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July 16, 1985

To: Members of the Executive Board

From: The Secretary

Subject: Executive Board Seminar of July 19

With reference to the forthcoming Executive Board Seminar, there is attached a staff note to guide the discussion of the paper on "Fund-Supported Programs, Fiscal Policy, and the Distribution of Income" (SM/85/113, 4/25/85). Also attached is an updating of the tables in SM/85/113 relating to the survey of Fund-supported adjustment programs to include all 1984 programs.

With regard to the paper on "Global Effects of Fund-Supported Adjustment Programs," attention is drawn to the conclusions of that paper which are to be found on pages 85 through 89 of SM/85/97 (4/4/85). Similarly, the conclusions of the paper on "The Effects of Fund-Supported Adjustment Programs on Economic Growth: A Survey of the Empirical Literature," are to be found on pages 41 through 43 of SM/85/96 (4/4/85).

It is suggested that Executive Directors address the three papers in one statement.

Att: (2)

Other Distribution:
Department Heads

Guidance Note for Seminar Discussion of
"Fund-Supported Programs, Fiscal Policy, and
the Distribution of Income" (SM/85/113, 4/25/85)

In its role of providing temporary finance to help support economic adjustment, the Fund has often been criticized for promoting policies that allegedly make income distributions less even and that unduly reduce the living standard of the poor. This paper reviews the circumstances typically confronted by countries as they approach the Fund. It then examines 78 Fund-supported adjustment programs, undertaken from 1980 to early-1984, to speculate on their probable impact on income distribution. It concludes that the available evidence provides no basis for concluding that Fund-supported adjustment programs are more damaging to income distribution than practical alternatives. The emphasis of the paper is on fiscal policies, but the study begins with a brief review of monetary and external sector policies to determine the macroeconomic background against which to assess the fiscal issues. It then proceeds to a more detailed review of revenue and expenditure policies.

In regard to revenue, the study examines most major tax and nontax revenue sources, including personal and corporate income taxes, customs duties, taxes on goods and services, and fees and charges, to determine the likely effect of their changes on income. The study concludes that there is no general presumption that the types of tax measures most often associated with Fund-supported adjustment programs make domestic tax systems more regressive. It acknowledges, however, that it would be possible under Fund programs to introduce tax measures that could actually improve income distributions. It notes, nonetheless, that frequently these measures would require more time than is available and might be rejected by the authorities for various reasons.

With respect to expenditures, the paper observes that Fund-supported adjustment programs typically do not refer to outlays as categorized by a functional classification; rather, efforts to limit public expenditure have focused on major economic categories, such as the wage bill of the government, food and petroleum subsidies, investment programs, and transfers to public enterprises. The study concludes that the policies followed under Fund-supported programs typically improve resource allocation as they attempt to bring domestic prices closer in line with world prices. They also act to make expenditure more efficient by inducing the authorities to target subsidies to those who need them the most.

The general conclusion reached by the study, that Fund-supported adjustment programs are unlikely to worsen income distributions (when compared to any practical alternative), raises the question of why these programs have provoked criticism. The study concludes that there are probably two reasons for these reactions. The first is the overall compression in domestic consumption that the demand management aspects of programs frequently require. It is difficult for countries to accept a reduction in their standard of living under the best of circumstances,

no matter how necessary; and it is to limit this reduction that many countries seek Fund support during the adjustment process. Still, the fact that the Fund is involved makes people blame it for whatever reduction occurs. A second but perhaps no less important factor is the nature of the policies followed to redress years of poor economic management. Demand management problems often result from a gradual economic decline characterized by the establishment of inappropriate economic policies which benefit relatively small groups. The costs of these policies are by definition transferred to the population as a whole, and in the process the costs are spread so thinly that they do not excite public interest until the need for fiscal adjustment becomes acute. The reversal of these policies even in a phased manner thus adversely affects a limited group more than it benefits the general population. Moreover, the many factors that favored the adoption of these policies in the first place--which often relate to the political clout of the recipients--act to perpetuate them regardless of concerns about economic efficiency and equity. The interests of such groups as urban workers, public servants (including the military), and owners or controllers of protected industries, often do not coincide with those of the general public. The reaction to Fund-supported adjustment programs may thus be more directly related to the ability of certain groups to express their discontent than to the inequitable distribution of the burden of adjustment that is imposed.

Table 1. Monetary Policies Employed in Fund-Supported
Adjustment Programs

	Number of Programs	Percent
Limit on credit expansion:		
Ceilings on:	92	99
Net domestic assets or total bank credit	82	88
Bank credit to central government	50	54
Bank credit to public sector including NPE	35	38
Separate ceiling on bank credit to parastatals	6	6
Reduction in the rate of growth of liquidity	28	30
Interest rate reform	25	27
Adequate share of credit to private sector	22	24
Measures to mobilize domestic savings	51	55
Interest rate measures	37	40
Reform of the financial system	23	25
Other	18	19

Source: Appendix I.

