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THE IMF AND SOCIAL PROTECTION: SEVEN EMERGING MARKET COUNTRY CASES

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ABBREVIATIONS

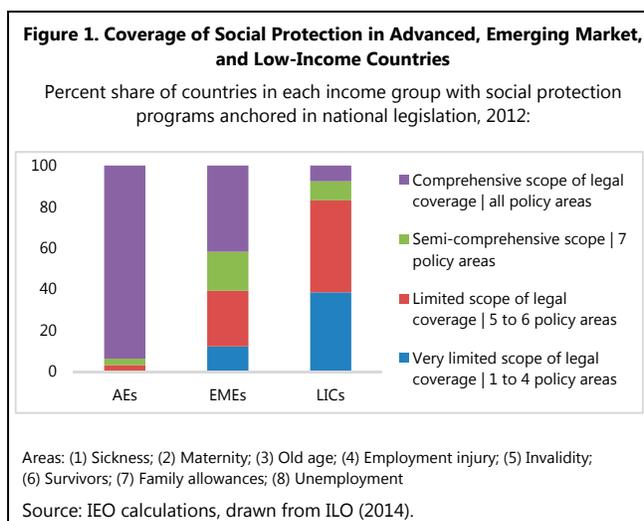
CCT	conditional cash transfer
DPL	Development Policy Loan (World Bank)
EC	European Commission
EFF	Extended Fund Facility
EME	Emerging Market Economy
EU	European Union
FAD	Fiscal Affairs Department (IMF)
GDP	gross domestic product
GMI	guaranteed minimum income
IDB	Inter-American Development Bank
ILO	International Labor Organization
LPG	liquefied petroleum gas
MCD	Middle East and Central Asia Department (IMF)
MDG	Millennium Development Goal
OECD	Organization for Economic Cooperation and Development
PAYG	pay-as-you-go
PLL	Precautionary and Liquidity Line
SBA	Stand-By Arrangement
SIP	Selected Issues Paper
TA	technical assistance
UNICEF	United Nations Children's Fund

I. INTRODUCTION

1. **This paper examines the IMF’s engagement in social protection issues in seven emerging market economies (EMEs) over the past decade.**¹ EMEs are defined here as the group of IMF member countries that are neither classified as advanced economies (in the IMF’s *World Economic Outlook (WEO)*) nor considered eligible for IMF concessional financing.

2. **EMEs faced a challenging external environment during the evaluation period of 2006–15.** The global financial crisis triggered by the collapse of Lehman Brothers in September 2008 led to a sudden stop in capital inflows, banking/financial sector crises, and external stability problems in many EMEs. Several EMEs with strong trade, tourism, and financial links with the United States experienced sharp disruptions in economic activity. A number of European EMEs asked for IMF financial support when capital flows dried up at the start of the crisis in 2008–09. Some countries in the Middle East and North Africa faced economic dislocations from social and political unrest associated with the 2011 Arab Spring.

3. **As a group, EMEs are diverse in terms of social protection coverage.** As shown in Figure 1, about 60 percent of EMEs have what the International Labor Organization (ILO) classifies as semi-comprehensive to comprehensive national social security systems; the rest have limited to very limited systems. According to World Bank (2015b), the share of the poorest population quintile covered by social safety net programs ranges from around one-quarter in lower-middle-income countries to 64 percent in upper-middle-income countries. Unconditional cash transfers account for most of the total spending on social safety nets in EMEs although conditional cash transfer (CCT) programs are becoming increasingly larger in social safety net budgets in Latin America (where they were pioneered) and in Asia.² In addition,



¹ Social protection encompasses policies that provide cash or in-kind benefits to vulnerable individuals or households, including: (i) social insurance (such as public pension schemes); (ii) social assistance (such as government transfers to the poor); and (iii) labor market interventions for the unemployed (such as unemployment insurance and active labor market policies). Food and fuel subsidies are also covered in this paper to reflect that such policies have social protection elements, but this paper does not assess the IMF’s work on general policies for development and long-term poverty reduction (such as government spending on education and health), or programs to boost job creation and labor force participation.

² According to World Bank (2015b), the five largest unconditional cash transfer programs in terms of number of beneficiaries are in EMEs (China; Indonesia; India; Malaysia; and South Africa), as are the four largest CCT programs (Brazil; Mexico; the Philippines; and Colombia).

many countries—especially in the Middle East and Latin America—operated energy and food subsidy programs with social protection elements, although generally the benefits were spread more broadly across the population.

4. **The World Bank was actively engaged in social protection issues in many EMEs during the evaluation period.** The Bank’s Social Protection and Labor (SPL) portfolio was particularly concentrated in EMEs (middle income countries) in the Latin America and Caribbean and the Europe and Central Asia regions. During the global economic and financial crisis, the Bank increased its SPL lending significantly in a number of EMEs to support the scaling up of safety nets, as well as reforms of unemployment and pension policies and programs. Regional development banks and United Nations (UN) agencies including the ILO also had some presence, but donor presence in EMEs was much less than in low-income countries. Some EMEs had sufficient domestic capacity and/or access to other resources (e.g., private consultants) to analyze and formulate social protection policies.

5. **This paper looks at seven EMEs where the IMF was involved in social protection during the evaluation period in the context of surveillance as well as programs and/or technical assistance (TA):** the Dominican Republic and El Salvador in the Western Hemisphere region; Latvia and Romania in Europe; Morocco and Tunisia in the Middle East; and Malaysia in Asia. Six of them had IMF-supported programs during the evaluation period; only Malaysia was a non-program country. Four of them received IMF TA that addressed social protection issues (El Salvador, Latvia, Malaysia, and Romania).

6. **The paper assesses the IMF’s involvement in social protection in light of the Fund’s mandate and role in social issues as interpreted by the Board and implemented by staff.** As noted in Abrams (2017), relevant Board guidance during the evaluation period did not identify social protection as a required area to be addressed in bilateral surveillance at the level of monetary, exchange rate, fiscal, and financial sector policies. Staff were expected to exercise their judgment and to address the issue if it was considered to be macro-critical or potentially so. Similarly, Board guidance allowed for conditionality pertaining to social protection in IMF-supported programs if staff judged such conditionality to be critical for the success of the program.³ Expertise from the World Bank or other institutions was to be relied upon as far as possible. At the same time, Management, in different degrees, directly called for staff to find ways to ensure that vulnerable segments of the population were shielded from any adverse impact of adjustment, particularly in the context of IMF-supported programs. All this would be expected to generate significant variability in the extent and nature of IMF involvement in individual countries. Examining that variability and, as far as possible, the factors behind it, is a key part of the evaluation.

³ In 2014, the guidance added that for all programs, “if feasible and appropriate, any adverse effects of program measures on the most vulnerable should be mitigated” (IMF, 2014f).

7. **The country cases focused on three major sets of questions.**

- (i) Why did the IMF become involved in social protection? Specifically, was IMF involvement consistent with the internal guidelines, i.e., prompted by a macro-critical issue and/or the need to protect the vulnerable from adverse effects of program measures?
- (ii) What was the IMF's contribution in the area of social protection, especially vis-à-vis other institutions that were active in that area (if any)? For example, what specific advice or assistance did IMF staff offer? In countries with an IMF arrangement, what kinds of measures were incorporated to mitigate the effects of adjustment on the vulnerable? Did IMF recommendations for and/or conditionality on social protection policies and programs reflect country-specific knowledge of institutional frameworks and implementation capacity? Were they supported with analysis such as poverty and social impact analysis, and were they embedded in the macroeconomic framework? Were they consistent with the advice of other institutions?
- (iii) How effective was the IMF's involvement, including its collaboration with other institutions (if relevant)? Did staff follow up on the outcomes?

8. **The country cases were based on information from desk reviews and interviews.**

Desk reviews analyzed policy documents and guidelines issued to staff, Article IV Consultation staff reports and Selected Issues Papers (SIPs), other surveillance and program documents, TA reports, and advocacy and outreach items. Interviews were conducted with staff from the IMF and other institutions, current and former government officials and other stakeholders.

II. MAIN FINDINGS

A. Why Did the IMF Get Involved in Social Protection?

9. **In EME crisis programs during 2009–13, the IMF's involvement in social protection was aimed at mitigating the effects of fiscal adjustment and gaining acceptance for the programs.** This was a key concern of the Managing Director at the time, who promoted efforts to ensure that program design took into account the impact on the poor and most vulnerable, specifically by helping countries develop or maintain social safety nets for segments of the population that might be affected by the program. This was done to varying degrees in the Stand-By Arrangements (SBAs) in the Dominican Republic (2009–12), El Salvador (2010–13), Latvia (2008–11), Romania (2009–11, 2011–13, 2013–15), and Tunisia (2013–15), and the Precautionary and Liquidity Line (PLL) arrangements in Morocco (2012–14, 2014–16).

10. **In both programs and surveillance, the IMF recommended reforms in social protection policies to improve expenditure efficiency, fiscal sustainability, and labor market flexibility, while strengthening protection provided for lower-income groups.** A common strand of advice was to implement "better targeted" social safety net programs in place of untargeted energy price subsidies, which were a strain on the budget (e.g., Dominican Republic,

El Salvador, Morocco, Tunisia). In a couple of cases (El Salvador, Dominican Republic), energy subsidy reform was reflected in program conditionality. In countries where the public pension system had become very burdensome for the budget (e.g., Romania), the IMF sought to address the problem through recommendations such as limiting the generosity of the pension indexation mechanism, or reducing special benefits accorded to certain groups. Such measures were part of program conditionality in Romania. In a couple of EMEs (Malaysia, Romania), the IMF advised on minimum wage policies, relaxing employment protection, or reducing the labor tax wedge to improve labor market flexibility and boost employment.

11. **In the surveillance context, the IMF also encouraged some EMEs to strengthen social safety nets to promote “inclusive growth” or to reduce excessive precautionary domestic saving.** The former motivation was based on IMF research on inequality and growth, notably Berg and Ostry (2011), and the policy implications suggested therein for improving income distribution, including social protection policies such as social assistance spending and active labor market policies. This argument was applied to Tunisia. The latter motivation—which featured also in multilateral surveillance, notably External Sector Reports—was based on the argument that “weaker safety nets tend to distort saving rates upwards” resulting in excess current account surpluses that contribute to global imbalances (IMF, 2014d). This argument was applied to Malaysia.

B. What Did the IMF Contribute?

12. **IMF-supported crisis programs took different approaches to mitigate the impact of adjustment on vulnerable groups.** Among the cases studied for this paper, the SBAs in the Dominican Republic (2009–12), El Salvador (2010–13), Latvia (2008–11), and Romania (2009–11) explicitly incorporated social safety net expenditures in the macroeconomic framework. In the Dominican Republic and El Salvador, the social safety net measures were part of the authorities’ own crisis response package developed with the assistance of the World Bank and the Inter-American Development Bank (IDB); in Latvia and Romania, the increase in social spending to scale up the guaranteed minimum income (GMI) scheme was built into the program at the IMF’s initiative. The measures were included as program conditionality in the Dominican Republic (where the 2009 SBA incorporated structural benchmarks to increase the coverage of the CCT program) and Latvia (where the 2008 SBA included structural benchmarks strengthen the social safety net). The 2013 SBA for Tunisia included an indicative target on social spending as well as a structural benchmark for approval of a new targeted household support program (to accompany the reform of generalized energy subsidies).

13. **In all the program cases studied, the specific social safety net measures were designed with the assistance of the World Bank or other development institution(s).** The IMF’s main contribution was to embed the measures in the macroeconomic framework and to insert structural benchmarks in the programs if necessary to help keep the reforms on track. IMF staff were sufficiently versed in the relevant social safety net programs and measures (to answer questions from the Board, for example) although IMF program documents often did not provide

much information on them or on the key measures the Bank (or other partner) was responsible for monitoring. In interviews for this evaluation, World Bank staff were uniformly appreciative of the IMF's support and rated their cooperation with IMF staff highly.

