ActionAid International USA & Co-Authors Respond to the IMF Critique of "Blocking Progress"

Prior to the October 2-3, 2004 annual meetings of the International Monetary Fund and World Bank in Washington DC, ActionAid International USA and its partners at Global AIDS Alliance, Student Global AIDS Campaign and RESULTS Educational Fund collectively released a policy briefing titled, "Blocking Progress: How the Fight Against HIV/AIDS is Being Undermined by the World Bank and International Monetary Fund." The briefing explains that current public spending on fighting HIV/AIDS in some of the world's poorest countries is being constrained by unnecessarily low inflation targets that are a direct or indirect result of IMF loan conditions. The briefing points out that there is an open debate among economists about what level of inflation begins to undermine economic growth rates, and states that the IMF has a position on one end of this open debate without adequate justification. Yet, this IMF position leads directly and indirectly to tight budget ceilings on public health expenditures that may not be necessary or justifiable. The full policy briefing is available at this weblink: http://www.actionaidusa.org/blockingprogress.pdf

On September 30, 2004 the IMF's External Relations Department posted on the front page of the IMF website, "A Response to ActionAid International and Other Organizations," which described our briefing as "partly correct but fundamentally wrong in how it assesses the role of the Fund in the fight against HIV/AIDS" and "a vehicle largely for recriminations and accusations." The full IMF response to our policy briefing is available at this weblink: http://www.imf.org/external/np/vc/2004/093004.htm

Though we welcome and are thankful for the IMF's willingness to debate our analysis with us, we feel the IMF response mischaracterizes and misstates the findings of and questions raised in our policy briefing. Consequently, we feel obliged to issue a point-by-point rebuttal publicly in order to clarify and correct many of the points made by the IMF in their response. We still look forward to discussing this issue and others with the IMF in the future.

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1. IMF: "The policy brief by the NGOs claims that the IMF undermines the fight against HIV/AIDS by insisting that keeping inflation low is more important than public spending to fight HIV/AIDS. However, this claim is wrong. The IMF strongly supports macroeconomic stability because it is a necessary condition for economic growth and poverty reduction, without which lasting improvements can not be made in public health conditions. However, there is no evidence that attempts to systematically target high inflation rates above a few percentage points will work: they will not create more growth or more room to spend on HIV/AIDS. When the higher inflation rate becomes embedded in expectations, it serves only to create uncertainty and complicate macroeconomic management."

Authors: Our briefing does not call for systematically targeting high inflation rates. We repeatedly underscored our understanding of the importance of macroeconomic stability and acknowledged that "It is widely agreed that macroeconomic stability is extremely important, and that levels of budget deficits and inflation should not be allowed to rise out of control. The point of this policy briefing is to shed light on the fact that there are varying opinions among economists as to what constitutes 'macroeconomic stability.' The question of what levels of inflation are acceptable is an open debate among economists and in the economics literature."

Rather than calling for governments to "systematically target high inflation rates," our briefing stressed that the issue is one of difficult trade-offs that must be made between the benefits of increasing public spending at the cost of experiencing slightly higher inflation or choosing to keep public spending inadequately low to fight HIV/AIDS in order to keep inflation as low as the IMF wishes. Our further point is to ask who should decide on such trade-offs-the IMF

or local policymakers whom are confronted with HIV/AIDS emergencies? We suggest it is the latter whom ought to be free to make the decisions on these difficult trade-offs. While we would expect the IMF to agree with us on the face of it that countries ought to be free to make such choices, and to repeat its claim that its policy conditionalities are "country owned", the IMF cannot deny the tremendous power and leverage it exerts through its notorious "signaling effect" to most other multilateral and bilateral donors and creditors, and the influence this brings to bear on borrowing countries. Borrowing governments will only truly own their choices about such trade-offs when the IMF and its leading Executive Board members, including the G7 Governments, explicitly and publicly announce that future IMF lending will no longer be contingent upon adhering to its current low-inflation targets.

2. IMF: [referring to the idea of systematically targeting high inflation] "It does not allow higher growth; on the contrary, growth is generally lower, and the paper leaves out much evidence that contradicts its arguments: The paper claims that IMF-supported programs target excessively low levels of inflation-"generally, below 10 percent, and often as low as 3-5 percent"-and notes that research, including by Michael Bruno and Bill Easterly dating back to the mid-1990s, has shown that higher rates of inflation ('up to 20 percent') have no discernable impact on growth. The Bruno and Easterly finding has inspired substantial subsequent research, including at the IMF. This work confirms that higher inflation robustly leads to lower growth. Further, it shows that this negative relationship starts at fairly low levels of inflation-somewhere between 2 to 11 percent." [In a footnote, the IMF cites two IMF Staff Papers: Khan, M. and A.S. Senhadji, "Threshold Effects in the Relationship Between Inflation and Growth," IMF Staff Papers, Vol. 48 (2001); and Ghosh, A. and S. Philips, "Warning: Inflation May be Harmful to Your Growth," IMF Staff Papers, Vol. 45 (1998).]

Authors: We do not find compelling the idea that citing two in-house staff papers constitutes "much evidence" that contradicts the research we cited. First, the IMF confused the findings and authors of the various research we cited: The research they mention that has shown that higher rates of inflation ('up to 20 percent') have no discernable impact on growth was not done by Bruno and Easterly, but rather by University of Massachusetts' Gerald Epstein (our footnote #12), although Bruno (1995) did have similar findings. The research by both Bruno and Easterly (1996) we cited (our footnote #13) actually found that rates of inflation between 15% - 30%, considered "moderate", can be sustained for long periods of time without damaging economic growth rates.

