CHAPTER 1—IMF TOOLS AND ANALYSIS UNDERPINNING FISCAL POLICY ADVICE, 2008–23

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The views expressed in this Chapter are those of the authors and do not necessarily represent those of the IEO, the IMF, or IMF policy. The Chapter in this Background Paper reports analyses related to the work of the IEO and is published to elicit comments and to further debate.

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EXECUTIVE SUMMARY

Over the past 15 years, the IMF has shown notable intellectual agility and institutional adaptability in advancing fiscal policy advice. In the aftermath of the Global Financial Crisis, the Fund moved beyond its traditional focus on fiscal sustainability to recognize the critical roles of fiscal policy in stabilizing output and supporting long-term growth. This evolution reflected a strong commitment to evidence-based policymaking, openness to revising established views, and sustained analytical innovation. The Fund's research helped shape global debates on fiscal consolidation, the implications of "low-for-long" interest rates, and the fiscal dimensions of climate change and inequality—often positioning the institution as an intellectual leader among international financial organizations.

Analytical progress was matched by important operational advances. The development of the Sovereign Risk and Debt Sustainability Framework (SRDSF), the Fiscal Space Framework (FSF), and FAD's optimizing models enhanced the rigor, transparency, and empirical grounding of fiscal assessments. Complementary realism tools embedded in these frameworks strengthened the credibility of projections by disciplining overly optimistic assumptions, while new methodologies—such as the Public Sector Balance Sheet, Fiscal Risk Assessment Tool, and Debt-at-Risk framework—broadened the coverage of vulnerabilities beyond traditional debt indicators. These innovations, supported by extensive research on fiscal multipliers, spillovers, and the distributional effects of fiscal measures, have provided a more comprehensive basis for tailoring fiscal advice to country circumstances.

Despite these advances, several analytical and operational gaps remain. Methodological transparency and replicability are uneven, limiting external scrutiny and the accumulation of cumulative knowledge. Empirical work remains heavily concentrated on advanced economies, leaving weaker guidance for countries with different transmission mechanisms and financing structures. Moreover, existing analytical toolkits still fall short of addressing several foundational questions—how to calibrate the fiscal–monetary policy mix under normal conditions, how to select desirable medium-term debt anchors from among feasible options, and how to quantify the long-run fiscal implications of investment, redistribution, and climate policies. Liquidity risks, though more systematically incorporated into the SRDSF and LIC-DSF, are not yet fully integrated across frameworks. Similarly, the IMF's growing work on inequality, defense, and climate adaptation has not been consistently embedded within debt sustainability analysis or medium-term fiscal planning. Addressing these gaps would strengthen the coherence and evenhandedness of IMF fiscal advice and ensure that analytical innovations translate more fully into operational guidance.

I. INTRODUCTION

1.   **The Fund's approach to fiscal policy is framed around three core goals: safeguarding fiscal sustainability, stabilizing output over the cycle, and raising potential output through the provision of public goods.** Fiscal sustainability has both a solvency dimension—ensuring that public debt remains on a sustainable path—and a liquidity dimension—ensuring governments can meet gross financing needs as they arise. Macroeconomic stabilization requires fiscal policy to operate countercyclically where possible, supporting demand during downturns and withdrawing stimulus in booms, in coordination with other macroeconomic policies. Raising potential output through the provision of public goods is achieved through measures that expand infrastructure and human capital investment, strengthen institutions, and advance broader priorities such as the Sustainable Development Goals (SDGs) and the green transition. The adoption of institutional strategies on social protection, climate change, and gender (IMF, 2019a; 2021a; 2022a) has further elevated the importance of synergies and trade-offs between financing these long-term objectives and fiscal sustainability.

2.   **This chapter reviews the analytical contributions and tools developed by the IMF to inform fiscal policy advice across the three objectives.** The emphasis is on the tools themselves—their conceptual foundations, empirical design, and practical features—while their application by country teams or integration into flagship publications is addressed in other background papers.[1] References to surveillance practice are included only where they help illustrate a tool's operational value or limitations. The chapter focuses on macro-fiscal tools used in the surveillance context, while noting that some are also applied in program work. It covers aspects of expenditure and tax composition relevant for macro-fiscal analysis, but excludes more structural issues—such as pension and health reforms, or the efficiency and incentive effects of specific taxes and spending programs—that lie beyond its scope.

3.   **This chapter reviews key innovations in IMF research and assesses their incorporation into toolkits that support country teams.** Reflecting the Fund's scientific culture, staff research has played a central role in shaping fiscal policy doctrines and recommendations (Ban, 2015; and Ban and Gallagher, 2015). The discussion is organized around the three thematic areas outlined above: (i) fiscal sustainability, including fiscal risk and fiscal space; (ii) fiscal policy for output stabilization; and (iii) fiscal policy to support potential output and the provision of public goods. Particular emphasis is placed on how these tools help operationalize trade-offs among competing fiscal objectives, clarifying when they reinforce one another and when tensions arise. In doing so, the chapter highlights the value of IMF toolkits in disciplining staff assessments and guiding the allocation of fiscal space in ways that balance short-term stabilization needs with long-term development goals.

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[1] A recurring challenge in the design and application of fiscal analytical tools is the uneven availability and quality of data, particularly in LICs. These limitations—ranging from gaps in coverage and timeliness, insufficient detail in fiscal classifications, lack of transparency around off-balance-sheet items, and the scarcity of high-frequency macroeconomic data—constrain the use of advanced methodologies and tend to bias tools toward the circumstances of advanced economies.

II. FISCAL SUSTAINABILITY

4.   **This section reviews the IMF's analytical work and operational toolkits for assessing debt sustainability, fiscal space, and fiscal risks, and explains how these inform fiscal advice.** We proceed in four steps. First, we review the IMF's research and operational frameworks on debt sustainability and sovereign risks—including the SRDSF for market-access countries and the LIC-DSF for low-income countries—highlighting their treatment of debt-carrying capacity, the implications of shifting interest-growth differentials, their core modules (solvency, liquidity, and risks at various horizons), the evolution of realism tools, and remaining analytical gaps. Second, we turn to complementary instruments: the Fiscal Space Framework (FSF), which provides a standardized approach to gauging room for policy support, and balance-sheet-based and risk tools—such as the Public Sector Balance Sheet database and Debt-at-Risk—that broaden coverage of vulnerabilities. Box 1 provides further details on the FSF.

Debt Sustainability and Sovereign Risks

5.   **IMF research has explored how macroeconomic and structural factors influence a country's debt-carrying capacity.** Analytical work has assessed member countries' ability to sustain higher debt-to-GDP ratios, quantified the fiscal adjustments required to reverse debt surges, and evaluated whether changes in debt trajectories are needed to meet long-term financing needs. Flagship publications have also explored the determinants of debt sustainability, including the implications of declining interest–growth differentials (e.g., Ghosh and others, 2013; October 2016 and April 2017 Fiscal Monitor (FM)) and the feedback effects of debt levels interest and growth rates (Box 2).

6.   **Completing this research, the IMF has developed tools to support staff assessments of debt sustainability and risks of debt distress.** Since 2002, different frameworks have been applied to market-access countries (MACs) and low-income countries (LICs), reflecting their distinct characteristics. These tools have evolved significantly, and current versions include modules that assess short-, medium-, and long-term debt risks under various macroeconomic and policy scenarios.

