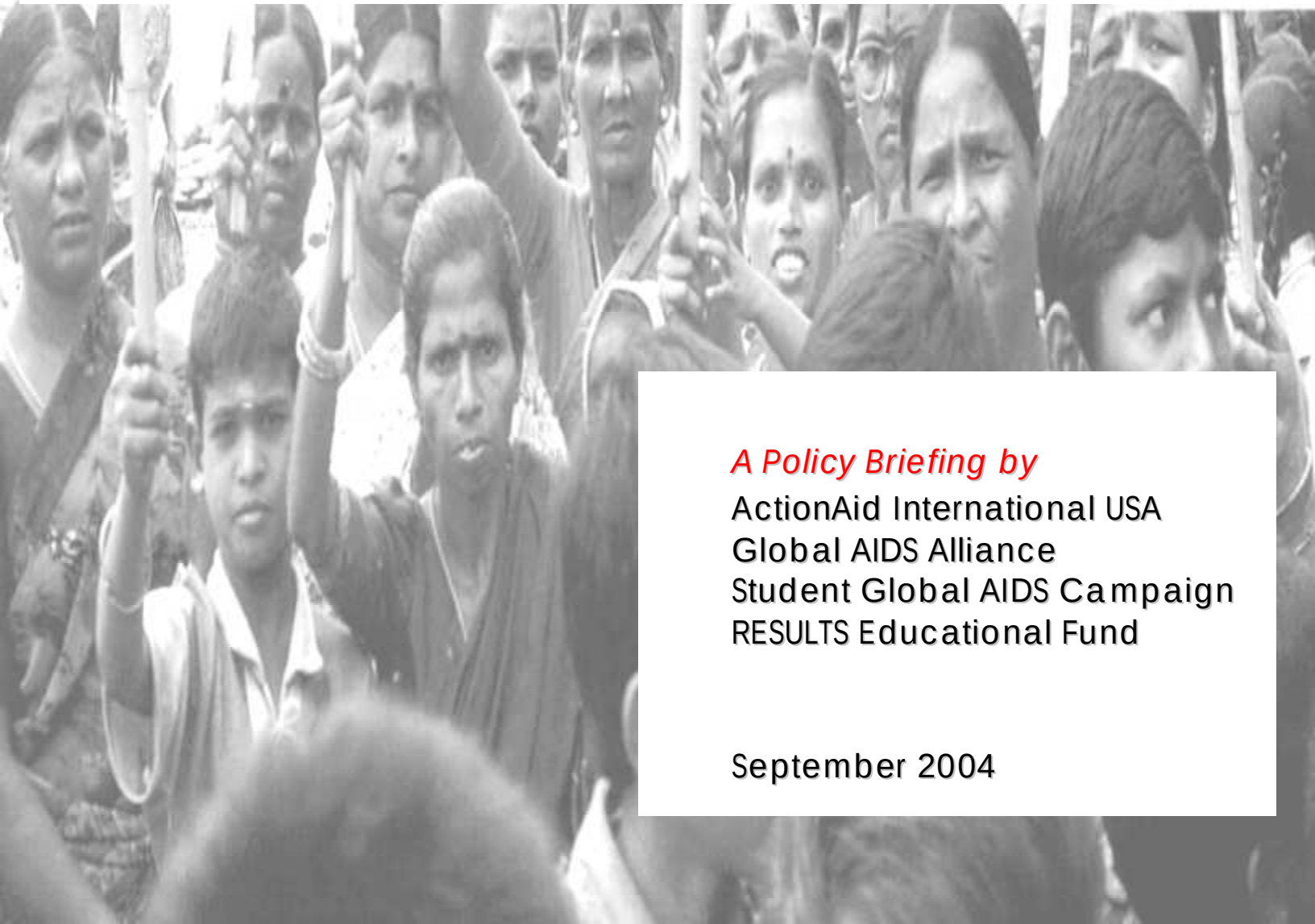
Blocking Progress

How the Fight against HIV/AIDS is Being Undermined by the World Bank and International Monetary Fund



A Policy Briefing by

ActionAid International USA
Global AIDS Alliance
Student Global AIDS Campaign
RESULTS Educational Fund

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Acronyms

DFID	Department for International Development (UK)
EURODAD	European Debt and Development Network
G7	"Group of Seven" wealthiest industrialized countries
GDP	Gross Domestic Product
GFATM	Global Fund to Fight AIDS, TB & Malaria
HIV/AIDS	Human Immunodeficiency Virus/ Acquired Immunodeficiency Syndrome
IMF	International Monetary Fund
MDGs	Millennium Development Goals
MTEF	Medium-Term Economic Framework
OPEC	Organization of Petroleum-Exporting Countries
TB	Tuberculosis
UNAIDS	Joint United Nations Programme on HIV/AIDS
UNICEF	United Nations Children's Fund
US	United States
USAID	United States Agency for International Development
VAT	Value-Added Tax

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Key Points

The Emerging Clash: "Washington Consensus" vs. Fighting HIV/AIDS: The seven wealthiest governments (G7)[i], who dominate IMF decisions and influence most other foreign aid donors have an unjustifiable preference for low inflation in developing countries. Poor countries with severe HIV/AIDS crises will not be able to significantly increase public health spending without the possibility of inflation also increasing slightly, but the G7 governments forbid higher rates of inflation. Effective treatment and prevention of HIV//AIDS in low-income countries will require that G7 governments change their policy position, allowing for desperately-needed increases in public health spending, that may however low the risk, result in slightly higher levels of inflation.

How it Works: Most poor countries with severe HIV/AIDS crises are dependent upon foreign aid from wealthy countries, but must adhere to loan conditions from the IMF, World Bank and other bilateral and international creditors and donors.

World Bank Complicity: Going Along With the IMF Conditions on Foreign Aid: The World Bank stands ready to lend large sums of money to fight HIV/AIDS but will only do so if borrowing countries first agree to adhere to IMF loan conditions, including those that keep inflation low (under 10% per year, or in many cases under 5%). The low-inflation loan conditions prevent higher levels of public spending. The World Bank should de-link their lending from IMF loan conditions.

An Open Question: What is an Acceptable Level of Inflation?: Despite the G7's and IMF's preference for low rates of inflation, there is no consensus among economists on what is an appropriate level of inflation, or at what level inflation begins to undermine economic growth rates.

What Do the IMF's Low-Inflation Targets Have to Do With Fighting HIV/AIDS?: In order to stay in favor with the G7 governments and IMF, and therefore keep access to foreign aid from other donors, borrowing countries must comply with the IMF's loan conditions to set strict limits on public spending in order to keep inflation low. But it is not possible for countries to vastly increase public spending on HIV/AIDS unless these restrictions on increased spending and low-inflation targets are fundamentally changed.

Is the Ability to Increase "Absorptive Capacity" Being Blocked By the IMF?: There is a consensus among all major donors and health professionals that the ability of low-income countries to accept more foreign aid to fight HIV/AIDS must first be improved. To absorb and effectively utilize large new amounts of foreign aid for fighting HIV/AIDS, countries will need to hire more doctors, nurses, medical assistants, administrators and accountants, build and staff more clinics and transport drugs to distant outlying areas in the countryside, etc. In order for governments to build such absorptive capacity, they will first need to increase public health spending, but they cannot do so under current IMF demands to restrict public spending in order to keep inflation low.

Main Point: The Need For Weighing the Trade-Offs: We believe local governments, elected officials, and public health officials in low-income countries should be able to choose for themselves how much more public spending they wish to engage in to fight HIV/AIDS according to their own priorities, and if inflation rises slightly as a result, they should be free to choose this as a trade-off based on those priorities. Local officials should be free to choose among a range of scenarios for higher levels of public spending and any increases in inflation that result, and be able to map out the short-term and long-term costs and benefits of each scenario. The freedom of choice of scenarios should not be precluded from the outset by the G7 governments behind closed doors at the IMF in Washington DC by their insistence that public spending and inflation be kept unnecessarily low.

Take Action: AIDS Activists Must Call on Their Governments to Abolish the IMF's Low-Inflation Targets.

Executive Summary

This briefing explores the logic of International Monetary Fund (IMF) loan conditions to developing countries and why the IMF insists that keeping inflation low is more important than increasing public spending to fight HIV/AIDS in Africa, Asia, Latin America, and Eastern Europe. In 2003, funding levels for HIV/AIDS prevention and treatment are estimated to have reached almost $5 billion; meanwhile financing needs will rise to $12 billion in 2005 and $20 billion by 2007. But if these large increases in foreign aid become available, will low-income countries be able to accept them? Despite the fact that the global community stands ready to significantly scale-up levels of foreign aid to help poorer countries finance greater public spending to fight HIV/AIDS, many countries may be deterred from doing so due to either direct or indirect pressure from the IMF. The IMF fears that increased public spending will lead to higher rates of inflation, but there is an open question in the economics profession about how high is too high, and what is an appropriate level of inflation. Despite this being an open question among economists, the IMF has taken an extremist position that lacks adequate justification. Such a position seriously undermines the best efforts of the global community to meaningfully address the HIV/AIDS epidemic and other health issues such as tuberculosis (TB) and malaria.

There are complex relationships between the levels of government spending, the money supply, inflation rates, and rates of economic growth. There is no doubt that macroeconomic stability is very important and that levels of deficit spending and inflation should not be allowed to rise out of control. Higher government spending could lead to slightly higher rates of inflation. However, while inflation certainly hurts the poor, not increasing public health budgets to fight HIV/AIDS also hurts the poor. The question is one of various trade-offs: how much more public spending would trigger how much higher inflation, and what are the short-term and long-term costs and benefits of a whole range of options that poor countries should consider? An equally important question is who should decide which trade-off is worth it—the IMF in Washington DC or local policymakers in the poorest countries themselves? We believe local policymakers and health professionals should have a range of options to choose from about trade-offs between slightly higher inflation and spending much more to effectively fight HIV/AIDS. We also believe that it is they who should decide, not unaccountable finance ministers of the world's seven wealthiest governments (G7) behind closed doors in Washington DC.