The University of Denver's Prof. Ilene Grabel, who has reviewed the economics literature on the inflation-growth relationship, says of the two IMF Staff Papers cited by the IMF in its response to our policy briefing, "The fact of the matter is that the work of Bruno and Easterly is seminal (published in top journals by extremely well-respected economists, consistently cited by other top economists, their findings are supported by cross-country, empirical evidence, etc.). The two studies that the IMF is now rallying behind simply do not compare in any sense with this work. They are not "important" studies in any sense (in terms of where they are published, who has authored them). They do not have the richness and detail of the work by Bruno and Easterly, have not been externally refereed, and simply cannot be seen as a refutation of this earlier work. These IMF papers are trivial. By the standards of our profession, one does not use a non-refereed working paper(s) to refute work that is seminal. The IMF is being most dishonest here. Imagine what they would have said if ActionAid used its own in-house metrics to disprove a key finding in a top journal."

The first IMF Staff Paper cited by the IMF in its response, by Khan and Senhadji (2001), finds that inflation begins to have a negative effect on economic growth rates beyond certain thresholds: for industrialized countries the threshold is between 1-3 percent; for developing countries, which are the focus of our policy briefing, Khan and Senhadji find that the threshold is between 11-12 percent. If this research is accurate, it does not justify the very low, often between 3-5 percent, inflation targets the IMF makes as binding loan conditions in many of the world's poorest developing countries [see below for further details]. In the IMF's response to our policy briefing, they conflate this study's findings by saying the threshold is

"between 2-11 percent", which could only be accurate if one were looking at both industrialized and developing countries, which our policy briefing was not. Additionally, other important questions linger about the efficacy of this study's findings, as Khan and Senhadji themselves forthrightly point out: "While the results are informative, some caveats are important to bear in mind when interpreting these results. First, the estimated relationship between inflation and growth does not provide the precise channels through which inflation affects growth-beyond the fact that, because investment and employment are controlled for, the effect is primarily through productivity. This also implies that the total negative effect of inflation may be understated. Second, inflation is not an exogenous variable in the growth-inflation regression, and the coefficient estimates may be biased. The seriousness of this problem will depend, to a large extent, on whether the causality runs mainly from inflation to growth, in which case the endogeneity problem may not be serious, or the other way around, in which case a bias may be present. As argued by Fischer (1993), the causality is more likely to run predominantly from inflation to growth, in which case the problem of simultaneity bias may not be very important. However, this assumption needs to be explicitly tested."

The second IMF Staff Paper cited by the IMF, by Ghosh & Phillips (1998), finds there are two important nonlinearities in the inflation-growth relationship. At very low inflation rates (around 2-3 percent a year, or lower), inflation and growth are positively correlated. Otherwise, they find inflation and growth are negatively correlated, but the relationship is convex, so that the decline in growth associated with an increase from 10 percent to 20 percent inflation is much larger than that associated with moving from 40 percent to 50 percent inflation. While this research, if accurate, is interesting, it also does not justify the IMF's binding loan conditions that call for inflation at or below 5 percent per year in many of the world's poorest developing countries. Ghosh & Phillips state, "Finally, it bears emphasizing that this study does not claim to precisely locate a 'growth-maximizing' rate of inflation (any such rate might be expected to differ, at least somewhat, across countries). Rather, our focus is on the more basic question of whether the negative inflation-growth relationship occurs only at very high inflation rates, or whether it extends down much further, perhaps to the single-digit range. All our findings suggest the latter." But they also add an important caveat: "Exactly how far this negative relationship extends, however, remains an open and difficult question-and one worthy of future research."

The important point is that we did not cite the Easterly & Bruno research in our policy briefing because we necessarily believe in it, but because Bruno was the World Bank Chief Economist, and the research was coming from the heart of the establishment, so to speak. The very existence of papers like that of Easterly & Bruno suggests that even within the center of the Bretton Woods Institutions the opinion on this issue is divided. The two IMF Staff papers cited in the IMF's response to our briefing do not necessarily disprove other papers, but the many important caveats offered about their methodologies used and their calls for further research suggest the debate is still an open question, as we attempted to highlight in our policy briefing. Furthermore, in direct response to the IMF's suggestion that Easterly's research "dating back to the mid-1990s" has since been refuted by its "subsequent" IMF Staff Papers, Easterly responded in an email of October 4, 2004: "I stand by my finding in the paper with Michael Bruno which found no evidence of any negative correlation between inflation and economic growth at inflation rates below 40 percent per year. I didn't find the subsequent IMF studies convincing. I have recently reproduced this finding in a paper to be published in the Handbook of Economic Growth. You can find the paper at the following website: http://www.nyu.edu/fas/institute/dri/DRIWP01.pdf "

Regarding the fact the IMF only cited two of its own internal Staff Papers in an attempt to refute the research we cited, we find it puzzling the IMF was unwilling to draw upon other outside research by academic, governmental or international organizations or other research institutions with which it could bolster its claim that there is "much evidence" that contradicts the research we cited. By only citing its own research to justify its controversial policy advice and loan conditions for borrowing countries, the IMF seems to act as both the defendant and

judge in a legal proceeding, without any apparent embarrassment or acknowledgement of the obvious conflict of interest.

What of the other research we cited by Robert Barro, who is considered an inflation hawk, or that by Gerald Epstein of University of Massachusetts, or the analysis of this literature by Chang & Grabel? Why was the IMF silent on their research?