7.   **The DSA framework for MACs has evolved considerably, most recently with the introduction of the Sovereign Risk and Debt Sustainability Framework (SRDSF) (IMF, 2021b; 2022b).**[2] The SRDSF provides two outputs: a sovereign risk assessment and a debt sustainability assessment. These assessments aim to capture vulnerability to sovereign stress events, risks that debt could become unsustainable, and prospects for stabilizing the debt trajectory in the baseline scenario. Analytical modules assess sovereign risks across three horizons. In the near term, an early warning system estimates the likelihood of sovereign stress

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[2] While DSAs had long been standard practice for LICs, they were not systematically used in fiscal analysis for advanced economies before the GFC. Recognizing this gap, the Fund introduced a DSA framework for market access countries (MAC DSA) in 2002, refined it in 2011, and ultimately replaced it with the SRDSF in 2021 (IMF, 2022b).

over a one-to two-year horizon. Medium-term risks are evaluated through: (i) the debt fanchart module, which assesses solvency over a five-year horizon; (ii) the gross financing needs module, which gauges liquidity pressures and the country's ability to meet its gross financing needs over the medium term; and (iii) stress tests for country-specific vulnerabilities, including contingent liability shocks. Long-term modules are used to capture structural risks, such as those related to climate change, demographics, and natural resource depletion.

Box 1. Measuring "Fiscal Space" in IMF Surveillance

Background

The concept of fiscal space—understood as a government's ability to raise spending or cut taxes without endangering debt sustainability or macroeconomic stability—has long informed IMF work (Heller, 2005). Earlier approaches to measuring fiscal space included: (i) fiscal gap indicators, based on medium-term debt stabilization paths; (ii) assessments of whether debt and deficits are "stationary" over time; and (iii) intertemporal budget constraint models incorporating macro-fiscal feedbacks (IMF, 2012). Each approach has strengths, but also limitations, including reliance on mechanistic assumptions or backward-looking indicators.

To improve rigor and consistency in its fiscal advice—particularly following the GFC—the IMF introduced a formal *Fiscal Space Framework* (FSF) in 2016 (IMF, 2016a). The tool defines fiscal space as the ability to provide stimulus without compromising debt sustainability or macroeconomic stability. Initially piloted in 38 advanced and emerging economies, it was extended to 31 additional countries (including some LICs with market access) in 2018 and is encouraged for all countries covered under the SRDSF.

The FSF in Practice

The FSF provides a standardized, spreadsheet-based platform for assessing fiscal space. Inputs include: (i) initial conditions (debt levels, output gaps, gross financing needs, and contingent liabilities among others); (ii) debt sustainability analysis (from the SRDSF); and (iii) simulations of alternative policy scenarios using macro-fiscal models developed by the Research Department. A detailed assessment table is prepared for internal Fund discussion not is not published in staff reports. Instead, reports for the 69 participating countries provide only a bottom-line assessment, ranging from "no space" to "substantial space." Country teams are encouraged to supplement the tool with judgment, especially where fiscal rules or unmodeled risks are important. The FSF does not generate a numerical estimate of fiscal space or recommend whether space should be used—these are left to staff discretion (IMF, 2022). Teams also decide whether to share the full assessment with national authorities.

Remaining Challenges

While the FSF has enhanced transparency and country tailoring, concerns persist. For example, Clift (2024) argues that in practice Fund policy advice has remained relatively unsupportive of relaxing fiscal policy, at least partly reflecting the inbuilt biases of the analytical frameworks that are used for assessing fiscal space, as well as inbuilt institutional aversion to accepting risks to macroeconomic stability. Other authors (Salamaliki and Venetis, 2024), while not directly criticizing the Fund's approach, argue that nonlinearities—i.e., risks become increasingly severe as thresholds are approached—need to be better accounted for. Many authors have noted that fiscal space assessments have limited relevance for LICs since the risk of losing market access for their debt is less important (Pick, 2017). Lastly, some have questioned whether the focus on numerical methodologies for assessing whether fiscal space exists may distract attention from the reforms that may be needed to existing budgeting frameworks or to expenditure and tax systems (Kentikelenis and Stibbs, 2024).

Interviews of Fund staff and others also surfaced similar concerns. Some staff expressed concern that the tool relied on overly complex debt sustainability analyses, and it also led to an overemphasis on a single metric rather than providing more granular fiscal policy advice. Questions were also raised about whether the review process was sufficient to ensure that the tool was consistently applied. And some interviewees noted that the approach was based on very long-run debt sustainability analyses and led to overly restrictive advice to LICs whose needs were much more immediate. For example, identified shortfalls in fiscal space led to Fund calls for restrictive policies rather than suggestions for how to durably increase fiscal space.

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Source: "Fiscal Space Assessment: A Reference Note for Country Teams," February 2023.

Box 2. Debt, Interest, and Growth: How the IMF's Thinking Has Evolved

This box reviews the evolution of IMF views on the relationship between public debt, interest rates, and growth.

Early Views

Early IMF analyses emphasized how higher public debt raises borrowing costs. The November 2009 FM estimated that a 10 percentage point (p.p.) increase in debt raised long-term interest rates by around 50 basis points. Deficits were seen as having a stronger impact, with a 1 percentage point of GDP increase in the deficit pushing up bond yields by 20–60 basis points (Baldacci and Kumar, 2010). Countries with weak fiscal fundamentals or high initial debt (above ~80 percent of GDP) faced even steeper increases. Based on these results, the FM estimated that a persistent increase in debt of about 20 percent of GDP would raise debt service costs by more than 1½ percent of GDP in G-20 countries.

The IMF also endorsed the view that high debt depresses growth, reinforcing concerns about fiscal sustainability. The April 2010 FM estimated that a 10 p.p. increase in debt reduced annual per capita growth by 0.15–0.2 p.p., with significant negative effects already emerging at "medium-to-high" debt levels (above 30–60 percent of GDP) and becoming nonlinear around 60–90 percent of GDP thresholds (Kumar and Woo, 2010). These findings echoed Cecchetti, Mohanty, and Zampolli (2011) and Reinhart and Rogoff (2010), who argued that growth slows sharply when debt exceeds 90 percent of GDP.

Weakening Links in the Great Recession

As AEs accumulated large amounts of public debt after the GFC, IMF research found that the anticipated surge in interest rates largely failed to materialize (October 2014 FM). While traditional estimates of debt sensitivity were still referenced, the Fund recognized that prolonged low rates, QE, and factors like investor risk appetite and safe haven status had weakened the debt-yield link for AEs (Abbas and others, 2013).

At the same time, IMF research increasingly questioned rigid debt thresholds and the causality of the debt-growth relationship. Pescatori, Sandri, and Simon (2014) found no universal tipping point where debt undermines growth, emphasizing that its impact depends on debt stability and whether fiscal policy supports productive investment. Similarly, Panizza and Presbitero (2014) suggested that low growth often drives higher debt, rather than the reverse. While traditional rules of thumb were still referenced (April 2013 FM), the IMF gradually shifted from fixed debt limits to more context-dependent assessments, considering debt trajectories, economic conditions, and the credibility of medium-term consolidation plans.

The "Low-for-Long" Era

By the mid-2010s, it became evident that interest rates on government debt in many AEs had remained below GDP growth rates (r < g) for an extended period, challenging earlier concerns about debt sustainability (Blanchard, 2019). The IMF began emphasizing that when r – g is negative, debt-to-GDP ratios can decline organically through growth rather than requiring fiscal consolidation (Ostry, Ghosh, Espinoza, 2015; FM October 2020). This marked a departure from the 2010 stance that prioritized fiscal consolidation.

However, the IMF remained cautious, warning that "low-for-long is not low forever" (Mauro and Zhou, 2020). By 2023, global inflation had pushed interest rates higher. While borrowing costs have risen, there has been no disorderly spike linked to credit risk. Nonetheless, the IMF's October 2022 and April 2023 FM highlighted growing concerns over rising debt service burdens, particularly for economies with already high debt levels (Adrian, Gaspar, and Gourinchas, 2024).

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Source: Authors.

