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August 21, 1995

To: Members of the Committee of the Whole
for the Development Committee

From: The Secretary

Subject: Implications of the Social Summit for the World Bank and the
International Monetary Fund

Attached for consideration by the Committee of the Whole is an issues paper on "Implications of the Social Summit for the World Bank and the International Monetary Fund," prepared jointly by the Bank and Fund staff, which is tentatively scheduled for discussion by the Committee of the Whole on Wednesday, September 6, 1995, in preparation for the Development Committee meeting on Monday, October 9, 1995.

Consistent with earlier discussions of changes in the arrangements for the Development Committee, and the August 2, 1995 memorandum to Executive Directors on "Development Committee - Topics for Paper on Implications of the Social Summit for the World Bank and the Fund," this paper has been kept short and issue oriented. The Committee of the Whole discussion is intended to help focus and further sharpen the issues to prepare the group for ministerial consideration. The paper will be revised after the Committee meeting to reflect discussions in both the Bank and Fund Boards.

Ms. Christensen (ext. 38397) or Mr. Chu (ext. 38349) is available to answer technical or factual questions relating to this paper prior to the Committee meeting.

Att: (1)

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Development Committee
October 9, 1995

Implications of the Social Summit for the World Bank and the International Monetary Fund

(Prepared jointly by the staffs of the World Bank and the International Monetary Fund)

I. Introduction

1. At its April 27, 1995 meeting, the Development Committee agreed to discuss at its next meeting the implications of the recent Social Summit in Copenhagen for the developing and transition countries, and for the Bank and Fund and donors. This paper is intended to provide a basis for discussion on this topic by Committee Members on October 9, 1995.
2. The Summit had three main themes: poverty reduction, employment generation, and social integration. Each of these topics would merit many hours of discussion, but the length of Committee sessions will not permit this. Thus, we propose to focus on one major aspect of the Summit conclusions which raises particularly difficult issues of special concern to Members of this Committee – specifically, the link between public expenditures and poverty reduction and the implications for resource transfers.
3. Other important aspects of the Summit Declaration and Program of Action will be taken up in other fora. To facilitate this, a number of implications for the Bretton Woods institutions and actions underway to respond to these are set out - in matrix form - in the annex to this paper.

II. The Role of Public Expenditure in Poverty Reduction

4. There is a global consensus on the importance of poverty reduction as the major goal of sustainable development. Signatories to the Social Summit Declaration and Program of Action committed themselves to the goal of “substantially reducing overall poverty ... and eradicat[ing] absolute poverty ...”. This broad commitment raises a number of interrelated issues for developing and transition countries, the Bank and the Fund, as well as for donors. For developing countries which need and seek external assistance, three key issues are: (a) how to demonstrate with concrete policy measures their commitment to the goal of reducing poverty; (b) how to measure and monitor performance; and (c) how to enhance the effectiveness of poverty reduction efforts. For the Bank and the Fund, as well as for donors, a fundamental concern is how best to encourage and support the efforts of developing countries to reduce poverty – the ultimate goal being the achievement of tangible results on the ground.

5. Public expenditures play a crucial role in reducing poverty. Sound public expenditure policies are important for achieving and maintaining macroeconomic stability and ensuring the efficient allocation of resources which are the foundation of sustainable economic growth and poverty reduction. Besides that, public expenditures are essential for human and physical capital formation and for providing income support for the poor. In recognition of this, the signatories to the Social Summit Declaration and Program of Action committed themselves to "increase significantly and/or utilize more efficiently the resources allocated for social development."

6. The Bank and the Fund work closely with borrower governments on public expenditure issues; the former, mainly through public expenditure reviews, and the latter, usually in the context of surveillance but also through the economic and financial programs that it supports. On June 27, 1995, the President of the Bank and the Managing Director of the Fund issued a guidance note designed to strengthen collaboration between their staffs on public expenditure issues. The focus of staff work will be on a number of technical questions, including how to improve public expenditure reviews and how to take better account of issues of public expenditure composition in stabilization and adjustment programs.

7. The issues discussed in the next section, and the questions posed there, center on the public expenditure reviews which are carried out from time to time by the Bank, and related issues. The reviews are intended to help governments restructure public expenditures. Many governments, however, continue to spend excessively on programs which benefit mostly the better-off members of society, on less productive sectors, such as state-owned enterprises, and on non-developmental activities, including the military. But just as developing countries should move away from unproductive expenditures, so too, donor governments have a responsibility to avoid funding low-priority investments (including military equipment). The message from the Social Summit, supported by 117 heads of state and government, is that this must change if more widespread poverty reduction is to become a reality.

