STRATEGY, POLICY,
AND REVIEW

HOW TO NOTES

How to Operationalize IMF Engagement on Social Spending during and in the Aftermath of the COVID-19 Crisis

NOTE 20/02

Strategy, Policy, and Review Department

How to Operationalize IMF Engagement on Social Spending during and in the Aftermath of the COVID-19 Crisis

Prepared by a Strategy, Policy, and Review Department team comprising Zuzana Murgasova (lead), Irene Yackovlev, Fei Liu, Gohar Minasyan, and Ke Wang

INTERNATIONAL MONETARY FUND

Cover Design: IMF Multimedia Services
Composition: The Grauel Group

HOW TO NOTE
Strategy, Policy, and Review Department
How to Operationalize IMF Engagement on Social Spending during and in the aftermath of the COVID-19 Crisis

Names: Murgasova, Zuzana. | Yackovlev, Irene. | Liu, Fei, 1979- | Minasyan, Gohar. | Wang, Ke (Economist). | International Monetary Fund. Strategy, Policy, and Review Department, issuing body. | International Monetary Fund, publisher.
Title: How to operationalize IMF engagement on social spending during and in the aftermath of the COVID-19 crisis / Prepared by a Strategy, Policy, and Review Department team comprising Zuzana Murgasova (lead), Irene Yackovlev, Fei Liu, Gohar Minasyan, and Ke Wang with administrative assistance from Pille Snydstrup, Natalia Romanova, and Elisavet Zachou. Approved by Kristina Kostial.
Other titles: How to notes (International Monetary Fund) ; 20/02.
Description: Washington, DC : International Monetary Fund, 2020. | How to notes (International Monetary Fund) ; 20/02. | September 2020. | Includes bibliographical references.
Identifiers: ISBN 9781513556048 (paper) | 9781513556086 (Web PDF)
Subjects: LCSH: Expenditures, Public. | Government spending policy. | COVID-19 (Disease).
Classification: LCC HJ7461.M87 2020

DISCLAIMER: Strategy, Policy, and Review Department (SPR) How to Notes offer practical advice from IMF staff members to policymakers on important fiscal issues. The views expressed in SPR How to Notes are those of the author(s) and do not necessarily represent the views of the IMF, its Executive Board, or IMF management.

Publication orders may be placed online, by fax, or through the mail:
International Monetary Fund, Publication Services
PO Box 92780, Washington, DC 20090, U.S.A.
Tel.: (202) 623-7430 Fax: (202) 623-7201
Email: publications@imf.org
www.imf bookstore.org

TABLE OF CONTENTS

Figures

EXECUTIVE SUMMARY

This note provides an overview of social spending issues that country teams may encounter during and in the aftermath of the coronavirus disease (COVID-19) crisis and describes resources available to staff. The note is based on the Strategy for IMF Engagement on Social Spending (Policy Paper No. 19/016).[1] It also draws on the IMF Fiscal Affairs Department's (FAD) crisis-related analytical work, including notes on fiscal issues in the Special Series on COVID-19.

The approach to social spending issues will differ over the various stages of the crisis and will depend on country-specific factors and circumstances. With the onset of the COVID-19 crisis, social spending is now at the forefront of the IMF's country work. The note distinguishes three phases of the COVID-19 crisis and its economic impact—containment, stabilization, and recovery—to highlight the relative policy priorities at different junctures of the crisis. The duration of each stage is inherently uncertain, and countries are likely to reach each stage at different times. For this reason, teams should use judgment and flexibility to decide which stage is applicable to their country at a given point in time. Further, collaboration with international development institutions involved in health and social protection (including the International Labour Organization, the United Nations Children's Fund, the World Health Organization, and the World Bank) could provide valuable insights to inform staff's assessment. Teams should also be mindful of governance issues. The focus of each phase is as follows:

- *Containment phase* – where the priority is to safeguard lives and livelihoods. The focus of social spending should be on whether it is adequate, being attentive to tradeoffs with efficiency.
- *Stabilization phase* – where the priority is to continue to support poor and vulnerable households and mitigate the distributional impact of the crisis, while being mindful of fiscal sustainability. Social spending should begin to focus on social programs that will hasten the recovery.
- *Recovery phase* – where the priority is to support poor and vulnerable households. Social spending issues should be incorporated into a well-articulated pandemic recovery plan. A medium-term perspective is needed to effectively address the scarring effects of the crisis. The focus on fiscal sustainability and efficiency issues may need to increase.

The note has benefited from early comments received from David Coady and Baoping Shang (both FAD).

[1]This note is not intended as the Staff Guidance Note for the Strategy for IMF Engagement on Social Spending, which is forthcoming but has been delayed due to the ongoing COVID-19 crisis.

HOW TO OPERATIONALIZE IMF ENGAGEMENT ON SOCIAL SPENDING DURING AND IN THE AFTERMATH OF THE COVID-19 CRISIS

Introduction

Why do we need a note on how to engage on social spending in the context of the COVID-19 crisis?