Because the IMF is not accountable to the citizens of any one country, citizens do not have any available direct channel of political recourse within the institution. However, the IMF's Board of Executive Directors, which decides its policies and approves its binding loan conditions for borrowing countries, is comprised of representatives dispatched from finance ministries of its 184 member countries. The G7 countries have the dominant share of voting rights and influence at the IMF. Citizens of the world's poorest countries, which are most impacted by IMF loan conditions, have the least political recourse through their governments to influence IMF decisions.

Therefore, we call on citizens of the G7 countries, and particularly the United States, to hold their governments accountable for the decisions they make at the IMF Executive Board.

Policy Recommendations:

- G7 Governments should issue clear policy positions on exactly how flexible they are willing to be in terms of increases in inflation levels that may result from higher public spending in countries that borrow from IMF.
- G7 Governments should issue clear policy statements ensuring that they will take no actions on the IMF Executive Board that will result in undermining the fight against HIV/AIDS and other health crises.
- G7 Governments should promise to lend their technical expertise to publicly provide an wide array of macroeconomic policy scenarios, that allow citizens and policymakers in low-income countries to make informed choices about the trade-offs and short and long term costs and benefits of increased public spending on HIV/AIDS and the slightly higher inflation that may result.

How the Fight Against HIV/AIDS is Being Undermined by the World Bank & International Monetary Fund

Overview: This policy briefing provides an overview of the important questions that have been raised over the last two years after which the Ugandan finance ministry attempted to block the acceptance of a $52 million grant awarded by the Global Fund to Fight AIDS, TB, and Malaria (GFATM). This briefing explores the logic of International Monetary Fund (IMF) loan conditions to developing countries, IMF budget austerity, the reasoning behind strict "budget ceilings" and why the Ugandan finance ministry may believe that adhering to such ceilings is more important than using new money for stepping-up the fight against HIV/AIDS. Will we see more such cases play-out among other countries that are awarded GFATM grants?

Speaking at the World Bank in November 2003, UNAIDS Exe cutive 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."

The Emerging Clash: "Washington Consensus" vs. Fighting HIV/AIDS

In recent years it has become widely accepted in the global community that much more needs to be done to address the HIV/AIDS epidemic, both in terms of increasing the levels of foreign aid from rich countries to poorer ones, and in terms of poor countries themselves increasing their public spending and political will to address the epidemic. International foreign aid donors have agreed to adopt the United Nations Millennium Development Goals, one of which seeks to halt and begin to reverse the spread of HIV/AIDS and the incidence of malaria and other major diseases in low-income countries by 2015. In 2003, funding levels for HIV/AIDS prevention and treatment are estimated to have reached almost $5 billion; while financing needs will rise to $12 billion in 2005 and $20 billion by 2007. Billions of dollars in increased foreign aid will also be required if the other Millennium Development Goals are to be achieved.

But if these large increases in foreign aid become available, will low-income countries be able to accept them?

The latest Annual Report released by UNAIDS offers new statistics about the spread of the disease, and highlights the desperate need to increase public spending to fight HIV/AIDS.[ii]

The global number of people living with HIV continues to grow – from 35 million in 2001 to 38 million in 2003. An estimated 25 million people are living with HIV in sub-Saharan Africa.

In 1995 AIDS treatment became available in the US. But today, only 7% of people in developing countries have access to antiretroviral treatment: fewer than one in ten. Five to six million people need HIV treatment in low- and middle-income countries, yet only 7% -- or 400,000 people -- had access by end 2003. In Africa, only 2% of people with HIV have access to life-saving medicine

There is a deepening and unresolved contradiction between the growing recognition of the need for low-income countries to significantly scale-up their public health systems to effectively fight HIV/AIDS and the continuing dominance of the market-based "structural adjustment" policy reforms required of low-income countries who receive loans from the International Monetary Fund (IMF). Known as the "Washington Consensus" because these policies are most heavily favored by the US Treasury Department, the IMF has attached these preferred economic policy reforms as binding loan conditions for developing countries for the last 20 years. They have been based on the goals of reducing high inflation and then maintaining inflation at very low levels (below 10 %) while also instituting a host of other policy reforms such as privatization, trade liberalization, subsidy cuts for prices of key goods and services, deregulation and financial liberalization. While many of these loan conditions have been highly controversial over the years, perhaps the most important IMF loan condition at odds with the fight against HIV/AIDS is that which compels low-income countries to tightly restrict their public spending, and the resulting limitations on their levels of public health expenditures. Such economic policies are in direct conflict with the objectives of AIDS activists who seek to significantly increase national public spending on the fight against HIV/AIDS.

How It Works: The Power and Leverage of Conditions on Foreign Aid

Rich countries give foreign aid to poor countries through both bilateral agencies such as US Agency for International Development (USAID) or the UK Department for International Development (DFID), or through international institutions such as the World Bank or the IMF. Often foreign aid comes with strings attached, and the countries that receive foreign aid or borrow from the World Bank and IMF must agree to enact a range of economic policy reforms. Therefore the rich donors can exert tremendous influence and leverage over the economic policies in poorer countries which are desperate for aid and financing. Because one of the key goals of the IMF policy reforms in low-income countries is to achieve and maintain low inflation rates, the IMF has long favored using loan conditions to insist that borrowing countries enact strict restraints that prevent countries from spending too much money in their national economies, whether this comes from increased government spending and higher deficit spending or from increased foreign aid. Because inflation rates are correlated with how much money is put into the domestic economy, the IMF has sought to use its leverage over low-income countries that borrow from it to call on them to reduce public spending. For many years the IMF put strict limits on how much of a fiscal budget deficit a country could have, but in recent years it has insisted that some low-income countries cannot run any budget deficit at all, and in some cases, the IMF has even insisted that countries actually run a budget surplus and put the extra money into reserves.

World Bank Complicity: Going Along With the IMF Loan Conditions

When it comes to the types of loans given—and loan conditions--the long-standing tradition in the relationship between the IMF and World Bank is that they each have their areas of expertise for which they are responsible. Issues related specifically to finance, such as fiscal policy (national budgets, public spending levels) or monetary policy (inflation rates, money supply, currency exchange rates or interest rates) have been the purview of the IMF. Issues related to broader development policy, such as large infrastructure development projects, trade liberalization, privatization of public companies and social sector policy reforms, have been the purview of the World Bank. While the World Bank gives hundreds of millions of dollars in loans each year, the IMF actually gives relatively much less money, and often in the form of lines of credit.

However, the broader development work of the World Bank is often seen as subordinate to the more important IMF mission of achieving "macroeconomic stability" and first ensuring that borrowing countries have agreed to implement what the IMF considers to be "sound macroeconomic policies," including adopting low-inflation targets. The IMF's approval of countries' macroeconomic policies functions as a type of international credit rating agency, and serves as an important signaling effect, or "green light" that then opens the doors to millions of dollars in foreign aid from other bilateral and multilateral donors and creditors around the world and private foreign direct investment. But when the IMF gives a "red light", aid from all of these other donors and creditors and foreign investment can be cut off. It is the tremendous power of this signaling affect that gives the IMF so much power over the world's poorest countries, including the power to impose low-inflation policies.

Therefore, even the World Bank will not approve the majority of its large development loans to borrowing countries unless the IMF first grants the green light. The World Bank's operational policies stipulate that, "The Bank undertakes… lending in a country only when it has determined that the country's macroeconomic policy framework is appropriate. The release of each tranche (portion) requires the maintenance of an

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Ugandan Finance Ministry to GFATM:

"No Thanks!"

In 2002, Uganda was awarded a $52 million grant from the Global Fund to Fight AIDS, TB and Malaria (GFATM), but the Ugandan finance ministry began to state that it could only accept the money if Uganda cut out $52 million from the existing health budget. The GFATM objected to this, since any grant that it awards must be in addition to current government spending. Thus set in motion a controversy which flared until December, 2003, when under public pressure, the finance ministry relented and finally agreed to let the first $18 million installment of the GFATM grant enter Uganda as additional monies to the existing health sector budget. However, senior officials in the Ugandan finance ministry have suggested that the following installments will not be additional.

Why would the Ugandan finance ministry take this position? Several important issues have arisen in this case, which stand to have wider implications for many other countries.

The first argument offered by the Ugandan finance ministry was that an excessive inflow of foreign aid into Uganda's domestic economy at one time could lead to an increase in the value of the local currency, the Ugandan Shilling, which could increase the spending power and consuming demand of Ugandans. In turn, more spending could lead to higher levels of inflation. This is known as "Dutch Disease," after profits from new oil sales flooded Holland's economy in the 1970s and was correlated with an over-valued currency that made their exports less competitive on world markets. However, the former IMF advisor and Columbia University economist, Jeffrey Sachs, wrote an open letter to the Ugandan Government in 2002 debunking concern over an appreciation of the Ugandan Shilling as the main reasoning of the finance ministry's decision. Sachs pointed out, "the risks of currency overvaluation from donor-financed health spending are way overblown… I don't know of a single country case where increased donor-financed health spending to respond to epidemics such as HIV/AIDS has been a trigger for macroeconomic instability. On the contrary, there is real and shocking macroeconomic instability caused by the failure to respond to such epidemics, since these epidemics result in a cascading destruction of families, communities, and businesses."

