

nonlinear, providing some further support for growth considerations embodied in initial program design. In contrast, such systematic fiscal reaction was less clear if not absent in PRGT programs.

83. In adapting programs for interim outcomes, updated fiscal projections balanced growth and sustainability considerations not only in GRA programs but also in PRGT programs. Fiscal adjustment targets tended to be revised downwards in response to interim growth shortfalls and upwards in response to adjustment shortfalls. Sustainability considerations were generally stronger in GRA programs than in PRGT programs. Country case studies broadly confirm these cross-country findings on program adaptation. Explicit discussions on program contingencies were relatively infrequent among programs studied, but nonetheless program reviews generally eased fiscal targets due to weaker growth outcomes or fiscal overruns in many programs. Program reviews were also combined and/or extended to provide time for corrective policy action and compliance with program conditions. Moreover, most authorities and staff viewed flexibility in program adaptation as contributing to program success.

## **VI. FISCAL ADJUSTMENT, FISCAL REFORMS, AND GROWTH**

84. This chapter examines growth-related aspects of fiscal policy in IMF-supported programs, looking first at how the growth impact of fiscal adjustment has been calibrated and then at how different growth-related aspects of fiscal policy have been reflected in program design and implementation.<sup>27</sup> It provides evidence on the extent to which IMF-supported programs have succeeded in mobilizing revenue, which can then be used to support growth-friendly public spending while delivering fiscal adjustment, and in modifying the composition of public spending in favor of public investment and social support. It then reviews the use of structural conditionality to support growth-friendly fiscal reforms.

### **A. Fiscal Multipliers in Program Design and Outcomes**

85. In practice, analysis of the growth implications of fiscal adjustment in the program context has generally been ad hoc and quite limited. There is no official IMF-wide guidance, although country desks have typically used a so-called bucket approach suggested by Batini and others (2014), which identified the key structural characteristics of an economy that influence the size of fiscal multipliers and proposed a plausible range of fiscal multipliers for different advanced, emerging, and LIC groups. However, while the paper suggested that staff fine-tune fiscal multiplier assumptions for the economy's cyclical position and monetary policy stance, this additional step has seldom been taken. Moreover, despite increased awareness among Fund staff of the relevance of fiscal multipliers in program design, they are not discussed widely in program documents (IMF, 2019c). Insufficient attention to fiscal multipliers implies that staff risks underestimating the adverse growth impact of fiscal adjustment in circumstances that could increase the size of the multiplier (for example, when the economy is already weak and room for offsetting monetary or exchange rate policy is limited) or overestimate the growth impact where there are significant offsetting benefits from higher confidence.

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<sup>27</sup> This chapter draws on Gupta (2021), Kim and others (2021), and country case studies prepared for the evaluation.

86. This section presents evidence on how program design incorporated fiscal multipliers reflecting the short-run relationship between fiscal policy and output, how multiplier assumptions were modified after program approval, and whether they differed from actual multipliers. For this purpose, we used formal regression analysis to estimate the short-run relationship between adjustment and growth embodied in program projections (using both initial and updated projection data) and program outcomes. The estimated coefficients of fiscal adjustment in the regressions are taken as fiscal multipliers.<sup>28</sup> It should be noted at the outset that the purpose of the regression analysis for program projections is not to establish a causal relationship between adjustment and growth, but to assess the underlying assumptions—particularly program assumptions on fiscal multipliers—used to formulate program projections.

87. The regressions found a statistically significant short-run tradeoff between fiscal adjustment and growth embodied in the initial program design in both GRA and PRGT programs (Table 2, Panel A). The estimated fiscal multipliers are on the order of 0.35–0.5 in GRA programs, a range which is consistent with the buckets proposed by Batini and others (2014), the broader literature on fiscal multipliers, and program assumptions in several country case studies as discussed below. In addition, GRA programs on average set revenue multipliers to be smaller than expenditure multipliers, which is again in line with existing evidence in the literature. According to the regressions, PRGT programs on average used smaller fiscal multipliers (on the order of 0.17–0.22) than assumed in GRA programs, which is consistent with the findings in the literature that fiscal multipliers are generally lower in emerging and low-income countries than in advanced economies.<sup>29</sup> As in GRA programs, revenue multipliers were assumed to be lower than expenditure multipliers although the difference between them was small and less marked than in GRA programs.

88. The same regression analysis was undertaken for updated program projections to assess how the macroeconomic framework evolved over the program period to incorporate new information from interim macroeconomic outcomes. Updated fiscal multipliers for GRA programs were on the order of 0.24–0.35, in general lower than those assumed in initial program design (Table 2, Panel B). By contrast, updated fiscal multipliers for PRGT programs were on the order of 0.1–0.3 (albeit rarely significant) and on average modestly larger than assumed in initial program design. Unlike in initial program design, updated revenue multipliers were on average larger, and not smaller, than expenditure multipliers in both GRA and PRGT programs. Moreover, none of the updated expenditure multipliers were statistically significant.

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<sup>28</sup> Strictly speaking, the estimated coefficient of fiscal adjustment should be considered as a proxy for the fiscal multiplier because in the regression analysis fiscal adjustment is measured by the change in the fiscal primary balance and not the change in the *structural* primary balance. Kim and others (2021) discuss in greater detail the growth regressions.

<sup>29</sup> See Batini and others (2014), Gupta (2021), IMF (2017) and the references therein. IMF (2017) found that estimated fiscal multipliers in Sub-Saharan Africa tend to be lower than those typically identified in advanced or emerging market economies.

89. Actual multipliers were estimated using a similar approach but based on cross-section data for program averages of growth deviations from the growth benchmark discussed in Chapter III. The use of cross-section rather than panel data was motivated by the desire to obtain sharper estimates of fiscal multipliers given that in practice the growth impact of fiscal adjustments could materialize over a period longer than a year.<sup>30</sup>

90. The results suggest that overall fiscal multipliers were in practice on the order of 0.35–0.45 in GRA programs, which lies within the range reported in the literature for advanced and emerging countries and also the multipliers effectively used in program design (Table 2, Panel C). For PRGT programs, the overall fiscal multiplier is estimated to be 0.6, which is substantially higher than suggested in the literature and the multipliers used in program design. When fiscal adjustment is disaggregated between revenue and expenditure adjustments, revenue multipliers exceed unity and are significantly larger than expenditure multipliers in both GRA and PRGT programs. The estimated expenditure multiplier is particularly low in PRGT programs (where it is not statistically different from zero). These findings are at odds with existing evidence that revenue-based adjustment is generally less contractionary than expenditure-based adjustment (Batini and others, 2014; Gupta, 2021).

