnerable populations. However, spending inefficiency is also a potential driver of poor outcomes, and its role should also be analyzed.

14. In some specific cases, additional spending needed to achieve Sustainable Development Goals (SDGs) are useful benchmarks over medium term. Using a benchmarking approach to high performing peer countries by income level, an IMF-FAD tool, the SDG additional spending assessment, can help estimate the additional amount that a country would need to perform well in the SDGs, including in health, education, roads, water and sanitation and electricity (Gaspar and others, 2019; Carapella and others, 2023).[4] These are the targets that countries should strive to achieve over the medium term but are constrained by limited financing and/or capacity in the short run.

How to Assess Spending Efficiency

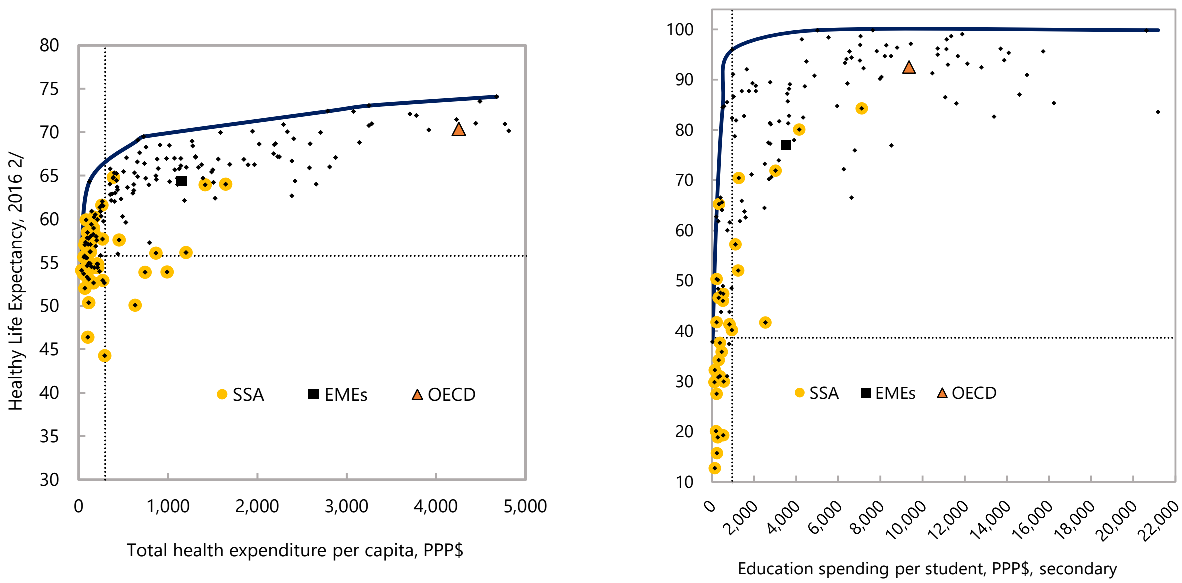
15. The assessment of spending efficiency varies by types of social spending. Efficiency frontier analysis is frequently used in education and health to assess how a country is performing, in terms of education and health outcomes for a given level of spending (Figures 3a and 3b and Garcia-Escribano and others, 2022). For pensions and social assistance, the focus tends to be on whether the spending reaches the targeted population (e.g., targeting efficiency), the cost of financing, and the economic and labor market distortions (e.g., work disincentives) (IMF, 2022b; IMF, 2022c).

16. Looking into components of spending often helps identify the drivers of spending inefficiencies. Some sub-categories of spending may tend to be inefficient (such as pharmaceutical spending or the mix between hospital and primary care); some sub-schemes may absorb disproportional resources and jeopardize the functioning of other sub-schemes, leading to poor overall performance (e.g., generous civil service pension and social benefits); and the wage bill is often a source of inefficiencies, with wages being too low or too high (with adverse effects on recruitment and retention or fiscal pressures), excessive employment level, or high allowances and other benefits.

[4] In 2015, world leaders endorsed the 17 UN SDGs. Gaspar and others (2019), using a dataset of 155 countries, estimate the additional annual spending for progress in education, health, roads, electricity, and water and sanitation.

Figure 3. An Assessment of Spending Efficiency in Health and Education

Health Spending Efficiency Frontier **Education Spending Efficiency Frontier**



Note: SSA, EMEs and OECD refer to group averages.
Source: Expenditure Assessment Tool

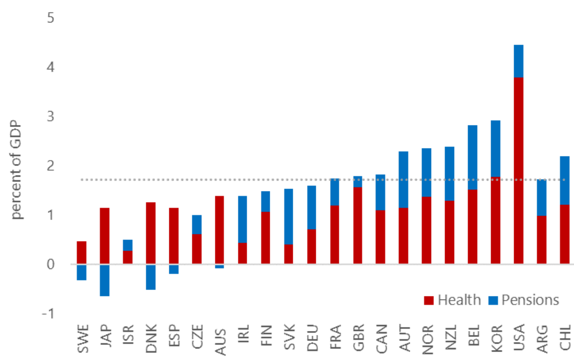
How to Assess Fiscal Sustainability

17. Different approaches are needed for assessing pressures to fiscal sustainability from social insurance and from non-contributory social spending. For social insurance schemes, the assessment should be based on whether the contributions, dedicated revenue sources, and assets are sufficient to sustain the benefits—putting pressures on public finances—both in the short term and over the long run, as it typically takes a long time for reforms to have material fiscal impact (e.g., raising retirement ages). Assessments on current and projected financial status of these schemes are typically available from various sources, including the IMF and the schemes themselves (e.g., Social Security and Medicare Trustees Reports and the ageing reports by the European Commission). For non-contributory social spending, comparing spending levels and growth rates—relative to revenues—with those of peer countries is an important starting point to assess fiscal pressures from the specific social spending. In addition, the assessment needs to consider available fiscal space, both in the short run and the long run.

18. Fiscal sustainability concerns can arise from a variety of factors (Figures 4a and 4b). Fiscal pressures from pensions and health due to population aging have been particularly concentrated in high-income countries to date but are expected to intensify in middle income countries in coming decades. Many EMEs and LICs have large development spending needs, including in human and physical capital, which, combined with low fiscal space and low growth, can drive fiscal sustainability concerns and alter the assessment on the levels of social spending that are fiscally sustainable (e.g., Greece in 2010-12).

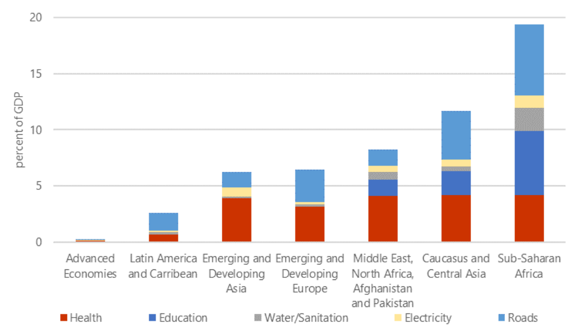
Figure 4. Main Sources of Fiscal Pressures by Country Group

Long-Run Fiscal Pressures in Advanced Economies / Some EMEs (Projected Increases Between 2022-30)



Source: IMF, Fiscal Monitor, April 2023

Fiscal Pressures from Large Development Needs in Many EMDEs (including LICs) (Projected Increases to Achieve SDGs by 2030)



Note: Only positive spending needs are included and so totals may differ from original source.
Source: Carapella et al (2023), " How-To-Assess-Spending-Needs-of-the-Sustainable-Development-Goals-The-Third-Edition"

Impact on Macroeconomic Outcomes

19. In addition to the three channels, the assessment of macrocriticality can also be based on direct assessments of the impacts of any social spending on macroeconomic outcomes. There is strong evidence that social spending can be an important driver of inclusive growth (see Box 3 of the 2019 strategy paper for a summary), and this can be directly assessed through macroeconomic modeling. While this would involve greater efforts, it helps with not only the assessment of macrocriticality but also the assessment of reform options and the formulation of Fund policy advice. It will also lead to richer engagement with the authorities on social spending issues. The modeling work can be built on existing models and toolkits (e.g., the Inequality Toolkit), with support from SPR and RES.

Country Cases

20. Several country cases help illustrate the assessment of macrocriticality of a social spending issue in surveillance (Box 3). For example, health spending was assessed as macro-critical in Thailand, because of rising costs from population aging and a fragmented health system. While government education spending in Sierra Leone was similar to peer countries, it was deemed macrocritical because of concerns about low secondary enrollment, financing constraints and the associated missed opportunities of an economic dividend. Health and pension spending were macrocritical in Japan because, as its population ages, the existing health and pension systems are not fiscally sustainable without reforms.

Box 3. Country Case Studies on Assessing Macrocriticality in Surveillance

Thailand (2016) – Health spending efficiency and fiscal sustainability

- **Policy context**. Thailand achieved universal health care coverage under its 2002 reforms. Before the reform, there were four different state health insurance schemes, which collectively covered over three-fourths of the population. The 2002 reforms consolidated two of those programs and extended coverage to everyone who did not already benefit from the country's health insurance programs for civil servants and formal sector workers.
- **Key metrics**:
    - Fiscal Sustainability: Public health expenditure as a share of GDP expected to increase by more than 2 percentage points by 2050.
    - Spending Efficiency: Thailand public health expert review identified significant efficiency savings in health spending. The public health insurance system remained fragmented, with wide differences in benefits, contributions, and financing schemes, which risked hindering service quality and access.

Japan (2012, 2018) – Pension and health spending fiscal sustainability and efficiency

- **Policy context**: The authorities made progress on pension reform but tackling pressures from healthcare proved challenging. Preserving Japan's public finances sustainability in the face of aging pressures would require revenue collection efforts and expenditure containment. Financing such a large increase in healthcare and pension costs with additional revenues would imply potentially disruptive large tax hikes. This situation necessitated Japan to advance healthcare system reforms.
- **Key metrics**:
    - Fiscal Sustainability: Contribution of increase in health spending (due to population aging) as a share of GDP to structural primary balance (Fiscal Sustainability). Without reforms, public spending on medical and long-term care was projected to double to near 20 percent of GDP by 2050.
    - Spending Efficiency: Contribution of health policy changes to containment of structural primary balance (Fiscal Sustainability) while preserving population welfare. There is limited room for further containing non-social security spending, which is already low by OECD standards.

Sierra Leone (2022) – Education spending adequacy and efficiency

- **Policy context**: Sierra Leone is a small, young, low-income country in West Africa. It has been through a range of governance and security challenges over recent decades. The young population provides an opportunity to benefit from a demographic dividend. Reforms under the Government's Free Quality School Education program were showing some progress.
- **Key metrics**:
    - Spending efficiency: Sierra Leone's population is young with more than 40 percent younger than 15, providing an opportunity for spending on human capital to have a high return (demography). World Bank Public Expenditure Review highlights governance and policies that are leading to poor learning outcomes (policy assessment). Expenditure is characterized by high teacher wages and low capital expenditure (spending mix).
    - Spending adequacy: Low enrollment and low completion rates of secondary school, and poor learning outcomes highlight high education spending needs (despite government spending on education as a share of GDP is similar to peer countries).

B. Engagement in Surveillance, Programs, and Capacity Development

21. Whether to engage and the extent of engagement differ by surveillance, programs and CD and depend on various factors.

Surveillance[5]

- For issues that are macrocritical and where the Fund has expertise, staff analysis and policy advice are required.
- For issues that are macrocritical but where the Fund does not have expertise, staff should analyze the issue, drawing on the expertise of, and in collaboration with, external partners as needed, but staff is not expected to provide specific policy advice.
- For issues that are not macrocritical but for which the Fund has expertise, staff may provide analysis and policy advice if requested by the member.
- For issues that are not macrocritical and where the Fund does not have expertise, analysis and policy advice should not be provided.
- While macrocritical issues need to be covered in bilateral surveillance, not all macrocritical issues will be covered in the same depth in every Article IV consultation, particularly given many social spending issues are structural and slow moving.