The second reason offered by the Ugandan finance ministry for attempting to turn down the money awarded by GFATM was that the health sector budget ceiling for the current three-year period was already set as a sub-sector within the national budget ceilings that have been agreed upon with the IMF, and they were committed to strictly adhering to the current budget expenditure plans as laid out in their 3-year Medium-Term Expenditure Framework (MTEF). The MTEFs are three-year budget windows used by many governments to ensure strict adherence to spending plans for all sectors in the economy, including the social sectors such as health and education. The MTEFs can be effective at "ring-fencing" or protecting health budgets from over-spending by other ministries. At issue in the Uganda case may well be the rigidity of the fixed budget ceilings for the various sectors in the MTEFs. Because the ceilings for the first of the three years in the MTEFs are not flexible, the Ugandan finance ministry had no way of raising the health sector budget ceiling (thus the overall national budget expenditure ceilings) in order to make room for accepting the GFATM money. To accept the money would have meant violating the strict agreements on the overall national fiscal deficit level, the overall public expenditure level, and possibly the level of inflation that Uganda had committed to with the IMF. So Uganda was faced with a choice of either accepting desperately-needed money to fight HIV/AIDS or violating its loan conditions on the fiscal and monetary policies it had agreed to with the IMF. ***The IMF's original low -inflation target, to which everything else was subordinated, was not up for debate.***

Another way of looking at the choice is: Which was Uganda more afraid of—an outraged GFATM, HIV/AIDS advocates, and its own citizens—or the IMF? Obviously, Uganda was very hesitant to violate its commitments made to the IMF, since the IMF has the power to signal to all of the other bilateral and multilateral creditors and aid donors if it thinks Uganda's economy is appropriately stable. When the IMF gives a green light signal, this opens the doors to millions of dollars from other donors and creditors around the world; but when the IMF gives the red light, aid form all of these other donors and creditors can be suspended. It is the tremendous power of this signaling affect that gives the IMF so much power over the world's poorest countries.

One thing that can be done in order to prevent the same problem from occurring in other countries whose finance ministries also use MTEFs is to critically scrutinize the METFs as planning devices, and find ways to make them more flexible so they can positively respond to newly-available and unanticipated funds that may become available during budget planning cycles. But ultimately, it will be the IMF's insistence on very low inflation targets that must be scrutinized and be brought into the center of public debates if countries are ever to be allowed to scale-up public health spending effectively to fight HIV/AIDS.

Appropriate macroeconomic policy framework."[iii] Further, the Bank's policies explain, "The presence of an appropriate IMF program is usually an important input in this determination. If there is no IMF arrangement, Bank staff ascertain, before making their own assessment, whether the IMF has any major outstanding concerns about the adequacy of the country's macroeconomic policies." In essence, this means the World Bank is in a subordinate position to the IMF when it comes to macroeconomic policies, including inflation targets and limits on government spending. Even when some World Bank economists may disagree with particular IMF policies, institutionally the World Bank goes along with what the IMF calls for on these matters. In so doing, the World Bank is complicit in IMF budget austerity policies that may prevent poor countries from spending more on fighting HIV/AIDS.

Inflation is the Issue

Why does the IMF believe achieving low inflation rates is so important? According to the IMF, levels of inflation above 10% hurt the poor because they raise the prices of basic consumer goods, drive away foreign investors, and undermine the prospects for future economic growth rates (Note: inflation also hurts politically powerful foreign and domestic investors and financiers, as the value of their bonds and other investments is diminished by increased inflation rates (See the Box: *The Politics of Inflation: Who Likes It The Least?*). The IMF also believes that governments whose public expenditures and fiscal deficits are too high risk putting too much money into the economy at one time (the money supply), which could increase consumer demand and threaten to increase the rate of inflation. Therefore, the IMF believes that once borrowing countries have achieved low levels of inflation, placing strict limits on the level of public expenditures is the best way to prevent excessive deficit spending that could spark higher inflation.

This logic has resulted in the IMF insisting (with binding loan conditions) that low-income countries that must borrow from it be required to implement economic policy reforms designed to maintain low-inflation. The primary tool used is for the IMF to make an agreement with the borrowing country on a low-inflation target. Based on this target, limits on how much money can be in the economy (money supply) are decided, and from this, caps on the overall "resource envelope" are decided (see page 19 *"5 Steps to Blocking the Fight Against HIV/AIDS"*). This means deciding how much money countries will spend in their national budgets, as well as how much foreign aid will be accepted into the economy in a given year. Based on the inflation goal and the related money supply goal, and the limits on government spending and foreign aid that result from them, a 3-year planning tool called the medium-term economic framework (MTEF) is used to help the country plan its spending priorities over the 3-year period. The MTEF ensures that borrowing countries will make spending plans that stay within the limits determined by the low-inflation targets agreed upon with the IMF as a condition for lending. Most low-income countries have acquiesced to these low inflation targets because they are desperate to get the "green light" approval rating from the IMF so that they can retain access to all other bilateral and multilateral creditors, foreign aid donors, and private foreign investors.

Once achieved, the IMF insists that borrowing countries maintain low inflation targets generally below 10%, and often as low as 3% - 5%. For example, an Oxfam International and EURODAD survey of 20 developing countries that have followed low inflation targets as conditions for IMF loans 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%.[iv] The uniformity of the IMF's macroeconomic policy targets for low inflation

rates (which result in the caps on deficit spending, caps on overall budget expenditure, and subsequently caps on the health budget and caps on the wages of health workers) contrasts with the fact that there can be no "one size fits all" approach in terms of addressing the challenges of a scaling-up of resources for HIV/AIDS. Countries differ in their states of the HIV/AIDS epidemic; their human resources and system capacity to quickly absorb additional foreign aid resources; and in the state of play in terms of their macroeconomic policy environment because of unknown variables such as external shocks to their economies like floods, droughts or drops in the prices of the exports in international markets.

Why Does the IMF Insist on Low Inflation?

The IMF states that its primary mission is to maintain "macroeconomic stability," which it defines as countries having "current-account and fiscal balances consistent with low and declining debt levels, inflation in the low single digits and rising per capita GDP"; whereas the IMF perceives macroeconomic instability as countries having "large current-account deficits financed by short-term borrowing, high and rising levels of public debt, double-digit inflation rates and stagnant or declining GDP".[v] The US Treasury Department, which has the most decision-making power on the executive board of the IMF, defines macroeconomic stability as consisting of three main features: 1) generally preventing financial crises in the global economy (such as the East Asia currency crisis of the late 1990s); 2) preventing countries from engaging in competitive devaluations with one another; and 3) preventing countries from "slipping" into higher inflation rates or into "hyperinflation" as was common in the late 1970s and early 1980s.[vi] As long as these three goals are being met, then the IMF is meeting its mission. Therefore, insisting that its borrowers maintain low inflation rates is understood to be a major part of the IMF's mission of ensuring macroeconomic stability in the global economy. Enabling countries to significantly scale-up public health spending to fight HIV/AIDS is not an explicit part of the IMF's mandate.

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What Is Sacrificed In Order To Maintain Low Inflation?

The price low-income countries pay for the IMF's use low-inflation targeting in its binding loan conditions is to sacrifice potentially higher economic growth rates, higher levels of employment, *and higher government spending* . A US General Accounting Office report cautioned, "Policies that are overly concerned with macroeconomic stability may turn out to be too austere, lowering economic growth from its optimal level and impeding progress on poverty reduction."[vii] The reason for such huge sacrifices is that the key method governments use to maintain low inflation is to reduce the level of overall economic activity in the national economy because too much money in the economy and too much spending power in the hands of businesses and consumers can spark a rise in inflation. Therefore, keeping inflation at very low levels involves sacrificing would-be higher levels of economic growth, employment and public spending.

The IMF logic is to use economic policy tools that will deliberately dampen the level of economic activity happening in the country as a way to keep inflation low. The main fiscal policy (national budget) tool used to dampen national economic activity is simply keeping

public expenditures low and limiting the inflow of foreign aid (our primary concern here). The two main monetary policy tools used to dampen national economic activity are the reduction of the amount of money circulating in the money supply and/or the raising of interest rates so that companies and individuals will slow down their borrowing and spending generally (as regular commercial loans or bank loans become too expensive). Therefore, potentially higher economic growth rates, more employment, and increased government spending are all sacrificed in order to keep inflation rates low. While the IMF often states that macroeconomic stability is required in order to realize higher economic growth rates, which are necessary to achieve poverty reduction, a better way to understand this claim is that the IMF is in favor of *whatever economic growth rates are possible after inflation is kept low* . While these economic policies may work to serve the IMF's goal of keeping inflation rates low, they are wholly incompatible with the need to significantly scale-up public spending on the national health budgets to effectively fight HIV/AIDS.

Finance ministers from the world's poorest and most heavily-indebted countries do not share the IMF's or US Treasury's concern with inflation. Indeed, high inflation rates have not been an apparent problem for many of their countries. Rather, they perceive a desperate need to vastly scale-up economic growth rates, employment and public spending for health and education, even at the risk of experiencing slightly higher inflation. In a formal declaration from an April 2002 meeting, these ministers stated their desire to see more "flexible growth-oriented macroeconomic frameworks," and the need "to think more closely about ways to increase growth and employment rather than further reducing inflation."[viii] But the IMF's concerns have overruled those of these finance ministers.

Today, there is a sense of despondency among many poor countries who are desperate to borrow from the IMF in order to maintain their access to all other major foreign aid donors and creditors. "It's not like they are losing the fight over the issue of low-inflation targets and low public spending with the IMF," said Joanne Carter, Legislative Director of US-based RESULTS Educational Fund, and a leading expert on tuberculosis and other diseases associated with poverty in developing countries. "It's more like they are not even fighting."