14. **IMF staff made several analytical contributions, including as part of TA provided at the request of the authorities.** For example, the TA mission to Malaysia in 2008 helped the authorities to analyze aspects of the social safety net. TA missions also provided help analyzing long-term pension and healthcare costs and discussing pension reform options (e.g., in Romania), and help evaluating the welfare impact of eliminating existing energy subsidies and discussing possible measures to protect low-income households (e.g., in El Salvador). Besides TA, staff analysis was also provided in SIPs prepared for Article IV consultations—good examples were SIPs on health care financing options for Romania and on El Salvador's pension system. Staff's analytical contributions, whether in TA reports or SIPs, focused primarily on fiscal questions and incidence analysis of social spending and subsidies, and not on specific social program-design issues. In that respect, there was very little overlap with the World Bank's work.

15. **Overall, the IMF's involvement in social protection varied widely—from active advocate to passive supporter—across the seven countries during the evaluation period.** In the crisis programs in Latvia (2008 SBA), Romania (2009 SBA), and Tunisia (2013 SBA), the IMF took pains to signal its concern about the impact of fiscal austerity on the vulnerable; staff took the initiative to incorporate increased social spending in the program framework; and, in the cases of Latvia and Tunisia, staff continued to press for enhancements in the social safety net even after the program ended. In the programs in the Dominican Republic (2009 SBA) and El Salvador (2010 SBA), staff also accommodated increased social spending in the macroeconomic framework, but the authorities took the lead and did not need to be convinced. In surveillance-only Malaysia, IMF staff played the role of "trusted advisor," assisting the authorities in analyzing the pros and cons as they deliberated reforms to the social safety net (and whether to introduce a minimum wage and unemployment insurance later on). And in the case of Morocco (which had two back-to-back PLL arrangements from 2012 to 2016), IMF staff were largely passive supporters reporting on the authorities' reforms of their social protection system.

C. How Effective was the IMF's Involvement?

16. **In the program context, the IMF's involvement helped to strengthen social protection in some cases but not in others:**

- Country authorities were pleased when the IMF supported their proposals to scale up social protection during an adjustment program by building such spending into the macroeconomic framework (e.g. in the Dominican Republic and El Salvador).
- However, the IMF's efforts to protect the vulnerable from adverse effects of program measures were not always well received. In Latvia, some officials pushed back against the IMF's recommendations for higher social spending, arguing that the existing social safety

net was adequate and that a slower fiscal adjustment would only prolong the pain— notwithstanding social unrest in the early stages of the program which included very large spending cuts. In Romania too, authorities resisted IMF-recommended increases in social protection.

- Program conditionality aiming to protect/increase social expenditures was not always met. In Tunisia, the indicative floor on social spending was missed on almost all test dates and the new targeted social transfer system was delayed. IMF staff underestimated the amount of time needed to achieve a minimum political consensus regarding cash transfers and to improve targeting.
- Once the immediate crisis passed, the IMF in some cases had difficulty getting traction on sustainable financing of the social safety net, which often hinged on eliminating energy price subsidies. The idea of replacing energy price subsidies with a better targeted social safety net encountered numerous obstacles such as political resistance, implementation constraints, and sequencing problems. In the SBAs in the Dominican Republic and El Salvador, CCT coverage was expanded during the program but energy subsidy reform was less successful.
- Program measures involving pension cuts were especially contentious and reversed by the Constitutional Court in some instances because they were seen to violate the acquired rights of pensioners (e.g., in Romania and Latvia). In Latvia, staff considered the failure to implement pension reform the biggest shortcoming of the 2008 SBA.

17. **Outside the program context, it is harder to assess the effectiveness of the IMF's recommendations on social protection, although a few observations may be made.** First, several country authorities interviewed for this evaluation did not recall having any significant dialogue with the IMF on social protection during Article IV consultations. There was no indication that this was a particular concern. On the contrary, there were a few instances where IMF staff may have been a little too zealous in raising social protection issues. In Latvia, for example, staff continued to argue—against the authorities' objections—for enhancements to the GMI scheme after the crisis subsided and the program ended. Second, IMF TA on social protection was always appreciated by the authorities (that requested the assistance) for bringing the issue into the policy debate or for contributing to capacity building, even if the mission's policy recommendations were not implemented.⁴

⁴ The requesting authorities were usually in the Ministry of Finance or related agencies, and not those directly in charge of implementing social protection programs or policies.

III. COUNTRY CASES

A. The Dominican Republic

18. **The main social protection issues covered by the IMF during the evaluation period revolved around targeting of CCTs and energy price subsidies.** These issues featured in both surveillance and program discussions. The Dominican Republic had two SBAs during the evaluation period: the first from January 2005 to February 2008; the second from November 2009 to March 2012. The World Bank and the IDB were also active in the country during that period, devoting a substantial portion of their portfolios to social protection investment projects and development projects in the health and education sectors, as well as sanitation and electricity sector reform. In parallel with the 2009 SBA, the World Bank approved a series of budget-support Development Policy Loans (DPLs), in 2009, 2010, and 2011, focused on improving the quality and efficiency of public spending, especially in the social sectors (mainly social protection, education and health).

19. **At the beginning of the evaluation period, the IMF's focus on social safety net programs was motivated by the concern to alleviate poverty,** which had risen sharply as a result of an earlier financial crisis in 2003 and the severe recession that followed.⁵ The IMF was concerned more generally with "social spending"—defined in this case as government expenditures on the social safety net (excluding social security), plus expenditures on education, health, water and housing, and municipal services (IMF, 2005)—which had fallen well below the levels needed to achieve targets set under the Millennium Development Goals (MDGs).

20. **Staff urged the authorities to increase social spending by finding savings elsewhere in the budget.** This recommendation was in line with the social protection reform program supported by the World Bank and the IDB, which aimed to improve the quality and effectiveness of social spending. The strategy was to eliminate "poorly-targeted" social programs—notably, subsidies on liquefied petroleum gas (LPG) and electricity—to make room for the expansion of "well targeted" programs, such as the CCT program, *Solidaridad* (IMF, 2008) (Box 1). The staff report did not elaborate on how to assess whether a program was "poorly targeted" or "well targeted," or how to improve the targeting of a program or measure.

21. **Initially, the IMF's advice on social protection was provided only in the context of policy discussions with the authorities.** The 2005 SBA had no program conditionality related to social protection or social spending until the fifth and sixth reviews when a structural benchmark was introduced to complete a study to improve the targeting of the electricity subsidy program and the timetable for its implementation by the end of April 2007. The subsequent review reported that the study was completed on time and made no comment on its implementation

⁵ The 2005 Article IV Staff Report cited a World Bank study indicating that about 15 percent of the Dominican Republic population became poor and close to 7 percent fell in extreme poverty between 2002 and 2004.

other than to note that “inspections [had] been stepped up to improve the targeting of the electricity subsidy in low-income areas” (IMF, 2007b).

Box 1. Dominican Republic: Key Social Assistance Programs at the Beginning of the Evaluation Period

The cash transfer program, *Solidaridad*, was created in 2005 as part of a social assistance reform initiated in 2002. It was not a full-fledged CCT program. Under *Solidaridad*, cash transfers were linked to human capital investments through two programs: (i) the Food Comes First Program (*Comer es Primero*), which provided poor households with RD\$550 (approximately US\$32) per month to buy food items in selected neighborhood stores; and (ii) the School Attendance Incentive Program (*Incentivo a la Asistencia Escolar*), which provided poor families with RD\$300 (approximately US\$17) per month for up to two children (and RD\$150 for each additional eligible child) enrolled in school. In 2005, these programs reached over 220,000 households nationwide.

The Blackout Reduction Program (*Programa de Reducción de Apagones*, or PRA) was established by the Dominican government in 2001 to provide electricity to the poor. Under this program, the lowest-income neighborhoods in cities received electricity at a highly subsidized price. In addition to the PRA, there was a universal subsidy for the first 300 KWh of electricity consumption and a universal subsidy for the first 100 pounds of LPG consumption. According to staff, the government had backed away from an earlier plan to replace the subsidy with direct monthly transfers to low-income households in the form of prepaid consumption cards “following the outbreak of violence to such a plan” (IMF, 2007b).

Targeting of social assistance programs was done through a unified beneficiary identification system (*Sistema Único de Beneficiarios*, or SIUBEN) based the results of a household socioeconomic survey from 2004–05.

22. **The 2009 SBA marked a significant strengthening of the IMF’s involvement in social protection issues.** The SBA, a 28-month arrangement totaling SDR 1 billion (around US\$1.7 billion or 500 percent of quota), aimed to limit the effects of the global recession on the Dominican economy through the implementation of short-term countercyclical policies, while establishing the conditions for robust, sustainable growth through structural reforms.⁶ Key elements of the fiscal stimulus were “current expenditures to strengthen social safety nets” and a focus of structural reform was on the electricity sector, specifically, “abolishing untargeted subsidies while providing adequate service to the public” (IMF, 2010c). In that context, the SBA contained conditionality pertaining to expansion of the CCT program and reform of electricity subsidies (Table 1).

⁶ In the period prior to the program, social tensions were manifested in sporadic unrest over poor delivery of social services, such as electricity and drinking water, and salary disputes between the government and employees in the health and education sectors.

Structural benchmark (unless otherwise specified)	Date introduced	Result
CCT program:		
1. Increase the permanent coverage of the CCT (<i>Solidaridad</i>) program by 70,000 families living in extreme poverty; by end-December 2009	Initial program (October 2009)	Met. As of March 2010, more than 70,000 families had been incorporated into the <i>Solidaridad</i> program.
2. Increase the permanent coverage of the CCT program (<i>Solidaridad</i>) by 60,000 additional families to 590,000 families; by end-December 2011	Second and third reviews (October 2010)	As of July 2011, work was ongoing.
Electricity subsidy program:		
1. Design a strategy to reform the electricity sector, including by eliminating indiscriminate electricity subsidies to achieve the medium-term budgetary expenditure objectives of the program; by end-December 2009	Initial program (October 2009)	Met. A satisfactory action plan was provided to staff in December 2009.
2. Increase the coverage of the <i>Bonoluz</i> program to 50,000 clients; by end-December 2010	First review (March 2010)	Met. As of July 2010, more than 100,000 clients were benefiting from <i>Bonoluz</i> .
3. Increase the coverage of the <i>Bonoluz</i> program to 250,000 clients; by end-December 2011	Second and third reviews (October 2010)	As of July 2011, work was ongoing.

23. **Including specific structural benchmarks to expand the coverage of the CCT program was quite unusual for the IMF at the time.**⁷ Staff interviewed for this evaluation indicated that they were persuaded on the feasibility of the CCT expansion by a knowledgeable and influential advisor in the President's Social Cabinet in charge of the program and the high level of consensus achieved within the executive. In addition, staff argued that increases in social expenditures to protect the poor would have the greatest fiscal multiplier effect and that establishing a credible track record of performance with "well-targeted expenditures (predominantly in capital and social spending)" would boost the government's ability to tap domestic and international bond markets (IMF, 2010c). The Board supported the temporary fiscal stimulus in 2009–10 and two Directors spoke in favor of strengthening the CCT program to mitigate the impact of the crisis on the most vulnerable.

24. **The IMF-supported program relied largely on the World Bank to provide design support for implementation of the CCT scheme.** Redesigning *Solidaridad* into a full-fledged CCT program and increasing budget allocations to meet the entitlements envisioned under the program were key objectives of the World Bank's DPLs which ran concurrently with the SBA. IMF program documents provided few details of the reform or the World Bank's role—this was clarified by staff verbally to the Board during the first review. There was little supporting analysis in the staff reports as to how the increase in CCT coverage was determined and what its

⁷ But it was not the first instance. The SBA for Paraguay approved by the Board in May 2006 included a structural benchmark to create a CCT mechanism for 7,000 families living under extreme poverty by the end of the year.

macroeconomic implications would be, or how (and how effectively) the *Solidaridad* program worked in terms of targeting and delivery of benefits. Staff had noted in 2005 that greater efforts were needed to strengthen beneficiary-roster management to ensure that families were not excluded due to lack of proper documentation (IMF, 2005) but there was no indication in the 2009 SBA program documents as to whether this problem had been resolved.⁸ The program documents did not discuss the implications for government spending on those public services on which the cash transfers were conditioned (namely, health and education).

25. **To the authorities, the IMF’s support for expanding the CCT scheme was highly valuable.** Dominican authorities interviewed for this evaluation expressed strong appreciation for IMF staff’s sensitivity to social issues and support for social protection, and for the effective complementarity between the work of the IMF and the World Bank. In particular, key interviewees in the Dominican Republic indicated that the IMF’s support was crucial for “locking in” budgetary funding for the expansion of the CCT program. Bank staff were also very appreciative of strong support they received from the IMF mission chief.

