Social Safety Nets in IMF Policy Advice

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Outline

- 1. Social Safety Nets (SSNs)
- 2. Instruments
- 3. Protecting or creating fiscal space for social spending
- 4. Reforming pension/social security system
- 5. Improving targeting of transfers (generalized energy subsidies)
- 6. Funding target 1.3 of SDGs
- 7. Developing a new framework

1. Social Safety Nets

General background:

- Have assumed a central place in the global policy discourse (e.g., the G-20 communiqués)
- Reflect a growing concern about income inequality, the impact of new technologies on workers and emphasis on inclusive growth
- Target 1.3 of Sustainable Development Goals (SDGs) calls for achieving **"nationally appropriate social protection systems and measures for all"**

1. Social Safety Nets

Evolution at the IMF:

- First defined in the early 1990s to include measures to mitigate the impact of reform measures on the poor
- Included adaptation of social security arrangements (pensions and unemployment insurance arrangements) relevant for transition economies
- Advent of structural programs (e.g., ESAF), HIPC Initiative, and the creation of PRGF facility led to emphasis on social spending

1. Social Safety Nets

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Definition and IMF’s mandate:

- Social safety nets, social safeguards and social protection used interchangeably
- Compared to the World Bank, the Fund’s definition is broader, it includes budgetary allocations for social spending
- SSNs are not explicit part of the IMF’s mandate, but over time recognized as an important contributor to macroeconomic stability and sustainability of reforms (and therefore viewed as macro-critical)
- SSN part of the discourse on inequality, viewed as macro critical now