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8.   **The SRDSF's solvency assessment evaluates whether debt is likely to stabilize over the medium term, how uncertain future debt paths are, and how institutional capacity shapes debt-carrying ability.** The debt fanchart module simulates multiple possible debt trajectories over a five-year horizon and summarizes the resulting distribution to illustrate uncertainty, the balance of risks, and prospects for stabilizing the debt-to-GDP ratio. The module reports three metrics: (i) the probability of debt non-stabilization, signaling that baseline policies

may be insufficient to stabilize debt, (ii) the width of the fanchart, reflecting uncertainty around the baseline and the potential for large projection errors, and (iii) the median level of debt in the final year of the projection period adjusted using an institutions index, which captures how governance affects debt-carrying capacity.[3]

9.   **In light of past experience with overly optimistic growth and fiscal forecasts, the SRDSF incorporates binding realism tools.** Initially introduced in 2013 as non-binding diagnostics, these tools now require corrections when projections appear unrealistic. Historical fan charts capture the impact of past shocks to primary balances, interest rates, exchange rates, and stock-flow adjustments. If projected debt ratios fall below the 20th percentile of historical distributions, a forecast optimism test is triggered. When the test confirms unrealistic assumptions about the scale of the fiscal consolidation, the framework penalizes the projection by lowering the probability of debt stabilization, thereby compelling staff to revise assumptions prior to publication. These diagnostics are tailored to country comparators—e.g., commodity versus non-commodity EMMIEs—enhancing relevance and specificity.

10.   **The SRDSF represents a significant improvement over the previous MAC DSA in capturing sovereign stress linked to liquidity.** As indicated above, the near-term risk assessment module focuses on predicting sovereign stress events over a one-to two-year horizon. It uses an early warning system that incorporates indicators such as institutional quality, past stress episodes, cyclical position, debt burden, buffers, and global conditions to assess the likelihood of near-term liquidity pressures. The Gross Financing Needs (GFN) module also evaluates whether key lenders—often domestic banks—can meet financing requirements under stress scenarios. In addition, the SRDSF flags optimistic assumptions about new borrowing and financing terms by comparing projected maturity profiles with historical patterns and applying the Laubach rule to test the plausibility of spread assumptions.[4]

11.   **At the same time, staff pointed to areas where the treatment of liquidity risks in the SRDSF could be further strengthened.** First, although the 2021 guidance allows teams to incorporate liquid assets, staff noted that the practical use of this option has been limited. Stronger and more systematic integration of cash buffers, contingent financing, and market depth would improve realism and policy relevance, particularly for countries with sizable buffers, where fiscal space may otherwise be understated. Second, staff observed that authorities tend to

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[3] A limitation of current frameworks is that they do not readily support scenario analysis of alternative fiscal paths consistent with specified debt targets. The Public Debt Dynamics Tool (DDT)—developed by the IMF's Institute for Capacity Development (Acosta-Ormaechea and Martinez, 2021)—was designed to bridge this gap by providing a practical platform for Fund teams and country authorities to explore alternative fiscal paths and policy scenarios in a transparent and accessible way. The tool computes fiscal adjustment paths to user-defined debt targets, runs standard and customized stress tests, generates fan charts, and presents results in standardized tables. However, the DDT is not a Board-approved DSA tool and remains primarily used for training and capacity development purposes, with only limited application in surveillance or program work.

[4] The Laubach (2009) rule states that bond spreads increase linearly by about 4 basis points in response to a 1 percentage point increase in the projected debt-to-GDP ratio.

place greater weight on the signals from the solvency modules. This can result in reassuring assessments of fiscal sustainability that underplay rollover and market-access risks, leading authorities to believe they have more scope to borrow and finance long-term priorities than may in fact be the case once liquidity pressures emerge.

12. **To address the specific circumstances of LICs, the Fund and the Bank developed a dedicated debt sustainability framework: the LIC-DSF**. The framework applies primarily to PRGT-eligible countries with access to IDA (International Development Association) resources, including all countries eligible for IDA grants.[5] For these economies, external financing is still largely concessional, and the present value of debt is central to assessing debt vulnerabilities, making the LIC-DSF more suitable than the MAC DSA frameworks (IMF and World Bank 2004; IMF 2018b).[6] Like the SRDSF, the LIC-DSF provides a forward-looking analysis of debt dynamics under baseline and stress scenarios, covering both traditional macro shocks (e.g., to export growth) and shocks tailored to LIC circumstances (e.g., natural disasters, commodity price shocks, contingent liabilities, and market access shocks).

13. **First introduced in 2005 and lastly overhauled in 2018, the framework combines indicative thresholds on debt and debt service with staff judgment to assign external public debt distress ratings** (IMF and World Bank, 2005; 2018). Countries are classified as having "strong," "medium," or "weak" debt-carrying capacity, based on a composite indicator that captures institutional strength, reserves, remittances, domestic and global growth. Since the 2018 Guidance Note, new challenges have grown in importance—including heightened risks from climate change, greater reliance on commercial and domestic borrowing, and a rising number of complex debt restructurings—prompting the need for more tailored implementation guidance. A Supplement to the 2018 Guidance Note, published in 2024 (IMF and World Bank, 2024), provides additional direction on how to address these issues within the current framework.

14. **The 2017 review of the LIC-DSF introduced four realism tools to strengthen the credibility of debt sustainability analyses.** These tools assess (i) the drivers of past and projected debt dynamics; (ii) the magnitude and plausibility of planned fiscal adjustments; (iii) the consistency between projected growth and the assumed pace of fiscal consolidation; and (iv) the coherence between projected growth and public investment paths. Each tool serves as a diagnostic rather than a binding constraint, prompting staff to justify departures from typical

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[5] Countries that graduate from PRGT eligibility may still remain within the LIC-DSF framework under certain circumstances. Graduation from the LIC-DSF can be delayed if there are significant short-term vulnerabilities, such as risks of losing market access or high borrowing costs, or if sufficient information is not available to apply the MAC DSA tools. Additionally, operational considerations for IDA financing may necessitate the continued use of the LIC-DSF for some countries, even after they have graduated from PRGT eligibility.

[6] If the discount rate and the contractual interest rate of a loan are the same, then the present value is equal to (or close to) the face value. If, however, the contractual interest rate of the loan is less than the discount rate, then the PV of the debt is less than the face value, implying that the loan has some degree of concessionally (IMF and World Bank, 2013).

experience and to ensure that baseline assumptions are grounded in realistic expectations. Together, these diagnostics encourage more rigorous scrutiny of the macro-fiscal framework by highlighting instances where debt reductions rely on historically uncommon adjustments or implausibly strong growth effects from fiscal or investment plans, thereby improving the transparency and credibility of the LIC-DSF.

15.   **While the framework has made progress in capturing liquidity pressures in LICs, its coverage remains incomplete.** The main channel is the Market Financing Pressures Tool, applied to LICs with market access, which checks in the baseline whether gross financing needs and EMBI spreads exceed critical thresholds (14 percent of GDP and 570 basis points, respectively). Country teams may also apply a tailored "market financing" stress test simulating adverse shifts in global risk sentiment, exchange rate depreciation, and shorter maturities on new borrowing. These innovations mark progress in recognizing liquidity risks. At the same time, the growing fragmentation of debt portfolios over the past decade—across bilateral creditors, private investors (especially bondholders), and domestic markets—has heightened the relevance of liquidity risks and underscores the need for more systematic analysis of maturity and currency composition, which are critical for rollover risk. The comprehensive review of the LIC-DSF now underway is expected to strengthen the integration of liquidity considerations.[7]

16.   **Finally, despite their analytical richness, insights from DSA tools appear underutilized in Article IV surveillance policy discussions.** While staff noted good integration of DSA outputs in Fund-supported programs, the same cannot always be said for surveillance work. A review of over 200 staff reports from 2008 to 2023 found significant variation in how DSA results were reflected in the main policy discussion, including for counties where fiscal sustainability was a relevant issue (Cohen-Setton and Montiel, 2025; Zoli and Ocampo, 2025; De Lannoy and Lane, 2025). In some cases, DSAs were relegated to appendices without influencing the fiscal advice; in others, key findings were referenced without a clear link to policy recommendations. More systematic use of DSA insights could enhance the credibility and operational relevance of fiscal advice, especially as countries confront tightening financing conditions and rising medium-term spending needs.