Programs[6]

- For social spending issues, whether they should be part of the program design and conditionality depends on the criticality standard under conditionality guidelines, including (i) whether social spending issues are critical for meeting program objectives or for monitoring the program's implementation, or (ii) whether social spending issues are necessary for implementing specific provisions of the Fund's Articles of Agreement or policies adopted under them. In the context of PRGT-supported programs, the objectives of the programs should be consistent with strong and durable poverty reduction and growth, and thus programs are expected to safeguard and whenever appropriate, increase social and other priority spending that would be needed to achieve this goal.

Capacity development (including Technical Assistance (TA) and training)

- CD in areas of Fund expertise, when requested by members, can also support them in addressing social spending issues to improve macroeconomic outcomes and/or support economic and financial stability.

[5] For details, see the 2022 Guidance Note for Surveillance under Article IV Consultation (IMF, 2022d).

[6] For details, see the 2024 Operational Guidance Note on Program Design and Conditionality (IMF, 2024b).

HOW TO ENGAGE ON SOCIAL SPENDING ISSUES IN COUNTRY WORK

This section covers a number of key issues on social spending engagement in both surveillance and programs. It clarifies the role of social spending in achieving program objectives and discusses specific considerations in designing social spending conditionality, including drawing from recent program experiences. It also discusses the role of capacity development and how it can complement and support engagement in surveillance and programs.

A. Formulating Policy Advice in Surveillance and Programs

22. Providing tailored policy advice to address social spending challenges is important. Below are several considerations that can help develop well-designed policy advice in achieving the policy objectives, while also enabling country ownership for policy traction in implementation:

- ***Accounting for members' specific circumstances, needs, and preferences.*** This is particularly important for social spending issues for two reasons: (i) the role of social spending and designs of social spending systems highly depend on the social and political preferences of a country, while economic and capacity considerations also play an important role. However, it is critical to distinguish between long-term structural needs/preferences and short-term policy responses to political/election cycles, and careful consideration is needed for engagement on social spending issues related to the latter; and (ii) the authorities are more likely to take ownership of reforms, and this would help improve traction of the policy advice. Furthermore, this consideration applies to both setting the reform agenda for social spending issues in general and formulating policy advice to address a specific social spending issue. On the former, many countries, especially EMDEs, often face multiple social spending challenges, and members' needs and preferences should be an important factor in the prioritization of different social spending issues (Box 4).

- ***Recognizing the macro focus of Fund expertise.*** When the Fund has expertise for a social spending issue for which it should engage, teams are expected to fully engage and offer specific policy advice. In this case, it is essential for country teams and experts to work closely from the start. As many institutions are working on social spending issues, often with complementary experiences and knowledge, close coordination with them is also important, particularly to align policy messages when appropriate and avoid duplication of work. For social spending issues for which the Fund should engage but lacks expertise, it is critical to collaborate with other stakeholders to leverage their expertise. However, in such cases, it is often challenging to balance between staying within our areas of expertise and being helpful with concrete policy advice (Box 5).

- ***Taking into account measurement and data limitations.*** Measurement and data limitations are often a barrier to high-quality analysis and policy advice. This has several important implications, including: (i) in the near term, the need to formulate policy advice based on existing imperfect information, which may require complementing data analysis for the member with lessons from the experiences of peer countries having a similar social spending design, relying on cross-country data from international organizations when available, and making the appropriate adjustments when administrative data from the member needs to be used—for example, in the case of programs. Good planning—leaving sufficient time for data-related preparation—and reaching out to FAD at an early stage would be particularly important; (ii) the need to work closely with partners, which may have access to additional data and experiences dealing with data limitations; and (iii) the-medium term need to improve social spending data, including through capacity development.

- ***Recognizing possible interlinkages between spending adequacy, spending efficiency, and fiscal sustainability as well as across different components of social spending.*** Effective policy advice needs to account for the interlinkages of the three channels, as policies to address one of the three typically have implications for the other two. For example, measures to address spending adequacy—through increasing coverage or benefit levels—could jeopardize fiscal sustainability, which means measures would need to be introduced to raise revenues, reallocate spending from other areas, or enhance spending efficiency (e.g., by reducing waste and administrative cost and/or improving allocation and targeting). Similarly, different social spending components can contribute to achieving the same policy objectives and thus policy designs need to consider their composition, for example between education and health spending in building human capital in the long term.

- ***Articulating policy advice and its social and macroeconomic implications.*** As social spending issues are often long-term and structural in nature, addressing them requires a long-term strategy often through a reform package:

    - *design of the reform, including sequencing and phasing of the different measures*. For example, to address fiscal sustainability of a pension scheme, retirement age would be gradually raised over time. To strengthen the protection of the poor, a targeted cash transfer program would be introduced, with clear eligibility criteria and benefit levels and supported by first an information campaign to raise awareness and participation, the establishment of a social registry, and tax administration and policy reforms to provide the needed financing. The benefits may need to be gradually withdrawn above a certain income level to limit work disincentives.

    - *assessment of the social and macroeconomic implications of the reform*. This includes the impacts of the reform on poverty, inequality including on gender, and economic growth, among others. This can help better understand the effectiveness of the reform and also communicate with the member and other stakeholders.

- ***Ensuring consistency in social spending policy advice in achieving near-term and medium-term objectives.*** There is sometimes a tension between medium-term policy advice in Article IVs (for example, the need over the medium term to increase the number of teachers and education spending) and near-term policy objectives in programs (for example, the need for fiscal consolidation and a reduction in the wage bill in the education sector in the near term to close the BOP gap). In this case, lowering the wage bill through a temporary reduction in wages may be best aligned with the medium-term policy objective for the education sector.

23. Typical policy reforms in social spending vary by spending area. These are discussed in more detail in the TNMs. Some general lessons from this analysis are below, with some country examples (Box 6).

- *Pensions* - A frequent pension policy trade-off is between addressing short-term fiscal adjustment and long-term objectives (such as expanding coverage or maintaining benefit adequacy for retirees), and the need to maintain the pension systems' credibility and sustainability in the eyes of taxpayers (contributors) and benefit recipients.

- *Social Safety Net (SSN*) – Typical social safety net reforms focus on expanding coverage, better targeting benefits (see Box 7 on targeted versus universal benefits), or adopting information technology and other mechanisms to improve the efficiency and equity of the SSN (Fiscal Monitor, 2018).

- *Health spending* – Health reforms can focus on lifting health coverage and financing, constraining costs through the identification of savings (in pharmaceutical and hospital spending) and addressing weaknesses in health system design (for example, fragmentation and duplication).

- *Education spending* – Education spending can be increased to support student enrollment or support approaches to lift teaching quality (including through wages and/or increasing the number of teachers)[7]; tertiary systems can become more responsive to the labor market or improving efficiency by supporting disadvantaged students, particularly in the early years.

Box 4. Prioritization Across Social Spending Issues in Fund Engagement

Many countries face multiple social spending challenges, potentially for example, in advanced economies, fiscal sustainability in pensions and health, spending efficiency in education, health and social protection, and spending adequacy for some segments of the population, and in EMDEs, spending adequacy and efficiency for nearly all social spending areas, constrained by fiscal space and administrative capacity. Country teams can draw on the following when considering prioritization of social spending issues in a specific Article IV:

- *Needs and preferences of the member*. As discussed earlier, significant weight, when appropriate, should be put on long-term structural needs and preferences of members—not short-term policy responses to political/election cycles—in prioritizing of social spending engagement.

[7] While many studies show that higher teacher pay and smaller class size are associated with increased student achievement, the relationship may vary by country-specific conditions. Furthermore, limited resources should be targeted at the most cost-effective interventions.

Box 4. Prioritization Across Social Spending Issues in Fund Engagement (concluded)

- *Complementarity with other stakeholders*. Fund engagement should prioritize social spending issues or aspects of social spending issues that it has expertise and avoid duplicating efforts with other stakeholders.
- *Social and macroeconomic impacts*. Even among macrocritical policy issues, the degree of their macrocriticality may vary. Priority should be given to those that have greater social and macroeconomic impacts, and some assessments of costs and benefits could be useful. Recent literature on marginal value of public funds (MVPFs) can help make such assessments (Finkelstein and Hendren, 2020; Hendren and Sprung-Keyser, 2020).
- *Policy traction*. The likelihood of a successful implementation should also be an important consideration. This may be related to administrative capacity of the member and/or its resource constraints when there are competing needs.
- *Addressing constraints*. Some reforms can help ease the constraints on administrative capacity and resources, such as revenue mobilization (e.g., Georgia, Maldives, Dominica, and Ghana), improving social spending efficiency, and institution building (particularly the use of MTEFs and MTFFs to embed spending plans in fiscally sustainable medium-term frameworks).

These considerations can also help prioritize the engagement on social spending issues in programs, particularly in assessing the extent to which different social spending issues meet the criticality standard under the conditionality guidelines.

Box 5. Depth of Engagement

The 2019 strategy paper outlines several principles on the depth of engagement in surveillance, indicating the depth of policy advice should reflect urgency of the issue, the authorities' policy agenda and capacity, and the Fund's comparative advantage and in-house expertise to provide specific policy advice. More specifically:

- When the Fund has deep knowledge in the specific social spending issue, staff should fully engage, staffing and resources permit. In addition, in-depth engagement can be spread over multiple surveillance cycles.
- When the Fund lacks expertise, staff should focus on macroeconomic aspects of the issue, leaving sector-specific policy advice to IDIs that with relevant expertise and capacity.
- When the Fund has some expertise, in addition to focusing on macroeconomic aspects of the issue, staff may offer some sector-specific advice including reiterating recommendations from other IDIs, provided they are consistent with Fund expertise and vetted by Fund expert. Staff should restrain from getting into controversial issues, including those for which key IDIs have different views.

Programs typically focus on implementing already developed policy advice and urgent policy issues. While specific policy advice on social spending issues may be deferred to the next Article IV cycle, in a program context, conditionality on an issue might be needed if it is critical to the program's success.

In all cases, staff should consult FAD early in the process to understand if the Fund has expertise on the issue and for further collaboration as appropriate.

Box 6. Social Spending Reforms: Key Options and Country Cases

Pensions:

- Pension reforms include parametric adjustments, structural reforms or paradigm shifts to address core system weaknesses. Parametric adjustments leave a pension system's overall objectives (e.g., defined benefit, defined contributions, level and mode of funding) and basic features unchanged but adjust key parameters related to eligibility, benefits, and contribution levels. The focus of structural changes is on the mix of fundamental features such as public and private management and risk sharing (e.g., defined benefit and defined contributions). Paradigm shifts involve overhauling the objectives of a pension system, such as the creation of a zero-pillar scheme dedicated to poverty alleviation.
- Retirement age increases are commonly used to improve the fiscal sustainability of the pension system (e.g., Cyprus, Denmark, Estonia, France, Greece, Italy, Portugal, United Kingdom). The increase the statutory retirement age delays the date at which beneficiaries can retire and receive pension benefits. When implemented in isolation from other parameters, this reduces the overall generosity of the pension system since beneficiaries contribute for a longer period and, on average, receive benefits for a shorter period, avoiding the need to reduce pension benefits. Equalizing the retirement age for men and women by raising women's retirement age has the same impact but may also help reduce the pension gender gap.