Not only can the IMF's hyper-vigilance against inflation impose serious costs on living standards and undermine potentially higher levels of economic growth, numerous studies have shown that there is little empirical evidence to support the IMF's common assertion that moderate levels of inflation (from 10% to 30%) hurt countries' economic growth performance; in fact, several major studies have shown that serious damage to economies usually occurs only after inflation rates rise above 30% or 40%.[ix]

An Open Question: What is an Acceptable Level of Inflation?

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. One leading expert who is considered tough on inflation, Robert Barro, has found that levels of between 10% - 20% per year have only low costs to overall economic growth rates, while all inflation rates below 10% have no discernable negative impact on growth.[x] The IMF's sister institution, the World Bank, differs strongly on the question. For example, a major comprehensive World Bank study of the link between inflation and economic growth in 127 countries from 1960 to 1992 found that inflation rates below 20% had no

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>
> - Joanne Carter, RESULTS Educational Fund

obvious negative impacts for long-term economic growth rates.[xi] While the IMF claims that high inflation will scare away foreign investors, another study showed for middle-income countries, rates of inflation up to 20 % had no clear negative effect on economic growth rates, domestic investment, or inflows for foreign direct investment.[xii] Another study showed that rates of inflation between 15% - 30%, considered "moderate", can be sustained for long periods of time without damaging economic growth rates.[xiii] Indeed, the historical record is replete with many 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.[xiv] Similarly, Japan and South Korea enjoyed high rates of economic growth in the 1960s and 1970s while also experiencing inflation rates of about 20%.[xv] However, despite there being no clear answers to this question on what is an "appropriate" level of inflation among the professional economists, the IMF is sitting on one extreme end of this debate, without adequate justification.

What Do the IMF's Low-Inflation Targets Have to Do With Fighting HIV/AIDS?

If budget planning begins with the IMF's low inflation targets, then everything else becomes subordinated to those low inflation targets, including how much money will ultimately be available to spend on AIDS: a) Once the borrowing country and the IMF agree upon the exact low inflation target, then a limit is created for how much spending can happen in the economy in the year (the money supply); b) the limit on the allowable level of money in the economy then is the basis for determining the ceilings on the overall national "resource envelope," which includes both domestic tax revenues and foreign aid coming into the country for the year (minus debts paid to creditors); c) this ceiling for the national resource envelope then determines the ceilings for the national budget; and d) based on the limit of the national budget, then individual budget ceilings are decided for each sector of the national economy, such as agriculture, education and health. In this way, such IMF

The Politics of Inflation:

Who likes it the least?

Obviously high levels of inflation hurt everyone, and no one wants their next paycheck to buy less than their last paycheck. While it is generally accurate for the IMF to point out that inflation hurts the poor as prices rise for basic goods, this neglects other more political questions about which sectors of society are hurt relatively more by inflation than others. In other words, who stand to lose disproportionately? All interest groups in society can harmed by high levels of inflation, including the financial community. As global finance has been liberalized over the last decade, the links between international and domestic financiers have strengthened, along with their mobility, political power and the increase of short-term speculative capital flows across international borders. Relatively speaking, global and domestic financiers are the most directly and profoundly affected by higher inflation, as it can diminish their expected level of profits over the lifetime of an investment project, loan, stock or bond before those profits can be realized.

One way the IMF advises governments to maintain low inflation is to reduce economic activity, borrowing & spending generally, and an effective way to do this is to raise interest rates on commercial loans for businesses. Therefore, potentially higher economic growth rates and more employment are sacrificed in order to keep inflation rates low. The high interest rates are meant to discourage over spending in the economy that could threaten to spark higher inflation. But who wins and who loses when interest rates are pushed higher in order to keep inflation low?

Local small and medium-sized companies, industrialists and export-oriented producers who hire many employees do not share the financial community's obsession with the need for low inflation. These sectors of society suffer disproportionately from high interest rates because they cannot afford to borrow regular commercial loans for their businesses or to invest in hiring more employees. But in contrast to those hurt by high interest rates, global financiers, speculators, bond holders and other types of investors tend to profit handsomely from the high interest paid to them when loans and bonds are repaid.

In his book, *Globalization and Its Discontents* (2002), former World Bank chief economist and Nobel Laureate Joseph Stiglitz, explained, "Wall Street regards inflation as the worst thing in the world; it erodes the real value of what is owed to creditors." Referring to the IMF loan conditions in the Asian crisis of the late 1990s, Stiglitz pointed out, "An excessive focus on inflation by the IMF led to high interest rates and high exchange rates, creating unemployment but not economic growth. Financial markets may have been pleased with the low inflation numbers, but workers—and those concerned with poverty—were not happy with the low growth and high unemployment numbers.

low-inflation targets ultimately end up translating into direct spending limits for the health sector.

These national and sector ceilings become the basis for planning 3-year budget planning in the MTEFs. The IMF often points out that it does not make loans conditional on how borrowing governments decide to allocate funds among their various sub-sectors of the national economy. However the IMF does make loans conditional on not overspending on agreed national budget ceilings, budget deficit limits, and the subsequent impact these may have on the level of inflation. In turn, the health sector spending limits include ceilings on the "wage bill," or the money available for the salaries of public staff, such as doctors or health workers.

AIDS activists and health care professionals first became alarmed at the role of IMF low inflation targets resulting in limits on public spending in 2002 when Uganda attempted to turn down a $52 million grant from the Global Fund to Fight AIDS, TB and Malaria *(See the Box: "Ugan dan Finance Ministry to GFATM: "No Thanks!")* . Because accepting the grant would have violated Uganda's agreement on public spending reached with the IMF, the Ugandan Finance Ministry first claimed the money could only be accepted if it reduced the existing health budget by $52 million. Because GFATM money is to be additional, the GFATM refused. Negotiations among the GFATM, Health Ministry, and Finance Ministry officials eventually led to an agreement in 2003 that enabled Uganda to accept the first portion of the GFATM money without reducing its own health spending. The finance ministry agreed to receive the funds outside of the normal health budget, thus avoiding the budget ceiling. Beginning in July 2004, however, the GFATM money (and other grants) will have to fit within the planned health sector budget ceiling in order for Uganda to accept the funds. The ceilings will be raised to accommodate grants from the GFATM, which had approved $135 million in grants to Uganda through 2003. As of January 2004, health officials were still negotiating with the Finance Ministry to ensure that the health sector ceiling will have the room necessary for these as well as any other grants that may become available.[xvi] More recently, however, health ministry officials have indicated that in fact the health budget remains the same, suggesting that the GFATM money will continue to be received through a separate channel.

In response to criticism it was receiving about Uganda's temporary refusal to accept GFATM money without reducing its own health spending, the IMF issued a press release denying their involvement in Uganda's actions: "It is not true that Uganda may have to refuse aid for health or any other poverty-eradication programs in order to adhere to IMF-imposed guidelines."[xvii] The letter did state that "managing large aid flows and their impact on the economy at large is a legitimate concern for governments." However, it continued, "In the specific case of Uganda, given that the aid flows in question are to be used for top priority spending such as imports of life-saving drugs and other essential medical supplies, we do not see any adverse effects on the macro economy." Aid spent on imported medicines and medical equipment has lesser macroeconomic effects than aid spent on domestic goods and services. But Uganda and the IMF are still concerned about the spending increases related to hiring additional domestic staff and health personnel to administer and use the increased foreign aid, and the possibly higher inflation that could result from this increased public spending.

The original IMF "structural adjustment" stabilization loans were meant to address the crisis of "hyperinflation" in the late 1970s and early 1980s.[xviii] This crisis was caused by a confluence of four major developments in the global economy: a) two global economic recessions; b) these economic slow-downs lowered the consumer demand in rich countries

for goods produced in poor countries, which resulted in prices for goods from poor countries dropping significantly; c) the OPEC oil cartel raising prices on oil, which deepened the debt burden of poor countries who imported oil; and d) interest rates on earlier development loans increased significantly, making debt-payments more costly. With poor countries earning much less than they had expected from their exports, and paying much more for imported oil and interest payments on loans, these trends contributed to overspending into deep "debt crises", and extraordinary cases of runaway hyperinflation.

Partially in response to these "debt crises," the key "structural adjustment" loan conditions then offered by the IMF and World Bank were designed to lower inflation to controllable levels. However, these resulted in massive cuts in overall national spending, and because the health and education budgets of many poorer countries had often comprised the largest portions of overall national budgets, these sectors consequently suffered the brunt of the massive budget cuts. By 1987, a UNICEF-sponsored study indicated that a combination of the global economic recessions, oil price increases, higher interest payments, and the severe cuts in social spending demanded by IMF budget austerity loan conditions had the effect of reducing such basic indicators of child welfare as nutrition, immunization levels and education.[xix] Among the consequences was reduced access to such services as health care and education as public expenditures were cut and user charges were introduced.[xx]

Long after the crises with hyperinflation had subsided (by the late 1980s), most public health systems have continued to suffer from insufficiently low budgets to meet the needs of their people.[xxi] Since the dramatic budget cuts of the early 1980s, the cumulative long-term effect of this low-inflation budget austerity in IMF loan conditions over many years has been the chronic and sustained under-funding of public health systems in countries across the developing world over the last 20 years. And because any effort to effectively battle HIV/AIDS must be built on the foundation of an adequately funded and staffed national health system, these current levels of health spending must be vastly increased.

Either way, Zambia cannot raise the wage bill high enough t o retain the doctors, teachers, or healthcare professionals needed to fight HIV/AIDS. Why? Because the IMF fears inflation.