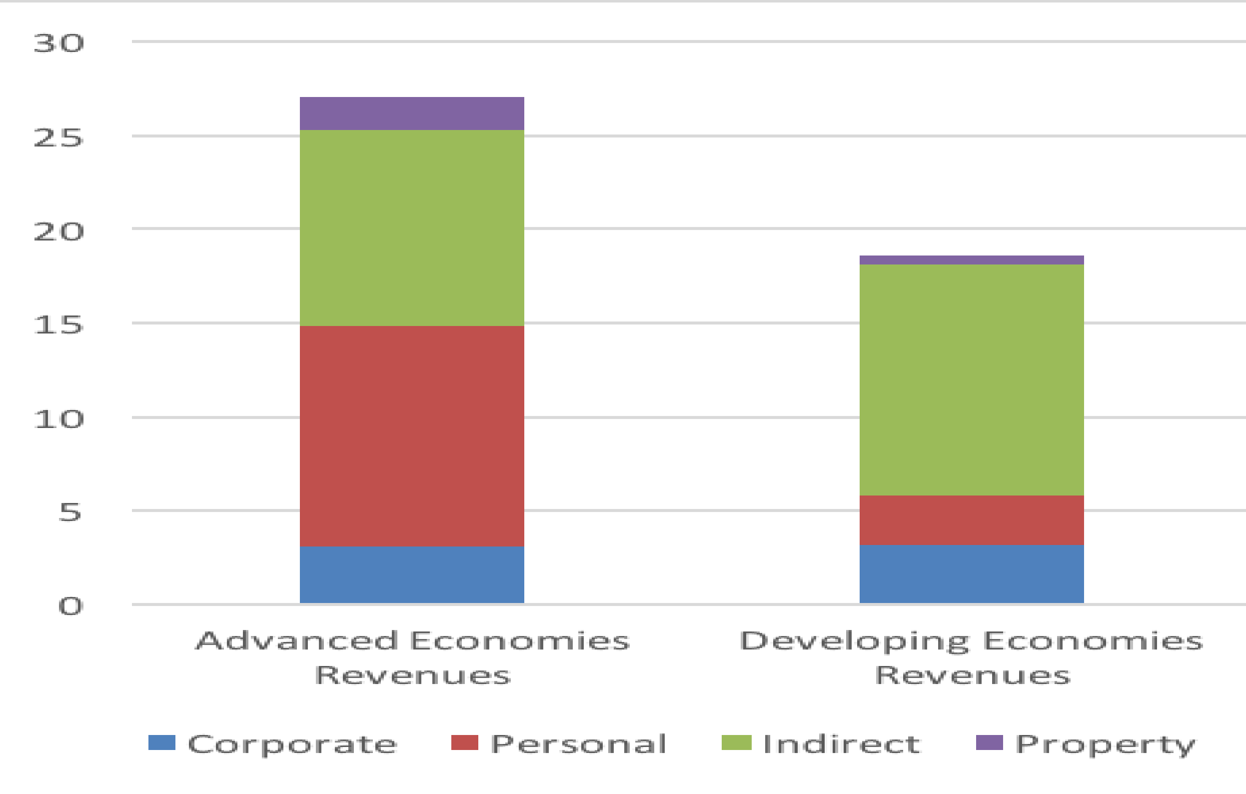
1. Social Safety Nets

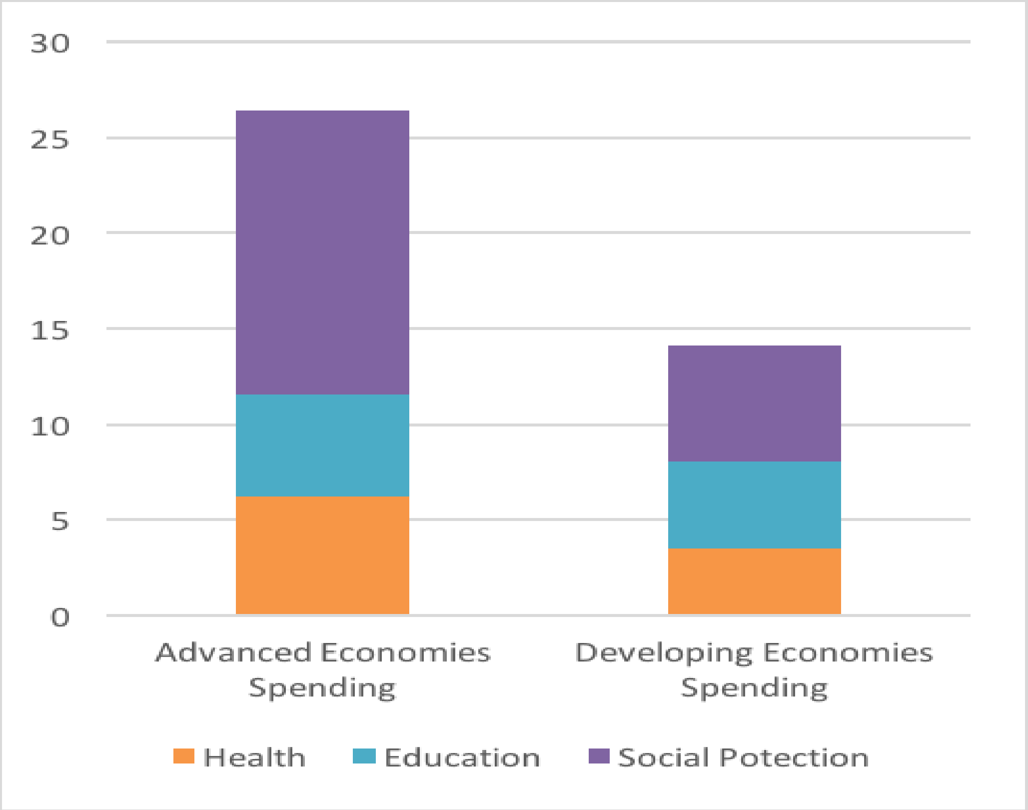
Other considerations:

- Recognition that SSNs should be in place before a crisis occurs—increased focus on them in IMF surveillance
- SSNs should be viewed as part of automatic fiscal stabilizers, designed to expand/contract benefits and coverage automatically as needed
- But this depends on the revenue position — developing countries collect less revenues (15-20 percent of GDP as compared to over 25 percent of GDP in advanced economies)

1. Social Safety Nets

Tax revenues and expenditures in advanced and developing countries





Source: Gupta (2018)

2. Instruments

- Protecting or creating fiscal space for social spending through floors, mainly in developing countries
- Social benefits/transfers; including through conditional and unconditional cash transfers, generalized or targeted subsidies
- Social security (old age, disability, sickness and death) in countries where they exist
- Unemployment assistance/minimum wage, where they exist
- Active labor market policies (such as public works), all types of countries