26. **The structural benchmarks to reform electricity subsidies were part of a broader effort to overhaul the electricity sector which was seen as a major drain on the budget.** Electricity sector reform was a longstanding challenge in the Dominican Republic and the shortcomings in the sector were well known. From the staff’s perspective, the rationale for eliminating electricity subsidies was clear: “The government spent 2¾ percent of GDP in electricity subsidies in 2008, or about US\$1.2 billion. If these resources were to be allocated each year as transfers to the poor (about 750,000 families), each family would have received US\$130 a month, which would go a long way toward eliminating poverty in the country (currently estimated at about 30 percent of the population). This transfer would be more than enough to eliminate extreme poverty” (IMF, 2010c). The idea was to reduce cross-subsidization of electricity consumption by introducing a flexible pricing mechanism for electricity tariffs and replacing the Blackout Reduction Program (PRA) and universal electricity subsidies (see Box 1) with a targeted subsidy for low-income consumers.

27. **The benchmarks were introduced in consultation with the World Bank and the IDB.** Prior to the SBA, the authorities had begun working with the World Bank and the IDB on a reform strategy which included “gradually eliminating the generalized electricity subsidy by 2012 and focusing it on the poor” (IMF, 2010c). Designing the strategy was a structural benchmark in the initial program and implementing the strategy—including expanding the coverage of the new electricity subsidy program (*Bonoluz*) which replaced the PRA program—became structural

⁸ At the Board discussion of the 2009 SBA request (November 2009), when one Director asked about the appropriateness of the framework for identifying vulnerable groups, staff simply responded that the authorities were comfortable with their identification methods, and claimed that the CCT program would cover about half of all poor households under the program targets. But at the fourth review (December 2010), staff noted that 200,000 families eligible for the Food Comes First Program did not receive the benefit due to “documentation constraints” (IMF, 2011d).

benchmarks later on in the program (see Table 1).⁹ Again, no explanation or supporting analysis was provided in the program documents as to how the increase in *Bonoluz* coverage was determined, what the *Bonoluz* program entailed, and how, if at all, it was related to the *Solidaridad* program. The staff report for the first review simply noted that the *Bonoluz* program provided “transparent subsidies to the poor clients” (IMF, 2011a). In response to further questions from Directors during subsequent reviews, staff explained that *Bonoluz* subsidized the first 100 kWh consumed per month by eligible households, and eligibility was based on family income (instead of geographical location, as was the case under the PRA).

28. **While the SBA was successful in supporting the enhancement of the social safety net, it was less effective in the area of energy price subsidies.** In particular, reforms to reduce cross-subsidization in electricity faltered with the spike in international oil prices, contributing to fiscal targets being missed and the program going off-track about half a year before it expired in March 2012 (IMF, 2012k). Country authorities interviewed for this evaluation acknowledged that the IMF played an important role in directly providing, as well as helping to mobilize budget support for, countercyclical financing during the global shock, which afforded fiscal space for the country to expand social protection. They also acknowledged the explicit efforts of IMF staff, particularly the mission chief, to facilitate the expansion of *Solidaridad*. According to World Bank (2013a), by end-2012 the CCT program *Solidaridad* had expanded to cover 650,000 households (90 percent of the extreme poor and 80 percent of the poor), and the *Bonoluz* to cover over 500,000 households. However, the country team did not follow up on these programs after the last (fifth and sixth) reviews when there was a change in mission chief.

29. **After the SBA expired, the IMF paid less attention to the social safety net or social protection.** The closest connection to social protection in staff reports at the end of the evaluation period was in urging access to health and social security insurance for the informal sector, including the self-employed. The reason for this advice, according to staff, was that widespread informality in the labor market—the informal sector accounts for about half of the labor force—together with low labor force participation “hamper[ed] inclusive growth” (IMF, 2014a).

B. El Salvador

30. **In El Salvador, the IMF focused on pension reforms and targeted energy subsidies in the context of Article IV and program discussions, and through TA.** The IMF’s involvement in these areas was to help the authorities design a medium term fiscal policy strategy to reduce the public debt while protecting social (and infrastructure) spending. Such a strategy, it was argued, “would increase the ability of fiscal policy to react to external or domestic shocks and adopt a

⁹ In conjunction with expanding *Bonoluz* coverage, the 2009 SBA included structural benchmarks for increasing the number of regulated clients of the electricity companies and adopting a flexible pricing mechanism for electricity tariffs. At the fourth review (in December 2010), a floor on the overall current balance of the public electricity sector was introduced as a performance criterion.

counter-cyclical stance, and at the same time enhance the economy's growth potential" (IMF, 2009c).

31. **During 2006–08, the IMF encouraged parametric pension reforms to contribute to fiscal consolidation.** As explained in a SIP for the 2006 Article IV consultation (Samuel, 2006), El Salvador had switched from a pay-as-you-go (PAYG) system to a system of privately managed individual pension accounts in 1998 and there were high transition costs associated with the switch.¹⁰ In line with the standard recommendations in TA reports by the Fiscal Affairs Department (FAD), staff suggested: raising the retirement age and contribution period; lowering replacement rates; applying income tax on pension benefits at upper income levels; and limiting future pension increases.¹¹ The IMF's concern was to reduce unfunded liabilities of the residual public pension system and to limit contingent fiscal liabilities in the private pension system. The authorities, however, were opposed to implementing parametric pensions reforms, noting that political support for such reforms would be difficult to achieve (IMF, 2009c).

32. **The IMF criticized El Salvador's energy subsidies as "expensive and poorly targeted" and provided TA on how to reform them** (IMF, 2007a). Rising oil prices had led the cost of energy subsidies to rise from 0.5 percent of GDP in 2003 to nearly 1.6 percent of GDP in 2008. According to IMF staff, a comprehensive reform strategy to improve the efficiency and targeting of energy subsidies—including limiting the electricity subsidy to low-income groups and improving the targeting and the pricing of public transport and gas subsidies—could save about 0.8 percent of GDP (IMF, 2009c). In response to the authorities' request, a TA mission visited El Salvador at the end of 2008 to advise on how to improve the targeting of energy subsidies.

33. **The TA mission recommended a reform strategy taking into explicit consideration the capacity of the social protection system to protect poor households.** In addition to a detailed analysis of energy pricing in the electricity, LPG and transport sectors, the TA mission evaluated the welfare impact of eliminating existing fuel energy subsidies (with a particular focus on low-income households), examined the existing social protection system, and discussed approaches to protecting low-income households from the adverse impacts of energy subsidy reform (Box 2).

¹⁰ Specifically, these costs were: (i) the net cost of benefits (benefits minus contributions) for individuals who remained in the PAYG system; (ii) the cost of recognition bonds used to transfer pension rights to the private system; (iii) the supplementary recognition bonds issued after 2003 to guarantee the benefits of individuals who chose to transfer to the private system; and (iv) administrative costs.

¹¹ These recommendations were similar to reform options suggested elsewhere in Central America by staff of the Western Hemisphere Department (see Fletcher and Schipke, 2007).

Box 2. El Salvador: Recommendations of the 2008 TA Mission on Energy Subsidy Reform

In 2008, the main energy subsidies in El Salvador took the form of: (i) subsidized electricity rates for consumers with monthly consumption below 100 kWh; (ii) a subsidized consumer price for LPG; and (iii) a cap on transport fares.

The TA mission recommended the following strategy:

- Eliminate transport subsidies and redirect the budgetary gains (\$83.4 million) to improving transport services and to social promotion programs (e.g., education, health and nutrition programs).
- Eliminate the remaining LPG subsidy and the electricity subsidy to above-lifeline consumers and redirect some of the budgetary savings (\$24 million and \$69 million respectively) to the existing CCT program (*Red Solidaria*) and to a new transfer program in urban areas. This latter program should be temporary, provide a low transfer level, use simple targeting methods, and should be eventually integrated into an improved social protection system.

34. **When the global financial crisis erupted in 2008, the IMF approved two precautionary SBAs to help El Salvador cope with the adverse impact:** a 14½ month SDR 514 million (about US\$800 million or 300 percent of quota) arrangement from January 2009 to March 2010; succeeded by a three-year arrangement of the same amount from March 2010 to March 2013.¹² The fiscal objectives of the first program in 2009 were to “safeguard medium-term sustainability, while raising public investment and sheltering the most vulnerable groups in society from the effects of the slowdown” (IMF, 2009b). Key priorities of the successor program in 2010 were to support domestic demand through a countercyclical fiscal policy, and “to increase the reach and efficiency of social programs” (IMF, 2010b). Thus the IMF’s (and the authorities’) short-term priority switched from fiscal consolidation to fiscal stimulus, while paying increased attention to social protection.¹³

35. **The 2010 SBA program embedded the government’s own anti-crisis program (*Programa General Anti-Crisis*, or PGA), which was launched in 2009 with the support of the World Bank and the IDB.**¹⁴ The PGA entailed almost 1 percent of GDP in “social spending”

¹² At the same time as the 2009 SBA, El Salvador also negotiated loans with the World Bank and the IDB for a total of US\$950 million.

¹³ The 2009 SBA program accommodated a fiscal deficit of 2.8 percent of GDP, 0.4 percent of GDP higher than the authorities’ original target for the year. The 2010 SBA program incorporated a larger fiscal deficit of 4.7 percent of GDP.

¹⁴ Prior to the evaluation period, the World Bank had completed a poverty assessment and a Public Expenditure Review and approved a multi-year Social Protection Project to support the implementation of its social safety net. In January 2009, the World Bank approved a US\$450 million Public Finance and Social Sector DPL aimed at maintaining improvements in social protection and improving the targeting of public spending, among other things; the project was complemented by a US\$500 million loan from the IDB. In November 2009, the World Bank approved a US\$100 million Sustaining Social Gains for Economic Recovery DPL to help finance the PGA, as well as a multi-year Income Support and Employability Project aimed at providing temporary income support and

per year in 2010–11, and comprised: an expansion of the CCT program (*Comunidades Solidarias*, previously *Red Solidaria*), including the provision of free medicines to hospitals and uniforms for school children; creation of a temporary employment program; and the launch of a public investment program for health, education, and infrastructure.¹⁵ IMF staff and the Board welcomed the PGA but staff did not delve into specific measures. According to Rowden (2009), officials from the Ministry of Finance said that the IMF was “not opposed” to the government prioritizing this type of spending but it only analyzed the measures in terms of fiscal deficits and did not delve into the rationale for specific projects: “For instance the idea behind school uniforms [was] also to boost the artisanal sector (tailors, seamstresses) thus generating employment.” This view was confirmed by staff in interviews with the IEO. According to staff, the World Bank was responsible for monitoring spending under the PGA.¹⁶ Overall, staff acknowledged their good collaboration and division of labor with the IDB and the World Bank.

36. **The PGA and the SBA did not incorporate the ILO’s recommendations for a Social Protection Floor**, even though El Salvador was one of three pilot countries for this joint IMF–ILO initiative (ILO and IMF, 2012; and Zhou, 2017). Interviews with IMF and ILO staff involved in the initiative indicated that while the authorities supported the idea of a social protection floor, they did not agree with the ILO’s specific reform proposals which came rather late in the game (after the authorities had already agreed on the PGA with the World Bank and the IDB) and did not match well with their priorities at the time.

37. **The 2010 SBA program also included structural benchmarks to redesign electricity, LPG, and water price subsidies to protect the most vulnerable.** This was part of the fiscal strategy—to redirect “inefficient expenditures” towards social programs and infrastructure—and was being done with assistance from the IDB (which had collaborated earlier with the 2008 FAD TA mission).¹⁷ The subsidy reforms were largely implemented (Table 2): electricity and LPG subsidies were rationalized and limited to households with low consumption levels (less than 200 kWh per month).¹⁸ When world energy prices rose in April/May 2011, however, the authorities decided to soften the impact by increasing (untargeted) subsidies on electricity and

improving the coverage of labor intermediation and training services to the urban vulnerable poor, and supporting the design and development of an integrated social protection system.

¹⁵ PGA outlays were reflected mostly in wages and salaries, goods and services, and capital spending.

¹⁶ According to World Bank and IDB staff interviewed for this evaluation, they (and IMF staff) did not fully approve of all the measures in the PGA, which were predicated on a “rights-based approach” to social service delivery adopted by the new administration.