Because the IMF's low-inflation targets lead directly to ceilings on overall national public spending, which in turn inform the ceilings on public health budgets, this process places severe limits on what is possible in the fight against HIV/AIDS. When borrowing governments spend more than they earn in tax revenue or bring in from foreign aid and therefore run up budget deficits, the IMF often makes new loan conditions that call on countries to lower the level of their budget deficits. The IMF often claims that central banks will simply print more money to pay down their higher deficit spending and this will spark higher inflation rates, yet there is no empirical evidence in the economics literature that indicates high deficits lead directly to higher inflation.[xxii]

Further, the IMF claims that the increase in economic activity that is associated with higher government spending in low-income countries will lead to higher inflation, but much of the research used to justify this claim is based on the experiences of industrialized countries. There is no empirical evidence that this is actually the case in poor countries. Higher public spending in lower-income countries may not necessarily lead to higher inflation rates because unlike rich countries, most developing countries have "excess capacity," including high unemployment and a low levels of resource utilization (e.g., the existing factories are not producing at their maximum output). When there is such "slack" in the economy (under-utilized resources), the idea that increases in public spending somehow pushes an economy past its limits (creates inflation) in reality does not hold up based on the economics literature.[xxiii]

One comprehensive study shows that the actual relationship between deficits and the money supply in developing countries is far more complex than the

IMF is willing to acknowledge.[xxiv] Nevertheless, the IMF has made deficit reduction a cornerstone of its low-inflation policies that are among its binding conditions for borrowing countries. This has lead to perverse situations in which countries which could be using more of their own domestic revenues and foreign aid 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).

An OXFAM International study of IMF budget austerity demonstrated how unjustifiable deficit reductions 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.[xxv] 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.[xxvi]

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.[xxvii] 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 is 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.

Is the Ability to Increase "Absorptive Capacity" Being Blocked By the IMF?

Abstract debates about macroeconomic policies, inflation rates, fiscal deficit levels, etc. can obscure the more concrete problems faced by AIDS activists and health professionals in the fight against HIV/AIDS. One such area is the issue of "absorptive capacity" (the degree to which countries are capable of using large amounts of new foreign aid that may become available) and the need for "capacity building." If poor countries with dilapidated public health systems are to be capable of "absorbing" new, large increases in foreign aid to fight HIV/AIDS, they will first need to train and hire more doctors and health care workers, build more clinics in the countryside, train and hire staff to deliver medicines to distant outposts, train and hire more qualified accountants and public administration managers for public health systems. While everyone agrees that building absorptive capacity must urgently be scaled-up if large increases in foreign aid can be used effectively, one contradiction that the IMF has not satisfactorily answered is how this money will be allowed to be spent while its current macroeconomic policies militate against increasing public expenditures. Obviously, any effort to build such absorptive capacity will require increases in overall public spending, but how can this happen within the confines of the IMF's insistence on keeping inflation low? Nowhere is this unanswered contradiction more evident than in the strict caps on the overall national "wage bill" for public sector employees. How can countries use new increases in foreign aid to hire more staff and offer more competitive salaries to retain skilled professionals while the wage bill is often so constrained by the IMF's low-inflation targets and other expenditure

constraints? This contradiction highlights the core of the fundamental problem with the IMF's low inflation targets.

The IMF's low-inflation targets contribute to severe limits on the public health budget and leave many low-income countries without the means to pay for needed doctors and health workers. For example, in AIDS-stricken Kenya, more than 4,000 nurses and several thousand other health workers are already trained and eager to work in their profession, but remain unemployed because of the strict limits on the wage bill for the health sector.[xxviii]

The low-inflation targets that translate into national budget ceilings, health budget ceilings, and ultimately into caps on the numbers of doctors and nurses that can be hired, lie at the heart of how the IMF's policies are undermining the fight against HIV/AIDS. An IMF publication from 1998 explained, "..since there is no ideal size for a country's civil service, its actual size is likely to continue to be dictated by macroeconomic realities, such as the need for fiscal adjustment, the amount of tax revenue available to pay civil servants, and the balance between wage and non-wage government spending." It notes that hiring freezes are one way of further reducing the civil service and preventing over-spending in the public sector.[xxix]

Zambia: Inflation or Death?

In the year 2000, Zambia became qualified to become eligible to receive up to a 50% reduction in its foreign debt burden as a possible beneficiary of the Heavily Indebted Poor Country (HIPC) initiative. All it had to do was follow all of the IMF's loan conditions satisfactorily for three years, and then it could benefit from a 50% reduction of its huge external debt of $6.8 billion. One of the binding IMF loan conditions called for Zambia to impose a strict cap on the government's wage bill at no more than 8% of its Gross Domestic Product (GDP). However, the Zambian government is the country's biggest employer, and the government is regularly faced with the threat of a worsening "brain drain," in which skilled professionals leave the country in search of higher wages abroad. In an attempt to stem this tide of fleeing professionals, the government introduced a housing allowance system that made staying and working in Zambia more attractive. The housing allowance was one of a number of measures contributing to an increase in civil service wages. Others were wage increases to security and defense forces, as well as the hiring of additional teachers and wage increases for established educators. As a result, the ratio of public sector wages to GDP reached 9%, exceeding the 8% agreed with the IMF in the budget agreement. Thus, Zambia was considered "off-track" with its IMF loan program, and was suspended from eligibility to receive debt relief. This means that Zambia will continue to pay close to $300 million in annual debt service payments to foreign creditors in rich countries. This amount will be drained from Zambia's scarce domestic revenues in 2004. If this issue is not resolved with the IMF, even larger payments from this desperately-poor country will be expected for subsequent years,

According to the IMF, Zambia can take steps to get back "on-track" with its IMF program, and again be in a position to eventually receive debt relief. But an IMF condition for doing so is to reduce the budget deficit to the agreed-upon target of not more than 3% of GDP and maintain a public sector wage bill of not more than 8% of GDP. Additionally, Zambia must privatize its remaining public utilities and state-owned companies in the energy and telecommunications sectors. To make matters worse, the monies realized from the sale of the utilities and companies must be used for increased debt servicing, and not for investment or consumption purposes.

The Zambian government is at a crossroads. If it pleases the IMF by going along with the new conditions, it is likely to cause industrial unrest by workers opposed to privatization in the energy and telecommunications sectors. If it goes with the will of the people and seeks to maintain public ownership of these companies, the country will miss its chance at receiving debt-relief and have to pay hundreds of millions of dollars more in debt servicing every year. Either way, Zambia cannot raise the wage bill high enough to retain the doctors, teachers, or healthcare professionals needed to fight HIV/AIDS. Why? Because the IMF fears inflation.

Source: "Life Under the IMF's Magnifying Glass," BrettonWoods Update No. 39. March -April 2004. http://www.brettonwoodsproject.org/article.shtml ?cmd[126]=x126 -42221

UNAIDS on IMF Budget Ceilings

"The problem of displacement of funding and expenditure ceilings.

It is an unfortunate reality that budgeting procedures too often may mean that new funds for HIV and AIDS can draw resources away from other activities, either at country level, or at donor level. Therefore, all parties need to commit themselves to the principle that additional funding for HIV and AIDS is to be used for additional spending, otherwise displacement is inevitable to the detriment of overall development.

Public expenditure ceilings are limits to expenditure within different sectors of an economy. In the 1970s and 1980s, caps on social spending, in particular, were a principal feature of structural adjustment programmes called for by the International Monetary Fund and the World Bank as conditions for concessional borrowing of money by low- and middle-income countries. Caps were considered a necessary discipline to mend ailing economies, promote growth, and ease poverty in the long run by curbing inflation. But when they were seen to intensify the hardship of the poor, they came under intense criticism, and were dropped as a specific condition for financial assistance.

Nevertheless, they exist *de facto* in many countries as a by-product of Medium Term Expenditure Frameworks. These frameworks are countries' detailed financial plans, required to show the Fund and the World Bank that they can balance their books and keep the macroeconomy on track. They are often included in, or referred to, by Poverty Reduction Strategy Papers, which are the basis on which public debt relief is granted, and much foreign aid is given. Low- and middle-income country governments are caught in conflicting pressures. They are exhorted to limit social spending in order to avoid damaging inflationary consequences, and yet are expected to ignore such pressures in the case of Global Fund or other earmarked money.

It is time to radically rethink how best to fund comprehensive country HIV programming. International financial institutions need to create mechanisms that alleviate countries' debt-service payments so they can devote additional resources to their AIDS response. 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."

Excerpted from: UNAIDS 2004 Report on the Global AIDS Epidemic,
4th Global Report, June 2004, pp. 145-6

Another example of the budget constraints on hiring adequate health workers to fight against HIV/AIDS is Mozambique. When the Clinton Foundation, headed by former US President Bill Clinton, attempted to provide resources for supporting the Government's efforts to expand treatment programs, it found it needed to intervene directly with the IMF to overcome the constraints. After such high-level intervention and negotiations with the IMF, the Clinton Foundation reported later that the "IMF has agreed to reduce restrictions on employment in [the] health sector."[xxx]

And in Ghana, when the Government sought to retain its health workers and civil servants by offering an increase in allowances, the IMF and other donors reportedly punished Ghana for exceeding its agreed upon wage bill limit by not disbursing loans worth $147 million in the last quarter of 2002.[xxxi] In late 2003, Columbia University Professor Jeffrey Sachs explained that the IMF had been insisting that Ghana remove these allowances and Ghana's Finance Ministry officials are said to have reported these unbudgeted wage increases to government workers were key factors in preventing Ghana from meeting IMF-set budget targets in 2002.

While these economic policies may work to serve the IMF's goal of keeping inflation rates low, they are wholly incompatible with the need to significantly scale-up public spending on the national health budgets to effectively fight HIV/AIDS.