2. Instruments

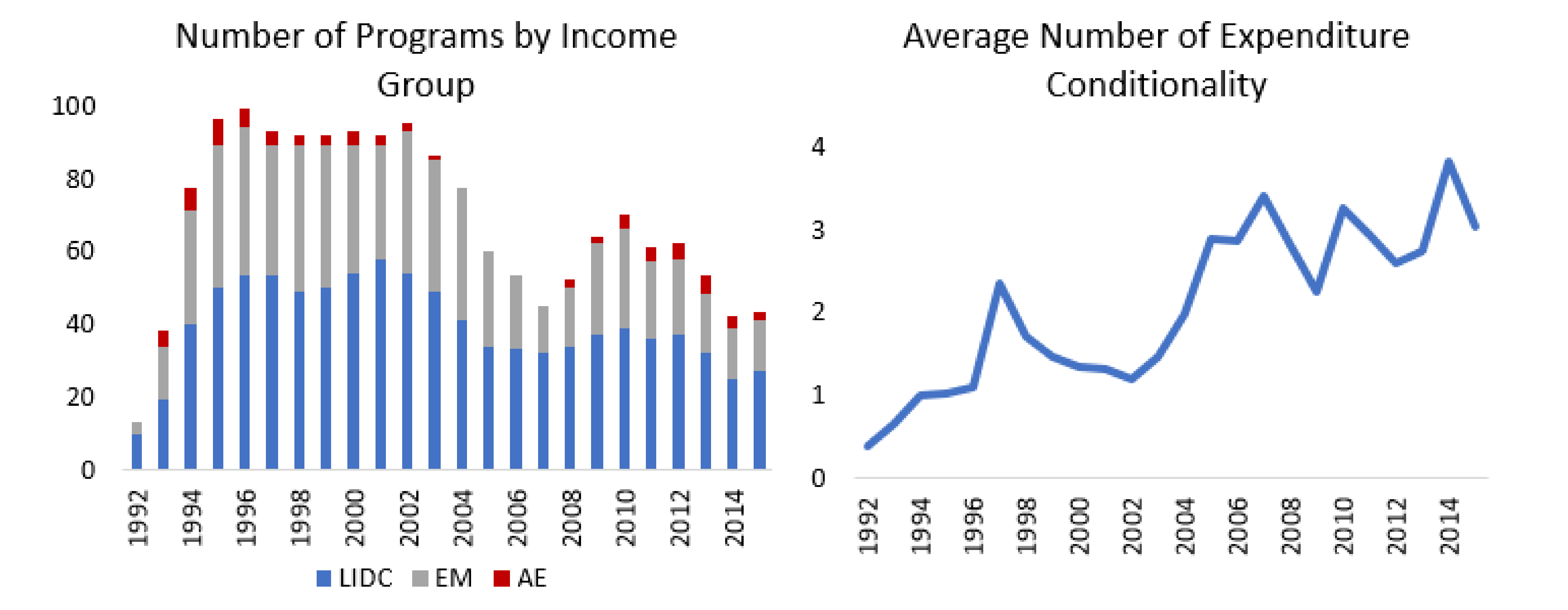
What determines the choice:

- Fiscal space (availability of financing)—integrating their cost into the budget for macroeconomic stability
  - Emphasis on enhancing their cost-effectiveness (expenditure efficiency)
- Country preferences
- Appropriateness and adaptability of existing instruments
- Administrative capacity