In June 2019, the IMF launched its Strategy for IMF Engagement on Social Spending. The strategy provided a definition of social spending (Figure 1) and clarification of *when* and *how* to engage on social spending, including in program contexts. It also identified internal resources available to support engagement, and measures to strengthen external communications on IMF policy advice and country-level engagement with international development institutions (IDIs) and other stakeholders. A core principle of the strategy is *that IMF engagement on social spending should be guided by an assessment of the macro-criticality*[1] *of a specific social spending issue in surveillance, and consideration of that issue in a program context,*[2] *as well as by the existence of in-house expertise* (Figure 2).

In the wake of the COVID-19 crisis, social spending has become macro-critical for most countries; therefore, IMF engagement on this issue with each of its members has become virtually inevitable. At the same time, social spending measures need to be considered in the context of the broader crisis response and macroeconomic policies.

[1]A structural issue has been deemed macro-critical if it affects, or has the potential to affect, domestic (e.g., growth and inflation) or external stability.

[2]In the Use of Fund Resources context, the establishment of program conditionality is subject to specific standards which are set forth in the Guidelines on Conditionality. The standards are that conditionality should only be set on measures that are: (i) critical for meeting program objectives or for monitoring the program's implementation; or (ii) necessary for implementing specific provisions of the IMF's Articles of Agreement or policies adopted under them. In the specific case of Poverty Reduction and Growth Trust (PRGT)-supported programs, under the current policy, all PRGT facilities, should safeguard and, whenever appropriate, increase social and other priority spending. This should be monitored through explicit program targets, wherever possible. The definition of priority spending should be established by the member, in accordance with the country's poverty reduction and growth strategy, and hence can be expected to vary from country to country. More generally, PRGT facilities are designed to support economic policies rooted in country-owned strategies that aim to support poverty reduction and economic growth.

While the conclusions and recommendations of the IMF's strategy on engagement in social spending remain valid, this note aims to provide country teams with advice and resources on how to apply the strategy in *surveillance and programs* during and in the aftermath of the COVID-19 crisis, taking into account country-specific factors and circumstances. Country teams should use judgment and flexibility in applying the suggestions from this note.

This note distinguishes three phases of the COVID-19 crisis and its aftermath—containment, stabilization, and recovery—applicable in both surveillance and program contexts. These stages are linked to the *evolution of the pandemic and its economic impact,* both of which may vary from country to country. The duration of each stage is inherently uncertain, and countries are likely to reach each stage at different times.[3] The advice for each stage is summarized in Annex I.

- *Containment* – is the most acute stage of the pandemic, involving the tightest containment measures. These measures restrict economic activity, while some economies effectively shut down. The IMF has focused on supporting members in containing the humanitarian and immediate economic fallout from the pandemic. IMF financing has been mainly focusing on emergency financing with no ex-post conditionality.
- *Stabilization* – when the acute stage of the pandemic tapers off, and some of the overall uncertainty and immediate financing urgencies are resolved. Economies start to reopen although at a different pace, while additional waves of outbreak remain a possibility. The overall macroeconomic outlook remains uncertain, including on the temporary versus persistent impact of the shock.
- ***Recovery*** – as uncertainty abates, there is more clarity on the impact of the crisis, including temporary versus permanent effects across different sectors and countries. The crisis could leave long-lasting damage

[3]For example, two countries with seemingly the same dynamics of confirmed COVID-19 cases may be in different phases, depending on the readiness of the health care system and the severity of the economic impact, among others.

Figure 1. IMF Definition of Social Spending

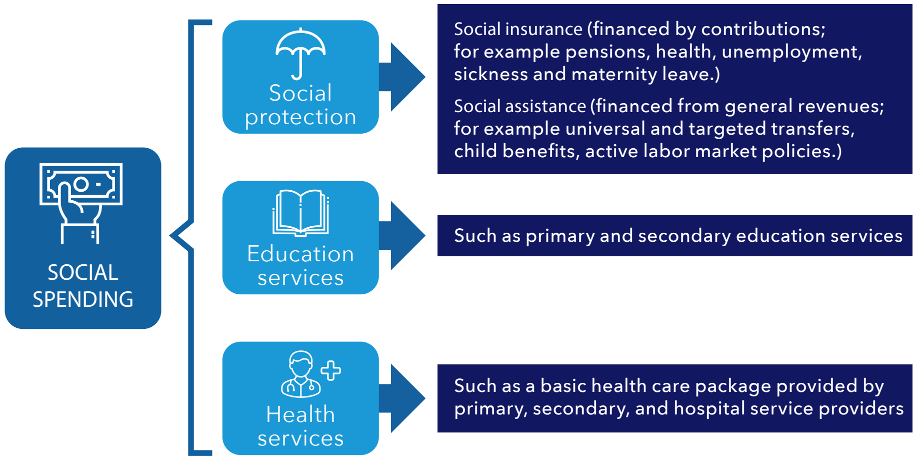
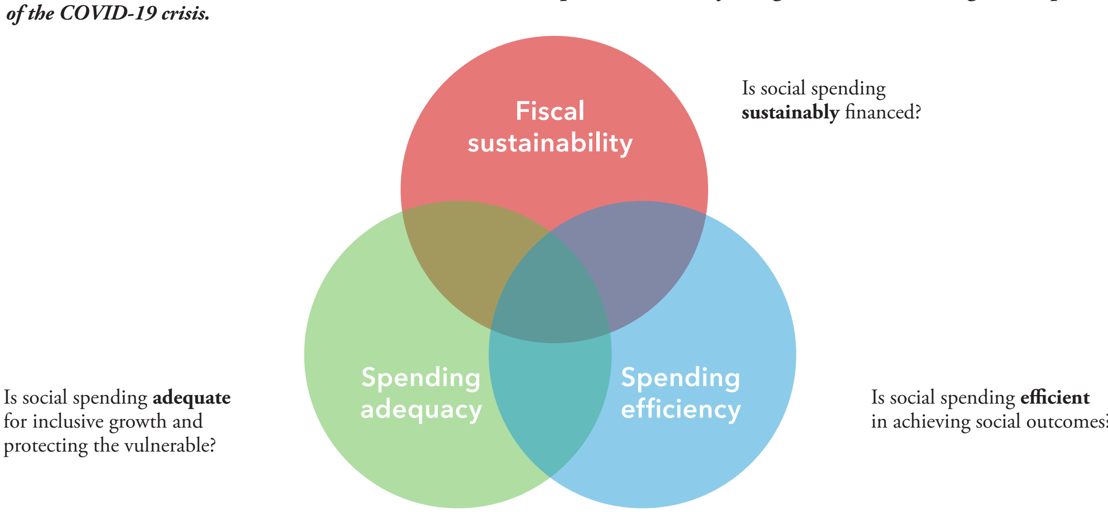