And on the IMF's claim that higher inflation "does not allow higher growth; on the contrary, growth is generally lower," why did the IMF offer no evidence to question the other research we found which showed that higher levels of economic growth rates were in fact correlated with higher levels of inflation historically in countries that did not adopt the IMF's monetarist-based low-inflation approach? For example, we cited the cases of developing countries that made impressive increases in economic growth rates despite rates of inflation up to 20%, such as Latin American economies in the 1950s and 1960s, and Japan and South Korea, which enjoyed high rates of economic growth in the 1960s and 1970s while also experiencing inflation rates of about 20%. Does the IMF disagree with this historical account? If not, then how does the IMF account for such cases? The IMF's silence on these cases left us wondering.

3. IMF: "Higher inflation targets are also a bad way to create room for more public expenditures, however worthwhile these may be. The amount of expenditure that the government can make depends on available financing. Higher inflation can generate resources for the government through the so-called inflation tax, but this tax is inefficient, regressive, and unreliable. There are much better alternatives in all countries."

Authors: Nowhere in our briefing do we call for governments to utilize the so-called inflation tax. We believe that in recent years donor countries have shown a willingness to provide more foreign aid to fight HIV/AIDS and we believe that all forms of aid from donors will be an important part of increasing spending in the fight against HIV/AIDS over the short and medium terms for many countries with HIV/AIDS emergencies. We note there are several ways additional revenues can be generated: by more effective tax collection (which the IMF is assisting with in some countries); by more progressive taxation structures, rather than regressive ones the IMF has traditionally favored (such as the value-added tax on consumption); by some degree of internal reallocation of existing budget priorities; when necessary, the freedom from IMF prohibitions to engage in slightly higher deficit spending; and by increased foreign aid from the donor community. However, the most important question raised in our policy briefing is, regardless of how the additional revenues are generated, will countries be allowed to spend them? Our primary concern is that the IMF will not permit countries to spend higher levels of revenues within the domestic money supply, because doing so is not possible while also adhering to the IMF's current low-inflation targets.

While increasing foreign aid is important, building the absorptive capacity of countries to be able to accept and effectively utilize that increased foreign aid will first require higher public spending on the "wage bill" for hiring and retaining more health professionals and school teachers, and such spending will need to be permitted by the IMF and room will have to also be allowed for slightly higher rates of inflation that may result from such increased spending. Again, this is not a call for higher inflation for no reason but is seen only within the context of difficult trade-offs that will have to be made, as we note in our policy briefing.

We stress that the whole debate about growth and inflation is a bit academic in countries where HIV infection rates are 25% or more and where future national economic growth rates are likely to be rapidly eroded by the epidemic. While inflation could reduce growth a bit, not providing people with anti-retrovirals (ARVs) will reduce it much more, if for no other reason than the increased deaths of economically active adults. As far back as January 2000, a U.S. National Intelligence Council report entitled, "The Global Infectious Disease Threat and Its Implications for the United States," confirmed that in Africa's worst-hit countries, AIDS has already cut 1 percentage point off of GDP. Also in 2000, the World Bank had estimated that

in South Africa, where 20 per cent of the population is HIV-positive, GDP will be 17 per cent lower by 2010 than it would have been without the AIDS epidemic. Even countries below the 20 per cent seroprevalence threshold were already seeing serious macroeconomic effects in 2001. Jane's Defence Weekly reported that Botswana's economy may shrink by 30 per cent by 2010 as a result of AIDS, and in Kenya GDP was projected to be 14.5 per cent smaller in 2005 than it otherwise would have been without the cumulative impact of AIDS. Also in 2001, the World Bank had estimated that the combined effect of AIDS and tuberculosis could cost Russia 1 per cent of its GDP by 2005. These types of projections are alsocurrently being examined and investigated by the IMF's Markus Haacker.

As difficult as it might be for some monetarists at the IMF to accept, there may be policymakers in countries with HIV/AIDS emergencies who may perceive the negative costs of slightly higher inflation in the short-term to be worth the positive benefits of greatly increased public health spending to stem the spread of HIV/AIDS over the long term. This is why we cited the new UNAIDS 2004 Report on the Global AIDS Epidemic released at the July 2004 global summit on AIDS in Bangkok when it says, "The short-term inflationary effects of increased and additional resources applied towards tackling the HIV epidemic pale in comparison with what will be the long-term effects of half-hearted responses on the economies of hard hit countries. AIDS is an exceptional disease; it requires an exceptional response." We believe part of that "exception" is that the IMF must be made by its Executive Board members to become more flexible on inflation-targeting in order to allow room for increased spending within economies to effectively fight HIV/AIDS.

4. IMF: "The IMF does not target extremely low rates of inflation. A recent evaluation by the Independent Evaluation Office (IEO) of the IMF concluded [see Box 4-7] that IMF programs for low income countries did not show an excessive deflationary bias. The IEO found a clear tendency in program design against tolerating double-digit inflation. But in the majority of cases where initial inflation was between zero and five percent, inflation as projected to go up. In light of the available evidence, countries that follow PRGF-supported programs should reap the benefits in the form of higher growth."