<b>Table 2. Fiscal Multipliers in Program Design</b>			
Program	Fiscal Multipliers		
	Overall	Revenue	Expenditure
A. Initial Program Projection			
GRA	0.37*** -- 0.51***	0.24* -- 0.39*	0.34** -- 0.60***
PRGT	0.17** -- 0.22**	0.14** -- 0.16**	0.17* -- 0.20*
B. Updated Program Projections			
GRA	0.25** -- 0.35**	0.43** -- 0.50**	0.01 -- 0.18
PRGT	0.07 -- 0.32*	0.03 -- 0.41*	0.11 -- 0.20
C. Program Outcomes			
GRA	0.35*** -- 0.45***	1.12** -- 1.48***	0.34** -- 0.63**
PRGT	0.61***	1.02**	0.05

Source: Kim and others (2021).  
 Note: Fiscal multipliers are based on the estimated coefficients of fiscal adjustment, revenue adjustment, and expenditure adjustment in growth regressions. Asterisks denote statistical significance. \* p<0.1, \*\* p<0.05, \*\*\* p<0.01.

## Lessons from Country Experience

91. Based on the case studies, fiscal multiplier discussions between staff and officials were typically quite limited, with few examples in which staff offered more than ad hoc adjustments to

<sup>30</sup> Unlike in the regression analysis for fiscal multiplier assumptions in program projections, the focus here is to establish a causal effect of fiscal adjustment on growth. In this respect, it is important to allow a longer horizon than a year for fiscal adjustment to affect growth. Moreover, the use of cross-section data—i.e., program period averages—helps to average out the cyclical component in the primary balance measured on an annual frequency and bring the resulting average primary balance closer to the structural primary balance. See Kim and others (2021) for further discussion.

standard multipliers. Staff reports supporting program requests rarely provided explicit analysis of multiplier assumptions.<sup>31</sup> In some cases, staff sought to modify standard assumptions, for example lowering the assumed multiplier in Grenada (2014) as a small very open economy, in Honduras (2014) to reflect beneficial effects through improved confidence, in Latvia (2008) because the tightening followed a boom, and in Mongolia (2009) because large cutbacks in public investment would mainly affect imports. In contrast, it appears that a mis-specified multiplier assumption contributed to a growth shortfall in Jordan and Ukraine. In the case of Jordan, while multiplier assumptions were not discussed explicitly in program documents, the case study cautiously pointed to a possibility that too low a multiplier assumption may have contributed to the program's growth shortfalls. In the case of Ukraine, staff suggested in ex post analysis that the deeper than expected contraction in output reflected excessive reliance on expenditure restraint rather than revenue measures to achieve fiscal objectives given their estimation of a higher expenditure multiplier (Mitra and Poghosyan, 2015).

92. In practice, in programs with a moderate degree of fiscal adjustment (typically PRGT programs and GRA programs out of a crisis), fiscal drag seems to have been quite modest, and countries were able to grow at or even better than their IEO-calculated benchmark, especially when benefiting from favorable supply conditions. By contrast, in a number of GRA crisis cases (e.g., Latvia 2008, Mongolia 2009, and Romania 2009), deep fiscal adjustment was associated with even deeper output contractions than projected. However, it is hard to assess the counterfactual given that weaker policy commitments could have undercut confidence gains and other factors such as credit constraints were also at play.

## **B. Attention to Growth-Friendly Fiscal Adjustment**

93. Increasing attention to growth objectives in Fund programs has led to efforts to design "growth-friendly" fiscal adjustment that can limit the adverse short-term effects from fiscal adjustment and contribute to raising medium-term growth potential. In this context, the distributional consequences of fiscal policy actions are relevant, particularly the impact on low-income and vulnerable groups.

### **Revenue Mobilization**

94. Revenue mobilization is growth friendly to the extent that it provides additional resources for priority spending, occurs in a non-distortionary way, and avoids imposing a burden on low-income groups. Evidence of improvements in tax mobilization is particularly marked in PRGT programs (Table 3). Relative to the pre-program period, the tax-to-GDP ratio rose on average by 1.1 percentage points in the post-program period, largely aided by increases in taxes on goods and services. Not surprisingly, tax mobilization was substantially stronger in completed programs (where the tax-to-GDP ratio increased on average by 3 percentage points between pre- and post-program periods) than in programs that went off track. Those countries with

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<sup>31</sup> For example, fiscal multiplier assumptions were not mentioned in the program documents of Egypt, Honduras, Latvia, Malawi, Pakistan, Romania, Senegal, Tunisia, and Ukraine.

completed programs collected more revenues not only from taxes on goods and services but also taxes on income, thereby making the tax structure more progressive by bringing individuals and businesses with rising incomes into the tax net.

**Table 3. Tax and Expenditure Trends Associated with IMF-Supported Programs  
(In percent of GDP)**

	PRGT Programs			GRA Programs		
	Pre-program	Program	Post-program	Pre-program	Program	Post-program
Taxes	13.6	14.4	14.7	20.1	20.5	20.4
On income, profits, and capital gains	5.5	6.3	5.6	9.8	11.3	9.7
On goods and services	3.7	4.5	4.3	7.6	6.9	8.2
On international trade and transactions	2.7	2.6	2.7	2.3	2.1	1.8
Social contributions	0.9	0.9	0.8	6.9	6.6	6.3
General government total expenditure	25.1	24.8	26.2	35.7	33.7	33.0
General government expense	17.4	16.8	17.2	32.2	29.9	30.1
Compensation of employees	6.8	6.4	7.3	9.5	9.3	9.2
Purchases/use of goods and services	4.3	4.1	3.7	5.6	5.6	4.9
Interest	1.2	1.5	1.6	2.9	2.9	2.8
Social benefits	2.6	3.0	2.2	9.4	9.2	9.3
Capital expenditure	7.3	7.4	8.4	5.0	4.5	3.7
Net acquisition of financial assets	0.1	0.4	0.1	0.6	-0.1	-1.4

Source: Gupta (2021).  
Note: "Pre-program" captures the three years prior to a program's starting year; "Program" captures program years; "Post-program" captures the three years following a program's ending year.

95. In GRA programs, the increase in the average tax-to-GDP ratio was much more modest, less than ½ percentage points. However, there is some evidence that the tax structure became more growth friendly in the post-program period. The dependence on distortionary trade taxes fell by ½ percent of GDP while reliance on more efficient taxes on goods and services increased by 0.6 percent of GDP. Crisis programs were no different in terms of tax mobilization outcomes from other completed GRA programs.