Figure 2. Macro-Criticality Channels of Social Spending

Engagement should be guided by an assessment of the macro-criticality of a specific social spending issue in surveillance and consideration of that issue in a program context, as well as by the existence of in-house expertise. The channels through which social spending may be macro-critical can be grouped into three, often interrelated channels: ***spending adequacy, spending efficiency, and fiscal sustainability.*** A social spending issue can be macro-critical if one, or any combination, of these channels is a policy concern. At the same time, it is recognized that the IMF should avoid duplicating the efforts of IDIs that often have greater expertise in these areas. Assessment of macro-criticality often requires joint consideration of multiple channels and possible trade-offs. ***Although all three channels should be considered at all times, their relative importance will likely change over time and throughout the phases of the COVID-19 crisis.***



to output and debt levels, with significant distributional effects within countries. Many economies could require debt resolutions and/or adjustment programs that support employment, facilitate structural reallocation, and foster an inclusive and green recovery.

In all phases of the crisis, collaboration with development partners involved in health and social protection including the International Labour Organization (ILO), the United Nations Children's Fund (UNICEF), the World Health Organization (WHO), and the World Bank as well as civil society organizations should be sought where feasible to help inform the staff's assessment and complement in-house resources.[4] The IMF's Fiscal Affairs Department (FAD) is acting as a hub for strengthening collaboration with development partners both at the technical and country specific levels, and country teams should get in touch to get information on relevant counterparts. FAD also organized seminars with the World Bank on social protection measures implemented in response to the pandemic. Development partners often have greater expertise on sectoral issues or specific social spending schemes, which are crucial in estimating social spending gaps and designing policy responses. Such collaboration may be especially helpful in low-income countries, particularly those with limited administrative capacity and in fragile states.[5] The strengthening of social safety nets in these countries will take time and needs to be integrated with countries' medium-term fiscal frameworks and informed by country-specific social protection strategies.

Containment Phase

What is the IMF's assessment of the impact of COVID-19 during containment?

The crisis is unprecedented. By the end of 2020, 170 countries—almost 90 percent of the world—are projected to have lower per-capita income than in 2019. The global response has also been unprecedented, with more than US$13 trillion in economic stimulus and rescue packages announced as of end-June 2020.

The priority is to save lives . . . The immediate priority has been to increase health spending as needed to prevent or mitigate the propagation of the virus and treat those requiring medical assistance (see FAD note).[6] Beyond spending for direct medical needs, countries also need to provide resources to public health systems to implement non-pharmaceutical interventions, such as social distancing, school closures, border closures and lockdowns, which should help avoid overwhelming health systems and allow a timely return of economic activity.

. . . and livelihoods. Containment also requires scaling-up social protection (for example, for the elderly who are vulnerable, for workers who are unemployed, and for children who are food insecure and no longer receive school meals). Adequate and progressive social spending, as well as work and payroll incentives, mitigate the economic impact of the outbreak on firms and households (see FAD note).[7]

Why is social spending relevant during containment?

During containment, providing adequate social spending (including on critical medicine, food and other supplies) to protect the poor and vulnerable from the crisis is critical for macroeconomic stability and is a priority. Where adequate social protection is not in place, priority should be given to adequacy and expanding the number of beneficiaries, consistent with realistic financing possibilities.[8] Typically, given information and administrative constraints at this stage, ensuring coverage of affected households may require a trade-off in terms of efficiency (e.g., imperfect targeting). Improving adequacy and efficiency during the crisis may be particularly challenging in low-income countries, where administrative capacity is limited.

The scale of the response in most countries should be looked at in the context of fiscal sustainability (liquidity constraints and debt burdens as well as potential for further revenue mobilization) and administrative capacity. The interplay of social spending policies with other crisis-response and macroeconomic policies should also be considered, taking into account the need to support social stability.[9] Countries may face difficult trade-offs balancing the adequacy and fiscal sustainability of social spending —those with

[4]For a more in-depth discussion, see the section on "Country-Level Engagement with IDIs and Other Stakeholders" in A Strategy of IMF Engagement on Social Spending (IMF Policy Paper 19/016) as well as the related Background Paper on "Consultation with Third Parties: An Overview" (IMF Policy Paper 19/017).