Dr. Francis Omaswa, Director General of Health Services in the Ugandan health ministry, complained about the IMF's low inflation concerns limiting the increases in spending needed in the national health budget. He stated that sometimes "donor priorities are different than ours," and that the IMF had successfully convinced Uganda's Finance Ministry that the strict commitment to deflationary policies must take priority over providing adequate health care for Ugandans. "The IMF… and Ugandan finance ministry have decided that protecting against inflation is more important than [protecting] peoples' lives," he said, referring to the many thousands of Ugandans who die each year unnecessarily because of lack of treatment for preventable diseases and curable illnesses, let alone HIV/AIDS.[xxxii]

Referring to these budget ceilings for the health sector that result from the IMF's low-inflation targets, a senior economist at UNAIDS, Robert Greener, said, "The issue will have to be confronted if there're going to be significant scaling up with HIV/AIDS intervention, or indeed, of any other development interventions and as we try to meet the Millennium Development Goals. In some way, shape or form, these rules will need to change." He later stated, "The rules, as literally interpreted, are completely unworkable and . . . new money cannot be spent under the rules. And clearly it's not always applied that way. But it is a major problem that one of the largest organizations, influential organizations, in heavily indebted countries is, in fact, acting as a barrier to social expenditure."[xxxiii]

If HIV/AIDS is to be effectively tackled in the years ahead, then advocates must challenge the IMF's insistence on such low inflation targets, and the budget ceilings that result. Such a challenge must put the IMF on the defensive so that it is compelled to defend the budget ceilings. Such a defense should be put to the test of public opinion. If such a challenge is not made of the IMF, then there may come a time when the Ugandan Finance Ministry and many other finance ministries throughout Africa, Asia, Eastern Europe, and Latin America may find themselves increasingly turning down GFATM monies and other future increases in foreign aid.

The Need for Weighing the Trade-Offs

If countries greatly increased public health spending and accepted higher levels of foreign aid in an effort to meaningfully combat HIV/AIDS, it is possible that the increased spending may lead to higher economic growth rates and slightly higher inflation as a result. But what are the trade-offs that should be weighed and considered? Do IMF concerns about short-term macroeconomic stability (e.g., higher inflation) take precedence over the need

for more extensive health programs that could save more lives and ultimately be of greater long-term benefit? Today there is an important need for a better understanding of the trade-offs between concerns for short-term macroeconomic stability and the desire to expand public health budgets. In the context of a worsening HIV/AIDS crisis, advocates of the fight against HIV/AIDS must now ask fundamental questions such as: Would the economic consequences of Rwanda keeping the higher deficit (and the possible threat of higher inflation) have been so severe that they would outweigh the major benefits of a substantial increase in health spending?

What if countries were not compelled to comply with the IMF's budget ceilings and deficit reduction as part of binding loan conditions, but were instead free to put some of those tens of millions of dollars of their own scarce revenues into increased spending on public health to better fight HIV/AIDS? What if countries were free to increase their wage bill and run a slightly higher fiscal deficit? What if countries were free to accept the consequences of slightly higher inflation? Would the long-term benefits of a healthier population far outweigh the short-term costs associated with the risk of slightly higher inflation or a slightly appreciated currency? What are the costs of suffering slightly higher inflation vs. the benefits of greatly increasing spending on fighting HIV/AIDS? Or conversely, what are benefits of keeping inflation low vs. the costs of not increasing health spending to fight HIV/AIDS? What are the short-term and long-terms consequences of each set of options? The vital task ahead for policy makers and health professionals and economists is to figure out methods of better understanding the answers to a whole range of various scenarios. We must have a clearer understanding of what exactly would be the trade-offs, and how can AIDS activists and policy makers better understand them?

Answers to these questions could best be understood by weighing the trade-offs involved with an array of possible scenarios to consider. Such scenarios should be weighed, debated and considered by policy makers and elected officials in AIDS-afflicted countries. Arguably there could be many more detailed scenarios with projected factors that could be calculated from which policymakers could be enabled to make the best choices according to their own immediate priorities. Government officials, parliamentarians, advocacy organizations and the media in every country should be able to publicly discuss and debate the inflation rates and budget expenditures that they believe best suit their national priorities.

These are the kinds of questions that policy makers, elected officials and c itizens in low - income countries should be asking and answering for themselves. Such decisions should be based on domestically-decided priorities and preferences, not by unaccountable G7 finance ministers behind closed doors on the closed executive board in the IMF in Washington, DC. The G7 finance ministries, including the US Treasury Department, which are heavily lobbied and influenced by the financial services industry, should not be allowed to decide among themselves the level of inflation in poor countries facing HIV/AIDS epidemics. The level of inflation deemed acceptable in crisis situations ought not to be based on the ideological or political preferences of those who seek low inflation rates.

Instead, policy makers, elected officials and citizens in low-income countries ought to be the ones deciding what the short-term and long-term costs and benefits should be regarding inflation rates vs. higher public spending levels to fight HIV/AIDS.

Four Related Issues for Consideration

1.) Grant Aid Should Be Allowed To Finance Higher Deficit Spending

When countries add up all of their revenues and weigh them against all of their budget debt payments and expenditures for a year, the total culminates in either a fiscal deficit or fiscal surplus. The IMF is concerned with high fiscal deficits because on the face of it, governments must borrow money, and pay interest on it, in order to pay for the deficit spending. However, often governments can use grants (not loans)

5 Steps to Blocking the Fight against HIV/AIDS

The Low-Inflation Target…

1

The IMF sets a low-inflation target (such as 5% per year) in consultation with a poor country's finance ministry and central bank behind closed doors. Poor countries which are desperate for more foreign aid will go along with whatever the IMF says is necessary for "macroeconomic stability."

Determining how Much Money can be Spent in the Economy…

2

Once the borrowing country and the IMF agree upon the exact low inflation target, then a limit is created for how much spending can happen in the economy in the year (the money supply).

Determining the Available "Resource Envelope" for the Year…

3

The limit on the allowable level of money in the economy then is the basis for determining the ceilings on the overall national "resource envelope," which includes both tax revenues collected domestically as well as any foreign aid coming into the country for the year (minus debts paid to foreign creditors in the rich countries).

Determining the Cap for the National Budget for the Year…

4

The ceiling for the national resource envelope then determines the ceiling for the overall national budget in the year. This includes any budget deficit spending the IMF permits or any budget surpluses the IMF insists upon.

Setting Caps on Spending in the Health Budget

5

Based on the limit set for the overall national budget, then individual budget ceilings are decided for each sector of the national economy, such as agriculture, education and health. In this way, the original IMF low-inflation target ultimately ends up translating into direct spending limits for the health sector. These limits can prevent governments from hiring the additional doctors, nurses, and health workers desperately required to effectively scale-up the fight against HIV/AIDS. These national and sector ceilings become the basis for 3-year budget planning in the Medium-Term Expenditure Frameworks (MTEFs). The MTEFs are tools that provide budget discipline and prevent various ministries, such as the health ministry, from over-spending in any given year.

from foreign aid donors to pay down some of the deficit. Because grant aid is free money and it doesn't have to be paid back, this is a much better way to finance deficit spending than borrowing money. However, traditionally grant aid by foreign donors has never been allowed to be added as domestic revenues when calculating the overall fiscal balance. This is primarily because donors have traditionally been very fickle about how much and how often they would provide grant aid. This degree of unpredictability and unreliability led most economists and finance ministries to traditionally exclude them in budget planning for future years' budgets.

However, the problem with the traditional treatment of grants is that they do, in reality, add to the domestic revenue side of the ledger, just as if they had been raised from domestic taxation. Had they been allowed to be calculated as revenues, then the overall fiscal deficit levels would have been lower. But because grants were traditionally excluded from the official fiscal balances, many countries' deficit levels appeared higher than they actually were. If governments were only financing the interest on their national deficits by issuing more government bonds or otherwise borrowing more money, then it would be appropriate to list that borrowing on the expenditure side of the budget ledger. But because in reality many governments are using the increasingly common grants in foreign aid to pay down their fiscal deficit levels, top World Bank officials sent out an important Guidance Note to all of their country offices around the world in 2002 and thought it important enough to send out again in 2003.[xxxiv] The note advised country offices that since grant aid, such as GFATM money, is free and does not have to be paid back, it ought to be allowed by finance ministries to be counted as revenues in the overall fiscal balance. This is important because, in theory, governments could engage in higher levels of deficit spending if they knew they would be able to finance the deficits with increased flows of grants in foreign aid. However, there is some concern that not all World Bank country offices are following the Guidance Note advisory. In Uganda in 2004, for example, the finance ministry continued the tradition of excluding donor grants from the revenue side of the ledger when calculating the overall fiscal deficit at 11% of GDP, when that deficit level would have been lower had they followed the advice of the Guidance Note, yet the World Bank country team in Uganda failed to object to the misleading deficit calculation. The Ugandan Finance Ministry then used the 11% of GDP deficit calculation as a justification for not increasing social spending.

In response to increasing concerns raised by advocates of the fight against HIV/AIDS, on July 26, 2004, the IMF and World Bank faxed a 1-page statement titled "The Use of Grants in Low-Income Countries," which reiterated the logic of the World Bank's Guidance Note, and stated that "the World Bank and the International Monetary Fund welcome increased external grants to low-income countries—including those from the Global Fund to Fight AIDS, TB and Malaria," but then added that "the macroeconomic and structural implications [of increased grant aid] will need to be analyzed on a case-by-case basis."[xxxv] The statement listed many steps low-income countries needed to take to effectively absorb increased grants, but listed no steps the IMF or World Bank would take to change their low-inflation targeting and the constraints on public spending that flow from them.