Table 2. External Sector Policies Employed in
Fund-Supported Adjustment Programs

	Number of Programs	Percent
Liberalization and reform of exchange rate arrangement:	52	56
Frequently adjusted rates	49	53
Gradual merging or unification of exchange rate	19	20
Other	3	3
Target on net foreign assets	21	23

Source: Appendix I.

Table 3. Other Macroeconomic Policies Employed in Fund-Supported Adjustment Programs

	Number of Programs	Percent
Wages and Prices	83	89
Partial or general wage restraint <u>1/</u>	36	39
Wage guidelines or wage reform policies	43	46
Flexible pricing system	36	39
Reduction in price-cost distortions	30	32
Review or increase sector prices	32	34
Increases in energy prices	43	46
Review price control system	27	29
Structural adjustment measures	70	75
Development and restructuring of a sector	63	68
Shift of overall management	15	16
Shift of resource from public to private	27	29
Investment planning and execution procedures	35	38

Source: Appendix I.

1/ One policy measure in the opposite direction.

Table 4. Administrative Improvements and Direct Tax Policies
Employed in Fund-Supported Adjustment Programs

	Number of Programs	Percent
Improve or reform of tax administration	52	56
Personal income tax	43	46
Move from schedular to global <u>1/</u>	3	3
Reduction of personal income tax	7	8
Increase of surcharge in personal income tax	11	12
Income tax reform or extension	20	22
Increase in payroll tax or social security contributions	9	10
Collection of tax arrears	1	1
Corporate tax	32	34
Income tax surcharge	11	12
Collection of tax arrears	7	8
Shorten lag for corporate tax payment	6	6
Modification or reduction of income or profit tax	14	15
Tax on property	10	11
Introduce or raise land tax	5	5
Introduce or raise urban property tax	5	5
Other property tax	6	6

Source: Appendix I.

1/ In one country the reverse policy was undertaken.

Table 5. Indirect Tax Policies Employed in Fund-Supported
Adjustment Programs

	Number of Programs	Percent
Domestic tax on goods and services	69	74
Raise excise tax rates (alcohol, cigarettes, etc.)	48	52
Increase tax on petroleum	34	37
Raise or modify sales tax	23	25
Temporary selected tax reduction	3	3
Raise taxes on other domestic goods and services	13	14
Import duties	54	58
General or selected increases in customs duties	29	31
Increase of petroleum import duties	10	11
Reduction or elimination of selected import duties	4	4
Tariff reform (exemptions)	34	37
Import duty surcharge	6	6
Export duties	23	25
Increase in rates <u>1/</u>	7	8
Extension of coverage	6	6
Export compensation schemes	7	8
Others (reform/reduction)	7	8
Other tax and nontax	48	52
Tariffs, fees, and charges	46	49
Other	7	8

Source: Appendix I.

1/ In one country the reverse policy was undertaken.

Table 6. Expenditure Policies Relating to Functional Expenditure
in Fund-Supported Adjustment Programs

	Number of Programs	Percent
Restrictions on central government outlays		
General public service	4	4
Defense outlays	7	8
Education	4	4
Housing outlays	1	1
Level of economic service	1	1
Restrictions on general government outlays		
Current expenditure	2	2
Public sector wages and employment	3	3
Official travel	5	5
Materials and supplies	5	5
Purchase of vehicles	3	3
Other	1	1

Source: Appendix I.

Table 7. Expenditure Policies by Economic Type in
Fund-Supported Adjustment Programs

	Number of Programs	Percent
Restraint of central government current expenditure	86	92
Wages and salaries	59	63
Freezing or reduction of numbers of government employees	32	34
Freezing, reduction, of wage increase <u>1/</u>	38	41
Change in the employment policy	13	14
Limit on salary indexation <u>1/</u>	18	19
Goods and services	51	55
Improvement in overall expenditure controls	24	26
Cumulative monthly/quarterly restrictions on expenditures	12	13
Reduction on appropriation for specific expenditures	32	34
Capital expenditure and net lending <u>2/</u> <u>3/</u>	56	60
Curtailement of investment	43	46
In real terms	26	28
In nominal terms	15	16
Other	2	2
Limit or delay new investment or new projects	23	25
Improvement of investment program	20	22
Reduction in domestically financed investment	11	12
Expenditure administration	40	43
Improve expenditure control	39	42
Others (shift in budgetary priorities)	4	4

Source: Appendix I.

1/ In one case, a policy in the opposite direction was suggested.

2/ World Bank collaboration specifically mentioned in 21 cases.

3/ In eight cases (not included) the policy mentioned was in the opposite direction.

Table 10. External Debt Policies Employed in Fund-Supported Adjustment Programs

	Number of Programs	Percent
External debt policies	86	92
Control of level and maturity of external debt:	80	86
Public or publicly guaranteed	80	86
Private sector debt	20	22
Other debt management policies	55	59
Debt relief/rescheduling	35	38
Other	53	57

Source: Appendix I.