[5]For fragile states, the Staff Guidance Note on the Fund's Engagement with Countries in Fragile Situations (2012) provides further resources on engagement with donors and on capacity development. See also How to Design Tax Policy in Fragile States (2019).

[6]For specific advice, see the note on "Managing the Impacts of the Coronavirus: Guidance on Health Spending Policies" included in the Fiscal Issues section of the IMF's Special Series on COVID-19.

[7]For specific advice on expenditure measures to mitigate the impact of the crisis during the containment phase, see FAD note on "Expenditure Policies in Support of Firms and Households" included in the Fiscal Issues section of the IMF's Special Series on COVID-19.

[8]Country teams should engage on social spending in countries implementing the Debt Service Suspension Initiative, since borrowers commit to use freed-up resources to increase social and health spending in response to the crisis.

[9]For example, coordination of state assistance to households and firms could be important, since support for firms may reduce the need for social assistance (e.g., financial assistance to firms may be conditional on maintaining employment, or ensuring severance payments are fulfilled, or providing healthcare through the employer).

limited fiscal space would need to explore alternative financing options (such as spending reallocation, international assistance/concessional financing). At the same time, due to nature and scale of the crisis it can often be difficult to correctly gauge the appropriate magnitude of policy responses and spending gaps and periodic reassessment may be necessary.

How are teams addressing social spending in the context of IMF financing arrangements?

- Emergency financing arrangements (Rapid Financing Instrument [RFI] and Rapid Credit Facility [RCF]) provide rapid financial assistance to member countries facing an urgent balance of payments need without engaging in a full-fledged economic program (and related conditionality). To meet large and urgent COVID-19-related financing needs, access limits under the regular window of the RFI and the exogenous shocks window of the RCF were temporarily doubled through at least October 2020 and the annual access for resources in the General Resources Account and under the Poverty Reduction and Growth Trust arrangements was increased through April 2021.[10]
- In response to the pandemic, the IMF also reformed the Catastrophe Containment and Relief Trust (CCRT) in April 2020. The CCRT provides grants to the IMF's poorest and most vulnerable members to cover their IMF debt obligations for an initial phase of six months to help them channel more of their scarce financial resources toward vital emergency medical and other relief efforts. Fundraising is ongoing so that the IMF can extend the duration of grant-based debt relief to the most vulnerable member countries for up to two years.
- In some cases, it has been deemed more appropriate to augment an existing UCT-quality program or start a new one under the containment phase of the COVID-19 crisis because: (i) financing needs exceed emergency financing (RFI/RCT) access limits; (ii) a UCT-quality program is already in place and on-track, so access can be swiftly augmented; or (iii) a UCT-quality program is in place and program design or phasing can be adjusted to meet financing needs.
- Both emergency financing and UCT-quality program requests require staff to prepare a baseline scenario for the macroeconomic framework.[11] During the containment phase, preparing a realistic baseline scenario typically requires an assessment of the social spending needs related to the COVID-19 response, particularly in the areas of health and social protection. Assessments should be prepared in consultation with the authorities and IDIs with expertise in the field, drawing on technical assistance, where possible.

  Teams may find it useful to ask questions such as:

- *What are the social spending needs and what measures have been taken so far?* Where possible, teams should work with the authorities to undertake an assessment of social spending needs and the policy measures required to meet those needs. Collaboration with development partners can be very helpful in this context as well.[12] How much are these policy measures projected to cost in addition to the pre-crisis budget allocation (e.g., a bottom-up approach)? What additional measures are under consideration and how much additional social spending (health services, public health, social protection) is needed for crisis containment? How is the social protection spending distributed between support for families, support for workers, and support for firms, and what are the tradeoffs and synergies?[13]
- *How will social spending needs be sustainably financed?* How much is available from external sources of financing, including the IMF, multilateral and regional development banks, and bilateral donors? Is additional external financing the result of reallocating donor priorities and is it temporary or permanent? How much is available from domestic sources of financing, such as drawdown of government deposits and domestic bond issuance, as well as through expenditure reallocation (such as

[10] See Enhancing the Emergency Financing Toolkit—Responding To The COVID-19 Pandemic and Temporary Modification to the Fund's Annual Access Limits.

[11] Similar assessments may be useful in the context of surveillance as well.

[12] For example, recent RCF/RFI requests have reflected ongoing work by the World Bank and other IDIs to design relief packages to address food insecurity during the COVID-19 crisis (Afghanistan), to expand coverage of social assistance registries (Ecuador), to expand coverage and finance cash transfers schemes (Mauritania), and to estimate social spending gaps (Madagascar).

[13] Special Series on COVID-19 FAD note on "Expenditure Policies in Support of Firms and Households" provides some considerations in this regard.

reprioritizing and putting on hold public investment projects, and cuts in non-priority spending)?