2.) A Need To Make Future Grant Aid More Sustainable and Predictable

The IMF and many finance ministries feel strongly about the problem of a general lack of predictability or reliability of foreign aid. In the past, donors have traditionally pledged higher levels of foreign aid than they later delivered, putting budget planners in difficult positions. Flows of grant aid (as opposed to loans) have been especially unreliable. To address this problem, the GFATM has established a process by which it delivers grants over a 2-year period, and if countries meet performance-based criteria on the use of these grants, they are awarded further grants for another 3-year period. However many other bilateral and multilateral foreign aid creditors and lenders are less reliable and predictable. Other grant aid donors ought to consider developing structures and formats in which their pledges and commitments to award grant aid can be designed for disbursal over a

multi-year period, such as over 3-5 years. Such confirmed and committed flows of grant aid over a medium-term would be far more reliable and predictable for budget planners.

Also of tremendous importance is the question of whether or not long-terms flows of grant aid should be allowed to be used for recurrent budget expenditures, such as the salaries of doctors, nurses and health workers in the public health systems. Traditionally, aid has only been allowed for things such as building clinics or buying drugs, but not for the salaries of health workers. Given that human resources and capacity building will be the foundation upon which an effective fight against HIV/AIDS is waged over the long-term, these traditional restrictions on the way aid is used must be reconsidered.

"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."

- UNAIDS 2004 Report on the Global AIDS Epidemic

3.) Money Is Needed for Public Health Systems As Well As Fighting HIV/AIDS

Foreign aid must be significantly increased for both fighting HIV/AIDS in particular and also for strengthening public health care systems generally. As important as it is, the increased foreign aid from rich countries for fighting HIV/AIDS is not necessarily addressing the problem of chronic under-funding that has afflicted the public health systems in developing countries over the last two decades. In fact, there are indications that new money specifically targeted for HIV/AIDS programs is unwittingly and unnecessarily exacerbating the staggering shortage of personnel for basic health care services. African doctors and nurses are leaving public-sector jobs in droves to take more lucrative positions in foreign-funded HIV-AIDS programs. Public hospitals and clinics are being stripped of staffers; rural and slum outposts are being abandoned, worsening health systems that have already nearly collapsed in some countries. In addition to health professionals fleeing the public health system to work specifically on HIV/AIDS programs, there is a larger problem of health professionals leaving their countries altogether to work in rich, industrialized countries where the opportunities and pay far exceed anything they could achieve in their own countries. US-based Physicians for Human Rights has reported that tens of thousands of highly skilled health professionals from developing countries have succumbed to a global "brain drain" and are today working in clinics and hospitals in the United States, Britain and Canada, primarily because their governments back home do not have the resources to create the conditions that will enable them to meet the needs of their patients or to meet their own needs, including earning an adequate salary.[xxxvi] However, there are indications that money is not the only issue; other important factors include crime rates, educational opportunities for children, career paths for professionals themselves, and the pervasiveness of sexual harassment directed against female health professionals, such as in southern Africa. While these complex issues are beyond the scope of the issue of IMF low-inflation targeting, the tide of fleeing health professional can only be stemmed if salaries and working conditions are significantly improved by scaling-up support for collapsing public health systems. Doing so will demand significantly increased public expenditures. The ironic fact is that even when new money to fight HIV/AIDS is made available in some countries, there are not enough local health care workers in many African countries to implement even modest treatment goals. For example, several years ago the Gates Foundation and other donors provided enough resources to Botswana to treat everyone in the country. But a crippling shortage of health care workers at every level, among other problems, limited the rollout of antiretrovirals to only 21,000 of the 110,000 who need them now to stay alive[xxxvii]. How can the fight against HIV/AIDS be better designed to also simultaneously build the capacity of entire public health systems? How can ambitious HIV/AIDS programs also be tied to broader goals of enhanced equity and sustainability of entire public health systems?

4.) Other Ways To Increase Spending to Fight HIV/AIDS

Traditionally the IMF has focused almost exclusively on cutting or maintaining low public expenditures as a way of solving the fiscal deficit imbalances and preventing the higher government spending that can lead to higher inflation. Ironically the IMF has traditionally claimed that its concern for maintaining low inflation is because inflation hurts the poor. But rather than increasing the level of national taxation in an effort to increase revenue collection, the IMF has preferred a consumption tax called the value-added tax (VAT) on basic goods and services used by poor people, which also very clearly hurts the poor. The VAT tends to act as a disincentive for people consuming and spending, which supports the IMF goal of keeping inflation low.

But rather than cutting or maintaining low government spending, there are other steps that can be taken. The IMF has always been reluctant to promote revenue increases as part of the solution to fiscal imbalances, including improving tax collection, taxing foreign investors (as was done traditionally before structural adjustment programs), and reforming the existing regressive tax structures into more progressive ones (in which the wealthier pay a higher portion of income tax). The IMF points out that raising revenue as a percent of GDP is complicated and takes time, but much of their objection stems from an ideological belief that taxation deters investment. Such a concern explains why they IMF has traditionally strongly promoted more regressive consumption taxes (such as a value-added tax) as opposed to corporate taxation, or trade taxes on imports and exports (which many low-income countries are heavily reliant on). Most low-income countries, especially in Africa, have exceptionally low tax/GDP ratios.

If the current restrictions on public spending and inflation are removed and spending is allowed to increase, how can increasing tax collection become more of a part of the strategy to reduce fiscal imbalances and raise revenues to increase public health spending?

Take Action

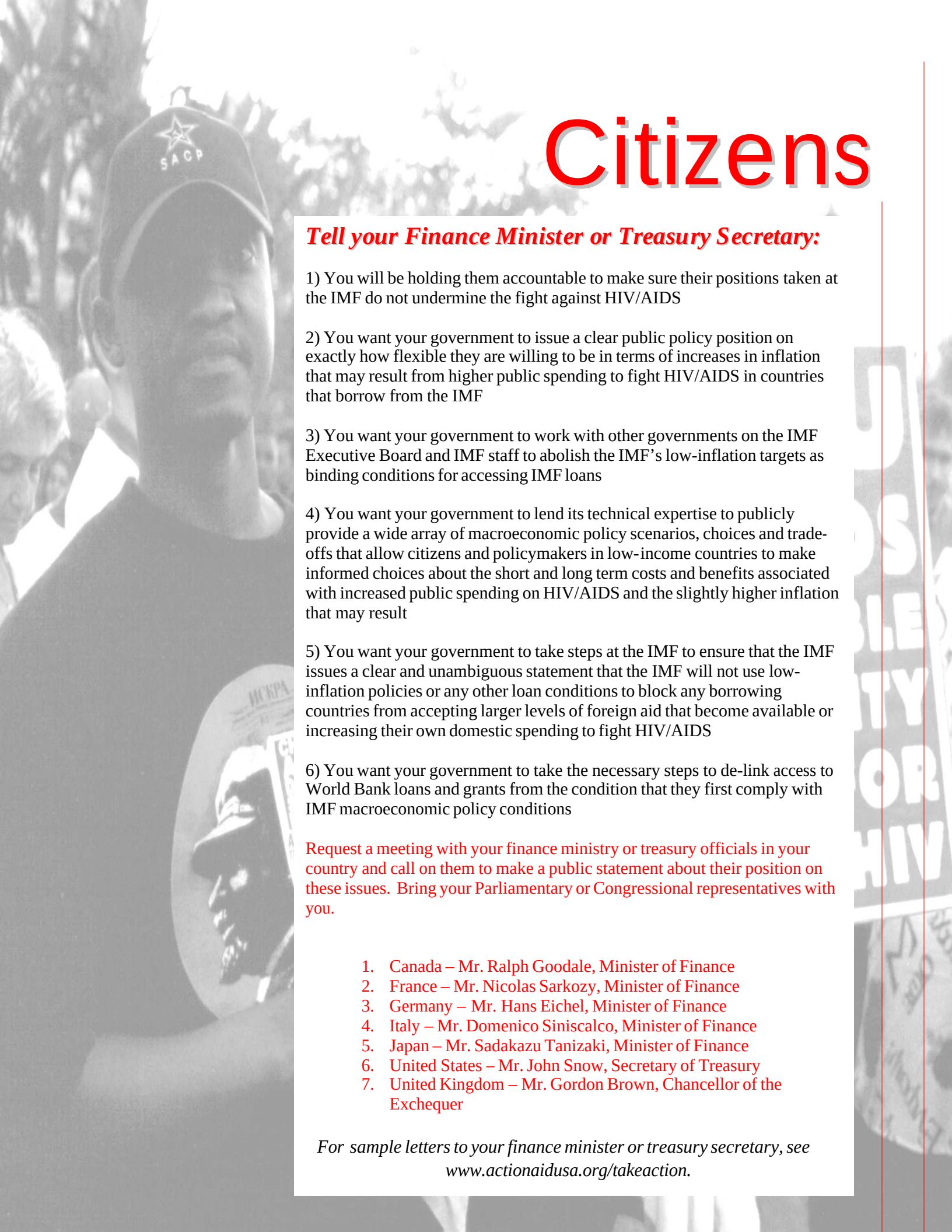
AIDS Activists Must Call on Their Governments to Abolish the IMF's Low-Inflation Targets

In November 2003, World Bank President James Wolfensohn responded to the concerns raised by UNAIDS Executive Director Dr. Peter Piot 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." [xxxvi] However, the IMF and World Bank have yet to make an official joint policy position on the problem. The IMF has yet to make clear its position on the degree to which it will be more flexible on its loan conditions related to low-inflation targets or the strict budget ceilings that flow from them.