Fiscal Space Assessment and Analysis of Fiscal Risks

17.   **The Fund introduced the Fiscal Space Framework (FSF) in 2016 to assess whether countries could expand fiscal policy without jeopardizing market access or debt sustainability.** Defined as "the room to raise spending or lower taxes relative to a pre-existing baseline, without endangering market access and debt sustainability" (IMF, 2018a), the concept of fiscal space was conceived as a guide for countercyclical policy during downturns and for supporting socially productive public investment. It has informed both bilateral surveillance and multilateral guidance, with the April 2017 FM featuring country-specific estimates of available

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[7] Since 2024, the LIC-DSF has incorporated domestic debt service indicators to better capture rollover risks (IMF and World Bank, 2024).

fiscal space. While the concept of fiscal space has long featured in Fund advice, the introduction of a formal tool marked a step forward in systematizing assessments. Since 2018, fiscal space assessments have been required for 69 countries—including 41 EMMIEs and 5 LICs with market access—though these requirements were temporarily suspended during the COVID-19 Pandemic (2020–early 2023).

18.   **Yet the framework's influence in practice remains contested.** A desk review of Article IV reports for advanced economies by Cohen-Setton and Montiel (2025) found that fiscal space assessments in recent years were more convincing and differentiated than in the early part of the 2008–23 evaluation period, a development they attribute to the introduction of the FSF, which helped standardize assessments and reduce reliance on judgment. At the same time, external critics argue that Fund advice has remained overly cautious in recommending fiscal expansion, even after the FSF's adoption. Some staff also voiced concern that reliance on a single composite indicator has crowded out more granular analysis and constrained the flexibility needed to adapt advice to country-specific contexts. These limitations underscore the need for greater clarity on how FSF diagnostics should be interpreted and how they should be integrated with broader macro-fiscal considerations, including political economy constraints and long-term spending needs (for more on the FSF, see Box 1).

19.   **Recent crises have underscored that unmanaged fiscal risks can upend macroeconomic plans and debt paths.** The GFC, commodity-price collapses, the pandemic, and climate-related shocks revealed large downside, correlated realizations of risk that propagate through public balance sheets. Historically, governments have faced an adverse fiscal shock averaging about 6 percent of GDP roughly once every twelve years (IMF, 2016c). These episodes highlighted gaps in transparency, coverage of the broader public sector, and the need to quantify how macro shocks and contingent liabilities interact to threaten solvency, liquidity, and financing capacity.

20.   **Against this backdrop, the IMF expanded its fiscal-risk work along two complementary tracks: (i) standards and diagnostics to embed risk identification, disclosure, and governance in country systems; and (ii) a modular toolkit to quantify exposures and transmission channels and to inform buffers, fiscal rules, and DSA scenarios.** On the first track, a revamped Fiscal Transparency Code introduced a dedicated Pillar III on "Fiscal Risks," now accounting for roughly one-third of the assessment, operationalized through Fiscal Transparency Evaluations that have informed surveillance and program design. On the second track, an initial Board paper on best practices (IMF, 2016c) catalyzed the development of a comprehensive Fiscal Risk Toolkit (Figure 1) that countries and area departments can apply at different capacity levels and link to LIC and MAC DSAs, MTDS, and calibration of fiscal anchors.

Figure 1. Fiscal Risk Toolkit

Source: IMF.
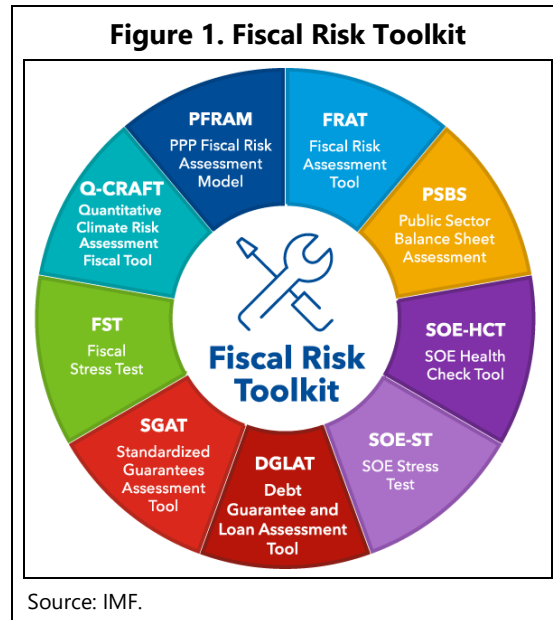
21.   **The Fund's systemwide tools broaden coverage beyond deficits and debt to the full public sector and to tail risks.** The Public Sector Balance Sheet (PSBS) work (October 2018 Fiscal Monitor) produced a cross-country PSBS database (Alves, De Clerk, and Gamboa-Arbelaez, 2020) that consolidates assets and liabilities—including SOEs, natural resources, and pensions—and supports balance-sheet risk assessments and fiscal stress tests. The Fiscal Stress Test (FST) integrates macro shocks with contingent-liability realizations to quantify impacts on solvency (comprehensive net worth), liquidity (gross financing needs), and financing burden (interest-to-revenue), and to derive stress scenarios for DSA and buffer sizing. The Fiscal Risk Assessment Tool (FRAT) provides a portfolio view across fourteen risk categories, prioritizes monitoring/mitigation, and links to transparency assessments. More recently, the Debt-at-Risk framework (October 2024 Fiscal Monitor; Furceri and others, 2025) applies a quantile-regression approach to map macro-financial and political conditions to the distribution of future debt outcomes; while outside our sample window, it illustrates continuing methodological upgrades.

22.   **Risk-specific modules deepen analysis where exposures are large.** For public corporations, the SOE Health Check Tool screens vulnerabilities and aggregates sector balance sheets, while the SOE Stress Test projects cash flows, liquidity, and debt-servicing resilience under baseline and stress scenarios—informing budget contingencies and DSA shocks. For credit support, the Discrete Guarantees and Loans Assessment Tool (DGLAT) estimates expected fiscal costs and maximum exposures on entity-specific loans and guarantees, and the Standardized Guarantees Assessment Tool (SGAT) values scheme-level portfolios under baseline and stress cases to inform pricing, provisioning, and disclosure. For infrastructure, the PPP Fiscal Risk Assessment Model (PFRAM, with the World Bank) quantifies cash- and accrual-basis impacts, sensitivity, and risk allocation at the project/portfolio level. For climate, Q-CRAFT projects long-horizon macro-fiscal paths under alternative IPCC scenarios (and adaptation speeds), supporting integration of climate risks into fiscal frameworks and fiscal risk statements.