- *What actions are needed to ensure fiscal transparency, public accountability, and institutional legitimacy of social spending measures?* The scale and urgency of policy responses during the containment phase necessitates attention to good governance in design, implementation, and oversight of measures (see related FAD note).[14] Procurement of goods and services in the health sector and cash transfers or provision of basic goods to households are among the areas of social spending most likely to be scaled-up during the containment phase that may also be susceptible to corruption or misuse.[15]
- *What is the estimated impact of additional spending on debt and fiscal sustainability?* While some measures taken during the containment phase will be temporary (purchases of personal protective equipment for essential workers, costs related to border closures, and testing and contact tracing to name a few), others will likely be more durable (additional health care capacity, social assistance to poor and vulnerable households, and/or extended unemployment benefits eligibility). While some of the temporary measures may need to extend beyond the containment phase, it would be useful to identify which expenditures are one-off and which measures may have sunset clauses.

What are the key elements that should be included in discussions of social spending in IMF program documents?

- The IMF team's assessment of the COVID-19 social spending needs should be reflected in the staff report (SR) and other program documents (memorandum of economic and financial policies [MEFP], letter of intent [LOI], and technical memorandum of understanding [TMU]) although the prominence and detail of the discussion will vary with country-specific circumstances.
- *Emergency financing* (RFI/RCF). Although these financing tools do not envisage ex-post conditionality, where social spending is deemed to be macro-critical the SR should report on: (i) the staff's assessment of social spending needs; (ii) social spending-related policy measures; and (iii) the estimated fiscal impact of these policy measures and sources of financing. In the LOI, the authorities should explain how they intend to address the crisis to ensure that resources are directed to those most in need and are not lost to corruption. For RCFs, the authorities should also specify what policies they will undertake to protect the vulnerable. As appropriate, this should also be considered in RFIs.
- *IMF-supported programs* (Extended Fund Facility [EFF], Extended Credit Facility [ECF], Stand-By Arrangement [SBA], and Stand-By Credit Facility [SCF]).[16] If emergency financing is provided in the form of an augmentation of an existing program or in the context of a new, full-fledged program, fiscal targets can be adjusted by the amount of additional social spending needed to respond to the coronavirus pandemic. The additional spending can also be met through reprioritization, particularly when there are binding capacity constraints or a need to safeguard the efficient use of scarce public resources. In addition to the items noted in the previous bullet, the SR should also report on contingency plans in the event of higher spending needs or domestic or external financing shortfalls. Where social spending is deemed critical for program success, a more careful assessment of the channels of macro-criticality and related discussion in the program documents (SR/MEFP/LOI/TMU) is warranted and conditionality could be considered. Indicative targets (ITs) on social spending can be (re)calibrated to include additional COVID-19 social spending needs. Reprioritizing within the existing social spending envelope could also be considered, particularly where there are binding capacity constraints or a need to safeguard the efficient use of scarce public resources.

    ○ ***Example of heath care sector adequacy concerns.*** In the SR, staff should: (i) assess whether heath

[14]Special Series on COVID-19 FAD note on "Keeping the Receipts: Transparency, Accountability, and Legitimacy in Emergency Responses" provides guidance and best public financial management (PFM) practices, drawing on cross-country examples.

[15]Authorities have typically provided commitments to reorient available resources toward crisis-mitigation efforts, such as healthcare and income support for affected households and firms. To reduce the risk of corruption, they often provided commitments to: (i) undertake and later publish an independent ex-post audit of crisis-related spending; and (ii) publish crisis-related procurement contracts, including the names of the contracted companies and their owners, as well as recording ex-post validation of delivery.

[16]This also applies to non-financing monitoring arrangements (Policy Support Instrument [PSI], Policy Coordination Instrument [PCI], and Staff Monitored Program [SMP]).

care services are adequate to curb the spread of COVID-19 and to provide medical attention to those infected, based on authorities' own assessments or those of international institutions with expertise in the field; (ii) report on the estimated additional fiscal cost of the authorities' proposed measures to scale up health spending to meet COVID-19 needs; and (iii) name the financing sources (e.g., the World Bank, bilateral donors, WHO, UNICEF) and explain the associated impact on fiscal and debt sustainability. The program documents could, in turn, contain commitments on hiring of additional personnel and the timely purchase of personal protective equipment and measures to strengthen the transparency of health spending (Honduras and Ukraine; see IMF Policy Tracker).

- ***Example of social assistance transfer adequacy concerns.*** In the SR, staff should: (i) attempt to determine whether social assistance spending is adequate (e.g., transfers as a share of the average income of a household in the poorest quintile) or whether coverage is low (e.g., share of households in the poorest quintile covered by transfers); (ii) report on planned measures to quickly increase adequacy and coverage, such as increasing payment amounts and enrolling new beneficiaries; and (iii) explain how additional costs will be financed or time-bound to ensure fiscal sustainability. The MEFP/LOI/TMU could commit to time-bound targets for increased enrollment of beneficiaries (Benin), increases in the cash transfer amount, measures to ensure transparency, and/or periodic review of programs during the crisis to recalibrate and prioritize social protection spending (see IMF Policy Tracker).

Stabilization Phase

Why is social spending relevant during stabilization?