Social Safety Nets:

- Countries employ a variety of (non-contributory) programs and policy instruments to protect households that make up the Social Safety Net. These range from poverty-targeted cash transfers (family, children, and orphan allowances) to social pensions, nutrition programs, and fee waivers (e.g., reduced medical fees, housing allowances, transportation benefits). There is no one-size-fits-all approach to the reform of SSNs as the focus of the reform will depend on whether weaknesses of the system are about adequacy, efficiency, or fiscal cost. The design of the SSN should also reflect complementarity with social insurance and labor market programs.
- Mauritania committed in September 2020 to protect the most vulnerable impacted by the pandemic and droughts/climate change by scaling up the targeted cash transfer scheme for the poor and vulnerable from 34,000 households to a target of 55,000 households by October 2020, and 70,000 households by end-2020. This required achieving an expansion of both the social registry of vulnerable households and the cash transfer program to cover the whole country, with support from the World Bank.

Health:

- Policy reforms can target system wide issues ("macro"), incentive issues and governance ("micro"), and services provided ("coverage and adequacy"). Macro level policies may include budget controls and caps to monitor health expenditure, defining the scope of health services covered by public schemes (e.g., general criteria of treatments and coverage of specific services such optical and dental), and workforce management (staffing levels, remuneration policy). Micro level policies focus on economic incentives to enhance health spending efficiency. Coverage and adequacy can involve expanding access and affordability (e.g., subsidizing immunization and nutrition services).
- Thailand's policy toward universal health coverage started in the early 2000s and expanded Thai citizens' access to preventive, curative, and palliative health services (Sumriddetchkajorn and others 2019). Over time, the disparities in per capita spending between the Universal Coverage Scheme and the scheme for private sector workers were reduced, and the provider payment mechanisms managed expenditure growth. In the decade after Universal Coverage Scheme was initiated, life expectancy at birth rose from 72 to 74 years and out-of-pocket spending came down.

Box 6. Social Spending Reforms: Key Options and Country Cases (concluded)

Education:

Reforms can focus on better translating education spending into schooling and learning that meets the government's education objectives (e.g., inclusive and equitable learning opportunities including by gender, social mobility, poverty reduction). Policy reforms can focus on investment on basic education, expanding access to education (including lifting enrollment, the teaching and professional workforces, and other reforms to improve the quality of learning outcomes.

Kenya made gains in education from increasing spending, increasing enrollments, and improving learning outcomes before the pandemic. The World Bank highlights the following critical priorities: (1) adequate resources to achieve sector objectives and implement ambitious reforms; (2) allocating resources more equitably, particularly development spending, teachers and school capitation grants and (3) using resources efficiently by exploiting data in management, particularly at the local level, as well as reducing fragmentated management of the sector.

Box 7. Targeted vs. Universal Social Benefits

The relative merits of targeted versus universal social benefits have attracted much attention and remain a policy challenge for staff and country authorities. The use of targeted and universal social benefits, as well as the targeting methods, varies by country and social spending issue. 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. The 2019 strategy paper, including one of its background papers, and the Technical Note and Manuals on IMF Engagement on Social Safety Nets:

- provide extensive discussions on the key considerations of targeted versus universal social benefits and the benefits and costs of targeting and different approaches to targeting; and
- emphasize that the appropriate use of targeted and universal social benefits depends on country preferences and circumstances and should be consistent with fiscal and administrative constraints.

A desirable income/welfare distribution can be broadly achieved through universal social benefits and progressive taxation, targeted social benefits and proportional/regressive taxation (e.g., through a consumption tax such as VAT), or somewhere in between with targeted benefits and progressive taxation. The comparison ultimately comes down to the advantages and disadvantages between targeting benefits and targeting taxation. They both face similar challenges, including:

- *Efficiency cost*. Means or proxy means-tested targeting for social benefits creates work disincentives. The main form of progressive taxation is a personal income tax (PIT) or a wealth tax, which also disincentivizes work.
- *Administrative feasibility and cost*. Both benefit targeting and taxation targeting requires collecting information on and verifying household income, as well as applying for and collecting benefits and filing tax returns, with private monetary and time costs.
- *Social and political cost from targeting error*. Means- or proxy means-tested targeting can never be perfect. Some poor may be wrongly excluded from receiving social benefits, while some high-income may be identified as eligible. Similarly for PIT, people may not pay their fair share, through tax avoidance and evasion. Alternative targeting methods for social benefits (e.g., categorical targeting) and for taxation (e.g., exemptions in consumptions tax) would lead to different tradeoffs between efficiency cost and targeting error.

Box 7. Targeted vs. Universal Social Benefits (concluded)

- Efficiency and administrative cost of universal social benefits and consumption taxes are expected to be relatively low but can also be considered.

The consideration should take into account that targeting can be improved over time with CD and also with technological developments. In some cases, when the available resources are fixed, this leads to an additional tradeoff between low benefits for the poor and thus limited impact on poverty alleviation with a universal scheme and a larger poverty impact with a targeted scheme. Here are a few country examples of targeted and universal social benefits (Mauritania 2020 ECF; Sri Lanka 2023 ECF; Argentina 2018 SBA; Nepal 2022 ECF).

B. Specific Issues on Social Spending in IMF-Supported Programs

24. Social spending can play an important role in achieving program objectives.

- Addressing spending adequacy can help protect the vulnerable from economic shocks, mitigate any adverse impacts of program policies on the vulnerable, and reduce disruptions to learning and the provision of healthcare during the program period, ultimately contributing to poverty reduction and inclusive growth. Addressing adequacy can also help build public support and political ownership of the program.

- Improving spending efficiency (e.g., reducing administrative cost by streamlining social programs, improving designs to reduce waste and distortions, and enhancing public financial management to raise the effectiveness of social spending) can help further improve social outcomes, for a given resource envelop which is typically the case in programs. Alternatively, improving spending efficiency can help strengthen fiscal sustainability, without jeopardizing the poverty reduction and inclusive growth objective.

- Some social spending reforms can contribute to fiscal consolidation and fiscal sustainability. For example, social protection benefits to the rich may be reduced through better targeting, parameter reforms to the pension systems can help improve its long-term sustainability, and there may be scope to make the health systems more sustainable by increasing private financing, depending on country circumstances.

25. Engagement on social spending in programs should be relevant for achieving program objectives, while supporting countries' policy objectives. While programs typically have a relatively short-term horizon to help countries restore macroeconomic stability, they are also designed to support countries' own long term development objectives, including on social spending, where this is consistent with the primary macroeconomic goals of the programs. This highlights the importance to work closely with development partners during and after the programs, as well as continued efforts in surveillance after programs end.

26. Social spending issues can enter into program design in two main ways: (i) social spending can be part of authorities' policy commitments as described in the Memorandum of Economic and Financial Policies (MEFP) or embedded in broader program conditionality such as ceiling on fiscal deficit, contributing to achieving program objectives; and (ii) when social spending is critical to achieve program objectives, quantitative conditionality—including Prior Actions (PAs), Quantitative Performance Criteria (QPCs), and Indicative Targets (ITs)—and/or structural conditionality—including PAs and Structural Benchmarks (SBs)—on social spending can be introduced to ensure commitments and progress.

27. The design of social spending conditionality (SSC) should be guided by the principles of realism, granularity, gradualism, and parsimony (2018 ROC). The starting point of designing effective SSCs is to apply these principles in the social spending context:

- *Realism:* program conditionality should reflect various constraints such as macroeconomic conditions, administrative capacity including governance, political constraints, availability of high-quality data, and complexity of the issues.[8] These are the key characteristics of social spending issues, and thus being realistic should be a key consideration in the design of SSC for it to be successful.

- *Granularity:* program conditionality should be specific. Where components of social spending are not well-designed, or/and inefficient, SSC focusing on specific schemes or issues can potentially be more effective.

- *Gradualism:* a gradual approach may work better, as reform implementation may require time, ownership, capacity building, and substantial financing. As many countries, particularly low-income countries, have weak capacity, including in implementing social spending reforms, and are constrained by limited fiscal space, a gradual approach would allow time to address the various constraints step by step.

- *Parsimony:* program conditionality should focus on fewer but deeper reforms. Many countries face a diverse set of social spending issues and SSCs should focus on those that are most critical to achieve program objectives, leaving other long-term structural reforms for surveillance.

28. The use of quantitative and structural conditionality should reflect the intended objective, the nature of social spending issues, and local capacity constraints. Quantitative and structural conditionality should be used in accordance with their specific purposes and conditions, as set out in the Guidelines on Conditionality. The relevant conditionality will depend on the type of social spending issues to be addressed, as well as country-specific conditions.[9] In broad terms,

[8] Please see the discussions under capacity development on related CD support by the Fund.

[9] PAs are steps a country agrees to take before the IMF approves financing or completes a review and ensure that a program will have the necessary foundation for success; QPCs are specific, measurable conditions for IMF lending that always relate to macroeconomic variables under the control of country authorities; ITs are flexible numerical trackers, may be set for quantitative indicators to help monitor progress in meeting a program's objectives. Heightened uncertainty and limited capacity may justify greater use of ITs under certain circumstances. As uncertainty is reduced, these targets may become QPCs, with appropriate modifications; and SBs are reform measures that often cannot be quantified but are critical for achieving program goals and used as markers to assess program implementation (see Guidelines on Conditionality for further details).

- For *spending adequacy*, quantitative conditionality (e.g., QPCs or ITs on spending, coverage and/or benefit level), coupled with structural conditionality (e.g., SBs to help improve coverage, for example, through a social registry, and targeting) could potentially work the best.[10] On quantitative conditionality, the choice between QPCs and ITs heavily depends on the extent to which social spending issues are critical for program success, the administrative capacity and availability of high-quality data on social spending by the authorities to avoid misreporting, and uncertainty associated with social spending issues. Additional consideration may be given to QPC to help enhance commitments and ownership of the authorities when data availability allows. In addition, an IT can be initially adopted and be converted into a QPC as administrative capacity and/or data quality improves, or an IT can be elevated to a QPC to improve policy traction when data availability allows (Pakistan 2019 EFF and Tunisia 2016 EFF, which helped achieve the inclusive growth objective of the programs).

- As improving *spending efficiency* often involves enhancing the designs of social spending programs, it is difficult to set quantitative targets. Even when quantitative criteria are possible (e.g., composition of spending, student-teacher ratio, or doctors per 100, 000 population), meeting the quantitative targets may not necessarily mean better efficiency as these reforms tend to be complex and often takes time. For example, increasing the number of teachers to reach a target on average student-teacher ratio may not necessarily mean that the best candidates are retained at the schools in most need. In addition, there may not be a widely acceptable evidence-based target, which may depend on country-specific conditions, and these types of reforms involve large uncertainty, with changes to employment framework, possibly through negotiation among stakeholders. Therefore, a bottom-up approach is likely to work better with SBs on, for example, employment framework, which would gradually lead to an increase in average student-teacher ratio.

- Even though it may be easier to set a quantitative target for fiscal sustainability than for spending efficiency, a bottom-up approach based on SBs would also likely work better to address *fiscal sustainability*. To resolve long-term fiscal sustainability, changes to the designs of social spending programs are likely to be needed to address the root causes of the issues. For example, parameter reforms for pensions, or reforms to increase private financing and improve efficiency for health systems, may be necessary. Quantitative targets, if more stringent than what the SBs can deliver, would likely lead to ad hoc cuts in spending which may lead to inefficiencies, equity concerns and potentially also arrears or rationing of services. For spending that are less subject to design issues (e.g., capital spending, wage bill, or spending on goods and services), it would make more sense to include them within the broader set of spending measures, supporting the overall fiscal balance target. With this, the authorities can balance the need for fiscal adjustment in different spending areas, without singling out any specific social spending. This is also more consistent with the parsimony principle on setting program conditionality.