23.   **The Fund's work on fiscal risks has established an impressive and comprehensive analytical architecture, but its application has remained incomplete.** Building on lessons from past crises, the IMF has developed a wide-ranging set of standards, databases, and tools that allow countries to identify, quantify, disclose, and manage fiscal risks, as well as to integrate stress scenarios into surveillance and program design. These innovations—spanning fiscal transparency evaluations, public sector balance sheet analysis, and a suite of specialized tools—represent a major step forward in how fiscal vulnerabilities are conceptualized and operationalized across the membership. Yet, implementation has been uneven: efforts to build a cross-country dataset on contingent liabilities (Bova and others, 2016) were not sustained, leaving significant gaps in the empirical foundation for fiscal risk assessments, and the systematic use of these tools in bilateral surveillance has remained limited. Strengthening the consistency of application across countries, particularly where climate, SOE, and financial-sector linkages are macro-critical, and renewing cross-country data collection would substantially enhance their policy impact.
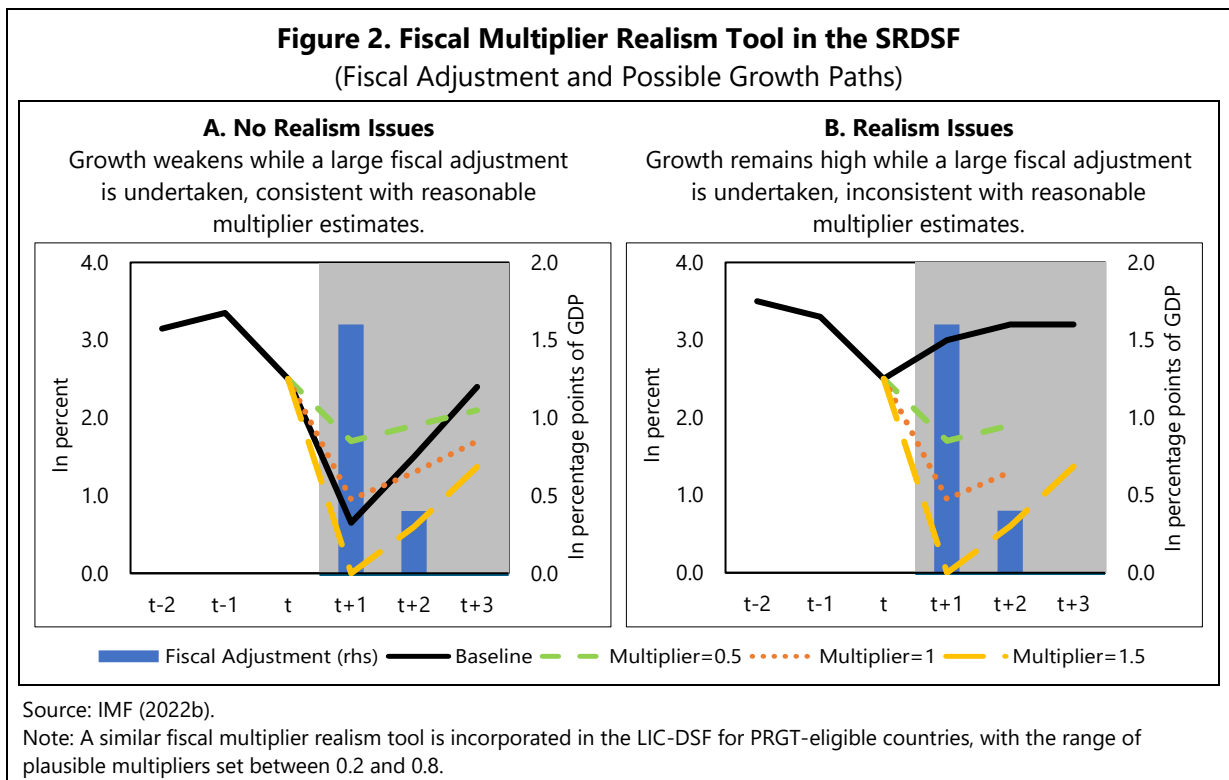
III. OUTPUT STABILIZATION

24.   **The Global Financial Crisis (GFC) prompted a fundamental reassessment of the role of discretionary fiscal policy at the IMF.** In September 2008, newly appointed Chief Economic Counsellor Olivier Blanchard prioritized a rethink of fiscal activism in light of the sharp collapse in global demand. A pivotal moment in this intellectual shift—widely recognized in the literature (Ban, 2015) and in staff interviews—was the December 2008 Staff Position Note *Fiscal Policy for the Crisis*, co-authored by Spilimbergo, Symansky, Blanchard, and then-FAD Director Cottarelli. The paper challenged pre-crisis orthodoxy by outlining principles for effective stimulus—arguing it should be timely, large, lasting, diversified, contingent, collective, and sustainable. This work was complemented by a practical manual (Spilimbergo, Symansky, and Schindler, 2009) to help IMF desk economists incorporate fiscal considerations into macroeconomic frameworks. Staff interviews suggest the episode was as much about building internal consensus as introducing new ideas and was underpinned by new empirical work on fiscal multipliers and spillovers.

Fiscal Policy Effects

25.   **IMF research played a central role in dismantling the "expansionary fiscal contraction" hypothesis and documenting the output costs of consolidation.** While earlier work had shown some ambivalence toward the idea of expansionary austerity (Daniel and others, 2006), post-crisis research provided robust evidence that consolidations are generally contractionary. The October 2010 WEO chapter *Will It Hurt?* introduced the narrative method developed by Romer and Romer (2010) to isolate exogenous episodes of fiscal consolidations. The resulting dataset, later published by Devries and others (2011), became a benchmark for studying the effects of consolidation on output, employment, external balances, and inequality (Ball and others, 2013; Woo and others, 2013). Initially focused on 17 OECD countries over 1978–2009, the dataset has since been expanded to include EMMIEs and cover more recent periods (Carrière-Swallow, David, and Leigh, 2018; Adler and others, 2024), cementing its role in IMF surveillance and research.

26.   **These findings, and evidence that staff systematically underestimated fiscal multipliers (Blanchard and Leigh, 2013), led to the development of the Fiscal Multiplier Realism Tool in the revamped DSA framework.** The tool assesses whether growth projections are consistent with the size and timing of planned fiscal adjustments (IMF, 2021b; 2022b). As shown in Figure 2, the tool compares baseline growth forecasts with those implied by a range of plausible multipliers (0.5–1.5). In the left panel, no realism flag is raised, as the baseline projection falls within the expected range given reasonable multipliers. In contrast, the right panel flags a potential issue, as it assumes growth will accelerate despite large fiscal tightening, suggesting overly optimistic assumptions.

Figure 2. Fiscal Multiplier Realism Tool in the SRDSF
(Fiscal Adjustment and Possible Growth Paths)

A. No Realism Issues
Growth weakens while a large fiscal adjustment is undertaken, consistent with reasonable multiplier estimates.

B. Realism Issues
Growth remains high while a large fiscal adjustment is undertaken, inconsistent with reasonable multiplier estimates.

Source: IMF (2022b).
Note: A similar fiscal multiplier realism tool is incorporated in the LIC-DSF for PRGT-eligible countries, with the range of plausible multipliers set between 0.2 and 0.8.

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27.   **Despite these analytical advances, empirical work often falls short in providing the methodological detail necessary for rigorous scrutiny and replication.** While most studies include technical documentation, key assumptions are not always specified clearly enough to permit independent validation, which limits external scrutiny and undermines confidence in the robustness of findings. For instance, studies using instrumental-variable approaches often provide insufficient information to assess the strength and relevance of the instruments, while papers employing sign restrictions do not always disclose the exact restrictions applied. This concern is especially salient for macro-fiscal studies—such as those estimating state-dependent fiscal multipliers—which tend to be highly sensitive to model specification, country context, and identification strategy. To enhance transparency and practical usefulness, fewer but more clearly presented results, accompanied by full methodological documentation, would be preferable. Main texts should explicitly identify the preferred model or set of estimates and briefly explain

why they were chosen over alternatives, while annexes should be self-contained, linking each key result in the text to the underlying data, model structure, assumptions, and estimation methods. Finally, the publication of replication packages—especially for flagship studies—would significantly strengthen the credibility, replicability, and policy relevance of the Fund's empirical work.[8]

28.   **The multiplier literature remains heavily AE-focused, with limited country-specific guidance for EMDEs.** Interviewees noted that the Fund often relies on stylized cross-country estimates and that staff rarely discuss instrument-specific multipliers in depth—particularly in countries with data constraints or limited analytical capacity. Some empirical work does exist: the October 2008 WEO provided early estimates for EMMIEs,[9] followed by surveys of the literature such as Batini and others (2014) and regional analyses including González-García and others (2013) for the Eastern Caribbean Currency Union. More recent Regional Economic Outlooks have extended the evidence to Latin America (Carrière-Swallow, David, and Leigh, 2018; October 2020 Western Hemisphere REO) and Sub-Saharan Africa (October 2017 Sub-Saharan Africa REO), while studies such as Honda, Miyamoto, and Taniguchi (2020) and Geli and Moura (2023) broadened coverage across income groups. Still, significant gaps remain, with limited country-specific analysis and little systematic evidence outside a few regions.[10]