- During stabilization, macroeconomic stability will likely require continued emphasis on providing adequate social spending and ensuring that social spending needs are met for as many poor and vulnerable households as feasible until the recovery in most cases. Fiscal sustainability is likely to become a more prominent concern, since financing constraints or debt sustainability concerns may limit the scope for policy responses at this stage. In most countries, it would also be appropriate to increase the focus on efficiency and evaluate the policy responses deployed at the outset of the crisis and adjust as needed. Trade-offs involving targeting of policy responses need to be carefully managed (see related FAD notes and background paper).[17]
- *Health sector.* During the stabilization phase, country teams may need to begin considering the transition of the healthcare system to its new normal. In many countries, the COVID-19 crisis uncovered weaknesses in healthcare systems, identified spending needs in the health sector, and underscored the urgency of reforms. In some cases, this has already led to the design of health sector reform programs that seek to bolster pandemic response capabilities in collaboration with the WHO and other stakeholders (e.g. Central Africa Republic, Chad, and Hong Kong SAR, see IMF Policy Tracker). In other cases, there may be a need to consider at this stage whether the increase in health spending should be recalibrated, including adequate funding in primary care centers (e.g., for COVID survivors and routine health services) and away from hospitals (as the number of hospitalizations declines). Country teams should ask whether: (i) the planned reforms will help achieve an adequate healthcare system for the eventual new, post-COVID normal; (ii) planned reforms are appropriately costed and are fiscally sustainable; and (iii) if there is scope for making health spending more efficient. Answers to these questions should be based on discussions with the authorities, IDIs.
- *Social protection.* During the stabilization phase, countries may seek to expand or adjust their social protection measures to make the policy response more effective and to incorporate lessons learned in the containment phase. In some cases, the focus may involve continued improvements in adequacy, through the expansion of coverage of social assistance and/or eligibility of unemployment benefits (Dominican Republic, Finland, and Peru; see IMF Policy Tracker) often

[17] Special Series on COVID-19 FAD note on "Managing the Impact on Households: Assessing Universal Transfers" discusses trade-offs involved in targeting and "Expenditure Policies in Support of Firms and Households" and "Background Paper IV: The Debate Between Universal and Targeted Transfers" of the Strategy for IMF Engagement on Social Spending.

to include groups that are normally not covered but are especially affected by the current crisis, such as informal workers.[18] At this stage, countries may also begin to assess the medium-term affordability of the crisis response measures (fiscal sustainability). They may also focus spending on those measures that are deemed most impactful or adjust eligibility criteria based on the evolving situation or to ensure economic incentives of beneficiaries are not distorted (spending efficiency). Collaboration with IDIs and other stakeholders during the stabilization phase would also help ensure that during the recovery, measures to strengthen social safety nets build on COVID-19-related measures.

How should teams assess social spending in the context of surveillance and IMF financing arrangements?

- IMF teams should take stock of the lessons from the containment phase and calibrate the discussion of social spending needs and issues accordingly. As countries move beyond the initial request for emergency assistance during the containment phase, they may look to augmenting an existing program or requesting a new IMF-supported program. Capacity development may be important at this stage for countries with weaker administrative capacity.
- Social spending related to the ongoing COVID-19 response will likely need to be reassessed before being incorporated into the baseline scenario of the macroeconomic framework. Discussions about social spending needs will likely begin to shift focus to the building blocks that will be needed for the recovery phase. Macroeconomic frameworks should integrate with individual country circumstances such as the severity of the impact, the epidemiological curve, and the authorities' capacity to implement social spending measures. In revisiting their assessments, country teams may want to probe further on key issues and revisit earlier estimates:
- What are the social spending needs, what measures have been taken so far and what measures are needed going forward? What are additional budget resources required to fill critical gaps during the stabilization phase? Is further expansion of social programs (i.e., unemployment benefits, direct transfers) or health care capacity (e.g., new labs, additional personnel training) envisaged and still needed to ensure adequacy? Are there some expenditure or social spending programs that are set to wind down, and others that should be ramped up, and what would be the appropriate pace? For example, as the pandemic curves flatten, health care priorities may shift from the need to increase intensive care unit (ICU) capacity to expanding testing and contact tracing and rebuilding stocks of medical supplies.
- Are the near- and medium-term spending needs financed in a sustainable way? Does crisis-related spending need re-prioritization, including to create space for economic stimulus measures? What is the impact on fiscal targets or rules (if any) and debt sustainability? For program countries, how much is available from external sources of financing to supplement the resources of the envisaged IMF-supported program?
- What capacity weaknesses have been exposed by the COVID-19 crisis? Is there a public financing management (PFM) system that ensures efficient and transparent procurement? Are addressing these areas of weakness, or at least selected areas of weaknesses, macro-critical or critical to program success?

What policies and reforms can mitigate the adverse distributional impact of the crisis?

- There is growing concern that the COVID-19 crisis, like past pandemics, will have adverse distributional impacts. Recent IMF work suggests that "major epidemics in this century have raised income inequality and hurt employment prospects of those with only a basic education while scarcely affecting employment of people with advanced degrees".[19] This heightens the importance of getting social spending policies right to mitigate the adverse distributional impact on the crisis. In addition, any spending conducive to promoting inclusive growth that was crowded out by COVID-related spending should be gradually restored.
- Distributional impact analysis can be helpful to understand the potential impact of the crisis and policy responses on inequality during the stabilization phase (see "How To Operationalize Inequality

[18]See Reaching Households in Emerging and Developing Economies: Citizen ID, Socioeconomic Data, and Digital Delivery (in IMF's Special Series on COVID-19).