### Expenditure Trends

96. Growth-friendly expenditure adjustment prioritizes resources for capital spending that can bring long-term benefits for the economy and social spending that supports low-income and vulnerable groups. Overall, total general government outlays increased in PRGT programs, buttressed by higher tax revenues (see Table 3, which is based on reported budgetary data). Moreover, there was a clear shift in the composition of spending in favor of capital projects. Capital spending rose on average by 1.1 percent of GDP between pre- and post-program periods, a desirable outcome for addressing the country's infrastructure needs. However, little progress was made in raising social benefits—these rose during the program itself but subsided

thereafter.<sup>32</sup> Outlays for compensation of government employees increased during the post-program period, but this data set does not distinguish compensation to health and education workers, which could be associated with providing social support. As with revenues, performance was significantly stronger in on track programs than in off track programs, suggesting that program completion matters not just in the short-run but also in the medium-run.

97. In contrast, government spending declined in GRA programs by about 3 percent of GDP between pre- and post-program periods, reflecting in part greater focus on bringing down the fiscal deficit and providing room for the private sector to grow, as well as the more modest progress in raising revenues. Capital spending declined by 1.3 percent of GDP between pre- and post-program periods, while social benefits remained flat.

98. Data from the World Development Indicators allow for a more focused look at trends in education and health spending related to IMF-supported programs, and suggest that overall progress in raising such social spending in the program context was limited.<sup>33</sup> In GRA programs, health and education spending showed little movement relative to GDP, although health spending increased in the post-program period as a share of the total budget, suggesting some increased prioritization of the health sector in government budgets (Table 4). In PRGT programs where such spending was relatively low, health spending remained unchanged as a share of GDP while spending on education declined somewhat after the program ended. These results occurred even though PRGT program conditionality actively sought to protect or increase social spending, suggesting that program conditionality to protect or raise social spending in the short-term was not enough to achieve sustained increases in such spending.<sup>34</sup>

### **C. Attention to Growth in Fiscal Reforms**

99. IMF-supported programs have typically incorporated reforms in revenue and expenditure structure aimed at strengthening countries' long-term growth prospects. To foster such reforms, programs have included structural conditionality and been supported by IMF capacity development work.<sup>35</sup>

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<sup>32</sup> Social benefits are current transfers to households, which may be paid in cash or in kind, to provide for needs arising from events such as sickness, unemployment, retirement, housing, or family circumstances.

<sup>33</sup> The effects of IMF-supported programs on education and health spending have been widely debated in the literature. Some studies argue that austerity measures and particularly conditionality on the wage bill have lowered such spending (Ooms and Hammonds, 2009; Rowden, 2009). In contrast, Clements, Gupta, and Nozaki (2013) show that spending in the education and health sectors increased at a faster pace in countries supported by IMF programs than in other developing countries. Similar results are found by IMF (2017).

<sup>34</sup> The 2017 IEO evaluation on *The IMF and Social Protection* found that social and other priority spending floors in IMF-supported LIC programs were generally not very useful for safeguarding social protection expenditures in part because of the difficulties of establishing a useful measure.

<sup>35</sup> Chapter VII of this report provides a fuller assessment of SCs and reforms in IMF-supported programs, including the impact of IMF capacity development support. The assessment of fiscal SCs provided here is based on the classifications and score indexes developed by the IEO (Kim and Lee, 2021).

**Table 4. Trends in Health and Education Spending in IMF-Supported Programs**

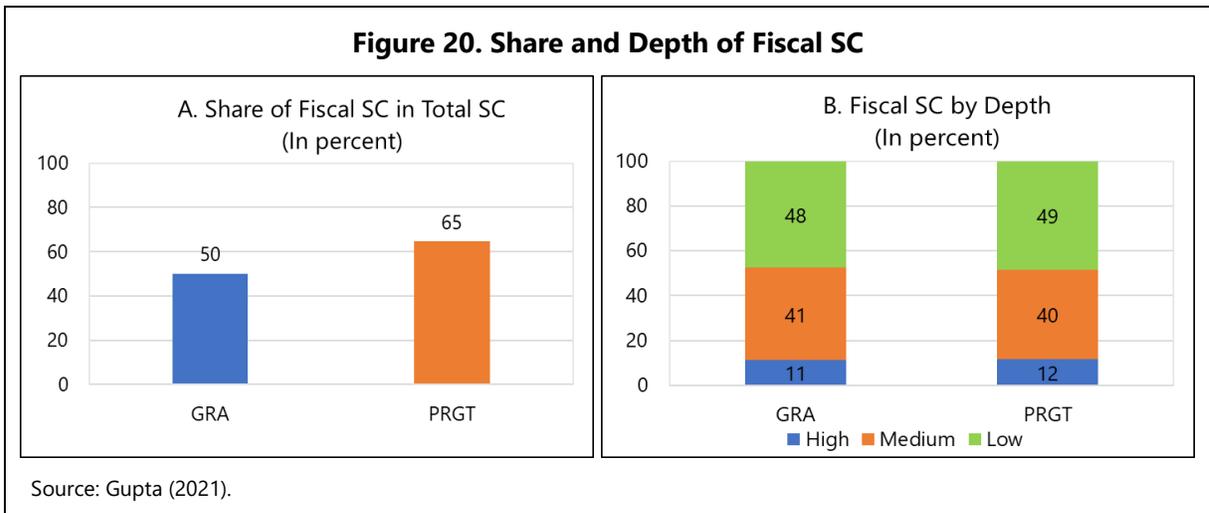
GRA Programs						
Expenditure	In percent of GDP			In percent of Government Expenditure		
	Pre-program	Program	Post-program	Pre-program	Program	Post-program
Health	3.5	3.5	3.6	10.2	10.3	11.3
Education	4.7	4.2	4.6	13.8	12.9	13.8

PRGT Programs						
Expenditure	In Percent of GDP			In percent of Government Expenditure		
	Pre-program	Program	Post-program	Pre-program	Program	Post-program
Health	1.9	2.0	1.9	7.1	7.7	6.3
Education	4.7	4.5	4.2	17.6	16.9	16.3