¹⁷ Elements of the strategy were set out in the Public Expenditure Review produced jointly by the World Bank and the IDB in 2010.

¹⁸ According to the staff report for the first review (IMF, 2010f), water usage subsidies were reformed in 2009, together with transportation subsidies.

transportation, to the disapproval of the IMF. The program went off-track after the third review in September 2011 and expired in March 2013.

Structural benchmark (unless otherwise specified)	Date introduced	Result
1. Finalize plans to improve the targeting of subsidies for electricity, water, and LPG; by end-May 2010	Initial program (March 2010)	Met with delay in October 2010
2. Implement plans to improve the targeting of subsidies for electricity, water, and LPG; by end-October 2010	Initial program (March 2010)	Met with delay in December 2010
3. Issue executive decree specifying the targeting of the LPG subsidy to start by April 1, 2011 (Prior action)	Second review (March 2011)	Met
4. Phase out temporary energy measures; by end-December 2011	Third review (September 2011)	Not met

38. **The IMF continued to push for better targeting of subsidies and social assistance after the SBA expired, emphasizing both equity and efficiency considerations.** The 2013 Article IV mission pointed out that low-income households received only one-third of the 1½ percent of GDP spent yearly on subsidies for the consumption of electricity, LPG, and public transportation during 2008–12. The 2014 Article IV mission claimed that “[e]liminating such subsidies while providing a more generous safety net for poorer households could generate fiscal savings of up to about 1 percent of GDP,” although the staff report did not elaborate on what those safety net measures might be (IMF, 2015a). The 2014 and 2016 Article IV missions recommended improving the targeting of school assistance programs, noting that about half of government spending on school uniforms and food programs accrued to middle- and high-income households (although staff did not register any objections when those programs were introduced as part of the PGA in 2009). At the Board, Directors called for an ambitious fiscal adjustment “alongside an increase in targeted social spending to protect the most vulnerable and lessen income inequality” (IMF, 2015a).

39. **The IMF also revisited the issue of pension reform**, this time through the lens of equity as well as fiscal (debt) sustainability.¹⁹ The 2013 Article IV mission highlighted that unfunded liabilities of the public pension system had reached an estimated 65–75 percent of GDP, and that 20 percent of (mostly high-income) pensioners received about half of the total pensions paid by the government.²⁰ The mission once again underscored the need for parametric changes to lower benefits, increase contributions, and extend retirement ages, and this message was reinforced with increasing urgency in the 2014 and 2016 consultations. The authorities once again demurred, arguing that there was little public support for such reforms (IMF, 2013d). A SIP prepared for the 2016 Article IV consultation (Lissovolik, 2016) provided a detailed critique of the authorities’

¹⁹ See Heller (2017) for an assessment of the Fund’s work on pension reforms during the evaluation period.

²⁰ According to Fund staff interviewed, the IDB was heavily involved in pension reform issues in El Salvador.

proposal to return most of the private segment to a public PAYG pillar, and laid out a recommended reform strategy to deal with the root causes of the pension sustainability problem.

C. Romania

40. **In Romania, the IMF's involvement in social protection issues was extensive, while largely relying on the World Bank for detailed guidance.** The involvement spanned a wide range of policies for social insurance and social assistance, and took place through various modalities—surveillance, programs, and TA. During the evaluation period, the IMF approved three two-year arrangements for Romania: an exceptional-access SBA in May 2009, followed by two much smaller precautionary SBAs—the first in March 2011, and the second in September 2013.

41. **The IMF's involvement in social protection issues began with the 2009 SBA; prior to that, these issues were almost exclusively addressed by the World Bank.** The 2006–08 Article IV staff reports for Romania listed “strengthening the social safety net”—including “poverty monitoring, social assistance, pension reform, health sector reforms, and labor retraining and redeployment”—among the policy areas led by the Bank and “not directly incorporated into the IMF program or country dialogue” (IMF, 2007a). Against the backdrop of Romania’s January 1, 2007 accession to the European Union (EU), the IMF highlighted structural reforms to improve (i) the quality of public expenditures—such as pension reforms to take into account the country’s demographic outlook and the sustainability of the public pension system; and (ii) the flexibility of the labor market—such as lower social contribution taxes and conservative minimum-wage policies.

42. **The 2009 SBA was intended to cushion the effects of a sharp drop in capital inflows and assist with an orderly correction of the large external imbalances and vulnerabilities that had built up during the pre-accession boom years.** The SBA, totaling SDR 11.4 billion (around €13 billion or over 1,000 percent of quota), was part of an international financial support package of almost €20 billion, with contributions from the EU (through the Balance of Payments Assistance program), the World Bank (through a series of three DPLs), and other international financial institutions.²¹ The SBA-supported program aimed to reduce the fiscal deficit from around 5 percent of GDP in 2008 to under 3 percent of GDP in 2011. To soften the effects of the fiscal adjustment and budget reforms, the program sought to boost social safety net spending and to protect the lowest-wage employees and the poorest pensioners in reforms of public wages and pensions (IMF, 2009d).

²¹ The EU provided €5 billion; the World Bank, €1 billion; and the European Bank for Reconstruction and Development (EBRD), the European Investment Bank (EIB), and the International Finance Corporation (IFC), a combined €1 billion.

43. **The program built in an explicit amount of social safety net spending for 2009–10, in particular to expand the GMI scheme.**²² Expansion of the GMI scheme was a part of a key reform to better target social assistance under the World Bank's DPLs (Box 3). The IMF's contribution was to embed this commitment in the programmed budget(s). A structural benchmark was added in the first program review in September 2009 for approval of the 2010 budget which would include, among other things, "savings from improved targeting of social assistance programs and the consolidation of more than 200 benefits, while providing additional resources to boost social safety nets" (IMF, 2009h). In addition, the quarterly ceiling on general government current primary spending (an indicative target beginning with the first review) specifically excluded social assistance payments. However, IMF program documents provided little information on the GMI scheme or follow-up as to whether the increased spending was realized. Staff interviewed for this evaluation said that the government was not keen on expanding GMI coverage and did not fully implement the policy. Staff chose not to pursue the matter because "you have to pick your fights."²³

Box 3. Romania: Expanding the Guaranteed Minimum Income Scheme and Targeting Social Assistance

The GMI is the main social assistance program in Romania. It is a means-tested program which provides social benefits to families with income below a poverty threshold; benefits increase if a family member works. According to the World Bank, as of 2009 the GMI was the best-targeted social assistance program in Romania, with a targeting accuracy (percentage of total benefits going to the poorest 20 percent of the population) of over 80 percent, comparable to that of the food stamps program in the United States and much higher than that of the main family allowance programs.

The World Bank identified several factors affecting the effectiveness of social assistance in Romania: (i) numerous, fragmented social assistance programs with overlapping objectives; (ii) inadequate targeting of child and family benefits; (iii) insufficient coverage of the GMI; and (iv) financing and administrative problems with the GMI. The DPLs sought to: increase the number of paid GMI beneficiaries; further improve the targeting accuracy of the GMI; reduce unpaid GMI benefits as share of due payments to entitled beneficiaries; and improve targeting of family benefits for the poorest quintile.

44. **Pension reform featured prominently in the program's design.** Staff saw the pension system as one of the greatest risks to medium-term fiscal stability—the pension deficit was projected at 2 percent of GDP in 2011 and rising to more than 6 percent of GDP by 2050—and supported parametric reforms to reduce this deficit. The initial program included as a structural benchmark passage of pension reform legislation by end-2009 (Table 3). The legislation, drafted with assistance from the World Bank, sought to gradually move pension indexation to consumer prices; eliminate the special regimes established for certain civil servants; revise conditions for early retirement to ensure that incentives provided an actuarially fair system; and tighten the

²² The commitments were RON 250 million (about 0.05 percent of GDP) in 2009 and RON 500 million (about 0.1 percent of GDP) in 2010.

²³ On the other hand, some World Bank staff interviewees indicated that the GMI program had fewer takers than forecasted because open unemployment was lower than predicted.

allocation of disability-related pension rights to ensure better control over fraudulent pension claims. To protect vulnerable pensioners, the authorities committed to “make efforts to boost targeted poverty support programs that would improve their living standards” (IMF, 200b). Staff did not elaborate on what these efforts were in the program documents.

45. **As economic conditions and the fiscal position deteriorated in 2010, IMF staff argued (rather unsuccessfully) against drastic expenditure cuts proposed by the authorities to close the fiscal gap**, including a 15 percent reduction in pensions and transfer payments. During the fourth review and 2010 Article IV discussion, staff highlighted implementation risks—legal and political challenges had made it very difficult to cut wages and social entitlements in the past—and distributional concerns, noting that increases in broad-based taxes would likely have less adverse impact on the disadvantaged than the social spending cuts chosen by the authorities; staff also reported that the trade unions shared their view (IMF, 2010d). To protect the more vulnerable members of society, minimum wages and minimum pensions were kept unchanged. However, the cuts were controversial and after a months-long political crisis, the Constitutional Court ruled against the 15 percent reduction in pensions in June 2010. The lengthy parliamentary debate over the fiscal package delayed the approval of the pension reform legislation to September 2010.²⁴

46. **A September 2010 TA mission from FAD provided advice on options for rationalizing public expenditure in the short term to support the fiscal consolidation.** The TA report examined not just the expected fiscal savings but also the equity and efficiency of measures planned by the authorities. The options presented in the report were consistent with those identified in the World Bank’s work (Box 4).

Structural benchmark (unless otherwise specified)	Date introduced	Result
1. Pass revised pension legislation; by end-December 2009	Initial program (April 2009)	Met in September 2010
2. Obtain parliamentary approval of revised pension legislation (Prior action)	Fifth review (September 2010)	Met
3. Enact pension reforms (Prior action)	Sixth review (December 2010)	Met

²⁴ The benchmark was delayed from end-December 2009 to end-June 2010 in the second review, and changed to a prior action for the fifth review in September 2010. The pension reforms were enacted in December 2010 (prior action for the sixth review).

Box 4. Romania: Recommendations of the 2010 TA Mission Pertaining to Social Protection

The TA report recommended rationalizing the number of social assistance programs, better targeting, and stricter controls in the provision of social assistance services. Detailed recommendations included: (i) limiting the generosity of child-raising allowances, special indemnities (to war veterans, subject of prosecution, heroes, etc.), and financing of home-care for the severely disabled; (ii) tightening controls in the GMI and other allowances, and reintroducing means-testing for disability allowances and state child allowances; and (iii) laying the groundwork for reforming the entire social assistance system as a single means-tested program by creating a unique beneficiary registry and capping the total amount of social benefits per household.

The mission endorsed the authorities' plan to eliminate thermal heating production subsidies and recommended that compensation be provided through an adjustment in the level of social assistance.

With regard to health insurance, the mission recommended limiting the generosity of the publicly financed benefits package and increasing the level of patient cost-sharing, with exemptions based on means testing (so that only those who were eligible for social assistance would be exempted from co-payments).

47. **The IMF welcomed the overhaul of the system of social assistance benefits, although it had no direct involvement in it.** The reform, undertaken towards the end of 2010 with assistance from the World Bank, aimed to consolidate the GMI scheme, incorporating heating benefits and family allowance into one new means-tested scheme; subject disability allowances to incomes testing; streamline maternity benefits; and strengthen inspections to reduce benefits fraud. The social benefits reform and the pension reform were considered as “major measures” under the 2009 SBA, yielding “significant fiscal savings” and “expected to improve incentives for work while providing support for the neediest” (IMF, 2011b). After the 2009 SBA, the IMF continued to report on the progress of the social assistance reform, mainly in terms of the fiscal savings that were being, or expected to be, generated. In 2015, the Article IV mission, noting Romania’s high at-risk-of-poverty or social exclusion rate (“almost twice as much as the EU average”), reported that some means-tested benefits programs had become better targeted but the envisaged merger of three programs had been delayed and that funding for means-tested programs was “relatively tight” compared to non-means-tested programs (IMF, 2015b). In 2016, the IMF called on the authorities to improve the targeting of social protection schemes (IMF, 2016a).