3. Protecting or creating fiscal space for social spending

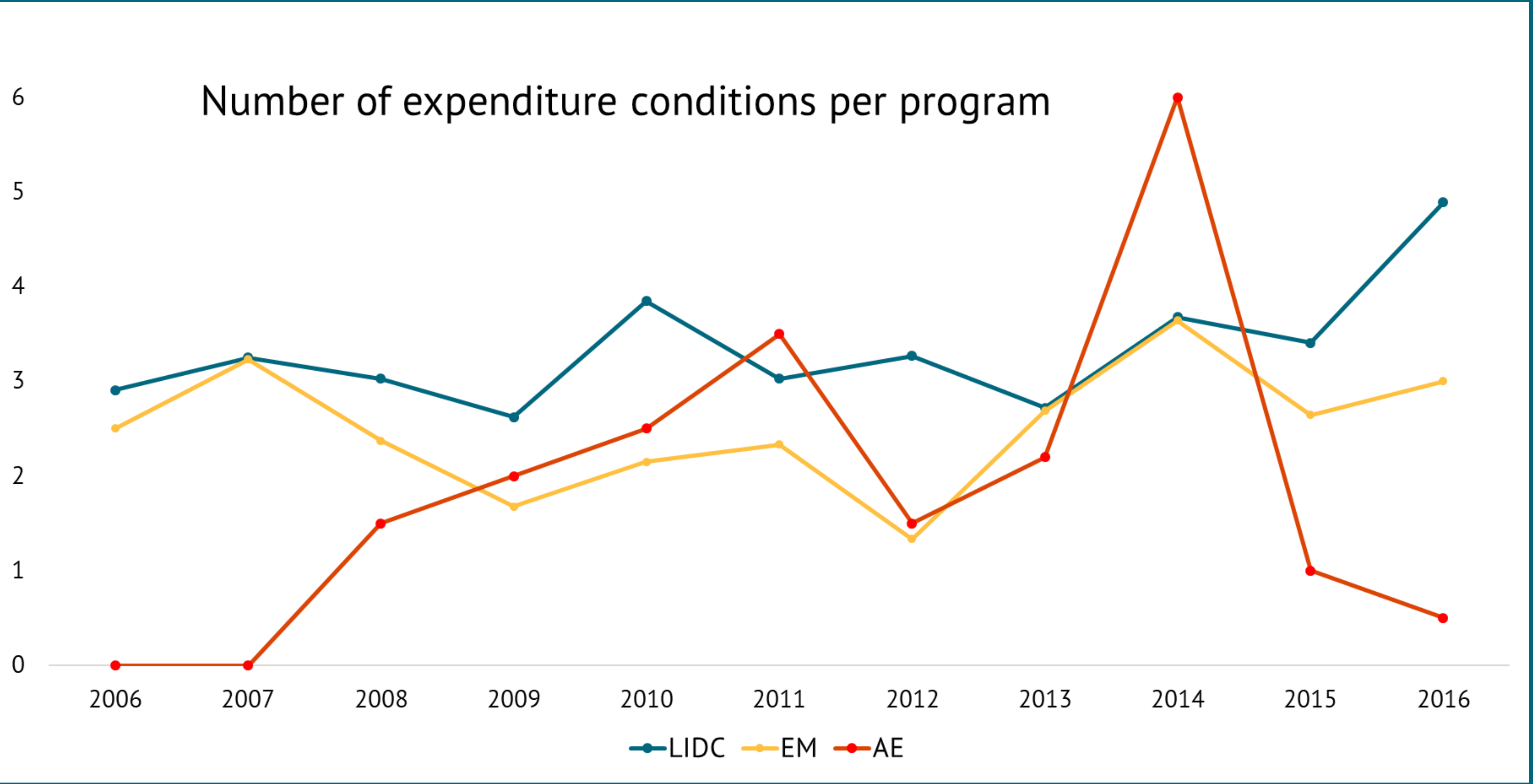
- Why?
- Critics claim that IMF programs have failed to deliver desired increases in social sector spending
- But the analysis has ignored channels through which programs can potentially increase social spending:
    - Higher growth during the program period which raises domestic revenues
    - Spending floors to protect social spending and catalyzing of foreign aid
- Empirically, social spending increases at a faster pace or remains protected in IMF programs

3. Protecting or creating fiscal space for social spending



Gupta, Schena, Yousefi (2018)

3. Protecting or creating fiscal space for social spending



Gupta, Schena, Yousefi (2018)

3. Protecting or creating fiscal space for social spending

- Spending floors, which are spread across QPC, ITs, SBs and PA, appear ineffective in the medium term in raising spending
- Structural conditionality, such as arrears payment or accounting and financial reporting, has a lasting impact on increasing social spending
- Conditionality on increasing public investment exerts downward pressure on the share of health spending, implying a tradeoff between spending categories

