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Prioritizing Expenditures for a Recovery with a Human Face:
Results from a Rapid Desk Review of 86 Recent IMF Country Reports

- Governments are withdrawing fiscal stimulus or cutting spending in a significant number of low and middle income countries
- In two thirds of the countries reviewed, the IMF has advised to contract total public expenditure in 2010, and further fiscal adjustment in 2011 for all but a few countries
- While the need for protecting social spending is now recognized in the IMF's advice, our review highlights several risks associated with the IMF recommendations of curtailing wage bills, removing subsidies, reforming and further targeting social programmes
- These findings should be followed up with more in-depth analysis to facilitate national dialogue on alternative policy options to promote a recovery with a human face

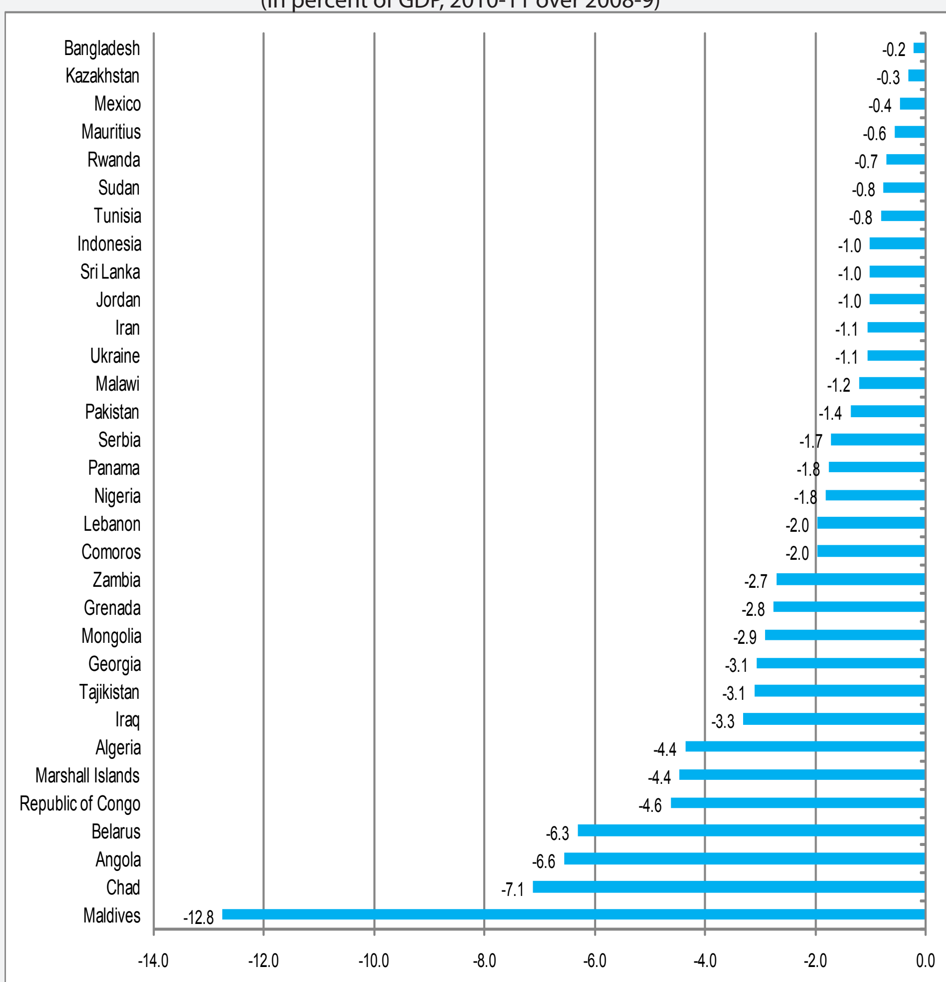
This brief assesses the extent to which fiscal tightening is already or likely occurring in 2010 among low and middle-income countries, by (i) examining the projected fiscal trends in 2010-11 compared to 2008-09; (ii) summarizing the IMF's advice to governments on the appropriate expenditure stance, and (iii) analyzing the IMF's recommendations pertaining to social spending. It is based on a rapid desk review of the latest IMF country reports dated between March 3, 2009 and March 16, 2010, which include 86 countries (28 low income, 37 lower-to-middle income, and 21 upper-to- middle income). These reports cover Article IV consultations, reviews conducted as part of various lending arrangements (e.g. Stand-by Arrangements and Extended Credit Facility), as well as consultations under non-lending arrangements (e.g. Policy Support Instruments and Staff Monitored Programs).