AIDS activists and health professionals must demand that the IMF make a clear statement on its position concerning inflation rates, fiscal deficit levels and caps on budget expenditures and wage bills. The IMF must publicly state exactly how much more flexible it will be regarding what levels of inflation are to be deemed acceptable over the short run as a byproduct of fighting AIDS successfully over the long run. At a June 28, 2004, IMF Workshop, leading IMF budget officials conceded there is a growing need for more pragmatism on their part, and within macroeconomic policy objectives, there "may need to be some flexibility shown in considering the potential short and long-term macroeconomic policy tradeoffs that will be faced by countries. For example, to the extent that there is a range within which inflation would not prejudice potential economic growth, there may be scope to accept more ambitious spending plans. The same may be true in terms of the extent to which an inflow of additional aid may lead to some real appreciation of the exchange rate." [xxxvii] While this acknowledgement is important, the IMF was noncommittal on the specifics, which is an unacceptable and incomplete response.

But lobbying the IMF is not enough. Because the IMF is not accountable to the citizens of any one country, citizens do not have any available direct channel of political recourse within the institution. However, the IMF's Board of Executive Directors, which decides its policies and approves its binding loan conditions for borrowing countries, is comprised of representatives dispatched from finance ministries of its 184 member countries. The Group of Seven (G7) industrialized countries, and some other European countries, have the dominant share of voting rights and influence on the Executive Board of the IMF. In contrast, citizens of the world's poorest countries, which are most impacted by IMF loan conditions, have the least political recourse through their governments to influence IMF Executive Board decisions. Therefore, citizens of the G7 countries, and particularly the United States, have a special obligation to exercise this channel of political recourse to lobby their finance ministries at home about what they are doing at the IMF Board.

Citizens of the G7 countries should insist that their governments take appropriate actions at the IMF and World Bank, as well as with ministries of finance of developing countries, and other partners, to develop new policies to ensure that macroeconomic constraints do not limit effective and productive spending by developing countries on health, education, and related sectors, or salaries and hiring of workers in these areas. New flexibility around spending limits and the macroeconomic targets, such as inflation and fiscal deficits, must be substantially increased and made explicitly clear to the public. Such flexibility must enable countries to accommodate increased foreign aid, and significantly increased domestic spending in these sectors as resources become available. Such new flexibility should be widely publicized among all stakeholders, including finance, health, education, and other national ministries, national parliaments and civil society organizations.



Citizens

Tell your Finance Minister or Treasury Secretary:

1) You will be holding them accountable to make sure their positions taken at the IMF do not undermine the fight against HIV/AIDS

2) You want your government to issue a clear public policy position on exactly how flexible they are willing to be in terms of increases in inflation that may result from higher public spending to fight HIV/AIDS in countries that borrow from the IMF

3) You want your government to work with other governments on the IMF Executive Board and IMF staff to abolish the IMF's low-inflation targets as binding conditions for accessing IMF loans

4) You want your government to lend its technical expertise to publicly provide a wide array of macroeconomic policy scenarios, choices and trade-offs that allow citizens and policymakers in low-income countries to make informed choices about the short and long term costs and benefits associated with increased public spending on HIV/AIDS and the slightly higher inflation that may result

5) You want your government to take steps at the IMF to ensure that the IMF issues a clear and unambiguous statement that the IMF will not use low-inflation policies or any other loan conditions to block any borrowing countries from accepting larger levels of foreign aid that become available or increasing their own domestic spending to fight HIV/AIDS

6) You want your government to take the necessary steps to de-link access to World Bank loans and grants from the condition that they first comply with IMF macroeconomic policy conditions

Request a meeting with your finance ministry or treasury officials in your country and call on them to make a public statement about their position on these issues. Bring your Parliamentary or Congressional representatives with you.

1. Canada – Mr. Ralph Goodale, Minister of Finance
2. France – Mr. Nicolas Sarkozy, Minister of Finance
3. Germany – Mr. Hans Eichel, Minister of Finance
4. Italy – Mr. Domenico Siniscalco, Minister of Finance
5. Japan – Mr. Sadakazu Tanizaki, Minister of Finance
6. United States – Mr. John Snow, Secretary of Treasury
7. United Kingdom – Mr. Gordon Brown, Chancellor of the Exchequer

For sample letters to your finance minister or treasury secretary, see www.actionaidusa.org/takeaction.

Photos

Cover: © 2001 Nrityanjali Academy, Courtesy of Photoshare, *Women participate in an AIDS Awareness rally.*
Page 2: © 2004 Stephen Shames, Keep Children Alive: Reebok Photography Project, *Young Child with AIDS during Medical Exam.*
Page 4: IBID, *4-Year Old AIDS Patient During Medical Exam*
Page 5: (top left) © 2000 Ketan K. Joshi, Courtesy of Photoshare, *The Prince of Jodhpur (far left) marches on World AIDS Day* (bottom right) Treatment Action Campaign, *AIDS Rally*
Page 6: Shames, OPCIT, *5-Year-Old AIDS Patient being comforted.*
Page 8: © 2000 Ketan K. Joshi, Courtesy of Photoshare, *A camel wears a banner that says "Protect yourself from AIDS… Johipur, India"*
Page 9: Shames, OPCIT, *Young AIDS Patient*
Page 12: Treatment Action Campaign, OPCIT
Page 14: Shames, OPCIT, *Young AIDS Patient/Orphan with Grandfather*
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World AIDS Day march in Dakar, Senegal.
Page 22: Shames, OPCIT, *Young AIDS Patient*
Page 24: © 2000 Ketan K. Joshi, Courtesy of Photoshare, *AIDS Marchers in Durban, South Africa*

End Notes

[i] The G7 countries include the United States, Great Britain, France, Italy, Germany, Japan, and Canada. The US has considerably more influence than any other Executive Director on the IMF's Board.
[ii] UNAIDS 2004 Report on the Global AIDS Epidemic, 4th Global Report, June 2004.
[iii] "Development Policy Lending," The World Bank Operational Manual: Operational Policies; Annex B. OP 8.60. August 11, 2004. http://lnweb18.worldbank.org/SCSL%20Dev/OD%208.60/CW-OD-860.nsf/f0adfbb30fc702bd85256bdc004d7896/0f2c0558a36e474285256bdc00502215/$FILE/OPBP8.60PolicyPaper08-16b.pdf
[iv] Oxfam International, *IMF and the Millennium Development Goals: Failing to Deliver for Low Income Countries.* Sept. 2003. Countries included Rwanda, Albania, Benin, Bolivia, Burkina Faso, Cambodia, Cameroon, Ethiopia, Ghana, Honduras, Malawi, Mauritania, Mozambique, Nicaragua, Niger, Senegal, Tanzania, Uganda, Vietnam and Zambia. http://www.oxfam.org.uk/what_we_do/issues/debt_aid/downloads/bp54_imfmdgs.pdf.
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[ix] Chang, Ha-Joon and Ilene Grabel. "Reclaiming Development: An Alternative Economic Policy Manual," Zed Books, New York, 2004. Chang and Grabel review several studies on the historical relationships between inflation levels and their impacts on economic growth rates.
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[xv] *Ibid.*
[xvi] Wendo, Charles, "Ugandan Officials Negotiate Global Fund Grants." The Lancet. January 17, 2004. vol. 363. p. 222. http://www.thelancet.com/journal/vol363/iss9404/full/llan.363.9404.news.28415.1.
The $135 million figure is from "Portfolio of Grants in Uganda," by GFATM. http://www.theglobalfund.org/search/portfolio.aspx?countryID=UGD Similar issues have arisen in Tanzania and Mozambique. See also: "Aligning the Poverty Reduction and Growth Facility (PRGF) and the Poverty Reduction Strategy Paper (PRSP) Approach: Issues and Options," by International Monetary Fund. April 25, 2003. p. 12, n. 13: "This would help preclude situations such as that which occurred in Uganda in late 2002, where the Finance Ministry was initially reluctant to accept a substantial grant from the GFATM unless it could be used to replace already budgeted health spending, owing to concerns about the macroeconomic effects of overshooting existing expenditure ceilings. Similar issues have arisen in Tanzania and Mozambique." http://www.imf.org/external/np/prsp/2003/eng/042503.pdf
[xvii] Thomas C. Dawson, Uganda and the IMF: The Debate on Aid Flows to Uganda: The IMF's Point of View, June 7, 2002. Available at: http://www.imf.org/external/np/vc/2002/060702.htm
[xviii] Hyperinflation occurs when prices rise out of control, such as over 1,000% per year.
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[xxii] Chang, Ha-Joon and Ilene Grabel. "Reclaiming Development: An Alternative Economic Policy Manual," Zed Books, New York, 2004. p. 193. The IMF's claim that budget deficits must always be avoided because they cause inflation is not supported by the evidence. The increase in economic activity that is associated with government spending does not necessarily cause inflation in countries with significant excess capacity (as is the case in most developing countries). Empirical evidence does not support the claim that central banks generally monetize budget deficits by increasing the money supply (and thereby causing inflation). Careful study of this matter by Sikken and de Haan ("Budget Deficits, Monetization, and Central Bank Independence in Developing Countries," Oxford Economic Papers. Vol. 50. 1998. pp. 493-511) has demonstrated that the relationship between budget deficits and the money supply is far more complex than the IMF acknowledges. Sikken and de Haan note: "Historically, periods of rapid economic growth in Continental Europe, the USA and Japan were associated with large programmes of public expenditure and even large budget deficits."

[xxiii] Email discussion with Prof. Ilene Grabel, University of Denver. See also: *Ibid*.

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[xxv] Oxfam International, *IMF and the Millennium Development Goals: Failing to Deliver for Low Income Countries* . Sept. 2003. http://www.oxfam.org.uk/what_we_do/issues/debt_aid/downloads/bp54_imfmdgs.pdf.

[xxvi] *Ibid.*

[xxvii] Oxfam International, *IMF and the Millennium Development Goals: Failing to Deliver for Low Income Countries.* Sept. 2003. http://www.oxfam.org.uk/what_we_do/issues/debt_aid/downloads/bp54_imfmdgs.pdf.

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