[10] Development partners may be better positioned to deliver some of these complementary structural reforms, given their capacity and expertise (Cameroon 2021 ECF-EFF, Ecuador 2020 EFF). This, however, requires close coordination.

- Recent program experiences indicate a mix of different types of conditionality, particularly ITs and SBs, broadly consistent with the discussions above (Annex IV; Hanedar and Munkacsi, forthcoming).

29. Social spending floors are the most common form of SSC and their design is of particular importance (Box 8). The design of a social spending floor should reflect and be aligned with program objectives to help improve adequacy or prevent a decline in adequacy under challenging macroeconomic conditions. In this respect, social spending floors do not aim at setting ideal or normative levels of social spending as a whole or for certain categories. More specifically, a social spending floor, better if combined with relevant SBs, can be an effective tool to protect the most vulnerable during the program period, for example, by excluding key social programs from fiscal adjustment or ensuring a steady increase in their spending levels. The design of a social spending floor involves defining its coverage, operationalizing the definition based on available data and administrative capacity, and setting the target.

30. The coverage of a social spending floor depends on the specific purpose of the floor in supporting program objectives and usually involves decisions along two key dimensions (Figure 5):

- ***Coverage of recipients: targeted vs. universal.*** This refers to whether the coverage of the social spending floor is only limited to the intended recipients, per the program objective, or is available for a broad population of recipients. [11] For example, if the program objective is to protect the poor, a targeted approach would mean limiting benefits only to the poor, while a universal approach would mean providing the benefits to the entire population. The policy options (e.g., benefit targeting, taxation targeting, low universal benefit with no targeting, and high universal benefit with no targeting and high fiscal cost) and their tradeoffs, as discussed in Box 7, still apply, though in the program context with a short-term horizon and often tight fiscal space.

- ***Coverage of spending categories and programs: narrow vs. broad.*** The choice, for example, involves specific social assistance programs vs. all social assistance programs, capital spending in education vs. total education spending, primary care spending vs. total health spending. Narrowly defined social spending is consistent with the granularity principle. If the social spending floor targets well-designed programs or spending categories, it can be more cost effective. However, this may come at the potential cost of a reduction in program flexibility or reaching only a small share of the intended recipients. For example, if the program objective is to protect learning and limiting any scaring effect during a crisis (which can help reduce poverty and achieve inclusive growth), the social spending floor can target capital spending and good

[11] An example of universal coverage is the Sudan Family Support Program (SFSP), a quasi-universal basic income scheme supported by the donor community and World Bank and a key component of the social spending floor. It was designed to alleviate the short-term effects of subsidy removal and exchange rate reform on the majority of the population and to help generate the political and economic space for a comprehensive program of economic reform. The program also served as a platform for the development of a future targeted social safety net system via the provision of national unified digital identity documents (Sudan 2021 ECF).

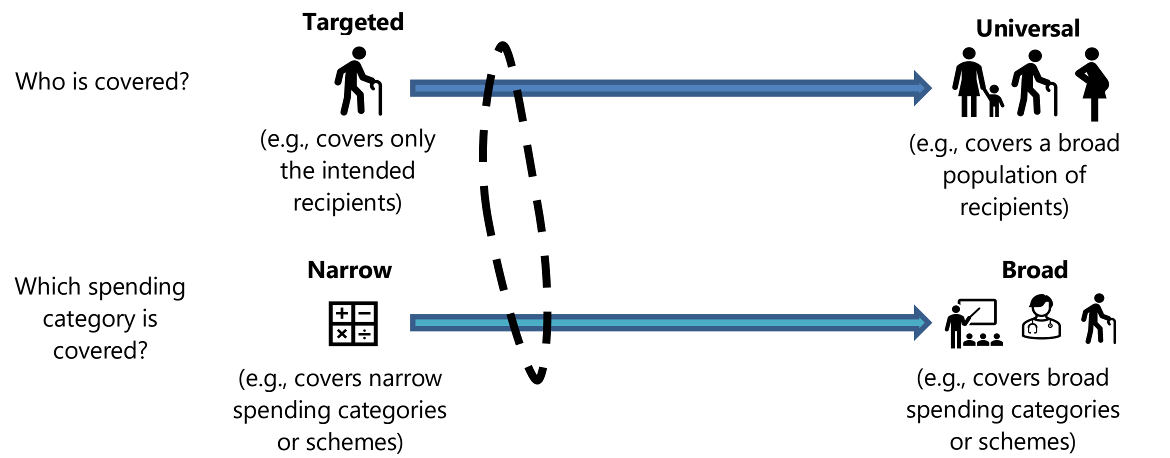
and services in the education sector or be set on entire education spending. In the former case, this would allow continued investment in the education sector and ensure that teachers and students have what they need, while leaving room for potential adjustment on the wage bill if needed. In the latter case of a broader floor, the design could make it difficult for the education sector to contribute to fiscal adjustment during the crisis, even if wages in education sector become too high related to the private sector and disincentivize reforms to improving spending efficiency. However, in the event when the education sector needs more teachers and less capital investment (contrary to the program assumption), the narrowly defined social spending floor would not be able to respond. Also, in the case of narrowly defined floor, if the specific social assistance programs under the floor have limited coverage in terms of the vulnerable, this could jeopardize the program objective of protecting the vulnerable, leaving a large portion of them unprotected.[12]

- ***The design would also need to consider additional factors*** such as data availability (e.g., disaggregated data), administrative capacity, how well-designed different social spending programs are, and the potential for crowding out across spending components covered by the social spending floor. For example, disaggregated spending data for narrowly defined targets (e.g., specific social assistance programs) may not be available on a timely basis. When direct measurement of the spending is not available, proxies based on other data may be considered. In the case of Madagascar 2021 ECF, under the IT on social spending floor, social spending was defined as domestically financed spending, excluding salaries, of the ministries of health, education, water and sanitation, and population. Putting in place new targeted programs may take time, particularly for countries with limited capacity, though some countries were able to create a social registry in a relatively short period during the COVID-19 pandemic. One feasible approach is to take an existing program—how well it is designed is thus critical—and gradually improving its targeting and coverage through SBs. For broadly defined targets, there are risks that resources may disappointedly go to certain areas (e.g., wages in the case of education and health spending), leading to spending inefficiency. The design of social spending floors may also need to be regularly revisited to reflect changing conditions (e.g., the 2017 expansion of the floor in Tunisia 2016 EFF).

31. Mixing different components of social spending or mixing social spending with other spending should be avoided. Consistent with granularity in designing program conditionality, it is not advisable to mix different social spending components or mix social spending with other spending in setting a social spending floor. This could jeopardize achieving program objectives, as the target could be met by too much spending on some and too little on the others.

[12] The social spending floor will initially focus on the child grant spending. While a universal child benefit, its relative low spending and coverage suggests that its impact on vulnerable households is likely limited (Nepal 2022 ECF).

Figure 5. Coverage of a Social Spending Floor: Two Key Dimensions



Source: IMF staff formulation.

32. Some basic considerations should be weighed when setting social spending floor targets. Social spending floors are typically expressed in nominal terms in program documents. The underlying design could be based on constant or increasing (i) spending as percent of GDP (the target varies with the state of the economy and could decline in real terms when the economy is weak), (ii) aggregate spending in real terms (a more robust target, which does not vary with the state of the economy), or (iii) per capita spending in real terms (likely the most robust target, which could lead to higher spending in real terms if coverage is expanding). There is clearly a tradeoff between protection of social spending and fiscal costs and risks, depending on the ability to project GDP, inflation, and coverage. Social spending floors could also set target on coverage when it is a key policy concern (Nepal, ECF/EFF, 2022). Adjustors, however, can potentially help manage the risks. For instance, the floor could increase if revenues overperform or coverage expansion is larger than expected.

33. SBs play a key role in addressing social spending issues in programs.[13] In addition to the discussion above, the design of SBs should also consider:

- Ensuring consistency between QPCs/ITs and SBs in case they are both used in a program. For example, when SBs help improve targeting and coverage of social assistance programs, they have implication on fiscal cost of the programs as well, which should be reflected in the design of QPCs/ITs.

- QPCs/ITs and SBs can potentially complement each other in achieving program objectives, with QPCs/ITs ensuring available resources and SBs improving the efficiency and coverage of social spending programs. Appropriate sequencing and phasing of SBs, including aligning with

[13] Structural public financial management conditionality (such as on budget execution and control) has proven to be effective in boosting the long-term level of education, health, and public investment expenditures (Gupta, Schena, and Yousefi. 2018).

technical assistance, can help maximize the benefits, and this requires realistic estimates of the time needed for each step, particularly those involving IDIs (see also Section VI).

Box 8. Country Case Studies on Social Spending Floor

Argentina (2018 - SBA).

Classification and objectives. Social spending floor under the program was set as a QPC with the objective of protecting society's most vulnerable by strengthening social spending (both recurrent and capital).

Definition and coverage. The Technical Memorandum of Understanding (TMU) definition of the "Floor on Federal Government Spending on Social Assistance Programs" indicated the federal universal program of social protection as main beneficiary of the priority spending and provided a detailed list of all its social protection schemes. The QPC aimed at providing universal benefits to children (including disabled), pregnant women, and education, and included additional targeted benefits for specific groups of families.

Calibration of the floor and implementation. The level of the social spending floor was calibrated starting from an ambitious but realistic spending in percent of GDP (1.3) coupled with the identification of the expected number of beneficiaries under each scheme (total recipients higher than the official census of people in poverty). The QPC included an adjustor to ensure that under worsening economic conditions spending for benefits under the universal child allowance program could be increased by up to 0.2 percent of GDP per calendar year. The QPC was met at each of the completed reviews.

Main lessons. The Success of the social spending conditionality benefited from a careful and tailored design of the QPC in collaboration with the authorities and experts. The target was ambitious but realistic and fully aligned with program objectives and priorities. The choice to favor existing social schemes efficiently administered and with wide coverage contributed to the success.

Barbados (2018 - EFF).

Classification and objectives. The social spending floor was set as an IT with the objective of mitigating any adverse effects on the vulnerable from the fiscal adjustment under the program reform agenda. The MEFP included commitments to strengthen social safety nets, streamline and integrate existing benefits programs, and improving social protection targeting.

Definition and coverage. The TMU clarified that the indicative floor on social spending would apply only to expenditures incurred by the Central Government on programs supporting the vulnerable—the unemployed, poor households, vulnerable children and youth, and the elderly—in education, health, social protection, housing/community services and recreational activities. The authorities worked closely with the IDB to improve the efficiency and effectiveness of social spending.

Calibration of the floor and implementation. No specific information on the calibration of the IT was included in the TMU or program description. The level of the social spending floor reached a maximum level of about 0.5 percent of GDP, and approximately 10-25 percent of IFIs budget support over the life of the program and did not include an adjustor. The IT was met at each review.

Main lessons. This is a typical case of social spending floors to mitigate the temporary adverse effects of program reforms on the most vulnerable. With no information on the calibration of the IT, it is unclear whether the spending floor level could have been more ambitious. Lack of specific information on the allocation of resources, the effectiveness of the existing social safety nets, and the quality of their administration prevents from an assessment of spending efficiency.

Benin (2022 – EFF/ECF).

Classification and objectives. The social spending floor IT was set to achieve the core program objective of improving socioeconomic outcomes, building on the authorities' social spending plans and taking into

Box 8. Country Case Studies on Social Spending Floor (concluded)

consideration data availability, timeliness, and measurability. The IT was also considered necessary to mitigate fiscal pressures on the most vulnerable part of society and improve Benin's social safety nets. The IT is supported by structural conditionality and the development of a national registry.