29.   **Beyond discretionary policy, the IMF has emphasized the importance of well-designed automatic stabilizers.** The Spring 2015 FM found that in 60 percent of AEs, automatic stabilizers accounted for over half of total fiscal stabilization. However, their underuse in expansions often led to asymmetry in fiscal responses and contributed to debt accumulation. For EMMIEs, the contribution of automatic stabilizers was estimated at just 30 percent. The IMF (2020) also explored stabilizers in Latin America, identifying legal and institutional reforms—such as embedding cyclical tax adjustments, indexing transfers, or pre-legislating stimulus triggers—as key to improving their effectiveness. Building on earlier work (Baunsgaard and Symansky, 2009), the Fund argued that strengthening automatic stabilizers could improve both the timeliness and reversibility of fiscal responses, reducing reliance on discretionary measures that are often delayed and politically contentious. The October 2022 FM compared the costs of discretionary policies versus automatic stabilizers policies and their impact on consumption and employment.

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[8] Similar observations and recommendations were made by an external panel report on FAD policy analysis (Ramey, Ball, Giavazzi, 2024).

[9] The earlier IMF Staff Position Note (Spilimbergo, Symansky, and Schindler, 2009) provided little specific evidence for EMMIEs.

[10] An ongoing project led by the Research Department estimates fiscal multipliers using an array of different methodologies, including AI tools for better identification of "fiscal shocks." The multiplier estimates as well as the underlying data and codes will be made available to the country teams to allow them to tailor estimates further to their countries.

Fiscal Spillovers

30.   **The IMF has incorporated the analysis of fiscal spillovers into its surveillance work, recognizing that the cross-border effects of national fiscal policies can be substantial.** Between 2011 and 2013, dedicated *Spillover Reports* assessed the external effects of domestic policies in five systemic economies—China, the euro area, Japan, the United Kingdom, and the United States—drawing on background analytical work. From 2014 to 2015, these reports adopted a more thematic focus, addressing spillover issues of global concern. Since 2016, spillover analysis has been integrated into the WEO, with an annual chapter devoted to global transmission channels. A notable example is Chapter 4 of the October 2017 WEO, *Cross-Border Impacts of Fiscal Policy: Still Relevant?*, which used Structural Vector Autoregressions (SVARs), the G-20 general equilibrium model, and a narrative identification approach to estimate fiscal spillovers. The analysis found that spillovers are larger when domestic fiscal multipliers are high, government spending (rather than revenue) drives the adjustment, and exchange rates are fixed—highlighting the conditions under which fiscal policy has the greatest international impact.[11]

31.   **The Fund has also developed a suite of global macroeconomic models to quantify fiscal spillovers and support cross-country policy analysis.** The Global Integrated Monetary and Fiscal Model (GIMF), a dynamic general equilibrium model featuring multiple regions and rich fiscal structure, has been widely used to evaluate fiscal policy in both advanced and emerging economies (Kumhof and Laxton, 2007; Kumhof and others, 2010). To complement GIMF and support more flexible, large-scale simulations—particularly in the G-20 context—the Fund developed the Flexible System of Global Models (FSGM) (Andrle and others, 2015). These tools allow staff to analyze the global implications of coordinated or asymmetric fiscal actions and assess how fiscal policy decisions in one country may amplify or dampen external imbalances, inflation, or financial stability risks elsewhere.

Trade-offs and Debt Anchors

32.   **The IMF has increasingly recognized the inherent trade-off between output stabilization and fiscal sustainability.** Stimulus may be necessary to close negative output gaps—particularly when monetary policy is constrained—but it can strain public finances by increasing borrowing needs or heightening rollover risks. Conversely, fiscal consolidation undertaken to improve debt dynamics may depress output in the short term, especially when implemented during periods of economic slack. These tensions underscore the importance of the timing, composition, and credibility of fiscal measures in minimizing short-term costs while safeguarding long-term sustainability. The experience of the global financial crisis and the COVID-19 pandemic has highlighted how difficult it can be to strike this balance in real time:

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[11] At the bilateral level, Article IV consultations frequently assess inward spillovers, analyzing how external shocks affect a country's economy. Recent staff reports on systemic economies (Systemic Five)—the U.S., China, the euro area, Japan, and the U.K.—have expanded coverage of outward spillovers, evaluating how their policies impact the global economy. The 2018 U.S. Article IV staff report, for instance, examined outward spillovers from the 2017 Tax Cuts and Jobs Act.

decisive fiscal support helped cushion activity but left many countries with sharply higher debt burdens, complicating subsequent policy choices. Against this backdrop, the IMF has placed growing emphasis on developing analytical frameworks that can guide policymakers in navigating these trade-offs more systematically, while recognizing that country circumstances and market perceptions inevitably shape the policy space available.

33.   **To navigate the trade-off between supporting activity and safeguarding fiscal sustainability, the IMF developed a toolkit to quantify the optimal pace of fiscal adjustment.** Traditional DSAs and FSF assessments indicate how much additional debt can be incurred without endangering sustainability, or how much needs to be reduced to restore it.[12] But they do not address whether it is desirable to expand or contract debt under prevailing macroeconomic conditions, nor the appropriate speed of adjustment. A model developed by FAD economists (Fournier, 2019; Fournier and Lieberknecht, 2020) fills this gap by providing an optimizing framework in which governments balance the short-term benefits of countercyclical fiscal support against the long-term costs of higher debt. When debt is low, the model permits more forceful stimulus in downturns; when debt is high, it recommends greater caution to preserve buffers and market confidence. The tool has been used in surveillance for AEs, with the European Department deploying an automated dashboard to generate country-specific fiscal paths. An extended version of the model that accounts for a portion of public debt to be denominated in foreign currency has also been developed and applied to EMDEs, including Mexico (Fournier and Roemer, forthcoming).

34.   **While the optimizing framework provides useful guidance on the *pace* of adjustment, it does not resolve the equally important question of the *appropriate anchor* for medium-term fiscal policy.** Earlier efforts, such as Eyraud and others (2018) and Akitoby, Honda, and Miyamoto (2019), developed a structured methodology for calibrating medium-term debt anchors based on debt-servicing capacity and safety buffers, and these tools have been applied widely in Fund surveillance and capacity-development work.[13] Yet, these approaches concentrate on fiscal sustainability rather than on balancing different objectives, and thus offer only a partial basis for policy advice. Moreover, IEO reviews of staff reports show that medium-term debt targets in both surveillance (Cohen-Setton and Montiel, 2025) and programs (Cohen-Setton, Li, and Montiel, 2024) often vary across countries and over time without clear justification. This raises questions both about whether alternative adjustment paths and debt targets might have offered better policy trade-offs and about whether long-term considerations have been incorporated consistently and evenhandedly across countries facing similar circumstances.

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[12] An FAD toolkit based on Cao and others (forthcoming) offers operational guidance to calibrate country-specific maximum sustainable debt and complements earlier work by Caselli and others (2022).

[13] IMF (2018b, 2023) proposed a three-step methodology: first, estimating a medium-term debt limit based on countries' debt repayment capacity; second, calibrating a safety buffer around that limit using historical macroeconomic and fiscal volatility; and third, deriving the debt anchor as the difference between the debt limit and the buffer. This approach provides a transparent template for assessing prudent debt levels, but it is anchored in debt-servicing capacity rather than in considerations of expenditure needs or development priorities. Comelli and others (2023) apply that approach to Sub-Saharan countries.