4. Reforming pension/social security system

- Focused on improving fiscal sustainability, also in the nonprogram context pensions can account for 20 percent of noninterest spending
- Increasing statutory retirement age:
  - Retirement age increase *(Brazil, Indonesia, Russia, Ukraine)*
  - Uniform retirement ages for men and women *(Russia)*
  - Automatic increases in line with life expectancy at retirement
- Increasing effective retirement age:
  - Increase lowest permissible retirement age *(Brazil)*
- Implications:
  - Slower inflow of beneficiaries, shorter retirement periods
  - Longer working careers with higher likelihood of adequate pensions
  - Potential positive impact on labor supply and growth

4. Reforming pension/social security system

Curtailing benefits:

- Universal:
  - Lower entry pensions *(Brazil)*
  - Reduce special tax treatment of pensions *(Brazil)*
  - Indexation to CPI instead of wages
- Targeted:
  - Claw back benefits from high earners
  - Reduce benefit accrual rates

Establish fiscally sustainable social pension

4. Reforming pension/social security system

- Increase effective contribution rates:
  - Universally higher contribution rates *(Russia)*
  - Raise cap on incomes subject to contributions
  - Lower the floor for incomes subject to contributions *(Australia)*
  - Make dependant benefits contributory *(Japan)*
  - Reduce matching government contributions *(Australia)*
  - More efficient collection *(Russia)*
- Implications:
  - Potentially greater increase in revenues than liabilities
  - Possible negative impact on labor market, inter-generational fairness

4. Reforming pension/social security system

- **Fund advice has not generally addressed:**
  - Pension coverage in the population
  - Adequacy of pension benefit

5. Improving targeting of transfers (generalized energy subsidies)

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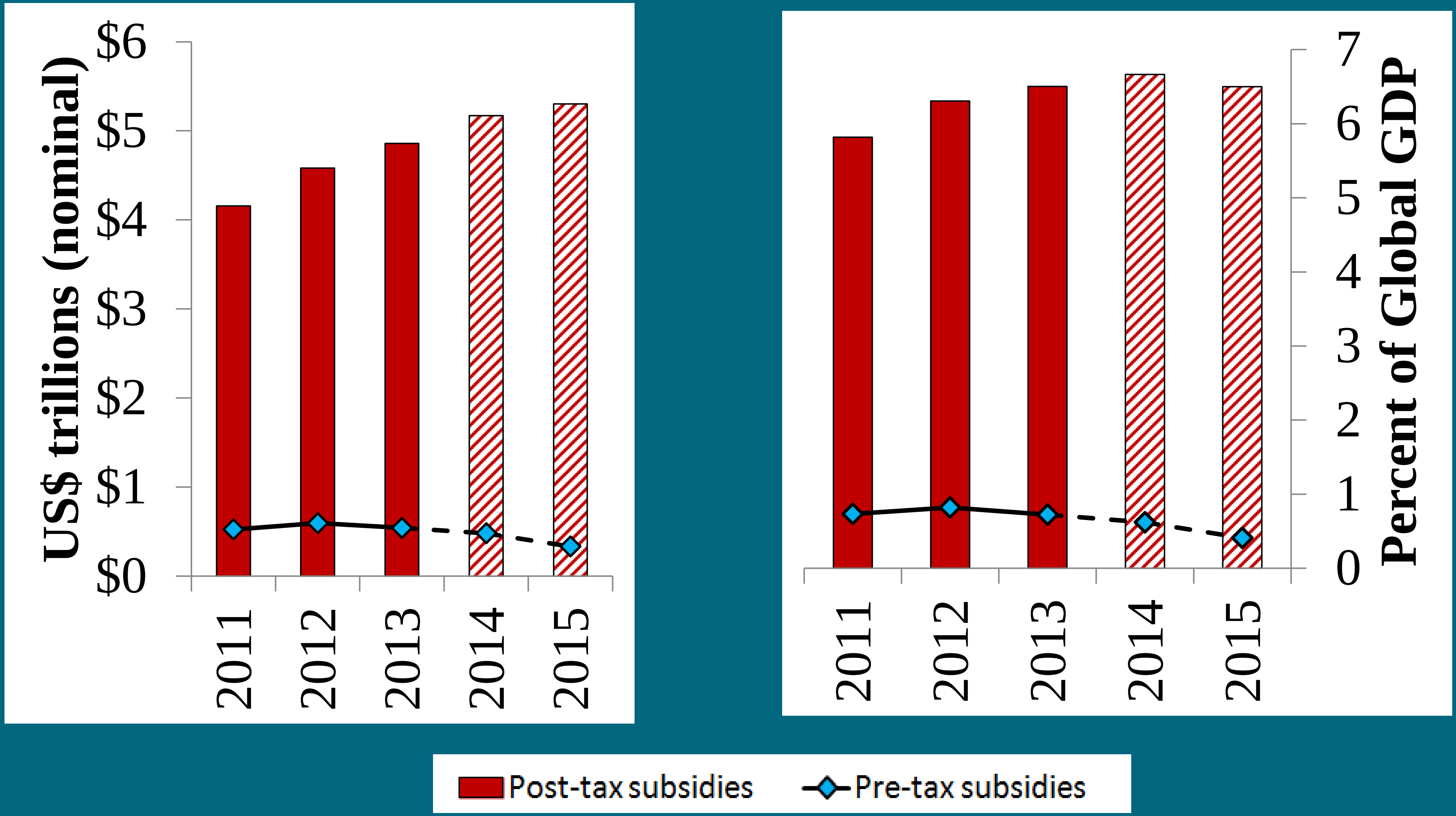