Definition and coverage. The TMU definition of the priority social spending (PSE) included expenditure executed from the State budget relating mainly to the areas of education, health and nutrition, the establishment of social safety nets, access to electricity, water and sanitation, microfinance security and civil protection. The PSE was set to be very selective, covering a specific list of recipients, and to capture only spending that directly reduces poverty.

Calibration of the floor and implementation. The level of the social spending floor has been calibrated at about 1.5 percent of GDP on annual basis, which seems at the same time sizable and realistic. The MEFP clearly identifies the expected groups and number of beneficiaries under each category of social spending. The IT was met at each of the completed reviews.

Main lessons. Social spending conditionality has been successful under the program until now thanks to the extensive analysis of Benin social system, challenges, and prospects, coupled with the rigorous design of an IT based on execution instead of allocation and of supporting SBs. The target, fully aligned with program objectives and priorities, is expected to be financed by a reduction of distortionary subsidies and other inefficiencies. Cooperation with the authorities and other IFIs, and the ongoing governance and capacity building reforms can help further accelerate progress.

Madagascar (2021 ECF).

Classification and objectives. The social spending floor was set as an IT with the objective of improving social spending execution and outcomes compared to previous programs, on the back of increased budgetary allocations. The MEFP included commitments to strengthen budget execution and transparency to support better performance on social spending conditionality.

Definition and coverage. In the TMU, priority social spending includes domestic spending for interventions in nutrition, education, health, and the provision of social safety nets. The floor is set as the sum of the budget allocations in the Loi de Finance to the Ministries of Health, Education, Population and Water, excluding salaries and externally financed investment. Coverage of beneficiaries and targeting are not defined in the program documents.

Calibration of the floor and implementation. Madagascar faced continuous challenges in meeting the floor—which was originally calibrated on increased resources devoted to social spending. Although the sources of social spending funding were clearly identified and available, the level of social spending remained significantly below target, despite the repeated downward revisions of the IT and continued technical assistance by the Word Bank and the European Union.

Main lessons. The main reasons behind this poor performance are related to low capacity, severe weaknesses in budget execution and monitoring, lack of transparency, and poor traction of the authorities under program conditionality.

C. Capacity Development

34. Capacity development is an integral part of Fund engagement on social spending, complementing and supporting surveillance and programs. In addition to helping members build their capacity, capacity development can be particularly useful for country engagement on social spending issues, under both surveillance and programs, by facilitating the development of policy advice and its implementation.[14] The IMF provides capacity development directly in several social spending areas (Table 1). In addition, capacity development in the general areas of public financing management, tax policy and revenue administration can also help improve the efficiency of social spending and create fiscal space for enhancing social spending adequacy.

Table 1. Examples of IMF Capacity Development in Social Spending

Department	Social Spending Areas	CD Activities	Country Examples
FAD	Social Safety Nets	Options to strengthen social safety nets to support other reforms and issues	Colombia: Options to strengthen SSN to support energy subsidy reform; Cyprus: Development of a well-targeted minimum income scheme to support vulnerable households
	Pension spending	Modelling long-run costs of pension systems and options for reform	Algeria: modelling long-term costs and options to improve sustainability; Other examples: Maldives, Grenada, Zimbabwe, Cyprus, Estonia, Panama
	Health spending	Health spending efficiency assessment Adequacy assessment of heath spending Assessment of wage bill (including health sector)	Jordan: Measures to improve health spending efficiency; The Gambia: Spending needs to achieve Health SDG (and education); South Africa/ Moldova/ Benin: Government wage bill assessment and options (including overall/ education)
	Education spending	Education spending efficiency assessment Adequacy assessment of education spending	Sierra Leone – Benefit incidence of education (and health) spending (including workshops and training); Namibia - Spending needs to achieve SDGs in Education (and health)
	Data	Chart of accounts functional classification of government spending	Egypt (jointly with STA): identifying and advancing key improvements to the Government Finance Statistics (GFS), including the coverage and quality of existing GFS and Public Sector Debt Statistics at the central and general government sector levels and the current sector classification of public sector units

[14] Please see Operational Guidelines for Integrating Capacity Development with Surveillance and Lending for further discussions.

Table 1. Examples of IMF Capacity Development in Social Spending (concluded)

Department	Social Spending Areas	CD Activities	Country Examples
STA	Data	GFS data compilation and reporting including for Classification of the Functions of Government (COFOG)	Rwanda: improving the coverage of COFOG to meet the requirement of GFS; Iraq: using a combination of administrative, economic, sectoral and program national classifications to map expenditure data into COFOG classification; Palau: compiling 2008-2019 COFOG time series using annual financial statements

EXTERNAL COLLABORATION AND OUTREACH

This section outlines the approaches to external collaboration and outreach at both the institutional level and the country team level.

A. Collaboration with External Development Partners

35. **Collaboration with external stakeholders is a key part of the 2019 social spending strategy.** Given extensive experiences and knowledge of some IDIs on social spending issues, close engagement with IDIs, such as the World Bank, the International Labor organization (ILO) and the World Food Program (WFP), can be very valuable, in several ways, including:

- Exchanging views and coordinating policy messages. The Fund and IDIs sometimes have different views on policy priorities and messages, partly reflecting differences in institutional focus, for example, the Fund's focus on short-term stabilization in programs versus the longer-term development focus of IDIs. 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.

- Leveraging specialized expertise and knowledge by IDIs. 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. The Fund can benefit from leveraging the expertise and experiences of IDIs in both developing broad policy messages on social spending issues and provide country-specific support, especially when the Fund has no or little expertise.

- Complementing each other's work and avoiding duplication. Each institution has its comparative advantage in addressing different aspects of social spending challenges (i.e., macroeconomic-related issues for the Fund), but there is also overlap among different institutions in their policy focus. One benefit of close collaboration is to amplify complementarity, while limiting duplication of efforts. For example, a number of international institutions have been developing cross-country databases, and close collaboration can help harmonize data collection efforts and share best practices in social spending data management and reporting.

36. Collaboration at the institutional level can help exchange policy views on broad social spending issues and facilitate further collaboration at the country team level. More specifically,

- FAD would act as a hub for identifying relevant counterparts and provide guidance on where IDIs take the lead or provide complementary support. FAD has been in close contact with IDIs on different social spending issues—for example with the World Bank on education, health, and social protection. In addition to developing and coordinating broad policy messages social spending issues, FAD can also help country teams identify relevant experts from the World Band and other IFIs and facilitate collaboration at the country level.[15]

- Joint events and country-level collaboration with external stakeholders on issues of common interests can be effective ways to foster knowledge exchange and enhance collaboration.[16]

37. Collaboration at the country team level can focus on policy issues in a specific country context (see Box 9 on the experiences of Jamaica). This includes:

- Reaching out to FAD and SPR at an early stage, so they can help identify the relevant IDIs and the right counterparts within those IDIs.

- Recognizing different institutional priorities and cycles of engagement, it is important to have early dialogue with IDIs—particularly when a country strategy is being developed—to better understand their workplans, priorities for the country, and policy views.

- Understanding that ultimately IMF staff is responsible for its policy advice and collaboration with IDIs help country teams in formulating such policy advice. Thus, frequent update and

[15] SPRAIIG can help identify the relevant counterparts on issues related to social spending and gender.

[16] For example, the Fund and ILO co-organized a workshop on labor market issues, and the Fund piloted country-level collaboration with ILO and WFP. The collaboration between the IMF and ILO has been effective and has shown that collaboration is mutually reinforcing. As a next step, the Fund is working with ILO's social protection directorate to mainstream the collaboration at country level.

consultation with Fund expert (e.g., FAD) is strongly encouraged, while working with IDIs on social spending issues.

B. Outreach and Communication

38. Outreach and external communication can help raise awareness of Fund engagement, articulate policy advice, and increase policy traction. Given the high political sensitivity of social spending issues, outreach and communication should be a key part of Fund engagement, with important roles for FAD, SPR, COM and country teams. This can help:

- highlight that the Fund sees social spending as an important issue and is actively engaging through its activities in surveillance, programs, and capacity development. However, the Fund's engagement can only focus on social spending issues that are macrocritical in the surveillance context or meet the criticality standard in programs, given its mandate and expertise.

- explain the considerations and rationales underlying Fund policy advice and counter any unfounded and unfair criticism of Fund engagement.

- improve the traction of Fund policy advice, including for social spending issues.

39. A structural approach should be taken at both the institutional level and country team level.

- At the institutional level, FAD and SPR should take the lead, with support from COM, regularly interacting and updating external stakeholders, including CSOs, on Fund engagement on social spending issues, as a group during the Spring and Annual meetings and bilaterally as needed with selective external stakeholder.

- Country teams, in collaboration with COM, should have a clear communication plan, if social spending issues are covered in surveillance or programs:

    - Before the mission: early collaboration between country teams and COM during the surveillance cycle and early stages of program design; engaging IDIs to explain the Fund views; and reporting back to FAD and SPR and consulting internally, particularly if there are strong disagreements.

    - During the mission: meeting with CSOs, academics, labor unions, local experts to explain Fund engagement; gather information to better understand social needs and the political economy; including references to social spending issues in concluding statement and press release as needed; and preparing to respond to potential questions during the press conference.

    - After the mission: ensuring adequate dissemination of the staff report to the authorities and other stakeholders within and outside the country; further engagement and outreach by the team and the IMF Resident Representative (ResRep) addressing any additional feedback; and considering upgrading ResRep webpages on the issues with COM support, as needed.

Box 9. Collaboration With IDIs: the Case of Jamaica

The Fund quickly engaged on social spending issues with Jamaica's government agencies. Jamaica requested assistance from the Fund twice during 2010-20 to tackle high public debt and development challenges. Strengthening the social safety net to better protect the vulnerable during adjustment was seen as an essential condition for program success. In 2016, the authorities asked for a comprehensive assessment of existing social programs to identify those that should be improved/expanded. Fund staff engaged early on with the Ministry of Finance and Public Service, the Planning Institute of Jamaica, as well as the ministries of education, health, labor, and social security. To assist the authorities in their reform efforts, staff sought in-house expertise to analyze the impact of reforms on the most vulnerable and propose policy measures to support them.

Technical assistance played an important role in informing policy measures implemented under the program, including from IDIs. FAD provided TA on expenditure rationalization to help create fiscal space in support of fiscal consolidation and the social protection system. The Fund and the World Bank jointly provided TA in the summer of 2016, designing reform options to offset the negative welfare effects of the regressive tax reform—in particular, boosting the PATH (Programme of Advancement through Health and Education) program—and reforming pensions. The authorities drew heavily on the findings of the TA mission in designing their reform measures.

The Fund, the World Bank, and the Inter-American Development Bank (IADB) continued to jointly monitor progress. For instance, the IADB and World Bank completed a review of benefit adequacy and engaged on a plan to regularly reassess the effectiveness of eligibility rules for PATH and extend of coverage of selected active labor market programs (on track).

To support reform momentum, staff regularly interacted with local stakeholders. These included the Jamaica Confederation of Trade Unions, the Private Sector Organization of Jamaica, local media, and the opposition political party.

Annex I. Social Spending Data: Measurement, Availability, and Challenges

Data gaps arise for many reasons including different definitions and coverage. These gaps often impede the authorities' ability to adequately assess, plan and execute social spending programs. Improving data availability and quality is essential to strengthen staff's engagement on social spending issues. Efforts could focus on improving data collection, reporting, management procedures, and institutions.