Authors: Our policy briefing statement that IMF-supported programs target low levels of inflation-"generally, below 10 percent, and often as low as 3-5 percent"- is based on published research we cited by Oxfam International and Eurodad, entitled "Eurodad 2003 PRGF Research Programme: Is the IMF Pro-Poor?", which surveyed 20 developing countries that have followed low inflation targets as conditions for IMF loans and found that 19 out of the 20 recent 3-year IMF loan programs have inflation targets of less than 10%, and 16 of the 20 IMF programs have inflation targets of less than 5%. The IMF did not explicitly refute this research in its response to our briefing. This claim was further bolstered by an examination undertaken by ActionAid International USA of 52 African countries with IMF arrangements and the low-inflation targets described in Article IV Consultations, Letters of Intent, Memorandum of Economic and Financial Policies, or other IMF documentation publicly available on the IMF website. That examination found that 25 of 52 African countries had inflation-targets at or below 5 percent.

We are happy to hear the IMF state that it "does not target extremely low rates of inflation" and we welcome evidence of this claim in future IMF loan conditions.

Regarding Box 4-7 in the report by the IMF's Independent Evaluation Office (IEO) that the IMF cited in its response to our briefing, that Box states: "Our evaluation indicates that PRGF-supported programs projected a smaller average reduction in inflation levels than ESAF-supported programs, but this largely reflects much lower initial inflation rates. Under ESAFs, inflation was targeted to fall from 22 percent on average in the year immediately preceding the program to about 10 percent and 5.5 percent in the first and second program years, respectively. By contrast, under PRGFs, the corresponding path was from 9 percent to about 6 percent and then to 4 percent. Looking at disaggregated data, we found a strong tendency in program design against tolerating double-digit inflation, but detected no systematic

disinflation tendency when inflation is already low." This does not contradict but rather confirms the low levels that Oxfam and Eurodad and we say are operative in current IMF programs to poor countries. The real difference is one of opinion about what is considered "extremely low" or "too low." This is why we cited samples of the differing opinions in the economics literature on this point and some of the historical cases of countries which had high economic growth rates that were correlated with higher inflation rates. Monetarists at the IMF may not consider 5 percent inflation rates or lower to be "low". But when contrasted with the higher economic growth rates and higher spending levels that are necessary for effectively combating HIV/AIDS, these are perceived as "low".

The main concern of Box 4-7 in the IEO study is about disinflation (going from one level of inflation down to a lower level), however the main concern of our policy briefing is the prohibition on borrowing countries from moving inflation rates in the other direction (allowing slightly higher inflation) that might result from significantly increased public spending on HIV/AIDS. As Box 4-7 of the IEO study accurately noted, because 20 of the last 25 years of IMF lending under the old Enhanced Structural Adjustment Facility (ESAF) loan conditions had already brought inflation levels down considerably by the 1990s, not much of a new disinflation bias can be seen between the old ESAF loans and the more recent Poverty Reduction and Growth Facility (PRGF) loans which began in 1999, because inflation levels had already been substantially lowered by 1999. Therefore contrasting the disinflation of ESAFs with PRGFs is not useful for the purposes of our policy briefing: one cannot draw sweeping conclusions by comparing lowered-inflation with low-inflation. Our concerns have to do with why and how the IMF prohibits inflation levels from going up again, and the spending constraints that result from this prohibition.

[This study is similar in its utility to another IEO study from September 003, "Fiscal Adjustment in IMF-Supported Programs," which purported to show that IMF budget austerity conditions in IMF loans over the years did not, contrary to popular perception, target reductions in current account and fiscal deficits or in public expenditures. However, what is striking about the study's methodology is that its data sample is only from 1993-2001 but the major budget cuts to education and health expenditures had occurred much earlier under IMF loan conditions in the 1980s, as we noted in our policy briefing. By 1993, the levels of social spending as a percent of GDP had already been greatly reduced. Thus it is not of tremendous value to contrast already-lowered public spending with continued low public spending to arrive at a conclusion that IMF loans do not substantially lower public spending. It would have been more comprehensive to conduct the study from 1981-2001, not to ask if the percentage of social spending was different between ESAFs and PRGFs, but to ask what the same monetarist approach over the whole 20 years has done to public spending as a percentage of GDP. Again, our concerns relate to why countries are not apparently allowed to increase their public spending commensurate with the levels projected to be needed to effectively combat HIV/AIDS.]

5. IMF: "Fiscal frameworks in PRGF-supported programs are designed to help countries mobilize and accommodate large sizable inflows of foreign aid, provided that macroeconomic stability and financial sustainability are maintained. Thus, the claim that the IMF's low inflation targets constrain the room for government spending on AIDS programs, even if donor funding is available, is wide of the mark. Its argument includes a series of misunderstandings regarding the IMF's operations."

Authors: Our concern is with the caveat in the second part of the first sentence: "provided that macroeconomic stability and financial sustainability are maintained." This is consistent with what we state in our policy briefing: countries can accept inflows of foreign aid up to and until the point at which the IMF determines it may threaten macroeconomic stability. We then cite the IMF's own definition of macroeconomic stability: when countries maintain "current-account and fiscal balances consistent with low and declining debt levels, inflation in the low single digits and rising per capita GDP". A key point of our policy briefing is that the IMF's absolute need for "inflation in the low single digits" is not uniformly shared among

economists, in the economics literature, by the World Bank, nor in many historical case records, and that the IMF's insistence on inflation "in the low single digits" is actively blocking countries from increasing public spending commensurate with the much higher levels UNAIDS and others project will be required to effectively combat HIV/AIDS.

5a. IMF: "IMF programs in no way limit the scope for government spending out of domestic tax revenues, contrary to what the paper argues."