35.   **A constructive way forward would be to make the rationale for selecting one option from the feasible set of medium-term debt targets more explicit**. One approach would be to adopt a common template for evaluating alternative medium-term debt targets, based on defined set of costs and benefits—not only in terms of fiscal sustainability and debt-servicing capacity, but also in relation to financing priority expenditures that could be applied across member countries.[14]

IV.   POTENTIAL OUTPUT AND OTHER LONGER-TERM ISSUES

36.   **In response to slowing growth after the GFC, the Fund deepened its analytical work on how fiscal policy could foster investment, productivity, and long-term growth.** The October 2014 WEO chapter highlighted the case for higher public investment in AEs, particularly against the backdrop of low interest rates and concerns about secular stagnation (Cohen-Setton and Montiel, 2025). For EMMIEs, it found that while public investment can boost long-term output, it often raises debt-to-GDP ratios due to lower investment efficiency—underscoring the need to strengthen efficiency to mitigate this trade-off. In parallel, the Debt, Investment, Growth, and Natural Resources (DIGNAR) model was developed to assess the macroeconomic impact of public investment plans in resource-rich developing economies (Melina, Yang, and Zanna, 2014). Building on this work, the October 2025 FM analyzed how the efficiency of different categories of government spending shapes their long-term growth impact.

37.   **To support countries in achieving the SDGs, the IMF has developed methodologies to estimate additional spending needs and assess financing options.** The spending needs framework benchmarks countries against well-performing peers to identify investment gaps in human capital (health and education) and physical infrastructure (water, sanitation, electricity, and roads) (Gaspar and others, 2019; Carapella and others, 2023). Building on this work, the IMF (2024) developed the SDG Financing Tool (SDG-FiT), an interactive platform that allows users to test alternative financing strategies, evaluate their macroeconomic consistency, and compare policy options. Together, these tools are designed to strengthen long-term development planning by clarifying the fiscal implications of pursuing SDG-related objectives.

38.   **The Fund has also highlighted that the effectiveness of structural reforms depends on the degree of policy support.** Two WEO chapters—focusing respectively on AEs and on EMMIEs and LICs—showed that labor market deregulation delivers larger output gains when implemented under favorable economic conditions and complemented by supportive fiscal measures (IMF, 2016b, 2019b; Duval, Furceri, and Jalles, 2019; Duval and Loungani, 2019). These findings underscore the importance of sequencing and coordination between structural and macro-fiscal policies.

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[14] An extension of the buffer-stock model goes in the direction of deriving debt anchors endogenously, with the expected debt path emerging as an outcome of the optimization process between fiscal sustainability and output stabilization, conditional on assumptions about time preference, the size of shocks, and the debt carrying capacity, potentially calibrated to reflect a given tolerance for debt risks (Fournier and Roemer, forthcoming).

39.   **Building on this focus of policy complementarities, the IMF also emphasized the synergies among fiscal, monetary, and structural policies in the context of declining interest rates.** Analytical work—including the April 2016 WEO, the October 2014 FM, and a Staff Discussion Note by Gaspar, Obstfeld, and Sahay (2016)—showed how well-targeted fiscal measures, such as investment in education and childcare or cuts in labor taxes, could support growth at different horizons while facilitating monetary policy normalization. Such measures broaden the tax base, strengthen fiscal sustainability, and raise potential output. By lifting the natural rate of interest, they also expand the room for monetary policy, reinforcing a virtuous cycle of macroeconomic stability. At the same time, staff interviews revealed tensions around this agenda: central bank governors in Europe pushed back against the so-called "3C paper" by Gaspar, Obstfeld, and Sahay (2016), which called for a Comprehensive, Consistent, and Coordinated approach and advocated a more active role for fiscal policy. Governors stressed that monetary autonomy required fiscal restraint, warning that loose fiscal policy could undermine efforts to control inflation and maintain credibility. Staff acknowledged these concerns but countered that prolonged subpar growth carried its own perils.

40.   **The Fund has strengthened its analysis of fiscal policy as a tool for inclusive growth.** A growing body of IMF research (Box 3) shows that redistribution can enhance both equity and growth, challenging the traditional view of a trade-off. The October 2017 FM discussed fiscal measures to support redistributive goals, while Furceri and others (2021) demonstrated that deeper post-pandemic fiscal consolidations have historically been associated with larger increases in inequality. To support operational advice, FAD has developed the Social Protection and Labor Assessment Tool (SPLAT), which benchmarks countries' social protection systems against peers and helps tailor recommendations, e.g., expanding coverage, improving targeting, and adjusting benefit adequacy. More recently, the October 2024 FM and October 2025 FM analyzed the growth and distributional impact of public spending and investment.

41.   **The IMF has developed a suite of datasets and tools to support fiscal policy analysis related to climate change, though concerns have been raised about their resource implications.** Three working papers (Coady and others, 2019; Parry, Black, and Vernon, 2021; Black and others, 2023a) produced detailed estimates of global fossil fuel subsidies. In 2021, the Fund launched the Climate Change Indicators Dashboard to provide a platform for climate change data for macroeconomic and financial stability analysis. In collaboration with the World Bank, the Fund created the Climate Policy Assessment Tool (CPAT) to estimate the fiscal, environmental, and economic effects of carbon pricing, fossil fuel subsidy reform, and green investment packages (Black and others, 2022; 2023b). A joint FAD–Asia and Pacific Department study (IMF, 2021c) evaluated the growth-debt trade-offs of adaptation and mitigation strategies in emerging markets, while a DSGE model calibrated for small developing states assessed the macroeconomic returns to adaptation investment (Fernandez-Corugedo, Gonzalez-Gomez, and Guerson, 2023). The Quantitative Climate Change Risk Assessment Fiscal Tool (Q-CRAFT) was added to the Fiscal Risk Toolkit to assess long term fiscal risks from climate change. Despite these advances, several interviewees raised concerns that the proliferation of climate-related

initiatives across departments has diverted resources from other core areas of Fund work which, in their view, could have undermined traction and operational relevance in more traditional areas of fiscal surveillance.

Box 3. The IMF's Growing Focus on Income Distribution in Fiscal Advice

The IMF's approach to income distribution has undergone a significant transformation over the past several decades, shifting from a peripheral concern to a central element of its policy advice. Initially, the IMF focused primarily on macroeconomic stability, growth, and fiscal sustainability, paying little attention to inequality. By the late 1980s and 1990s, however, concerns about the economic and political sustainability of adjustment programs led the Fund to integrate social safety nets into its lending programs (Clements, Gupta, and Nozaki, 2013) and emphasizing the need to safeguard social spending on health and education during fiscal adjustments (Gupta and others, 2000). Yet, at this stage, income distribution was still seen largely as a secondary issue, rather than a macro-critical factor affecting growth and stability. The GFC of 2008–09 marked a turning point in the IMF's perspective on inequality, as the crisis exacerbated income disparities and intensified global debates about income and wealth distribution.

The IMF's Research Department (RES) began producing influential studies that challenged traditional economic assumptions. Berg and Ostry (2011) demonstrated that higher inequality is associated with shorter and less durable growth spells, suggesting that inequality is not just a social issue but a key determinant of macroeconomic performance. Subsequent research by Ostry, Berg, and Tsangarides (2014) found that redistributive policies do not necessarily harm growth, contradicting the view that redistribution always weakens economic efficiency. These findings—reinforced by Dabla-Norris and others (2015), who showed that income growth among the bottom 20 percent of earners is associated with stronger GDP growth—helped shift the IMF's perspective, elevating inequality from a secondary outcome of economic policies to a core policy concern in its own right. According to Clements and others (2015), a key lesson from this research is that well-designed tax and spending measures can simultaneously foster stronger economic growth and enhance equality. Senior IMF staff emphasized in interviews that this shift reflected a broader evolution in the economics profession, which increasingly recognized the unequal effects of policies. They highlighted the influential findings of Autor, Dorn, and Hanson (2013) on the unequal effects of trade policies, noting that similar distributional considerations had also become central to fiscal policy discussions. They also explained that inequality pilots were launched in 2015-17. Later, working with the U.K.'s DFID, general equilibrium models were developed.