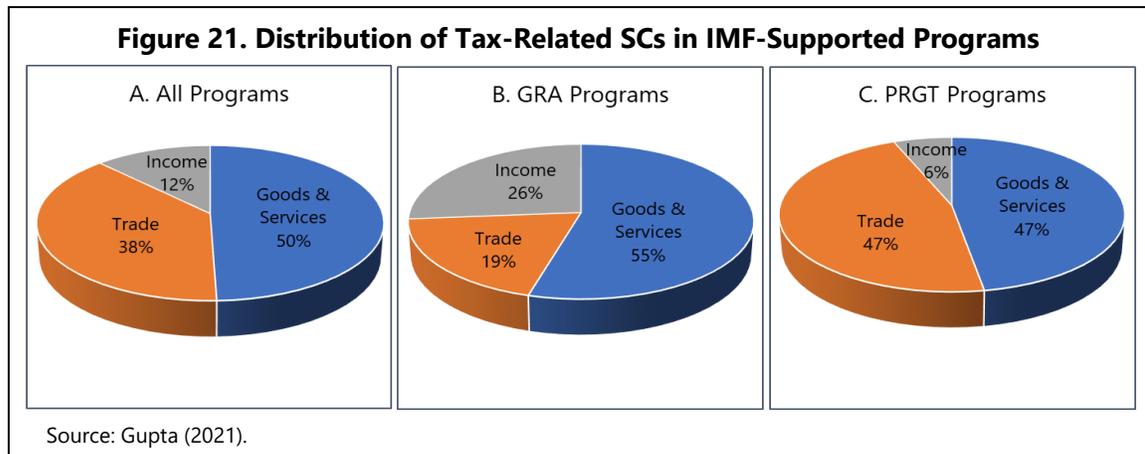
Source: Gupta (2021).  
 Note: "Pre-program" captures the three years prior to a program's starting year; "Program" captures program years; "Post-program" captures the three years following a program's ending year.

100. Fiscal SCs have played a particularly important role in PRGT programs, given the criticality of building and strengthening fiscal institutions in low-income economies. Nearly four-fifths of fiscal SCs were classified as intended to support fiscal adjustment. Fiscal SCs (covering actions related to revenues, expenditures, debt, civil service reform, and fiscal transparency) constituted two-thirds of all SCs in PRGT programs while half in GRA programs (Figure 20, Panel A). Most fiscal SCs were of low or medium depth, and only around 10 percent were of high depth in both GRA and PRGT programs (Figure 20, Panel B). A high proportion of fiscal SCs was implemented in both GRA and PRGT programs, but only a small fraction of fiscal SCs required a permanent institutional change, reflecting in part the low average depth of fiscal SCs.



101. On the revenue side, the bulk of the structural conditionality in IMF-supported programs focused on taxes on goods and services, followed by conditionality on taxes on international transactions and on income (Figure 21). It is notable that in PRGT programs the share of SCs on taxes on international transactions (mostly related to customs management and control) was as large as that on taxes on goods and services and significantly larger than the corresponding

share in GRA programs, while the share for income tax was much smaller than that of GRA programs. In general, revenue measures focused on broadening the tax base including by curtailing exemptions and enhancing tax compliance through strengthened revenue administration (IMF, 2019d). In addition, a larger number of administrative measures were included as fiscal SCs in PRGT programs given the emphasis on mobilizing more domestic resources in PRGT countries to finance the Sustainable Development Goals by building new or strengthening existing revenue institutions.



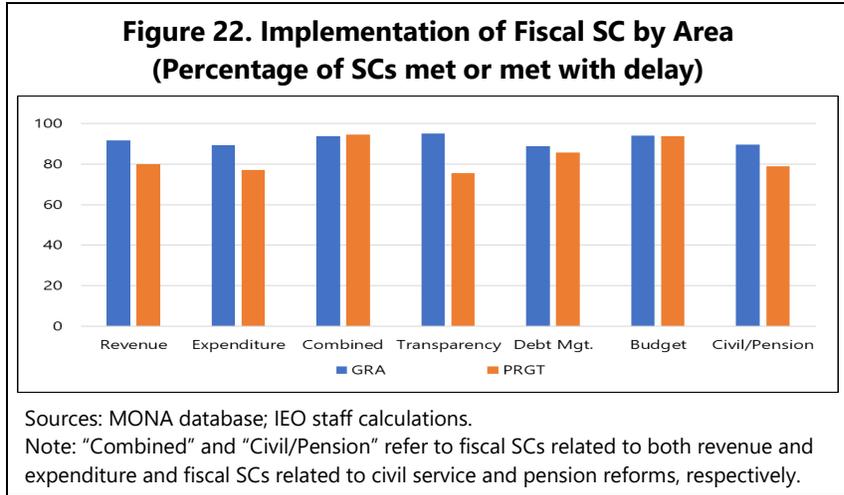
102. On the spending side, SCs covered strengthening of budget preparation, debt management, and fiscal transparency. Conditionality on fiscal transparency was more prevalent in PRGT programs given the weaknesses in public financial management systems of LICs.<sup>36</sup> Weak public financial systems have been linked to widespread leakages of public resources and associated corruption (IMF, 2016). The IMF's new framework on governance stresses improvements in public financial management and enhancing transparency of government operations as widespread and pervasive corruption can undermine program goals and thereby growth (IMF, 2018b).

103. Compliance with fiscal SCs was high overall but generally weaker in PRGT programs than GRA programs (Figure 22). In particular, compliance with fiscal transparency conditionality was significantly weaker in PRGT programs (by 19 percent) than in GRA programs.<sup>37</sup> Compliance in revenue and expenditure measures was also weaker in PRGT programs (by 12 percent), followed by those related to civil service and pension reforms (11 percent). While fiscal SCs were drawn increasingly more from IMF CD work, it is not clear from the data that growing provision of fiscal

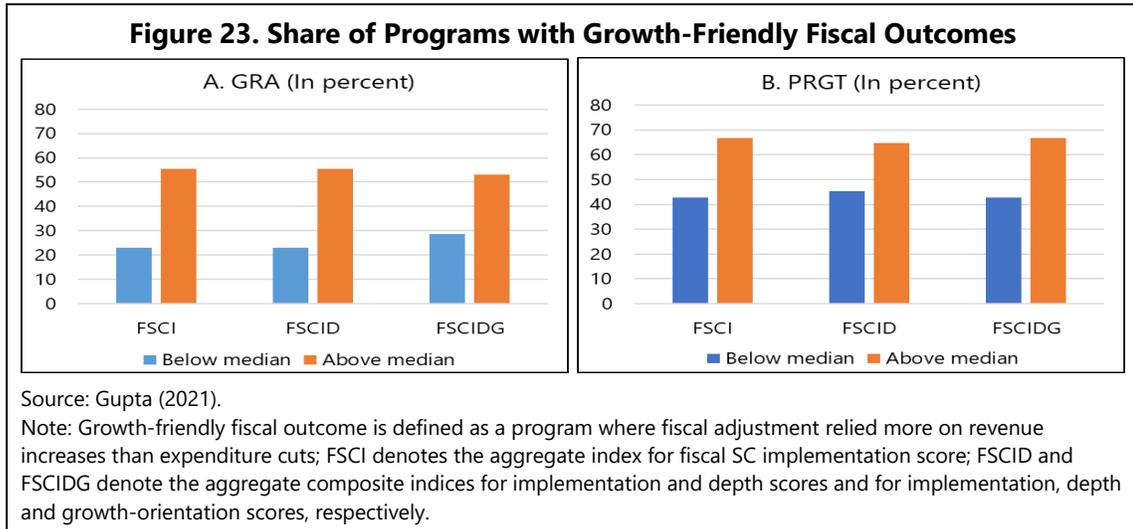
<sup>36</sup> Fiscal transparency includes publication of financial statements of public institutions including state-owned enterprises. It also includes publication of details of infrastructural project costs/bids, publication of arrears and budget execution reports, passing and presentation of fiscal responsibility law, and asset disclosures of cabinet members.