Authors: We note in our policy briefing that the IMF has made deficit reduction a cornerstone of its low-inflation policies and that it is among the IMF's binding loan conditions for borrowing countries. This has lead to perverse situations in which countries which could be using more of their own domestic revenues to fight HIV/AIDS are instead being required by the IMF to use these scarce resources to pay down the level of the deficit, or in some cases, even put money into reserves (a surplus). The IMF seeks to limit the spending of any extra domestic revenues and/or to limit the degree to which any additional spending enters the domestic money supply beyond a certain point because of its fear of the possible inflationary response.

We cited a September 2003 study of IMF budget austerity by Oxfam International, "IMF and the Millennium Development Goals: Failing to Deliver for Low Income Countries," which demonstrated how strict deficit reduction loan conditions diverted scarce resources that could be better applied to increasing education or public health spending. For example, one of the IMF's loan conditions for Senegal is for it to reduce its budget deficit from 4.0% of Gross Domestic Product (GDP) to 3.5% of GDP over a three year period. But if that extra 0.5% of GDP were used to increase spending in the health sector rather than for paying down the deficit, the national health budget could have been doubled for each year of the 3-year loan program. In another example, a 3-year IMF loan program for Cameroon is requiring that the government achieve a budget surplus by 2005 by moving from a 0.7% of GDP budget deficit in 2003 to a 0.7% budget surplus by 2005. However, Cameroon could have more than doubled its health spending over these three years if it could have shifted that 1.4% of GDP into the health sector budgets. Similarly, an IMF loan condition for Rwanda is requiring a reduction in the budget deficit from 9.9% of GDP to 8.0% of GDP over three years. However, that 1.9% of GDP that the IMF determined should be spent on paying down the deficit level could have been used instead to double Rwanda's health and education budget in each of the three years of the loan period.

We conceded in our policy briefing that these kinds of calculations imply that if governments were free of such strict IMF deficit reduction loan conditions, they would be putting all of that revenue into public health. While they would not necessarily do so, the purpose here was to show the high costs of complying with often unjustifiable IMF budget austerity. Such IMF loan conditions have significant costs in terms of constraining what might otherwise be possible in the fight against HIV/AIDS.

5b. IMF: "Contrary to the paper's claim (page 20), IMF programs for virtually all low income countries treat foreign grants as a part of government revenue. This means that the receipt and spending of grant money does not raise the government deficit and, as a result, is not subject to program limits on the deficit or its financing."

Authors: A more careful reading of page 20 of our policy briefing would show that we actually agree with a best-practices Guidance Note articulated by the World Bank and IMF on how they instruct their Country Directors and Resident Representatives to advise finance ministries about how to most accurately calculate official budget deficit levels. We agree in particular with the main point of this Guidance Note sent out by the World Bank that grant aid from foreign donors should be allowed to be used to pay down budget deficits that have been run up by countries. Our concern discussed on page 20 of our policy briefing was that

the Ugandan Government's finance ministry did not utilize this best practice during a recent Public Expenditure Review event in Kampala in May 2004 when it claimed Uganda could not increase public spending any further because the country already run up a budget deficit of 11 percent of GDP. In fact, that was the figure which excluded grant aid. Had the finance ministry followed the best practices advocated by the World Bank and IMF and included the use of available grant aid in their calculation, it would have shown a much lower deficit level (arguably with room for additional public spending). This was extremely frustrating for our partners in Uganda and health advocates who understand the need for far greater spending to effectively combat HIV/AIDS.

However, we acknowledge we did not adequately explain this on page 20. We also should haven given the IMF credit for taking a further public step towards highlighting its best-practices position on this issue with the publication of its September 21, 2004 Issue Brief entitled "External Grants and IMF Policies," which reiterates that governments should calculate official deficit levels after having used available grant aid to pay down portions of the deficit. While this does not address the main concern of our policy briefing about the spending constraints that flow from the IMF's low-inflation targets, it is an important point with which we agree with the IMF, and we call on citizens in borrowing countries to address their parliamentarians and finance ministries to adopt this best-practice to official deficit calculation.

5c. IMF: "The vast majority of Fund-supported programs also include no limit on the spending of concessional project loans."

Authors: We made no statements in specific reference to concessional project loans, but recognize that increased spending related to some projects may have an impact on the money supply.

6. IMF: "The claim that IMF conditionality deters countries from using available foreign aid is also grossly misleading. A key objective of most IMF-supported programs is to ensure that the conditions necessary for absorbing foreign aid are in place, again, with a view to promoting growth and poverty reduction."

Authors: Here the IMF neglects to respond to one of the most worrisome aspects of its constraints on public spending, and fails to answer the most striking contradiction we raised in our policy briefing about how countries can not be expected to both maintain low spending/low inflation while also attempting to increase their "absorptive capacity" to enable them to accept higher amounts of foreign aid in the future to fight HIV/AIDS. Building capacity in a period time to effectively address HIV/AIDS emergencies will require relatively significant increases in spending in many countries. The impetus for writing the policy briefing was inspired by the repeated concerns expressed to the authors by our colleagues in the field and others at Doctors Without Borders (Médecins Sans Frontières), UNAIDS, and elsewhere that budget ceilings were preventing countries from be able to increase their absorptive capacity necessary for accepting and using higher levels of foreign aid to fight HIV/AIDS. The current restrictive ceilings on staff levels and wages in the public health and public education systems were at the heart of these concerns. Speaking at the World Bank in November 2003, UNAIDS Executive Director Peter Piot stated, "When I hear that countries are choosing to comply with the...ceilings at the expense of adequately funding AIDS programs, it strikes me that someone isn't looking hard enough for sound alternatives." World Bank President James Wolfensohn responded by acknowledging that the problem of the strict budget ceilings in the medium-term expenditure frameworks (MTEFs) were "a very real issue" and that the World Bank was "working with the IMF on this issue of limits on medium-term expenditure framework." However, we wrote this policy briefing precisely because we have not seen any movement towards substantial new flexibility on the part of the IMF and its low-inflation targeting that lies at the root of the budget ceilings. The IMF cannot say that it is working to "ensure that the conditions necessary for absorbing foreign aid are in place," when its low-inflation targeting explicitly limits the amount of spending in the money supply.