48. **The IMF also called for eliminating heating and energy subsidies, “while protecting vulnerable groups”** (IMF, 2011b). Prior to the evaluation period, IMF missions had worked with the World Bank on restructuring and reforming (with the objective of eventually privatizing) the electricity, gas, and district heating industries. The elimination of heating subsidies came up again during the 2009 SBA in the context of securing further savings to meet the fiscal targets, but no action was taken by the authorities until mid-2011, after the social benefits reform consolidated the heating and family allowances with the GMI.²⁵ The 2011 SBA turned its attention to phasing out electricity and gas subsidies as part of a renewed effort to reform the energy sector. Among

²⁵ See “Romania Revamps System for Heating Benefits,” World Bank Feature Story, November 15, 2011 (<http://www.worldbank.org/en/news/feature/2011/11/15/romania-revamps-system-for-heating-benefits>).

other measures, the authorities agreed with European Commission (EC) and IMF staff on a roadmap for phasing out regulated prices in electricity and gas; and with the EC on defining vulnerable consumers according to EU legislation and developing mechanisms to protect them (IMF staff were not involved in this part). The IMF made approval of the roadmap a prior action for the fourth review (in February 2012) and added a structural benchmark to increase electricity prices by 5 percent by June 2012. Subsequently, IMF staff reported that a package of tax and regulatory measures was being prepared, in consultation with gas and electricity sector stakeholders, that would include a windfall levy to help finance the social protection measures, and once again urged that “targeted social assistance ... be put in place to protect vulnerable households from the impact of the necessary price adjustments” (IMF, 2012i). In 2013, staff reported that the authorities were working with the World Bank on measures to protect vulnerable consumers (IMF, 2013g).

49. **Healthcare reform took center stage in the 2011 SBA.**²⁶ After the pension system was reformed in 2010, the public healthcare system emerged as a source of fiscal stress and a threat to medium-term fiscal sustainability. Chronic problems in healthcare spending were requiring government budget transfers of nearly ½ percent of GDP (on top of social contributions) to the social health insurance fund per year (Box 5). At the same time, staff repeatedly pointed out that public healthcare spending in Romania was among the lowest in the EU as a share of GDP, and that population ageing would aggravate the funding shortfall (see IMF, 2011c; IMF, 2011e; IMF, 2012a; IMF, 2012e). In the third review (in December 2011) a structural benchmark was introduced to prepare amendments to the healthcare legislation to contain the growth of spending and ensure adequate financing.²⁷ However, the draft reform bill, produced with the World Bank’s assistance, had to be withdrawn in January 2012 in the face of significant public objections and a revised draft, prepared in consultation with the World Bank, the IMF, and the EU, was put up for public debate later that year. The IMF contributed to the debate by analyzing financing options for Romania’s public healthcare system in a SIP for the 2012 Article IV consultation (Eich, 2012).²⁸ The 2013 SBA included a structural benchmark to prepare the basic health package for the insured population within the existing spending envelope by end-September 2013. The benchmark was met in January 2014 and the package was implemented later that year. Design of the healthcare reforms was done in close consultation with the World Bank and the EC.

²⁶ Health spending is not included under social protection in this evaluation, but is discussed here due to its link to the broader social security system in Romania.

²⁷ The 2011 SBA had a ceiling on social security domestic arrears as a quarterly performance criterion. Short-term measures to improve revenues via copayments and a clawback tax on pharmaceuticals were part of the structural conditionality in the second and third reviews.

²⁸ In 2013, the government began to broaden the contribution base of the social health insurance scheme.

Box 5. Romania: Social Health Insurance

Prior to the reforms, Romania was relying partly on social security contributions to finance its public healthcare system. Social health contributions were paid by those in formal employment (with employee and employer contribution rates of 5½ and 5.2 percent, respectively), the self-employed, and pensioners with monthly incomes above a legal threshold. Groups exempt from contributions included the unemployed, those on social assistance, children below the age of 18, young adults in full-time education below the age of 26, war veterans, and agricultural workers. For those groups, the government contributed 5½ percent of the prevailing minimum wage to the social health insurance fund on their behalf. According to Eich (2012), while almost 90 percent of Romania’s population was covered by the social health insurance, only about half of those covered paid social health contributions.

50. **The IMF also weighed in on labor market issues linked to social protection.** Even before the evaluation period, the IMF had highlighted the problems of the low rates of labor force participation and employment and the large informal sector in Romania, and urged policy and legislative changes (consistent with EU and ILO conventions) to increase labor market flexibility and competitiveness.

- One issue was the minimum wage. Whereas the Romanian authorities saw the minimum wage as an instrument to achieve a fairer distribution of income between labor and capital, the IMF was (initially) primarily concerned with its implications for macroeconomic management.²⁹ In the context of the 2009 SBA, however, the IMF did not object to keeping the minimum wage unchanged (as opposed to reducing it) “to mitigate the impact on the most vulnerable” (IMF, 2010d). More recently, IMF staff recommended that the pace of minimum wage increases “balance social considerations with competitiveness, productivity growth, and employment prospects” (IMF, 2016a) and devoted two SIPs to analyzing the efficiency-equity tradeoffs associated with minimum wage policies in Romania (Sodsriwiboon, 2016) and in the region (IMF, 2016c).
- The second issue was the labor tax wedge.³⁰ Staff had argued for several years that the high labor tax wedge—in particular, substantial social security contributions, especially for those at the low end of the income distribution—was a major contributing factor to poor labor market outcomes. The 2015 Article IV mission recommended further lowering the labor tax wedge for low-income earners and elaborated on possible targeted measures in a SIP (Ralyea, Xu, and Eich, 2015) using scenario analysis tailored to Romania’s situation (including its social security system) and drawing on experiences in other EU countries.

²⁹ An earlier SBA approved in July 2004 specified ceilings on the minimum wage as continuous structural performance criteria in 2004 and 2005. In 2007, the Fund criticized the authorities’ proposal for a sharp increase in the minimum wage as incompatible with the inflation objective.

³⁰ The labor tax wedge measures the percentage of the gross salary paid by an employer that is collected by the government in the form of income taxes and social security contributions.

D. Latvia

51. **In Latvia, the IMF’s concern with social protection took hold during the crisis program of 2008.** Latvia joined the EU on May 1, 2004, and in the early part of the evaluation period, the IMF was primarily concerned with large internal and external imbalances associated with the post-accession credit and growth boom and their implications for, among other things, the authorities’ goal of euro adoption. The global financial crisis hit the country severely at a time when it was particularly vulnerable. In December 2008, the IMF approved an exceptional-access SBA for Latvia as part of a coordinated international effort to restore confidence and stabilize the economy. The 27-month arrangement, totaling SDR 1.5 billion (about €1.7 billion, or about 1,200 percent of the country’s quota), was complemented by financial assistance from the EU, the European Bank for Reconstruction and Development (EBRD), the World Bank (under exceptional Special Development Policy Lending terms, as Latvia had graduated from World Bank financial assistance in 2007), and other bilateral creditors.³¹

52. **The SBA-supported program was notable for the exceptionally strong policies—including a massive fiscal adjustment—required to stem the liquidity crisis and ensure external stability, while maintaining the exchange rate peg** that was needed to lay the groundwork for Latvia’s entry into the euro area. The authorities’ initial program aimed to bring the 2009 fiscal deficit down from a projected 12 percent of GDP to 5 percent. Cognizant of the difficult consequences implied by this choice of program strategy, the IMF made special efforts to announce its support for “the protection of social spending” in the program (IMF, 2009a).³²

53. **The program embedded an increase in “social spending” from 21 to 25 percent of the budget**, where social spending referred to social insurance benefits, which made up the bulk of such transfers in Latvia’s case (especially old-age pensions), and social assistance (non-contributory state benefits), which made up a much smaller share (World Bank, 2007). In formulating this notion, IMF staff drew on a 2007 Living Standards Assessment Report for Latvia by the World Bank and, especially, the aide memoire from a June 2007 Bank-led TA mission on Public Expenditure Review and public financial management issues. Staff interviewees said they found those reports extremely useful and were very fortunate to have them on hand. According to interviews with those involved, the authorities were not keen to discuss social protection with the IMF (or the World Bank). Some officials felt that these additional budgetary allocations would slow down the required fiscal adjustment and the eventual recovery of growth. As it turned out, civil

³¹ The EC participated in the preparation of the program, along with representatives from the European Central Bank (ECB) (in line with Latvia’s Exchange Rate Mechanism (ERM2) membership), Sweden and other Nordic countries.

³² See also the Latvia mission chief’s letter to The Economist (March 12, 2009) stressing that social spending was “explicitly protected” under the program.

unrest in January 2009 over the economic crisis ultimately led to the collapse of the government the following month.³³

54. **The economic situation deteriorated markedly in 2009 and the IMF, concerned that public discontent would flare up again, intensified its call for sustainable and structurally sound fiscal reforms that would “[protect] the most vulnerable at a time of painful dislocation”** (IMF, 2009g). Staff criticized the supplementary budget passed by the new government in June 2009 for putting a disproportionate burden on the poor.³⁴ The First Deputy Managing Director said: “In addition to containing the budget deficit, the policy program will need to ensure a path to medium-term fiscal sustainability and, as IMF Managing Director Dominique Strauss-Kahn has said, should include actions to minimize the impact on vulnerable groups” (IMF, 2009e). Staff argued for allowing a slightly higher budget deficit in 2009 (of up to 13 percent of GDP) so that the most socially painful measures in the supplementary budget could be reversed. Importantly, an adjustor was added to the budget balance program target that allowed increased spending to strengthen social safety nets.

55. **In addition to the adjustor for additional social safety net spending, structural conditionality to enhance social protection was inserted in the program** (Table 4). With the additional fiscal room provided under the program, staff urged the authorities to work closely with the World Bank to develop an emergency social safety net strategy that would help alleviate the social costs of rising poverty and joblessness.³⁵

56. **However, the government did not make full use of the flexibility in the budget to protect the poorest.** By January 2010, it had added only 0.1 percent of GDP in additional social safety net spending (to cover health copayments for the poor and additional transportation for schoolchildren), far less than the 1 percent of GDP allowed under the program. Some officials interviewed for this evaluation said they were surprised to see the IMF taking such an active interest in social protection but felt that the additional spending placed an unwelcome constraint on their ability to meet what were already ambitious fiscal targets. Staff argued that “increasing

³³ “Latvian Anti-Government Protest Turns into Riot,” *Reuters*, January 13, 2009; “Latvia is Shaken by Riots over its Weak Economy,” *The New York Times*, January 14, 2009. The IMF Managing Director Dominique Strauss-Kahn was quoted as saying the financial crisis could cause further turmoil “almost everywhere,” and listing Latvia, Hungary, Belarus and Ukraine as among the most vulnerable nations: “It may worsen in the coming months,” he told the BBC. “The situation is really, really serious” (“Global Financial Crisis Fuels Political Unrest in Eastern Europe and Iceland,” *The Washington Post*, January 26, 2009).

³⁴ IMF TA missions visited Riga in April and May 2009 to assist the authorities in preparing the supplementary budget, but according to staff, the missions’ suggestions were not incorporated in the budget that was passed in June (IMF, 2009g).

³⁵ The government put in place an emergency social safety net strategy, prepared with the World Bank’s assistance, in September 2009. Implementation of the strategy was a critical area of focus under the World Bank’s Special DPLs in 2010–11.

central government co-financing of GMI benefits from 50 to 75 percent (perhaps even 100 percent) would ensure that poor people in financially weaker municipalities would still be protected” but reported that “despite the increase in unemployment, the authorities regarded the existing social safety net as largely adequate” (IMF, 2010a). Interviews with Latvian officials revealed that some were opposed to active labor market policies which they believed would create “artificial jobs” that could not be sustained when the economy recovered. Nonetheless, during the year, the authorities spent another 0.1 percent of GDP or so on active labor market policies and emergency public employment under the Workplace with Stipend scheme (Box 6).³⁶

Table 4. Latvia: Structural Conditionality on Social Protection in the 2008 SBA

Structural benchmark (unless otherwise specified)	Date introduced	Result
1. Design a strategy to strengthen the social safety net; by August 2009	First review (July 2009)	Met
2. Conduct a thorough review of welfare benefits [to identify permanent measures to ensure benefits remain at a sustainable level]; by June 2010	Second review (January 2010)	Partially met: a separate report was not produced although a proposal to make permanent the reduction in parental benefits was included in the pension strategy paper
3. Prepare changes in the pension system in order to ensure future sustainability of [the] three pillars and share the burden of fiscal adjustment fairly; by June 2010	Second review (January 2010)	Met
4. Prepare an active labor market policy (ALMP) that will replace the WWS program; by November 2011	Fourth review (May 2011)	Met

57. **Staff stressed the need for some pension cuts, pointing to large pension cost increases in the past.** A structural benchmark to prepare changes in the pension system was introduced during the second review in January 2010 (Table 4) after the Constitutional Court ruled against pension cuts imposed in the June 2009 supplementary budget (10 percent across-the-board and 70 percent for working pensioners). The benchmark was considered met with the preparation of a strategy paper offering a number of possible approaches to reform the pension system and improve the system's sustainability.