Table 11. Chronological List of Stand-by and Extended Arrangements
Approved in 1980-84 and Sample Coverage (underlined)

	1980	1981	1982	1983	1984
Argentina				<u>SBA</u>	<u>SBA</u>
Bangladesh 1/	EFF		<u>EFF</u>	<u>SBA</u>	
Barbados			<u>SBA</u>		<u>SBA</u>
Belize					<u>SBA</u>
Bolivia	<u>SBA</u>				
Brazil				<u>EFF</u>	
Burma		<u>SBA</u>			
Central African Republic	SBA*	<u>SBA</u>		SBA	SBA
Chile				<u>SBA</u>	
China		<u>SBA*</u>			
Costa Rica	SBA	<u>EFF</u>	<u>SBA</u>		
Cyprus	<u>SBA*</u>				
Dominica		<u>EFF</u>			<u>SBA</u>
Dominican Republic				EFF	
Ecuador				<u>SBA</u>	
El Salvador	SBA*		<u>SBA</u>		
Equatorial Guinea	<u>SBA</u>				
Ethiopia		<u>SBA</u>			
Gabon	<u>EFF</u>				
Gambia			<u>SBA</u>		<u>SBA</u>
Ghana				<u>SBA</u>	<u>SBA</u>
Grenada		<u>SBA</u>		<u>EFF</u>	
Guatemala		<u>SBA*</u>		<u>SBA</u>	
Guinea			<u>SBA</u>		
Guinea-Bissau					<u>SBA*</u>
Guyana	<u>EFF</u>				
Haiti			<u>SBA</u>	SBA	
Honduras			<u>SBA</u>		
Hungary			<u>SBA</u>		<u>SBA</u>
India 1/		<u>EFF</u>			
Ivory Coast		<u>EFF</u>			<u>SBA</u>
Jamaica		<u>EFF</u>			<u>SBA</u>
Kenya	<u>SBA</u>		SBA	<u>SBA</u>	
Korea	<u>SBA</u>	<u>SBA</u>		<u>SBA</u>	
Laos	<u>SBA</u>				
Liberia	<u>SBA</u>	SBA	<u>SBA</u>	<u>SBA</u>	SBA

Table 11. (continued) Chronological List of Stand-by and Extended Arrangements Approved in 1980-84 and Sample Coverage (underlined)

	1980	1981	1982	1983	1984
Madagascar	<u>SBA</u>	SBA	SBA	SBA	
Malawi <u>1/</u>	<u>SBA</u>		SBA	<u>EFF</u>	
Mali			<u>SBA</u>	SBA	
Mauritania	<u>SBA</u>	SBA			
Mauritius	<u>SBA</u>	SBA		SBA	
Mexico			<u>EFF</u>		
Morocco <u>1/</u>	EFF	<u>EFF</u>	<u>SBA</u>	SBA	
Niger				<u>SBA</u>	<u>SBA</u>
Pakistan <u>1/</u>	EFF	<u>EFF</u>			
Panama	<u>SBA</u>		SBA	SBA	
Peru			<u>EFF</u>		<u>SBA</u>
Philippines	<u>SBA</u>			<u>SBA</u>	<u>SBA</u>
Portugal				<u>SBA</u>	
Romania		<u>SBA</u>			
Senegal	EFF	<u>SBA</u>	SBA	<u>SBA</u>	
Sierra Leone <u>1/</u>		<u>EFF</u>			<u>SBA</u>
Solomon Islands		<u>SBA</u>		SBA	
Somalia	<u>SBA</u>	<u>SBA</u>	SBA		
South Africa			<u>SBA</u>		
Sri Lanka <u>1/</u> (1979 EFF)				SBA	
Sudan			<u>SBA</u>	SBA	<u>SBA</u>
Tanzania	<u>SBA</u>				
Thailand		<u>SBA</u>	<u>SBA</u>		
Togo		<u>SBA</u>		<u>SBA</u>	<u>SBA</u>
Turkey	<u>SBA</u>			<u>SBA</u>	<u>SBA</u>
Uganda	<u>SBA</u>	SBA	SBA	<u>SBA</u>	
Uruguay	<u>SBA*</u>	SBA		<u>SBA</u>	
Western Samoa				<u>SBA</u>	<u>SBA</u>
Yugoslavia	<u>SBA</u>	SBA			<u>SBA</u>
Zaire		EFF		<u>SBA</u>	
Zambia <u>1/</u>		<u>EFF</u>		<u>SBA</u>	<u>SBA</u>
Zimbabwe		<u>SBA*</u>		<u>SBA</u>	

1/ Covers second or third year of the extended Fund facility.
* First credit tranche.

Fiscal Policies Undertaken in Fund-Supported Adjustment Programs, (cont'd.)

(Addendum to 1984 partial data)

[illegible]

Financial Policies Undertaken in Fund-Supported Adjustment Programs, (Model'd.)

(Addendum to 1984 partial data)

[illegible]