1. Effective engagement on social spending typically requires a broad range of data and information that goes beyond public spending. Availability of high-quality data is key to effective engagement on social spending, including assessing the macrocriticality of social spending issues, formulating well-designed policy advice, and putting policies into practice. The data requirements are broad;

- *Spending data.* This includes public spending data from various sources (e.g., central government, local governments, public financial corporation, state-owned enterprises, and mandatory private schemes) and private spending data (e.g., by voluntary private schemes, firms, households, charities, and donors). They help provide a complete picture of total resources for different social policy areas and assess spending adequacy and efficiency.

- *Data on output and outcomes.* For example, information on student-teacher ratios, the number of medical professionals (e.g., doctors or nurses) per 100,000 population, and coverage of the vulnerable by social assistance schemes can help understand spending adequacy. Data on education and health outcomes (e.g., school enrollment, test scores, infant mortality, and life expectancy) are key to assess spending efficiency. Household survey data are particularly useful to understand the incidence of overall and main social spending programs.

- *Data and information on designs of social spending schemes.* Information on the designs of social spending schemes (e.g., eligibility criteria, targeting methods, benefit levels, and method of delivery) can help identify the drivers of inadequacy, inefficiency, and fiscal pressures and formulate policy reforms.

- *Other data.* This includes, for example, demographic trends and projections to assess future spending needs, information on contingent liabilities to assess fiscal sustainability, a database/social registry for targeting and benefit delivery.

2. Data on social spending may vary because of different definitions. For example, the GFSM 2014 has a broader definition for overall social spending that also includes housing, though the definitions are broadly in line with those of the strategy paper and guidance note, when it comes to health, education, and social protection. In some cases, the boundary of spending may not be clear because there may be more than one statistical concept associated with it. For example, in health, there are differences in the treatment of certain categories of spending depending on whether a GFS definition, a System of Health Accounts definition, or the System of National

Accounts definition is used. Moreover, social safety nets may be defined more broadly (e.g., treatment of subsidies) which may impact the delineation of social spending.

3. The definition of government may also impact social spending data. Social spending can be analyzed at the level of central government, general government (including social security), or overall economy, depending on the issue. Social spending is often delivered at the local or state levels and outside the scope of the central government. Therefore, general government level is typically preferred, particularly given its importance for assessing fiscal sustainability. However, data availability at general government level can be challenging, particularly in fiscally decentralized countries, where both central and local governments can have social spending responsibilities, often with parallel schemes and unintegrated databases.

4. Off-budget social spending may be an important source of data differences. Cross-country data for off budget spending (e.g., social spending financed by donor support) can be challenging to identify. This is particularly the case for some cash transfer schemes, as well as for health and education programs in LICs. COFOG will also not be sufficient where there is a high level of private spending.

5. Data on social benefits can be understated because of large in-kind payments. For many less advanced economies, national accounting and budget systems are not equipped to capture and/or properly report in-kind social assistance.

6. Data weaknesses may reflect capacity constraints. In many LICs or EMDEs, social spending data sources are fragmented. Data may be provided through individual line ministries and/or individual public entities and may differ from budget execution data used for the macro-fiscal framework. Countries that have adopted GFSM 2014 are likely to have better quality data because the GFSM 2014 presentation has cross checks that ensure consistency between COFOG and economic expenditure.

7. Consistency and timely availability of data are often a challenge, particularly for low-income countries where IMF engagement is especially needed. Given the complexity of social spending systems and the broad range of data requirements, it takes time and efforts to collect and consolidate data from different sources. In addition, the measurement of social spending may vary by cross-country database and country. For example, certain categories of health spending are treated differently in the GFS, the System of Health Accounts, and the System of National Accounts. While the availability and quality of social spending data have been improving over the past decades, there are still some significant gaps:

- Cross-country data. Most databases are published with a considerable lag, and coverage of low-income countries is still uneven in some cross-country databases, often with missing data (e.g., education spending and social assistance spending). Private spending data (e.g., for education) are still lacking for many countries. In addition to coverage, outcome data (e.g., test scores) often lack compatibility, as different tests are administered at different countries.

- Administrative data from authorities. The main issue is the lack of consistency in the definition both across countries and over time. In addition, functional classification is often not available on a timely basis or sufficiently disaggregated, with difficulties in consolidating data from the many different sources.

8. Cross-country databases are the most reliable data sources for cross-country comparisons, while the availability of country-level data is essential in the context of a program.

- Social spending engagement in surveillance can be primarily based on cross-country data, complemented by administrative data from the authorities. For countries with limited cross-country data, lessons from countries with a similar design and socioeconomic circumstances may be useful. Administrative data can be useful in two ways. First, it can provide useful information on the latest development of social spending programs; and second, it can provide more granular information that is often not included in cross-country data, such as more detailed classification of spending, program designs, and coverage of different schemes. Close collaboration among IDIs and capacity development to improve statistical capacity of the authorities can both help improve data availability and quality.

- For programs, with broad policy advice from surveillance work and maybe complemented with additional analysis using cross-country data, the focus is typically the implementation of policy advice and monitoring progress and administrative data from the authorities are central to this effort. In countries where functional classification of social spending is inexistant, a proxy based on a combination of administrative classification and other available classification (e.g., program or economic) may be considered (Sierra Leone, 2018 ECF). Staff has an important role to play in identifying data weaknesses and proposing a reform agenda, in cooperation with CD departments, to close these data gaps. Where data gaps adversely impact program success or its monitoring, staff should propose conditionality to ease data constraints.

Annex II. Social Spending Data Sources for Surveillance

1. **There is a wide range of data sources available on social spending.** The Government Finance Statistics database covers functional expenditure, including on social spending elements. The UN, World Bank and OECD also collect information across a wide group of countries for the social spending elements. Most of the cross-country data in this annex are published with a lag of 2 years or longer and many have coverage gaps.

2. **There are a number of different sources of pension data, depending on the issue of interest.** The World Bank provides detailed data through its ASPIRE database. The OECD website presents various pensions-related datasets, covering design, replacement rates, demographics, pension wealth, income, and poverty among elderly people. The ILO compiles numerous databases related to labor markets and social protection. The databases are internally consistent (i.e., they correspond to the same definitions), but the vintages are often old. The United Nations has historic and projected population data by gender, by 5-year and single year age groups until 2100.

3. **The World Bank Atlas of Social Protection Indicators of Resilience and Equity (ASPIRE) is the World Bank's compilation of indicators to analyze the scope and performance of SP programs.** ASPIRE provides indicators for 139 countries on social assistance, social insurance and labor market programs based on program-level administrative data and national household survey data. The European System of Integrated Social Protection Statistics (ESSPROS) is a common framework which enables international comparison of the administrative national data on social protection. The OECD Social Spending Database includes reliable and internationally comparable statistics on public and (mandatory and voluntary) private social expenditure at program level.

4. **The Global Health Expenditure Database and the World Bank Health Data are primary sources of cross-country health spending data.** Additional information includes: (1) the WHO's Global Health Observatory Data, (2) OECD Health Statistics, (3) The UN health statistics, (4) Eurostat's Health database. Generally cross-country health expenditure data is published with an 18 month to 2-year lag (i.e., 2020 health spending data was published at the end of 2022).

5. **A primary source of education financing statistics is Education Finance Watch.** This is a collaborative effort of the World Bank, the Global Education Monitoring Report, and the UNESCO Institute of Statistics – the latest (2022) publication available is here and the latest database here. Other sources include: (1) UNESCO Institute for Statistics,(2) World Bank Education Statistics, (3) OECD Education statistics, (4) UNICEF, and (5) UNSD — Education statistics. Education spending data is typically published with a longer lag than for health, and the availability of private education spending is often limited.

6. The **Expenditure Assessment Tool (EAT)** is a tool that provides information to assess public expenditures, including spending on pensions, SSN, health and education, and allows benchmarking with country peers. The TNMs on the social spending areas also provides more detailed guidance within social spending areas.

Annex III. Main Indicators of Spending Adequacy, Spending Efficiency, and Fiscal Sustainability

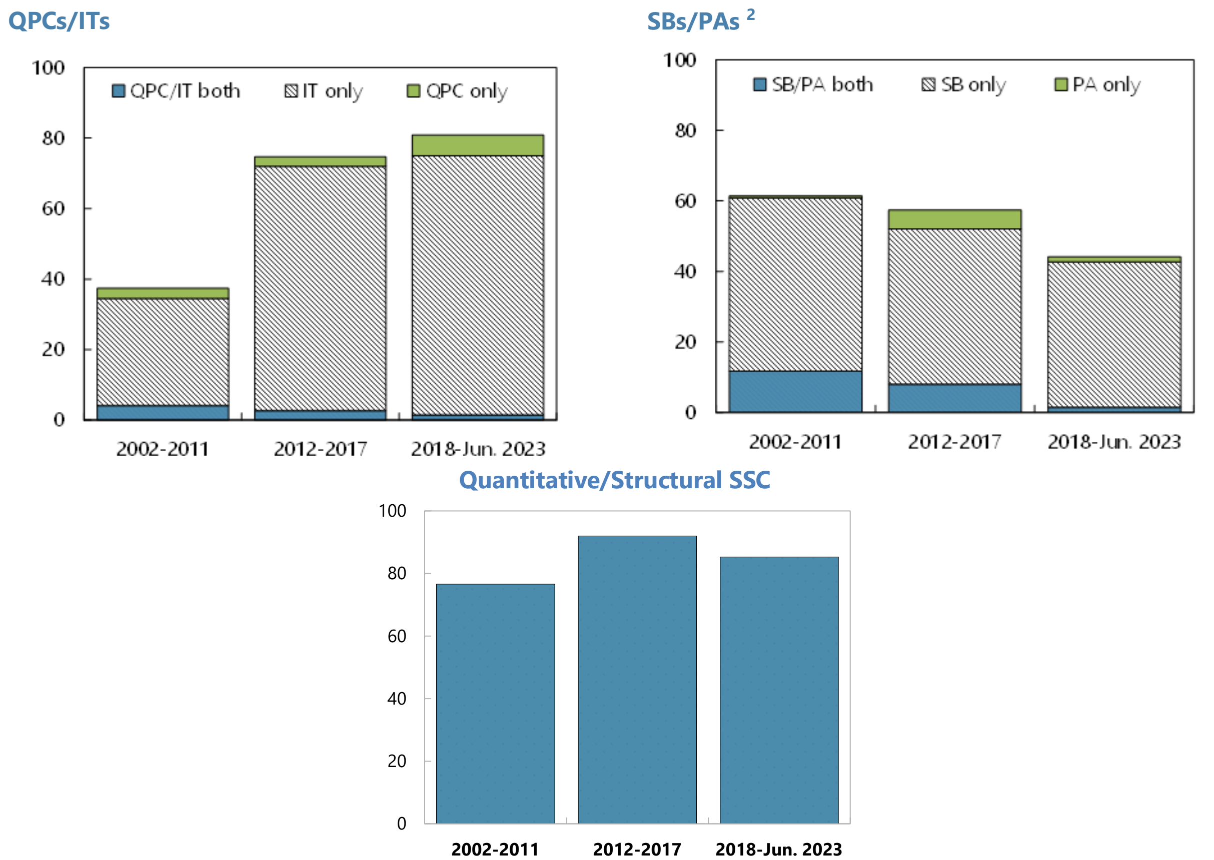
	Spending Adequacy Indicators	**Spending Efficiency Indicators**	**Fiscal Sustainability Indicators**
Health	Health spending as share of GDP/Per Capita relative to peer countries. Spending relative to per capita spending thresholds – e.g., the cost of access to essential health benefits. The cost of expanding access to healthcare services – e.g., universal health coverage. Additional spending needed to make progress towards achieving health SDG3. Universal health coverage progress. Out-of-pocket expenditures.	Comparison of level of health spending and health outcomes (e.g., life expectancy) relative to peer countries. Includes frontier analysis and input efficiency methodologies. Composition of health spending – e.g., primary and secondary, wages, pharmaceuticals, and inpatient care.	Health spending as a share of GDP. Drivers of spending pressures – e.g., population ageing, excess cost growth, income levels, and coverage – and their implications for future spending. Sources of financing – e.g., public, private, and the role of insurance.
Education	Education spending as a share of GDP/Per Student relative to peer countries. Enrollment and completion rates for primary and secondary education. Attainment scores relative to peer countries – e.g., PISA scores.	Comparison of level of education spending / outcomes (e.g., enrollment, completion, and test scores) relative to peers. Includes frontier analysis and input efficiency. Composition of education spending – e.g., wages, infrastructure, teaching and non-teaching staff, and level of education.	Education spending as a share of GDP. Drivers of spending pressures – e.g., birth rates – and their implications for future spending.