INTRODUCTION

Many developing countries expanded public spending as a way to combat the effects of the global crisis—a response that was generally supported by the International Financial Institutions. For example, according to the International Monetary Fund (IMF), over 80 percent of the Sub-Saharan African countries increased total government spending by an average of 4.1 percent of GDP between 2007 and 2009. Olivier Blanchard, Economic Counselor and Director, Research Department IMF stated (December 2008): "In normal times, the Fund would indeed be recommending to many countries that they reduce their budget deficit and their public debt. But these are not normal times…if no fiscal stimulus is implemented, then demand may continue to fall…what is needed is…a commitment by governments that they will follow whatever policies it takes to avoid a repeat of a Great Depression scenario."

Only fourteen months later, advice given by the IMF appear to have undergone a major change. With green shoots of recovery emerging, the IMF began recommending fiscal tightening aimed at limiting fiscal risk, strengthening reserves and containing debt build-up. Two recent IMF Board papers—"Exiting from Crisis Intervention Policies" and "Strategies for Fiscal Consolidation in the

Figure 1. Projected Change in Total Government Expenditure
(in percent of GDP, 2010-11 over 2008-9)



Sources: IMF country reports and authors' calculations.

Post-Crisis World"—call for large-scale fiscal adjustment (i.e. reduction in government budget deficit) "when the recovery is securely underway" and for structural reforms in public finance to be initiated now "even in countries where the recovery is not yet securely underway."

At this juncture, all indications suggest that economic recovery is uneven and fragile. More importantly, according to UN agencies and the World Bank, the social impacts of the economic slowdown are still felt in terms of raising poverty levels, unemployment, mortality rates and hunger. Premature fiscal tightening or withdrawal of countercyclical measures will not contribute to a socially inclusive recovery and undermine efforts to progress towards the Millennium Development Goals (MDGs). Urgent actions are needed to address the human and long-term economic costs of fiscal adjustment.

FISCAL TRENDS: A LARGE NUMBER OF GOVERNMENTS TIGHTENING SPENDING OR PHASING OUT FISCAL STIMULUS

We compiled total government expenditure figures from the fiscal operations tables in the latest IMF reports. An examination of fiscal trends in these 86 countries shows that nearly 40 percent of governments are planning to cut total spending in 2010-11, compared to 2008-09 (Figure 1). The average size of the projected expenditure contraction is 2.6 percent of GDP, with large cuts (4-13 percent of GDP) expected in seven countries (i.e. Algeria, Marshall Islands, Republic of Congo, Belarus, Angola, Chad, and Maldives). The expected cuts in total expenditure may reflect one or more of the following factors:

- Initial fiscal imbalance made worse by the impact of the global slowdown (e.g. Maldives where large fiscal contraction is underway to reduce the serious imbalance caused by the severe downturn in tourism activities);
- Large drop in oil revenues that led to sharp adjustments in public spending (e.g. Angola and Chad);
- Reversal of the measures put in place to mitigate the impact of the 2007-08 food and fuel price increases; and
- The IMF's advice on fiscal policy, which is reflected in the projected fiscal trends, especially in countries that currently have lending agreements with the IMF.