<sup>37</sup> In 2018, the IMF adopted a new framework on governance (IMF, 2018a) that calls for greater attention to be paid to strengthening public financial systems and enhancing fiscal transparency in surveillance, program, and CD work. Staff are now producing detailed governance diagnostic reports for an increasing number of (mostly program) countries.

TA has helped to improve implementation of fiscal SCs. Specifically, no evidence is found for a positive and statistically significant relationship between fiscal TA and fiscal SC implementation in both bivariate and multivariate settings (Gupta, 2021).<sup>38</sup>



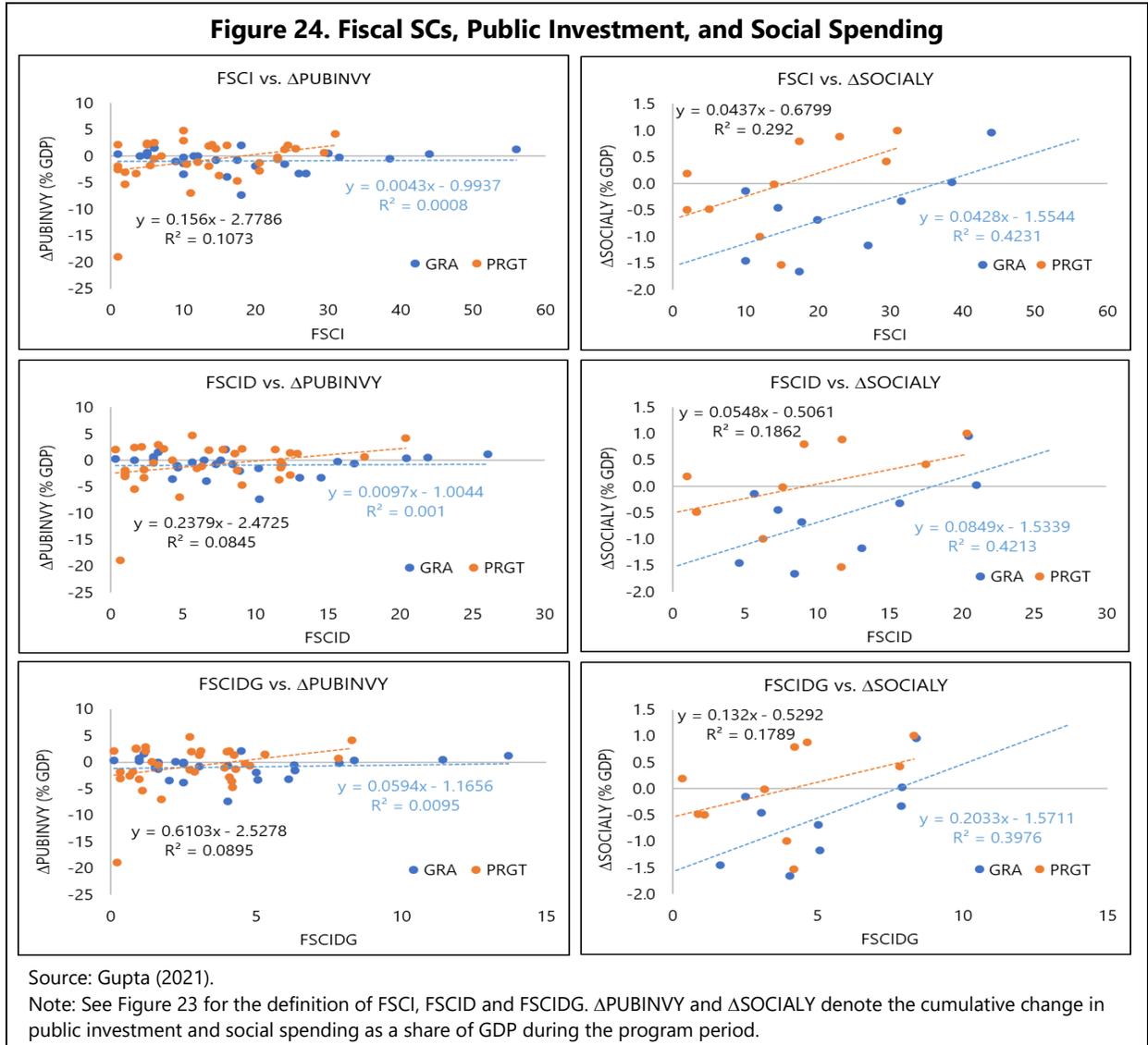
104. Stronger compliance and higher quality of fiscal SCs was associated with more growth-friendly fiscal outcomes.<sup>39</sup> Dividing the sample of programs with overall fiscal consolidation into two subgroups depending on whether fiscal SC scores are above (first group) or below (second group) the cross-country median, the share of programs where fiscal adjustment relied more on revenue increases than expenditure cuts is on average 24–32 percentage points and 19–24 percentage points higher in the first group than in the second in GRA and PRGT programs, respectively (Figure 23).



<sup>38</sup> See Chapter VII for a fuller assessment of the relationship between IMF CD support and overall SC implementation in the program context.

<sup>39</sup> Based on the literature, a growth-friendly fiscal outcome is defined as a program where fiscal adjustment relies more on revenue increases than expenditure cuts.

105. Higher fiscal SC scores also have on average been positively and statistically significantly associated with higher social (health and education) spending, while a positive but insignificant association is found between fiscal SC scores and public investment in both GRA and PRGT programs (Figure 24). Moreover, the impact of fiscal SCs on social spending depends not only on the implementation (Figure 24, top right panel) but also on the depth and growth-orientation of fiscal SCs (Figure 24, middle and bottom right panels).



