sis.[50] Social safety nets are incorporated into about two-thirds of PRGF-supported programs.[51] Examples include severance payments for retrenched state enterprise employees or civil servants (as in Kenya, Mongolia, and Vietnam) and provision of free electricity to the poor (as in Georgia).

The design of social safety nets can be aided by poverty and social impact analysis (PSIA). PSIA consists of the analysis—ex ante, during implementation of reforms, and ex post—of the positive and negative impacts of reform policies on the well-being of the poor and other vulnerable groups. As such, PSIA can be a powerful tool for both redesigning policies (to avoid an adverse effect on low-income groups) or for implementing social safety net measures.

PSIA is a key feature of PRGF-supported programs, although significant improvement is needed in this area. More than half of all PRGF-supported programs refer to some form of PSIA. However, the majority of measures that could potentially affect the poor have not been covered by PSIA or by social safety net measures. Moreover, in the majority of low-income countries, the technical capacity to perform PSIA is very weak. Thus, the IMF, together with the World Bank and other development partners, is actively working to widen the depth and scope of PSIA, with their efforts concentrating on increasing countries' capacity to undertake such analyses, although experience indicates that it will be several years before most countries are able to implement PSIA based on analytical studies.

Governance and Sustainable Development

Poor governance poses a number of obstacles to human development.[52] Corruption results in the allocation of budgetary resources for unproductive programs and inefficiencies in public spending, which reduces the effectiveness of outlays on social and poverty-reducing programs in fostering social development. Poor governance results in budgetary allocations tilted in favor of less-productive investment projects and defense-related

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[50]See Gupta and others (1999). For a review of issues in the design of social safety nets, see Chu and Gupta (1998).

[51]See Gupta and others (2002c).

[52]Governance covers a wide set of issues. This paper focuses on only those most germane to fiscal policy. For a further discussion of fiscal policy and governance, see Abed and Gupta (2002); for the impact of corruption on output growth, see Shleifer and Vishny (1993); and for a more general discussion on corruption, see Bardhan (1997).

spending and against nonwage operations and maintenance expenditures, which reduces the quality and productivity of existing infrastructure. Corruption also reduces revenue and therefore the ability of the government to mobilize the resources needed to finance critical poverty-reducing programs. Corruption results in the poor capturing a smaller share of the benefits from public spending and, more generally, in higher poverty and income inequality.

Good governance is essential to ensuring that higher social spending translates into better social outcomes. Even if spending is allocated to pro-poor activities, public funds must be used for their intended purposes to ensure that these outlays have a positive impact on human development. As such, a sound public expenditure management (PEM) system and transparency in government operations are pivotal not only for good macroeconomic management but also for good governance.

Good governance is also essential for promoting environmental sustainability. Progress in alleviating environmental problems in developing countries has been slow, often owing to ill-defined property rights regimes, corruption, and a general lack of capacity and political will at the national level.[53] The IMF's general emphasis on improving the quality and transparency of spending decisions has improved the effectiveness of developing countries' environmental and other spending. In Brazil, for example, federal spending on environmental protection programs grew during an IMF-supported program. The IMF has also explicitly addressed environmental governance issues in a number of countries (for example, Cambodia and Indonesia) where these were important to overall macroeconomic performance.

Almost all PRGF-supported programs incorporate measures to strengthen PEM systems. Each program, on average, incorporates four to five measures, which generally include steps to improve budget formulation, budget execution (to keep spending within budgeted amounts), and budget reporting (including auditing). Both the IMF and the World Bank have provided countries with substantial technical assistance to strengthen their budget systems. For 24 of the heavily indebted poor countries (HIPCs) that have qualified for debt relief under the enhanced HIPC Initiative, the World Bank and the IMF, together with country authorities, have

[53]World Bank (1997).

drawn up action plans to strengthen budget systems. These action plans are being implemented in the context of the countries' World Bank- and IMF-supported programs. Despite recent progress, PEM systems remain deficient in many of these countries, and rigorous implementation of these action plans will be essential for achieving sustainable development.

Increasing the transparency of government operations will be essential to ensure that governments are accountable for their use of public funds. In this regard, transparency can be enhanced if governments adhere to the IMF's Code of Good Practices on Fiscal Transparency. The participation of governments in reports on the observance of standards and codes (ROSCs)—which assess a government's practices on transparency against this benchmark—can provide a useful step in this regard. Thus far, 36 developed and developing countries have participated in fiscal ROSCs, with another 15–20 per year expected in the near future.

Moving Forward

There are many economic, social, and environmental challenges along the path to sustainable development, and there is no panacea to address them all. Rather, accelerated development will require progress in multiple policy areas, with the right policy mix and focus varying from country to country. Countries may also need to make difficult choices regarding trade-offs between competing policy objectives. Achieving more sustainable development will thus require a concerted effort from developing countries, the international community, and the international financial institutions.

Developing Countries

Sound fiscal and macroeconomic policies are essential. Sustainable growth and poverty reduction are possible only with prudent macroeconomic and, in particular, fiscal policies.

Tax and expenditure policies should also be designed to minimize adverse incentive effects, which can hinder economic growth. Tax policies should seek to raise revenue in a way that least distorts labor supply, consumption, saving, and other decisions. Expenditure policies should not deter the active participation of the poor in the labor market and the process of economic development.