It is worrisome that such a large number of countries are already tightening expenditures

at a time when the populations in many of these countries are still coping with the lingering effects of high local food and fuel prices. In particular, several of the countries (e.g. Angola, Chad and Republic of Congo) that set out to cut public expenditures have high initial vulnerabilities in terms of child mortality, malnutrition, or HIV prevalence, implying that a significant portion of their populations have limited capacity to cope on their own. Rather than scaling up services to provide immediate and adequate support to these vulnerable populations, the curtailing of public expenditure in 2010-11 will likely incur potentially irreversible long-term human costs.

IMF PRESCRIPTION: CURTAIL SPENDING IN A GREATER NUMBER OF COUNTRIES

As the majority of the countries reviewed are under some form of IMF-supported programs, the IMF's advice carries weight in governments' policy decisions. To what extent has the IMF advised governments to tighten or curtail spending already for 2010 and 2011?

While increased government spending and fiscal stimulus was encouraged in the peak of the crisis, our review finds that in two thirds of the countries, IMF is advising or supporting curtailing public expenditures for 2010 (Table 1). For 2011 and beyond, fiscal tightening is advised in all but a few countries.

While country circumstances vary, the main rationale behind the fiscal tightening advice appears to be predominantly concerns about fiscal and debt sustainability. However, as many of the countries reviewed here are low or lower-to-middle income countries with limited linkages to international markets, it raises the question of whether the preoccupation with the need to reduce fiscal expenditure to ensure "market confidence" is justified in light of the continued need for fiscal policy to support economic and social recovery.

SOCIAL SPENDING: CUTTING SUBSIDIES, WAGES, RATIONALIZING AND FURTHER TARGETING IN A MAJORITY OF COUNTRIES

In a large number of countries reviewed, the IMF has advised to contract total public expenditure while protecting and, in some cases, expanding pro-poor, priority social spending. The IMF's recognition of the need to scale-up pro-poor spending is welcome, as there remains a continued need to support vulnerable population groups through subsidies, social services, and employment-generating investments and programs. However, how will this much needed spending be adequately addressed in parallel to fiscal adjustment?

According to the IMF Board paper "Strategies for fiscal consolidation in the post-crisis world" (2010), fiscal adjustment includes reforming health and pension entitlements and containing the growth of other primary spending, while maintaining adequate safety nets, increasing revenues and proper asset/liability management, including exploiting room for privatization.

As IMF reports show only aggregates, this review cannot present impacts of IMF advice on expenditures by function (education, health, social security, agriculture, etc.). However, examining key measures discussed in 86 IMF country reports, a large number of governments have been advised to remove fuel or food subsidies, cap/cut wages, and rationalize or reform social services, whereas in a fewer number of countries the IMF supports expanding subsidies, social services, wages and investments in agriculture (Table 2).

- **Wage bill**: As recurrent expenditures like salaries tend to be the largest component of the budget, a large number of countries

are advised to cut or cap wage bills, often in conjunction with civil service reforms. In practice, at least in the short term, this may translate to salaries being reduced, not indexed to real living costs, paid in arrears, or hiring freezes. As low pay is a key factor behind teacher absenteeism, informal fees and brain drain, it is essential to protect the positions and compensation of essential public sector employees such as teachers, medical and social protection staff, particularly in rural, high poverty areas. Moreover, UNESCO's Education For All 2010 Report points that the rate at which teaching post are created will need to increase if universal primary education is to be achieved by 2015. Decisions on wage bills must ensure the employment and retention of essential social sector staff and protection of pay of frontline workers in social services, vital to ensuring recovery with a human face and achieving the MDGs.