By the mid-2010s, the IMF had integrated income distribution concerns into its flagship publications, **including the WEO and FM.** The 2014 FM emphasized that fiscal policy is a powerful tool for reducing inequality, advocating for more progressive tax policies, better-targeted social transfers, and stronger investment in human capital. Similarly, the 2017 FM devoted an entire chapter to examining how governments could use tax and spending policies to mitigate inequality without undermining growth. These analyses reflected the Fund's growing recognition that excessive inequality can erode social cohesion, weaken demand, and ultimately threaten financial stability. As part of this shift, the IMF increasingly cautioned AEs to avoid austerity measures that disproportionately harm lower-income groups and to implement more progressive tax structures, including higher taxes on wealth and property (Bastagli, Coady, and Gupta, 2012).

The evolution of the IMF's stance was also shaped by institutional and leadership changes. Under Christine Lagarde's tenure as Managing Director (2011–19), the Fund placed a stronger emphasis on inclusive growth and social protection. Lagarde frequently underscored the risks of rising inequality, warning that it could undermine long-term economic stability and social cohesion (Lagarde, 2013). This shift was reflected in the 2019 IMF social spending strategy, which formally committed the Fund to integrating social protection considerations into its policy advice and technical assistance (IMF, 2019a). The strategy encouraged governments to preserve or expand social spending, even in the context of fiscal consolidation, and to design tax policies that ensure a fairer distribution of the adjustment burden (Clements and others, 2015). By this point, the IMF's position had moved beyond simply acknowledging inequality to actively promoting policies that reduce it. The IMF's evolution has continued into the 2020s, particularly in response to the COVID-19 pandemic. Under Kristalina Georgieva's leadership, the Fund has emphasized that fiscal policies should support a more equitable recovery, including through targeted social transfers, expanded healthcare and education spending, and progressive taxation (October 2020 FM).

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Source: Clements and others (2015).

42.   **Staff in area departments noted that several tools designed to address longer-term challenges—such as DIGNAR, SPLAT, CPAT, GMMET, and SDG-FiT—tend to be treated as "add-ons" rather than integrated into core surveillance products.** In particular, their outputs are often developed in parallel to, rather than embedded within, the debt sustainability framework. This limits their influence on policy discussions and weakens the coherence between long-term scenario analysis and short- to medium-term fiscal advice. Staff suggested that a more systematic incorporation of long-term scenarios into DSAs and baseline projections—similar to the approach adopted for climate considerations in the LIC-DSF—would enhance the operational relevance of these tools and ensure greater consistency across country work.

V. Assessment

43.   **While the IMF's fiscal policy advice has traditionally emphasized fiscal sustainability, the institution has demonstrated notable agility in adapting to shifting macroeconomic realities**. As economic conditions evolved, the Fund broadened its approach to recognize the central role of fiscal policy in demand management, especially during periods of subdued growth and constrained monetary policy. This evolution was underpinned by a strong commitment to research-driven policymaking, fostering an environment in which established ideas are continually reassessed and analytical resources redirected toward areas with greatest potential payoffs. The Fund's analytical work has evolved in step with advances in the economics profession, at times positioning the institution as an intellectual leader. As a result, it has played an active role in shaping global policy debates—offering evidence-based insights on fiscal consolidation, the implications of low interest rates for fiscal sustainability, the macroeconomic effects of climate transition policies, and the distributional consequences of fiscal measures.

44.   **The Fund has also made significant progress in developing analytical toolkits that enhance the rigor, consistency, and transparency of its fiscal advice.** The FSF and SRDSF represent important advances, providing structured frameworks to assess countries' debt-carrying capacity while accounting for institutional quality, financing conditions, and the interest–growth differential. Normative tools developed by FAD further quantify trade-offs between output stabilization and debt sustainability, informing advice on fiscal adjustment paths and policy sequencing. Complementary realism tools—such as the Fiscal Adjustment and Fiscal Multiplier Realism Tools embedded in the SRDSF—have reduced the risk of overly optimistic forecasts by grounding projections in empirical evidence and historical experience.

45.   **Despite important advances, key limitations remain—both in the transparency of empirical analysis and the coverage of critical policy questions** Some studies lack sufficient documentation to allow for replication or rigorous scrutiny, making it difficult to assess the robustness of their findings. Moreover, much of the empirical analysis remains concentrated on AEs, with less coverage of EMDEs, where fiscal transmission mechanisms and policy trade-offs differ markedly. Expanding the empirical base and improving methodological transparency would strengthen the credibility and policy relevance of the Fund's analytical work. Expanding the empirical base and improving methodological transparency would strengthen the credibility

and operational relevance of the Fund's analytical work. In addition, several dimensions of fiscal policy analysis remain underdeveloped—including the articulation of the fiscal–monetary policy mix,[15] the integration of long-term policy goals into sustainability assessments, the identification of desirable medium-term debt targets, and the treatment of distributional and political economy factors. The following paragraphs discuss these gaps in greater detail.

46.   **A clearer analytical framework is also needed to guide advice on the appropriate fiscal–monetary policy mix for short-term stabilization outside of ZLB episodes.** Such assessments depend not only on the size of fiscal multipliers but also on the effectiveness of monetary transmission. While this issue was less salient in the post-GFC period, given the ZLB in many advanced economies or the lack of monetary autonomy in euro area countries, it is increasingly relevant elsewhere. To ensure fiscal policy plays an effective stabilizing role under varying monetary conditions, staff would benefit from objective guidance to assess how country-specific factors influence the strength of monetary transmission and, in turn, the optimal policy mix.

47.   **Beyond short-term stabilization, the integration of fiscal sustainability analysis with long-term policy objectives remains incomplete.** IMF staff have produced valuable work on the macroeconomic effects of fiscal policies aimed at advancing longer-term goals such as improving the quality of public infrastructure, strengthening defense capabilities, promoting redistribution, and supporting climate adaptation. However, the feedback effects of these measures on fiscal sustainability, including their impact on growth, revenues, and permanent spending, are rarely quantified. More systematic assessment of these effects would help determine the extent to which such policies ultimately strengthen or weaken the public sector's balance sheet. Ultimately, the implications of these policies depend not only their social returns but also on the fiscal returns accruing to the state.

48.   **Similarly, while existing frameworks assess whether public debt trajectories are sustainable and feasible, they offer little guidance on how to choose among alternative fiscal paths anchored by different medium-term debt targets.** The SRDSF, LIC-DSF, and FSF provide valuable assessments of sustainability, while FAD's optimization tool quantifies the trade-off between output stabilization and fiscal consolidation. Yet, the rationale for selecting a specific terminal debt target—say, converging to 60 rather than 65 percent of GDP—remains largely judgment-based and focused narrowly on fiscal sustainability. A more systematic approach that explicitly articulates the trade-offs among fiscal objectives—such as sustainability and the financing of priority investments—would help determine which medium-term debt paths are most desirable given country circumstances and policy priorities.

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[15] The evaluation did not identify dedicated IMF toolkits assessing the appropriate fiscal–monetary policy mix outside of the ZLB. This gap is therefore discussed only in the assessment rather than in the main text.

49.   **A more complete understanding of fiscal sustainability also requires deeper analysis of the distributional effects of fiscal policy.** Building on influential research from the 2010s and the 2019 Social Spending Strategy, Fund departments have analyzed the distributional impact of fiscal policy changes, with a justified focus on protecting the poorest. To enhance the policy relevance of this work, future efforts should extend beyond the lowest deciles to capture impacts on middle-income groups, whose perceptions of fairness often shape the political feasibility of reforms. Embedding such analysis more systematically into fiscal toolkits would help the Fund better integrate political economy considerations into its fiscal advice.

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