8. Linking public expenditure policies more closely with the goal of poverty reduction has important implications for borrower governments, as well as for the Bank and the Fund. Most governments need to shift resources increasingly towards programs of greater benefit to the poor; that is, basic social services and essential economic infrastructure. Public expenditure reviews must have this as their major objective. Moreover, governments need to focus more on labor market issues. For its part, the Bank needs to work with member governments to: (a) improve the quality of public expenditure reviews, especially by analyzing the extent to which public expenditures in a given country favor the poor rather than the rich; (b) carry out more public expenditure reviews, as and when needed, to facilitate the restructuring of government budgets; and (c) strengthen the cooperative character of these reviews by involving the Fund and donors more closely in the process. At the same time, the Fund will need to (a) enhance its surveillance to assess more systematically the cost-effectiveness and fiscal sustainability of social policy options; and (b) pay increased attention to the impact on

poverty and employment of adjustment measures in Fund-supported programs, and options for cost-effective social safety nets. Both institutions will need to assist member governments in building up institutional capacity to implement these policies.

9. Public expenditure reviews form an essential building block for restructuring government budgets, but taken in isolation they do not provide a full and accurate picture of country performance and commitment to a sound poverty reduction strategy. Thus, poverty assessments/poverty analyses provide an important additional basis for preparation of country assistance strategies, policy reforms, and the design of development projects. Poverty assessments, which are usually based on household data, are designed to provide detailed analysis of poverty: who the poor are; where they live; what their sources of livelihood are; what types of social services they have access to, and so on. The insights provided by these studies are valuable not only for the purpose of monitoring the outcome of a country's poverty reduction efforts but also for designing more effective poverty reduction strategies and programs.

10. The fundamental question is whether or not borrower governments and donors, as well as the Bank and the Fund, are prepared to follow the recommendations that emerge from carefully conducted public expenditure reviews and associated poverty assessments.

III. Issues for Discussion

11. In preparation of country assistance strategies, a primary goal for the Bank is to focus on steps needed to help countries reduce poverty and improve living standards. The Fund contributes to this objective by fostering conditions for sustainable high-quality economic growth, which is necessary for poverty reduction over the medium term. Increasingly, the Bank expects governments to demonstrate their commitment to poverty reduction, *inter alia*, by channeling adequate resources into basic social and economic services (primary and secondary education, primary health care, safe drinking water and proper sanitation, rural roads, and so on) from which the poor stand to gain the most. Budgetary allocations must always be made within the context of a sustainable overall fiscal policy. The Bank and donors rely on the results of public expenditure reviews to assess a government's commitment to poverty reduction. Do ministers support this increased attention given to the composition of public expenditures as a measure of performance? Do ministers have suggestions for alternative and/or complementary tools for measuring commitment and performance with regard to poverty reduction?

12. In assessing the strength of a country's economic and financial program, the Fund pays special attention to fiscal adjustment, as well as to the implications of adjustment for the poor. While the primary focus is placed on aggregate fiscal measures, the Fund also stresses the importance of the quality of fiscal adjustment, including the composition and sustainability of government revenues and expenditures. In the context of surveillance, the Fund analyzes the fiscal and macroeconomic implications of social programs, including anti-poverty programs and social security arrangements, with emphasis on their

cost-effectiveness, longer-term sustainability, and consequences for the functioning of the labor market and unemployment. In view of the Social Summit's call for developing the poor's human capital and improving their access to productive assets, should the Fund in its surveillance and program discussions focus more on the composition of public expenditure, including health, education, and other social expenditure but relying in their work on the expertise of the Bank and other institutions?

13. Although countries have varied defense and security needs, signatories to the Social Summit Declaration and Program of Action undertook " ... to explore new ways of generating ... resources, *inter alia*, through the appropriate reduction of excessive military expenditures ...". This applies to global military expenditures, including arms production and trade. More generally, the Summit called for increased attention to the composition of public expenditures. In some countries, the level of military spending is either making increased social spending impossible, or is itself a cause of unsustainable fiscal deficits. Where this has been the case, a number of countries have shown a readiness to work with the Bank, the Fund, and donors to make appropriate changes in the composition of public expenditures so as to increase allocations for productive purposes. The level of military expenditures for a country is a matter which is typically based on security and political considerations and, as such, falls outside the mandates of the Bank and the Fund. However, these mandates include consideration of the effect of the overall level of public expenditures, including military expenditures, on a country's external obligations, and the adequacy of public expenditures for investments in social and economic development. It also covers analysis of the balance between development and non-development expenditures. The Bank and the Fund provide technical assistance, if requested by a government, in analyzing these issues. They also provide information to the international community. Increasingly, bilateral donors and creditors take into account, in their own lending decisions, a borrowing country's military expenditures as determined, *inter alia*, on the basis of this analysis. To what degree are donors and creditors prepared to avoid funding low-priority investments, including military equipment, in developing countries? What further role, if any, should the Bank and the Fund play in relation to the analysis of public expenditures for social and economic development as against non-productive spending, such as military expenditures?

14. In many borrower countries, the Bank is a major financier of the government budget -- through project lending, the local currency generated from balance of payments support and technical assistance. The Fund also provides balance of payments support and technical assistance. Other important external financiers are bilateral donors, the regional development banks, and UN agencies. The Bank and the Fund would be more effective when a coherent set of public expenditure priorities has been established by the country concerned. Enhanced collaboration with other agencies would help ensure that those priorities are widely shared by the donors. In the recent Halifax Communiqué, G-7 leaders urged the multilateral development banks to "cut sharply" funding for countries which do not show a commitment to poverty reduction. But often, donors do not themselves follow the recommendations of budget reviews. Are donors prepared, in their own bilateral programs, to adhere to the spending priorities that emerge from public

expenditure reviews? Are they prepared to focus additional resources on countries demonstrating commitment and performance, and to reduce resource allocations in countries persistently failing to meet agreed priorities?