- **Subsidies**: IMF is advising limiting subsidies in a significant number of countries, often accompanied by the development of more targeted social safety nets. The logic behind this advice is to remove market distortions while supporting the poor by targeted transfers. However, in the absence of a well-functioning safety net, consumer subsidies are a quick way to protect vulnerable populations from rising prices of essential goods and services (e.g. food and energy). In addition, while subsidies are often withdrawn quickly, well-functioning targeting mechanisms take a long time to design and implement, and this timing mismatch threatens to leave behind the vulnerable, especially given that food prices remain stubbornly high in some areas

- **Targeting**: Targeting is advised in a majority of countries. Economists often advise governments to target their spending better when cuts are called for, as a way to reconcile poverty reduction with fiscal austerity. For example, in Maldives nominal salaries of government workers are expected to be cut and subsidies removed, while more targeted transfers are being planned to protect the poorest. While targeting could generate fiscal savings over the medium term, in practice, targeting designs and implementations often have limitations that may have the unintended effects of excluding vulnerable children and women, particularly where poverty is widespread. For example, means-tested targeting is costly and administratively complex, requiring significant civil service capacity, and often leads to large under-coverage (people not being served). Additionally, current practices of targeting by income or consumption poverty, do not adequately take into account other dimensions of poverty, such as lack of access to clean water or health facilities.

- **Health and pension reform**: A key element of the IMF strategies for fiscal adjustment in higher income countries in the post-crisis world is reform of pension and health entitlements, which is likely to be controversial in light of the large amounts spent to bail out the financial sector. A small number of low and middle-income countries (Belize, Cote d'Ivoire, Russian Federation, St. Vincent and the Grenadines) are also advised to undertake pension or health reforms. To support the much-needed development of lasting social protection systems in developing countries, these reforms could be better framed and undertaken, where feasible, as part of UN's social protection floor initiative.

- **Pro-poor investments (e.g. in agriculture),** when tailored to country circumstances and designed with features aimed at reducing inequality, can generate

employment and broad-based economic activities that benefit households, and promote long-term food and income security. Expanding investments in these areas is crucial to a recovery with a human face, especially given the fact that many countries are still reeling from lingering high local food prices, compounded by chronic food insecurity. Our review shows that increasing investments in agriculture and rural areas is only advised in a small number of countries.

As IMF reports do not provide details on the "priority" or "poverty reduction" spending, it is not clear to what extent investments in social sectors, agriculture or other pro-poor programs would be protected or enhanced. To encourage and ensure greater resources channelled to these investments, more detailed disclosure and discussion on the content of poverty reduction spending are necessary.

CONCLUSION

Our review suggests that a large number of low and middle-income countries are tightening or are planning to tighten public expenditures at a time when there is no clear indication of a strong economic recovery, or even less indication of a social recovery that ensures adequate protection of children from shocks with potentially irreversible long-term effects.

Fiscal adjustment in a greater number of countries, largely, reflects the shift in policy focus to macroeconomic balance and debt sustainability. However, this raises the risk of derailing efforts to develop socio-economic policies aimed at ensuring a socially inclusive recovery. In addition, while the need for protecting social spending is now recognized in the IMF's advice, we identified several conceptual and implementation problems associated with the recommendations of further targeting, wage bill cuts/caps, removing subsidies, and health and pension reforms. Until these problems can be adequately addressed, measures aimed at improving fiscal efficiency could result in the exclusion of vulnerable groups, undermining the efforts for a human-faced recovery and progressing towards achieving the MDGs.

Given limitations of a desk-based review, we recommend that these findings be followed up with more in-depth analysis within countries to facilitate dialogues on alternative policy options to promote a recovery with a human face. Underlying the risks of an early withdrawal from fiscal stimulus, our review raises some important questions:

- To what extent spending on services and programs essential to children is part of the "priority" social spending? What is "non-priority" social spending? Will the protection of "priority" spending still lead to declines in social expenditures?
- What are the human costs of decreasing fiscal deficits and reducing debts during this period of economic recovery?
- Is the fiscal adjustment trajectory (in terms of scope and pace) conducive to the achievement of the MDGs?
- Are indicators for economic recovery, often the basis for fiscal policy decisions, inclusive of economic and social conditions faced by the poor?
- Is the debt and fiscal sustainability assessment too restrictive to accommodate a socially responsive recovery?
- Given the limitations of the targeting approaches that have been commonly practiced, is some basic level of social protection and services (e.g. the UN's social protection floor) a better form of "social conditionality" to achieve the objective of protecting the vulnerable from the crisis effects?