### D. Lessons from Country Experience

#### Composition of Fiscal Adjustment

106. The case studies reveal a wide variety of country experience within the aggregate data presented earlier. While most PRGT programs in the case studies envisaged growth-friendly revenue-based fiscal consolidation, in some programs such as Ghana (2009, 2015),

Honduras (2014), and Malawi (2010, 2018), significant upfront reductions in expenditures were incorporated, given that the reforms needed to raise revenue would take time to accomplish.

107. Initial commitment to growth-friendly fiscal adjustment often needed to be adapted in the face of implementation slippages. Programs had to pull back from growth-friendly fiscal strategies during implementation owing to weak revenue results, shortfalls in grants, and/or pressures on current spending, including strong resistance to public wage restraint. In a number of cases, these pressures led to cuts, as opposed to programmed increases in public investment (Benin, Jordan, Malawi, and Tunisia). In some cases, weak expenditure controls contributed to large accumulation of public domestic arrears with a negative impact on growth (e.g., Benin, Cameroon, Grenada, Malawi, and Senegal); subsequent clearance or reduction of arrears supported growth by freeing up resources for the private sector (Grenada, Romania, and Senegal).

108. In many case studies, revenue mobilization efforts had modest success during the program period. In a number of cases, tax reforms faced substantial internal opposition and complicated implementation challenges and were delayed or watered down. In some PRGT cases, an increase in tax revenue was achieved after the program or during a successor program (Benin), while in others it remained elusive even after reform was rolled out (Bangladesh). Revenue measures proved challenging in some GRA countries too, particularly in the face of political resistance (Jordan 2016).

### **Public Investment for Growth**

109. In a number of the case studies, programs were able to accommodate significant increases in public investment. For example, in the case of Honduras, increased revenues and efforts to contain non-essential spending were instrumental to increase spending on infrastructure. In Senegal, increased access to external finance helped by use of IMF signaling instruments and flexibility in adapting the fiscal program to shortfalls in adjustment allowed a build-up in such spending. In Egypt, increases in capital spending by state-owned enterprises were not restrained by program conditionality. Targeted efforts at protecting public investment were generally successful. Bangladesh (2012), for example, protected 10 mega public investment projects (in areas such as transport, ports, and power generation) that were already underway at the start of the program, despite the associated strain on public finances and the current account. In other cases, public investment spending was ring-fenced from budget cuts and supported by external financing. In Latvia and Romania, pro-growth capital spending was supported by EU financing.

110. At the same time, case studies also raised questions about the medium-term growth impact of higher public investment, highlighting the need for strong management and governance, including greater attention to the assessment of infrastructure gaps, transparent selection of projects based on cost-benefit analysis, effective monitoring and execution, and improved debt management. While scaling up infrastructure spending to support growth was a primary fiscal objective of many PRGT programs, some countries accumulated debt rapidly and did not always see the expected productivity gains from increased public capital, raising concerns about the quality and growth impact of public investment as well as the risks created for debt

sustainability (Benin and Senegal). In Senegal, for instance, debt tripled between 2008 and 2019. A Public Investment Management Assessment (PIMA) highlighted the low quality of public investment spending in Benin, Cameroon, and Senegal. Another factor leading to rapid increases in debt was off-balance sheet operations, including from state-owned enterprises, and hidden domestic arrears, pointing to the need for monitoring comprehensive fiscal targets and debt (Cameroon).

111. In response to governance concerns surrounding public investment, the IMF has provided TA to enhance the efficiency of public investment (Cameroon and Senegal) and to establish a legal framework for public private partnership to encourage private sector participation in public investment (Benin). Partner institutions have also contributed to this effort. The World Bank provided extensive TA on public investment management for Cameroon, Jordan, Malawi, and Mongolia. The USAID also joined in this effort for Jordan, and the EU for Malawi. However, the results of such efforts have typically taken considerable time to materialize.

### **Subsidy Reform and Social Spending for Inclusive Growth**

112. Case studies show widespread attention in program discussions to supporting social spending and inclusive growth. Approaches followed were adapted to account for institutional capacity and national preferences, and typically involved considerable support from the World Bank and regional development banks with deeper experience and expertise in this policy topic. Particular areas of focus included reforms of costly and distortionary energy and food subsidies and provision of social transfers to protect vulnerable groups.

113. Varying success was achieved in reforming energy subsidies. In Egypt (2016), energy subsidy reforms were extensively prepared, had strong political support and were accompanied by social assistance measures to protect the most vulnerable, such as additional food subsidies, cash transfers to the elderly and poor families, and other targeted social programs. Notwithstanding progress, however, concerns remained about the adequacy of targeting. In Jordan, energy subsidy reforms gained less traction because the cash transfer intended to protect the vulnerable from the impact of the automatic fuel price adjustment was poorly targeted, resulting in 70 percent of the population receiving this cash transfer. In some cases, political factors were behind delays or failures in energy sector reforms. In Ukraine, meaningful progress on curtailing gas losses was eventually achieved in the 2015 EFF after serious shortfalls in the 2008 and 2014 SBAs. Similarly, in Pakistan progress was made in power sector reforms in the 2013 EFF after failure in this area in the 2008 SBA.

114. Two lessons emerge from this varied country experience. First, strong domestic political commitment and ownership are crucial to overcome resistance from vested interests. Second, particularly where progress is key to program success, the Fund may need to pay more attention to mobilizing technical support for reforms with development partners, including applying leverage related to the IMF's access to senior decision makers, rather than taking a "hands off" attitude and effectively delegating responsibility to other agencies.

115. Turning to social safety nets, the case studies confirm that effective steps to safeguard vulnerable groups from the adverse impact of fiscal adjustment and energy subsidy reform can play an important part to maintain domestic support (Grenada, Honduras, and Malawi). However, in some cases (e.g., Romania 2009), reforms to the social safety net were too slow to provide protection to the most vulnerable. Nearly all programs aimed at improving the efficiency of social spending through better targeting. In some cases, the Fund adapted their recommended approach in view of national preferences (e.g., Latvia 2008) or faced a lack of political buy-in (e.g., Mongolia 2017). Given limited expertise of Fund staff in this area, social programs were often implemented with TA from the World Bank and other multilateral institutions (Bangladesh, Benin, Grenada, Honduras, Latvia, Malawi, Mongolia, Romania, Tunisia, and Ukraine).