58. **TA by the IMF and the World Bank identified options for rationalizing expenditures in social security and social benefits in 2011–12.** One of the main messages of the World Bank's 2010 Public Expenditure Review was that “the most immediate fiscal savings could be had from well targeted measures to recover at least part of the windfall gains made by the recipients of social insurance pensions, while protecting the lowest pensions” (World Bank, 2010). The August 2010 FAD TA mission (on options for fiscal consolidation of social insurance, state

³⁶ A SIP for the 2010 Article IV consultation (Jurzyk, 2010) discussed the crisis-induced unemployment problem in Latvia and the authorities' response under the emergency social safety net strategy but the focus of the analysis was on how to support job growth and not on social protection for the unemployed.

social benefits, and subsidies) offered policy options consistent with those in the World Bank's review.

Box 6. Latvia: The Guaranteed Minimum Income and Workplace with Stipend Schemes

Since 2003, similar to other EU members, Latvia has operated a "last resort social assistance scheme" in the form of a GMI (World Bank, 2013b). The GMI is a means-tested scheme aimed at guaranteeing a minimum income for the poorest segment of the population. The eligibility threshold is determined annually by the Cabinet of Ministers as a nominal per capita amount. Able-bodied GMI recipients are required to register with the State Employment Agency and to comply with job search requirements and participate in active labor market policies and public works organized by the Agency.

Latvia's GMI is designed at the central government level but its implementation and financing are delegated to the municipalities. There was a departure from this during the crisis when the program received state budget co-financing from October 2009 until end-2012.

The WWS scheme was introduced in 2009 as part of the emergency package of measures to cushion the impact of the crisis. This public works scheme—primarily financed by the European Social Fund and designed by the World Bank, the Ministry of Welfare, and the State Employment Agency, in collaboration with local municipalities—provided jobs for those not receiving unemployment benefits, including those at risk of social exclusion (such as the long-term unemployed and ex-convicts). Participants were paid a stipend of L100 (€140) per month—equivalent to 80 percent of the minimum wage, so as to provide an incentive for them to seek other employment as soon as the labor market recovered. According to Hazans (2012), demand for the program was high, with around 20,000 persons (17–20 percent of the target group) working under the program in a given month, and almost twice as many on the waiting list.

The WWS Emergency Public Works Program was in place until the end of 2011, when it was replaced by the so-called Temporary Public Works Program.

59. **As economic recovery began to take hold in 2011, staff urged the authorities not to dismantle the emergency social safety net schemes but to integrate them into the welfare system.** In the fourth review (in May 2011), a new structural benchmark was added for the authorities to prepare an active labor market policy strategy to replace the emergency Workplace with Stipend program which they planned to terminate at the end of 2011. In the fifth review (in December 2011), staff, pointing to the country's high unemployment and poverty rates relative to the rest of Europe, criticized the government's proposed cuts in social safety net spending and limits on social benefits. Instead, staff reiterated their call for the government to maintain or even increase its co-financing of GMI payments and to work with the World Bank to integrate the emergency schemes into a robust permanent safety net, specifically, by merging those schemes with the system of social assistance and by centralizing and improving the targeting of the GMI, while reforming the system to avoid poverty traps. The authorities disagreed, arguing that the crisis was over and hence "responsibility for providing welfare ("eating, heating, and housing") should be decentralized to municipalities, as it was before the crisis" (IMF, 2012b).

60. **The IMF also remained concerned about the pension system.** During the fifth review at the end of 2011, staff highlighted the failure to implement pension reform as "the biggest shortcoming of the government's crisis policy" and worried that some "reform fatigue" seemed to have set in (IMF, 2012b). In assessing the quality of the budget, staff expressed concern that

“savings from pensions (while making sure poor pensioners would not be worse off) were also ruled out, even though the average pension for new retirees had increased almost 70 percent in real terms from 2005 to 2009,” whereas a large part of the adjustment was being borne by local governments and the poorest municipalities that were already facing difficulties in financing their social safety nets (IMF, 2012b). But ultimately no substantive action was taken to reform the pension system due to “political reasons” (IMF, 2012b). In post-program monitoring discussions in 2012, staff highlighted the actual and expected fiscal impact of gradually reversing the crisis-related consolidation measures including restoring second pillar pension contributions, the ceiling on social contributions, and indexation of paid-out pensions; removing the freeze on pensions; and increasing social insurance benefits for high-earners (IMF, 2012f; IMF, 2013a).

61. **The IMF continued to press for GMI enhancements in the post-program period.** Even after the World Bank’s lending engagement concluded (at the end of 2011), the IMF team continued to work with the Bank’s DPL team leader on social protection. The justification was that unemployment was likely to remain high in Latvia for some time. In October 2012, a World Bank-led TA mission (with FAD participation) made several detailed recommendations for reforming the GMI. However, the authorities stood by their decision to cut GMI benefits and central government co-financing in 2013 (IMF, 2013a). In the Article IV discussions in 2014, 2015, and 2016, IMF staff—citing a World Bank study on long-term unemployment in Latvia (World Bank, 2013b)—urged the authorities to reverse the 2013 measures, but to no avail.³⁷ The IMF also argued for a more gradual tapering of the GMI benefit in the transition to employment, in order to improve work incentives. By this time, the IMF had broadened its notion of strengthening the social safety net to include measures such as “a rise in the minimum wage, indexation of small pensions, and a rise in the minimum income tax threshold” (IMF, 2014b).

E. Morocco

62. **In Morocco, the main social protection issues covered by the IMF were strengthening the social safety net and reforming public pensions.** These issues were covered in the course of surveillance and program discussions. During the evaluation period, Morocco received two two-year PLL arrangements: in August 2012 (for SDR 4.1 billion or 700 percent of quota); and July 2014 (for SDR 3.2 billion or 550 percent of quota).³⁸ Both arrangements were treated as precautionary and were not drawn. There was no structural conditionality in Morocco’s PLL programs.³⁹

63. **Social protection took on greater prominence in Morocco in the wake of the Arab Spring and the “February 20” protest movement in 2011.** In reaction to social unrest, the

³⁷ The study was undertaken with the Latvian Ministry of Welfare, under the aegis of the European Social Fund.

³⁸ Morocco received a third two-year PLL arrangement in July 2016 for SDR 2.5 billion (280 percent of its quota).

³⁹ Conditionality under Morocco’s PLL arrangements took the form of indicative targets quantifying government objectives regarding the fiscal deficit and net international reserves.

government increased spending on subsidies, wages, and pensions. Spending on food and fuel subsidies more than doubled to about 5½ percent of GDP in 2011 (prices for certain food products and fuel were kept unchanged in the face of rising international commodity prices)—like other countries in the region, Morocco relied heavily on these subsidies as a form of social protection (Box 7). Civil service wages, the minimum wage, and the minimum pension were also increased.

Box 7. Morocco: Food and Fuel Price Subsidies at the Beginning of the Evaluation Period

The subsidy system in Morocco dates back to 1941 when a stabilization fund, *Caisse de Compensation*, was established to stabilize the prices of basic commodities such as flour, bread, edible oils, charcoal, sugar, and milk during the Second World War. In the three decades that followed, many other products were added to the *Caisse's* list, including petroleum products in 1955. According to Verme and El-Massnaoui (2015), the subsidies served various functions such as price stabilization and export promotion as well as social protection.

During the 1980s and 1990s, however, the government gradually liberalized the prices of a number of subsidized products—including for petroleum products (except butane or LPG), through the establishment of a price indexation system in 1995. But in September 2000, in response to large increases in the world oil price the government suspended the price indexation and fixed retail prices on gasoline, diesel, and fuel oil, supporting the difference between the administered price and the recovery price through the budget. (The price of butane, which is consumed relatively more by the poor, remained fixed throughout).

Among food products, after the liberalization of the edible oils sector in November 2000, only flour and sugar remained subsidized. Imports of sugar were subject to tariffs (and other taxes), the proceeds of which covered about half the cost of the sugar subsidies; the remainder was borne by the state budget. The flour subsidy was more limited and targeted—there was an annual quota on subsidized flour and it was distributed to targeted populations through the use of poverty maps.

64. **The IMF had long held the view that food and fuel subsidies were a budgetary burden that Morocco could ill afford.** Every Article IV consultation from 2006 to 2011 included an exhortation to reduce and/or reform these subsidies in order to contain fiscal costs and the public debt (in 2006-07) and to improve expenditure efficiency and minimize fiscal risks (in 2008-11).⁴⁰ In a May 2011 blog post, the Director of the IMF's Middle East and Central Asia Department (MCD) argued against the use of (universal) food and fuel price subsidies as a form of social protection and listed alternatives such as “[c]ash transfers and other forms of income support” and “school feeding programs, waiving fees for public services for the poor (such as health, education, or public transport), or labor-intensive public works” that would “do a better job of protecting the poor” (Ahmed, 2011). In response to the authorities’ concern that subsidy reform would be politically difficult, the 2011 Article IV mission underlined that public and political resistance could be overcome through “good targeting and a well-designed and well-implemented communication strategy” but the staff report did not elaborate on what these entailed (IMF, 2011f). Civil society

⁴⁰ See also Feltenstein (2017).

activists from Arab countries, meanwhile, urged the IMF to ease pressure on their governments to reduce food and fuel subsidies until stronger social protection schemes could be implemented.⁴¹

65. **In the event, the Moroccan government moved ahead with policies to improve the targeting and effectiveness of social protection.** According to Moroccan authorities interviewed for this evaluation, the government built on an existing framework which included the flagship National Initiative for Human Development Support (INDH), with World Bank support.⁴² The 2012 PLL was intended to support the authorities' home-grown reform agenda aimed at achieving rapid and inclusive economic growth, while providing an insurance against external shocks. To mitigate the impact of the reform of food and fuel subsidies—the quota on subsidized wheat was lowered, the diesel subsidy was reduced, the subsidies on gasoline and industrial fuel were eliminated, and the price indexation mechanism was (re)introduced in 2013–14⁴³—on the poor, the authorities expanded two existing social programs (providing CCTs to poor rural families to send their children to school and providing basic health insurance for the poor); introduced programs to support low-income widows and physically disabled individuals; and provided support to the public transportation sector to alleviate the cost of higher fuel prices and limit fare increases. These measures were financed through a Social Cohesion Fund set up by the government in 2012.⁴⁴

66. **The IMF was highly supportive of the authorities' reforms and reported on each step over the course of the two PLLs.** The Ex Post Evaluation of the first (2012) PLL lauded subsidy reform as “a major achievement, especially in light of the difficult regional socio-economic context” as well as the “[p]rogress ... made in strengthening the social safety net and improving targeting of vulnerable groups” (IMF, 2015d). However, IMF staff reports did not discuss how the targeting had improved and whether the social protection measures introduced were appropriate or effective in mitigating the impact of the subsidy reform on the poor. Moroccan authorities interviewed for this evaluation indicated that the dialogue with the IMF focused on macroeconomic stability and not social stability and the IMF played little role when it came to social protection design beyond calling for better targeting. World Bank staff interviewed for this evaluation indicated that the Bank provided TA to the Moroccan authorities to develop a social registry and unique identification cards but there was little interaction with the IMF in this area due to constraints on the sharing of confidential data.

⁴¹ See “Subsidy Reform in Arab Countries: Reflection on IMF Recommendations,” Bretton Woods Project, Minutes of Civil Society Forum held during the IMF/World Bank Annual Meetings, October 12, 2013; and “Arab NGOs Warn IMF Against Sharp Cuts to Subsidies,” *Inter Press Service News Agency*, February 28, 2014.