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About the Working Brief Series

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Table 1. Latest IMF Advice for 2010

Curtail or Adjust Public Expenditure		Expand or Maintain Public Expenditure
Angola	Poland	Algeria
Armenia	Russian Federation	Bolivia
Bangladesh	Serbia	Burundi
Belize	Solomon Islands	Cameroon
Belarus	Sri Lanka	Cape Verde
Bhutan	Sudan	Central African Republic
Burkina Faso	St. Kitts & Nevis	Chile
Cambodia	St. Vincent & Grenadines	Costa Rica
Chad	Syria	Democratic Republic of Congo
Comoros	Tanzania	Haiti
Cote d'Ivoire	Timor-Leste	Indonesia
El Salvador	Tonga	Iran
Ethiopia	Ukraine	Kazakhstan
The Gambia		Kenya
Georgia		Kyrgyz Republic
Ghana		Mali
Guatemala		Paraguay
Grenada		Republic of Congo
India		Rwanda
Iraq		Samoa
Jordan		Senegal
Kiribati		Sierra Leone
Latvia		South Africa
Lao PDR		Suriname
Lebanon		Tajikistan
Liberia		Thailand
Libya		Togo
Lithuania		Tunisia
Malaysia		Uganda
Malawi		Vanuatu
Maldives		Zambia
Mauritius		
Marshall Islands		
Mexico		
Moldova		
Mongolia		
Morocco		
Mozambique		
Nigeria		
Pakistan		
Panama		
Philippines		

Table 2. IMF Advise on Social Spending

Limit subsidies	Wage bill caps/cuts	Rationalize and further target	Pension and/or health reform
Barbados	Algeria	Armenia	Belize
Belarus	Barbados	Cambodia	Cote d'Ivoire
Bolivia	Belarus	Georgia	Russian Federation
Burkina Faso	Belize	Grenada	St Vincent & Grenadines
Cambodia	Bhutan	India	
Cote d'Ivoire	Burundi	Indonesia	
El Salvador	Cambodia	Libya	
India	Comoros	Maldives	
Indonesia	Cote d'Ivoire	Mauritius	
Iran	DR Congo	Mongolia	
Iraq	Georgia	Poland	
Jordan	Ghana	Slovenia	
Kiribati	Grenada	Syria	
Libya	Iraq	Timor-Leste	
Malaysia	Jordan	Togo	
Maldives	Kiribati	Ukraine	
Mexico	Latvia		
Mongolia	Libya		
Morocco	Lithuania		
Nigeria	Maldives		
Pakistan	Mali		
Panama	Marshall Islands		
Republic of Congo	Mauritius		
Sri Lanka	Morocco		
Sudan	Paraguay		
Syria	Philippines		
Timor-Leste	South Africa		
Togo	Sri Lanka		
Tunisia	St Kitts & Nevis		
	Syria		
	Tonga		
	Vanuatu		
	Zambia		
	Zimbabwe		

Expand subsidies and/or social services	Increase wage bill	Expanded targeted transfer programmes	Increase agricultural investment
Burundi	Angola	Bolivia	Burundi
Chile	Lao PDR	Cameroon	Liberia
Central African Republic	Malawi	Chile	Libya
DR Congo	Mozambique	Ghana	Mali
Lebanon	Tajikistan	Guatemala	Morocco
Mali	Sierra Leone	Lebanon	Paraguay
Slovenia	Suriname	Libya	Sierra Leone
Suriname	The Gambia	Lithuania	Mauritius
Thailand		Malawi	
		Maldives	
		Morocco	
		Pakistan	
		Paraguay	
		Russian Federation	
		Sri Lanka	
		Sudan	
		Suriname	
		Tajikistan	
		Tanzania	
		Thailand	
		Timor-Leste	
		Tunisia	
		Vanuatu	