15. Another way to support governments which demonstrate commitment to poverty reduction is for the Bank and donors to provide assistance within the framework of sector programs that support agreed strategies, rather than through uncoordinated project-by-project aid. The Bank is beginning to do this. Where governments have demonstrated the ability to set priorities effectively, are donor governments prepared to shift their aid more rapidly to agreed sectoral programs and away from donor-initiated project-by-project commitments?

Social Summit Action Matrix
Proposed Actions by the Bank

Issues	Proposed Actions
<p>1. Improving the quality of social sector spending. The Social Summit called for improving the efficiency, effectiveness, and equity of social sector spending.</p>	<p>The Bank will improve the quality of public expenditure reviews. In particular, it will carry out, subject to data availability, more detailed analysis of the extent to which public expenditures actually benefit the poor.</p>
<p>2. Increased spending on basic social services. The Summit called on governments and the international community to allocate more resources for basic social services.</p>	<p>Within an enlarged resource envelope for the social sectors, the Bank will maintain the trend of increased lending for primary education, girls' education, primary health care, and nutrition programs.</p>
<p>3. Poverty monitoring. As a follow-up to the Social Summit, governments and donors are expected to set up or improve existing mechanisms for poverty monitoring.</p>	<p>The Bank has initiated discussions with UNDP and UNICEF with a view to collaborating with these agencies on poverty monitoring at the country level, as well as the regional and global levels.</p>
<p>4. Structural adjustment and social sector spending. Given the importance attached to social sector spending in the fight against poverty, governments are expected to protect this spending from budget reductions during the implementation of adjustment programs.</p>	<p>Increasingly, Bank-supported structural adjustment programs include conditionality requiring the government to protect, or increase, social sector spending, especially on basic services.</p>
<p>5. Employment. The Summit called upon governments and the international community to promote development strategies and policies that foster employment creation and the reduction of unemployment.</p>	<p>Given the importance it attaches to labor incomes and conditions in poverty reduction, the Bank devoted the 1995 World Development Report (WDR) to the subject of Workers in an Integrating World. Drawing upon the analysis in this WDR, the Bank will pay greater attention to issues of labor policy and institutions in its operations.</p>
<p>6. Cooperation with other UN agencies. The follow-up to the Social Summit envisages increased collaboration between the Bank and other UN agencies.</p>	<p>The Bank will strengthen its collaboration with other UN agencies, particularly UNICEF, WHO, UNESCO and others whose activities are concentrated in the social sectors. The Bank will work more closely with other UN agencies to assist governments in designing national strategies for poverty reduction and elaborating expenditure policies in specific sectors.</p>

Social Summit Action Matrix
Proposed Actions by the IMF

Issues	Proposed Actions
<p>1. Surveillance. The Social Summit highlighted the need for monitoring countries' public spending on basic social services; and placed emphasis on employment creation.</p>	<p>Country consultations and economic reports will pay more attention to the composition of expenditure, especially expenditure on the social sectors, and on labor market policies, including labor market efficiency, measures to reduce unemployment, and the impact of social insurance programs on the labor market.</p>
<p>2. Program design. The Social Summit called for incorporating adequate social safety nets in adjustment programs to complement poverty reduction, and for promoting basic social expenditures.</p>	<p>The design of adjustment programs will pay more attention to the implementation of cost-effective social safety nets and to reallocation of public expenditures to better meet the needs of poor and vulnerable groups.</p>
<p>3. Technical assistance. The Social Summit called for ensuring budgetary transparency and accountability in the use of public resources, increasing the quality and effectiveness of social expenditures, and expanding revenues.</p>	<p>The Fund's technical assistance will continue to focus on helping countries to achieve greater budgetary transparency, build institutional capacity to set and implement expenditure priorities, analyze the macroeconomic and budgetary implications of social and poverty programs, and raise revenues in an efficient and nondistortionary manner.</p>
<p>4. Strengthened analysis of social sector spending. The restructuring of public expenditure towards the social sectors requires detailed analysis of the composition of expenditure.</p>	<p>The Fund will rely more on the Bank for information, analysis, and policy options regarding social sector spending and will participate more fully in the public expenditure review process. The recent guidance note on public expenditure issued by the Bank's President and the Fund's Managing Director will facilitate this process.</p>
<p>5. Collaboration with UN agencies. The Social Summit called for increased cooperation between Bretton Woods institutions and the UN agencies in the field of social development.</p>	<p>The IMF will strengthen collaboration with other UN agencies at the country level to seek to ensure that social sector programs, as well as Country Strategy Notes prepared by the UN, are consistent with a sustainable macroeconomic framework.</p>