[19]See IMFBlog by Furceri, Loungani and Ostry, 2020 for a summary of how pandemics leave the poor further behind.

Issues in Country Work"). Collaboration with IDIs and other stakeholders, especially the World Bank, may also be helpful in this area.

What are the key elements that should be included in discussions of social spending in IMF program documents, and how should program design and conditionality address social spending issues?

- *Assessment.* The assessment of ongoing COVID-19 social spending needs during the stabilization phase should be reflected in the SR and other program documents (MEFP/LOI/TMU). The prominence and detail of the discussion will vary with country-specific circumstances.
- *Coverage.* Most likely, the coverage of social spending issues in program design will focus on measures that will support macroeconomic stability, whereas coverage of medium-term reforms of the health care sector and social safety net may be less prominent. In any case, the focus should be consistent with the type of lending arrangement (e.g., short-term SBA/SCF versus three-year EFF/ECF) and with existing guidance on keeping conditionality parsimonious and centered on measures critical to program success.
- *Quantitative conditionality.* Where deemed critical for program success, quantitative targets (performance criteria [PC] or IT floors) on social spending could be included in program conditionality. These should be consistent with the fiscal targets in the program and be built (from the bottom-up) on realistic estimates of ongoing social spending needs, including social spending related to the COVID-19 crisis. Country teams will need to clearly define social spending as it relates to quantitative targets and identify which expenditures are COVID-19 related. Since there may still be significant uncertainty about the trajectory of the pandemic, a clear description of measures and costing under both a baseline and an adverse scenario would be useful. These scenarios should also be mindful of the positive impact of social spending on growth, via potentially high fiscal multipliers. Country teams should also be mindful that it may be necessary to reprioritize within the overall social spending envelope, for example by postponing capital improvement projects in hospitals and diverting funding to immediate needs in the health sector.
- *Financing.* If social spending is expected to remain elevated for a prolonged period due to higher spending needs in health and social protection, program documents should explain how additional spending will be financed. If, conversely, social spending is expected to taper during the stabilization phase, program projections should be calibrated to reflect the pace of retrenchment and describe financing plans. Financing sources need to be carefully considered to ensure fiscal sustainability. If the social spending response is reliant on external financing sources, documents should discuss contingency plans in the event external financing (such as donor budget support) falls short. Any off-budget spending, including donor-financed spending, should be discussed in program documents.
- *Structural conditionality.* Structural measures to close gaps in the health care sector and in the social safety net may be time-sensitive and deemed critical to program success. These could include implementation of policy commitments made under an RFI/RCF during the containment phase to strengthen governance of social spending related to the COVID-19 response. If program objectives are limited to short-term macroeconomic stabilization, and/or capacity does not allow implementation of the intended reforms, it would be useful to discuss with the authorities (as well as IDIs and other stakeholders) the appropriate sequencing for a medium-term reform agenda that would address identified, macro-critical gaps in social spending adequacy and efficiency. This can be particularly relevant for low-income countries and fragile states.
- *Transparency, accountability, and legitimacy* of emergency responses will continue to be important during the stabilization phase. Specifically, this phase may provide an opportunity to conduct more thorough oversight, and to adjust policy measures to increase efficiency (see FAD note).[20]

[20]Special Series on COVID-19 FAD note on "Keeping the Receipts: Transparency, Accountability, and Legitimacy in Emergency Responses" provides guidance and best PFM practices, drawing on cross-country examples.

Recovery Phase

Why is social spending macro-relevant?

- In most countries social spending will most likely be deemed macro-critical through the fiscal sustainability and spending efficiency channels. As the costs of ramping up health and social protection spending during the COVID-19 crisis mount, fiscal constraints may become more binding as debt sustainability needs to be tackled. Countries may also wish to create more fiscal space for measures to support and accelerate the economic recovery, including through gains in spending efficiency. At this stage, country teams should take a medium-term view of social spending policies, with a focus on those that will (i) continue to support poor and vulnerable households throughout the recovery; and (ii) provide adequate health services until a vaccine or effective treatments to combat COVID-19 are identified. At this stage, consideration of targeting policy responses to poor and vulnerable households, or sectors most affected by the pandemic, may also be appropriate (see related FAD notes[21] and Background Paper IV in Strategy for IMF Engagement on Social Spending.[22]
  - o *Health sector.* Countries might seek to significantly scale back spending on health services during the recovery phase, although it may still need stay above pre-crisis levels. Funding for public crisis response health measures and overtime pay for medical workers may no longer be required. Country teams could ask: (i) what is the appropriate new normal for health spending and is it fiscally sustainable, based on the lessons learned from this pandemic and advice from the WHO and other stakeholders; and (ii) is there scope for improving health outcomes through more efficient spending in a post-COVID environment?
  - o *Social protection. A*s the job market recovers, spending on means-tested social assistance and unemployment insurance will decline automatically. Countries may also wish to scale back structural changes (e.g., eligibility) to unemployment benefits and other direct transfers introduced during earlier phases of the pandemic with an eye to preserving fiscal sustainability. In some cases, political economy constraints may make this process difficult. Country teams could also assess the effectiveness and efficiency of those measures in the context of social objectives and discuss the appropriate timeline for phasing out those that will not drive better social outcomes during the recovery. Conversely, the recovery may be a time to consider introducing alternative social spending measures that can minimize the long-term scarring effects of the crisis. For example, additional spending on active labor market policies may be warranted to get low-skilled workers back into the labor force.
  - o *Education.* Education budgets may also need to be bolstered to make up for any learning loss during the lockdown period. Learning interruptions during the lockdown will inevitably impact student achievement during the recovery. It is likely that the impact will be both large and unequally distributed, with students from poor and vulnerable households suffering the highest learning loss.