Indeed, countries will not be able to pay doctors and nurses more, hire new doctors, nurses and health workers or school teachers necessary for staffing distant rural clinics and schools or transporting drugs and medicines and books to them without significant increases in the wage bill.

7. IMF: "The IMF programs for low-income countries (i.e., PRGF-supported programs) clearly envisage that the fiscal and financing targets in programs will accommodate higher poverty-reducing spending in cases where additional foreign aid flows on concessional terms are available and absorptive capacity exists."

Authors: We are particularly concerned with the many countries where absorptive capacity does not exist, and in the constraints on spending increases that are blocking it from being built. This primary concern inspired the title of our policy briefing: "Blocking Progress".

8. IMF: "The paper, however, erroneously attributes all fiscal conditionality in IMF-supported programs to inflation objectives."

Authors: Our policy briefing was a brief; not a full report. It was not intended to, nor claimed to provide a comprehensive analysis of all of the components of IMF fiscal and monetary conditionality. To do so would have required a much longer and more comprehensive report. The key point of our policy briefing was to highlight the fact that the IMF's insistence on low inflation targets is not based on any consensus among economists or in the economics literature and that the policy should therefore be up for public debate and deeper public scrutiny, if for no other reason than it leads to spending constraints that are at odds with the significant spending increases which will be necessary for effectively combating HIV/AIDS.

9. IMF: "The limits that IMF programs impose on the use of nonconcessional borrowing, both from domestic and foreign sources, and, in some cases, on the overall fiscal deficit, are often related to risks to debt sustainability. In order to support growth and stability, it is critical to avoid a recurrence of the debt crises, which resulted in a major setback to economic development in many low income countries during the 1980s and into the 1990s."

Authors: The IMF suggestion that "debt crises" have ended for developing countries in the 1990s belies the current failure of the Heavily-Indebted Poor Countries (HIPC) Initiative, in which so little debt relief was offered and so much lending continued, that HIPC countries have been unable to maintain the arbitrary "debt sustainability thresholds" of a 150 percent of debt-to-exports ratio. The failure of the HIPC Initiative and continuing and deepening debt crisis has been documented in successive IMF-World Bank HIPC Status of Implementation Reports. The failure of the World Bank to adequately or soundly gauge levels of "debt sustainability" or to do 'debt sustainability analysis" (DSA) was articulated in Bank's Annual Review of Development Effectiveness 2003 report, which stated, "The evaluation found that a) growth assumptions in HIPC DSAs were optimistic (more than twice historical averages); and b) that the Initiative, as implemented, was not underpinned by credible country strategies consistent with these assumed levels of growth...The evaluation also flagged inadequacies in DSA risk analysis-i.e., examination of the sensitivity of projected results to deviations from baseline assumptions; DSAs give particularly inadequate treatment to export volatility." With regard to the IMF's inference that the "debt crises" existed only during "during the 1980s and into the 1990s", the IMF's 2003 World Economic Outlook notes that public debt in emerging market economies has risen sharply since the mid-1990s to about 70 percent of GDP, more than reversing the decline that took place in the first half of the 1990s.

We believe a more meaningful measure of "debt-sustainability" should be based on the level of debt payments countries could afford while still meeting the UN Millennium Development

Goals on time and effectively addressing their HIV/AIDS emergencies. If that level of debt is zero for countries, then these countries should have 100% of their foreign debts cancelled, with a financing plan that includes IMF reserves and gold stocks.

10. IMF: "If the concern is that IMF-supported programs constrain wage bills, with the exception of few programs where the wage level is either excessively high relative to other low-income countries or a rapid increase risks causing serious macroeconomic destabilization, Fund-supported programs do not have wage ceilings."

Authors: Here the IMF makes two important concessions that form the underlying basis for the concerns we expressed in our policy briefing. First, the IMF concedes that it only seeks to constrain wage bills in certain countries which have wage levels "excessively high relative to other low-income countries." This presumes that the prevailing wage levels of many other low-income countries are a sound barometer of acceptable or sufficient wage levels. We join with many health ministries, professional health associations, health-oriented NGOs and service providers, and the World Health Organization and UNAIDS in strongly questioning this presumption. Second, with regard to the IMF's other concession that its programs contain wage ceilings where "a rapid increase risks causing serious macroeconomic destabilization," the two key purposes of our policy briefing were to show: a) that there is not a consensus on the IMF's definition of what constitutes macroeconomic destabilization if the IMF's definition of stability includes "inflation in the low single digits"; and b) even where the inflation level may rise as a consequence of increases in the wage bill, this is a trade-off that should be made by local policymakers facing HIV/AIDS emergencies and not by the IMF.

11. IMF on Uganda: "No global funding for HIV/Aids projects has been rejected by Uganda because of overall budget limits. The NGO paper is wrong to say that a $52 million grant was "nearly" rejected by Uganda because of IMF budgetary constraints."