⁴² Launched in May 2005, the INDH is a nationwide social inclusion program targeting poor and vulnerable populations in rural and urban areas throughout Morocco. The World Bank was the key partner for this program, with a loan of US\$100 million approved in December 2006 and a second loan of US\$300 million approved in June 2012. The IMF was not involved in this initiative.

⁴³ Full liberalization of fuel prices (except for butane) took place at the end of 2015.

⁴⁴ The World Bank provided TA on social protection reform including improving targeting practices.

67. **The IMF also urged Morocco and countries in the region to “[u]ntangle social protection from labor regulations”** (Ahmed, 2010). Pointing to the high rate of unemployment, particularly youth unemployment, in the region, the MCD Director posted: “No doubt, governments must help their citizens when they are hit by misfortune. However, this needs to be done in a way that does not create other problems... Instead of too stringent labor market regulations, a tight and targeted social safety net—that includes an unemployment insurance system—is a better way of protecting those in need” (Ahmed, 2010). The same advice was reiterated by the IMF in subsequent years.⁴⁵ However, IMF staff reports did not provide details as to how labor market regulations or the social safety net should be reformed to help the unemployed in Morocco.⁴⁶ At the end of 2013, Morocco introduced a limited unemployment benefit scheme, *Indemnité pour Perte d'Emploi* (IPE) after more than a decade of negotiations between the government, unions, and employers. The 2013 Article IV staff report took note of this (without comment) and continued to urge the reform of labor market policies, especially hiring and firing costs. In early 2015, Morocco launched a National Strategy for Employment designed in consultation with social partners and business representatives with support from the ILO and the development cooperation agencies of Canada, Spain, and Sweden and containing a range of measures to reduce unemployment, such as improving the effectiveness of employment support and vocational training programs and the functioning of the labor market. The second PLL review staff report welcomed the strategy (again without comment) while continuing to call for specific reforms of labor regulation, taxation, and minimum wage policy.

68. **The IMF was concerned about the sustainability of the public pension system.** The 2011 Article IV mission noted that the public pension funds—particularly the main civil service pension fund, *Caisse Marocaine des Retraites* (CMR)—would have to rely on their capital base to finance pension payments as soon as 2014. Staff stressed that apart from the basic pension, all pension schemes should be designed to be fully funded to ensure financial sustainability. At the end of 2012, after almost a decade of work, a government-appointed technical commission prepared a set of formal recommendations to restore the viability of the system while increasing its relatively low coverage (27 percent of the labor force in 2010) (Box 8). The authorities

⁴⁵ In a May 2011 commentary, the MCD Director noted that “while such labor market regulations are intended to protect the worker, they in fact impede job creation in the formal sector and contribute to driving firms into the informal economy, where young people have limited opportunities for human capital development and little to no rights or social protection. Policy should therefore aim at relaxing rigid labor market regulations, while at the same time preserving the right to collective bargaining and providing effective social protection, including unemployment insurance, for workers” (Ahmed, 2011a). In a 2012 speech in London on “Enabling Economic Transformation in the Middle East and North Africa,” the First Deputy Managing Director also urged governments in the region to “reform labor market regulation to reduce disincentives for hiring, while maintaining adequate worker protection” (Lipton, 2012).

⁴⁶ A SIP for the 2011 Article IV consultation (Guillaume, Furceri, and Bernal Verdugo, 2011) employed a panel regression of annual data for 183 countries over the period 1980–2008 to show that reforms to increase labor market flexibility (especially those related to minimum wages and mandated hiring costs) led to lower unemployment over the medium term, and used the results to draw labor market policy implications for Morocco.

emphasized the difficult political and regional context and the importance of building wide consensus on complex reforms (IMF, 2013f). Staff supported these reforms as “crucial to preserve fiscal sustainability and extend social protection” (IMF, 2014c) and repeatedly pressed for faster progress in implementing the reforms. In the event, the pension reforms faced opposition from the major trade unions, which held 24-hour general strikes in protest in 2014 and again in 2016.⁴⁷ In 2016, staff, while noting that social tensions had increased (“including in reaction to the pension reform proposal submitted to parliament”), continued to stress the urgency of the reforms and urged the authorities to “limit the potential fiscal cost of any accompanying measures (such as possible increases in the minimum pension)” (IMF, 2016e). Staff informed the IEO that the authorities were determined to press ahead with the pension reforms and that “no significant protests” followed the adoption of the reforms in July 2016.⁴⁸

Box 8. Morocco: Pension Reforms

Morocco has four main pension schemes: one for civil servants (*Caisse Marocaine de Retraites*, or CMR), one for employees of state owned enterprises (RCAR), and two for the private sector (a basic regime, CNSS; and a complementary regime, CIMR). These systems differ in their contribution rates and in the method used to calculate benefits at retirement.

The issue of pension reform in Morocco surfaced more than a decade ago. In 2003, a technical committee comprising representatives from the pension funds, social partners, and the government, was tasked with reforming the system. The committee completed its work in 2012 and recommended a two-step reform involving: (i) parametric reforms to prolong the financial viability of the funds by several years, such as a gradual increase in the retirement age and contribution rate, together with a reduction in the accrual rate and benefits; and (ii) broader structural reforms to put the system as a whole (public and private) on a sustainable footing for the long term, such as merging the separate funds into two poles (one for the public sector and one for the private sector), and setting incentives for non-covered workers to become part of the formal pension system.

The first step was launched in June 2014 with the announcement of parametric reforms of the CMR to be implemented in 2015. After many delays in the face of strong opposition, the reforms were adopted by the government in January 2016 and passed by Parliament in July 2016, with implementation starting in September 2016.

F. Tunisia

69. **The evaluation period, 2006–15, spans a time of significant political and social change in Tunisia** marked by the popular uprising at the end of 2010 that culminated in the overthrow of the longtime president in January 2011 and the birth of the Arab Spring. During the evaluation period, the IMF engaged with Tunisia on social protection issues through surveillance and TA, as well as an SBA which lasted from June 2013 to December 2015.⁴⁹ The IMF focused on strengthening the social safety net in the context of major policy/institutional reforms (of food

⁴⁷ “Moroccan unions call national strike to protest economic reforms,” *Reuters*, October 14, 2014; “Moroccan unions call for general strike on Feb. 24,” *Reuters*, February 10, 2016.

⁴⁸ “Thousands rally against Morocco pension reforms,” *Agence France Presse*, July 14, 2016.

⁴⁹ Tunisia’s last program prior to the 2013 SBA was an extended arrangement from 1988 to 1992. It currently has a 48-month arrangement under the Extended Fund Facility (EFF), which was approved in May 2016.

and fuel price subsidies, the labor market, and the civil service), and on pension reform. The World Bank was actively involved in social safety net issues from 2011 onwards through donor grant-based projects.

70. **In the first half of the evaluation period, the IMF was not particularly concerned about social protection in Tunisia.** The 2006 Article IV mission noted that the incidence of extreme poverty and the fraction of the economically vulnerable population had fallen sharply since the mid-1990s. On the macro and fiscal side, the main issues of concern were: costly fuel subsidies; the financial position of the social security system; the high public sector wage bill; and high unemployment. The IMF's view was that further fiscal consolidation was necessary to maintain long-term fiscal sustainability.

71. **In the face of rising international fuel and food prices and the global financial turmoil, the 2009 Article IV mission was reassured by Tunisia's "relatively wide social safety net, built over the years"** (IMF, 2009i). It reported that social security coverage was nearly universal; health insurance had recently been reformed to ensure the system's sustainability; there was a subsidized housing program for the poorer segments of the population; and social assistance was available for fired workers for up to one year. The IMF urged the authorities to resume fiscal consolidation as soon as possible after the crisis, and emphasized as key pillars of the strategy the reduction in fuel and food subsidies and "finding a better targeted mechanism to support the poorer segments of the population," and parametric reforms of the pension system to ensure its medium to long-term sustainability (IMF, 2009i).

72. **The IMF became more concerned about social protection after the January 2011 revolution and the economic crisis that followed.** Domestic social unrest and the conflict in neighboring Libya contributed to a severe recession, to which the (interim) government responded by raising budgetary spending to appease social demands: "The wage bill increased significantly, food and energy subsidies almost doubled to offset higher international prices, and new social measures were implemented, including revamped youth unemployment programs" (IMF, 2012h). The 2012 Article IV mission found that poverty rates and inequality were "higher than previously stated" (IMF, 2012h). It advocated "targeted policies, including strengthening social safety nets ... to protect the most vulnerable segments of the population through the economic transformation process" (IMF, 2012h).

73. **The concern was conveyed to the country directly by IMF Management.** In a visit to Tunisia in February 2012, the Managing Director offered the IMF's help, assuring that "[t]he 2012 version of the IMF differs from the past" (IMF, 2012d). In a visit later the same year, the First Deputy Managing Director said: "An effective social safety net that protects those most in need must complement a strong private sector that creates jobs... The IMF has been engaged with Arab Countries in Transition in advising on how to manage shocks to maintain economic stability, ensure that vulnerable households are protected during the transition, and lay the basis for job-creating growth" (IMF, 2012j).

74. **Strengthening social protection became a principal goal of the SBA that was approved in June 2013.** The SDR 1.1 billion arrangement (amounting to US\$1.7 billion or 400 percent of Tunisia’s quota) aimed to “strengthen fiscal and external buffers, while laying the building blocks for stronger growth and protecting the most vulnerable” (IMF, 2013c). A key element of the program, and an integral part of the authorities’ reform agenda, was “strengthening social assistance mechanisms and undertaking a systematic assessment of the social impact of the envisaged reforms” (IMF, 2013c). This was seen as essential to accompany the fiscal consolidation agenda—resting on subsidy reform and wage bill containment—which aimed at creating fiscal space for priority capital and social spending. To that end, the program included: (i) an indicative target (floor) on “social spending,” which included social protection expenditures,⁵⁰ and (ii) a structural benchmark requiring submission to the Council of Ministers of a new targeted household support program to accompany the reform of generalized energy subsidies by end-August 2013 (Box 9). The World Bank provided the authorities with needed technical support, in the context of a multi-year \$5.7 million Social Protection Reforms Support project, approved in October 2013, to strengthen institutional capacity to design social protection reforms and improve the targeting of safety net programs.

75. **The indicative target on social spending was missed on almost all test dates.** Only the 2014 end-March and end-June targets were achieved thanks to an increase in the number of beneficiaries covered by the families-in-need (PNAFN) program and increased educational assistance. The targets before that were not met due to “implementation capacity constraints” (IMF, 2014c); the targets after that were not met due to “administrative delays” and issues in the delivery mechanism in remote areas (IMF, 2015f).

76. **The new targeted household support program—viewed by the IMF as critical for the success of the energy subsidy reforms—was delayed several times by implementation challenges:** from August 2013 to March 2014, and then to June 2014. An FAD TA mission in September 2013 on adopting an automatic fuel pricing mechanism advised the government to identify forthwith appropriately targeted compensating measures to build support for the new fuel pricing policy to be introduced in 2014. The IMF team urged the authorities not to wait for the new unified registry or the perfect targeting system to go ahead with the targeted household support program. Because energy subsidy reform was such a contentious issue among the Tunisian public, staff repeatedly emphasized the importance of implementing the household support program ahead of the planned fuel price increase and in conjunction with a comprehensive communication campaign explaining the benefits of moving away from regressive energy subsidies that benefit mostly the well-off. Nonetheless, challenges in identifying the

⁵⁰ Social expenditures were defined as “capital expenditures (development expenditures) on education, health, social transfers to needy families, the AMEL employment training program (and university scholarships), UTSS indemnities, family allocation as well as development expenditures of the Ministry of Women and Family Affairs, Youth and Sports and Social Affairs;” current expenditures of the above-mentioned sectors and programs, as well as food and energy subsidies, were excluded (IMF, 2013c).

beneficiaries and mode of delivery of the transfers led to several delays in the launch of the program, and it was finally put in place in July 2014, just ahead of a 6 percent increase in the price of gasoline and diesel.⁵¹

Box 9. Tunisia: Cash Transfer System and Household Support Program

Social safety net programs in Tunisia comprise non-contributory social assistance programs for poor households through unconditional cash transfers and free health cards. Benefits are provided through the National Assistance to Needy Families Program (PNAFN) managed by the Ministry of Social Affairs.