How should teams engage on social spending during the recovery?

Engagement during the recovery phase—when the uncertainty has diminished—may resemble previous engagement in countries following economic crisis and macroeconomic stabilization. Discussions with the authorities should center around a well-articulated pandemic recovery plan, which could include reforms to strengthen social spending systems for the longer term by improving identification and delivery systems. Collaboration with IDIs or IMF technical assistance could ensure that the plan meets the country's needs and enhances resilience to health risks, including through macro-critical preparedness measures. Country teams should refer to the Strategy for IMF Engagement on Social Spending for how and when to engage on social spending in both surveillance and program cases.

[21] Special Series on COVID-19 FAD notes on "Managing the Impact on Households: Assessing Universal Transfers" and "Expenditure Policies in Support of Firms and Households".

[22] "The Debate on Universal and Targeted Transfers," in Strategy for IMF Engagement on Social Spending –Background Papers (IMF Policy Paper No. 19/017)..

Annex I. Focus and Program Engagement on Social Spending during and in the Aftermath of the COVID-19 Crisis

	Focus	Program Engagement
Containment	Priority is to save lives and livelihoods • Social spending **critical for macroeconomic stability** • Immediate priority is to **scale up health and social protection** • Measures to provide **adequate** social spending to protect the poor and vulnerable and expand number of beneficiaries • Possible **efficiency** tradeoff (imperfect targeting due to urgency) • Advice should be consistent with **realistic financing** possibilities	<u>RCF/RFI</u>: • Social spending needs can widen fiscal/BOP gaps • No ex-post conditionality • Assessment of social spending: quantify needs, assess policy measures and fiscal impact, identify sources of financing, ensure governance and sustainability <u>EFF/ECF/SBA/SCF</u>: • As in RCF/RFI • Also need contingency plans in case of higher social spending or external financing shortfalls; social spending conditionality possible <u>All:</u> Reflect in PN, SR, MEFP/LOI/TMU – with varying detail as needed
Stabilization	Priority is to continue supporting poor and vulnerable households, mitigate the distributional impact of crisis, while being mindful of fiscal sustainability • **Draw lessons** from containment phase and **recalibrate** the focus of social programs to **make policy response more effective** • Continued emphasis on providing **adequate** social spending and ensuring coverage of poor and vulnerable households • Increased focus on **efficiency** and transition to new normal (health) • Mindful of **sustainability of financing** to meet social spending needs through the end of the crisis	<u>EFF/ECF/SBA/SCF, including new program requests or augmentations:</u> • Take stock of lessons from the containment phase • Shift focus to building blocks for the recovery phase • Assess social spending needs, measures taken so far and future measures needed, sustainability of financing, capacity, governance; • Quantitative and structural conditionality if critical for program success • Reflect in PN, SR, MEFP/LOI/TMU – with depth of coverage reflecting country-specific circumstances
Recovery	Priority is to provide support to the poor and vulnerable through the recovery • Focus on **sustaining support for health and social protection** in the new normal **(medium-term perspective)** • Consider social spending **measures to accelerate the recovery** (ALMPs, education) • Focus on **fiscal sustainability** and **efficiency** channels of macro-criticality… • …though **adequacy** still needs to be assessed • Consider **targeting**, if appropriate	<u>EFF/ECF/SBA/SCF:</u> • Social spending integrated into well-articulated pandemic recovery plan in baseline • Discussions with authorities should take a medium-term view emphasis on sustaining support and accelerating the recovery • Quantitative and structural conditionality if critical for program success • Reflect in PN, SR, MEFP/LOI/TMU – with analysis and depth reflecting country circumstances

References

A Strategy for IMF Engagement in Social Spending (IMF Policy Paper No. 19/016 and SU/19/66).

The Debate Between Universal and Targeted Transfers (Background Paper IV in A Strategy for IMF Engagement in Social Spending: Background Papers, IMF Policy Paper No. 19/016).

Furceri, Loungani and Ostry, 2020. IMFBlog on "How Pandemics Leave the Poor Even Further Behind."

Lending Strategy during the Pandemic and Beyond (FO/DIS/20/141).

IMF Special Series on COVID-19 – Fiscal Issues:

- Expenditure Policies in Support of Firms and Households
- Keeping the Receipts: Transparency, Accountability, and Legitimacy in Emergency Responses
- Managing the Impacts of the Coronavirus: Guidance on Health Spending Policies
- Managing the Impact on Households: Assessing Universal Transfers
- Reaching Households in Emerging and Developing Economies: Citizen ID, Socioeconomic Data, and Digital Delivery