	Spending Adequacy Indicators	Spending Efficiency Indicators	Fiscal Sustainability Indicators
Pensions	Pension spending as a share of GDP/Per Capita relative to peer countries. Pension coverage (as the predominant driver of adequacy). Earnings replacement rate of the pension system. Old-age poverty rates.	Coverage gaps – i.e., the share of working-age adults participating in a pension scheme relative to policy targets. Misalignment between benefit levels and contribution rates (with the latter insufficient to support the former). Variation in pension adequacy by groups of pensioners – e.g., former public servants compared to other groups. Special treatment, exclusion, and exemption of different groups. Disincentives for compliance with contributory schemes due to overly generous social/minimum pensions. Existence of early and deferred retirement options without actuarially neutral deductions and increments.	Pension spending as a share of GDP. Drivers of spending pressures – e.g., demographics, coverage, generosity, and type of pension system – and their implications for future spending. Sources of financing – e.g., general revenues, social contributions, and government debt.
Social Safety Net	Social safety net spending as a share of GDP/Per Capita spending relative to peer countries. Additional spending required to close the aggregate poverty gap (requires selection of appropriate poverty line). Share of unemployed individuals enrolled in active labor market participation (ALMP) programs.	Targeting efficiency – as measured by benefit incidence and benefit-cost ratio metrics. Size of administrative costs. Work disincentives - as measured by participation tax rates and marginal effective tax rates.	Social Safety Net spending as a share of GDP. Drivers of spending pressures – e.g., demographics, coverage, unemployment, and generosity – and their implications for future spending. Sources of financing – e.g., general revenues, social contributions, government debt.

Annex IV. Social Spending Conditionality: Recent Experiences

1. **The share of programs that included SSC has steadily increased over the past two decades.**[1] 82 percent of the programs approved during the period January 2002-June 2023 included at least one SSC, with quantitative conditionality in 56 percent of programs and structural conditionality in 57 percent. The use of quantitative conditionality increased in the past decade—notably after the global financial crisis--and most quantitative targets take the form of ITs (Annex IV. Figure 1). The use of structural conditionality has remained largely stable over time. The share of social spending quantitative conditionality is higher in PRGT or blended PRGT/GRA programs than in GRA programs, whereas the share of structural conditionality is more or less the same. The share of programs with at least one SSC in GRA and PRGT/blended programs increased during 2012-2017, but then dropped slightly in the more recent period, likely reflecting COVID-19.

Annex IV. Figure 1. Share of Programs With Social Spending Conditionality (Percent) [1]



[1] The division of the two periods broadly corresponds to the sample periods of the 2011 ROC (Jan. 2002-Sep. 2011) and the 2018 ROC (Sep. 2011-Dec. 2017).

[2] For SBs/PAs, the share in the most recent period tends to be low due to ongoing programs, as social spending SBs, for example, may only be introduced at a later stage of the programs.

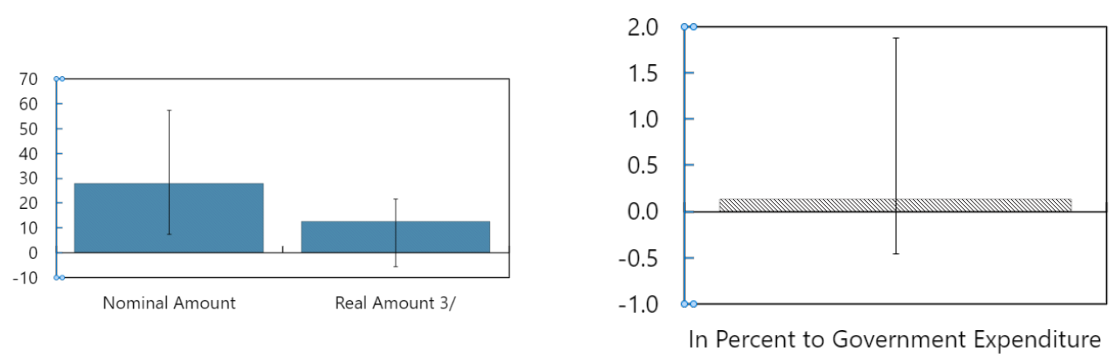
Source: MONA, IMF staff calculations

[1] The MONA database contains annual comparable information on all quantitative and structural conditionality of all programs from year 2002 onward. The results were manually filtered to ensure that all the captured conditionalities are in the area of social spending.

2. **Most SSC are set by means of ITs and SBs.** In the 58 programs approved from January 2018 to June 2023, 48 percent of SSC were set as ITs and 45 percent SBs, accounting together for more than 90 percent of total SSC and with QPCs consisting of only 4 percent and PAs of 3 percent respectively. Of the 57 structural SSCs in programs between Jan. 2018-June 2023, 95 percent (54) were set as SBs, whereas PAs (3) are used for pension reforms that are critical to proceed with a program (Argentina 2022 EFF (2), Moldova 2021 ECF-EFF). All of the total 62 quantitative targets (57 ITs and 5 QPCs) across 58 programs approved during January 2018-June 2023, are in the form of social spending floors.

3. **Social spending floors are the most prevalent form of quantitative SSC.** These floors help preserve social spending, mitigating the adverse impacts of fiscal adjustments, but they are usually not earmarked to a specific use. A target is typically calibrated as a nominal value,[2] and target values are generally calibrated to ensure increases in social spending during the program period both in nominal and real terms (Annex IV. Figure 2). The median increase in the social spending floor from the first review to the review in the last year of the program is 27.7 percent with the inter-quantile range covering 7.5 to 57.5 percent. The increases in real terms are modest, with the median increase being 12.5 percent, whereas some programs experience declines of the floor in real values, including due to higher-than-expected inflation.[3] The target values relative to total government expenditure follow a similar pattern with the median increase during the program period around 0.1 percent point.

Annex IV. Figure 2. Developments of Social Spending Floor Targets During Programs [1]



(Percent Change from the First Review's Target to the Target of the Last Available Review in the Same Month) [2]

(Percent Point Change from the First Review's Target to the Target of the Last Available Review in the Same Month) [3]

[1] The sample included programs approved during 2018-Jun. 2023. Bars indicate the median, whereas bands show the 25th and 75th percentiles of the sample.
[2] Information is obtained from the last completed review. Target values are compared between those in the same month (e.g., end-Dec target) to eliminate the effects of in-year patterns as the floors are often set as the cumulative amounts from the beginning of a year.
[3] Deflated by the consumer price index.
Sources: MONA, WEO database, and IMF staff calculations.

[2] All but one social spending floors are in nominal values; the remaining one (Senegal 2020 PCI) is defined as a percentage of total spending given the difficulty for the authorities to precisely control an amount relative to GDP or a share in total spending due to fluctuations in denominators.

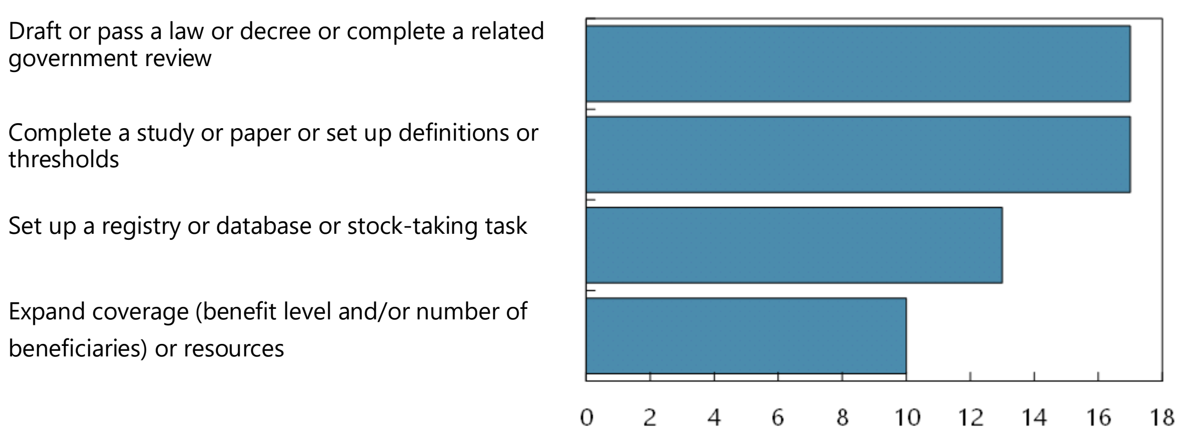
[3] In Figure 2, realized inflation rates are used where available in the October 2023 WEO database.

4. Flexibility has been often used in setting social spending floors, taking into account country specific situations. While most programs set one quantitative SSC in a program, in some cases, more than two quantitative SSC are set to closely monitor social spending. These include cases where a target is set for each social spending area, separately (e.g., cash transfer, health, and education spending) (Pakistan 2019 EFF, Moldova 2021 ECF-EFF), and where multiple targets were used to discipline social spending at different levels (i.e., one target for a broad-based social spending; the other for a narrowly defined one) (Uganda 2021 ECF). In some cases, a quantitative SSC was introduced later in the program, following a carefully tailored sequencing of reform implementations, reflecting the authorities' capacity (Nepal 2022 ECF).

5. Structural SSC are used to achieve various objectives, including improvements in monitoring and calibration of social spending. These measures are aimed at (i) improve the efficiency in social spending including through better targeting of social assistance, (ii) scaling up the amount of social spending (Congo 2019 ECF/2021 ECF, Pakistan 2019 EFF, Tanzania 2022 ECF, Mauritania 2023 ECF-EFF), (iii) enhancing sustainability of social spending system (e.g., pension) to help ensure overall fiscal sustainability (Barbados 2018 EFF/2022 EFF, Argentina 2022 EFF, Cameroon 2021 ECF-EFF, Moldova 2021 ECF-EFF). The first category includes but is not limited to: (i) improving the existing system associated with social spending (e.g., education, health) (Senegal 2020 PCI, Kenya 2021 ECF-EFF); (ii) enhancing the measurement of social spending (e.g., validation of vulnerable households) (Benin 2022 ECF-EFF); (iii) ensuring the publication of eligibility thresholds (Ecuador 2019 EFF); and (iv) improving efficiency through digitalization (Costa Rica 2021 EFF, Armenia 2019 SBA).