116. More broadly, all PRGT programs have been required to include indicative targets establishing floors on social spending. Some GRA programs also established indicative floors on social spending (Jordan and Tunisia). Design of these floors has had to be adapted to data availability and are often broad rather than well targeted. As a result, even though the floors have typically been observed, in some cases, they have not been effective for safeguarding social expenditures for low-income and vulnerable groups (IEO, 2017). Malawi provides a case in point as its indicative floor on social spending was progressively lowered and the coverage was broadened over time.

117. The IMF's increased attention to social spending was well-received by many, though not all, country authorities. Ghanaian authorities, for example, "appreciated that they had flexibility on the choice of fiscal measures" that allowed them to implement free high school education. Latvian authorities, however, expressed "concerns about program costs, possible adverse impacts on work incentives, and cultural preferences for family-based rather than government-based safety nets." Malawi authorities, meanwhile, thought growth-promoting development programs should be prioritized ahead of social spending, which includes items that do not directly benefit the most vulnerable such as the wages and salaries of government employees. In some cases, authorities preferred to follow universal rights rather than targeted approaches usually advocated by the Fund, arguing that a targeting approach can be more expensive than universal programs and/or exclude large segments of vulnerable populations.<sup>40</sup> In Mongolia, for instance, the 2009 SBA included conditionality to shift from universal to targeted social transfers. But progress was difficult without a clear social and political consensus.

118. One general issue raised in many of the case studies relates to the lack of monitoring and reporting on the social impact of the overall program and specific policies to protect vulnerable groups. Very few staff reports provided much information in this area, which made it hard for this evaluation to reach conclusions on the extent to which the undoubted attention to protecting the vulnerable was actually successful in achieving its objectives. Even more important, the lack of a capacity to track effectiveness made it hard to identify emerging risks and assess the need for further reinforcing actions.

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<sup>40</sup> While IMF policy advice on social spending often centers on targeting mechanisms based on means testing, IMF (2019d) noted that the appropriate use of targeted and universal transfers depends on country preferences and circumstances and should be consistent with fiscal and administrative constraints.

## Fiscal Reforms and Growth

119. A clear lesson across the case studies is that meaningful fiscal reforms often take a long time to put in place, implying that the growth benefits are slow to materialize, often well beyond the program period. This experience implies a need for realism in setting program timelines for reform progress and in anticipating growth benefits. It also underlines the importance of building political support for reforms and sustaining reform efforts well after programs are completed.

120. A case in point is Bangladesh (2012) where the introduction of the VAT was the centerpiece of fiscal reform of the program. Notwithstanding the enactment of the VAT law in 2012 and a short extension of the program to give time for reform implementation, the tax reform was not implemented because of strong opposition from vested interests. Eventually, Bangladesh implemented a VAT four years after program completion, but a positive revenue impact has been slow to materialize.

121. The case of Mongolia also highlights the importance of continued efforts to preserve program achievements after the program; otherwise the hard-earned reform benefits may be lost. The major achievement under the 2009 SBA was the establishment of the fiscal stability law (FSL) which was set up to avoid boom-bust fiscal cycles related to world mineral prices and to ensure saving of a greater proportion of windfall revenues during the good times. However, the fiscal rules under the FSL were circumvented after the SBA was completed and, as a result, the boom intensified during 2011–14 as mineral production expanded, and commodity prices rose. When the boom turned to bust, authorities sought a new three-year program in 2017.

122. Country case studies on Egypt, Jordan, and Tunisia illustrate the importance of sequencing fiscal adjustments, garnering political support and avoiding reform fatigue. All three countries were affected by economic and social disruptions in the context of the Arab Spring uprisings and protracted regional conflicts. They all asked for Fund financial support to attain two key objectives—regaining macroeconomic stability and reinvigorating growth to address longstanding social problems at the root of the uprisings. Among the three, only Egypt was able to attain both the adjustment and growth goals although it took a number of years for Egypt to lay the groundwork before a program could be put in place. At the start of the program, the Egyptian authorities took decisive policy measures, centered on fiscal consolidation and the liberalization of the foreign exchange market, and used the savings from the elimination of fuel subsidies to strengthen social programs for the most vulnerable. Such early decisive actions helped the authorities to avoid reform and donor fatigue which emerged in the other two countries over time and fueled skepticism and opposition to reform.

123. The case studies illustrate the critical role of program ownership in implementing fiscal adjustment and reaping the benefit of fiscal reforms. In Latvia (2008), which involved bold, front-loaded fiscal adjustments, authorities retained strong political support despite a sharp initial growth downturn by clearly communicating to the public the national strategy for sustaining progress towards closer EU integration. The program achieved its goals and resolved external and fiscal imbalances relatively quickly. After three years of recession, growth resumed at a

respectable pace and Latvia joined the Eurozone in January 2014. By contrast, Pakistan (2008 SBA) is a case in which limited political support undermined critical tax reform implementation. Despite massive IMF TA and program extensions to allow more time to unlock the VAT reform, the tax reform failed to be implemented before the program expired in 2011 due to lack of political support. As the VAT reform remained politically infeasible, another program in 2013 sought revenue mobilization via a combination of several incremental reforms (e.g., scaling back tax exemptions, broadening the tax base, increasing goods and services taxes, and improving tax administration) and achieved partial success.

### **Domestic Arrears**

124. A number of case studies highlight that large accumulation of public domestic arrears has a negative impact on growth and business climate (e.g., Benin, Cameroon, Grenada, Malawi, Romania, and Senegal). These strains typically received considerable attention in program design although implementation of needed reforms was often challenging. In Senegal (2015), a large increase in domestic arrears was not reported on a timely basis and required introduction of appropriate program conditionality. In Malawi (2012), program efforts to control government spending were partly circumvented by the accumulation of arrears to domestic suppliers, which led to increased nonperforming loans (NPLs) in the banking sector. Creditors were issued promissory notes amounting to a cumulative nine percent of GDP between 2013 and 2018. The 2012 program also included conditionality on public financial management designed to better limit and track new arrears. Cameroon (2017) aimed at a gradual elimination of domestic arrears to contractors to reduce banks' NPLs and unlock bank credit to the private sector, but efforts have not been effective, resulting in persistent domestic arrears. In Romania (2009, 2011), both authorities and staff viewed efforts to strengthen public sector arrears management as having particularly benefited growth and business climate as payment arrears by state-owned enterprises, local governments, and health sector bodies were an important burden on the business community. Pre-existing arrears were regularized, and disciplinary rules were established to deter new arrears. In Grenada (2014), the private sector benefited from improved fiscal management as the government had a history of accumulating significant arrears on domestic payables, which were eliminated under the program. In Benin (2017), business climate benefited from the completion of an audit of government arrears to domestic suppliers.