According to the World Bank, the PNAFN covered about 9 percent of the population considered vulnerable (an estimated 235,000 households) in 2012, and beneficiary households received a cash transfer of TD 100 (about US\$66) per month (equivalent to approximately 20 percent of the poverty line used to determine eligibility).

In light of Bank estimates (based on the 2005 household survey) indicating leakage to the non-poor of around 60 percent, the government took a decision in 2012 to improve the PNAFN. The plan was to introduce a unique social identification number that would be used as a basis for creating a new register of families in need. The authorities also launched an evaluation of the PNAFN program as well as the school assistance programs (with the help of UNICEF).

In the interim, the authorities committed to implementing a targeted household support program to accompany the reduction in energy subsidies planned for 2014. The program consisted of the following measures: (i) expanding the coverage of the existing cash transfer program for needy families to 250,000 families in 2014; (ii) providing one-time, temporary assistance for PNAFN beneficiary households as well as additional poor households identified by regional committees to mitigate the impact of the fuel price increases; and (iii) increasing the PNAFN allowance by about 10 percent to a monthly amount of TD 120 per family (with an additional TD 10 per month for families with school-age children). The World Bank provided extensive TA in this area.

77. **The IMF repeatedly pressed the authorities to speed up progress in developing a new social safety net.** As work on the unique social identification number proceeded (Box 9), staff urged the authorities not to wait until it was complete to start improving the targeting system. By the fifth review (in December 2014), after a unique social identification number had been introduced for 8.5 million Tunisians and an evaluation of existing social protection programs had been completed (showing fewer leakages to non-poor than previously estimated), staff called for the quick adoption of a new social safety net (an improved PNAFN). The Managing Director reinforced this message in a visit to Tunisia in September 2015, exhorting the authorities to “move forcefully ahead” with the next phase of its transition including “a modern social safety net” (IMF, 2015e). According to IMF (2016b), by the end of the SBA program, the PNAFN had been expanded to cover 235,000 families and to provide higher benefits (with a tripling of the average transfer to about US\$80 per month). According to World Bank staff, improving the country’s social

⁵¹ Interim measures were introduced to soften the impact of the increase in electricity tariffs and natural gas prices in January 2014, such as: a social housing program for needy families; an increase in the income tax deduction for the poorest households; and a tiered electricity rate system adapted to energy use, plus a “social” electricity tariff for households consuming less than 100 kwh per month (in addition to the “lifeline” tariff for households consuming less than 50 kwh per month). Also, the guaranteed minimum salary was raised by about 6 percent, effective retroactively from May 1, 2014.

safety net was a long-term reform with a high degree of difficulty at every step, not something that could have been accomplished within the timeframe of an SBA. However, the IMF's tenacious efforts to highlight the importance of social safety nets was valued by the Bank for helping to mobilize attention to the issue (for example, by bringing it to the attention of the Ministry of Finance) and maintain the momentum of the reforms.

78. Pension reform also featured in the 2013 SBA albeit without related conditionality.

The social security system in Tunisia consists of the National Pension and Social Insurance Fund (CNRPS) for public sector employees; the National Social Security Fund (CNSS) for private sector employees; and the National Health Insurance Fund. The IMF had flagged the worsening financial condition of the two pension funds well before the program: the 2007 Article IV mission pointed out that the funds had moved from a surplus in the late 1990s to a small deficit in 2006, and urged the authorities to accelerate a comprehensive reform (planned for 2010) to ensure their long-term viability; the same advice was given in every Article IV consultation that followed. By 2012, when the CNRPS had already depleted its reserves, the IMF stressed the need for parametric reforms of the pension system to contain expenditure pressures over the medium term and avoid transfers from the central government budget. In 2013 the authorities launched an actuarial study, supported by the World Bank, to review the sustainability of the pension system and analyze the social and budgetary implications of different reform scenarios, and initiated a national consensus dialogue to discuss policy options. By the fourth SBA program review (in August 2014), the CNRPS was relying on budgetary transfers of around 0.3 percent of GDP to cover pension payments and the IMF was urging "quick actions" to reduce the deficit (IMF, 2014g). The government proposed a one-off voluntary increase in the retirement age in 2016 to help alleviate short-term budgetary pressures (but the draft law was not adopted) and it established a National Council on Social Dialogue to discuss a comprehensive reform of the pension system.

79. The IMF discouraged the use of public employment as a form of social protection.

When unemployment—which the Article IV team already found "unacceptably high" at around 12 percent in 2006 (IMF, 2006)—jumped to almost 19 percent in the context of the 2011 revolution, the government undertook an aggressive public sector recruitment program and launched a youth employment program (AMAL) for unemployed university graduates.⁵² IMF staff were concerned about the large increase in current expenditures, especially the public sector wage bill, and stressed that "the creation of unnecessary public jobs" was a "very costly and inefficient strategy for reducing unemployment" (IMF, 2014g). They repeatedly urged the authorities to speed up completion of the long-delayed National Employment Strategy and to

⁵² According to Angel-Urdinola, Nucifora, and Robalino (2015), AMAL was conceived as a labor activation program but in practice it mainly provided cash assistance to unemployed graduates in an effort to achieve social peace. The World Bank approved a grant-financed project ("Emergency Support for Youth") in September 2011 aimed at providing emergency income support and short-term employment to approximately 3,000 youth to meet their basic needs through cash-for-work, training, apprenticeship and self-employment opportunities; the project became effective in October 2012.

work with the World Bank to implement a comprehensive civil service reform.⁵³ These remained outstanding issues at the expiration of the SBA program. In the staff report for Tunisia’s request for a new EFF arrangement, staff noted that the authorities were continuing to build consensus amongst stakeholders to finalize a national employment strategy, and urged the authorities to accelerate work in this area with TA from the ILO (IMF, 2016b).

G. Malaysia

80. **During the evaluation period, the IMF provided advice to Malaysia on various social protection issues**, including reforming the social safety net, pension reform, and introducing a minimum wage. The advice was provided by Article IV and TA missions. According to staff interviewed for this evaluation, the IMF was anxious to re-engage with Malaysia after a period of somewhat tense relations since the Asian financial crisis, and mission chiefs wishing to gain the authorities’ trust put much effort into relationship-building and tried to be helpful in contributing to domestic policy debates when their advice was sought.

81. **The IMF took note of the fact that Malaysia lacked a comprehensive social safety net in 2009.**⁵⁴ Malaysia was hit hard by the global downturn. While the country was able to cope with the crisis from a position of macroeconomic resilience, the recession added urgency to outstanding structural issues—fiscal consolidation and strengthening domestic-oriented activity—and provided an opportunity to revisit the national development model. IMF staff argued that strengthening social protection would help in two ways: (i) it would allow the authorities to proceed with long-planned fiscal reforms, specifically, an overhaul of the fuel subsidy system and introduction of a goods and services tax, in a socially and politically acceptable way; and (ii) it could reduce the high rate of precautionary saving which was contributing to external current account surpluses and what the IMF assessed to be an undervalued exchange rate (IMF, 2009f).

82. **FAD fielded a diagnostic TA mission to assess Malaysia’s social safety net in the fall of 2009.** The TA team took stock of the existing major social safety net programs and analyzed their distributional impact using the authorities’ confidential household survey data. The team also provided some suggestions for improving the social safety net (e.g., phasing out and restructuring energy price subsidies, improving social assistance program design, and improving targeting criteria and the benefit structure), drawn in part from experiences in other countries. According to a statement by the Executive Director for Malaysia at the conclusion of the 2010 Article IV consultation, the authorities were appreciative and credited the TA mission for “bringing the issue [of social safety net reform] into the central policy debate” (IMF, 2010e).

⁵³ The World Bank provided TA and policy analysis on social protection and labor policy as part of its Development Policy Review (World Bank, 2014) and Systematic Country Diagnostic (World Bank, 2015a).

⁵⁴ This was mentioned in a footnote in the 2009 Article IV staff report (IMF, 2009f) and it became a point of interest for several Directors at the Board meeting in July 2009.

83. **Staff from the World Bank and the United Nations Children’s Fund (UNICEF) participated in the TA mission but neither institution was active in that area in Malaysia at that time.** They were not given the same access to data as the IMF team and did not contribute to the TA report. World Bank staff contacted for this evaluation noted that the Bank’s first engagement with Malaysia on social safety nets took place around 2011 in the context of a Public Expenditure Review and it did not involve collaboration with the IMF.

84. **In 2010, Malaysia unveiled its New Economic Model with the goals of high income, sustainability, and inclusiveness, and the policy framework for implementing the strategy over the next five years.** With “inclusive growth” now a key medium term priority for the authorities, Article IV missions from 2011 to 2015 discussed various policies to strengthen social protection including CCTs, pension reforms, unemployment insurance, and a minimum wage (IMF, 2012c).

- **Cash transfers:** Staff suggested improving the targeting of cash transfer schemes and making them conditional on access to education and healthcare, noting that such programs had “proved successful in Brazil and Mexico and not too costly” (IMF, 2012c). Staff also emphasized that the reform of universal fuel subsidies should be accompanied by “targeted support measures for vulnerable groups” (IMF, 2013b). In 2012, the Malaysian government established *Bantuan Rakyat 1 Malaysia* (BR1M), a cash transfer program for low-income households. (The IMF was not involved, according to staff interviewees.) When fuel subsidies were abolished at the end of 2014, a one-off cash transfer was made to low-income households under the BR1M program.
- **Pension reforms:** Staff discussed the adequacy of Malaysia’s pension system for rapid population aging, noting on the one hand the relatively low pension replacement ratios and lack of coverage for low or non-contributors, and on the other hand the fiscal risks posed by rising pension liabilities. With regard to the first point, staff supported the introduction of the Private Retirement Scheme to supplement the compulsory Employees Provident Fund (EPF), and suggested increasing the minimum age for pension withdrawals from the EPF, raising the rate of return on EPF investments, and introducing a publicly funded, pillar-one pension scheme (Box 10).⁵⁵ With regard to the second point, staff drew on a 2013 FAD TA report assessing fiscal risks in Malaysia to suggest parametric reforms to the Civil Service Pension Fund.
- **Unemployment insurance:** Staff suggested introducing an unemployment insurance scheme funded by employers and employees. The 2012 Article IV mission noted that the authorities tasked the ILO to produce a report on how to design an appropriate scheme

⁵⁵ Staff’s recommendations were drawn from a 2009 OECD report on pensions in Asia/Pacific.

(IMF, 2013b). The ILO report (Keyes, Carter, and Bédard, 2015) was published in April 2015 but there was no mention of it in the next Article IV discussion.

- **Minimum wage:** Staff discussed with the authorities the pros and cons of introducing a minimum wage during the 2011 Article IV consultation. In the event, the authorities introduced a minimum wage in January 2013 with advice from the ILO. Staff agreed that the policy would enhance social protection “provided any negative impact on employment is small” and urged the authorities to retain some flexibility to adjust the policy as they gained experience with its implementation (IMF, 2013b).

Box 10. Malaysia: Public Pension Schemes

Malaysia has two main public pension schemes: the Employees Provident Fund (EPF) and the Civil Servants Pension Fund (KWAP). The EPF primarily covers private sector employees and is a fully funded defined contribution scheme. The government guarantees a minimum annual return of 2.5 percent. The KWAP covers public sector employees and is a defined benefit scheme, funded on a PAYG basis through the budget. Civil servants do not contribute to the scheme, with the government bearing the full cost. The 2013 TA report on Fiscal Risks Assessment recommended that the government increase its contribution to the KWAP in the short term and consider reforms to ensure its long-term sustainability.

85. **In addition to the authorities’ priority of achieving “inclusive growth,” IMF multilateral surveillance emphasized external rebalancing as another motivation for strengthening social protection.** The 2012 Pilot External Sector Report noted that Malaysia’s external surplus partly reflected high private saving “stemming from young demographics and underdeveloped social safety nets” and recommended “[s]tructural reforms to strengthen social protection” as a possible policy response to reduce the savings-investment gap (IMF, 2012g). The 2013 Pilot External Sector Report made more specific suggestions such as enhancing the risk-sharing characteristics of the pension scheme and introducing employment insurance (IMF, 2013e). Subsequent External Sector Reports repeated the advice to “improve social protection and the risk sharing characteristics of the pension system” to help moderate the current account surplus, noting it was “[c]onsistent with the authorities’ intentions” (IMF, 2014e; IMF, 2015c; IMF, 2016d).

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