Authors: One of the leading daily newspapers in Uganda, The New Vision, carried a story on December 19, 2003, "Health, Finance Agree on Funds," which stated "Health minister Brigadier Jim Muhwezi has said the Ministry of Finance is cooperating with his in receiving funds from donors to fight HIV/AIDS, TB and malaria in the country. He said the recent disagreement between the two ministries on whether Uganda should accept additional donor funding against the diseases had ended and the Ministry of Finance was cooperative and positive. Muhwezi's announcements come after Sunday Vision quoted the Switzerland-based Global Fund to Fight AIDS, TB and Malaria (GFATM) complaining that some finance ministry officials were frustrating anti-AIDS cash from the organisation. The GFATM Executive Director, Prof. Richard Feachem said, 'We recently approved $136m to cover Uganda for two years. But in the summer of 2002, a public row broke out between the health and finance ministries on whether these monies could be absorbed. It is a real scandal. Can you imagine that only US$300,000 has been disbursed to Uganda?' But Muhwezi said, 'The matter was resolved when the Minister of Finance issued a clarification affirming Uganda's commitment to accepting the funds as being additional to the Government resources.'"

The hold-up in Uganda's accepting the funds was related to the finance ministry insisting that the funds could not be "additional spending" to the fixed health budget, whose ceiling had already been established as it related to the agreed level of money supply and inflation targets. The finance ministry had stated for over a year and half that it could only accept the money from GFATM if it first lowered the existing health budget by the same amount, which the GFATM rejected; that the money would not be "additional" spending. "Any new donor monies absorbed into a government sector must be accompanied by a similar reduction within the sector in order to keep the expenditure limit", said Francis Tumuheirwe, Director of Budget in Uganda's Ministry of Finance (The Lancet, 7 Dec. 2002). At first the finance

ministry explained at a May 21, 2002 Public Expenditure Review its objection to accepting the money was based on a concern that doing so would cause an appreciative effect on the currency and hurt the ability of Uganda to export more (and thus not be able to repay foreign creditors as quickly); then it later said that ceilings for overall health spending in the economy (money supply) had already been set for the medium-term expenditure framework. Finally, after nearly two-years of indecision, an agreement was reached

Charles Wendo, a reporter with Uganda's New Vision newspaper, published a report from Kampala on this issue in the British Medical Journal, The Lancet, on January 17, 2004, entitled, "Ugandan Officials Negotiate Global Fund Grants: Government limits on health-sector spending may jeopordise funding agreement." It is worth quoting at length. It is available at: http://www.thelancet.com/journal/vol363/iss9404/full/llan.363.9404.news.2841

5.1 "Ugandan health and finance officials are in fresh negotiations over the future of grants from the Global Fund to fight HIV/AIDS, Tuberculosis, and Malaria. Last month [Dec 2003], the Ministry of Finance declared that, with effect from July 2004, all donor project funds, including the Global Fund's grants, would have to fit within fixed sector ceilings. Such ceilings mean that public-sector spending has a fixed limit. Therefore, if a sector receives any new funds that were not initially budgeted for, it forfeits a similar amount from the government coffers.

"The new plan announced by the Ministry of Finance deviates from the current arrangement in which money from the Global Fund falls outside the health-sector ceiling. According to an agreement signed last year, the Ministry of Finance is supposed to receive the funds as a project grant independent of the health-sector expenditure limits. The Ministry of Health can then spend the money on Global Fund-approved programmes.

"However, from July, 2004, this situation will change and Global Fund grants will be included in health-spending budgets. It is not yet certain how this is going to affect the inflow from the Global Fund. Whereas health officials fear that this might restrict the amount of grant available to them in future, finance officials say there is room for negotiation to expand the ceiling.

"The director of economic monitoring in the Ministry of Finance, Keith Muhakanizi, said this change affects donor projects in all ministries, not only that of health. It would help the Ministry of Finance to effectively monitor and control public spending in order to stabilise the macroeconomy. 'We want to have one budget so that we know all the money that the government is getting and how it is affecting the economy', he said. Health officials worry that for a sector that is severely underfunded, such restrictions will jeopardise service delivery. Uganda's per capita public-health spending is below US$12, far below the $27 recommended by WHO.

" 'We are still negotiating for an increase in the ceiling so that we have more resources', said Mike Mukula, Minister of State for Health. Mukula does not agree that increasing health expenditure can destabilise the macroeconomy. Instead he thinks if the government puts more money into health, then the economy will grow faster. He argues that a population that is not healthy cannot develop a nation. "If you have a parent caring for children who are suffering from malaria all the time, production will definitely go down", he said.

"The position of the Global Fund is that grants can be released only if they add to whatever governments are already spending on health. During a visit to Uganda at the end of November Executive Director Richard Feachem asserted that the grants cannot be used to save any government resources. Grace Murindwa, a principal health planner in the Ministry of Health, thinks the ceiling needs to be raised sufficiently in order to accommodate the Global Fund grant. However, he fears that finance officials might not raise the ceiling

substantially, thus locking out some grants. 'The Global Fund [grants] for the next financial year may be at risk unless we negotiate higher ceilings. If they don't raise it, we shall be in trouble', he said.

"For the current financial year, the budget for health is about $180 million. And so far, the Global Fund has approved for Uganda $137 million, signed a grant agreement for $36 million, and disbursed $287 029. These funds alone may exceed the current health ceiling. Should the new arrangements interrupt the flow of grants from the Global Fund, then the lives of thousands of patients could be at risk. The Ministry of Health has already promised free antiretroviral treatment to AIDS patients, most of whom cannot afford the treatment on their own. In Uganda a triple antiretroviral combination costs at least $30 per patient per month. Comparatively, the average expenditure of Ugandans on all necessities of life is estimated at about $15 per person per month, according to a recent household survey."