## **E. Assessment**

125. The experience covered in this evaluation clearly shows the Fund paying considerable attention to encouraging growth-friendly fiscal adjustment and reforms. Empirical analysis suggests that program design generally incorporated multiplier relationships broadly in line with the professional literature. Moreover, efforts were made to raise revenue mobilization, increase public investment, and at least protect social spending, by building these goals into program objectives and structural conditionality, often with capacity development support. These efforts were usually tailored to country circumstances, including through program adaptation that helped to adjust for slippages, alleviate the growth impact, and foster country ownership.

126. Overall, PRGT programs did manage to raise revenues and public spending on average; efforts at raising social support were less successful, although assessment is complicated by lack of data. GRA programs by contrast were less growth-friendly, relying more heavily on spending cutbacks, including to public investment and social spending. The cross-country analysis and country case studies suggest a number of lessons.

127. First, more systematic attention should be paid to calibrating the growth consequences of fiscal adjustment and reforms in program design. Our cross-country evidence suggests that actual short-term fiscal multipliers could differ substantially from assumed multipliers. In particular, assumed fiscal multipliers seem to have been typically too low in PRGT cases (where results suggest that the adverse growth impact of higher revenue is under-estimated and growth benefit of higher public investment is over-estimated). In GRA cases, multipliers seem to have been under-estimated in some circumstances when the economy was weak and there was little scope for offsetting monetary support—although multipliers seem to have been less under-estimated in crisis cases where confidence effects helped in part alleviate the income effect of adjustment. In this respect, explicit analysis of short-term fiscal multipliers in staff reports would enable a better understanding of the underlying assumptions and assessment regarding the short-term growth consequences of fiscal adjustment and could help reduce growth optimism bias. In addition, explicit discussion in program documents of the longer-term growth impact of fiscal reforms would help to incentivize authorities to undertake growth-enhancing reforms as well as to underpin realistic assessment of medium-term debt sustainability.

128. Second, fiscal structural conditionality should give greater emphasis to fostering deep reforms, including through increasing the proportion of high-depth SCs and cutting back on the proliferation of low-depth ones. This would help focus authorities' attention on measures crucial for improving fiscal performance supportive of growth (such as enhancing the efficiency and compliance of the VAT and improving the governance of capital spending).

129. Third, programs should take a longer-term perspective on seeking to raise public spending on public infrastructure, education and health by focusing more on strengthening public financial practices instead of merely protecting or raising such spending through short-term conditionality. The IMF has intensified efforts to help strengthen governance through technical assistance (TA) to member countries since the adoption of a new framework in 2018. The recommendations of those missions on fiscal transparency and public financial management should be incorporated in IMF-supported programs.

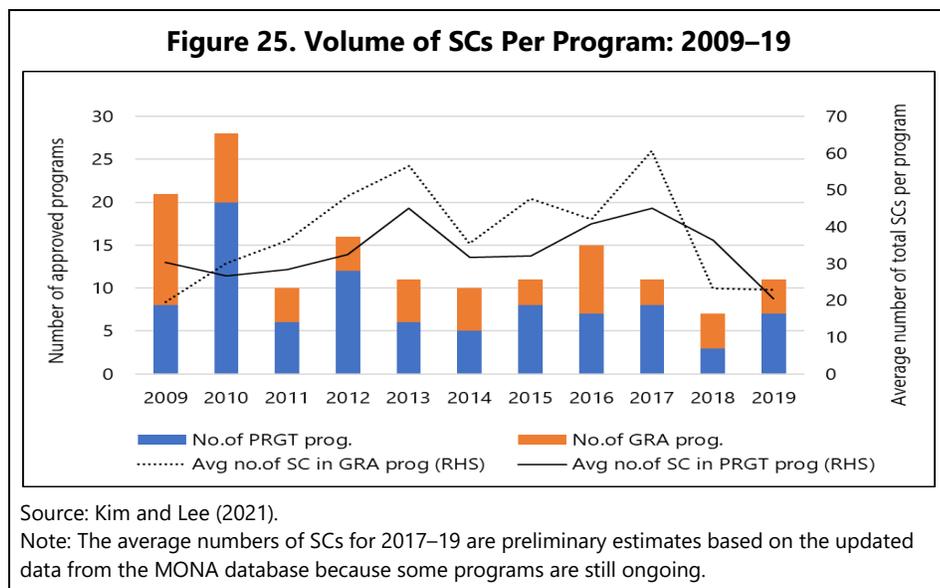
130. Fourth, programs should seek ways to incentivize the authorities to report domestic arrears with candor and on a timely basis and to prevent new arrears by, for example, limiting the scope for using off-balance sheet operations or using domestic arrears to meet program targets. In addition, ex post accommodation of unmet conditionality on domestic arrears should be granted as an exception based on clear justification. Fund technical assistance related to PFM should pay particular attention to how to improve monitoring and control of domestic arrears.

131. Fifth, there is a need to strengthen the monitoring and reporting of the social and distributional impact of the overall program and of the specific policies to protect vulnerable groups. The lack of a capacity to track effectiveness made it hard to track progress made in achieving inclusive growth, to identify emerging risks and to assess the need for further reinforcing actions.

## VII. STRUCTURAL CONDITIONS, STRUCTURAL REFORMS AND GROWTH

132. This chapter assesses the effectiveness of structural conditionality in promoting growth-enhancing structural reforms.<sup>41</sup> It also examines the role of IMF capacity development work and collaboration with partner institutions in supporting the design and implementation of SCs.

133. IMF-supported programs have used SCs to encourage needed adjustments, support structural reforms and ultimately promote growth. In the programs under evaluation, SCs accounted for more than 40 percent of total program conditions. The volume of SCs per program has increased significantly since the end of the 2000s, particularly in GRA programs, reflecting in part that more programs in the 2010s were dealing with protracted structural challenges in a weak global environment (Figure 25). The average number of SCs for GRA programs peaked in 2013 and has since been on a broadly declining trend except for 2017.<sup>42</sup> PRGT programs have exhibited similar time pattern but with on average fewer SCs and less time variation than GRA programs.



<sup>41</sup> This chapter draws on Kim and Lee (2021) and country case studies prepared for the evaluation.

<sup>42</sup> The spike in 2017 in the average number of SCs in GRA programs is explained mainly by the fact that one of the three GRA programs approved in 2017 had an exceptionally large number of SCs (80 in total).