Source: Coady, Parry, Sears, Shang (2015)

5. Improving targeting of transfers (generalized energy subsidies)

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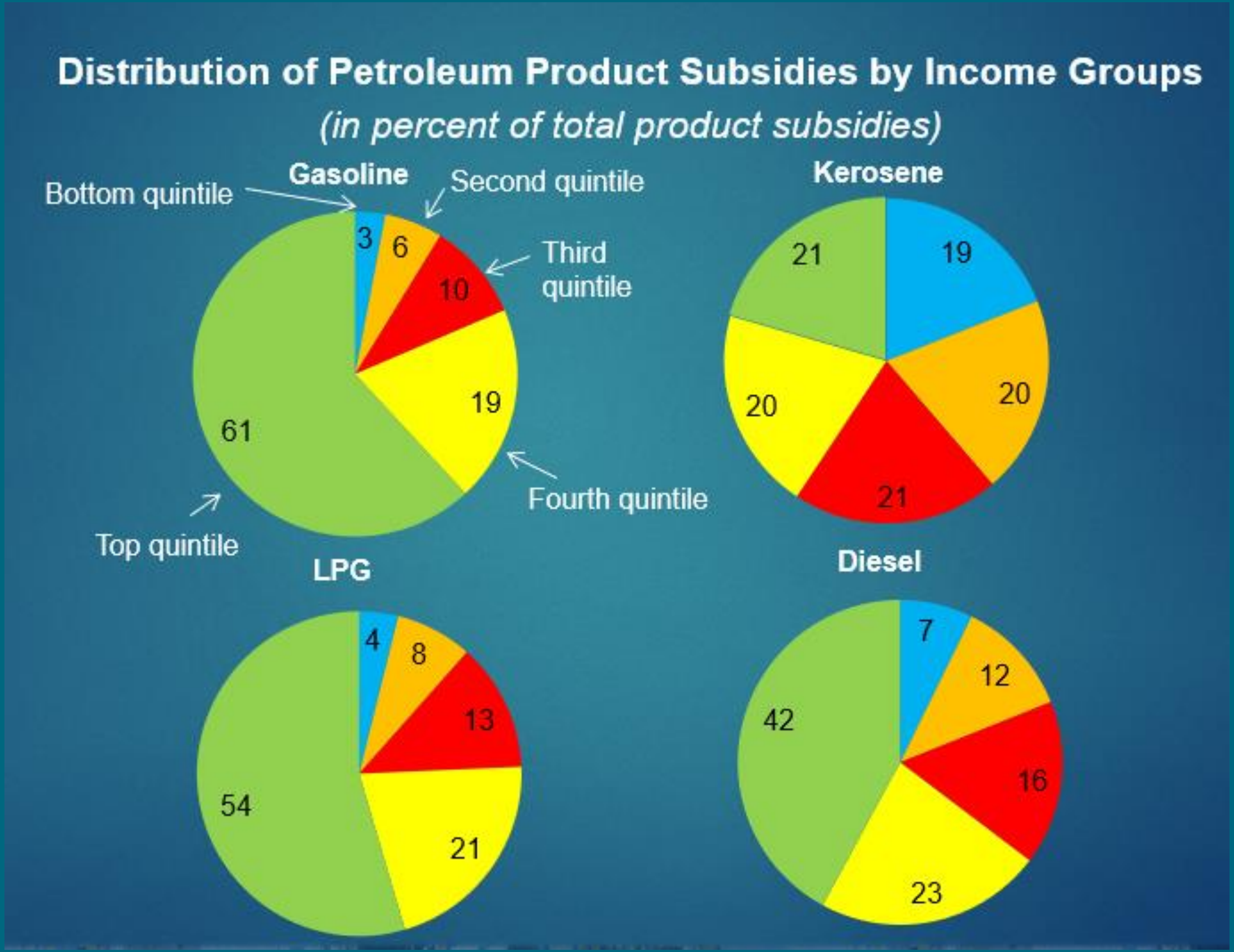
- Generalized energy subsidies depress growth:
    - Reduce investment in the energy sector
    - Crowd-out critical public spending
    - Over-allocate resources to energy intensive sectors
- Exert pressure on balance of payments of energy importers
- Create negative externalities (for example, global warming)
- Reinforce inequality