Annex IV. Figure. 3. Broad Categories of Structural Social Spending Conditionality

(Number of Conditionality, 2018-Jun. 2023)



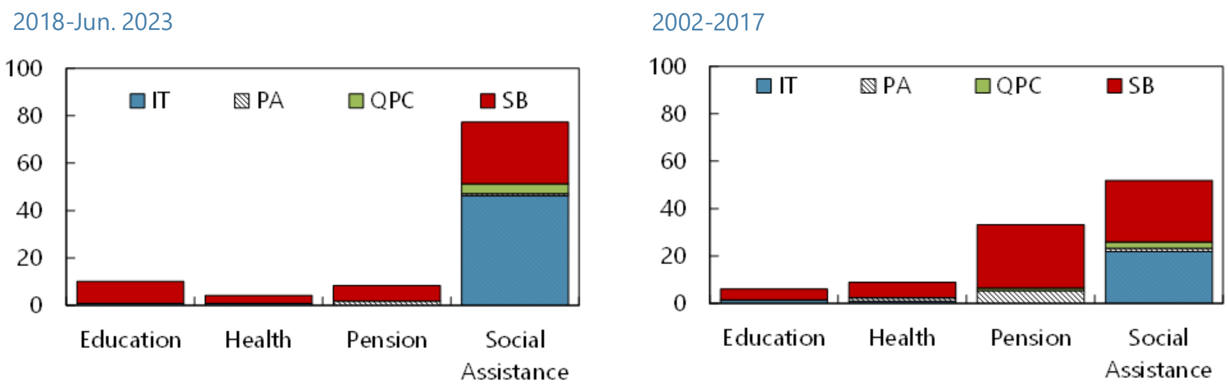
Sources: MONA, IMF staff calculations

6. To this end, specific structural SSC could be set to support consistent implementation in different phases during the program. They would broadly fall under one of the four categories (Annex IV. Figure 3): (i) set up a registry or develop a database, (ii) expand coverage (benefit level and/or number of beneficiaries), (iii) complete a study or paper or set up definitions or thresholds, and (iv) draft or pass a law or decree or complete a related government review. Of the 57 structural

SSCs in programs between Jan. 2018-June 2023, 95 percent (54) were set as SBs, whereas PAs (3) are used for pension reforms that are critical to proceed with a program (Argentina 2022 EFF (2), Moldova 2021 ECF-EFF).

7. In recent programs, most SSC focused on social assistance. In the period of Jan. 2018-Jun. 2023, 77 percent of targets are set on social assistance, which is followed with a wide margin by education (10 percent), pensions (8 percent), and health (4 percent) (Annex IV. Figure 4).[4] The situation is in stark contrast with the earlier period of 2002-17 when SSC on pensions and health were used much more often. This shift reflects the increased use of social spending floors in recent years, as well as pressing needs for pension reforms in earlier years (e.g., Greece 2012 EFF, Ukraine 2015 EFF, Bosnia and Herzegovina 2012 SBA), many of which resulted in a series of structural SSC in each program.

Annex IV. Figure. 4. Social Spending Conditionality by Economic Category
(Percent, Share in Total Number of SSC)



Sources: MONA, IMF staff calculations

8. Though relatively limited, some SSC are set on broad areas, tailored to country specific situations. Several recent programs incorporated structural SSC to enhance the sustainability of pension systems (Argentina 2022 EFF, Barbados 2018 EFF/2022 EFF, Moldova 2021 ECF-EFF, Cameroon 2021 ECF-EFF). Support to education and health spending has been provided through the adoption of a financing strategy (Uganda 2021 ECF), spending rationalization (Kenya 2021 ECF-EFF) and reduction of associated risks (Georgia 2022 SBA), improvement in the organization and operation of school and health systems (Benin 2022 ECF-EFF, Tanzania 2022 ECF).

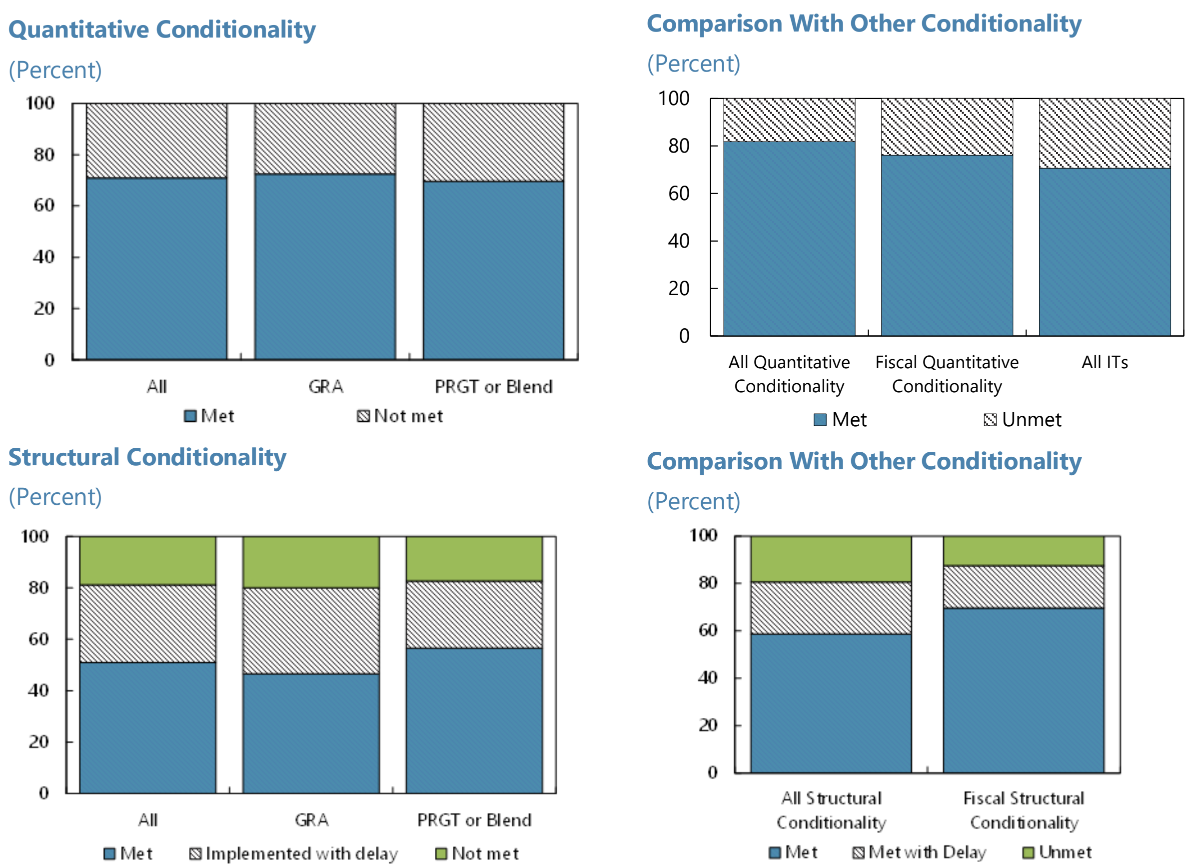
9. The implementation rate[5] for quantitative SSC is broadly consistent with that of similar conditionality, but structural SSC implementation remains somewhat lower compared

[4] This is in line with Hanedar and Munkacsi (forthcoming) that reports a vast majority of conditions are in the areas of energy subsidies and social safety nets.

[5] Following the methodology used in the ROC 2018 paper, the implementation rate is measured in terms of whether the SSC was met. Looking at the life cycle of the program through its latest review, we determine the percentage of SSC that was met. We then compute the average completion rate for quantitative and qualitative SSC across GRA and PRGT, and by category. Implementation is categorized as "Met" or "Unmet" for quantitative SSC, and as "Met," "Implemented with Delay," or "Unmet" for structural SSC.

to other conditionality during Jan. 2018-June 2023 (Annex IV. Figure 5). The implementation rate of quantitative SSC (ITs and QPCs) in programs is around 70 percent, whereas structural reforms (SBs) have a rate of about 50 percent, with around 30 percent of measures falling under the 'implemented with delay' category. No clear difference can be observed between GRA and PRGT programs. The implementation rates for quantitative SSC, which is predominantly in the form of IT, are similar to average rates for other types of ITs, although somewhat lower than those of all quantitative conditionality and fiscal quantitative conditionality (which however predominantly rely on QPC). The implementation rates of structural SSC are significantly lower than those of other structural conditionality, which may reflect the difficulties of implementing socially and politically sensitive reforms in a timely manner, especially at times of macroeconomic challenges.

Annex IV. Figure 5. Implementation Rates of SSC (2018-Jun. 2023) [1, 2]



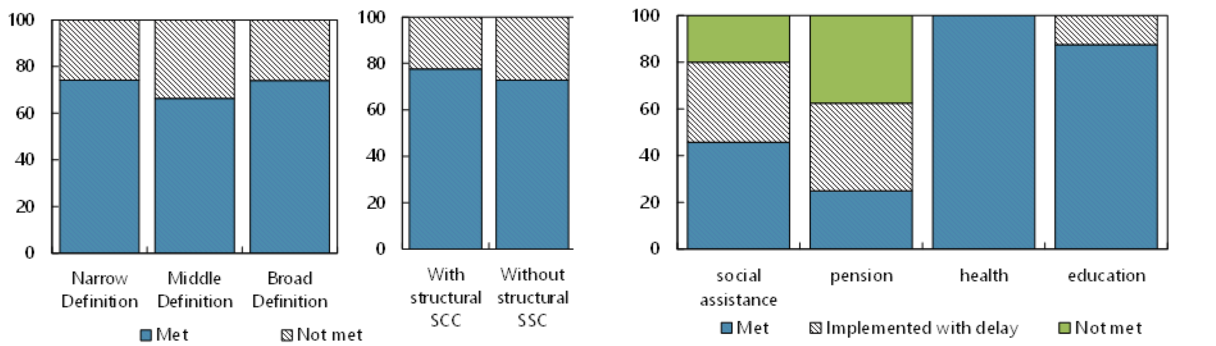
[1] Quantitative conditionality includes QPCs and ITs; Structural conditionality is only SBs, excluding PAs as PAs must be met before a program review is completed.
[2] Fiscal quantitative conditionality includes QPCs/ITs on fiscal balance and domestic arrears. Fiscal structural conditionality includes SBs covering "general government," "civil service and public employment reforms, and wages," "pensions and other social sector reforms," and "public enterprise reform and pricing (non-financial sector)" under the MONA categories.
Sources: MONA, IMF staff calculations.

10. There does not seem to be a clear correlation between how specifically SSC is defined and implementation rate (Annex IV. Figure 6). Quantitative SSCs are classified into three broad categories, most specific, medium specific defined, and least specific, based on their definitions in the TMU.[6] As defined, most specific and medium specific definitions cover the cases where spending implementation, rather than budget allocation, are monitored, when social programs are implemented by entities outside of the central government (e.g., Mozambique 2022 ECF). The results may suggest that targets are calibrated according to the authorities' implementation and monitoring capacity of quantitative SSCs.

Annex IV. Figure 6. Implementation Rates by Category (2018-Jun. 2023) [1]

Quantitative Conditionality by Category (Percent)

Structural Conditionality by Category



[1] Quantitative conditionality includes QPCs and ITs; Structural conditionality is only SBs, excluding PAs as PAs must be met before a program review is completed.
Sources: MONA, IMF staff calculations.

11. Combination of quantitative and structural conditionality could improve the implementation rate of SSC (Figure 6). Among 58 programs that had at least one SSC between Jan. 2018-June 2023, 27 programs had both quantitative and structural SSCs. These programs had a slightly higher implementation rate of quantitative SSC. This result seems to suggest that structural SSC could support the provision of adequate resources for social spending and improve the authorities' monitoring capacity, which could contribute to the implementation of quantitative SSC.

[6] A quantitative SSC falls under "narrowly defined", if the definition provides detailed information on specific social programs included under the SSC, specific entities mandated to its implementation, and an exact methodology to measure both targets and actual values of spending. If the definition SSC only specifies certain sectors, certain communities, or capital expenditure, it falls under "mediumly defined". Finally, if the SSC's description does not meet the criteria for either most or medium specific, it would be defined as "broadly defined".

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