While we do not disagree with the IMF that other administrative bottlenecks may have also played a role in the hold-up, these were not the key issues related to the "additional or non-additional to the existing health budget" concerns articulated by the finance ministry. Further, while Uganda may be a case in which its finance ministry officials are adopting policies even "more IMF than the IMF," the underlying logic operative in the thinking of both the Ugandan Finance Ministry and the IMF economists is that of monetarism, a belief that keeping the money supply and spending constrained is necessary to keep inflation low and that other goals are subordinate to this goal. Ultimately, the Uganda case was not about how or if GFATM money should be counted as additional or not, but about the very efficacy of the IMF's definition of macroeconomic stability that includes "inflation in the low single digits".

12. IMF on Zambia: "The economic programs that the IMF has supported in Zambia under the PRGF have not included limits on government hiring in health or education, as alleged by the NGO report. Teachers, doctors and nurses were excluded from the freeze on civil service hiring in the government's Memorandum of Economic and Financial Policies dated November 2002. The program supported by the PRGF arrangement approved in June 2004 does not include a freeze on hiring in the public sector."

Authors: We note that the IMF states "teachers, doctors, and nurses were excluded from the freeze on civil service hiring in the government's Memorandum of Economic and Financial Policies dated November 2002" but we are equally concerned with the IMF's policies on the matter prior to November 2002. The widespread and devastating impact of HIV/AIDS on Zambia's society was well established from at least 1996. One of us (co-authors of the policy briefing), Dr. Paul Zeitz, Executive Director of Global AIDS Alliance, worked in Zambia from 1996-2000, when during a national health reform process, there was a strong effort to increase the number and quality of health care workers that was dramatically undermined by the IMF requirement that the health sector wage bill had to be cut. It's a striking comment that the IMF only took actions to address the significantly negative impact of the wage freezes in 2002. The same applies to the education sector.

We acknowledge that Zambia is suffering from severe economic crises and extraordinarily tight budget constraints, one of which is its unsustainable debt burden owed to foreign creditors like the IMF. One of Zambia's major economic crises is that it is sending $377 million (or 7.3 percent of GDP) in debt payments to creditors in rich countries in 2004 alone, and in particular, $247 million of this is going directly to the IMF, which always insists that it be repaid before other rich creditors. We agree that technically, the wage freeze was not a condition for the IMF's PRGF arrangement with Zambia. However, maintaining the wage freeze was an explicit IMF condition set for Zambia to qualify for HIPC debt relief, as we stated in our policy briefing. In so doing, the IMF insists that Zambia first comply with a constrained wage bill that prevents the country from adequately fighting HIV/AIDS in order to eventually qualify for debt relief. Whether it comes from a condition for a PRGF loan or for

HIPC debt-relief, we believe the logic is perverse and wholly neglects the nature of the HIV/AIDS emergency in Zambia.

The IMF has shown a tendency over the years to penalize borrowing countries with suspensions in loan programs and interruptions in debt-relief programs for not satisfactorily complying with its loan conditions. The on-again/off-again flows of IMF lending and promises of HIPC debt relief (as well as the interruptions this then influences among many other creditors and donors) to Zambia stand in stark contrast to what we, and the IMF say are important in terms of making donor aid flows consistent and predictable over time. In our policy briefing, the IMF concurs with our recommendation that donor loans and grants be made more predictable and sustainable and that disbursals are structured to be steady and reliable over a multi-year period. However, the IMF has itself repeatedly cut-off lending and promises of impending debt cancellation when borrowing countries have failed to meet all of its key policy conditionalities. If the IMF adhered to its own advice in this regard, it would cease and desist with such interruptions of aid flows and debt-relief processes.

If "poverty reduction" was truly a leading priority for the IMF as it has claimed since 1999, the IMF would immediately announce that it will not accept payment of the $247 million owed to it by Zambia in 2004 but instead work to ensure that this $247 is redirected towards addressing the HIV/AIDS and illiteracy crises there and to work with other creditors and lenders to arrange for cancellation of 100 percent of the rest of Zambia's unpayable debts due to its emergency situation. However, the reality is the IMF is a creditor institution whose leading priority is to ensure it is repaid while maintaining "macroeconomic stability" according to a definition of stability that is questioned by other economists and in the economics literature. This is why we advocate in our policy briefing for citizens, health professionals and AIDS activists to call upon their own governments, particularly the G7 governments, to make significant changes as to what they are agreeing to on the IMF Executive Board when it comes to inflation targeting, and to take steps to ensure that macroeconomic policies will enable countries to increase spending to combat HIV/AIDS. We acknowledged that the IMF is not mandated with fighting HIV/AIDS. We conclude, therefore, that it is citizens have a particular obligation to hold their own Finance Ministries and Treasury Departments accountable as to their actions taken on the IMF Executive Board and to make certain their governments are not approving any IMF loan conditions that will block progress in the fight against HIV/AIDS in borrowing countries.

In conclusion, we would like to reiterate that welcome and are thankful for the IMF's willingness to debate our analysis with us. While we may disagree on many points, we are glad that the IMF found some points within our policy briefing on which we could agree. We look forward to discussing this issue and others with the IMF in the future.

Sincerely,
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