5. Improving targeting of transfers (generalized energy subsidies)

Most benefits from energy subsidies in developing countries accrue to upper income households



Sources: Arze del Granado, Coady, and Gillingham (2012).

5. Improving targeting of transfers (generalized energy subsidies)

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Targeted cash transfers:

- Preferred, made possible by fiscal savings
- Dominican Republic: replacement of LPG subsidy with a targeted transfer accompanied by program benefiting drivers of LPG-fueled taxes
- Armenia: targeted cash transfer program maintained consumption after electricity price hikes
- Indonesia: nonconditional cash transfer program, which covered 35 percent of the population, helped overcome social and political opposition to fuel subsidy reforms

5. Improving targeting of transfers (generalized energy subsidies)

When cash transfers are not feasible, other programs can be expanded as administrative capacity is developed:

- Gabon, Ghana, Niger, Nigeria, and Mozambique expanded existing social spending programs targeting the poor
- Morocco expanded existing support to school-age children, helped the poor with medical expenses, and introduced new support for low-income widows, physically disabled individuals, and users of public transport
- Philippines maintained electricity subsidies for indigent families, provided college scholarships for low-income students, and subsidized loans to convert engines used in public transportation to less costly LPG

5. Improving targeting of transfers (generalized energy subsidies)

In addition, implement a far-reaching communications strategy:

- Inform the public of the size of subsidies and benefits of reform
- Jordan: wealthiest quintile received three times more in fuel subsidies than the poorest quintile

Strengthen transparency in reporting subsidies

Depoliticize price setting mechanism:

- Implement automatic price mechanism (with price smoothing)
- Establish an autonomous body to oversee price setting

5. Improving targeting of generalized energy subsidies

Appropriately phase and sequence price increases:

- Permit households and enterprises time to adjust and governments to build social safety nets
- Sequence increases differently across products

Implement measures to improve the efficiency of state-owned enterprises (SOEs) to reduce their fiscal burden

6. Funding target 1.3 of SDGs

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- Some idea from the cost of funding five sectors: education, health, roads, electricity and water and sanitation
- According to the IMF, delivering the SDG agenda in these five areas by 2030 will require additional spending of 15 percentage points of GDP in LICs and 4 percentage points of GDP in EMs
- The IMF assumes that EMs can find these resources
- For LICs, tax-to-GDP ratio must rise by 5 percentage points of GDP or 0.5 percent of GDP every year; the remaining will have to come from public and private sources
- Against this background, how will target 1.3 of SDGs be financed? Social spending is covered in the above estimates

7. Developing a new framework

- Possible inconsistency between targeting and rights-based (universal approach) approach followed by UN agencies, particularly in the context of SDGs (which the Fund has endorsed)
- Implications for collaboration with other institutions
- Fund’s IEO prepared an evaluation in 2017 and requested a paper for the Board defining the term, scope, boundaries, and objectives of IMF engagement in social protection—the paper expected by May 2019
- In addition, the forthcoming conditionality review will consider how program design and conditionality can more effectively be applied for social protection

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